



BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

**FIFTY-FOURTH ANNUAL REPORT
AND
STATEMENT OF ACCOUNTS
2021**

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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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*Financial Stability Surveillance
and Research*

*as at 30 March 2022

**as from 2 March 2022

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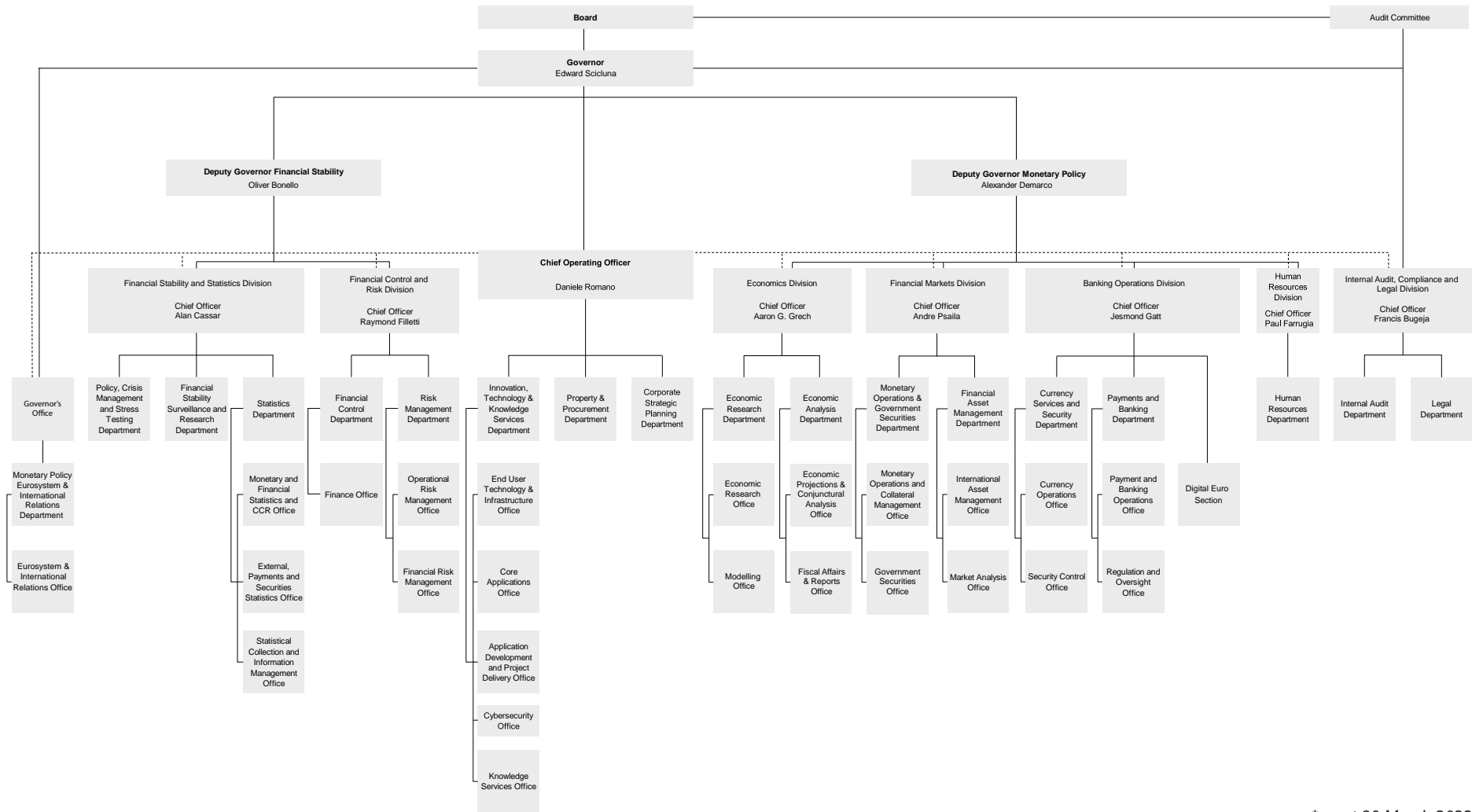


(left to right)

Professor Frank Bezzina (Director), Professor Peter J. Baldacchino (Director), Dr Lauren Ellul (Director), Mr Oliver Bonello (Deputy Governor), Professor Edward Scicluna (Governor and Chairman), Mr Alexander Demarco (Deputy Governor), Dr Romina Cuschieri (Director), Mr Francis Bugeja (Secretary).

**as at 30 March 2022*

ORGANISATION CHART*



*as at 30 March 2022

*Bank Ċentrali ta' Malta
Eurosystema*

A-Gvernatur



*Central Bank of Malta
Eurosystem*

The Governor

30 March 2022

The Hon Clyde Caruana
Minister for Finance and Employment
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 2021.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'e.g.l.' or similar initials.

Professor Edward Scicluna

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ABBREVIATIONS

ABS	asset-backed security
AIIB	Asian Infrastructure Investment Bank
ADPDO	Application Development and Project Delivery Office
AML	anti-money laundering
APP	asset purchase programme
BCI	Business Conditions Index
BCP	Business Continuity Plan
BLS	Bank Lending Survey
BOP	balance of payments
CCyB	countercyclical capital buffer
CFF	Cystic Fibrosis Fundraising
CGE	Computable General Equilibrium
CGS	COVID-19 Guarantee Scheme
CO ₂	carbon dioxide
COICOP	Classification of Individual Consumption by Purpose
CPE	compensation per employee
CPI	Consumer Price Index
CRA	credit reference agency
CRR	Capital Requirements Regulation
CSPP	corporate sector purchase program
CSR	corporate social responsibility
DCS	Depositor Compensation Scheme
DDA	deficit-debt adjustment
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
EEL	Employment Expectations Indicator
EER	effective exchange rate
EFC	Economic and Financial Committee
EIB	European Investment Bank
EONIA	Euro OverNight Index Average
EPP	Enterprise Payments Platform
ESA	European System of Accounts
ESCB	European System of Central Banks
ESG	Environment, Social and Governance
ESI	economic sentiment indicator
ESMA	European Securities Market Authority
ESRB	European Systemic Risk Board
€STR	Euro short-term rate
ETF	Exchange Traded Funds
EU	European Union
EUI	Economic Uncertainty Indicator
EURIBOR	Euro Interbank Offered Rate
EUTI	End User Technology and Infrastructure
FATF	Financial Action Task Force
FCI	Financial Conditions Index
FMI	Financial Market Infrastructure
FSB	Financial Stability Board
FSR	Financial Stability Report
FX	Foreign Exchange
GDP	gross domestic product
GEAD	generalised exactly additive decomposition
GFCF	gross fixed capital formation
GVA	gross value added
HCI	harmonised competitiveness indicator
HFCS	Household Finance and Consumption Survey
HICP	Harmonised Index of Consumer Prices
HVAC	heating, ventilation and air conditioning
IAC	Internal Auditors Committee

ICS	Investor Compensation Scheme
IIP	International Investment Position
IMF	International Monetary Fund
IPC	Investment Policy Committee
ITKS	Innovation, Technology and Knowledge Services
JFSB	Joint Financial Stability Board
LFS	Labour Force Survey
LTRO	longer-term refinancing operation
MCAST	Malta College of Arts, Science and Technology
MCH	Malta Clearing House
MDB	Malta Development Bank
MFI	monetary financial institution
MGS	Malta Government Stocks
MIA	Malta International Airport
MIP	macroeconomic imbalance procedure
MPC	Monetary Policy Committee
MQF	Malta Qualifications Framework
MRO	main refinancing operation
MS	Microsoft
MSE	Malta Stock Exchange
NCB	national central bank
NDSF	National Development and Social Fund
NEIG	non-energy industrial goods
NFC	non-financial corporation
NGEU	Next Generation EU
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
NSFR	net stable funding ratio
NSO	National Statistics Office
OECD	Organization for Economic Co-operation and Development
ORM	Operational Risk Management
O-SII	other systemically important institutions
PELTRO	pandemic emergency longer-term refinancing operation
PEPP	pandemic emergency purchase programme
POS	point of sale
PPD	Property and Procurement Department
PPI	Property Price Index
PSG	Pillar 2 Guidance
PSPP	public sector purchase programme
RPI	Retail Price Index
SAFE	Survey on Access to Finance of Enterprises
SDDS	Special Data Dissemination Standard
SDR	special drawing right
SEPA	Single Euro Payments Area
SME	small and medium-sized enterprise
SRI	Sustainable and Responsible Investment
SURE	Support to mitigate Unemployment Risks in an Emergency
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TARGET2	Trans-European Automated Real-Time Gross Settlement Express Transfer System 2
TDV	time dummy variable
TIPS	TARGET Instant Payment Settlement
TLTRO	targeted longer-term refinancing operation
UCA	Urban Conservation Area
UK	United Kingdom
ULC	unit labour cost
US	United States
VAT	value added tax
WBG	World Bank Group

GOVERNOR'S STATEMENT

The year 2021 saw the global economy beginning to recover from the COVID-19 shock as progress with vaccination enabled several economies to re-open and containment measures to be more limited in scope. However, the recovery remained uneven across sectors, as travel and personal contact services remained restricted. The recovery has also been uneven across countries. The strong rebound in global demand amplified bottlenecks caused by disruptions in production and supply. Mismatches between supply and demand in turn led to broadening of inflationary pressures that were amplified by rising energy prices. Against this background, towards the end of the year, the central banks of a number of economies began to signal that the end of expansionary monetary policy was under consideration.



In the euro area, real gross domestic product (GDP) grew by 5.3% in 2021 and by the end of the year stood on a par with its pre-pandemic level.

The recovery in activity as well as continued reliance on pandemic-related job retention schemes supported an improvement in labour market conditions. The number of persons in employment increased by 1.1%, after a fall of 1.5% in 2020. Hours worked and participation rates also rose in 2021. Meanwhile, the unemployment rate in the euro area decreased marginally to average 7.7% for 2021. By December, it had fallen to 7.0%.

As in several other advanced economies, euro area inflation rose significantly during the year. The annual average rate of inflation based on the Harmonised Index of Consumer Prices (HICP) reached 2.6% from 0.3% in 2020. This increase was largely driven by higher energy inflation, though services and non-energy industrial goods (NEIG) inflation also increased. Indeed, HICP inflation excluding energy and food broadly doubled, reaching 1.5% from 0.7% in 2020.

During 2021, the European Central Bank (ECB) calibrated some of the monetary policy measures that had been introduced in response to the pandemic, in line with the evolving health situation and the changing inflation outlook. Nonetheless, overall the ECB maintained an accommodative monetary policy stance, as such a stance was still deemed necessary for inflation to stabilise at the ECB's inflation target over the medium-term horizon.

In July, the Governing Council approved a new inflation target, following the conclusion of its strategy review that had been launched in 2020. The Council adopted a new, symmetric 2% inflation target over the medium term and confirmed that HICP remains the most appropriate price measure, while noting that owner-occupied housing should be introduced in the HICP over time.

Following the conclusion of this strategy review, the Council also modified its forward guidance on interest rates. Key interest rates were set to remain at their present or lower levels until the Council sees inflation reaching two per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and it judges that realised progress in underlying inflation was sufficiently advanced to be consistent with inflation stabilising at 2% over the medium term. The Governing Council acknowledged that this may also imply a transitory period in which inflation was moderately above target.

Meanwhile, the Eurosystem continued to make net purchases under the asset purchase programme (APP) and the pandemic emergency purchase programme (PEPP). As the economic and inflation outlook improved in the second half of the year, in September the Governing Council decided that the pace of net purchases under the PEPP could be scaled back. Subsequently, it announced that such purchases would end in March 2022. By contrast, net purchases under the APP will continue and were expected to end shortly before the ECB starts raising the key ECB interest rates.

In 2021, the Eurosystem also settled the last four out of ten targeted longer-term refinancing operations (TLTRO-III) that were launched in September 2019.

In March 2022, the Governing Council revised down the pace of net asset purchases planned for the second quarter of the year under the APP. Furthermore, it announced that unless incoming data signal weakening inflation, net APP purchases could end in the third quarter. The Council also stated that any adjustments to interest rates would take place some time after the end of net purchases under this programme and would be gradual.

Maltese economy

In line with a trend observed in most other economies, the Maltese economy also began to recover from the effects of the pandemic. In 2021, GDP rose by 9.4%, with the GDP level surpassing marginally that of 2019. Growth was driven by domestic demand although net exports also supported the recovery.

Employment continued to benefit from the ongoing normalisation of economic activity in the context of a tight labour market and from COVID-related support measures, in particular the Wage Supplement Scheme. According to the Labour Force Survey (LFS), employment expanded at an average annual rate of 2.0% during the first three quarters of 2021, following growth of 3.5% during the corresponding period of 2020. The pace of job expansion improved as the year progressed with the number of job holders in the third quarter around 5% higher than that recorded before the pandemic. The unemployment rate averaged 3.7% between January and September 2021, down from 4.3% in the same period of 2020. It thus remained well below its average since at least 2003 and the average rate in the euro area.

The fiscal balance remained strongly in deficit, reflecting the extension of COVID-19 related economic support amid renewed containment measures in response to new variants of the virus and an aggressive vaccination campaign. The Bank estimates that the fiscal balance will show a deficit of 9.3% of GDP in 2021, while the general government debt is estimated to have reached 57.7% of GDP.

The current account balance is also estimated to have remained in deficit in 2021, reflecting a significant increase in imports which included the aviation sector. Furthermore, tourism-related earnings, while recovering, remained well below pre-pandemic levels.

HICP inflation decreased marginally from 0.8% in 2020 to 0.7% in 2021. Nonetheless, by December 2021, inflation had risen to 2.6% as international price pressures began to transmit locally. Notwithstanding the increase in inflation in the second half of the year, HICP inflation in Malta remained well below that in the euro area, which ended December at 5.0%. This partly reflects the fact that domestic energy prices remained cushioned from the surge in international commodity prices. Changes in the weights assigned to HICP sub-indices in light of pandemic related changes in consumption patterns also contributed to the negative inflation differential relative to the euro area. Inflation based on the Retail Price Index (RPI), which is unaffected by the aforementioned changes in weights, rose from 0.6% in 2020, to 1.5% in 2021.

The Bank's latest economic projections show that economic activity levels are expected to continue recovering in 2022. However, as economic activity levels have already returned to those prevailing before the pandemic, growth is expected to moderate to more normal levels. The Bank expects that GDP will grow by 6.0% in 2022, 5.3% in 2023 and 3.8% in 2024. Inflationary pressures are expected to remain elevated in 2022 but should begin to dissipate in 2023, as supply bottlenecks are expected to gradually fade.

On balance, risks to economic activity over the medium term are judged to be balanced, with some downside risks in the short-term when the pandemic could further weaken tourism exports more than anticipated in the baseline. Moreover, a prolongation of supply bottlenecks could adversely affect manufacturing activity and domestic demand, with higher than projected inflation. However, the start of the conflict in Ukraine in late February 2022, after the cut-off date of our latest projections, has heightened uncertainty and represents additional downside risks to economic activity, mostly through indirect effects from lower activity in trading

partners. Furthermore, in the absence of a swift resolution to the conflict, prolonged elevated commodity prices could impact domestic consumption in the medium term, unless mitigated by fiscal support and/or a faster decline in the saving ratio.

With regards to inflation, risks are on the upside during the entire projection horizon. In particular, if supply bottlenecks and disequilibria between demand and supply persist, more firms are likely to be constrained to raise selling prices, which in turn could trigger second round effects through higher wage demands. Moreover, prolonged geopolitical tensions in Europe could also lead to higher imported inflation than envisaged in this projection exercise.

The general government balance is expected to remain in deficit until the end of the projection horizon, although narrowing to 3.3% of GDP by 2024 as COVID-related support measures are phased out. Government debt is set to reach 60.9% of GDP by that year. Risks to the fiscal projections mainly affect 2022 and are deemed to be deficit-increasing. In particular, these risks relate to the likelihood of additional COVID-related support, the impact of Air Malta's restructuring on the likelihood of State aid to the airline, and support to cushion the impact of rising commodity prices following the conflict in Ukraine.

Monetary and macroprudential policy

As regards to its operational activities, the Bank continued to implement the Eurosystem's monetary policy decisions in Malta through standing facilities, liquidity-providing operations and asset purchases. Credit institutions established in Malta participated in main refinancing operations (MROs) conducted by the ECB with a total cumulative amount of €84.0 million, significantly above the €1.0 million utilised in 2020. In 2021, the banking system also made significant use of the TLTRO-III instrument. Domestic banks participated in such operations with an aggregate amount of €520.0 million, compared to €63.5 million a year earlier, due to the attractive pricing of such instrument. Take up of pandemic emergency long term refinancing operations (PELTROs) also increased over 2020, rising from €45.0 million to €75.4 million, while use of three-month long-term refinancing operations (LTROs) remained more limited. As in 2020, Maltese credit institutions did not use the marginal lending facility. Recourse to the deposit facility decreased as banks continued to add to their balances held at the Central Bank of Malta.

Credit institutions in Malta continued to benefit from the 2-tier system for reserve remuneration. Since the system was introduced in 2019, credit institutions in Malta benefitted from an estimated €14.3 million compared to a situation where the negative interest rates would have applied to all their excess reserves.

During 2021, the Bank purchased €216.1 million worth of Maltese sovereign bonds under the public sector purchase programme (PSPP) – more than twice the amount purchased in 2020. Meanwhile, purchases of sovereign bonds under the PEPP reached €235.2 million. Apart from purchasing sovereign bonds for its PSPP and PEPP portfolios, the Bank made additional purchases for the ECB's portfolios.

The Bank's balance sheet continued to expand, reaching €12,400.1 million at the end of 2021 from €10,035.4 million a year earlier. Operating profit before transfer to provisions decreased to €26.1 million from €42.8 million in 2020. Following the transfer of €3.9 million to provisions, the amount of €22.2 million is payable to the Government of Malta, as against €33.0 million a year earlier.

The Bank carried out regular assessments of financial sector conditions, also through stress tests and sensitivity analysis, and through the Bank Lending Survey (BLS). The Bank also published a first analysis on the extent of non-bank financial intermediation in Malta and of the domestic financial sector's exposure towards climate-sensitive sectors.

As the pandemic situation in Malta improved, certain macroprudential policy measures that were postponed in response to the pandemic were reviewed. Moreover, following a public consultation, the Bank published an amended version of Directive No. 16 on borrower-based measures, mainly reflecting revisions to borrower definitions and other refinements. Meanwhile, institutions whose O-SII buffer rates are subject to

transitory provisions were granted an extension, enabling them to resume with phasing-in arrangements in 2022. The countercyclical capital buffer (CCyB) was maintained unchanged at 0% throughout 2021, while the capital conservation buffer remained in force with banks required to hold an additional capital of 2.5% of risk weighted assets.

During 2021, the Bank worked on a comprehensive dataset to be reported by banks, targeting the whole population of real estate loans. The dataset is partly aimed at assessing compliance with the aforementioned Directive No. 16 and addressing the ESRB Recommendation on closing real estate data gaps. It also fulfils the Bank's requirements on hedonic property prices and bank lending standards.

Other Bank activities

As in past years, the Bank continued to participate in ECB and ESRB meetings related to the financial sector. Financial stability issues and the general economic situation were regularly discussed with the European Commission, the International Monetary Fund (IMF) and the rating agencies.

Locally, the Bank remained active in the Joint Financial Stability Board (JFSB) as well as the Domestic Standing Committee and its Crisis Management Task Force. Meanwhile, it continued to monitor developments concerning anti-money laundering (AML) as the different stakeholders continued their work in addressing the recommendations made by MONEYVAL and the Financial Action Task Force (FATF).

The Bank again held webinars on economic topics as well as its Annual Research Symposium, which focused on climate change. Work progressed on a Computable General Equilibrium (CGE) model for the Maltese economy, which would complement the Bank's existing toolkit in addressing policy questions related to demand and supply conditions in specific industries. Staff continued to work with the National Statistics Office (NSO) on the fourth round of the Household Finance and Consumption Survey (HFCS). The results were transmitted to the ECB in January 2022. The Bank also remained active in domestic fora, such as the National Productivity Board, the Building Industry Consultative Council and the Housing Authority's Rental Observatory. Contacts with private and public institutions were maintained.

The Bank continued to compile and disseminate a variety of statistics to official institutions and the general public. New and amended statutory returns were launched to fulfil the revised ECB Regulations and Guidelines on Payments and Balance Sheet statistics of the monetary financial institutions (MFIs). Work was also carried out on the operational phase of the Anacredit database, the Integrated European Reporting Framework project, the ECB's Centralised Securities Database and climate change indicators. In 2021, the Bank launched directive No. 15 on the supervision of credit rating agencies. The first applicant in terms of this directive was licensed to act as a credit rating agency by the Commerce Department in consultation with the Bank. Meanwhile, the Bank continued to operate its Central Credit Register to provide information on borrowers' credit risk to eligible institutions and borrowers.

The Bank collaborated with the NSO to enhance the quality of a number of datasets on external statistics and address related recommendations of the ECB and Eurostat. Enhanced estimation methods were also adopted in the area of financial accounts statistics, while additional payment statistics were published on the Bank's website. The Bank continued to publish monthly information on the take up of loan moratoria and the Malta Development Bank (MDB) COVID-19 Guarantee Scheme (CGS). Meanwhile, the Bank pursued its preparation, together with the NSO, to meet the requirements for Malta's adherence to the IMF's Special Data Dissemination Standard (SDDS) Plus.

The Bank continued to monitor credit institutions and other professional cash handlers, ensuring that all cash handlers were certified and trained to detect counterfeit euro banknotes and recirculate banknotes. Unannounced inspections were carried out at branches of credit institutions to ensure compliance with the relevant ECB Directive and meetings were held regularly with credit institutions to keep them informed of the latest developments regarding currency issues. Directive No. 19 was issued with a view to reduce the usage and potential abuse in the use of cheques and bank drafts. The Directive entered in force on 1 January 2022.

Meanwhile, following the ECB's launch of the investigation phase of a digital euro project, a unit was set-up to build the required expertise for the Bank to be in a position to contribute to such project.

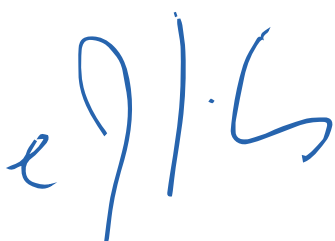
In 2021, the Bank carried out further upgrades to its physical as well as IT infrastructure. As regards the latter, it implemented a new virtual infrastructure and a cloud-based application, while upgrading cybersecurity capabilities. It also continued to enhance various systems used in ESCB operations as well as the infrastructure used for executing transactions. Furthermore, enhanced Wi-Fi services were provided across all buildings of the Bank. Work also began on the implementation of a new Financial Crime Risk Management system.

As part of its efforts to support the transition towards a sustainable global economy, the Bank applied several Sustainable and Responsible Investment (SRI) practices in its investment decisions. In 2021 it continued to ensure that any external institutions involved in the management of some of its portfolios comply with Environment, Social, and Governance (ESG) considerations in all their investment decisions. A norm-based negative screening approach was applied, which has resulted in divestment from companies involved in the tobacco industry and/or linked to the production of nuclear weapons. Furthermore, there was an increase in the share of green, social and sustainable bonds in the Bank's internally managed portfolios. The Bank, also continued to participate in the Network for Greening the Financial System (NGFS), which brings together several of the global systemically-important banks and insurers.

With a view to reduce its ecological footprint, the Bank maintained a number of initiatives that were introduced in recent years, including waste separation for recycling, tree planting and switching to more energy efficient computers. Additionally, in 2021 the Bank leased its first hybrid electric car. It intends to gradually convert its entire fleet to hybrid vehicles. Internal processes underwent further streamlining to achieve efficiencies and reduce the use of paper. Meanwhile, initial studies relating to the planned installation of solar panels and more efficient standby generators were completed.

Looking ahead, the Bank will continue to monitor closely the economy and the financial system and to disseminate its knowledge to the general public. Within its remit, it will also collaborate with other stakeholders to strengthen Malta's anti-money laundering/combating the financing of terrorism framework. Another area which will merit particular attention during the upcoming year includes the alignment of the Bank's analytical and operational practices in line with various ECB initiatives that are being planned to bring climate change considerations in the monetary policy framework. At the same time, the Bank will need to comply with standards and guidelines that the ECB may adopt in relation to non-monetary policy portfolios.

On behalf of the Board, I would like to thank the Bank's staff for their continued effort and dedication, especially in light of the various challenges created by the pandemic.



Professor Edward Scicluna



I. FINANCIAL AND ECONOMIC DEVELOPMENTS



1. THE EXTERNAL ENVIRONMENT AND THE EURO AREA

During 2021, economic activity in the United States (US) and the United Kingdom (UK) started to pick-up even though the emergence of new COVID-19 variants weighed on activity towards the end of the year. Unemployment declined in the United States – admittedly from COVID-related high rates – while it remained unchanged in the United Kingdom. Price pressures rose in both economies, largely reflecting developments in energy prices and higher global demand for goods. The annual rate of consumer price inflation averaged 4.7% in the United States and 2.6% in the United Kingdom. By December though, inflation exceeded the policy target by a wider margin.

During the year, the Federal Reserve kept its key interest rate unchanged but the Bank of England raised its Bank Rate in December. Both central banks continued to make available liquidity support measures to enable the smooth functioning of financial markets and the flow of credit to the economy. However, in the United States, the Federal Reserve started withdrawing some monetary stimulus by unwinding some emergency lending programmes that were introduced since the outbreak of the COVID-19 pandemic. Towards the end of the year, the Bank of England also signalled that it would shortly begin to withdraw such stimulus.

In the euro area, real GDP grew by 5.3% in 2021 and by the end of the year stood on a par with its pre-pandemic level. Employment also increased and stood slightly above the level registered just before the onset of the pandemic, while the unemployment rate fell to 7.7%, from 8.0% in 2020. Consumer price inflation, measured on the basis of the HICP, rose significantly during 2021, with the average for the year standing at 2.6% from 0.3% in 2020. The increase in inflation affected most components, but was mainly driven by a strong rebound in energy prices.

During 2021, the ECB calibrated some of the measures that had been introduced in response to the pandemic, in line with the evolving health situation and changing inflation outlook. Nonetheless, overall the ECB maintained an accommodative monetary policy stance.

In July, the Governing Council approved a new inflation target, following the conclusion of its strategy review that had been launched in 2020. The Council adopted a new, symmetric 2% inflation target over the medium term and confirmed that HICP remains the most appropriate price measure, while noting that owner-occupied housing should be introduced in the HICP over time. It also modified its forward guidance on interest rates.

Meanwhile, the Eurosystem continued to make net purchases under the APP and the PEPP. As the economic and inflation outlook improved in the second half of the year, in September the Governing Council decided that the pace of net purchases under the PEPP could be scaled back. Subsequently it announced that such purchases would end in March 2022. In 2021, the Eurosystem also settled the last four out of ten TLTRO-III that were launched in September 2019.

During 2021, the price of oil increased, supported by the pick-up in demand in the context of persistent supply bottlenecks among some key oil producers. The price of Brent crude oil ended 2021 at USD 78.6 per barrel, 54.5% above its level at end-2020.

Key advanced economies

US economy grows at a strong pace

During 2021, the US economy grew at a strong pace with real GDP rising by 5.7%, the strongest rate in nearly four decades (see Table 1.1). This follows a contraction of 3.4% in 2020. In 2021, the GDP level stood

Table 1.1
REAL GDP GROWTH IN SELECTED ADVANCED ECONOMIES

Percentage changes over preceding period

	2016	2017	2018	2019	2020	2021
United States	1.7	2.3	2.9	2.3	-3.4	5.7
Euro area	1.9	2.6	1.8	1.6	-6.4	5.3
United Kingdom	2.3	2.1	1.7	1.7	-9.4	7.5

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

2.1% above its 2019 level. Vaccination efforts and liquidity support measures coupled with government stimulus helped the economy rebound from the previous year's contraction.

The rise in real GDP was driven by domestic demand. Growth in personal consumption expenditure turned positive as did growth in gross private domestic investment. Both exceeded their pre-pandemic level. Government consumption grew further but at a slower pace compared to 2020. On the other hand, the trade deficit widened in volume terms as imports increased at a faster rate than exports.

In the labour market the participation rate averaged 61.7% in 2021, slightly below the rate of 61.8% registered in 2020. Meanwhile, employment increased by 3.2% after falling sharply by 6.2% in 2020. Compared to 2019 there were 3.1% fewer persons in employment.

Non-farm payroll data suggest that during 2021 employment was higher across all main economic sectors, apart from the mining and logging sector, though jobs in this sector declined at a slower pace compared with 2020. After reaching a peak in April 2020 the unemployment rate generally declined during the course of 2021, to reach 3.9% by December. In 2021, the unemployment rate averaged 5.4%, down from 8.1% in 2020, but was still relatively high compared to pre-pandemic rates (see Chart 1.1).

Inflationary pressures increased markedly during 2021, with the annual inflation based on the consumer price index (CPI) averaging 4.7%, up from 1.2% in 2020 (see Chart 1.2). US inflation remained under 2.0% in the first two months of the year. However, it quickly increased thereafter, reaching 7.0% by December, the highest rate in almost 40 years. The

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

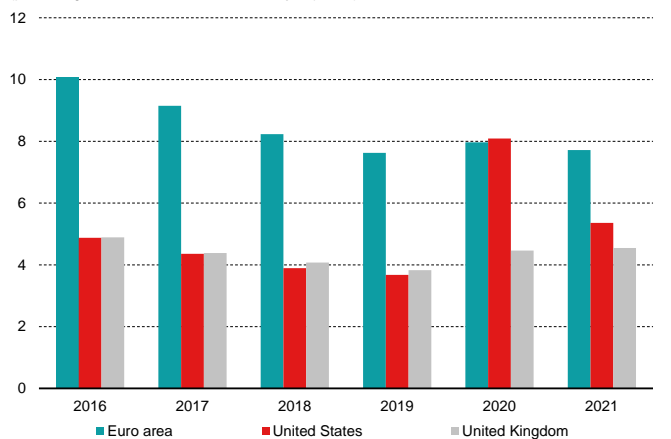
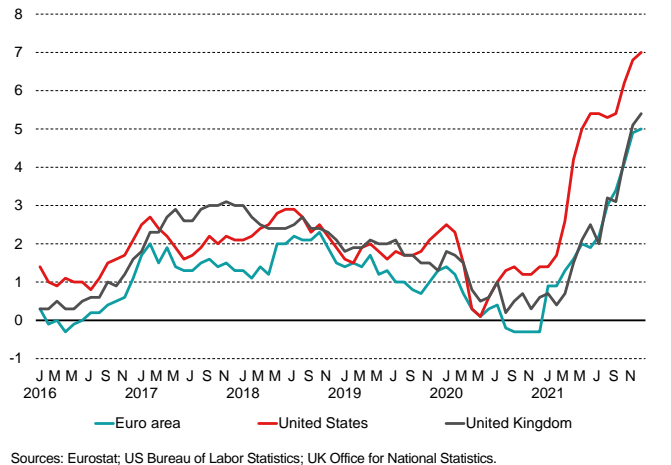
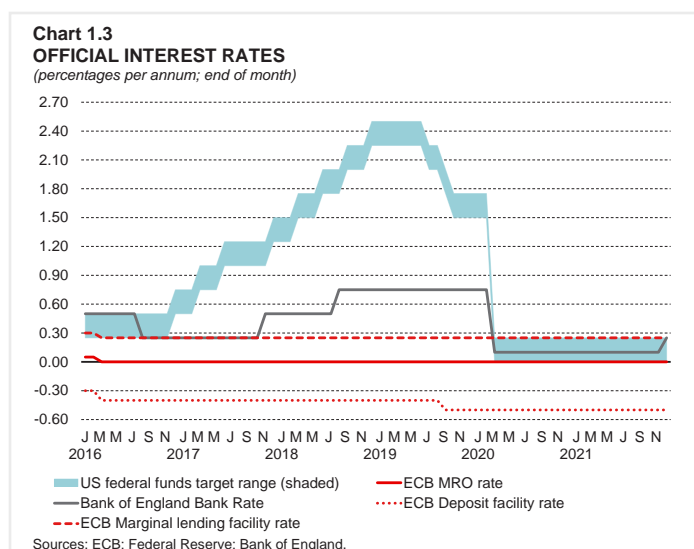


Chart 1.2
CONSUMER PRICE INFLATION
(annual percentage changes)



increase in the average inflation rate for 2021 mainly reflected developments in the energy prices which rose by 21.0% after decreasing by 8.5% in 2020. Food price inflation rose to 3.8% from 3.3%. Meanwhile, prices of commodities excluding food and energy grew at a markedly faster pace. Services inflation also increased at a faster rate, reflecting developments in both services prices and commodities other than food and energy. As a result, inflation excluding food and energy accelerated to 3.6% in 2021 from 1.7% in 2020.

During 2021, the Federal Open Market Committee remained committed to use its full range of tools to support the economy thereby promoting its maximum employment and price stability goals. The target range for the federal funds rate was kept unchanged in a range between 0.00% and 0.25% (see Chart 1.3).¹



To help foster smooth market functioning and accommodative financial conditions, and therefore the flow of credit to households and businesses, the Federal Reserve continued to increase its holdings of Treasury securities and of the agency mortgage-backed securities. However, towards the end of the year, as inflationary pressures rose and conditions in the labour market improved, the Committee decided to reduce the monthly pace of its net asset purchases.

In June, the Federal Reserve also extended its Paycheck Protection Program Liquidity Facility, which supports the flow of credit to small businesses, for a final time until the end of July 2021. Usage of the other facilities – the Commercial Paper Funding Facility, the Money Market Mutual Fund Liquidity Facility and the Primary Dealer Credit Facility – was not significant such that these facilities were ended as scheduled at the end of March 2021.

In June, the Federal Reserve also announced plans to begin winding down the portfolio of the Secondary Market Corporate Credit Facility, a temporary emergency lending facility that closed at the end of 2020. It also announced the extension of its temporary US dollar liquidity swap lines with nine central banks through end-2021, which helped sustain improvements in global US dollar funding markets by serving as an important liquidity backstop.

The Committee also established two standing repurchase agreement (repo) facilities: a domestic standing repo facility and a repo facility for foreign and international monetary authorities. These overnight facilities serve as backstops in money markets to support the effective implementation of monetary policy and smooth market functioning.

UK economy starts to recover

Real GDP in the United Kingdom grew strongly in 2021, as the economy started to recover from the effects of the pandemic, even though growth was somewhat restrained by disruption in supply chains and labour shortages in a number of sectors.

¹ This decision was confirmed in January 2022, when the Committee also announced that net asset purchases will end in early March 2022. The Committee also noted that given the high inflation rate and a strong labour market, it expected that the target range for the federal funds rate would increase soon.

Real GDP increased by 7.5% in 2021, after declining by 9.4% in 2020 (see Table 1.1). Household expenditure increased, as did gross fixed capital formation (GFCF) and government consumption. On the other hand, the contribution of net trade turned negative. Towards the end of 2021, UK economic activity returned to pre-pandemic levels but for the year as a whole, the GDP level stood 2.6% below its level in 2019.

In 2021, on average, employment was down by 0.5% compared with 2020, when it had declined by 0.8%. The average unemployment rate stood at 4.5%, unchanged from a year earlier (see Chart 1.1).

Higher energy prices and shortages of materials and labour, coupled with an increase in demand for goods, pushed prices up during 2021. In fact, the CPI inflation rate rose above 2.0% in May and generally continued to rise thereafter (see Chart 1.2). It ended the year at 5.4%, the second highest inflation rate since the data series started to be compiled. For 2021 as a whole, the CPI inflation rate averaged 2.6%, up from 0.9% in 2020.

Energy price inflation turned positive, while prices for NEIG and services grew at a faster pace. Food prices rose at roughly the same annual rate recorded in 2020. The average annual rate of inflation based on the CPI but excluding energy, food, alcohol and tobacco, rose to 2.4% in 2021 from 1.4% in 2020.

For most of the year, the Bank of England's Monetary Policy Committee (MPC) maintained the Bank Rate unchanged at 0.1%. However, in December, the MPC started a tightening cycle, as it increased this rate by 0.15 percentage point to 0.25%, amid signs of greater persistence in domestic cost and price pressures and further tightening in the labour market (see Chart 1.3).

The Committee decided to keep the stock of sterling non-financial, investment-grade, corporate bond purchases financed by the issuance of central bank reserves, at GBP 20 billion. It also agreed to continue with its existing programme of UK government bond purchases, financed by the issuance of central bank reserves, maintaining the target for the stock of these government bond purchases at GBP 875 billion and the target for the total stock of asset purchases at GBP 895 billion.

At its last meeting for the year held in December, the MPC said that it would continue to focus on the medium-term prospects for inflation and that it continued to judge that there are two-sided risks around the inflation outlook in the medium term, but that some modest tightening of monetary policy is likely to be necessary to meet the 2% inflation target sustainably.²

Economic and financial developments in the euro area

Euro area gross domestic product recuperates³

After having contracted by 6.4% in 2020, real GDP in the euro area grew by 5.3% in 2021 (see Table 1.2). As a result, by the end of 2021, GDP stood on a par with its pre-pandemic level registered in the fourth quarter of 2019. Economic activity remained subdued at the beginning of the year, but picked up strongly as containment measures related to the COVID-19 pandemic were eased and infection rates declined as a result of the strong progress in the ongoing vaccination campaigns. The spread of the Omicron variant, however, led to a slowdown in growth towards the end of the year.

The expansion in real GDP was largely driven by domestic demand. Private consumption was the main domestic demand component pushing up economic activity as it contributed 1.8 percentage points to GDP growth and rose by 3.5% over the previous year. Consumption rebounded strongly as pandemic-related restrictions were relaxed and consumer confidence recovered. This was followed by increases in government consumption and GFCF which both contributed 0.9 percentage point to GDP growth. Government

² In its meeting held in February 2022, the MPC increased the Bank Rate by 0.25 percentage point to 0.5%. The Committee also decided to begin reducing the stock of UK government bond purchases, and the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, by stopping reinvestments. Furthermore, in the case of corporate bonds, a sales programme is expected to be completed no earlier than towards the end of 2023, with a view to fully unwind the stock of these purchases.

³ The cut-off date for data on GDP and the labour market in this chapter is 8 March 2022.

Table 1.2
REAL GDP GROWTH IN THE EURO AREA

Chain-linked volumes

	2016	2017	2018	2019	2020	2021
	<i>Annual percentage changes</i>					
Private consumption	2.0	1.8	1.5	1.3	-7.9	3.5
Government consumption	1.9	1.1	1.1	1.8	1.1	3.8
GFCF	4.0	3.9	3.1	6.8	-7.0	4.3
Exports	3.0	5.6	3.6	2.7	-9.1	10.9
Imports	4.3	5.2	3.8	4.7	-9.0	8.7
GDP	1.9	2.6	1.8	1.6	-6.4	5.3
	<i>Percentage point contributions</i>					
Private consumption	1.1	1.0	0.8	0.7	-4.2	1.8
Government consumption	0.4	0.2	0.2	0.4	0.2	0.9
GFCF	0.8	0.8	0.6	1.4	-1.6	0.9
Changes in inventories	0.0	0.2	0.1	-0.1	-0.5	0.4
Exports	1.4	2.6	1.7	1.3	-4.4	4.9
Imports	-1.8	-2.1	-1.6	-2.1	4.0	-3.6
GDP	1.9	2.6	1.8	1.6	-6.4	5.3

Source: Eurostat.

consumption increased by 3.8% while GFCF increased by 4.3% over the previous year. Changes in inventories also had a positive impact on GDP growth during 2021. At the same time, net exports pushed up GDP growth by a further 1.3 percentage points as exports and imports grew by 10.9% and 8.7%, respectively.

From a sectoral perspective, as pandemic-related restrictions were lifted, the services sector, notably the high-contact activities that include travel and tourism, benefited. Activity in the manufacturing sector also picked up though it continued to be affected by supply-side bottlenecks resulting in shortages of imported intermediate inputs and equipment and strong increases in energy prices.

Labour market conditions improve

After having deteriorated significantly during 2020 amid the COVID-19 pandemic, labour market conditions in the euro area improved during the year under review. The labour market was sustained by policy measures, such as job retention schemes, aimed at safeguarding employment by preventing redundancies and supporting workers in response to the outbreak of the pandemic.

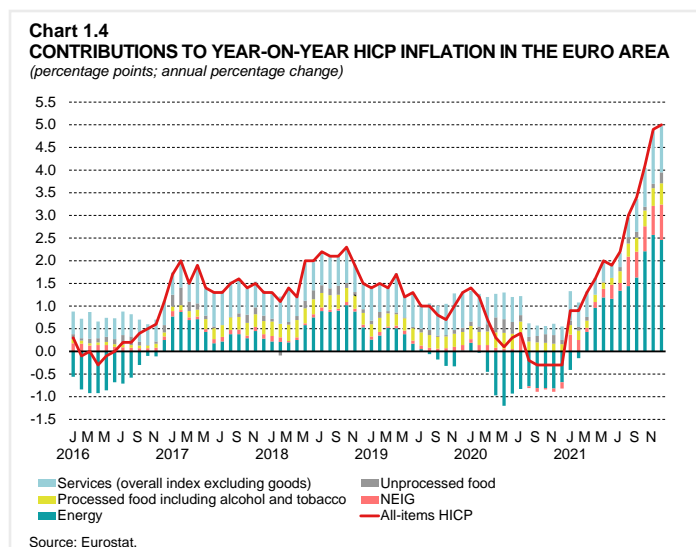
Employment increased by 1.1% in 2021, compared to a decline of 1.5% in 2020. Seasonally-adjusted data imply that during the final quarter of 2021, the number of people in employment was slightly above that registered in the final quarter of 2019 which is the quarter just before the onset of the pandemic. Similarly, the rise in unemployment observed in 2020 came to a halt as the unemployment rate declined. Indeed, the seasonally-adjusted unemployment rate averaged 7.7% during the year, down from 8.0% in 2020 (see Chart 1.1). In December 2021, the unemployment rate stood at 7.0% as against 8.2% a year earlier. Cross-country data show that the unemployment rate fell throughout the euro area, with the largest decline recorded in Spain. Nevertheless, wide disparities across countries remain, with the unemployment rate at the end of the year standing at 13.0% in Spain and Greece but only 3.2% in Germany and Malta.

HICP inflation surges

The annual rate of HICP inflation in the euro area rose significantly during 2021, with the average for the year as a whole standing at 2.6%, up from 0.3% in 2020 (see Chart 1.4). This rise in the inflation rate during the year mainly reflected a strong rebound in energy prices. Indeed, reflecting sharp increases in prices of fuels, gas and electricity, energy prices rose by an average of 13.0% during the year, so that the contribution of energy to overall inflation rose to 1.2 percentage points from -0.7 percentage point in the previous year.

To a lesser extent, services inflation also rose on average, to 1.5%, so that its contribution to overall inflation increased to 0.6 percentage point from 0.4 percentage point in 2020. Meanwhile, NEIG inflation also picked up to 1.5% on average, pushing up its contribution to overall inflation to 0.4 percentage point, from 0.1 percentage point in 2020.

On the other hand, the annual rate of change of processed food prices moderated, so that its contribution to overall inflation was unchanged from 2020 on average. In contrast, unprocessed food prices rose by 1.6% on average during 2021, as against 4.0% in 2020, implying that the contribution of this component to overall inflation decreased marginally.



Inflation rose as the year progressed. The annual rate of HICP inflation went up from -0.3% in December 2020 to 2.0% in May 2021 and 3.0% in August. It surpassed 4.0% in October and ended the year at 5.0%. The latter was the highest rate of inflation ever recorded since the inception of the euro area. Apart from the aspects related to energy inflation mentioned earlier, the upswing in headline inflation was influenced by other factors. Most importantly, as pandemic restrictions eased, recovering demand stemming from the reopening of the economy outpaced supply, which remained constrained by various bottlenecks. This is mostly visible in the prices of services, especially travel-related services, cultural activities, and restaurants, as well as the prices of goods, which were affected most significantly by supply shortages. Base effects related to the end of the value added tax (VAT) reduction in Germany in December 2020 also contributed.

HICP inflation excluding energy and food averaged 1.5% during 2021, 0.8 percentage point higher than that recorded in 2020. This measure of inflation hovered around 1.0% between January and July, before rising in the last five months of the year, and ending it at 2.6%.

European Central Bank revises projections for economic activity down and inflation up

According to the ECB staff macroeconomic projections published in March 2022, the outlook for euro area activity and inflation has become very uncertain. The evolution of the Russian invasion in Ukraine, the impact of current sanctions and of possible additional measures will be key factors shaping economic developments in the euro area over the projection horizon.⁴

Real GDP in the euro area is expected to expand by 3.7% in 2022, before moderating to 2.8% and 1.6% in 2023 and 2024, respectively (see Table 1.3). In the near term, domestic demand will be held back by the steep increase in energy prices and negative confidence effects. In addition, the announced sanctions and sharp deterioration in the prospects for the Russian economy will weaken prospects for euro area trade. The baseline projections assume that disruptions to energy supplies and negative impacts on confidence linked to the conflict are temporary and that the conflict does not disrupt global supply chains significantly. Consequently, the conflict will have a significant adverse impact on euro area growth in 2022. Nevertheless, the projections envisage relatively strong growth in the coming quarters, given the robust performance of the labour market in the euro area and the fact that adverse effects related to the pandemic and supply bottlenecks fade away. Over the medium term, against a backdrop of a tighter fiscal policy stance and higher interest rates, growth is projected to converge towards historical average rates.

⁴ These projections include an initial assessment of the impact of the war on the euro area economy based on the information available up to 2 March 2022.

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

	2021	2022	2023	2024
GDP	5.4	3.7	2.8	1.6
Private consumption	3.4	4.6	2.6	0.9
Government consumption	3.8	0.1	0.3	1.1
GFCF	3.5	3.0	3.8	2.5
Exports	10.6	7.8	6.3	3.1
Imports	7.8	7.0	5.8	2.8
HICP	2.6	5.1	2.1	1.9

Source: ECB.

⁽¹⁾ ECB staff macroeconomic projections (March 2022).

Compared with the December 2021 projections, real GDP growth has been revised downward by 0.5 percentage point for 2022 and 0.1 percentage point for 2023. The growth projections are unchanged for 2024. The revision for 2022 reflects the impact of the Ukraine crisis on energy prices, confidence and trade. This is partly offset by a positive effects stemming from a better than expected outcome in 2021.

Turning to the outlook for prices, according to the March 2022 projections, HICP inflation is envisaged to rise significantly to 5.1% in 2022, before moderating to 2.1% and 1.9% in 2023 and 2024, respectively. The high inflation expected in 2022 follows a series of exceptional energy price shocks and the conflict in Ukraine. Price pressures have built up significantly in the near term, reflecting developments in prices of oil and gas commodities, and are expected to last longer than previously envisaged. These are expected to outweigh the dampening effects on demand from lower confidence and by weaker trade growth related to the conflict. In the absence of further upward shocks to commodity prices, however energy inflation is projected to drop significantly over the projection horizon.

Compared with the December 2021 projections, HICP inflation has been revised upwards by 1.9 percentage points for 2022, by 0.3 percentage point for 2023 and by 0.1 percentage point for 2024. The upward revision for 2022 reflects the fact that recent outcomes exceeded expectations, the higher energy commodity prices, more persistent upward pressures from supply disruptions and stronger wage growth. Moreover, survey-based indicators of medium-term inflation expectations have also risen to levels consistent with the ECB's inflation target.

In view of the significant uncertainty related to the impact of the conflict in Ukraine on the euro area economy, ECB staff have prepared two alternative scenarios for the euro area. An adverse scenario assumes that stricter sanctions are imposed on Russia, leading to some disruptions in global value chains. Persistent cuts in Russian gas supplies would lead to higher energy costs and to temporary cuts in euro area production. In addition, prolonged geopolitical tensions would lead to additional financial disruptions and more persistent uncertainty. Under this scenario, euro area GDP growth would be 2.5% and inflation 5.9% in 2022. Effects on 2023 would be limited. In 2024, growth would be somewhat stronger than the baseline, at 2.1%, as the economy catches up after the larger negative impact on economic activity in the previous two years. In this scenario, inflation would fall to 1.6% by 2024 as the earlier increases in energy prices would gradually unwind.

A more severe scenario includes – besides the features of the adverse scenario – an even stronger reaction of energy prices to more stringent cuts in supply, and a larger adverse impact in financial markets. In addition, the rise in energy prices would have more substantial effects on other prices and wages. In this scenario, real GDP growth would stand at 2.3% in both 2022 and 2023. It would then slow further to 1.9% in 2024, as the disruptions triggered by the war would be more persistent. Inflation would climb to 7.1% in 2022, before moderating to 2.7% and 1.9% over the remainder of the forecast horizon.

European Central Bank reinforces its accommodative monetary policy stance

The ECB's Governing Council maintained its accommodative monetary policy stance during 2021 to provide support to the economy and to raise inflation towards the policy target. Indeed, the interest rates on the MROs, on the marginal lending facility and on the deposit facility were held unchanged at 0.00%, 0.25%, and -0.50%, respectively throughout the year (see Chart 1.3).

At the beginning of the year, the Governing Council confirmed the monetary policy stance adopted in December 2020. As regards the purchase programmes, in January 2021 the Governing Council confirmed that the Eurosystem would continue to conduct net asset purchases under the PEPP with a total envelope of €1,850 billion until at least the end of March 2022 and, in any case, until it judged that the coronavirus crisis phase was over. It also confirmed that net purchases under the APP would continue at a monthly pace of €20 billion. The Governing Council expressed its expectation that asset purchases under the APP would run for as long as necessary to reinforce the accommodative impact of the ECB's policy rates, and to end shortly before it starts raising the key ECB interest rates. The Governing Council also stated its intention to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the first rate hike, and in any case, for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. Furthermore, it noted that the TLTROs remained an attractive source of liquidity for banks.

In March, the Governing Council decided to step up the pace of purchases under the PEPP in the second quarter of 2021, to counter a tightening of financial conditions in the euro area while leaving all other monetary policy measures unchanged. In June, the Governing Council decided to continue net purchases under the PEPP at a significantly higher pace than during the first months of the year, while retaining all other policy measures.

On 8 July 2021, the Governing Council approved its new monetary policy strategy following the conclusion of its strategy review that had been launched in January 2020. The ECB's strategy review aimed at making sure that the monetary policy strategy remained fit for purpose. The review covered all aspects of monetary policy within the framework of the ECB's mandate, which is that to maintain price stability. The Governing Council adopted a new, symmetric 2% inflation target over the medium term. Furthermore, it confirmed that HICP remains the most appropriate price measure and recommended inclusion of owner-occupied housing in the HICP over time. It also approved an ambitious climate change action plan. The Governing Council expressed its intention to assess periodically the appropriateness of its monetary policy strategy, with the next assessment expected in 2025.

Following the adoption of the new strategy, in July, the Governing Council revised its forward guidance on interest rates. More specifically, the Governing Council stated that it expected the key ECB interest rates to remain at their present or lower levels until it saw inflation reaching two per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and it judged that realised progress in underlying inflation was sufficiently advanced to be consistent with inflation stabilising at 2% over the medium term. The Governing Council acknowledged that this may also imply a transitory period in which inflation is moderately above target.

By September, as the economic recovery in the euro area gained momentum and the inflation outlook improved, the Governing Council decided that the pace of net purchases under the PEPP could be scaled back, while confirming all its other measures.

In December, the Governing Council considered that, given progress towards the medium-term inflation target and an improving outlook for activity, favourable financing conditions could be maintained with a moderately lower pace of net asset purchases under the PEPP in the first quarter of 2022. Furthermore, such purchases would cease at the end of March 2022.

At the same time, it decided on a monthly net purchase pace under the APP of €40 billion in the second quarter of 2022, €30 billion in the third quarter of 2022, and at a monthly pace of €20 billion from October 2022 onwards, for as long as necessary, to reinforce the accommodative impact of its policy rates.

The Governing Council also extended the reinvestment period for the principal payments from maturing securities purchased under the PEPP until, at least, the end of 2024. In any case, the future roll-off of the PEPP portfolio would be managed to avoid interference with the appropriate monetary policy stance. The Governing Council also confirmed that the reinvestment of maturing principal amounts under the APP would continue for an extended period of time after it began to raise the key ECB interest rates and, in any case, for as long as necessary to maintain favourable liquidity conditions and ample monetary policy accommodation.

Finally, the Governing Council would continue to monitor bank funding conditions and the contribution of targeted lending operations to the monetary policy stance.⁵

Money market rates reach new historical lows

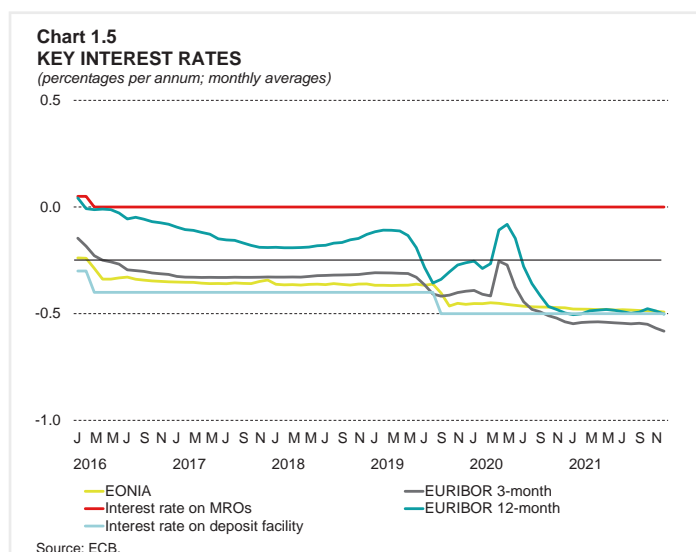
In the light of the accommodative monetary policy stance and of ample excess liquidity, money market rates in the euro area declined further, reaching new historical lows during 2021. The Euro OverNight Index Average (EONIA) rate stood at -0.48% in the year up to August and fell marginally to -0.49% in September, remaining at that level until the end of the year.⁶ Thus, it remained slightly above the interest rate on the ECB's deposit facility throughout the year.

The 3-month Euro Interbank Offered Rate (EURIBOR) hovered between -0.55% and -0.54% in the first ten months of the year. As excess liquidity rose, it then edged down to -0.57% and -0.58% in November and December, respectively. The 12-month EURIBOR ranged from -0.48% to -0.50%, ending the year at -0.50% (see Chart 1.5).⁷

Euro area bond yields increase

Ten-year benchmark government bond yields in the euro area rose during 2021, supported by an improved economic outlook following the progress in vaccination rates in the euro area and the reopening of the economy, together with rising inflation expectations. On the other hand, the accommodative monetary policy stance of the ECB countered upward pressure on yields. Overall, the euro area ten-year government benchmark bond yield increased and turned positive, going from -0.09% in December 2020 to 0.28% in December 2021.

Looking at individual sovereigns, German ten-year bond yields remained in negative territory, although they rose from -0.62% in December 2020 to -0.38% twelve



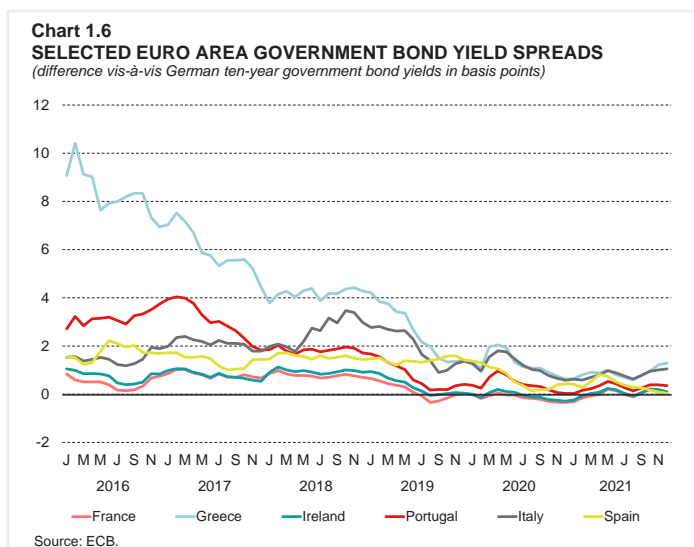
⁵ In March 2022 the Governing Council revised down the pace of net asset purchases planned for the second quarter of the year under the APP. Furthermore, it stated that unless incoming data signals weakening inflation, net APP purchases could end in the third quarter. The Council also stated that any adjustments to interest rates would take place some time after the end of net purchases under this programme and would be gradual.

⁶ The EONIA was a measure of the effective interest rate prevailing in the euro overnight market. Until 30 September 2019, it was measured as the weighted average of the interest rates on unsecured interbank overnight lending transactions, in euro, as reported by a panel of contributing banks. As of 2 October 2019, and until its discontinuation on 3 January 2022, the EONIA was calculated as €STR plus a fixed spread of 8.5 basis points. The euro short-term rate (€STR) is a reference rate based on money market data collected by the Eurosystem, reflecting the wholesale euro unsecured overnight borrowing costs of banks located in the euro area. See: https://www.ecb.europa.eu/stats/financial_markets_and_interest_rates/euro_short-term_rate/html/index.en.html

⁷ The 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.

months later. Yields on Greek bonds recorded the strongest increase, gaining 66 basis points and closing the year at 1.29%. Latvian and Slovak bond yields also gained considerably, going up by 59 basis points and 50 basis points, respectively. More moderate though still significant increases were recorded in yields on Italian, French, Irish, Spanish and Portuguese bonds. All sovereign bond yields of individual euro area countries rose during the year except for Lithuanian yields, which remained unchanged.

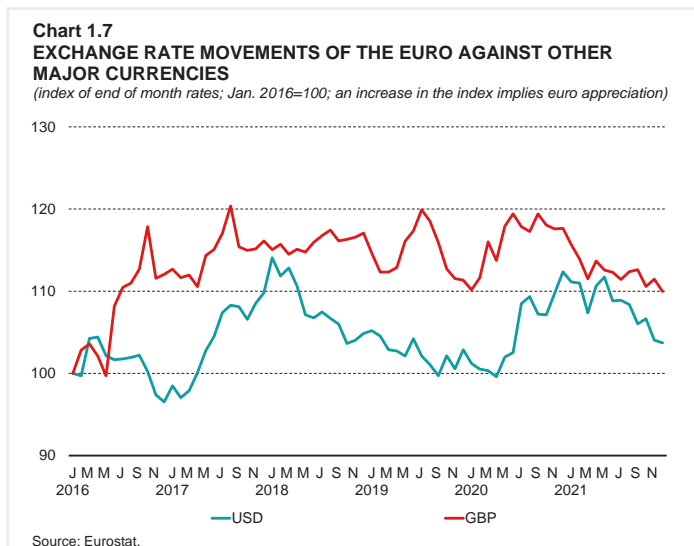
As a result, spreads between yields on 10-year German bonds and those on bonds issued by most other euro area governments widened over the year (see Chart 1.6). Spreads on Greek bonds widened by 42 basis points, while those on Italian ones widened by 23 basis points. Similarly, spreads on Latvian and Slovak bonds widened by 35 and 26 basis points, respectively. On the other hand, spreads on Lithuanian bonds narrowed.



The euro depreciates

The euro exchange rate depreciated in nominal effective terms during 2021, with the EER-19 losing 5.1% from its end-2020 level.⁸ This followed an appreciation of 4.7% in 2020. The fall in the external value of the euro during 2021 largely stemmed from the divergence between the monetary policy stance of the ECB and that of other major central banks. Heightened risks from the faster spread of variants of COVID-19 in Europe compared to other regions also weakened the euro by supporting safe haven currencies.

On a bilateral basis, the euro lost 7.7% against the US dollar, on the back of the broad-based strength of the dollar reflecting positive macroeconomic developments in the United States as well as market expectations of a faster normalisation of US monetary policy relative to the euro area (see Chart 1.7). The euro also depreciated by 6.5% against the pound sterling, with exchange rate movements towards the beginning of the year largely driven by the conclusion of the Brexit process. Subsequently, expectations of a tightening of monetary policy in the United Kingdom supported the pound sterling.⁹



⁸ The nominal effective exchange rate 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.

⁹ The EU-UK Trade and Cooperation Agreement was signed in December 2020 and entered into effect in May 2021.

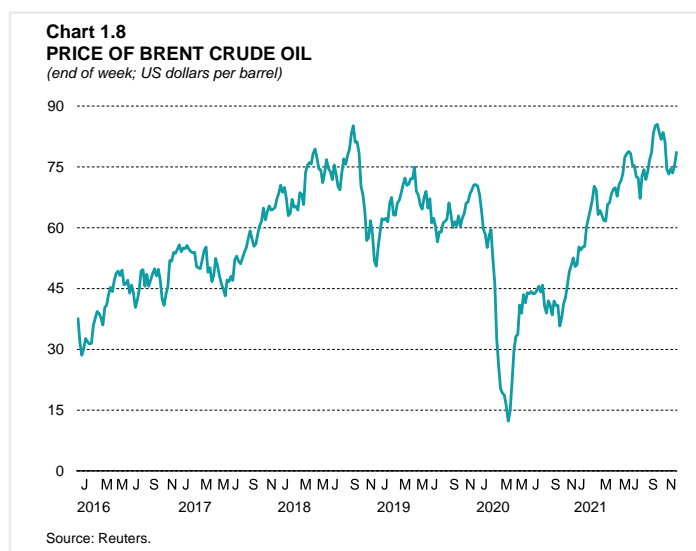
Over the year as a whole, the euro lost significant ground against a number of other currencies, including the Chinese renminbi, the Canadian dollar, the Hong Kong dollar and the Singapore dollar. To a lesser extent, it strengthened against the Polish zloty and the Hungarian forint.

Commodities

Oil prices increase significantly during 2021

During 2021, the price of oil increased, supported by the pick-up in economic activity as progress with vaccination in several countries and the lifting of restrictions related to the pandemic enabled several economies to re-open. This recovery in demand occurred amid supply bottlenecks among major producers that were amplified by the pandemic. Towards August, however, the price of oil declined somewhat, reflecting renewed increases in COVID-19 cases and expectations that this would undermine the recovery in demand. Thereafter, the price of oil regained momentum and by the beginning of October it stood above USD 80 per barrel, supported by signs of an ongoing global economic recovery and substitution from gas to oil amid high gas prices. Following news about the Omicron variant in November though, oil prices returned on a downward path amid increasing doubts about the strength of the global recovery in demand. Nevertheless, the price of Brent crude oil ended 2021 at USD 78.6 per barrel, 54.5% above the level prevailing at the end of 2020 (see Chart 1.8).

Non-energy commodity prices rose during 2020, with World Bank data showing an increase of 32.3%. The increase was broad-based across all non-energy commodities but was more pronounced in the case of fertilisers.





2. MONETARY AND FINANCIAL DEVELOPMENTS

According to the Bank's Financial Conditions Index (FCI), in 2021 financing conditions loosened markedly compared with 2020, and were also loose from a historical perspective.

The total assets of domestic MFIs in Malta rose during 2021, contrasting the drop in the asset holdings of international banks. Meanwhile, Maltese residents' deposits continued to expand at a strong pace. The shift away from longer-term deposits towards more liquid overnight deposits persisted in an environment of very low interest rates. Meanwhile, growth in credit to residents expanded further, driven by robust growth in both credit to general government and credit to the private sector. Lending to households rose at a faster pace, reflecting stronger growth in loans for house purchases, while consumer credit and other lending to households continued to decrease. Meanwhile, loans to non-financial corporations (NFCs) rose marginally in annual terms.

Compared with 2020, NFCs' net issuance of corporate debt and equity increased substantially. Meanwhile, net issuance of Malta Government Stocks (MGSs) continued to increase from a year earlier as the Government sought to raise funding to finance the extension of fiscal support in response to the pandemic.

Interest rates on both deposits and loans to Maltese residents fell during the year, with the latter declining at a faster rate. As a result, the spread narrowed slightly, although it remained at elevated levels compared with that in the euro area.

In the primary money market, domestic yields rose during 2021. Similarly, yields on 5-year and 10-year Maltese government bonds increased, mirroring upward movements in the corresponding euro area yields. In the equity market, the Malta Stock Exchange (MSE) Equity Price Index fell when compared with the level registered at the end of December 2020, though the decline was less pronounced than that registered a year earlier.

The outstanding amount of loans subject to a moratorium has fallen consistently during the year and reached very low levels by the end of December 2021 as the moratoria period gradually expired and economic activity continued to normalise in most sectors. By the end of the year, there were €14.1 million in loans covered by moratoria, or 0.1% of total outstanding loans to residents. All the outstanding loans covered by moratoria were held by firms, as resident households no longer held such loans. Meanwhile, firms' recourse to guarantees in terms of the MDB CGS continued throughout the year, with sanctioned amounts under this scheme reaching €505.9 million at the end of 2021.

Financial conditions

Financial Conditions Index turns positive

The Bank monitors domestic financial conditions through a summary measure which combines a number of domestic and international financial variables that influence economic activity.¹

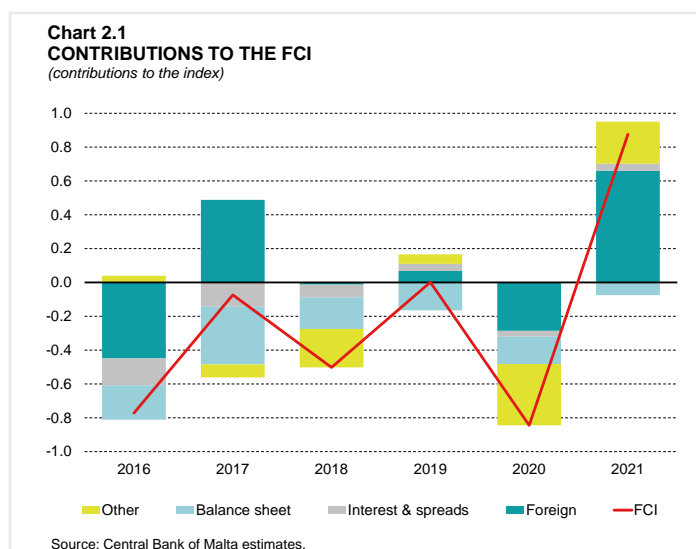
Financial conditions in 2021 improved markedly when compared with 2020. While in 2020 they were tight by historical standards, in 2021 they were loose compared to past regularities. This primarily reflected more

¹ The analysis in this section is based on the Bank's FCI, as described in Micallef, B., and 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*.

favourable developments in foreign influences, although domestic factors also contributed significantly to the improvement in financial conditions (see Chart 2.1).

In particular, developments in foreign influences reflected the positive trend in stock prices in the euro area during 2021, as well as a decline in uncertainty. Meanwhile, domestic factors also contributed to the looser financial conditions, mostly as a result of higher issues of NFC securities and a slower decline in domestic stock prices, which are subsumed in the 'other' category. Moreover, 'balance sheet' factors for domestic banks had a weaker tightening effect when compared with the previous year, due to an increase in the return on equity, which offset the slower growth in real credit and in real deposits. Furthermore, the 'interest rate and spreads' category also contributed to the loosening effect on financial conditions, reflecting a decline in the spread between yields on Maltese long-term government bonds and the German bund.

Following these developments, the FCI on average signalled significantly looser conditions compared to historical patterns.



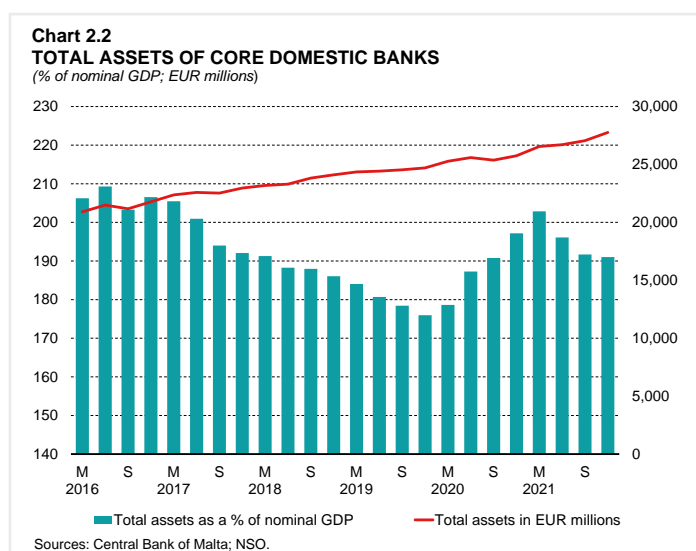
Assets of the banking sector and other monetary aggregates

Total assets pertaining to the Maltese banking system (including the Central Bank of Malta) stood at €55,256.8 million at the end of 2021, an increase of €4,585.8 million when compared with 2020. This increase masks contrasting developments in the assets of domestic and international banks.

The assets of core domestic MFIs increased by €2,012.2 million, or 7.8%.² As a result, the share of core domestic banks' assets in GDP stood at 191.0% at the end of 2021. This was below the 197.2% recorded a year earlier (see Chart 2.2), partly reflecting the rise in GDP. At the same time, assets pertaining to non-core domestic banks rose by €347.4 million, or 11.6%. On the other hand, assets pertaining to international banks dropped by €151.6 million, or 1.3%.

Residents' deposits continue to expand at a strong pace

Total deposits held by residents with MFIs in Malta rose further



² 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

(Annual percentage changes; EUR millions)

	2019 Dec.	2020 Dec.	2021 Dec.	2021 Amount outstanding	Absolute change
Overnight deposits	6.2	9.8	12.2	18,899.7	2,061.3
<i>of which</i>					
Households	11.0	14.4	12.8	12,476.3	1,417.8
NFCs	5.4	16.8	11.2	4,362.9	439.6
Deposits redeemable at notice up to three months	14.7	40.1	59.9	190.3	71.3
<i>of which</i>					
Households	-6.6	4.7	14.7	39.5	5.1
NFCs	40.5	150.1	67.3	115.7	46.5
Deposits with agreed maturity up to two years	-8.7	-3.3	-4.3	2,420.4	-109.4
<i>of which</i>					
Households	-7.8	-2.3	-6.2	1,870.3	-123.5
NFCs	-1.6	-10.9	-12.8	197.3	-29.0
Deposits with agreed maturity above two years⁽¹⁾	10.3	-19.6	-13.9	1,169.4	-189.0
<i>of which</i>					
Households	5.4	-15.6	-12.7	1,041.4	-151.1
NFCs	22.1	-35.9	-1.1	53.1	-0.6
Total residents' deposits⁽²⁾	4.3	5.7	8.8	22,679.8	1,834.2

Source: Central Bank of Malta.

⁽¹⁾ Deposits with agreed maturity above two years are classified outside M3.

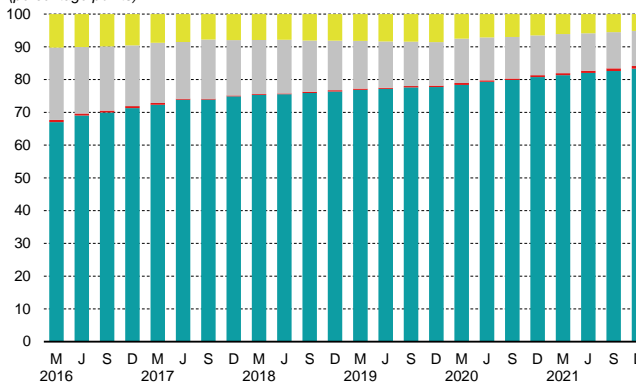
⁽²⁾ Total residents' deposits exclude deposits belonging to Central Government.

during 2021, reaching €22,679.8 million by the end of the year (see Table 2.1). This signifies an increase of €1,834.2 million, or 8.8% when compared with December 2020. This high level of deposits, as well as the expansion therein during 2021 mainly reflects developments in household deposits, though deposits held by NFCs also increased during the year.

Overnight deposits remained the dominant category of deposits for residents during 2021, reflecting a preference for liquid assets in the context of the low interest rate environment. This component increased by 12.2% over the 12 months to December, above the increase of 9.8% registered a year earlier. As a result, by the end of 2021, the share of overnight deposits in total deposits had risen to 83.3% from 80.8% in December 2020 (see Chart 2.3). This share has increased significantly since 2013, when it stood at 53.6%, driven by a surge in households' overnight balances.

In contrast to overnight deposits, time deposits with a maturity of less than two years – the second largest category – contracted further in 2021. These decreased by 4.3%, following a decline of 3.3% a year earlier, with their share in overall deposits falling to 10.7% from 12.1% in December 2020. Additionally, deposits with a maturity above

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



Source: Central Bank of Malta.

⁽¹⁾ Deposits exclude those belonging to central government.

two years were down by 13.9% when compared with their end-2020 level. Following this decline, their share in the total stood at 5.2% at the end of 2021, below the 6.5% registered 12 months earlier. The share of deposits redeemable at notice of up to three months edged up but remained very small.

Credit to residents expands

Credit to residents of Malta expanded during 2021, albeit at a slower pace compared to 2020. It reached €17,066.6 million by the end of the year (see Table 2.2). This signifies an increase of €1,307.0 million, or 8.3%, over the December 2020 level. This expansion was mainly driven by developments in credit to residents outside general government, which increased by €686.4 million, or 5.8% (see Chart 2.4). Credit to general government rose by €620.6 million, or 16.0%, following an increase of 32.3% in 2020. The latest increase partly reflects additional net issues of government securities during the year.

The acceleration in credit to residents outside general government was largely driven by faster growth in loans to households. At the same time, lending to NFCs rose marginally by just 0.1% following an 8.6% increase over the 12 months to December 2020. This reflects an increase in lending to private sector NFCs, which was mostly offset by a decline in credit to public sector NFCs. Meanwhile, MFI holdings of securities and equity issued by the private sector partly recovered from the previous year's decline.

The faster growth in loans to households mainly reflected stronger growth in lending for house purchases (see Chart 2.5). Indeed, mortgage lending grew by 9.6% during 2021, compared with a 5.4% increase recorded in 2020. At the same time, consumer credit and other lending contracted at a slower rate of 4.1%, following a contraction of 6.4% over the year to December 2020.

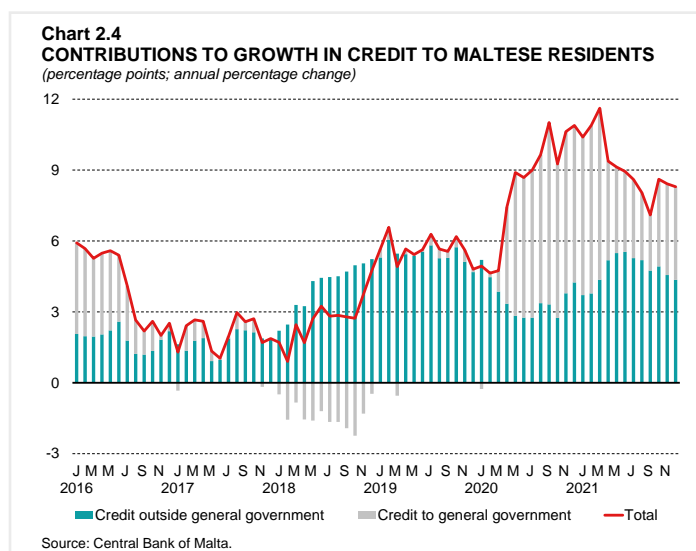


Table 2.2
MFI CREDIT TO MALTESE RESIDENTS

(Annual percentage changes; EUR millions)

	2019	2020	2021		
	Dec.	Dec.	Dec.	Amount outstanding	Absolute change
Credit to general government	0.6	32.3	16.0	4,488.0	620.6
Credit to residents outside general government	6.0	5.3	5.8	12,578.6	686.4
Securities & Equity	-5.7	-25.9	8.7	335.8	26.8
Loans	6.5	6.5	5.7	12,242.9	659.6
of which:					
Loans to Households	9.8	5.4	9.6	7,010.6	613.7
Mortgages	10.3	6.7	10.9	6,470.7	637.1
Consumer Credit and Other Lending	5.2	-6.4	-4.1	540.0	-23.4
Loans to NFCs ⁽¹⁾	3.7	8.6	0.1	4,287.9	6.3
Total credit to residents	4.8	10.9	8.3	17,066.6	1,307.0

Source: Central Bank of Malta.

⁽¹⁾ NFCs include sole proprietors and non-profit institutions serving households.

A sectoral breakdown of loans to NFCs suggests a loss of momentum across most sectors, primarily driven by developments in loans to the sector comprising real estate activities (see Chart 2.6). The latter declined strongly in 2021. Credit to the transport, storage, information and communication sectors also declined in the year under review. There were also declines in credit to the electricity, gas and water supply sector as well as lending to the 'other' sector category. Meanwhile, loans to the accommodation and catering sector and to a lesser extent credit to construction, manufacturing and the wholesale and retail trade sectors rose.

Supplementary data suggest that NFCs have increased their reliance on alternative sources of finance, such as internal funding and capital markets following a slight decrease in the previous year. By the end of 2021, €1,669.4 million in corporate debt was outstanding on the MSE, 13.0% higher than the amount listed 12 months earlier (see Chart 2.7). Meanwhile, issuance of equity rose by one of the highest rates in a decade, following large issues in the final quarter of the year. The largest equity issues were in companies within the real estate sector. As a result, the amount of listed equity outstanding at the end of 2021 exceeded that of bonds by over 60%.³

Interest rates fall

Interest rates on residents' deposits with MFIs in Malta declined further in 2021, with the weighted average deposit rate offered to households and NFCs going down by 4 basis points to 0.16% by the end of the year (see Table 2.3).⁴ This was mainly driven by a drop in rates on time deposits with a maturity of over two years, followed by rates on time deposits with a maturity of less than two years.

Chart 2.5
CONTRIBUTIONS TO GROWTH IN LOANS TO HOUSEHOLDS
(percentage points; annual percentage change)

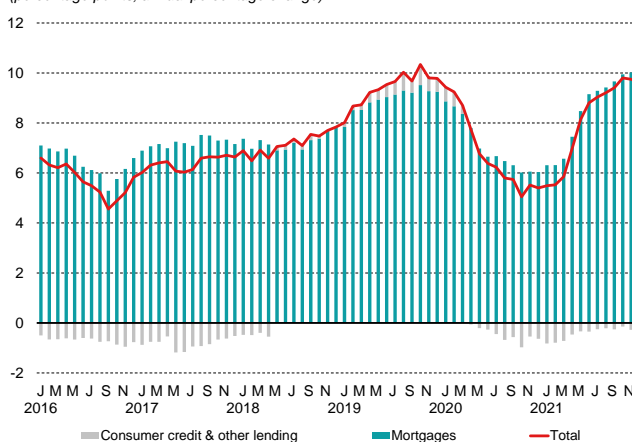
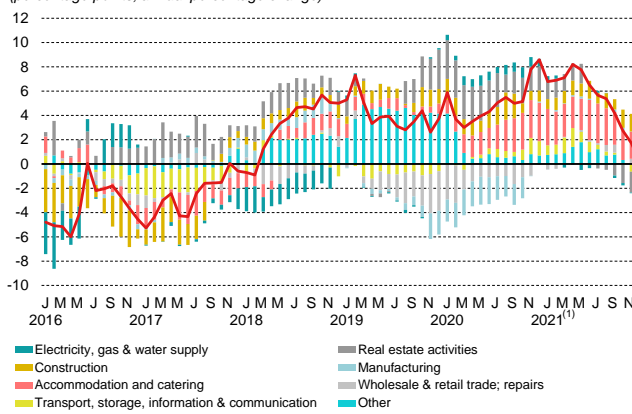
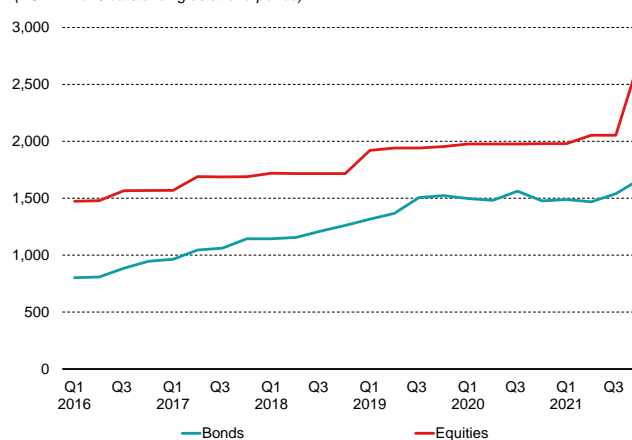


Chart 2.6
LOANS TO NFCs BY SECTOR
(percentage points; annual percentage change)



⁽¹⁾ Mainly includes entertainment, health, education, professional services, communication, and administration.

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



³ Apart from the official MSE platform, small and medium-sized enterprises can also obtain finance through the specifically-g geared platform – Prospects.

⁴ 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

	2018	2019	2020	2021			
	Dec.	Dec.	Dec.	Mar.	June	Sep.	Dec.
Total deposits⁽¹⁾	0.33	0.30	0.21	0.20	0.18	0.18	0.16
<i>of which</i>							
Overnight deposits							
Households	0.05	0.05	0.02	0.02	0.02	0.02	0.02
NFCs	0.02	0.03	0.01	0.01	0.01	0.02	0.01
Time deposits (less than 2 years)							
Households	0.75	0.71	0.57	0.57	0.54	0.53	0.51
NFCs	0.76	0.72	0.58	0.62	0.53	0.48	0.49
Time deposits (more than 2 years)							
Households	2.13	1.97	1.87	1.80	1.79	1.77	1.78
NFCs	1.88	1.53	1.39	1.41	1.15	1.05	1.12
Total Loans⁽¹⁾	3.55	3.46	3.36	3.32	3.30	3.25	3.23
<i>of which</i>							
Households and NPISH	3.38	3.29	3.21	3.15	3.12	3.05	3.01
Lending for house purchases	3.09	3.03	2.98	2.93	2.90	2.83	2.80
Consumer credit and other lending	5.14	4.87	4.77	4.72	4.71	4.72	4.67
NFCs	3.83	3.76	3.61	3.60	3.62	3.60	3.63
Spread⁽²⁾	3.22	3.16	3.15	3.12	3.12	3.07	3.06
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.

Meanwhile, the weighted average lending rate paid by households and NFCs to resident MFIs fell by 13 basis points, reaching 3.23%. This decline was driven by lower rates charged to households. Mortgage rates decreased more strongly than rates on consumer credit and other lending. By contrast, rates paid by NFCs increased slightly above those recorded at the end of 2020 and rose further above those charged to households, reflecting differences in credit risk.

The spread between the weighted average lending rate and the deposit rate closed the year under review at 306 basis points, below the 315 basis points recorded at the end of 2020.

BOX 1: ACCESS TO FINANCE IN 2021¹

Access to finance is essential for the development of enterprises. However, small and medium-sized enterprises (SMEs) face challenges that differ from those of large-scale corporations when it comes to their financing, especially with regard to access to capital markets. This box analyses information provided by the Survey on Access to Finance of Enterprises (SAFE) on the financial situation of SMEs in Malta and across the European Union, with specific emphasis on the availability of external financing and the challenges that SMEs faced in 2021.²

Results reported in this study are derived from the SAFE which the European Commission conducted in co-operation with the ECB between 6 September and 15 October 2021. This round was spread across 13,079 enterprises in the European Union and covered the period April to September 2021. The information provided by the SAFE is relevant for Malta considering that according to the Structural Business Statistics published by the NSO, 99.7% of firms in the non-financial business economy, namely those covering activities in industry, construction, wholesale and retail trade as well as services, were SMEs in 2019. These accounted for 77.3% of all persons employed in Malta and generated 63.1% of turnover.³

The financial situation of small and medium-sized enterprises

Survey results show that between April and September 2021 – the reference period for the latest survey – slightly more than a third of SMEs in Malta reported unchanged turnover in the six months preceding the survey. The remaining respondents were almost equally divided between those reporting higher or lower turnover. As a result, on balance turnover was assessed to have remained unchanged over the six months preceding the survey. This is a significant improvement over 2020 when a net 64% of respondents had reported a decrease in turnover.

Meanwhile, on balance, 18% of domestic SMEs in Malta reported lower profit. By contrast a net 70% of domestic SMEs had reported a decrease in profits in 2020 – the strongest decline recorded since 2011.⁴

In the European Union, a net 14% of SMEs reported higher turnover as opposed to a net 45% that reported a decline a year earlier, while profits fell for 6% of firms compared to 70% in 2020. The higher incidence of companies reporting unchanged or lower turnover and lower profits in Malta may reflect the larger share of respondents in trade and services, which include the sectors hit hardest by the pandemic.⁵

In 2021, 60% of firms reported an unchanged level of fixed investment, with the rest almost evenly split between those reporting a decrease and those reporting an increase. In fact, on balance, only 2% of SMEs in Malta reported an increase in investment in plant, machinery or equipment. This compares with 11% of SMEs in the European Union. At the same time, investment by SMEs in Malta likely recovered from its trough of 2020, when a net 20% of Maltese SMEs had reported a decrease in investment.

Meanwhile, a net 18% of firms in Malta reported an increase in inventories and working capital compared with 6% in the European Union.

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 Companies that employ less than 250 persons and make less than 50 million in turnover are classified as SMEs.

³ NSO News Release 120/021 – https://nso.gov.mt/en/News_Releases/Documents/2021/07/News2021_120.pdf

⁴ Figures from SAFE are rounded, in line with the approach followed by the ECB when commenting on SAFE results.

⁵ In Malta, 83% of participating firms were classified in these sectors, compared to 73% in the European Union in 2021.

On balance, the number of employees was assessed to have remained stable, while 6% of SMEs in the European Union have reported an increase in employees. These developments are still below those recorded in 2019 when 35% and 22% of SMEs in Malta had reported a net increase in investment and in the number of employees. Hence, the survey confirms that the labour market has been relatively resilient given the fact that firms in Malta on balance reported unchanged employment levels despite lower turnover. Nevertheless, these developments contrast with those in the European Union where the net share of firms reporting a higher staff complement turned positive in 2021 in line with net positive developments in turnover.

Regarding labour and other costs, on balance, 44% and 58% of SMEs in Malta claimed that these have increased in 2021. While the net share of respondents reporting higher labour costs is similar to that in the European Union (46%), Maltese SMEs were significantly less likely to report higher costs for materials, energy and others than those in the European Union (72%). The significant increase in the incidence of cost increases relative to 2020 – when only around a tenth of Maltese firms, on balance, had reported such cost increases – dents the improvement in turnover and likely explains why profitability on balance decreased again in 2021. Nevertheless, the share of firms reporting higher labour and other costs remained below that recorded in 2019.

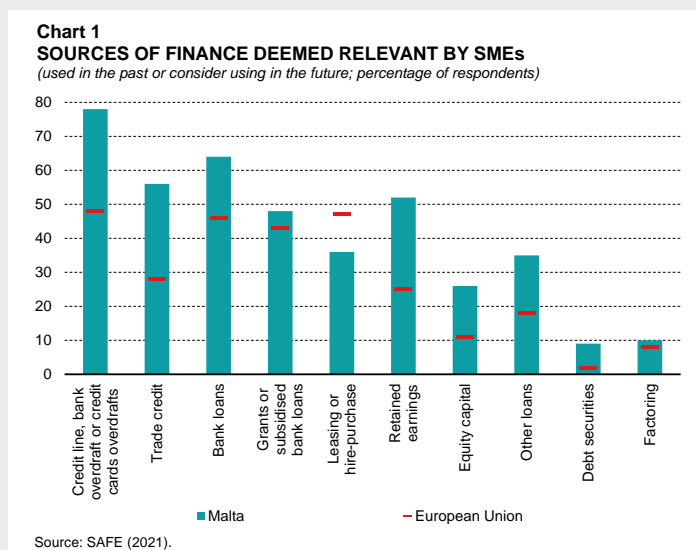
The SAFE also reveals that the share of local SMEs reporting an increase in interest rate expenses rose to 13%, from 4% a year earlier. Similar developments were observed in the European Union, where this share rose to 10%, from 5% in 2020.

Sources of finance used by small and medium-sized enterprises

In 2021, domestic SMEs continued to prefer bank-related products such as overdrafts and credit lines, and to a lesser extent, bank loans over market-based products and other sources of finance (see Chart 1). The share of SMEs in Malta that used credit lines, bank overdrafts or credit cards, or that expected to use them in the future, rose to 78% in the year under review. This marks the first increase since 2016, as the relevance of this type of financing has been consistently decreasing – falling gradually from 83% in 2016 to 74% in 2018 and 71% in 2019 and 2020. Similarly, the share of firms that used bank loans in the past or considered using them in the future rose – standing at 64% up from 58% in 2020.

By comparison, in the European Union, just below half of the respondent SMEs used bank loans and credit lines, bank overdrafts or credit cards, or expected to use them in the future.

The share of SMEs in Malta that considered grants or subsidised bank loans as being relevant to their enterprise dropped to 48% in 2021, from 54% a year earlier. Meanwhile, the share of SMEs in the European Union that mentioned this type of financing as being relevant fell marginally to 43% from 44% in 2020.



Furthermore, the share of domestic SMEs that considered trade credit as relevant to their business fell to 56% when compared with 63% a year earlier. This was however, the third most considered source of finance by SMEs possibly because certain businesses might have considered this type of financing to fill liquidity gaps triggered by the pandemic. Meanwhile, retained earnings were also considered as being a relevant share of finance. These were mentioned by 52% of domestic SMEs, up from 39% in 2020 and more than double the share of SMEs in the European Union that considered this type of financing as relevant for their business.

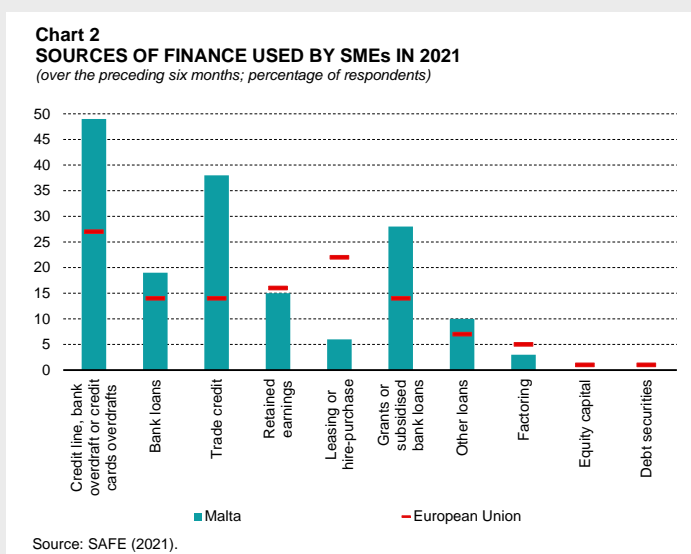
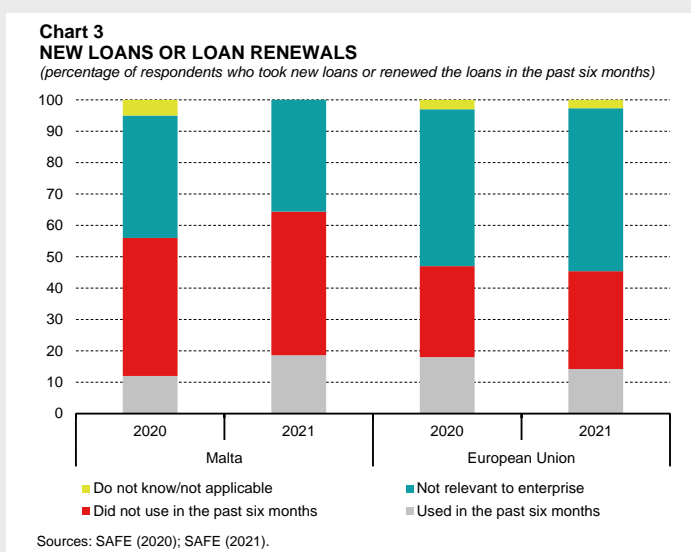


Chart 2 reports on the use of different types of funding sources during 2021 both in Malta and in the European Union. Credit lines or overdraft were used most often. The share of domestic SMEs using this type of financing has increased from around 41% in 2020 to 49% in 2021 and stood well above the share of EU firms reporting that they used this source of funding in recent months (29%). Similarly, the share of firms that used bank loans in the last 6 months preceding the survey rose to 19% in Malta from 12% a year earlier, but fell from 18% to 14% in the European Union.

Less than half (46%) of domestic SMEs did not use bank loans in 2021, as opposed to 44% in 2020, while 36% replied that they considered them irrelevant for their enterprise, down from 39% a year earlier. These contrasted with replies from their EU counterparts. In the European Union, 31% of SMEs claimed that they did not use bank loans in the six months preceding the survey, while 52% of SAFE respondents stated that bank loans were irrelevant for their enterprise. The figures for 2021 were thus broadly similar to those reported a year earlier, with EU firms still more likely to say that bank loans are irrelevant than Maltese firms do (see Chart 3).



When asked to elaborate on why bank loans are not deemed relevant, 83% of such domestic SMEs stated

that they did not need this type of financing. Meanwhile, 10% reported that interest rates or prices were too high as opposed to 7% of their EU counterparts. A further 4% of domestic SMEs claimed that no bank loans were available while 3% cited other reasons – in particular, that too much paperwork is involved.⁶

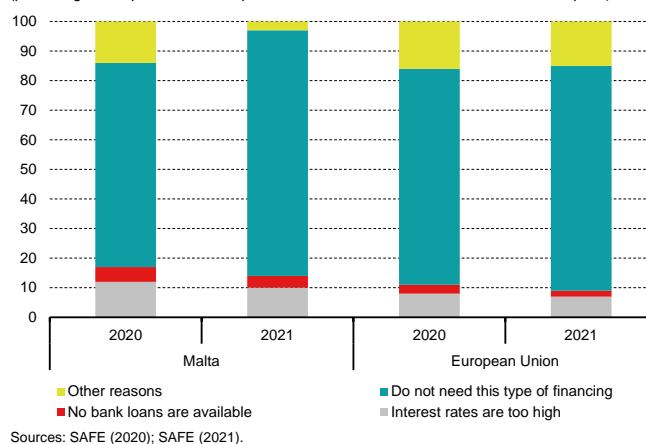
In the European Union, 76% of firms that considered bank loans irrelevant replied that they do not need such financing. A further 7% mentioned too high interest rates, while only 2% reported that bank loans were unavailable, with 14% of SMEs mentioning other reasons.

The reasons behind the irrelevance of bank loans cited by EU firms were largely unchanged from those reported in 2020. In Malta, the composition of responses changed more significantly when compared with 2020. While the share of SMEs that cited bank loan unavailability or high interest rates fell marginally, those that claimed that they do not need this type of finance rose significantly. There was also a small increase in the share of respondents in Malta mentioning an increase in paperwork although the percentage of domestic SMEs that gave other unspecified reasons fell since 2020 (see Chart 4).

During the period under review domestic SMEs noted that the relevance and need for trade credit increased when compared to 2020. Similarly, the proportion of those that used this type of financing stood at 38% in 2021, up from 32% a year earlier and in the same level as that recorded in 2019. Hence, the share of SMEs in Malta that used this type of finance remained significantly above that in the European Union which was stable at 14%. The SAFE notes substantial differences between countries. At 45%, SMEs in Ireland were the highest users of this source of financing – and the only country with a usage higher than that in Malta, while in other EU countries less than 10% of SMEs in 10 countries obtained this type of financing. According to the SAFE, SMEs in trade and industry were most likely to have obtained trade credit, whereas those in services were least likely to have used this type of financing.

The share of SMEs that used retained earnings or proceeds from the sale of assets during 2021 rose to 28% from 17% in 2020, slightly higher than the share of 25% in 2019 (see Chart 2). Hence, this share stood above that in the European Union, which remained stable at 14%. Indeed, whereas in Malta, 52% of SMEs stated that this method of financing is relevant to their enterprise, this share stood at 25% in the European Union (see Chart 1). The much higher recourse to retained earnings in Malta could explain why Maltese firms were more likely than their EU counterparts to report that they did not need bank financing.

Chart 4
REASONS WHY BANK LOANS ARE DEEMED IRRELEVANT FOR BUSINESS
(percentage of respondents who replied that bank loans were irrelevant for their enterprise)



⁶ 'Other reasons' include insufficient collateral or guarantees, reduced control over the enterprise, too much paperwork and unspecified reasons.

Meanwhile the share of firms that reported actually using subsidised loans or grants decreased to 15% in 2021, from 20% in 2020. This share was marginally below that reported for the European Union (16%). This lower use of such funding may reflect the fact that the number of beneficiaries of moratoria on loan repayments in Malta has been falling gradually as the moratoria period is gradually expiring for many borrowers and economic activity continued to normalise in most sectors.

The share of SMEs that used leasing or hire-purchase remained unchanged at 6% in 2021. Hence, the share of domestic SMEs making use of this method of financing remained below that in the European Union, at 22%. Meanwhile, the use of other loans such as those from family and friends, a related enterprise or shareholders, fell marginally to 10% from 13% a year earlier. During the same period, domestic SMEs made no use of equity and debt securities. In fact, debt securities, factoring and equity capital remained the three sources of finance that were least used in Malta and across the European Union.

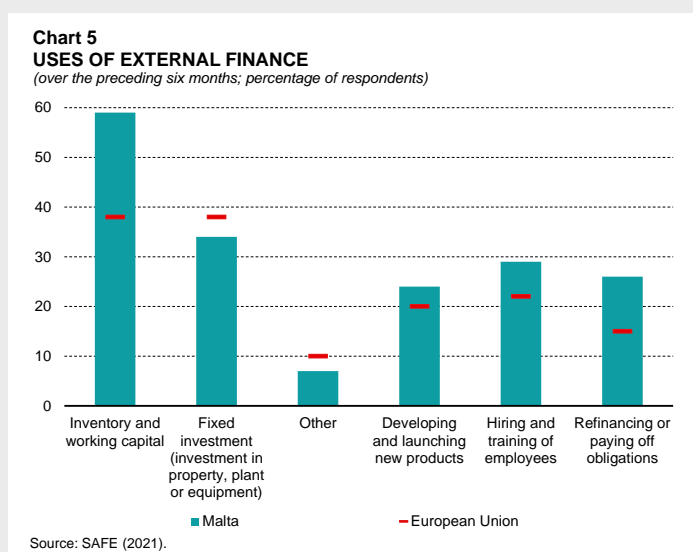
Uses of external finance

Chart 5 shows the purpose for which SMEs in Malta and in the European Union used external financing obtained during 2021. The share of SMEs that obtained external finance for inventory or working capital rose to 59% in 2021 from 52% a year earlier and stood above that of 38% in the European Union. In the latter case, this share fell from 41% a year earlier.

A larger proportion of domestic SMEs (34%) used external financing for fixed investment in property, plant or equipment, compared with 22% in 2020. This share nonetheless remained below that of 38% in the European Union. Meanwhile, the proportion of SMEs in Malta that used external financing for the development and launching of new products rose to 24% from 19% in the preceding year and stood above that of 20% in the European Union. Similarly, at 29%, the share of domestic SMEs that used external financing for the hiring and training of employees was almost double that in 2020 and in line with the share reported for 2019. This share was also above that of 22% recorded among respondent firms in the European Union. Almost a quarter of domestic SMEs used external finance to refinance or pay off obligations, compared to 15% in the European Union.

Most pressing problems facing SMEs

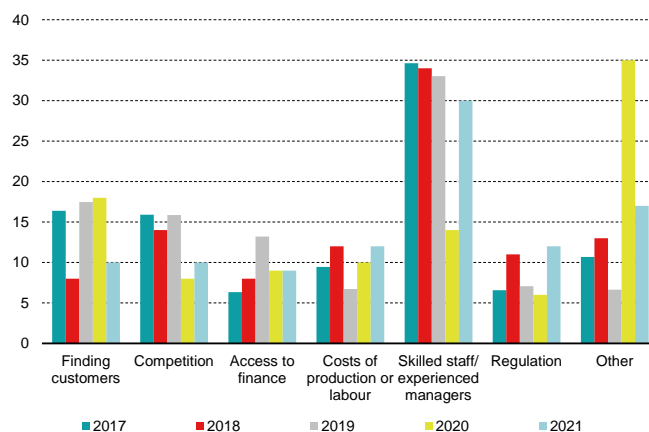
Chart 6 provides a breakdown of the most pressing problems that SMEs faced between 2017 and 2021. The share of respondent SMEs that cited the availability of skilled staff or experienced managers as the most pressing problem stood at 30% in 2021, up from 14% a year earlier and only marginally below the shares recorded in the three years preceding the pandemic. This was also the most pressing problem



for SMEs in the European Union (27%).

Skills availability was particularly problematic in the Netherlands (40%) and Austria (37%) and least of an issue in Spain (15%) and Portugal (17%). The availability of skilled staff, along with uncertainty about the future were also the most frequently cited long-term barriers to investment in Malta and across the European Union according to the European Investment Bank (EIB) Survey on Investment and Investment Finance 2021.

Chart 6
MOST PRESSING PROBLEM FACING FIRMS
(percentage of respondents)



Source: SAFE (2021).

Meanwhile, 17% of domestic SMEs have reported ‘other problems’ than those listed in the survey as the most challenging issues that they faced in 2021. When asked about the main issues underlying these other problems, around a third of domestic SMEs related these to new challenges brought about by the pandemic as opposed to 75% across the European Union. By contrast, around two-thirds of SMEs continued to cite other problems besides those brought about by COVID-19, a significantly higher proportion than 13% of SMEs in the European Union. Nonetheless, no SMEs in Malta and across the European Union reported Brexit as being a most important problem. Furthermore, no domestic firms considered issues related to taxes, cash flow and liquidity, bureaucracy and exchange rate fluctuations as the most important problem currently facing their firm.

Other non-financial barriers that undermine firm growth include costs of production and labour and a burdensome regulatory framework. The share of SMEs in Malta that consider these problems as their most pressing ones rose to 12% in 2021 – double the share of SMEs citing regulation as a most important problem in 2020 and marginally above the 10% of domestic SMEs concerned about costs of production and labour that year. The share of firms concerned with these issues in 2021 was similar to that in the European Union.

During the reference period, 10% of SMEs in Malta considered the problem of finding customers for their products or services as their most pressing problem, down from 18% a year earlier and in the European Union.

Similarly, 10% of domestic SMEs considered competition as the most pressing problem – marginally above the share of 8% in 2020 but below that of 16% reported pre-pandemic. In 2021, competition was considered as a most important problem for only 9% of SMEs across the European Union.

Meanwhile, access to finance has declined steadily in importance throughout the survey years. The share of SMEs in Malta that considered access to finance as a most pressing problem was unchanged from the preceding year’s 9% and slightly above that of 7% of SMEs in the European Union. According to SAFE 2021, access to finance remains a very pressing problem to SMEs in Greece where it was mentioned by around 16% of participating firms, and least of a problem in Austria, Belgium and the Netherlands – reported by just 5% of respondents in each country.

Availability of financing

When asked about the availability of different types of financing, a net share of 3% reported a deterioration in the availability of bank loans in Malta, as opposed to an improvement in 2020, when a net share of 2% reported improved availability of this source of funding. By contrast, in the European Union the net share reporting an improvement rose to 6% from 4% a year earlier.

Furthermore, a net 3% of SMEs in Malta believed that the availability of credit lines, bank or credit card overdrafts has deteriorated in 2021. This contrasts with a net share of 5% which reported an improvement in 2020. Meanwhile, in the European Union the net share of SMEs reporting improved availability rose to 6% from 2% a year earlier.

By contrast, on balance, SMEs in Malta claimed improved availability of trade credit and 'other loans', with the share of firms reporting such improvement standing at 7% in each category. Availability of trade credit improved compared to 2020, when on balance 7% of respondents had reported a deterioration. By contrast, the availability of 'other loans' worsened.

Although a small net share of domestic respondents claimed that the availability of financing through leasing or hire-purchase has deteriorated, the extent of deterioration was smaller than in 2020.

Meanwhile, on balance, respondents in the European Union reported improved availability in all these types of financing.

Looking forward to the six months ahead, domestic SMEs expected a deterioration in the availability of credit line, bank overdraft or credit cards overdraft, equity capital, leasing or hire-purchase as well as other loans. By contrast, they expected an improvement in the availability of retained earnings and trade credit. Meanwhile, in the European Union, on balance, surveyed SMEs expected an improvement in the availability of the various types of financing mentioned above.

Credit demand

The SAFE also provides information on the demand for finance by participating firms to complement replies on the availability of financing (supply). 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 bank overdraft, credit lines or credit card overdrafts fell from 26% in 2020 to 14% in 2021. During the same period, the share of those that did not apply because of possible rejection rose marginally to 4% from 3% a year earlier, while the proportion of those that did not apply for other reasons increased to 27%. However, slightly more than half of the surveyed firms – 55% – did not apply because of sufficient internal funds. This was above the share of 46% reported for the European Union.

During 2021, the proportion of domestic SMEs that applied for bank loans increased marginally to 21% from 20% a year earlier. While just 3% of respondent firms did not apply because of possible

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

Over the preceding 6 months; percent of responding firms

	Bank overdraft, credit line or credit card overdrafts					Bank loans					Trade credit				
	2017	2018	2019	2020	2021	2017	2018	2019	2020	2021	2017	2018	2019	2020	2021
Applied over the past 6 months	16	42	24	26	14	16	22	16	20	21	30	48	32	29	32
Did not apply because of possible rejection	2	2	8	3	4	3	1	6	1	3	5	0	1	1	2
Did not apply because of sufficient internal funds	31	32	48	51	55	33	45	53	59	58	18	32	29	44	48
Did not apply for other reasons	45	23	14	20	27	43	25	16	19	18	38	16	28	23	18

Source: SAFE (2021).

rejection, slightly less than a fifth failed to apply for other reasons. Meanwhile 58% of firms – compared with 59% in 2020 and 48% of SMEs in the European Union – did not seek bank loans due to sufficient internal funds.

The percentage of respondents that applied for trade credit rose to 32% in 2021 from 29% in the preceding year – the same share as that recorded in the pre-pandemic year. This was marginally above that of 30% in the European Union. Survey results show that a significantly higher share of respondents (48%) did not apply because of sufficient internal funds compared with 44% a year earlier. Only 2% did not apply for fear of rejection, while 18% did not apply for other reasons.

Looking forward, when asked about the type of external financing they would solicit to realise their growth ambitions, domestic SMEs expressed a strong preference for bank loans. Almost three quarters of SMEs in Malta as opposed to 65% of SMEs across the European Union prefer this type of financing. Only 12% of domestic SMEs showed preference to taking loans from other sources while 8% of respondents replied that they would seek equity investment.

Meanwhile, slightly over a third of domestic SMEs believed that there were no obstacles to get external financing as opposed to 47% across the European Union. The share of SMEs that considered interest rates or price as being a potential limiting factor stood at 17% compared with 12% in the European Union, while 13% of respondents said that they had insufficient collateral or guarantee, only marginally higher than 12% reported by their EU counterparts. A small share of respondents (around 7%) considered other issues as their most limiting factors, such as too much paperwork, lack of control over the enterprise and unavailability of financing.

Conclusion

The SAFE 2021 notes that on balance, turnover for domestic SMEs was unchanged during 2021, a significant improvement over 2020. On balance, Malta's SMEs continued to report lower profits as significant increases in the cost of labour and other costs (materials and energy) seem to have outweighed improvements in turnover compared with 2020. Nonetheless, the share of firms reporting higher labour and other costs remained below that in 2019.

Both in Malta and across the European Union, bank financing remained the most used source of external financing. In 2021 usage rates among domestic SMEs rose when compared to a year earlier and surpassed those in the European Union. Similarly, the proportion of SMEs that resorted to retained earnings and trade credit increased as the latter type of financing might have helped fill liquidity shortages. In fact, almost two thirds of Maltese SMEs reported that they had sufficient internal funds not to apply for a bank loan.

The share of SMEs in Malta that used grants or subsidised bank loans fell slightly in 2021 when compared to a year earlier. This reflects the fact that although policies that were introduced to support the flow of bank credit to enterprises during the COVID-19 pandemic remained in place, the number of beneficiaries has fallen gradually as the moratoria period gradually expired for many borrowers and economic activity continued to normalise in most sectors (Please refer to the section on liquidity conditions in this chapter).

Access to finance was among the least pressing of obstacles during the period under review. While no change was reported in the incidence of firms reporting this as their most pressing problem, labour shortages have returned to being the most pressing problem for SMEs in Malta and across the European Union. These were followed by other challenges, though those brought about by the pandemic were less of concern among domestic SMEs than their EU counterparts.

Liquidity support measures related to COVID-19

In response to the COVID-19 pandemic and subsequent containment measures, the Central Bank of Malta issued Directive No.18 in order to regulate the moratorium on credit facilities in exceptional circumstances. The Directive regulates the temporary suspension of debt repayment on credit facilities advanced by credit institutions to borrowers prior to 14 April 2020.⁵ A number of businesses and households that were faced with liquidity challenges applied with MFIs in Malta for a moratorium on loan repayments.⁶

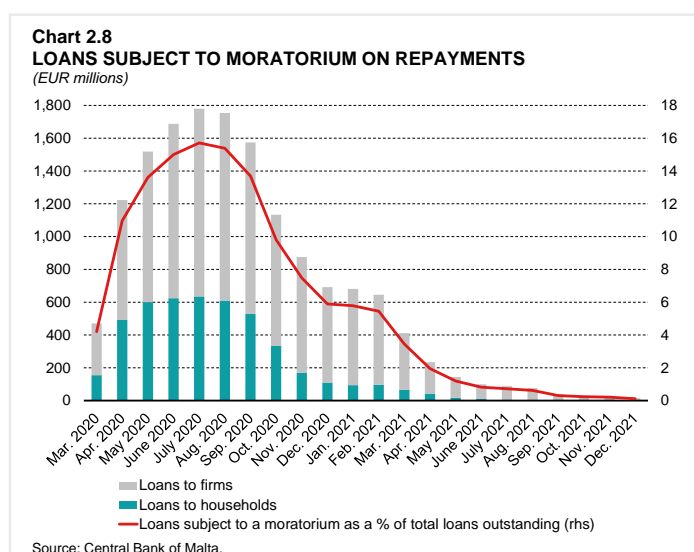
At the end of December 2021, only seven loans were subject to a moratorium. These amounted to €14.1 million, or 0.1% of total loans outstanding to residents. The value of loans subject to a moratorium on loan repayments reached a peak in July 2020, at €1.8 billion, or 15.7% of total loans outstanding to residents (see Chart 2.8). The number of beneficiaries as well as the value of loans subject to a moratorium declined gradually since then, as the moratoria period expired for many borrowers and economic activity continued to normalise in most sectors.

By the end of 2021, all the outstanding loans covered by moratoria were held by firms. The number of households benefitting from these moratoria had declined significantly since February 2021 and by the end of the year there were none requiring such moratoria.

As at end December, the largest number and value of loans subject to a moratorium was held in the sector comprising professional, scientific and technical activities. This was followed by the accommodation and food services activities sectors although in the latter case loans subject to moratoria accounted for only 0.6% of total outstanding loans. This contrasts with the end of 2020, when over 40.0% of outstanding loans to the accommodation and food services activities sector were subject to a moratorium.

Furthermore, in order to alleviate liquidity shortfalls as a result of the pandemic, the Government launched the MDB CGS. This scheme provides guarantees to commercial banks with the aim of enhancing access to new working capital loans for businesses. The scheme was later extended to cover loan repayments. It enables credit institutions to leverage government guarantees up to a total portfolio volume of €777.8 million.⁷

By the end of 2021, 654 facilities were approved under the CGS, covering total sanctioned lending of €505.9 million (see Table 2.4). As the scheme partly guarantees new loans for working capital, the



⁵ This Directive was issued in consultation with the Malta Financial Services Authority and the Malta Bankers' Association and entered into force on 13 April 2020. A number of banks had already started to provide moratorium facilities voluntarily in March 2020. In view of the protracted impact of the COVID-19 pandemic, on 14 January 2021, the Minister for Health, in consultation with the Ministry for Finance issued [Legal Notice \(LN\) 15 of 2021 on 'Moratorium on Credit Facilities in Exceptional Circumstances'](#), which relates to the reactivation of moratoria in Malta. This reactivation allows borrowers to submit their applications for new moratoria or to extend their existing moratoria subject to a number of conditions, before 31 March 2021.

⁶ Data on moratoria include both pre and post the Legal Notice 142 of 2020 on the Moratorium on Credit Facilities Regulations in Exceptional Circumstances (see <http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lp&itemid=30087&l=1>) and Central Bank of Malta Directive No. 18. Data on moratoria refer to loans that were issued before the onset of the pandemic and which became subject to a moratorium as a result of COVID-19 before CBM Directive No. 18 of 2020, or in terms of the same Directive.

⁷ The MDB CGS was approved by the European Commission on 2 April 2020. See <https://mdb.org.mt/en/Schemes-and-Projects/Pages/MDB-Working-Capital-Guarantee-Scheme.aspx> for further details.

Table 2.4
MDB CGS – AS AT DECEMBER 2021

Number of facilities; EUR millions

	Total number of facilities ⁽¹⁾	Sanctioned amount ⁽²⁾
Manufacturing	56	24.6
Construction	37	48.4
Wholesale and retail trade; repair of motor vehicles and motor cycles	174	100.8
Transportation and storage and information and communication	42	51.5
Accommodation and food service activities	156	121.7
Professional, scientific and technical activities	41	21.6
Administrative and support service activities	40	14.0
Real estate	20	7.3
Other ⁽³⁾	88	116.0
Total	654	505.9

Source: MDB.

⁽¹⁾ The number of facilities taken by various sectors.

⁽²⁾ The total number of loans sanctioned under the scheme as at end month, in EUR millions.

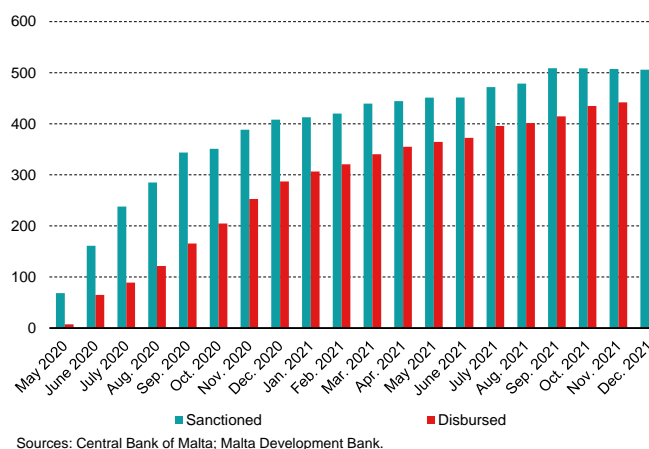
⁽³⁾ Includes loans to education, health and social work, financial and insurance activities, arts, entertainment and recreation and other services activities, activities of households, electricity, gas & water supply sector and agriculture, forestry and fishing, and public administration and defence.

amounts actually disbursed under the scheme may fall short of those sanctioned. In fact, €453.0 million were disbursed by the end of the year. Hence, as at the end of December, 65.0% of the scheme was sanctioned while 58.2% was disbursed (see Chart 2.9). By the end of 2021, the amount of disbursed loans in terms of the scheme stood at 10.6% of total outstanding NFC loans.

In value terms the sector comprising accommodation and food services activities had the largest total value of sanctioned loans at €121.7 million, spread over 156 facilities. This was followed by the sector comprising wholesale and retail

activities, with a total value of sanctioned loans at €100.8 million and 174 facilities. The sector comprising transportation, storage, information and communication and the construction sector also had a significant value of sanctioned loans.

Chart 2.9
SANCTIONED AND DISBURSED LOANS UNDER THE MDB CGS
(EUR millions)



Sources: Central Bank of Malta; Malta Development Bank.

Credit standards, terms and conditions remain stable

Results from the BLS show that credit standards, and credit terms and conditions on loans to NFCs in Malta remained unchanged in 2021. Responses with regards to demand for credit by NFCs were more mixed but by the end of the year, the majority of the banks surveyed reported that demand had somewhat declined.

Credit standards, and terms and conditions for house purchases as well as consumer credit and other lending were mostly unchanged throughout the year. Likewise, most banks reported no change in the demand for this credit category.

In response to a series of ad hoc questions on banks' access to wholesale and retail funding and on their risk transfer capability as a result of the prevailing situation in financial markets, some of the participating banks reported some easing in market access to short-term retail deposits while results were more mixed with regards to access to long-term retail funding. Most of the surveyed banks reported no impact in terms of their ability to access the unsecured segment of the interbank money market or indicated that this market segment was not relevant for their business. Surveyed banks also reported that access to wholesale debt securities was either not relevant for their business or that there was no change in access conditions. The ability to transfer credit risk off balance sheet was also assessed to have remained unaffected by the situation in financial markets or not relevant.

Participating banks generally claimed that their non-performing loan (NPL) ratio had not affected their credit standards, and credit terms and conditions during 2021. In the last quarter of the year, banks were also asked to gauge the impact of regulatory or supervisory requirements relating to capital, liquidity or provisioning on their assets, capital and funding conditions as well as on their lending policies. Half of the surveyed banks reported increases in their capital positions. However, in most cases no changes were reported in assets, funding conditions, credit standards or margins as a result of the regulatory or supervisory requirements.

Banks were also asked to assess the impact of the ECB's APP on their financial situation, assets and lending behaviour. Most of the surveyed banks said that the APP had no impact on their assets, on their liquidity position and overall market financing position. Results were more mixed when assessing the impact of the ECB's APP on the banks' profitability. In the first half of the year, half of the banks reported no change in profitability with the remaining half giving contrasting replies. In the second half of the year, the majority of banks reported no such impact. None of the participating banks reported that the APP affected their credit standards, lending volumes, and terms and conditions.

With regard to the impact of the ECB's negative deposit facility rate, all participating banks reported a fall in their overall profitability as a result of lower net interest income. Most of the respondent banks reported no changes in their lending rates, loan margins, non-interest rate charges and lending and deposits volumes. The majority of respondents also claimed that there were no changes to their deposit rates as a result of the deposit facility rate.

Respondent banks were also asked about the impact of the ECB's two-tier system for remunerating excess liquidity holdings on their financial situation, lending and deposit rates. Most of the banks reported an improvement in their overall profitability on account of higher net interest income. No impact on interest rates on loans and deposits was detected.

The majority of respondent banks stated that they did not participate in the Eurosystem's third TLTROs that took place in March 2021 and all banks did not take part in the September 2021 operation. Their financial situation, lending policy and lending volumes were largely not affected by these operations.

Respondent banks were asked to state how their credit standards, terms and conditions on new loans and the demand for loans had changed across the main sectors of economic activity – namely manufacturing, construction, services, wholesale and retail trade, and real estate. Generally, banks reported no change in credit standards. With regards to terms and conditions, banks mostly said that these were also unchanged. Replies regarding demand for loans were more mixed across participating banks and sectors.

Banks were also asked to assess changes in the credit standards, the terms and conditions on loans benefiting from COVID-19 related government guarantees and those on loans without government guarantees. With regards to credit standards on government guaranteed loans, all participating banks experienced no

changes. The majority said that the terms and conditions for such loans were also unchanged. Moreover, the majority of banks said that loans without government guarantees were not affected.

With regards to demand for loans backed by government guarantees, half of the banks reported lower demand, another bank said that demand increased, while the remaining bank reported no change in demand. No changes were reported in demand for loans without government-related guarantees.

The money market

In the domestic primary market, the yield on 3-month Treasury bills rose to -0.41% at the end of 2021, from -0.50%, 12 months earlier.

In total, the Treasury issued €1,904.2 million worth of bills in 2021, slightly less than the amount of €1,992.0 million issued in 2020. The majority of bills issued had a maturity of three months, followed by those with a maturity of six months. New bills issued with a longer maturity made up around 10.8% of all bills. The amount of Treasury bills issued in 2021 was lower than the amount of maturing bills, which stood at €1,948.8 million.

The capital market

In the capital market, total issues of long-term debt by the Government and the private sector increased further, rising to €1,697.4 million in 2021, from €1,511.0 million in 2020. Taking into account the amount of redemptions, roll-overs and buybacks made over the year, positive net issues of long-term debt were recorded in 2021. These stood at €1,188.9 million, as against €887.9 million in 2020, mostly due to elevated issuances of MGS. Meanwhile, in the private sector, as redemptions and buybacks were smaller than new issues, net issues were positive.

New issues of Malta Government Stocks exceed redemptions

In 2021, the Government issued €1,455.2 million in long-term debt and redeemed €458.8 million, such that net issues for the year were positive for the second consecutive year (see Table 2.5). According to information published by the Treasury, 19 new bond issues took place, with maturity dates ranging from five to 30 years. Demand for MGS remained strong and all issues were oversubscribed and largely taken up by credit institutions.

Table 2.5
ISSUES OF LONG-TERM DEBT SECURITIES⁽¹⁾

EUR millions⁽²⁾

	2017	2018	2019	2020	2021
Government					
Total issues ⁽³⁾	257.8	150.0	350.0	1335.0	1,455.2
Redemptions & roll-overs ^(4,5)	268.4	384.1	422.2	461.1	458.8
Net issues	-10.6	-234.1	-72.2	873.9	996.4
Corporate sector					
Total issues	338.6	117.3	377.6	176.0	242.2
Redemptions, roll-overs & buybacks ^(5,6)	180.7	85.5	167.9	162.0	49.7
Net issues	157.9	31.8	209.7	14.0	192.5
Total net issues	147.3	-202.3	137.5	887.9	1,188.9

Sources: Central Bank of Malta; MSE; Treasury.

⁽¹⁾ Banks, non-MFIs 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.

The amount of outstanding MGS increased to €6,637.8 million at the end of 2021, of which 79.1% was held domestically and 20.9% was held by non-residents (see Chart 2.10). Resident credit institutions held 52.2% of outstanding MGS, compared to 49.5% in 2020. The share of MGS held by resident households fell further to 10.8% from 15.1% previously.

Secondary market turnover of MGS fell during 2021. It stood at €144.8 million compared with €162.9 million a year earlier.

Secondary market yields on domestic MGS increased during 2021, with the 5-year and 10-year yields rising by 39 and 45 basis points respectively, to 0.17% and 0.72% at end-December (see Chart 2.11). Meanwhile, in the euro area, the benchmark 5-year yield increased by 26 basis points compared with its end-2020 level and ended the year at -0.20%. The euro area 10-year yield rose by 37 basis points to 0.28%. As euro area yields increased to a lesser extent than domestic yields, the spread between the 5-year and 10-year yields in Malta and their euro area benchmark widened. At the end of 2021, the spreads on the 5-year and 10-year yields stood at 37 and 44 basis points respectively.

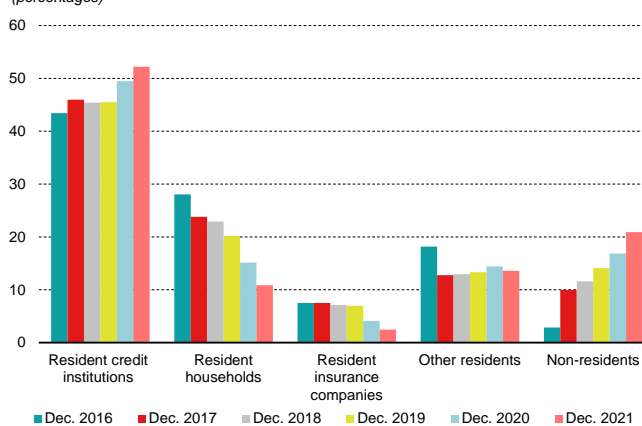
Corporate bond issues increase

In the corporate bond market, new issues of long-term debt listed on the MSE stood at €242.2 million in 2021. As the amount of redemptions and buybacks stood at €49.7 million, net issues for the year were positive and considerably higher than in 2020. During 2021, eight private companies had new bonds listed on the MSE.

By the end of the year, 22 firms had listed bonds through Prospects, an unchanged amount compared with a year earlier.⁸

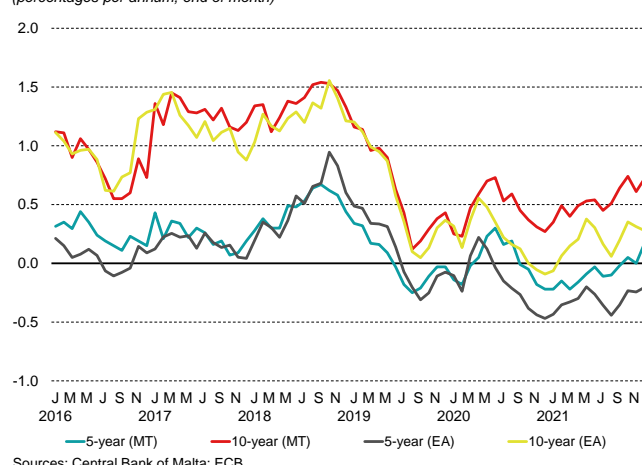
Turnover in the secondary corporate bond market declined during 2021. It stood at €89.5 million, down from €102.7 million in the previous year.

Chart 2.10
OUTSTANDING MGS BY INVESTOR BASE⁽¹⁾
(percentages)



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

Chart 2.11
GOVERNMENT BOND YIELDS
(percentages per annum; end of month)



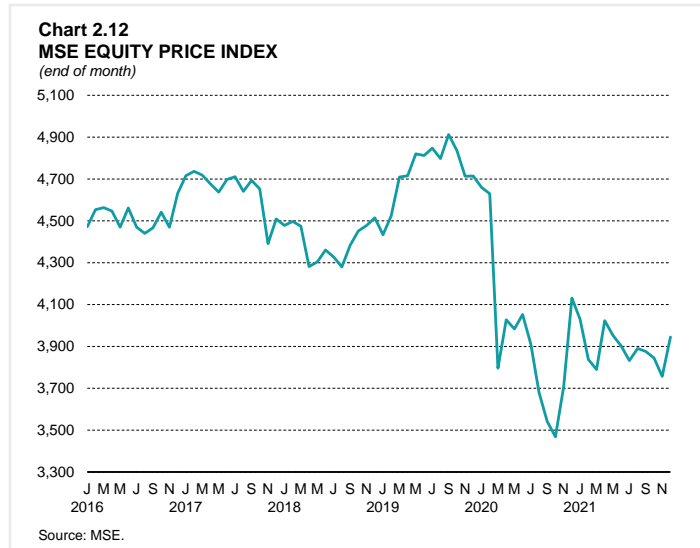
Sources: Central Bank of Malta; ECB.

⁸ Prospects is a multi-lateral trading facility operated by the MSE with the aim of facilitating access to capital markets for SMEs.

MSE index declines

In 2021, turnover in the equity market fell substantially to €32.5 million, from €58.6 million a year earlier. The MSE Equity Price Index fell by 4.5% during 2021 and ended the year at 3,944.6 (see Chart 2.12). This decline was, however, less pronounced than that registered in 2020. Almost half of the 29 equities in the index registered a decline in prices in 2021.

Meanwhile, the MSE Equity Total Return Index, which accounts for changes in equity prices and dividends, was 3.2% lower than its level at end-December 2020.



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 end-September 2021. 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}

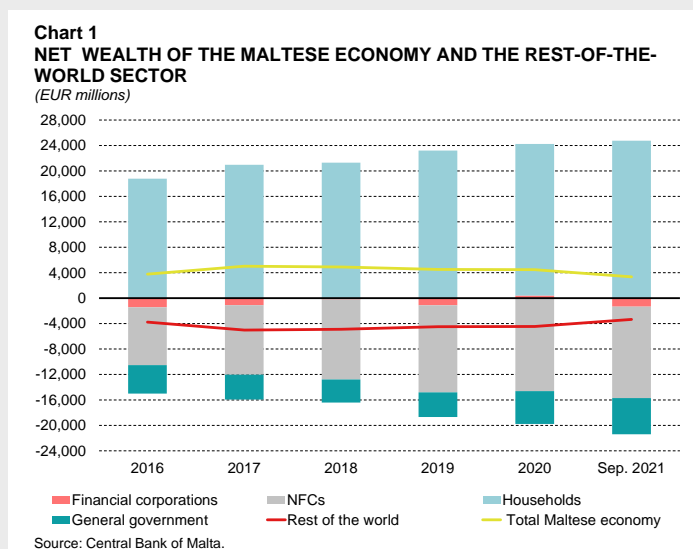
This Box includes three sections: The first section contains an analysis of the net financial wealth of each sector of the economy, the second provides an analysis of private sector debt on the basis of the European Commission's macroeconomic imbalance procedure (MIP) and the final section outlines the financial interlinkages among the resident sectors.⁵

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 2021 (see Chart 1). The net financial wealth of the total resident economy amounted to €3,347.4 million, a decline from €4,469.0 million in December 2020.⁶ The decrease was mainly driven by a drop in the net financial wealth of financial corporations and, to a lesser extent, that of the general government which offset improvements in the net financial wealth of households and NFCs.⁷

Financial assets and liabilities of the financial corporations sector

The aggregate net financial wealth of Malta's financial corporations declined from €404.0 million at the end of 2020 to -€1,339.3 million in September 2021 (see Chart 2). The decrease since December 2020 was mainly due to lower net assets in the form of loans as well as higher net liabilities in the form of insurance technical reserves, accounts payable and



¹ Prepared by Kimberly Mamo, Economist Statistician, and Janica Borg, Senior 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 See also *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 non-resident units engaging in transactions with resident institutions.

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 ESA 2010, financial corporations include the central bank, depositary-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.

equity. These offset decreases in net liabilities arising from deposits and an increase in net holdings of debt securities.

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 narrowed over the period 2016 to 2019, reflecting the improvement in the Government's fiscal position, it widened in 2020 and 2021 mainly as a result of increased financing needs following the introduction of COVID-19 fiscal support measures. In September 2021, the net financial position of general government deteriorated further compared with end-2020. It stood at -€5,695.1 million, decreasing by €540.5 million or 10.5% when compared with December 2020.

The increase in the net liability position since the end of 2020 was driven mainly by an increase in net payables. An increase in debt securities outstanding and in loans – partly related to borrowing from the EU's instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) – also contributed. These offset an increase in net assets in the form of deposits, which in 2020 had declined in line with higher financing needs caused by the pandemic. As Chart 3 shows, the general government remained a net asset holder of currency and deposits as well as equity, but a net liability holder of other instruments, mainly of debt securities.

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

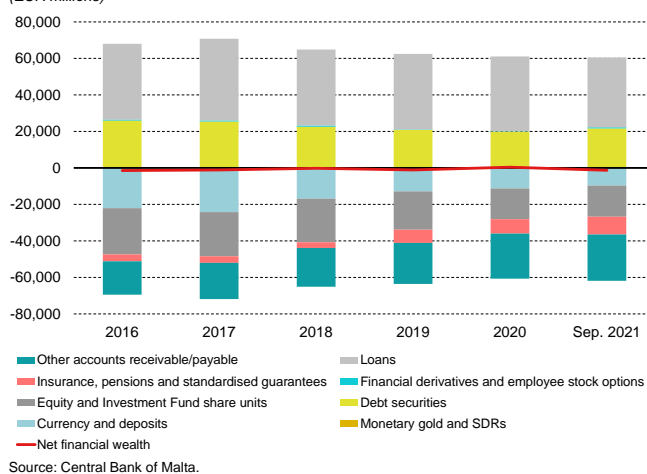
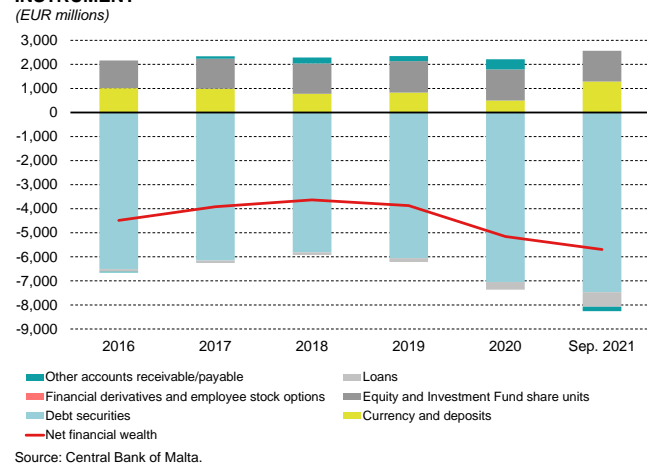


Chart 3
GENERAL GOVERNMENT'S NET FINANCIAL WEALTH BY INSTRUMENT
(EUR millions)



Financial assets and liabilities of non-financial corporations

Chart 4 shows that NFCs had net financial liabilities of €14,370.8 million as at September 2021, a decrease of €245.8 million or 1.7% since December 2020. In September 2021, 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 2020, the marginal decrease in the NFCs' net liability position was due to a rise in holdings of currency and deposits and a decline in net accounts payables (the latter due to an increase in receivables) which offset the increase in their financing through

loans, equity and, to a lesser extent, debt securities.

Financial assets and liabilities of households

In September 2021, households' net financial wealth reached €24,752.6 million, increasing by 3.8% or €916.5 million, when compared with December 2020. 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, but also held smaller net asset positions related to insurance products as well as debt securities. By contrast, this sector was a net liability holder of loans and other accounts payable. The improved net financial wealth position since 2020 was mostly driven by an increase in currency and deposits, which offset an increase in loans. In part, the improvement in the net financial wealth position of households reflected an increase in households' savings, which remained high in the context of still elevated uncertainty related to the pandemic.

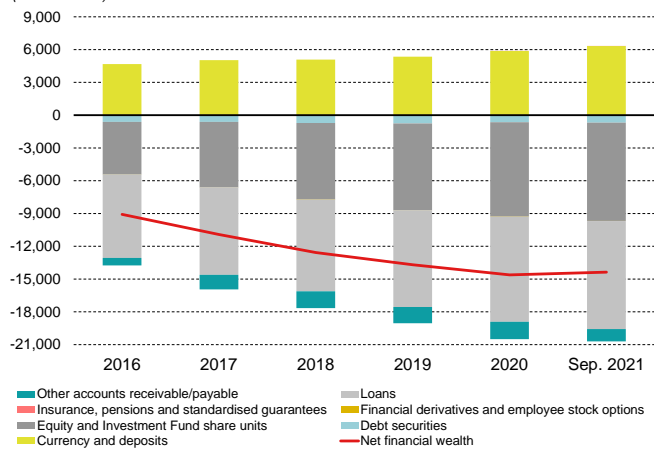
Malta's private sector debt

Financial accounts statistics also shed light on Malta's private sector debt. In line with the methodology of the EU's MIP – which, inter alia, prescribes such indicators on an annual basis – Chart 6 shows Malta's consolidated private sector debt as a percentage of GDP by sector and compares it to the consolidated private sector debt as a percentage of GDP of the euro area. In recent years, this ratio has been on average within the debt-to-GDP threshold of 133% set by the MIP.^{8,9}

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 on a consolidated basis). 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. The definition of private sector debt is in line with the EU's MIP definitions.

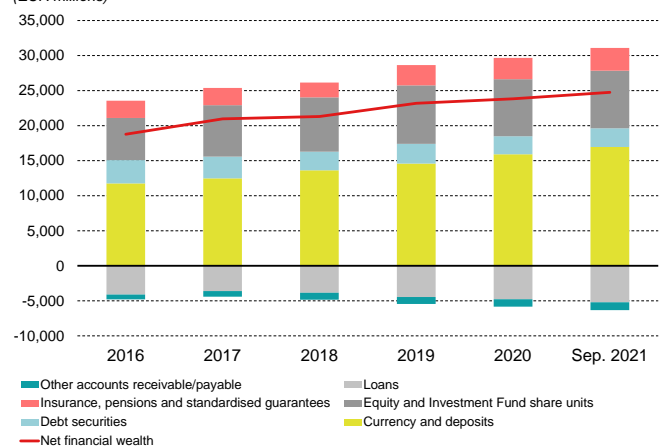
⁹ In terms of EU Regulation No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances.

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.

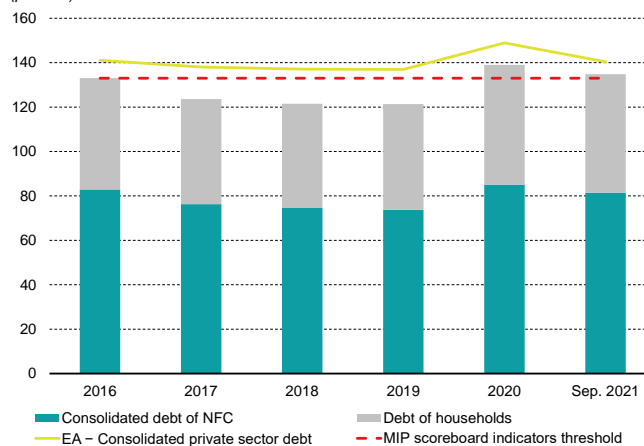
As at September 2021, the indicator stood at 134.8 %, exceeding the threshold by 1.8% yet less than its end-2020 level of 139.0%. Notwithstanding the indicator is exceeding the threshold, it stood 5.6 percentage points lower than the euro area average (see Chart 6).¹⁰

Although NFC's debt and household debt rose in level terms, this was offset by a stronger level increase in GDP.

Corporate debt since 2016 constitutes on average 61.3% of the consolidated private sector debt. Chart 7 shows the unconsolidated 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 sector. From this perspective, the largest exposures stemmed from liabilities to the NFC sector itself, followed by liabilities to financial corporations.

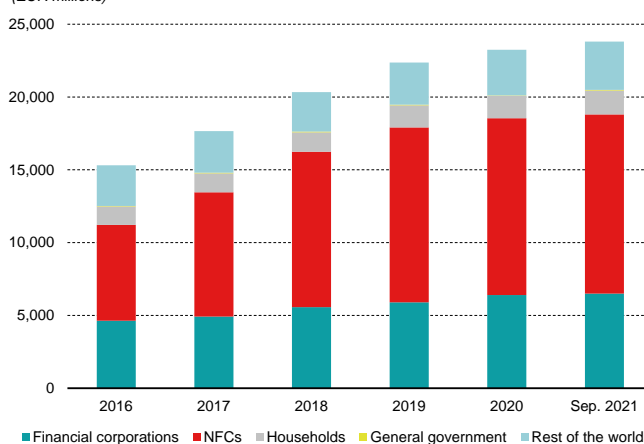
Firms in Malta rely significantly more on loans than on debt securities. Even though the issuance of debt securities increased over the years, this remained relatively low, amounting to 3.7% of total NFCs' debt in the third quarter of 2021. Over the years, bank credit has been one of the main sources of financing for NFCs, although the importance of this source of funding has been declining over time. In turn, non-bank financing became more significant, particularly taking the form of intra-group lending or lending from related parties.¹¹ In fact, as at September 2021, debt from other corporates (mainly loans) amounted to €12,310.7 million, or 51.7% of total NFCs' debt with most of this debt being in the form of intragroup loans. Debt from financial corporations, mainly bank loans, amounted to €6,497.0 million or 27.3% of total NFCs' debt. Another important source of finance for resident corporates was debt from abroad, which amounted to €3,314.1 million in September 2021, partly reflecting the number of foreign-owned

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



Sources: Central Bank of Malta; Eurostat; ECB.

Chart 7
NFC DEBT BY CREDITOR SECTOR
(EUR millions)



Source: Central Bank of Malta.

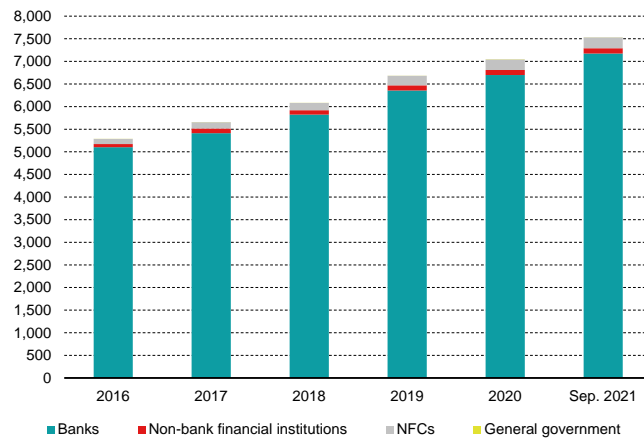
¹⁰ Eurostat statistics for the euro area are only available annually. On the other hand, the ECB's Statistical Data Warehouse contains quarterly data. There are discrepancies between the two sources due to different vintages. For this analysis, Eurostat's data were used until 2019, while ECB data were utilised to obtain the September 2021 data.

¹¹ See Box 2: Non-Financial Corporations' loans from other corporates – evidence from Malta's Financial Accounts Statistics, *Financial Stability Report 2017*.

subsidiaries operating in Malta. Meanwhile, debt from households (mainly loans from directors and shareholders) amounted to €1,638.2 million in September 2021.

Chart 8 shows that households' debt as at end-September 2021 stood at €7,533.6 million, increasing by €486.5 million since end-December 2020 – primarily due to an increased take up of loans from credit institutions. Indeed, household debt mainly comprises loans from credit institutions, which amounted to 95.2% of the sector's total debt. The remaining debt mainly consisted of directors/shareholders' loans, amounting to around €355.6 million. Nonetheless, household debt as a ratio of their total assets increased marginally from 21.9% in December 2020 to 22.3% in September 2021.

Chart 8
HOUSEHOLDS' DEBT
(EUR millions)

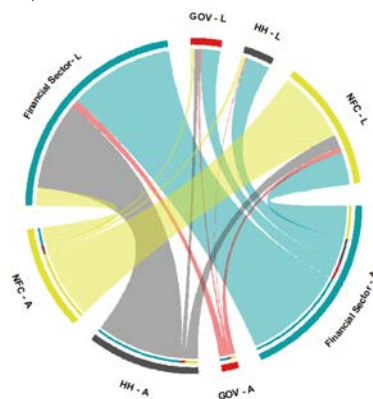


Source: Central Bank of Malta.

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 'from-whom-to-whom' accounts. Chart 9 shows the interlinkages between the resident sectors as at September 2021.¹² 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, and deposits. These amounted to 58.3% of their total domestic holdings in the third quarter of 2021, a marginal decrease from 58.5% in December 2020. 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 47.5% of its total domestic financial assets with the financial sector, primarily in

Chart 9
FINANCIAL INTERLINKAGES BETWEEN RESIDENT SECTORS
(as at September 2021)



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.

¹² The interlinkages between resident sectors as at December 2020 is not being shown graphically since there were no major changes.

the form of deposits. This share increased from 40.9% in December 2020. With regards to NFCs, most of their assets are held by other NFCs. These decreased marginally to 73.2% of NFC's total domestic assets in September 2021, from 74.2% in December 2020. Finally, households' domestic asset holdings continued to be held mainly with the financial sector. Households' domestic financial asset holdings increased to 83.1% of their total assets in September 2021, from 82.4% in December 2020.

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



3. OUTPUT, EMPLOYMENT AND PRICES

The Bank's Business Conditions Index (BCI) increased to 2.4 in 2021 from -2.4 in 2020 as several economic indicators recovered from the low levels recorded in 2020. At the same time, the negative output gap narrowed significantly.

Real GDP increased by 9.4% in 2021 following a decrease of 8.3% a year earlier and exceeded slightly its 2019 pre-pandemic level. The expansion in economic activity was primarily driven by domestic demand. Net exports also contributed positively but to a lesser extent. Real gross value added (GVA) data show that the increase in real GDP was largely driven by the services sector which recovered from the stricter travel restrictions and mitigation measures in 2020. The largest additions within the services sector stemmed from the sector comprising wholesale and retail trade, transportation, accommodation and related activities. The GVA of firms within the information and communication sector as well as the sector comprising public administration and the arts and entertainment sector, also exhibited notable positive contributions to growth. GVA also rose in the construction and manufacturing sectors, although their contribution to economic growth was modest compared to that of services.

LFS data for the first three quarters of 2021 show a labour market in recovery from the COVID-19 pandemic, with employment rising above its pre-pandemic level. Employment continued to benefit from the ongoing normalisation of economic activity in the context of a tight labour market, although Government measures – such as the Wage Supplement Scheme – also provided support.

The unemployment rate fell below the Bank's estimate of structural unemployment after rising above it during the pandemic. Moreover, the unemployment rate remained low from a historical perspective and was less than half of that reported for the euro area. Administrative data show that in 2021 the average number of registered unemployed persons fell by 1,367, to 1,795 persons, but remained above the average level for 2019. The number of registered unemployed fell throughout the year and stood at 1,167 by December.

Annual inflation based on the HICP edged down to 0.7% in 2021, from 0.8% in 2020. Although inflation was very low in the first months of the year, by December inflation had reached 2.6%.

In contrast to the HICP, the RPI shows that inflation rose in 2021 to 1.5%, from 0.6% in 2020. The gap between the two measures of inflation and their contrasting trajectory is mostly related to the large change in HICP weights in 2021 due to the COVID-19 pandemic.

Potential output and Business Conditions Index

Malta's negative output gap narrows considerably¹

In 2021, potential output growth is estimated to have stood at 3.5%, up from 1.4% in 2020 (see Chart 3.1). At the same time, GDP recovered strongly from the impact of the COVID-19 pandemic, exceeding slightly its pre-pandemic level by 2021. Reflecting these developments, the output gap narrowed, standing at -0.3% in 2021 from the -5.7% in 2020, implying there is still some degree of underutilisation of the economy's productive capacity, mostly in high-contact service sectors.²

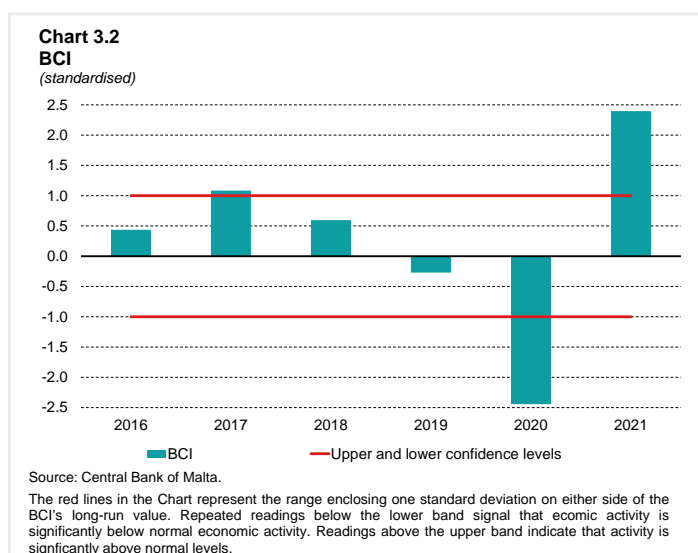
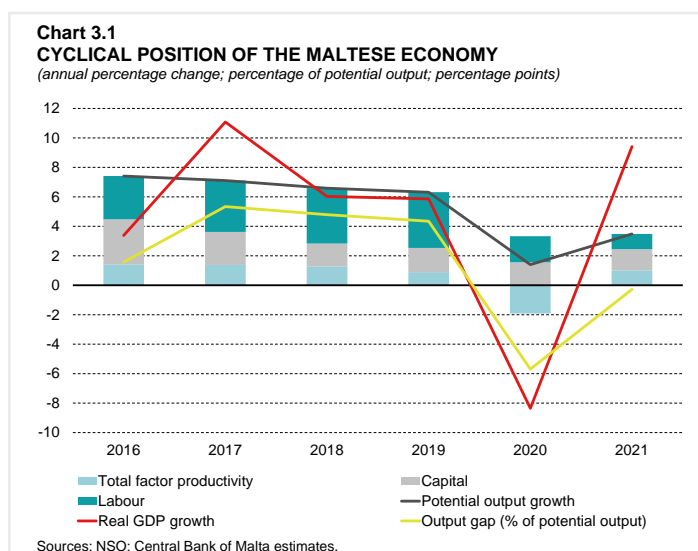
¹ Potential output measures the medium-to-long-term level of real output which is sustainable in an economy. The estimates presented here are derived using a production function approach. For further details on the methodology adopted see Micallef, B., and Ellul, R. (2017), "Medium-term Estimates of 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 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.

The acceleration in potential output growth in 2021 was driven by total factor productivity. The latter's contribution to growth turned positive during the year as firms were able to make better use of their resources following the easing of containment measures. By contrast, the contribution of labour continued to ease reflecting developments in the working age population. The contribution of capital also eased slightly.

Business Conditions Index increases³

The Bank's BCI also recovered from the low level estimated for 2020, which was significantly impacted by restrictions on mobility as a result of the COVID-19 pandemic (see Chart 3.2). The index averaged 2.4 during 2021, compared with -2.4 in 2020. The rise reflected strong increases in almost all measures of economic activity included in the index – in particular, GDP, tourist arrivals and economic sentiment. At the same time, unemployment decreased. Overall, the index marks a dramatic improvement in economic conditions. This is also observed in the strong growth rate of real GDP during the year (see below).



Gross domestic product and industrial production

Real GDP growth increases, largely driven by domestic demand

Economic activity in Malta increased significantly in 2021, following a strong decline in 2020. Real GDP rose by 9.4%, after contracting by 8.3% a year earlier.⁴ In 2021 as a whole, the level of economic activity exceeded slightly – by 0.3% – its pre-pandemic level (see Chart 3.3).

The level of government consumption exceeded 2019 levels by around a fifth, partly as a result of spending on treatment and vaccination against COVID-19. Meanwhile, GFCF also attained pre-pandemic levels as it stood 10.2% above the corresponding level in 2019. Notwithstanding the recovery in private consumption, this component remained 4.6% below its level two years earlier. In addition, net exports were

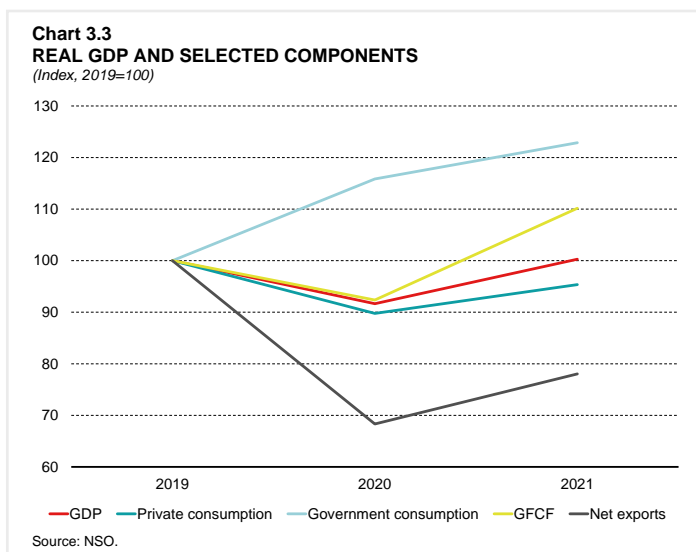
³ The BCI is a synthetic indicator, which includes information from a number of economic variables such as the term-structure of interest rates, industrial production, an indicator for the services sector, economic sentiment, tax revenues and private sector credit. By construction, it has an average 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.

⁴ The analysis of GDP in this Chapter is based on data published in *News Release* 037/2022 published on 1 March 2022.

around a fifth below the level prevailing in 2019.

Domestic demand is the main driver of economic growth

In 2021, the expansion was largely underpinned by developments in domestic demand, which added 7.6 percentage points to GDP growth. The positive contribution of net exports was smaller (see Table 3.1). All domestic demand components rose on a year earlier, with the exception of changes in inventories. However, GFCF and private consumption expenditure were the main drivers behind this expansion. Meanwhile, net exports added 1.8 percentage points to GDP growth as exports outpaced imports.



Private consumption increased by 6.2%, after contracting by 10.2% in 2020, and added 2.8 percentage points to GDP growth. Data on the Classification of Individual Consumption by Purpose (COICOP) show that the rise in private consumption was broad-based across all expenditure categories, with the exception of spending on clothing and footwear. The strongest increase in absolute terms was recorded in expenditure on restaurants and accommodation services. This was followed by spending on recreation and culture as well as transport. In 2020, these sectors were significantly affected by pandemic-related travel restrictions and mitigation measures.

Table 3.1
GROSS DOMESTIC PRODUCT⁽¹⁾

	2016	2017	2018	2019	2020	2021
<i>Annual percentage changes</i>						
Private final consumption expenditure	3.0	5.8	8.9	4.6	-10.2	6.2
Government final consumption expenditure	-3.7	2.0	12.3	13.1	15.8	6.1
GFCF	-2.5	2.0	5.5	8.4	-7.6	19.3
Domestic demand	1.0	4.3	8.7	7.2	-3.6	8.7
Exports of goods and services	7.0	8.7	-0.5	7.0	-5.6	8.2
Imports of goods and services	5.8	4.5	0.2	8.0	-2.2	7.6
Gross domestic product	3.4	11.1	6.0	5.9	-8.3	9.4
<i>Percentage point contributions</i>						
Private final consumption expenditure	1.5	2.8	4.1	2.1	-4.6	2.8
Government final consumption expenditure	-0.6	0.3	1.8	2.0	2.6	1.3
GFCF	-0.6	0.5	1.1	1.7	-1.6	4.0
Changes in inventories	0.7	0.2	0.1	0.1	0.6	-0.4
Domestic demand	0.9	3.8	7.1	5.9	-3.0	7.6
Exports of goods and services	10.9	13.8	-0.8	10.1	-8.2	12.2
Imports of goods and services	-8.4	-6.5	-0.3	-10.2	2.9	-10.4
Net exports	2.5	7.3	-1.0	-0.1	-5.3	1.8
Gross domestic product	3.4	11.1	6.0	5.9	-8.3	9.4

⁽¹⁾ Chain-linked volumes, reference year 2015.

Sources: NSO; Central Bank of Malta calculations.

In the national accounts, private consumption data by COICOP category are based on the domestic concept and thus include the expenditure of non-residents in Malta. Given that tourist arrivals exceeded the previous year's levels, certain COICOP categories of expenditure were affected by a statistical base effect, reflecting a significant increase in non-residents' expenditure in Malta. At the same time, the remaining part of domestic consumption – the expenditure of residents of Malta – also rose on a year earlier. Similarly, the expenditure of Maltese residents abroad increased on its year-ago level as trips abroad continued to normalise, even though it was less than half of its level in 2019.

In 2021, government consumption grew by 6.1%, mainly due to higher outlays on compensation of employees and intermediate consumption. The latter partly reflected higher expenditure on health, which remained elevated due to treatment for COVID-19. The increase in outlays on compensation of employees reflected higher wages and allowances in the health sector as well as payment of arrears within public administration and defence following the signing of collective agreements. Meanwhile, revenue from sales – which is netted against expenditure – increased marginally. Overall, government consumption added 1.3 percentage points to annual GDP growth.

Following a decline of 7.6% in 2020, GFCF rose by 19.3% in 2021, adding 4.0 percentage points to GDP growth. This primarily reflected a significant increase in machinery and transport equipment, partly supported by exceptionally large investments in the aviation sector. The remaining investment categories also grew over 2020 but jointly accounted for only around a tenth of the increase in GFCF during the year. This in turn was mostly driven by higher investment in non-residential dwelling and intellectual property.

Meanwhile, changes in inventories shed 0.4 percentage point from GDP growth in 2021.

During 2021, exports grew by 8.2%, mainly as an easing in travel restrictions supported a recovery in services exports. By contrast, goods exports decreased. Imports rose by 7.6% on a year earlier, mostly on account of an increase in capital-intensive goods imports, although services imports were also higher. As exports grew faster than imports, net exports increased. A larger deficit from trade in goods was offset by a higher surplus on services.

The contributions shown in Table 3.1 are consistent with the approach usually followed in official databases and economic publications. However, this approach does not account for the fact that the import content varies across the different expenditure components. Consequently, they fail to represent the true underlying relative contribution of domestic and external demand to economic growth.

Table 3.2 presents import-adjusted contributions, which addresses this limitation by apportioning imports to the respective domestic demand components and exports. In line with the strong increase in imports in the

	2016	2017	2018	2019	2020	2021
	<i>Percentage point contributions</i>					
Private final consumption expenditure	0.8	2.2	2.7	1.1	-3.4	1.8
Government final consumption expenditure	-0.5	0.3	1.5	1.7	2.1	1.1
GFCF	-0.3	0.6	0.6	0.5	-1.0	1.5
Changes in inventories	0.2	0.0	0.0	0.1	0.4	-0.2
Domestic demand	0.2	3.2	4.8	3.3	-2.0	4.2
Exports of goods and services	3.2	7.9	1.3	2.6	-6.4	5.2
GDP	3.4	11.1	6.0	5.9	-8.3	9.4
Source: Central Bank of Malta estimates.						
⁽¹⁾ Chain-linked volumes, reference year 2010.						

year under review, the majority of import-adjusted contributions are smaller than those based on the traditional approach, as reported in Table 3.1. This is particularly the case for exports, and, to a lesser extent, private consumption, investment and government expenditure.

According to this method, the main driver behind the growth of real GDP in 2021 were exports rather than GFCF as in Table 3.1.

GDP data from the output approach show that real GVA grew by 9.0%, after contracting by 7.3% in 2020. In 2021, GVA added 8.1 percentage points to real GDP growth (see Table 3.3).

Services were the main driver of economic activity, accounting for 7.4 percentage points of real GDP growth. The largest additions within the services sector stemmed from the sector comprising wholesale and retail trade, transportation, accommodation and related activities. This sector added 2.9 percentage points to real GDP growth after contributing negatively a year earlier. The information and communication sector, as well as the sector comprising public administration, education, health and related activities, and the arts and entertainment sector also contributed positively to growth, jointly adding a further 3.0 percentage points. Their contribution increased when compared with 2020. Sectors comprising financial and insurance activities, professional, scientific and administrative activities and real estate activities lifted GDP growth by 1.5 percentage points. Compared with 2020, the contribution from the latter two sectors improved the most, having been negative a year earlier, while the contribution of financial and insurance activities was unchanged. Furthermore, the contribution from construction stood at 0.2 percentage point, while the manufacturing sector – which has contracted in 2020 – contributed 0.3 percentage point to real GDP growth.

Table 3.3
CONTRIBUTION OF SECTORAL GVA TO REAL GDP GROWTH

Percentage points

	2016	2017	2018	2019	2020	2021
Agriculture, forestry and fishing	0.2	-0.2	0.1	-0.2	-0.1	0.0
Mining and quarrying; utilities	0.4	-0.2	0.0	0.3	0.0	0.3
Manufacturing	-0.2	0.6	0.6	0.5	-0.2	0.3
Construction	0.0	0.6	0.4	0.5	0.1	0.2
Services	2.5	9.4	4.2	5.0	-6.4	7.4
<i>of which:</i>						
Wholesale and retail trade; repair of motor vehicles; transportation; accommodation and related activities	-0.9	2.5	1.3	1.2	-6.2	2.9
Information and communication	1.4	1.2	1.3	1.1	0.4	1.1
Financial and insurance activities	0.7	0.8	0.5	0.3	0.4	0.4
Real estate activities	0.3	0.6	0.3	0.1	-0.2	0.5
Professional, scientific, administrative and related activities	2.1	2.8	1.8	1.3	-1.2	0.6
Public administration and defence; education; health and related activities	0.7	0.7	0.6	1.0	0.0	0.9
Arts, entertainment; household repair and related services	-1.9	0.7	-1.6	-0.1	0.4	0.9
GVA	3.0	10.1	5.2	6.1	-6.5	8.1
Net taxation on products	0.4	0.9	0.8	-0.2	-1.8	1.3
Annual real GDP growth (%)	3.4	11.1	6.0	5.9	-8.3	9.4

Source: NSO.

Nominal GDP growth recovers strongly

Nominal GDP rose by 11.3% in annual terms in the year under review after contracting by 7.0% in the previous year.

Compensation of employees grew by 7.4% in 2021, compared with 1.7% in the previous year. It added 3.4 percentage points to nominal growth. The increase was spread across both the general government and private sector.

In the private sector, the largest increases in level terms were recorded in the professional, scientific and technical activities, the wholesale and retail trade sector and arts and entertainment. These were followed by developments in financial and insurance activities and in the manufacturing sector.

In addition, profitability increased sharply in 2021. Gross operating surplus rose by 13.5% after it had contracted by 5.8% in 2020. Gross operating surplus added 6.5 percentage points to nominal GDP growth, following a negative contribution in 2020 (see Chart 3.4).

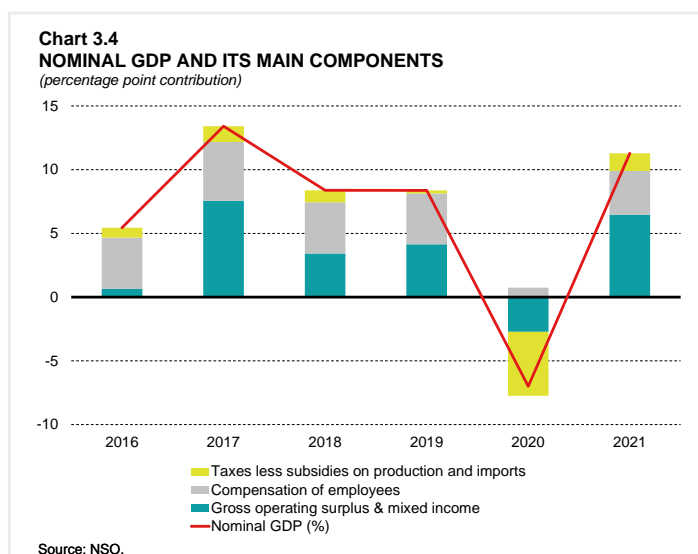
Almost all sectors registered an increase in their gross operating surplus when compared with a year earlier. The largest increase in absolute terms was recorded in the transportation and storage sector, and in the information and communication sector. This was followed by the sector comprising accommodation and food services sector and the arts, entertainment and recreation sector. Conversely, the sector comprising administrative and support service activities and to a smaller degree, the agriculture sector, posted a decrease in operating profit during 2021.

In 2021, subsidies on production and imports were broadly unchanged from a year earlier, since the Wage Supplement Scheme remained operational for most of 2020. On the other hand, due to the recovery in economic activity, taxes on production and imports rose. As a result, 'net taxes on production and imports' increased, though they remained below their level in 2019.

Industrial production⁵

Industrial production declined by 0.5% in 2021 following a decrease of 0.2% in 2020 (see Table 3.4). Industrial production fell strongly on an annual basis in the first quarter of the year, partly due to base effects and also because of a weak demand and supply-chain disruptions brought about by the pandemic. Output then increased in the second quarter and was broadly unchanged in the third quarter, before it fell again in the last three months of the year.

The small contraction in output reflected lower production in the manufacturing sector. By contrast, production in the energy sector – which excludes energy generated abroad and imported through the interconnector – increased. It also rose in the mining and quarrying sector.



⁵ 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. Industrial production measures the volume of output without taking into account input costs. The sectorial coverage also differs, as industrial production data include the output of the energy sector, as well as mining and quarrying.

Table 3.4**INDUSTRIAL PRODUCTION⁽¹⁾***Percentages; annual average percentage changes*

	Shares	2019	2020	2021
Industrial production	100.0	1.2	-0.2	-0.5
Manufacturing	87.1	0.8	-0.9	-0.9
<i>Of which:</i>				
Food products	15.4	-5.6	-1.3	-11.8
Repair and installation of machinery and equipment	7.9	7.9	-16.9	0.1
Basic pharmaceutical products and pharmaceutical preparations	7.3	-12.0	33.4	5.4
Printing and reproduction of recorded media	7.3	12.0	18.2	-11.7
Beverages	5.6	1.0	-21.2	12.6
Rubber and plastic products	5.4	-5.3	-1.2	1.2
Computer, electronic and optical products	5.0	-6.4	3.4	1.5
Energy	12.5	4.8	1.5	1.5
Mining and quarrying	0.5	8.3	-14.2	6.6

Sources: NSO; Eurostat.

⁽¹⁾ The annual growth rates of the industrial production index are averages for the year based on working-day adjusted data. The annual growth rates of the components are based on unadjusted data.

The volume of production in the manufacturing sector, which has the largest weight in the index of industrial production, fell by 0.9% in 2021, following the same rate of decline in 2020.

The decline in manufacturing output was driven by a fall in the production of food products. This was followed by lower output by firms that print and reproduce recorded media. Activity also fell in smaller sectors such as those that manufacture certain non-metallic mineral products, chemicals and chemical products and electrical equipment. These falls offset increases in most other economic sectors.

Across the larger sectors, such increases were most significant among firms that produce beverages and pharmaceutical products. Small increases were also reported among firms that produce computer, electronic and optical goods as well as rubber and plastic products. Production also rose across smaller sectors, notably those specialising in textiles and wearing apparel, wood products as well as motor vehicles, trailers and semi-trailers. Firms that produce “other manufacturing” products – which include medical and dental instruments, toys and related products – also reported higher activity.

Data on manufacturing sales point to an increase in turnover of 4.8% in 2021, following a contraction of 0.5% in 2020.⁶ This rise in turnover reflects higher sales in both the domestic and non-domestic market.

Construction

In 2021, the number of permits issued for the construction of residential dwellings continued to decline from the record high levels issued in the years prior to the pandemic but remained slightly above their historic average. By contrast, permits for commercial buildings increased.

National accounts data indicate a pick-up in construction activity, with the annual rate of growth of GVA more than doubling compared to that of 2020 and investment broadly returning to pre-pandemic levels. The increase in investment was driven by non-residential investment as the recovery in residential investment was modest, leaving the latter below its pre-pandemic level. Jobsplus data for the first nine months of the year show a rise in full-time employment when compared to the corresponding period of 2020, with job creation driven entirely by the private sector.

⁶ Data on manufacturing sales are sourced from Eurostat.

Construction sector shows signs of a further pull back towards historic levels

The number of permits for residential units issued by the Planning Authority continued to decrease. In 2021, such permits declined for the third consecutive year, reaching the lowest level since 2016. Permits issued stood at 7,578, down from 7,837 in the previous year and from 12,485 in 2019 (see Table 3.5). That said, this remains above the historic average of 7,061.

The overall decline in the number of permits issued in 2021 was largely on account of lower permits for apartments, followed by a small decrease in permits for terraced houses. These offset an increase in the number of permits issued for maisonettes and other property categories. Despite a drop of 4.2% in the number of permits issued for apartments, this dwelling category remained by far the largest, accounting for 85.1% of total residential permits issued in 2021.

In contrast to residential dwellings, the number of development permits for commercial buildings increased by 3.1% in 2021, following a decline of 22.7% in the preceding year. In 2021, 2,770 commercial permits were issued, slightly above the 2,687 permits approved in 2020. This compares with 3,474 permits issued in 2019 and is in-line with the historic average of 2,734.

During the year under review, construction investment increased by 3.7% in real terms, broadly reversing the 2020 decrease. The latest increase was largely driven by growth in non-dwelling investment, which rose by 4.5% after expanding by 7.5% in the preceding year. Following the latest increase, non-residential investment stood around a tenth higher than its 2019 level. Residential investment grew by 2.1% in the year under review, following a contraction of 21.3% in 2020, thus remaining well below pre-pandemic levels.

GVA in the construction sector increased by 5.8% following an increase of 2.0% in the preceding year (see Table 3.6). Its share in GVA for the total economy declined slightly.

Jobsplus data for the first nine months of 2021 show that the number of persons employed on a full-time basis in the construction sector rose by 942 or 6.3%, compared with the same period of the previous year (see Table 3.6). This followed a 12.4% increase in 2020. Private sector employment in this sector increased by 6.8%, offsetting a decrease in employment within the public sector. The construction sector's share in the total gainfully occupied population increased to 6.7%, from 6.4% in 2020. Growth in headcount averaged 6.3% between January and September 2021, higher than that in the economy as a whole.

Table 3.5
PERMITS ISSUED FOR THE CONSTRUCTION OF DWELLING UNITS BY TYPE

	2016	2017	2018	2019	2020	2021
Apartments	6,316	7,762	11,211	10,726	6,735	6,451
Maisonettes	706	852	1,166	1,226	727	738
Terraced houses	297	301	396	402	299	290
Other	189	91	112	131	76	99
Total	7,508	9,006	12,885	12,485	7,837	7,578

Source: Planning Authority.

Table 3.6
CONSTRUCTION ACTIVITY INDICATORS⁽¹⁾

	2018	2019	2020	2021
Real GVA (EUR millions)	427.8	489.6	499.2	528.1
Share in total economy GVA (%)	3.9	4.2	4.7	4.5
Total employment	11,893	13,316	14,965	15,907
of which private employment	11,821	12,686	14,373	15,355
Share in total gainfully occupied population (%)	5.7	6.0	6.4	6.7

Source: NSO.

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

According to national accounts data for the full year, compensation of employees in the sector increased by 10.3%, following a 15.1% increase in 2020.

The labour market⁷

Employment grows at a slower pace

During the first three quarters of 2021, employment expanded at an average annual rate of 2.0% compared to the 3.5% recorded during the corresponding period of 2020 (see Table 3.7). Employment growth was lower than its 2003-2021 average of 3.2% (see Chart 3.5). This mostly reflected a year-on-year fall in employment in the first quarter of 2021 resulting from the impact of the pandemic. Since then, employment levels recovered. The annual rate of change in employment during the second and third quarters of the year was close to the average since 2003. Indeed,

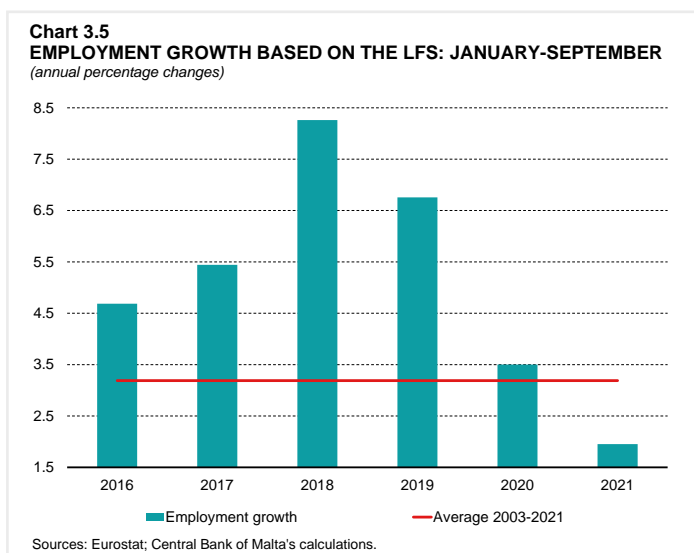


Table 3.7

LABOUR MARKET INDICATORS BASED ON THE LFS⁽¹⁾

Persons; annual percentage changes

	2020 (revised) Jan.-Sep.	2021 Jan.-Sep.	Annual change %
Labour force	272,900	276,300	1.2
Employed	261,100	266,200	2.0
<i>By type of employment:</i>			
Full-time	228,900	236,300	3.2
Part-time	32,300	29,900	-7.3
Unemployed	11,800	10,100	-14.1
Activity rate (%)	77.0	77.4	
Male	85.2	85.5	
Female	67.8	68.1	
Employment rate (%)	73.7	74.5	
Male	81.5	82.1	
Female	64.7	65.8	
Unemployment rate (%)	4.3	3.7	
Male	4.2	3.9	
Female	4.5	3.4	
Actual hours worked (per week)	33.7	34.0	

Sources: NSO; Eurostat.

⁽¹⁾ Labour force figures are based on averages for the first three quarters published by Eurostat and are rounded to the nearest 100 persons. Growth rates reported in this Table are derived from Eurostat period averages.

⁷ 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 based on definitions set by the International Labour Organization (ILO) and Eurostat; and administrative records compiled monthly by Jobsplus, according to definitions established by domestic legislation on employment and social security benefits.

the employment level in the third quarter stood around 5% higher than that recorded in the same quarter of 2019 (before the pandemic).

Meanwhile, the number of unemployed persons fell by around 14% on the same period of the previous year. The decline in the number of jobless persons partly reflected the effectiveness of government measures during the pandemic to stem job losses. In particular, feedback collected by the Bank from industry indicates that the Wage Supplement Scheme was instrumental in limiting redundancies. The decrease in the number of unemployed persons was also supported by the re-opening of the economy during the year, as progress with vaccination enabled a substantial easing of restrictions in most sectors, which lifted demand.

In the first three quarters of 2021, the number of actual weekly hours worked averaged 34.0, above the average of 33.7 hours reported in the same period of 2020. Therefore, firms adjusted to higher demand by increasing both employment and extending working time. However, hours worked are still below pre-pandemic levels.⁸

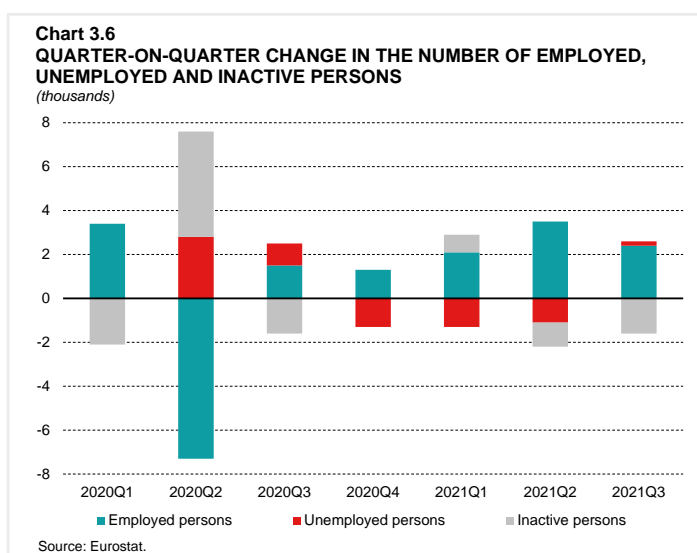
In absolute terms, the rise in the number of employed persons during the first three quarters of the year was driven by full-time jobs, which went up by around 7,400. On the other hand, persons employed on a part-time basis fell by around 2,400. Over the same period, the number of unemployed persons fell by around 1,700, to 10,100 persons according to the LFS.

On average, the labour force expanded by 1.2% in the first nine months of 2021, a slower pace than that registered in the same period of 2020, partly reflecting smaller net migration flows. The activity rate went up by 0.4 percentage point on a year earlier, to 77.4%, exceeding the euro area average of 73.6%.⁹ The male activity rate rose by 0.4 percentage point to 85.5%, standing higher than the euro area average of 78.4%. The female activity rate edged up by 0.3 percentage point to 68.1% but stood lower than the 68.8% average for the euro area.

Meanwhile, the overall employment rate rose by 0.8 percentage point to 74.5% in the first three quarters of 2021, higher than the 67.7% registered in the euro area.¹⁰ The female employment rate registered the strongest increase, gaining one percentage point to reach 65.8%, thus remaining above the euro area average of 63.0%. The male employment rate rose by 0.7 percentage point to 82.1% and remained well above the average rate of 72.4% recorded for the euro area.

By the third quarter of 2021, the activity and employment rates stood at 78.0% and 75.1%, respectively, both above their pre-pandemic level.

Given the various adjustments in containment measures since the onset of the pandemic in 2020, the annual percentage changes could mask the actual impact of the recovery from COVID-19 on the labour market. This impact is more visible when looking at quarter-on-quarter developments.



⁸ Actual hours refer to the number of hours actually spent at the place of work during the reference week for the main job.

⁹ 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.

¹⁰ 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.

The labour force – which is composed of employed and unemployed persons – increased consistently in quarter-on-quarter terms during the year, mostly driven by higher employment (see Chart 3.6). On the other hand, the number of jobless people declined in the first two quarters of the year, before rising marginally during the third quarter. Meanwhile, the number of inactive persons rose slightly in the first quarter of 2021, possibly reflecting the reinstatement of broad containment measures during that quarter, before falling in the following two quarters.

In the first three quarters of 2021, actual hours worked averaged 34.0 per week, which is higher than the number of hours worked in the previous year, but lower than the 36.3 actual weekly hours reported for the same period during 2019 (pre-pandemic).

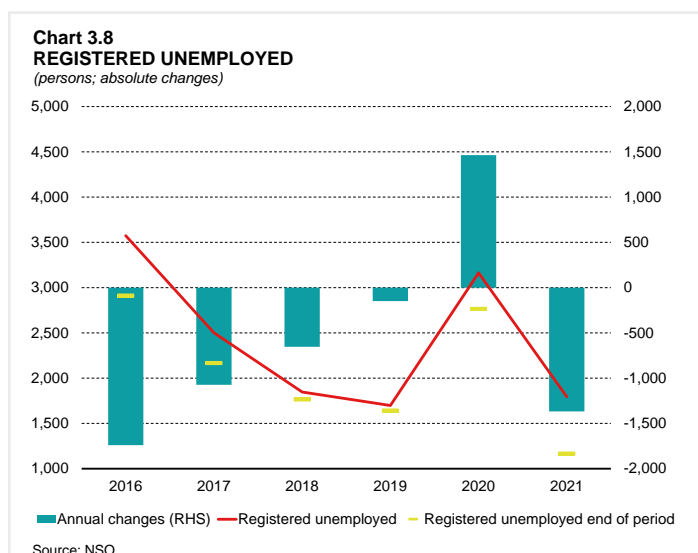
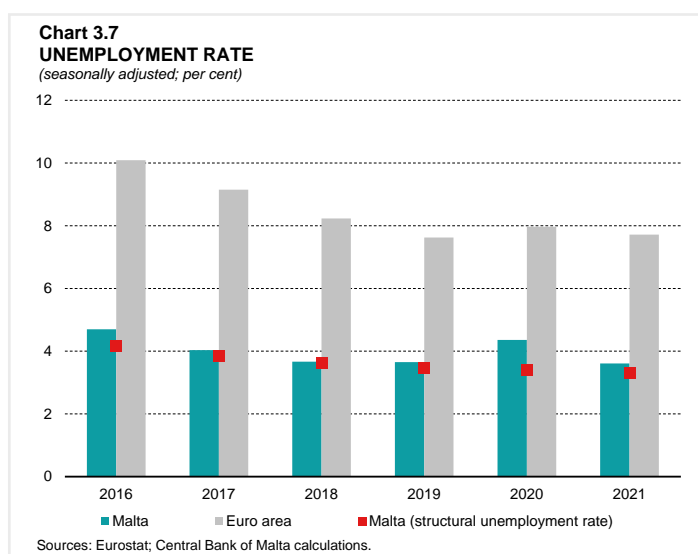
Unemployment rate edged down

The LFS unemployment rate averaged 3.7% during the first three quarters of 2021, compared to 4.3% in the same period of 2020 (see Table 3.7). Nevertheless, it remained well below the average rate for the euro area, which stood at around 8% in 2021, and also well below Malta's historical average.

The seasonally-adjusted unemployment rate published by Eurostat – which takes into account LFS data up to the third quarter as well as more recent administrative data up to the end of 2021 – averaged 3.6% in 2021, lower than the average of 4.4% recorded in 2020 (see Chart 3.7).

The unemployment rate stood slightly below the Bank's estimate of the structural measure of 3.9% for 2021.¹¹

Administrative data also show a decline in the number of registered unemployed persons during 2021. According to Jobsplus data, on average, the number of unemployed persons fell by 1,367 persons over 2020, to 1,795, though still remaining slightly above the average level for 2019 (see Chart 3.8).¹²

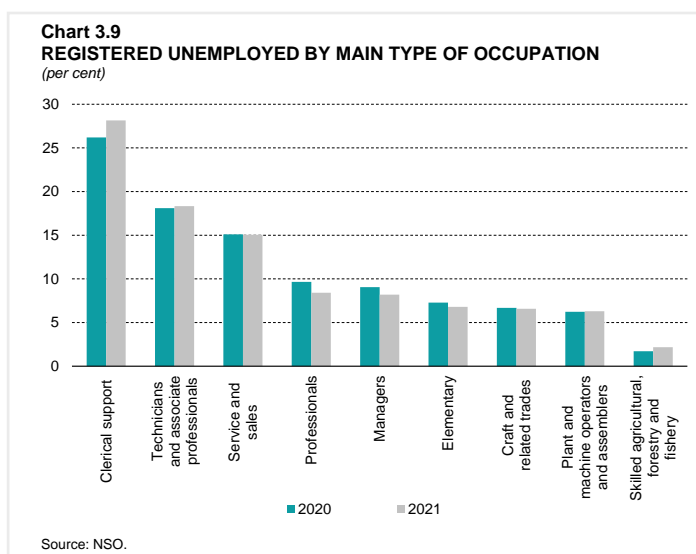


¹¹ The structural unemployment rate in this chapter refers to the non-accelerating inflation rate of unemployment (NAIRU), that is, the unemployment rate that is consistent with stable inflation. This measure of the unemployment rate is based on an unobserved components model as described in Ellul, R., (2019). "An Unobserved Components Model for potential output in Malta", Article published in the *Quarterly Review* 2019:2, pp. 17-21.

¹² The annual number of registered unemployed is based on the average of the total registered unemployed published by NSO on a monthly basis.

On a month-on-month basis, the number of jobless persons on the unemployment register fell continuously between January and December 2021, with the strongest month-on-month falls registered in May and June. The number of registered unemployed stood at 1,167 in December 2021, compared to 2,765 at the end of 2020.

During 2021, on average, the registered unemployed fell across all age cohorts. The largest decrease was observed among those aged between 30 and 44, which fell by 488 persons, to 553. This was closely followed by those aged 45 and over which fell by 452 persons to 827. The 25-29 age cohort fell by 213 persons to an average of 136.



In terms of duration, the decline in the number of unemployed reflected a fall in both short-term (unemployed for less than a year) and long-term unemployed. The largest decline was among those who were unemployed for less than 21 weeks, which fell by more than 1,000 persons. This was followed by those unemployed between 21 to 52 weeks, which fell by around 200 persons, and by those unemployed for more than a year which fell by almost 70 people.

During the year under review, over a fourth of those on the unemployment register were looking for clerical support work and almost a fifth registered for the post of technician or associate professional. The third most sought-after occupation category was that of service and sales, with this category selected by 15.1% of persons on the unemployment register. Managerial and professional occupations each accounted for around 8% of requested jobs (see Chart 3.9). Elementary occupations as well as those related to crafts and related trades, operating and assembling plant and machinery, and roles in agriculture and fisheries attracted less interest.

Although unemployment decreased in all occupation categories compared to 2020, the largest decline in absolute terms was recorded among unemployed persons interested in clerical support work, in the role of technician or associate professional and in services and sales work. Persons expressing a preference for such occupations accounted for more than half of the overall decrease in registered unemployment during 2021.

Compared to 2020, there was a larger share of unemployed persons interested in clerical support work. The share of persons looking for work in agriculture and as technicians and associate professionals also rose. The shares of the rest of the occupations decreased, in particular professionals and managers.

Business and consumer surveys

Economic sentiment rises above its long-term level in 2021

During 2021, the European Commission's Economic Sentiment Indicator (ESI) for Malta averaged 105.2, up from 81.5 in 2020 and even exceeding its pre-pandemic level of 102.3 (see Table 3.8). This may reflect the slightly lower level of COVID-19 restrictions compared to 2020 as well as a further increase in vaccination rates achieved in the second half of the year.^{13,14}

¹³ 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.

¹⁴ The ESI summarises developments in confidence in five surveyed sectors (industry, services, construction, retail and consumers).

Table 3.8
SENTIMENT INDICATOR BY SECTOR

Annual average; absolute change

	2019	2020	2021	Change	2021			
					Mar.	June	Sep.	Dec.
Economic sentiment indicator	102.3	81.5	105.2	23.7	94.5	113.0	111.1	97.5
Services confidence indicator	20.7	-24.9	13.5	38.5	-11.1	36.7	32.8	-9.0
Industrial confidence indicator	-6.7	-25.1	2.7	27.8	-1.1	8.7	0.1	-8.7
Retail trade confidence indicator	4.2	-31.0	-11.4	19.5	-38.2	-8.7	21.8	35.9
Construction confidence indicator	26.2	-5.7	6.6	12.3	-8.5	8.9	12.5	6.4
Consumer confidence indicator	4.5	-5.6	3.0	8.6	-7.9	6.0	7.4	-0.3
Employment expectations indicator	102.3	85.9	104.1	18.2	88.5	110.0	117.7	104.4
Industry	12.8	-12.5	14.7	27.2	-8.1	21.4	8.6	21.2
Services	17.5	-2.4	24.6	26.9	-9.9	37.3	55.2	26.1
Construction	32.6	-5.2	12.4	17.6	-5.0	6.1	19.0	13.2
Retail	4.7	-11.6	3.7	15.3	14.5	6.0	17.7	-3.4
ESI demeaned	2.3	-18.4	5.2	23.6	-5.5	13.0	11.1	-2.5
EI demeaned	2.7	-14.0	4.6	18.6	-11.8	10.8	18.6	5.1

Source: European Commission.

The ESI reached a 3-year high of 116.3 in April 2021, as active cases of COVID-19 dropped and containment measures eased following a month-long shutdown in March. Sentiment remained relatively strong during the second and third quarters of the year, reflecting the recovery in economic activity and the stable pandemic situation. Although restrictions on activity remained lower compared to the same period of 2020, news about a more contagious COVID-19 variant and rising infections weighed down on sentiment in the last quarter of 2021. In fact, by December, the ESI decreased to 97.5, slightly below the long-term average of around 100.0 (see Chart 3.10).

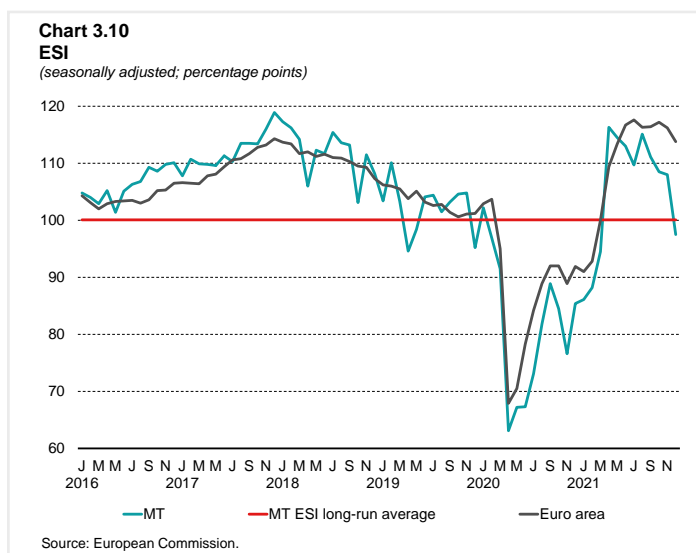


Table 3.8 presents the annual average reading for each sector included in the ESI and the absolute change relative to 2020.

During 2021 as a whole, positive sentiment was registered across all sectors bar the retail sector, though even here, sentiment stood less negative when compared with 2020. The most positive readings were recorded in the services sector, followed by construction. The overall ESI indicator stood below that in the euro area, which averaged 110.1. This reflects weaker sentiment in the domestic retail sector and in industry.

While sentiment improved in all sectors in 2021, the strongest increase was recorded in the services sector, followed by industry and the retail sector.

When accounting for the variation in the weights assigned to each sector in the overall index, the amelioration in the ESI relative to 2020 was largely driven by developments in industry and in the services sector.¹⁵

¹⁵ Weights are assigned as follows: industry 40%; services 30%; consumers 20%; construction 5%; and retail trade 5%.

Furthermore, the evolution of sentiment in industry largely explains why the overall ESI stood above its long-term average during the year under review (see Chart 3.11). Notwithstanding the amelioration in sentiment during 2021, the contribution of the services and retail sectors remained negative, though by a smaller magnitude, relative to the previous year.

Confidence in the services sector turns positive¹⁶

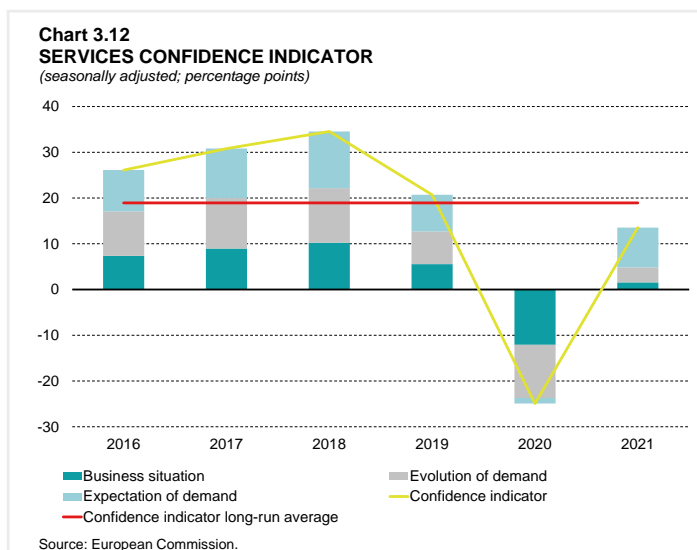
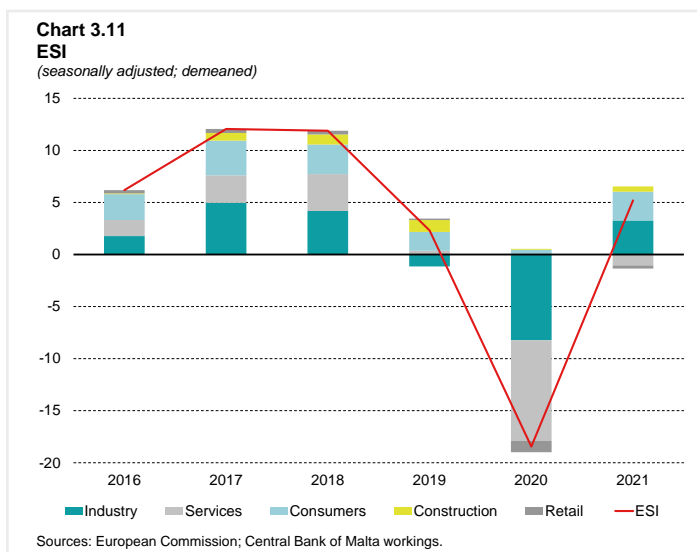
Confidence within the services sector stood at 13.5, up from -24.9 in the preceding year (see Chart 3.12). Firms' assessment of demand and of the business situation over the past three months were the main contributors to the increase, although respondents' demand expectations also edged up. Notwithstanding this development, confidence in the services sector remained somewhat below its long-term average of 18.9.

Sentiment in services was positive during most months, except during the first quarter of the year and in December. The latter likely reflected the uncertain outlook for tourism-related sectors as well as the strong increase in COVID-19 infections, which in turn led to the re-introduction of mandatory face masks in public.

Supplementary data indicate that the assessment of prevailing employment conditions was mildly negative in the year under review. By contrast, employment expectations turned strongly positive in 2021. At the same time, and in contrast to 2020, on balance, firms expected their selling prices to increase in the three months following the survey. Indeed, selling price expectations reached a record high as international price pressures began to affect local firms.

Industrial confidence indicator increases above its long-term mean¹⁷

The index representing sentiment among manufacturing firms reached 2.7, from -25.1 in 2020, thus rising above its long-term mean of -3.9 (see Chart 3.13). Higher sentiment largely reflected an increase in produc-



¹⁶ 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.

¹⁷ 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).

tion expectations for the months ahead. Furthermore, by contrast to the year 2020, firms now assessed their stocks of finished goods to be well below normal levels.¹⁸ At the same time, a smaller share of respondents deemed order book levels to be below normal.

After standing firmly negative in the first two months of the year, sentiment in industry was mostly positive before weakening again to -8.7 in December.

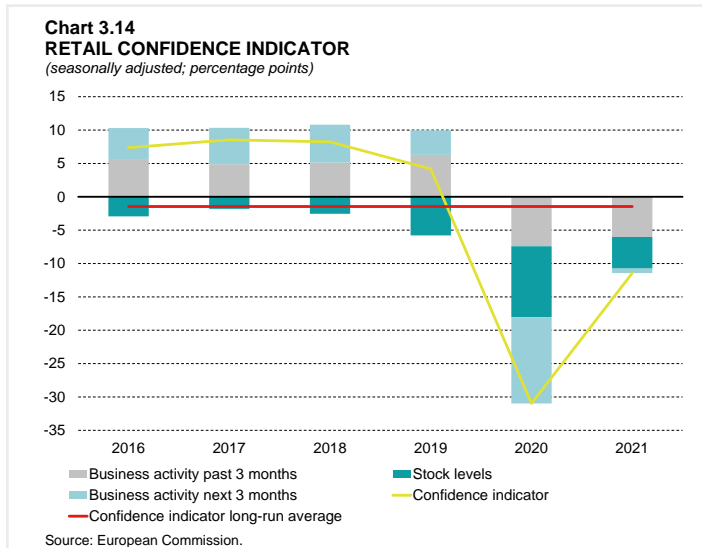
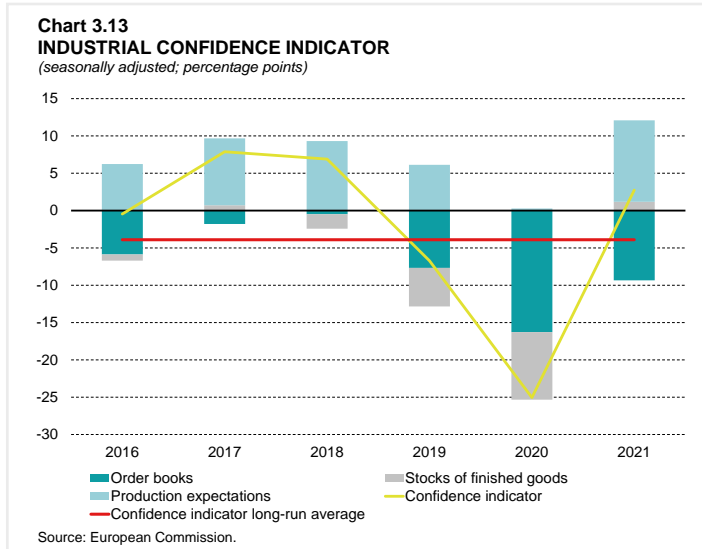
Supplementary data indicate that employment expectations and selling price expectations turned positive in 2021, with the latter reaching a record high.

Confidence in the retail sector improves but remains in negative territory¹⁹

The retail confidence indicator stood at -11.4 in 2021, up from -31.0 a year earlier but below its long-term average of -1.5 (see Chart 3.14). This increase was largely driven by business activity expectations. At the same time, on balance, a significantly smaller share of respondents reported above normal stock levels compared to 2020. The assessment of activity in recent months also improved but to a much lesser extent compared to the other components of the index.

Sentiment in this sector was strongly negative in the first months of the year but improved mid-year, before turning positive in August with the index recovering to 35.9 in December.

Additional survey data indicate that, on balance, the net share of retailers anticipating order expectations to be below normal levels broadly halved compared to 2020. Meanwhile, employment prospects turned positive and price expectations grew strongly, reaching unprecedented levels.



¹⁸ 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 3.13.

¹⁹ 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.

Confidence indicator in construction turns positive²⁰

The sentiment indicator for the construction sector averaged 6.6 during 2021, up from -5.7 in the preceding year. Following this increase, confidence remained above its long-term average of -9.8 (see Chart 3.15). Both order book levels and employment expectations contributed to the rise in confidence during the year, with the latter playing a more significant role.

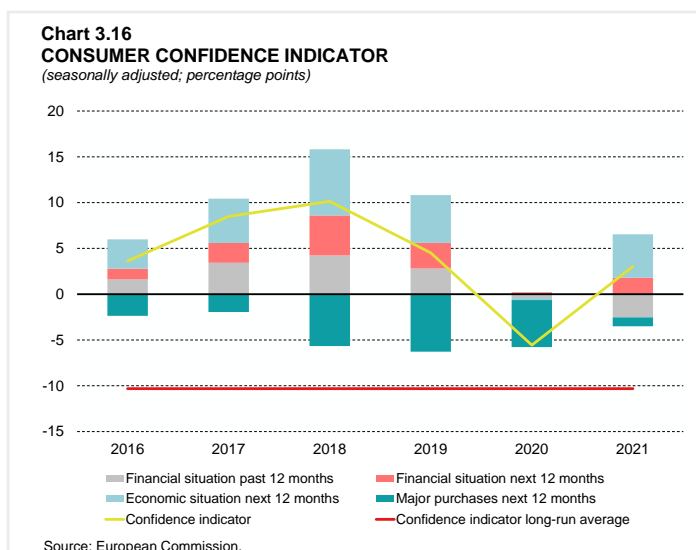
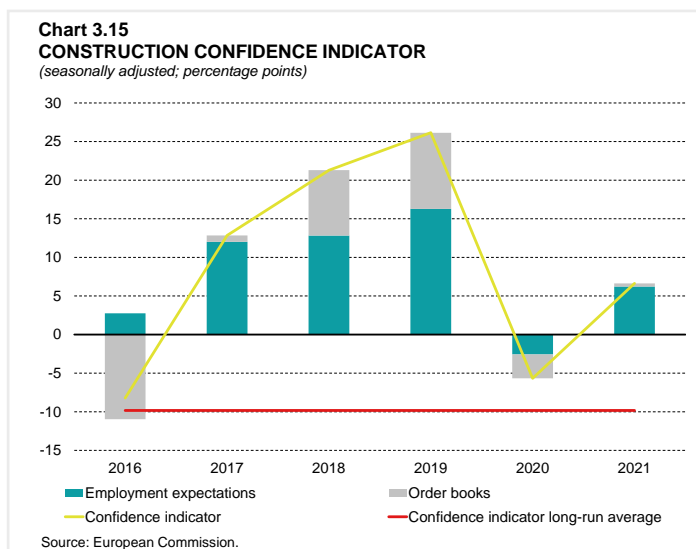
Additional survey data show that on average, during 2021, respondents anticipated selling prices to increase for the months ahead, which contrasts with 2020 when on balance respondents anticipated a decline. Labour shortages remained among the most frequently cited factors limiting production, followed by financial constraints.

Consumer confidence indicator edges up²¹

The consumer confidence index rose to 3.0, up from -5.6 in 2020. Sentiment has continued to stand above its long-term average of -10.3 (see Chart 3.16).

The rise in sentiment was driven by the forward-looking components, with the strongest increase being recorded in consumers' expectations of the general economic situation over the next 12 months. At the same time, a smaller share of households signalled that they intended to make fewer major purchases in subsequent months. Expectations about their financial situation over the coming year also improved, but the assessment of their financial situation over the last 12 months stood more negative.

Additional survey information suggests that on balance respondents expected unemployment to decline in the following 12 months. This contrasts with 2020, when unemployment was expected to increase. Meanwhile, savings expectations increased compared to a year earlier. The survey also reveals that both inflation perceptions and expectations stood more positive on average, relative to 2020.



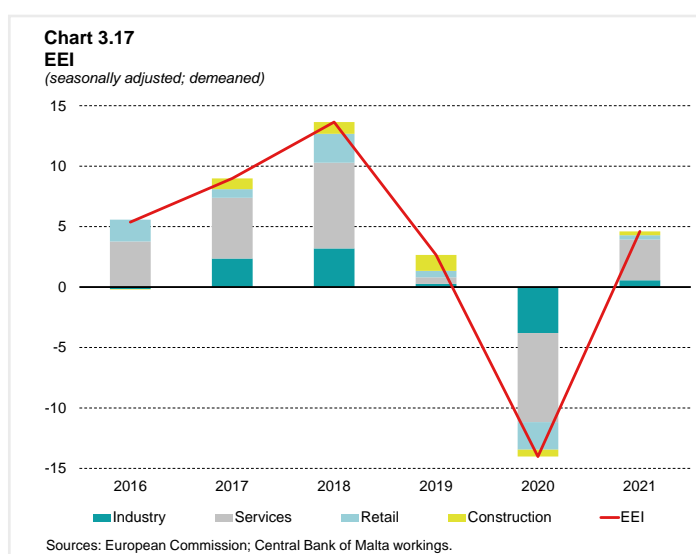
²⁰ The construction confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to two survey questions, namely those relating to order books and employment expectations over the subsequent three months.

²¹ 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 European Commission.

Employment Expectations Indicator increases substantially

The Employment Expectations Indicator (EEI) – which is a composite indicator of employment expectations in industry, services, retail trade and construction – ameliorated significantly.²² It averaged 104.1, compared with 85.9 a year earlier, and stood above its long-term average of around 100.0.

Employment expectations were positive across all sectors, particularly in industry and the services sector. When accounting for the variation in the weights assigned to each sector in the overall index, it appears that the increase in expectations relative to 2020 was largely driven by developments in the services sector and, to a lesser degree, industry (see Chart 3.17). Employment expectations in the retail and construction sectors also contributed to the increase in the EEI but in a more limited way.



Economic uncertainty increases towards year-end

Over the period May to December 2021, the European Commission's Economic Uncertainty Indicator (EUI) for Malta averaged 21.3, above the euro area average of 15.7.²³ During this period, uncertainty exceeded that in the euro area in all sectors, except in industry (see Table 3.9).

Table 3.9
ECONOMIC UNCERTAINTY INDICATOR BY SECTOR

Annual average; absolute change

	2021	2021			
	May-Dec.	Mar.	June	Sep.	Dec.
Euro area	15.7	21.8	14.1	15.1	18.1
Industry	28.2	32.6	25.3	28.0	30.5
Services	17.5	30.5	16.7	16.7	19.6
Consumer	-15.8	-16.8	-16.8	-16.3	-12.3
Construction	14.0	17.2	16.4	11.7	12.5
Retail	32.6	42.3	30.1	31.4	36.4
Malta⁽¹⁾	21.3	-	32.2	21.0	36.9
Industry	21.0	-	38.1	28.6	51.4
Services	32.2	-	47.3	28.2	42.8
Consumer	-3.5	-9.7	-5.1	-8.7	-0.9
Construction	30.1	-	19.9	16.8	12.8
Retail	48.8	-	56.5	40.6	60.8

Source: European Commission.

⁽¹⁾ Data for Malta is only available from May 2021.

²² The EEI is based on question 7 of the industry survey, question 5 of the services and retail trade surveys and question 4 of the construction survey, which gauge the respondent firms' expectations as regards changes in their total employment over the next three months. Before being summarised in one composite indicator, each balance series is weighted on the basis of the respective sector's importance in overall employment. The weights are applied to the four balance series expressed in standardised form. Further information on the compilation of the EEI is available in European Commission (2020). *The Joint Harmonised EU Programme of Business and Consumer Surveys User Guide*.

²³ The EUI is made up of five balances (in percentage points) which summarise managers'/consumers' answers to a question asking them to indicate how difficult it is to make predictions about their future business/financial situation. The series are not seasonally-adjusted. The five balance series are summarised in one composite indicator using the same weights used to construct the ESI. The questions asked correspond to Q51 of the industry survey, Q31 of the services survey, Q41 of the retail trade and construction surveys and Q21 of the consumer survey.

Malta's EUI reached a 4-month low in August, when it stood at 4.5, before increasing to 21.0 in September. The index eased thereafter but rose sharply to 36.9 in December, the highest reading recorded so far, possibly reflecting the surge in COVID-19 cases.^{24,25}

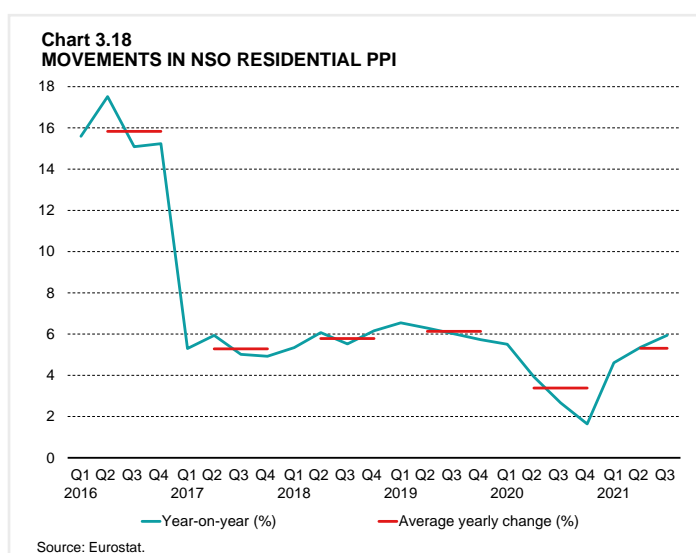
Towards the end of the year, uncertainty increased sharply in all sectors except in the construction sector. By contrast, consumers continued to report that they were able to predict their household's financial situation with relative ease.

Residential property prices

Residential property prices grow at a faster pace

Residential property prices continued to increase during the first three quarters of 2021. 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 5.3% during the first three quarters of the year, following the 3.4% increase recorded in 2020 as a whole (see Chart 3.18).²⁶ House price inflation in Malta was significantly lower than that in the euro area where it averaged 7.2% in the first nine months of 2021.

Residential property prices continued to be supported by several factors, including the low-interest rate environment as well as the various government schemes supporting the property market. Furthermore, property prices were also supported by the enhancement of government support in response to the pandemic. This includes for instance the reduction in tax rate and stamp duty to eligible transfers of immovable property. In particular, the property tax and stamp duty on the first €400,000 of the value of the transfer were reduced to 5.0% and 1.5%, respectively.²⁷ These measures were initially intended for final transfers made before 1 April 2021 but were later extended for promise of sale agreements entered into until 31 December 2021.²⁸ Additionally, the Budget for 2021 extended or introduced more favourable terms on some existing schemes supporting this sector.²⁹



²⁴ Data on consumer uncertainty in Malta became available in October 2020, while data for industry, services, retail and construction became available in May 2021.

²⁵ In January 2022, the EUI fell to 25.1, largely reflecting lower uncertainty in industry, followed by the construction sector, and to a lesser extent, the retail sector.

²⁶ 'Apartments are defined as dwellings with self-contained rooms or a suite of rooms that have a separate entrance accessible from a common passageway, landing or stairway. This category includes penthouses. '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* 118/2021.

²⁷ These reductions in taxes on property transfers and stamp duty were introduced in terms of Legal Notices 240 and 241 of 2020.

²⁸ Legal Notice 240 was followed by Legal Notice 427 of 2020, Legal Notice 130 of 2021 and Legal Notice 324 of 2021. Legal Notice 241 was followed by Legal Notices 459 of 2020, 129 of 2021 and 325 of 2021.

²⁹ These include the first-time and second-time buyers' schemes, the purchase of vacant property located in Urban Conservation Areas (UCA), purchases of property in Gozo as well as the refund schemes for restoration expenses. Furthermore, the threshold for the duty exemption for first time buyers was increased from €175,000 to €200,000, while that applicable on immovable property donated by parents to their descendants was increased from €200,000 to €250,000. Additional schemes offering tax exemptions on property within UCA, vacant or built in a traditional style were introduced in the Budget for 2022.

Misalignment index suggests house prices were broadly in line with fundamentals in 2021

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.^{30,31} 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 below the level consistent with fundamentals in the first half of 2021, but stood around 0.9% above it in the third quarter (see Chart 3.19).³²

The misalignment index had increased almost continuously since 2017 and turned positive in the last quarter of 2019. It remained positive through the second quarter of 2020, although the extent of misalignment remained modest compared to the pre-crisis housing boom. Following this, the misalignment index stood below the fundamentals for four consecutive quarters, before turning positive in the third quarter of 2021.

The slight overvaluation in the third quarter is driven by the house price-to-inflation ratio and the price-to-cost ratio. Both indicators stood above their long-term averages. The loan borrowing constraint, which is an indicator of the loan-bearing capacity of households, also contributed to the positive misalignment. The housing investment-to-GDP ratio, which is an indicator of overheating, contributed negatively to the index in the third quarter, when the ratio fell below its long-term average. The price-to-hypothetical borrowing volume – that is the affordability indicator – also contributed negatively to the misalignment index, reaching pre-pandemic levels.

Residential property transactions rise³³

NSO data on residential property transactions show that demand in the property market has picked up in 2021 following a drop in the previous year. Indeed, 14,362 final deeds of sale were concluded in 2021, around 30.0% more than a year earlier (see Table 3.10). This follows a drop of 21.1% in 2020. Over 90% of these transactions involved purchases by individuals.

Table 3.10
NSO RESIDENTIAL PROPERTY TRANSACTIONS

	2019	2020	2021	Annual change	
				Abs.	%
Residential transactions					
Promise of sale	11,614.0	11,261.0	15,653.0	4,392.0	39.0
Final deeds of sale	14,019.0	11,057.0	14,362.0	3,305.0	29.9
Transaction value (millions)	2,705.4	2,126.5	3,126.2	999.7	47.0

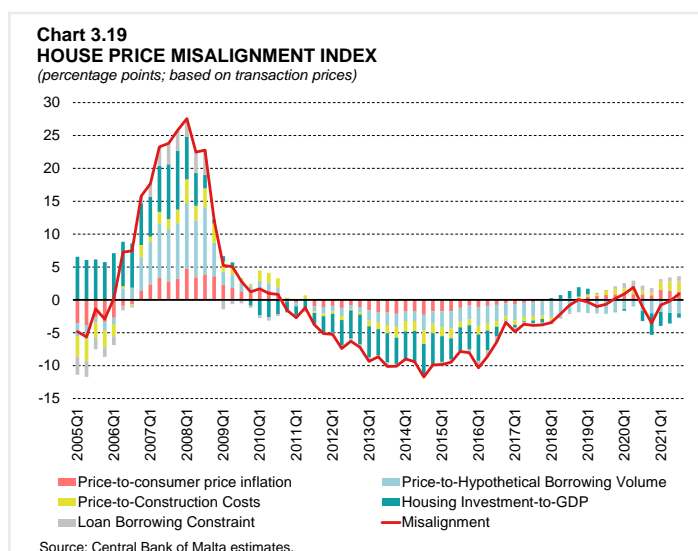
Source: National Statistics Office.

³⁰ 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.

³¹ 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.

³² A separate assessment based on advertised house prices can be found in Gatt, W., Micallef, B. and Rapa, N. (2018). "A macroeconomic model of the housing market in Malta", *Annual Research Bulletin*, Central Bank of Malta, pp. 11-18.

³³ This section is based on NSO *News Release* 020/2022. The data presented cover the following property types: airspace, boathouse, bungalow, farmhouse, flat/apartment, garage, garden, house, maisonette, penthouse, plot of land, semi-detached villa, terraced house, 'terran', urban tenement and villa.



Moreover, at 15,653, the number of promise-of-sale agreements was 39.0% more than the amount registered in 2020. This follows a drop of 3.0% in 2020.

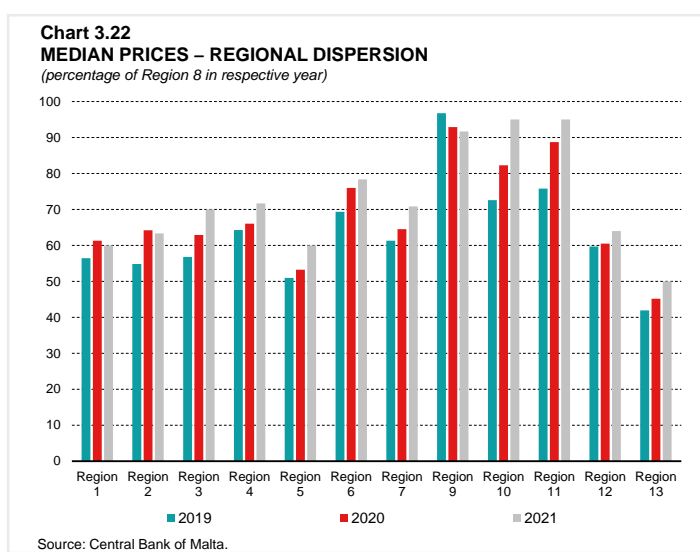
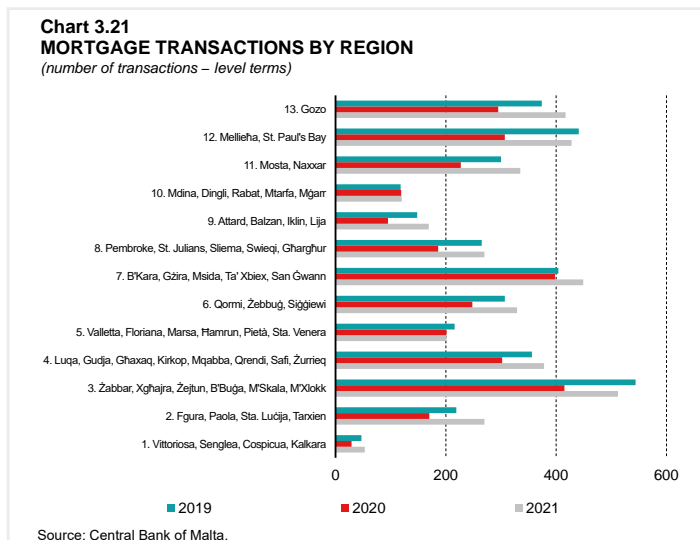
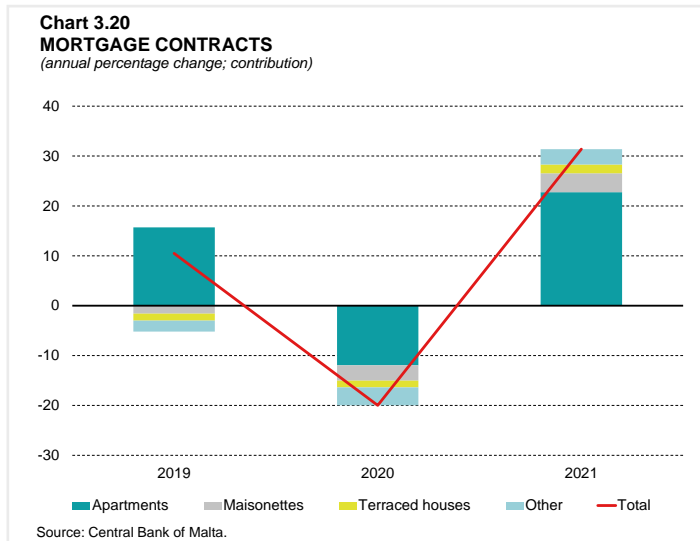
The value of final deeds reached €3,126.2 million, an increase of €999.7 million, or 47.0%, compared to the previous year.

Mortgage transactions also increase³⁴

This Report presents for the first time provisional data on mortgages collected by the Banks. The number of mortgage contracts increased by 31.4% in 2021, after declining by 20.0% in 2020 (see Chart 3.20). All dwelling types contributed to this increase, but the apartments' category – which includes both flats and penthouses – registered the largest increase. This category had recorded the highest contribution to the decline in mortgage transactions in 2020.

In 2021, the highest number of transactions related to properties were located in region 3, followed by region 7. On the other hand, the lowest number of mortgage transactions involved properties located in region 1. Following a decline in mortgage transactions across all regions in 2020, contracts rose sharply in almost all regions in 2021 (see Chart 3.21). The largest increases in absolute terms occurred in regions 12 and 13.

Region 8 has been the most expensive in terms of median prices in recent years. During the year under review, this was followed by regions 10 and 11. The cheapest prices were registered in region 13 (see Chart 3.22). In 2021, almost all regions have approached the median prices transacted in region 8, which indicates that the price dispersion across Malta's property prices has declined.



³⁴ The data used in this section is collected by the Central Bank of Malta from four commercial banks and relates only to properties which have been purchased with a mortgage. It excludes properties that have either been transacted using other means of financing, as well as mortgages that have been refinanced. The property types included are: flats, penthouses, maisonettes, terraced houses, town houses, houses of character, farmhouses, bungalow, and villa. It hence excludes other property types included in the previous section, such as garage, plot of land, etc.

BOX 3: ADVERTISED RENTS IN MALTA¹

Introduction

The private rental market has expanded rapidly over the last decade. Among other factors, this growth was driven by the demand for rental accommodation by foreign workers, evolving trends in the tourism industry, as well as changes in socio-demographic and lifestyle preferences. The introduction of a new legislative framework on 1 January 2020 – the Private Residential Leases Act – was intended to promote the development of the private rented sector by ensuring standards of fairness, clarity and predictability in contractual relations between landlords and tenants. This was possible through the regulation of rental contracts and the introduction of various responsibilities on both landlords and tenants that are overseen by the Housing Authority, which was designated as the regulator of the housing market in Malta.²

As part of its regular assessment of the housing market, in 2017, the Central Bank of Malta started to collect advertised private sector rents on a quarterly basis. Advertised rents are set prior to the negotiation process that takes place between lessors and prospective lessees and thus they can differ from actual contracted rents. Moreover, some segments of the market may be excluded as certain properties are not advertised for rent, which may lead to an incomplete view of the private rental market in Malta. However, in the absence of an index based on contracts, advertised rents may still provide valuable insight on rental price dynamics. In 2020, this dataset was used in a study to develop an advertised rent index using standard hedonic equations to account for observable characteristics such as property type, location, size, and other attributes that have an impact on the price.³ This box provides an update of this study using data until 2021Q4.

Characteristics of the database

The database comprises publicly available quarterly data about residential properties advertised for rent since 2017Q4. Data were collected using big data techniques. Until 2018Q4, the database consisted of solely two housing types – apartments and maisonettes – along with information about the locality in which the property is located and the number of bedrooms. As part of a continuous effort to enrich this database, starting in 2019Q1, this information was supplemented by the collection of data about penthouses and additional localities that were previously not incorporated. In addition, information started being collected on other observable property characteristics besides location and number of bedrooms such as the availability of a garage, garden or pool facilities, proximity to a seafront or availability of a view.⁴ The database incorporates only listings of properties with a monthly rent, thus excluding properties listed with daily prices which are usually intended for short-let purposes.

Following these improvements and a data cleaning process to remove outliers and duplicates, at the end of 2021 the database comprised 46,315 listings made up of apartments, maisonettes, and penthouses (see Chart 1). In 2021, the average number of observations collected per quarter amounted to 4,670, compared to an average of 2,784 listings in 2020.

¹ Prepared by Dr Brian Micallef and Tiziana M. Gauci. Dr Brian Micallef is the Manager of the Economic Research Office at the Central Bank of Malta, whilst Tiziana M. Gauci is a senior Research Economist in the Economic Research Office. The views expressed in this paper are the authors' own and do not necessarily reflect the views of the Central Bank of Malta.

² Further details on this reform are available in the first edition of the Annual Malta Residential Rental Study published by the Housing Authority in 2021.

³ Debono, N., Ellul, R. & Micallef, B. (2020). A hedonic index for private sector rents in Malta, *Central Bank of Malta Research Bulletin* 2020, pp. 5-12.

⁴ Properties classified as having a garage include only those whose access to a garage is included with the rent. A property is classified as having a garden or pool only if such facilities (private or communal) can be enjoyed within the property. Views may include country, town and sea views.

The database captures properties available for rent in different localities and areas across Malta and Gozo. In the empirical analysis, these localities are grouped in ten different clusters to account for the substantial rent heterogeneity that exists among these areas while, at the same time, ensuring enough observations in each cluster. The localities included in each cluster are listed in Table 1. Advertised rents in high-end complexes, which amount to around 2.4% of the database, are classified

separately in cluster J. Around 28% of all properties advertised since 2019Q1 are found in the Northern Harbour area of cluster A mainly comprising Sliema, St. Julian's and Valletta. This is followed by cluster E, which incorporates St. Paul's Bay area (16%) and cluster B, which includes the localities of Gzira, Msida and Ta' Xbiex (12%). Around 3.5% of all properties in the database are in Gozo.

In terms of additional characteristics, apartments constitute the largest proportion of listings (75%), followed by penthouses (14%) and maisonettes (11%).⁵ Most of the properties advertised for rent are two-bedroom (40%) and three-bedroom (43%) properties, respectively. Around 14% of listings have only one bedroom while a very limited number of properties (2%) come with four or more bedrooms.

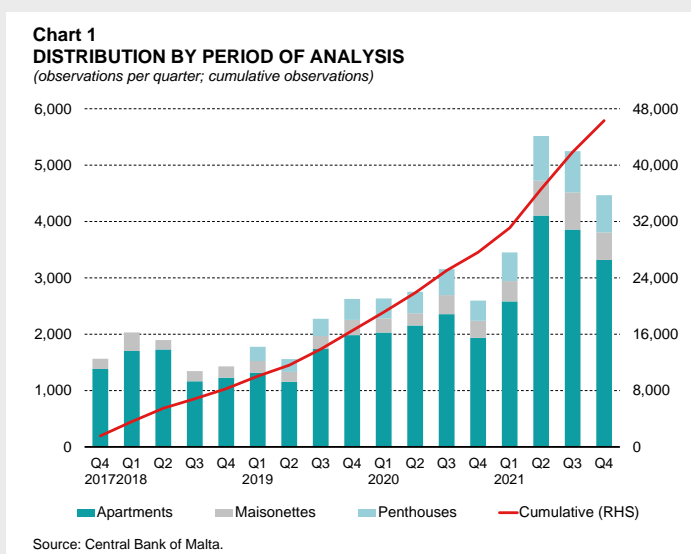


Table 1
LOCALITIES INCLUDED IN EACH CLUSTER

Cluster A	Sliema, St Julian's, Valletta, Paceville, Ta' Ġiorni, The Village
Cluster B	Gzira, Msida, Ta' Xbiex
Cluster C	Ibraġġ, Madliena, Pembroke, St. Andrews, Swatar, Swieqi
Cluster D	Attard, Baħar iċ-Ċagħaq, Balzan, Bidnija, Birguma, Gharghur, Iklin, Lija, Magħtab, Mosta, Naxxar, Salina, San Pawl tat-Tarġa
Cluster E	Buġibba, Burmarrad, Manikata, Mellieħa, Qawra, St Paul's Bay, Wardija, Xemxija
Cluster F	Birkirkara, Blata l-Bajda, Fleur de Lys, Floriana, Guardamangia, Ħamrun, Kappara, Luqa, Mriehel, Pietà, Qormi, San Ġwann, Santa Venera
Cluster G	Birżebbuġa, Cospicua, Fgura, Għaxaq, Gudja, Kalkara, Marsa, Marsascala, Marsaxlokk, Paola, Santa Luċija, Senglea, Tarxien, Vittoriosa, Xgħajra, Żabbar, Żejtun
Cluster H	Baħrija, Dingli, Kirkop, Mdina, Mġarr, Mqabba, Mtarfa, Qrendi, Rabat, Safi, Siġġiewi, Żebbiegħ, Żebbug, Żurrieq
Cluster I	Gozo – Fontana, Għajnsielem, Għarb, Għasri, Kerċem, Marsalforn, Mġarr, Munxar, Nadur, Qala, San Lawrenz, Sannat, Santa Luċija, Victoria, Xagħra, Xewkija, Xlendi, Żebbug
Cluster J	Fort Cambridge, Fort Chambray, Pender Place, Portomaso, Tigne Point

Source: Central Bank of Malta.

Note: All properties classified in Cluster H and a number of other smaller localities across Malta were added in 2019Q1.

⁵ Descriptive statistics include the full database and are thus restricted for the period 2019-2021.

In terms of prices, 39% of listings are advertised between €701 and €1,000, followed by 30% whose price ranges between €1,001 and €1,500. The share of listed properties with a monthly rent exceeding €1,500 stands at 20%, while on the other end, only 11% of listings are advertised for €700 or less. After the high-end cluster J, properties in cluster A tend to be the next most expensive in the market while properties for rent advertised in Gozo are on the lower side of the price range.

Properties available for rent that are advertised with access to a garage, garden or pool are quite limited. The number of properties which were advertised as having a garage, garden or pool amounted to 2%, 1% and 2%, respectively of all listings. In comparison, the number of properties advertised as being on, or close to a seafront over the same period amounted to 17% of all adverts while 27% were described as properties which enjoy country, town, or sea views.

Methodology

Five different rental price indices are constructed using alternative methodologies, namely the time dummy variable (TDV) method, the rolling time dummy (RTD) method with a window length of two periods (Q=2) and the average characteristics method chained using the Laspeyres, Paasche and Fisher methods.⁶

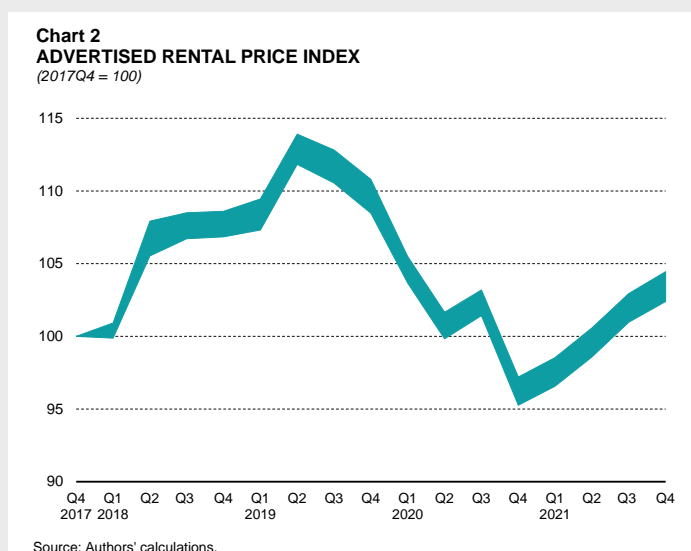
Each of these methodologies is estimated for two sample periods. Estimates using the entire database – including the inclusion of penthouses, cluster H and other small localities, and the availability of other attributes such as garage, garden, pool, seafront, and views – are only available starting from 2019Q1. On the contrary, indices excluding the latter characteristics and features are based on the full sample (i.e., 2017Q4-2021Q4).

Empirical results

Chart 2 shows the development of the advertised rental price index since its inception in 2017Q4. The estimates are based on the full sample (starting in 2017Q4) and consequently, use information only on property type, size, and location. Advertised prices continued to recover in 2021Q4, following the trough reached in 2020Q4, and stand at slightly below the level observed in 2020Q1. However, the index remains substantially lower compared to the pre-COVID peak observed in 2019Q2. Taking the average of the different approaches, advertised rents in 2021Q4 stood around 8.3% lower than the peak reached in 2019Q2.

The index constructed using the full set of characteristics that starts in 2019Q1 follows a similar pattern – it peaks in 2019Q2, reaches a trough in 2020Q4, and recovers thereafter. In this case, the index in 2021Q4 stands around 9.5% lower compared to its peak in 2019Q2.

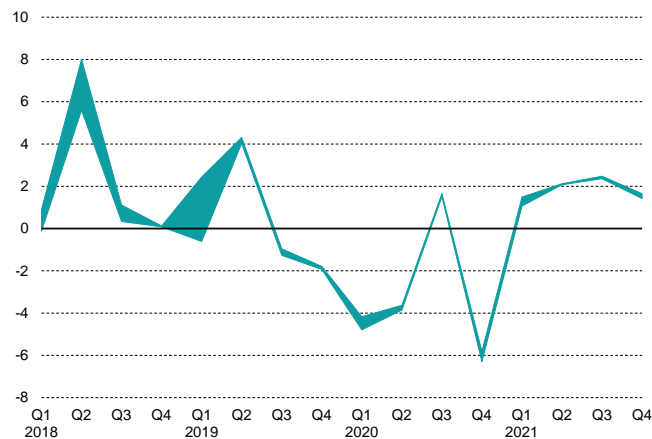
These indices are used to calculate quarterly and



⁶ Additional technical details are available in Debono, N., Ellul, R. & Micallef, B. (2020). A hedonic index for private sector rents in Malta, Central Bank of Malta *Research Bulletin* 2020, pp. 5-12.

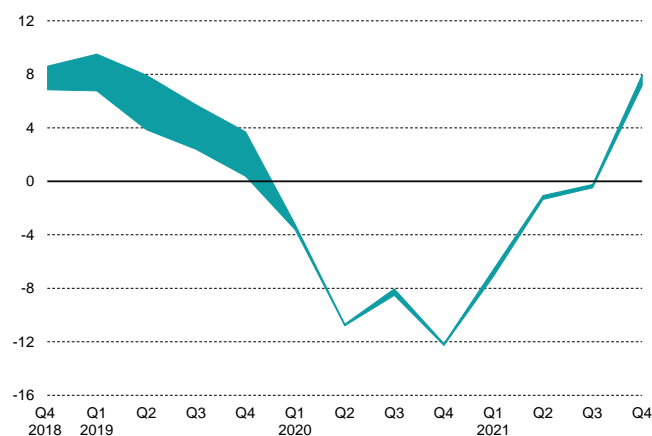
annual growth rates in advertised rents, while controlling for the characteristics of the property.⁷ Chart 3 plots the quarterly changes in the indices. Excluding quarter-on-quarter fluctuations, growth rates were mostly positive in 2018 and early 2019 but turned negative in the second half of 2019 and 2020 especially as the market suffered from the effects of the COVID-19 pandemic. Advertised rents recovered in 2021, with positive quarterly growth rates recorded throughout the year. In 2021Q4, all hedonic approaches indicate that advertised rents increased between 1.4% and 1.6% compared to the previous quarter. The application of the same hedonic methods to the data commencing in 2019Q1 has a similar growth profile but yields somewhat less pronounced increases in rental prices. Under this approach, advertised rents in 2021Q4 were around 1.0% and 1.1% more expensive than in 2021Q3.

Chart 3
QUARTER-ON-QUARTER GROWTH RATE IN ADVERTISED RENTS
(per cent)



Source: Authors' calculations.

Chart 4
YEAR-ON-YEAR GROWTH RATE IN ADVERTISED RENTS
(per cent)



Source: Authors' calculations.

Chart 4 plots the annual growth rates in advertised rents. Growth rates were positive in 2019, albeit on a downward trend, but declined sharply in 2020. Advertised rents started to recover in 2021 but, in annual terms, the growth rate only turned positive towards the end of the year. In 2021Q4, advertised rental prices were between 7.2% and 8.0% higher than the corresponding quarter in 2020. When taking into consideration the additional characteristics first introduced in 2019Q1, advertised rents in 2021Q4 stood between 6.7% and 7.1% higher compared to a year earlier.

⁷ The inclusion of penthouses, cluster H and other small localities in 2019Q1 implies that the house characteristics in 2017 and 2018 are different to those in 2019 and onwards. Inevitably, this has some implications on the growth rates calculated by the average characteristics method, which in itself calculates the price of the 'average' house based on house characteristics. In particular, these improvements in data collection cause some discrepancy among the different methods when calculating (i) the quarterly change in prices between 2018Q4 and 2019Q1 and (ii) the yearly price changes between 2018 and 2019. The calculation of such growth rates under the Paasche methodology are particularly on the high side because this method divides the average house characteristics of time t+1 estimated at time t+1 by the average house characteristics of time t estimated at time t. It also follows that the Fisher index, being the geometric mean of the Laspeyres and Paasche indices, is also slightly on the high side when compared to the Laspeyres or the time dummy methods.

Conclusion

This box provided an update of the dataset on advertised rents collected by the Central Bank of Malta. This dataset provides some insight on the evolution of private sector rents. It also allows for the construction of quality-adjusted rent indices based on standard hedonic methods that include advertised rents and a set of observable characteristics. The results point to a recovery in advertised rents in 2021 following the sharp contraction registered in 2020 as a result of the COVID-19 pandemic. In terms of growth rates, the range of estimates indicate that, in 2021Q4, rents have increased between 1.0% and 1.6% compared to the previous quarter and between 6.7% and 8.0% compared to a year ago. However, advertised rents remain between 8.3% and 9.5% lower than the pre-pandemic peak reached in 2019Q2.

Consumer price inflation

Average rate of HICP inflation edges down in 2021

The average rate of consumer price inflation, as measured by the HICP, stood at 0.7% during 2021 (see Table 3.11).³⁵ This was slightly lower than the rate of 0.8% registered in the previous year.

This average yearly figure for Malta, though, masks significant differences between the first half of the year, when inflation was very low, and the second half of the year when domestic inflation began to rise, reaching 2.6% in December (see Chart 3.23). The rise in inflation over the course of 2021 was broad based, though energy prices remained unchanged from their level in December 2020.

When looking at 2021 as a whole, the marginal fall in HICP inflation in Malta partly reflects a downward revision in the weight of services. Movements were mixed across components. Prices of services and processed food prices rose at a slower pace, while energy prices fell at a faster rate compared to 2020. By contrast, NEIG inflation turned positive and unprocessed food prices rose at a significantly faster pace. Furthermore, reflecting developments in NEIG prices, the HICP excluding food and energy stood at 0.7%, up from 0.6% in 2020.

NEIG and food inflation were the main contributors to overall HICP during 2021. Indeed, NEIG prices increased by 1.5% following a decrease of 0.4% in 2020. NEIG inflation in 2021 reflected growth in all subcomponents, with the highest price increases registered in semi-durable goods. Furthermore, stronger inflation in NEIG reflected higher import prices, largely driven by cost pressures.

Food inflation decreased from 2.0% in 2020 to 1.9% in 2021, reflecting weaker processed food inflation as unprocessed food inflation rose strongly. Indeed, the latter

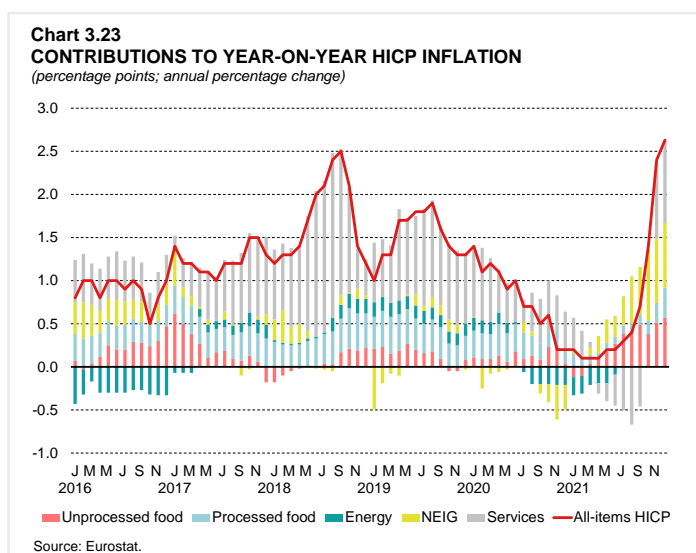


Table 3.11
HICP INFLATION RATES

Average annual rate of change

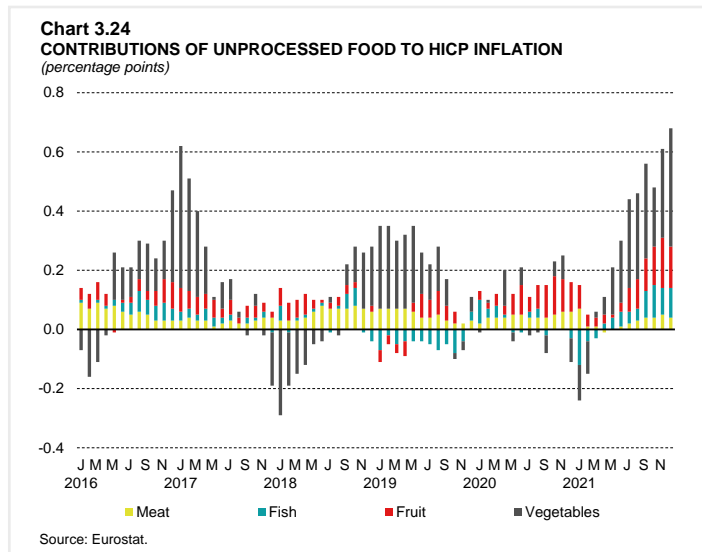
	2016	2017	2018	2019	2020	2021
Unprocessed food	2.8	0.9	1.1	3.5	2.9	5.5
Processed food including alcohol and tobacco	2.2	2.2	2.2	2.3	1.8	0.8
Energy	-4.2	1.1	1.3	2.5	-0.6	-1.6
NEIG	0.9	0.3	0.3	0.0	-0.4	1.5
Services (overall index excluding goods)	1.0	1.3	2.2	1.8	1.0	0.7
HICP (annual average inflation rate)	0.9	1.3	1.7	1.5	0.8	0.7

Source: Eurostat.

³⁵ The HICP weights are revised on an annual basis to reflect changes in overall consumption patterns. In 2021, the weight allocated to services stood at 42.6%, while that of NEIG was 28.6%. Food accounted for 22.1% of the index, while the share allocated to energy stood at 6.7%.

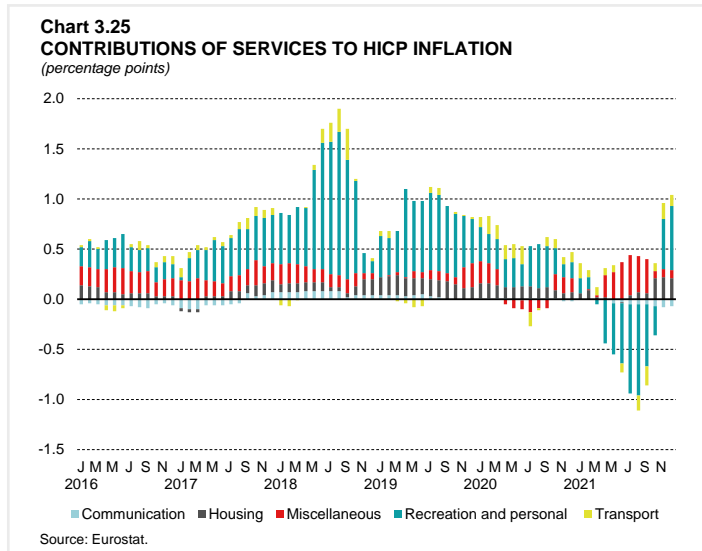
almost doubled, reaching 5.6% in 2021, while processed food inflation stood at 0.8% in 2021, down from 1.8% a year earlier.

The main driver of the increase in unprocessed food inflation was a significantly faster rate of increase in vegetable prices (see Chart 3.24). These increased by 9.4% on average during 2021, contributing 0.2 percentage point to overall HICP inflation, up from 0.0 percentage point in the previous year. The contribution from fish and fruit also increased, while that of meat edged down.



Processed food inflation moderated due to slower growth in the prices of bread and cereals, milk, cheese and eggs, as well as sugars. On the other hand, prices of oils and fats declined at a slower rate compared to 2020.

The contribution of overall food inflation to HICP was broadly unchanged when compared to the previous year, standing at 0.4 percentage point.



In 2021 services inflation averaged 0.7%, against 1.0% in 2020. This decrease was mainly driven by a negative contribution from recreation and personal services.

Although prices for such services increased, the HICP weight attributed to this component decreased significantly in line with changes in consumer spending patterns during the COVID-19 pandemic, pushing its contribution into negative territory (see Chart 3.25). Indeed, due to the restriction on travel and mass events, the weight of recreation and personal care declined from 25.3% in 2020 to 19.2% in 2021.³⁶

Movements in the prices of other services categories generally also contributed to the fall in services inflation, although to a lesser extent than recreational services. In particular, prices related to housing and transport services rose at a slower pace in 2021, while those of services related to communication declined. On the other hand, prices of miscellaneous services increased at a faster pace.

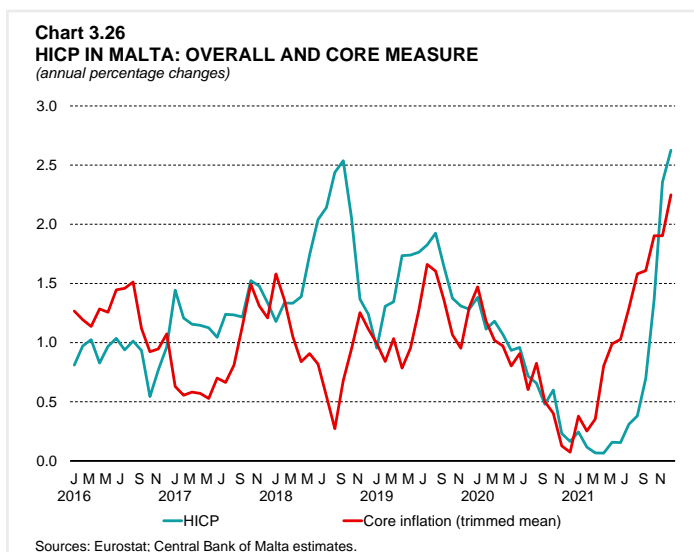
As a result of these developments, the contribution of services inflation to overall HICP inflation eased further to 0.0 percentage point, from 0.5 percentage point in 2020.

³⁶ For more details see Box 1: The implications of the 2021 HICP weights on inflation forecasts, in *Outlook for the Maltese Economy 2021:2*. https://www.centralbankmalta.org/site/Publications/2021_2.pdf?revcount=4607

Energy inflation fell further during 2021, averaging -1.6% compared to -0.6% in 2020. This mainly reflected the cut in transport fuel prices as from mid-2020 and a reduction in gas prices that became effective in April 2020.

Core HICP inflation accelerates

The core measure of HICP inflation, based on the Bank's 'trimmed mean' approach, accelerated to 1.2% during 2021, from 0.7% in 2020 (see Chart 3.26).³⁷ Following this increase, core inflation stood above overall inflation during most of the year under review. In part, this reflects the aforementioned weight changes for the HICP basket during 2021.



RPI inflation increases

In contrast to HICP inflation, which as noted earlier decreased slightly, annual inflation based on the RPI increased during 2021. The latter averaged 1.5%, up from 0.6% a year earlier.

After declining in 2020, prices of recreation and culture services and those of household equipment and maintenance rose, on average, during 2021. These components were the main drivers of the increase in RPI inflation last year. The contributions of the other components remained unchanged or recorded marginal movements.

Food inflation remained the main contributor to overall RPI inflation in 2021, followed closely by recreation and culture (see Table 3.12).

Table 3.12
CONTRIBUTIONS TO RPI INFLATION⁽¹⁾
Percentage points (annual averages)

	2016	2017	2018	2019	2020	2021
Food	0.5	0.7	0.6	0.8	0.4	0.5
Beverages and tobacco	0.2	0.2	0.1	0.1	0.1	0.0
Clothing and footwear	-0.1	-0.2	-0.2	0.0	0.0	0.1
Housing	0.1	0.0	0.1	0.2	0.2	0.1
Water, electricity, gas and fuels	0.0	0.0	0.0	0.0	0.0	0.0
Household equipment and maintenance	0.1	0.2	0.1	0.0	-0.1	0.1
Transport and communications	-0.5	0.1	0.2	0.3	-0.1	0.0
Personal care and health	0.1	0.1	0.1	0.1	0.2	0.1
Recreation and culture	0.1	0.2	0.0	0.2	-0.1	0.3
Other goods and services	0.1	0.0	0.0	0.1	0.1	0.1
RPI (annual average inflation rate)	0.6	1.4	1.2	1.6	0.6	1.5

Source: NSO.

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

³⁷ 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), pp. 39-45, Central Bank of Malta.

Developments in the overall HICP and RPI inflation rates could divert due to differences in the composition of the consumption basket and the frequency of weight updates.³⁸ The gap between the two measures of inflation during 2021 is mostly related to the large change in HICP weights due to the COVID-19 pandemic. On the other hand, the weights of the RPI are not updated annually and are hence not affected by such changes.

In 2021, the change in HICP weights had a negative impact of 0.9 percentage point on annual HICP inflation (see Chart 3.27). When using the 2020 weights (which are based on pre-pandemic spending patterns), HICP inflation would have stood at 1.6% as opposed to the actual rate of 0.7% using the 2021 weights.

HICP in Malta also stood below the 2.6% rate registered in the euro area as well as below the ECB's inflation target of 2% (see Chart 3.28). The difference in relation to the euro area was largely driven by the energy and services sub-components. While the former contributed negatively in the Maltese overall HICP inflation, it contributed an average of 1.2 percentage point to overall HICP inflation in the euro area.

This reflected the fact that electricity prices in Malta are administered and were kept fixed in accordance with the existing hedging agreement. Furthermore, in November 2021 government introduced a reduction in excise tax on fuels, to help maintain fixed consumer fuel prices. Malta's lower contribution from services reflects two factors. Firstly, year-on-year growth in services prices in Malta was lower in Malta when compared to the euro area average. Moreover, when compared to 2020, one notes that the services contribution to Malta's overall HICP inflation declined significantly, reflecting the lower weight of services in 2021. The revision in HICP weights also impacted negatively euro area inflation, but the impact was more limited than in Malta.³⁹

Costs and competitiveness

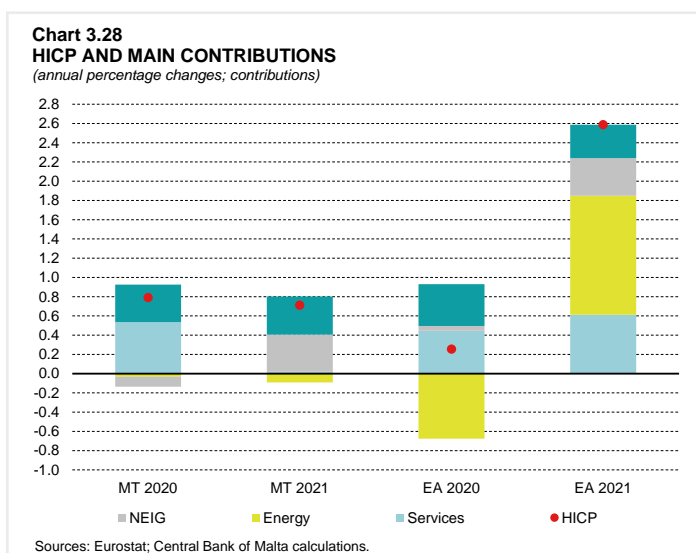
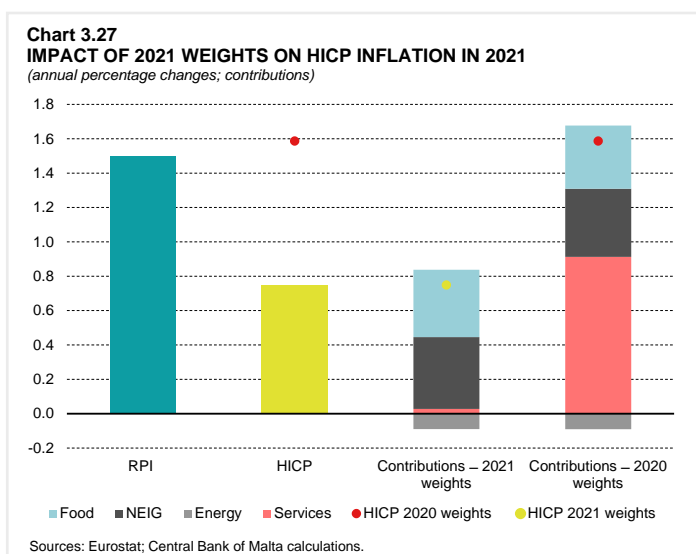
Producer price inflation picks up

Growth in producers' output prices, as measured by the producer price index (PPI), increased to 3.1% during 2021, from 0.3% a year earlier.⁴⁰ All components had a positive contribution, except energy, where inflation

³⁸ 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.

³⁹ See Chart 8: <https://www.ecb.europa.eu/pub/economic-bulletin/html/eb202201.en.html#toc6>

⁴⁰ The PPI measures the prices of goods at the factory gate and is commonly used to monitor inflationary pressures at the production stage.



remained at zero. Furthermore, the rise in producer price inflation mostly reflects a higher contribution from intermediate goods, which include items such as computer products and electronics, where a strong positive contribution in 2021 followed a negative contribution a year earlier. Consumer and capital goods inflation also increased in 2021.

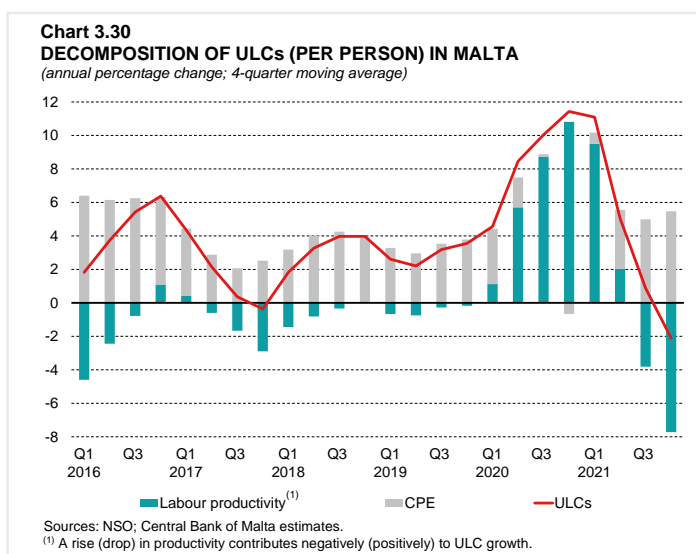
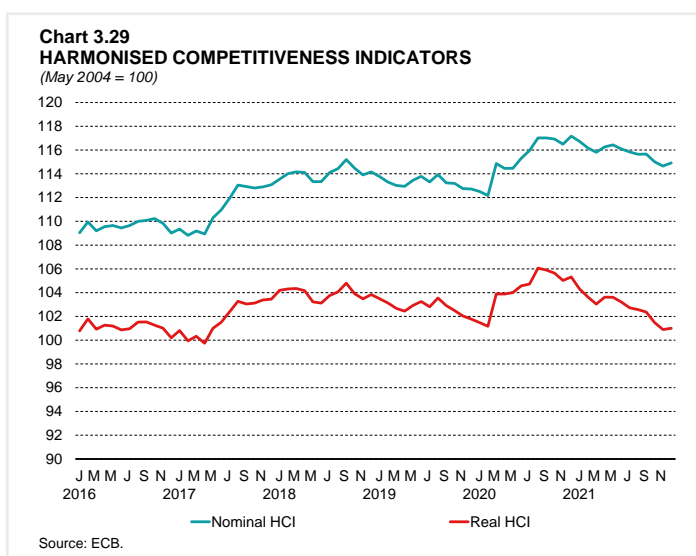
Real harmonised competitiveness indicator points to an improvement in external competitiveness

In 2021, the nominal harmonised competitiveness indicator (HCI), which is conditioned by developments in trade-weighted nominal exchange rates, was up by 0.4%, compared with its average reading for 2020 (see Chart 3.29).⁴¹ In contrast to the previous year, when the nominal HCI was mostly on an upward path due to the appreciation of the effective exchange rate (EER) against a number of currencies, in 2021 the nominal HCI tended to follow a downward path as the euro weakened against currencies of Malta's main trading partners.

The real HCI, which also takes into account changes in price inflation relative to trading partners, was down by 1.5% over its 2020 average level, pointing to an improvement in Malta's international competitiveness. This partly reflects the fact that unlike in other trading partners, energy prices in Malta were cushioned from the recent increase in international oil and gas prices.

Unit labour costs declined but remained above 2019 levels⁴²

Malta's ULC index, measured as the ratio of compensation per employee (CPE) to labour productivity, declined in 2021, compared to 2020.⁴³ When measured in headcount terms, ULCs in Malta fell by 2.1% in 2021, following an increase of 11.4% in the previous year (see Chart 3.30).



⁴¹ HCIs act as an 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.

⁴² This section shows productivity and compensation averaged over the number of persons in employment and on the basis of hours worked. Conceptually measures based on hours worked provide a more reliable assessment of developments in productivity, compensation and ULCs. They also better reflect the impact of the pandemic in view of the sharp correction in hours worked.

⁴³ Annual growth in ULCs, CPE, and labour productivity is measured on a four-quarter moving average basis. A degree of caution is required in the interpretation of ULCs 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.

The fall in ULCs during 2021 occurred as productivity rebounded more strongly than CPE.

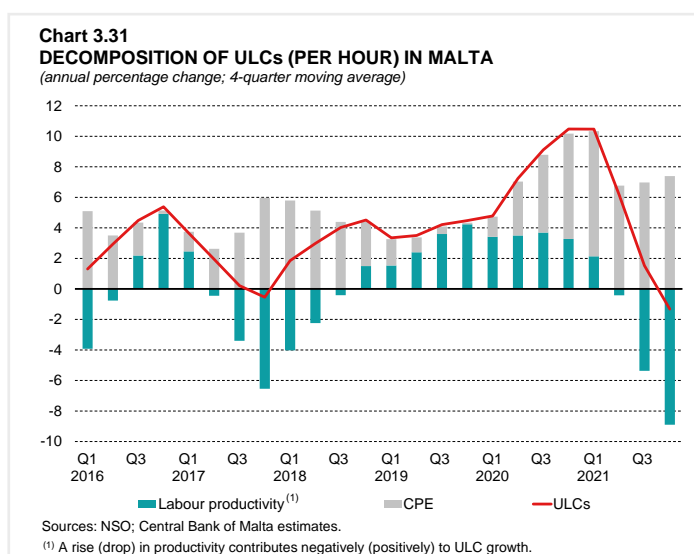
Labour productivity rose by 7.7% in 2021, following a contraction of 10.8% in the previous year. While both GDP and employment grew on a year earlier, growth in GDP was higher than employment growth, resulting in a strong expansion in labour productivity.

Meanwhile, annual growth in CPE rose to 5.5% from -0.7% in 2020, as growth in total compensation was stronger than the increase in headcount.

Notwithstanding the recent decrease, in 2021 ULCs were still around a tenth above their level in 2019, as productivity has not yet reached its pre-pandemic level.

National accounts data show that total hours worked were broadly unchanged in 2021, after contracting by 4.8% in 2020.⁴⁴ The wage bill increased strongly as compensation per hour increased by 7.4% in 2021, above the rate of 6.9% recorded in 2020. Meanwhile, productivity per hour increased by 8.9%, after falling by 3.3% in 2020. Following this improvement in productivity per hour, ULCs per hour decreased by 1.3% in 2021 following a 10.5% increase in the previous year (see Chart 3.31).

Although productivity per hour stood above 2019 levels, the increase in the hourly wage rate was more significant. As a result, similar to ULCs in headcount terms, ULCs per hour stood above their pre-pandemic level.



⁴⁴ Hours worked refer to employee hours.

BOX 4: SECTORAL CONTRIBUTIONS TO AGGREGATE LABOUR PRODUCTIVITY AND ULC GROWTH

In August 2020, the NSO carried out benchmark revisions to national accounts data and published data on chain-linked GVA by sector.¹ This additional information allows for the analysis of sectoral developments in labour productivity and ULCs while accounting for the impact of price changes.

This box looks at sectoral contributions to total labour productivity and real ULC growth during 2021 using national accounts data. To ensure the additivity of sectoral contributions, the analysis utilises the generalised exactly additive decomposition (GEAD) of productivity growth first developed by Tang and Wang (2004).² This method was also employed to analyse labour productivity growth in Malta over the past two decades.³

In the GEAD approach, aggregate labour productivity can be decomposed into three effects. The first is the *pure productivity effect* which is the sector's contribution to aggregate productivity growth that is solely due to changes in its labour productivity, weighted by its share in nominal aggregate output.

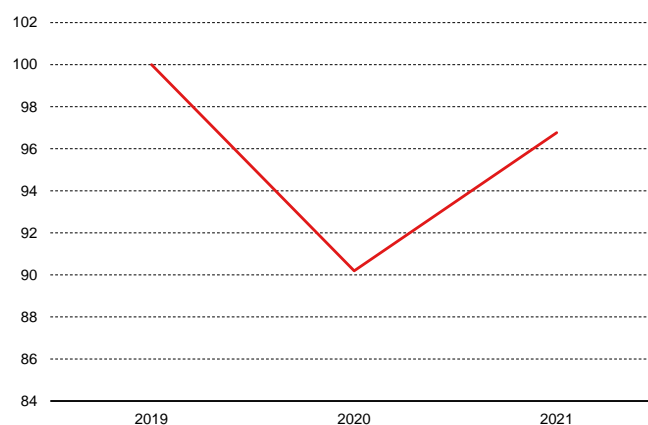
There is also a *reallocation effect* which measures a sector's contribution to aggregate productivity growth due to changes in its relative size. This reallocation effect is split into a static (level) effect and a dynamic (growth) effect. The *static reallocation level effect* measures the impact of absolute changes in labour shares and/or relative prices, scaled by the ratio of the respective sector's labour productivity level to the economy-wide productivity level. The *dynamic reallocation growth effect* takes into account whether these changes are occurring within a growing or a declining productivity industry.

Sectoral contributions to aggregate labour productivity growth

As economic activity rebounded in 2021 – following the sharp contraction in 2020 – aggregate labour productivity levels also rose. Indeed, chain-linked GVA rose by 9.0% in 2021, which follows a contraction of 7.3% in 2020. Meanwhile, according to national accounts data, employment rose by a more modest 1.6% in 2021, after a 2.6% increase in 2020. As a result, labour productivity – measured as chain-linked GVA per person employed – rose by 7.3% in 2021 following a decline of 9.8% in 2020.⁴

Despite the sharp improvement in 2021, the labour productivity level for the whole economy remained below that of 2019 (see Chart 1). While output stood around

Chart 1
PRODUCTIVITY LEVELS
(2019=100)



Source: NSO.

¹ See "The 2020 National Accounts Benchmark Revision", *Quarterly Review* 2021:1.

² Tang, J., & Wang, W. (2004) "Sources of aggregate labour productivity growth in Canada and the United States", *Canadian Journal of Economics*, 37(2), pp. 421-444.

³ Montebello R., & Darmanin J., (2021). "Labour Productivity Growth in Malta: A sectoral decomposition analysis", WP/04/2021, Central Bank of Malta.

⁴ This analysis is based on GVA rather than GDP per person employed, as sectoral data are only available for GVA. Aggregate productivity and ULCs may thus deviate from those reported in the section of this Report on costs and competitiveness where aggregate productivity and ULCs are derived using GDP.

1% higher than the level prevailing in 2019, employment stood around 4% higher than its pre-pandemic level.

Almost all sectors registered higher productivity in 2021 except for the agricultural and fishing sector (see Chart 2).

Productivity gains were strongest in the group of sectors comprising trade, transportation, accommodation and food services. The latter were the sectors that experienced the largest decline in productivity in

2020 mainly due to the disproportionate negative impact of pandemic-related containment measures. As containment measures were eased in 2021, the group of sectors' output recovered sharply and outpaced employment growth. Nevertheless, both its output and productivity levels remained below those prevailing in 2019.

In 2021, productivity growth rose strongly also in the arts, entertainment, recreation, and miscellaneous sector, the information and communication sector, as well as in the manufacturing industry. The improvement in productivity in these sectors was also driven by stronger growth in their output relative to that in employment. In each of these sectors, moreover, productivity levels in 2021 were higher than those prevailing in 2019. On the other hand, while productivity growth was positive in the construction sector, the real estate sector as well as in professional and administration sector, productivity levels in these sectors remained below those in 2019.

Table 1 shows the sectoral contributions to aggregate labour productivity growth derived using the GEAD decomposition. In line with its sharp rise in productivity, the sector comprising trade, transportation,

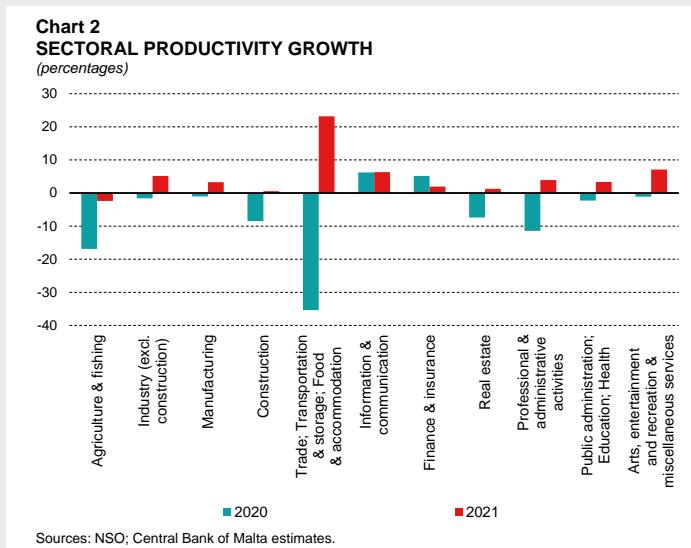


Table 1
SECTORAL CONTRIBUTIONS TO AGGREGATE LABOUR PRODUCTIVITY GROWTH

Percentage points; chain-linked

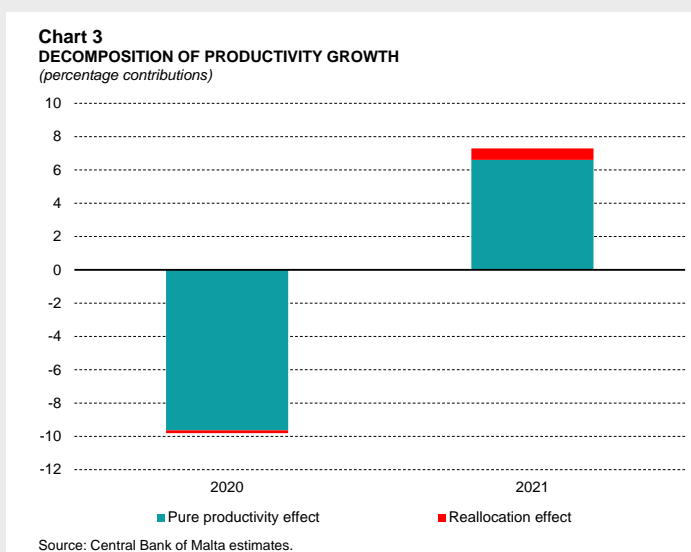
	2016	2017	2018	2019	2020	2021
Agriculture, forestry & fishing	0.0	-0.3	0.1	-0.2	-0.1	0.0
Industry (excl. construction)	0.0	-0.5	0.1	0.2	-0.6	0.4
of which: Manufacturing	-0.4	-0.1	0.2	0.0	-0.5	0.2
Construction	-0.1	0.3	0.2	0.3	0.0	0.2
Wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities	-1.6	1.0	-0.2	-0.2	-7.5	2.8
Information & communication	0.9	0.4	0.6	0.5	0.4	1.1
Finance & insurance activities	0.4	0.2	0.1	-0.1	0.1	0.0
Real estate activities	0.4	0.1	0.0	0.0	-0.3	0.2
Professional, scientific and technical activities; administrative and support service activities	1.7	1.9	1.1	0.7	-1.8	0.3
Public administration and defence; education, health and social work activities	0.2	-0.3	0.0	0.4	-0.3	1.2
Arts, entertainment and recreation, repair of household goods and other services	-3.0	0.5	-2.1	-0.5	0.3	1.0
Aggregate labour productivity growth (%; GVA-based)	-1.2	3.2	-0.1	1.1	-9.8	7.3

Sources: NSO; Central Bank of Malta estimates.

accommodation and food services had the largest positive contribution to aggregate productivity growth in 2021, contributing 2.8 percentage points.

The public sector had the second largest contribution to aggregate labour productivity growth in 2021, mainly on account of the relatively high share in nominal GVA of this sector, which amplifies its contribution. Moreover, the information and communication sector, as well as the arts and entertainment sector also contributed markedly to the growth in overall labour productivity.

Together, these sectors contributed 3.3 percentage points to productivity growth in 2021.



Using the GEAD approach, Chart 3 decomposes overall productivity growth into the pure productivity effect and the reallocation effect. The pure productivity effect – which captures the change in productivity within sectors – was the dominant contributor to the decrease in overall productivity in 2020 but also emerged as the main driver behind the increase in productivity in 2021. However, in 2021, the reallocation effect – which represents the reallocation of resources among sectors – also contributed positively towards the growth in productivity.

The dominance of the pure productivity effect reflects the unique nature of the contraction in 2020 and the recovery in 2021. In 2020, large parts of the economy were forced to shut down or limit production simultaneously, while fiscal support curtailed the number of layoffs. As a result, it is likely that the economy mostly absorbed the COVID-19 shock through a temporary decline in productivity rather than a change in employment or prices. In 2021, most of the recovery in productivity occurred due to the rise in output amid the re-opening of most economic sectors. At the same time, given that many firms had kept headcount numbers generally stable in 2020 despite the decline in activity, employment growth in 2021 was relatively muted, limiting the scope for re-allocation of resources across sectors.

When compared to other recessions, the positive contribution from the reallocation effect during the first year of the recovery from the pandemic seems rather small. For example, following the recession in 2009, the contribution of the reallocation effect to overall productivity growth in 2010 is estimated to have stood at around 2.5%, which is much higher than the 0.7% contribution in 2021. This could reflect the extraordinary fiscal support which was intended to limit the impact of the pandemic on employment levels across all affected sectors. In turn this may have limited the extent of structural changes that typically occur in the recovery period following a recession.⁵

Table 2 elaborates further by decomposing the contribution of each sector into the pure productivity effect, the reallocation level effect as well as the reallocation growth effect. While the

⁵ See Montebello R., & Darmanin J., (2021). “Labour Productivity Growth in Malta: A sectoral decomposition analysis”, WP/04/2021, Central Bank of Malta, for a decomposition of productivity growth in Malta during and after recessions.

Table 2
SECTORAL CONTRIBUTIONS TO PRODUCTIVITY GROWTH DECOMPOSED

Percentage points; chain-linked

	2021				
	Total contribution	Pure productivity effect	Total reallocation effect	Reallocation effect	
				Reallocation level effect	Reallocation growth effect
Agriculture, forestry & fishing	0.0	0.0	0.0	0.0	0.0
Industry (excl. construction)	0.4	0.5	-0.1	-0.1	0.0
of which: Manufacturing	0.2	0.3	0.0	0.0	0.0
Construction	0.2	0.0	0.1	0.1	0.0
Wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities	2.8	3.2	-0.4	-0.4	-0.1
Information & communication	1.1	0.6	0.5	0.5	0.0
Finance & insurance activities	0.0	0.2	-0.1	-0.1	0.0
Real estate activities	0.2	0.1	0.2	0.2	0.0
Professional, scientific and technical activities; administrative and support service activities	0.3	0.7	-0.4	-0.4	0.0
Public administration and defence; education, health and social work activities	1.2	0.6	0.6	0.6	0.0
Arts, entertainment and recreation, repair of household goods and other services	1.0	0.7	0.3	0.3	0.0
Total economy	7.3	6.6	0.7	0.7	0.0

Sources: NSO; Central Bank of Malta estimates.

group of trade, transportation, accommodation and food services sector was the main driver of the increase in overall productivity in 2021, this sector experienced a negative contribution from the reallocation level effect. This reflects the decline in its relative size in the economy, primarily due to a decline in the share of employment. The reallocation level effect was also negative in the professional and administrative sector and, to a lesser extent, in the financial and insurance activities sector.

Conversely, reallocation level effects were positive in most other sectors, particularly in the public and administration sector, the information and communication sector, as well as in the arts, entertainment, and recreation sectors. In each case, the relative size of these sectors rose in 2021 due to an increase in their employment share.

Sectoral contributions to growth in real compensation per employee and real unit labour costs⁶

Real CPE rose by 2.7% in 2021, following a decline of 2.5% in 2020 when a significant share of employees were receiving below normal wages in terms of the wage supplement scheme (see Table 3).⁷

The largest contributor to the latest increase was the sector comprising the professional and administrative services sector, which reversed some of the decline experienced in 2020. This was followed by higher wages in the public administration, education and health sector, which was partly driven by one-off increases in allowances in the health and defense sectors. The sectors comprising trade, transportation, accommodation and food services, financial and insurance activities, manufacturing, and information and communication also contributed positively to the growth in real wages in 2021. On the other hand, real wage levels in the construction sector fell marginally, while the remainder registered minor changes.

⁶ Using the GEAD decomposition of productivity, it is possible to calculate approximate sectoral contributions to real ULC growth as the log difference of sectoral contributions to CPE growth and aggregate productivity growth.

⁷ In this box, overall real CPE is calculated as total CPE divided by the overall GVA deflator.

Table 3
SECTORAL CONTRIBUTIONS TO GROWTH IN REAL COMPENSATION PER EMPLOYEE⁽¹⁾

Percentage points

	2016	2017	2018	2019	2020	2021
Agriculture, forestry & fishing	0.0	0.0	0.0	-0.1	0.0	0.0
Industry (excl. construction)	-0.2	0.2	0.0	0.2	-0.1	0.3
of which: Manufacturing	-0.3	0.1	0.0	0.1	-0.1	0.2
Construction	0.2	-0.1	0.0	-0.2	-0.3	-0.1
Wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities	0.6	-1.1	-0.1	-0.8	-1.3	0.5
Information & communication	0.5	0.6	0.6	0.3	-0.3	0.1
Finance & insurance activities	0.5	0.1	0.2	0.7	0.2	0.4
Real estate activities	0.0	0.0	0.0	0.0	0.0	0.0
Professional, scientific and technical activities; administrative and support service activities	0.6	-0.6	0.2	0.0	-1.1	0.8
Public administration and defence; education, health and social work activities	0.7	-0.1	0.4	1.3	0.3	0.7
Arts, entertainment and recreation, repair of household goods and other services	0.5	1.4	0.4	0.3	0.1	0.0
Aggregate CPE growth (%)	3.1	0.3	1.6	1.5	-2.5	2.7

Sources: NSO; Central Bank of Malta estimates.

⁽¹⁾ Sum of sectoral contributions may not exactly match aggregate CPE growth due to chain-linking.

Despite the increase in real wages, aggregate ULCs declined by 4.3% during 2021. This follows an increase of 8.1% in the previous year (see Table 4). The drop in overall ULCs was mainly due to the aforementioned increase in aggregate productivity which offset the increase in real wages. The large decline in labour costs mirrors the sharp correction in output and subsequent rebound, concurrent with the smooth evolution of employment levels during the past two years which have created substantial movements in overall productivity growth. Despite the decline in overall ULCs, labour costs remain a significant concern for firms that participate in the Bank's *Business Dialogue*, especially in view of high labour shortages.

Table 4
SECTORAL CONTRIBUTIONS TO GROWTH IN REAL ULCs⁽¹⁾

Percentage points

	2016	2017	2018	2019	2020	2021
Agriculture, forestry & fishing	0.0	0.3	0.0	0.2	0.1	0.0
Industry (excl. construction)	-0.2	0.7	-0.1	0.0	0.4	-0.1
of which: Manufacturing	0.1	0.2	-0.2	0.1	0.3	0.0
Construction	0.2	-0.5	-0.2	-0.6	-0.3	-0.2
Wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities	2.2	-2.1	0.1	-0.6	6.2	-2.3
Information & communication	-0.4	0.2	-0.1	-0.2	-0.7	-1.0
Finance & insurance activities	0.1	-0.1	0.1	0.8	0.1	0.4
Real estate activities	-0.4	-0.1	0.0	0.0	0.3	-0.2
Professional, scientific and technical activities; administrative and support service activities	-1.1	-2.5	-0.9	-0.7	0.7	0.5
Public administration and defence; education, health and social work activities	0.6	0.2	0.4	0.9	0.6	-0.6
Arts, entertainment and recreation, repair of household goods and other services	3.4	1.0	2.5	0.7	-0.2	-1.0
Annual ULC growth (%)	4.3	-2.8	1.8	0.4	8.1	-4.3

Sources: NSO; Central Bank of Malta estimates.

⁽¹⁾ Sum of sectoral contributions may not exactly match aggregate ULC growth due to chain-linking.

Similar to the development in sectoral contributions to productivity growth, the main driver behind the drop in ULCs was the group of trade, transportation, accommodation and food services sectors. This was followed by the arts, entertainment and recreation, as well as the information and communication sector. These sectors experienced both an increase in productivity as well as very low growth in real wages. Moreover, the public sector also contributed negatively to overall ULC growth but to a lower extent, also on account of the sector's positive contribution to overall productivity.

Conversely, the professional and administration sector as well as the financial and insurance activities sector, both contributed positively to ULC growth in 2021. This was driven by the positive contribution in their wage levels which outpaced their modest contribution to productivity growth.

A number of observations can be drawn from the above results. Firstly, developments in productivity seem large and extraordinary mainly due to the unique nature of the economic contraction that occurred in 2020 and the concomitant government support to employment. Secondly, despite the strong economic recovery in 2021, the pandemic remained disruptive in some sectors. On the other hand, government support schemes – such as the wage supplement scheme – remained active for most part of the year and have been extended further into 2022. Hence, it is likely that the economy has not yet experienced to the full extent a sectoral reallocation of resources.

Finally, for the purposes of this box, productivity levels calculations are based on the number of persons employed rather than hours worked. The latter would have been a better indicator of changes to sectoral productivities, since hours worked responded much more to the decline in economic activity than employment levels in 2020. However, sectoral data for hours worked are not as yet available.

BOX 5: ECONOMIC PROJECTIONS

Economic outlook

The Bank's latest economic projections were finalised on 11 February 2022 and thus pre-date the latest release of national accounts on 1 March 2022 as well as the recent rise in geopolitical tensions in Europe. According to these projections, economic growth is expected to moderate to more normal levels in 2022 following the strong recovery in economic activity levels in 2021. GDP is projected to grow by 6.0% in 2022, 5.3% in 2023, and 3.8% in 2024 (see Table 1).

Domestic demand is expected to be the dominant driver of economic growth over the projection horizon, underpinned by an amelioration in all its components. Net exports are also expected to contribute positively towards growth as exports are set to outpace imports.

Table 1
PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES FOR MALTA⁽¹⁾

	2021	2022 ⁽²⁾	2023	2024
Real economic activity (% change)				
GDP	9.4	6.0	5.3	3.8
Private consumption expenditure	6.2	6.4	4.8	4.8
Government consumption expenditure	6.1	4.8	3.0	3.2
GFCF	19.3	-0.9	4.6	1.4
Exports of goods and services	8.2	5.8	3.8	3.3
Imports of goods and services	7.6	4.3	2.9	3.1
Contribution to real GDP growth (in percentage pts)				
Final domestic demand	8.0	3.6	3.7	3.0
Net exports	1.8	2.5	1.6	0.8
Changes in inventories	-0.4	0.0	0.0	0.0
Labour market (% change)⁽²⁾				
Total employment	1.6	2.6	2.3	2.0
Unemployment rate (% of labour supply)	3.6	3.5	3.6	3.6
Prices and costs (% change)				
Overall HICP	0.7	3.4	2.0	1.8
Public Finances(% of GDP)⁽³⁾				
General government balance	-9.3	-6.2	-4.3	-3.3
General government debt	57.7	60.6	60.8	60.9

Sources: NSO; Central Bank of Malta.

⁽¹⁾ Data on GDP were sourced from NSO *News Release 037/2022* published on 1 March 2022, while HICP was sourced from *News Release 030/2022* published on 23 February 2022. Inflation projections presented here differ from those published by the Bank in February 2022, due to new information available after the cut-off date for that exercise.

⁽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⁾ Central Bank of Malta projections.

Private consumption is projected to grow at a slightly faster pace in 2022, as containment measures on consumption are envisaged to recede further. In particular, the partial recovery in residents' consumption abroad in 2021 is set to extend into 2022 as restrictions on international travel ease further. Moreover, in view of the accumulation of savings during the past two years, pent-up demand should also support growth in private consumption. Growth is set to slow down in 2023 and remain broadly unchanged in 2024, following the rebound in 2021 and 2022 and in line with an expected moderation in disposable income growth. Private consumption is projected to outpace disposable income with the saving ratio retreating from recent peaks but remaining high from a historical perspective.

With regards to investment, this is projected to decline in 2022, which follows extraordinary outlays on transport equipment in the aviation sector in 2021. Conversely, investment in both residential and non-residential construction is projected to increase in 2022, though the former is expected to remain below pre-pandemic levels. Investment growth is set to turn positive again in 2023 and increase further in 2024, which reflects growth in economic activity. Furthermore, the EU Budget as well as the Next Generation EU (NGEU) funds will provide a substantial boost to investment during the projection horizon.

Net exports are expected to pick-up in 2022. Firstly, this reflects an anticipated recovery in goods exports. It is envisaged to benefit from the expected gradual moderation in the adverse impact of supply bottlenecks on manufacturing activity. Services exports are expected to remain buoyant due to the projected normalisation in tourism. Secondly, import growth is set to decelerate in 2022, partly reflecting the foreseen contraction in capital expenditure on transport equipment. Subsequently, net exports are envisaged to slow down in line with the envisaged moderation in foreign demand growth.

The labour market is expected to remain robust. Indeed, employment growth in 2022 is expected to reach 2.6% from 1.6% in 2021. The pick-up in employment growth reflects the increase in demand, and is supported by an expected gradual normalisation in net migration flows beginning in 2022. The latter should start to gradually alleviate the broad-based labour shortages that were experienced in many sectors during 2021. That said, however, employment is set to grow more slowly than GDP during the whole projection horizon, as firms seek to regain some of the productivity losses experienced during the pandemic.

With regards to consumer prices, these are expected to be affected by the intensification of import price pressures brought about by global supply-chain disruptions. Indeed, headline HICP inflation is set to accelerate to 3.4% in 2022, largely reflecting a higher contribution from services inflation. In addition, the rise in food prices is projected to pick up in 2022, largely due to higher unprocessed food inflation. However, processed food inflation is also expected to increase sharply, reflecting the indirect impact of higher energy prices and poor harvests globally. NEIG inflation is expected to increase strongly due to higher import price pressures in source markets as well as higher transport costs. Despite the increase in international energy commodity prices, energy inflation is expected to turn only slightly positive in 2022 and remain subdued in light of the recent announcements which indicate that the Government intends to keep stable prices until, at least, the end of the year. HICP is then expected to moderate to 2.0% and 1.8% in the following two years as import price pressures gradually normalise over the course of this year.

The headline budget balance is expected to remain in deficit throughout the forecast horizon but should narrow over time as COVID-related support measures are withdrawn and activity improves. It is set to decline to 6.2% of GDP in 2022 and to continue declining over the rest of the forecast horizon, reaching 3.3% of GDP by 2024. As a result, the general government debt-to-GDP ratio is projected to rise to 60.9% by the end of the projection horizon, driven by the projected primary deficits and debt-increasing, deficit-debt adjustments (DDAs).

On balance, risks to economic activity over the medium term are judged to be balanced with some downside risks in the short-term, when the pandemic could further weaken tourism exports more than anticipated in the baseline. Moreover, a prolongation of supply bottlenecks could adversely affect manufacturing activity and domestic demand with higher than projected inflation. In addition, a prolongation or escalation of geopolitical tensions in Europe could amplify some of these risks, though mostly through indirect effects from lower activity in trading partners. On the other hand, a faster decline in the saving ratio could lead to faster than expected growth in economic activity over the medium term.

With regards to inflation, risks are on the upside during the entire projection horizon. In particular, if supply bottlenecks and disequilibria between demand and supply persist, more firms might be constrained to raise selling prices, which in turn could trigger higher wage demands. Moreover, geopolitical tensions in Europe could also lead to higher imported inflation than envisaged in this projection exercise.

Risks to public finances mainly affect 2022 and are deemed to be deficit-increasing. In particular, these risks relate to the likelihood of additional COVID-related support measures and the impact of Air Malta's restructuring on the likelihood of State aid to the airline.



4. BALANCE OF PAYMENTS

During the first three quarters of 2021, the current account deficit on the balance of payments (BOP) widened when compared to the corresponding period of 2020. This increase was on account of a significant rise in the merchandise trade deficit which outweighed higher net services receipts and lower net primary and secondary income outflows. These developments are based on the 2021Q3 vintage of the BOP that the NSO issued in December 2021 and therefore may not be consistent with the most recent trade data reported for 2021 in other chapters, which are based on the GDP release covering the full year. The next vintage of BOP data is expected to revise the BOP position reported here.

Between January and September net inflows on the capital account increased slightly compared to the corresponding period of 2020. On the financial account, net lending was recorded as opposed to net borrowing during the same period of 2020. Net errors and omissions remained positive, but increased.¹

When measured over the four quarters to September 2021, the current account balance registered a deficit equivalent to 4.3% of GDP. This contrasts with a current account surplus of 2.8% of GDP in the euro area.² The cyclically-adjusted current account balance was estimated to have recorded a deficit of 3.4% during the third quarter of 2021.

The current account

Between January and September 2021, the current account recorded a deficit of €584.8 million, up from €373.2 million a year earlier (see Table 4.1). This was entirely driven by a large increase in the merchandise trade

Table 4.1
BALANCE OF PAYMENTS

EUR millions

	2018	2019	2020	2020 Q1-Q3	2021 Q1-Q3
Current account	831.9	756.6	-400.8	-373.2	-584.8
Goods	-1,482.9	-1,645.8	-1,421.6	-1,182.7	-1,774.3
Services	3,502.8	3,700.7	2,444.6	1,870.6	2,176.9
Primary income	-1,031.4	-1,133.0	-1,260.8	-932.8	-880.3
Secondary income	-156.6	-165.3	-163.0	-128.3	-107.1
Capital account	117.7	107.2	81.7	78.3	82.8
Financial account⁽¹⁾	659.9	44.3	-317.4	-170.3	475.9
Errors and omissions	-289.7	-819.5	1.7	124.6	977.8

Source: NSO.

⁽¹⁾ Net lending (+) / net borrowing (-).

¹ Positive net errors and omissions indicate an underestimation of net inflows on the capital and current accounts and/or an overestimation of net lending on the financial account.

² BOP data for 2020 and 2021 for Malta and the euro area should be interpreted in the context of the unprecedented developments related to COVID-19.

deficit which offset an increase in net services receipts, as well as lower net outflows on both the primary and secondary income accounts.

When measured as a 4-quarter moving sum, the balance on the current account showed a deficit of €612.3 million, more than three times that of €178.4 million recorded a year earlier. The current account-to-GDP ratio stood at -4.3% in the third quarter of 2021, down from -1.3% in the corresponding quarter a year earlier (see Charts 4.1 and 4.2).

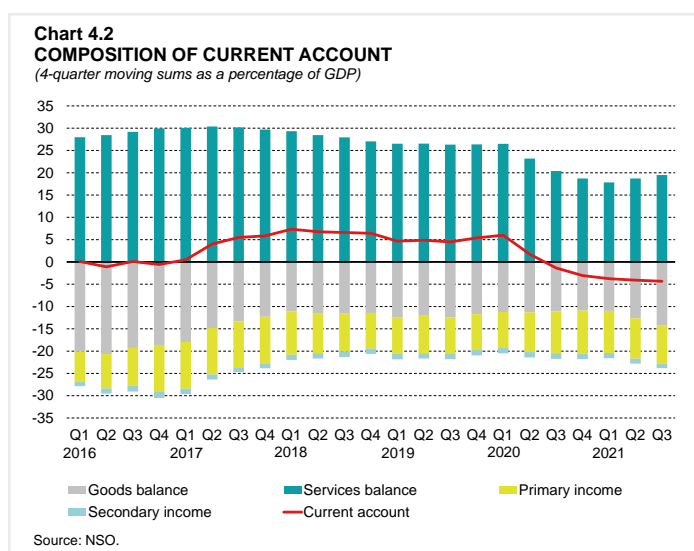
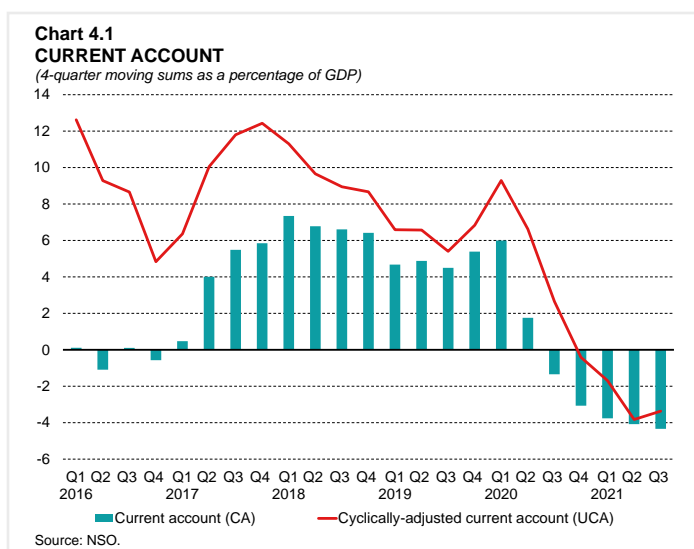
Malta's cyclically-adjusted current account balance is estimated to have stood at -3.4% of GDP in the year to September 2021, above the headline measure, as Malta's economic cycle was slightly stronger than that estimated for its trading partners (see Chart 4.1).³ However, given the high uncertainty and the volatility in trade related to COVID-19, cyclically-adjusted estimates are likely to be affected by several one-off factors that are difficult to quantify and interpret. For example, the output gap measure for the whole economy that is used to derive the cyclically-adjusted balance may not fully reflect the degree of underutilisation in sectors hit hardest by the pandemic and related social distancing measures.

Goods deficit widens

In the first three quarters of 2021, the merchandise trade gap widened by €591.6 million when compared with the corresponding period of 2020 and stood at €1,774.3 million. This was mainly the result of a €587.9 million rise in imports and, at the same time, a €3.7 million fall in goods exports. Just over 40% of the rise in imports reflects large-scale investments in the aviation sector.

The visible trade gap widened to €2,013.2 million when measured on a 4-quarter cumulative basis, €536.2 million more than the deficit recorded a year earlier. This stemmed from a €374.0 million rise in goods imports as well as a €162.2 million drop in exports. This decrease was mainly driven by lower exports of machinery and transport equipment and, to a lesser extent, fuel re-exports. As a result, the share of the goods deficit

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.



in GDP rose to 14.3% in the year to September 2021, from 11.1% a year earlier (see Chart 4.3).

The surplus on services also widens

Between January and September 2021, the balance on services increased by €306.3 million on a year earlier, reaching €2,176.9 million, as the increase in services receipts were almost four times that in services payments.

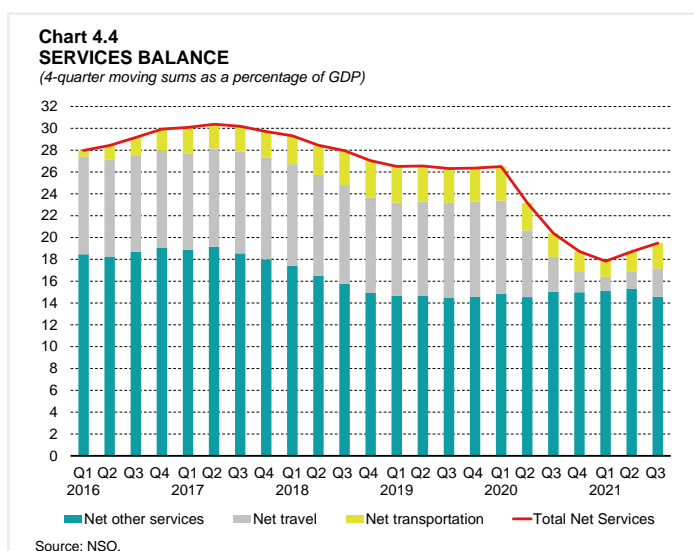
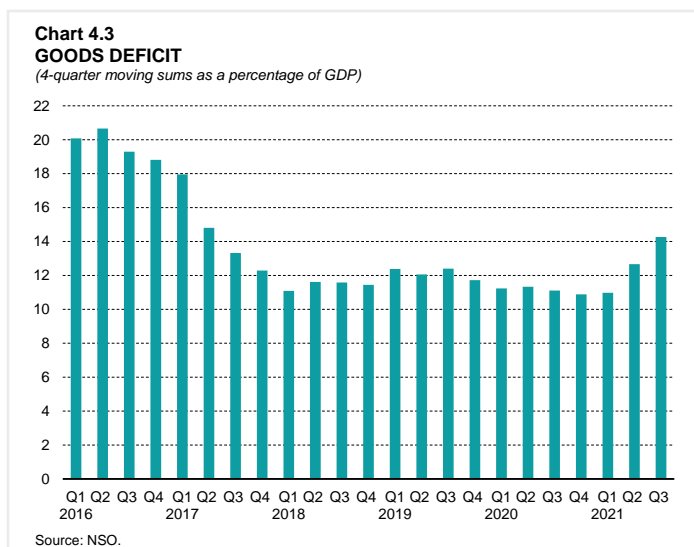
All services components saw an increase in net receipts. The partial recovery of the tourism sector from the low levels of activity recorded during the pandemic had a positive impact on both the travel and transport accounts. Net travel receipts increased by €113.2 million as the increase in tourism exports outweighed a rise in expenditure by Maltese residents on travel abroad. Additionally, net receipts on the transport account rose by €93.8 million when compared to the corresponding period of last year.

Net receipts on the “other” services account increased by €99.3 million as a rise in net receipts related to personal, cultural and recreational services, which include remote gaming offset lower net receipts from financial services and higher net payments related to ‘other’ business services. In particular, net payments related to professional and management consulting services as well as technical, trade-related, and other business services increased on a year earlier

When measured over the year to September 2021, the overall surplus from services stood at €2,750.9 million, an increase of €39.4 million when compared with the corresponding period of 2020. Nonetheless, the share of net services receipts in GDP decreased to 19.5% in the year to September 2021, from 20.4% in the corresponding period of 2020, due to the stronger rebound in GDP (see Chart 4.4).

Net outflows related to primary income decrease⁴

Between January and September 2021, net primary income outflows fell to €880.3 million, €52.5 million less than in the first three quarters of 2020. This was due to lower net outflows on investment income, as higher net outflows on direct investment were outweighed by higher net inflows on ‘other investment’. Higher net inflows on portfolio income also contributed but to a lesser extent. Movements on the primary income account continued



⁴ The primary income account shows income flows related mainly to cross-border investment and compensation of employees.

to be strongly influenced by internationally oriented firms, including subsidiaries of foreign banks, which transact predominantly with non-residents.

When measured on a 4-quarter cumulative basis, net outflows on this component also increased. However, at 8.6%, their share in GDP stood 0.8 percentage point less than in the four quarters to September 2020 due to the denominator effect (stronger GDP growth).

Net outflows from secondary income decline⁵

During the first nine months of 2021, net outflows on the secondary income account amounted to €107.1 million, down by €21.2 million on the corresponding period of 2020.

When measured over four quarters, net outflows on the secondary income account stood at €141.8 million, or 1.0% of GDP, 0.3 percentage point lower than in the four quarters to September 2020.

Tourism

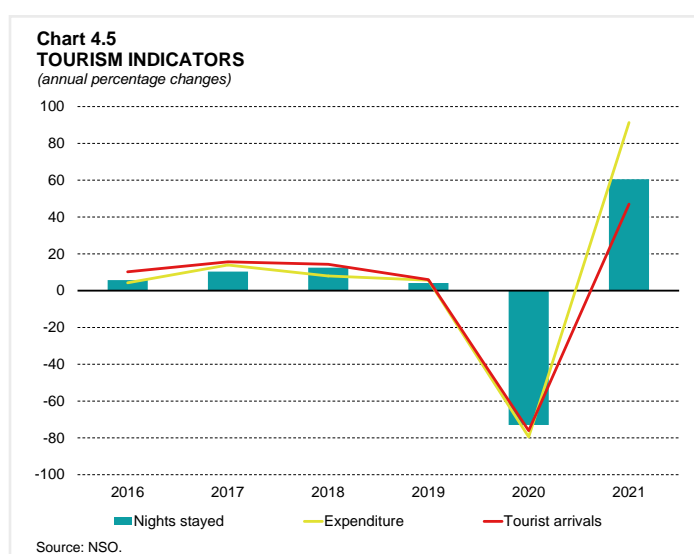
During 2021, tourism activity started to recover from the low levels recorded in 2020 but was still affected by a number of COVID-19 travel-related restrictions still in place. Although the number of inbound tourists, nights stayed and tourist expenditure in Malta rose markedly compared with 2020, nevertheless, these remained below the levels reached in 2019.

The number of inbound tourists in 2021 increased by 47.0% over 2020, but at 968,136, it was just over a third of the arrivals registered in 2019 (see Chart 4.5). Tourists visiting Malta for leisure purposes accounted for most of the increase in arrivals in absolute terms. This segment recorded 861,268 arrivals, an increase of 279,546 or 48.1% on 2020. Those coming over for business and other reasons also increased, but these segments accounted for less than a tenth of the total increase.

Increases in arrivals were reported from all major source markets, with the United Kingdom and France registering the largest increases in absolute terms. These two countries were the most important markets in 2021, accounting for 22.1% and 13.8% of total tourist arrivals respectively. They were followed by Italy and Germany which accounted for 13.2% and 10.0% of arrivals respectively.

The number of nights that tourists spent in Malta increased to 8.4 million in 2021, a 60.5% increase over a year earlier. This was primarily due to a rise in nights stayed in rented accommodation as the increase in nights stayed in non-rented accommodation was more muted. Nights stayed were still less than half the level recorded in 2019, when they had exceeded 19 million nights.

The total average occupancy rate in collective accommodation establishments rose to 33.1% in 2021, from 25.4% a year earlier, but it remained well short of that recorded in 2019 when it reached 65.7% (see Chart 4.6). Higher



⁵ The secondary income account shows current transfers between residents and non-residents.

occupancy rates were registered across all accommodation categories, with the 5-star category reporting the largest increase.

During 2021, the share of non-residents in the total number of guests using collective accommodation increased relative to a year earlier, to reach 75.0%, though it remained below that of 90.1% recorded in 2019.

Tourist expenditure nearly doubled over 2020, to reach €870.7 million. The largest increase in absolute terms was in the 'other' expenditure category followed by non-package expenditure and package expenditure. Since tourism expenditure increased at a faster pace compared with arrivals, expenditure per capita rose to €899.4, from the €691.1 recorded in 2020. It also stood around 11% higher than the €806.6 reported for 2019.

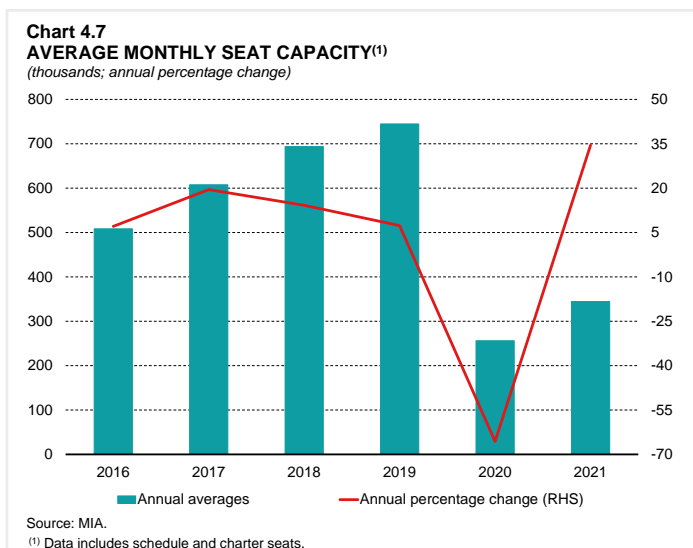
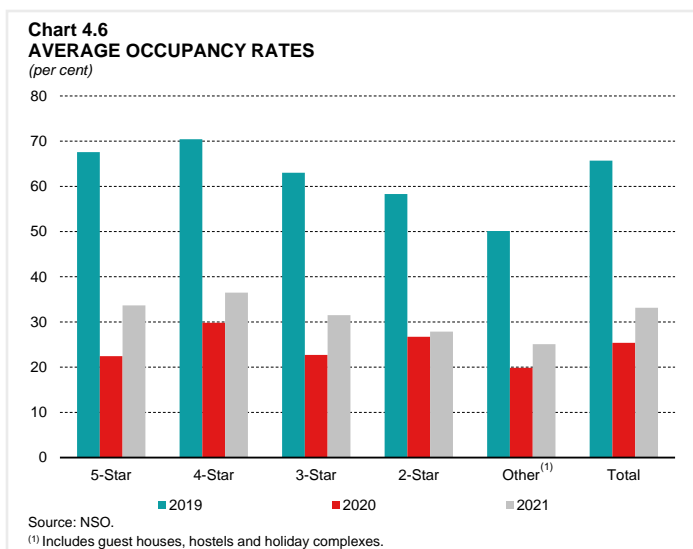
Notwithstanding this improvement, overall tourist expenditure was still only 39.2% of the level recorded in 2019. However, the gap in relation to 2019 levels narrowed as the year progressed. Indeed, while in the first half of 2021, tourist expenditure was only 13.6% of the 2019 level, in the second half of the year, it stood at 56.1% of the expenditure that prevailed in the corresponding period of 2019.

According to Malta International Airport (MIA) data, in 2021, seat capacity increased by 34.5%, reaching an average 344,538 seats per month (see Chart 4.7). This was less than half its 2019 level.

The capital and financial accounts

The capital account recorded net inflows of €82.8 million in the first three quarters of 2021, an increase of €4.5 million on a year earlier (see Table 4.1). On the other hand, a small decline was observed on a 4-quarter moving sum basis whereby capital inflows fell by €5.2 million on a year earlier, standing at €86.1 million.

Meanwhile, the financial account showed net lending of €475.9 million in the first nine months of 2021. This contrasts with net borrowing of €170.3 million in the same period of 2020. A similar shift is observed when financial accounts flows are measured on a 4-quarter sum basis.





5. GOVERNMENT FINANCE

In the first three quarters of 2021, the general government deficit narrowed when compared with the same period a year earlier, marking the beginning of a recovery from the COVID-19 pandemic. When measured on a 4-quarter moving sum basis, the deficit-to-GDP ratio narrowed from 9.7% at the end of 2020 to 8.5% in the third quarter of 2021.

However, general government debt as a share of GDP increased. The general government net financial worth deteriorated in the period under review as an increase in financial liabilities offset a rise in financial assets. Meanwhile, the cyclically-adjusted balance improved in the four quarters up to September 2021.

Quarterly developments

General government deficit narrows

In the first three quarters of 2021, the general government registered a deficit of €886.5 million, €76.2 million lower when compared to the deficit recorded in the corresponding period of 2020 (see Table 5.1). This was due to a significant increase in government revenue offsetting the rise in government expenditure. As a result, the primary deficit narrowed from €833.8 million in the first three quarters of 2020 to €762.0 million in the corresponding period of 2021.

Table 5.1
REVENUE, EXPENDITURE AND DEBT
EUR millions

	2016	2017	2018	2019	2020	Q1-Q3		Change Q1-Q3	
						2020	2021	Amount	%
Revenue	3,942.6	4,489.4	4,872.1	5,119.5	4,731.1	3,380.2	3,784.9	404.7	12.0
Taxes on production and imports	1,259.6	1,401.4	1,572.4	1,613.0	1,397.0	1,007.3	1,120.9	113.6	11.3
Current taxes on income and wealth	1,383.9	1,569.8	1,650.4	1,827.0	1,689.8	1,216.9	1,440.0	223.1	18.3
Social contributions	639.3	702.9	764.8	800.1	841.1	623.9	620.3	-3.6	-0.6
Capital and current transfers receivable	118.1	140.6	229.5	254.2	252.0	141.8	136.4	-5.4	-3.8
Other ⁽¹⁾	541.7	674.7	655.0	625.3	551.2	390.3	467.4	77.0	19.7
Expenditure	3,827.1	4,106.7	4,628.7	5,055.2	6,001.8	4,342.9	4,671.4	328.5	7.6
Compensation of employees	1,205.7	1,301.1	1,396.1	1,509.5	1,583.9	1,187.8	1,314.3	126.4	10.6
Intermediate consumption	626.6	715.4	830.9	979.7	1,179.8	806.7	952.7	146.0	18.1
Social benefits	1,086.2	1,133.7	1,181.0	1,244.9	1,347.1	1,011.3	1,047.9	36.6	3.6
Subsidies	132.1	139.9	179.0	195.1	653.7	471.6	446.7	-24.9	-5.3
Interest	220.8	210.6	194.0	183.7	170.7	128.8	124.5	-4.3	-3.4
Other current transfers payable	196.9	211.0	269.9	283.0	314.8	232.2	311.6	79.4	34.2
GFCF	271.1	287.6	416.8	538.6	585.3	404.9	361.5	-43.3	-10.7
Capital transfers payable	81.6	101.2	164.5	110.4	147.0	89.5	80.9	-8.6	-9.6
Other ⁽²⁾	6.2	6.2	-3.6	10.4	19.5	10.1	31.3	21.2	-
Primary balance	336.3	593.3	437.4	248.0	-1,099.9	-833.8	-762.0	71.9	-
General government balance	115.5	382.8	243.4	64.3	-1,270.7	-962.7	-886.5	76.2	-
General Government debt	5,769.3	5,703.7	5,660.4	5,718.5	6,977.5	6,851.5	7,989.3		

⁽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.

Source: NSO.

Economic recovery supports revenue growth

During the period under review, general government revenue increased by €404.7 million, or 12.0% in annual terms. This was largely due to higher inflows from current taxes on income and wealth and from taxes on production and imports. The former increased by €223.1 million, primarily on the back of higher income tax receipts from firms. Meanwhile, the surge in revenue from taxes on production and imports is largely due to higher VAT receipts, reflecting the partial rebound in tourism activity compared with the same period a year earlier. This rise was complemented -albeit to a lower extent- by higher inflows from duties on fuel and stamp duty.

Overall, developments in non-tax revenue also had a positive impact on general government finances during the period under review. The “other” component of government revenue increased by €77.0 million, mainly driven by higher revenue from sales and to a lower extent an increase in dividend income. This increase more than offset a €5.4 million drop in capital and current transfers receivable, reflecting lower grants from the European Union.

Current expenditure underpins expenditure growth

During the period under consideration, government expenditure remained elevated partly on account of COVID-related economic support measures and health-related outlays on testing, treatment and vaccination. When compared to the corresponding period a year earlier, government spending increased by €328.5 million or 7.6%, as a drop in capital expenditure was more than offset by higher recurrent expenditure.

Intermediate consumption grew by €146.0 million, partly on the back of higher expenditure related to health as well as in public administration. Spending on compensation of employees increased by €126.4 million, driven by higher wages in the public administration and, to a lower extent, in the health care and social work sectors. At the same time, other current transfers payable rose by €79.4 million, mainly reflecting higher transfers to the EU budget. Meanwhile, spending on social benefits increased by €36.6 million, mainly due to higher outlays on retirement pensions.

Among the main current expenditure items, only subsidies and interest payments declined in the period under review. The former declined by €24.9 million, mainly due to a base effect stemming from the pandemic-related support measures offered a year earlier. Interest payments declined by €4.3 million, as the prevailing low interest rate environment offset the impact of increased financing needs.

Meanwhile, capital expenditure fell in the period under consideration, largely due to lower outlays related to GFCF. These declined by €43.3 million, reflecting the timing of payments part financed by the European Union as well as lower outlays on other, locally-financed projects. A drop in capital transfers payable also contributed to lower capital expenditure. These declined by €8.6 million.

Debt increases

In September 2021, the stock of general government debt was up by €1,011.8 million from its level at the end of 2020, standing at €7,989.3 million. The stock of long-term debt securities (composed of MGS) increased by €602.6 million, on the back of new MGS issues. Notwithstanding this increase in level terms, the share in total government debt declined by 2.2 percentage points, to reach 74.6%. The stock of short-term securities outstanding (composed of Treasury bills) also increased, albeit to a lower extent, by €104.0 million. Its share in total debt increased slightly by 0.2 percentage point to reach 8.6%. Moreover, the stock of loans outstanding increased by €307.1 million, mainly attributable to an increase in long-term loans. The latter reflects the second and third tranche of funds from the European Union’s SURE programme. Consequently, the share of long-term loans in total debt rose by 2.9 percentage points to 10.4%. Meanwhile, the level of currency and deposits outstanding declined slightly by €1.9 million, so that their share in total debt declined by 0.9 percentage point to 5.9%. This reflects a lower level of outstanding 62+ Malta Government Savings Bonds, which are classified as deposits according to ESA methodology.

Headline and cyclically-adjusted developments

Headline balance ratio improves, while debt ratio increases

When measured on a 4-quarter moving sum basis, the general government deficit-to-GDP ratio narrowed from 9.7% at end 2020 to 8.5% in the third quarter of 2021.

During this period, the ratio of total revenue in GDP rose by 0.2 percentage point (see Chart 5.1). This was mainly due to a 0.3 percentage point increase in the share of current revenue in GDP which offset a 0.2 percentage point drop in the share of capital revenue. At the same time, the ratio of total expenditure in GDP declined by 1.1 percentage points, with this fall mostly attributable to a lower share of capital expenditure.

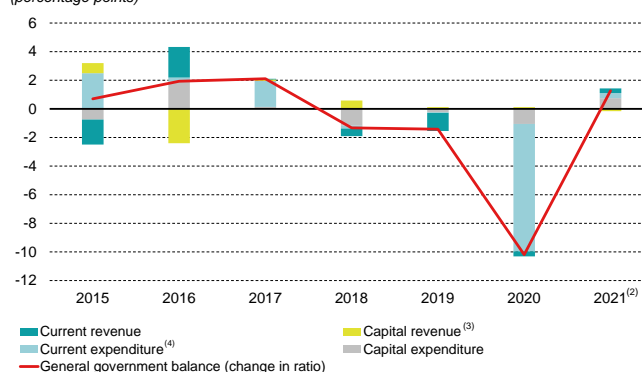
Despite the improvement in the headline balance, the deficit incurred in the first three quarters of the year remained substantial. Financing needs also reflected debt-increasing DDAs, partly due to a build-up of bank deposits following a drawdown in the previous year. As a result, the government debt-to-GDP ratio continued to increase. Overall, it rose by 3.2 percentage points, compared to December 2020, reaching 56.6% (see Chart 5.2). In contrast with 2020, when GDP had contracted sharply, the interest-growth differential exerted a debt-decreasing effect in the period reviewed.

Net financial worth deteriorates

The market value of financial assets as at end-September 2021 stood at €5,059.1 million, up by €914.6 million when compared with December 2020.¹ This was mainly due to higher deposits held at banks and, to a lower extent, due to higher accounts receivable. Consequently, the share of financial assets in GDP rose by 4.1 percentage points to 35.8% (see Chart 5.3).

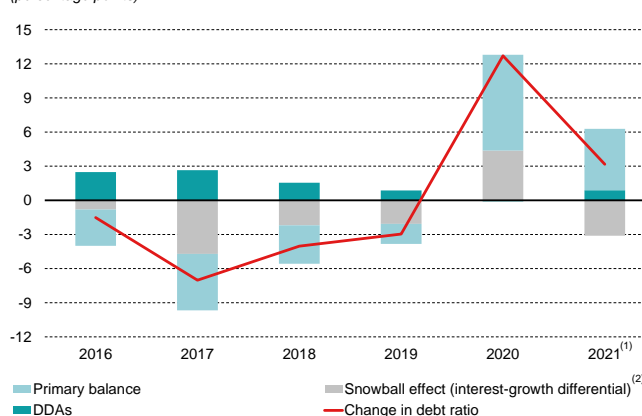
At the same time, financial liabilities increased by €1,416.8 million, ending the third quarter of 2021 at €10,716.1 million. This is mainly due to an increase in accounts payable as well as higher outstanding debt securities and loans. As a result, the share of financial liabilities in GDP increased by 4.7 percentage points to 75.9%.

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⁾ 4-quarter moving sums up to Q3.
⁽³⁾ The term 'current revenue' represents most tax revenue as well as income from investments and sales. 'Current 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 2021.
⁽²⁾ Difference between effective interest rate (interest payments at year t relative to debt outstanding at year t-1) and GDP growth.

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

The resulting net financial worth of general government as a share of GDP deteriorated by 0.6 percentage point and closed the third quarter of the year at -40.1%, from -39.5% as at end 2020. Notwithstanding these developments, the net financial worth of the Maltese Government continued to compare favourably with the euro area average. The latter stood at -72.7% of GDP in September 2021, up from -75.2% registered in December 2020.

Debt ratio continues to compare favourably with the euro area's despite a higher deficit

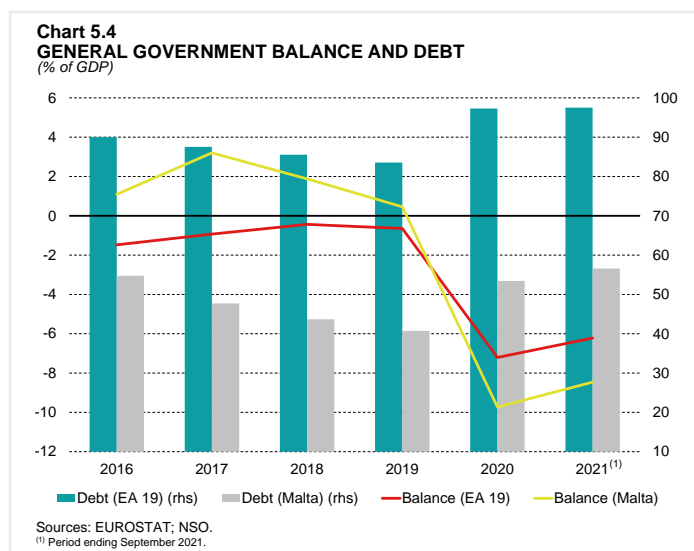
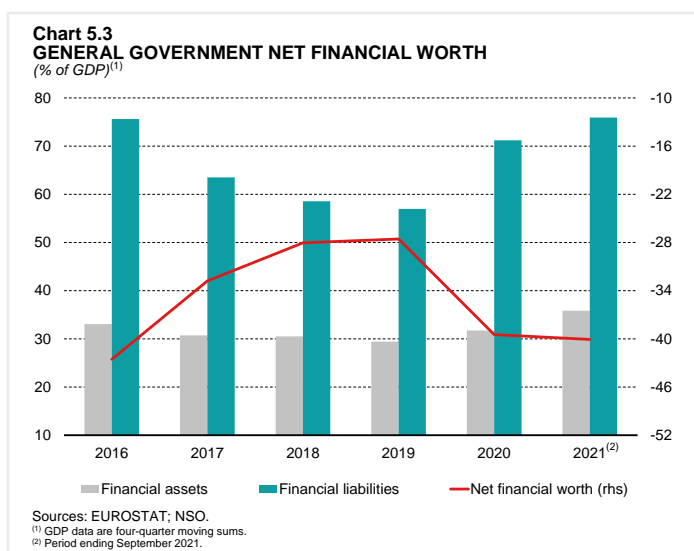
In September, the euro area general government deficit stood at 6.2% of GDP when measured on a 4-quarter moving sum basis. This marks a fall of 1.0 percentage point when compared to the deficit recorded in 2020 (see Chart 5.4). However, over the same period, the euro area debt ratio increased to 97.5% of GDP from 97.3%. This increase reflects the negative repercussion the pandemic has had on public finances across euro area countries since 2020.

In this period, the increases in Malta's deficit and debt ratio were more pronounced than those in the euro area. However, the Maltese government debt-to-GDP ratio remained well below that for the euro area.

Cyclically-adjusted balance improves²

On a 4-quarter moving sum basis, the cyclically-adjusted deficit stood at 7.5% of GDP in September 2021, 0.3 percentage point lower than the deficit posted at the end of 2020 (see Chart 5.5). This improvement is less pronounced than the change in the headline balance during the same period and reflects the partial closure of the output gap.

The reduction in the cyclically-adjusted deficit since December 2020 partly reflects a rise of 0.9 percentage point in the share of cyclically-adjusted revenue in GDP (see Table 5.2). This primarily reflects a rise of 0.8 percentage point in the share of non-tax revenue in GDP, largely due to the aforementioned increase



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 European Commission 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

	2016	2017	2018	2019	2020	2021 ⁽¹⁾
Revenue	-0.6	0.6	-0.1	-1.2	-1.0	0.9
Taxes on production and imports	1.3	-0.5	-0.3	0.3	1.3	0.1
Current taxes on income and wealth	0.1	-0.2	0.4	-0.6	-0.8	0.1
Social contributions	-0.1	0.0	0.0	-0.2	0.4	-0.1
Other ⁽²⁾	-2.0	1.2	-0.1	-0.6	-1.9	0.8
Expenditure	-3.9	-0.3	1.1	0.1	5.6	0.6
Compensation of employees	-0.4	-0.1	-0.2	-0.1	0.3	0.4
Intermediate consumption	-0.2	0.3	0.4	0.6	1.3	0.7
Social benefits	-0.7	-0.3	-0.5	-0.3	0.2	0.0
Interest payments	-0.3	-0.3	-0.3	-0.2	-0.1	-0.1
GFCF	-1.8	-0.1	0.8	0.6	0.2	-0.5
Other ⁽³⁾	-0.6	0.1	0.9	-0.5	3.8	0.1
Primary balance	3.0	0.6	-1.5	-1.5	-6.7	0.2
General government balance	3.3	0.9	-1.2	-1.3	-6.6	0.3

Sources: NSO; Central Bank of Malta estimates.

⁽¹⁾ 4-quarter period up to September 2021.

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

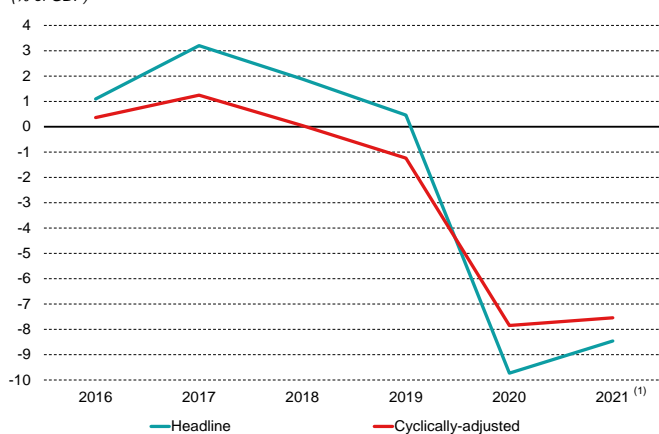
⁽³⁾ Mainly includes subsidies, current and capital transfers.

in revenue from sales and dividend income. Cyclically-adjusted inflows from taxes also contributed, as the share of taxes on production and imports in GDP and the share of current taxes on income and wealth in GDP both rose by 0.1 percentage point.

The share of cyclically-adjusted expenditure rose by 0.6 percentage point. This was mainly due to a higher share of current expenditure in GDP, which more than offset the decline in capital expenditure. The increase in current expenditure mostly reflects a rise in intermediate consumption and in compensation of employees, which rose by

0.7 and 0.4 percentage point, respectively. At the same time, the decline in the share of capital expenditure in GDP was attributed to lower government investment.

Chart 5.5
GENERAL GOVERNMENT BALANCE
(% of GDP)



Sources: NSO; Central Bank of Malta estimates.
⁽¹⁾ Period ending September 2021.

BOX 6: THE SUSTAINABILITY OF MALTESE GOVERNMENT DEBT¹

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 published by the Bank.^{2,3} The term ‘sustainability’ as used throughout this analysis is in line with the IMF’s definition that ‘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

The main messages can be summed up as follows:

- The pandemic has brought about increased risks related to the structure and financing of debt, macro-financial linkages and competitiveness, according to a heatmap of relevant indicators.
- This box presents two scenarios which explore the impact on the debt-to-GDP ratio arising from different fiscal policies in the medium term. In most simulations, the debt ratio is not expected to embark on an explosive path. However, the debt ratio can be explosive in periods of prolonged large fiscal deficits, coupled with a shock in GDP growth. In all simulations, the debt ratio is expected to remain above pre-pandemic levels. The extent to which the debt ratio can be brought down depends on the extent and speed of the economic recovery and the pace of fiscal consolidation.
- There exist risks which could not be quantified and incorporated in the scenario analysis. In the immediate term, these mainly reflect the likelihood of additional COVID-related support, state aid to Air Malta and support to cushion the impact of rising commodity prices following the conflict in Ukraine. Medium-to-long term risks include the impact of pre-1995 rent reform on government finances, the reform in the international corporate tax framework and the introduction of new EU-wide revenue raising measures. While these risks may be substantial, the resulting changing structure of the Maltese economy, including as a result of reform implemented in the context of the national Recovery and Resilience Plan, may bring both a positive impact on debt sustainability as well as a negative impact.

Scenario analyses

In the coming years, Government is set to reduce the deficit from the levels it incurred in 2020 and 2021, as COVID-related support measures end and economic activity recovers. At the same time, fiscal policy is set to remain supportive of economic growth in the short term. The following two scenarios explore the impact on the debt-to-GDP ratio arising from different fiscal policies in the medium term.

Up until 2024, assumptions for GDP growth, inflation and Government’s borrowing costs in both scenarios are in line with the Bank’s latest forecast exercise.⁴ Thereafter, a series of common assumptions govern the path of macro items, prices and interest rates (see section at the end of this box). The scenarios differ mainly in the forecast path of fiscal consolidation which is assumed to take place.

¹ Prepared by John Farrugia, Manager Fiscal Issues and Reports Office 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.

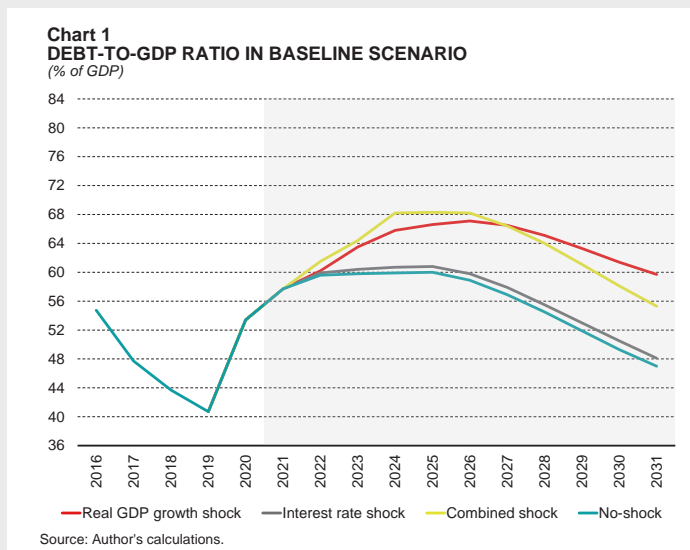
² For further details on government debt dynamics and fiscal sustainability, see Farrugia, J. and Grech, O., “The Sustainability of Maltese Government Debt Revisited”, in Grech, A.G., and Zerafa, S. (eds.), *Challenges and Opportunities of Sustainable Economic Growth: the Case of Malta*, Central Bank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

³ This study uses the national accounts vintage up to the fourth quarter of 2021, published in March 2022 and the general government data vintage up to the third quarter of 2021, published in January 2022. The cut-off date for projections is 11 February 2022.

⁴ This exercise includes the impact of fiscal measures announced at the start of February 2022. It is available here: <https://www.centralbankmalta.org/economic-projections>

Scenario 1 – Baseline Scenario

In this scenario, fiscal deficit targets until 2024 are in line with the Bank's latest projections. Thereafter, it is assumed that Government reverts to its pre-COVID target (a budget surplus in structural terms). Consequently, additional fiscal consolidation measures are assumed to take place between 2025 and 2027. In this scenario, a balanced structural budget is achieved by 2027 and a small surplus is posted in subsequent years.



On the basis of these assumptions and excluding the impact of any shocks, the general government debt is expected to peak in 2024 before declining to around 47.0% of GDP by 2031 (see Chart 1).

Owing to the low level of interest rates at the start of the forecast period, a permanent interest rate shock is expected to exert a small impact on public debt. On the other hand, owing to the denominator effect, a pure permanent shock to GDP growth would have a significant impact on the debt ratio. In the event of a combined shock, where fiscal policy is more supportive in periods of shocks to GDP growth but reverts to a contractionary stance thereafter, the debt-to-GDP ratio stands at just over 55% by 2031.

In this scenario, the debt ratio is not explosive even during periods of shock. In fact, it remains on a downward trajectory even in the combined shock scenario, which reflects a more plausible outcome compared with the pure GDP and interest rate mechanical shocks. However, by the end of the simulation horizon, the debt ratio is expected to remain above pre-pandemic levels. The extent to which the debt ratio is brought down depends on Government's commitment to adhere to consolidation targets.

Scenario 2 – Alternative Scenario

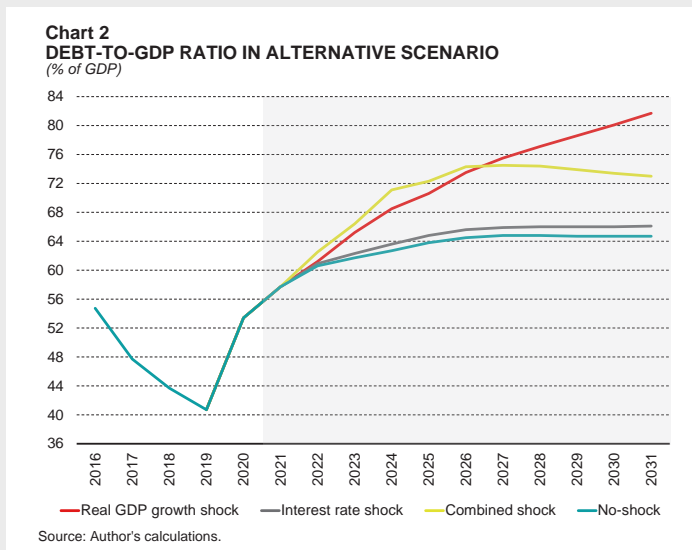
In this scenario, it is assumed that fiscal consolidation is not pursued as aggressively as in the baseline scenario. Between 2022 and 2024, the general government deficit-to-GDP ratio is wider by around one percentage point compared with the baseline scenario. Thereafter, Government is assumed to target a headline deficit-to-GDP target of 3.0%. Consequently, the structural balance remains in deficit throughout the simulation horizon.

Excluding the impact of any shocks, general government debt is set to reach just under 65.0% by 2027 and remain broadly stable thereafter (see Chart 2).

A mechanical and permanent interest rate shock is not expected to significantly affect the debt-to-GDP path. However, owing to the continuous projected large deficits, a mechanical and permanent shock to GDP growth puts the debt ratio on an upward and explosive path. In a more credible scenario as envisaged by the combined shock simulation, the debt-to-GDP ratio is set to gradually decline once

the supportive fiscal stance is scaled down. However, since Government is still assumed to retain a deficit throughout this simulation, the debt ratio is set to decline at a very slow pace and to remain around 73% of GDP by 2031.

In this scenario, government adopts a looser fiscal stance compared with the baseline scenario. Consequently, in a mechanical shock simulation, debt may embark on an explosive path. In the combined shock simulation, which offers a more plausible path for GDP and fiscal policy in the event of a shock, debt is not explosive. That said, the debt ratio remains significantly above the debt ratio in the baseline scenario. When compared with the baseline scenario, therefore, the alternative scenario highlights the significance of short-to-medium term consolidation measures in bringing down the debt burden.



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 mainly sourced from the European Commission's *Debt Sustainability Monitor* series. The threat that 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.

This is a backward looking analysis using information up to 2020. At the time this exercise was completed, data at end-2021 was not available for most indicators.

The pandemic has brought about increased risks surrounding the structure of debt and liquidity risks. In 2020, the share of short-term debt in the total debt maintained its upward trend and consequently remained as a medium threat. This is mainly due to a higher level of Treasury bills outstanding and the increased financing needs brought about by the pandemic. Despite a drawdown of existing government deposits (from 8.6% of GDP in 2019 to 7.4% of GDP in 2020), the net financing needs of general government remained substantial and stood just above the high-risk threshold used in this heat map.

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. This metric increased for the first time since 2013, reflecting adverse pandemic-related conditions. Nevertheless, it remained close to historic lows.

Regarding implicit liabilities, ageing costs (pensions, healthcare and long-term care) as a share of GDP form another significant risk to sustainability. According to the Commission's 2021 *Ageing Report* projections, at 8.0 points, Malta is set to have the fourth highest increase in age-related spending in the euro area between 2019 and 2070. Compared with the previous *Ageing Report* publication, costs

Table 1
HEAT MAP

	2016	2017	2018	2019	2020
Structure of debt					
Share of short-term debt	Green		Yellow		
Change in share of short-term debt (y-o-y)	Green		Red	Green	Red
Share of foreign currency denominated debt	Green				
Share of debt with variable interest rate in GDP	Green				
Share of debt held by non-residents	Green				
Liquidity risks					
Gross financing needs (% of GDP) (High/Low risk)	Green				Yellow
Net financing needs (% of GDP)	Green				Red
10-year government bond spread over German Bund	Green				
Macro-financial risks					
Private sector debt (% of GDP)	Yellow	Green			Yellow
Private credit flow (% of GDP)	Yellow	Green			Yellow
Net international investment position (% of GDP)	Green		Yellow	Green	
Share of NPLs to gross loans: core banks	Red				
Change in share of NPLs (core banks) (y-o-y)	Green				Red
Bank loans-to-deposits ratio (core banks)	Green				
Change in nominal house prices (y-o-y)	Green				
Competitiveness risks (High/Low risk)					
ULCs (% change over 3 years)	Yellow		Red	Yellow	Red
Real EER (% change over 3 years)	Green				
Current account balance (3 yr average as % of GDP)	Green				
Export market shares (% change over 5 yrs)	Green				
Implicit/ contingent risks					
Commission Ageing Report: 2019-2070 ageing costs (pp of GDP)	Red	Yellow			Red
General government guarantees (% of GDP)	Red	Yellow			

Source: Author's calculations.

are expected to increase at a faster rate. However, whereas in the previous Report costs were set to reach the euro area average by 2070, they are now set to remain below it.

Government-guaranteed debt increased in 2020 due to the introduction of pandemic-related support schemes (see below). Its share in GDP stood at 9.0%, with the bulk of guarantees debt mainly concentrated in the energy sector.⁵ However, this ratio is in line with the euro area average and remains lower than the recent peaks observed in 2012 and 2014. For this reason, this metric remains classified as a medium risk.

Non-quantifiable risks

This section outlines other debt sustainability risks which are likely to materialise but cannot be quantified at present.

In the immediate term, the main risks to debt sustainability concern the likelihood of additional support measures. These include schemes to support industries hard-hit by the pandemic as well as measures aimed at mitigating high commodity prices. At the time this exercise was finalised, no definite date for the withdrawal of existing COVID-19 support measures was announced and Government remained committed towards cushioning the impact of rising commodity prices following the conflict in Ukraine. Another immediate risk concerns the likelihood of state support to Air Malta. In January, the Finance Minister announced a restructuring exercise in which the company's existing personnel

⁵ See National Audit Office Malta (2021). "Annual Audit Report: Public Accounts 2020" for further details.

is set to be reduced by around half. Employees will be offered the option to transfer to another public sector institution, under similar working conditions. At the same time, Government remains in talks with the European Commission over the possibility of additional State aid.

In the short-to-medium term, sustainability risks relate to the inability of some firms to repay loan obligations, particularly once government guarantees and moratoria are phased out. Government finances stand to be affected through its exposure to the MDB CGS, if a portion of the guarantees are called. However, according to the Bank's *Interim Financial Stability Report 2021*, this risk is seen as small given banks' overall resilience, the substantial decline in active moratoria and the relative stability in the volume of loans granted under the CGS in 2021 (see chapter on monetary and financial developments).

Other short-to-medium term risks reflect the impact of a reform in rental costs for properties bound under pre-1995 leases. Under the reform, which came into effect in June 2021, landlords can increase the annual rent up to two per cent of the property's market value. However, tenants in gainful employment will not spend more than 25% of their income on rent, while pensioners and social welfare beneficiaries will not experience an increase in rent. Instead, the difference in rent will be borne by the State. This reform will affect up to 10,000 families. Since any increases in rent need to be determined on a case-by-case basis by the Rent Regulation Board, the fiscal impact in the medium term cannot be ascertained at present.

Medium-to-long term sustainability risks reflect the impact of a reform in the international corporate tax framework, as agreed by members of the Organization for Economic Co-operation and Development (OECD)/G20 Inclusive Framework. The reforms affect large multinational companies and seek the partial re-allocation of taxing rights from their home countries to markets where they also earn turnover. The reforms are also set to introduce a 15% global minimum effective corporate tax rate. The European Commission already proposed a directive on the implementation of the minimum effective tax, which is set to take effect from 2023. The impact of these proposals on Government finances is hard to quantify at this stage but could prove to be material.

Other medium-to-long terms risks reflect the likelihood of new EU-wide revenue raising measures, which Member States in principle agreed to introduce in order to repay financing of the NGEU rescue package. These include a revision of the EU Emissions Trading System, the introduction of a carbon border adjustment mechanism and an own resource requirement from the above mentioned international corporate taxation framework.⁶ If implemented, such measures have the potential to significantly affect the Maltese economy and public debt sustainability. On the one hand, the introduction of new taxation systems may disrupt existing industries and negatively affect inflows from corporate taxes. On the other hand, the shift towards new industries may boost competitiveness and productivity, leading to increased investment. The long-run impact of structural reforms implemented as part of the national Recovery and Resilience Plan – which ought to reduce sustainability risks – is also difficult to gauge.

Assumptions and technical information

Scenario analyses: common assumptions (from 2025 onwards)

Potential output growth is determined exogenously in this framework. 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 policy affects economic growth – and the output gap, which eventually closes. For further details, refer to the *Annual Report 2018* Box.

⁶ See https://ec.europa.eu/commission/presscorner/detail/en/ip_21_7025

Table 2
SCENARIO ASSUMPTIONS: MAIN DETERMINANTS OF DEBT

Per cent

	Baseline scenario		Alternative scenario	
	2021-2024 average	2025-2031 average	2021-2024 average	2025-2031 average
Real GDP growth rate	6.1	3.3	6.1	3.3
Inflation (GDP deflator growth rate)	2.2	2.0	2.2	2.0
Interest rate applied to				
Short-term debt	-0.2	0.4	-0.2	0.4
Long-term debt maturing within a year	0.4	0.9	0.4	0.9
Non-maturing long-term debt	2.5	2.7	2.5	2.7
DDAs (% of GDP)	0.4	0.5	0.4	0.5
Primary balance (% of GDP)	-4.7	0.8	-5.4	-1.5

Source: Authors' calculations.

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

Meanwhile, the level of the DDA is assumed to revert to its long-run average. No temporary fiscal measures, other than those related to COVID-19, are assumed to take place.

Government debt is forecast on the basis of different types of maturity. The share of each category of debt is assumed to revert to 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).⁷ Interest rates on non-maturing debt are based on the maturity profile of outstanding Malta Government Bonds.

The forecast path for the main determinants of debt is shown in Table 2.

Scenario analyses: shocks (applied from 2022 onwards)

Permanent mechanical 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 Mission. On average, compared with the no-shock scenarios, there is a 2.3 percentage point decrease in the yearly, real GDP growth and a 0.9 percentage point increase in the interest rate.

Combined shock simulations assume a 1.0 percentage point decline in real GDP growth for three years, and a permanent 1.0 percentage point increase in interest rates. At the same time, the pace of fiscal consolidation is relaxed in the years when GDP growth is negatively affected, but is then pursued more vigorously compared with the no-shock simulation.

⁷ The euro area interest rate projections were sourced from the ECB's technical assumptions.



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 Central Bank of Malta regularly conducts open market operations with credit institutions established in Malta. It also offers standing facilities, administers the minimum reserve requirement system and participates in the APP and in the PEPP.

Open market operations

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

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.

During 2021, the Eurosystem continued to offer liquidity to eligible credit institutions via fixed-rate tender procedures with full allotment, through both MROs and LTROs.

More specifically, during 2021, the ECB conducted 52 MROs. Credit institutions established in Malta participated in these operations with a total cumulative amount of €84.0 million, €83.0 million higher when compared to 2020 (see Table 1.1).

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

EUR millions

Type of operation ⁽¹⁾	2020	2021
MROs	1.0	84.0
LTROs		
- Three-month	10.0	10.0
- PELTROs	45.0	75.4
- TLTROs	63.5	520.0
US dollar collateralised operations (USD millions)		
- Seven-day	1,840.2	5,881.9
- 84-day	35.1	61.0

⁽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.

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.

The ECB also conducted 12 regular three-month LTROs with full allotment and at a fixed rate equal to the average MRO rate during the life of the operations. Credit institutions established in Malta participated with an aggregate amount of €10.0 million in such operations, similar to 2020 (see Table 1.1).

During 2021, the ECB conducted four PELTROs as fixed rate tender procedures with full allotment, with the interest rate set at 25 basis points below the average MRO rate applied over the life of the respective PELTROs.² Credit institutions established in Malta participated in these operations with an amount of €75.4 million, which is higher than the €45.0 million taken up in the previous year (see Table 1.1).

During 2021, the ECB conducted the last four quarterly operations from the third series of the TLTROs that started in September 2019. On 10 December 2020, the Governing Council modified the terms and conditions of these operations. The modifications included an extension of the pandemic-related low interest rate period by an additional 12 months, to June 2022, three additional operations with a maturity of three years to be allotted in June, September and December 2021 and an increase in the borrowing allowance from 50% to 55% of eligible loans. As illustrated in Table 1.1, credit institutions established in Malta borrowed a total of €520.0 million from the TLTROs conducted in 2021.

As from September 2021 and one year after the settlement of each TLTRO, credit institutions, on a quarterly basis, have the possibility to partially or fully repay the amounts allotted in such TLTROs. Maltese credit institutions with outstanding TLTROs did not participate in the early repayments.

During 2021, the ECB continued the weekly liquidity-providing operations of US dollars 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 USD 5,811.9 million, which is considerably higher than the USD 1,840.2 million taken up in the previous year.

Additionally, on a weekly basis and until 1 July 2021, the ECB also conducted the 84-day liquidity-providing operations of US dollars. Credit institutions established in Malta participated for a cumulative amount of USD 61.0 million in the 84-day USD operations, which is higher than the USD 35.1 million taken up in the previous year. On 23 April 2021, in view of the sustained improvements in US dollar funding conditions and low demand in such operations, the ECB, the Bank of England, the Bank of Japan and the Swiss National Bank, in consultation with the Federal Reserve, jointly decided to discontinue offering the US dollar liquidity at the 84-day maturity as of 1 July 2021.

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.

Recourse to the overnight deposit facility by Maltese credit institutions amounted to a daily average of €18.6 million, a decrease of €15.2 million compared to the 2020 average. Similar to 2020, Maltese credit institutions did not utilise the marginal lending facility in 2021.

The interest rates on the MROs, the marginal lending facility and the overnight deposit facility remained unchanged throughout the year at 0.00%, 0.25% and -0.50% respectively.

Reserve requirements

The ECB requires credit institutions established in the euro area to hold reserve deposits with their respective national central bank (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 with the Central Bank of Malta, equivalent to a fraction of certain liabilities, mainly deposits. During 2021, this reserve requirement ratio remained unchanged at 1.0%. The average

² These operations were announced by the Governing Council of the ECB on 10 December 2020.

balance required as minimum reserve deposits by credit institutions established in Malta amounted to €289.2 million in 2021, almost unchanged compared to €289.8 million in 2020. The average daily balances held in the current accounts with the Central Bank of Malta amounted to €6,115.1 million in 2021, compared to €5,066.2 million in 2020.

During the year, credit institutions in Malta continued benefitting from the two-tier system for reserve remuneration which was introduced by the Governing Council of the ECB as from 30 October 2019. Such system exempts part of credit institutions' excess liquidity holdings from the negative deposit facility rate. Currently, the volume of reserve holdings in excess of the minimum reserve requirements that is exempted from the deposit facility rate is determined as a multiple of six on an institution's minimum reserve requirements. 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 is remunerated at zero per cent or the deposit facility rate, whichever is lower. Since the introduction of the two-tier system until the maintenance period ending on 21 December 2021, credit institutions in Malta saved an estimated €14.3 million compared to a situation where the negative interest rates would apply to all their excess reserves.

Asset purchase programme

Throughout the year, the Central Bank of Malta continued to participate in the PSPP, which is part of the APP.¹

During 2021, the Central Bank of Malta purchased €216.1 million worth of Maltese sovereign bonds under the PSPP. Since inception, the total securities purchased by the Central Bank of Malta for its PSPP portfolio amounted to €1,406.6 million at the end of 2021.² The Central Bank of Malta's PSPP holdings had a weighted average remaining maturity of 10.97 years as at the last trading day for December 2021.

During the year, the Central Bank of Malta also purchased €23.5 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 €258.7 million.³

The Central Bank of Malta 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.

Pandemic emergency purchase programme

The Central Bank of Malta also participated in the PEPP, announced on 18 March 2020 by the Governing Council as one of the ECB's responses to the economic and financial market fallout from the COVID-19 pandemic. On 10 December 2020, the Governing Council of the ECB decided to increase the PEPP envelope by a further €500.0 billion to €1,850.0 billion and to extend the horizon for net purchases to at least the end of March 2022.⁴

During 2021, the Central Bank of Malta purchased €235.2 million worth of Maltese sovereign bonds under the PEPP. Since the inception of this programme, the Central Bank of Malta bought €471.1 million worth of Maltese sovereign bonds.⁵ The Central Bank of Malta's PEPP holdings had a weighted average remaining maturity of 11.36 years as at the last trading day for December 2021.

¹ On 16 December 2021, the Governing Council of the ECB decided on a monthly net purchase pace of €40 billion in the second quarter and €30 billion in the third quarter of 2022 under the APP. From October 2022 onwards, the Governing Council will maintain net asset purchases under the APP at a monthly pace of €20 billion for as long as necessary to reinforce the accommodative impact of its policy rates. The Governing Council expects net purchases to end shortly before it starts raising the key ECB interest rates.

² This figure does not reflect the amortisation of securities held under the PSPP portfolio. Purchases of securities which matured between 2017 and 2021 are also included in this figure.

³ See footnote 4.

⁴ On 16 December 2021, the Governing Council of the ECB decided that in the first quarter of 2022, it expects to conduct net asset purchases under the PEPP at a lower pace than in the previous quarter. Furthermore, it will discontinue net asset purchases under the PEPP at the end of March 2022. The Governing Council also decided to extend the reinvestment horizon for the PEPP and it now intends to reinvest the principal payments from maturing securities purchased under the PEPP until at least the end of 2024.

⁵ This figure does not reflect the amortisation of securities held under the PEPP portfolio. Purchases of securities which matured in 2020 and 2021 are also included in this figure.

During the same period, the Central Bank of Malta also purchased €38.2 million worth of Maltese sovereign bonds that were transferred to the ECB's own PEPP portfolio, with total securities bought since inception in this portfolio amounting to €64.6 million.⁶

Similar to the APP, the Central Bank of Malta participated only in the public sector purchases under the PEPP.

Collateral management

All Eurosystem credit operations take place against eligible collateral. The Central Bank of Malta is responsible for assessing the eligibility of domestic marketable securities which can be used as collateral in Eurosystem monetary operations and for reporting them to the ECB. As at end-December 2021, the nominal outstanding value of eligible domestic marketable securities amounted to €7,237.2 million, compared with €6,286.9 million a year earlier.

At the end of the year, the market value after haircuts of securities pledged with the Central Bank of Malta by credit institutions established in Malta stood at €1,387.5 million. This consisted of both domestic and foreign assets, with the share of debt instruments issued by the Maltese government accounting for around 75.8% of the securities pledged.

As from 1 January 2021, bonds with coupon structures linked to certain sustainability performance targets became eligible as collateral for Eurosystem credit operations and outright purchases for monetary policy purposes, provided they comply with all other eligibility criteria.

Furthermore, as from 1 January 2021, secured marketable assets other than Asset-Backed Securities (ABSs), legislative covered bonds and multi-cédulas were phased out as collateral following a press release issued by the ECB on 22 September 2020.

On 28 June 2021, the ECB announced that as of 1 October 2021, ABSs under the scope of the Securitisation Regulation will only be assessed for compliance against Eurosystem collateral eligibility criteria if loan-level data is submitted to the European Securities Market Authority (ESMA) registered securitisation repository and according to the templates developed by ESMA. All ABSs seeking eligibility as Eurosystem collateral are subject to the same loan-level data requirements, regardless of any exemption from the disclosure requirements under the Securitisation Regulation. Moreover, for eligible ABS transactions issued prior to 1 January 2019, the Eurosystem's current loan-level data reporting requirements will be maintained until 31 September 2024.

Liquidity management

The Central Bank of Malta 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 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.

Extension of the bilateral euro liquidity lines with non-euro area central banks

On 4 February 2021, the ECB decided to extend the temporary euro liquidity lines by nine months to March 2022. The lines were established in 2020 to provide euro area liquidity to financial institutions in respective countries via the corresponding NCBs. The objective of these euro liquidity lines is to address possible euro liquidity needs in non-euro area countries in the presence of market dysfunctions due to the COVID-19 pandemic. Furthermore, they aim at preventing spillback effects on euro area financial markets and economies that might adversely impact the smooth transmission of the ECB monetary policy.

⁶ This figure does not reflect the amortisation of securities held under the PEPP portfolio. During 2020 and 2021 there were no maturities in this portfolio.

Benchmark interest rate reform

On 11 May 2021, the private sector working group on euro risk-free rates published its recommendations addressing events that would trigger fallbacks in EURIBOR-related contracts, as well as €STR-based EURIBOR fallback rates. While there is currently no plan to discontinue EURIBOR, the development of more robust fallback language addresses the risk of a potential permanent discontinuation and is in line with the EU Benchmarks Regulation. As with similar fora in other currency areas, the working group's recommendations are not legally binding for market participants. However, they provide guidance and represent the prevailing market consensus on EURIBOR fallback trigger events and €STR-based fallback rates, which market participants may consider in their contracts.

Furthermore, it was decided that the working group secretariat will move to ESMA, which, as provided for in the BMR, will supervise the administrator of EURIBOR as of 2022.

Additionally, to encourage and support the wider use of the €STR, including in fallback provisions in contracts based on the EURIBOR, the ECB started publishing compounded €STR average rates and a compounded index as from April 2021.

Treatment of leverage ratio in the Eurosystem monetary policy counterparty framework

On 7 May 2021, the ECB published amendments to its monetary policy implementation guideline according to which the leverage ratio becomes a binding Pillar 1 own-funds requirements. Accordingly, as of 28 June 2021, the treatment of the leverage ratio in the Eurosystem monetary policy counterparty framework will be aligned with that of existing Pillar 1 own-funds requirements, consisting of the common equity tier 1 capital ratio, the tier 1 capital ratio and the total capital ratio.

Non-monetary policy operations

The Central Bank of Malta's investment portfolio amounts to circa €2,100 million of euro and foreign currency denominated financial assets. The EUR portfolio represents approximately 60% of assets under management, while the remaining 40% are predominantly invested in USD denominated assets, with a smaller allocation of securities invested in the other G10 currencies. The Bank seeks to limit its foreign exchange (FX) risk by hedging its foreign currency holdings. The Bank's asset holdings are determined through a Strategic Asset Allocation exercise which is carried out annually and approved by the Board of Directors. During 2021, the investment portfolio was spread across several asset classes including money market instruments, fixed income securities, equities, derivatives, and gold. The fixed income asset classes include sovereign bonds, securities issued by supranational and national government agencies, bank covered bonds and senior debt. The majority of the Bank's assets are internally managed through held-to-maturity fixed income portfolios as well as fixed income portfolios that are actively managed against internally constructed benchmarks. A relatively smaller part of the Bank's financial assets is managed by external asset managers either through a mandate or investments in funds.

The Bank's Investment Policy Committee (IPC) is chaired by the Governor and includes the Deputy Governors and senior officials from the Bank's Investments, Financial Risk and Finance Departments. Its mandate is to set the investments policy upon which the management of the Bank's financial assets will be based as well as to monitor the performance of such assets. When setting its investment policy, the Bank aims to optimise returns, preserve capital and ensure sufficient liquidity in line with pre-set financial risk parameters that stipulate acceptable interest rate, credit and market risks, amongst others. The IPC subsequently evaluates the implementation of investment strategies, reviews reserve-management practices and assesses the overall investment policy. During 2021, the Committee met on a monthly basis, with additional meetings held to address specific issues. Proposals relating to parameters or investment universe and the respective impact on the Bank's profitability were discussed as part of the Strategic Asset Allocation exercise. The Committee is also responsible to set the Tactical Benchmark for the internally active managed funds on a monthly basis.

During 2021, the Bank increased its holdings of foreign currency denominated securities in the fixed income held-to-maturity portfolio thus contributing to an increase in foreign reserves. The Bank liquidated part of

its externally managed corporate bond portfolio whilst increasing exposure to unconstrained fixed income mutual funds, one of which has an ESG theme. Moreover, with the aim of diversifying risks and potentially increasing longer-term returns, the Bank has started to invest a small share of its assets under management in SRI compliant equities through Exchange Traded Funds (ETFs) and a mutual fund.

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 Central Bank of Malta remains a participant in the European Exchange Rate Mechanism, a mechanism set up with the intention to ensure that exchange rate fluctuations between the euro and other EU currencies do not disrupt economic stability within the single market, while simultaneously helping non-euro area countries to prepare themselves for participation in the euro area. The Bank continued to enter into spot/outright foreign currency purchases and FX swap purchases and sales as part of the management of its own FX positions. This activity has increased compared to the previous year. The Central Bank of Malta continued to repo out fixed income holdings in the general collateral pooling market and special repo market. This activity was lower in 2021 compared to the previous year. The Bank continued to report to the ECB information on its FX transactions and holdings as well as on the EUR denominated portion of the investment portfolio.

The Bank continued to manage the financial assets of the Investor Compensation Scheme (ICS) and Depositor Compensation Scheme (DCS) on behalf of the Malta Financial Services Authority (MFSA). During the year, the Bank also kept on fulfilling its obligations of its agreement with the National Development and Social Fund (NDSF) to administer part of the NDSF's portfolio. During 2021 the Fund appreciated compared to an initial investment of €100 million.

Government securities market-making operations

The Central Bank of Malta has been acting as a market-maker for MGSs since its inception in 1968. The Bank continued to provide market-making facilities by quoting daily bid and offer prices for the listed MGSs on the MSE and through providing two-way trading by purchasing MGSs on offer, at the prevailing indicative Bank bid price or lower, and by placing stocks on offer. Furthermore, the Bank also acted as an agent on behalf of public institutional clients.

Total turnover activity in the secondary market for MGSs in 2021 declined when compared to the previous year. In nominal terms, total trading in these securities fell from €126.9 million in 2020 to €114.1 million in 2021. As in recent years, the Treasury of Malta targeted most of its bond auctions to the wholesale sector, with the auction held in July 2021 being the only exception. The hold-to-maturity tendency of the wholesale investor was seen as a determining factor for the drop in secondary market liquidity. Another major factor contributing to the lower total turnover was the substantial decline in inter-broker deals in which activity declined from €84.7 million in 2020 to €61.1 million in 2021. Furthermore, the number of inter-brokers participating in the market decreased from 16 in 2020 to 12 in 2021.

The Bank's market-making function effected 46.5% of the total on-exchange deals. The percentage recorded last year relative to the traded turnover was 33.2%. Total Bank purchases amounted to €24.8 million, whilst sales totalled €28.3 million, for a total Bank turnover of €53.1 million. These figures are slightly higher when compared to the €42.2 million in turnover registered in 2020 by the Bank.

After being inactive since 2014, the Bank purchased Treasury Bills for a total nominal value of €24.3 million in 2021. The three-month Treasury bill is the most issued short-termed instrument by the Treasury. At the start of the year, the primary market yield for the three-month benchmark stood at -0.47%, increasing by a maximum of 8 basis points to -0.39% at the auctions held in September, ending the year with an overall increase of 6 basis points, at -0.41%.

Over the past year, the Government Securities Office continued to enhance its pricing policy model and implemented a more dynamic bid/ask spread for each Treasury Bill and MGS on issue, to better capture any market developments which occur from time to time.

The Government of Malta continued to increase the maximum amount of issuance from €1.3 billion in 2020 to €1.5 billion in 2021 to sustain the increased spending deemed necessary to protect the economy from the repercussions of the COVID-19 pandemic. Despite these record issuances in the past two years, the secondary turnover activity continued its downward trend. The Bank assisted the Treasury in these auctions, by advising in the choice of maturities and coupons to offer in the primary market with the aim of attracting sufficient demand while limiting somewhat the refinancing risk during the COVID-19 pandemic, where amounts on issue exceeded the €1.0 billion mark. Furthermore, the Bank was involved in analysing potential additional avenues for financing other than the prevailing MGSs.



2. FINANCIAL STABILITY

In its capacity as the Macroprudential Authority in Malta, the Central Bank of Malta is entrusted with maintaining the stability of the financial system. The Bank carries out this function through the Financial Stability Surveillance & Research Department and the Policy, Crisis Management & Stress Testing Department. Together, these Departments monitor developments in the financial system, focusing on potential financial stability risks, as well as with the formulation, implementation and maintenance of the macroprudential policy framework in Malta. These are complemented by stress testing and risk model assessments to gauge the extent of vulnerabilities and relative resilience of the domestic financial system to severe, yet plausible shocks.

Main developments

The Bank, in its efforts to keep the public and stakeholders informed of financial stability matters, published its risk assessments, results of stress testing exercises and work related to macroprudential policy in its *Financial Stability Report (FSR) 2020* and its *Interim FSR* covering the first half of 2021. These publications also carried several special features and boxed articles which assessed the extent of non-bank financial intermediation in Malta, the take-up of moratoria in Malta, an overview of a revised methodology for a credit risk quantification model, as well as an account of the revised methodologies for categorising banks and selecting domestically-relevant investment funds. Furthermore, in light of the increased recognition of the importance of climate change and its effect on the financial sector, a Special Feature was published in the *Interim FSR 2021* as a first attempt to gauge the domestic financial sector's exposure towards climate-sensitive sectors.

The year 2021 marked a continuation of the previous year, particularly in terms of the activation of macroprudential policy tools. While some of the measures were still in place until, at least, the first half of 2021, some measures started to be eased while others were phased-out.

The application deadline for loan moratoria under CBM Directive No. 18 expired on 31 March 2021. As of December 2021, only a negligible amount of loan moratoria remained active as moratoria periods continued to gradually expire. Active moratoria amounted to just 0.2% of total outstanding loans to Maltese residents and Maltese households held no loans that were subject to a moratorium.

The relaxation of Borrower-Based Measures communicated by the Bank in June 2020, in response to the COVID-19 pandemic, have expired and, as from July 2021, the fully phased-in loan to value-O limit of 75% for Category II borrowers became applicable. Moreover, following a public consultation, the Bank published an amended version of Directive No. 16 in November 2021, mainly reflecting revisions to borrower definitions and other refinements.¹

During 2021, the Bank also worked on a comprehensive dataset to be reported by banks, targeting the whole population of real estate loans.² The data set is aimed, amongst others, at addressing the ESRB Recommendation on closing real estate data gaps, and at assessing banks' compliance with the Bank's

¹ Link to amended Central Bank of Malta Directive No.16: <https://www.centralbankmalta.org/site/About-Us/Legislation/Directive-16-2021.pdf?revcount=2314>

² Recommendation of the ESRB of 21 March 2019 amending Recommendation ESRB/2016/14 on closing real estate data gaps (ESRB/2019/3). Source: https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation190819_ESRB_2019-3-6690e1fbd3.en.pdf

Directive No. 16. This data will enhance the Bank's internal analysis and will be used to inform any potential change needed to revise the Directive. Meetings were conducted with credit institutions to discuss clarifications on data submissions.

The identification of the Other Systemically Important Institutions (O-SII) and the related applicable buffer is an annual exercise carried out by the Bank in conjunction with the MFSA.³ The same four credit institutions identified as O-SIIs in 2020 have been re-confirmed in 2021 while changes in the buffer rates for two designated O-SIIs were announced. Due to the repercussions stemming from the COVID-19 pandemic, a one-year postponement of the phasing-in arrangements was granted to those institutions whose O-SII buffer rates are subject to transitory provisions. The affected banks are expected to resume their phasing-in arrangements during 2022.

In 2021, the Bank updated its methodology for the classification of domestic banks as well as for investment funds according to their domestic relevance. Developments assessed within the banking sector led to the reclassification of one bank from an international bank to a non-core domestic bank. Furthermore, following discussions with the MFSA, the list of investment sub-funds considered as domestically-relevant were updated. Both new classifications were used for the assessment as from the FSR 2020 onwards. In the same *Report*, the Bank provided a first analysis on the extent of non-bank financial intermediation in Malta. Drawing on the methodologies of the Financial Stability Board (FSB) and the European Systemic Risk Board (ESRB), the Bank defined the size of this sector, first according to the Broad Measure, and then filtered further to the Narrow Measure. The latter is made up of a selection of investment funds, lending institutions and Financial Vehicle Corporations for which an initial risk assessment was also provided.

The CCyB was maintained unchanged at 0% throughout 2021 with the credit-to-GDP gap widening slightly towards the end of the year, following the significant narrowing reported in previous quarters. The gap remained negative, with the assessment of supplementary indicators also supporting the decision not to activate the CCyB at the current juncture. Meanwhile, the capital conservation buffer remained in force with banks required to hold an additional capital of 2.5% of risk weighted assets.

During 2021, a revised version of the Capital Requirements Regulation (CRR II) was introduced in the European Union and became applicable on 28 June 2021.⁴ The main changes emanating from CRR II incorporate, amongst others, a net stable funding ratio (NSFR) of 100%, a binding leverage ratio set at 3%, the introduction of a fundamental trading framework and the EU's implementation of the new Basel standardised approach to counterparty credit risk.

In line with the ESRB's Recommendation on the assessment of cross-border effects of voluntary reciprocity for macroprudential measures, the Bank analyses macroprudential policy measures recommended for reciprocation by other Member States.⁵ During 2021, there were two new measures recommended for reciprocation, by Norway and Luxembourg. After analysing the recommendations, it was decided not to reciprocate on the basis that domestic credit institutions do not have material exposures towards these countries, and domestic banks do not make use of Internal Ratings-Based models for the purpose of calculating their regulatory capital requirements.

Pursuant to the ESRB Recommendation 2015/1 on the recognition and the setting of the CCyB buffer rates for exposures to third countries, in 2021 the Bank conducted its annual exercise with the aim to identify material third countries to which the domestic banking sector is exposed.⁶ The United States of America, the United Arab Emirates and the United Kingdom were identified as material third countries for Malta for

³ Link to the Bank-MFSA Policy Document on the revised methodology for the identification of O-SIIs and the related capital buffer calibration: <https://www.centralbankmalta.org/systemically-important-institutions>

⁴ Link to CRR II: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32019R0876&from=EN>

⁵ [Recommendation of the European Systemic Risk Board of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures \(ESRB/2015/2\) \(europa.eu\)](#)

⁶ ESRB/2015/1: Recommendation of the ESRB of 11 December 2015 on recognising and setting countercyclical buffer rates for exposures to third countries.

the period between the second quarter of 2021 and the second quarter of 2022. Compared to last year, the Republic of Turkey no longer represents a material third country for Malta whilst the UK was identified as a new material third country for the domestic sector.⁷

In addition to these capital buffers, banks are also expected by the respective supervisor to set aside the Pillar 2 guidance (P2G). Although this is a non-binding supervisory requirement, the P2G serves as an additional buffer to withstand severe financial stress. In 2021, the SSM has aligned the P2G methodology to the relevant legislation (the Capital Requirements Directive V by linking it to capital depletion under an adverse stress test). The resulting P2G is then adjusted and the final P2G is defined. The joint supervisory teams assess each bank's individual position both in terms of the overall risk and mitigation measures taken since the stress test reference date to determine the final P2G. To this end, the SSM used the results of the European Banking Authority (EBA) 2021 EU-wide stress test for the 38 banks it supervises and the results of the SSM stress test (based on the same macroeconomic scenarios and a broadly aligned methodology as the EBA exercise) for another 51 banks it supervises, including the three domestic Significant Institutions. The latter three banks were also included in the EBA 2021 transparency exercise, which provides data on 120 institutions over four reference dates (from the third quarter of 2020 until the second quarter of 2021) to foster transparency and market discipline.

In the local context, the Bank continued to run its suite of stress tests which continued to be refined to better reflect the outlook of main risks with specific adaptations to COVID-19, as well as changes in the regulatory frameworks. In particular, the NSFR was already being monitored long before it became binding. Further checks were conducted to ensure consistent reporting under the EBA Implementing Technical Standards reporting framework 3.0, while also developing a set of adverse scenarios to assess banks' resilience through its NSFR, that will be included in future FSRs.

As per previous years, the Bank acting on behalf of the ECB, carried out four quarterly rounds of the BLS in 2021, the results of which help the Bank in the monitoring of developments in lending standards and credit demand of households and NFCs. The BLS is carried out locally among the four large core domestic banks, which make up about 90% of total resident bank credit in Malta. The BLS results were published in a dedicated box in the Bank's FSR 2020, where local developments were also compared with the rest of the euro area.

The Bank also continued monitoring developments concerning AML as the different stakeholders, including the government, national authorities and market operators continued their work in addressing the recommendations made by MONEYVAL and the FATF. Going forward, the Bank will continue to contribute, within its remit, to strengthen Malta's AML/CFT regime.

Committee meetings at the domestic and European levels

The Bank's Financial Stability Committee (FSC) met five times in 2021 to discuss topics related to financial stability. Amongst other items, the FSC discussed the main changes effected to Directive No. 16, the setting of the macroeconomic scenario for the macro stress testing framework, the publication of FSRs and the annual O-SII identification and calibration exercise.

The JFSB met seven times in 2021 to discuss specific developments in the financial sector and to provide recommendations to the regulatory authorities.

Senior Bank officials participated in meetings, both at the European level with the ESRB, the ECB and their sub-structures, including the European Commission in the context of the European semester, as well as with the IMF and external credit rating agencies. The Bank as a member of the Network of Central Banks and Supervisors for Greening the Financial System participated in meetings of the Plenary, in outreach sessions and workstreams related to sustainable investments.

⁷ <https://www.centralbankmalta.org/reciprocity>

To increase the knowledge base of its employees, the Central Bank of Malta, in conjunction with the European Insurance and Occupational Pensions Authority, organised a two-day training event between 15 and 16 December 2021. The training provided an overview of the latest theoretical and practical concepts of macroprudential oversight with specific focus on banks and insurance companies.

The Domestic Standing Committee and its permanent task force, the Crisis Management Task Force, continued working on updating the Domestic Crisis Management Framework and the Memoranda of Understanding (MOUs) between the Bank, the MFSA and the Ministry for Finance and Employment amongst others. The Framework sets out the structure and high-level principles and procedures that guide the Authorities in the event of a financial crisis, whereas the MOUs ensure that there is efficient co-operation and exchange of information between the three Authorities in the prevention and management of financial crisis situations.

Future developments

Policy initiatives and risk assessments will continue to take place during 2022 with the aim of continuing to safeguard the stability of the financial system. These include further enhancement of the risk identification toolkit and research initiatives such as the inclusion of relevant emerging risks. Furthermore, areas which will merit particular interest during the upcoming year include further research on the effects of climate change on the domestic financial system, investigation into capital buffer usability and the potential need for the setting of macroprudential tools commensurate with a possible build-up of certain risks, as well as other risk models that may complement the Bank's stress testing toolkit.



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.

In 2021, staff continued to provide input for the monetary policy process by briefing the Governor ahead of his participation in the Governing Council of the ECB. Staff also contributed to briefing material ahead of meetings of the ECB's General Council. As in previous years, meetings were held with officials from the European Commission, the IMF and credit rating agencies to discuss the economic situation and outlook. Furthermore, the Bank also continued to participate in several teams set up in the context of the ECB's Monetary Policy Strategy Review which was concluded in July.

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 enhance the various tools used in the forecasting processes. Modifications were made to better account for the significant volatility in growth rates of several variables resulting from the impact of the pandemic in the previous year and the subsequent recovery of the economy in 2021 from the low level of activity in 2020. The commentary on the Bank's projections continued to feature boxes on specific aspects related to forecasting. In 2021, these boxes explored various topics, such as the implications of pandemic-related changes in consumption patterns on inflation; the economic impact of fiscal and liquidity support measures; the effects of the pandemic on the labour market; and the effects of lower tourist expenditure on private consumption data.

The Bank maintained its regular dialogue with companies' representatives and public sector institutions to obtain a better gauge of economic conditions and prospects. As containment measures were eased during the year, the exercise was carried out on a weekly basis. The Bank also launched a new quarterly publication – the *CBM Business Dialogue* – with general information about this exercise as well as reporting of responses at sectoral level.

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 and structural unemployment, a BCI, the FCI, as well as cyclically-adjusted fiscal and current account balances. Meanwhile, a previously developed indicator that summarises the degree of COVID-19 stringency measures began to feature regularly in the Bank's publications and was also adapted in line with the relevant international methodology, which was in turn itself reviewed as the global pandemic situation evolved. Moreover, the Bank continued to publish a monthly *Economic Update*. In addition to information on building development permits, this publication also started featuring information on promise of sale agreements and final deeds for residential property. In addition, the Bank's publications comprised COVID-19 related sections such as information on loans benefitting from moratoria and government-guaranteed loans issued in the aftermath of the pandemic.

The Economic Analysis Department worked closely with the statistical compilers in other institutions and participated in the work of the ECB's Statistics Committee. The Bank liaised closely with the NSO on the

¹ The Bank's publications can be found at: <https://www.centralbankmalta.org/publications>.

fourth wave of the HFCS. The related fieldwork was concluded mid-year and the first results presented to the Bank in the second half of the year, ahead of the first transmission of data to the ECB planned for early 2022.

Bank staff undertook specialised research which resulted in five working papers, nine policy notes and 17 articles in the Bank's regular publications. Three working papers covered an analysis of the business cycle in Malta, labour productivity and household savings behaviour. Two additional working papers documenting the exchange rate pass-through and public mobility during the COVID-19 pandemic were also summarised in the *Research Bulletin*. Four of the policy notes dealt with inflation for low-income households, trends in education attainment, governance, and the impact of migration assumptions on ageing expenditure forecasts. Three other policy notes focused on the impact of the COVID-19 pandemic, while another two on the labour market, more specifically, unemployment duration and regional employment.

Research was also presented externally, both locally and abroad. Five studies were published in foreign peer-reviewed journals. Staff participated in the Rental Observatory set up by the Housing Authority to scrutinize the developments in the private rental market and contributed to a number of sections of the first edition of the Annual Residential Rental Study. The Economic Research Department also provided input to several ECB working groups and task forces and presented research results in local and external virtual conferences or webinars on a diverse range of topics.

In 2021, the Bank organised its fourth Annual Research Symposium. The symposium focused on climate change and had two external speakers. In the first presentation, Ms Alexandra Maratou, Senior Policy Analyst at the European Roundtable on Climate Change and European Transition focused on the role of market-based instruments under the EU *Fit for 55* climate and energy package. In the second presentation, Professor Francesca Severini from the University of Macerata provided an overview of a CGE model for the Maltese economy that is currently being developed. This model is the result of a cooperation agreement between the Central Bank of Malta and the University of Macerata to develop a CGE model, which once completed, will be a useful addition to the Bank's suite of models to address policy questions related to demand and supply conditions in specific industries. During the virtual workshop, the Bank launched the fourth edition of its *Research Bulletin*. The four articles in the *Research Bulletin* covered the transmission of external shocks to the local economy; the mobility during the COVID-19 pandemic; the relationship between education and salaries in Malta; and the channels of transmission of exchange rates to domestic consumer prices.

The Bank continued to organise regular internal seminars to stimulate economic discussion and debate on its studies prior to their publication. Staff members kept regular contact with academia, both locally and abroad. In addition, assistance from external institutions was sought for the peer-review of the Bank's technical studies. The Bank remained active in domestic fora, such as the National Productivity Board, the Building Industry Consultative Council and the Rental Observatory. An economist from the Economics Division also presented his research during a seminar organised jointly by the Central Bank of Malta and the Malta Chamber of Commerce on current inflationary pressures.

Research plans for 2022 include studies on long-term structural trends in the Maltese economy, including demographic changes, climate change and digitalisation, as well as fiscal, monetary and macroprudential policy analysis. In addition, the Economics Division will continue to assess the impact of COVID-19 on the economy and on specific sectors. Finally, resources will be also allocated for the Bank to pursue further development of econometric and structural models to complement the Bank's forecasting toolkit and enhance its research capacity.



4. STATISTICS

The Central Bank of Malta is primarily responsible for the collection and compilation of a wide range of data sets. These include statistics on monetary, banking, payments, securities, financial accounts, financial soundness, financial market and financial institutions in Malta. The Bank also collects various other data for internal policy-making purposes, such as prudential supervisory and macroeconomic statistics. These statistics, which are regularly updated in the Bank's website, are also used by other national and international authorities and organisations, market participants, media and the public. The Bank also contributes to the compilation of the NSO's BOP/International Investment Position (IIP) statistics. It also fulfils various international statistical reporting obligations, mainly to the ECB and the IMF. In the latter case, the Bank participates in the Fund's SDDS and the General Data Dissemination System, as well as in various surveys of the Fund.

Participation in Eurosystem-related work pursued during the year. New and amended statutory returns were launched to fulfil the revised ECB Regulations and Guidelines on Payments and Balance Sheet statistics of the MFIs. At the same time, participation continued in initiatives on climate change indicators. Work also proceeded on the operational phase of the Anacredit database, aimed at providing a harmonised set of credit and credit risk data across participating euro-area Member States. Moreover, the Bank continued to enhance the quality of the Maltese securities data held within the ECB's Centralised Securities Database.

The Bank continued to participate in the ESCB's Integrated European Reporting Framework project, which in the long-term aims to integrate a number of reporting requirements into one common harmonised reporting template. Moreover, credit institutions were invited to participate in its preparation. Meanwhile, the ECB's Register of Institutions and Affiliates Database continued to be populated with reference data of all newly licenced institutions.

The Bank continued with its efforts to fulfil the ESRB's recommendation on closing real estate data gaps and to monitor developments as per Directive No. 16 on borrower-based measures.¹ The reporting of data by credit institutions is being phased in throughout 2021 and 2022. The reporting template also fulfils the Bank's requirements on hedonic property prices and bank lending standards.

The Bank also continued to collaborate with the NSO to enhance the quality of the BOP, IIP and other external statistics and to follow-up on the joint recommendations of the ECB and Eurostat on this dataset within the framework of the Macroeconomic Imbalances Procedure. The quarterly BOP/IIP data transmission to the ECB in June included substantial additional requirements as per the amended ECB Guideline on external statistics. Bank officials collaborated with NSO counterparts to facilitate the migration of the whole BOP database to the new solution. In the area of Malta's Financial Accounts statistics, enhanced methods of estimation were used in the case of partnerships and intra-company loans statistics. Work progressed well to meet the amended ECB Guideline in this area of statistics targeted for 2021 and 2022. Meetings were held with various financial institutions to enhance the collected data and to launch revised reporting manuals. Meanwhile, the statutory return submitted by the investment services providers was separated from the MFSA's supervisory package and started to be submitted directly to the Bank. Various statistics from the rest of the financial institutions' sector kept on being collected, namely from pension funds, insurance corporations and investment funds. The Bank pursued the widening of the range of published statistics on its website by including enhanced payments statistics. Given the developments caused by the COVID-19

¹ Directive No. 16 on borrower-based measures: <https://www.centralbankmalta.org/file.aspx?f=72401>

pandemic, additional statistics, such as on the moratoria of loans granted by the banks to their clients, continued to be collected during 2021.

Collaboration with *Banca d'Italia* on the Central Bank of Malta's statistical platform, INFOSTAT, continued during 2021. Furthermore, an application-to-application solution, allowing the supervisory returns to be automatically transferred from the MFSA's platform to that of the Bank, was implemented. The Statistics Department also organised virtual training courses on INFOSTAT's data querying tools aimed at both internal and external users. Moreover, the collection module was upgraded to the latest service-oriented architecture technology. The credential management function continued to manage the authorisation process and the helpdesk to support users. Reports were developed to provide a more in-depth analysis on the performance and usage of the solution. More formal and deterministic validation checks were implemented in the solution to ensure higher data quality at the collection stage, while more advanced outlier detection methods were implemented to assess the compiled statistics. An interactive enquiry solution was introduced on the website to guide respondents in acquiring more information on the reporting of statistics to the Bank.

The Statistics Department also spearheads the use of modern data analytics tools, such as business intelligence tools and other big data oriented programmes, with the aim to enhance further its data visualisation and quality management capabilities.

The Bank continued to operate its Central Credit Register to provide information on borrowers' credit risk mainly to credit institutions as well as to borrowers themselves, though in the latter case only information about their own credit risk can be obtained. This is in line with CBM Directive No. 14 which empowers the Bank to operate the Register in pursuit of its objectives regarding financial system stability, monetary policy analysis and the processing of statistical information. During the year, searches on the Register by credit institutions amounted to 41,050 compared to 38,169 in 2020. Requests from consumers, both natural and legal persons, for an extract of their credit report held on the Register increased from 477 in 2020 to 515 in 2021.

In view of its role of supervisory authority of credit reference agencies (CRAs), the Bank launched Directive No. 15 during 2021. The function of a CRA is primarily to issue credit scores on natural and legal persons, including credit institutions. The Bank received the first application from a prospective CRA, namely Creditinfo Malta Limited. Following the due diligence exercise on the applicant, in December, the Commerce Department's Trade Licencing Unit, in consultation with the Bank, granted this company a five-year renewable licence to operate as a CRA.

Cooperation with the MFSA continued to evolve through the Joint Data Coordination Group which recommends policy actions on common data management. The Forum for Central Bank of Malta Statistics was held with the banks. Bank officials participated in the Statistics Committee (in both ESCB and in Single Supervisory Mechanism composition) and in its various sub-structures, which aim to develop statistics to support the various tasks of the ECB and the ESCB. The Bank's internal Statistics Committee, supported by its sub-structure, met to define and implement the statistical information policy within the Bank. The Bank's internal network on big data and machine learning convened on various occasions to discuss and implement concrete and practical Bank-wide initiatives. Meanwhile, the Bank pursued its preparation, together with the NSO, to meet the requirements for Malta's adherence to the IMF's SDDS Plus.



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 also issues coins on behalf of the Government of Malta 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

The Central Bank of Malta provides an adequate supply of euro banknotes and coins to meet the demand of the banking system and ensures the high quality and authenticity of the currency in circulation. All currency returned to the Bank 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, the Currency Operations Office monitors recycling activities performed by credit institutions and other professional cash handlers. Annual monitoring tests are performed on banknote handling machines and coin processing machines. 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).

Despite the impact of the COVID-19 pandemic on consumption and changes in payment behaviour, the number of euro banknotes in circulation continued to grow strongly while the number of counterfeit banknotes removed from circulation dropped to a historically low level.

Circulation of notes and coins

During 2021, the number of notes inspected by the Bank totalled 76.3 million compared with 78.8 million in 2020. The inspected notes had a value of approximately €1,867.7 million, €182.9 million lower than in 2020. A total of 67.7 million banknotes with a value of €1,620.7 million were found suitable for re-issue, while 8.6 million banknotes with a value of €246.3 million were destroyed. The share of banknotes destroyed decreased from 16.3% in 2020 to 11.3% in 2021. The decrease in banknotes inspected in 2021 can be attributed to the impact of COVID-19 measures during the year, which led to a substantial reduction in the volume of banknotes deposited at the Bank (see Table 5.1) and also to an increase in re-circulation activities by commercial banks during the third quarter of 2021. The decrease in banknotes destroyed during the year can be partly attributed to the lower saturation of first series banknotes in circulation.

Table 5.1
BANKNOTES ISSUED AND OUTSTANDING BY THE CENTRAL BANK OF MALTA

EUR millions

Total	Issued	Withdrawn	Net issue	Issued and outstanding
2020	2,180.0	1,896.0	284.0	1,832.3
2021	2,130.8	1,831.6	299.2	2,131.5

Source: Central Bank of Malta.

Table 5.2
COINS ISSUED AND OUTSTANDING BY THE CENTRAL BANK OF MALTA

EUR millions

Total	Issued	Withdrawn	Net issue	Issued and outstanding
2020	24.3	22.2	2.1	96.1
2021	24.4	20.3	4.1	100.2

Source: Central Bank of Malta.

No new series of notes were issued during 2021.

The outstanding volume of euro coins rose by 4.1%. By the end of 2021, there were 381.2 million coins issued and outstanding, equivalent to €100.2 million (see Table 5.2). There were 35.8 million coins, equivalent to €21.5 million, that were processed by the Bank during 2021. Between 2020 and 2021, the number of coins examined increased from 35.2 million to 35.8 million, a slight increase of 1.7%.

No coins were demonetised or ceased to be exchangeable at the Bank during 2021.

During 2021, the Bank continued using the Cash Single Shared Platform system for the stock management of banknotes and coins. There were no changes in 2021, although testing on the new system to be released in 2023 was undertaken.

During 2021, the Currency Operations Office continued with the certification of professional cash handlers. Various employees involved in cash handling from different credit institutions, financial institutions, insurance companies and casinos renewed their certificates by taking the online tests in the Anti-Money Laundering and Know Your Banknotes platforms, while a significant number of new cash handlers were enrolled for the first time. By the end of 2021, there were 1,411 certified professional cash handlers.

Anti-counterfeit measures

Despite the challenges the Bank continued to face during 2021 due to the COVID-19 pandemic, the Central Bank of Malta continued to monitor credit institutions and other professional cash handlers, ensuring that all cash handlers were certified and trained to detect counterfeit euro banknotes and recirculate banknotes. Monitoring tests were performed on each type of banknote handling machine, device and coin processing machine held by financial institutions and other professional cash handlers. A total of 32 unannounced inspections at branches of credit institutions were also undertaken to ensure compliance with the ECB Directive on authenticity and recirculation of banknotes. Data on recirculation were collected from credit institutions during the year, analysed and sent to the ECB.

Quarterly online meetings with credit institutions continued to be held to keep members updated on currency matters including developments on the counterfeit situation in the euro area. Assistance was provided to institutions, other cash handlers and retailers with the upgrading of their Banknote Handling Machines.

In 2021, the number of counterfeit euro banknotes decreased to its lowest level since 2008. During the year, the Currency Operations Office analysed 756 banknotes and 383 coins. Following analysis, 305 banknotes and 256 coins were confirmed to be counterfeit and removed from circulation. The findings were uploaded into the ECB's Counterfeit Monitoring System. Staff was also asked to provide expert evidence during seven court sittings. Moreover, the Currency Operations Office issued one press release to inform the public on the status of counterfeit notes in the Eurosystem in general and more specifically, on the local situation.

In spite of the decline in the quality of counterfeits, the Bank continues to advise the public to remain vigilant and to remember the "feel-look-tilt" test, and not to rely on just one security feature. In addition, the training scheme to retailers is offered to professional cash handlers on a continuous basis, intended to build up and enhance cash handlers' skills in checking the authenticity of banknotes at the point of sale (POS). Upon completing the training, retailers are given a sticker, valid for a two-year period. Participating in such training events can reduce the risk of financial losses and reputational risks.

BOX 7: NUMISMATIC RELEASES 2021

550th Anniversary of the Birth of Albrecht Dürer

The Central Bank of Malta issued numismatic coins in gold and silver commemorating 550 years since the birth of artist Albrecht Dürer. Albrecht Dürer was born in the city of Nuremberg on 21 May 1471. Although his work was steeped in the German late-Gothic style, his travels to Italy brought him in contact with the Italian Renaissance, which influenced him profoundly. He was an accomplished artist but is best remembered for the prodigious number of engravings he made: some 346 woodcuts and 108 copper engravings. Dürer elevated engraving to a high art form. His prints are appreciated for their aesthetic qualities, intricate and minute details, and the deft techniques employed to create shading and spatial depth.



The coins were designed and engraved by Noel Galea Bason and were minted at the Royal Dutch Mint. The coin obverse features the coat of arms of Malta. The reverse shows a representation of one of Dürer's woodcut engravings entitled *St George and the Dragon*.

25th Anniversary of Junior College

On 19 July 2021, the Central Bank of Malta issued a silver coin to mark 25 years since the Junior College opened its doors in 1995. This modernist building, which was popularly known as the Polytechnic, was designed by Victor Anastasi. It was funded through Britain's Colonial Welfare and Development Fund, and UNESCO. The building was formally inaugurated on 16 July 1966. The coin, struck at the Royal Dutch Mint, shows the emblem of Malta and the year of issue, 2021, on the obverse. On the reverse, the coin carries a representation of the Junior College premises in Msida.



225th Anniversary of the completion of the Bibliotheca building

The Bibliotheca was the last major public building constructed by the Order of St John in Malta and it is also the first purposely built library on the island. The plans for the Bibliotheca were drawn by Stefano Ittar, a respected and well-known architect who had settled in Catania. The construction works started in 1786, but the building was not completed until 1796, just two years before the Order of St John was ousted from Malta by Napoleon. The building today houses the National Library of Malta.



The coin was designed and engraved by Noel Galea Bason and was minted by the Royal Dutch Mint. The obverse of the coin features the emblem of Malta and the year of issue, 2021. The reverse shows a representation of the Bibliotheca's magnificent façade.

Heroes of the Pandemic

On 2 August 2020, the Central Bank of Malta issued a €2 commemorative coin with the theme *Heroes of the Pandemic*. The coin was struck at *Monnaie de Paris* in France. The coin reverse shows the common €2 side. The obverse (national side) was designed and engraved by Anna Maria Frisone and depicts two medical professionals bracing themselves to face the unknown, inspired by a photograph taken by Diane Faenza of two Maltese nurses – Doreen Zammit and Charmaine Cauchi.



Centenary of the 1921 Malta Self-Government Constitution

On 30 April 1921, hundreds of Maltese congregated in Valletta to witness the proceedings connected with the promulgation of the new constitution, which granted the Maltese a measure of responsible government. It seemed that, after 120 years of British rule, Maltese aspirations for autonomy in local affairs were fulfilled. The constitution established a diarchy through which an elected Maltese Government was responsible for local affairs, whilst the Imperial Government was responsible for “reserved matters” which included defence and foreign policy. The Maltese experiment with self-government was short-lived, as the constitution was withdrawn in 1936. Nevertheless, it paved the way for further constitutional development, which culminated in Malta achieving political independence from Britain in 1964.



On 24 September 2020, a numismatic coin in silver, marking the centenary of the 1921 self-government constitution, was issued. The coin was designed and engraved by Noel Galea Bason and minted at the Royal Dutch Mint. The coin obverse features the coat of arms of Malta, while the reverse depicts Melita, an allegory of Malta.

Tarxien Temples coin and year set

The Central Bank of Malta issued a €2 commemorative coin depicting the Tarxien Temples. This coin is the sixth in a series of seven dedicated to the Maltese islands’ prehistoric sites which are on the UNESCO World Heritage list. The coin reverse shows the common €2 side and the obverse shows a representation of the Tarxien Temples. The national side of the coin was designed and engraved by Noel Galea Bason. The coin was minted at *Monnaie de Paris*. On the same date, the Bank issued its 2021 coin set which also included the commemorative €2 coin depicting the Tarxien temples.



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, 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.

Payment and securities settlement systems

The Bank's responsibility to carry out regulation and oversight activities stems from Articles 34 and 34A of the Central Bank of Malta Act. To promote the stable and sustainable development and provision of the payments landscape in Malta, the Bank is responsible to oversee and regulate the operation of, and the participation in, domestic payment systems. Moreover, the Bank oversees and regulates the provision of payment services, payment applications, payment card schemes and payment transactions operated and effected by credit and financial institutions. Executing the regulatory function responsibilities requires participation in the various legislative developments and enforcement, as well as the carrying out of multiple oversight assessments on relevant entities, with the aim of promoting an effective and efficient payments landscape in Malta.

On 7 July 2021, the Bank issued Directive No. 19 on the use of cheques and bank drafts. This was preceded by a public consultation with the relevant stakeholders¹ which was launched during the first quarter of 2021. As part of an educational campaign to prepare the community for the eventual application of Directive No. 19 on 1 January 2022, between October and November 2021 the Bank organised several webinars with the relevant stakeholders, Government Departments, and the media.

Moreover, a webinar held with the Chamber of Small and Medium Enterprises on 30 November 2021 was followed by a discussion and distribution of a survey on the use and acceptance of payment instruments by merchants.

During 2021, in order to fulfil its responsibilities, the regulatory function carried out, inter alia, several tasks as described hereunder:

Second Annual Review of the Malta Stock Exchange under the Central Securities Depository Regulation

As outlined in the Central Securities Depository Regulation, both the Competent Authority (i.e. the MFSA) and the Relevant Authority (i.e. the Bank) are required to perform an annual review and evaluation process on the Central Securities Depositories to confirm that the provisions outlined in the Regulation are implemented. To this effect, the regulatory function performed the second annual assessment on the MSE. The assessment report was approved by the Eurosystem decision-making bodies. Furthermore, an abridged version of the approved report was provided to the MFSA for consideration.

Besides the annual review and evaluation process, the Bank organised several triparty meetings (involving the Bank, MFSA and MSE) on a regular basis to follow-up on the pending issues and other concerns.

Analysis on the Payment Statistics

The regulatory function carried out statistical analysis on the transactions effected through different payment instruments, and prepared several reports, namely on transactions at POS, card transactions by a specific institution and other international card schemes. An abridged version of the POS transactions report was published in the Bank's *Quarterly Review*. Payment transactions data was also collected and reported on a semi-annual basis.

Annex 3 of CBM Directive No. 1

CBM Directive No. 1 requires that credit and financial institutions submit an annual report on the Information and Communications Technology and Security Risk Management of their operations. During 2021, the regulatory function received and reviewed 60 reports from credit and financial institutions.

Surveys on Cyber Resilience and Critical Service Providers of Financial Market Infrastructures

Through the Oversight Working Group, the ECB has launched two oversight surveys during 2021, one on cyber resilience and the other one on critical service providers. Given that these surveys were addressed to

¹ Malta Bankers Association, Malta Association of Credit Management, Financial Institutions Malta Association, MaltaPost, Institute of Financial Services Practitioners, Kunsill Nutarili ta' Malta, College of Stockbrokers, Chamber of Commerce, Consumer Association, Association of Insurance Brokers, Malta Hotels and Restaurants Association and Malta Chamber of SMEs.

European Financial Market Infrastructures (FMIs), NCBs were required to liaise with FMIs in their jurisdiction to provide the necessary information. To this effect, the Bank liaised with the MSE, MTEUROPAY and Malta Clearing House (MCH) to discuss the provision of the necessary data. The regulatory function performed an assessment on the FMIs' responses and liaised with the ECB on their outcome.

Introduction of Directive No. 19

During 2021, the Bank issued Directive No. 19 which regulates the use of cheques and bank drafts. The main aim of this Directive is to make cheques safer and to reduce any potential abuses related to the use of cheques. A public consultation was held in March 2021 with relevant stakeholders and the final text was published in July 2021. The Directive became applicable on 1 January 2022. Together with the Malta Bankers Association, the Bank has embarked on an educational campaign where several initiatives were undertaken to raise awareness about the provisions of this Directive as listed hereunder:

- Various webinars with relevant stakeholders;
- Participation on several radio and tv programmes;
- The issuance of a brochure to every household;
- Adverts on bus shelters;
- Response to queries made by the public.

Updated Cross-Border Payments Regulation

As of April 2020, the obligations which stem from the Cross-Border Payments Regulation (Regulation (EU) 2019/518 on information on currency conversion charges for card-based transactions and online credit transfers) came into force. Payment service providers providing card issuing and acquiring services were obliged to express the currency conversion charges as a percentage mark-up over the latest available euro FX reference rates issued by the ECB.

As from April 2021, payment service providers providing card issuing services were obliged to send an electronic message quoting the currency conversion charges as a percentage mark-up over the latest available euro FX reference rates issued by the ECB, whenever a transaction denominated in a European Economic Area currency is received. Such electronic message are required to be sent free of charge on a monthly basis.

Open Banking Requirements

As from 14 September 2019, credit and financial institutions offering a payment account which is accessible online had an obligation to provide an access interface to third party providers. Such interface could either be in the form of a dedicated interface or the modification of the interface used by the user to access his account online. Those institutions which opted for the dedicated interface had an obligation to implement a fall-back mechanism if the dedicated interface is down. However, subject to certain criteria being met, institutions could be exempted from the provision of the fall-back mechanism. The regulatory function has received several exemption requests from various credit and financial institutions. In 2021, six institutions met the criteria for the granting of an exemption.

Revised Guidelines on major incident reporting

On 10 June 2021, the EBA published the revised Guidelines on Major Incident Reporting which repealed the previous Guidelines. To this effect, Annex 1 of CBM Directive No. 1 was updated to reflect the new requirements. These revisions aim to optimise and simplify the reporting process and the standardised template. Furthermore, the amendments concentrate on incidents with significant impact to payment service providers and improve the relevance of the information to be reported. The changes also remove unnecessary steps from the reporting process and reduce the reporting burden for payment service providers. The amendments came into force on 1 January 2022.

Assessment of terms and conditions

The regulatory function assessed the terms and conditions of credit and financial institutions which govern the payment services they provide, in line with the provisions of CBM Directive No. 1. Several meetings were held during 2021 to discuss and clarify any shortcomings identified.

Monitoring of Secure Customer Authentication compliance for e-commerce transactions

As from 14 September 2019, payment service providers had to implement stronger security requirements whenever customers access their payment account online or initiate an electronic payment transaction. Since the card industry was not prepared to implement the security requirements on time, the EBA provided supervisory flexibility on e-commerce transactions until the end of 2020. In this regard, as from 1 January 2021, payment service providers were required to apply strong customer authentication for e-commerce transactions. During the first part of 2021, the regulatory function monitored the progress of the implementation of strong customer authentication solutions being implemented by card issuers and acquirers.

Review of the terms and conditions by card acquiring firms

The regulatory function engaged with local card acquirers to ensure that the provisions of the Interchange Fee Regulation are being followed and more specifically, that unblended rates are being offered to the merchant by default. In this regard, local card acquirers were requested to submit their terms and conditions to ensure compliance with the Regulation.

Malta Clearing House

Members of the MCH meet every morning at the Bank's premises to physically exchange the cheques negotiated during the previous working day. As at the end of 2021, the MCH comprised 10 members.

The decrease in the number of cheques issued when compared to 2020 could be attributed to the COVID-19 pandemic and also to the fact that online shopping increased leading to a wider use of electronic means for settlement (see Table 5.3).

TARGET2-Malta

During 2021, the number of direct participants remained unchanged. The total volume of payments processed during 2021 was 86,274 for a total value of €603.4 billion. The Trans-European Automated Real-Time Gross Settlement Express Transfer System 2 (TARGET2)-Malta payments traffic in 2021 registered a 6.5% increase in terms of volume and an increase of 57.8% in terms of value when compared to 2020. The volume of customer payments was 62,419 for a total value of €9.4 billion, leading to an increase in volume of 7.0% and an increase in value of 30.6% when compared to 2020. The volume of inter-bank payments was 23,855 for a total value of €593.9 billion, indicating an increase of 5.2% in terms of volume and an increase of 58.3% in terms of value (see Table 5.4).

Table 5.3
NUMBER AND VALUE OF CHEQUES PROCESSED BY THE MCH, 2020 AND 2021

	Number of cheques	Value (EUR millions)
2020	3,614,019	7,210.4
2021	2,843,666	7,280.6
Change	-770,353	-70.2
Percentage change	-21.3	-1.0

Source: Central Bank of Malta.

Table 5.4
TARGET2 PAYMENTS

	Total volume of payments	Total value of payments (EUR billions)	Total volume of customer payments	Total value of customer payments (EUR billions)	Total volume of inter-bank payments	Total value of inter-bank payments (EUR billions)
2020	80,988.0	382.3	58,318.0	7.2	22,670.0	375.1
2021	86,274.0	603.4	62,419.0	9.4	23,855.0	593.9
Change	5,286.0	221.1	4,101.0	2.2	1,185.0	218.8
Percentage change	6.5	57.8	7.0	30.6	5.2	58.3

Source: Central Bank of Malta.

Table 5.5
NUMBER AND VALUE OF CHEQUES DRAWN ON THE CENTRAL BANK OF MALTA BY THE PUBLIC SECTOR

	Number of cheques	Value (EUR millions)
2020	738,535	293.7
2021	427,040	205.2
Change	-311,495	-88.5
Percentage change	-42.2	-30.1

Source: Central Bank of Malta.

Banker to the public sector

Banking services continued to be provided to the Government as in the previous year. These include the opening and maintenance of various euro and foreign denominated accounts, the encashment of cheques drawn on the Bank and issued by government departments (see Table 5.5), the deposit of cash and cheques, the provision of safe deposit and safe custody facilities, processing of payment instructions through TARGET2, Society for Worldwide Interbank Financial Telecommunication (SWIFT) and Single Euro Payments Area (SEPA) Credit Transfers and Direct Debits.

In 2021, the Bank processed 3.2 million SEPA Credit Transfers for a total value of €8.2 billion on behalf of its customers. This represents an increase of 6.7% and 18.8% in the volume and value of SEPA Credit Transfers respectively.

The Bank continued to offer a range of FX services to the Government and public sector entities during the year under review, including the sale and purchase of foreign currency, non-euro outward and inward payments by SWIFT, the encashment of drafts in foreign currency, and the maintenance of foreign currency accounts.

During 2021, the Bank continued servicing the Government's external debt through periodic payments. As in 2020, where €123,058 worth of capital repayments were settled, in 2021 such settlements stood at €125,192. The associated interest paid in 2021 was €7,557, which is 88% of last year's amount of €8,631. The Bank also paid €437,600 as interest for the first time during 2021 regarding a new SURE loan.

The total value of funds transferred to external debt sinking funds by debit of the Government account during 2021 amounted to €50,353.

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 ICS and DCS.

Other financial services

During 2021, the Bank continued to increase the participants in its retail payment system MTEUROPAY. During 2021, four institutions were onboarded, bringing the number of participants to six. Another participant concluded testing and will be onboarded during the second week of January 2022. Another two participants were accepted by the Payment System Participation Review Board² and will start the testing phase during 2022. The Bank is currently holding bilateral discussions with other institutions that showed interest in such service. The traffic through the Bank's payment system MTEUROPAY is as listed in Table 5.6.

² Composed of the Bank, the MFSA and the Financial Intelligence Analysis Unit.

Table 5.6
MTEUROPAY PROCESSED PAYMENTS FOR 2021

	SEPA OUT – SCTs		SEPA IN – SCTs		SEPA OUT – SDDs	
	Value (EUR millions)	Volume	Value (EUR millions)	Volume	Value (EUR millions)	Volume
Totals	1,642.1	80,720	17,388.1	37,574	21.9	322,299

Source: Central Bank of Malta.

Digital euro

The Governing Council of the ECB decided to launch the investigation phase of a digital euro project in July 2021. The digital euro would be an electronic form of money, similar to banknotes, issued by the Eurosystem and it will be accessible to all citizens and firms for their daily payments. It would complement cash without replacing it. To this effect, a unit was set-up to build the required expertise for the Bank to be in a position to contribute to such project.



6. CORPORATE GOVERNANCE

Governance

Board of directors

In 2021, the Board of Directors was composed of Professor Edward Scicluna as Governor and Chairman, Mr Alexander Demarco and Mr Oliver Bonello as Deputy Governors responsible for Monetary Policy and Financial Stability respectively, and 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 2021. 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 acting on the advice of the Cabinet of Ministers while the other non-executive Directors of the Board are appointed by the Prime Minister acting on the advice of the Cabinet of Ministers. Mr Herbert Zammit LaFerla continued to act as Secretary to the Board up to September 2021, following which Mr Francis Bugeja was appointed as the new Board Secretary. Thirteen Board meetings were held during 2021.

During most of 2021, Board Meetings continued to be held through videoconferencing as a preventive measure due to circumstances concerning the transmission of COVID-19. This continued up to the meeting of 3 September 2021, following which the remaining four meetings were held physically at the Board Room of the Bank.

The Board of Directors is responsible for policy making and the general administration of the Bank, except for functions relating to the Treaty on the Functioning of the ECB, 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 January 2021, the Board of Directors approved the acquisition of the MAPS Treasury Management System, a front-to-back system developed by central banks for central banks. During the same month, the Board approved the restructuring of the Economic Research Department through the creation of two offices, namely the Economic Research Office and the Modelling Office. In an effort to obtain more synergies across offices and streamline further the organisational structure of the Bank, in September 2021 the Board undertook a restructuring process as follows.

- Created a new position of a Governor's Press Officer within the Office of the Governor.
- Merged International Relations Department with the Monetary Policy and Eurosystem Relations Department into a new Department renamed Monetary Policy, Eurosystem & International Relations Department. This Department now includes the Eurosystem & International Relations Office and a section supporting the Head of Department in Eurosystem Monetary Policy matters.
- Renamed the Investments Division to Financial Markets Division, comprising Financial Asset Management Department and Monetary Operations & Government Securities Department.
- Reorganised Economic Analysis Department to comprise two offices, namely Economic Projections & Conjunctural Analysis, and Fiscal Affairs & Reports.
- Set up a new Digital Euro Section within the Banking Operations Division.
- Migrated the Communications Department duties to the Corporate Strategic Planning Department and the Knowledge Services Office.

The Board of Directors also approved a new Harassment and Bullying Policy, superseding the previous policy on sexual harassment. In the same month it also approved the 2022 Collector and Commemorative

Coin Programme. In December, the Board of Directors approved the 2022 Corporate Strategic Plan and Projects Report.

Governor's activities

Professor Edward Scicluna started his term as Governor of the Central Bank of Malta in January 2021. A month later, he was appointed Deputy Chairman on the Board of Governors of the MFSA. Governor Scicluna is a member of the JFSB and the National Coordinating Committee on Combating Money Laundering and Funding of Terrorism. He also 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.

Throughout 2021, as a member of the Governing Council and the General Council of the ECB, Governor Scicluna attended the regular Governing Council and General Council meetings.

During the year, the Governor was interviewed by various media houses, both locally and overseas. The Governor attended meetings of various international institutions, including the Council, European Commission and IMF, as well as welcomed local and overseas distinguished guests, including Ministers, foreign diplomatic representatives and academics.

In 2021, the Governor was invited as a keynote speaker at a number of conferences, some of which were held by videoconference due to the pandemic.

- Article *The economic impact of lockdowns*, Times of Malta, March 2021.
- Interview *Banking on it*, Money Magazine, April 2021.
- Co-chairing of conference organised by the Central Bank of Malta and the EIB entitled *Investment in the post COVID-19 era, digitalisation and climate change*, May 2021.
- Participated in the informal ECOFIN meeting held in Lisbon, Portugal, May 2021.
- Keynote speech at the National Conference organised by the Office of the President of the Republic of Malta, *I-Istat tan-Nazzjon: Ekonomija u Ambjent: Naħsdu Li Niżirgħu?*, San Anton, June 2021.
- Intervention during a panel discussion at a conference entitled *Central Banks at the Frontline of the COVID-19 Crisis: Weathering the Storm, Spurring the Recovery*. The online conference was organised by Banco de España, the Central Bank of Tunisia, the OECD and the European Institute of the Mediterranean, June 2021.
- Article *Price stability and beyond – the ECB's strategy review*, Times of Malta, July 2021.
- Keynote speech, *Malta's Financial Services Industry: Emerging Stronger*, Annual conference (14th edition) of FinanceMalta, July 2021.
- Address at the European Bank for Reconstruction and Development (EBRD)'s 30th Annual Meetings, July 2021.
- Intervention during the launch of the commemorative coin Heroes of the Pandemic, July 2021.
- Participated in the informal ECOFIN and EUROFI meeting, held in Ljubljana, Slovenia in September 2021.
- Interview, *Punching Above One's Weight*, Forbes Middle East, Promotional Country Report – Malta, September 2021.
- Presentation of coin commemorating the 100th anniversary of the Self-Government Constitution of 1921, House of Representatives, Valletta, September 2021.
- Interview with David Barwick, Econostream, October 2021.
- Statement at the Annual IMF and World Bank Meetings, October 2021.
- Address at the Commonwealth Central Bank Governors Meeting, October 2021.
- Interview with Chief ECB & SNB Correspondent, MNI Market News, November 2021.
- Keynote speech at a conference organised jointly by the Malta Chamber of Commerce and the Central Bank of Malta entitled *Inflation: Trends, Threats and Transitions*, November 2021.
- Speaker at a panel discussion *COVID-19 and Debt for All* organised within the framework of the Atlantic Dialogues, Morocco, December 2021.
- Annual Address of the Governor entitled *Resilience and financial stability in pandemic times* at the Institute of Financial Services Annual Dinner, Saint Julian's, December 2021.

Audit Committee

The Bank's Audit Committee, which is chaired by Professor Peter J. Baldacchino and includes Professor Frank Bezzina and Dr Romina Cuschieri, convened 11 times during the year. During such meetings, the Chief Officer Internal Audit continued to brief 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 on the completion of the Annual Audit Plan was also provided, which by the year-end was completed as approved. Furthermore, Committee members were kept informed, through regular status reports, on progress in addressing outstanding audit findings, whilst regular bank-wide, divisional and individual business area audit opinions were also tendered. During the July meeting, Chief Officer Internal Audit once again tabled an updated report on the Department's annual review of its 5-year rolling strategic plan¹ which provided a detailed account of the Department's achievements in working towards full attainment of its strategic focus. The Bank's external auditors, KPMG, were also invited to attend several Audit Committee meetings.

External auditors

The Bank's external auditors, KPMG, carried out the statutory audit for the financial year ending 31 December 2021, expressing their opinion on the financial statements and presenting their Management Letter to the Board.

Internal Audit Department

Internal Audit Department continued to provide assurance through the conduct of risk-based audits in line with the approved 2021 Annual Audit Plan. A total of 17 local audit engagements were completed, the vast majority of which assessed the effectiveness of governance, risk management and control processes implemented across several business areas. In line with methodological developments previously introduced, an opinion on the level of efficiency demonstrated in the use and deployment of resources in the processes reviewed was also provided for each of these audits. This rather innovative concept within internal auditing circles was further extended with the performance of one fully-fledged efficiency audit. The Department also conducted a smaller number of audits focusing specifically on areas which are inherently deemed more susceptible to fraud.

As a member of the ESCB Internal Auditors Committee (IAC) in the Eurosystem, ESCB and SSM compositions, the Internal Audit Department provided the necessary assurances to the ESCB decision-making bodies through the conduct of four IAC audits and on-going participation in IAC meetings. The Department also actively engaged in the Audit Task Forces on Information Technology and that of Monetary Policy, Financial Stability and Market Operations, both of which are IAC substructures.

During the year, the Internal Audit function underwent an internal quality assessment which once again confirmed that the function "generally conforms" to the Institute of Internal Auditors Standards and Code of Ethics in terms of its set-up and activities undertaken during the review period.

The Internal Audit function also conducted an independent assessment of the Bank's SWIFT architecture to assess its level of compliance with the controls listed in SWIFT's Customer Security Control Framework, a requisite that has now become mandatory on an annual basis.

Throughout the year, the internal audit function was involved in the review of some of the Bank's Policies and Procedures. The internal auditors continued to be involved in the work of the Compliance Committee, mostly in the capacity of observers to preserve their independence and objectivity.

Risk management

The Risk Committee met eight times during 2021. The Committee members focused on risks related to the Bank's operations and financial assets on the Bank's balance sheet, apart from other relevant issues. The

¹ The first 5-year rolling strategic plan, covering the years 2019-2023 was originally presented to the Audit Committee in 2019.

various risks identified together with any arising incidents were thoroughly discussed, mitigation measures agreed upon and their implementation monitored.

The operational risk status of the various business areas was reported on a regular basis to the Risk Committee. The third cycle of the Operational Risk Management (ORM) exercise was finalised during the year and presented to the Board of Directors. Work also began on the fourth cycle which should be concluded by mid-2022.

During 2021, the relevant business areas updated their existing Business Impact Analysis accordingly and created new ones where necessary. Each business area continued with its review of the Business Continuity Plans (BCPs) of critical and important operations and regular resilience testing was carried out. The second BCP cycle was completed and the results presented to the Board of Directors. Work also began on the third cycle and is expected to be concluded by mid-2022.

A consolidation exercise was conducted with all business areas to ensure that all policies and processes are covered in the ORM and Business Continuity Management cycles. In addition, in-house training sessions related to operational risk and business continuity were provided to selected staff members.

As part of the information security responsibilities, risk assessments of various Bank initiatives were undertaken. The Information Security Officer also provided a presentation on risks for students in a cyber world during the MBA *Euro Moneyweek* activities.

In relation to its Financial Risk Management responsibilities, the Risk Management Department participated in the monthly IPC meetings during which various investment decisions were taken. In addition, performance measurement of assets under management was analysed and compared against the tactical and strategic benchmarks. This Department also closely monitored the performance of the investments managed by the Bank's external asset managers. The Strategic Asset Allocation exercise for 2022 was finalised and approved by the Board of Directors.

The Risk Management Department also continued to participate in various ESCB activities related to its financial and operational risk functions.

Legal issues

In 2021, the Bank's Legal Department was involved in issuing and amending the following Central Bank of Malta Directives.

- CBM Directive No. 1 on the Provision and Use of Payment Services was updated to implement the revised EBA Guidelines on major incident reporting issued in terms of EU Directive 2015/2366 on payment services. The update simplifies the reporting process and focuses on incidents with significant impact on payment service providers.
- CBM Directive No. 2 on Payment and SSSs was amended to ensure full compliance with Directive (EU) 2019/879 on the loss-absorbing and recapitalisation capacity of credit institutions and investment firms.
- CBM Directive No. 6 on Harmonised Conditions for Opening and Operating Payments Module Accounts, TARGET2-Securities Dedicated Cash Accounts in TARGET2-Malta, and TARGET Instant Payment Settlement (TIPS) Dedicated Cash Accounts in TARGET2-Malta was updated to implement the Guideline ECB/2021/30 on TARGET2. The amendments included:
 - (i) new TIPS reachability measures, which require the migration of Automated Clearing Houses, SEPA Instant Credit Transfers and the Ancillary Systems Interface to TIPS.
 - (ii) the reachability of Payments Module account holders, indirect participants and addressable Bank Identifier Codes in TIPS.
 - (iii) an extension of the endpoint security requirements.
- CBM Directive No. 8 on Monetary Policy Instruments and Procedures was amended following the annual update of the Eurosystem monetary policy framework (ECB General Documentation Guideline).

Furthermore, a memorandum of understanding was signed between the Bank and the MSE in respect of SSSs in order to set up and maintain an arrangement which incorporates the relative Eurosystem requirements falling under the eligibility regime.

- CBM Directive No. 10 on Authentication, Fitness Checking and Recirculation of Euro Banknotes and Coins was amended to ensure full compliance with Directive (EU) 2014/62 on the protection of the euro and other currencies against counterfeiting by criminal law.
- A number of amendments were introduced in CBM Directive No. 16 on Regulation of Borrower-Based Measures, with the aim of providing flexibility over lending beyond retirement age and to address feedback received from credit institutions.
- CBM Directive No. 17 on Business Continuity Measures was re-issued to set the maximum outages allowed to banks as part of their contingency arrangements when providing essential services to clients.
- A new CBM Directive No. 19 on the Use of Cheques and Bank Drafts was issued on 7 July 2021 and entered into force on 1 January 2022. This Directive seeks to ensure the safe and effective use of cheques and bank drafts by reducing the legal and operational risks associated with these payment instruments.

The legal function continued to provide advice on diverse legal, contractual and operational matters. Business areas were assisted in revising several of the Bank's policies and procedures and in vetting contracts, agreements and memoranda of understanding entered into by the Bank. Legislative developments impacting the Bank were also thoroughly assessed, with the Department also being involved in advising senior management over the implementation of recommendations made by international organisations.

The legal team was extensively involved in major projects embarked upon by the Bank during 2021, such as the implementation of a treasury management system and Cloud services. Online training to all Bank staff was conducted by the Department to increase awareness on the Bank's Policy for the Prevention of Abuse of Insider Information.

The Department's responsibilities in compliance include the conduct of periodic exercises, such as the annual Bank-wide data protection stocktake exercise, assistance in customer due diligence to counter anti-money laundering and terrorist financing risks, and the bi-annual prevention of abuse of insider information compliance exercise.

The legal function maintained its involvement in various internal committees and continued to participate in the ESCB's Legal Committee and its sub-structures.

Human resources

The number of full-time positions at the end of 2021 stood at 384 while the number of part-timers was eight.

Table 6.1 shows the number of Bank employees who hold an academic qualification at Malta Qualifications Framework (MQF) level 5 or higher as at the end of 2021.

Qualification	Male employees	Female employees	Number of employees	Per cent of total employees ⁽¹⁾
MQF 8	5	3	8	2.3
MQF 7	75	61	136	38.6
MQF 6	54	46	100	28.4
MQF 5	17	28	45	12.8

Source: Central Bank of Malta.
⁽¹⁾ Excluding Governors and support staff.

During 2021, the Bank recruited 48 employees (two Senior Executives, one Executive, six Assistant Executives, 29 Officers II, nine Officers I and a Driver/Security Officer), while an employee was seconded to the Bank from the MFSA. Thirty staff members resigned during 2021 and seven employees retired from the Bank, while a part-time employee took up a full-time position at the Bank. In 2021, 11 employees were seconded to offices within the public sector.

Eight University students were offered temporary summer work experience between mid-July and mid-September. These students were offered part-time work placements at the Bank on a 9-month internship programme starting in October 2021 during their final year of studies. During the year under review, the Bank also participated in the Malta College of Arts, Science and Technology (MCAST) Apprenticeship Scheme and offered temporary work placements to six MCAST students; five in the area of ICT and one in the area of maintenance. The Bank also offered a period of work practice to a student reading the Bachelor of Commerce in Economics and Public Policy as part fulfilment of his study requirements.

In March 2021, the Bank signed a new collective agreement with the *Union Haddiema Bank Ċentrali*, representing the executive and clerical category, while in October the Bank reached an agreement with the Professionals, Finance and Services Section of the General Workers Union, representing the support staff. Both agreements cover the period 2020 to 2023.

Gender balance

The Central Bank of Malta continued to make progress with respect to gender balance at the top levels of its executive structure. In 2012, there were six female members of staff among the 39 employees in the top three grades – comprising Senior Executives, Heads and Chief Officers. However, there were no women in the positions of Head or Chief Officer.

By the beginning of January 2022, there were 11 women in these 45 top grade posts, as well as two female Board members. In January 2022, there were five women in the 12 Head positions, though still no women in the Chief Officer positions.

The gender distribution of staff below the Senior Executive grade is more balanced, with 51% of all staff in these grades now being women as at end 2021, compared to 47% in 2012.

Training and development

As in previous years, the Bank allocated resources to staff training, within the Bank and through courses organised by local and foreign providers, attended mainly online due to COVID-19 restrictions.

A total of 1,193 participants attended 35 different in-house courses. These were mainly induction programmes organised for all new employees. Early in 2021, the Human Resources Department, in collaboration with the Innovation, Technology and Knowledge Services (ITKS) Department launched three online training sessions on three major Bank policies, namely, the Bank's Confidentiality Policy, the Code of Ethics, and the Policy on the Prevention of Abuse of Insider Information.

Several other learning initiatives were delivered in-house during 2021, including a course on Vector Autoregression Modelling Techniques in collaboration with the Economic Research Department; workshops as part of the implementation phase of a new Treasury Management System; and a programme on Financial Stability facilitated by a Financial Stability Team Leader at the European Insurance and Occupational Pensions Authority and Associate Professor of Economics and Finance.

As shown in Table 6.2, 296 staff members participated in external training programmes in 2021, offered by local and foreign institutions. These courses were mostly conducted online by local training organisations and professional institutions, the ECB, other central banks and financial institutions. The areas covered included economics and economic modelling; risk management; data protection; accounting;

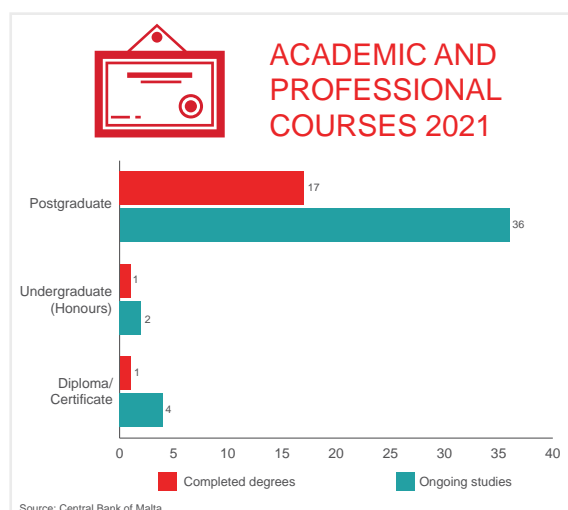
Table 6.2
STAFF TRAINING DURING 2021

Type of training	Number of courses/seminars	Number of participants
Internal	35	1,193
Internal physical	14	133
Internal online	21	1,060
External	103	184
Local physical	4	10
Local online	99	174
Foreign	72	112
Foreign physical	0	0
Foreign online	72	112

Source: Central Bank of Malta.

internal audit; cybersecurity; environmental, social and governance issues; macroprudential policy; mental health; equality and diversity; taxation, management development and data science.

During 2021, several employees either completed or continued their programme of studies (see infographic). Seventeen staff members completed their postgraduate education. A staff member who was fully supported by the Bank to read a full-time postgraduate course under the Learning, Research and Development Study Programme, successfully completed a Master's degree in Investments, Banking and Finance from the University of Glasgow. A total of 36 employees continued their enrolment in postgraduate degree programmes, while six employees were reading qualifications at undergraduate level.



During 2021, three employees embarked on a full-time postgraduate study programme in overseas universities in the United Kingdom and the Netherlands in areas directly related to the Bank. These courses are fully supported by the Bank under the Learning Research and Development Study Programme. Another employee continued his doctorate studies in social policy on a part-time basis with the University of Bristol also supported by the Bank's development scheme.

In 2021, three staff members continued their studies to read for the Higher Diploma in Computer Studies offered by MCAST specifically designed to meet the Bank's needs.

Following the approval in 2020 by the Governing Council of the ESCB & SSM Learning & Development Strategy, the Task Force on Training and Development launched pilot programmes under two of the three different pillars, namely, Leadership and Behavioural skills. The Bank nominated a different candidate to attend each of these learning events. Under this strategy, a high level ESCB/SSM conference, entitled *The Agile (R)Evolution: Rethink, Reimagine, Reinvent*, was organised by the ECB for members of the Governing Council and Board of Directors of NCBs, in December 2021.

Innovation, Technology and Knowledge Services

Innovation and technology

In 2021, the End User Technology and Infrastructure (EUTI) Office focused on the implementation of a new virtual infrastructure and in the adoption of cloud-based applications, with several ongoing initiatives that will continue throughout 2022. The primary objectives were to improve the End User Experience, Mobility and Security Posture of the Bank's data. As part of the initiatives delivered in 2021, a new virtual infrastructure was successfully implemented to improve the support and scalability of the Bank's applications.

The EUTI Office implemented a Multi-Factor Authentication and Self-Service Password Reset, starting the implementation of a dedicated suite of applications to manage end-user devices through an enhanced security model. EUTI staff also started the exploratory phase for new technology that could be potentially introduced at the Bank in the coming months. The team participated also in the Infrastructure Portfolio Management, Operations and Service Management in all compositions at ESCB level.

The Application Development and Project Delivery Office (ADPDO) was very active in project delivery during 2021. The recruitment of a dedicated Project Management Lead enabled the Bank to actively plan and develop a state-of-the-art Payment Acquisition Platform, to complement the Bank's Payment Hub architecture, with the objective to facilitate and interface payments across the Bank's customer base. This project was implemented using the *Agile Project Management* methodology.

The ADPDO also planned and commenced the implementation of a new *Financial Crime Risk Management* system and started to assist and execute the Payments Hub Releases to improve the current banking operational practices of the Bank.

During 2021, the ADPDO supported other major enhancements to enable the possibility to onboard Credit Bureaux in the Credit Register. Moreover, the execution of releases and upgrades pertaining to ESCB systems on collateral management systems, eligible assets and others was implemented. The team also provided additional assistance to business areas and Government Departments on systems interfacing the SEPA application. Furthermore, staff developed in-house systems to support the data capture reporting, through the Centralised Bank Account Register application.

The team participated also in the Architecture Taskforce and the Business Portfolio Management Working Group which fall under the Information Technology Committee of the ESCB.

The Core Applications Office was primarily involved in the go-live of Phase 4 of the Enterprise Payments Platform (EPP) application. This included the implementation effort, in collaboration with business areas and external suppliers, to migrate all foreign currency transactions from the Bank's accounting system onto the new digital payments platform. Such works included the deployment of new secure channels between the accounting system, EPP and SWIFT; a new interface to handle cash transactions; and another new interface to handle information exchange between the EPP and the trading platforms.

Significant effort was also performed to enhance the SWIFT platform, in compliance with the SWIFT customer security programme. The works ensured that new mandatory guidelines are properly adhered to and that existing controls can meet the established security standards. This work was independently assessed by the Bank's Internal Auditors as part of the SWIFT recommendations.

The team also supported the Knowledge Services Office to migrate Microsoft (MS) SharePoint services onto a new platform and worked in collaboration with Human Resources Department to prepare and issue a new request for tender for Payroll services.

The team participated also in the Information Technology Committee and the Market Infrastructure Risk Forum.

In 2021, the cyber threat landscape was characterised by large scale attacks against organisations of all types and sizes. Ransomware remained a top threat, where adversaries were seen leveraging all sorts of vulnerabilities to find ways of monetizing their attacks. A rise in supply chain attacks, where attackers exploited intermediary applications and service providers to expand their attack surface, were also noticed. An increase in zero-day vulnerabilities was also observed, leaving organisations with little time available to react.

In response to these threats, the Bank continued to invest in Cybersecurity, both from a technology and from a human resource perspective. The Bank attracted new talent to ensure that the right skills are available and developed. From a project perspective, several improvements were made in cloud security, endpoint protection, security operations, vulnerability management and security testing. The Bank actively participated in the ESCB Security Risk Management Working Group and the Operational Situational Security Operations forum, which comprise several international financial organisations. In 2022, the Bank will focus on increased collaboration by improving its threat intelligence sharing platforms.

Library

The Central Bank of Malta Library is one of Malta's principal facilitators of financial, economic and social research. The Library aims at supporting and promoting scholarly debate and dissemination of scientific knowledge in these fields. Since the Library's establishment back in 1968, a substantial collection of standard works on economics and finance has been accumulated. The Library presently contains more than 13,000 volumes with 38 new titles added in 2021.

The Library increased the number of electronic subscriptions to include several specialised academic journals. Moreover, it uses the database *Business Source Complete* which provides premium full-text content and peer-reviewed business journals. The *Business Book Summaries* is another useful tool which offers concise yet comprehensive summaries of the best business books.

The Library's Knowledge Vault was redeveloped using a new MS SharePoint technology, with a more user-friendly appearance and new contents. Awareness on-line sessions were provided to staff on ways to use the various information sources available on the platform, including the *Financial Times*, *Business Source Complete* and *Central Banking*.

The Central Bank of Malta's Library also participated in the 12th ESCB/SSM Meeting on Information Management.

Knowledge Services

The mission of the Knowledge Services team is to capture, manage, preserve, store and deliver the right information to the right people at the right time.

The year 2021 was particularly challenging for Knowledge Services staff who migrated the various office and committee portals to the new knowledge management system. The Bank's intranet was also completely redeveloped to reflect better the needs of the institution and the necessity for enhanced collaboration and knowledge sharing using information technology.

The Knowledge Services staff uploaded and migrated more than 170,000 new policy documents in the Bank's system, together with the relative metadata. In addition, 500 policy documents were added to the Corporate Record's database as part of an ongoing retrospective policy document scanning exercise.

Following an internal reorganisation, the Publications and Media units became part of the Knowledge Services Office. During 2021, the Publications unit was responsible for preparing and uploading the Bank's official publications, supporting all relevant Departments and maintaining relationships with its external partners.

The latter unit continued to deliver graphic design support to the various business areas, creating multimedia content, including videos and posters with strong brand recognition. Press releases were sent out to the media and made available on the Bank's website and social media accounts. In 2021, the Bank continued to improve its website to enhance users' experience. Staff continued to use multimedia messages to reach out to the public. The contribution to different media campaigns was of particular importance (e.g., the implementation of Directive No. 19 and the celebration of the #EUROat20). Interviews on radio and television stations and other media-related events involving the participation of staff were also organised. This Office also maintained interactions with the public, through the dedicated email and social media channels.

Over the past few decades, the number of central banks using social media platforms has gradually increased. The Central Bank of Malta is present on four social media platforms (LinkedIn, Facebook, YouTube, Instagram). All social media channels targeted different audiences with different content.

The Bank's LinkedIn account followers increased during 2021. The Facebook page, introduced in 2020, was originally intended to publicise events only. However, in October 2021, the page was refocused, and it now contains press releases, publications, job vacancies as well as events.

The Bank's Facebook page's popularity was also on the rise. Some posts included important announcements, such as the update to Directive No. 19 on the use of cheques which was of particular interest to the public. In addition, the Bank's Instagram account saw an increase in followers.

Corporate Strategic Planning

In 2021, the Corporate Strategic Planning Department conducted the Corporate Strategic Planning Process, composed of five steps, namely a strategy definition; identification of objectives and key performance indicators; project portfolio creation; budgeting; prioritization of objectives and projects; and approval of the plan. The projects were selected through a pre-agreed prioritization framework. This ensured that the selection of projects included in the portfolio was based on the best financial and social return to the Bank. The planning process was executed through several workshops with the participation of the Governors, Chief Officers, Heads of Departments and Office Managers.

The planning process led to an updated Corporate Strategic Plan. The Plan ensured that the strategic objectives are translated into divisional, departmental and office objectives, in line with the Bank's organizational structure, and that there is a clear association between the objectives assigned to each staff member and the achievement of the Bank's mission. The Bank's strategic objectives are grouped into eight building blocks:

- to ensure active contribution to the ESCBs, support its drives and initiatives, while participating in its fora and activities;
- to foster financial stability by strengthening the resilience of the domestic financial sector;
- to ensure a smooth functioning payment system and a secure provision of cash;
- to continue to be a reference for economic and financial analysis, research and statistics in Malta;
- to optimise return on financial assets under the Bank's management;
- to enhance risk mitigation and security measures, especially to fully safeguard the systems' integrity;
- to maintain strong internal governance, in full compliance with the law;
- to enhance overall efficiency and effectiveness, while actively promoting environmental awareness, corporate social responsibility (CSR), inclusiveness and diversity.

In 2021, the Bank monitored closely the progress of the objectives and the implementation of the Project Portfolio. This was performed in collaboration with the Bank's main decision-making bodies; by identifying problems at early stages and by implementing remedial actions swiftly to allow projects to remain on track.

In September 2021, following changes to the Bank's organizational structure, the Events Management unit was transferred to the Corporate Strategic Planning Department.

Property and procurement

The Bank's Property and Procurement Department (PPD) supports the Bank's business areas through the commitment to a safe, effective, and efficient management and maintenance of the Bank's premises, project administration and the procurement of goods, services and insurance coverage, with an emphasis on transparency, accountability and cost optimisation in the use of public funds.

During 2021 the Bank maintained its focus on the adoption of measures to mitigate the effects of the COVID-19 pandemic with an emphasis on providing a safe work environment for all staff. Despite the pandemic, the Bank continued with its programme of maintenance, upgrading and embellishment works. In detail, the Department completed the works on the replacement of the heating, ventilation, and air conditioning (HVAC) system in *Binja Ġlormu Cassar*. This project also involved other works related to refurbishment and upgrades to the buildings' infrastructure. During the year, the PPD in collaboration with ITKS Department, also implemented a Corporate Wi-Fi service across all buildings of the Bank.

The Bank continued to be an active participant in initiatives coordinated by the Eurosystem Procurement Coordination Office, which enables NCBs within the Eurosystem and the ESCB to benefit from efficiencies in joint procurement exercises, primarily in the areas of hardware, software, rating agency services and market data provision. As regards procurement, the Bank issued 15 calls for quotations and nine calls for tenders. The Bank entered or renewed a significant number of maintenance agreements to ensure that the Bank's premises and equipment are always serviced and maintained to the highest standards.

During 2021, the Bank also maintained its participation in the ESCB Heads of Administration Conference, exchanging best practices on procurement, property management services and pandemic mitigation measures across EU central banks.



7. CLIMATE CHANGE AND SUSTAINABILITY

Introduction on monetary policy considerations and climate change risks

On 8 July 2021, following the conclusion of the monetary policy strategy review, the Governing Council of the ECB announced that it had decided on a comprehensive action plan to strengthen the consideration of climate change in the monetary policy framework. The Governing Council recognised the impact of climate change and of measures taken to mitigate it on key economic variables, including inflation. The Governing Council also highlighted the effects of climate change on financial stability, the transmission of monetary policy and the risk-profile of the Eurosystem's own balance sheet.

To this end, the ECB, in co-operation with the NCBs, will work on developing macroeconomic models to study the impact of climate change and related policies on the economy and the financial system. The ECB will also develop new statistical indicators to be used in the analysis of climate change. It will also work on disclosures and on stress-testing the Eurosystem's balance sheet to assess exposure to risks stemming from climate change. Furthermore, the ECB will review its collateral management framework and the corporate sector purchase programme (CSPP) to take into account climate-related aspects. As a member of the Eurosystem, the Central Bank of Malta will also be involved in these initiatives.

Climate change considerations in the monetary policy implementation framework

As regards the monetary policy framework, the comprehensive action plan announced by the Governing Council of the ECB includes climate change considerations in the areas of disclosure requirements, enhancement of risk assessment capabilities, collateral framework and the CSPP. The implementation of the action plan will be closely aligned with progress on EU policies and initiatives in the field of environmental sustainability disclosure and reporting and other relevant EU legislation.

In 2022, the ECB will announce a detailed plan to introduce disclosure requirements for private sector assets as a new eligibility criterion, or a basis for a differentiated treatment, for collateral and asset purchases. Such requirements, which will be aligned with EU regulations, will promote more consistent disclosure practices in the market and maintain proportionality through adjustments for small and medium-sized enterprises.

The ECB will also enhance its capabilities for assessing climate change-related risks. During the course of 2022, the ECB will conduct climate stress tests of the Eurosystem balance sheet to assess the Eurosystem's risk exposure to climate change, leveraging on the methodology of the ECB's economy-wide climate stress test. The ECB will also assess whether credit rating agencies accepted by the Eurosystem Credit Assessment Framework disclose the information necessary on how they incorporate climate change risks into credit ratings. In addition, the ECB will also consider developing minimum standards for incorporating climate change risks into its internal ratings.

For the collateral framework, the ECB takes into account climate change considerations when reviewing the valuation and risk control frameworks for assets used as collateral by counterparties for Eurosystem credit operations. The ECB will also continue to monitor structural developments in markets for sustainability products with the aim of supporting innovation in sustainable finance within the scope of its mandate.

Regarding the CSPP, the ECB already takes climate change risks into account when conducting due diligence for its purchases. The ECB will also adjust the framework guiding the allocation of corporate bond purchases to incorporate climate change criteria, in line with its mandate. These will include the alignment

of issuers with, at a minimum, EU legislation implementing the Paris Agreement through climate change-related metrics or commitments of the issuers to such goals. Furthermore, the ECB will start disclosing climate-related information in relation to the CSPP by the first quarter of 2023.

Sustainability and climate-change considerations in non-monetary policy portfolios

In its bid to comply with the Eurosystem's common stance for climate change-related SRI principles for euro-denominated non-monetary policy portfolios as well as with the NGFS¹ recommendation to integrate sustainability factors in the management of own portfolios, the Bank has sought to adopt several SRI practices in its investment decisions.

The Bank has part of its assets managed externally through mandates, ETFs and mutual funds. When selecting external asset managers, the Bank always ensures that they are United Nations Principles for Responsible Investments signatories and thus are committed to include ESG considerations in all their investment decisions and report accordingly. Moreover, the Bank engages in frequent discussions with the external asset managers with the aim to better understand how such considerations are being implemented. The funds' ESG or SRI ratings² are monitored on a regular basis and reported to the IPC to ensure that there is no deterioration in the rating.

During 2021, a norm-based negative screening approach was applied to the externally managed corporate bond portfolio through a change in the mandate based on the exclusion list of one of the world's largest pension funds, managed by the Norges Bank Investment Management. This has resulted in divestment from companies involved in the tobacco industry and/or linked to the production of nuclear weapons.

The Bank has been progressively increasing the share of green, social and sustainable bonds in its internally managed portfolios, whilst also increasing investment in an ESG-focused unconstrained fixed income mutual fund. The Bank has opted to have equity exposure through ETFs that track SRI or low-carbon indices as well as through a long-term capital growth mutual fund where at least 90% of the Fund is evaluated by an SRI rating. The share of green bonds in the assets under management has increased from 3.05% in 2020 to 3.93% in 2021, while the share of all thematic bonds has increased from 3.77% to 6.04%. The share of all SRI holdings in the assets under management has increased from 6.25% in 2020 to 12.27% in 2021.

The Bank recognises climate change as a financial risk and is cognisant of the negative impact that physical and transition risks can have on its financial assets. The Bank is seeking to lead by example and therefore such considerations are becoming increasingly an integral part of the Bank's investment decisions. The Bank is looking into the possibility to increase investments into funds with a focus on climate transition. As part of the Eurosystem, the Central Bank of Malta will comply with the common stance adopted for climate-related disclosures of the non-monetary policy portfolios and thus will continue to be guided by the ECB in this regard.³

The Bank is continuously seeking to increase the expertise in this area through research and continued participation in work streams and experience sharing webinars held by the NGFS and other bodies.

Climate change considerations and financial stability

During 2021, the Bank conducted its first analysis on the quantification of the Maltese financial system's exposures to sectors of economic activity that may be affected by the transition to a less polluting economy. Given the lack of an internationally-harmonised list, the Bank constructed its own methodology for the identification of the most emission-intensive sectors and thus, those most prone to climate transition risks drawing from the methodologies adopted by the ECB and the EBA.

¹ The Central Bank of Malta has been a member of the NGFS since July 2019.

² These ratings are reported to us by the external asset managers themselves and are based on the ratings provided by their own SRI data providers.

³ https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210204_1~a720bc4f03.en.html

Being a first attempt, as highlighted in the *Interim FSR*, this analysis was constrained by a number of data limitations which necessitate caution when interpreting results.⁴ Given these caveats, the study finds that as of June 2021, just over 23% of the domestic banking sector's lending was directed towards sectors identified to be high carbon dioxide (CO₂) intensive, while an additional 27.7% was issued towards mid CO₂ intensive sectors. The analysis of the banking system's securities portfolio showed that only 1.6% pertains to issuers operating in high CO₂ intensive sectors, with 5.2% invested in mid CO₂ intensive sectors. Meanwhile, the non-bank sector, composed of domestically-relevant insurance companies and investment funds for the purpose of this analysis, invested about 14% and 10% of their securities portfolio towards issuers operating in high CO₂ intensive and mid CO₂ intensive sectors, respectively. Indeed, the exposures of both banks and non-banks remained concentrated towards low CO₂ intensive sectors at least since 2016. This suggests that the potential impact from transition risk could be relatively contained.

Going forward, such an analysis can be enhanced further as more granular and robust data, for example on firm-level emissions and revenues, is made available. While this first analysis focuses on quantifying transition risk, in the future, the Bank intends to expand its assessment to also consider physical risks, while also keeping abreast with developments relating to climate stress testing.

In 2021, the ECB published results of its economy-wide climate stress test which has been developed to assess the resilience of NFCs and euro area banks to climate risks, under various assumptions in terms of future climate policies. The results showed that both banks and firms benefit from early adoption of green policies which will aid the transition to a zero-carbon economy. Malta was included in publications of the [ECB economy-wide climate stress test](#) and the [ECB/ESRB Project Team's report on climate-related risk and financial stability](#).

Environmental initiatives

European Central Bank

During 2021, a lifecycle assessment study on cash payments in the euro area was carried out to assess the potential environmental repercussions of the euro banknotes lifecycle, with a "cradle-to-grave" approach. The latter considered the extraction impact of the raw materials used and their pre-processing on the banknotes production, distribution and use, and eventually, their end of life. The objective of the report was the identification and possible solution of hotspots, and eventually, the minimisation of their negative effects. The report is to also provide criteria for the design of a more sustainable next generation of euro banknotes. Data collection and analysis was performed in 2021, and the complete report will be issued in 2022.

Additionally, several measures were already taken to promote the prudent use of natural resources and protect human health in the production, supply and circulation of euro banknotes. The ECB is committed to increase the amount of sustainable cotton in the euro banknote paper, with the objective of achieving a euro banknote where all cotton used would originate from sustainable sources.

Central Bank of Malta

The Bank is actively striving to further reduce its ecological footprint. In 2021, the Bank continued with its recycling exercises and separated for recycling 5.2 tonnes of paper and 1.6 tonnes of plastic. An additional tonne of glass and metal was also separated and recycled.

During the year, the Bank leased its first hybrid electric car and issued a call for tenders with the aim of gradually converting its entire fleet to hybrid vehicles. The Bank also sought to streamline several processes with the aim of achieving further efficiencies and reducing the use of paper.

Regarding the efficient use of energy, the Bank continued to install LED lighting throughout its premises and implemented a new HVAC system at *Binja Ġlormu Cassar* that will reduce the ecological footprint. It is calculated that the new system will achieve reductions of around 35 tonnes of CO₂ emissions annually,

⁴ *Interim FSR 2021* – <https://www.centralbankmalta.org/site/Publications/Interim-FSR-2021.pdf?revcount=5534>

approximately equivalent to 80 barrels of oil saved annually. The Bank also continued to deploy energy efficient computers to replace old energy-intensive machines. Furthermore, the initial studies relating to the planned installation of solar panels and more efficient standby generators were completed.

As part of its efforts towards contributing to sustainability, partially offsetting its ecological footprint, the Bank, through corporate and staff contributions, supported tree planting initiatives. A relevant contribution was made to Birdlife Malta for the purchase and installation of drip irrigation systems at Salina Nature Park and Simar Nature Reserve. Following an initiative by Zabbar Local Council, financial assistance was provided for the planting of 100 citrus trees in a children's home within the locality. The Bank also continued to implement several water conservation measures, ranging from the collection of rainwater for irrigation purposes to the use of sensor operated faucets.



8. INTERNATIONAL RELATIONS

During 2021, the Central Bank of Malta maintained active relations with international financial institutions to which it is affiliated.

Eurosystem and European System of Central Banks

The Governor is a member of the Governing Council of the ECB, which is the highest decision-making body of the ECB. The Governing Council is made up of the members of the ECB's Executive Board and the NCB 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 2021, the Governing Council held 21 meetings, with eight being focused on monetary policy. The Governing Council also held two seminars, one on employment and another on Eurosystem collaboration, as well as a retreat in connection with the monetary policy strategy review. Owing to the COVID-19 pandemic, almost all the meetings were conducted by videoconference. Furthermore, the Governing Council took a significant number of decisions through written procedures. In addition, 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 monetary policy strategy review, which had been launched in January 2020, was concluded in July following an intensive series of seminars and listening events, as well as a co-ordinated research effort across the Eurosystem that also involved the Bank's staff.

Following several decisions taken by the Governing Council, during 2021 the Governor signed a number of agreements on behalf of the Bank. More specifically, these agreements covered a Side Letter Agreement related to the Single Shared Platform related to TARGET Services; an amendment to the TARGET2 Securities Framework Agreement (to include Denmark's Nationalbank); the TARGET Services Analytical Environment; and the amended Level 2 – Level 3 Agreement on TARGET2 Securities.

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 NCB Governors of all Member States of the European Union, mainly performs an advisory role. There were four General Council meetings in 2021.

During 2021, there were two sessions dedicated to the Macroprudential Forum held jointly by the Governing Council and the ECB's Supervisory Board. The Deputy Governor for Financial Stability sits on the ECB's Supervisory Board together with the Chief Executive Officer of the MFSA.

The Governing Council and the General Council are supported by several 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 Governing Council and the General Council. They also give feedback on written procedures addressed to the Governing Council and the General Council.

European Systemic Risk Board

The Bank is also a participant in the ESRB where the Governor is a voting member of the General Board.

In 2021, the Governor and the Deputy Governor for Financial Stability took part in the meetings of the ESRB's General Board where various issues on potential vulnerabilities and risks within the EU financial system and potential policy measures were discussed. Senior officials of the Bank also participated in the meetings of the ESRB's Advisory Technical Committee and its substructures.

The ESRB continued to publish its risk dashboard and working papers to increase awareness and stimulate public debate on macroprudential matters.

Other EU institutions

During 2021, 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. The Deputy Governor for Financial Stability also participated in the EFC-Alternates meetings.¹

During the year, the Bank engaged in EFC discussions on matters related to the 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, the most prominent topic of which concerned measures designed to mitigate the financial impact of the pandemic and promote economic recovery. Additional items of interest focused on the strengthening of the Banking Union, renewed discussion pertaining to the Capital Markets Union, the assessment of national recovery plans and measures concerning AML and countering the financing of terrorism.

The EFC continued to play a crucial role in the preparation of common European positions at the G20 meetings and other international fora, such as the IMF and the FSB.

Other Bank officials also participated in meetings of several EFC sub-committees, where matters of relevance to central banks, such as sovereign debt, the impact of the COVID-19 pandemic and IMF-related topics were discussed.

Apart from participating in the EFC and its sub-structures, Bank staff took part in several other EU committee structures related to central banking functions. Bank officials also accompanied the representatives of the MFSA at meetings of the EBA and the Supervisory Board of the Single Supervisory Mechanism. 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.

International Monetary Fund

In the IMF, Malta forms part of a constituency headed by Italy and which also includes Albania, Greece, Portugal and San Marino. With the Governor of the Central Bank of Malta occupying the position of Malta's Governor on the Board of Governors of the Fund, the Bank upheld its leading role in maintaining Malta's relationship with the Fund. In their capacities as Governor and Alternate Governor for Malta in the Fund respectively, the Governor of the Bank and the Minister for Finance and Employment participated in the virtual Spring IMF and World Bank Group (WBG) Meetings in April and the hybrid Annual Meetings in October, being accompanied on both occasions by the Deputy Governor for Monetary Policy. During the year, the Governor voted on a number of resolutions proposed by the Fund's Executive Board.

In addition to these regular proceedings, throughout the course of the year a number of matters were handled by the Bank.

In January a new bilateral loan agreement between the Central Bank of Malta and the IMF was finalised, succeeding that which had been agreed in 2017. As per the new agreement, the original special drawing rights (SDRs)-denominated loan amount of €260 million was lowered to €112 million upon the activation of the New Arrangements to Borrow. The current loan agreement will run until December 2023 and may be extended for an additional year. During 2021, no drawings were effected under the agreement.

¹ In view of the COVID-19 pandemic, during 2021, most of these meetings continued to be held in virtual format via teleconferences.

Subsequent to a request by the Fund, in June, Malta pledged to contribute SDR0.916 million in support of the comprehensive debt-relief to Sudan under the IMF-WBG's Heavily Indebted Poor Countries initiative.²

In July 2021, IMF staff members conducted a virtual visit in connection with the 2021 Article IV consultation. The Fund's mission held meetings with senior officials of the Central Bank of Malta, the Government, the MFSA and other entities. The consultation was concluded in September 2021.

Following considerable preparations and spurred on by the adverse effects of the pandemic, on 23 August, the Fund carried out the fourth general SDRs allocation in its history, disbursing a total of SDR456 billion – representing 95.85% of the then-existing quota – to member countries. Distributed on the basis of its quota share, Malta's net cumulative allocation and holdings of SDR both increased by SDR161.3 million to SDR256.7 million and SDR248.5 million respectively. In contrast, during 2021, Malta's reserve tranche position remained unchanged at SDR40.7 million and consequently the Fund's holdings of the national currency with the Bank likewise remained unaltered from the end-2020 figure of SDR127.7 million.

In view of the general SDR allocation and the anticipated resultant increase in SDR transactions, in December the Central Bank of Malta and the Fund signed a revised Voluntary Trading Arrangement agreement.

World Bank Group

Although Malta is represented in the WBG by the Minister for Finance and Employment, throughout the year the Bank continued to assist the Ministry in monitoring developments within the WBG and providing advice on initiatives from the Group. During 2021, the Bank provided the Ministry with background documentation and recommendations on various resolutions that required to be voted upon.

European Bank for Reconstruction and Development

In view that the Governor of the Central Bank of Malta was Governor for Malta on the Board of Governors of the EBRD during the year, the Bank continued to take the lead on issues related to Malta's membership in this institution. In particular, the Governor of the Bank voted on several EBRD resolutions. The COVID-19 pandemic continued to affect the ability of international financial institutions to conduct flagship meetings, with the 2021 EBRD Annual Meeting and Business Forum being conducted through virtual means and attended by the Governor and the Minister for Finance and Employment. Major themes of the meeting centered on the global recovery from the pandemic along with the EBRD's climate ambitions, potential expansion into new areas of operation and the commencement of its 2021-2025 Strategic and Capital Framework. Moreover, the Governor and the Minister for Finance and Employment represented Malta at the meeting held between member countries of the constituency of which Malta forms part.

Asian Infrastructure Investment Bank

During 2021, Malta was represented on the Asian Infrastructure Investment Bank's (AIIB) Board of Governors by the Governor of the Central Bank of Malta, with the Minister for Finance and Employment as the Alternate Governor. Malta forms part of the euro area constituency which also includes Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. In June, an election for a new Director for the constituency was held, with Ms. Ana Sobrino being successfully elected as the Director in succession to Mr Philip O'Quin. Additionally, the Governor of the Central Bank of Malta voted on several AIIB resolutions.

The Bank, together with the Ministry for Finance and Employment, started monitoring developments in the 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 establish the AIIB as an international organisation in December 2015.

² The joint IMF–WBG comprehensive approach to debt reduction under the Heavily Indebted Poor Countries initiative is designed to ensure that no poor country faces a debt burden it cannot manage.

In 2021, several constituency meetings were also held virtually. On these occasions Malta was represented by officials from the Ministry for Finance and Employment with the support of the Bank. At the sixth Annual Meeting of the AIIB since its inception – hosted by the United Arab Emirates between 26 and 28 October 2021³ – Malta was represented by officials from the Central Bank of Malta as well as the Ministry for Finance and Employment.

Commonwealth

The Commonwealth is a voluntary association of 54 independent countries of which Malta forms part. In 2021, the Governor of the Central Bank of Malta, Professor Edward Scicluna, addressed the Commonwealth Central Bank Governors Meeting held virtually. The event, jointly organised with the Commonwealth Finance Ministers Meeting, brought together in October the top economic decision-makers from the 54 member states. In this edition, the agenda of the meeting was focused on Central Bank Digital Currencies and the Commonwealth Fintech Programme. The agenda reflected the rapid transformations derived from digitalisation and offered the Governors a forum to discuss the upcoming challenges and share experiences. As part of the Fintech Programme, the Commonwealth Secretariat prepared the FinTech Toolkit which development was endorsed by the Governors at their 2018 meeting. Malta's support for Virtual Financial Assets was included in the said toolkit as a successful case study.

The Bank continued to support the establishment of a trade finance facility for the small states of the Commonwealth by providing banking services. The Commonwealth Small States Trade Finance Facility was set up to enhance trade and investment finance particularly for small and vulnerable Commonwealth States with limited access to international trade finance. No transactions involving the Bank took place during 2021.

Other international relations developments

Considering the on-going COVID-19 pandemic, Bank staff compiled several reports covering COVID-19 developments in EU Member States, as well as selected non-EU countries. These reports provided extensive information on the epidemiological measures taken by countries to tackle the COVID-19 pandemic, as well as on COVID-19 vaccinations.

In addition, regular presentations, regarding COVID-19 epidemiological developments and vaccinations, were delivered to the IPC.

Staff prepared presentations regarding merchandise trade and trade in services between Malta and the United Kingdom. These presentations focused on the trade flows of goods and services between these two countries in 2019 and 2020, as well as in the first and second quarters of 2021.

Another ongoing study relates to 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.

³ Previous AIIB Annual Meetings were usually held in July, however, the 2021 Annual Meeting was delayed to October due to the COVID-19 pandemic.



9. CORPORATE SOCIAL RESPONSIBILITY

The Central Bank of Malta is one of Malta's leading institutions both in terms of human resources and in its role in maintaining stability in prices and in the country's financial system. Despite the COVID-19 restrictions, the Bank remained as active as possible in all spheres of CSR, which encompasses a broad definition of its stakeholders, from its employees and the environment to the community and the national heritage.

Tribute to COVID-19 Frontliners

In August 2021, the Bank issued a €2 commemorative, themed coin as a tribute to Malta's health sector workers during the COVID-19 pandemic. The design is based on a photograph of two medical professionals taken by their colleague. On behalf of the many individuals who were at the fore, risking their own health during such difficult times, the Bank invited for the event the two medical professionals depicted on the coin and their colleague who had taken the photo, where the Deputy Prime Minister and the Governor honoured these medical professionals on the launch of the coin.



Governor Edward Scicluna presenting the €2 commemorative coin to Deputy Prime Minister and Health Minister Chris Fenech

Philanthropy

In spite of the COVID-19 pandemic once again affecting the activities planned by the Central Bank of Malta's Social Club, the committee increased its focus on CSR activities. The committee decided to support several voluntary organisations, namely Cystic Fibrosis Fundraising (CFF) and *Fondazzjoni Sebh*. Staff members participated in a walking and running festival in aid of CFF and donated money during an ice-cream day held at the Bank's premises to raise funds towards *Fondazzjoni Sebh*.

The committee was also actively involved in raising awareness about cancer through initiatives taken during the Pink October and Movember campaign whereby staff donated funds towards Hospice Malta. In the latter part of the year, the committee reached out to Smiling with Jerome Foundation by offering gifts to vulnerable children and once again, supported the Children's Dreams campaign. The Social Club donated six new laptops to adolescents with social issues in their home environment who wished to pursue studies in secondary and post-secondary education.



Chairman of the Bank's Social Club Mr Antoine Scicluna presenting the donation to Ms Yvonne Mallia, Director of Fondazzjoni Sebh

As in previous years, the Bank donated profits from sale of coins from the Children in Solidarity issue to the Malta Community Chest Fund Foundation. The sum was topped up by the Bank's Social Club through funds usually allocated for social gatherings and from proceeds of a dress-down day. The sum was presented during *L-Istrina* telethon.

Outreach

Conscious of its role in society in its widest sense, the Bank improved the accessibility of its website. In 2021, the website was given a high score for accessibility by the Malta Communications Authority, the entity responsible for ensuring that relevant EU regulations are followed by public sector bodies. This project is part of an ongoing review of the website, which improved the site map and made it easier for visitors to find content more intuitively.

The Bank's Social Club also organised blood drive events every four months in collaboration with the National Blood Transfusion Service with an encouraging number of staff donating blood.



Staff members during the blood drive

Financial literacy

The Bank is committed to raise the level of financial literacy locally and has an active outreach programme run by the Currency Office. In this regard, the Office has ongoing educational campaigns in order to promote financial education among professional cash handlers working in financial institutions, retailers and casinos. Moreover, with the collaboration of the Ministry for Education and Sports, the Bank offers information sessions on euro currency to all schools. The Bank believes that it can contribute to the younger generation awareness and education on euro banknotes and coins.

During 2021, due to the COVID-19 pandemic, 103 online sessions were held with students, including those attending *Skola Sajf*. In total, 3,399 students attended these online sessions. Another 32 online educational sessions were carried out to cash handlers, retailers and hotels' staff. In 2021, staff also physically visited 61 retail outlets and public entities, providing informal sessions about banknotes' security features to the cash handlers working on the day. Training was provided to 221 cash handlers at retail outlets, casinos, hotels, restaurants and local councils etc., in addition to the school students who attended online presentations. A pen drive containing relative information on euro currency was distributed to all participants.

During the first quarter of 2021, the Bank also published an article on the Cash Cycle in *Sagħtar* which is a publication intended for young students. In addition, the Bank participated in two television programs to reach out to the public.



Central Bank of Malta Fund

Educational, cultural and scientific activities are three main fields which have been recognised by the Bank as worthy of receiving financial support through funds set aside for non-business-related purposes. During 2021, the Bank's Board of Directors decided that the Central Bank of Malta Fund shall administer this financial support through an advisory board composed of persons of recognised standing and experience in these fields.

The members of the Fund's Advisory Board are Reverend Dr Marius J. Zerafa, who acts as Chair, Professor Yosanne Vella, Professor Marvin Formosa, and Mr Nancy Calamatta. Dr Pauline Lanzon Head of Legal is the Advisory Board Secretary.

Amongst the projects pursued during 2021, was a recorded televised concert by the Malta Philharmonic Orchestra intended to communicate a message of optimism and hope during the pandemic. The Bank, which is also a patron of the Malta Youth Orchestra, coordinated the concert and chose Robert Samut Hall as the filming location. The concert originally aired on TVM2 in March 2021 and a repeat broadcast is planned to be aired on the same channel during 2022. Other beneficiaries who will be receiving the Bank's support during 2022 are Fondazzjoni Wirt Artna and Inspire Foundation.



Screenshot of Concert 2021 video

PUBLIC EVENTS 2021

12 MARCH 2021

ECONOMIC ANALYSIS

Accenture Research senior principal, Ms Ladan Davarzani, delivered the Bank's first virtual public lecture in 2021 entitled *Digital Transformation: Realizing the Full Value of Emerging Technologies*. She highlighted that Cloud and Artificial Intelligence accounted for the great majority of technologies being considered by companies. Furthermore, according to an Accenture study, Artificial Intelligence has the potential to double economic growth by 2035 in the 12 countries it had analyzed. However, she stressed that policymakers needed to be aware of the pitfalls associated with technological change such as a widening digital divide, job losses, ethical concerns and cybercrime.

The webinar was opened by the Bank's Chief Economist, Dr Aaron Grech, who noted that the digital transformation could present significant opportunities for the Maltese economy as it helped reducing the disadvantages stemming from the peripheral nature of the islands vis-à-vis Malta's main markets. He also noted how this transformation could be key for the success of the plan to become carbon neutral by 2050.



3 MAY 2021

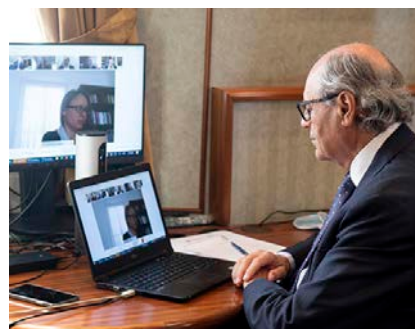
JOINT EUROPEAN INVESTMENT BANK AND CENTRAL BANK OF MALTA SEMINAR

During a webinar organised jointly by the EIB and the Central Bank of Malta the results of the annual survey conducted by the EIB were presented.

The survey – carried out between May and August 2020 – found that despite the severity of the pandemic crisis, perceived obstacles to investment were lower than the previous year, except for the prevailing general uncertainty and availability of finance. Financing constraints were larger in the construction and infrastructure sector and for micro and small companies.

A presentation on the Maltese economy was made by the Bank's Head of the Economic Analysis Department, Ms. Rita Schembri. The webinar was addressed by Minister for Finance and Employment, the Honourable Clyde Caruana, while the opening remarks were made by the EIB's Vice-President, Mr Dario Scannapieco, and the Bank's Deputy Governor, Mr Alexander Demarco.

The Governor of the Central Bank of Malta, Professor Edward Scicluna, chaired a panel discussion with key stakeholders involved in investment finance and business transformation. These included Mr Mahmood Pradhan, Deputy Director, European Department, IMF; Professor Josef Bonnici, Chairman of MDB; Mr Rick Hunkin, Chairman of the Malta Bankers' Association; Ms Marisa Xuereb, President of the Malta Chamber of Commerce, Enterprise and Industry; Mr. Paul Abela, President of the Malta Chamber of SMEs; and Mr Andrea Clerici, a representative of the EIB Rome Office.



14 JUNE 2021

CURRENCY

The Central Bank of Malta issued a silver numismatic coin depicting the Bibliotheca, which currently houses the National Library of Malta. To commemorate this event, the Bank organised a virtual Public Webinar entitled *An Architectural Jewel Box: Commemorating the 225th Anniversary of the completion of Malta's Bibliotheca*. The lecture was delivered by Professor William Zammit, who has a PhD in History, headed the Department of Library Information and Archive Sciences at the University of Malta for over a decade and is involved in several research projects.



Professor Zammit delved into both the rich architectural history of the iconic Bibliotheca and the extensive collection it holds. He outlined the historical development of what was to become the island's national library and its deeply rooted and intricate ties with Maltese and European cultural developments.

15 SEPTEMBER 2021

ECONOMIC ANALYSIS

A webinar on the higher health cost, but improved survival rates, entitled *Age, morbidity or something else? A residual approach using microdata to measure the impact of technological progress on health care expenditure* was organized by the Bank's Economic Analysis Department.

The webinar was addressed by Professor Mauro Laudicella, a Professor in health economics at the Danish Centre for Health Economics, at the University of Southern Denmark. He explained that a study of increasing health care costs found that the survival probability for patients increased by 2.5 percentage points for those being studied, with a better survival rate for some diseases such as heart attacks and strokes, and even higher one for others such as cancer. The study was carried out in Denmark among people aged over 50 who had been admitted to hospital as an emergency between 2005 and 2014.



24 NOVEMBER 2021

JOINT MALTA CHAMBER AND CENTRAL BANK OF MALTA SEMINAR

The Central Bank of Malta jointly with the Malta Chamber of Commerce, Enterprise and Industry organised a seminar entitled *Inflation: Trends, Threats and Transitions*.

In his keynote speech on inflation, the Governor of the Central Bank of Malta, Professor Edward Scicluna, discussed the implications of the reviewed ECB Monetary Policy Strategy and some misconceptions regarding price stability and the work of the central banks. Additionally, he reflected on the importance of inflationary expectations in the current juncture and stressed the value of a good communication policy. Finally, he recalled the challenges derived in a context of uncertainty and structural changes. He concluded his intervention by encouraging the audience to reach out to the Bank and take advantage of its

expertise, thanking the business community for their participation in the Business Dialogues carried out by the Bank.

The seminar was addressed by Saxo Bank Director, Mr Christopher Dembik, who spoke of the global scenario in terms of inflationary trends and some of the key factors which are leading to this increase while Central Bank of Malta's Mr Jude Darmanin delivered a presentation on a recent study focusing on the inflation impact on low-income households in Malta.

The joint seminar opening address was delivered by Ms Marisa Xuereb, President of the Malta Chamber of Commerce, Enterprise and Industry.





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 2021.

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 2021, 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) and Guideline of 11 November 2021 (ECB/2021/51).

Financial results

The Bank's financial statements for the year ended 31 December 2021 are set out on pages A-4 to A-38 and disclose a profit for the year of €22.17 million (2020: €33.0 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 2021 and up to the date of authorisation for issue of the financial statements were:

Professor Edward Scicluna – Governor
Mr Alexander Demarco – Deputy Governor Monetary Policy
Mr Oliver Bonello – Deputy Governor Financial Stability
Professor Peter J. Baldacchino
Dr Romina Cuschieri
Professor Frank Bezzina
Ms Philomena Meli (appointment until 22 January 2022)
Dr Lauren Ellul (appointed on 2 February 2022)

During the financial year, Mr Francis Bugeja was appointed Secretary to the Board with effect from 29 October 2021. Mr Herbert Zammit LaFerla served as Secretary to the Board until 28 October 2021.

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) and Guideline of 11 November 2021 (ECB/2021/51).

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 2021 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.

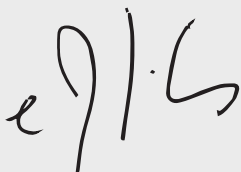
The Directors are also responsible for designing, implementing and maintaining internal controls relevant to the preparation and the fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error, and that comply with the requirements set out above. 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 2021 are included in the Annual Report 2021, 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 the financial year ended 31 December 2019 and have signified their willingness to continue in office.

By order of the Board.



Professor Edward Scicluna
Governor



Mr Alexander Demarco
Deputy Governor



Mr Oliver Bonello
Deputy Governor

Central Bank of Malta
Pjazza Kastilja
Valletta VLT 1060
Malta

16 March 2022

* www.centralbankmalta.org/annual-reports

Balance Sheet as at 31 December 2021

	2021	2020
Assets	€'000	€'000
A 1 Gold and gold receivables	4,668	8,504
A 2 Claims on non-euro area residents denominated in foreign currency	1,009,609	725,179
A 2.1 Receivables from the IMF	357,395	151,042
A 2.2 Balances with banks and security investments, external loans and other external assets	652,214	574,137
A 3 Claims on euro area residents denominated in foreign currency	204,992	103,389
A 4 Claims on non-euro area residents denominated in euro	607,378	521,479
A 4.1 Balances with banks, security investments and loans	607,378	521,479
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	712,900	148,500
A 5.1 Main refinancing operations	14,000	-
A 5.2 Longer-term refinancing operations	698,900	148,500
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	774	77
A 7 Securities of euro area residents denominated in euro	2,148,853	1,511,780
A 7.1 Securities held for monetary policy purposes	1,476,129	1,147,295
A 7.2 Other securities	672,724	364,485
A 8 General government debt denominated in euro	-	-
A 9 Intra-Eurosystem claims	7,386,303	6,142,735
A 9.1 Participating interest in ECB	21,594	20,954
A 9.2 Claims equivalent to the transfer of foreign reserves	42,314	42,314
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)	7,322,395	6,079,467
A 10 Items in course of settlement	8,009	37,833
A 11 Other assets	316,569	835,933
A 11.1 Coins of euro area	54	57
A 11.2 Tangible and intangible fixed assets	40,363	39,136
A 11.3 Other financial assets	237,222	745,580
A 11.4 Off-balance sheet instruments revaluation differences	642	658
A 11.5 Accruals and prepaid expenses	19,385	23,542
A 11.6 Sundry	18,903	26,960
Total Assets	12,400,055	10,035,409

* Only an ECB balance sheet item

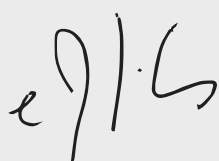
	2021	2020
Liabilities	€'000	€'000
L 1 Banknotes in circulation	1,490,332	1,384,304
L 2 Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	7,707,110	5,822,497
L 2.1 Current accounts (covering the minimum reserve system)	7,707,110	5,797,497
L 2.2 Deposit facility	-	25,000
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	77,506	-
L 4 Debt certificates issued*	-	-
L 5 Liabilities to other euro area residents denominated in euro	1,240,693	1,174,878
L 5.1 General government	807,140	593,841
L 5.2 Other liabilities	433,553	581,037
L 6 Liabilities to non-euro area residents denominated in euro	31,079	23,174
L 7 Liabilities to euro area residents denominated in foreign currency	310,996	453,051
L 8 Liabilities to non-euro area residents denominated in foreign currency	-	29,134
L 8.1 Deposits, balances and other liabilities	-	29,134
L 8.2 Liabilities arising from the credit facility under ERM II	-	-
L 9 Counterpart of special drawing rights allocated by the IMF	317,268	112,441
L 10 Intra-Eurosystem liabilities	641,133	447,972
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	641,133	447,972
L 10.4 Other liabilities within the Eurosystem (net)	-	-
L 11 Items in course of settlement	-	-
L 12 Other liabilities	44,619	44,496
L 12.1 Off-balance sheet instruments revaluation differences	1,213	2,179
L 12.2 Accruals and income collected in advance	7,325	4,041
L 12.3 Sundry	36,081	38,276
L 13 Provisions	128,809	124,896
L 14 Revaluation accounts	11,554	11,869
L 15 Capital and reserves	376,783	373,652
L 15.1 Capital	20,000	20,000
L 15.2 Reserves	356,783	353,652
L 16 Profit for the year	22,173	33,045
Total Liabilities	12,400,055	10,035,409

* Only an ECB balance sheet item

Profit and Loss account for the year ended 31 December 2021

	2021 €'000	2020 €'000
1.1 Interest income	59,635	53,065
1.2 Interest expense	1,950	5,670
1 Net interest income	61,585	58,735
2.1 Realised gains/losses arising from financial operations	14,779	18,916
2.2 Write-downs on financial assets and positions	(7,753)	(168)
2.3 Transfer to/from provisions for financial risks	(3,913)	(9,800)
2 Net result of financial operations, write-downs and risk provisions	3,113	8,948
3.1 Fees and commissions income	818	640
3.2 Fees and commissions expense	(1,580)	(1,302)
3 Net income/expense from fees and commissions	(762)	(662)
4 Income from equity shares and participating interests	559	2,305
5 Net result of pooling of monetary income	(17,382)	(13,360)
6 Other income	1,638	1,112
Total net income	48,751	57,078
7 Staff costs	(14,598)	(13,324)
8 Administrative expenses	(9,497)	(8,525)
9 Depreciation of tangible and intangible fixed assets	(2,112)	(1,887)
10 Banknote production services	(367)	(294)
11 Other expenses	(4)	(3)
Profit for the year	22,173	33,045
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)	22,173	33,045

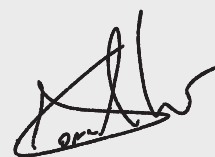
The financial statements on pages A-4 to A-38 were approved for issue by the Board of Directors on 16 March 2022 and are signed on its behalf by:



Professor Edward Scicluna
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 2021

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 guidelines² (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 2021 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

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.

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.

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 and Guideline ECB/2021/51 entered into force on 31 December 2021.

Foreign currency transactions

Foreign exchange transactions, comprising spot and forward deals in gold and foreign currencies, are recorded as off-balance sheet commitments on trade date at the prevailing spot exchange rate of the forward transaction. All security transactions in foreign currencies are recorded on-balance sheet on settlement date at the applicable exchange rate. All other transactions are recorded in the balance sheet at market exchange rates prevailing on the day of the transaction.

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.

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. 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. 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.

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.

Securities and marketable investment funds

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.

Debt securities held for monetary policy purposes and marketable debt securities classified as held-to-maturity are measured at amortised cost and subject to impairment.

Held-to-maturity securities have fixed or determinable payments and a fixed maturity date, 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;

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 and Guideline of 11 November 2021 (ECB/2021/51), OJ L 419, 24.11.2021, p. 14.

- 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.

Marketable investment fund units held for investment purposes without the Bank intervening in the decisions on the purchase or sale of the underlying assets, are valued at market prices on a net fund basis at year end. Gains and losses arising on measurement of these investment funds are accounted for in accordance with the Guideline (see 'Recognition of income and expenses' in 3 'Accounting policies' in the general notes to the financial statements).

Financial instruments held as a counterpart to the Bank's capital and statutory reserves are designated as part of an earmarked portfolio.

Malta Government Stocks (MGS) and Treasury bills purchased on the secondary market in the Bank's role as a market maker, are designated as part of another earmarked portfolio. Financial instruments forming part of this earmarked portfolio are measured at mid-market prices prevailing at the balance sheet date. Unrealised gains are reflected on-balance sheet under L 12.3 'Sundry', while unrealised losses are recognised under A 11.6 'Sundry'.

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 'Recognition of income and expenses' in 3 'Accounting policies' in the general notes to the financial statements.

Unrealised valuation gains or losses on spot and forward foreign exchange contracts are recorded from the trade date to the settlement date under A 11.4 'Off-balance sheet instruments revaluation differences' and L 12.1 'Off-balance sheet instruments revaluation differences' as applicable.

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.

Recognition of income and expenses

Income and expenses are recognised in the period in which they are earned or incurred.

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 and amortised premiums or discounts on securities 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.

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 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, with the exception of those relating to the earmarked portfolio, 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, are not netted against unrealised gains in other securities or other foreign currencies.

Claims on the International Monetary Fund (IMF)

The IMF Reserve Tranche Position, SDR 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 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 L 6 'Liabilities to non-euro area residents denominated in euro'.

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.

Tangible and intangible fixed assets

Tangible and intangible fixed assets are stated at historical cost less depreciation and 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.

Leases

For lease agreements, the related right-of-use asset and lease liability are recognised in the balance sheet at the lease commencement date under A 11.2 'Tangible and intangible fixed assets' and L 12.3 'Sundry' respectively.

The right-of-use asset is valued at cost less depreciation and impairment (see 'Tangible and intangible fixed assets' in 3 'Accounting policies' in the general notes to the financial statements). 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 at 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 8 'Administrative expenses'.

Provisions

Provisions are recognised by the Bank in accordance with the Guideline. The general risk provision covers all financial risks, defined as market, liquidity and credit risks.

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.

4 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.

5 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. The capital key of the Bank as at 31 December 2020 and 2021 was 0.0853%.

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. The Bank's Eurosystem capital key as at 31 December 2020 and 2021 stood at 0.1049%.

6 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. 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.⁴ The share of banknotes allocated to each NCB is disclosed in the balance sheet under L 1 'Banknotes in circulation'.

During the financial years ended 31 December 2020 and 2021, 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 remunerated⁵ on a daily basis at the latest available marginal interest rate used by the Eurosystem in its tenders for main refinancing operations (MROs). If the value of the euro banknotes actually issued is greater than the value according to the banknote allocation key, the excess is recognised as a liability in the balance sheet under 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 as an asset in the balance sheet under A 9.4 'Net claims related to the allocation of euro banknotes within the Eurosystem'.

In the cash changeover year⁶ 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 affected by taking into account the differences between the average value of the banknotes which the NCB had in circulation in the reference

⁴ ECB decision of 13 December 2010 on the issue of euro banknotes (recast) (ECB/2010/29), OJ L 35, 9.2.2011, p. 26 as amended by ECB Decision of 22 January 2020 (ECB/2020/7), OJ L 271, 1.2.2020, p. 21.

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 as amended by ECB Decision of 12 November 2020 (ECB/2020/55), OJ L 390, 20.11.2020, p. 60.

⁶ Cash changeover year refers to the year in which the euro banknotes are introduced as legal tender in the respective Member State.

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 recognised in the profit and loss account under 1 'Net interest income'.

7 ECB profit distribution

The Governing Council of the European Central Bank (the Governing Council) 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), the public sector purchase programme (PSPP) and the pandemic emergency purchase programme (PEPP) 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 to make transfers to the provision for financial risks. The Governing Council 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 recognised in the profit and loss account under 4 'Income from equity shares and participating interests'.

8 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 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 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 value⁹ 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.

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, ECB decision of 28 November 2019 (ECB/2019/36) OJ L 332, 23.12.2019, p. 183 and ECB decision of 12 November 2020 (ECB/2020/56) OJ L 390, 20.11.2020, p. 63.

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.

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'.

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 6 'Banknotes in circulation' in the general notes to the financial statements).

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 2021, gold was revalued at €1,609.483 (2020: €1,543.884) per fine troy ounce. The unrealised valuation gains of €332,752 (2020: €830,438) are disclosed under L 14 'Revaluation accounts'.

	€'000	Fine troy ounces
Balance as at 31 December 2020	8,504	5,508
Net effect of transactions during the year	(3,338)	(2,608)
Movement in unrealised valuation gains during the year	(498)	-
Balance as at 31 December 2021	4,668	2,900

A 2 Claims on non-euro area residents denominated in foreign currency

These claims consist of receivables from the IMF and other claims on counterparties resident outside the euro area denominated in foreign currency as follows:

	2021 €'000	2020 €'000	Change €'000
Special drawing rights	357,395	151,042	206,353
US dollar	286,795	290,850	(4,055)
Canadian dollar	119,605	84,431	35,174
Great Britain pound	68,359	62,958	5,401
Swedish krona	58,065	55,777	2,288
Australian dollar	50,333	29,935	20,398
Norwegian krone	34,651	35,218	(567)
New Zealand dollar	20,216	-	20,216
Others	14,190	14,968	(778)
Total	1,009,609	725,179	284,430

A 2.1 Receivables from the IMF

	2021 €'000	2020 €'000	Change €'000
Reserve tranche position (net)	50,245	47,916	2,329
SDR holdings	307,150	103,126	204,024
Total	357,395	151,042	206,353

IMF quota

Malta's membership subscription to the IMF as at 31 December 2020 and 2021 was SDR168,300,000.

Up to 25% of the quota is paid in SDR (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. As at 31 December 2020 and 31 December 2021, the reserve tranche position amounted to SDR40,654,776.

Malta's SDR position in the IMF

Upon membership, every member is allocated with an amount of SDR in proportion to the country's quota. During 2021, the IMF approved a general allocation of SDR equivalent to US\$650 billion. As a result, as at 31 December 2021, the SDR allocated to Malta increased to SDR256,709,738 (2020: SDR95,401,757). This is reported under L 9 'Counterpart of special drawing rights allocated by the IMF'. SDR allocated to Malta cannot be withdrawn unless such advice is received from the IMF.

Along the years, the Bank entered into arrangements made by the IMF to buy and sell SDR to various member countries. During 2021, there were two transactions under these arrangements for a total of SDR300,000. As at 31 December 2021, Malta's SDR holdings, including interest received thereon, amounted to SDR248,523,215 (2020: SDR87,498,866) equivalent to €307,149,823 (2020: €103,126,197). 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.

Bilateral Borrowing Agreement

During 2021, the Bank entered into a new bilateral loan agreement with the Fund. Upon this becoming effective, the original SDR-denominated loan amount of €260,000,000, which expired in December 2020, was lowered to €112,000,000 due to the activation of the New Arrangements to Borrow. The new agreement is for a three-year term, which may be extended to four years. During 2021, no drawings were affected under this agreement.

A 2.2 Balances with banks and security investments, external loans and other external assets

These assets principally consist of security investments issued by non-euro area residents and balances with banks.

	2021	2020	Change
	€'000	€'000	€'000
Marketable debt securities other than those held-to-maturity	179,208	200,061	(20,853)
Held-to-maturity debt securities	455,150	366,577	88,573
Current accounts and overnight deposits with banks	17,856	7,499	10,357
Total	652,214	574,137	78,077

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.

	2021	2020	Change
	€'000	€'000	€'000
Marketable debt securities other than those held-to-maturity	30,064	23,953	6,111
Held-to-maturity debt securities	28,886	26,556	2,330
US dollar liquidity-providing operations	145,241	52,563	92,678
Current accounts and overnight deposits with banks	801	317	484
Total	204,992	103,389	101,603

During 2021, credit institutions established in Malta participated for a total amount of US\$5,872,900,000 (2020: US\$1,875,300,000) in US dollar liquidity-providing operations. The outstanding amount as at 31 December 2021 amounted to US\$164,500,000 (2020: US\$64,500,000). Under this programme, the US dollar was provided by the Federal Reserve to the ECB by means of a 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.

Claims on euro area residents were denominated in foreign currency as follows:

	2021	2020	Change
	€'000	€'000	€'000
US dollar	177,728	78,275	99,453
Great Britain pound	12,701	11,854	847
Swiss franc	3,892	3,738	154
Others	10,671	9,522	1,149
Total	204,992	103,389	101,603

A 4 Claims on non-euro area residents denominated in euro

These claims consist of marketable debt securities issued by non-euro area residents, a fixed income investment fund managed by external asset managers and balances with banks outside the euro area.

	2021	2020	Change
	€'000	€'000	€'000
Marketable debt securities other than those held-to-maturity	154,692	163,361	(8,669)
Held-to-maturity debt securities	374,791	358,053	16,738
Fixed income investment fund	77,887	-	77,887
Current accounts and overnight deposits with banks	8	65	(57)
Total	607,378	521,479	85,899

During 2021, the Bank changed its management intention to hold to maturity those marketable debt securities previously forming part of the earmarked portfolio held as a counterpart to the Bank's capital and statutory reserves (see 'Securities' in 3 'Accounting policies' in the general notes to the financial statements). Following this decision, non-euro area debt securities denominated in euro were reclassified from the earmarked portfolio reported under A11.3 'Other financial assets' to this balance sheet sub-item.

As from 2021, the Bank's position in a fixed income investment fund, consisting of marketable debt securities, was reclassified from A11.3 'Other financial assets' to this balance sheet sub-item, in line with the fund's currency and country of issue.

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.

On 31 December 2021, the total Eurosystem holding of monetary policy assets amounted to €2,202 billion (2020: €1,793 billion) of which the Bank held €712,900,000 (2020: €148,500,000). 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, 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.

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. MROs play a key role in achieving the aims of steering interest rate, managing market liquidity and signalling the monetary policy stance.

During 2021, MROs carried out with the Bank amounted to €84,000,000, of which an amount of €14,000,000 remained outstanding at the end of the year. There were no outstanding amounts of these operations as at 31 December 2020.

Throughout the financial years ended 31 December 2020 and 2021, the marginal interest rate used by the Eurosystem in its tenders for MROs 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.

During 2021, credit institutions established in Malta participated in three-month LTROs with an aggregate amount of €10,000,000. These operations were conducted through fixed rate tender procedures with full allotment, at the average rate of the MROs prevailing over the life of the respective operation. As at 31 December 2020 and 2021, there were no outstanding LTROs.

In 2019, the Governing Council introduced a new series of seven quarterly targeted longer-term refinancing operations (TLTRO III). Furthermore, on 10 December 2020 the Governing Council added three further operations to this series, which were conducted between June and December 2021. These operations have a three-year maturity. For the first seven TLTRO III, from September 2021, starting 12 months after the settlement of each TLTRO III, participants have the option on a quarterly basis of terminating or reducing the amount of the TLTRO III concerned before maturity. For the eighth or subsequent TLTRO III, participants have this option on a quarterly basis starting in June 2022. According to the initial decisions taken by the Governing Council, 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.

In response to COVID-19, in 2020, the Governing Council decided to reduce the interest rate on the outstanding TLTRO III for the period between 24 June 2020 and 23 June 2021, and the period between 24 June 2021 and 23 June 2022, referred to as the special interest rate period and the additional special interest rate period respectively. The applicable interest rate can be as low as 50 basis points below the average interest rate on the deposit facility prevailing over the same period, but in any case, may not become less negative than -1%.

As a prudent approach, given that the actual interest rates will only be known at the maturity of each operation and that a reliable estimate is not possible until that time, the deposit facility rate minus 50 basis points, with a ceiling of -1% is used for calculating the TLTRO III interest over the two special interest rate periods and the deposit facility rate is used for calculating the TLTRO III interest over the remaining life of the operation, until more reliable data is available.

For the financial year 2021, the following interest rates were used for calculating the TLTRO III interest accruals: the interest rate as communicated to the counterparties on 10 September 2021 was used over the special interest rate period until 23 June 2021, and the deposit facility rate minus 50 basis points, with a ceiling of -1%, was used over the additional special interest rate period from 24 June 2021 until 31 December 2021.

During 2021, new participations in TLTRO III carried out with the Bank amounted to €520,000,000. The outstanding amount of these operations as at 31 December 2021 amounted to €623,500,000 (2020: €103,500,000).

On 30 April 2020, the Governing Council introduced a new series of seven LTROs, called pandemic emergency longer-term refinancing operations (PELTROs). On 10 December 2020, the Governing Council decided to offer four additional PELTROs in 2021 allotted on a quarterly basis, each with a tenor of one year. These operations provide a liquidity backstop to the euro area banking system and contribute to preserving the smooth functioning of the money market during the extended pandemic period. The PELTROs are conducted as fixed rate tender procedures with full allotment. The interest rate is 25 basis points below the average rate applied on the Eurosystem's MROs over the life of the respective PELTRO. The aggregate PELTROs carried out with the Bank amounted to €75,400,000 which remained outstanding as at 31 December 2021 (2020: €45,000,000).

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 2020 and 2021.

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 2020 and 2021.

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 2021, there were no participations in the marginal lending facility by credit institutions established in Malta. There were no outstanding transactions as at 31 December 2020 and 2021.

Throughout the financial years ended 31 December 2020 and 2021, 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 affected.

A 6 Other claims on euro area credit institutions denominated in euro

This item consists of claims on credit institutions within the euro area not relating to monetary policy operations, mainly current accounts and overnight deposits with banks.

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 2021, this sub-item consisted of securities acquired by the Bank within the scope of the SMP,¹⁰ the PSPP¹¹ and the PEPP.¹² The Bank's PSPP and PEPP related purchases comprised MGS from the secondary market. The amortised cost of the securities under these programmes as well as their market values,¹³ are as follows:

	2021		2020		Change	
	Amortised cost €'000	Market value €'000	Amortised cost €'000	Market value €'000	Amortised cost €'000	Market value €'000
Securities markets programme	9,551	11,214	9,349	11,585	202	(371)
Public sector purchase programme	1,012,161	1,066,052	903,964	1,000,894	108,197	65,158
Pandemic emergency purchase programme	454,417	446,973	233,982	237,933	220,435	209,040
Total	1,476,129	1,524,239	1,147,295	1,250,412	328,834	273,827

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 ECB Decision of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17), OJ L 91, 25.03.2020, p. 1 as amended by ECB Decision of 28 July 2020 (ECB/2020/36), OJ L 248, 31.7.2020, p. 24 and ECB Decision of 10 February 2021 (ECB/2021/6), OJ L 50, 15.2.2021, p. 29.

¹³ 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.

The Governing Council decided to cease further SMP purchases on 6 September 2012.

During 2021, the Eurosystem continued with net purchases of securities under the asset purchase programme (APP)¹⁴ at an average of €20 billion per month. In December 2021, the Governing Council decided that in 2022, the monthly net purchases of the Eurosystem for the second and third quarter will be at the pace of €40 billion and €30 billion respectively. As from October 2022 onwards, net asset purchases will be maintained at a monthly pace of €20 billion. The Governing Council expects net purchases to continue for as long as necessary to reinforce the accommodative impact of its policy rates, and to cease shortly before it starts raising the key ECB interest rates. The Governing Council 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.

In 2021, the Eurosystem continued with net asset purchases under the PEPP, with an envelope of €1,850 billion. Purchases were conducted in a flexible manner based on the assessment of financing conditions and the inflation outlook. In December 2021, the Governing Council decided to discontinue the net asset purchases under the PEPP at the end of March 2022. However, they can be resumed, if necessary, to counter negative shocks related to the pandemic. Furthermore, the Governing Council extended the reinvestment horizon for the principal payments from maturing securities purchased under the PEPP until at least the end of 2024. The PEPP reinvestments can be adjusted across time, asset classes and jurisdictions at any time. The future roll-off of the PEPP will be managed to avoid interference with the appropriate monetary policy stance.

The Governing Council 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. In these tests, impairment indicators are assessed separately for each programme. The total Eurosystem NCBs' holding of such securities amounts to €4,268 billion (2020: €3,345 billion).

In accordance with the decision of the Governing Council taken under Article 32.4 of the Statute, losses from holdings of SMP, CBPP3,¹⁵ ABSPP,¹⁶ PSPP supranational securities, PEPP securities other than public sector securities and CSPP,¹⁷ if they were to materialise, are to be shared in full by the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares.

Following the impairment tests carried out as at 31 December 2021, the Governing Council identified an impairment indicator relating to two securities falling under the ABSPP for which significant deterioration of the credit quality was observed. The Governing Council 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. As a result of the impairment tests conducted as at 31 December 2021 on securities purchased under the other portfolios, the Governing Council decided that all future cash flows on such securities are expected to be received.

¹⁴ The APP consists of the CBPP3, the ABSPP, the PSPP and the corporate sector purchase programme (CSPP).

¹⁵ 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, as amended by ECB Decision of 25 September 2020 (ECB/2020/48), OJ L 379, 13.11.2020, p. 58.

¹⁶ 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.

¹⁷ 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, ECB Decision of 18 May 2017 (ECB/2017/13), OJ L 190, 21.7.2017, p. 20 and ECB Decision of 24 March 2020 (ECB/2020/18), OJ L 91, 25.3.2020, p. 5. Under this programme, the NCBs may purchase investment grade euro denominated bonds issued by non-bank corporations established in the euro area.

A 7.2 Other securities

This sub-item comprises all the Bank's investments in non-monetary policy debt securities and marketable investment funds with euro area residents.

	2021	2020	Change
	€'000	€'000	€'000
Marketable debt securities other than those held-to-maturity	109,410	113,062	(3,652)
Held-to-maturity debt securities	262,192	251,423	10,769
Marketable investment funds	301,122	-	301,122
Total	672,724	364,485	308,239

During 2021, the Bank decided to reclassify its investments in the earmarked portfolio held as a counterpart to the Bank's capital and statutory reserves to this balance sheet sub-item (see 'Securities' in 3 'Accounting policies' in the general notes to the financial statements). The Bank's change in management intention was brought about by: (i) the transfer of marketable debt securities, which were not classified as held-to-maturity, to the held-to-maturity classification, and (ii) the decision to continue investing in marketable investment funds. As at 31 December 2020, these marketable investments were shown under A11.3 'Other financial assets'.

A 9 Intra-Eurosystem claims

This item consists of claims arising from the Bank's participating interest in ECB, claims equivalent to the transfer of foreign reserves to the ECB 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 ESCB NCBs.

Following the departure of the United Kingdom from the EU on 31 January 2020, the ECB kept its subscribed capital unchanged at €10,825 million. The share of the Bank of England in the ECB's subscribed capital, was reallocated among the euro area NCBs and the remaining non-euro area NCBs.

In 2020, the ECB's paid-up capital also remained unchanged at €7,659 million, as the remaining NCBs were required to cover the withdrawn Bank of England's paid-up capital of €58 million. In addition, euro area NCBs are required to pay up in full their increased subscriptions to the ECB capital in two equal annual instalments in 2021 and 2022. As a result, the Bank has paid up the first instalment of €639,880 on 29 December 2021, increasing its share in the paid-up capital of the ECB to €8,593,851 (2020: €7,953,971). The second instalment will be paid-up in 2022.

The Bank's share in the ECB's accumulated net profits as at 31 December 2020 and 2021 amounted to €13,000,376.

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. As at 31 December 2020 and 2021 these claims amounted to €42,313,997. 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.

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 6 'Banknotes in circulation' in the general notes to the financial statements). As at the end of 2020 and 2021, the Bank had no claims in this respect but had a liability which is presented in 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 2021, the balance of €7,322,395,015 (2020: €6,079,467,337) included three main 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.

	2021	2020	Change
	€'000	€'000	€'000
TARGET2 balance	7,339,298	6,091,587	1,247,711
Net result from pooling of monetary income	(17,382)	(13,442)	(3,940)
ECB profit distribution	157	1,322	(1,165)
Other claims within the Eurosystem	322	-	322
Total	7,322,395	6,079,467	1,242,928

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 2020	35,642	12,310	47,952
Additions	508	3,109	3,617
Derecognition of assets	(390)	(30)	(420)
Disposal of assets	-	(3)	(3)
As at 31 December 2021	35,760	15,386	51,146
Accumulated depreciation			
As at 31 December 2020	4,618	4,814	9,432
Charge for the year	471	1,546	2,017
Derecognition of assets	(23)	(21)	(44)
Disposal of assets	-	(3)	(3)
As at 31 December 2021	5,066	6,336	11,402
Net book value			
As at 31 December 2020	31,024	7,496	38,520
As at 31 December 2021	30,694	9,050	39,744
Right-of-use assets			
As at 31 December 2020	433	183	616
Additions	-	118	118
Depreciation charge for the year	(9)	(86)	(95)
Derecognition of assets	-	(20)	(20)
As at 31 December 2021	424	195	619
Total net book value			
As at 31 December 2020	31,457	7,679	39,136
As at 31 December 2021	31,118	9,245	40,363

As at 31 December 2021, the net book value included an amount of €1,984,266 (2020: €201,931) which related to assets not yet available for use and not depreciated.

A 11.3 Other financial assets

The Bank holds an earmarked portfolio comprising MGS purchased on the secondary market by the Bank in its role as market maker.

During 2021, the Bank decided to reclassify its marketable investment funds and debt securities held as part of its earmarked portfolio to other portfolios reported under A 4 'Claims on non-euro area residents denominated in euro' and A 7.2 'Other securities' (see 'Securities' in 3 'Accounting policies' in the general notes to the financial statements). Furthermore, during 2021, the Bank's position in a fixed income investment fund was reclassified from this balance sheet sub-item to A 4 'Claims on non-euro area residents denominated in euro'.

	2021	2020	Change
	€'000	€'000	€'000
Earmarked Malta Government Stocks	237,222	302,610	(65,388)
Earmarked marketable investment funds	-	178,913	(178,913)
Earmarked marketable debt securities, other than those held-to-maturity	-	158,995	(158,995)
Fixed income investment fund	-	105,062	(105,062)
Total	237,222	745,580	(508,358)

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.

A 11.5 Accruals and prepaid expenses

As at 31 December 2021, this sub-item included accrued interest income of €19,223,236 (2020: €23,542,413), mainly on securities. There was no interest attributable to intra-Eurosystem claims.

A 11.6 Sundry

Sundry assets mainly consisted of loans amounting to €12,455,924 (2020: €10,536,875) and unrealised losses attributable to the earmarked portfolio amounting to €2,558,314 (2020: €4,009). At 31 December 2020, these assets also included realised gains attributable to off-balance sheet positions, principally foreign exchange forward transactions outstanding at the year end, amounting to €12,544,901 (see L 12.3 'Sundry' in the notes to the balance sheet for position held as at 31 December 2021).

Liabilities

L 1 Banknotes in circulation

This item consists of the Bank's share of the total euro banknotes in circulation (see 6 'Banknotes in circulation' in the general notes to the financial statements).

During 2021, the total value of banknotes in circulation within the Eurosystem increased by 7.6% from €1,435 billion at 31 December 2020 to €1,544 billion at 31 December 2021. According to the banknote allocation key, the Bank had an amount of euro banknotes in circulation of €1,490,332,490 at the end of the year (2020: €1,384,304,080).

The value of the euro banknotes issued by the Bank in 2021 increased by 16.3% from €1,832,276,090 to €2,131,465,485 at year end. As this is more than the allocated amount, the difference of €641,132,995 (2020: €447,972,010) is shown under 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.

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, excluding funds of credit institutions that are not freely disposable and accounts of credit institutions exempt from minimum reserve requirements, which are disclosed separately under L 3 'Other liabilities to euro area credit institutions denominated in euro'.

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 minimum reserve balances are remunerated at the latest available interest rate used by the Eurosystem in its tenders for MROs. 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.

As from 30 October 2019, the Governing Council introduced a two-tier system for reserve remuneration consisting of exempt and non-exempt tiers. The exempt tier, which is determined as a multiple of six¹⁸ on an institution's minimum reserve requirements, is remunerated at 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.

Current accounts amounting to €7,707,110,197 remained outstanding as at 31 December 2021 (2020: €5,797,496,607).

L 2.2 Deposit facility

This facility is available to eligible counterparties to make overnight deposits with Eurosystem NCBs at pre-specified rates. During 2021, the aggregate volume of such deposits with the Bank amounted to €4,640,000,000 (2020: €8,680,000,000). There were no outstanding deposits as at 31 December 2021 (2020: €25,000,000).

Throughout the financial years ended 31 December 2020 and 2021, the overnight deposit facility rate remained unchanged at the level of -0.5%.

¹⁸ The multiplier may be adjusted by the Governing Council over time in line with changing levels of excess liquidity holdings.

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 2020 and 2021. Accordingly, there were no outstanding liquidity absorbing fine-tuning operations as at 31 December 2020 and 2021.

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 2020 and 2021, and accordingly there were no outstanding operations as at 31 December 2020 and 2021.

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. During 2021, the aggregate volume of deposits related to margin calls with the Bank amounted to €29,718,653, while no such deposits were recorded during 2020. There were no outstanding deposits related to margin calls as at 31 December 2020 and 2021.

L 3 Other liabilities to euro area credit institutions denominated in euro

As at 31 December 2021, this item consisted of funds of credit institutions that were not freely disposable amounting to €77,505,968. This was consequent to the Guideline amendment of 11 November 2021 (ECB/2021/51) requiring these funds to be reported under this balance sheet item. As at 31 December 2020, funds of credit institutions that were not freely disposable amounting to €73,817,587 were reported under L 5.2 'Other liabilities'.

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 remunerated in accordance with the provisions established by the Governing Council.¹⁹

	2021	2020	Change
	€'000	€'000	€'000
Current accounts	626,224	430,120	196,104
Sinking fund accounts	180,916	163,721	17,195
Total	807,140	593,841	213,299

¹⁹ 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 as amended by ECB Decision of 8 September 2020 (ECB/2020/38), OJ L 297, 11.9.2020, p. 5 and ECB Decision of 26 May 2021 (ECB/2021/25), OJ L 191, 31.5.2021, p.43.

L 5.2 Other liabilities

This sub-item included current accounts in euro which are repayable on demand amounting to €173,553,167 (2020: €221,036,674),²⁰ of which €42,218,247 (2020: €40,873,317) related to balances of former credit institutions. These balances are remunerated in accordance with the provisions established by the Governing Council.²¹

Collateralised inward deposits, which as at 31 December 2021 amounted to €260,000,000 (2020: €360,000,000), are also included in this sub-item. These liabilities are attributable to securities sold subject to repurchase agreements entered into by the Bank (see 'Sale and repurchase agreements and lending of securities' in 3 'Accounting policies' 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 'Claims on the International Monetary Fund' in 3 'Accounting policies' in the general notes to the financial statements). As at 31 December 2021, balances with such organisations amounted to €31,078,794 (2020: €23,173,849). Whereas the IMF account is non-interest bearing, the other balances are remunerated in accordance with the provisions established by the Governing Council.

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.²² Other current accounts and fixed-term deposits included balances of former credit institutions amounting to €72,934,269 (2020: €11,960,255).

	2021	2020	Change
	€'000	€'000	€'000
Government of Malta current accounts	42,388	36,444	5,944
Government of Malta sinking fund accounts	41	52	(11)
Liabilities to banks	179,925	395,622	(215,697)
Other current accounts and fixed-term deposits	88,642	20,933	67,709
Total	310,996	453,051	(142,055)

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.

²⁰ See L 3 'Other liabilities to euro area credit institutions denominated in euro' in the notes to the balance sheet.

²¹ See footnote 19.

²² See footnote 19.

L 9 Counterpart of special drawing rights allocated by the IMF

This item represents the counterpart of SDR allocated by the IMF to Malta (see A 2.1 '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 2021 reflects the relatively higher increase (16.3%) in the banknotes issued by the Bank as compared to the increase in banknotes put into circulation by the Eurosystem as a whole (7.6%).

L 10.4 Other liabilities within the Eurosystem (net)

As at 31 December 2020 and 2021, the Bank had a net claim within the Eurosystem as reported under 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.

	2021	2020	Change
	€'000	€'000	€'000
Accrued interest payable	6,741	1,185	5,556
Others	584	2,856	(2,272)
Total	7,325	4,041	3,284

L 12.3 Sundry

Sundry liabilities mainly included realised losses attributable to off-balance sheet positions, principally foreign exchange forward transactions outstanding at the year end, amounting to €15,785,360 (see A 11.6 'Sundry' in the notes to the balance sheet for the position held as at 31 December 2020). These losses 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. This sub-item also included unrealised revaluation gains attributable to MGS held as part of an earmarked portfolio amounting to €5,955,636 (2020: €20,099,362) and lease liability of €618,650 (2020: €616,273) (see 'Leases' in 3 'Accounting policies' in the general notes to the financial statements).

At 31 December 2020, this sub-item also included unrealised revaluation gains of €9,429,752 attributable to the marketable debt securities and investment funds which were held as part of the other earmarked portfolio.

L 13 Provisions

Provision for financial risks

This item includes a provision of €128,808,660 (2020: €124,895,842) 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 buffers²³ 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.

Provision for credit risks in monetary policy operations

During 2020, the impaired securities held by one of the Eurosystem NCBs under the CSPP were sold, resulting in the full release of previously established provision by 31 December 2020.

During 2021, there were no impairment losses on monetary policy operations which resulted in provision for credit risks (see A 7.1 'Securities held for monetary policy purposes' in the notes to the balance sheet).

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 investment funds at year end.

	2021	2020	Change
	€'000	€'000	€'000
Gold	333	830	(497)
Foreign currency positions	4	2	2
Marketable instruments	11,217	11,037	180
Total	11,554	11,869	(315)

L 15 Capital and reserves

The following table analyses the movement in capital and reserves of the Bank:

	Capital	General	Reserve for	Capital	Total
	€'000	reserve fund	risks and	contribution	€'000
	€'000	€'000	contingencies	€'000	€'000
	€'000	€'000	€'000	€'000	€'000
Balance as at 31 December 2020	20,000	75,505	187,776	90,371	373,652
Net issuance of euro coins	-	-	-	3,131	3,131
Balance as at 31 December 2021	20,000	75,505	187,776	93,502	376,783

²³ 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

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.

Reserve for risks and contingencies

The reserve for risks and contingencies is 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.

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. Negative interest falling within interest income or expense on monetary policy operations is netted on a balance sheet sub-item level (see 'Recognition of income and expenses' in 3 'Accounting policies' in the general notes to the financial statements).

1.1 Interest income

Interest income includes income on foreign reserve assets and euro-denominated portfolios, as well as interest income on monetary policy instruments.

	2021	2020	Change
	€'000	€'000	€'000
Marketable debt securities			
- In euro	8,398	12,713	(4,315)
- In foreign currency	10,849	12,459	(1,610)
Current accounts and overnight deposits			
- In euro	(11)	(5)	(6)
- In foreign currency	(7)	71	(78)
IMF	1,113	52	1,061
Monetary policy operations			
- Minimum reserves	22,721	17,626	5,095
- Overnight deposits	94	174	(80)
- Deposits related to margin calls	1	-	1
- Securities acquired under the SMP	672	742	(70)
- Securities acquired under the PSPP	11,994	11,665	329
- Securities acquired under the PEPP	1,071	275	796
Forward foreign exchange contracts	(2,592)	(6,474)	3,882
Marketable investment funds	5,308	3,734	1,574
Other interest income	24	33	(9)
Total	59,635	53,065	6,570

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.

	2021	2020	Change
	€'000	€'000	€'000
Government accounts			
- In euro	(4,422)	(4,395)	(27)
- In foreign currency	(30)	(19)	(11)
Other customer accounts			
- In euro	(1,347)	(1,082)	(265)
- In foreign currency	547	1,038	(491)
Monetary policy operations			
- Longer-term refinancing operations	4,753	619	4,134
Other interest expense	(1,451)	(1,831)	380
Total	(1,950)	(5,670)	3,720

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 arising from the disposal of financial instruments, mainly debt securities, and reductions in foreign currency positions.

	2021	2020	Change
	€'000	€'000	€'000
Net gains on disposal of financial instruments	14,112	11,787	2,325
Net gains on foreign currency positions	667	7,129	(6,462)
Total	14,779	18,916	(4,137)

2.2 Write-downs on financial assets and positions

This sub-item comprises unrealised revaluation losses arising from the price revaluation of marketable debt securities and investment funds 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.

	2021	2020	Change
	€'000	€'000	€'000
Write-downs on marketable instruments	7,752	139	7,613
Write-downs on foreign currency positions	1	29	(28)
Total	7,753	168	7,585

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 2021, the Bank received an amount of €401,771 (2020: €982,868) representing its relative share of the ECB's distributable remaining profits for 2020, in proportion to the Bank's subscribed capital key (see 5 'Capital key' in the general notes to the financial statements).

Also, included under this caption is the amount of €157,325 (2020: €1,321,714) due to the Bank with respect to the ECB's 2021 interim profit distribution (see 7 'ECB profit distribution' in the general notes to the financial statements).

5 Net result of pooling of monetary income

This item contains the net result of pooling of monetary income for 2021 amounting to an expense of €17,205,760 (2020: €13,385,303). In 2021, a net expense of €176,554 (2020: €56,652) was paid in relation to adjustments for previous years.

During 2021, there was no provision against losses in monetary policy portfolios. In 2020, an income of €82,288, representing the Bank's share of the release of the provision established in previous years was included in this item (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; deposit liabilities to defaulted Eurosystem counterparties which have been reclassified from L 2.1 'Current accounts (covering the minimum reserve system)'. 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,²⁴ CBPP2²⁵ 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 and PEPP.

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 2020 and 2021 was a payment by the Bank. This net result is the difference between the net monetary income pooled by the Bank amounting to €18,433,059 (2020: €17,921,769) and the redistributed amount of €1,227,299 (2020: €4,536,466).

6 Other income

This item mainly includes the income from the issuance of numismatic coins.

7 Staff costs

Staff costs consist of salaries and other ancillary costs.

	2021	2020	Change
	€'000	€'000	€'000
Staff salaries	12,429	11,293	1,136
Other staff costs	1,248	1,224	24
Training, welfare and other related expenditure	921	807	114
Total	14,598	13,324	1,274

The full-time equivalent average number of staff employed by the Bank during the year was as follows:

	2021	2020	Change
	Number	Number	Number
Governors	3	3	-
Chief Officers	7	7	-
Heads and executives	182	154	28
Officers II and I	126	145	(19)
Non-clerical staff	29	31	(2)
Total	347	340	7

²⁴ 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.

²⁵ 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.

8 Administrative expenses

This item consists of operating expenditure incurred by the Bank.

Administrative expenses of €9,497,041 (2020: €8,525,041) comprised maintenance expenditure, professional fees, travelling costs and other expense items which were incurred in the course of the Bank's operations. Auditors' remuneration, inclusive of VAT, for the year ended 31 December 2021 amounted to €126,100 (2020: €81,500).

Compensation to the members of the Board of Directors for the financial year ended 31 December 2021 amounted to €408,256 (2020: €305,342). The Governor and Deputy Governors are entitled to benefits such as health insurance cover and refund of certain other expenses. The other members of the Board of Directors are entitled to a 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 'Tangible and intangible fixed assets' and 'Leases' in 3 'Accounting policies' 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

Off-balance sheet instruments

As at 31 December 2021, the Bank had outstanding net foreign exchange forward and swap contracts of €548,196,775 (2020: €292,348,449) against other currencies (principally the US dollar). Unsettled net spot transactions as at 31 December 2021 were €26,460,000 (2020: €8,630,000).

At the balance sheet date, the Bank had outstanding interest rate futures contracts linked to German government securities (net short position with a notional amount of €44,276,100) and US treasury notes (net short position with a notional amount of US\$61,539,532).

Contingent liabilities and commitments

As at the end of the year, the Bank had commitments in respect of tangible and intangible fixed assets which extended beyond the balance sheet date. Capital commitments, which amount to €8,540,800 (2020: €8,705,300), are expected to be incurred during the forthcoming financial year and relate mainly to capital expenditure attributable to buildings and investment in IT.

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 net interest on deposits arising from these banking transactions is recognised in 1.2 'Interest expense' in the Bank's 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.

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 €2,745,402 (2020: €3,109,292), 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.

Investment securities pledged as collateral

As at 31 December 2021, 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 €57,391,000 (2020: US\$65,000,000 or approximately €52,900,000). No amounts were borrowed under these facilities at the balance sheet dates.

Assets held in custody

As at 31 December 2021, assets held in custody by the Bank in terms of the Insurance Business Act (Cap. 403) amounted to the equivalent of €19,146,336 (2020: €18,387,295).

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 2021, the Investor and Depositor Compensation Schemes had deposits of €208,081 (2020: €429,999) and €8,089,302 (2020: €8,284,746) respectively, with the Bank.

Statement of the Bank's investments as at 31 December 2021

	EUR €'000	USD €'000	Others €'000	Total €'000
Cash and balances with banks				20,493
Gold balances				4,668
Securities by issuer category:				
Government	1,974,255	70,303	93,144	2,137,702
Monetary financial institutions	517,488	173,281	243,659	934,428
Other financial institutions	90,514	56,071	47,248	193,833
Non-financial institutions	20,995	9,601	-	30,596
Supranational	11,184	-	-	11,184
	2,614,436	309,256	384,051	3,307,743
Claims on the IMF				357,395
Participating interest in the ECB				21,594
Transfer of foreign reserves to the ECB				42,314
Marketable investment funds				379,009
Total investments				4,133,216



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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 2021, 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 2021, 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 *Auditors' 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' *International Code of Ethics for Professional Accountants* (including International Independence Standards) (IESBA Code), 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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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 Guide-line, 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 2022

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