

BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

FIFTY-SECOND ANNUAL REPORT
AND
STATEMENT OF ACCOUNTS
2019

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MISSION STATEMENT

The Central Bank of Malta is an independent institution, which forms an integral part of the Eurosystem and, as a member of the European System of Central Banks (ESCB), has the primary objective of maintaining price stability. The Bank is entrusted with all major central banking tasks, particularly that of ensuring the stability of the financial system.

It seeks to carry out its statutory responsibilities in the public interest and is committed to performing its functions effectively, efficiently and economically to the highest level of integrity, competence and transparency. In this regard it will continue to:

i. **undertake economic and financial analysis and research** to support the Governor's participation in the decision-making process of the Governing Council of the European Central Bank (ECB) and provide independent advice to Government on economic and financial policy issues;

ii. **implement the ECB's monetary policy** through market operations conducted within the operational framework of the Eurosystem;

iii. **contribute effectively to the stability of the financial system** by identifying and assessing systemic risks and imbalances, and making the appropriate policy recommendations;

iv. **formulate and implement a macroprudential policy** to fulfil the tasks of the Bank as the national macroprudential authority;

v. **promote and support the development and integration of financial markets** in Malta through oversight of market infrastructures and by ensuring the availability of cost-efficient securities settlement and payment systems;

vi. **provide an adequate supply of banknotes and coin (the latter on behalf of Government)** to meet the demands of the public, while ensuring high quality and authenticity of the currency in circulation;

vii. **collect, compile and publish economic and financial statistics** in line with international standards;

viii. **act as banker to Government and to the banking system;**

ix. **hold and actively manage financial assets** with the aim of optimising returns, subject to prudent risk management practices;

x. **actively participate in the ESCB, the Eurosystem and other relevant European Union bodies, including their sub-structures.**

As a member of the Eurosystem, the Bank subscribes to the Eurosystem's mission, strategic intents and organisational principles.

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**as at 30 March 2020*

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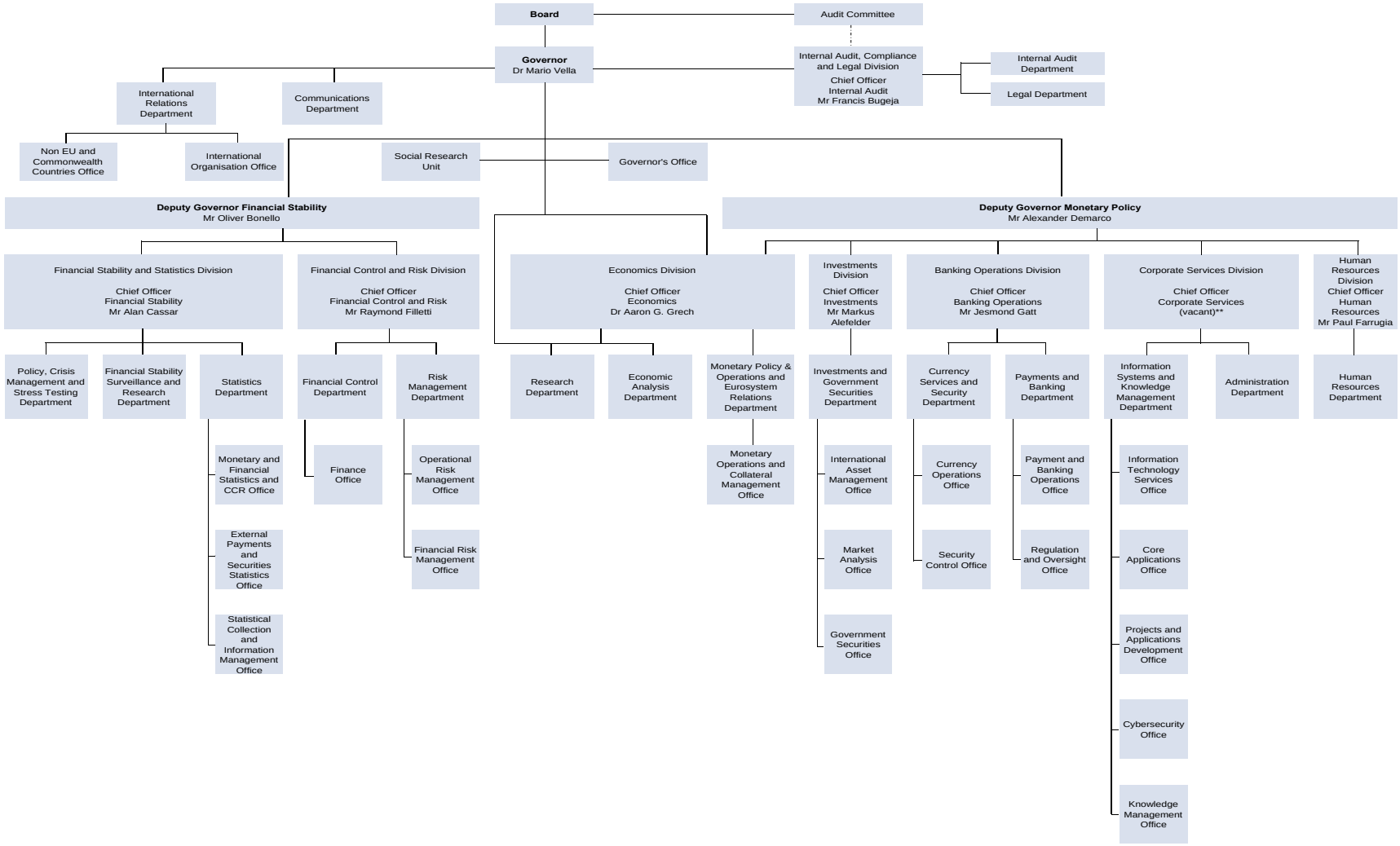
(left to right)

Back row: Ms Philomena Meli (Director), Mr Herbert Zammit LaFerla (Secretary), Professor Frank Bezzina (Director), Professor Peter J. Baldacchino (Director), Dr Romina Cuschieri (Director)

Front row: Mr Oliver Bonello (Deputy Governor), Dr Mario Vella (Governor and Chairman), Mr Alexander Demarco (Deputy Governor).

**as at 30 March 2020*

ORGANISATION CHART*



as at 30 March 2020

** Mr Raymond Bonnici retired on 30 January 2020*

Bank Ċentrali ta' Malta
Eurosistema
Il-Gvernatur

Central Bank of Malta
Eurosystem
The Governor

30 March 2020

The Hon Professor Edward Scicluna
Minister for Finance and Financial Services
Maison Demandols
South Street
Valletta VLT 1102

Dear Minister

LETTER OF TRANSMITTAL

In terms of article 21 of the Central Bank of Malta Act (Cap. 204), I have the honour to transmit to you, in your capacity as Minister responsible for finance, a copy of the Annual Report of the Bank for the financial year ended 31 December 2019.

Yours sincerely

Dr Mario Vella

CONTENTS

GOVERNOR'S STATEMENT 13

I FINANCIAL AND ECONOMIC DEVELOPMENTS 17

1 The External Environment and the Euro Area 18
Key advanced economies
Economic and financial developments in the euro area
Commodities

2 Monetary and Financial Developments 27
Monetary aggregates and financial conditions
Box 1: Access to finance in 2019
The money market
The capital market
Box 2: Overview of the financial assets and liabilities of the Maltese economy by institutional sector

3 Output, Employment and Prices 50
Potential output and business conditions index
Gross domestic product and industrial production
Construction
The labour market
Business and consumer surveys
Residential property prices
Consumer price inflation
Costs and competitiveness
Box 3: Economic Projections

4 Balance of Payments 69
The current account
Tourism
The capital and financial accounts

5 Government Finance 75
Quarterly developments
Headline and cyclically-adjusted developments
Box 4: The sustainability of Maltese Government debt

II BANK POLICIES, OPERATIONS AND ACTIVITIES 87

1 The Conduct of Monetary Policy and Financial Market Operations 88
Monetary policy operations
Collateral management
Liquidity management
Euro short-term rate
Reserves management
Market-making operations

2 Financial Stability 93
Main developments
Committee meetings at the domestic and European levels
Future developments

3 Economics Analysis and Research **96**

4 Statistics **98**

5 Currency, Payment Systems and Banking Services **100**
Currency operations
Payment and securities settlement systems
Cyber resilience assessment
Malta Clearing House
TARGET2-Malta
Banker to the public sector
Banker to the banking system
Other financial services
Box 5: Numismatic Releases 2019

6 Corporate Governance **107**
Governance
Social Research Unit
Audit Committee
External auditors
Internal Audit Department
Risk management
Legal issues
Human resources
Information Systems and Knowledge Management
Premises and procurement
Information and public relations

7 International Relations **117**
Eurosystem and European System of Central Banks
European Systemic Risk Board
Other EU institutions
European Bank for Reconstruction and Development
International Monetary Fund
World Bank Group
Asian Infrastructure Investment Bank
Commonwealth Small States Trade Finance Facility
Other international institutions
Non EU, Bilateral and Commonwealth Relations Office

8 Corporate Social Responsibility **121**

Public Events 2019 **124**

III FINANCIAL STATEMENTS **A-1**
Directors' report
Statement of Directors' responsibilities in respect of the financial statements
Balance sheet
Profit and loss account
Notes to the financial statements
Independent auditors' report

ABBREVIATIONS

ABSPP	Asset-backed Securities Purchase Programme
AIIB	Asian Infrastructure Investment Bank
AML	anti-money laundering
APP	Asset Purchase Programme
BBMs	borrower-based measures
BCI	Business Conditions Index
BIS	Bank for International Settlements
BLS	Bank Lending Survey
BoP	Balance of Payments
BRRD	Bank Recovery and Resolution Directive
CBPP	Covered Bond Purchase Programme
CCyB	countercyclical capital buffer
CCR	Central Credit Register
CPI	Consumer Price Index
CRA	credit reference agency
CRD IV	Capital Requirements Directive IV
CRR	Capital Requirements Regulation
CSDR	Central Securities Depositories Regulation
CSPP	corporate sector purchase programme
CSR	Corporate Social Responsibility
DDA	deficit-debt adjustment
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
ECMS	Eurosystem Collateral Management System
EER	effective exchange rate
EFC	Economic and Financial Committee
EONIA	Euro OverNight Index Average
ES2	Europa series
ESCB	European System of Central Banks
ESA	European System of Accounts
ESI	Economic Sentiment Indicator
ESRB	European Systemic Risk Board
€STR	Euro short-term rate
EU	European Union
EURIBOR	Euro Interbank Offered Rate
FCI	Financial Conditions Index
FOMC	Federal Open Market Committee
FSAP	Financial Sector Assessment Programme
FSC	Financial Stability Committee
FX	Foreign Exchange
GDP	gross domestic product
GDPR	General Data Protection Regulation
GVA	gross value added
HCI	harmonised competitiveness indicator
HFCS	Household Finance and Consumption Survey
HICP	Harmonised Index of Consumer Prices
IIP	Individual Investor Programme
IMF	International Monetary Fund

IAC	Internal Auditors Committee
IPC	Investments Policy Committee
JFSB	Joint Financial Stability Board
LFS	Labour Force Survey
LiST	sensitivity analysis on liquidity stress
LTROs	longer-term refinancing operations
MDB	Malta Development Bank
MCAST	Malta College of Arts, Science and Technology
MCCF	Malta Community Chest Fund
MCH	Malta Clearing House
MFI	monetary financial institution
MFSA	Malta Financial Services Authority
MGS	Malta Government Stocks
MIA	Malta International Airport
MIP	Macroeconomic Imbalance Procedure
MPO	Malta Philharmonic Orchestra
MQF	Malta Qualifications Framework
MRO	main refinancing operation
MSE	Malta Stock Exchange
NCB	national central bank
NEIG	non-energy industrial goods
NFC	non-financial corporation
NGFS	Network for Greening of the Financial System
NHPAB	Numismatics and Historical Publications Advisory Board
NPISH	non-profit institutions serving households
NPL	non-performing loan
NSO	National Statistics Office
OPEC	Organization of the Petroleum Exporting Countries
ORM	Operational Risk Management
O-SII	other systemically important institution
PADO	Projects and Applications Development Office
PPI	Property Price Index
PSD2	Payment Services Directive
PSPP	Public Sector Purchase Programme
QMUL	Queen Mary University of London
RPI	Retail Price Index
RTGS	real-time gross settlement
SAFE	Survey on Access to Finance
SBA	Small Business Act
SDR	Special Drawing Rights
SEPA	Single Euro Payments Area
SGP	Stability and Growth Pact
SME	small and medium-sized enterprise
SRMR	Single Resolution Mechanism Regulation
SRU	Social Research Unit
SSM	Single Supervisory Mechanism
SSSs	securities settlement systems
SWIFT	Society for Worldwide Interbank Financial Telecommunication
T2S	TARGET2-Securities
TARGET2	Trans-European Automated Real-time Gross settlement Express Transfer system 2
TIPS	TARGET Instant Payment Settlement
TLTRO	targeted longer-term refinancing operation
UK	United Kingdom
ULC	unit labour cost
US	United States

GOVERNOR'S STATEMENT



In 2019, uncertainty about trade policy, difficulties in some pockets of the manufacturing sector and persistent geopolitical tensions continued to prevent a solid global recovery. Signs of stabilisation began to emerge towards the end of year, as fears of a disorderly exit of the United Kingdom from the European Union mellowed and relations between the United States and China improved. Nonetheless, growth in several advanced economies remained modest, in the context of increasing social unrest and weather-related events, even as central banks provided additional monetary stimulus.

In the euro area, growth in real gross domestic product (GDP) slowed down to 1.2% from 1.9% in 2018, mainly reflecting the impact of weaker global trade and an extended period of global uncertainty on the manufacturing sector. Notwithstanding this deceleration in activity, the labour market remained resilient, with the unemployment rate decreasing to 7.6%, close to that prevailing in 2007. As unemployment fell, growth in wages and salaries increased during the year. However, generally wage pressures remained contained. Meanwhile, the annual average rate of consumer price inflation in the euro area edged down to 1.2% from 1.8% in 2018, with this moderation largely reflecting developments in energy inflation. By contrast, inflation excluding energy and food stabilised at the low level of 1.0%.

In light of these developments, the European Central Bank (ECB) maintained an accommodative monetary stance and introduced a number of additional measures as the year progressed. The interest rate on main refinancing operations (MROs) and the rate on the marginal lending facility were held at 0.00% and 0.25%, respectively, while the rate on the deposit facility rate was lowered to -0.50%. The Governing Council noted on several occasions that interest rates would remain at their current level for as long as necessary to ensure the continued sustained convergence of inflation to its aim over the medium terms. In September, however, the Council announced that it expected the key ECB interest rates to remain at their present or lower levels until the inflation outlook would have robustly converged to a level sufficiently close to, but below, 2% within the ECB's projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

A number of measures were introduced to further support monetary accommodation and maintain favourable liquidity conditions. In particular, a new series of quarterly targeted longer-term refinancing operations (TLTRO-III) were launched during the year. Furthermore, net purchases under the asset purchase programme (APP) resumed in November, while the European System of Central Banks (ESCB) continued with the previous practice of fully reinvesting principal payments from maturing securities under this programme. In October, the ECB also began to apply a two-tier system for reserve remuneration in which part of banks' holdings of excess liquidity will be exempt from the negative deposit facility rate. This decision was taken to enhance the bank-based monetary transmission.

Additional measures were announced in March 2020 to mitigate the negative economic impact of COVID-19. These measures are aimed at enhancing liquidity support to the euro area financial system. They include considerably more favourable terms on TLTRO-III operations, temporary additional LTROs to bridge the period until the June 2020 TLTRO-III operation, and a temporary increase in the envelope of net asset purchases under the APP. Furthermore, the Governing Council established a temporary €750 billion Pandemic Emergency Purchase Programme.

Notwithstanding the more challenging environment globally and in the euro area, the domestic economy continued to register a healthy rate of economic expansion in 2019. Although GDP growth moderated to

4.4%, from 7.3% in 2018, it remained above its long-term average of around 4.0%. The expansion was driven by domestic demand, particularly government consumption and gross fixed capital formation. Private consumption had a positive impact, although it increased at a slower pace following the very strong outturn in 2018. Meanwhile, the contribution of net exports turned negative, as imports outpaced exports.

The Bank estimates that the fiscal surplus narrowed somewhat compared with 2018, while the debt-to-GDP decreased further.

The annual average rate of inflation in Malta based on the Harmonised Index of Consumer Prices (HICP) stood at 1.5% in 2019, down from 1.7% in 2018, reflecting slower growth in the prices of services and non-energy industrial goods (NEIG). In contrast, inflation based on the Retail Price Index (RPI) rose from 1.2% to 1.6%. The different dynamic in the latter partly reflects the fact that it excludes tourist expenditure on accommodation services, which contributed to the fall in HICP inflation, and partly because the weight assigned to food and beverages is larger in the RPI.

In the near term, GDP will be affected significantly, mainly on account of the negative effects of COVID-19 on confidence, disruptions in global supply chains and lower demand in a number of services sectors, most notably those related to tourism. However, growth should recover from 2021. The fiscal balance will also inevitably be negatively affected, as this event provides an opportunity to use part of the fiscal space created in recent years. The use of such fiscal space, together with the support of additional expansionary monetary policy measures announced by the ECB in March should help mitigate some of the negative impact of COVID-19 on economic activity in Malta. However, at this juncture, projections of economic activity, both for Malta and globally, critically hinge on the duration of the pandemic, as well as the size of the local and global fiscal response.

As regards operational activities, in 2019, the Bank continued to implement the Eurosystem's monetary policy decisions in Malta, through standing facilities, liquidity-providing operations and the Public Sector Purchase Programme (PSPP). In the context of ample excess liquidity, credit institutions established in Malta continued to place excess funds with the Eurosystem through the overnight deposit facility.

Moreover, they participated only once in the MROs, with an amount of €1.0 million, and made no use of the marginal lending facility or the three-month LTROs. While they participated in two TLTRO-III operations in September and December, the amounts borrowed were half the repayments of outstanding balances from TLTRO-II, reflecting ample local liquidity. During 2019, the Bank purchased €63.3 million worth of Maltese sovereign bonds through the PSPP, bringing total purchases before amortisation to €1,105.5 million by the end of 2019.

The Bank's balance sheet continued to expand, reaching €9,288.2 million at the end of 2019 from €8,853.9 million a year earlier. Operating profit before transfer to provisions increased to €49.5 million from €38.3 million in 2018. With net interest income relatively stable, this was mainly due to higher capital gains arising from the sale of securities and realised gains due to the partial liquidation of externally managed funds. Moreover, lower price revaluation losses on securities also contributed positively to this year's net profit. Following the transfer of €18.0 million to provisions, the amount of €31.5 million is payable to the Government of Malta.

The Bank continued to advise Government on legislative and regulatory developments specific to financial stability. It carried out regular assessments of financial sector conditions, including by means of stress tests and sensitivity analysis, while enhancing its macro-prudential framework and crisis management policies. As in past years, the Bank continued to monitor the banks' lending standards and private sector demand for credit through the Bank Lending Survey (BLS). On the basis of assessments of potential risks related to excessive credit growth, the Bank kept the countercyclical capital buffer (CCyB) rate unchanged at 0%. The capital conservation buffer was fully phased in, with banks required to hold an additional capital of 2.5% of

risk weighted assets. The domestic significant institutions formed part of the Single Supervisory Mechanism (SSM)/ECB Banking Supervision's 2019 sensitivity analysis on liquidity stress (LiST).

The Bank assessed feedback received through a public consultation on a Regulation on borrower-based measures (BBMs). The related Directive came into force in July 2019. Another public consultation focused on the revised methodology for the identification of other systemically important institutions (O-SIIs) and the related capital buffer calibration, which aligns the domestic framework with the Guidelines of the European Banking Authority (EBA). The stress testing toolkit was enhanced further, in part to address recommendations put forward by the International Monetary Fund (IMF) in the context of the 2018 Financial Sector Assessment Programme (FSAP).

Apart from participating in ECB and European Systemic Risk Board (ESRB) meetings related to the financial sector, meetings of the EBA and the SSM, the Bank participated actively in the Joint Financial Stability Board (JFSB), the Forum for Financial Stability and the Domestic Standing Committee. Financial stability issues and the general economic situation were regularly discussed with the European Commission (EC), the IMF and the rating agencies.

The Bank again offered public lectures in economics and finance, and organised its Annual Research Symposium, which focused on macro prudential policies, cybersecurity risks and modelling activities at the Bank. The Bank published the results of the third wave of the Household Finance and Consumption Survey (HFCS) and initiated preparations for the fourth wave with the National Statistics Office (NSO). The Social Research Unit conducted further research on gender issues and inclusiveness, while the Regulation and Oversight Office began to analyse information collected through the Payment Habits Survey, the results of which were published in early 2020.

In the area of statistics, the Bank continued to compile and disseminate a variety of statistics to official institutions and the general public. It also extended access to the Central Credit Register (CCR) to the Malta Development Bank (MDB).

Work on the AnaCredit project of the ESCB advanced, and steps were taken to improve the quality of data held within the ECB's Centralised Securities Database and balance of payments data. Bank staff participated in discussions with NSO, the ECB and Eurostat on the quality of balance of payments and financial accounts statistics. Central Bank of Malta Directive No 5 was modified to empower the Bank to collect statistical information from pension funds. The Bank continued to collaborate with Banca d'Italia on the implementation of the Bank's statistical solution and with the latter organised a seminar on big data and machine learning in a central bank environment. Meetings were also held with the NSO on the preparations needed to meet the requirements of the ESRB concerning real estate data gaps and a Joint Data Coordination Group was set up with the Malta Financial Services Authority (MFSA), to co-ordinate financial data reporting.

During the year the Bank collaborated with other national central banks (NCBs) on the consolidation of the technical and functional aspects of Trans-European Automated Real-time Gross settlement Express Transfer system 2 (TARGET2) and TARGET2-Securities (T2S), implemented amendments to the T2S framework and modified the regulatory standards which support the Payment Services Directive (PSD2). Work also began on the establishment of a payments hub that would help the Bank meet the increased and enhanced payment demands of the domestic financial system. A cybersecurity office was set up to gather intelligence on imminent cyber threats, while an internal task force met regularly to discuss developments related to the exit of the United Kingdom from the European Union.

The Central Bank of Malta Foundation was set up to support projects in the fields of education, culture, scientific research, national heritage and social causes. The Bank also implemented a number of environmentally-friendly initiatives and joined the Network for Greening the Financial System (NGFS) which brings together several of the global systemically-important banks and insurers.

Looking ahead, the Bank will continue to monitor the financial system, work with other data providers to enhance the quality of Maltese statistics and disseminate its knowledge to the general public. In 2020, it will also be participating in Eurosystem discussions on the review of the monetary strategy.

Other priorities include the provision of agency services to local institutions for the settlement of euro payments and the development of concrete projects in the area of big data and machine learning through collaboration with academia.

On behalf of the Board, I would like to thank the Bank's staff for their continued hard work and professionalism, especially in the extremely difficult circumstances brought about by the pandemic.



Dr Mario Vella



I. Financial and Economic Developments



1. THE EXTERNAL ENVIRONMENT AND THE EURO AREA

During 2019, the US economy grew at a slower pace compared with the previous year, while economic activity in the United Kingdom increased at a slightly faster rate. Price pressures eased throughout the year in both economies, largely reflecting developments in energy price inflation. The annual rate of consumer price inflation averaged 1.8% in both economies. During the year, the Federal Reserve lowered the official federal funds rate target on three occasions, while the Bank of England kept the Bank Rate unchanged.

In the euro area, real growth in GDP eased to 1.2% in 2019, from 1.9% in the previous year. Labour market conditions continued to improve, with the unemployment rate edging down to 7.4% by December. Consumer price inflation, measured on the basis of the HICP, fell to an average of 1.2% in 2019, with the fall stemming mainly from lower energy inflation.

The ECB's Governing Council maintained an accommodative monetary policy stance during 2019. Although the interest rates on MROs and the marginal lending facility were unchanged, the interest rate on the deposit facility was reduced by 10 basis points to -0.50% in September. While the Governing Council had initially indicated that rates would remain on hold at least through the first half of 2020, it then said that it expects the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

The Governing Council also decided to restart purchases under the APP and reaffirmed its intention to reinvest in full the principal payments from maturing securities under this Programme for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

Furthermore, a new series of seven quarterly TLTROs was launched starting in September 2019. These are expected to end in March 2021. The Governing Council also introduced a two-tier system for reserve remuneration in which part of banks' holdings of excess liquidity will be exempt from the negative deposit facility rate.

Lower oil supplies lifted the price of Brent crude oil during 2019, while concerns about the impact of weak global growth on demand led to falls in the prices of a number of non-energy commodity prices, including metals.

Key advanced economies

US economic activity slows down

During 2019, economic activity in the United States slowed down, with real GDP growth falling to 2.3%, from 2.9% in 2018 (see Table 1.1). This reflected weaker increases in gross private domestic investment and personal consumption expenditure, which were only partly offset by faster growth in government expenditure. Net exports continued to dampen GDP growth, as exports were broadly unchanged and imports increased. However, they contributed less negatively than in 2018.

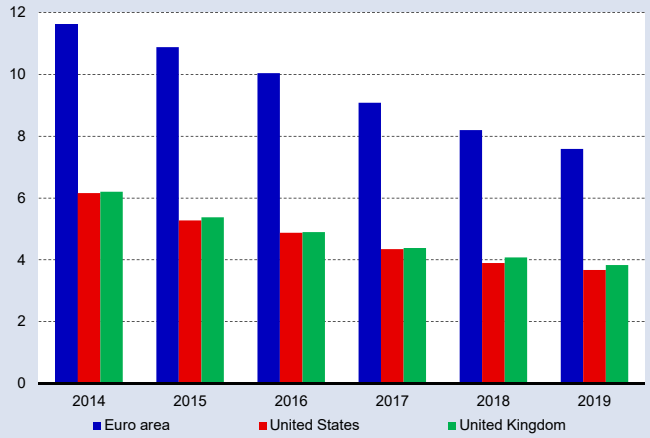
Table 1.1
REAL GDP GROWTH IN SELECTED ADVANCED ECONOMIES
Percentage changes over preceding period

	2014	2015	2016	2017	2018	2019
United States	2.5	2.9	1.6	2.4	2.9	2.3
Euro area	1.4	2.1	1.9	2.5	1.9	1.2
United Kingdom	2.6	2.4	1.9	1.9	1.3	1.4

Sources: Bureau of Economic Analysis, US; Eurostat; Office for National Statistics, UK.

In the labour market, the participation rate averaged 63.1% in 2019 from 62.9% in 2018. Meanwhile, employment continued to rise, but the rate of increase eased to 1.1% in 2019 compared with 1.6% in 2018. Non-farm payroll data suggest that there was a slowdown in the pace of job creation in most sectors of the economy. The average unemployment rate in 2019 stood at 3.7%, down from 3.9% in the preceding year (see Chart 1.1).

Chart 1.1
UNEMPLOYMENT RATE
(percentage of the labour force; seasonally adjusted)

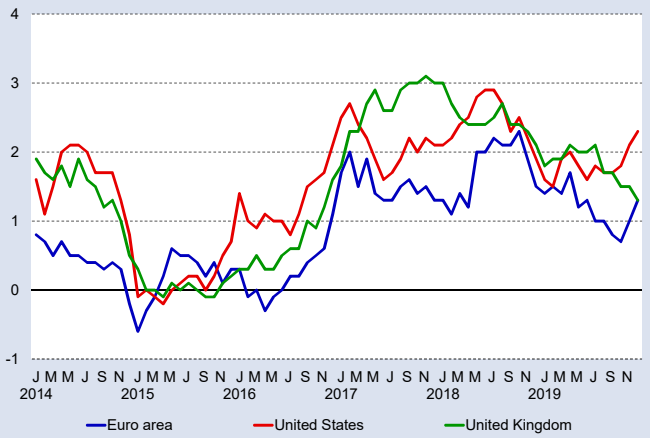


Sources: Eurostat; US Bureau of Labor Statistics; Office for National Statistics, UK.

The annual rate of inflation based on the Consumer Price Index (CPI) averaged 1.8% in 2019, down from 2.5% in 2018 (see Chart 1.2). US inflation increased to 2.0% in April, before decelerating to 1.6% in June. Thereafter, it generally retreated before exceeding again the 2% target of the Federal Reserve in November and December.

The drop in the average inflation rate for 2019 reflected developments in energy inflation as this turned negative, after averaging 7.6% a year earlier. Services price inflation remained relatively unchanged while food price inflation increased. Meanwhile, inflation excluding food and energy rose marginally to 2.2%, from 2.1% in 2018.

Chart 1.2
CONSUMER PRICE INFLATION
(annual percentage changes)

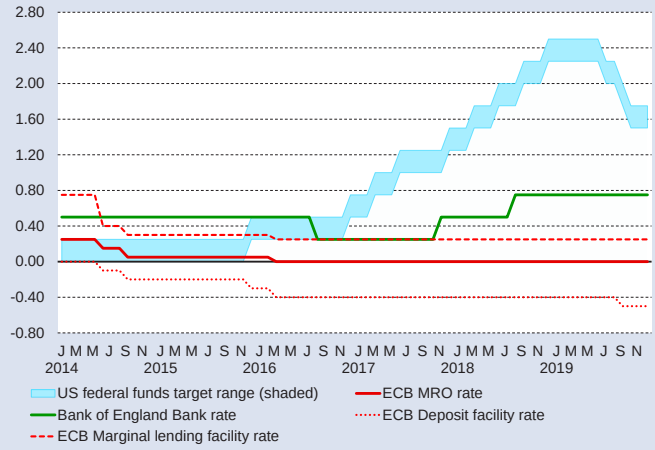


Sources: Eurostat; US Bureau of Labor Statistics; UK Office for National Statistics.

In the first half of 2019, the Federal Open Market Committee (FOMC) maintained the target for the federal rate unchanged between 2.25% and 2.50% (see Chart 1.3). At the time, the Committee continued to view a sustained expansion of economic activity, strong labour market conditions and inflation near the Committee's symmetric 2% objective as the most likely outcomes.

In July, however, the Committee lowered the target range for the federal funds rate to between 2.00% and 2.25% as it considered that significant risks and uncertainties in the external environment could have an impact on the US economy. Furthermore, inflationary pressures remained muted. This assessment was broadly confirmed as the year progressed and the target range was lowered again on two occasions in September and October, to end the year between 1.50% and 1.75%.

Chart 1.3
OFFICIAL INTEREST RATES
(percentages per annum; end of month)



Sources: ECB; Federal Reserve; Bank of England.

Meanwhile, the Committee maintained its existing policy of reinvesting principal payments from its agency debt and mortgage-backed security holdings, and rolling over maturing Treasury securities at auction.[1]

UK economic growth increases marginally

Economic growth in the United Kingdom increased marginally in 2019, with real GDP expanding by 1.4%, from 1.3% a year earlier (see Table 1.1). An acceleration in government consumption and investment had a positive impact on growth. These offset lower growth in private consumption. Meanwhile the contribution of net exports was flat.

In the year to November, employment growth averaged 1.1%, 0.1 percentage point lower than the average for the corresponding period in 2018. The unemployment rate fell further to 3.8% in 2019, from 4.1% in 2018 (see Chart 1.1).

Inflation in the United Kingdom, as measured by the CPI, averaged 1.8% in 2019, down from 2.5% a year earlier (see Chart 1.2). This was primarily a result of developments in energy inflation which declined markedly during 2019. Food and beverage inflation and NEIG also eased. On the other hand, the prices of services rose at a slightly faster pace. Reflecting the aforementioned moderation in NEIG inflation, the annual rate of inflation based on the CPI excluding food and energy fell to 1.7%, from 2.1% a year earlier.

Throughout 2019, the Bank of England's Monetary Policy Committee maintained the Bank Rate unchanged at 0.75% (see Chart 1.3). On several occasions the Committee reiterated that the economic outlook would continue to depend on the new trading arrangements between the European Union and the United Kingdom – whether the transition to them is abrupt or smooth – and how households, businesses and financial markets respond. The appropriate path of monetary policy will depend on the balance of these effects on demand, supply and the exchange rate. In all circumstances, monetary policy would be set with a view to achieve the Bank of England's 2% inflation target.

Towards the end of the year, the Committee noted that if global growth fails to stabilise or if Brexit uncertainties remained entrenched, monetary policy may need to reinforce the expected recovery in UK GDP growth

[1] In March 2020, the FOMC lowered the target range for the federal funds rate, first to between 1.00% and 1.25% and later to between 0.00% and 0.25%, in view of downside risks to the US economy arising from COVID-19. To support the smooth functioning of markets for US Treasury securities and agency mortgage-backed securities, the FOMC also said that it will increase its holdings of Treasury securities by at least USD 500 billion and its holdings of agency mortgage-backed securities by at least USD 200 billion. Meanwhile, the Federal Reserve Board broadened its programme of support for the flow of credit to households and businesses by establishing a number of funding facilities.

and inflation. Further ahead, provided these risks do not materialise and the economy recovers broadly in line with the MPC's latest projections, some modest tightening of policy, at a gradual pace and to a limited extent, may be needed to maintain inflation sustainably at the target.

The Committee maintained the stock of sterling non-financial investment-grade corporate bond purchases, and the stock of UK government bond purchases, financed by the issuance of central bank reserves, at GBP 10 billion and GBP 435 billion, respectively.[2]

Economic and financial developments in the euro area

Euro area GDP growth moderates[3]

Real GDP in the euro area increased at a slower pace of 1.2% in 2019, compared with a growth rate of 1.9% in 2018 (see Table 1.2).

Economic activity in the euro area was supported by domestic demand, in particular gross fixed capital formation. While private consumption and government consumption also supported the expansion, they contributed to a lesser extent. Meanwhile, changes in inventories contributed negatively. The contribution of net exports was also negative, as imports rose at a faster pace than exports. The slower GDP growth rate between 2018 and 2019 stemmed from a much lower contribution of net exports. By contrast, the positive contribution of domestic demand increased further.

HICP inflation falls

The annual rate of HICP inflation in the euro area fell during 2019, with the average for the year as a whole standing at 1.2% in 2019, down from 1.8% in 2018 (see Chart 1.4). This drop in the inflation rate mainly reflected weaker growth in energy prices, with the contribution of energy inflation decreasing from 0.6 percentage point to 0.1 percentage point. Processed food and unprocessed food inflation also moderated, while

Table 1.2
REAL GDP GROWTH IN THE EURO AREA
Chain-linked volumes

	2014	2015	2016	2017	2018	2019
			Annual percentage changes			
Private consumption	0.9	1.9	2.0	1.7	1.4	1.3
Government consumption	0.8	1.3	1.9	1.3	1.1	1.6
Gross fixed capital formation	1.4	4.8	4.0	3.4	2.3	5.7
Exports	4.8	6.6	2.9	5.5	3.4	2.5
Imports	4.9	7.7	4.1	5.0	2.7	3.8
GDP	**1.4**	**2.1**	**1.9**	**2.5**	**1.9**	**1.2**
			Percentage point contributions			
Private consumption	0.5	1.0	1.1	0.9	0.8	0.7
Government consumption	0.2	0.3	0.4	0.3	0.2	0.3
Gross fixed capital formation	0.3	0.9	0.8	0.7	0.5	1.2
Changes in inventories	0.4	0.0	0.0	0.2	0.0	-0.5
Exports	2.1	3.0	1.3	2.5	1.6	1.2
Imports	-2.0	-3.1	-1.7	-2.1	-1.2	-1.7
GDP	**1.4**	**2.1**	**1.9**	**2.5**	**1.9**	**1.2**

Source: Eurostat.

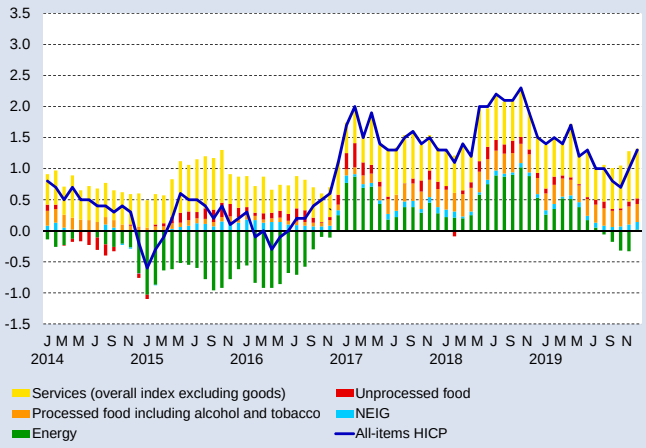
[2] These decisions were confirmed in January 2020. However, in March the Bank of England announced a number of measures to help UK businesses and households bridge across the economic disruption that is likely to be associated with COVID-19, including a lowering of the bank rate to 0.1%, a new term funding scheme for SMEs and an increase in its holdings of UK government and corporate bonds by GBP 200 billion, to GBP 645 billion. The Bank of England also announced that it will implement a Covid Corporate Financing Facility on behalf of HM Treasury.

[3] The cut-off date for data on GDP in this Chapter is 19 March 2020.

NEIG and services inflation were unchanged from 2018 on average.

The overall inflation rate hovered around 1.4% in the first three months of 2019, before edging up to 1.7% in April. It later retreated to rates of 1.0% or lower for much of the remainder of the year. It ended the year at 1.3%.

Chart 1.4
CONTRIBUTIONS TO YEAR-ON-YEAR HICP INFLATION IN THE EURO AREA
(percentage points; annual percentage change)



Source: Eurostat.

HICP excluding energy and food averaged 1.0% during 2019 as a whole, the same rate recorded in 2018. This measure of inflation showed some volatility in the first half of the year, before easing to 0.9% over the summer. By the end of the year, it had increased to 1.3% from 0.9% 12 months earlier. The profile of this component was heavily influenced by developments in services inflation, as the contribution of NEIG inflation was broadly stable at around 0.1 percentage point.

Labour market conditions improve further

Labour market conditions continued to improve during 2019, albeit at a more moderate pace. Employment growth averaged 1.2% in 2019, down from an average of 1.5% in 2018. Meanwhile, the rate of unemployment averaged 7.6% during the year, down from 8.2% in 2018 (see Chart 1.1). In December 2019, it stood at 7.4%, compared with 7.9% a year earlier.

Cross-country data show that the unemployment rate fell in most euro area countries. Nevertheless, wide disparities across countries remain, with the unemployment rate standing above 13% in Greece and Spain, but only 3.2% in Germany.

ECB staff projections point towards significantly weaker growth in the near term[4]

According to the ECB staff macroeconomic projections published in March 2020, real GDP growth in the euro area is expected to ease to 0.8% in 2020 from 1.2% in 2019, before picking up to 1.3% in 2021 and 1.4% in 2022 (see Table 1.3).

Table 1.3
MACROECONOMIC PROJECTIONS FOR THE EURO AREA(1)
Annual percentage changes

	2020	2021	2022
GDP	**0.8**	**1.3**	**1.4**
Private consumption	1.2	1.2	1.2
Government consumption	1.7	1.5	1.5
Gross fixed capital formation	0.4	1.9	2.2
Exports	1.6	2.5	2.6
Imports	1.8	2.7	2.8
HICP	**1.1**	**1.4**	**1.6**

Source: ECB.

(1) ECB staff macroeconomic projections (March 2020).

4 The cut-off date for oil prices and other technical assumptions was 18 February. The projections were finalised on 28 February 2020 and thus do not fully reflect the impact of COVID-19. An indication of the impact of the COVID-19 outbreak is provided by supplementary model-based estimates reported in the text.

Domestic demand is projected to remain the main driver behind euro area GDP growth over the projected horizon, whereas the contribution of net exports is expected to be broadly neutral.

The projections foresee very muted GDP growth in the first half of 2020, followed by an improvement in the second half of the year. The near-term outlook for economic activity in the euro area has sharply deteriorated, reflecting the high uncertainty surrounding the outbreak of COVID-19, implying a significant negative shock to the economy. This is expected to have a strong adverse effect on euro area activity, at least in the short term, affecting both demand and supply. Weaker activity in affected countries implies lower euro area export growth and disruptions to global supply chains. Business and consumer sentiment are also negatively affected. Some of these effects are amplified by the containment measures that are being introduced to limit the spread of COVID-19.

Over the medium term, though, growth should pick up, as global headwinds dissipate. In particular, the March 2020 ECB staff projections assume that the virus outbreak will be contained over a few months, allowing GDP growth to normalise in the second half of 2020. Additionally, activity will also be supported by very favourable financing conditions, a gradual recovery in foreign demand and a degree of fiscal easing.

Compared with the Eurosystem staff projections published in December 2019, euro area GDP growth was revised down by 0.3 percentage point in 2020 and by 0.1 percentage point in 2021, reflecting carry-over effects from the weaker than expected outturn in the last quarter of 2019, a more protracted weakness than expected in the manufacturing sector and the impact of the COVID-19 outbreak. However, two model-based adverse scenarios that allow for a more extended epidemic in China and a significant widening of the spread of COVID-19 in the euro area imply an additional downward revision to GDP growth in 2020 of between 0.6 and 1.4 percentage points.

According to the March 2020 ECB staff projections, HICP inflation is envisaged to ease slightly to 1.1% in 2020. The dip in HICP inflation in 2020 reflects negative rates for HICP energy inflation, on account of recent declines in the oil price. The projections assume that the downward pressures on prices related to weaker demand in 2020 are largely offset by upward effects related to supply disruptions. Over the medium term, overall HICP inflation is set to reach 1.6% by 2022. It will be partly supported by an increase in HICP inflation excluding energy and food, which should respond to the gradual recovery in activity, relatively robust wage growth in a context of tight labour market conditions, and recovering profit margins. Rising non-energy commodity prices and import prices are also expected to contribute to the increase in this measure of inflation.

Compared with the December 2019 projections, HICP inflation projections were unrevised. However, the aforementioned model-based estimates that allow for an intensification of the COVID-19 pandemic would imply downward revisions to the baseline inflation projections of between 0.2 and 0.8 percentage points, depending on the severity of the scenario and model used.

In both scenarios, monetary and fiscal policy are assumed not to react. Including such policy reactions could significantly mitigate the negative economic impact.

The ECB introduces additional monetary accommodation

The ECB's Governing Council maintained an accommodative monetary policy stance during 2019. The interest rate on MROs and the marginal lending facility were maintained at 0.00% and 0.25% respectively throughout the year (see Chart 1.3). In September, the ECB reduced the interest rate on the deposit facility by 10 basis points to -0.50%. Furthermore, while the Governing Council had previously indicated that rates would remain on hold at least through the first half of 2020, it later said that it expects the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

The Council also reaffirmed its intention to reinvest in full the principal payments from maturing securities under the APP for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

In March, the Governing Council further announced that it will launch a new series of seven quarterly TLTROs (TLTRO-III) starting in September 2019 and ending in March 2021, each with a maturity of two years. Counterparties were entitled to borrow up to 30% of the eligible loan stock held as at end February 2019. The Council also extended the full allotment procedure for its lending operations at least until the end of the reserve maintenance period starting in March 2021.

In June, the Council announced that the interest rate in each operation in the TLTRO-III series will be set at a level that is 10 basis points above the average rate applied in the Eurosystem's MROs over the life of the respective operation. For banks whose eligible net lending exceeds a benchmark, the TLTRO-III rate will be lower and can be as low as the average interest rate on the deposit facility prevailing over the life of the operation plus 10 basis points.

The terms of these operations were modified in September, when their maturity was lengthened from the original two to three years and the 10 basis point spread over the MRO rate was dropped.

In September, the Governing Council also stated that net purchases under the APP will restart at a monthly pace of €20 billion as from 1 November 2019. These purchases are expected to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before the ECB starts raising its key interest rates.

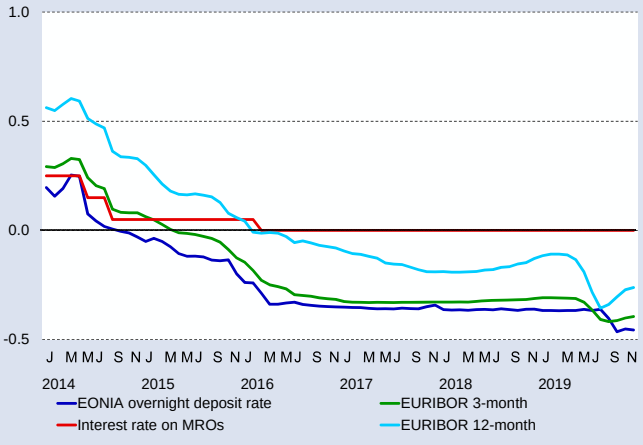
Furthermore, a two-tier system for reserve remuneration was introduced, in which part of banks' holdings of excess liquidity will be exempt from the negative deposit facility rate.[5] These additional non-standard measures are aimed at preserving favourable bank lending conditions, ensuring the smooth transmission of monetary policy and further supporting the accommodative stance of monetary policy.[6]

Money market rates reach new historical lows

In the light of the accommodative monetary policy stance, money market rates in the euro area declined further, remaining at historical lows during 2019. The Euro Over Night Index Average (EONIA) overnight deposit rate remained unchanged at -0.37% up to August and subsequently fell to between -0.40% and -0.45% following the additional monetary accommodation announced by the ECB in September.

Similarly, the three-month EURIBOR remained unchanged at around -0.31% in the first half of the year before it fell in the second half of the year. It stood at -0.39% in December. Meanwhile, the 12-month EURIBOR decreased through August before recovering slightly in the last few months of the year. It stood at -0.26% in December (see Chart 1.5).[7]

Chart 1.5
KEY INTEREST RATES
(percentages per annum; monthly averages)



Source: ECB.

[5] The two-tier system applied as of the seventh maintenance period of 2019, which started on 30 October 2019.

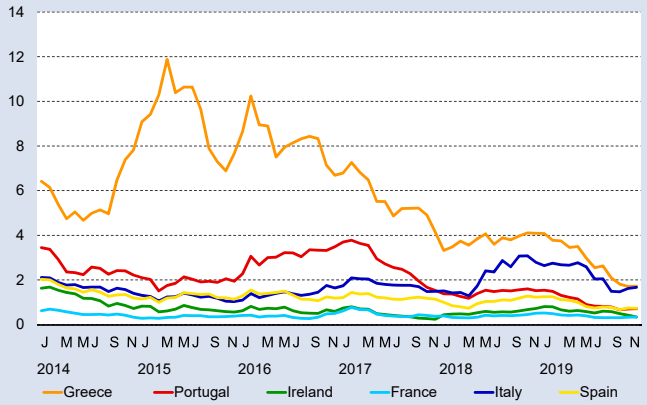
[6] On 12 March 2020, the ECB announced a number of measures aimed at enhancing liquidity support to the euro area financial system. These include considerably more favourable terms on TLTRO-III operations that will be carried out between June 2020 and June 2021, temporary additional LTROs to bridge the period until the June 2020 TLTRO-III operation as well as a temporary envelope of additional net asset purchases equivalent to €120 billion until the end of 2020. The ECB's key interest rates and forward guidance on interest rates and the APP were unchanged. Additional measures were announced on 18 March. These include a temporary €750 billion Pandemic Emergency Purchase Programme, an expanded range of assets eligible under the corporate sector purchase programme (CSPP) and changes to the main risk parameters of the collateral framework.

[7] EURIBOR is an interest rate benchmark indicating the average rate at which principal European banks lend unsecured funds on the interbank market in euro for a given period. The EONIA is an effective overnight interest rate and was measured as the weighted average of the interest rates on unsecured overnight lending transactions, in euro denomination, as reported by a panel of contributing banks. Since 2 October 2019, the EONIA methodology has been modified to become euro short-term rate (€STR) plus a fixed spread of 8.5 basis points.

Euro area bond yields decline

Yields on ten-year government bonds in the euro area fell during 2019. Yields on Greek bonds recorded the strongest decline, falling by 286 basis points, to stand at 1.42% in December. Strong decreases were also recorded in the ten-year yields on Italian and Portuguese sovereign debt, which fell by 161 and 130 basis points since December 2018, to close the year under review at 1.37% and 0.41%, respectively.

Chart 1.6
EURO AREA TEN-YEAR GOVERNMENT BOND YIELD SPREADS(1)
(vis-à-vis German ten-year government bond yields)



Source: ECB.
(1) Since there were no data for Greece for July 2015 due to market closure, the spread in this chart was left equal to that of the previous month.

More subtle drops were recorded in Spain, Ireland, and France, where ten-year government bond yields fell by 99, 87, and 66 basis points. They stood at 0.43%, 0.04%, and 0.04% in December, respectively. The yields on French and Irish sovereign securities recorded negative values in certain months throughout the year. German bond yields also were negative, reaching -0.59% in September, only to recover slightly thereafter. The main factor contributing to these declines was the growing expectation of further monetary accommodation in major economies, in an environment of increased uncertainty emanating from fragile global trade relations and the deteriorating general macroeconomic outlook.

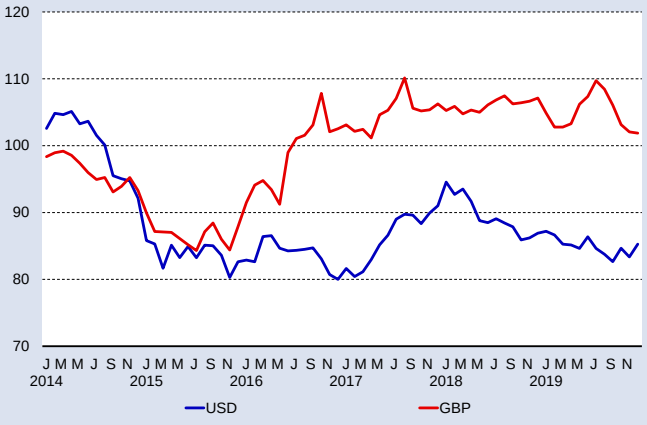
As government bond yields fell more strongly in most euro area countries than in Germany, spreads between yields on ten-year German bonds and those on bonds issued by other euro area governments narrowed over the year (see Chart 1.6). Greece and Italy recorded the most significant narrowing in spreads, of 237 and 112 basis points, respectively. In Greece, factors behind these developments were the announcement of an early general election which led some investors to expect more market-friendly policies from a new administration, investors' perceptions that the Greek economy continued to make progress in terms of correcting imbalances and the Greek government's decision to lift the remaining capital controls. As for Italy, this partly reflected optimism relating to the anticipation and subsequent formation of a new governing coalition.

The euro depreciates

The euro exchange rate depreciated in nominal effective terms during 2019, with the EER-19 down by 1.6% since its end-2018 level.[8] This followed another depreciation of 0.6% in 2018.

On a bilateral basis, the euro fell by 3.1% against the Japanese yen and by 1.9% against the US dollar amid weak economic growth in the euro area (see Chart 1.7). It also depreciated by 4.9% against the pound

Chart 1.7
EXCHANGE RATE MOVEMENTS OF THE EURO AGAINST OTHER MAJOR CURRENCIES
(index of end of month rates; Jan. 2012=100; an increase in the index implies euro appreciation)



Source: Eurostat.

[8] The nominal effective exchange rate NEER is based on the weighted averages of the euro exchange rate against the currencies of Australia, Bulgaria, Canada, China, Croatia, Czech Republic, Denmark, Hong Kong, Hungary, Japan, Norway, Poland, Romania, Singapore, South Korea, Sweden, Switzerland, the United Kingdom and the United States.

sterling, which was heavily influenced by market sentiment regarding the withdrawal of the United Kingdom from the European Union. The pound sterling rallied towards the end of the year as prospects of a no-deal Brexit diminished. The euro also weakened against a number of other currencies, including the Czech koruna, the Polish zloty, the Swiss franc and the Chinese yuan renminbi.

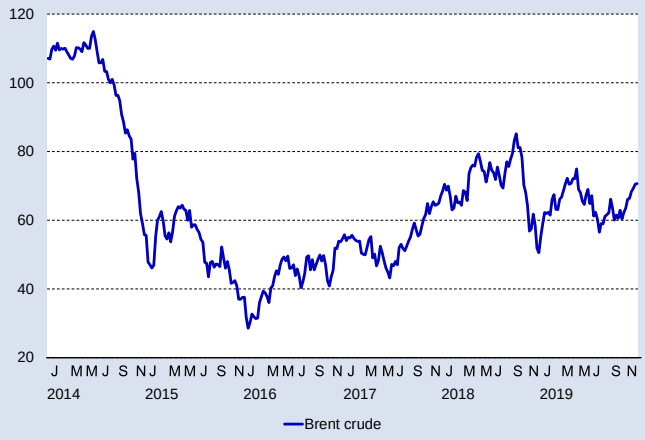
Commodities

Oil prices end the year at a higher level

The price of Brent crude oil generally rose up to mid-May on the back of lower oil supplies amid high compliance with the OPEC+ agreement to cut production (see Chart 1.8). Moreover, US sanctions against Iran and Venezuela also negatively impacted supply. Thereafter, crude oil prices receded somewhat amid growing fears that demand for oil would weaken as the global economy slowed down and downside risks to the outlook, partly related to volatile trade relations between China and the United States, persisted. By mid-August, the oil price had fallen below the USD 60 mark. In early September, though, the price of Brent crude oil began to regain some of its earlier losses as concerns about supply shortages intensified, market sentiment improved and OPEC+ producers agreed to implement more substantial production cuts. The price of Brent crude oil stood at USD 68.97 at the end of 2019, an increase of 36.5% on its level a year earlier.

Non-energy commodity prices declined during 2019, with World Bank data showing a drop of 4.2%. The fall was mainly driven by lower prices for metals and minerals – and, to a lesser extent – agriculture.

Chart 1.8
PRICE OF OIL
(end of week; US dollars per barrel)



Source: Reuters.



2. MONETARY AND FINANCIAL DEVELOPMENTS[1]

According to the Bank's Financial Conditions Index (FCI), in 2019 financing conditions loosened markedly compared with 2018 and were broadly neutral from a historical perspective.

The total assets of domestic monetary financial institutions (MFI) in Malta rose during 2019, contrasting with a drop in the asset holdings of international banks. Meanwhile, Maltese residents' deposits continued to expand, remaining the main source of funding for resident MFIs. The shift away from longer term deposits towards more liquid overnight deposits persisted, in an environment of very low interest rates and robust income growth. At the same time, growth in credit to residents expanded further, driven by robust growth in credit to the private sector and a modest increase in credit to general government. Lending to households picked up further, reflecting faster growth in loans for house purchase, while lending to non-financial corporations (NFCs) grew at a slower pace. NFCs also continued to increase their usage of capital markets as an alternative form of financing. Interest rates on both deposits and loans to Maltese residents fell slightly during the year, with the spread between the two rates narrowing somewhat from elevated levels.

In the primary market, domestic yields fell during 2019. Similarly, yields on five-year and ten-year Maltese government bonds decreased mirroring downward movements in the corresponding euro area yields. In 2019, net government bond issues were negative. By contrast, the private sector's net issues remained positive and rose significantly when compared with 2018. In the equity market, the Malta Stock Exchange (MSE) Equity price index rose when compared with the level registered at the end of December 2018.

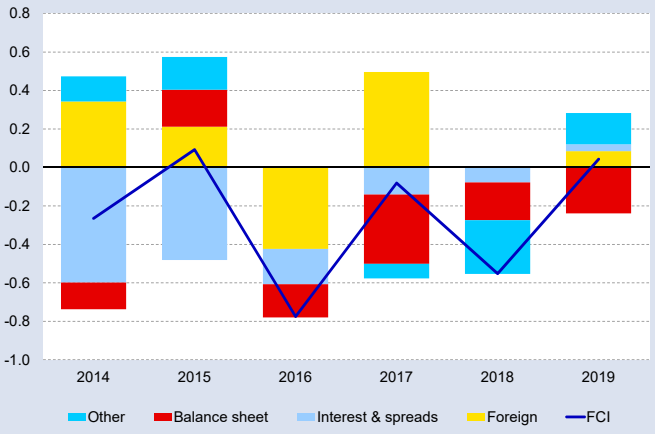
Monetary aggregates and financial conditions

FCI turns positive

The Bank monitors domestic financial conditions through a summary measure which combines a number of local and international financial variables that influence economic activity.[2]

Financial conditions in 2019 improved markedly when compared with 2018. While in 2018 they were tight by historical standards, in 2019 they were broadly neutral. This primarily reflects a recovery in domestic factors, although foreign influences also contributed to the improvement (see Chart 2.1). In particular, the 'other' category

Chart 2.1
CONTRIBUTIONS TO THE FCI
(contributions to the index)



Source: Central Bank of Malta estimates.

[1] The cut-off date for this Chapter has been extended to 3 March 2020.

[2] The analysis in this section is based on the Bank's FCI, as described in Micallef, B., & Borg, I., "A Financial Conditions Index for the Maltese Economy", in Grech, A.G., & Zerafa, S. (eds.), *Challenges and Opportunities of Sustainable Economic Growth: the case of Malta,* Central Bank of Malta, 2017, and later updated in the Central Bank of Malta – *Annual Report* 2017.

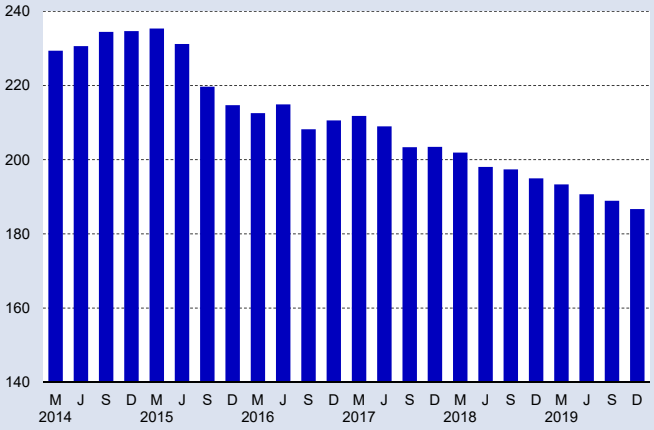
recovered sharply, mirroring the rise in issues of NFC securities and domestic stock prices. Moreover, the 'interest rate and spreads' category also recovered in 2019 when compared with the previous year due to a decline in the spread between yields on Maltese long-term government bonds and the German bund. The positive trend in stock prices in the euro area during 2019 also contributed to an improvement in foreign influences on Malta's financial conditions. The FCI on average signalled slightly looser conditions compared to historical patterns.

Domestic banks' assets increase

Total assets pertaining to the Maltese banking system (including the Central Bank of Malta) stood at €50,899.0 million at the end of 2019, signifying a drop of €2,554.9 million when compared with 2018. This drop masks contrasting developments in the assets of domestic and international banks.

During the year under review, assets pertaining to international banks dropped by €3,798.3 million. On the other hand, assets of core domestic MFIs increased by €547.9 million, or 2.3%.[3] As a result, the share of core domestic banks' assets in GDP stood at 186.7% at the end of 2019, down from 195.0% a year earlier (see Chart 2.2), reflecting faster growth in GDP. At the same time, assets pertaining to non-core domestic banks rose by €250.6 million.

Chart 2.2
TOTAL ASSETS OF CORE DOMESTIC BANKS
(% of nominal GDP; GDP data are four-quarter moving sums)



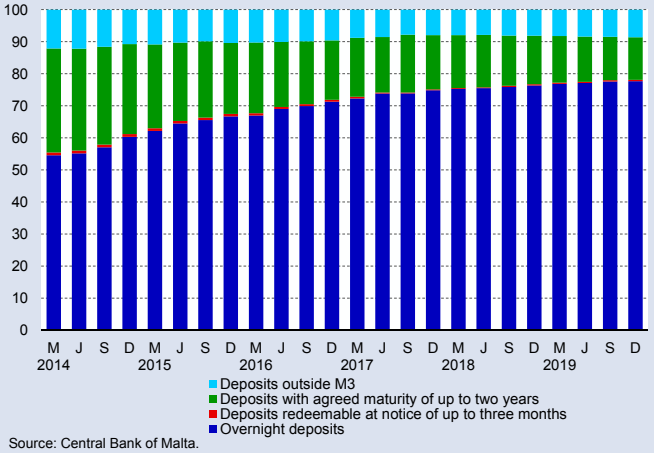
Sources: Central Bank of Malta; NSO.

Maltese residents' deposits continue to expand

Total deposits held by Maltese residents with MFIs in Malta rose further during 2019, reaching €19,698.9 million by the end of the year (see Table 2.1). This signifies an increase of €781.2 million, or 4.1% when compared with December 2018. This high level of deposits, as well as the expansion therein during 2019 mainly reflects developments in household deposits, which were supported by robust income and employment growth, along with a strong preference for liquidity in an environment of low interest rates. However, deposits held by NFCs also increased during the year.

Reflecting the preference for liquid assets, overnight deposits remained the preferred category of deposits for residents during 2019. Annual growth in this component, which is the most liquid deposit category and comprises both demand and savings deposits, stood at 6.0% in December 2019, slightly down from the increase of 8.0% registered a year earlier. As a result, by the end of the year, the share of overnight deposits in total deposits had risen to 77.7% from 76.4% 12 months earlier (see Chart 2.3). This share

Chart 2.3
DISTRIBUTION OF TOTAL RESIDENT DEPOSITS(1)
(percentage points)



Source: Central Bank of Malta.
(1) Deposits exclude those belonging to central government.

[3] The core domestic banks in Malta are APS Bank Limited, Bank of Valletta plc, BNF Bank plc, HSBC Bank Malta plc, Lombard Bank Malta plc, and MeDirect Bank (Malta) plc.

Table 2.1
DEPOSITS OF MALTESE RESIDENTS

	2017 Dec.	2018 Dec.	2019 Dec.	Amount outstanding	Absolute change
	Annual percentage change			*EUR millions*	
Overnight deposits	**10.0**	**8.0**	**6.0**	**15,307.7**	**860.3**
of which					
Households	15.6	14.7	10.6	9,636.6	920.5
NFCs	2.6	5.8	-0.6	3,331.8	-19.6
Deposits redeemable at notice up to 3 months	**-55.8**	**62.3**	**14.7**	**85.0**	**10.9**
of which					
Households	-51.0	-10.2	-6.6	32.9	-2.3
NFCs	-69.5	530.2	40.5	27.6	8.0
Deposits with agreed maturity up to 2 years	**-4.4**	**-5.2**	**-8.7**	**2,616.2**	**-248.3**
of which					
Households	-6.3	-6.0	-7.9	2,039.9	-175.8
NFCs	19.8	-6.6	-1.0	254.4	-2.6
Deposits with agreed maturity above 2 years	**-13.0**	**8.0**	**10.3**	**1,690.0**	**158.3**
of which					
Households	-12.0	2.2	5.3	1,412.3	71.3
NFCs	-29.9	10.5	21.7	83.8	14.9
Total residents' deposits[(1)]	**4.7**	**5.9**	**4.1**	**19,698.9**	**781.2**

Source: Central Bank of Malta.
[(1)] Total residents' deposits exclude deposits belonging to Central Government.

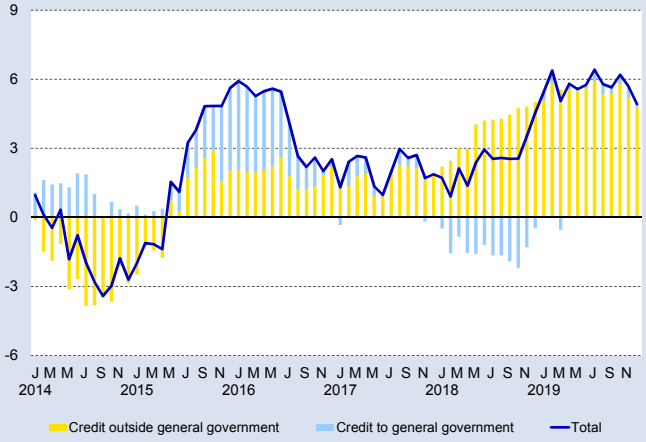
has increased almost consistently since the end of 2012, when it stood at 51.4%, driven by a surge in households' holdings.

In contrast to overnight deposits, time deposits with a maturity of less than two years – the second largest category – contracted further in 2019. These decreased by 8.7%, with their share in overall deposits falling to 13.3% from 15.1% a year earlier. Meanwhile, time deposits with a maturity above two years grew by 10.3% when compared with their end-2018 levels, although in absolute terms the increase was much smaller than that in overnight deposits. In fact, the share of time deposits with maturities of over two years remained limited, at 8.6%. The share of deposits redeemable at notice of up to three months remained very small.

Credit to residents expands

Credit to Maltese residents expanded at a faster pace during 2019, reaching €14,197.2 million by the end of the year (see Table 2.2). This signifies an increase of €665.9 million over 2018 levels, or 4.9% in percentage terms. This expansion was almost entirely driven by developments in credit to residents outside general government, which added 6.1% (see Chart 2.4). On the other hand, after contracting in 2018, credit to general government edged up by 0.6%.

Chart 2.4
COMPOSITION OF CREDIT TO RESIDENTS OF MALTA
(percentage points; annual percentage change)



Source: Central Bank of Malta.

Table 2.2
MFI CREDIT TO MALTESE RESIDENTS

	2017 Dec.	2018 Dec.	2019 Dec.	Amount Outstanding	Absolute Change
	Annual percentage change			*EUR millions*	
Credit to general government	**0.2**	**-2.0**	**0.6**	**2,923.6**	**16.7**
Credit to residents outside general government	**2.4**	**6.5**	**6.1**	**11,273.6**	**649.2**
Securities & Equity	-4.9	5.1	-5.8	416.6	-25.5
Loans	2.7	6.6	6.6	10,857.0	674.7
of which:					
Loans to Households	6.6	7.8	10.0	6,079.6	554.3
Mortgages	8.2	8.8	10.7	5,484.8	529.3
Consumer Credit and Other Lending	-4.2	-0.4	4.4	594.8	25.0
Loans to NFCs[(1)]	-1.8	7.1	3.0	3,944.7	114.3
Total credit to residents	**1.9**	**4.5**	**4.9**	**14,197.2**	**665.9**

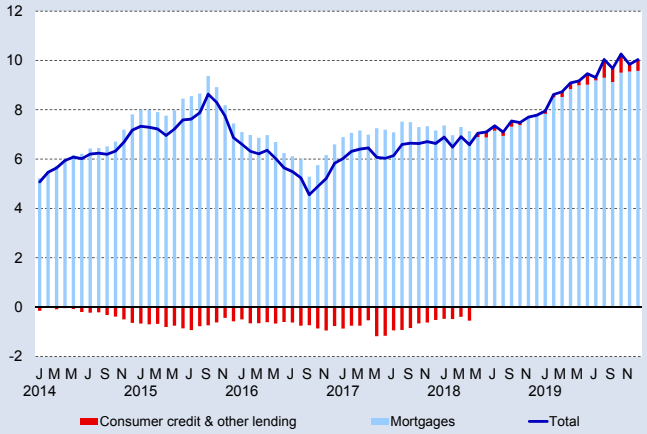
Source: Central Bank of Malta.
[(1)] NFCs include sole proprietors and non-profit institutions serving households (NPISH).

The deceleration in credit outside general government was entirely driven by slower growth in loans to NFCs. At the same time, MFI holdings of securities and equity issued by the private sector contracted. Loans to Maltese residents grew at an unchanged rate of 6.6%, as faster growth in lending to households offset a deceleration in loans to NFCs.

During the 12 months to December 2019, loans to households rose by 10.0% (see Chart 2.5). This component has grown continuously for a number of years, driven by lending for house purchases. Indeed, mortgage lending grew by 10.7% during 2019, following an 8.8% increase in 2018. At the same time, consumer credit and other lending rose by 4.4%, after contracting by 0.4% over the year to December 2018.

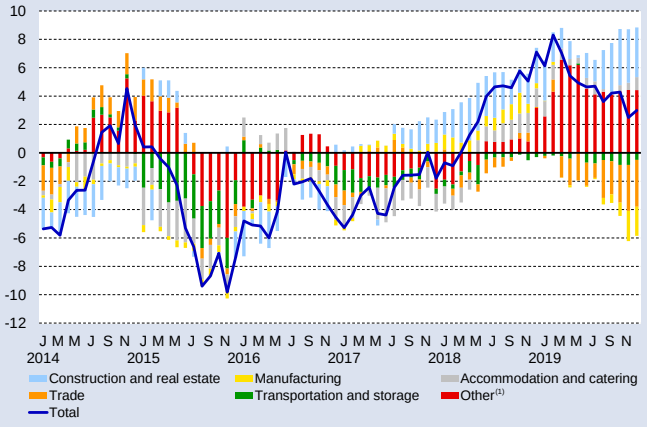
On the other hand, loans to NFCs grew by a moderate 3.0%, following an expansion of 7.1% in the previous year. A sectoral breakdown suggests that growth was supported by the extension of credit to various sectors of the economy, including construction and real estate, professional and scientific activities, as well as the administrative and support services sector. The latter are both part of the

Chart 2.5
COMPOSITION OF LOANS TO HOUSEHOLDS
(percentage points; annual percentage change)



Source: Central Bank of Malta.

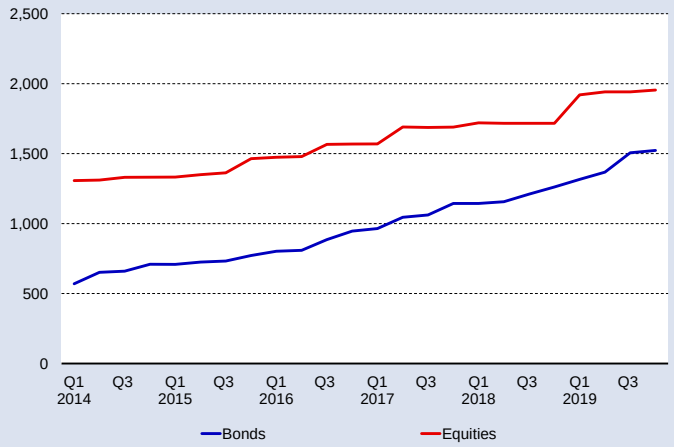
Chart 2.6
LOANS TO NFCs BY SECTOR
(percentage points; annual percentage change)



Source: Central Bank of Malta.
[(1)] Includes energy, entertainment, health, education, professional services, communication, and administration.

'other' component (see Chart 2.6). By contrast growth in loans to the manufacturing sector turned negative, while lending to the wholesale and retail trade sector fell at a faster rate.

Chart 2.7
CAPITAL ISSUED ON MSE BY NFCs
(million units outstanding as at end-period)



Sources: MSE; Central Bank of Malta estimates.

Although recourse to bank lending decreased, supplementary data suggest that NFCs made increased use of alternative sources of finance, such as internal funding and capital markets. NFC financing through the issuance of listed debt securities has grown in recent years, albeit from low levels. By the end of 2019, €1,522.7 million in corporate debt was outstanding on the MSE, 20.7% higher than the listed amount 12 months earlier (see Chart 2.7). In total, bank lending to NFCs and the stock of outstanding NFC bonds issued on the MSE rose by 7.4% in 2019, compared with 7.9% in the previous year.

Issuance of equity capital also increased strongly, with the amount outstanding at the end of 2019, exceeding that of bonds by almost 30.0%.[4]

Interest rates fall

Interest rates on residents' deposits with MFIs in Malta declined further in 2019, with the weighted average deposit rate offered to households and NFCs going down by 3 basis points to 0.30% by the end of 2019 (see Table 2.3).[5] This was mainly driven by a drop in rates on time deposits with a maturity of over two years.

Meanwhile, the weighted average lending rate paid by households and NFCs to resident MFIs fell by 9 basis points, reaching 3.46%. Both households and NFCs paid lower rates, though lending rates to NFCs remained above those charged to households, possibly reflecting differences in credit risk. As regards household loans, moreover, the lending rate on consumer credit and other lending decreased more strongly than that on mortgages.

The spread between the weighted average lending rate and the deposit rate narrowed to 316 basis points at the end of 2019, from 322 basis points a year earlier. Nonetheless, the level of the spread remains elevated, suggesting that the transmission of the ECB's monetary policy easing measures to retail lending rates remains weaker than that to deposit rates.

Credit market conditions remain stable

Respondent banks participating in the BLS reported unchanged credit standards, terms and conditions on loans to NFCs in Malta during 2019. By contrast, the assessment of NFCs' demand for credit was mixed. In the first quarter of the year, half of the respondent banks reported an increase in demand, while the remaining banks reported unchanged demand.

During the rest of the year, half of the banks continued to report unchanged demand, while the other half reported some decrease.

[4] Apart from the official MSE platform, small and medium-sized enterprises (SMEs) can also obtain finance through the specifically-geared platform Prospects.

[5] Basis points are rounded to the nearest whole number.

Table 2.3
INTEREST RATES ON DEPOSITS AND LOANS

Percentages per annum to residents of Malta; weighted average rates as at end of period

	2016	2017	2018	2019			
	Dec.	Dec.	Dec.	Mar.	June	Sep.	Dec.
Total deposits[1]	**0.48**	**0.38**	**0.33**	**0.32**	**0.32**	**0.31**	**0.30**
of which							
Overnight deposits							
Households	0.06	0.07	0.05	0.05	0.05	0.05	0.05
NFCs	0.03	0.04	0.02	0.03	0.03	0.03	0.03
Time deposits (less than 2 years)							
Households	0.79	0.78	0.75	0.74	0.76	0.75	0.71
NFCs	0.65	0.54	0.76	0.71	0.62	0.73	0.72
Time deposits (more than 2 years)							
Households	2.64	2.41	2.13	2.07	2.03	1.98	1.97
NFCs	2.03	1.98	1.88	1.84	1.55	1.53	1.53
Total Loans[1]	**3.68**	**3.64**	**3.55**	**3.52**	**3.50**	**3.48**	**3.46**
of which							
Households and NPISH	3.52	3.48	3.38	3.36	3.35	3.32	3.29
NFCs	3.93	3.91	3.83	3.79	3.75	3.74	3.76
Spread[2]	**3.20**	**3.26**	**3.22**	**3.20**	**3.18**	**3.17**	**3.16**
ECB MROs rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Source: Central Bank of Malta.

(1) Annualised agreed rates on outstanding euro-denominated amounts belonging to households (incl. NPISH) and NFCs.

(2) Difference between composite lending rate and composite deposit rate.

Credit standards, terms and conditions for house purchases were unchanged during the first and final quarters of the year. In the second quarter, replies were mixed, while in the third, half of the banks reported some tightening and the other half signalled unchanged standards.

With regard to the demand for credit for house purchases, initially most of the participating banks reported unchanged demand. However, during the second half of the year, most participating banks reported that the demand for this credit category had somewhat decreased.

Participating banks generally reported no changes to credit standards, terms and conditions for consumer credit and other lending to households during the first and final quarters of the year. However, some banks provided mixed replies for the remaining quarters of the year. In the first half of the year, all participating banks reported that demand for consumer credit and other lending had remained unchanged. However, a couple of banks reported some decrease in second half of the year.

Banks participating in the BLS also replied to a series of ad hoc questions on their market access to wholesale and retail funding and their risk capability as a result of the prevailing situation in financial markets. In this regard, the majority of banks generally reported unchanged market access to funding and risk capabilities.

Banks were also asked to gauge the impact of the new regulatory or supervisory requirements relating to capital, leverage, liquidity or provisioning on their assets, capital and funding conditions as well as on their lending policies. The majority of participating banks did not report any changes in their assets, risk-weighted

assets, capital and funding conditions. Similarly, no changes were reported in credit standards or margins as a result of new regulatory or supervisory requirements. However, in the second quarter of the year, one bank reported a slight increase in its risk-weighted assets, while two banks reported tighter credit standards on loans for house purchases, which persisted into the fourth quarter.

The majority of banks participating in the BLS also reported that their non-performing loan (NPL) ratio had not affected their lending policies during 2019, though one bank reported some easing in the bank's credit standards for loans to households for house purchases in the first six months of the year.

Participating banks reported that the expanded APP as well as the reinvestment of the principal payments from maturing APP securities did not impact their financial situation or their lending policies and volumes. No impact on their balance sheets and profitability was detected.

As regards the impact of the ECB's negative deposit facility rate, most banks reported that they had experienced a reduction in their net interest income. Some of the banks reported some loosening in lending rates and margins on loans to enterprises as well as increased lending to this sector. The effect on loans to households appeared to be more limited initially, but as the year progressed more banks reported a positive impact on these loans as well. By contrast, none of the banks reported an impact on their non-interest rate charges.

In the final quarter of the year, all respondent banks stated that they did not participate in the Eurosystem's TLTRO-III carried out in September and December 2019. Their financial situation, lending policy and lending volumes were not affected by these operations.

BOX 1: ACCESS TO FINANCE IN 2019[1]

SMEs have contributed significantly to the growth of the Maltese economy in recent years. Between 2014 and 2018, overall growth of SMEs in the Maltese 'non-financial business economy' was remarkably strong.[2] According to the latest Small Business Act (SBA) Factsheet, the value added of SMEs rose by 58.1% compared with 43.2% for large firms over this period. In terms of employment, SMEs created 19,300 new jobs overall, more than double the amount generated by large firms.[3]

In 2018, only 0.2% of firms in the non-financial business economy sector in Malta were large firms employing more than 250 persons.[4] The vast majority of firms in Malta (93.1%) employed fewer than nine persons and are considered micro firms, whereas the rest (6.7%) classify as small and medium-sized ones. This distribution of firms by size was almost identical to that in the European Union.

However, during the year, Maltese SMEs in the 'non-financial business economy' generated 81.8% of value added and 77.7% of employment, exceeding the respective EU average shares of 56.4% and 66.6%. The greater reliance of the Maltese economy on SMEs compared with that across the European Union could be beneficial as it reduces its susceptibility to shocks. At the same time, SMEs tend to experience greater financial constraints than larger firms.

The aim of this Box is to provide an insight into the challenges that SMEs are facing, in particular those relating to their financing needs. It summarises the main results from the Survey on the Access to Finance of Enterprises (SAFE), which was conducted in 36 countries across Europe between September and October 2019. Results, which refer to the six-month period between April and September 2019, are compared with those of previous waves and other economies in the European Union.

The financial situation of SMEs

A slightly smaller positive proportion of SMEs in Malta – 29% – reported increases in turnover compared with 35% a year earlier. SMEs in Malta seem to have outperformed those in the European Union, where the net share of respondents reporting higher turnover in 2019 stood at 20%. The net balance of SMEs reporting higher profits halved to 6% from 12% in 2018, but exceeded the corresponding figure for the European Union of 0%. This may reflect the fact that a higher share of SMEs in Malta than in the European Union achieved turnover growth of over 20% per annum in the past three years (2016-2018). This divergence was expected to persist in the period 2019-2021.

Meanwhile, a significantly higher share of domestic SMEs faced higher labour and operating costs. Whereas across the European Union this share was largely stable at 53%, in Malta this rose to 73% as opposed to 59% a year earlier. These trends were also observed for non-labour costs, such as those related to materials and energy. A net share of 60% of domestic SMEs reported an increase in these costs during 2019 compared with 49% a year earlier and 55% across the European Union.

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[1] Prepared by Sandra Zerafa. Ms. Zerafa is the coordinator of economic publications within the Economic Analysis Department of the Central Bank of Malta. The views expressed are those of the author and do not necessarily reflect the views of the Central Bank of Malta. Any errors are the author's own.

[2] A detailed analysis of the contribution of SMEs to the Maltese economy was carried out by Grech G. A. (2018), SMEs' contribution to the Maltese economy and future prospects, *Policy Note October 2018,* Central Bank of Malta.

[3] The 2019 SBA Fact Sheet may be found at https://ec.europa.eu/docsroom/documents/38662/attachments/20/translations/en/renditions/native

[4] The 'business economy' includes sectors other than agriculture and fisheries, public administration, education, health, social work, and arts, entertainment and recreation (including remote gaming). The 'non-financial business economy' also excludes the financial sector.

Sources of finance used by SMEs

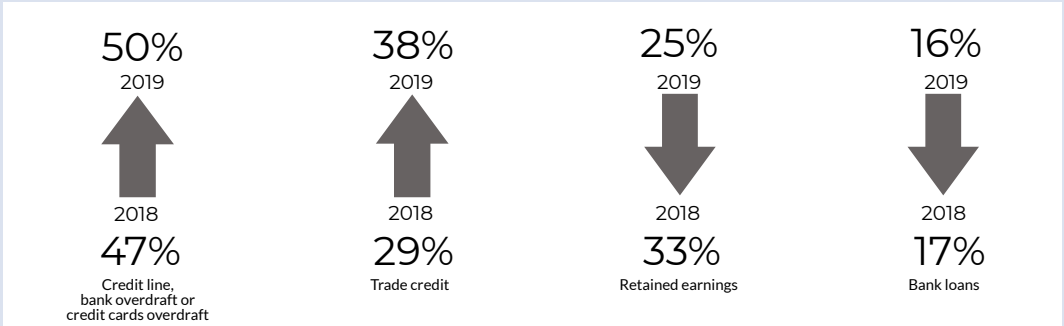
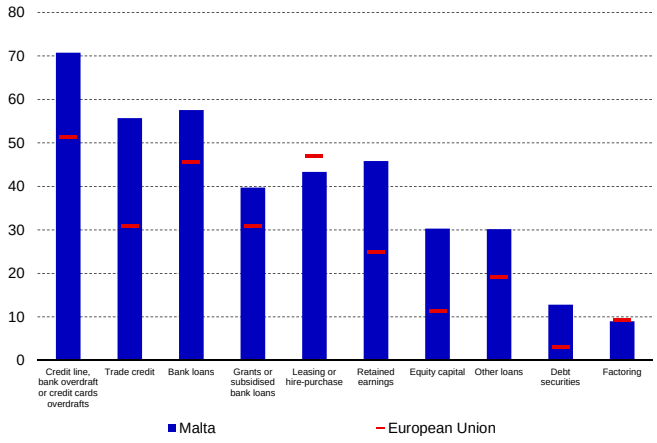


Chart 1 illustrates the financing sources deemed relevant by SMEs in Malta and in the European Union. Domestic SMEs have continued to prefer bank-related products such as bank loans, overdrafts and credit lines over market-based products and other sources of finance. However, the share of SMEs in Malta which used credit lines, bank overdrafts or credit cards or expected to use them in the future has fallen gradually over the past years, from 83% in 2016, to 74% in 2018 and 71% in 2019. Meanwhile, the share of those that used bank loans in the past or considered using them in the future has been largely stable over the years, and stood at 58% in 2019. Compared with SMEs across the European Union, SMEs in Malta continued to attach greater reliance on bank financing. In 2019, 51% and 46% of EU SMEs considered overdrafts and bank loans respectively as being relevant.

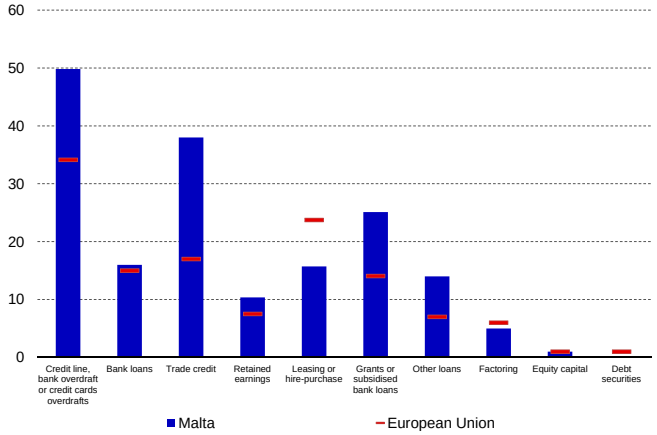
Chart 1
SOURCES OF FINANCE DEEMED RELEVANT BY SMEs
(used in the past or consider using in the future; percentage of respondents)



Source: SAFE (2019).

In 2019, the proportion of SMEs in Malta that resorted to credit lines, bank overdraft or credit card overdrafts during the previous six months rose slightly to 50% from 47% a year earlier. This share remained significantly above that of 34% registered in the European Union (see Chart 2). Meanwhile, the

Chart 2
SOURCES OF FINANCE USED BY SMEs IN 2019
(over the preceding 6 months; percentage of respondents)



Source: SAFE (2019).

use of bank loans, at 16% in Malta, was close to the 17% recorded a year earlier and 15% in the European Union. Survey results indicate that 39% of surveyed SMEs consider bank loans as being irrelevant for their enterprise as opposed to 52% in the European Union, while 41% stated that they did not use bank loans in the past six months. When asked to elaborate on why banks loans are not deemed relevant, around three quarters of domestic SMEs stated that they did not need this type of financing, confirming the previous assessment while 13% said that no bank loans were available. A further 13% mentioned that interest rates were high, that bank loans reduced their firm's control over the enterprise or that they required excessive paperwork.

The share of SMEs that used retained earnings or proceeds from the sale of assets during the reference period edged downwards to 25%, compared with 33% in the preceding year. However, this share was still almost twice that in the European Union. Indeed, the majority of SMEs (72%) in the European Union stated that this method of financing is not relevant to them as opposed to 46% of SMEs in Malta. Latest SAFE results indicate that the relative number of enterprises in the European Union that used retained earnings or sold assets increases with enterprise size.

The proportion of firms that used trade credit during the same period rose to 38% from 29% in the corresponding period a year earlier. This was significantly above the percentage of those that used trade credit in the European Union, which stood at 17%. Substantial differences prevail in the use of trade credit across countries. Survey results rank Malta (38%) and Ireland (47%) among the countries with a large share of SMEs making use of this source of financing as opposed to countries such as Austria, France and Germany where less than a tenth of SMEs relied on this type of finance. The higher use of trade credit by domestic SMEs may have partly made up for the reduced availability of bank financing, as perceived by firms participating in the SAFE.

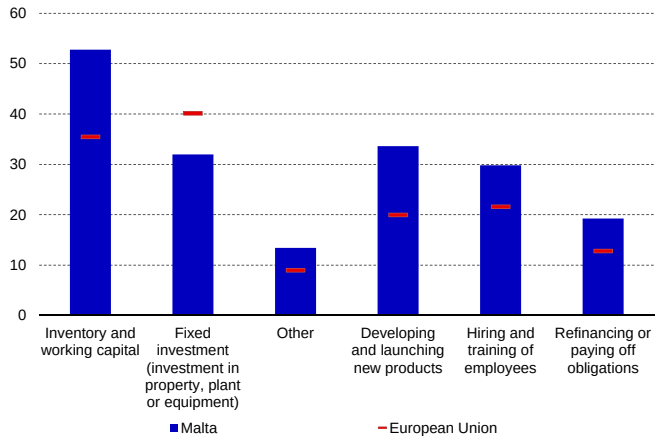
The share of SMEs that used leasing or hire-purchase doubled during 2019. However, at 16%, the share of domestic SMEs making use of this method for financing stood below that of 24% in the European Union. Survey results show that its use varies greatly among countries.

More than 30% of SMEs in Poland, Estonia, Finland, Sweden and Germany used leasing and hire-purchase compared with less than 15% of SMEs in Spain, Luxembourg, Greece, Italy and Cyprus.

The use of other loans such as those from family and friends, a related enterprise or shareholders rose to 14% in 2019 from 8% a year earlier. The share of domestic SMEs using this source of funding was double that in the European Union, which stood at 7%. During the same period, debt securities, factoring and equity capital remained the three sources of finance that were least used in Malta and across the European Union.

Chart 3 shows the purpose for which SMEs in Malta and in the European Union used external financing obtained between April and September 2019. In line with previous years, slightly more than half of domestic SMEs (53%) have resorted to external finance

Chart 3
USES OF EXTERNAL FINANCE
(over the preceding 6 months, percentage of respondents)



Source: SAFE (2019).

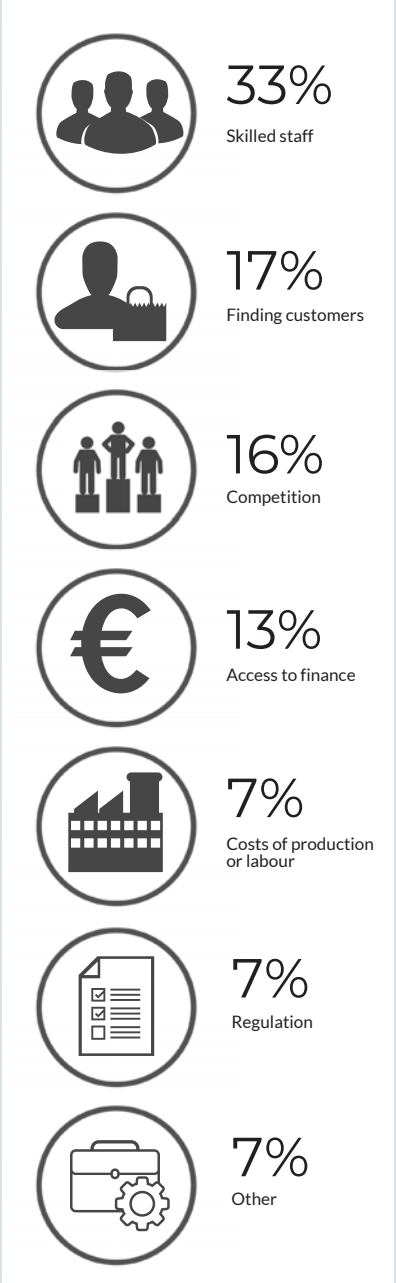
for inventory and working capital as opposed to more than a third in the European Union. When compared with the European Union, a smaller share of domestic SMEs have used external finance for the development and launching of new products (34%), fixed investment in property, plant or equipment (32%) and the hiring and training of employees (30%). Whereas the proportion of those that used external finance for human resources purposes was largely in line with that of last year, the share of those using external finance to develop and launch new products rose substantially from 23% in 2018 and was also significantly above the EU average of 20%. Both domestic and EU SMEs were less likely to use external finance to refinance or pay off obligations and for other purposes, although these reasons were cited more often by domestic SMEs than their EU counterparts.

Most pressing problems facing SMEs

From the varied set of potential problems enterprises may encounter, a third of SMEs in Malta cited the availability of skilled staff or experienced managers as the most pressing problem. This problem has persisted notwithstanding continuous increases in labour market participation rates and rising foreign employment. It may reflect the robust pace of economic expansion as well as the shortage of certain skills. Survey results show that the availability of skilled staff and experienced managers has also become the most pressing problem experienced by SMEs in the European Union over the years, with the share of SMEs mentioning this issue in the European Union reaching 26%. SAFE results for Malta corroborate those from the European Investment Bank Survey 2019, which reports an increase in the percentage of businesses that cited the availability of skilled staff as a barrier to investment.

SMEs in Malta consider the problem of finding customers for their products or services as the second most pressing problem. The share of SMEs mentioning this issue rose to 17% – almost double the ratio observed a year earlier. However, it remains below the share of 22% of SMEs in the European Union, where the prevalence of this problem has been decreasing since 2016.

Other non-financial barriers that undermine firm growth include costs of production and labour, a burdensome regulatory framework as well as competition. Competition is considered as the third most pressing problem for domestic SMEs, though at 16% the share of firms citing this as their most pressing issue, is only marginally below the proportion of those that consider finding customers as the most urgent problem. Competition is also considered the third most urgent problem for 12% of SMEs in the European Union along with other equally urgent problems such as the costs of production or labour and regulation. Both in Malta and in the European Union, the share of SMEs that considered competition as a most pressing problem has declined. Domestically, however, this decline was more abrupt, falling from 30% in 2015 to 16% in 2019. This may reflect the effects of increased demand from a growing economy which tend to make up for the loss of revenue due to competitors.



Meanwhile, the share of SMEs in Malta that considered access to finance as a most pressing problem has risen to 13% from 8% in 2018. This contrasts with only 7% of SMEs in the European Union which consider this as the most pressing problem. Indeed, access to finance has become the least mentioned pressing problem in the European Union, though large divergences still prevail across countries. Only 5% of SMEs in Germany and Austria, and 4% of SMEs in Luxembourg consider it as an urgent problem as opposed to 12% in Cyprus, 13% in Lithuania and 21% of SMEs in Greece. Malta's weaker performance with regard to access to finance may reflect the de-risking policies of banks and also the low degree of pass-through of lower policy rates.

Meanwhile, costs of production or labour and regulation were considered the least pressing of the problems identified. Labour costs, which include wages, employee benefits and payroll taxes paid by an employer, as well as regulation, were mentioned as most urgent problems by only 7% of domestic SMEs, respectively.

Terms and conditions of bank loan financing

Survey results show that 71% of domestic SMEs believe that the availability of bank loan financing remained unchanged during 2019, as against 64% across the European Union. The results for Malta were substantially above the share of 55% reported in the preceding year. However, 16% of SMEs claimed that their availability deteriorated compared with 8% of SMEs in the European Union. As a result, while in the European Union a net share of 8% of SMEs reported improved access to this source of funding, in Malta, the net balance turned more negative than before, at -8%. At the time of the survey, 62% of domestic SMEs anticipated unchanged availability over the following six months compared with 59% of EU SMEs. Concurrently, 19% of domestic SMEs anticipated a deterioration, while 11% expected an improvement. As a result, on balance, 8% of surveyed SMEs predicted a deterioration. This compares with a net positive balance of 3% In the European Union.

The proportion of domestic SMEs which reported a net increase in interest rates fell to 8% in 2019 compared with 13% a year earlier, as a smaller share of SMEs reported higher interest rates.

By contrast, 56% of participating firms in the European Union claimed that interest rates were unchanged during 2019, largely in line with the share of SMEs that made similar observation in the past years. Around 17% of SMEs reported an increase in the level of interest rates, whereas 21% were faced with lower interest rates by banks. Hence, a net 5% of SMEs reported a fall in rates, compared with a net 7% that reported an increase a year earlier.

With regard to developments in the cost of financing other than interest rates, 37% of SMEs reported an unchanged level of costs such as charges, fees and commission, significantly below the share of SMEs reporting unchanged costs in the preceding year. By contrast, the share that reported higher costs increased from 47% in 2018 to 63% in 2019. As no domestic firms reported falling costs, on balance, almost two thirds of SMEs in Malta reported higher non-interest rate costs, as opposed to almost half of SMEs in 2018. These figures diverge from trends observed in the European Union, where the net share of firms reporting higher non-interest costs, at 27%, stood largely stable over the past years.

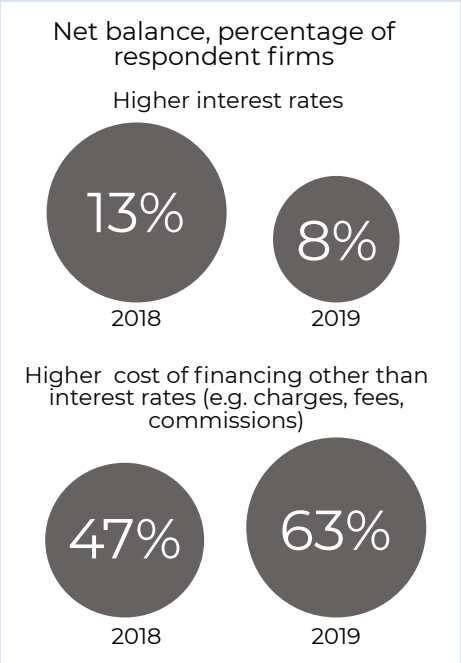


Table 1
FOR EACH OF THE FOLLOWING WAYS OF FINANCING, COULD YOU PLEASE INDICATE WHETHER YOU:

Over the preceding 6 months; per cent of responding firms

	Bank overdraft, credit line or credit card overdrafts			Bank loans			Trade credit		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Applied over the past 6 months	16	42	24	16	22	16	30	48	32
Did not apply because of possible rejection	2	2	8	3	1	6	5	0	1
Did not apply because of sufficient internal funds	31	32	48	33	45	53	18	32	29
Did not apply for other reasons	45	23	14	43	25	16	38	16	28

Source: SAFE.

Credit demand and supply

SMEs participating in the SAFE also provide information on their demand for financing, complementing replies on the supply (availability of financing). Table 1 shows the number of firms that applied for bank overdraft, trade credit, overdraft and credit lines since 2017. The proportion of SMEs that applied for these facilities almost halved when compared with a year earlier, though it remained within the range reported in previous rounds. The latest decrease mainly reflects a significant increase in the share of those that did not apply because of sufficient internal funds. At the same time, the share of firms that failed to apply because of fear of rejection rose slightly. In the latter case, figures were largely in line with those observed in the European Union.

Meanwhile, the proportion of domestic SMEs that applied for bank loans fell to 16%, below the proportion of 22% that applied for such financing in 2018. In this case too, the lower recourse to bank loans can be largely attributed to a higher share of firms that did not apply because they had sufficient internal funds.

Similarly, the percentage of respondents that applied for trade credit declined to 32%, below the rate of 48% recorded a year earlier, but the same as that registered in the European Union. Survey results indicate that the lower rate of application in 2019 did not reflect increased fear of rejection or increased availability of internal finds, but rather other reasons.

Conclusion

Between 2018 and 2020, SMEs growth in Malta is expected to remain very strong, with value added expected to rise by 17.8% compared with a projected 12.5% increase for large firms. Similarly, employment by SMEs is forecast to increase by 8.1% or 9,700 jobs by 2020.[5]

SAFE results indicate that SMEs in Malta are being predominantly negatively affected by labour shortages with access to finance remaining of lesser importance. Nonetheless, access to finance appears to have become more challenging than before, at least for a small segment of borrowers.[6] In particular, while a strong majority of firms considered that the availability of bank loans had not changed compared with 2018, the remaining firms were more likely to signal lower rather than greater availability of bank loans. According to SAFE participants, this situation is expected to persist in the near term. The latest SAFE results also indicate a significantly higher share of respondents reporting an increase in non-interest rate costs.

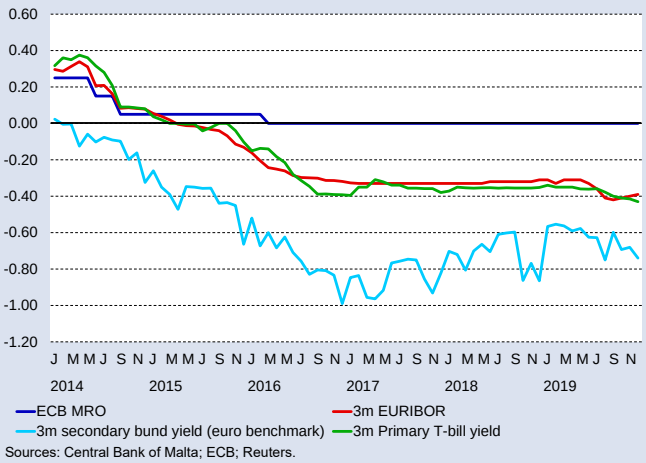
[5] European Commission, *2019 Small Business Act Fact Sheet - Malta*.
[6] See footnote 5.

According to the European Investment Bank Investment Survey 2019, firms using external finance are on balance satisfied with the amount, cost, maturity, collateral and type of finance received. Only 5% of all firms in Malta can be considered constrained in terms of external finance, in line with the EU average, though micro and small firms are three times as likely to be finance-constrained than medium/large firms. On balance, while financing conditions have not changed much, they seem to have become tighter for some companies. This may reflect the local banking sector's de-risking efforts, as well as some hesitance to extend credit to finance new activities. Schemes launched recently by the Malta Development Bank could help bridge this gap and possibly reduce financing costs.

The money market

The ECB maintained its accommodative monetary policy stance during 2019. While the interest rate on the MROs and the interest rate on the marginal lending facility remained unchanged at historically low levels, the deposit facility rate was lowered by 10 basis points to -0.50. During the year, the Governing Council also modified its forward guidance and introduced additional non-standard monetary measures.

Chart 2.8
MONEY MARKET INTEREST RATES
(percentages per annum; end of month rates)



Sources: Central Bank of Malta; ECB; Reuters.

As a result, money market interest rates in the euro area remained in negative territory, with the three-month EURIBOR ending 2019 at -0.39%, below the rate of -0.31% at the end of 2018 (see Chart 2.8).

Meanwhile, in the domestic primary market, the yield on three-month Treasury bills fell to -0.43% at the end of 2019, from -0.35% 12 months earlier.

In total, the Treasury issued €1193.9 million worth of bills in 2019, largely similar to issues of €1209.4 million in 2018. Nonetheless, the amount of Treasury bills issued was marginally higher than the amount of maturing bills, which stood at €1183.9 million in 2019. The majority of bills issued had a maturity of three months, followed by those with a maturity of one month. New bills issued with a longer maturity made up 12.6% of all bills.

In the secondary market, the yield on three-month German government securities, which acts as a benchmark for euro area yields, increased by 13 basis points, to -0.74% in December 2019 from -0.87% at the end of 2018. Consequently, the spread between the domestic rate and the euro benchmark narrowed to 31 basis points from 51 basis points in the preceding year.

The capital market

In the capital market, total issues of long-term debt by the Government and the private sector rose to €727.6 million in 2019, from €267.5 million in 2018. Taking into account the amount of redemptions and roll-overs made over the year, positive net issues of long-term debt were recorded in 2019. These stood at €123.8 million compared with negative net issues of €209.0 in 2018. Negative net issues by the Government were lower relative to 2018, while net issues by the private sector rose significantly.

Redemptions of Malta Government Stocks (MGS) exceed new issues

In 2019, the Government issued €350.0 million in long-term debt, but redeemed €435.9 million, such that net issues for the year were negative (see Table 2.4). According to information published by the Treasury, seven new bond issues took place in March, July, September and November, with maturity dates ranging from five to ten years. Demand for MGS was strong and all issues were oversubscribed and taken up by credit institutions.

The amount of outstanding MGS fell to €4,769.4 million at the end of 2019, of which 85.9% was held domestically. Resident credit institutions remained the main holders of outstanding MGS, with their share remaining largely stable at 45.5%. The share of MGS held by resident individuals fell to 20.1%, while holdings of non-

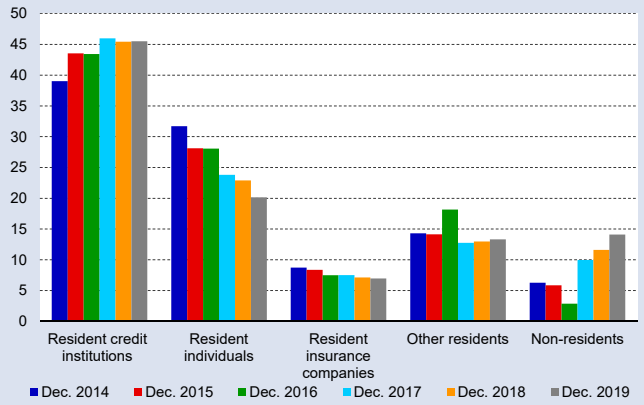
Table 2.4
ISSUES OF LONG-TERM DEBT SECURITIES[1]
EUR millions [2]

	2015	2016	2017	2018	2019
Government					
Total issues[3]	475.2	598.6	258.9	150.3	350.0
Redemptions & roll-overs[4,5]	349.2	232.0	268.4	391.0	435.9
Net issues	126.0	366.6	-9.5	-240.7	-85.9
Corporate sector					
Total issues	205.0	399.2	338.6	117.3	377.6
Redemptions, roll-overs & buybacks[5,6]	65.0	190.2	177.5	85.5	167.9
Net issues	140.0	209.0	161.4	31.8	209.7
Total net issues	**266.0**	**575.7**	**151.9**	**-209.0**	**123.8**

Sources: Central Bank of Malta; MSE; Treasury.
[1] Banks, non-monetary financial institutions and public NFCs are included with corporate issuers. Long-term securities are those with an original term to maturity exceeding one year, and include preference shares.
[2] Amounts denominated in foreign currency are converted to euro according to the exchange rate prevailing on the day of transactions.
[3] Data exclude MGSs that were issued directly to the Foundation for Church Schools.
[4] Redemptions exclude the redemption of MGSs that were issued directly to the Foundation for Church Schools.
[5] Roll-overs refer to the reinvesting of funds from a mature security into a new issue of the same or a similar security. They are therefore deducted from new issues.
[6] Buy-backs, which consist of the purchase of corporate bonds by the issuing company are also deducted from new issues.

residents comprised 14.1% of total outstanding MGS (see Chart 2.9).

Chart 2.9
OUTSTANDING MGS BY INVESTOR BASE[1]
(percentages)



Sources: Central Bank of Malta; MSE.
[1] Incorporates both fixed-rate and floating-rate MGS.

Secondary market turnover of MGS rose during 2019. It stood at €302.3 million, compared with €212.7 million a year earlier.

Secondary market yields on domestic MGS fell during 2019, with the five and ten-year yields falling by 47 and 90 basis points, respectively, to -0.03% and 0.43% at end-December (see Chart 2.10). The benchmark five-year yield in the euro area fell by 19 basis points compared with its end 2018 level, and closed the year at -0.46%. The euro area ten-year yield fell by 43 basis points to -0.19%. As euro area yields fell to a lesser extent than domestic yields, the spread between the five-year and ten-year yields in Malta and their euro area benchmark narrowed during the year. At the end of 2019, the spreads on the five-year and ten-year yields stood at 43 and 62 basis points, respectively.

Corporate bond issues rise significantly

In the corporate bond market, new issues of long-term debt listed on the MSE stood at €377.6 million in 2019. As the amount of redemptions and buybacks amounted to €167.9 million, net issues stood at €209.7 million, €177.9 million more than those in the preceding year.

During 2019, 13 private companies had new bonds listed on the MSE. Furthermore, by the end of the end year, 22 firms had listed bonds through Prospects, up from twelve a year earlier. Hence, €93.7 million were issued through this facility in 2019.

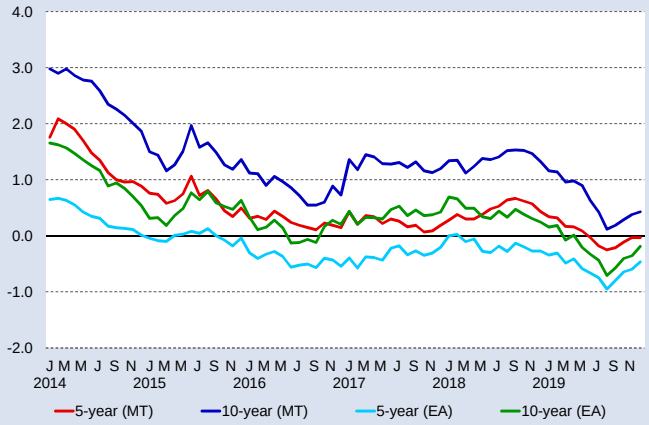
Turnover in the secondary corporate bond market increased marginally during 2019. It stood at €96.0 million, up from €93.7 million in the previous year.

MSE index rises

Turnover in the equity market rose to €89.2 million during 2019, marginally up from €86.3 million a year earlier. The MSE Equity Price Index rose by 4.4% during 2019, and ended the year at 4714.2 (see Chart 2.11). Slightly more than half the 25 equities in the index registered an increase in prices in 2019.

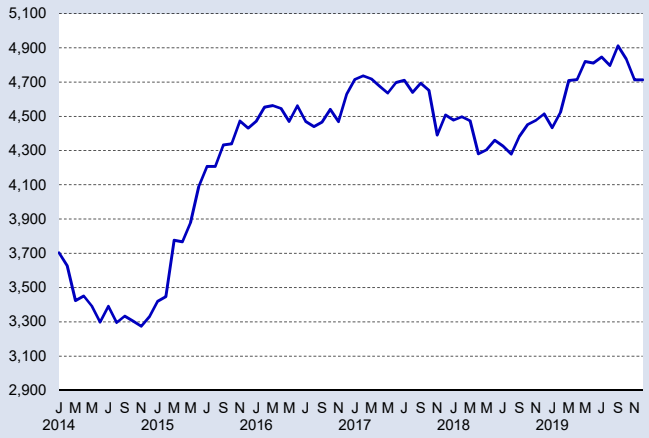
Meanwhile, the MSE Equity Total Return Index, which accounts for changes in equity prices and dividends, was 6.9% higher than its level at end-December 2018.

Chart 2.10
GOVERNMENT BOND YIELDS
(percentages per annum; end of month)



Sources: Central Bank of Malta; ECB.

Chart 2.11
MSE EQUITY PRICE INDEX
(end of month)



Source: MSE.

BOX 2: OVERVIEW OF THE FINANCIAL ASSETS AND LIABILITIES OF THE MALTESE ECONOMY BY INSTITUTIONAL SECTOR[1,2]

The Central Bank of Malta has been compiling Malta's financial accounts statistics since 2004. The latest available statistics in this regard refer to September 2019. Financial accounts statistics provide comprehensive information on the financial assets and liabilities of the Maltese economy classified by institutional sector, namely households, NFCs, credit and financial institutions, the general government, and the 'rest-of-the-world' sector.[3,4]

This Box includes three sections: the first section contains an analysis of the net financial wealth of each sector of the economy; the second provides an analysis of private sector debt as stipulated in the EC's Macroeconomic Imbalance Procedure (MIP);[5] and the final section outlines the financial interlinkages among the resident sectors.

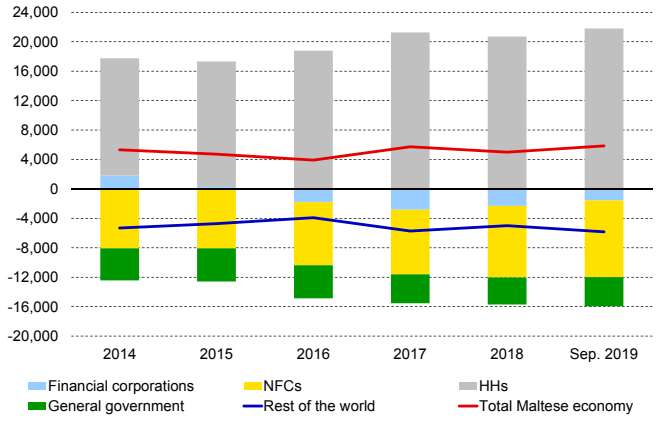
Net financial wealth of the Maltese economy

Sectoral level balance sheet statistics on net financial wealth show that overall the resident economic sectors continued to be net lenders in September 2019 (see Chart 1). The net financial wealth of the total resident economy amounted to €5,851.3 million compared with €5,001.6 million in December 2018.[6] The increase was mainly driven by an improvement in the net financial wealth of households and financial corporations which offset drops in the net financial wealth of both NFCs and the general government sector.[7]

Financial assets and liabilities of the financial corporations sector

The aggregate net financial wealth of Malta's financial corporations, including the credit institutions, improved in September 2019 when compared to with December 2018. This stood at -€1,567.2 million in September 2019, up from -€2,305.7 million at the end of 2018 (see Chart 2). The increase since December 2018 was mainly due to a higher level

Chart 1
NET WEALTH OF THE MALTESE ECONOMY AND THE REST-OF-THE-WORLD SECTOR
(EUR millions)



Source: Central Bank of Malta.

[1] Prepared by Kimberly Mamo, Economist Statistician, and Janica Borg, Expert at the External, Payments and Securities Statistics Office within the Statistics Department. The views expressed are those of the authors and do not necessarily reflect those of the Central Bank of Malta.

[2] For the purpose of this Box, the term 'Maltese economy' is used interchangeably with the term 'resident sectors/economy'.

[3] Annual Report 2016, "Sectoral Financial Linkages Using Malta's Financial Accounts", pp. 30-35, Central Bank of Malta.

[4] The rest of the world sector comprises of non-resident units engaging in transactions with domestic institution units.

[5] Regulation (EU) 1176/2011 on the prevention and correction of macroeconomic imbalances sets out the MIP procedure.

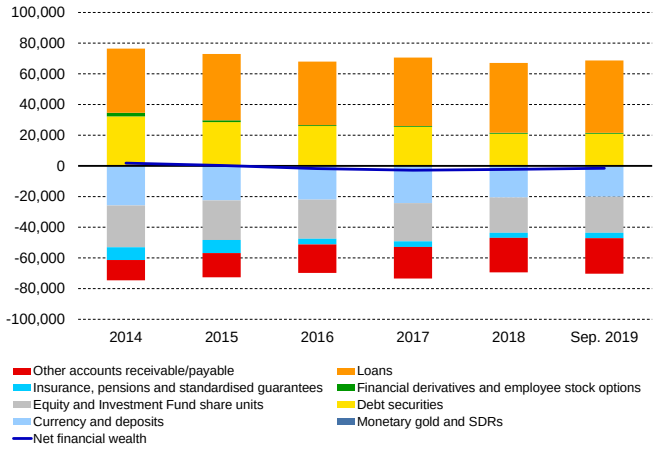
[6] Net financial wealth is defined as the difference between financial assets and liabilities; it shows which sectors are net lenders and which are net borrowers.

[7] In line with European System of Accounts (ESA) 2010, financial corporations include the central bank, deposit-taking corporations except the central bank, money market funds, non-money market investment funds, insurance corporations, pension funds, other financial intermediaries, financial auxiliaries and captive financial institutions and money lenders.

of financial assets largely in the form of deposits and loans which exceeded the growth in liabilities.

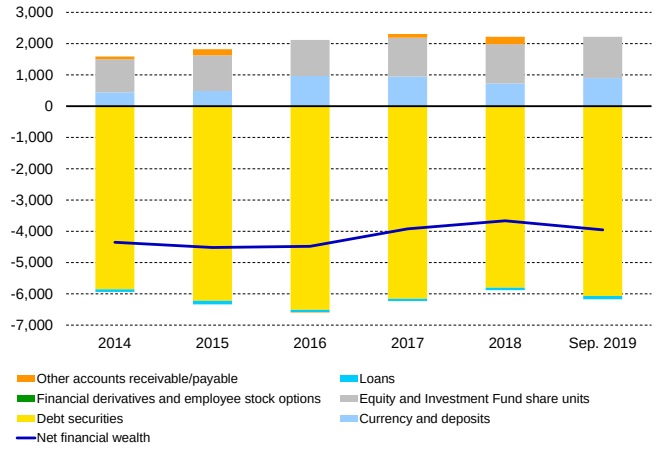
As regards the main contributing instruments to the net financial position of the financial sector, over the period December 2018 to September 2019, net issuances of loans increased significantly, mostly on account of higher loans from monetary financial institutions; the increase in holdings of loans offset smaller increases in net liabilities arising from equity and accounts payable. Debt securities were broadly consistent with the figures seen last year.

Chart 2
FINANCIAL SECTOR'S NET FINANCIAL WEALTH BY INSTRUMENT
(EUR millions)



Source: Central Bank of Malta.

Chart 3
GENERAL GOVERNMENT'S NET FINANCIAL WEALTH BY INSTRUMENT
(EUR millions)



Source: Central Bank of Malta.

Financial assets and liabilities of the general government

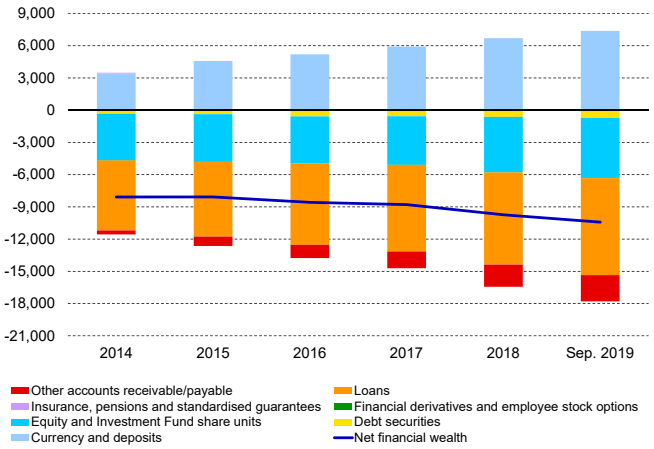
The net financial wealth position of the general government has been persistently in negative territory, although this negative position has been narrowing since 2016, reflecting the improvement in the government's fiscal position. In September 2019, the net financial position of general government stood at -€3,953.6 million, decreasing by €289.4 million or 7.9%, when compared with December 2018. Chart 3 shows that the general government remained a net asset holder of equity and of currency and deposits, and a net liability holder of other instruments, mainly of debt securities. The increase in the net liability position since end 2018 was driven by an increase in debt securities outstanding and other accounts payable which offset a small increase in net assets in the form of deposits and equity.

Financial assets and liabilities of NFCs

Chart 4 shows that NFCs had net financial liabilities of €10,424.0 million as at September 2019, an increase of €686.3 million or 7.0% since December 2018 due to the increase in liabilities outstripping the increase in financial assets. In September 2019, NFCs continued to be net asset holders of currency and deposits and net liability holders mainly of loans, equity and other accounts payable. When

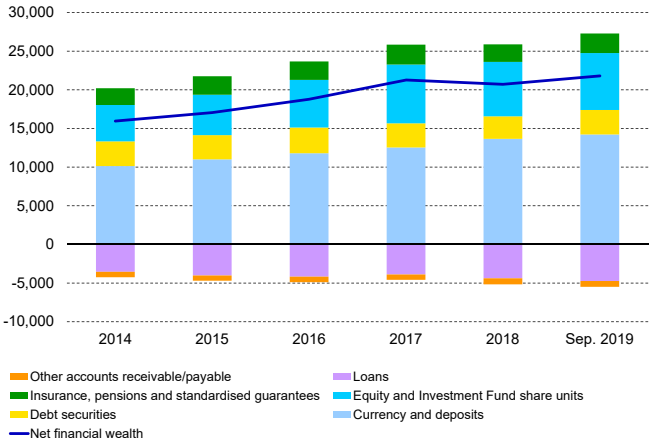
compared with December 2018, the increase in NFCs' net liability position is due to the increase in their financing through loans, equity and, to a lesser extent, bonds. These increases offset a rise in holdings of currency and deposits.

Chart 4
NFCs' NET FINANCIAL WEALTH BY INSTRUMENT
(EUR millions)



Source: Central Bank of Malta.

Chart 5
HOUSEHOLDS' NET FINANCIAL WEALTH BY INSTRUMENT
(EUR millions)



Source: Central Bank of Malta.

Financial assets and liabilities of households

In September 2019, households' net financial wealth reached €21,796.1 million, increasing by 5.2% or €1,086.9 million, when compared with December 2018. This was due to an increase in holdings of financial assets, which surpassed the increase in liabilities. Chart 5 shows that households maintained large net assets in the form of currency and deposits and in the form of equity, but also held smaller net asset positions related to debt securities as well as insurance products. By contrast, this sector was a net liability holder of loans and other accounts payable. The improved net financial wealth position since 2018 was driven by an increase in currency and deposits and in equity, which offset an increase in loans, mainly for house purchases.

Malta's private sector debt

Financial accounts statistics also shed light on Malta's private sector debt. In line with the methodology prescribed by the EU's MIP, which inter alia produces such indicators on an annual basis, Chart 6 shows Malta's consolidated private sector debt by sector and compares it to with the consolidated private sector debt of the euro area. Although this ratio has been falling up to 2016, it was relatively higher than the debt-to-GDP threshold of 133% set by the MIP.[8,9] However, in 2017, the indicator decreased below the set threshold, while in 2018 the indicator stood at 129.2%, the lowest level since 2014.

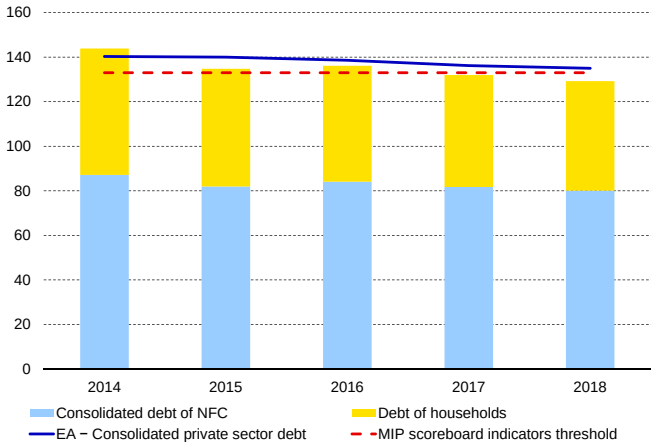
[8] The private sector debt is the stock of liabilities in the form of loans and securities other than shares held by NFCs and Households and NPISH. Transactions within sectors are eliminated (i.e. statistics are thus consolidated). The threshold of 133% of GDP is derived from the upper quartile of the statistical distribution of the indicator. Annual data for the period 1995-2007 were used to establish the threshold.

[9] In terms of EU Regulation No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances.

The fall in Malta's private sector debt as a proportion of GDP between 2017 and 2018 was principally driven by a decrease in NFCs' debt ratio and the increase in GDP, which more than compensated for households' increase in debt.

Up to 2014, Malta's consolidated private sector debt was higher than that of the euro area average, though it then fell at a faster rate than the latter. By 2018, it stood 5.8 percentage points lower than the euro area average.

Chart 6
PRIVATE SECTOR'S DEBT AS % OF GDP (CONSOLIDATED)
(per cent)



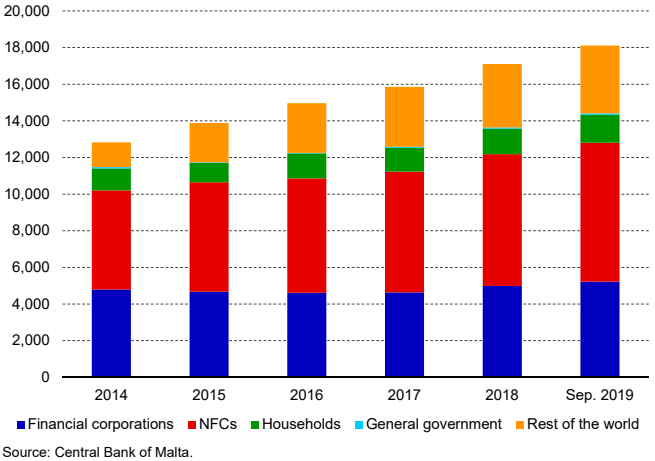
Sources: Central Bank of Malta; Eurostat.

While household debt in Malta has been typically lower than that of the euro area, the consolidated debt of the resident NFCs was on average higher than its euro area counterpart for the period between 2014 and 2018, although on a decreasing path. In 2018, NFCs' debt indicator for Malta stood at 80.1% of GDP, which is marginally above the debt ratio of NFCs within the euro area, which stood at 78.2%.

Corporate debt constitutes around 62.0% of the consolidated private sector debt. Chart 7 shows the debt of NFCs in the form of debt securities and loans by creditor sectors, the latter constituting the financial corporations, households, NFCs, general government and the rest of the world. From this perspective, the largest exposures stemmed from liabilities to financial corporations and the NFC sector itself.

Firms in Malta rely significantly more on loans than on debt securities. Even though the issuance of debt securities increased over the years, this still remained relatively low, amounting to 4.9% of total NFCs' debt in the third quarter of 2019. Over the years, bank credit has been one of the main sources of financing for NFCs although the importance of this source of funding has been declining over the last few years. In turn, non-bank financing became more significant, particularly

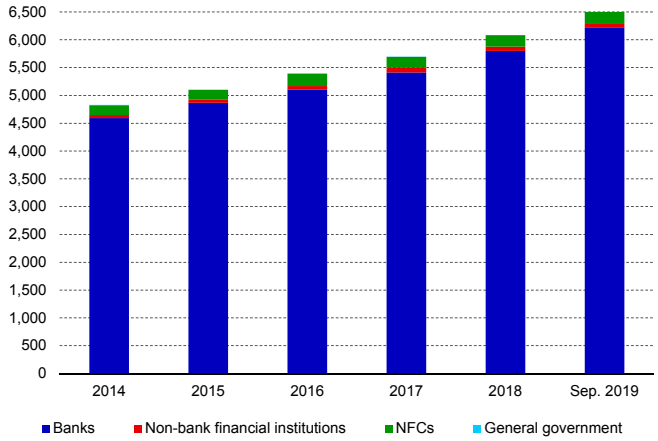
Chart 7
NFC DEBT BY CREDITOR SECTOR
(EUR millions)



Source: Central Bank of Malta.

taking the form of intra-group lending or lending from related parties.[10] In fact, as at September 2019, loans from other corporates – mainly intra-group loans – amounted to €7,576.1 million or 41.8% of total NFCs' debt while loans from financial corporations, mainly bank loans, amounted to €3,740.4 million or 20.6% of total NFCs' debt. Another important source of finance for resident corporates, other than loans from domestic sectors, were loans from abroad which amounted to €3,424.2 million in September 2019, partly reflecting the number of foreign-owned subsidiaries operating in Malta. Meanwhile, loans from households (mainly from directors and shareholders) amounted to €1,107.2 million in September 2019.

Chart 8
HOUSEHOLD DEBT
(EUR millions)



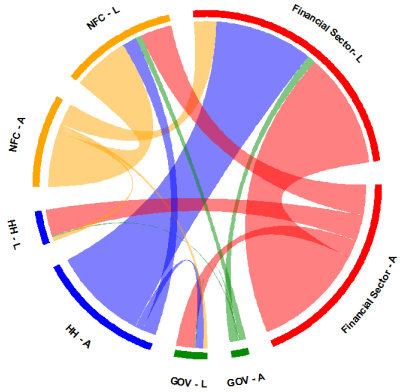
Source: Central Bank of Malta.

Chart 8 shows that households' debt as at end September 2019 stood at €6,516.8 million, increasing by €431.5 million since end-December 2018 primarily due to an increased takeup of loans from credit institutions. Household debt is in fact composed mainly of loans from credit institutions which amounted to 95.5% of the sector's total debt. The remaining debt mainly consisted of directors/shareholders' loans, which amounted to around €284.7 million. Nonetheless, household debt as a ratio of their total assets increased marginally from 21.8% in December 2018 to 22.1% in September 2019.

Financial interlinkages between resident sectors

Financial accounts identify financial linkages among economic sectors, whereby one sector is an asset holder while the counterpart sector is the borrower. Such accounts are also referred to as the from-whom-to-whom accounts. Chart 9 shows the interlinkages between the

Chart 9
FINANCIAL INTERLINKAGES BETWEEN RESIDENT SECTORS
(as at September 2019)



NFC - A: NFCs' Asset
Financial Sector - A: Financial Sector Assets
GOV - A: Central Government Assets
HH - A: Households Assets
NFC - L: NFCs' Liabilities
Financial Sector - L: Financial Sector Liabilities
GOV - L: Central Government Liabilities
HH - L: Households Liabilities

Source: Central Bank of Malta.
Note: Nodes along the circle represent the total financial assets (A) and liabilities (L) of each economic sector. Each sector is represented by a different colour and the arc's width is proportional to financial assets and liabilities with other sectors.

[10] Box 2: Non-Financial Corporations' loans from other corporates – evidence from Malta's Financial Accounts Statistics, *Financial Stability Report*, 2017.

resident sectors as at September 2019.[11] The largest asset position of the financial sector, including the credit institutions, reflects intra-sectoral holdings, that is, holdings with other credit and financial corporations, mainly in the form of equity and investments funds as well as deposits. These amounted to 60.2% of their total domestic holdings in the third quarter of 2019, a marginal increase from 59.9% in December 2018. Chart 9 also shows that the financial sector has significant interlinkages with households and NFCs – mainly through banks' funding. Moreover, the general government holds around 48.9% of its total domestic financial assets with the financial sector, primarily in the form of deposits. This share increased from 47.7% in December 2018. With regards to NFCs, the majority of their assets are held by other NFCs. They rose marginally to 65.1% of their total domestic assets from 65.0% over the period December 2018 to September 2019. Finally, households' domestic asset holdings continued to be held mainly with the financial sector. However, households' domestic financial asset holdings decreased to 81.7% in September 2019, from 82.2% in December 2018.

Further statistical information can be found on the website of the Central Bank of Malta at: https://www.centralbankmalta.org/financial-accounts.

[11] The comparison with interlinkages between resident sectors as at December 2018 is not being shown graphically since there were no major changes.



3. OUTPUT, EMPLOYMENT AND PRICES

Potential output growth in Malta eased from 6.7% in 2018 to 5.5% in 2019, mainly reflecting a pull-back in the contribution of labour, which nevertheless remained high from a historical perspective. The output surplus is estimated to have halved to 1.1%, from 2.2% in 2018.

Similarly, the Bank's Business Conditions Index (BCI) continued to indicate above-average conditions in 2019, although the index moved significantly closer to its long-run average.

In 2019, GDP growth moderated to 4.4%, from 7.3% a year earlier. The expansion was driven by domestic demand, as the contribution from net exports was slightly negative. Nominal gross value added (GVA) data show that the expansion continued to be largely supported by services, although the manufacturing and construction sectors also expanded.

In 2019, the number of permits issued for the construction of residential dwellings declined, but remained high from a historical perspective. National accounts data show that GVA in construction continued to expand, with the annual rate of growth reaching 13.9% in 2019. Investment in the residential sector increased at a slower pace, while that in non-residential construction recovered from the previous year's contraction. Jobsplus data for the first nine months of the year show a rise in employment when compared to the corresponding period of 2018, with job creation driven entirely by the private sector.

Labour Force Survey (LFS) data for the first three quarters of 2019 show that employment continued to rise against the backdrop of a buoyant economy. Eurostat data for the year show that the unemployment rate decreased further and remained well below that in the euro area. It was also lower than the Bank's estimate of structural unemployment.

Favourable labour market developments are also corroborated by data based on administrative sources. These show that in 2019 the average number of registered unemployed fell by 149, to 1,698 persons.

Annual inflation based on the Harmonised Index of Consumer Prices (HICP) moderated to 1.5% in 2019, from 1.7% in 2018. By contrast, inflation measured by the Retail Price Index (RPI) accelerated to 1.6%, from 1.2% in the previous year. These contrasting developments reflect the different consumption baskets used to calculate the two indices.

Meanwhile, the annual average rate of change of the producer price index fell to 2.1% in 2019. Malta's Harmonised Competitiveness Indicators (HCIs) pointed to an improvement in international price competitiveness, on account of favourable exchange rate and relative price movements. Malta's ULC rose at a faster pace in 2019, as productivity growth turned negative.

Potential output and BCI

Positive output gap narrows[1,2]

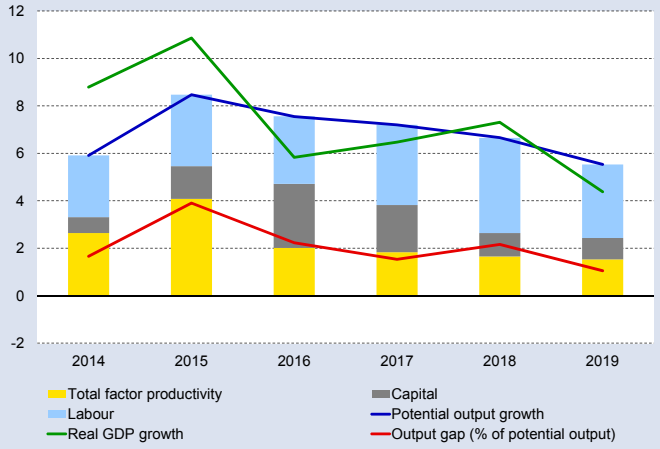
In 2019, potential output growth pulled back to 5.5%, from 6.7% in 2018 (see Chart 3.1), though this still remained elevated from a long-term perspective. Meanwhile, GDP growth edged down, from 7.3% in 2018 to 4.4% during the year under review.

[1] Potential output measures the medium-to-long-term level of real output which is sustainable in an economy. The estimates presented here are derived using a production function approach. For further details on the methodology adopted see Micallef, B., and Ellul, R. (2017), "Medium-term Estimates of Potential Output Growth in Malta", in Grech, A. G., and Zerafa, S. (Eds.), *Challenges and Opportunities of Sustainable Economic Growth: the Case of Malta*, Central Bank of Malta.

[2] Real GDP and potential output are reported as annual growth rates in the respective quarter. The output gap/surplus is expressed as a percentage of potential output on the basis of four-quarter moving averages.

Reflecting these developments, the positive output gap is estimated to have narrowed to 1.1% in the year under review, from 2.2% in 2018. The degree of overutilisation of the economy's productive capacity remains well below that in 2015, when the output gap was 3.9%.[3] Potential growth continues to be driven by an increasing number of foreign workers and higher labour participation, with the labour contribution remaining elevated from a historical perspective, albeit lower than in 2018. The contributions of total factor productivity and capital in 2019 were also slightly less than in 2018.

Chart 3.1
CYCLICAL POSITION OF THE MALTESE ECONOMY
(annual percentage change; percentage of potential output; percentage points)

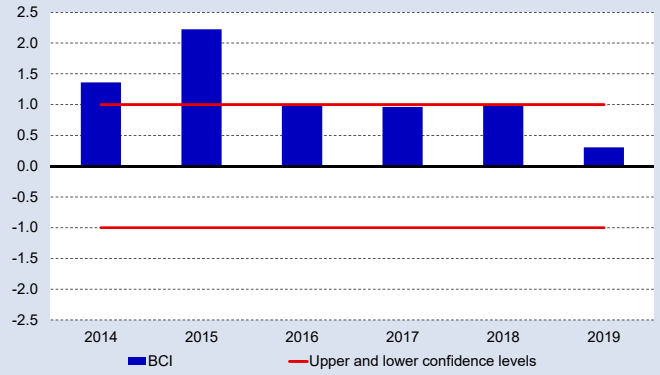


Sources: NSO; Central Bank of Malta estimates.

BCI eases[4]

The Bank's BCI continued to signal above-average conditions (see Chart 3.2). The index averaged 0.3 during 2019, compared with 1.0 in 2018. The decrease reflected the normalisation in GDP growth rates over the year as well as weaker sentiment. The index was buoyed upwards by a fall in unemployment, higher government revenues, and continued strong growth in tourism. Overall, the index suggests that economic conditions remained favourable but were less buoyant than those prevailing in 2017 and 2018.

Chart 3.2
BCI
(standardised)



Source: Central Bank of Malta.

Note: The red lines in the Chart represent the range enclosing one standard deviation on either side of the BCI's long-run value. Repeated readings below the lower band signal that economic activity is significantly below normal economic activity. Readings above the upper band indicate that activity is signficantly above normal levels.

GDP and industrial production

Real economy continues to grow, albeit at a more moderate pace

The Maltese economy continued to grow strongly, albeit at a more moderate pace. Real GDP rose by 4.4%, following a 7.3% increase in 2018.[5]

The expansion was underpinned by domestic demand, as net exports contributed negatively to growth (see Table 3.1). All domestic demand components rose on a year earlier, and jointly contributed 4.5 percentage points to GDP growth. However, government expenditure and gross fixed capital formation were the main

[3] The output gap may be viewed as a gauge of over or underutilisation of the productive capacity of the economy over the business cycle. A positive gap signals overutilisation of resources, whereas a negative one indicates underutilised resources.

[4] The BCI is a synthetic indicator, which includes information from a number of economic variables such as the term-structure of interest rates, industrial production, an indicator for the services sector, economic sentiment, tax revenues and private sector credit. By construction, it has an average value of zero over the estimation period since 2000. A full-time series can be found at https://www.centralbankmalta.org/business-conditions-index. For further details on the methodology underlying the BCI, see Ellul, R., (2016), "A real-time measure of business conditions in Malta," Working Paper 05/2016.

[5] The analysis of GDP in this Chapter is based on data published in NSO *News Release* 034/2020 published on 28 February 2020.

Table 3.1
GDP[1]

	2014	2015	2016	2017	2018	2019
			Annual percentage changes			
Private final consumption expenditure	2.3	4.9	2.4	3.4	7.6	2.4
Government final consumption expenditure	6.6	3.7	-3.0	1.8	12.7	12.0
Gross fixed capital formation	7.0	55.7	-0.3	-6.9	-2.1	7.2
Domestic demand	**2.9**	**14.2**	**1.2**	**-1.7**	**8.2**	**3.0**
Exports of goods and services	4.1	15.5	4.5	4.8	3.5	1.7
Imports of goods and services	0.2	18.1	1.6	-0.5	3.4	2.1
GDP	**8.8**	**10.9**	**5.8**	**6.5**	**7.3**	**4.4**
			Percentage point contributions			
Private final consumption expenditure	1.3	2.5	1.1	1.6	3.4	1.0
Government final consumption expenditure	1.3	0.7	-0.5	0.3	1.9	1.9
Gross fixed capital formation	1.2	9.6	-0.1	-1.6	-0.4	1.4
Changes in inventories	-1.0	-0.4	0.5	-1.7	1.6	0.2
Domestic demand	**2.8**	**12.4**	**1.1**	**-1.5**	**6.5**	**4.5**
Exports of goods and services	6.4	23.1	7.0	7.3	5.2	2.4
Imports of goods and services	-0.4	-24.7	-2.3	0.7	-4.3	-2.6
Net exports	**6.0**	**-1.6**	**4.7**	**8.0**	**0.9**	**-0.2**
GDP	**8.8**	**10.9**	**5.8**	**6.5**	**7.3**	**4.4**

[1] Chain-linked volumes, reference year 2010.

drivers behind this expansion. With imports rising at a faster pace than exports, the contribution of net exports turned slightly negative in 2019.

Private consumption increased by 2.4%, after growing by 7.6% in 2018, and contributed 1.0 percentage point to GDP growth. Nominal data show that the deceleration affected most components.

Government consumption growth eased slightly, to 12.0% from 12.7% in 2018. The recent increase mainly reflected growth in the two principal components of government consumption; i.e. intermediate consumption and compensation of employees. Revenue from sales, which are netted against expenditure in the national accounts, increased in 2019 following a decrease in the previous year. This was the main factor behind the slowdown observed in government consumption growth, as intermediate consumption and, to a lesser extent, compensation of employees both rose at a faster rate.

After contracting a year earlier, gross fixed capital formation increased by a significant 7.2% in 2019, contributing 1.4 percentage points to GDP growth. Although dwelling investment rose at a slower pace, this was offset by stronger growth in transport equipment and non-residential investment.

Changes in inventories also supported activity, though to a lesser extent than in 2018. It added 0.2 percentage point to GDP growth in 2019.

Exports rose by 1.7% while imports increased by 2.1% on a year earlier. As a result, net exports shed 0.2 percentage point from GDP growth, as a further widening in the services surplus was offset by a larger deficit from trade in goods.

Nominal GDP growth decelerates; services remain the main driver of growth

Nominal GDP rose by 6.8% in annual terms in the year under review, after increasing by 9.6% in the previous year (see Table 3.2). The deceleration partly reflected slower growth in GVA, which rose at an annual rate of 7.5%, after growing by 9.2% in 2018. In 2019, GVA contributed 6.6 percentage points to nominal GDP growth.[6]

[6] The difference between nominal GDP and GVA is made up of taxes on products, net of subsidies.

Table 3.2
CONTRIBUTION OF SECTORAL GVA TO NOMINAL GDP GROWTH

Percentage points

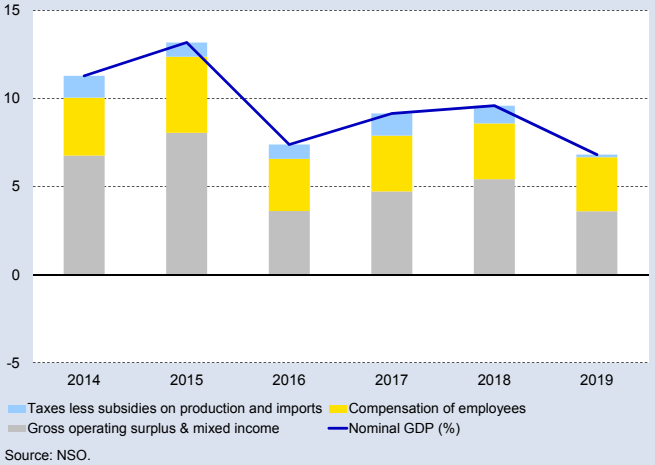
	2014	2015	2016	2017	2018	2019
Agriculture, forestry and fishing	0.1	0.1	0.2	-0.4	0.2	0.0
Mining and quarrying; utilities	0.0	0.3	0.4	-0.1	0.2	0.1
Manufacturing	0.1	-0.2	0.2	0.8	0.8	0.3
Construction	0.1	0.3	0.0	0.4	0.3	0.4
Services	9.6	11.9	5.7	7.3	6.7	5.9
of which:						
Wholesale and retail trade; repair of motor vehicles; transportation; accommodation and related activities	1.4	3.3	0.7	1.4	1.6	1.1
Information and communication	1.3	1.1	0.6	0.6	0.4	0.4
Financial and insurance activities	-0.2	0.4	0.4	0.3	0.2	0.1
Real estate activities	0.0	0.7	0.3	-0.1	0.4	0.3
Professional, scientific, administrative and related activities	1.7	2.7	1.3	2.6	1.4	1.4
Public administration and defence; education; health and related activities	1.4	1.2	1.0	1.1	1.2	1.3
Arts, entertainment; household repair and related services	4.0	2.5	1.3	1.3	1.5	1.3
GVA	**9.8**	**12.3**	**6.6**	**8.0**	**8.2**	**6.6**
Net taxation on products	**1.4**	**0.9**	**0.8**	**1.2**	**1.4**	**0.2**
Annual nominal GDP growth (%)	**11.3**	**13.2**	**7.4**	**9.1**	**9.6**	**6.8**

Source: NSO.

Services remained the main driver of activity, accounting for 5.9 percentage points of nominal GDP growth. The largest additions within the services sector came from professional and scientific activities, from the sector comprising public administration, and from arts and entertainment. Together, these three sectors contributed 3.9 percentage points to nominal GDP growth. Wholesale and retail trade contributed a further 1.1 percentage points, while financial and insurance activities, real estate as well as information and communication jointly added a further 0.8 percentage point. The contribution from construction stood at 0.4 percentage point, while the manufacturing sector contributed 0.3 percentage point to nominal GDP growth.

GDP data from the income approach show that gross operating surplus grew at a more moderate pace of 7.4%, following an increase of 11.4% in 2018. Gross operating surplus contributed 3.6 percentage points to nominal GDP growth, with this contribution lower than in 2018 (see Chart 3.3). Compensation of employees grew by 7.6% in 2019, virtually unchanged from 7.7% in 2018. The latter added 3.1 percentage points to nominal growth. Net taxes on production and imports account for the remaining 0.1 percentage point of nominal GDP growth.

Chart 3.3
NOMINAL GDP AND ITS MAIN COMPONENTS
(percentage point contribution)



Source: NSO.

Almost all sectors registered an increase in their gross operating surplus when compared with a year earlier. The largest increases in absolute terms were recorded in arts, entertainment and recreation, and in the sectors comprising administrative and support service activities, as well as professional, scientific and technical activities.

Compensation of employees continued to grow strongly in the vast majority of sectors, with the largest absolute increases registered in public administration, in the sector comprising professional, scientific and technical activities, in the arts, entertainment and recreation sector, and the sector comprising financial and insurance activities.

Industrial production[7]

Industrial production rose by 1.6% in 2019, following an expansion of 1.3% in 2018 (see Table 3.3). The slight increase in the annual rate of change reflected a recovery in the manufacturing sector. By contrast, production in the energy and quarrying sectors increased at a slower pace, following double digit growth in 2018.

The volume of production in the manufacturing sector, which has the largest weight in the index of industrial production, rose by 0.8% in 2019, following a decline of 0.4% in 2018.

The increase in 2019 was largely driven by increased production among firms involved in the printing and reproduction of recorded media, where production rose by 10.9%. Activity also expanded strongly in the "other manufacturing" sub-sector, which includes firms involved in the production of medical and dental instruments, toys and related products. On the other hand, production declined by 12.0% in the pharmaceuticals sector and by 6.4% among firms that produce computer, electronic and optical products. Firms producing food as well as rubber and plastics recorded falls of 4.8% and 4.6%, respectively. A smaller decrease, of 0.5%, was also recorded in the production of beverages.

Data on manufacturing sales point to an expansion in turnover of 3.5% in 2019, following a rise of 4.4% in the previous year.[8] This rise in turnover in 2019 largely reflects increased sales to export markets, although sales to the domestic market also edged up.

Table 3.3
INDUSTRIAL PRODUCTION
Percentages; annual average percentage changes

	Shares	2017	2018	2019
Industrial production	**100.0**	**8.5**	**1.3**	**1.6**
Manufacturing	**83.3**	**3.5**	**-0.4**	**0.8**
Of which:				
Computer, electronic and optical products	18.4	1.7	-14.2	-6.4
Basic pharmaceutical products and pharmaceutical preparations	10.4	-2.8	-14.4	-12.0
Food products	8.1	-0.9	-6.7	-4.8
Printing and reproduction of recorded media	5.9	-2.0	36.9	10.9
Rubber and plastic products	4.4	5.6	-9.5	-4.6
Beverages	3.9	4.6	3.2	-0.5
Energy	**16.3**	**51.1**	**13.2**	**7.3**
Mining and quarrying	**0.4**	**-7.0**	**23.6**	**7.6**

Sources: NSO; Eurostat.

[7] Industrial production data are based on samples of firms engaged in quarrying, manufacturing and energy production. Methodological differences may account for divergences between developments in GVA in the manufacturing sector and industrial production. GVA nets input costs from output to arrive at value added and is expressed in nominal terms. Industrial production measures the volume of output without taking into account input costs. The sectoral coverage also differs, as industrial production data include the output of the energy sector, as well as mining and quarrying.

[8] Data on manufacturing sales are sourced from Eurostat.

Construction

Construction sector shows signs of normalisation

The number of permits for residential units issued by the Planning Authority declined in 2019, following five consecutive years of substantial growth. Permits issued in 2019 remained high from a historical perspective, standing at 12,485. However, they were slightly down from 12,885 in 2018 (see Table 3.4).

This was entirely due to a lower number of permits issued for the construction of apartments, which were down by 4.3%. Notwithstanding recent developments, apartments still accounted for 85.9% of total residential permits issued in 2019. On the other hand, permits issued for maisonettes and terraced houses rose during the year under review and accounted for 9.8% and 3.2%, respectively of all residential permits issued during the year. Permits issued for other dwellings also increased over the year, reaching a three-year high. However, these continued to account for a very small proportion of all residential permits issued.

Construction investment increased by 12.6% in nominal terms, following an increase of 3.9% in 2018. This acceleration was driven by non-dwelling investment, which rose by 21.6%, after declining by 10.2% in 2018. By contrast, annual growth in residential investment moderated to 4.6%, from 20.8% previously.

GVA in the construction sector increased at a faster pace during 2019. It rose by 13.9% following an increase of 7.9% in the preceding year (see Table 3.5).

Jobsplus data for the first nine months of 2019 show that the number of persons employed in the construction sector rose by 1,442, or 12.1%, compared with the same period of 2018 (see Table 3.4). This followed a 5.3% increase in 2018. Private sector employment in the sector increased by 13.5%, but was partly offset by a fall in employment in the public sector.

The construction sector's share on the total gainfully occupied population increased to 6.2%, from 5.8% in 2018. Growth in headcount was higher than that in the economy as a whole, which averaged 5.8% between January and September 2019. Growth in employment in construction was entirely driven by foreign workers, as Maltese nationals employed on a full-time basis within construction declined in the period under consideration. As a result of this development, the sector's dependence on foreign workers continued to increase, with the latter accounting for 35.3% of full-time employment in the sector.

Table 3.4
PERMITS ISSUED FOR THE CONSTRUCTION OF DWELLING UNITS BY TYPE

	2014	2015	2016	2017	2018	2019
Apartments	2,221	3,019	6,316	7,762	11,211	10,726
Maisonettes	414	471	706	852	1,166	1,226
Terraced houses	204	342	297	301	396	402
Other	98	115	189	91	112	131
Total	**2,937**	**3,947**	**7,508**	**9,006**	**12,885**	**12,485**

Source: Planning Authority.

Table 3.5
CONSTRUCTION ACTIVITY INDICATORS[(1)]

	2016	2017	2018	2019
GVA (EUR millions)	**325.6**	**364.3**	**393.1**	**447.8**
Share in total economy GVA (%)	3.6	3.7	3.6	3.8
Total employment	**10,806**	**11,292**	**11,893**	**13,335**
of which private employment	9,774	10,329	10,967	12,448
Share in total gainfully occupied population (%)	6.0	5.9	5.8	6.2

[(1)] Employment data are averages for the first nine months of the year, and are sourced from administrative records.

Source: NSO.

Meanwhile, according to national accounts data for the full year, compensation of employees increased by 16.5%, following an increase of 3.5% in the preceding year.

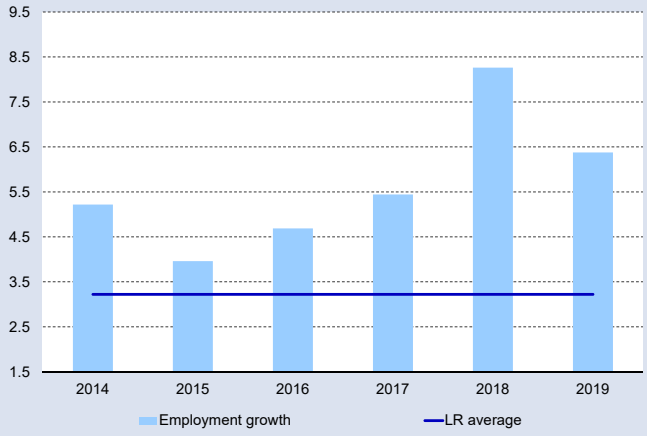
The labour market[9]

Employment continued to grow in the first three quarters of 2019

During the first three quarters of 2019, employment expanded at an average annual rate of 6.4%, as against 8.3% recorded during the corresponding period of 2018 (see Table 3.6). Despite this deceleration in the pace of job creation, employment growth was double its long run average of 3.2% (see Chart 3.4).

The increase in the number of jobs during the first three quarters of the year was mainly underpinned by a rise in full-time employment which went up by around 14,000 and to a lesser extent by part-time employment.

Chart 3.4
EMPLOYMENT GROWTH BASED ON THE LFS: JANUARY-SEPTEMBER
(annual percentage changes)



Sources: Eurostat; Central Bank of Malta calculations.

Table 3.6
LABOUR MARKET INDICATORS BASED ON THE LFS[(1)]
Persons; annual percentage changes

	2018 (revised) Jan.-Sep.	2019 Jan.-Sep.	Annual change %
Labour force	**245,400**	**260,400**	**6.1**
Employed	236,300	251,400	6.4
By type of employment:			
Full-time	202,900	217,300	7.1
Part-time	33,400	34,100	2.3
Unemployed	9,100	9,000	-0.7
Activity rate (%)	**74.4**	**75.8**	
Male	84.5	84.8	
Female	63.6	66.0	
Employment rate (%)	**71.6**	**73.1**	
Male	81.2	81.9	
Female	61.3	63.5	
Unemployment rate (%)	**3.8**	**3.5**	
Male	3.9	3.4	
Female	3.6	3.7	

(1) Figures are based on averages for the first three quarters and are rounded to the nearest 100 persons. Growth rates based on these figures may differ slightly from those shown in the table.
Source: Eurostat.

9 This section draws mainly on labour market statistics from two sources: the LFS, which is a household survey conducted on a quarterly basis by the NSO on the basis of definitions set by the International Labour Organization and Eurostat, and administrative records compiled monthly by Jobsplus, according to definitions established by domestic legislation on employment and social security benefits.

On average, the labour force expanded by 6.1% in the first nine months of 2019. As a result, the activity rate went up by 1.4 percentage points on a year earlier, to 75.8%, exceeding the euro area average of 73.6%.[10] The female activity rate posted the strongest gain, rising by 2.4 percentage points to 66.0%. Notwithstanding this increase, the female rate remained below the euro area average of 68.4%, reflecting low activity rates among older women. The male activity rate edged up by 0.3 percentage point to 84.8%, standing higher than the euro area average of 78.8%.

Meanwhile, the overall employment rate rose by 1.5 percentage points to 73.1%.[11] This compares with 67.8% in the euro area. Both activity and employment rates reached the highest levels recorded since the survey was conducted in Malta.

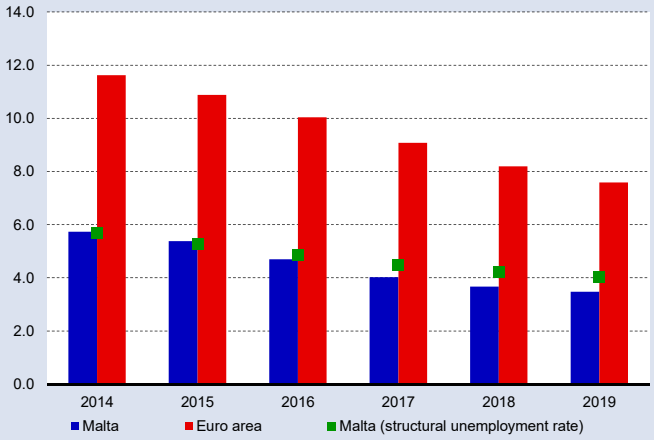
Besides buoyant economic conditions, higher activity and employment rates also reflect the continuation of active labour market policies encouraging inactive persons to join the labour market.

Unemployment rate reaches a new low

The unemployment rate edged down as job creation outpaced growth in the supply of labour. The seasonally-adjusted unemployment rate published by Eurostat, which takes into account LFS data up to the third quarter as well as more recent developments in administrative data, averaged 3.5% in 2019, lower than the average of 3.7% recorded in 2018 (see Chart 3.5).[12] It also stood below the Bank's estimate of the structural measure and thus continued to suggest a degree of tightness in the labour market during the year under review. Furthermore, Malta's unemployment rate remained well below and less than half the average rate for the euro area, which stood at 7.6% in 2019.

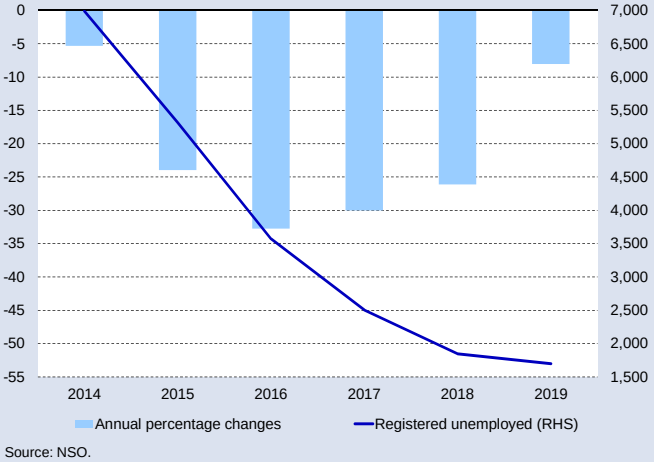
On average in 2019, the number of unemployed based on Jobsplus data fell by 149 persons over 2018 to 1,698 (see Chart 3.6).[13] Apart from a growing demand for labour in the context of robust economic growth, the drop in the number of registered unemployed reflected the extension of previously

Chart 3.5
UNEMPLOYMENT RATE
(seasonally adjusted; per cent)



Sources: Eurostat; Central Bank of Malta calculations.

Chart 3.6
REGISTERED UNEMPLOYED
(annual percentage changes; persons)



Source: NSO.

[10] The activity rate measures the number of persons in the labour force aged 15-64 years (whether employed or seeking work) as a proportion of the working-age population, which is defined as all those aged 15-64 years.
[11] The employment rate measures the number of persons aged 15-64 years, employed on a full-time or part-time basis as a proportion of the working-age population, which is defined as all those aged 15-64 years.
[12] According to the LFS, the unemployed comprise persons above 15 years of age who are without work, available for work and who have actively sought to work during the four weeks preceding the survey. In contrast, the number of unemployed on the basis of Jobsplus data includes only those persons registering for work under Part 1 and Part 2 of the unemployment register.
[13] The annual number of registered unemployed is based on the average of the total registered unemployed published by NSO on a monthly basis.

introduced measures aimed at facilitating the transition from inactivity to activity and improving the employability of specific target groups. Such schemes include the Tapering of Benefits Scheme, the Access to Employment Scheme, the Bridging the Gap Scheme, the Youth Guarantee Scheme and the Mature Workers Scheme.

The largest drop in the number of unemployed was registered among those aged 45 and over. This fell by 107 persons, to 866. The number of those aged between 25 and 44 years fell marginally. By contrast, the number of registered unemployed aged 24 and under edged up marginally by 4 persons, to 201 persons.

The fall in the number of unemployed was broad-based across all duration categories, although the largest declines were registered among the long-term unemployed who would have been on the unemployment register for one year or more.

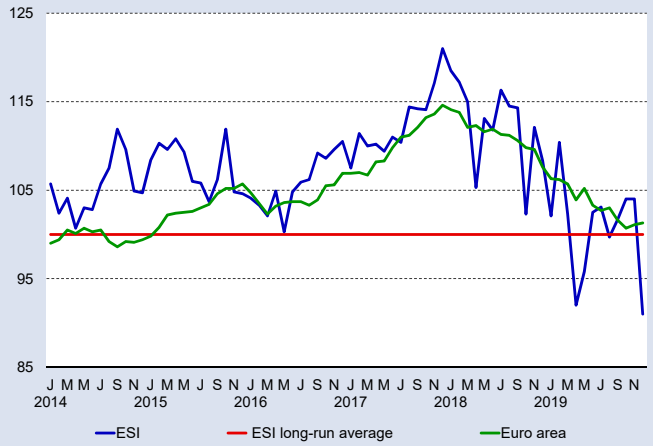
Business and consumer surveys

Economic sentiment pulls back in 2019 to its long-term level

During 2019, the EC's Economic Sentiment Indicator (ESI) for Malta averaged 100.7, down from 112.4 in 2018 (see Table 3.7), pulling back to marginally above its long-term average of 100.0 (see Chart 3.7).[14,15] This pull-back in confidence was spread across most sectors, with the strongest declines being recorded in the services sector and in industry. As a result of these developments, the overall ESI indicator stood below that in the euro area, which averaged 103.4.

Chart 3.7 shows that the ESI started the year at 102.1. The indicator stood above its long-term average for most of the year, but

Chart 3.7
ESI
(seasonally adjusted; percentage points)



Source: European Commission.

Table 3.7
SENTIMENT INDICATOR BY SECTOR
Annual average; absolute change

	2018	2019	Change
ESI	**112.4**	**100.7**	**-11.8**
Services confidence indicator	34.6	20.7	-13.8
Industrial confidence indicator	6.9	-6.7	-13.6
Consumer confidence indicator	10.1	4.5	-5.6
Retail trade confidence indicator	8.2	4.2	-4.1
Construction confidence indicator	21.3	26.2	4.9

Source: European Commission.

[14] Long-term averages are calculated over the entire period for which data are available. For the consumer and industrial confidence indicators, data became available in November 2002, while the services and construction confidence indicator data became available in May 2007 and May 2008, respectively. The long-term average of the retail confidence indicator is calculated since May 2011, when it was first published. The long-term average of the ESI is computed from November 2002.

[15] The ESI summarises developments in confidence in five surveyed sectors (industry, services, construction, retail and consumers).

was particularly weak in April and December, when its reading fell to just above 90.0. However, the sharp declines experienced in these two months appear to have been attributable to exceptionally temporary factors, as a sharp recovery in sentiment was registered within practically the subsequent month or two.[16]

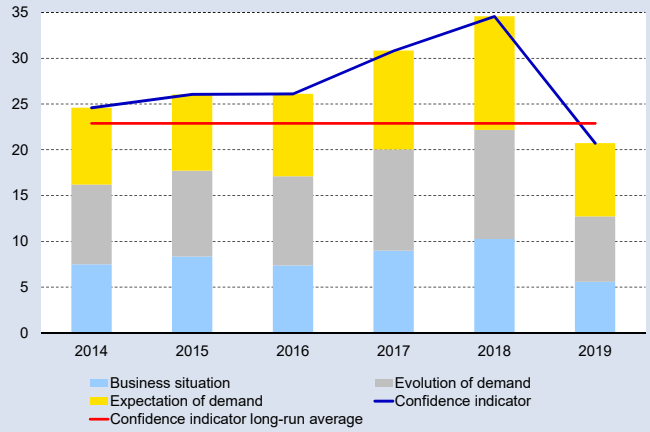
Table 3.7 presents the annual average reading for each sector included in the ESI and the absolute change relative to 2018. The strongest decline was recorded in the services sector and, to a lesser extent, in industry. Confidence among consumers and retailers also declined, although by a smaller magnitude compared to industry and services. By contrast, sentiment improved in the construction sector.

Confidence in the services sector declines[17]

Confidence within the services sector fell in 2019. It stood at 20.7, down from 34.6 in the preceding year (see Chart 3.8). This weakening in sentiment was mostly visible in the air transport and travel agency sub-sectors. Following this development, confidence in the services sector fell slightly below its long-term average.

Firms' assessment of demand and of the business situation over the past three months were the main contributors to the fall in confidence in 2019. Respondents' demand expectations for subsequent months also edged down. While all components of the indicator for this sector eased when compared with 2018, they were still positive, suggesting that the sector may be normalising after a long period of very rapid growth, yet remains resilient.

Chart 3.8
SERVICES CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



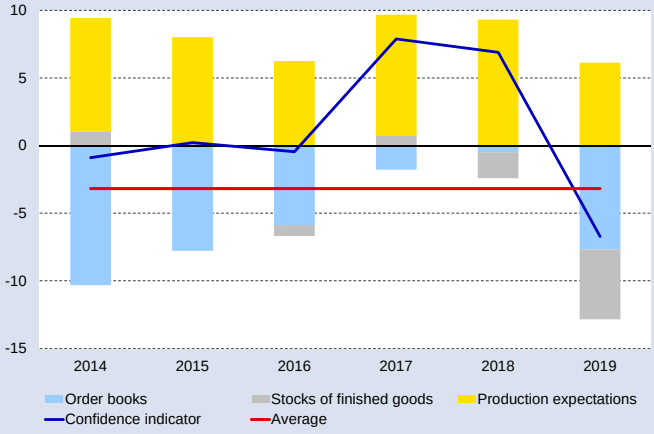
Source: European Commission.

Supplementary data indicate that both the assessment of prevailing employment conditions and employment expectations weakened in 2019. In contrast, on balance, more firms expected their selling prices to increase in the following three months.

Industrial confidence turns negative[18]

Sentiment among manufacturing firms turned negative, despite supportive productive expectations and stood below its long-term mean of -3.2 (see Chart 3.9). This decline

Chart 3.9
INDUSTRIAL CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

[16] In January 2020, the ESI rose to 99.9, marginally below its long-term average of 100.0.
[17] The services confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to survey questions relating to the business climate, the evolution of demand in the previous three months and demand expectations for the subsequent three months.
[18] The industrial confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to a subset of survey questions relating to expectations about production over the subsequent three months, current levels of order books and stocks of finished goods (the last with inverted sign).

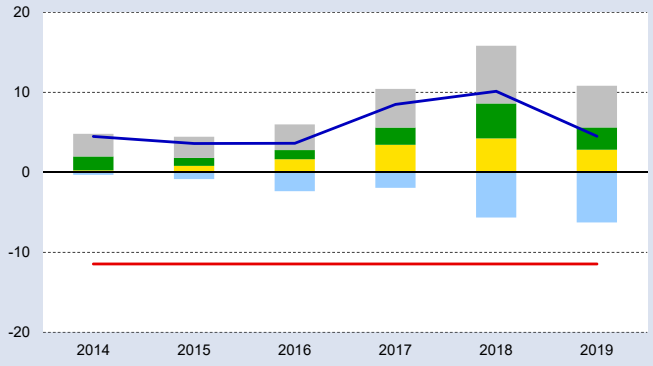
was mainly driven by an increase in the share of firms reporting order books to be below normal. At the same time, a higher share of respondents deemed stock levels to be above normal, while fewer firms expected production to rise in the months ahead.[19] Although weaker than in 2018, production expectations continued to support the industrial confidence indicator.

Supplementary data indicate that the average share of respondents foreseeing a rise in employment was lower in 2019 than in 2018. Meanwhile, selling price expectations turned more negative.

Consumer confidence eases but remains very positive[20]

The consumer confidence indicator pulled back to 4.5 in 2019 from 10.1 in the preceding year. Notwithstanding this decline, it continued to stand well above its long-term average of -11.5 (see Chart 3.10).

Chart 3.10
CONSUMER CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

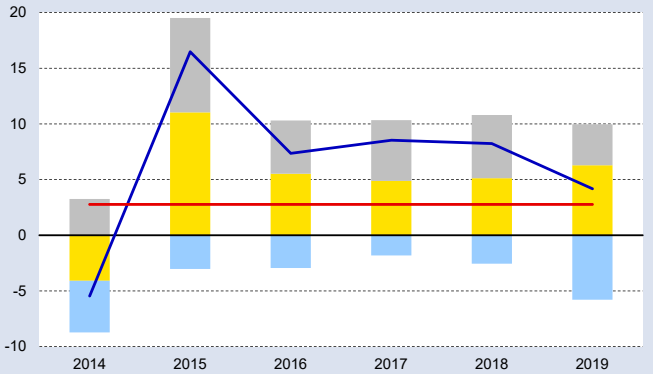
The fall in sentiment was driven by all sub-components, with the strongest decline being recorded in consumers' expectations of the economic situation over the next 12 months, and to a lesser extent, their assessment and expectations of the financial situation. Meanwhile, a slightly larger share of households signalled that they intended to make fewer major purchases in subsequent months.

Additional survey information suggests that the share of respondents expecting unemployment to fall in the following 12 months decreased when compared to 2018. Savings expectations, while still positive, also declined. The survey also reveals that both inflation perceptions and expectations were more positive.

Confidence in the retail sector weakens while remaining positive[21]

The retail confidence indicator edged down to 4.2 in 2019, from 8.2 in the preceding year. Nonetheless, it remained above its long-term average of 2.8 (see Chart 3.11). Compared with 2018, a higher share of retailers reported

Chart 3.11
RETAIL CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

[19] A rise in the stock levels indicates lower turnover and affects the overall indicator in a negative way. Such decreases are thus represented by bars below the 0 mark in Chart 3.9.

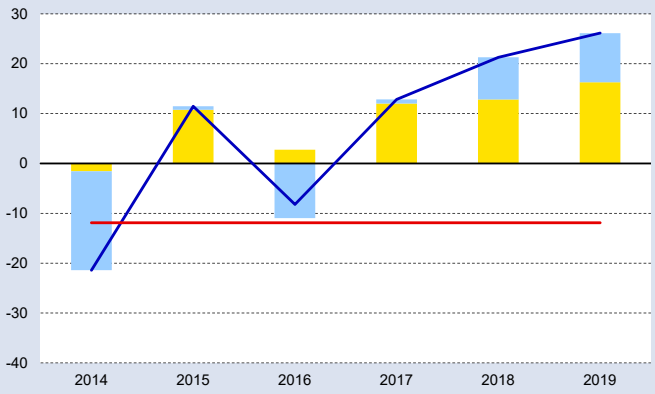
[20] The consumer confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to a subset of survey questions relating to households' assessment and expectations of their financial situation, their expectations about the general economic situation and their intention to make major purchases over the subsequent 12 months. The computation of this indicator was changed as reflected in the January 2019 release of the EC.

[21] The retail confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to survey questions relating to the present and future business situation and stock levels.

above normal stock levels. Furthermore, on balance fewer respondents anticipated business activity to improve in the months ahead. By contrast, the share of retailers reporting improved sales in the preceding months edged up.

Additional survey data indicate that on balance order expectations improved over 2018. However, employment expectations, while still positive, weakened and price expectations turned negative.

Chart 3.12
CONSTRUCTION CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

Confidence in construction rises further above its long-term average[22]

Sentiment in the construction sector averaged 26.2 during 2019, up from 21.3 in the preceding year. It thus remained well above its long-term average of -11.9 (see Chart 3.12). Both order book levels and employment expectations contributed to the increase in confidence during the year.

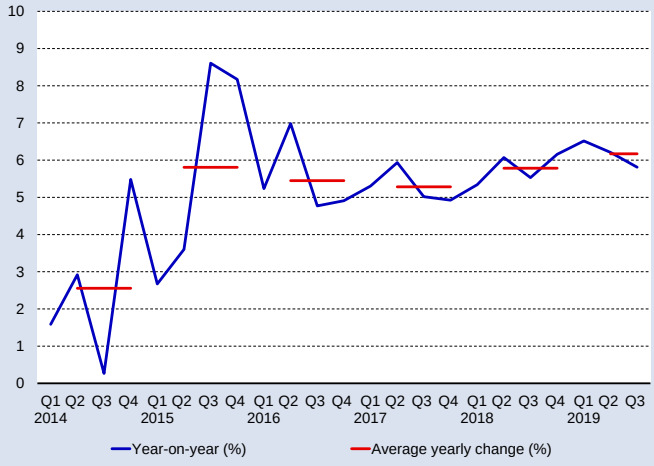
Additional survey data show that, on balance, fewer respondents recorded improved building activity over past months. Meanwhile, during 2019, on average a marginally higher share of respondents anticipated increased selling prices for the months ahead.

Residential property prices

Residential property prices grow at a faster pace

Residential property prices continued to increase during the first three quarters of 2019. The NSO's Property Price Index (PPI) – which is based on actual transactions involving apartments, maisonettes and terraced houses – increased at an average annual rate of 6.2% during the first nine months, higher than the 5.8% recorded in 2018 as a whole (see Chart 3.13).[23] House price inflation in Malta was higher than that in the euro area, where it averaged 4.7% in 2018 as a whole and 4.2% in the first three quarters of 2019.

Chart 3.13
MOVEMENTS IN RESIDENTIAL PROPERTY PRICES



Source: Eurostat.

[22] The construction confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to two survey questions, namely those relating to order books and employment expectations over the subsequent three months.

[23] 'Apartments' are defined as dwellings with self-contained rooms or a suite of rooms that have a separate entrance accessible from a common passage way, landing or stairway. 'Maisonettes' have a separate entrance that is accessible from the street and are either at ground-floor level with overlying habitation, or at first-floor level with underlying habitation. 'Terraced houses' are dwellings with at least two floors, own access at street level and airspace and with no underlying structures that are not part of the house itself. They are attached to other structures on both sides. Further information is available in NSO *News Release* 109/2019.

Residential property prices are being supported by a number of factors, including the low-interest rate environment and fiscal incentives targeting first and second time buyers.[24] These incentives, together with strong growth in tourism (particularly in private accommodation), disposable income, and the increase in foreign workers, are making the property market a more attractive investment opportunity.

Misalignment index suggests house prices above fundamentals in 2019

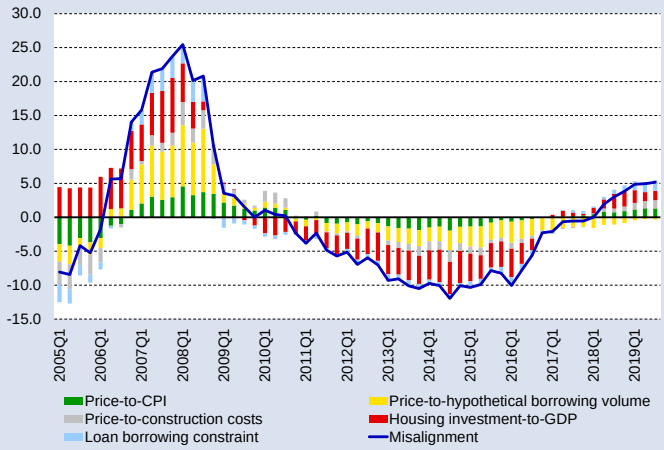
As part of its ongoing macroeconomic analysis, the Bank calculates a house price misalignment index to provide an indication of the evolution of house prices against fundamentals.[25,26] This indicator consists of five sub-indices that capture household, investor, and system-wide factors, with the weights being derived using principal component analysis.

House prices, as measured by the NSO's PPI, were above the level consistent with fundamentals in the third quarter of 2019 (see Chart 3.14), with a misalignment of 5.2%.[27] The misalignment index has increased constantly since 2018Q1, when it turned positive, though the degree of misalignment has levelled off in recent quarters. Moreover, the extent of misalignment remained modest, especially when compared to the pre-crisis housing boom.

The housing investment-to-GDP ratio, the house price-to-inflation ratio, and the price-to-cost ratio stood slightly above their long-term averages, thereby contributing to the positive misalignment. The loan borrowing constraint, which is an indicator of the loan bearing capacity of households also contributed to the current misalignment. By contrast, the price-to-hypothetical borrowing volume, which is an affordability indicator, still contributed slightly negatively to the index, reflecting increases in income, a higher share of two wage-earning households and the prevailing low interest rate environment.

As the large number of permits issued in recent years translates into additional supply of property on the market, going forward house price inflation should moderate and lead to a gradual normalisation of the misalignment index.

Chart 3.14
HOUSE PRICE MISALIGNMENT INDEX
(percentage points; based on transaction prices)



Source: Central Bank of Malta estimates.

Consumer price inflation

HICP inflation moderates in 2019

The 12-month average rate of consumer price inflation, as measured by the HICP, stood at 1.5% during

[24] The Government scheme for first-time buyers, introduced in 2014 and subsequently extended, provides relief from the duty on documents due on the first €175,000 (previously €150,000) of the total amount paid for the purchase of eligible property. The scheme for second-time buyers, first introduced in 2018, was also extended. Following the Budget 2020, it provides for a reduced stamp duty rate of 3.5% on the first €175,000. This refund was previously capped at €3,000.

[25] See Micallef, B. (2018), "Constructing an index to examine house price misalignment with fundamentals in Malta", *International Journal of Housing Markets and Analysis*, 11(2), pp. 315-334.

[26] The actual numerical results presented in this section should not be overstated given the limitations in the construction of this index. For example, relevant variables such as foreign capital inflows are not included and the unavailability of an official rental index precludes the use of the price-to-rent ratio in the index.

[27] A separate assessment based on advertised house prices can be found in Gatt, W., Micallef, B. and Rapa, N. (2018), "A macroeconometric model of the housing market in Malta", *Annual Research Bulletin*, Central Bank of Malta, pp. 11-18.

Table 3.8
HICP INFLATION RATES
Average annual rate of change

	2014	2015	2016	2017	2018	2019
Unprocessed food	-0.4	4.3	2.8	0.9	1.1	3.6
Processed food including alcohol and tobacco	2.7	2.0	2.2	2.2	2.2	2.3
Energy	-7.6	-6.5	-4.2	1.1	1.3	2.5
NEIG	1.0	1.1	0.9	0.3	0.3	0.0
Services (overall index excluding goods)	1.8	1.7	1.0	1.3	2.2	1.8
HICP (annual average inflation rate)	**0.8**	**1.2**	**0.9**	**1.3**	**1.7**	**1.5**

Source: ECB.

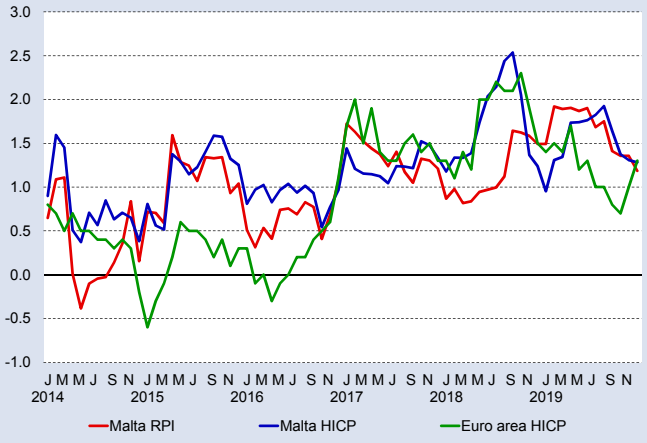
2019 (see Table 3.8).[28] This was slightly lower than the rate of 1.7% registered in the previous year. Notwithstanding this moderation, HICP inflation in Malta was slightly above that of 1.2% registered in the euro area (see Chart 3.15), but still well below the ECB's inflation target.

The moderation in HICP inflation in Malta reflected slower growth in the prices of services and NEIG. In fact, HICP excluding food and energy stood at 1.1%, down from 1.7% in 2018.

Services inflation remained the main contributor to overall HICP during 2019 (see Chart 3.16). However, inflation in this component decelerated, averaging 1.8% against 2.2% in 2018. This was mainly driven by slower growth in the prices of recreational and personal services, including accommodation services, transport services and miscellaneous services (see Chart 3.17). As a result, the contribution of services inflation to overall HICP inflation eased to 0.9 percentage point, from 1.2 points in 2018.

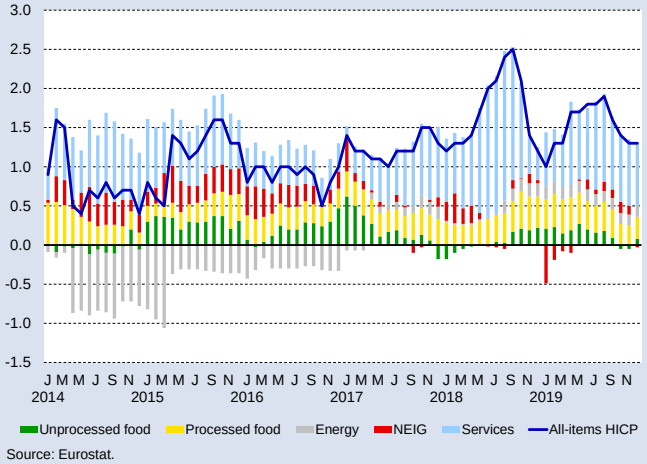
Meanwhile, inflation in NEIG weakened in 2019, with prices

Chart 3.15
INFLATION RATES IN MALTA AND IN THE EURO AREA
(annual percentage changes)



Sources: NSO; Eurostat.

Chart 3.16
CONTRIBUTIONS TO YEAR-ON-YEAR HICP INFLATION
(percentage points; annual percentage change)



Source: Eurostat.

[28] The HICP weights are revised on an annual basis to reflect changes in overall consumption patterns. In 2019, the weight allocated to services stood at 46.7%, while that of NEIG was 27.4%. Food accounted for 19.9% of the index, while the share allocated to energy stood at 6.0%.

unchanged on average, in contrast to a 0.3% increase in the previous year. The weaker price growth in this component was broad-based, across durable and semi-durable goods, and mainly reflects downward pressures on the import side.

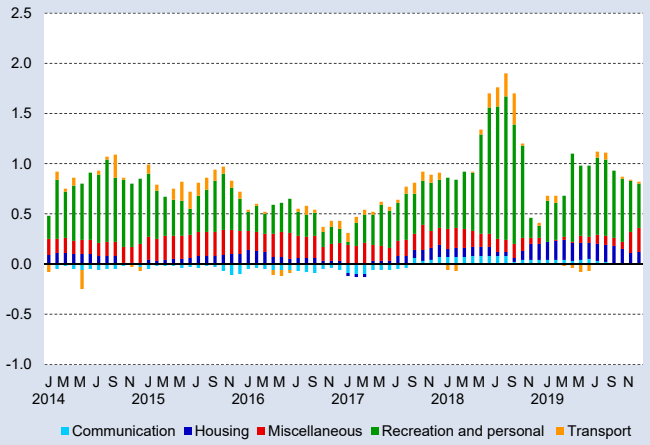
On the other hand, food inflation increased from 2.0% in 2018 to 2.6% in 2019. This mainly reflected developments in unprocessed food inflation, which registered 3.6% against 1.1% in 2018. The main driver of this increase was the price of fresh vegetables, which rose very strongly during the first half of the year (see Chart 3.18). Contributions from the other subcomponents of unprocessed food remained stable on average when compared with 2018. At the same time, processed food inflation averaged 2.3% in 2019, compared with 2.2% in the previous year. The prices of items included in this component continued to be impacted by the previous year's increase in bread prices, as well as a rise in the price of milk during the third quarter of 2019. The contribution of overall food inflation to HICP rose to 0.5 percentage points during 2019, from 0.4 in the previous year, mainly as a result of the faster growth in unprocessed food prices.

Energy inflation also accelerated during 2019, averaging 2.5% from 1.3% in 2018. This mainly reflected the carry-over effect from an increase in the price of transport fuel in August 2018, as well as the subsequent increase that became effective in August 2019.

Core HICP inflation picks up

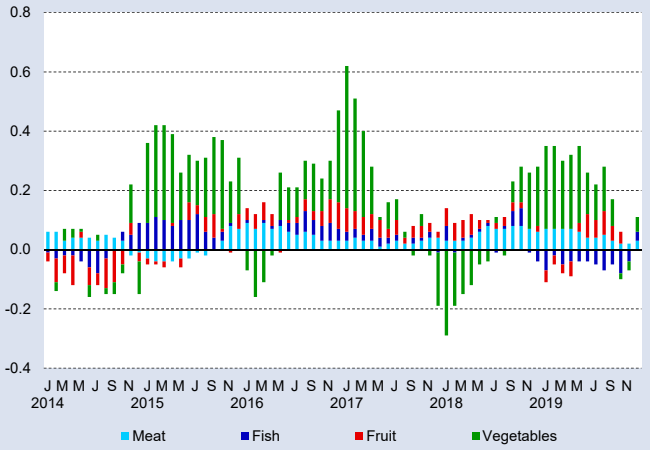
The core measure of HICP inflation, based on the Bank's "trimmed mean" approach, accelerated to 1.2% during 2019, from 0.9% in

Chart 3.17
CONTRIBUTIONS OF SERVICES TO HICP INFLATION
(percentage points)



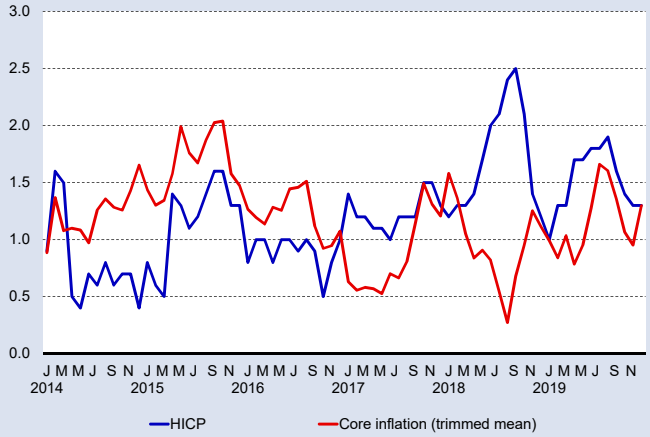
Source: Eurostat.

Chart 3.18
CONTRIBUTIONS OF UNPROCESSED FOOD TO HICP INFLATION
(percentage points)



Source: Eurostat.

Chart 3.19
HICP IN MALTA: OVERALL AND CORE MEASURE
(annual percentage changes)



Sources: Eurostat; Central Bank of Malta estimates.

Table 3.9
CONTRIBUTIONS TO RPI INFLATION[(1)]
Percentage points (annual averages)

	2014	2015	2016	2017	2018	2019
Food	0.1	0.6	0.5	0.7	0.6	0.8
Beverages and tobacco	0.3	0.2	0.2	0.2	0.1	0.1
Clothing and footwear	0.1	0.1	-0.1	-0.2	-0.2	0.0
Housing	0.0	0.1	0.1	0.0	0.1	0.2
Water, electricity, gas and fuels	-0.5	-0.2	0.0	0.0	0.0	0.0
Household equipment and maintenance	0.1	0.1	0.1	0.2	0.1	0.0
Transport and communications	-0.1	-0.3	-0.5	0.1	0.2	0.3
Personal care and health	0.1	0.1	0.1	0.1	0.1	0.1
Recreation and culture	0.3	0.2	0.1	0.2	0.0	0.2
Other goods and services	0.0	0.2	0.1	0.0	0.0	0.1
RPI (annual average inflation rate)	**0.3**	**1.1**	**0.6**	**1.4**	**1.2**	**1.6**

Source: NSO.

(1) Totals may not add up due to rounding.

2018 (see Chart 3.19).[29] Despite this upward movement, core inflation remained below the overall inflation measure during the year under review. This suggests that overall inflation is in part supported by strong growth in a small number of volatile subcomponents.

RPI inflation accelerates

Annual inflation based on the RPI rose during 2019, averaging 1.6% from 1.2% a year earlier. Food inflation was the main driver of this acceleration, and this also remained the main contributor to overall RPI inflation (see Table 3.9). Other components, such as clothing and footwear, housing, and transport and communication, also registered slightly higher contributions.

The contrasting developments between the overall HICP and RPI inflation rates during 2019 mainly reflect differences in the consumption baskets and weights assigned in the measurement process for the two indices.[30] In particular, the RPI basket excludes tourist expenditure on accommodation services, which contributed to the fall in HICP inflation, while attributing a larger weight to the recent increases in food and beverage prices.

Costs and competitiveness

Producer price growth moderates

Growth in producers' output prices, as measured by the producer price index, moderated to 2.1% during 2019, from 4.5% a year earlier.[31] This mainly reflected a lower contribution from intermediate goods, which include items such as computer products and electronics. Nonetheless, this component remained the main contributor to overall producer price inflation during the year. On the other hand, inflation within the capital goods and the consumer goods components accelerated when compared with 2018, while energy inflation remained zero.

[29] The Central Bank of Malta uses a "trimmed mean" approach to measure core inflation, whereby the more volatile components of the index are removed from the basket of consumer goods so as to exclude extreme movements from the headline inflation rate. See Gatt, W. (2014), "An Evaluation of Core Inflation Measures for Malta", *Quarterly Review* 2014(3), p. 39-45, Central Bank of Malta.

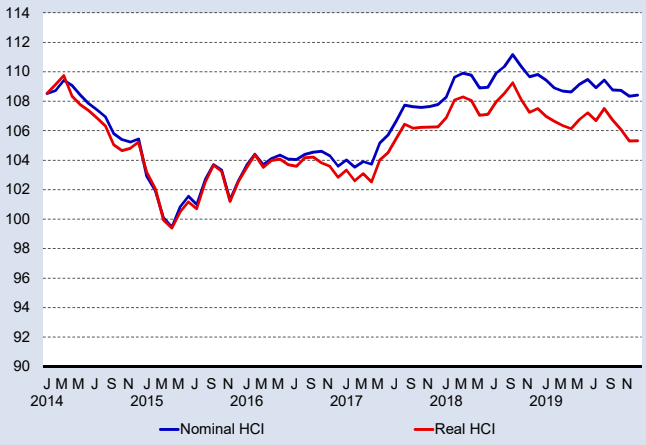
[30] The RPI index differs from the HICP index in that RPI weights are based on expenditure by Maltese households, while HICP weights also reflect expenditure patterns by tourists in Malta, such as accommodation services. See Darmanin, J. (2018), "Household Expenditure in Malta and the RPI Inflation Basket", *Quarterly Review* 2018(3), pp. 33-40, Central Bank of Malta.

[31] The PPI measures the prices of goods at the factory gate and is commonly used to monitor inflationary pressures at the production stage.

HCIs point to improvement in external competitiveness

Malta's HCIs pointed towards an improvement in international price competitiveness during 2019 (see Chart 3.20).[32] The nominal HCI, which is conditioned by developments in trade-weighted exchange rates, was down by 0.7% during the year, compared with its average reading for 2018, when the index had gained 3.6%. The real HCI, which also takes into account changes in price inflation relative to trading partners, decreased by 1.3%, following growth of 3.0% in 2018. This suggests that both movements in the euro exchange rate and in relative prices vis-à-vis trading partners had a positive impact on Malta's competitiveness during 2019.

Chart 3.20
HARMONISED COMPETITIVENESS INDICATORS
(May 2004 = 100)

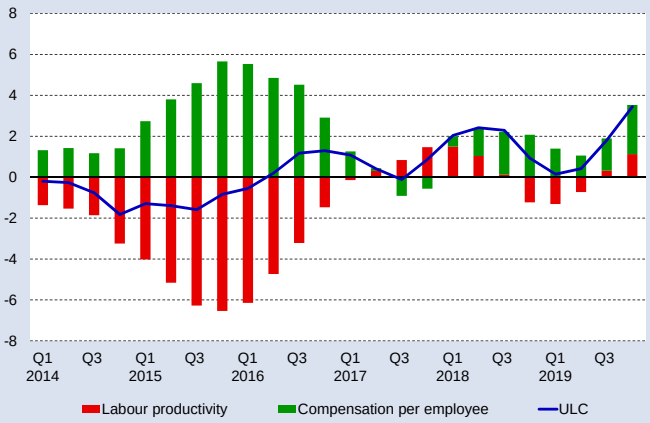


Source: ECB.

Unit labour costs accelerate

Following a moderate increase in 2018, growth in Malta's ULC accelerated in 2019 (see Chart 3.21).[33] ULC growth averaged 3.4% during the year under review, compared with 0.9% in the previous year. This pickup was driven by developments in productivity growth, which turned negative. In 2019, this stood at -1.1%, compared with 1.2% in 2018. Faster growth in compensation per employee also contributed to the pickup in ULC, although to a lesser degree. Compensation per employee rose by 2.4%, following a 2.1% increase in 2018.

Chart 3.21
DECOMPOSITION OF UNIT LABOUR COSTS IN MALTA
(annual percentage change; four-quarter moving average)



Sources: NSO; Central Bank of Malta estimates.
(1) A rise (drop) in productivity contributes negatively (positively) to ULC growth.

[32] HCIs act as an effective exchange rate (EER) measure for countries operating within the euro area monetary union. The nominal HCI tracks movements in the euro exchange rate against the currencies of Malta's main trading partners, weighted according to the direction of trade in manufactured goods. The real HCI also takes into account the relative inflation rate of Malta vis-à-vis its main trading partners. A higher (or lower) score in the HCI indicates a deterioration (or improvement) in Malta's international price competitiveness.

[33] Annual growth in ULC, compensation per employee, and labour productivity is measured on a four-quarter moving average basis. A degree of caution is required in the interpretation of ULC in view of contemporaneous structural shifts in the composition and factor-intensity of production, notably the shift to labour-intensive services. See Micallef, B. (2015), "Unit labour costs, wages and productivity in Malta: a sectoral and cross-country analysis", Policy Note August 2015, Central Bank of Malta, available at http://www.centralbankmalta.org/en/policy-notes-2015, and Rapa, N. (2016), "Measuring international competitiveness", *Quarterly Review* 2016(1), pp. 53-63, Central Bank of Malta.

BOX 3: ECONOMIC PROJECTIONS

Economic outlook[1]

The Bank's latest economic projections were based on information available until 28 February 2020. This was prior to the first case of COVID-19 in Malta. Hence, the baseline projections do not include the containment measures introduced by the Maltese authorities to limit the spread of COVID-19. However, this Box includes an additional section which quantifies the impact these containment measures might have in 2020.

Baseline projections

Before the global COVID-19 outbreak, economic activity in Malta was foreseen to moderate over the period 2020-2022 (see Table 1). Growth was expected to average 3.7% over this period, from 4.4% in 2019.

Domestic demand was foreseen to be the dominant driver of economic growth over the projection horizon, underpinned by all domestic demand components. On the other hand, net exports were set to contribute marginally to GDP growth throughout the projection horizon. In line with the expected moderation in economic activity, the pace of employment growth was projected to ease somewhat, while the unemployment rate was expected to rise marginally but remain low from a historical perspective.

Table 1

PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES FOR MALTA(1)

	2019	2020	2021	2022
Real economic activity (% change)				
GDP	4.4	3.8	3.6	3.5
Private consumption expenditure	2.4	3.9	3.8	3.8
Government consumption expenditure	12.0	6.1	4.6	4.3
Gross fixed capital formation	7.2	4.2	4.2	3.7
Exports of goods and services	1.7	1.5	1.8	2.0
Imports of goods and services	2.1	1.5	1.8	2.0
Contribution to real GDP growth (in percentage pts)				
Final domestic demand	4.3	3.6	3.3	3.1
Net exports	-0.2	0.3	0.3	0.4
Changes in inventories	0.2	0.0	0.0	0.0
Labour market (% change)(2)				
Total employment	5.6	3.7	3.0	2.5
Unemployment rate (% of labour supply)	3.4	3.5	3.7	3.8
Prices and costs (% change)				
Overall HICP	1.5	1.6	1.8	1.9
Public Finances(% of GDP)(3)				
General government balance	1.4	1.3	1.3	1.3
General government debt	42.9	40.4	38.1	36.1

(1) Data on GDP were sourced from NSO *News Release* 034/2020 published on 28 February 2020.

(2) Data on the number of employed are consistent with national accounts data. The unemployment rate is based on the number of unemployed and employed as reported in the LFS.

(3) CBM calculations based on NSO *News Release* 034/2020 (published on 28 February 2020) and *News Release* 004/2020 (published on 13 January 2020).

1 The projections in Table 1 were based on information available up to 28 February 2020.

HICP inflation was set to pick up gradually over the projection horizon, and reach 1.9% by 2022. This primarily reflects an expected pick-up in the price of services due to the envisaged intensification of wage pressures.

The headline budget balance was expected to remain in surplus throughout the forecast horizon. Moreover, the general government debt-to-GDP ratio was projected to decline, driven by high primary balances and a favourable interest-growth differential.

Estimating the impact of recent containment measures in 2020

COVID-19 has caused a worldwide public health emergency. In response, governments have put in place a number of containment measures to stem the spread of the virus. The economic impact is expected to be substantial, though likely to be concentrated in 2020. The Organisation for Economic Co-Operation and Development has estimated that the outbreak could lead to world GDP growth being between 0.5 percentage point and 1.5 percentage points lower in 2020 than previously projected. The ECB staff calculations released on 12 March foresee an impact of between 0.8 and 1.4 percentage points on euro area GDP growth in 2020.

The situation is unprecedented and fluid and hence it is very challenging to quantify the economic impact at this juncture, given the high uncertainty concerning the duration of this pandemic. The Bank has built a scenario which attempts to cater for the impact of COVID-19 on the Maltese economy. It is based on external developments, the announcements made by the Maltese Government up to 15 March 2020 and a number of assumptions.[2]

In particular, the scenario assumes a severe drop in tourist expenditure due to the travel ban and extension of quarantine to all visitors to Malta, shocks related to possible supply-chain disruptions, lower employment hours, and a drop in confidence due to the environment of acute uncertainty. Moreover, the oil price is lower compared with that assumed in the baseline, reflecting developments in the international price of oil between 28 February and 15 March. Due to disruptions, a portion of government investment projects is assumed to be delayed.

GDP growth is estimated to be around 3.5 percentage points lower in 2020, when compared with the baseline projection shown in Table 1. The sectors that are expected to bear the largest drops are the accommodation and food service sector, travel agency-related services, sports and other recreational activities, the transport sector and firms involved in the production of food products. However, almost all other sectors are expected to experience a negative impact due to COVID-19.

The government balance is expected to remain in surplus, but is expected to be around 0.8 percentage point lower than that projected in the baseline, as a result of the assumed lower economic activity.

The Bank will continue to monitor the situation and will update its assessment as new information becomes available. The impact of COVID-19 reported in this section depends on the duration of this pandemic. Measures addressing the financial sector and any fiscal support the Maltese Government may offer to the private sector in Malta should mitigate the negative economic impact of COVID-19.

[2] The duration assumption underlying this scenario is two months.



4. BALANCE OF PAYMENTS

During the first three quarters of 2019, the surplus on the current account of the balance of payments widened when compared with the corresponding period of 2018. This improvement was attributable to a rise in net services receipts and a narrowing in the merchandise trade deficit. Together, these offset higher net outflows related to the primary and secondary income components of the current account.

Between January and September, net inflows on the capital account increased substantially on a year earlier, while lower net lending was recorded on the financial account. Net errors and omissions remained negative.[1]

When measured over the four quarters to September 2019, the current account registered a surplus equivalent to 10.1% of GDP, 0.6 percentage point lower than in the year ending in September 2018 and markedly above the 2.9% recorded in the euro area. The cyclically-adjusted current account balance was estimated to stand at 13.9% during the period under review (see Chart 4.1).[2]

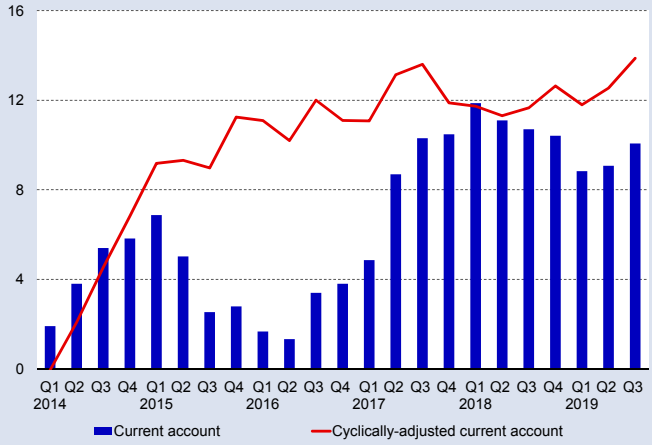
The current account

Between January and September 2019, the current account recorded a surplus of €1,154.9 million, a rise of €22.0 million on the same period of 2018 (see Table 4.1). This improvement was driven by a rise in net services exports and a lower merchandise trade deficit. These offset substantially higher net primary income outflows and a marginal increase in net outflows related to secondary income.

In the four quarters to September 2019, the surplus on the current account stood at €1,310.7 million, up by €16.0 million from the four quarters to September 2018, with transactions in services and goods explaining most of the improvement. Nevertheless, as GDP grew faster, the current account surplus-to-GDP ratio edged down to 10.1%, from 10.7% previously (see Charts 4.1 and 4.2).

Malta's cyclically-adjusted current account balance stood at 13.9% of GDP, up from 11.7% in the year to September 2018.[3] The cyclically-adjusted and the unadjusted current

Chart 4.1
CURRENT ACCOUNT
(four-quarter moving sums as a percentage of GDP)



Source: NSO.

[1] Negative net errors and omissions imply an overestimation of the current and capital account surplus and/or an underestimation of net lending.

[2] Data shown in Chart 4.1 are based on information published up to the end of January 2020 and thus are not consistent with the latest GDP figures used in the rest of this *Report*.

[3] For more information on Malta's cyclically-adjusted current account see Grech, A. G., & Rapa, N., "An evaluation of recent shifts in Malta's current account position", in Grech, A.G., & Zerafa, S. (eds.), *Challenges and Opportunities of Sustainable Economic Growth: the case of Malta,* Central Bank of Malta, 2017.

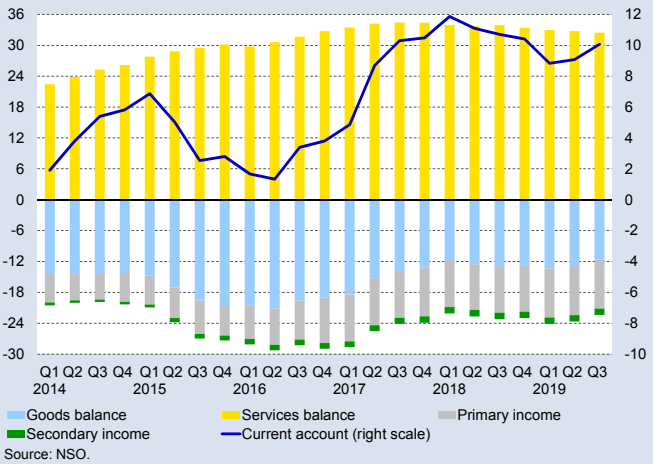
account balances for the Maltese economy tracked each other closely in recent years. However, the gap between these two measures has widened during the last few quarters, with the cyclically-adjusted measure exceedingly above the headline measure (see Chart 4.1). The current account position is being dampened by slower growth in Malta's trading partner economies, which is negatively impacting the cyclical component of Malta's current account surplus.

Goods deficit narrows

Balance of payments data show that in the first three quarters of 2019, the merchandise trade gap narrowed by €62.2 million when compared with the corresponding period of 2018 and stood at €1,135.7 million. This was the result of a €212.6 million increase in exports which offset an expansion of €150.4 million in payments for goods imports.

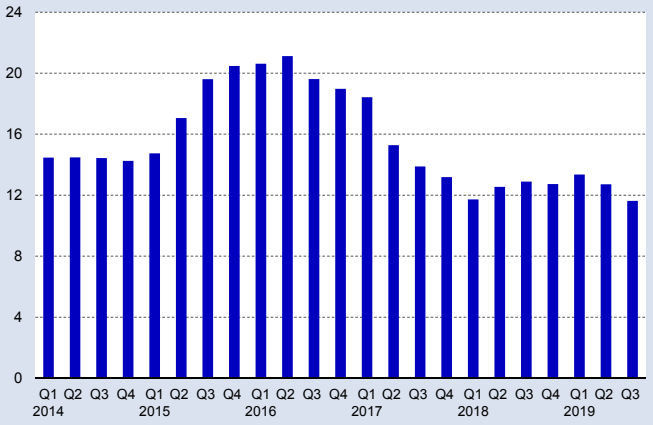
Largely reflecting developments in the first nine months of the year, when expressed as a four-quarter moving sum the merchandise trade deficit narrowed to 11.6% of GDP, from 12.9% a year earlier (see Chart 4.3).[4]

Chart 4.2
COMPOSITION OF CURRENT ACCOUNT
(four-quarter moving sums as a percentage of GDP)



Source: NSO.

Chart 4.3
GOODS DEFICIT
(four-quarter moving sums as a percentage of GDP)



Source: NSO.

Table 4.1
BALANCE OF PAYMENTS
EUR millions

	2016	2017	2018	2018 Q1-Q3	2019 Q1-Q3
Current account	**394.3**	**1,187.5**	**1,288.8**	**1,132.9**	**1,154.9**
Goods	-1,966.7	-1,493.7	-1,575.1	-1,197.9	-1,135.7
Services	3,395.6	3,897.4	4,135.4	3,230.9	3,319.3
Primary income	-920.1	-1,075.2	-1,116.8	-786.3	-912.3
Secondary income	-114.5	-141.0	-154.8	-113.8	-116.4
Capital account	**32.2**	**74.0**	**115.3**	**31.9**	**102.5**
Financial account[(1)]	**805.6**	**1,242.4**	**558.6**	**666.7**	**625.3**
Errors and omissions	379.1	-19.1	-845.4	-498.2	-632.2

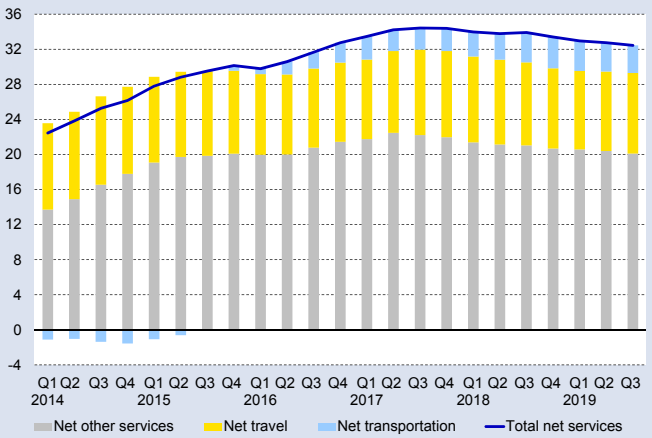
Source: NSO.
[(1)] Net lending (+) / net borrowing (-).

[4] In the compilation of balance of payments statistics, customs data on merchandise trade are adjusted for coverage, valuation and timing. During the period reviewed, these methodological differences were especially pronounced with regard to trade in fuel, as well as imports of capital goods, mainly related to the registration of boats and aircraft.

Surplus on services widens

Between January and September 2019, the positive balance on services increased by €88.4 million on a year earlier, reaching €3,319.3 million. This was due to higher services receipts which offset a rise in payments.

Chart 4.4
SERVICES BALANCE
(four-quarter moving sums as a percentage of GDP)



Source: NSO.

The improvement in the net services balance was largely the result of an increase in net receipts from travel and "other" services. A further expansion in the tourism sector continued to boost the services balance. During the first three quarters of 2019, the net surplus on travel stood at €1,003.4 million, €62.9 million more than a year earlier, as tourism receipts continued to outpace Maltese residents' expenditure abroad. At the same time, net receipts on "other" services climbed to €1,003.4 million in the first three quarters of 2019, adding €58.0 million on a year earlier. This was largely driven by a rise in receipts related to remote gaming which offset a rise in professional and management consultancy payments.

In the meantime, the net surplus from transport services decreased by €32.5 million, to €302.4 million.

When measured over the year to September 2019, the surplus on the services account reached €4,223.9 million, an increase of €121.6 million on the level recorded 12 months earlier. Nonetheless, its share in GDP decreased to 32.4%, reflecting relatively faster growth in nominal GDP (see Chart 4.4).

Net outflows related to primary income increase[5]

Between January and September 2019, net primary income outflows went up to €912.3 million, €126.0 million more than in the first nine months of 2018. Movements on the primary income account continued to be strongly influenced by internationally-oriented firms, including subsidiaries of foreign banks, which transact predominantly with non-residents.

When measured on a four-quarter cumulative basis, net outflows on this component reached 9.5% of GDP, 0.4 percentage point more than in the four-quarters to September 2018. Higher net outflows were mostly driven by lower net interest earnings on portfolio investment. A rise in distributed profits of foreign-owned firms operating in Malta and related flows also contributed. Together these offset higher net interest earnings in the 'other investment' income component.

Net outflows from secondary income edge up

During the first nine months of 2019, net outflows on the secondary income account amounted to €116.4 million, up by €2.6 million on the corresponding period of 2018.

When measured over four quarters, net outflows on the secondary income account stood at €157.4 million, or 1.2% of GDP, 0.1 percentage point less when compared with the four quarters to September 2018.

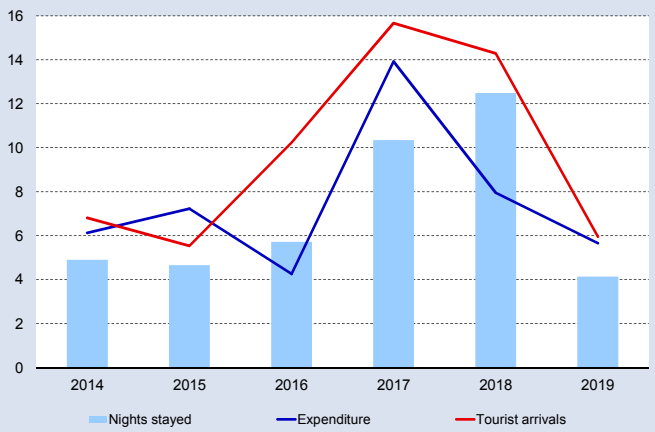
[5] The primary income account shows income flows related mainly to cross-border investment and compensation of employees. The secondary income account shows current transfers between residents and non-residents.

Tourism

The tourism sector continued to expand in 2019, although the expansion moderated following an extended period of very high growth. While tourist arrivals, expenditure and nights stayed continued to increase strongly, they all grew at a more moderate pace compared with the preceding year.

During 2019, tourist arrivals were up by 5.9% after increasing by 14.3% in 2018 (see Chart 4.5). The total number of visitors exceeded 2.7 million, 154,550 tourists more compared with a year earlier.

Chart 4.5
TOURISM INDICATORS
(annual percentage changes)



Source: NSO.

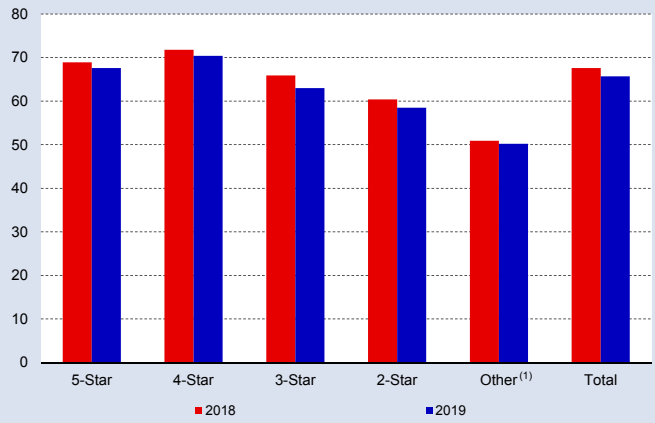
The leisure segment remained the major contributor to the sector's expansion. Over 2.4 million tourists visited Malta for leisure purposes during 2019, an increase of 156,519 or 6.8% on 2018. Those travelling for business purposes totalled 189,086, a rise of 8,807 or 4.9%. Meanwhile, 116,007 persons visited Malta for other purposes, a drop of 10,776 or 8.5% over 2018.

Increases in arrivals were reported from nearly all major source markets. However, the number of visitors arriving from Germany and, to a lesser extent, the number of persons arriving from Austria and Scandinavia declined on a year earlier. The United Kingdom and Italy remained Malta's most important source markets, accounting for 23.6% and 14.3% of total visitors, respectively.

The number of nights that tourists spent in Malta reached 19.3 million in the year under review, a rise of 4.1% on 2018. This was largely propelled by an increase in nights stayed in rented accommodation other than collective accommodation, which accounted for over 95% of the overall increase in nights stayed in Malta, offsetting a marginal decrease in nights spent in collective accommodation.[6] Nights spent in non-rented accommodation also increased in annual terms.

The total average occupancy rate in collective accommodation establishments fell to 65.7% in 2019, from 67.6% a year earlier (see Chart 4.6). Lower occupancy rates were registered across all accommodation categories, with the three-star category reporting the largest decline.

Chart 4.6
AVERAGE OCCUPANCY RATES
(per cent)



Source: NSO.
(1) Includes guest houses, hostels and holiday complexes.

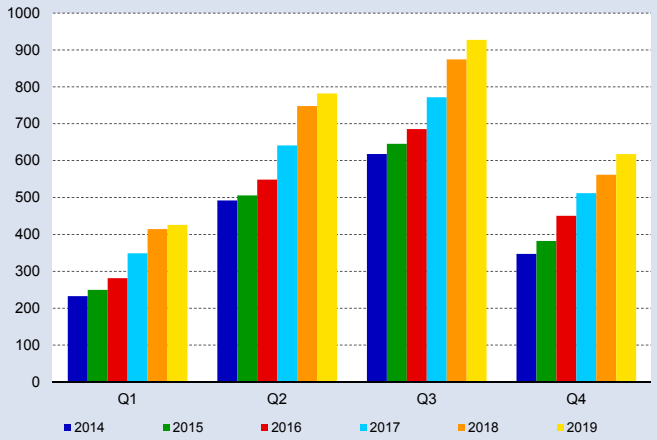
[6] Collective accommodation comprises hotels, aparthotels, guesthouses, hostels and tourist villages. Non-collective rented accommodation comprises holiday furnished premises (farmhouses, flats and villas), host families, marinas, paid-convents, rented yachts and student dormitories. Non-rented accommodation includes own private residence, staying with friends or relatives and other private accommodation (e.g. free-convents or timeshare).

An assessment of the seasonal spread in average occupancy rates in total collective accommodation establishments in recent years shows that the increase in visitors during the shoulder months is to an extent being mirrored in higher occupancy rates (see Charts 4.7 and 4.8). As can be seen in Chart 4.8, occupancy rates in collective accommodation establishments rose in each quarter of the year between 2014 and 2019. Nonetheless, as occupancy rates in the summer months were already relatively high, the rise in rates during this period was more contained. On the contrary, more pronounced increases in occupancy rates were recorded in the second quarter, followed closely by the outer quarters.

After an 8.0% increase in 2018, tourist spending was up by 5.7% in 2019, reaching €2,220.6 million.[7] Higher expenditure was registered in the non-package category and the "other" category, which were up by 17.1% and 5.9%, respectively.[8] These increases were partly offset by a decline in the package category, which fell by 8.2%. As tourist expenditure increased at a slightly slower pace compared with arrivals, expenditure per capita fell marginally. It decreased to €806.6 in 2019 from €808.8 a year earlier. This partly reflected a shorter length of stay, which fell slightly to 7.0 nights from 7.1 nights in 2018.

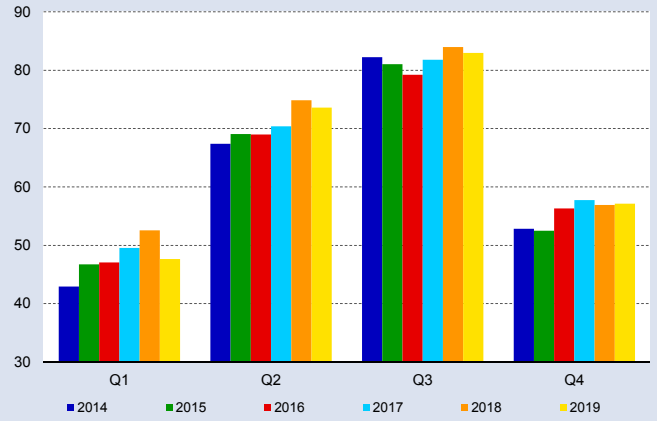
According to Malta International Airport (MIA) data, in 2019, seat capacity increased by 7.4% in comparison with 2018 (see Chart 4.9).[9] This was partly driven by improved flight schedules for both the winter and the summer months. During 2019, MIA inaugurated 18 new routes spanning three

Chart 4.7
INBOUND TOURIST ARRIVALS PER QUARTER
(thousands)



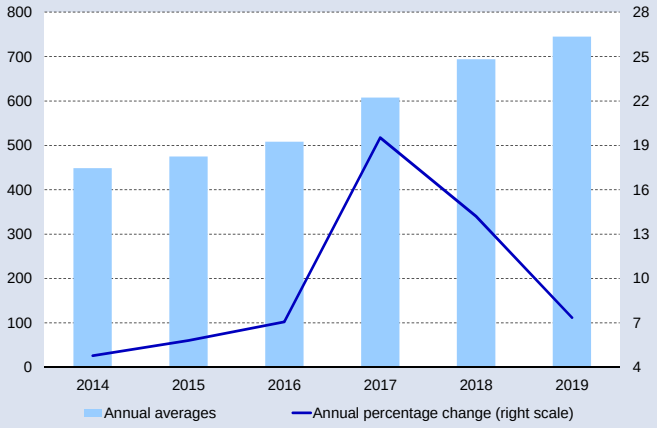
Source: NSO.

Chart 4.8
OCCUPANCY RATES IN TOTAL COLLECTIVE ACCOMMODATION ESTABLISHMENTS PER QUARTER
(per cent)



Source: NSO.

Chart 4.9
AVERAGE SEAT CAPACITY[(1)]
(thousands; annual percentage change)



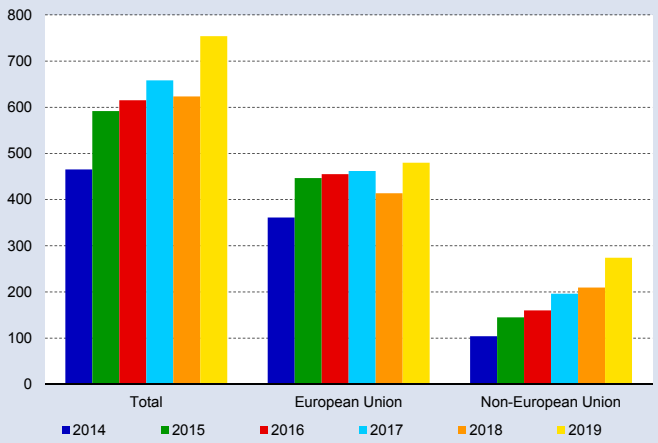
Source: MIA.
[(1)] Data includes schedule and charter seats.

[7] Total expenditure is split into package, non-package and "other" with the latter component capturing any additional expenditure by tourists during their stay in Malta, such as expenditure on excursions and entertainment.
[8] Non-package holiday expenditure is subdivided into spending on accommodation and travel fares.
[9] MIA data are subject to revisions.

continents, and introduced other initiatives aimed at further enhancing the islands' connectivity, particularly in the off-peak months.

Malta's performance compared positively with other countries, gaining market share. According to the World Tourism Barometer, arrivals in Southern and Mediterranean European countries grew by an annual rate of 5.5%, while the global tourism industry registered a 3.8% increase in 2019.

Chart 4.10
CRUISE LINER PASSENGERS
(thousands)



Source: NSO.

After reporting a decline in the previous year, the number of foreign cruise liner passengers increased by 21.0% to 0.7 million in 2019 (see Chart 4.10). Passengers coming from both the EU and non-EU countries rose. The highest increases were recorded from German and American markets. The number of cruise liner calls in 2019 totalled 359, 49 more than in 2018.

The capital and financial accounts

The capital account recorded net inflows of €102.5 million in the first three quarters of 2019, up by €70.6 million on a year earlier (see Table 4.1). A significant increase was also observed on a four-quarter moving sum basis. This expansion was mostly attributable to higher transfers to Government, which in turn reflected the timing of funds received under EU financing programmes.

Meanwhile, the financial account showed a net lending flow of €625.3 million. This compares with net lending of €666.7 million in the same period of 2018. When the balance on this account is expressed as a four-quarter sum, net lending flows were also lower in year-on-year terms. Movements on this account continued to be heavily influenced by transactions of internationally-oriented financial institutions.



5. GOVERNMENT FINANCE

In the first three quarters of 2019, the general government surplus narrowed compared with the same period a year earlier. In the four quarters up to September 2019, the cyclically-adjusted general government balance also deteriorated when compared with the rate reached at end-2018. Meanwhile, general government debt as a share of GDP continued to decline. Despite an increase in the share of financial assets in GDP, the general government net financial worth deteriorated in the period under review, due to a larger increase in financial liabilities.

Quarterly developments

General government surplus decreases

In the first three quarters of 2019, the general government registered a surplus of €79.1 million, €137.8 million less than the surplus recorded in the corresponding period of 2018. This was due to a strong increase in primary expenditure offsetting higher revenue inflows. As a result, the primary surplus decreased by €147.5 million to €213.0 million (see Table 5.1).

Higher tax receipts support revenue

During the period under review, Government revenue grew by €212.1 million, or 6.2% in annual terms, reaching €3,646.9 million. Growth in revenue was mainly driven by higher tax receipts, which continued to

Table 5.1
REVENUE, EXPENDITURE AND DEBT
EUR millions

							Q1 - Q3		Change Q1-Q3	
	2013	2014	2015	2016	2017	2018	2018	2019	Amount	%
Revenue	**3,021.4**	**3,346.4**	**3,719.9**	**3,872.0**	**4,438.7**	**4,764.1**	**3,434.8**	**3,646.9**	**212.1**	**6.2**
Taxes on production and imports	988.7	1,107.4	1,180.5	1,259.6	1,401.4	1,572.4	1,156.0	1,201.6	45.6	3.9
Current taxes on income and wealth	1,043.3	1,155.4	1,237.5	1,383.9	1,569.8	1,650.4	1,217.4	1,325.6	108.3	8.9
Social contributions	524.8	560.3	596.3	639.3	702.9	764.8	547.3	576.7	29.3	5.4
Capital and current transfers receivable	182.3	244.5	350.9	99.3	141.8	197.3	90.8	128.3	37.5	41.3
Other[1]	282.3	278.7	354.6	489.9	622.8	579.2	423.4	414.7	-8.6	-2.0
Expenditure	**3,206.9**	**3,494.2**	**3,818.1**	**3,777.7**	**4,053.5**	**4,528.5**	**3,217.9**	**3,567.8**	**349.9**	**10.9**
Compensation of employees	977.8	1,049.9	1,115.7	1,179.5	1,268.5	1,373.5	1,029.9	1,083.0	53.1	5.2
Intermediate consumption	471.0	519.6	591.7	627.4	727.1	810.8	549.9	692.4	142.4	25.9
Social benefits	964.2	1,010.3	1,041.2	1,086.1	1,133.7	1,180.9	871.3	906.6	35.3	4.1
Subsidies	80.3	105.0	111.7	132.1	139.9	168.2	114.9	140.6	25.7	22.4
Interest	219.1	230.5	226.3	216.5	206.1	190.3	143.6	133.9	-9.7	-6.7
Other current transfers payable	176.4	186.7	200.8	195.7	210.3	271.0	165.6	234.8	69.3	41.9
Gross fixed capital formation	219.9	300.9	402.9	259.3	267.8	376.9	224.6	292.9	68.3	30.4
Capital transfers payable	95.4	94.6	134.6	79.5	98.5	168.4	124.6	78.0	-46.6	-37.4
Other[2]	3.0	-3.3	-6.9	1.8	1.5	-11.5	-6.4	5.6	12.0	-
Primary balance	**33.6**	**82.7**	**128.1**	**310.7**	**591.4**	**425.9**	**360.5**	**213.0**	**-147.5**	**-**
General government balance	**-185.5**	**-147.8**	**-98.2**	**94.3**	**385.3**	**235.6**	**216.9**	**79.1**	**-137.8**	**-**
General government debt	**5,226.6**	**5,390.0**	**5,586.2**	**5,739.9**	**5,682.1**	**5,641.1**	**5,543.6**	**5,614.9**		

Source: NSO.

[1] "Other" revenue includes market output as well as income derived from property and investments.

[2] "Other" expenditure principally reflects changes in the value of inventories and in the net acquisition of valuables and other assets.

benefit from a favourable labour market environment and overall buoyant economic activity, especially in tourism.

Current taxes on income and wealth registered the largest increase in absolute terms, of €108.3 million. This reflects higher income tax revenue derived from households and corporations. Inflows from taxes on production and imports also rose significantly. This increase was mainly on the back of higher inflows from VAT receipts reflecting further growth in private consumption.

Overall, developments in non-tax revenue also had a positive impact on general government finances during the period under review. Capital and current transfers receivable increased by €37.5 million, buoyed by higher funds from the EU, which more than offset the drop in "other" component of government revenue. The latter was driven by a decline in dividend income as well as lower revenue from the Individual Investor Programme (IIP).

Current and capital expenditure increase

Government expenditure increased by €349.9 million or 10.9%, mainly reflecting higher recurrent expenditure.

Spending on intermediate consumption contributed more than two-fifths of the increase in current expenditure, rising by €142.4 million. This increase mostly resulted from higher outlays in public administration and, to a certain extent, by increased expenditure on health and residential care. Other current transfers payable increased by €69.3 million, mainly due to higher payments to the EU budget.

Spending on other current spending items increased at a comparatively slower pace. The increase in outlays on compensation of employees was driven by higher wages in the public administration and health sectors. At the same time, expenditure on social benefits increased mainly due to higher pension outlays.

Among the main current expenditure items, only interest payments declined in the period under review, reflecting lower financing needs and the low interest rate environment.

Meanwhile, capital expenditure rose, as significantly higher outlays on gross fixed capital formation offset lower capital transfers. The former was boosted by higher spending on road construction and other infrastructural projects. Lower capital transfers payable reflect a negative base effect. In the first quarter of 2018, capital transfers were boosted by the Government's acquisition of landing rights from Air Malta. These transactions were not repeated in 2019.

Government debt decreases further

In September 2019, the stock of general government debt was down by €26.2 million from its level at the end of 2018, standing at €5,614.9 million. This was largely due to a decline in the nominal value of debt securities which fell by €155.8 million. In particular, the stock of long-term debt securities (composed of MGS) fell by €145.1 million, as MGS redemptions exceeded new issues. Consequently, the share of long-term debt securities in total government debt declined by 2.2 percentage points to reach 81.3%. The stock of short-term securities outstanding (composed of Treasury Bills) also decreased. This went down by €10.7 million. Hence, its share in total debt dropped by 0.2 percentage point and reached 5.0%.

Meanwhile, currency and deposits outstanding rose by €101.7 million, with their share in total debt rising by 1.8 percentage points to 6.7%. This increase was largely due to the issue of a new 62+ Government Savings Bond, which is classified as deposits according to the ESA methodology. Moreover, the stock of loans outstanding increased by €27.9 million such that its share in total debt rose by 0.5%, to reach 7.0%.

Headline and cyclically-adjusted developments

Headline surplus improves slightly while debt ratio declines

When measured on a four-quarter moving sum basis, the general government surplus-to-GDP ratio reached 0.8% in the third quarter of 2019. This is lower than the surplus of 1.9% of GDP for 2018.

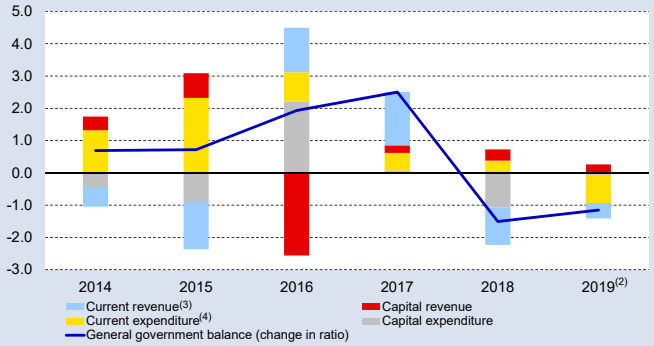
During this period, the ratio of total revenue in GDP declined by 0.2 percentage point, as the rise in revenue did not keep pace with the increase in GDP (see Chart 5.1). The share of current revenue in GDP dropped by 0.5 percentage point, offsetting a 0.3 percentage point increase in the ratio of capital revenue. Meanwhile, the ratio of total expenditure in GDP rose by 0.9 percentage point, with this increase almost fully due to a higher ratio of current spending.

Meanwhile, the government debt-to-GDP ratio declined by 2.4 percentage points, to 43.2%. Although deficit-debt adjustments (DDAs) carried out in this period contributed to a 0.4 percentge point increase in the debt ratio, primary surpluses and the interest-growth differential exerted a much stronger downward effect (see Chart 5.2). The latter contributed towards a 1.2 percentage point decline, as the rate of GDP growth surpassed the effective rate of interest on government debt. Meanwhile, the primary surplus posted in this period contributed to a 1.6 percentage point drop in the debt ratio.

Net financial worth deteriorates

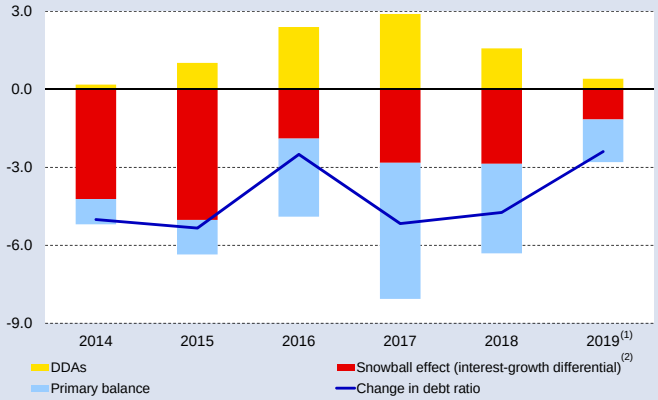
The market value of financial assets as at end-September 2019 stood at €4,363.1 million, up by €443.0 million when compared with the end of 2018.[1] This was mainly due to higher deposits held at banks, which rose by €270.3 million. Consequently, the share of financial assets in GDP rose by 1.9 percentage points to 33.5% (see Chart 5.3). At the same time, financial liabilities increased by €727.8 million, ending the third quarter of 2019 at €8,316.1 million. This is due to an increase in accounts payable and also in the market value of outstanding debt securities. Consequently, general government liabilities in this period

Chart 5.1
IMPACT ON GENERAL GOVERNMENT BALANCE(1)
(percentage points)



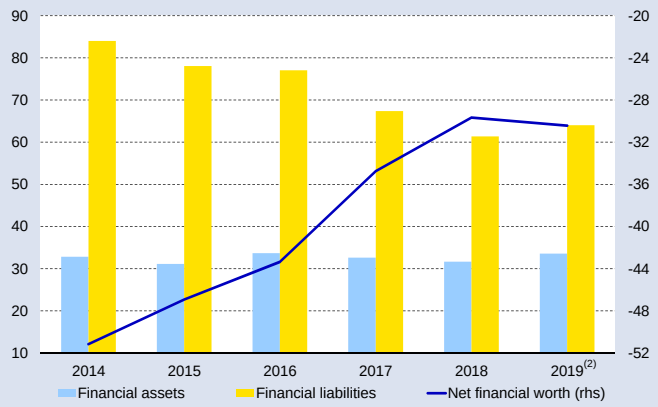
Sources: NSO; Central Bank of Malta.
(1) Revenue items: +ve sign represents higher revenue and vice versa. Expenditure items: +ve sign represents lower expenditure and vice versa.
(2) Four-quarter moving sums up to Q3.
(3) The term 'current revenue' represents most tax revenue as well as income from investments and sales. 'Capital revenue' mainly represents capital taxes and grants received.
(4) The term 'current expenditure' mainly represents spending on wages, social benefits and operational and maintenance expenses. 'Capital expenditure' mainly represents spending on investment and capital transfers.

Chart 5.2
CONTRIBUTION TO CHANGE IN DEBT
(percentage points)



Sources: NSO; Central Bank of Malta.
(1) Period ending September 2019.
(2) Difference between effective interest rate (interest payments at year t relative to debt outstanding at year t-1) and GDP growth.

Chart 5.3
GENERAL GOVERNMENT NET FINANCIAL WORTH
(% of GDP)(1)



Sources: EUROSTAT; NSO.
(1) GDP data are four-quarter moving sums.
(2) Period ending September 2019.

[1] According to the ESA 2010 methodology the stock of financial assets and liabilities are measured at market value. For further details see: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Net_financial_worth&stable=1

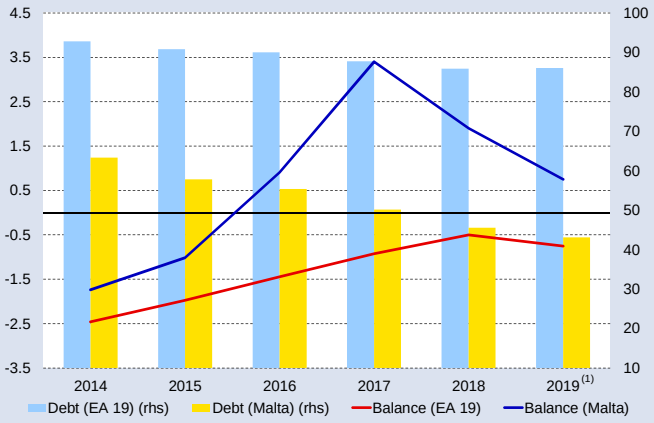
were considerably affected by the revaluation of debt securities, even though such debt declined in nominal terms. As a result, the share of financial liabilities in GDP increased by 2.7 percentage points to 64.0%.

The resulting net financial worth of general government as a share of GDP deteriorated by 0.8 percentage point of GDP and closed the third quarter of the year at -30.4%, from -29.7% as at end 2018.

Public finances compare favourably with the euro area's

In September, the euro area general government deficit stood at 0.8% of GDP when measured on a four-quarter moving sum basis. This marks an increase from the 0.5% recorded in 2018 (see Chart 5.4). Between December 2018 and September 2019, the euro area debt ratio increased slightly to 86.1% of GDP, from 85.9%. Malta's public finances therefore continue to compare favourably with the euro area average, as a surplus was maintained, even if its ratio narrowed in the period under review. Moreover, the Maltese debt ratio fell further, well below the 60% threshold referenced in the Stability and Growth Pact and stood at approximately half the corresponding ratio for the euro area.

Chart 5.4
GENERAL GOVERNMENT BALANCE AND DEBT
(% of GDP)



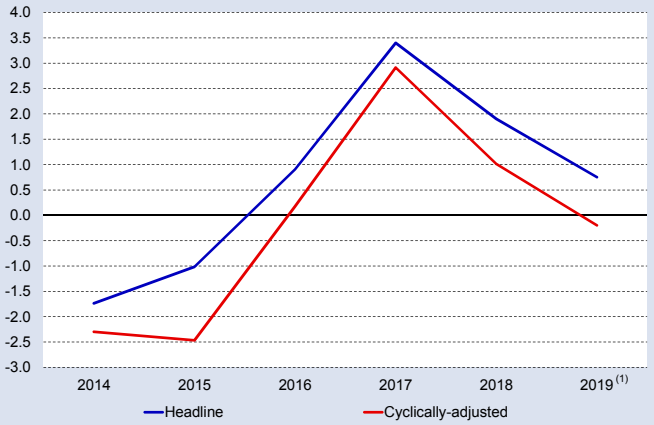
Sources: NSO; EUROSTAT.
(1) Period ending September 2019.

The net financial worth of the Maltese general government also compares favourably with the euro area average. The latter stood at -66.3% of GDP in September 2019 up from -63.3% registered in December 2018. Although the net financial worth in Malta also deteriorated in this period, the rate of change was much smaller: from -29.7% to -30.4%.

Cyclically-adjusted balance[2]

After adjusting for the impact of a positive output gap in the four quarters up to September 2019, the cyclically-adjusted balance turned into a small deficit, amounting to -0.2% of GDP (see Chart 5.5). Compared with the ratio for 2018 as a whole, this marks a decline of 1.2 percentage points, in line with developments in the headline surplus-to-GDP ratio during the same period.

Chart 5.5
GENERAL GOVERNMENT BALANCE
(% of GDP)



Sources: NSO; Central Bank of Malta estimates.
(1) Period ending September 2019.

[2] The cyclically-adjusted balance is corrected for the impact of the economic cycle on government tax revenue and unemployment assistance. This methodology is in line with the approach used by the EC but is based on own estimates for fiscal items' elasticities and the output gap. For an overview of the method used by the Commission, see Mourre, G., C. Astarita, and S. Princen (2014): "Adjusting the budget balance for the business cycle: the EU methodology," European Economy – Economic Papers 536, (DG ECFIN), European Commission.

Table 5.2

YEAR-ON-YEAR CHANGES IN CYCLICALLY-ADJUSTED FISCAL COMPONENTS

Percentage points of GDP

	2014	2015	2016	2017	2018	2019[1]
Revenue	**0.1**	**-0.5**	**-1.4**	**1.8**	**-0.6**	**-0.4**
Taxes on production and imports	-0.4	-1.0	0.7	0.6	-0.6	0.3
Current taxes on income and wealth	0.1	-0.7	-0.1	0.2	0.3	-0.4
Social contributions	-0.2	-0.4	-0.1	0.0	0.0	-0.2
Other[2]	0.6	1.6	-1.9	0.9	-0.3	-0.2
Expenditure	**0.3**	**-0.4**	**-4.0**	**-0.9**	**1.3**	**0.8**
Compensation of employees	-0.1	-0.5	-0.4	-0.3	-0.1	0.0
Intermediate consumption	0.1	0.2	-0.2	0.2	0.3	0.7
Social benefits	-0.3	-0.7	-0.5	-0.6	-0.4	-0.3
Interest payments	-0.1	-0.3	-0.3	-0.3	-0.3	-0.2
Gross fixed capital formation	0.7	0.8	-1.8	0.0	0.7	0.5
Other[3]	0.0	0.2	-0.9	0.0	1.1	0.1
Primary balance	**-0.3**	**-0.5**	**2.3**	**2.5**	**-2.2**	**-1.4**
General government balance	**-0.2**	**-0.2**	**2.6**	**2.7**	**-1.9**	**-1.2**

Sources: NSO; Central Bank of Malta estimates.

[1] Four-quarter period up to September 2019.

[2] Includes market output, income derived from property and investments and current and capital transfers received.

[3] Mainly includes subsidies, current and capital transfers.

The deterioration in the cyclically-adjusted balance in the four quarters up to September 2019 occurred mainly as a result of a higher share of expenditure in GDP. The share of current expenditure in GDP increased as a rise in the share of intermediate consumption was only partly offset by declines in other forms of spending. The share of social benefits in GDP decreased as a result of ongoing efforts to reduce dependency on unemployment benefits and incentivise people to seek employment. The share of interest payments in GDP declined as the prevailing low interest rate environment, coupled with lower financing requirements, led to a level decrease in spending. Meanwhile, the share of capital expenditure in GDP increased.

At the same time, the share of cyclically-adjusted revenue decreased by 0.4 percentage point. Despite increasing in level terms, tax revenue did not rise in line with GDP growth. This was due to a decline in the share of current taxes on income and wealth which declined by 0.4 percentage point and a 0.2 percentage point decrease in the ratio of social contributions. On the other hand, the share of taxes on production and imports in GDP rose by 0.3 percentage point. At the same time, the share of the 'other' component of revenue in GDP declined by 0.2 percentage point, reflecting the aforementioned decline in dividend income and IIP receipts.

BOX 4: THE SUSTAINABILITY OF MALTESE GOVERNMENT DEBT[1]

This box assesses the sustainability of Maltese general government debt over different time horizons and evaluates risks stemming from macro-financial linkages. It updates previous debt sustainability analyses (DSA) published by the Bank.[2,3] The term 'sustainability' as used throughout this study is in line with the IMF's definition: sovereign debt is sustainable if the country is able to finance its policy objectives and service the resulting debt, without resorting to unduly large adjustments which could otherwise compromise its stability.

Main messages

Compared with the analysis in the Bank's Annual Report 2018, the main messages are largely unchanged, and can be summed up as follows:

- In the medium term, the government debt-to-GDP ratio is expected to remain low if current fiscal targets are adhered to. Debt is expected to embark on an upward path if Government adopts a looser fiscal policy, especially if this takes place in a period of slower economic growth and/or higher interest rates. Nevertheless, even in such conditions, debt would not increase at a sudden or extraordinary pace.

- Risks associated with the structure and financing of debt, macro-financial linkages and competitiveness are mostly seen as low. The main sources of risk stem from the high level of implicit and contingent liabilities, as well as the level of NPLs of credit institutions. However, these risks have diminished somewhat in recent years.

- Risks can be reduced further if sufficient fiscal buffers exist to address any unexpected adverse developments. This requires a commitment towards prudent fiscal targets and a continued reduction in government guaranteed debt. Moreover, the next review of the pension system should introduce additional measures which balance adequacy needs with sustainability considerations.





[1] Prepared by Kurt Sant and John Farrugia, economists within the Economic Analysis Department of the Central Bank of Malta. The views expressed are those of the authors and do not necessarily reflect the views of the Central Bank of Malta. Any errors are the authors' own.

[2] For further details on government debt dynamics and fiscal sustainability, see Farrugia, J. and Grech, O. "The Sustainability of Maltese Government Debt Revisited", in Grech, A.G., and Zerafa, S. (eds.), Challenges and Opportunities of Sustainable Economic Growth: the Case of Malta, Central Bank of Malta, 2017.

[3] This study uses the national accounts vintage up to the fourth quarter of 2019 published in February 2020 and the general government data vintage up to the third quarter of 2019, published in January 2020. Therefore, this exercise makes use of an additional year of data compared with the assessment in the *Annual Report* 2018.

Scenario analyses

This section outlines the resulting debt paths from 2020 to 2028 under different assumptions for GDP growth, inflation, government's borrowing costs and the primary balance, and compares them with the baseline projection for the debt ratio. Two separate scenarios are considered (the main assumptions underpinning these scenarios are outlined at the end of this box). The basic framework is similar to that outlined in the Bank's *Annual Report* 2018.

Scenario 1 – assuming government fiscal targets are met

This scenario explores the implications for the debt if Government adheres to its fiscal target – ensuring an annual surplus in structural terms, excluding inflows from the Individual Investor Programme (IIP).

In the baseline scenario, the general government debt retains its downward trend, such that it declines from 45.6% of GDP in 2018 to 27.1% by 2028 (see Chart 1). Debt remains on a downward trajectory when assuming individual shocks to real GDP growth and borrowing costs. In the event of a combined shock, the debt-to-GDP ratio initially decreases, before stabilising in the outer years of this exercise. However, the overall level of debt remains relatively low, standing at 36.1% in 2028.

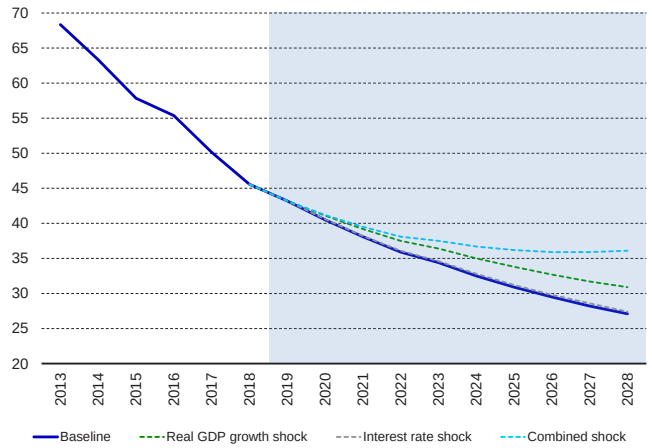
Owing to the low level of interest rates at the start of the forecast period, an interest rate shock is expected to exert a negligible impact on the debt. On the other hand, owing to the denominator effect, a pure shock to GDP growth would have a significant impact on the debt ratio, even if Government does not react to the slowdown by adopting a looser fiscal policy.

Scenario 2 – assuming fiscal policy reacts to changes in indebtedness

This scenario assumes that in the last six years of the projection period, Government relaxes its stance and adopts a looser fiscal policy.

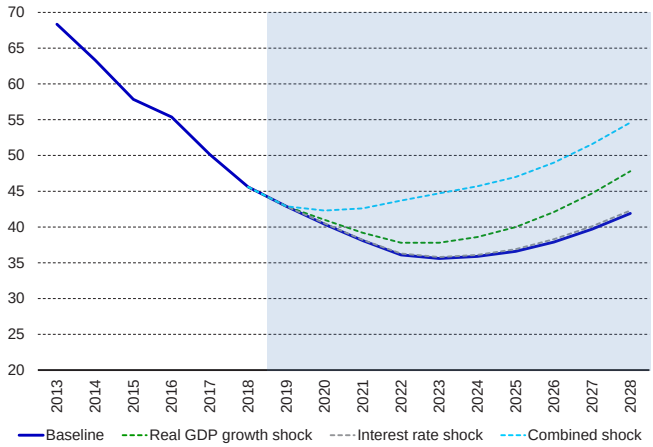
In the baseline scenario, the decline in the debt ratio halts and even reverses by the end of the forecast period. The resulting debt ratio is thus significantly higher when compared with the forecast in the baseline scenario 1. By 2028, however, the resulting debt ratio – at 41.9% – is still below the 2018 starting point (see Chart 2).

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



Source: Author's calculations.

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



Source: Author's calculations.

In line with the forecast shocks under scenario 1, shocks to real GDP growth and the combined shock exert the largest impact on the debt ratio profile. In the event of a combined shock, the debt-to-GDP ratio reaches 54.6% of GDP by 2028. In this scenario, the debt ratio is expected to remain below the 60% threshold referenced in the Stability and Growth Pact (SGP). However, since the underlying fiscal balance is assumed to deteriorate significantly over time, the debt-to-GDP ratio is expected to embark on an upward path from 2021, ending the extended forecast horizon above the 2018 ratio.

This scenario thus showcases the importance of adhering to prudent fiscal targets, as set out in the SGP, and the importance of retaining sufficient buffers to deal with adverse economic shocks.

Heat map of indicators

This section assesses a number of indicators which, according to the literature, are highly relevant for debt sustainability in the short and long term. The thresholds used to grade these indicators are sourced from the EC's *Fiscal Sustainability Report* and the *Debt Sustainability Monitor* series. The threat each indicator poses to the debt ratio is colour coded – red indicates a high threat, yellow indicates a medium threat and green signals a low threat to sustainability. The heat map is presented in Table 1.

Table 1
HEAT MAP

	2014	2015	2016	2017	2018
Structure of debt					
Share of short-term debt					
Change in share of short-term debt (y-o-y)					
Share of foreign currency denominated debt					
Share of debt with variable interest rate in GDP					
Share of debt held by non-residents					
Liquidity risks					
Gross financing needs (% of GDP) (High/Low risk)					
Net financing needs (% of GDP)					
10-year government bond spread over German Bund					
Macro-financial risks					
Private sector debt (% of GDP)					
Private credit flow (% of GDP)					
Net international investment position (% of GDP)					
Share of NPLs to gross loans: core banks					
Change in share of NPLs (core banks) (y-o-y)					
Bank loans-to-deposits ratio (core banks)					
Change in nominal house prices (y-o-y)					
Competitiveness risks (High/Low risk)					
Unit labour costs (% change over 3 years)					
Real EER (% change over 3 years)					
Current account balance (3 yr average as % of GDP)					
Export market shares (% change over 5 yrs)					
Implicit/contingent risks					
Commission Ageing Report: 2016-2070 ageing costs (pp of GDP)					
General government guarantees (% of GDP)					

Source: Author's calculations.

Overall, risks surrounding the structure of debt and liquidity risks are limited. In 2018, the share of short-term debt in the total debt developed into a medium threat, as opposed to it being a low threat in recent years. This is mainly due to new issues of 62+ Government Bonds during that year. According to ESA methodology, these bonds are classified as deposits and are consequently considered as short-term debt. However, there are no significant risks related to financing of debt in the immediate term. In fact, existing deposits held by the Government, which form part of the financial assets held by Government, are more than enough to finance debt with a maturity of less than one year.

From a macro-financial perspective, the main risks to debt sustainability stem from the elevated share of NPLs in the total loans extended by the core domestic banks compared with the applicable threshold. Nevertheless, it is encouraging to note that this share remained on a declining path in 2018, and continued to decline further in 2019 to its lowest ever value. This partly reflects cyclical factors, but also de-risking measures by Maltese banks.

Implicit liabilities, in the form of ageing costs (pensions, healthcare and long-term care), form another significant risk to sustainability. According to the Commission's latest *Ageing Report* projections, at 6.8 points, Malta is set to have the second highest increase in age-related spending in the European Union between 2016 and 2070. This is 5.6 percentage points higher than the EU average. However, Malta's current spending on social security as a proportion of GDP is currently well below the EU average and is expected to remain so till at least 2040.[4]

Government-guaranteed debt in Malta has been relatively high over the past couple of decades. In 2018, it stood at 8.7% of GDP. While lower than in 2017, this ratio remains one of the highest in the euro area. Moreover, a significant portion of such debt is concentrated in the energy sector.[5]

Assumptions and technical information

Scenario analyses: scenario specific assumptions
In scenario 1, forecasts for macro and fiscal items between 2020 and 2022 are in line with the Government's 2020 Budget and Draft Budgetary Plan. The primary balance path post-2022 is set such that, overall, the structural balance net of IIP receipts remains in surplus.[6]

In scenario 2, forecasts for macro and fiscal items in the period 2020-2022 are partly based on the Bank's latest forecasts.[7] Subsequently, the primary balance is assumed to react to previous years' debt levels and the output gap according to parameters estimated by a fiscal reaction function.[8]

Scenario analyses: common assumptions
The following assumptions hold for both scenarios, from 2023 onwards:
Real GDP growth is set to grow in line with the forecast structural primary balance and potential output growth. The growth is therefore determined by the fiscal multiplier – i.e. the degree to which fiscal

[4] In Malta, spending on social benefits excluding those in kind amounted to 8.9% of GDP in 2018, whereas the figure for the EU average stood at 15.6%.
[5] See National Audit Office Malta (2019) "Annual Audit Report: Public Accounts 2018" for further details.
[6] IIP revenue is forecast separately and is assumed to decline gradually over time, until the cap on naturalised applicants is reached. It is then assumed that a new, more restrictive Programme is set up, such that its impact on the fiscal balance is minimal.
[7] This exercise was prepared before the finalisation of the Bank's Annual Report 2020 projections, and reflects economic and fiscal measures announced until February 2020. The analysis, therefore, does not take into account the impact of COVID-19 on fiscal and macroeconomic variables.
[8] Fiscal reaction functions are based on the idea that fiscal policy is likely to react to changes in the debt ratio, with governments generally counteracting rising debt levels by improving the primary balance, and vice-versa. In this exercise, the function is estimated under an error-correction framework, in which the long-run reaction of the primary balance to the debt ratio is also conditioned by short-term changes in lagged public debt and the output gap. The regression results provide evidence of a positive and significant fiscal reaction to rising indebtedness.

policy affects economic growth – and the output gap, which eventually closes. For further details, refer to the 2018 *Annual Report* Box.

Inflation, which in this box is measured by growth in the GDP deflator, is assumed to remain at just below 2.0%, in line with the ECB's target for inflation over the medium term.

Meanwhile, the level of DDAs is assumed to revert to its long-run average. No temporary fiscal measures are assumed to take place throughout the extended forecast horizon.

Government debt is forecast on the basis of different types of maturity. The share of each category of debt is assumed to be in line with its long-run average. Interest payment projections are based on separate interest rate estimates, applied to each maturity category.

The forecast path of interest rates is based on ECB assumptions for the EURIBOR (used to determine interest payments on short-term debt) and the 10-year yield on Malta Government Bonds (used to determine interest payments on rolled-over long-term debt).[9] Interest rates on non-maturing debt are based on the maturity profile of Malta Government Bonds outstanding at end-September 2019.

Scenario analyses: shocks
Permanent shocks to GDP growth and interest rates are based on the standard deviation of historic data, similar to the approach used by the IMF in its Article IV Missions. On average, compared with the baseline scenarios, the shocks translate into a 1.5 percentage point decrease in the yearly real GDP growth and a 0.9 percentage point increase in the interest rates.

Combined permanent shock scenarios are calibrated such that real GDP growth and interest rates each change by 1.0 percentage point. This is in line with the method adopted by the EC in its shock scenarios.

The forecast path for the main determinants of debt is shown in Table 2, while the nature of shocks is shown in Table 3.

Table 2
SCENARIO ASSUMPTIONS: MAIN DETERMINANTS OF DEBT
Per cent

	Baseline scenario 1		Baseline scenario 2	
	2020-2022 average	2023-2028 average	2020-2022 average	2023-2028 average
Real GDP growth rate	3.6	3.7	3.6	3.7
Inflation (GDP deflator growth rate)	1.9	1.9	2.1	1.9
Interest rate applied to				
Short-term debt	-0.3	0.2	-0.3	0.2
Long-term debt maturing within a year	0.2	0.8	0.2	0.8
Non-maturing long-term debt	3.7	3.9	3.7	3.9
DDAs (% of GDP)	1.1	0.7	1.2	0.7
Primary balance (% of GDP)	2.5	1.5	2.4	-1.0

Source: Authors' calculations.

[9] The euro area interest rate projections were provided by the ECB as part of the common set of assumptions underlying the Eurosystem's March 2020 Eurosystem staff projections.

Table 3
PERMANENT SHOCKS APPLIED TO BASELINE SCENARIOS

	Real GDP shock	Interest rate shock	Combined shock
Nature	Lower GDP growth	Higher interest rates on short-term and maturing debt	Primary balance reacts to lower GDP growth and higher interest rates on short-term and maturing debt
Magnitude	1/2 standard deviation of historic real GDP growth	1/2 standard deviation of interest rates on maturing debt	1 percentage point impact on GDP growth and interest rates
Impact on debt ratio	Denominator effect (debt level held constant but GDP declines)	Numerator effect (higher coupon payments but no offsetting fiscal consolidation)	Numerator and denominator effects (worsening nominal balance and lower GDP)



II. Bank Policies, Operations and Activities



1. THE CONDUCT OF MONETARY POLICY AND FINANCIAL MARKET OPERATIONS

Monetary policy operations

As part of the Eurosystem, the Central Bank of Malta implements the monetary policy decisions of the ECB in Malta.[1] Thus, the Bank regularly conducts open market operations with credit institutions established in Malta. It also offers standing facilities, administers the minimum reserve system and participates in the APP.

Open market operations

Standard monetary policy measures include open market operations, aimed at managing the level of liquidity in the money market and at steering short-term market interest rates close to the official rates of the ECB. The Eurosystem has various types of open market operations at its disposal.

The MROs are short-term liquidity-providing reverse transactions, which are executed according to a pre-specified calendar. They take place on a weekly basis with a maturity of one week. The Eurosystem also conducts LTROs, which consist of reverse transactions at a monthly frequency and with a normal maturity of three months.

Throughout 2019, the Eurosystem continued to offer liquidity to eligible credit institutions via fixed-rate tender procedures with full allotment, through both MROs and LTROs.

During 2019, the ECB conducted 52 MROs. In the context of ample excess liquidity, credit institutions established in Malta participated only once in the MROs with an amount of €1.0 million whereas there was no participation in such operations in 2018 (see Table 1.1).

The ECB also conducted 12 regular three-month LTROs with full allotment and at a fixed rate equal to the average of the MRO rate during the lifetime of the operations. Similar to 2018, credit institutions established in Malta did not participate in the three-month LTROs during 2019 (see Table 1.1).

In March 2019, the Governing Council of the ECB announced the third series of quarterly TLTRO-III starting in September 2019 and ending in March 2021. The maturity of TLTRO-III operations is three years as of their respective settlement date. Counterparties are able to repay the amounts borrowed under TLTRO-III earlier than their final maturity, at a quarterly frequency starting two years after the settlement of each operation. The interest rate on TLTRO-III is equal to the average rate applied to the Eurosystem's MROs over the life of the respective TLTRO-III operation. For counterparties whose eligible net lending exceeds a benchmark, the rate applied in TLTRO-III operations will be lower. It can be as low as the average interest rate on the deposit facility prevailing over the life of the respective TLTRO-III operation. The first two TLTRO-IIIs were conducted in September and December 2019. As illustrated in Table 1.1, credit institutions established in Malta borrowed a total of €40.0 million in the TLTRO-IIIs held in 2019.

Furthermore, during 2019, credit institutions established in Malta also repaid outstanding balances from the second series of TLTROs for an amount of €80.0 million.

[1] For a description of the monetary policy decisions taken by the Governing Council, please refer to the Chapter titled "The euro area and the external environment", which can be found in Part 1 of this *Report*.

Table 1.1
PARTICIPATION OF ELIGIBLE MALTESE CREDIT INSTITUTIONS IN EUROSYSTEM OPEN MARKET OPERATIONS

EUR millions

Type of operation[1]	2018	2019
MROs	-	1.0
LTROs		
- Three-month LTROs	-	-
- TLTRO-III	N/A	40.0
US dollar collateralised operations (USD millions)		
- Seven-day	1,438.1	1,359.3

[1] In these Eurosystem operations, the amounts shown are the amounts allotted. These are equivalent to the amounts bid, owing to the full allotment policy.

During 2019, the ECB continued the weekly provision of US dollar liquidity-providing operations with a one-week tenor through collateralised lending in conjunction with the US Federal Reserve. During the year under review, credit institutions established in Malta participated regularly, for a total cumulative amount of $1,359.3 million, which was lower than the amount they took up in the previous year.

Standing facilities

Eligible counterparties may utilise two standing facilities on their own initiative, either to obtain overnight liquidity against eligible collateral or to place overnight deposits with the Eurosystem.

In the context of elevated excess liquidity in the domestic banking system during 2019, counterparties continued to place excess funds with the Eurosystem through the overnight deposit facility. Recourse to this facility by Maltese credit institutions amounted to a daily average of €1,015.8 million in 2019, a decrease of €2,494.3 million compared to the 2018 average. This decrease is mainly attributable to a shift in deposits at the beginning of the year by one credit institution from the overnight deposit facility to its current account and the introduction of the two-tier system for the remuneration of excess reserves in the last quarter of 2019 (explained in detail below), with credit institutions shifting their balances to their current accounts held with the Bank. On the other hand, Maltese credit institutions did not use the marginal lending facility in 2019, compared to a total amount of €11.4 million utilised in 2018.

The rates on the MROs and on the marginal lending facility remained unchanged throughout the year at 0.00% and 0.25% respectively. However, the Governing Council decided to lower the deposit facility rate by 10 basis points from -0.40% to -0.50% with effect from 18 September 2019.

Reserve requirements

The ECB requires credit institutions established in the euro area to hold reserve deposits with their respective NCB. The objective of the Eurosystem's minimum reserve system is to contribute to the stability of money market interest rates and to help ensure the efficient operation of the Eurosystem as a liquidity supplier. Each credit institution established in Malta is accordingly obliged to hold minimum reserve deposits, equivalent to a fraction of certain liabilities, mainly deposits, with the Central Bank of Malta. During 2019, this reserve requirement ratio remained unchanged at 1.0%. The average balance held as minimum reserve deposits in 2019 amounted to €306.5 million compared to €303.6 million in 2018.

On 12 September 2019, the Governing Council announced the introduction of a two-tier system for reserve remuneration, starting from 30 October 2019, which exempts part of credit institutions' excess liquidity holdings from the negative deposit facility rate. The two-tier system applies to excess liquidity held in current accounts with the Eurosystem but does not apply to deposit facility holdings. The volume of reserve holdings in excess of minimum reserve requirements that will be exempt from the deposit facility rate is determined as a multiple of an institution's minimum reserve requirements. The multiplier, which is currently set at six,

is determined to ensure that euro short-term money market rates are not unduly influenced. The multiplier may be adjusted by the Governing Council in line with changing levels of excess liquidity holdings. The size of the exempt tier is calculated on the basis of average end-of-calendar-day balances in the institutions' reserve accounts over a maintenance period. The exempt tier of excess liquidity holdings is remunerated at an annual rate of 0% while the non-exempt tier of excess liquidity holdings will continue to be remunerated at 0% or the deposit facility rate, whichever is lower.

APP

Throughout the year, the Central Bank of Malta participated in the PSPP, which is part of the APP. During 2019, the Bank purchased €63.3 million worth of Maltese sovereign bonds. This was a lower amount than what was bought during 2018, mainly because the PSPP entered the reinvestment phase at the beginning of January 2019. As a result, for most of the year, the Bank's purchases were aimed at rolling over maturing debt securities held in the PSPP portfolio.

However, on 12 September 2019, the Governing Council decided to resume net purchases as of 1 November 2019 at a monthly pace of €20.0 billion.

Since inception, the total securities purchased by the Bank for its PSPP portfolio amounted to €1,105.5 million[2] at the end of the year. The Bank's holdings had a weighted average remaining maturity of 9.68 years as at the last trading day for December 2019.

During the year, the Bank also purchased €17.3 million worth of Maltese sovereign bonds that were transferred to the ECB's own PSPP portfolio, with total securities bought since inception in this portfolio amounting to €203.3 million.[3]

The Bank did not participate in the private-sector programmes, which also form part of the APP, owing to the lack of eligible securities in the domestic markets.

Collateral management

All Eurosystem credit operations take place against collateral. The Central Bank of Malta is responsible for assessing the eligibility of domestic marketable securities that can be used as collateral in Eurosystem monetary operations and for reporting them to the ECB. As at end-December 2019, the nominal outstanding value of eligible domestic marketable assets amounted to €5,069.4 million, compared with €5,182.7 million a year earlier.

At the end of the year, the market value, after haircuts, of securities pledged by eligible Maltese counterparties with the Central Bank of Malta stood at €343.1 million. This consisted of both domestic and foreign securities, though debt instruments issued by the Maltese Government accounted for the bulk of the securities pledged.

On 13 May 2019, among other decisions related to the implementation of monetary policy, the ECB announced that the possibility of using theoretical valuation for credit claims pledged as collateral will be removed from the general framework. This implies that credit claims will be valued at the outstanding amounts. The ECB also amended the criteria for own-use of covered bonds. In fact, as from 1 February 2020, covered bonds must have an external credit assessment institution rating to be eligible for own-use.

Liquidity management

The Bank continued to provide the ECB with daily forecasts of items on its balance sheet that are unrelated to monetary policy instruments, such as banknotes in circulation, government deposits, net foreign assets

[2] This figure does not reflect the amortisation of securities held under the PSPP portfolio. Purchases of securities which matured between 2017 and 2019 are also included in this figure.

[3] This figure does not reflect the securities' amortisation under the ECB PSPP portfolio. Purchases of securities which matured between 2017 and 2019 are also included in this figure.

and net assets denominated in euro. This information enables the Eurosystem to determine liquidity needs, even if the current full allotment policy ensures ample liquidity.

Euro short-term rate (€STR)

On 2 October 2019, the ECB started publishing the €STR which reflects the wholesale euro unsecured overnight borrowing costs of banks located in the euro area as reported under the Money Market Statistical Reporting. This rate is published on each TARGET2 business day based on transactions conducted and settled on the previous TARGET2 business day.

Furthermore, as from 2 October 2019, the administrator of EONIA, the European Money Markets Institute, changed the EONIA methodology so that, until its discontinuation on 3 January 2022, it will be determined as a fixed spread of 8.5 basis points over the €STR.

Reserves management

The Central Bank of Malta manages an investment portfolio of nearly €2,300.0 million, comprising both euro and foreign currency denominated assets. The EUR portfolio represents approximately 65% of assets under management, while the remaining 35% is predominantly invested in US dollar denominated securities, with smaller exposures to other currencies including the Australian dollar, Canadian dollar, Pound sterling, Swedish krona, Norwegian krone, Japanese yen and Swiss franc. The investment portfolio comprises money market instruments, fixed income securities, derivatives and gold. The fixed income asset classes include sovereign bonds, securities issued by supranational and national government agencies, bank covered bonds and senior unsecured debt. The Bank holds both held-to-maturity as well as actively managed fixed income portfolios. A relatively smaller part of the Bank's assets under management are managed through three external mandates.

The scope of the Investments Policy Committee (IPC) is to set the investments policy upon which the management of the Bank's financial assets will be based with a view of optimising returns, subject to prudent risk management practices, as specified in the mission statement. The IPC monitors the performance of the Bank's financial assets, evaluates the implementation of investment strategies, reviews reserve-management practices and assesses the overall investment policy. The Committee, which is chaired by the Governor and includes the Deputy Governors and senior officials of the Bank, met on a monthly basis during 2019. Additional meetings were held to address pressing issues as they arose.

Proposals relating to parameters or the investment universe and the respective impact on the Bank's profitability were discussed with a view to setting the Strategic Asset Allocation at the beginning of the year. The investment proposals and changes to the risk parameters agreed upon for 2019 were approved by the Bank's Board of Directors. The Committee is also responsible to set the Tactical Benchmark for the actively-managed funds on a monthly basis. Furthermore, during 2019, a number of amendments to internal risk parameters, gold holdings and external managed mandates were made with a view to strengthen the Bank's own reserve management capacities, particularly in the light of persistently low and negative yielding environment.

Since the start of 2019, the Bank has experienced a reduction in the size of the held-to-maturity portfolios due to the low and negative yielding environment in the EUR universe. The Bank closed one of its externally managed funds in Q1 2019, while making changes to the sizes of others. The Bank continued its investment in the Bank for International Settlements Investment Pool Sovereign China Fund. During the year, in order to diversify further its portfolio, the Central Bank of Malta increased its gold holdings.

The Bank continued to co-manage its portion of US dollar reserves on behalf of the ECB by way of a pooling mechanism jointly with the Central Bank of Ireland. During the year, the International Asset Management Office worked closely with the Central Bank of Ireland to review the investment strategy, discuss trades and analyse the portfolio's performance. The Bank continued to transmit to the ECB information on its foreign-exchange transactions and holdings as well as on the EUR denominated portion of the investment portfolio. The Bank duly participated in ERMII test interventions as directed by the ECB.

The Bank continued to enter into spot/outright foreign currency purchases and foreign exchange (FX) swap purchases and sales. When compared to the previous year, both the spot and outright foreign currency purchases and sales decreased. In contrast, FX swap purchases continued to increase while FX swap sales decreased.

The Bank continued to manage the funds pertaining to the Investor Compensation Scheme and Depositor Compensation Scheme on behalf of the Malta Financial Services Authority (MFSA). During the year, the Bank also continued to fulfil its obligations resulting from its agreement with the National Development and Social Fund to administer part of the latter's portfolio.

Within the framework of its efforts towards Sustainable and Responsible investing, the Bank will consider investing in Environmental, Social and Governance compliant funds as early as 2020.

In July 2019, the Bank joined the NGFS. The NGFS is a group of central banks and supervisors from around the world that aim to strengthen the role of the financial system to manage risks and to shift capital towards green and low carbon investments. Moreover, throughout 2019 the Bank also contributed towards the launch of the Bank for International Settlements (BIS) Green Bond Fund while being an active member in the BIS Green Bond Fund Advisory Board.

Market-making operations

The Central Bank of Malta, through the Government Securities Office, continued to provide market-making facilities by quoting daily bid and offer prices for the listed MGSs on the MSE.

The Bank remained the main market player in the Maltese sovereign bond market when compared with the other individual stockbrokers. In fact, the Bank's market-making function effected approximately 55.0% of the total on-exchange deals, while the inter-brokers effected the remaining 45.0%.

Overall, turnover activity in MGSs increased in 2019, when compared to the previous year. In nominal terms, the Bank's market-making function effected a total of €132.9 million (€78.0 million purchases; €54.9 million sales), which is considerably higher than the €93.4 million registered in 2018. Inter-broker dealing also increased noticeably from €91.4 million in 2018 to €108.8 million in 2019.

There was no secondary market activity in the Treasury bill market.

As part of its mandate, the Bank is obliged to provide liquidity in the MGS market. The Bank bought MGSs on offer at the prevailing Central Bank of Malta price or lower, while putting on offer MGSs in order to provide two-way trading. The Bank also acted as an agent on behalf of public institutional clients.

The Bank assisted the Treasury in choosing which maturities and coupons to offer in the primary market in order to attract sufficient demand while at the same time, limiting the refinancing risk to the lowest possible levels. Furthermore, the Bank was involved in analysing and presenting the technical aspects of potential additional avenues for financing other than the prevailing MGSs.



2. FINANCIAL STABILITY

The Financial Stability Departments, namely the Financial Stability Surveillance & Research Department, and Policy, Crisis Management & Stress Testing Department, fulfil the Central Bank of Malta's statutory mandate of ensuring financial stability through ongoing assessments of developments within the financial sector and the implementation and maintenance of the macroprudential framework in Malta. The surveillance and assessment of the Maltese financial sector is also backed by stress tests and sensitivity analyses to gauge the level of vulnerabilities and the resilience of the system to potential severe shocks.

Main developments

During the year, the Bank has been very active in the strengthening of the domestic macroprudential policy framework and its risk assessment capabilities.

Following a public consultation, the Central Bank of Malta Directive No. 16 on the Regulation of Borrower-Based Measures (BBMs) came into force in July 2019. The Bank received feedback from a number of stakeholders and in February 2019, the Bank jointly with the MFSA held a meeting with them to discuss new amendments to the proposed Directive. It sets a number of measures aimed at mitigating the potential build-up of vulnerabilities in the residential real estate market by strengthening the resilience of both lenders and borrowers. The Directive complements the banks' existing credit risk management practices and is not intended to replace their existing policies. The Bank issued a set of Frequently Asked Questions to assist lenders in ensuring full compliance with the Directive.

The Bank issued a public consultation on the revised methodology for the identification of O-SIIs and the related capital buffer calibration.[1] The new framework further aligns the domestic methodology with the EBA's Guidelines while capturing recent developments within the domestic banking sector.[2] The revised methodology came into force in January 2020.

The CCyB, aimed at attenuating excessive credit growth, remained unchanged at 0% throughout 2019. This decision was supported by a persistently negative credit-to-GDP gap and the assessment of supplementary indicators. In the meantime, the capital conservation buffer was fully-phased in, with banks required to hold an additional capital of 2.5% of risk weighted assets.

In line with the ESRB's Recommendation 2015/1, the Bank carried out its annual exercise to identify material third countries, in terms of asset exposure, for the Maltese banking system. Furthermore, as the macroprudential authority, the Bank analysed requests for the reciprocation of macroprudential measures implemented by Finland, Belgium and Sweden. The Bank decided not to reciprocate such measures as these targeted banks using Internal-Ratings Based models, which are not used by credit institutions licensed in Malta.

During 2019, the Bank's stress testing toolkit was enhanced further in part to address the recommendations put forward by the IMF in the context of the 2018 Financial Sector Assessment Programme (FSAP) for Malta. The methodology together with the results also featured in the *Financial Stability Report* 2018.[3]

1 The public consultation closed on 8 November 2019.
2 EBA/GL/2014/10
3 https://www.centralbankmalta.org/financial-stability-report

The IMF's FSAP was concluded in 2019 with the publication of the Financial System Stability Assessment (FSSA) in February of that year.[4] This document provides a summary of the IMF's assessment of the Maltese financial sector and puts forward a set of recommendations related to micro- and macroprudential issues to relevant authorities. In November 2019, the IMF published six Technical Notes on Macroprudential Policy, Risk Analysis, Insurance and Securities Sector Supervision, Banking Supervision, Bank Resolution and Crisis Management, and Anti-Money Laundering (AML) and Combating the Financing of Terrorism, to provide additional background information and analyses.

The Bank, in collaboration with the ECB, conducted four rounds of the BLS to monitor developments in lending standards and credit demand by non-financial corporates and households. The survey is conducted among the four large core domestic banks capturing about 93% of domestic lending. Survey results were published in a box in the Bank's latest *Financial Stability Report*. Three domestic credit institutions have also participated in the EBA's Annual EU-Wide Transparency exercise, with individual bank data also published on the EBA's website.[5] Furthermore, the domestic significant institutions formed part of the Single Supervisory Mechanism (SSM)/ECB Banking Supervision's 2019 sensitivity analysis on LiST.[6]

During the year, the Bank continued to follow and advise Government on legislative and regulatory developments specific to financial stability. One such area was the consultation on the Risk Reduction Measures package, which incorporates the Capital Requirements Regulation (CRR), the Capital Requirements Directive (CRD) IV, the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR). This package was published in the Official Journal of the European Union (EU) on 7 June 2019. The amended CRDIV (CRDV) and the amended CRR (CRR2) entered into force on 27 June 2019 and will apply from 29 December 2020 and 28 June 2021, respectively. The BRRD and SRMR came into force on 27 June 2019 and will apply in December 2020.

Committee meetings at the domestic and European levels

The Bank's Financial Stability Committee (FSC) met three times in 2019. Besides these sittings, the Committee members were also formally consulted on a number of financial stability related matters.[7] Discussions also covered the publication of the *Financial Stability Reports*, the methodologies for the categorisation of banks, the revised methodology for the identification of O-SIIs, the assessment of material third countries and the framework for voluntary reciprocity of measures by other member states.

The JFSB met three times in 2019 to discuss specific developments in the financial sector and to provide recommendations to the regulatory authorities such as the level of the CCyB and a number of policies including the BBMs and O-SII methodology.[8]

The Forum for Financial Stability was held in December 2019. Cyclical risks in Malta, the CCyB as well as other macroprudential policy tools were discussed. The FSC's decisions were also communicated to stakeholders. The Malta Bankers' Association (MBA) was also invited to discuss its members' experience with the BBMs following their implementation six months earlier.

The Domestic Standing Committee and its permanent task force, the Crisis Management Task Force, continued working on updating the Domestic Crisis Management Framework. The Framework sets out the

4 https://www.imf.org/en/Publications/CR/Issues/2019/02/27/Malta-Financial-System-Stability-Assessment-46636
5 https://eba.europa.eu/risk-analysis-and-data/eu-wide-transparency-exercise
6 https://www.bankingsupervision.europa.eu/press/pr/date/2019/html/ssm.pr191007_annex~537c259b6d.en.pdf
7 The FSC is chaired by the Governor and includes the two Deputy Governors, the Chief Officer Economics, the Chief Officer Financial Control and Risk, the Chief Officer Financial Stability, the Head Financial Stability, Policy and Crisis Management, Stress Testing and Risk Models, and the Head Financial Stability Surveillance and Research.
8 The JFSB is chaired by the Governor and includes two other representatives of the Bank and two representatives of the MFSA. The Minister for Finance and Parliamentary Secretary for Financial Services, Digital Economy and Innovation attend the meetings as observers. The objective of the JFSB is to establish a co-ordination platform between the Bank and the MFSA to formulate macroprudential policy and to contribute to the safeguard of the stability of the financial system in Malta. During 2019, the FIAU was represented as an observer upon the request of the Governor as chair of the JFSB.

structure and high-level principles and procedures that guide the Authorities in the event of financial crises. Meetings also focused on the resolution status of domestic banks and the Depositor Compensation Scheme.

At a European level, senior Bank officials participated in 44 meetings of the ESRB and the ECB, and their sub-structures. Furthermore, several meetings on financial stability issues were held with the IMF, the EC in the context of the European Semester and credit rating agencies.

Future developments

During 2020, a number of initiatives are expected to take place including the enhancement of risk identification and stress testing. Amendments to Central Bank of Malta Directive No. 11 in line with the revised Basel III Framework are also envisaged. Furthermore, the Bank in conjunction with other authorities will continue its work to bridge the gaps in real estate data as well as to monitor the domestic banks' compliance with Directive No. 16 and assess the impact of such measures.[9]

[9] https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation190819_ESRB_2019-3~6690e1fbd3.en.pdf



3. ECONOMIC ANALYSIS AND RESEARCH

The Central Bank of Malta monitors and assesses economic developments and prospects in support of its key policy-making function. At the same time, the Bank carries out economic research, and develops and maintains a suite of econometric models.

Staff provided input for the monetary policy process by briefing the Governor ahead of his participation in the Governing Council and the General Council of the ECB, as well as in relation to contacts with external bodies, such as the EC, the IMF and credit rating agencies.

Four projection exercises were conducted, two of which were undertaken as part of the Eurosystem's Broad Macroeconomic Projection Exercise. Further work was carried out to update the Bank's core macro-econometric model and enhance other tools used in the forecasting processes. The commentary on the Bank's projections also began to feature short boxes on specific aspects related to forecasting. Issues addressed in 2019 included the recent evolution of import shares, the implications of increases in food prices for the projections, the long-term development of participation rates, the approach used to forecast selected fiscal variables, and the economic impact of Brexit under different scenarios. Staff also continued to meet regularly with companies' representatives and public sector institutions to obtain a better gauge of economic conditions and prospects.

The Bank published its analysis of domestic and foreign economic and financial developments in its *Quarterly Review* and *Annual Report*.[1] Apart from commenting on official statistics, these publications include commentaries on a number of internally developed indicators, including the Bank's estimate of potential output, its BCI, a measure of structural unemployment, the FCI as well as cyclically-adjusted fiscal and current account balances. Moreover, the Bank continued to publish a monthly *Economic Update*.

The Economic Analysis Department worked closely with statistical compilers in other institutions and participated in the work of the ECB's Statistics Committee. Following the validation of data collected in the 2017 wave of the Household Finance and Consumption Survey (HFCS), the Bank published the main results for Malta.[2] Selected information from the HFCS was also combined with official data in studies on consumption patterns and on the distribution of income and wealth in Malta. The Bank and the NSO agreed on a detailed action plan for the conduct of the fourth wave of this survey.

Bank staff undertook specialised research which resulted in four working papers, five policy notes and 18 articles in the Bank's regular publications. The working papers dealt with external trade, house prices and inequality. As mentioned above, another working paper described the main findings from the HFCS, which the Bank conducted as part of a coordinated research project with the ECB and other NCBs. The policy notes focused on the length of stay of foreign workers in Malta, short term rentals, labour market participation rates, trends in business and consumer surveys, and the macroeconomic effects of closing the public sector infrastructure gap in Malta.

Research was also presented externally, both locally and abroad. Seven articles were published in foreign peer-reviewed journals, while another three featured in a local peer-reviewed journal. Staff gave input to a number of ECB task forces on the exchange rate pass through, low wages and potential output growth. Five

[1] The Bank's publications can be found at: https://www.centralbankmalta.org/publications.
[2] Further information is available at: https://www.centralbankmalta.org/en/household-finance-and-consumption-survey

presentations were delivered by staff in foreign conferences in Italy, France, Germany, Luxembourg and Greece. Another presentation was delivered during a workshop on public finance issues which the Bank organised in July, following the meeting of the ECB's Working Group on Public Finance that was held in Malta.

In 2019, the Bank organised its second Annual Research Symposium. Two external speakers from Banca d'Italia and the BIS delivered presentations on macroprudential policies and cybersecurity risks, respectively. Two economists from the Research Department discussed the latest structural modelling activities at the Bank. During this workshop, the Bank launched its second *Research Bulletin*, with articles on the re-estimation of the Bank's econometric model, a structural model with housing and credit frictions, hedonic house prices and the key findings from the HFCS.

The Bank also continued to offer a number of public lectures in economics and finance. All four lectures were delivered by foreign speakers and dealt with uncertainty, competitiveness, the impact of Brexit on businesses and inflation targeting.

The Bank held regular internal seminars and in 2019, four of these were delivered by speakers from outside the Bank, including by three foreign academics and another one by an academic from the University of Malta. The foreign academics were from the University of Edinburgh, the University of San Diego and the University of Macerata. One academic from the United States was hosted by the Bank as a Fulbright Scholar, which was funded by the US Embassy in Malta.

Staff members presented their research to external stakeholders, such as the Malta Developers Association, the Building Industry Consultative Council and the Malta Tourism Authority. These presentations focused on the housing market and short-term rentals. Staff represented the Bank in the newly established National Productivity Board, as well as in the Advisory Committee and Property Working Group of the Building Industry Consultative Council.

In collaboration with Queen Mary University of London (QMUL), the Bank organised an intensive three-day course on Bayesian econometrics. This initiative forms part of an agreement signed by the Bank with QMUL, which also paves the way for joint research collaboration, internship and visiting exchange programmes.

The Bank also participated in a session on *Innovating Finance for Sustainable Growth* in the context of the Malta-Africa Dialogue. This is an informal round table that brings together representatives of Government and industry, as well as international financing institutions with the aim of fostering closer economic links and co-operation between Malta and African states.

Research plans for 2020 include studies on particular aspects or sectors of the Maltese economy, demographics, migration, macro-financial linkages and fiscal policy. The Bank will continue to allocate resources to develop econometric and structural models to complement its forecasting toolkit and enhance its research capacity.



4. STATISTICS

The Central Bank of Malta is primarily responsible for the collection and compilation of statistics relating to monetary, banking, financial market, payments, securities, financial stability, financial accounts and financial institutions in Malta. For internal policy-making purposes, the Bank also collects other statistical information such as prudential supervisory and macroeconomic statistics. These statistics are regularly updated on the Bank's interactive website and are also used by public authorities, financial market participants, the media and the public. The Bank also contributes to the compilation of the balance of payments (BoP)/international investment position statistics in cooperation with the NSO. The Bank fulfils international statistical reporting obligations, mainly to the ECB and the IMF. It also participates in the Fund's Special Data Dissemination Standard and the General Data Dissemination System, and in various surveys conducted by the IMF. Officials from the Statistics Department also participated in the Fund's Article IV mission meetings including the technical follow-up of the 2018 FSAP mission on data matters.

The Bank continued to operate its CCR so as to provide both credit institutions and natural and legal borrowers with access to borrowers' credit risk information. This is in line with Directive No. 14 which empowers the Bank to organise and operate the Register in pursuit of its objectives regarding financial system stability, monetary policy research and analysis, and the processing of statistical information. The Malta Development Bank was given access to the Bank's register for it to carry out client assessments. The availability of such a register in Malta also addresses a key requirement of the World Bank in its *Doing Business* report. The queries on prospective and existing clients by credit institutions increased by 8% in 2019 when compared to the previous year. Meanwhile, the Bank continued to prepare the necessary legal, technical and organisational requirements to cater for the Bank's regulatory and supervisory role of credit reference agencies (CRAs), meetings with prospective licence holders, and stakeholders pursued.

Participation in other Eurosystem-related work continued to increase with the operational phase of the ESCB's Anacredit project, aimed at providing a harmonised set of credit and credit risk data across participating euro area countries. In the meantime, the Bank continued to enhance the data quality of the Maltese securities' data held within the ECB's Centralised Securities Database while data on securities holding statistics continued to be transmitted to the ECB on a quarterly basis.

During the year, the Bank also continued to collaborate with the NSO to enhance the BoP data quality. *From-whom-to-whom* tables, which explain the financial linkages between the country's institutional sectors, continued to be released on the Bank's website. In April, a delegation from the ECB and Eurostat visited the Bank and the NSO in the context of the quality assurance of statistics underlying the Macroeconomic Imbalances Procedure, with particular reference to the balance of payments and financial accounts statistics. The Bank and the NSO will be collaborating to follow up on the resultant recommendations.

The Bank also made the necessary preparations for the implementation of the ECB Regulation on statistical reporting requirements for pension funds, with first reporting undertaken for the reference data of Q3 2019 that were transmitted to the Bank in January 2020. A meeting with the Malta Association of Retirement Scheme Practitioners was organised to discuss the way forward, followed by a workshop for all the reporting retirement funds/schemes. The Central Bank of Malta Directive No. 5 was amended to give powers to the Bank to collect statistical information from these institutions. Meanwhile, the Bank continued to collect statistical information on insurance corporations, including European Insurance and Occupational Pensions Authority's Solvency II regulatory returns, mainly for financial stability purposes.

Collaboration with Banca d'Italia continued on the implementation of the Bank's statistical solution (INFOSTAT) in respect of a number of new processes or amendments to current ones, notably the:

(a) revised balance of payments to cater for the amended ECB Guideline;
(b) enhancement of the insurance corporations' surveys to cater for EIOPA taxonomy 2.4.0;
(c) implementation of the pension funds statistics;
(d) prudential supervisory data (i.e. FINREP/COREP returns).

In June, the Bank and Banca d'Italia jointly organised a seminar entitled *Big data and machine learning technologies in a central bank environment*. The two central banks concur on the importance of these topics and how they are shaping their environment. The seminar attracted participants from the Bank, MFSA, NSO and the University of Malta. Following this seminar, the Bank created an internal network on these areas with the aim of working on concrete and practical initiatives. The Bank will be endeavouring to collaborate further with the University of Malta on related projects.

In November, the Bank hosted a delegation from the Statistics Department of Eesti Pank to discuss items of mutual interest in the area of statistical information management/solutions. The Central Bank of Malta/Banca d'Italia (INFOSTAT) Steering Committee continued to supervise the initiatives, evaluate and resolve arising issues. In December, the two parties signed a document regulating the relationship between Banca d'Italia, as the data processor, and the Bank, as the data controller, with regards to the protection of personal data in INFOSTAT in accordance with Regulation (EU) 2016/679 (referred to as the GDPR Regulation). To enhance users' knowledge, courses in basic SQL and the use of INFOSTAT continued to be delivered, while officials from the Statistics Department attended on-the-job training at Banca d'Italia. The help-desk within the Statistics Department continued to provide on-going technical assistance and has become a single point of contact for internal and external users.

The joint Central Bank of Malta/NSO Working Group continued to meet regularly to be able to meet the ESRB's requirements as per Recommendation ESRB/2019/3 on closing real estate data gaps. The Working Group also proposed additional data needs for the Bank to be able to monitor developments following the introduction of Directive No. 16 on BBMs. An *Interim Status Report* was transmitted to the ESRB in December.

With a view to improve financial data reporting at a national and international level, the Bank and the MFSA organised a *Joint Data Coordination Group*. The Group's key objectives are to recommend policy actions on common data management and coordinate operational matters. The Bank's Statistics Committee, supported by its sub-structure, continued to meet to define and implement the policy on statistical information within the Bank. Concurrently, Bank officials participated in the Statistics Committee in ESCB and SSM composition and in its various sub-structures, which aim at developing statistics to support the various tasks of the ECB and the ESCB.



5. CURRENCY, PAYMENT SYSTEMS AND BANKING SERVICES

The Central Bank of Malta is responsible for the issue and circulation of euro banknotes in accordance with the legal framework of the ESCB, the ECB and of the Central Bank of Malta Act. The Bank issues coins on behalf of the Government through a Memorandum of Understanding. Moreover, the Bank is responsible for the regulation and oversight of the payment and securities settlement systems in Malta.

Currency operations

Currency Operations Office provides an adequate supply of banknotes and coins to meet the demand of the banking system and ensure the high quality and authenticity of the currency in circulation. All currency returned to the Central Bank of Malta is processed by ECB accredited machines. Counterfeit banknotes and coins are withdrawn while those found to be unfit for circulation are destroyed. Data on stocks and flows of banknotes and coins are reported on a daily and monthly basis to the ECB through the Currency Information System.

In terms of the obligations laid down under Central Bank of Malta Directive No. 10, Currency Operations Office monitors recycling activities performed by commercial banks and other professional cash handlers. Annual monitoring tests are done on banknote handling machines and other monitoring checks are undertaken on an ad-hoc basis at branches of commercial banks.

The Currency Operations Office analyses banknotes and coins suspected to be counterfeit and also provides expert evidence related to counterfeit currency in terms of the obligations laid down under Article 54 of the Central Bank of Malta Act (Cap. 204).

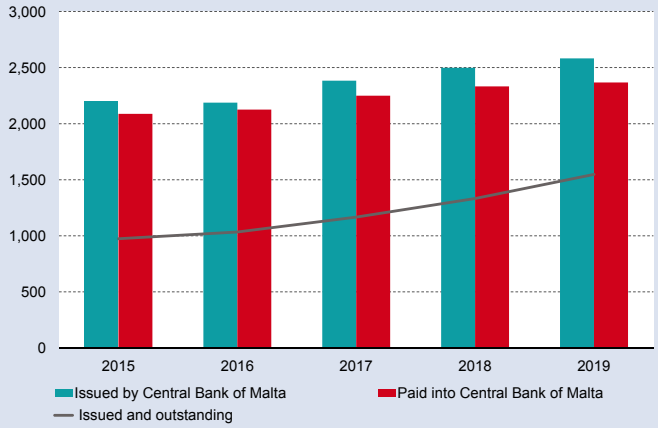
Circulation of notes and coins

During 2019, the notes inspected by the Bank numbered 99.2 million compared with 100.1 million in 2018. The inspected notes had a value of approximately €2,379.4 million, €44.5 million lower than in 2018. The percentage of banknotes destroyed decreased from 15.2% to 13.5% in 2019.

The new €100 and €200 banknotes of the *Europa series* (*ES2*) were circulated for the first time on 28 May 2019. The €100 and €200 banknotes completed the *ES2* project.

The outstanding volume of euro coins rose by 6.9%. By the end of 2019, there were 349.3 million coins issued and outstanding, equivalent to €94.0 million. 62.4 million coins, equivalent to €36.7 million, were processed by the Bank during 2019. Between 2018 and 2019, the number of coins examined

Chart 5.1
BANKNOTES ISSUED BY AND PAID INTO THE CENTRAL BANK OF MALTA
(EUR millions)



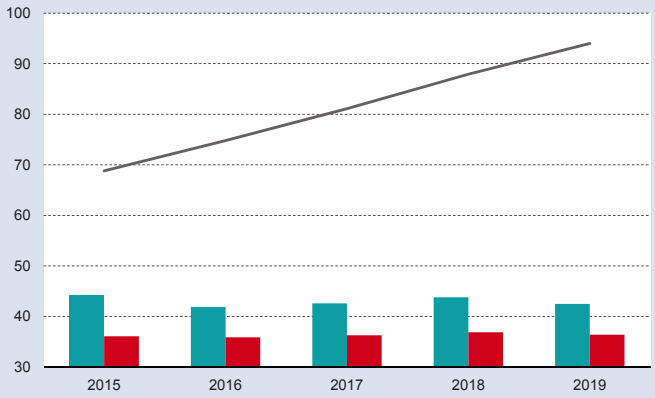
Source: Central Bank of Malta.

increased from 62.0 million to 62.4 million, a rise of 0.7%. No coins were demonetised or ceased to be exchangeable during 2019.

During 2019, the Bank continued using the Cash Single Shared Platform system as the cash management system for banknotes and for coins.

During 2019, there were no developments regarding Bank Directives in relation to cash management.

Chart 5.2
COINS ISSUED BY AND PAID INTO THE CENTRAL BANK OF MALTA
(EUR millions)



Source: Central Bank of Malta.

In 2019, Currency Operations Office continued with the certification of professional cash handlers. Various employees involved in cash handling from different credit institutions, financial institutions and casinos renewed their certificates by taking the online tests in AML and Know Your Banknotes, while a significant number of new cash handlers were enrolled in the online platform for the first time. By the end of 2019, there were 1,500 professional cash handlers enrolled.

Onsite training was provided to 231 cash handlers in different financial institutions and casinos. Training sessions were also provided to 318 cash handlers at retail outlets and 590 secondary school business students. Moreover, Currency Operations Office continued its collaboration with the Ministry for Education and Employment. During 2019, the *Money Matters* programme was offered to 660 Year six pupils together with their teachers and Learning Support Educators from all three sectors – State, Church and Independent schools.

With the introduction of the new *ES2* €100 and €200 banknotes, information sessions on the new notes were provided on six different TV and radio programmes on different stations and different time slots in order to target different audiences.

Furthermore, the Office distributed brochures and posters to an estimated 164 different retailers, governmental institutions and financial institutions. Brochures were provided to all local banks' cash handlers.

Anti-counterfeit measures

A total of 99.2 million banknotes with a value of €2,379.4 million were examined at the Note Examination Room where 86.0 million banknotes with a value of €1,990.8 million were found suitable for re-issue. 13.4 million banknotes with a value of €393.4 million were destroyed.



During 2019, a total of 62.4 million euro coins with a value of €36.7 million were examined by the Bank. There were no significant changes in the volume of coin examination from the previous year.

During the year, the Central Bank of Malta continued to monitor financial institutions and other professional cash handlers, ensuring that each cash handler is certified and trained to detect counterfeit euro banknotes. Monitoring tests were performed on each type of banknote handling machine and device held at financial institutions and other professional cash handlers. Seventy-four unannounced inspections at branches of commercial banks were also undertaken to ensure compliance with the ECB directive on authenticity and recirculation of banknotes. Data on recirculation was collected from commercial banks during the year, analysed and sent to the ECB.

Quarterly meetings with credit institutions continued to be held during 2019 to keep members updated on currency matters including developments on the counterfeit situation in the euro area. Assistance was provided to institutions or retailers with the upgrading of their machines.

During 2019, 1,389 banknotes and 453 coins were analysed and confirmed as counterfeits and the findings were uploaded into the ECB's Counterfeit Monitoring System. The Currency Operation Office personnel was also asked to provide expert evidence during ten court sittings.

During 2019, Currency Operations Office issued two press releases to inform the public on the status of counterfeit notes in the Eurosystem in general and more specifically on the local situation.

Counterfeit awareness was also raised, through participation in various television and radio programmes and also by setting up a dedicated section during the annual *Notte Bianca* event.

Payment and securities settlement systems

The Bank's responsibility to carry out regulation and oversight activities stems from Article 34 of the Central Bank of Malta Act, whereby the Bank, also as part of the Eurosystem, is responsible for regulating and overseeing the operation of payment systems and securities clearing and settlement systems (SSSs). In addition to its participation in oversight assessments carried out on TARGET2, T2S and Target Instant Payment Settlement (TIPS), the Bank is responsible to oversee MaltaClear, the MSE Securities Settlement System, as well as the Malta Clearing House (MCH) which is designated as Other Retail Payment System by the ECB in the annual payment system classification exercise as indicated in the Systemically Important Payment System Regulation.

The Regulatory Technical Standards on Strong Customer Authentication and Secure Open Standards of Communication which supplement the provisions of the revised PSD2 were one of the major regulatory developments in 2019.

Such regulatory standards mandated stronger security requirements when payment service users access their payment accounts online or when initiating electronic payment transactions. As a result of such stronger security measures, credit and financial institutions were required to revamp their online portals and mobile applications as well as to phase out magnetic stripe-only payment cards.

Furthermore, credit and financial institutions offering a payment account online were also mandated to share financial data with third party providers as long as these had customer consent. This concept is usually referred to as *open banking* and will enable both current and new market players to create innovative and value-added payment services to consumers.

In 2019, the Bank held numerous meetings with market players to ensure a timely and smooth implementation of these requirements.

Following a thorough assessment together with the Bank, on 17 October 2018, the MFSA as stipulated under Article 16 of the Central Securities Depository Regulation (CSDR), issued a letter of authorisation to the MSE. During 2019 the Bank held regular meetings with the MFSA and the MSE in order to follow-up on the implementation of the issued recommendations outlined in the authorisation letter.

Moreover, as per Article 22 of the CSDR, the MFSA and the Bank are mandated to launch an annual review and evaluation process in relation to the MSE's re-authorisation. Such process was initiated in December 2019 whereby the Bank commenced the review of the relevant MSE's documentation.

In addition, to comply with the CSDR requirements, the MSE must also abide with other Eurosystem requirements set out in the General Documentation which has been nationally transposed into Central Bank of Malta Directive No. 8 as an Annex – *Eligibility criteria for the use of the Security Settlement Systems (SSSs) and links between SSSs in Eurosystem credit operations*. To this effect, Payments and Banking Department circulated a questionnaire in the last quarter of 2019 in order to assess the MSE's compliance with these requirements.

Cyber resilience assessment

Given the importance of cyber resilience in today's financial landscape, the ECB launched the second Cyber Resilience Survey for Financial Market Infrastructures. Similar to the previous exercise, the Bank launched an enhanced second Eurosystem Cyber Resilience survey to the MSE in mid-2019. Replies were analysed by the Bank together with the ECB in order to re-assess the MSE's cyber resilience position and compare results with the first survey conducted in 2017. The Bank envisages presenting the finalised assessment report to the MSE during 2020. This is an ongoing process followed up on a regular basis.

Malta Clearing House

The MCH meets every morning at the Bank's premises to physically exchange the cheques negotiated during the previous working day by each participant of the MCH on behalf of the other participants. The total number of direct participants remained unchanged; however, one member was suspended.

During the year a decrease in the number of cheques was registered; however, the underlying value increased by over €402.7 million (see Table 5.1).

TARGET2-Malta

Towards the end of 2019, the number of direct participants in TARGET2-Malta increased to 14, out of which, as in the previous year, one direct participant was suspended.

TARGET2-Malta payments traffic in 2019 registered a 24.7% decrease in terms of volume and a decrease of 57.7% in terms of value, when compared to 2018. Both customer payments and inter-bank payments registered a decrease in volume and value, mainly consisting of a 28.6% drop in customer payments volume due to a possible shift to Single Euro Payments Area (SEPA) payments and a 58.1% decrease in interbank payments value, as one relatively important TARGET2 participant opted to retain its daily TARGET2 balances as excess funds with the Bank instead of utilising the overnight deposit facility. The total volume of payments processed during 2019 was 87,341 for a total value of €442.4 billion. The volume of customer payments was 67,325 for a total value €6.6 billion. Moreover, the volume of inter-bank payments was 20,016 for a total value of €435.8 billion.

Banker to the public sector

The banking services provided to the Government remained the same as the ones provided in the previous year. These included the opening and maintenance of various euro and foreign denominated accounts, the encashment of cheques drawn on the Bank and issued by Government Departments, deposits of cash

Table 5.1
NUMBER AND VALUE OF CHEQUES PROCESSED BY THE MCH, 2018 AND 2019

	Number of cheques	Value (EUR millions)
2018	4,758,599	10,204.6
2019	4,558,845	10,607.3
Change	-199,754	402.7
Percentage change	-4.4	4.0

Source: Central Bank of Malta.

Table 5.2
NUMBER AND VALUE OF CHEQUES DRAWN ON THE CENTRAL BANK OF MALTA BY THE PUBLIC SECTOR

	Number of cheques	Value (EUR millions)
2018	759,170	550.8
2019	746,050	605.1
Change	-13,120	54.3
Percentage change	-1.7	9.9

Source: Central Bank of Malta.

and cheques, safe deposit facility, safe custody, payments through TARGET2 and SWIFT, and SEPA Credit Transfers.

Mirroring the developments at an overall MCH level, the number of cheques drawn on the Bank by the public sector (see Table 5.2) decreased by approximately 1.7%. Nonetheless, the underlying value of the latter increased by 9.9%.

During 2019, the Bank processed 2.7 million SEPA credit transfers for a total value of €5.0 billion. This represents an increase of over 32,600 and €1.1 billion in terms of volume and value respectively, compared to the previous year. Such an increase is attributable to a greater use by the Bank's clients of this route to channel their payment needs.

The range of foreign exchange services offered to the Government and public sector organisations during the year under review remained the same and included the sale and purchase of foreign currency, non-euro outward and inward payments by SWIFT, encashment of drafts in foreign currency, and the maintenance of foreign currency accounts.

During 2019, the Bank continued to effect payments in connection with servicing of the Government's external debt. In contrast to 2018, in 2019, the amount of capital repayments was much lower due to a loan which matured in 2018. In addition, the associated interest paid in 2019 decreased substantially.

Banker to the banking system

The Central Bank of Malta continued to act as banker to the rest of the banking system by providing deposit facilities to credit institutions. These institutions maintain balances at the Bank mainly to meet their reserve deposit requirements. They generally hold reserve accounts, margin call accounts and accounts pledged in favour of the Investors Compensation Scheme and Depositors Compensation Scheme.

Other financial services

As from the second quarter of 2020 the Bank intends to start offering agency services to local institutions for the settlement of euro payments.

During 2019, the Bank has collaborated with the other NCBs on two ESCB projects.

i) The TARGET2 and T2S consolidation project which will go live in November 2021. The Eurosystem has launched a project to consolidate TARGET2 and T2S, in terms of both technical and functional aspects. The objective is to meet changing market demands by replacing TARGET2 with a new real-time gross settlement (RTGS) system and optimising liquidity management across all TARGET Services.

ii) The Eurosystem Collateral Management System (ECMS) which will go live in November 2022. The ECMS is a unified system for managing assets used as collateral in Eurosystem credit operations. It will replace the existing systems of the 19 NCBs, currently used to manage assets used as collateral for Eurosystem credit operations.

These projects will be furthered in 2020.

BOX 5: NUMISMATIC RELEASES 2019

Gran Carracca Sant'Anna of the Order of St John



March 2019
Coins in gold and silver depicting the Order of St John's Gran Carracca Sant'Anna were issued under the Europa Star Programme with the theme 'Renaissance' and bear the Europa Star logo.

The warship Gran Carracca Sant'Anna, was renowned for its large size and prodigious firepower. It was one of the most influential ship designs of the Renaissance. Of robust construction and combining speed with manoeuvrability, carracks could serve as both merchant ships and warships. The Order of St John's carrack Sant' Anna, was launched in December 1522, at about the same time that the knights lost Rhodes. This ship, the pride of the Order's navy, carried Grand Master Philippe Villiers de L'Isle Adam to Malta in 1530. This event marked the start of the Order's long sojourn on the island and the start of a new epoch in Maltese history.

The coins are in proof quality and were designed by Noel Galea Bason.

Dated coin set 2019



May 2019
The limited edition set consists of the eight Maltese euro coins as well as a €2 coin, depicting the prehistoric temples of Ta' Ħaġrat. The latter is the fourth in a series of seven coins dedicated to Maltese prehistoric monuments.

All the coins in the set are in brilliant uncirculated quality and were struck at the Monnaie de Paris in France. The national sides of the euro coins and the commemorative €2 coin were designed by Noel Galea Bason.

The Sette Giugno Riots Centenary



June 2019
The events of 7 June 1919 took place in a colonial setting against the background of economic hardship, massive unemployment and popular demand for self-government. Four demonstrators lost their lives and many were wounded. The coins carry a representation of a standoff between the crowd and a party of armed soldiers.

Only 100 pieces of the gold coin – which has a face value of €100 – were minted. They were struck in 0.999 gold while the silver coin has a face value of €10. Both coins were designed and engraved by Noel Galea Bason and struck at the Royal Dutch Mint.

€2 Commemorative Coin – Ta' Ħaġrat Temples



July 2019
Ta' Ħaġrat Temples in Mġarr date to around 3,600-3,000 BC. The site was brought to the attention of Sir Temi Zammit in 1916 and the first excavations were conducted in 1923. This temple is one of the best preserved in Malta and its imposing portal, together with the three steps leading to it, are the main features of the coin's design.

This coin is the fourth in a series of seven dedicated to the Maltese islands' UNESCO World Heritage prehistoric sites. The coin reverse shows the common €2 side. The obverse (national side), designed by Noel Galea Bason, shows a representation of Ta' Ħaġrat Temples.

€2 Commemorative coin 'Nature and Environment



October 2019
The fourth €2 commemorative coin under the 'From Children in Solidarity' programme had the theme of 'Nature and Environment'.

The 'From Children in Solidarity' coin programme was launched in 2015 by the Central Bank of Malta in collaboration with the Ministry of Education and the Malta Community Chest Fund Foundation. Profits from the sale of the coin cards are channelled in aid of the Malta Community Chest Fund Foundation.

Joshua Stuart, a student of the Maria Regina College in Naxxar – one of the winners of the design competition, opted for a simple stylised representation of the sun and a fruit tree. The coin, emngraved by Noel Galea Bason, has as its central theme the sun's benevolent action, which provides warmth and light, and enables trees and vegetation to grow and bear fruit. The coins were minted at the Monnaie de Paris.

150th anniversary of the Suez Canal



November 2019
The last coin issue for 2019 commemorated the 150th anniversary of the opening of the Suez Canal, an event which had a profound impact on Malta's economy.

The building of the Suez Canal was a feat of engineering, dramatically shortening the trade routes between Europe and Asia. As a result, Malta became an important waypoint on the new imperial highway linking Britain with her empire in the east. The increase in maritime traffic fuelled the demand for coal bunkering and ship-related services and Malta also benefitted from increased spending on naval and military infrastructure.

The reverse of the silver coin shows steamships transiting the Suez Canal, and was designed and engraved by Matyas Houf. The obverse, which carries the coat-of-arms of the Republic of Malta, was designed by Noel Galea Bason.

The Numismatics and Historical Publications Advisory Board (NHPAB) was set up in 2017 to propose themes for the Central Bank of Malta commemorative coins programme and to act as editorial board for historical publications. It took over this role from the Currency Advisory Board.

The NHPAB is chaired by the Governor of the Central Bank of Malta Dr Mario Vella, with Chief Officer Banking Operations Jesmond Gatt, Prof. John Chircop, Dr Lillian Sciberras and Dr Mario Brincat as members. Board secretary is Kevin Cassar, Curator of the Central Bank's Museum.



6. CORPORATE GOVERNANCE

Governance

Board of Directors

The Board of Directors of the Central Bank of Malta is composed of Dr Mario Vella as Governor and Chairman, Mr Alexander Demarco and Mr Oliver Bonello as Deputy Governors responsible for Monetary Policy and Financial Stability respectively, Professor Peter J. Baldacchino, Professor Frank Bezzina, Dr Romina Cuschieri and Ms Philomena Meli as non-executive Directors. There were no changes in the Board composition during 2019. All members of the Board are appointed for a statutory term of five years and are eligible for reappointment. In terms of the Central Bank of Malta Act (Cap. 204) the Governor and the Deputy Governors are appointed by the President of Malta upon the recommendation of the Prime Minister while the other non-executive Directors of the Board are appointed by the Prime Minister. Mr Herbert Zammit LaFerla continued to act as Secretary to the Board. During 2019, the Board met 13 times.

The Board of Directors is responsible for the policy and general administration of the Bank, except for functions relating to the Treaty on the Functioning of the ECB and the protocol of the ESCB and functions which are conferred exclusively on the Governor in terms of the Central Bank of Malta Act (Cap. 204).

Management and internal organisation

In December 2018, the Board of Directors agreed that, with effect from 1 January 2019, the Bank may consider requests on a case-by-case basis from staff members born between 1956 and 1961 to work beyond their statutory retirement age until they reach the age of 65 years. In February 2019, the Board approved a proposal to restructure the International Asset Management Office such that the new structure would contribute to more efficiency and staff retention.

In April 2019, the Board approved a proposal to restructure the Internal Audit Department with the re-introduction of the role of Manager Internal Audit.

In May 2019, the Board considered proposals and resolved to establish the position of a Chief Operating Officer. During the same month, the Board approved a proposal to restructure the Statistics Department reflecting the increased responsibilities of the Department.

In August 2019, the Board endorsed a proposal and relevant job description to create the new position of Senior Principal Research Officer within the Office of the Governor.

In October 2019, consequent to developments that took place in terms of staff movements and gaps identified during a strategic review of the Financial Stability Department, the Board approved restructuring proposals to amalgamate the Stress Testing and Risk Modelling Office with the Policy and Crisis Management Department and renaming the Department Policy, Crisis Management and Stress Testing. The Board also agreed to introduce a research function within Financial Stability Surveillance and Assessment and renamed the Department as the Financial Stability Surveillance and Research Department.

Moreover, the Board accepted proposals for the establishment of a payments hub that would enable the Bank to meet the increased and enhanced payment demands and requirements of the domestic financial system.

In November 2019, the Board approved the setting up of the Cybersecurity Office within the Information Systems and Knowledge Management Department. The new Office will take over the tasks from the current Information Technology (IT) Security Unit and will have two important domains: proactive security and defensive security. The former will focus on threat intelligence assimilation to ensure protection against imminent threats. Defensive security will further develop the current capability of monitoring and appropriately managing the security components to ensure continued protection.

During 2019, the Governor continued to be supported by the Office of the Governor and the two Deputy Governors. The Office of the Governor also comprised the Social Research Unit (SRU). The Governor was also directly responsible for the departments of International Releations and Communications. The Research Department and the Economic Analysis Department reported to both the Governor and Chief Officer Economics. Internal Audit Department administratively reports to the Governor but functionally to the Audit Committee. Legal Department reports to the Governor.

Governor's activities

In 2019, the Governor served as a member of the Board of Governors of the MFSA and the National Coordinating Committee on Combating Money Laundering & Funding of Terrorism. He participated in the proceedings of the Malta Council for Economic and Social Development, and the Research, Innovation and Development Trust of the University of Malta, of which he is a trustee.

In 2019, the Governor made the following interventions:

- Presentation, Central Bank of Malta's *Annual Report* 2018, press launch – 10 April 2019.
- Paper presented during Central Bank of Malta conference, *Waiting for populism? Problems of interpretation and policy implications Four lectures and a conversation* – 9 May 2019.
- Economic Overview, Ambassadors' Circle – 19 June 2019.
- Address delivered during President's visit – 11 November 2019.
- Speech *Progressing safely in a riskier world*, annual dinner of the Institute of Financial Services – 19 November 2019.

In addition, the Governor was interviewed by various news media. The Governor welcomed a number of distinguished guests, including foreign diplomatic representatives.

The Governor delivered opening and closing remarks during various public lectures organised by the Central Bank of Malta.

Social Research Unit

During the first half of 2019, the SRU mentored two social researchers originally recruited by the Central Bank of Malta on an internship basis. At the end of the internship, one of the two was recruited on a part-time basis.

During 2019, the SRU focused on gender and inclusiveness as a major line of research. The Unit was involved in an extensive study exploring gender equality and diversity within the Bank itself, providing a detailed picture of the present situation as well as a historical analysis of the situation as it evolved. Additionally, a second study was carried out in relation to female representation in the top decision-making positions in the banking and finance sector, shedding further light on the Bank's gender representation profile.

Furthermore, the SRU complemented the Bank's existing economic research by looking into the social impact dimensions of some of the emerging trends of interest indicated by the research papers. Topics ranged from poverty and employment to equality, diversity and inclusion.

During 2019, the SRU participated in two international events. The unit took part in a panel discussion and Q&A session together with Ms Joanna Place, Chief Operating Officer at the Bank of England, during the *Parliamentary Affairs International Symposium* at the Bank of England. Research conducted on the Central Bank of Malta's gender profile was presented.

Moreover, the Unit continued to keep abreast of recent developments, policies and best practices on gender and career progression in central banking. In this regard, the SRU also attended *The Second Joint Conference on Gender and Career Progression*, held at the ECB in Frankfurt.

Looking ahead, the SRU seeks to engage in further research into the political economic dimensions of social cohesion, with the demographics of an aging population as a focal issue.

Audit Committee

The Bank's Audit Committee, which is composed solely of non-executive directors, is chaired by Professor Peter J Baldacchino and also includes Professor Frank Bezzina and Dr Romina Cuschieri. It convened 10 times in 2019. During such meetings, the Chief Officer Internal Audit briefed the Committee members on matters relating to governance, risk management and the adequacy and effectiveness of the design and deployment of controls across the Bank. Progress reports on the completion of the Annual Audit Plan were also provided, as were regular status updates on prevailing residual risk levels. These were supported by opinions tendered at bank-wide, divisional and individual business area levels. The Chief Risk Officer was also invited to meetings to provide an update on both operational and financial issues. Audit Committee meetings were at times attended by the Bank's external auditors, PricewaterhouseCoopers (PwC).

External auditors

During 2019, PwC – for the last year of their mandate – carried out the statutory audit for the financial year ending 31 December 2018. The external auditors expressed their opinion on the financial statements and presented their Management Letter to the Board.

Internal Audit Department

In accordance with the Internal Audit Plan for 2019, which was approved by the Audit Committee and noted by the Board of Directors, the Bank's internal auditors continued to provide assurance through the conduct of risk-based audits. A total of 16 audits were completed which assessed the effectiveness of governance, risk management and control processes implemented across a number of business areas. In line with methodological enhancements introduced recently, the internal auditors continued to tender opinions not just on risk-sensitive operational effectiveness but also on the level of efficiency demonstrated in the use and deployment of resources applied during the discharge of processes reviewed. A number of audits were also conducted on areas within the Bank which are deemed more inherently susceptible to fraud.

The internal audit function is also responsible for assignments on behalf of the ESCB Internal Auditors Committee (IAC), thus providing the necessary assurances to the ECB's decision-making bodies. In fulfilment of such responsibilities, the Bank performed two IAC audits and continued to participate in IAC meetings. The Bank's internal audit activity was also represented through active membership in the Audit Task Force on Information Technology, which is one of the IAC substructures. Furthermore, during the latter part of the year, one of the Lead Auditors was also appointed to form part of the Audit Task Force on Monetary Policy, Financial Stability and Market Operations.

The internal audit function was involved in a number of consultancy engagements covering different aspects and business areas within the Bank. The function also handled the review of several sets of Policies and Procedures which required updating. It continued to be involved in the Compliance Committee, mostly in the capacity of participating observers to preserve its independence and objectivity.

Risk management

The Risk Committee met six times during 2019. The Committee members focussed on risks related to the Bank's operations, financial assets under management, the Public Sector Purchase Programme portfolio, the Malta Government Securities portfolio and other relevant issues. The various risks identified together with any arising incidents were thoroughly discussed, mitigation measures agreed upon and their implementation monitored. The Chief Risk Officer also updated the Audit Committee members with the activities of the Risk Committee and highlighted any issues requiring their attention.

The third cycle of the Operational Risk Management (ORM) exercise is currently underway and will be finalised during the course of 2020. The operational risk status of the various business areas was reported on a regular basis to the Risk and Audit Committees.

During 2019, each business area continued with its review of the Business Continuity Plans of critical and important operations. Regular resilience testing was carried out by the business areas together with members from the ORM office. Various Frameworks and Policies related to Operational Risk, Business Continuity and Information Security were also reviewed and updated.

Monthly Investment Policy meetings were held, during which performance measurement of assets under management was presented and compared to the tactical benchmark which in turn was compared to the strategic benchmark. The Strategic Asset Allocation exercise for 2020 was finalised and agreed with the Governors, and subsequently approved by the Board of Directors, in January 2020.

Legal issues

During 2019, the Bank's Legal Department was involved with the relevant business areas in amending or drafting new legislation as follows:

- Central Bank of Malta Directive No. 6 on Harmonised Conditions for Opening and Operating Payments Module Accounts, T2S Dedicated Cash Accounts in TARGET2-Malta, and TIPS Dedicated Cash Accounts in TARGET2-Malta and Central Bank of Malta Directive No. 7 on Provision of Intraday Credit and Auto-Collateralisation were amended to transpose the Guideline ECB/2019/30 amending Guideline ECB/2012/27 on TARGET2. The amending Guideline introduced a new Single Shared Platform functionality to enable the processing of very critical payments in a contingency, to which Eurosystem central banks must adhere.
- Central Bank of Malta Directive No. 8 on Monetary Policy Instruments and Procedures was amended following the annual update of the General Documentation.
- Amendments to Central Bank of Malta Directive No. 14 on Monetary Policy Instruments and Procedures made in terms of article 24(2) of the Central Bank of Malta Act (Cap. 204 of the Laws of Malta), were also carried out. The Directive was amended to:
    i. grant the Malta Development Bank (MDB) access to the CCR for the fulfilment of its functions in terms of the Malta Development Bank Act (Cap. 574 of the Laws of Malta);
    ii. extend the applicability of the rules for access to also cover the MDB, and to lay down the reporting requirements of this institution.
- Central Bank of Malta Directive No. 16 on Regulation of BBMs was issued, introducing binding measures to strengthen the resilience of lenders and borrowers against the potential build-up of vulnerabilities stemming from the real estate market. The measures were implemented in collaboration with the MFSA following a recommendation by the JFSB.

The Bank's in-house lawyers advised on diverse legal, contractual and operational matters, as well as on issues related to the Bank's governance structure, including but not limited to:

- general legal advice to the Board of Directors;
- legal advice to the Governor and Deputy Governors on various aspects of the Bank's functions and operations;
- legal advice concerning CRAs in Malta and cybersecurity;
- court-related matters involving the Bank;
- support to relative business areas in revising a number of the Bank's policies and procedures;
- review of several tenders issued by the Bank and advice on the procurement process;
- legal advice on regulatory legislation which has an impact on the ease of doing business, in the context of the World Bank report for 2019;
- extensive legal advice and vetting of contracts entered into by the Bank with service providers and other third parties;
- the initiation of consultation processes with the ECB in terms of Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union;

- the Annual Data Protection Stocktake Exercise, undertaken to assess compliance in all business areas with respect to the GDPR;
- enhancement of the Bank's Prevention of Money Laundering and Financing of Terrorism Policies and Procedures;
- advice on the transposition of the Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral in collaboration with the Financial Stability Department, the Ministry of Finance and other entities.

The Legal Department participates in various Bank's committees, including the Management Committee, the Risk Committee, the Security Committee, ESCB Committee and the Brexit Taskforce. In 2019, the Legal Department also held the secretariats to the Executive Committee and Audit Committee. The Legal Department also participates in the Joint Committee for the prevention of money laundering organised by the Financial Intelligence Analysis Unit.

An important part of the work carried out by the Bank's Legal Department relates to the ECB, the ESCB and the Eurosystem. In 2019, the legal team participated actively in various ESCB committees and sub-committees, among them the ESCB's Legal Committee, the Financial Law Experts Group, the Ethics and Compliance Task Force, the ESCB and SSM Legal Information System, the ad hoc Working Group of Financial Law Experts and the Network of ESCB and SSM Experts on Data Protection. The legal team was also engaged in official duties at the EC, namely at the Euro Counterfeiting Experts Group and a workshop on the Deposit Register under the 5th AML Directive.

Human Resources

By the end of 2019, the Bank had 338 full-time equivalent employees, 14 more than in 2018. The number of full-time positions at the end of 2019 stood at 353, while the number of part-timers was 10.



The Central Bank of Malta has made progress – albeit modest – when it comes to gender balance at the top levels of its executive structure. In 2008, there were no female members of staff among the 31 employees in the top grades – comprising senior executives, heads and chief officers. By the beginning of January 2020, there were 12 women in the 46 posts as well as two female board members. The gender distribution of staff below the senior executive grade is predictably more equitable, with 50.7 per cent of all staff in these grades being women as at 2019, compared to 44.3 per cent in 2008.

Table 6.1
STAFF ACADEMIC QUALIFICATIONS

Qualification	Male employees	Female employees	per cent of total employees[1]
MQF 8	5	2	2.12
MQF 7	60	54	34.55
MQF 6	57	44	30.61
MQF 5	11	12	6.97

Source: Central Bank of Malta.
[1] Excluding support staff.

Table 6.1 shows the number of Bank employees who hold an academic qualification at Malta Qualifications Framework (MQF) level 5 and above as at the end of 2019.

During 2019, the Bank recruited 31 employees (one Senior Executive, six Assistant Executives, 22 Officers II [one of whom on part-time basis] and two Officers I) while 17 employees resigned from the Bank.

In 2019, seven employees were seconded to offices within the public sector, another employee was seconded on a part-time basis with a non-governmental organisation while one employee was seconded to a charitable organisation. The latter staff member resumed duties at the Bank with effect from 1 April 2019. One staff member who was seconded to the ECB for a period of nine-and-a-half months from May 2018 returned to the Bank at the end of February 2019.

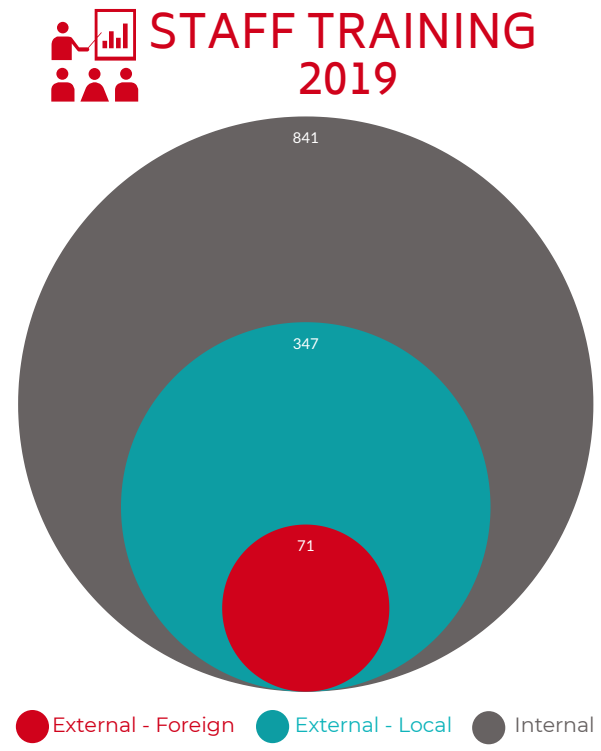
A total of 14 university students were offered temporary summer work experience between mid-July and mid-September while 11 interns were offered work placements at the Bank on a nine-month internship programme starting in October 2019 while finalising their final year at the University of Malta or the Malta College of Arts, Science and Technology (MCAST). The Bank also offered an internship to a student in March 2019.

Training and development

As in previous years, the Bank allocated resources to staff training, both within the Bank and through courses organised by local and foreign providers.

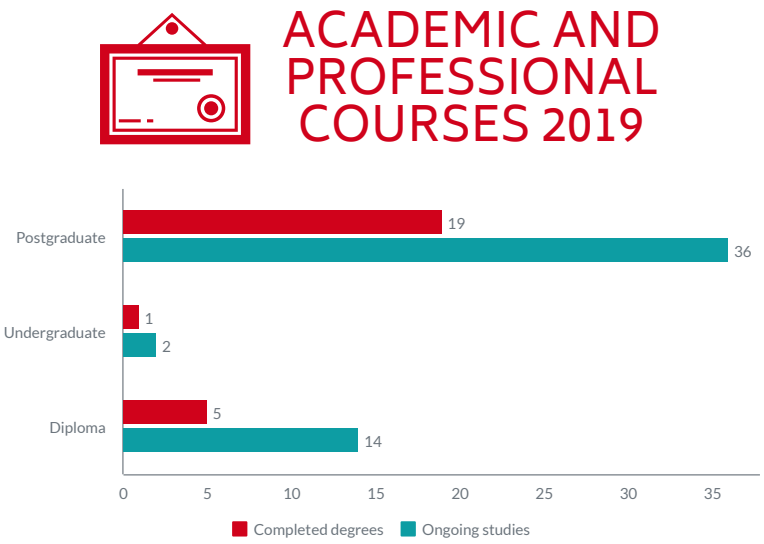
A total of 841 participants attended 62 different in-house courses mainly in the areas of finance, economics, management development, IT, mental wellbeing and first aid. An information session on cybersecurity awareness was also organised for all employees of the Bank. In addition, all new employees benefit from an induction programme.

As shown in the infographic, 418 staff members participated in external training programmes in 2019, both local and overseas. These courses were provided by local training organisations and professional institutions, the ECB, other central banks and financial institutions.



Source: Central Bank of Malta.

During the course of the year a number of employees continued to benefit from the Bank's study programmes. Nineteen staff members completed their postgraduate education, four of whom were supported on a full-time basis to read Master's degree programmes in foreign universities under the Bank's Learning Research and Development Study Programme. A total of 36 employees continued their enrolment in postgraduate degree programmes (see infographic).



Source: Central Bank of Malta.

During 2019, two employees were awarded a full-time study sponsorship to study for a postgraduate course in UK universities in areas directly related to the Bank's interests and remit, also under the Bank's Learning Research and Development Study Programme. Two other employees continued their doctoral studies at the University of Nottingham and the University of Bristol. Both doctorate courses are currently supported by the Bank and are undertaken on a part-time basis.

During 2019, the Bank continued with its collaboration with MCAST in facilitating the Undergraduate Certificate in Accounting at MQF Level 5. Eight employees are following this course which will be concluded by end 2020. As a result of the successful completion of their Undergraduate Certificate in Computer Systems and Networks, four employees are furthering their studies through reading the Higher Diploma in Computer Studies, specifically designed by MCAST to meet the Bank's needs.

In 2019, the Bank hosted *Module A* of the Heading for Leadership Programme. One staff member attended this learning event. The programme was attended by 14 participants from 12 different NCBs, including the ECB.

In 2019 a policy on diversity and inclusion was finalised and Board approval was obtained in the first quarter of 2020. This policy aims at providing guidance on ways to successfully manage diversity issues. Furthermore, it would contribute to create a supportive, flexible and inclusive environment in the workplace. Such a policy will also help realise the full potential of all employees by focusing on their strengths and in turn help the Bank achieve its business goals.

Information Systems and Knowledge Management

Information Systems

The Information Systems and Knowledge Management department's mission is to enable the core business functions to meet the strategic goals by delivering value through consistent, resilient and cost-effective information and knowledge services. The department deals with the management of information in physical or electronic form. The Project and Applications Development, Core Applications and IT Services offices cater for technology-related services. A unit directly responsible for IT Security operations and monitoring reports directly to the Head of Department. The Knowledge Management Office deals with the physical document lifecycle and the management of the library. This office also manages the Bank's electronic document repository.

A major milestone for 2019 was the setting up of a Cybersecurity Committee. The Cybersecurity Committee remit establishes an oversight role, which coordinates resources from business areas, or external experts

to recommend actions that mitigate cyber risk. During the year, it actively gauged the effectiveness of the Bank's cybersecurity framework and its practices for identifying, assessing and mitigating cybersecurity risks across all business functions. Moreover, it identified areas of improvement to the Bank's cybersecurity stance and established a set of high priority tasks. The Cybersecurity Committee continues to gauge and report on the progress of these tasks to the Bank's Board of Directors to ensure that cybersecurity is at the top of the institution's agenda. One identified gap highlighted the ever-increasing cyber threat landscape and prompted organisational changes that will enable the department to be more focused in dealing with malicious threats. To this regard, the Bank extended the IT security team remit and established a Cybersecurity Office with dedicated resources to monitor and protect information assets. The department continued to review and develop its policies and practices by establishing several new policies related to service management, IT security and system ownership.

The Core Applications office engaged business stakeholders in discussion to assess options and solutions that would establish robust business-focused IT solutions. In collaboration with the Change Advisory Board, works led to the kick-off of a new payments hub which will be deployed in 2020. The solution will be partially serviced through a cloud-based environment thus paving the way forward for other similar deployments in the future. Moreover, the solution will also ensure alignment of the payment platform with the ISO 20022 standards. The use of a cloud service for the payments hub has also brought about enhancements on how the service will be distributed and secured. In fact, dedicated security equipment will take charge of the communications between the Bank's internal network and the cloud solution. The SWIFT environment, being the main payments infrastructure, continued to undergo further developments. These developments were aligned with the recommendations established by the SWIFT security controls framework and best practices.

As the Core Accounting solution continued to settle throughout its first year since undergoing a major version upgrade, external consultants delivered hands-on training sessions to IT administrators and specialised training to key personnel from the business areas.

The network infrastructure is a critical component in the delivery of any IT service; it was updated and improved in order to enhance network throughput to the users and to segregate the Bank's internal network into predetermined zones for enhanced security purposes. Operational controls and security have also been strengthened with the launch of various activities. Of particular relevance is the implementation of a two-factor authentication solution to safeguard administrative tasks carried out on the Bank's ESCB-Net infrastructure. This infrastructure is a critical component to securely connect the Bank to the rest of the ESCB.

The Projects and Applications Development Office (PADO) supports the Bank's business areas in fulfilling their technology and innovation requirements by providing in-house developed solutions that are not normally available on the market. During 2019, PADO embraced additional support to business areas, enhanced its architecture framework and assumed additional responsibility for several applications and demands. New business demands drove the re-engineering of processes and applications including the CCR. The need to further improve secure development practices features prominently in the Bank's development methodology. To this end, training sessions and collaboration with external IT experts took place.

In 2020, the Bank will be deploying a platform that leverages the latest artificial intelligence technology to provide enhanced visibility into network based cyber threats which would be otherwise very difficult for a human analyst to spot.

Conceding the need to constantly review and enhance business applications, the Bank has now established a project management role. The Cybersecurity Office will participate in project initiatives to ensure that cyber risks are properly addressed at an early stage during the project life cycle. It is envisaged that in 2020 there will be further developments pertaining to critical services such as the Payments Hub project, the Treasury Management System and the Financial Crime Risk platform.

The department continues to participate in the ESCB Information Technology Committee and its substructures. This ensures alignment with the ESCB governance and operational policies and practices at a local

level. Furthermore, it also guarantees that the necessary applications and interfaces are in place to enable the Bank to conduct its business with the ESCB community.

The Library

The Central Bank of Malta Library aims to excel as a principal facilitator in Malta of financial, economic and social research, and to support and promote scholarly endeavour, debate and dissemination of scientific debate in these fields. Since the Library's establishment in 1968, it has accumulated a wealth of standard as well as innovative, ground-breaking works.

The Library continues to increase its efforts to make more publications available in digital form and promote their dissemination through the Library portal. Indeed, in the year under review, the Library initiated a very ambitious process to convert a large number of paper documents into digital format and upload the respective metadata onto the Library's portal.

The Library subscribes to various specialist academic journals as well as to comprehensive electronic bibliographic tools, invaluable for the Bank's research activities. The Library runs a popular public lecture programme focussed on regional and national economic history, and participates in the annual National Book Festival.

Knowledge Management

The Knowledge Management team aims to capture, manage, preserve, store and deliver the right information to the right people at the right time. The main activity consists of scanning, uploading and cataloguing documents on to Microsoft SharePoint and the handling of requests for information. In 2019, almost 3,000 new policy documents were uploaded on the system together with the relative metadata and eventually declared as records.

The Bank's librarian actively participated in the 10th Annual ESCB/SSM Meeting on Information Management in Frankfurt. The conference, with the theme '*Digital, the new typical*', brought together knowledge management experts from the ESCB and non-EU countries.

The Library is poised to adopt a three-year strategy, while continuing to implement the Bank's Knowledge Management programme to develop SharePoint Portals into an Enterprise Content Management system.

Premises and procurement

In 2019, the Bank continued with its programme of maintenance, upgrading and embellishment works.

During the year, works were undertaken to replace a few asbestos-containing drain pipes located in the Bank's main building. Other works involved the installation or modifications in partitioning consequent to the creation or relocation of office spaces. Various preparatory tasks were also necessary in relation to new projects and refurbishments of the Bank's infrastructure. These included the enhancement of parking controls and security measures.

As part of its environmentally oriented efforts, the Bank continued with its recycling exercises and sent for recycling 6.5 tonnes of paper and 2.1 tonnes of plastic during the year. Efforts to reduce the use of plastic were pursued.

With regard to procurement, the Bank started utilising the national electronic public procurement portal for its tendering procedures. During the year, the Bank issued nine calls for tenders and 37 calls for quotations. The tenders related to the leasing of multifunction printers, the replacement of a Heating, Ventilation and Air Conditioning system, audio visual equipment, an integrated library system and web hosting among others.

During 2019, the Bank continued to participate at the semi-annual meetings of the ESCB Heads of Administration Conference, where various topics relating to facility and environmental management were discussed.

The Bank is also an active participant in initiatives coordinated by the Eurosystem Procurement Coordination Office which enables Eurosystem and ESCB members to benefit from efficiencies in joint procurement exercises, primarily in the areas related to hardware, software, rating agency services and market data provision.

Information and public relations

Publications and website

The section that deals with publications has once again been kept busy throughout the year, preparing and uploading the official publications: the *Quarterly Reviews*, *Annual Report*, *Financial Stability Report* and *Interim Report*, monthly *Economic Updates* and *Economic Projections*.

The website has been very dynamic, with the normal operational uploads being complemented by other activities, such as detailed testimonials to deceased artists who are connected to the Bank, and in-depth features on Malta's culture and heritage. Employees are also being encouraged to contribute to a new section called *Quick Questions and Answers*, where a wide range of topics is covered through one-on-one interviews. A new section was put online to focus on international central banking courses.

Investment in various software packages relating to graphic design has enabled the department to take on a more proactive role with regard to collateral used by other business areas, assisting with a number of projects ranging from the Library's participation in the Malta Book Fair to school presentations delivered as part of the Bank's Corporate Social Responsibility (CSR) programme. Infographics are now being used to add a visual element to releases and publications, as well as to the *Annual Report* 2019.

Uniform corporate email signatures were also designed and deployed across the Bank.

Events management

The department helped with the organisation and logistics of three Out-of-Frankfurt meetings held in Malta during 2019, as well as with nine public lectures, various seminars, courses and conferences, and CSR events.

Media

The public relations (PR) section has been working more proactively in the latter half of the year, tapping into PR opportunities in a number of magazines and publications. Apart from regular interviews with local media, the department also coordinated interviews for international media. Dozens of communications were sent out to the media, resulting in a publication rate of 2.7 mentions per item in print and online. Two press conferences were also held, one to present the *Annual Report* and one for the signing by the Central Bank of Malta Foundation of a sponsorship agreement with the Malta Philharmonic Orchestra. The department was instrumental in running the campaign to familiarise the public with the new €100 and €200 notes.

Social media

The Bank's LinkedIn account was activated in mid-October 2019, and posts are being uploaded regularly, covering the Bank's official activities and its social outreach and vacancies, as well as promoting key decisions and activities of the ECB. In just four months since the first post was uploaded, the number of followers increased by 78 per cent with over 13,000 impressions. In the meantime, the number of Twitter followers increased by 35 per cent, reaching over 900.



7. INTERNATIONAL RELATIONS

In 2019, the Central Bank of Malta maintained active relations with international financial institutions to which it is affiliated.

Eurosystem and ESCB

The Governor is a member of the Governing Council of the ECB. The Governing Council is made up of the members of the ECB's Executive Board and the NCBs' Governors of the euro area Member States. The Governing Council is responsible for monetary policy in the euro area and decides on the implementation of tasks entrusted to the Eurosystem, which comprises the ECB and the euro area NCBs.

During 2019, the Governing Council held 18 physical meetings, eight of which focused on monetary policy. In addition, a significant number of Governing Council decisions were taken through written procedures. Also, in connection with the ECB's responsibilities in the area of bank supervision, the Governing Council approved numerous draft supervisory decisions prepared by the ECB's Supervisory Board.

The Governor is also a member of the General Council of the ECB, which meets on a quarterly basis. The General Council, which is composed of the President and Vice-President of the ECB, and the NCBs' Governors of all Member States of the European Union, mainly performs an advisory role. There were four General Council meetings in 2019.

The Governor – or, in his absence, a Deputy Governor – also participated in the three sessions dedicated to the Macroprudential Forum held jointly by the Governing Council and the ECB's Supervisory Board during 2019.

The Deputy Governor for Financial Stability sits on the ECB's Supervisory Board together with the Head responsible for banking supervision at the MFSA.

During 2019, the Governor signed a number of agreements on behalf of the Bank which resulted from decisions taken by the Governing Council. More specifically, these were the amendments to the Level 2 – Level 3 agreement on T2S; the Agreement on Net Financial Assets (ANFA) following a quinquennial review; and Updates to the Information Security Policy for TARGET2 and T2S.

The Governing Council and the General Council are supported by a number of committees, working groups and other structures, in which various Bank officials participated actively throughout the year. These officials play a key role in briefing the Governor on issues to be discussed in meetings of both the Councils. They also give feedback on written procedures addressed to the Governing Council and the General Council.

ESRB

In 2019, the Governor and the Deputy Governor for Financial Stability took part in the meetings of the ESRB's General Board where various issues revolving around potential vulnerabilities and risks within the EU financial system and potential policy measures were discussed. Senior officials of the Bank also participated in meetings of the ESRB's Advisory Technical Committee and its substructures.

The ESRB continued to publish its risk dashboard, working papers, macroprudential commentaries and also papers of the Advisory Scientific Committee in a bid to stimulate public debate on macroprudential issues.

Other EU institutions

During 2019, the Governor and the Deputy Governor for Monetary Policy participated in the informal meetings of the Economic and Financial Affairs Council held in April and September in Bucharest and Helsinki respectively. Furthermore, the Deputy Governor for Monetary Policy regularly participated in meetings of the Economic and Financial Committee (EFC) when issues relevant to central banks were discussed.

In particular, during 2019, the Bank engaged in EFC discussions on matters related to developments in financial markets and the regular monitoring of risks to financial stability in the European Union prior to the formulation of appropriate policy responses. Other discussions related to strengthening the Banking Union, completion of the Capital Market Union, implementation of the AML Action Plan and also on the potential implications of stable coins.

The EFC continued to play a crucial role in the preparation of common European positions at the G-20 meetings and other international fora, such as the IMF and the Financial Stability Board.

Other Bank officials also participated in meetings of a number of EFC sub-committees, where matters of relevance to central banks – such as sovereign debt, currency issues and IMF-related topics – were discussed.

Apart from participating in the EFC and its sub-structures, Bank staff takes part in a number of other EU committee structures related to central banking functions. The Deputy Governor for Financial Stability is a member of the Board of Supervisors of the EBA. The Bank also continued to contribute extensively, through consultations on matters of an economic and financial nature, to the participation of Malta's representatives within various EU decision-making bodies.

European Bank for Reconstruction and Development

As the Governor of the Central Bank of Malta is the Alternate Governor for Malta on the Board of Governors of the European Bank for Reconstruction and Development (EBRD), the Bank continued to collaborate closely with the Ministry for Finance on issues related to Malta's membership of this institution. In particular, the Bank provided advice to the Ministry on various resolutions, which required decisions by the EBRD's Board of Governors.

The EBRD constituency – of which Malta forms part – is led by Austria and includes Bosnia and Herzegovina, Cyprus, Kazakhstan and Israel. In March, the annual constituency meeting was held in Cyprus to discuss current developments ahead of the EBRD Annual Meeting. The main focus was the Bank's assistance in terms of the Green City Framework given the critical importance of cities in delivering climate change mitigation and adaptation goals. During this meeting, the Central Bank of Malta was represented by the Deputy Governor for Monetary Policy.

In May, the Deputy Governor for Monetary Policy accompanied the Minister for Finance to the 2019 EBRD Annual Meeting and Business Forum in Bosnia and Herzegovina. The over-arching theme of the meeting was "Connecting Economies for Stronger Growth", during which discussions focussed on various topics from boosting small businesses to the effects of migration on labour markets, the opportunities and drawbacks of tourism, and ways to connect countries and regions to the global economy.

IMF

In the IMF, Malta forms part of the IMF constituency headed by Italy which also includes Albania, Greece, Portugal and San Marino.

In February, the joint IMF/World Bank Constituency meeting was held in Malta, the main theme of which was gender inclusion and equality. The Minister for Finance, in his capacity as Malta's Governor on the Board of Governors of the IMF, was accompanied by the Governor of the Bank as the Alternate Governor of the

Fund. The Minister for Finance attended the joint IMF/World Bank Spring Meetings in April and the Annual Meetings in October held in Washington. On both occasions, the Minister was accompanied by the Deputy Governor for Monetary Policy. During the year, the Central Bank of Malta advised the Ministry for Finance on a number of resolutions proposed by the Fund's Executive Board.

In January 2019, IMF staff members conducted a visit in connection with the 2019 Article IV consultation. The IMF mission held a number of meetings with senior officials of the Central Bank of Malta, the Government, the MFSA and other entities. The consultation was concluded on 27 February 2019.

During 2019, Malta's net cumulative allocation of Special Drawing Rights (SDR), which is computed in proportion to its quota share, remained unchanged at SDR95.4 million. The Bank's SDR holdings also remained broadly unchanged at SDR87.5 million.

The Bank also continued to carry out transactions related to the IMF's operational budget. During 2019, Malta's reserve tranche position increased by SDR3 million on a year earlier to SDR31.7 million on account of new drawings under the Financial Transaction Plan.[1] Correspondingly the Fund's holdings of the national currency with the Bank decreased to the equivalent of SDR136.7 million[2] by the end of the year from SDR139.7 million a year earlier.

The current bilateral loan agreement between the Bank and the Fund was endorsed by the Governor in September 2017. The loan is for an SDR-denominated amount of up to the equivalent of €0.26 billion, the amount being the same as the previous loan agreement which expired in January 2017. No drawings were effected during 2019. In July 2019, the Bank agreed to the extension of the bilateral loan agreement for a further year up to 2020.

World Bank Group

The Bank continued to assist the Minister for Finance in his role as Malta's representative by monitoring developments within the World Bank Group and by providing advice on particular initiatives from the Group. During 2019, the Bank provided the Ministry with background documentation and recommendations on various resolutions.

Asian Infrastructure Investment Bank

The Bank, together with the Ministry for Finance, started monitoring developments in the Asian Infrastructure Investment Bank (AIIB), following the acceptance of the instrument of ratification for Malta in January 2016. The Maltese Parliament had approved the ratification of the articles of agreement, which established the AIIB as an international organisation, in December 2015.

Malta is represented on the AIIB's Board of Governors by the Minister for Finance, with the Governor of the Central Bank of Malta as the Alternate Governor. Malta forms part of the euro area constituency which also includes Austria, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Portugal, Spain, Cyprus, Ireland and Greece.

During the year the Bank advised the Ministry for Finance on a number of AIIB resolutions related to the formation and administration of the recently set up AIIB including applications for new membership.

In 2019, a number of constituency meetings were also held, on which occasions Malta was represented by officials from the Ministry for Finance with the support of the Bank. At the AIIB Annual Meeting which was held in Luxembourg between 12 and 13 July, Malta was represented by the Minister for Finance in his capacity of Governor of the AIIB, accompanied by the Deputy Governor for Monetary Policy.

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[1] The Financial Transactions Plan is the mechanism through which the Fund finances its lending and repayment operations in IMF's principal account.

[2] Figures for the reserve tranche position and the Fund's holdings of national currency do not add up to SDR168.3 million (quota) due to rounding.

Commonwealth Small States Trade Finance Facility

The Bank continued to support efforts to establish a trade finance facility for the small states of the Commonwealth, by providing banking services. The Commonwealth Small States Trade Finance Facility is expected to play an important role in enhancing trade and investment finance – particularly for small and vulnerable Commonwealth States with limited access to international trade finance. The Facility became operational in autumn 2018.

Other international institutions

An internal task force, chaired by the Governor, which was set up to monitor developments related to the exit of the United Kingdom from the European Union, continued to co-ordinate internal work on the economic and financial implications of Brexit.

The Central Bank of Malta is aiming to becoming a regional hub of specialist teaching, training and research excellence through its expanding network of cooperation agreements with international academic institutions of high repute.

In September, two international courses on central banking were organised by the Central Bank of Malta, together with the School of Economics of the University of Nottingham in the context of an agreement between the two institutions on a joint training programme for central bankers. Central bankers from Europe, Africa and the Middle East joined Maltese colleagues and a number of University of Malta graduates for the week-long courses. Dr Paul Mizen, Professor of Monetary Economics at the University of Nottingham, delivered a course on *Monetary Theory and Policy*. Dr Alejandro Riaño, Associate Professor at the University of Nottingham, lectured on *Macroeconomics: Economic Cycles, Frictions and Policy*.

Non EU, Bilateral and Commonwealth Relations Office

During 2019, the Non EU, Bilateral and Commonwealth Relations Office was established within the International Relations Department. The office was involved in numerous projects.

- **Libyan citizens working and residing in Malta**
  Following queries received by a foreign journalist about the impact of Libyan migration on the Maltese economy, the Office analysed available data on Libyans working and residing in Malta, as well as trade relations between Malta and Libya.
- **Report on Maghreb and Mashreq countries**
  The Office compiled extensive information on Maghreb and Mashreq countries, including Algeria, Libya, Tunisia, Morocco, Egypt, Jordan, Lebanon, Syria and Iran. The report presented an overview of:
  - the economic, social and political situations in each of the above-mentioned countries;
  - their trade and investment relations with Malta;
  - their relations with the European Union;
  - the role of each country's central bank and recent monetary policy decisions.
- **International sanctions on Iran**
  The Office prepared a document providing general information about the international sanctions against Iran. The document outlined the different sanctions imposed against Iran over the years, the impact of these sanctions on Iran's economy, and possible developments regarding US and EU relations with Iran.
- **Trade relations between Malta and Czech Republic**
  In preparation for a public lecture delivered at the Central Bank of Malta by the Deputy Governor of the Ceská Národní Banka, staff analysed data on trade between Malta and Czech Republic, which showed that trade between these two countries is minimal.
- **Trade flows between the Commonwealth and the European Union**
  A main project for this Office, which is still ongoing, is the study of trade flows between Commonwealth countries and EU member states. This study makes use of granular trade data to provide an analysis of different trade scenarios between the Commonwealth and the European Union.



8. CORPORATE SOCIAL RESPONSIBILITY

The Central Bank of Malta is one of Malta's leading institutions – both in terms of human resources and through its role in maintaining stability in prices and in the country's financial system. It is, therefore, well aware of its CSR, which encompasses a broad spectrum of stakeholders, ranging from its employees and the environment, to the community and national heritage.

As from this year, CSR has been given its own section in the annual report, a symbolic move that reflects the ever-increasing emphasis on the Bank's activities, all of which receive the highest levels of support across management and employees.

The setting up of a foundation as a separate legal entity also ensured that any outreach is subjected to full transparency and accountability, particularly given the funding involved in the Bank's sponsorship and support of various initiatives.

The selection below provides some insight to the Bank's rich input into this important field.

CBM Foundation



It has been a busy six months for the Central Bank of Malta Foundation, which was formally established as a public benefit foundation in July 2019, following a resolution by the Board of Directors. The Foundation has an autonomous Board of Administrators, who assess proposals and requests, keeping a vigilant eye on the stated aim: to support projects of a national stature with lasting visibility relating to education, culture, scientific research, preservation of Maltese national heritage and social causes.

The first major project to be undertaken was a one-year sponsorship of the Malta Philharmonic Orchestra (MPO), which had already been supported by the Bank for the previous two years.

Malta Coin Centre



In 2015, the Bank and the Malta Community Chest Fund (MCCF) collaborated on the launch of a five-year programme involving coins designed by students from secondary schools, with the theme: *Mit-tfal b'Solidarjetà*. The MCCF is a charitable foundation under the auspices of the President of Malta, which helps individuals in need. €2 commemorative coins were issued by the Bank in coin cards and commemorative coin rolls, and profits from the sale were donated to the MCCF. In 2019, a total of €50,000, representing the profits from the third coin card issued in 2018, were presented to H.E. President of Malta George Vella. The last of the series of five coins will be issued in 2020.

President's Visit



H.E. President of Malta George Vella made an official visit to the Bank in autumn, meeting the Board of Directors and executives, as well as spending time with all the staff. A presentation was delivered on the Bank's role as a responsible employer and as an important institution in the community.

Apart from a five-year collaboration between the Malta Coin Centre and the MCCF, the Bank organises various events to raise money for the charity, including a book sale during *Notte Bianca* and an annual dress down day against staff donations, which were topped up to €12,000 – presented during the Boxing Day Strina telethon. It also sponsors staff participation in the annual Fun Run, which also raises money for MCCF.

Malta Philharmonic Orchestra



The Bank had already sponsored the MPO for two years but, in 2019, that honour was passed on to the Central Bank of Malta Foundation, which confirmed its support for a third year.

The agreement brings a number of benefits for the Bank, including an exclusive concert (photo above) for staff and guests, this year held at the Manoel Theatre under the auspices of H.E. President of Malta George Vella, ensembles performing at Bank activities and an outreach concert (see more below).

The MPO uses such funding mainly to buy instruments and to help with its internship programme.

Notte Bianca 2019



The Bank has opened its doors to the public during *Notte Bianca* since 2010, with 2019 being no exception. A special exhibition of coins was brought in to enhance the museum's existing collection, while the Malta Coin Centre was busy selling coins throughout the night. The Bank took the opportunity to offer advice on recognising genuine banknotes, explaining its role and offering souvenir bags of shredded banknotes.

Thousands of visitors were entertained by an ensemble from the Malta Youth Orchestra and by a harp/flute ensemble, while the Bonsai Society were given the opportunity to show off their masterpieces.

Outreach



The Bank maintains strong relations with the community and frequently uses its respected status to help others. One of the main events in 2019 was a joyful Christmas-themed concert for residents and staff of *Id-Dar tal-Providenza*, performed by an ensemble from the MPO. However, there were several other campaigns during the year, including one organised by the Social Club which successfully promoted registration of staff as organ donors, and events to mark Pink October and Movember, with staff donations being passed on to the Marigold Foundation. Other staff-related initiatives included an ice-cream day in aid of Inspire Foundation and a generous donation to The Children's Dreams campaign organised by *Aġenzija Appoġġ*. Blood donation events have also become a regular feature, organised every four months.

Education and Career Development



The Bank accommodates a number of requests for schools visits, from both Malta and overseas, to explain its role to younger generations, as well as to inspire them to think of the Bank as a rewarding employer. The Bank also has close ties with the University of Malta and the Malta College for Arts, Science and Technology and offers a number of internships every year. The Bank takes career development very seriously and has signed agreements with the University of Nottingham and Queen Mary University in London for the provision of courses. Under the Learning Research and Development programme, the Bank assists staff members to pursue academic studies on both full time, part time or on distance learning basis paying tuition fees, and releases in hours – without loss of pay – to attend lectures at reputable academic institutions.

Staff



The Social Club – which has sub-committees to look after sports, cultural and religious aspects – has an active role in fostering a team spirit among employees, organising a number of events for staff as well as for their families. It also organised staff participation in the President's Fun Run, which raises money for the MFCC. Events varied in size and genre, including a quiz night, cookery sessions, teambuilding events, summer and Christmas parties, karaoke and bowling among others. Pictured above is a staff visit to Sicily.

Just as importantly, the Bank has a number of measures in place to help staff maintain a work/life balance as well as support during difficult times. Family-friendly measures include reduced hours, childcare subsidies, parental leave, flexitime, teleworking, and – of course – gender pay equality.

Library



The Library has been given a broad role in supporting the activities of the Bank, and is constantly building up its stock of printed and digital publications relating to economics and finance. The number of subscribers registered with the Library has been growing steadily and was given a boost by participation in the popular National Book Fair (seen above).

The Library's staff is frequently roped in to help with research being undertaken by both staff and other academics, while the unit also promotes financial literacy and other causes through a schedule of public lectures.

Environment



The Central Bank of Malta was proud to join the NGFS last July, joining more than two-thirds of global systemically-important banks and insurers. However, even on a micro-level, it has taken steps to improve its environmental footprint. Single-use plastic was reduced by providing filtered tap water in glass jugs rather than small plastic bottles during meetings, while employees are encouraged to bring their own mugs – or paper cups – for hot drinks. Plastic stirrers were also replaced with wooden ones. Second-class water is used in the toilets, as well as for the drip irrigation of the extensive garden areas, while electricity bills were contained by introducing energy-efficient lighting. The Bank also extended its tree planting programme beyond its own premises and planted dozens of trees in various locations through *Ambjent Malta* (shown above).

PUBLIC EVENTS 2019

28 FEBRUARY 2019

LIBRARY

Ms Josephine Farrugia delivered a lecture with the theme *'Aviation in Malta'*, explaining the diverse economic sectors of the aviation industry in which Malta is involved, as well as the growing aviation register.

7 and 13 MARCH 2019

ECONOMICS DEPARTMENT

Two lectures were delivered by Fulbright Scholar Professor Andrew Narwold of the Department of Economics at the University of San Diego, whose core expertise is in housing market economics and consumer financial decisions. These dealt with *'Hedonic pricing and housing price indices'* and *'Assessing the impact of policy changes on house prices'*.



While in Malta, Professor Narwold also lectured game theory to postgraduate economics students, an essential part of the intermediate microeconomics curriculum.

15 MARCH 2019

ECONOMICS DEPARTMENT

Professor Sujoy Mukerji, Head of the School of Economics and Finance at QMUL, delivered a public lecture with the theme *'Knightian uncertainty and asset prices'*, explaining decision-making under ambiguous uncertainty, and its relevance in economic and financial contexts, in particular the credit crises between 2008 and 2012.

12 APRIL 2019

LIBRARY

Professor Yosanne Vella delved into a topic that she has researched for the past 20 years, on the theme of *'Women in Malta in the 18th Century'*, based on findings from a number of papers on the subject.



2 MAY 2019

ECONOMICS DEPARTMENT

Dr Filippo di Mauro delivered a public lecture on the main findings from the Competitiveness Research Network (CompNet).

CompNet, which he chairs, was set up by central banks and EU institutions to understand how firms' productivity changes in the era of digitalisation and integrated global value chains.

Dr di Mauro is Professor of Economics at the Business School at the National University of Singapore and consultant for the Monetary Authority of Singapore, the Economic Development Board of Singapore and the World Bank.

9 MAY 2019

GOVERNOR'S OFFICE

Speakers from Finland, Italy, Malta the Netherlands and United Kingdom delivered lectures on the theme *'Waiting for populism? Problems of interpretation and policy implications Four lectures and a conversation'*. The Central Bank of Malta is promoting the setting up of an informal interdisciplinary European populism research network.



The lectures were delivered by the Governor of the Bank of Finland Dr Olli Rehn, economist Professor Donato Masciandaro of Bocconi University, Milan, sociologist Professor Emeritus Nico Wilterdink of the University of Amsterdam, political theorist Professor Jason Glynos from Essex University, UK, and Dr Mario Vella, Governor of the Central Bank of Malta.

18 SEPTEMBER 2019

MONETARY POLICY & OPERATIONS AND EUROSYSTEM RELATIONS DEPARTMENT

Professor Paul Mizen from the University of Nottingham delivered a public lecture entitled: *'Are we nearly there yet? Evidence from business expectations and uncertainty about Brexit'*.



Professor Mizen has been a consultant to the ECB and the Bank of England, among other institutions, and he forms part of the Decision Maker Panel (DMP) team, which runs a large and representative monthly survey of UK firms.

In addition to this lecture, two high-level training courses on monetary policy and macroeconomics were also delivered in September by Professor Mizen and Dr Alejandro Riaño, who is an Associate Professor at the University of Nottingham's School of Economics.

25 OCTOBER 2019

LIBRARY

'Blasphemous rumours? From school to industry in post-colonial Malta' was the theme of the public lecture by University of Malta lecturer Dr Joseph Gravina. The lecturer provided critical insights into the relationship between education strategies and models of economic development in post-colonial Malta. He devoted special attention to the changing language of policy, observing that changes in rhetoric are not always in line with reality.

12 NOVEMBER 2109

GOVERNOR'S OFFICE

The Deputy Governor of the Czech National Bank, Marek Mora, delivered a public lecture entitled *'Czech Republic: 20 years of inflation targeting and the way forward'*, during which he explained that setting flexible inflation targets had turned out to be a successful monetary policy tool for the Republic over the past 20 years, bringing high inflation levels down to the desired targets.

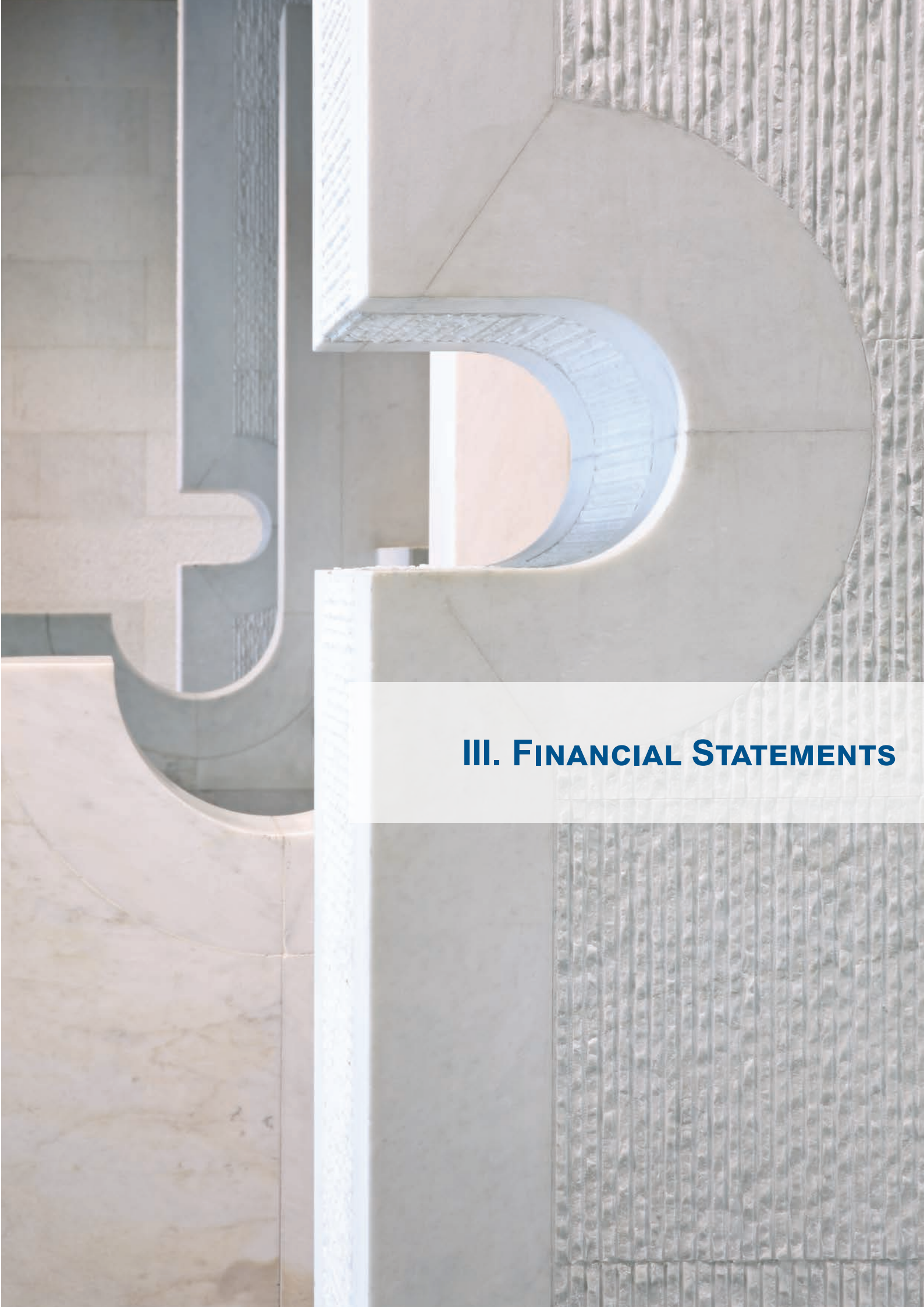


9 DECEMBER 2019

LIBRARY

Fascinating insights into centuries of banking in Malta were shared by banking historian Dr John Consiglio, who has written a number of books and articles on Malta's banking history and the history of banking in the Mediterranean. His 2006 book on the history of banking in Malta remains the only comprehensive historical record so far on the topic.





III. Financial Statements

Directors' report

The Directors present their report and the audited financial statements of the Central Bank of Malta (the Bank) for the year ended 31 December 2019.

Presentation of the financial statements

These financial statements have been prepared so as to give a true and fair view of the state of affairs of the Bank as at 31 December 2019, and of its profit for the year then ended. The financial statements have been prepared in accordance with the provisions established by the Governing Council of the European Central Bank under Article 26.4 of the Statute of the European System of Central Banks and of the European Central Bank and in accordance with the requirements of the Central Bank of Malta Act (Cap. 204). The provisions established by the Governing Council of the European Central Bank are outlined in the Guideline of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2016/34) as amended by the Guideline of 28 November 2019 (ECB/2019/34).

Financial results

The Bank's financial statements for the year ended 31 December 2019 are set out on pages A-4 to A-41 and disclose a profit for the year of €31.5 million (2018: €28.0 million) which is payable to the Government of Malta.

Board of Directors

The members of the Board of Directors during the year ended 31 December 2019 and up to the date of authorisation for issue of the financial statements were:

Dr Mario Vella – Governor
Mr Alexander Demarco – Deputy Governor Monetary Policy (re-appointed 1 January 2019)
Mr Oliver Bonello – Deputy Governor Financial Stability
Ms Philomena Meli
Professor Peter J. Baldacchino
Dr Romina Cuschieri
Professor Frank Bezzina

During the financial year, Mr Herbert Zammit LaFerla was Secretary to the Board.

Statement of Directors' responsibilities in respect of the financial statements

The Board of Directors is responsible for ensuring that the financial statements are drawn up in accordance with the requirements of the Central Bank of Malta Act (Cap. 204). The Bank is required to prepare financial statements in accordance with the requirements of the Guideline of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2016/34) as amended by the Guideline of 28 November 2019 (ECB/2019/34).

The Board of Directors is responsible for ensuring that these financial statements give a true and fair view of the state of affairs of the Bank as at 31 December 2019 and of the profit for the year then ended.

In preparing the financial statements, the Directors are responsible for selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

The Directors are also responsible for designing, implementing and maintaining internal controls relevant to the preparation and the fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error, and that comply with the requirements set out above. They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The financial statements of the Central Bank of Malta for the year ended 31 December 2019 are included in the Annual Report 2019, which is published in printed form and is made available on the Bank's website*. The Directors are responsible for the maintenance and integrity of the Annual Report on the website in view of their responsibility for the controls over, and the security of, the website. Access to information published on the Bank's website is available in other countries and jurisdictions, where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

Auditors

KPMG were appointed as the auditors of the Bank with effect from this financial year and signify their willingness to continue in office.

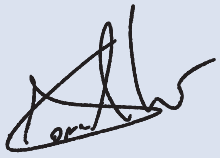
By order of the Board.



Dr Mario Vella
Governor



Mr Alexander Demarco
Deputy Governor



Mr Oliver Bonello
Deputy Governor

Central Bank of Malta
Pjazza Kastilja
Valletta VLT 1060
Malta

16 March 2020

* https://www.centralbankmalta.org/annual-reports

Balance Sheet as at 31 December 2019

	Assets	2019 €'000	2018 €'000
A 1	**Gold and gold receivables**	**23,708**	**3,484**
A 2	**Claims on non-euro area residents denominated in foreign currency**	**752,287**	**829,626**
A 2.1	Receivables from the IMF	147,005	140,956
A 2.2	Balances with banks and security investments, external loans and other external assets	605,282	688,670
A 3	**Claims on euro area residents denominated in foreign currency**	**93,089**	**60,207**
A 4	**Claims on non-euro area residents denominated in euro**	**584,989**	**683,087**
A 4.1	Balances with banks, security investments and loans	584,989	683,087
A 4.2	Claims arising from the credit facility under ERM II	-	-
A 5	**Lending to euro area credit institutions related to monetary policy operations denominated in euro**	**40,000**	**80,010**
A 5.1	Main refinancing operations	-	-
A 5.2	Longer-term refinancing operations	40,000	80,010
A 5.3	Fine-tuning reverse operations	-	-
A 5.4	Structural reverse operations	-	-
A 5.5	Marginal lending facility	-	-
A 5.6	Credits related to margin calls	-	-
A 6	**Other claims on euro area credit institutions denominated in euro**	**8,330**	**13,609**
A 7	**Securities of euro area residents denominated in euro**	**1,349,111**	**1,459,172**
A 7.1	Securities held for monetary policy purposes	889,290	946,040
A 7.2	Other securities	459,821	513,132
A 8	**General government debt denominated in euro**	**-**	**-**
A 9	**Intra-Eurosystem claims**	**5,620,180**	**4,588,041**
A 9.1	Participating interest in ECB	21,028	15,859
A 9.2	Claims equivalent to the transfer of foreign reserves	42,420	37,552
A 9.3	Claims related to the issuance of ECB debt certificates*	-	-
A 9.4	Net claims related to the allocation of euro banknotes within the Eurosystem	-	-
A 9.5	Other claims within the Eurosystem (net)	5,556,732	4,534,630
A 10	**Items in course of settlement**	**34,362**	**13,586**
A 11	**Other assets**	**782,133**	**1,123,036**
A 11.1	Coins of euro area	48	31
A 11.2	Tangible and intangible fixed assets	37,302	37,382
A 11.3	Other financial assets	700,976	1,030,416
A 11.4	Off-balance sheet instruments revaluation differences	1,924	3,010
A 11.5	Accruals and prepaid expenses	26,232	30,917
A 11.6	Sundry	15,651	21,280
Total Assets		**9,288,189**	**8,853,858**

* Only an ECB balance sheet item

	Liabilities	2019 €'000	2018 €'000
L 1	**Banknotes in circulation**	**1,247,496**	**1,046,464**
L 2	**Liabilities to euro area credit institutions related to monetary policy operations denominated in euro**	**5,433,289**	**5,265,242**
L 2.1	Current accounts (covering the minimum reserve system)	5,395,289	1,651,432
L 2.2	Deposit facility	38,000	3,613,810
L 2.3	Fixed-term deposits	-	-
L 2.4	Fine-tuning reverse operations	-	-
L 2.5	Deposits related to margin calls	-	-
L 3	**Other liabilities to euro area credit institutions denominated in euro**	**-**	**-**
L 4	**Debt certificates issued***	**-**	**-**
L 5	**Liabilities to other euro area residents denominated in euro**	**1,276,909**	**1,335,125**
L 5.1	General government	725,741	585,414
L 5.2	Other liabilities	551,168	749,711
L 6	**Liabilities to non-euro area residents denominated in euro**	**19,114**	**72**
L 7	**Liabilities to euro area residents denominated in foreign currency**	**310,239**	**279,275**
L 8	**Liabilities to non-euro area residents denominated in foreign currency**	**8,902**	**-**
L 8.1	Deposits, balances and other liabilities	8,902	-
L 8.2	Liabilities arising from the credit facility under ERM II	-	-
L 9	**Counterpart of special drawing rights allocated by the IMF**	**117,716**	**115,951**
L 10	**Intra-Eurosystem liabilities**	**300,791**	**287,254**
L 10.1	Liabilities equivalent to the transfer of foreign reserves*	-	-
L 10.2	Liabilities related to the issuance of ECB debt certificates	-	-
L 10.3	Net liabilities related to the allocation of euro banknotes within the Eurosystem	300,791	287,254
L 10.4	Other liabilities within the Eurosystem (net)	-	-
L 11	**Items in course of settlement**	**-**	**-**
L 12	**Other liabilities**	**43,347**	**24,204**
L 12.1	Off-balance sheet instruments revaluation differences	939	434
L 12.2	Accruals and income collected in advance	3,709	4,388
L 12.3	Sundry	38,699	19,382
L 13	**Provisions**	**115,178**	**97,228**
L 14	**Revaluation accounts**	**11,255**	**7,331**
L 15	**Capital and reserves**	**372,453**	**367,712**
L 15.1	Capital	20,000	20,000
L 15.2	Reserves	352,453	347,712
L 16	**Profit for the year**	**31,500**	**28,000**
Total Liabilities		**9,288,189**	**8,853,858**

* Only an ECB balance sheet item

Profit and Loss account for the year ended 31 December 2019

		2019 €'000	2018 €'000
1.1	Interest income	58,426	55,333
1.2	Interest expense	669	4,830
1	**Net interest income**	**59,095**	**60,163**
2.1	Realised gains/losses arising from financial operations	17,247	3,644
2.2	Write-downs on financial assets and positions	(415)	(2,198)
2.3	Transfer to/from provisions for financial risks	(18,016)	(10,323)
2	**Net result of financial operations, write-downs and risk provisions**	**(1,184)**	**(8,877)**
3.1	Fees and commissions income	629	394
3.2	Fees and commissions expense	(1,075)	(792)
3	**Net income/expense from fees and commissions**	**(446)**	**(398)**
4	**Income from equity shares and participating interests**	**1,858**	**1,361**
5	**Net result of pooling of monetary income**	**(7,169)**	**(6,630)**
6	**Other income**	**1,575**	**3,685**
	Total net income	**53,729**	**49,304**
7	**Staff costs**	**(13,169)**	**(12,547)**
8	**Administrative expenses**	**(7,270)**	**(7,067)**
9	**Depreciation of tangible and intangible fixed assets**	**(1,550)**	**(1,348)**
10	**Banknote production services**	**(236)**	**(342)**
11	**Other expenses**	**(4)**	**-**
	Profit for the year	**31,500**	**28,000**
	Transfer to reserves for risks and contingencies	**-**	**-**
	Payable to the Government of Malta in terms of article 22(2) of the Central Bank of Malta Act (Cap. 204)	**31,500**	**28,000**

The financial statements on pages A-4 to A-41 were approved for issue by the Board of Directors on 16 March 2020 and are signed on its behalf by:

Dr Mario Vella
Governor

Mr Alexander Demarco
Deputy Governor

Mr Oliver Bonello
Deputy Governor

Mr Raymond Filletti
Chief Officer
Financial Control and Risk

Ms Maryanne Attard
Head
Financial Control

Notes to the financial statements for the year ended 31 December 2019

General notes to the financial statements

1 The Eurosystem

The Central Bank of Malta (the Bank) is a participating member of the Eurosystem and has joint responsibility for monetary policy and for exercising the common strategic goals of the European System of Central Banks (ESCB).[1]

2 Basis of preparation

The Bank is required to prepare its financial statements in accordance with the guideline on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) ECB/2016/34 issued on 3 November 2016 as amended by subsequent ECB guidelines[2] (the Guideline), as established by the Central Bank of Malta Act (Chapter 204, Laws of Malta) (the Act).

In line with the requirements of the guideline, in cases where the guideline does not provide specific direction, the requirements of generally accepted accounting principles are applied. In the case of the Bank, reference is made to International Financial Reporting Standards (IFRS) as adopted by the EU.

These financial statements have been drawn up so as to give a true and fair view of the state of affairs of the Bank as at 31 December 2019 and of its profit for the year then ended. The accounts have been prepared on a historical cost basis, modified to include the revaluation of gold, foreign currency instruments, securities (other than securities classified as held-to-maturity and securities held for monetary policy purposes that are accounted for at amortised cost), as well as other financial instruments, both on-balance sheet and off-balance sheet, at mid-market rates and prices.

3 Accounting policies

(a) Basic accounting principles

The basic accounting principles applied by the Bank in the preparation of these financial statements are:

- economic reality and transparency;
- prudence;
- materiality;
- consistency and comparability;
- going concern;
- accruals principle;
- post-balance sheet events.

(b) Change in accounting policy

Until 31 December 2018, the Bank recorded costs related to lease agreements under the profit and loss account item 8 ‘Administrative expenses’ over the lease term. As from 1 January 2019, the Bank modified

[1] The European Central Bank (ECB), together with national central banks (NCBs), shall constitute the ESCB. The ECB together with the NCBs of the Member States whose currency is the euro, constitute the Eurosystem and shall conduct the monetary policy of the Union, as per Article 282.1 of the Treaty of the Functioning of the European Union. The Eurosystem and the ESCB will co-exist as long as there are European Union (EU) Member States outside the euro area.

[2] Guideline ECB/2019/34 entered into force on 31 December 2019.

its accounting policy following the issue of IFRS 16 'Leases'. On initial application, the Bank reassessed all lease agreements of tangible fixed assets to determine whether they meet the definition of a lease accordingly.

The Bank recognised leases using the modified retrospective approach, according to which a right-of-use asset is equivalent to the related lease liability. The lease liabilities were measured at the present value of the future lease payments, discounted using the Bank's incremental borrowing rate. This approach implies that the comparative information for 2018 was not restated.

The resulting right-of-use assets and lease liabilities recognised on the Balance Sheet as at 1 January 2019, under asset item A 11.2 'Tangible and intangible fixed assets' and liability item L 12.3 'Sundry', are as follows:

	Balance as at 31 December 2018 €'000	Adjustment due to policy change on 1 January 2019 €'000	Balance as at 1 January 2019 €'000
Tangible and intangible fixed assets	37,382	719	38,101
Sundry liabilities	19,382	719	20,101

(c) Recognition of assets and liabilities

An asset or liability is only recognised in the balance sheet when it is probable that any associated future economic benefit will flow to or from the Bank, substantially all of the associated risks and rewards have been transferred to or from the Bank, and the cost or value of the asset or liability can be measured reliably.

(d) Recording of transactions

Foreign exchange transactions, comprising spot and forward deals in gold and foreign currencies, are recognised on trade date at the prevailing spot exchange rate of the forward transaction. Realised gains and losses arising from sale transactions are calculated at the average cost of the currency position on trade date in accordance with the daily netting procedure for purchases and sales.

All security transactions in foreign currencies are recorded on-balance sheet on settlement date at the applicable exchange rate. Accrued interest, premiums and discounts related to financial assets and liabilities are calculated and booked daily from the settlement date at daily exchange rates, as applicable, and the foreign currency position is affected daily by these accruals denominated in foreign currency.

All other transactions are recorded in the balance sheet at market exchange rates prevailing on the day of the transaction.

(e) Balance sheet valuation rules

Financial assets and liabilities denominated in foreign currency, including off-balance sheet positions, are revalued at the prevailing mid-market exchange rates at the balance sheet date. Securities and Treasury bills other than those classified as held-to-maturity, and securities held for monetary policy purposes that are accounted for at amortised cost, are revalued at the prevailing mid-market prices at the balance sheet date.

Gold balances are revalued at market prices prevailing at the year-end. No distinction is made between price and currency revaluation differences for gold, but a single gold revaluation difference is accounted for on the basis of the euro price per defined unit of weight of gold derived from the euro/US dollar exchange rate at the balance sheet date.

Foreign currency positions (including off-balance sheet transactions) are revalued on a currency-by-currency basis. Holdings of special drawing rights (SDRs), including designated individual foreign exchange holdings underlying the SDR basket, are treated as one holding. In the case of securities, revaluation is carried out on a code-by-code basis (same ISIN number/type) and is treated separately from exchange rate revaluation.

(f) Cost of transactions

The average cost method is used on a daily basis for calculating the acquisition cost of assets and liabilities that are subject to price and/or exchange rate movements. The average cost price of securities and/or the average rate of the foreign currency position are adjusted by unrealised losses taken to the profit and loss account at the end of the year.

All securities are initially recorded at transaction price. For the purpose of calculating the average purchase cost of a security, all purchases made during the day are added to the cost of the previous day's holding to produce a new weighted average price before applying the sales for the same day.

In the case of long foreign currency or gold positions, net inflows made during the day are added, at the average rate or gold price of the inflows of the day for each respective currency and gold, to the previous day's holding, to produce a new weighted average cost. Where a short position exists, the reverse treatment applies whereby the average cost is affected by net outflows.

(g) Recognition of income and expenses

Income and expenses are recognised in the period in which they are earned or incurred.

(i) Interest income and expense

Interest income and expense are recognised in the profit and loss account for all interest-bearing assets and liabilities.

Interest income and interest expense arising from monetary policy operations are reported on a net basis on a balance sheet sub-item level, under either 'Interest income' or 'Interest expense' depending on whether the net amount generated or incurred is positive or negative.

Premiums or discounts arising from the difference between the average acquisition cost and the redemption price of securities are presented as part of interest income and are amortised over the remaining term of the security using either the straight-line method or the internal rate of return method. The internal rate of return method is used in the case of discount securities with a remaining maturity of more than one year at the time of acquisition. Interest accruals on foreign currency assets and liabilities are converted at the mid-market rate on each business day and are included in the respective foreign currency position to determine the average book value, as applicable.

Accordingly, interest income includes coupons earned on securities and amortised premiums or discounts on Treasury bills and other instruments. In respect of forward exchange contracts, the difference between the deemed spot exchange rate of the forward contract and the deal rate is considered as interest income or expense and is amortised on a straight-line basis from the trade date to settlement date.

(ii) Gains and losses arising from foreign exchange, gold and securities

Realised gains and realised losses can only arise in the case of transactions leading to a reduction in foreign currency positions or on the sale of securities.

In the case of foreign currency or gold positions, inflows and outflows are compared against each other to determine any realised gains or losses. The resulting net inflow or outflow, apart from changing the foreign

currency or gold positions, will give rise to either a change in the average rate of that currency or the average price of gold. It may also give rise to the realisation of a further profit or loss depending on whether the Bank has a long or short position in a particular currency or gold. On a daily basis, a weighted average rate for foreign currencies and a price for gold are calculated, firstly on inflows and then on outflows. The realised gain or loss is calculated by applying the difference between these average rates and prices to the lower of the day's inflows or outflows.

For long positions, where outflows exceed inflows, a second realised gain or loss is calculated, equating to the difference between the net outflows of the day valued at the average outflow price and at the average cost of the day's opening position. Where inflows exceed outflows, the net inflow is added to the position held at the beginning of the day, thus changing the average cost of the position. For short positions, the reverse accounting treatment is applied.

In the case of securities, realised gains or losses are derived by comparing the transaction value with the average cost of the respective security. All realised gains and losses are taken to the profit and loss account.

Unrealised revaluation gains and losses arise as a result of the revaluation of assets and liabilities by comparing the market value with the average book value. Unrealised gains are not recognised as income but are transferred directly to a revaluation account. Unrealised losses, except as explained in accounting policy 3 (i) (ii), are taken to the profit and loss account when they exceed previous unrealised gains registered in the corresponding revaluation account. Unrealised losses recorded in the profit and loss account in previous years are not reversed against unrealised gains in subsequent years. Unrealised losses in any one security or in any foreign currency (including gold holdings) are not netted against unrealised gains in other securities or other foreign currency.

(h) Off-balance sheet instruments

Spot and forward foreign exchange contracts and daily changes in the variation margins of future contracts are included in the net foreign currency position for the purpose of calculating the average cost of currencies and determining realised foreign exchange gains and losses. Futures are accounted for and revalued on an item-by-item basis. Daily changes in the variation margins of open futures contracts, representing realised gains and losses, are recognised in the profit and loss account.

Gains and losses arising from off-balance sheet instruments are recognised and treated in a similar manner to on-balance sheet instruments. Realised and unrealised gains and losses are measured and accounted as outlined in the accounting policy 3 (g) 'Recognition of income and expenses' above.

Unrealised valuation gains or losses on spot and forward foreign exchange contracts are recorded from the trade date to the settlement date under asset sub-item A 11.4 'Off-balance sheet instruments revaluation differences' and under liability sub-item L 12.1 'Off-balance sheet instruments revaluation differences' as applicable.

(i) Securities

(i) Securities held for monetary policy purposes

Debt securities currently held for monetary policy purposes are accounted for at amortised cost subject to impairment.

(ii) Securities held for other than monetary policy purposes

Marketable debt securities classified as held-to-maturity are measured at amortised cost subject to impairment. Held-to-maturity securities are securities with fixed or determinable payments and a fixed maturity,

which the Bank intends to hold until maturity. Securities classified as held-to-maturity may be sold before their maturity in any of the following instances:[3]

- if the quantity sold is considered not significant in comparison with the total amount of the held-to-maturity securities portfolio;
- if the securities are sold during the month of the maturity date;
- under exceptional circumstances, such as a significant deterioration of the issuer's creditworthiness.

Marketable securities (other than those held-to-maturity) are valued at the mid-market prices at the balance sheet date, on a security-by-security basis. For the year ended 31 December 2019, mid-market prices at that date were used.

The Bank holds financial instruments which are designated as part of an earmarked portfolio comprising investments held as a counterpart to the Bank's capital and statutory reserves. The Bank also holds securities forming part of another earmarked portfolio comprising Malta Government Stocks (MGS) and Treasury bills purchased on the secondary market in its role as a market maker. These two earmarked portfolios are measured at mid-market prices prevailing at the balance sheet date. Unrealised gains are reflected on-balance sheet under liabilities sub-item L 12.3 'Sundry', while unrealised losses are recognised under assets sub-item A 11.6 'Sundry'.

(j) Sale and repurchase agreements and lending of securities

Securities sold subject to repurchase agreements (repos) are retained in the financial statements in the appropriate classification on the assets side of the balance sheet while the counterparty liability is included as a collateralised inward deposit on the liabilities side of the balance sheet, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as a collateralised outward loan on the assets side of the balance sheet, as appropriate. The difference between the sale and repurchase price is treated as interest and is accrued in the profit and loss account over the term of the agreement on a straight-line basis. Securities lent to counterparties are also retained in the financial statements.

(k) Claims on the International Monetary Fund (IMF)

The IMF Reserve Tranche Position, SDRs and other claims on the IMF are translated into euro at the year-end ECB euro to SDR exchange rate. The IMF euro holdings are revalued against the SDR at the prevailing representative rate for the euro as quoted by the IMF at the close of business on the last working day of the year.

The IMF reserve tranche position is presented on a net basis representing the difference between the national quota and the holdings in euro at the disposal of the IMF. The euro account for administrative expenses is included under item L 6 'Liabilities to non-euro area residents denominated in euro'.

(l) Euro coins

Subsequent to the agency agreement between the Bank and the Government of Malta, euro coins issued by the Bank give rise to a reserve in the form of a capital contribution by the Government. Deposits of euro coins with the Bank constitute a reversal of the capital contribution.

(m) Demonetised Maltese lira currency notes

Maltese lira currency notes were replaced by euro banknotes when Malta became part of the euro area on 1 January 2008 and remained legal tender until 31 January 2008. In accordance with the provisions of

[3] Refer to article 9(6) of the Guideline of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2016/34), OJ L 347, 20.12.2016, p. 37 as amended by the Guideline of 28 November 2019 (ECB/2019/34), OJ L 332, 23.12.2019, p.184.

article 62(3) of the Act, any demonetised Maltese lira currency notes not presented for redemption ceased to be included in the Bank's currency liabilities on 1 January 2009. Demonetised Maltese lira currency notes continued to be exchangeable by the Bank for a ten-year period which ended on 31 January 2018. During such period, the value of Maltese lira currency notes, after deducting therefrom the amount of currency notes redeemed, was apportioned as income in the profit and loss account.

(n) Tangible and intangible fixed assets

Tangible and intangible fixed assets are stated at historical cost less depreciation or amortisation respectively, with the exception of land and works of art which are stated at historical cost and not depreciated. Historical cost includes expenditure that is directly attributable to the acquisition of the asset. Subsequent costs are included in the carrying amount of the asset or are recognised as a separate asset, as appropriate, only when they are a present economic resource controlled by the Bank as a result of past events. All repairs and maintenance costs are charged to the profit and loss account during the financial period in which they are incurred.

Depreciation is calculated using the straight-line method to allocate the cost of the assets to their residual values over their estimated useful lives as follows:

Freehold buildings	2%
Leasehold property	over the remaining term of the lease
Computer hardware and software, equipment and other fixed assets	10% to 25%

Tangible and intangible fixed assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying amount of an asset is written down to its recoverable amount if that carrying amount is greater than its estimated recoverable amount.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Gains and losses arising on derecognition are determined by comparing sale proceeds with the carrying amount. These are included in the profit and loss account in the year when the asset is derecognised.

(o) Leases

Right-of-use assets are valued at cost less depreciation and impairment (see 3 (n) 'Tangible and intangible fixed assets' above). Depreciation is calculated on a straight-line basis from the commencement date to either the end of the useful life of the right-of-use asset or the end of the lease term, whichever is earlier.

The lease liability is initially measured at the present value of the future lease payments, discounted using the Bank's incremental borrowing rate. Subsequently, the lease liability is measured at amortised cost using the effective interest method.

Short-term leases with duration of twelve months or less and leases of low-value assets are recorded in the profit and loss account under item 8 'Administrative expenses'.

(p) Provisions

Provisions are recognised by the Bank in accordance with the Guideline. The amendment to the Guideline in 2019 broadened the scope of the general risk provision to cover for all financial risks. In this context, all financial risks are defined as market, liquidity and credit risks. Prior to such amendment, the general risk provision was limited to foreign exchange rate, interest rate, credit and gold price risk.

Taking into due consideration the nature of its activities, the Bank has established a provision for all financial risks within its balance sheet. The Bank decides on the size and use of the provision on the basis of a reasoned estimate of its risk exposure.

(q) Fixed income investment funds

Fixed income investment funds are reported as a single investment and are valued at market prices on a net fund basis. Gains and losses arising on measurement of these investment funds are accounted for in accordance with the Guideline in the manner outlined in the accounting policy 3 (g) 'Recognition of income and expenses' above.

(r) Post-balance sheet events

The values of assets and liabilities are adjusted for events that occur between the annual balance sheet date and the date on which the financial statements are approved by the relevant bodies if they affect the condition of assets or liabilities at the balance sheet date. No adjustment shall be made for assets and liabilities, but disclosure shall be made of those events occurring after the balance sheet date if they do not affect the condition of assets and liabilities at the balance sheet date, but which are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.

4 Capital key

The capital key determines the allocation of the ECB's share capital to the NCBs on the basis of population and gross domestic product in equal share. It is adjusted every five years and whenever there is a change in the composition of the EU in accordance with the requirements of the Statute.

On 1 January 2019, the ESCB experienced a quinquennial capital key change in accordance with Article 29.3 of the Statute. As a result, the Bank's allocation of the ECB's share capital increased from 0.0648% to 0.0732%. Following the departure of the United Kingdom from the EU and the consequent withdrawal of the Bank of England from the ESCB on 31 January 2020, the Bank's share in the capital of the ECB on 1 February 2020 was 0.0853% (see (a) 'Post-balance sheet events' in the other notes).

The Eurosystem capital key, which is the respective NCB's share of the total share capital held by euro area NCBs, is used as the basis for the allocation of monetary income and the financial results of the ECB among the nineteen Eurosystem NCBs. Consequential to the ESCB quinquennial capital key change on 1 January 2019, the Bank's Eurosystem capital key increased from 0.0921% to 0.1051%. Following the withdrawal of the Bank of England from the ESCB on 31 January 2020, the Bank's Eurosystem capital key as at 1 February 2020 was 0.1049%.

5 Banknotes in circulation

The ECB and the euro area NCBs, which together comprise the Eurosystem, issue euro banknotes. The total value of euro banknotes in circulation is allocated to the Eurosystem central banks on the last working day of each month in accordance with the banknote allocation key.[4]

The ECB has been allocated a share of 8% of the total value of euro banknotes in circulation, whereas the remaining 92% has been allocated to the NCBs according to their weightings in the capital key of the ECB. The share of banknotes allocated to each NCB is disclosed in the balance sheet under liability item L 1 'Banknotes in circulation'.

[4] According to the ECB decision of 13 December 2010 on the issue of euro banknotes (recast) (ECB/2010/29), the banknote allocation key represents the percentage that results from taking into account the ECB's share in the total euro banknote issue and applying the subscribed capital key to the NCBs' share in such total.

On 1 January 2019, as a result of the ESCB quinquennial capital key change, the Bank's share in euro banknotes changed from 0.0850% to 0.0965%. Following the withdrawal of the Bank of England from the ESCB on 31 January 2020, the Bank's share in euro banknotes remained unchanged at 0.0965%.

The difference between the value of the euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the euro banknotes that it actually puts into circulation, as reduced by banknotes withdrawn from circulation, gives rise to intra-Eurosystem balances remunerated[5] on a daily basis at the latest available marginal interest rate used by the Eurosystem in its tenders for main refinancing operations (MRO). If the value of the euro banknotes actually issued is greater than the value according to the banknote allocation key, the excess is recognised in the balance sheet under liability sub-item L 10.3 'Net liabilities related to the allocation of euro banknotes within the Eurosystem'. If the value of the euro banknotes actually issued is less than the value according to the banknote allocation key, the shortfall is recognised in the balance sheet under asset sub-item A 9.4 'Net claims related to the allocation of euro banknotes within the Eurosystem'.

In the cash changeover year[6] and in the subsequent five years, the intra-Eurosystem balances arising from the allocation of euro banknotes are adjusted in order to avoid significant changes in the NCB's relative income positions as compared to previous years. The adjustments are effected by taking into account the differences between the average value of the banknotes which the NCB had in circulation in the reference period,[7] and the average value of banknotes which would have been allocated to it during that period in accordance with its capital key. The adjustments are reduced in annual stages until the first day of the sixth year after the cash changeover year, when income on banknotes are allocated fully in proportion to the NCB's paid-up shares in the ECB's capital.

Any interest income or expense on these balances is cleared through the accounts of the ECB and is disclosed in the profit and loss account under item 1 'Net interest income'.

6 ECB profit distribution

The Governing Council of the ECB has decided that the seigniorage income of the ECB, which arises from the 8% share of euro banknotes allocated to the ECB, as well as income arising from the securities held under the securities markets programme (SMP), the third covered bond purchase programme (CBPP3), the asset-backed securities purchase programme (ABSPP) and the public sector purchase programme (PSPP) is distributed in January of the following year by means of an interim profit distribution, unless otherwise decided by the Governing Council.[8] This income is distributed in full unless it is higher than the ECB's net profit for the year and subject to any decisions by the Governing Council of the ECB to make transfers to the provision for financial risks. The Governing Council of the ECB may also decide to charge costs incurred by the ECB in connection with the issue and handling of euro banknotes against income earned on euro banknotes in circulation.

The amount distributed to the Bank is disclosed in the profit and loss account under item 4 'Income from equity shares and participating interests'.

7 Intra-Eurosystem balances/Intra-ESCB balances

Intra-Eurosystem balances result mostly from cross-border payments in the EU that are settled in central bank money in euro. They are primarily settled in the Trans-European Automated Real-time Gross settlement

[5] ECB Decision of 3 November 2016 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (recast) (ECB/2016/36), OJ L 347, 20.12.2016, p. 26.
[6] Cash changeover year refers to the year in which the euro banknotes are introduced as legal tender in the respective Member State.
[7] The reference period refers to a 24-month period commencing 30 months prior to the day on which euro banknotes become legal tender in the respective Member State.
[8] ECB Decision of 15 December 2014 on the interim distribution of the income of the European Central Bank (recast) (ECB/2014/57), OJ L 53, 25.2.2015, p. 24 as amended by ECB Decision of 2 July 2015 (ECB/2015/25), OJ L 193, 21.7.2015, p.133 and ECB decision of 28 November 2019 (ECB/2019/36) OJ L 332, 23.12.2019, p. 183.

Express Transfer system (TARGET2) and give rise to bilateral balances in the TARGET2 accounts of EU central banks. These bilateral balances are netted and then assigned to the ECB on a daily basis, leaving each NCB with a single net bilateral position vis-à-vis the ECB only. Intra-Eurosystem balances of the Bank vis-à-vis the ECB arising from TARGET2, as well as other intra-Eurosystem balances denominated in euro (e.g. interim ECB profit distributions to NCBs and monetary income results), are presented on the balance sheet of the Bank as a single net asset or liability position and disclosed under A 9.5 'Other claims within the Eurosystem (net)' or L 10.4 'Other liabilities within the Eurosystem (net)'. Intra-ESCB balances versus non-euro area NCBs not arising from TARGET2 are disclosed either under A 4 'Claims on non-euro area residents denominated in euro' or L 6 'Liabilities to non-euro area residents denominated in euro'.

Intra-Eurosystem claims arising from the Bank's participating interest in the ECB are reported under A 9.1 'Participating interest in ECB'. In particular this balance sheet item includes (i) the NCBs' paid-up share in the ECB's subscribed capital, (ii) any net amount paid by the NCBs due to the increase in their shares in the ECB's equity value[9] resulting from all previous ECB's capital key adjustments, and (iii) contributions in accordance with Article 48.2 of the Statute of the ESCB with respect to central banks of Member States whose derogations have been abrogated.

Intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem are reported as a single net asset or liability under A 9.5 'Other claims within the Eurosystem (net)' or L 10.4 'Other liabilities within the Eurosystem (net)' as appropriate (see 5 'Banknotes in circulation' in these general notes).

Intra-Eurosystem claims arising from the transfer of foreign reserve assets by the Bank to the ECB are denominated in euro and reported under A 9.2 'Claims equivalent to the transfer of foreign reserves'.

[9] Equity value consists of the total ECB's reserves, revaluation accounts and provisions equivalent to reserves, less any losses carried forward from previous periods. In the event of capital key changes the equity value also includes the ECB's accumulated net profit or net loss until the date of the adjustment.

Notes to the balance sheet

Assets

A 1 Gold and gold receivables

The Bank's gold balances consist of correspondent accounts with foreign banks and holdings with counterparties. On 31 December 2019, gold was revalued at €1,354.104 (2018: €1,120.961) per fine troy ounce. The unrealised valuation gains of €1,963,364 (2018: €646,654) are disclosed under L 14 'Revaluation accounts'.

	€'000	Fine troy ounces
Balance as at 31 December 2018	3,484	3,108
Net effect of transactions during the year	18,907	14,400
Increase in valuation on 31 December 2019	1,317	-
Balance as at 31 December 2019	**23,708**	**17,508**

A 2 Claims on non-euro area residents denominated in foreign currency

These claims consist of receivables from the IMF and claims on counterparties resident outside the euro area denominated in foreign currency as follows:

	2019 €'000	2018 €'000	Change €'000
US dollar	**346,269**	427,569	(81,300)
Special drawing rights	**147,004**	140,956	6,048
Canadian dollar	**99,814**	91,978	7,836
Swedish krona	**62,644**	63,930	(1,286)
Norwegian krone	**38,023**	37,536	487
Great Britain pound	**33,894**	41,220	(7,326)
Australian dollar	**19,475**	21,112	(1,637)
Others	**5,164**	5,325	(161)
Total	**752,287**	829,626	(77,339)

A 2.1 Receivables from the IMF

	2019 €'000	2018 €'000	Change €'000
Reserve tranche position (net)	**39,059**	34,827	4,232
SDR holdings	**107,946**	106,129	1,817
Total	**147,005**	140,956	6,049

(a) IMF quota

Malta's membership subscription to the IMF as at 31 December 2018 and 2019 was SDR168,300,000.

Up to 25% of the quota is paid in SDRs (IMF's unit of account) or foreign currencies acceptable to the IMF, while the remainder of the membership subscription is paid in the member's own currency. The former portion constitutes the reserve tranche as a claim on the IMF, while the residual represents balances in euro at the disposal of the Fund. Hence, the reserve tranche position represents the difference between the quota of SDR168,300,000 and the balance in euro at the disposal of the IMF.

During the financial year ended 31 December 2019, the reserve tranche position increased by SDR3,000,000 to SDR31,654,776 (2018: SDR28,654,776) due to additional drawings by the Fund under the IMF Financial Transaction Plan.

(b) Malta's SDR position in the IMF

In November 2009, the Bank entered into a two-way voluntary trading arrangement with the IMF, whereby the Bank stands ready to buy and sell SDRs against euro, subject to certain limits, in transactions that the IMF arranges between prospective buyers and sellers of SDRs. During 2019, no transactions were effected under this agreement. As a result, the increase in SDR holdings from the previous year is mainly attributable to interest received. Malta's SDR holdings, as at 31 December 2019, including interest received thereon, amounted to SDR87,483,187 (2018: SDR87,320,495).

The total SDRs allocated to Malta remained unchanged from 2010 at SDR95,401,757 against which a corresponding liability exists in the form of a restricted demand deposit of the Government of Malta included under liability item L 9 'Counterpart of special drawing rights allocated by the IMF' together with other SDRs acquired in accordance with IMF requirements and procedures. SDRs allocated to Malta cannot be withdrawn unless such advice is received from the IMF.

(c) IMF interest on the SDR position

The net reserve tranche position, SDR holdings and the SDR allocation are subject to SDR interest rates quoted by the IMF on a weekly basis. The IMF current accounts are not subject to interest.

(d) Bilateral Borrowing Agreement

In 2017, the Bank entered into an agreement for an SDR-denominated amount of up to the equivalent of €260,000,000 which as at 31 December 2019 was not utilised. In July 2019, the Bank agreed to extend this bilateral agreement for an additional year.

A 2.2 Balances with banks and security investments, external loans and other external assets

These assets principally include security investments issued by non-euro area residents and balances with banks.

	2019	2018	Change
	€'000	€'000	€'000
Marketable debt securities other than those held-to-maturity	**238,165**	274,604	(36,439)
Held-to-maturity debt securities	**354,167**	405,949	(51,782)
Current accounts and overnight deposits with banks	**12,950**	8,117	4,833
Total	**605,282**	688,670	(83,388)

A 3 Claims on euro area residents denominated in foreign currency

These foreign currency assets mainly comprise investments in marketable debt securities issued by euro area residents, claims arising from reverse operations with euro area counterparties and balances with banks.

	2019	2018	Change
	€'000	€'000	€'000
US dollar	**83,285**	54,224	29,061
Canadian dollar	**3,785**	3,608	177
Others	**6,019**	2,375	3,644
Total	**93,089**	60,207	32,882

During 2018 and 2019, the ECB conducted regular US dollar liquidity-providing operations with maturities of one week. Under this programme, the US dollars were provided by the Federal Reserve to the ECB by means of a temporary swap line with the aim of offering short-term US dollar funding to Eurosystem counterparties. The ECB simultaneously entered into back-to-back swap transactions with euro area NCBs, which used the resulting funds to conduct liquidity-providing operations with the Eurosystem counterparties in the form of reverse and swap transactions.

During 2019, credit institutions established in Malta participated for a total amount of US$1,359,300,000 (2018: US$1,438,100,000) in these operations. The outstanding amount of US dollar liquidity providing operations as at 31 December 2019 amounted to US$23,400,000 (2018: US$10,000,000).

	2019	2018	Change
	€'000	€'000	€'000
Marketable debt securities other than those held-to-maturity	**58,032**	41,161	16,871
Held-to-maturity debt securities	**14,200**	10,250	3,950
US dollar liquidity-providing operations	**20,830**	8,733	12,097
Current accounts and overnight deposits with banks	**27**	63	(36)
Total	**93,089**	60,207	32,882

A 4 Claims on non-euro area residents denominated in euro

These claims include marketable debt securities issued by non-euro area residents and balances with banks outside the euro area.

	2019	2018	Change
	€'000	€'000	€'000
Marketable debt securities other than those held-to-maturity	**191,397**	233,284	(41,887)
Held-to-maturity debt securities	**393,154**	448,185	(55,031)
Current accounts and overnight deposits with banks	**438**	1,618	(1,180)
Total	**584,989**	683,087	(98,098)

A 5 Lending to euro area credit institutions related to monetary policy operations denominated in euro

This item reflects operations carried out by the Bank within the framework of the single monetary policy of the Eurosystem.

In 2019, the total Eurosystem holding of monetary policy assets amounted to €624,231,965,798 (2018: €734,380,815,361) of which the Bank held €40,000,000 (2018: €80,010,000). In accordance with Article 32.4 of the Statute, losses from monetary policy operations (if they were to materialise) may be shared, by decision of the Governing Council of the ECB, in full by the Eurosystem NCBs in proportion to the prevailing ECB capital key shares.

Losses can only materialise if the counterparty fails and the funds recovered from the resolution of the collateral provided by the counterparty are not sufficient. In relation to specific collateral which can be accepted by NCBs at their own discretion, risk sharing has been excluded by the Governing Council of the ECB.

A 5.1 Main refinancing operations

MROs are executed through regular liquidity-providing reverse transactions carried out by the Eurosystem NCBs with a weekly frequency and a maturity of normally one week, on the basis of standard tenders. Since October 2008, these operations were conducted as fixed rate tender procedures with full allotment. MROs play a key role in achieving the aims of steering interest rates, managing market liquidity and signalling the monetary policy stance.

All counterparties that fulfil the general eligibility criteria may submit bids within a specified timeframe. Participation in MROs requires the availability of eligible collateral.

During 2019, MROs carried out with the Bank amounted to €1,000,000. There were no outstanding amounts of these operations as at 31 December 2018 and 2019.

Throughout the financial years ended 31 December 2018 and 2019, the MRO rate remained unchanged at the level of 0.00%.

A 5.2 Longer-term refinancing operations

Longer-term refinancing operations (LTROs) are regular liquidity-providing reverse transactions aimed at providing counterparties with additional longer-term refinancing liquidity. Participation in LTROs requires the availability of eligible collateral. In 2019, LTROs were conducted with a three-month maturity. These operations were conducted through fixed rate tender procedures with full allotment, with the rate fixed at the average rate of the MROs over the life of the respective operation.

During the years ended 31 December 2018 and 2019, credit institutions established in Malta did not participate in the three-month LTROs.

In 2016, the Governing Council of the ECB introduced a series of four targeted longer-term refinancing operations (TLTRO II). These operations have a four-year maturity, with a possibility of repayment after two years. In 2018, the outstanding amount of TLTRO II with credit institutions established in Malta amounted to €80,010,000. During 2019, all outstanding balances from TLTRO II were fully repaid.

Additionally, in 2019 the Governing Council of the ECB introduced a new series of seven quarterly targeted longer-term refinancing operations (TLTRO III). These operations have a three-year maturity, with a

possibility of repayment after two years. According to the decisions taken by the Governing Council of the ECB, the final interest rate applicable to each TLTRO III can be as low as the average interest rate on the deposit facility prevailing over the life of the operation. As a prudent approach, given that the indicative rate for accruing interest will only be known as from 2021 and that a reliable estimate is not possible until that time, the deposit facility rate is used for calculating the interest on these operations for 2019.

During 2019, the aggregate TLTRO III carried out with the Bank amounted to €40,000,000 which remained outstanding at the end of the year.

A 5.3 Fine-tuning reverse operations

Fine-tuning reverse operations aim to regulate the market liquidity situation and steer interest rates, particularly to smooth the effects on interest rates caused by unexpected market fluctuations. Owing to their nature, they are executed on an ad hoc basis. No fine-tuning reverse operations were conducted by the ECB during the years ended 31 December 2018 and 2019.

A 5.4 Structural reverse operations

These are reverse open-market transactions through standard tenders to enable the Eurosystem to adjust its structural liquidity position vis-à-vis the financial sector. No structural operations were conducted by the ECB during the years ended 31 December 2018 and 2019.

A 5.5 Marginal lending facility

Marginal lending facilities may be used by counterparties to obtain overnight liquidity from Eurosystem NCBs at a pre-specified interest rate against eligible assets. During 2019, there were no participations in the marginal lending facility by credit institutions established in Malta. There were no outstanding transactions as at 31 December 2018 and 2019.

Throughout the financial years ended 31 December 2018 and 2019, the marginal lending facility rate remained unchanged at the level of 0.25%.

A 5.6 Credits related to margin calls

This sub-item refers to cash paid to counterparties in those instances where the market value of the collateral exceeds an established trigger point implying an excess of collateral with respect to outstanding monetary policy operations.

Since the Bank operates a general pooling system, no payments to counterparties are effected.

A 6 Other claims on euro area credit institutions denominated in euro

This item consists of claims on credit institutions within the euro area which do not relate to monetary policy operations, mainly current accounts and overnight deposits with banks which as at 31 December 2019 amounted to €8,329,936 (2018: €13,608,657).

A 7 Securities of euro area residents denominated in euro

This item consists of securities held for monetary policy purposes as well as other securities.

A 7.1 Securities held for monetary policy purposes

As at 31 December 2019, this sub-item consisted of securities acquired by the Bank within the scope of the SMP[10] and the PSPP.[11] The Bank's PSPP related purchases comprised MGS from the secondary market. The amortised cost of the securities under both programmes as well as their market values,[12] are as follows:

	2019		2018		Change	
	Amortised cost	**Market value**	Amortised cost	Market value	Amortised cost	Market value
	€'000	**€'000**	€'000	€'000	€'000	€'000
Securities markets programme	**14,144**	**16,594**	33,879	27,874	(19,735)	(11,280)
Public sector purchase programme	**875,146**	**964,643**	912,161	929,168	(37,015)	35,475
Total	**889,290**	**981,237**	946,040	957,042	(56,750)	24,195

The Governing Council of the ECB decided to cease further SMP purchases on 6 September 2012.

For the first ten months of 2019, the Eurosystem only reinvested, in full, the principal payments from maturing securities purchased under the asset purchase programme (APP).[13] On 1 November 2019, the Eurosystem restarted its net purchases of securities under the APP at an average of €20,000,000,000 per month. The Governing Council of the ECB expects net purchases to continue for as long as necessary to reinforce the impact of its policy rates, and to cease shortly before it starts raising the key ECB interest rates. The Governing Council of the ECB also intends to continue the reinvestments for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case, for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

The Governing Council of the ECB assesses on a regular basis the financial risks associated with the securities held for monetary policy purposes. Impairment tests are conducted on an annual basis, using data as at the end of the year and are approved by the Governing Council of the ECB. In these tests, impairment indicators are assessed separately for each programme. The total Eurosystem NCBs' holding of such securities amounts to €2,381,647,997,507 (2018: €2,399,625,021,945).

In accordance with the decision of the Governing Council of the ECB taken under Article 32.4 of the Statute, losses from holdings of SMP, CBPP3,[14] ABSPP,[15] PSPP (issued by international organisations and multilateral development banks) and CSPP[16] if they were to materialise, are to be shared in full by the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares.

[10] ECB Decision of 14 May 2010 establishing a securities markets programme (ECB/2010/5), OJ L 124, 20.5.2010, p. 8.

[11] ECB Decision of 3 February 2020 on a secondary markets public sector asset purchase programme (ECB/2020/9), OJ L 39, 12.2.2020, p. 12. Under this programme, the ECB and the NCBs may purchase, in the secondary market, euro-denominated securities issued by euro area central, regional or local governments, recognised agencies located in the euro area and international organisations and multilateral development banks located in the euro area.

[12] Market values are indicative and derived on the basis of market quotes. When market quotes are not available, market prices are estimated using internal Eurosystem models.

[13] The APP consists of the CBPP3, the ABSPP, the PSPP and the corporate sector purchase programme (CSPP). Further details on the APP can be found on the ECB's website (https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html).

[14] ECB Decision of 3 February 2020 on the implementation of the third covered bond purchase programme (recast) (ECB/2020/8), OJ L 39, 12.2.2020, p. 6.

[15] ECB Decision of 19 November 2014 on the implementation of the asset-backed securities purchase programme (ECB/2014/45), OJ L 1, 6.1.2015, p. 4, as amended by ECB Decision of 10 September 2015 (ECB/2015/31), OJ L 249, 25.9.2015, p. 28, ECB Decision of 11 January 2017 (ECB/2017/3), OJ L 16, 20.1.2017, p. 55 and ECB Decision of 18 May 2017 (ECB/2017/15), OJ L 190, 21.7.2017, p. 24.

[16] ECB Decision of 1 June 2016 on the implementation of the corporate sector purchase programme (ECB/2016/16), OJ L 157, 15.6.2016, p. 28 as amended by ECB Decision of 11 January 2017 (ECB/2017/4), OJ L 16, 20.1.2017, p. 57 and ECB Decision of 18 May 2017 (ECB/2017/13), OJ L 190, 21.7.2017, p. 20. Under this programme, the NCBs may purchase investment grade euro denominated bonds issued by non-bank corporations established in the euro area.

As a result of the impairment tests conducted as at 31 December 2019 on securities purchased under the SMP and the PSPP, the Governing Council of the ECB decided that all future cash flows on such securities are expected to be received.

An impairment test was carried out as at 31 December 2019 on securities purchased under the ABSPP. The Governing Council of the ECB identified an impairment indicator relating to one security for which significant deterioration of the credit quality was observed. The Governing Council of the ECB considered that the identified impairment indicator had not affected the estimated future cash flows. No impairment losses were therefore recorded in respect of securities held under the ABSPP.

In the context of the impairment test conducted as at the end of 2019 on securities purchased under the CBPP3, the Governing Council of the ECB identified one impairment indicator relating to a particular issuer which is still undergoing significant financial difficulties. The Governing Council of the ECB considered that the identified impairment indicator had not affected the estimated future cash flows. No impairment losses were therefore recorded in respect of securities held under the CBPP3.

As a result of the impairment test conducted on the CSPP, the Governing Council of the ECB has deemed it appropriate to maintain a buffer against credit risks in monetary policy operations during 2019 (see L 13 'Provisions' in the notes to the balance sheet).

A 7.2 Other securities

This sub-item comprises all the Bank's holdings of debt securities issued by euro area residents that are not used in monetary policy operations and are not part of investment portfolios earmarked for specific purposes.

	2019	2018	Change
	€'000	€'000	€'000
Marketable debt securities other than those held-to-maturity	**143,284**	161,920	(18,636)
Held-to-maturity debt securities	**316,537**	351,212	(34,675)
Total	**459,821**	513,132	(53,311)

In 2019, the Bank reclassified securities with a nominal value of €3,800,000 from its held-to-maturity portfolio in advance of a sale carried out in January 2020, due to an exceptional circumstance in which the sale was requested by the ECB in light of investment limits in place related to a limit framework. At 31 December 2019, these reclassified securities were valued at their mid-market prices.

A 9 Intra-Eurosystem claims

This item consists of claims arising from the Bank's share in the ECB's net equity and claims equivalent to the transfer of foreign reserves to the ECB. It may also include net claims related to the allocation of euro banknotes within the Eurosystem and other net claims within the Eurosystem.

A 9.1 Participating interest in ECB

This sub-item consists of the Bank's paid-up share in the ECB's subscribed capital and the Bank's share in the ECB's accumulated net profits.

Pursuant to Article 28 of the Statute, the ESCB NCBs are the sole subscribers to the capital of the ECB. Subscriptions depend on shares which are determined in accordance with Article 29 of the Statute and are

subject to adjustment every five years or whenever there is a change in the composition of the ECSB NCBs. The last quinquennial capital key change took effect on 1 January 2019.

Based on the Council Decision 2003/517/EC of 15 July 2003 on statistical data to be used for the adjustment of the key for subscription of the capital of the ECB, the NCBs' capital key shares were adjusted as follows on 1 January 2019:

	Key for subscription of the ECB's capital from 1 January 2019	**Key for subscription of the ECB's capital until 31 December 2018**
Nationale Bank van België/ Banque Nationale de Belgique	2.528	2.4778
Deutsche Bundesbank	18.367	17.9973
Eesti Pank	0.1968	0.1928
Central Bank of Ireland	1.1754	1.1607
Bank of Greece	1.7292	2.0332
Banco de España	8.3391	8.8409
Banque de France	14.2061	14.1792
Banca d'Italia	11.8023	12.3108
Central Bank of Cyprus	0.1503	0.1513
Latvijas Banka	0.2731	0.2821
Lietuvos bankas	0.4059	0.4132
Banque centrale du Luxembourg	0.2270	0.2030
Central Bank of Malta	0.0732	0.0648
De Nederlandsche Bank	4.0677	4.0035
Oesterreichische Nationalbank	2.0325	1.9631
Banco de Portugal	1.6367	1.7434
Banka Slovenije	0.3361	0.3455
Národná banka Slovenska	0.8004	0.7725
Suomen Pankki	1.2708	1.2564
Subtotal for euro area NCBs	**69.6176**	**70.3915**
Българска народна банка (Bulgarian National Bank)	0.8511	0.8590
Česká národní banka	1.6172	1.6075
Danmarks Nationalbank	1.4986	1.4873
Hrvatska narodna banka	0.5673	0.6023
Magyar Nemzeti Bank	1.3348	1.3798
Narodowy Bank Polski	5.2068	5.1230
Banca Naţională a României	2.4470	2.6024
Sveriges Riksbank	2.5222	2.2729
Bank of England	14.3374	13.6743
Subtotal for non-euro area NCBs	**30.3824**	**29.6085**
Total	**100**	**100**

*Due to rounding, totals may not correspond to the sum of all figures shown.

On 1 January 2019, the Bank's share in the ECB's share capital increased from 0.0648% to 0.0732% resulting into an additional contribution of €909,300 transferred to the ECB. As at 31 December 2019, the Bank's paid-up share in the ECB's subscribed capital amounted to €7,923,905 (2018: €7,014,605).

	Subscribed capital from 1 January 2019	Paid-up capital from 1 January 2019	Subscribed capital until 31 December 2018	Paid-up capital until 31 December 2018
Nationale Bank van België/ Banque Nationale de Belgique	273,656,179	273,656,179	268,222,025	268,222,025
Deutsche Bundesbank	1,988,229,048	1,988,229,048	1,948,208,997	1,948,208,997
Eesti Pank	21,303,614	21,303,614	20,870,614	20,870,614
Central Bank of Ireland	127,237,133	127,237,133	125,645,857	125,645,857
Bank of Greece	187,186,022	187,186,022	220,094,044	220,094,044
Banco de España	902,708,165	902,708,165	957,028,050	957,028,050
Banque de France	1,537,811,329	1,537,811,329	1,534,899,402	1,534,899,402
Banca d'Italia	1,277,599,809	1,277,599,809	1,332,644,970	1,332,644,970
Central Bank of Cyprus	16,269,986	16,269,986	16,378,236	16,378,236
Latvijas Bankas	29,563,094	29,563,094	30,537,345	30,537,345
Lietuvos bankas	43,938,704	43,938,704	44,728,929	44,728,929
Banque centrale du Luxembourg	24,572,766	24,572,766	21,974,764	21,974,764
Central Bank of Malta	7,923,905	7,923,905	7,014,605	7,014,605
De Nederlandsche Bank	440,328,813	440,328,813	433,379,158	433,379,158
Oesterreichische Nationalbank	220,018,269	220,018,269	212,505,714	212,505,714
Banco de Portugal	177,172,891	177,172,891	188,723,173	188,723,173
Banka Slovenije	36,382,849	36,382,849	37,400,399	37,400,399
Národná banka Slovenska	86,643,357	86,643,357	83,623,180	83,623,180
Suomen Pankki	137,564,190	137,564,190	136,005,389	136,005,389
Subtotal for euro area NCBs*	**7,536,110,123**	**7,536,110,123**	**7,619,884,851**	**7,619,884,851**
Българска народна банка (Bulgarian National Bank)	92,131,635	3,454,936	92,986,811	3,487,005
Česká národní banka	175,062,014	6,564,826	174,011,989	6,525,450
Danmarks Nationalbank	162,223,556	6,083,383	161,000,330	6,037,512
Hrvatska narodna banka	61,410,265	2,302,885	65,199,018	2,444,963
Magyar Nemzeti Bank	144,492,194	5,418,457	149,363,448	5,601,129
Narodowy Bank Polski	563,636,468	21,136,368	554,565,112	20,796,192
Banca Naţională a României	264,887,923	9,933,297	281,709,984	10,564,124
Sveriges Riksbank	273,028,328	10,238,562	246,041,586	9,226,559
Bank of England	1,552,024,564	58,200,921	1,480,243,942	55,509,148
Subtotal for non-euro area NCBs*	**3,288,896,947**	**123,333,635**	**3,205,122,220**	**120,192,082**
Total*	**10,825,007,070**	**7,659,443,757**	**10,825,007,070**	**7,740,076,935**

*Due to rounding, subtotals and totals may not correspond to the sum of all figures shown.

As a result of the capital key change that occurred on 1 January 2019, the Bank's share in the ECB's accumulated net profits increased by €4,259,529 to €13,104,026 as at 31 December 2019 (2018: €8,844,497).

A 9.2 Claims equivalent to the transfer of foreign reserves

This asset represents the Bank's claims arising from the transfer of foreign reserve assets to the ECB, when the Bank joined the Eurosystem. The remuneration of these claims is calculated daily at the latest available marginal interest rate used by the Eurosystem in its tenders for MROs, adjusted to reflect a zero return on the gold component.

The adjustments to the capital key weightings of the ECB on 1 January 2019 resulted in an increase in the Bank's claim with respect to the foreign reserve assets transferred to the ECB of €4,867,887 to €42,420,163 as at 31 December 2019 (2018: €37,552,276).

	Claim equivalent to the transfer of foreign reserves from 1 January 2019	Claim equivalent to the transfer of foreign reserves until 31 December 2018
Nationale Bank van België/ Banque Nationale de Belgique	1,465,002,366	1,435,910,943
Deutsche Bundesbank	10,643,868,063	10,429,623,058
Eesti Pank	114,047,653	111,729,611
Central Bank of Ireland	681,156,559	672,637,756
Bank of Greece	1,002,089,435	1,178,260,606
Banco de España	4,832,595,425	5,123,393,758
Banque de France	8,232,583,116	8,216,994,286
Banca d'Italia	6,839,555,945	7,134,236,999
Central Bank of Cyprus	87,100,418	87,679,928
Latvijas Banka	158,264,298	163,479,892
Lietuvos bankas	235,223,283	239,453,710
Banque centrale du Luxembourg	131,548,868	117,640,617
Central Bank of Malta	42,420,163	37,552,276
De Nederlandsche Bank	2,357,274,575	2,320,070,005
Oesterreichische Nationalbank	1,177,854,948	1,137,636,925
Banco de Portugal	948,484,720	1,010,318,483
Banka Slovenije	194,773,455	200,220,853
Národná banka Slovenska	463,840,148	447,671,807
Suomen Pankki	736,441,854	728,096,904
Total*	**40,344,125,295**	**40,792,608,417**

*Due to rounding, totals may not correspond to the sum of all figures shown.

A 9.4 Net claims related to the allocation of euro banknotes within the Eurosystem

This sub-item reflects claims which would arise from application of the banknote allocation key (see 5 'Banknotes in circulation' in the general notes to the financial statements). As at the end of 2018 and 2019, the Bank had no claims in this respect but had a liability which is presented in liability sub-item L 10.3 'Net liabilities related to the allocation of euro banknotes within the Eurosystem'.

A 9.5 Other claims within the Eurosystem (net)

As at 31 December 2019, the balance of €5,556,732,290 (2018: €4,534,630,175) represented the sum of three components, namely (i) the claim of the Bank vis-à-vis the ECB in respect of the transfers issued and received through TARGET2 by the ESCB NCBs, including the ECB, plus the balances held with the Eurosystem NCBs through correspondent accounts; (ii) balances resulting from the pooling and allocation of monetary income within the Eurosystem pending settlement (see 5 'Net result of pooling of monetary income' in the notes to the profit and loss account), and (iii) balances with the ECB in respect of any amounts receivable or refundable, including the amount due to the Bank in respect of the ECB's interim profit distribution (see 4 'Income from equity shares and participating interests' in the notes to the profit and loss account).

The remuneration of the debit balance in respect of TARGET2 is calculated daily at the latest available interest rate used by the Eurosystem in its tenders for MROs.

	2019	2018	Change
	€'000	€'000	€'000
TARGET2 balance	**5,562,462**	4,540,078	1,022,384
Net result from pooling of monetary income	**(7,235)**	(6,545)	(690)
ECB profit distribution	**1,505**	1,097	408
Total	**5,556,732**	4,534,630	1,022,102

A 10 Items in course of settlement

These assets comprise transactions which were not yet settled as at the end of the financial year.

A 11 Other assets

A 11.1 Coins of euro area

This sub-item represents the Bank's holdings of euro coins issued by euro area countries.

A 11.2 Tangible and intangible fixed assets

Tangible and intangible fixed assets principally comprise the Bank's premises, computer hardware and software, equipment and other assets.

	Land and buildings	Other assets	Total
	€'000	€'000	€'000
Cost			
As at 31 December 2018	35,326	8,256	43,582
Additions	41	684	725
Derecognition of assets	-	(25)	(25)
As at 31 December 2019	**35,367**	**8,915**	**44,282**
Accumulated depreciation			
As at 31 December 2018	3,654	2,546	6,200
Charge for the year	481	972	1,453
Derecognition of assets	-	(18)	(18)
As at 31 December 2019	**4,135**	**3,500**	**7,635**
Net book value			
As at 31 December 2018	31,672	5,710	37,382
As at 31 December 2019	**31,232**	**5,415**	**36,647**
Right-of-use assets			
As at 31 December 2018	-	-	-
Initial recognition of assets	452	267	719
As at 1 January 2019	452	267	719
Additions	-	32	32
Depreciation charge for the year	(9)	(87)	(96)
As at 31 December 2019	**443**	**212**	**655**
Total net book value			
As at 31 December 2018	31,672	5,710	37,382
As at 31 December 2019	**31,675**	**5,627**	**37,302**

As at 31 December 2019, the net book value included an amount of €274,654 (2018: €49,172) related to assets which are not yet available for use and are not depreciated.

As from 1 January 2019, the Bank recognised the right-of-use assets for leased land and building and motor vehicles (see 3 (b) 'Change in accounting policy' and 3 (o) 'Leases' in the general notes to the financial statements).

A 11.3 Other financial assets

Other financial assets comprise debt securities and investments held by the Bank as part of an earmarked portfolio as a counterpart to the Bank's capital and statutory reserves (see 3 (i) (ii) 'Securities held for other than monetary policy purposes' in the general notes to the financial statements).

The Bank also holds another earmarked portfolio comprising MGS purchased on the secondary market by the Bank in its role as market maker.

In 2018, the Bank held two fixed income investment funds managed by external asset managers. During 2019, the Bank liquidated one of the funds and reduced its investment in the other one. As at 31 December 2019, the fund was valued at market prices on a net fund basis.

	2019	2018	Change
	€'000	€'000	€'000
Earmarked investments	**305,125**	352,766	(47,641)
Earmarked Malta Government Stocks	**343,448**	323,961	19,487
Fixed income investment funds	**52,403**	353,689	(301,286)
Total	**700,976**	1,030,416	(329,440)

A 11.4 Off-balance sheet instruments revaluation differences

This sub-item reflects revaluation gains arising on off-balance sheet positions, mainly foreign exchange forward transactions outstanding as at the balance sheet date. As at 31 December 2019, these gains amounted to €1,923,874 (2018: €3,009,987).

A 11.5 Accruals and prepaid expenses

As at 31 December 2019, this sub-item included accrued interest income of €26,232,379 (2018: €30,829,150) on income-earning assets. At the end of the current financial year, there was no interest attributable to intra-Eurosystem claims.

A 11.6 Sundry

Sundry assets mainly consist of loans amounting to €8,477,410 (2018: €7,475,160) and unrealised losses attributable to the earmarked portfolio amounting to €2,881,320 (2018: €5,087,789). These assets also include realised gains attributable to off-balance sheet positions, principally foreign exchange forward transactions outstanding at the year-end, amounting to €44,986 (2018: €4,931,767). These gains arose from the conversion of such transactions into their euro equivalent at the respective currency's average cost on the balance sheet date, compared with the euro amounts at which the transactions were initially recorded.

Liabilities

L 1 Banknotes in circulation

This item consists of the Bank's share of the total euro banknotes in circulation (see 5 'Banknotes in circulation' in the general notes to the financial statements).

During 2019, the total value of banknotes in circulation within the Eurosystem increased by 5.0% from €1,231,133,605,720 at 31 December 2018 to €1,292,741,745,910 at 31 December 2019. According to the banknote allocation key, the Bank had an amount of euro banknotes in circulation of €1,247,496,030 at the end of the year (2018: €1,046,463,900).

The value of the euro banknotes issued by the Bank in 2019 increased by 16.1%, from €1,333,717,400 to €1,548,286,900 at year-end. As this is more than the allocated amount, the difference of €300,790,870 (2018: €287,253,500) is shown under liability sub-item L 10.3 'Net liabilities related to the allocation of euro banknotes within the Eurosystem'.

L 2 Liabilities to euro area credit institutions related to monetary policy operations denominated in euro

These interest-bearing liabilities arise from the monetary policy operations conducted by the Bank on behalf of the Eurosystem.

	2019	2018	Change
	€'000	€'000	€'000
Current accounts (covering the minimum reserve system)	**5,395,289**	1,651,432	3,743,857
Deposit facility	**38,000**	3,613,810	(3,575,810)
Total	**5,433,289**	5,265,242	168,047

L 2.1 Current accounts (covering the minimum reserve system)

Current accounts contain the credit balances of credit institutions that are required to hold minimum reserves. The minimum reserve requirements have to be met on average over the reserve maintenance period in accordance with the schedule published by the ECB. These balances are currently remunerated at the MRO rate. Since June 2014, the reserve holdings exceeding the required minimum reserves are remunerated at zero per cent or the deposit facility rate, whichever is lower.

Starting on 30 October 2019, the Governing Council of the ECB introduced a two-tier system for reserve remuneration, which exempts part of credit institutions' excess liquidity holdings (i.e. reserve holdings in excess of minimum reserve requirements) from negative remuneration, at the rate applicable on the deposit facility. The volume of reserve holdings in excess of minimum reserve requirements that was exempt from the deposit facility rate in 2019 was determined as a multiple of six on an institution's minimum reserve requirements.[17] The exempt tier of excess liquidity holdings is remunerated at an annual rate of zero per cent. The non-exempt tier of excess liquidity holdings continues to be remunerated at zero per cent or the deposit facility rate, whichever is lower.

[17] The multiplier may be adjusted by the Governing Council of the ECB over time in line with changing levels of excess liquidity holdings.

L 2.2 Deposit facility

The overnight deposit facility is available to eligible counterparties to make overnight deposits with Eurosystem NCBs at pre-specified rates. During 2019, the aggregate volume of such transactions with the Bank amounted to €259,036,119,421 (2018: €895,079,824,476). The outstanding balance as at year-end amounted to €38,000,000 (2018: €3,613,809,679).

As at 31 December 2018, the overnight deposit facility rate was -0.4%. On 17 September 2019, this rate decreased by 10 basis points to -0.5% thereafter.

L 2.3 Fixed-term deposits

These liabilities relate to liquidity-absorbing fine-tuning operations for a fixed-term at variable rate tenders. No liquidity-absorbing fine-tuning operations were conducted by the ECB during the years ended 31 December 2018 and 2019. Accordingly, there were no outstanding liquidity-absorbing fine-tuning operations as at 31 December 2018 and 2019.

L 2.4 Fine-tuning reverse operations

Fine-tuning liquidity-absorbing reverse operations are executed on an ad hoc basis through bilateral procedures with the purpose of managing the liquidity situation in the market and setting interest rates. Their frequency and maturity are not standardised. No fine-tuning absorption reverse operations were conducted during the years ended 31 December 2018 and 2019, and accordingly there were no outstanding operations as at 31 December 2018 and 2019.

L 2.5 Deposits related to margin calls

This sub-item refers to cash received from counterparties in those instances where the market value of the collateral pledged has fallen below an established trigger point, implying a shortfall of collateral to cover the outstanding monetary policy operations. No instances of deposits related to margin calls were recorded during the years ended 31 December 2018 and 2019.

L 5 Liabilities to other euro area residents denominated in euro

L 5.1 General government

This liability includes current and sinking fund accounts denominated in euro held by the Government of Malta. These balances are repayable on demand and are remunerated in accordance with the provisions established by the Governing Council of the ECB.[18]

	2019	2018	Change
	€'000	€'000	€'000
Current accounts	**591,814**	479,033	112,781
Sinking fund accounts	**133,927**	106,381	27,546
Total	**725,741**	585,414	140,327

[18] ECB Decision of 20 February 2014 on the prohibition of monetary financing and the remuneration of government deposits by national central banks (ECB/2014/8), OJ L 159, 28.5.2014, p. 54 as amended by ECB Decision of 4 September 2015 (ECB/2015/29), OJ L 245, 22.9.2015, p. 12 and ECB Decision of 9 April 2019 (ECB/2019/8), OJ L 113, 29.04.2019, p.9; the Guideline of 9 April 2019 on domestic assets and liability management operations by the national central banks (recast) (ECB/2019/7), OJ L 113, 29.4.2019, p. 11; and ECB Decision of 15 October 2019 on the remuneration of holdings of excess reserves and of certain deposits (recast) (ECB/2019/31), OJ L 267, 21.10.2019, p. 12.

L 5.2 Other liabilities

This sub-item includes current accounts which are repayable on demand and fixed-term deposits denominated in euro held by Maltese public sector corporations and other entities amounting to €120,167,609 (2018: €178,360,917). This amount includes balances of former credit institutions amounting to €29,541,057 (2018: €30,646,737). These balances are remunerated in accordance with the provisions established by the Governing Council of the ECB.[19]

Collateralised inward deposits, which as at 31 December 2019 amounted to €431,000,000 (2018: €571,317,830) are included in this sub-item. These liabilities are attributable to securities sold subject to repurchase agreements entered into by the Bank (see 3 (j) 'Sale and repurchase agreements and lending of securities' in the general notes to the financial statements).

L 6 Liabilities to non-euro area residents denominated in euro

This item consists of balances denominated in euro held by international and supranational organisations and by non-Eurosystem central banks, including the IMF No. 2 current account for administrative expenses (see 3 (k) 'Claims on the International Monetary Fund' in the general notes to the financial statements). As at 31 December 2019, balances with such organisations amounted to €19,114,243 (2018: €71,592). Whereas the IMF account is non-interest bearing, the other balances are remunerated in accordance with the provisions established by the Governing Council of the ECB.[20]

L 7 Liabilities to euro area residents denominated in foreign currency

Balances held by the Government of Malta which are repayable on demand and other customer deposits are included in this item. Deposits by banks are subject to fixed interest rates. All other balances are remunerated in accordance with the provisions established by the Governing Council of the ECB.[21] Other current accounts and fixed-term deposits include balances of former credit institutions amounting to €73,485,961 (2018: €71,129,168).

	2019	2018	Change
	€'000	€'000	€'000
Government of Malta current accounts	**48,292**	56,323	(8,031)
Government of Malta sinking fund accounts	**72**	82	(10)
Liabilities to banks	**186,005**	149,258	36,747
Other current accounts and fixed-term deposits	**75,870**	73,612	2,258
Total	**310,239**	279,275	30,964

L 8 Liabilities to non-euro area residents denominated in foreign currency

L 8.1 Deposits, balances and other liabilities

This sub-item consists of balances denominated in foreign currency held by supranational institutions.

19 See footnote 18.
20 See footnote 18.
21 See footnote 18.

L 9 Counterpart of special drawing rights allocated by the IMF

This item represents the counterpart of SDRs allocated by the IMF to Malta (see A 2.1 (b) 'Receivables from the IMF' in the notes to the balance sheet).

L 10 Intra-Eurosystem liabilities

This item represents the Bank's liabilities to the ECB and to the other Eurosystem NCBs.

L 10.3 Net liabilities related to the allocation of euro banknotes within the Eurosystem

This sub-item consists of the liability of the Bank vis-à-vis the Eurosystem relating to the excess of euro banknotes issued by the Bank over and above the amount allocated to the Bank by the ECB in accordance with the banknote allocation key (see L 1 'Banknotes in circulation' in the notes to the balance sheet). The increase in the excess euro banknotes in 2019 reflects the relatively higher increase (16.1%) in the banknotes issued by the Bank as compared to the increase in banknotes put into circulation by the Eurosystem as a whole (5.0%).

L 10.4 Other liabilities within the Eurosystem (net)

As at 31 December 2018 and 2019, the Bank had a net claim within the Eurosystem as reported under asset sub-item A 9.5 'Other claims within the Eurosystem (net)'.

L 12 Other liabilities

L 12.1 Off-balance sheet instruments revaluation differences

This sub-item reflects revaluation losses arising on off-balance sheet positions, mainly foreign exchange forward transactions outstanding as at the balance sheet date.

L 12.2 Accruals and income collected in advance

This sub-item includes accrued interest expense on interest-bearing liabilities, and other accrued expenses.

	2019	2018	Change
	€'000	€'000	€'000
Accrued interest payable	**1,646**	1,711	(65)
Others	**2,063**	2,677	(614)
Total	**3,709**	4,388	(679)

L 12.3 Sundry

Sundry liabilities mainly included unrealised revaluation gains attributable to MGS held as part of the earmarked portfolio amounting to €22,605,928 (2018: €9,644,460) and unrealised revaluation gains attributable to the other earmarked portfolios amounting to €6,663,705 (2018: €2,540,017).

This sub-item also included lease liability of €654,891, resulting from the change in accounting policy for leases as from 1 January 2019 (see 3 (b) 'Change in accounting policy' and 3 (o) 'Leases' in the general notes to the financial statements).

L 13 Provisions

(i) Provision for financial risks

This item includes a provision of €115,095,842 (2018: €97,079,853) approved by the Board of Directors in accordance with the Guideline. The calculations are based on the universe of investment assets and monetary policy assets using the Expected Shortfall (ES) technique; a risk measure applied in the evaluation of market and credit risks of a portfolio that derives the expected loss at the 99% level of confidence in the worst 1% of cases. This methodology is the base case scenario to measure the total economic risk and corresponding financial buffers[22] that could be absorbed in the event of such shocks. Full coverage for the resultant shortfall will have to include the Bank's capital and reserves, until sufficient above-the-line buffers have been accumulated.

(ii) Provision for credit risks in monetary policy operations

In accordance with the decision of the Governing Council of the ECB taken under Article 32.4 of the Statute, the provision against credit risks in monetary policy operations is allocated between NCBs in proportion to their subscribed capital key shares in the ECB prevailing in the year when the initial impairment occurred. As a result of the annual impairment test of the CSPP, the Governing Council of the ECB has reviewed the appropriateness of the volume of the provision against credit risks established in 2018 and decided to reduce this provision from €161,074,918 as at 31 December 2018 to €89,388,328 as at 31 December 2019. The Bank's share in this provision amounted to €82,288 (2018: €148,280). The resulting income of €65,992 is reflected in the Bank's profit and loss account for 2019 (see 5 'Net result of pooling of monetary income' in the notes to the profit and loss account).

L 14 Revaluation accounts

The revaluation accounts include the unrealised revaluation gains arising from the valuation of foreign currency on and off-balance sheet positions, gold, marketable securities and other instruments at year-end.

	2019	2018	Change
	€'000	€'000	€'000
Gold	**1,963**	647	1,316
Foreign currency positions	**744**	389	355
Securities and other instruments	**8,548**	6,295	2,253
Total	**11,255**	7,331	3,924

L 15 Capital and reserves

The following table analyses the movement in capital and reserves of the Bank:

	Capital	General reserve fund	Reserves for risks and contingencies	Capital contribution	Total
	€'000	€'000	€'000	€'000	€'000
Balance as at 31 December 2018	20,000	75,505	187,776	84,431	367,712
Net issuance of euro coins	-	-	-	4,741	4,741
Balance as at 31 December 2019	**20,000**	**75,505**	**187,776**	**89,172**	**372,453**

[22] Above-the-line buffers include provisions, profit for the year and revaluation accounts. Below-the-line buffers include capital and reserves.

L 15.1 Capital

In terms of article 19(1) of the Act, the Bank shall have an authorised capital of €20,000,000. This is fully paid-up and is held exclusively by the Government of Malta.

L 15.2 Reserves

(i) General reserve fund

In terms of article 19(2) of the Act, the Bank shall also maintain a general reserve fund which shall be of not less than €20,000,000 and which shall be available for any purpose as may be determined by the Board of Directors. Whenever amounts are drawn from the general reserve fund, these shall be replaced as may be decided by the Board.

(ii) Reserves for risks and contingencies

Reserves for risks and contingencies are maintained in terms of article 22(1) of the Act to cover the broad range of risks to which the Bank is exposed. The major risks in this regard arise from potential movements in market values of the Bank's holdings of domestic and foreign securities and other investments, losses which could arise from support of the financial system in the Bank's role as a lender of last resort and other non-insured losses.

(iii) Capital contribution

This reserve represents the capital contribution made by the Government of Malta to the Bank in respect of the agency agreement between the Bank and the Government relating to the issuance of euro coins. The Bank shall act as agent of the Government and shall retain full responsibility for procurement, storage and issuance of euro coins. This reserve represents seigniorage revenue arising from the issue of euro coins. In terms of the agency agreement, the Government has agreed not to withdraw such revenue and retain these amounts in a reserve account held at the Bank. Allocation of revenue to the reserve account shall be deemed as a capital contribution to the Bank by the Government.

Notes to the profit and loss account

1 Net interest income

This item represents the net result of interest income and interest expense. The negative interest rates prevailing during the year have resulted in certain financial assets giving rise to interest expense rather than interest income and certain financial liabilities giving rise to interest income rather than interest expense. As outlined in note 3 (g) (i) 'Interest income and expense' in the general notes to the financial statements, negative interest falling within interest income or expense on monetary policy operations is netted on a balance sheet sub-item level.

1.1 Interest income

Interest income includes income on foreign reserve assets and euro-denominated portfolios, as well as interest income monetary policy instruments.

	2019	2018	Change
	€'000	€'000	€'000
Marketable debt securities			
- In euro	**16,348**	21,587	(5,239)
- In foreign currency	**17,170**	14,893	2,277
Fixed-term deposits			
- In foreign currency	**5**	-	5
Current accounts and overnight deposits			
- In euro	**(15)**	(30)	15
- In foreign currency	**86**	76	10
IMF	**203**	124	79
Monetary policy operations			
- Minimum reserves	**13,420**	1,084	12,336
- Overnight deposits	**4,220**	14,240	(10,020)
- Securities acquired under the SMP	**1,557**	2,983	(1,426)
- Securities acquired under the PSPP	**11,584**	11,295	289
Forward foreign exchange contracts	**(9,004)**	(12,601)	3,597
Other interest income	**2,852**	1,682	1,170
Total	**58,426**	55,333	3,093

1.2 Interest expense

Interest expense mainly arises from Government of Malta and other customer accounts and liabilities to euro area credit institutions related to monetary policy operations.

	2019	2018	Change
	€'000	€'000	€'000
Government accounts			
- In euro	**(3,312)**	(3,004)	(308)
- In foreign currency	**(14)**	-	(14)
Other customer accounts			
- In euro	**(698)**	(666)	(32)
- In foreign currency	**5,250**	1,535	3,715
Monetary policy operations			
- Longer-term refinancing operations	**94**	201	(107)
Other interest expense	**(1,989)**	(2,896)	907
Total	**(669)**	(4,830)	4,161

2 Net result of financial operations, write-downs and risk provisions

2.1 Realised gains/losses arising from financial operations

This sub-item includes realised gains/losses arising from the disposal of financial instruments, mainly debt securities, and transactions leading to reductions in foreign currency positions.

	2019	2018	Change
	€'000	€'000	€'000
Net gains on disposal of financial instruments	**16,173**	2,011	14,162
Net gains on foreign currency positions	**1,074**	1,633	(559)
Total	**17,247**	3,644	13,603

2.2 Write-downs on financial assets and positions

This sub-item comprises unrealised revaluation losses arising from the price revaluation of debt securities and the exchange rate revaluation of foreign currency assets and liabilities, including off-balance sheet positions, by comparing the market value at balance sheet date with the average book value.

	2019	2018	Change
	€'000	€'000	€'000
Write-downs on debt securities	**175**	2,197	(2,022)
Write-downs on foreign currency positions	**240**	1	239
Total	**415**	2,198	(1,783)

2.3 Transfer to/from provision for financial risks

This sub-item consists of movements in provisions (see L 13 'Provisions' in the notes to the balance sheet).

3 Net income/expense from fees and commissions

Fees and commissions receivable mainly arise from banking services provided by the Bank. Fees and commissions payable include correspondent account charges, handling fees on cheques drawn on the Bank and TARGET2 connection and participation fees.

4 Income from equity shares and participating interests

During 2019, the Bank received €353,527 (2018: €264,231) representing its relative share of the ECB's distributable remaining profits for 2018 in proportion to the Bank's subscribed capital key (see 4 'Capital key' in the general notes to the financial statements).

Also included under this caption is the amount of €1,504,568 (2018: €1,096,727) due to the Bank with respect to the ECB's 2019 interim profit distribution (see 6 'ECB profit distribution' in the general notes to the financial statements).

5 Net result of pooling of monetary income

This item contained the net result of pooling of monetary income for 2019 amounting to an expense of €7,220,428 (2018: €6,544,768). In 2019, a net expense of €14,713 (2018: income of €253,764) was paid in relation to an adjustment for the previous two years.

This item also included the Bank's share of the net result of the provisioning against credit risks in monetary policy operations of the Eurosystem amounting to an income of €65,922 as compared to an expense of €148,280 in 2018 (see L 13 'Provisions' in the notes to the balance sheet).

The amount of each Eurosystem NCB's monetary income is determined by measuring the actual annual income that is derived from the earmarkable assets held against the liability base. The liability base consists mainly of the following items: banknotes in circulation; liabilities to euro area credit institutions related to monetary policy operations denominated in euro; net intra-Eurosystem liabilities resulting from TARGET2 transactions; net intra-Eurosystem liabilities related to the allocation of euro banknotes within the Eurosystem, accrued interest recorded at quarter-end by each NCB on monetary policy liabilities with a maturity of one year or longer; and liabilities vis-à-vis the ECB backing the claim in relation to swap agreements that earn net income for the Eurosystem. Any interest paid on liabilities included within the liability base is to be deducted from the monetary income to be pooled.

The earmarkable assets consist mainly of the following items: lending to euro area credit institutions related to monetary policy operations denominated in euro; securities held for monetary policy purposes; intra-Eurosystem claims equivalent to the transfer of foreign reserve assets to the ECB; net intra-Eurosystem claims resulting from TARGET2 transactions; net intra-Eurosystem claims related to the allocation of euro banknotes within the Eurosystem; claims on euro area counterparties related to swap agreements between the ECB and non-Eurosystem central banks that earn net income for the Eurosystem; accrued interest recorded at quarter-end by each NCB on monetary policy assets with a maturity of one year or longer; and a limited amount of each NCB's gold holdings in proportion to each NCB's capital key share.

The amount of each NCB's monetary income shall be determined by measuring the actual income that is derived from the earmarkable assets recorded in its books. As an exception to this, gold is considered to generate no income and the following are considered to generate income at the latest available marginal interest rate used by the Eurosystem in its tenders for MROs: securities held under CBPP[23], CBPP2[24] and debt instruments issued by central, regional and local governments and recognised agencies and substitute debt instruments issued by public non-financial corporations under the PSPP.

The net income derived from the earmarkable assets held and the liability base shall be offset by applying the latest applicable marginal rate for the Eurosystem MROs to the difference between the value of the NCB's earmarkable assets and the value of the liability base.

The monetary income pooled by the Eurosystem is allocated among NCBs according to the ECB capital key. The pooling and reallocation of monetary income to NCBs leads to certain net reallocation effects. One reason is that the yields earned on certain earmarkable assets and the interest expense paid on certain liability base items may differ to a varying degree among the Eurosystem NCBs. In addition, usually each Eurosystem NCB's share of earmarkable assets and the liability base deviates from its share in the subscribed capital of the ECB. The net result arising from the calculation of monetary income for 2018 and 2019 was a payment by the Bank. This net result is the difference between the net monetary income pooled by the Bank amounting to €19,102,890 (2018: €18,035,471) and the redistributed amount of €11,882,462 (2018: €11,236,939).

[23] ECB decision of 2 July 2009 on the implementation of the covered bond purchase programme (ECB/2009/16), OJ L175, 4.7.2009, p. 18.

[24] ECB decision of 3 November 2011 on the implementation of the second covered bond purchase programme (ECB/2011/17), OJ L297, 16.11.2011, p. 70.

6 Other income

In 2019, this item mainly includes the income from the issuance of numismatic coins.

In 2018, other income also included an amount of €2,928,484 reflecting the recognition of income in respect of Maltese lira currency notes which remained unredeemed after the expiry of the ten-year redeemable period ending on 31 January 2018 (see 3 (m) 'Demonetised Maltese lira currency notes' in the general notes to the financial statements).

7 Staff costs

Staff costs consist of salaries and other ancillary costs.

	2019	2018	Change
	€'000	€'000	€'000
Staff salaries	**10,744**	10,141	603
Other staff costs	**1,226**	1,235	(9)
Training, welfare and other related expenditure	**1,199**	1,171	28
Total	**13,169**	12,547	622

The full-time equivalent average number of staff employed by the Bank during the year was as follows:

	2019	2018	Change
	Number	Number	Number
Governors	**3**	3	-
Chief Officers	**8**	7	1
Heads and executives	**141**	125	16
Officers II and I	**151**	161	(10)
Non-clerical staff	**31**	33	(2)
Total	**334**	329	5

8 Administrative expenses

This item consists of operating expenditure incurred by the Bank.

Administrative expenses of €7,269,536 (2018: €7,066,863) comprise maintenance expenditure, professional fees, travelling costs and other services or expense items which are incurred in the course of the Bank's operations. Auditors' remuneration, inclusive of VAT, for the year ended 31 December 2019 amounted to €79,000 (2018: €104,480).

Compensation to the members of the Board of Directors for the financial year ended 31 December 2019 amounted to €269,598 (2018: €271,896). The Governor and Deputy Governors are entitled to such benefits as health insurance cover and refund of certain other expenses. The other members of the Board of Directors are entitled to health insurance cover and the refund of certain other expenses.

9 Depreciation of tangible and intangible fixed assets

Depreciation of buildings, computer hardware and software, equipment and other assets was charged to the Bank's profit and loss account according to the depreciation rates disclosed in 3 (n) 'Tangible and intangible fixed assets' and 3 (o) 'Leases' in the general notes to the financial statements.

10 Banknote production services

This item consists of expenditure relating to the procurement and transportation of euro banknotes and other ancillary costs.

Other notes

(a) Post-balance sheet events

As a result of the departure of the United Kingdom from the EU and consequent withdrawal of the Bank of England from the ESCB, the weightings assigned to the remaining NCBs in the key for subscription to the ECB's capital were adjusted with effect from 1 February 2020.

(i) Impact on the Bank's capital

Following the withdrawal of the Bank of England from the ESCB, the ECB's subscribed capital remained unchanged at €10,825,007,070. The share of the Bank of England in the ECB's subscribed capital, which stood at 14.3% on 31 January 2020, was reallocated among the euro area and non-euro area NCBs. As a result, the Bank's share in the ECB's subscribed capital increased from 0.0732% to 0.0853% (see 4 'Capital key' in the general notes to the financial statements).

At 1 February 2020, the ECB's paid-up capital also remained unchanged at €7,659,443,757, as the remaining NCBs covered the withdrawn Bank of England's paid-up capital of €58,200,921. In 2021 and 2022, euro area NCBs will be paying to the ECB their remaining share in the increased subscriptions in the ECB's capital in two additional equal instalments. As a result, the Bank transferred to the ECB an amount of €30,066 in 2020 and will be transferring €639,880 in 2021 and 2022.

(ii) Impact on the Bank's claims equivalent to the foreign reserve assets transferred to the ECB

Pursuant to Article 30.2 of the Statute, the contributions of the NCBs to the transfer of foreign reserve assets to the ECB are fixed in proportion to their share in the ECB's subscribed capital. Following the Bank of England's withdrawal from the ESCB, the NCBs' total claim equivalent to these transfers was only marginally adjusted. This was due to (i) the increase in the weighting of the euro area NCBs in the ECB's subscribed capital, and (ii) a decision of the Governing Council to reduce the proportion of the euro area NCBs' contributions, so that the total amount of foreign reserve assets already transferred by them will remain at the same level as before the Bank of England's withdrawal from the ESCB. The Bank's claim marginally decreased by €106,166 and was repaid by the ECB in 2020.

(b) Off-balance sheet instruments

As at 31 December 2019, the Bank had outstanding foreign exchange forward and swap contracts which related to the forward purchases of €691,472,370 (2018: €841,073,469) against the sale of other currencies (principally the US dollar), and forward sales of €304,000,000 (2018: €342,950,000) against the purchase of other currencies (principally the US dollar). As at 31 December 2018 and 2019 there were no outstanding foreign exchange contracts for the forward sale or purchase of SDR. Unsettled net spot transactions as at 31 December 2019 were €16,730,000 (2018: €54,850,000).

At the balance sheet date, the Bank had outstanding interest rate future contracts linked to German government securities (net short positions with a notional amount of €8,323,600) and US treasury notes (net long position with a notional amount of US$5,882,735).

(c) Contingent liabilities and commitments

The Bank's contingent liabilities as at 31 December 2019 consisted of outstanding guarantees amounting to €2,300 (2018: €100,110).

As at 31 December 2019, the Bank also had commitments in respect of tangible and intangible fixed assets which extended beyond the balance sheet date. Capital commitments, which amount to €6,953,000 (2018: €2,610,200), are expected to be incurred during the forthcoming financial year and relate mainly to capital expenditure attributable to buildings and investment in IT.

(d) Transactions with Government

In the course of its operations, the Bank conducts banking transactions with, and provides several banking services to, the Government of Malta, government departments, public sector corporations and other entities owned by the Government. The Bank holds the principal accounts of the Government and maintains accounts for the other entities. Balances held with the Bank by the Government and the other entities as at the balance sheet date, together with the terms of such instruments, are disclosed in L 5 'Liabilities to other euro area residents denominated in euro' and L 7 'Liabilities to euro area residents denominated in foreign currency' in the notes to the balance sheet. The principal impact of banking transactions entered into with the Government and the entities referred to above on the Bank's profit and loss account is net interest on deposits as disclosed in 1.2 'Interest expense' in the notes to the profit and loss account. The Bank provides these entities with foreign exchange and related services, which do not have a significant impact on the Bank's profit and loss account.

(e) Market maker in Malta Government securities

The Bank acts as market maker in MGS and Treasury bills and ensures their liquidity in the secondary market by being ready to trade in such securities on the initiative of the market (see A 11.3 'Other financial assets' in the notes to the balance sheet). Income earned by the Bank from these assets, amounting to €3,838,260 (2018: €4,238,119), is included in 1.1 'Interest income' in the notes to the profit and loss account and presented within income from euro marketable debt securities.

(f) Investment securities pledged as collateral

As at 31 December 2019, investment securities were pledged as collateral against the provision of credit lines by a counterparty up to an amount of US$65,000,000 or approximately €58,300,000 (2018: US$65,000,000 or approximately €57,000,000). No amounts were borrowed under these facilities at the balance sheet dates.

(g) Assets held in custody

As at 31 December 2019, assets held in custody by the Bank in terms of the Insurance Business Act (Cap. 403) amounted to the equivalent of €22,398,008 (2018: €22,124,834).

(h) Management of funds belonging to the Investor and Depositor Compensation Schemes

The Bank is an investment manager in respect of funds belonging to the Investor and Depositor Compensation Schemes. These funds are managed on a discretionary basis in accordance with the investment parameters set by the Management Committees of the respective Schemes. As at 31 December 2019, the Investor and Depositor Compensation Schemes had deposits of €234,654 (2018: €741,131) and €21,276,138 (2018: €9,081,122) respectively, with the Bank.

Statement of the Bank's investments as at 31 December 2019

	EUR €'000	USD €'000	Others €'000	Total €'000
Cash and balances with banks				**22,792**
Gold balances				**23,708**
Securities by issuer category:				
Government	**1,614,941**	**37,057**	**43,988**	**1,695,986**
Monetary financial institutions	**663,140**	**264,668**	**181,985**	**1,109,793**
Other financial institutions	**107,241**	**60,494**	**27,420**	**195,155**
Non-financial institutions	**20,894**	**30,158**	**9,002**	**60,054**
Supranational	**31,379**	**9,795**	**-**	**41,174**
	2,437,595	**402,172**	**262,395**	**3,102,162**
Claims on the International Monetary Fund				**147,005**
Participating interest in the European Central Bank				**21,028**
Transfer of foreign reserves to the European Central Bank				**42,420**
Fixed income investment funds				**52,403**
Other assets				**144,640**
Total investments				**3,556,158**

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Independent Auditors' Report

To the Directors of the Central Bank of Malta

Opinion

We have audited the financial statements of the Central Bank of Malta (the "Bank") which comprise the balance sheet as at 31 December 2019, the profit and loss account for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31 December 2019, and of its financial performance for the year then ended in accordance with the basis of accounting described in the guideline on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) ECB/2016/34 issued on 3 November 2016 as amended by subsequent European Central Bank guidelines (the "Guideline"), as established by the Central Bank of Malta Act (Chapter 204, Laws of Malta).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing ("ISAs"). Our responsibilities under those standards are further described in the A*uditors' responsibilities for the audit of the financial statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants*, together with the ethical requirements that are relevant to our audit of the financial statements in accordance with the *Accountancy Profession (Code of Ethics for Warrant Holders) Directive* issued in terms of the Accountancy Profession Act (Chapter 281, Laws of Malta), and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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The firm is registered as a partnership of Certified Public Accountants in terms of the Accountancy Profession Act.

A list of partners and directors of the firm is available at 92, Marina Street, Pietà, PTA9044, Malta.

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Independent Auditors' Report (continued)

To the Directors of the Central Bank of Malta

Other information

The directors are responsible for the other information. The other information comprises

(i) the 'Directors' Report', which we obtained prior to the date of this auditor's report; and
(ii) the 'Governor's Statement', the 'Financial and Economic Developments'; and the 'Bank Policies, Operations and Activities', which are expected to be made available to us after that date.

The other information does not include the financial statements and our auditors' report thereon. Our opinion on the financial statements does not cover the other information and, we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above, and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we have obtained prior to the date of this auditors' report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

When we read the other information not yet received identified in this section of our report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to the directors. In the event that a material misstatement in the other information not yet received is not corrected by the directors, we are required to determine the appropriate course of action in accordance with the requirements of ISAs.

Responsibilities of the directors for the financial statements

As those charged with governance of the Bank, the directors are responsible for the preparation of financial statements that give a true and fair view in accordance with the basis of accounting described in the Guideline, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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Independent Auditors' Report (continued)

To the Directors of the Central Bank of Malta

Responsibilities of the directors for the financial statements (continued)

In preparing the financial statements, the directors are responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern. The directors are required to use the going concern basis of accounting as pronounced in the Guideline, provided there are no factual or legal impediments to do so.

The directors are also responsible for overseeing the financial reporting process.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. 'Reasonable assurance' is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

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Independent Auditors' Report (continued)

To the Directors of the Central Bank of Malta

Auditors' responsibilities for the audit of the financial statements (continued)

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

The Principal authorised to sign on behalf of KPMG on the audit resulting in this independent auditors' report is Claude Ellul.



KPMG
Registered Auditors

16 March 2020

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