



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.

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

During 2022, 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 2022, the ECB conducted 52 MROs. Credit institutions established in Malta participated in these operations with a total cumulative amount of €185.0 million, €101.0 million higher when compared to 2021 (see Table 1.1).

The ECB also conducted 12 regular three-month LTROs with full allotment and at a fixed rate equal to the average MRO rate during the life of the operations. Credit institutions established in Malta participated with an aggregate amount of €159.0 million in such operations, €149.0 million higher when compared to 2021 (see Table 1.1).

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

EUR millions

Type of operation ⁽¹⁾	2021	2022
MROs	84.0	185.0
Three-month LTROs	10.0	159.0
US dollar collateralised operations (USD millions)		
- Seven-day	5,811.9	8,027.6

Source: Central Bank of Malta.

⁽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.

As from September 2021 and one year after the settlement of each TLTRO-III operations, credit institutions, on a quarterly basis, have the possibility to partially or fully repay the amounts allotted in such operations. Furthermore, on 27 October 2022, the Governing Council recalibrated the TLTRO-III operations to ensure consistency with the broader monetary policy normalisation process. The recalibration aims to address unexpected and extraordinary inflation increases by reinforcing transmission of policy rates to bank lending conditions. Accordingly, from 23 November 2022, the interest rate on all remaining TLTRO-III operations is indexed to the average applicable key ECB interest rates from that date onward. Furthermore, three additional voluntary early repayment dates were introduced for banks wishing to terminate or reduce borrowings before maturity. During 2022, an amount of €513.5 million from the TLTRO-III operations was early repaid by credit institutions established in Malta.

During 2022, 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 8,027.6 million, higher than the USD 5,811.9 million taken up in the previous year.²

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 €1,698.0 million, an increase of €1,679.4 million compared to the 2021 average. Similar to 2021, Maltese credit institutions did not utilise the marginal lending facility in 2022.

The interest rates on the MROs, the marginal lending facility and the overnight deposit facility increased four times throughout the year, standing at 2.50%, 2.75% and 2.00% respectively as at end-2022.

Reserve requirements

The ECB requires credit institutions established in the euro area to hold reserve deposits with their respective national central bank. 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 2022, the reserve requirement ratio remained unchanged at 1.0%. The average balance required as minimum reserve deposits by credit institutions established in Malta amounted to €305.9 million in 2022, compared to €289.2 million in 2021. The average daily balances held in the current accounts with the Central Bank of Malta amounted to €5,074.7 million in 2022, compared to €6,115.1 million in 2021.

Following the rise of the deposit facility rate to above zero, the two-tier system for the remuneration of excess reserves which was introduced by the Governing Council as from 30 October 2019, is no longer necessary. The Governing Council therefore decided to suspend the two-tier system by setting the multiplier to zero.

On 27 October 2022, the Governing Council decided to set the remuneration of minimum reserves at the Eurosystem deposit facility rate effective as of the beginning of the reserve maintenance period starting on 21 December 2022.

² Until 1 July 2021, the ECB also conducted the 84-day USD liquidity-providing operations, with credit institutions established in Malta participating with a cumulative amount of USD 61.0 million during 2021.

Asset purchase programme

Throughout the year, the Central Bank of Malta continued to participate in the PSPP, which is part of the APP.^{1,2}

During 2022, the Central Bank of Malta purchased €109.0 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 €1,515.6 million at the end of 2022.³ The Central Bank of Malta's PSPP holdings had a weighted average remaining maturity of 10.85 years as at the last trading day for December 2022.

During the year, the Central Bank of Malta also purchased €17.5 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 €276.2 million.⁴

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 continued its participation 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.⁵

During 2022, the Central Bank of Malta purchased €77.5 million worth of Maltese sovereign securities under the PEPP. Since the inception of this programme, the Central Bank of Malta bought €548.6 million worth of Maltese sovereign securities.⁶ The Central Bank of Malta's PEPP holdings had a weighted average remaining maturity of 10.90 years as at the last trading day for December 2022.

During the same period, the Central Bank of Malta also purchased €14.5 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 €79.2 million.⁷

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

Transmission Protection Instrument

On 21 July 2022, the ECB approved the TPI to support the effective transmission of monetary policy. TPI is an addition to the ECB's toolkit and can be activated to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across the euro area. By safeguarding the transmission mechanism, the TPI will allow the Governing Council to deliver on its price stability mandate more effectively. Subject to fulfilling established criteria, the Eurosystem will be able to make secondary market purchases of securities issued in jurisdictions experiencing a deterioration in financing conditions not warranted by country-specific fundamentals to counter risks to the transmission mechanism to the extent

¹ On 9 June 2022, the Governing Council decided to end the net asset purchases under the APP as of 1 July 2022. Accordingly, from 1 July 2022 onwards, the APP consist exclusively of the reinvestment phase.

² On 15 December 2022, the Governing Council announced that it will continue reinvesting in full, the principal payments from maturing securities purchased under the APP until the end of February 2023. Subsequently, the APP portfolio will decline at a measured and predictable pace, as the Eurosystem will not reinvest all of the principal payments from maturing securities. The decline will amount to €15.0 billion per month on average, until the end of the second quarter of 2023 and its subsequent pace will be determined over time.

³ This figure does not reflect the amortisation of securities held under the PSPP portfolio. Purchases of securities which matured until 2022 are also included in this figure.

⁴ See footnote 3.

⁵ On 10 March 2022, the Governing Council decided to discontinue the net asset purchases under the PEPP at the end of March 2022. The Governing Council announced that it intends to reinvest the principal payments from maturing securities purchased under the PEPP at least until the end of 2024 and will continue applying flexibility in reinvesting redemptions from this portfolio, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic.

⁶ This figure does not reflect the amortisation of securities held under the PEPP portfolio. Purchases of securities which matured until 2022 are also included in this figure.

⁷ This figure does not reflect the amortisation of securities held under the PEPP portfolio. There were no maturities in this portfolio.

necessary. The scale of TPI purchases would depend on the severity of the risks facing monetary policy transmission.

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 2022, the nominal outstanding value of eligible domestic marketable securities amounted to €8,153.9 million, compared with €7,237.2 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 €1,382.9 million. This consisted of both domestic and foreign assets, with the share of debt instruments issued by the Maltese government accounting for around 72.7% of the securities pledged.

On 24 March 2022, the Governing Council decided to gradually phase out the package of pandemic collateral easing measures in place since April 2020. The phasing out of these measures will be done in three steps between July 2022 and March 2024. From 8 July 2022, the temporary reduction in collateral valuation haircuts across all assets was changed from the 20% adjustment to 10%. Furthermore, marketable assets that fulfilled the minimum credit quality requirements on 7 April 2020 but whose credit ratings subsequently deteriorated below the minimum rating threshold lost eligibility. The limit with respect to unsecured debt instruments issued by any single other banking group in a credit institution's collateral pool was restored to 2.5% from 10%, as was the case before April 2020. Finally, the temporary easing of certain technical requirements for the eligibility of additional credit claims were phased out.

In June 2023 the Governing Council will implement a new valuation haircut schedule based on its pre-pandemic risk tolerance level for credit operations, phasing out the remaining general 10% reduction in collateral valuation haircuts. Finally, in March 2024 the ECB will in principle phase out the remaining pandemic collateral easing measures, following a comprehensive review of the Additional Credit Claims frameworks that will take into account counterparties' collateral needs for their continued participation in the outstanding TLTRO-III operations until December 2024.

Additionally, on the 2 December 2022, the Governing Council decided to reschedule the launch of the Eurosystem Collateral Management System (ECMS) from 20 November 2023 to 8 April 2024. The ECMS will be a unified system for managing assets used as collateral in Eurosystem credit operations.

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.

Liquidity lines with non-euro area central banks

On 10 March 2022, in view of the highly uncertain environment caused by the Russian invasion of Ukraine and the risk of regional spill overs that could adversely affect euro area financial markets, the ECB decided to extend the Eurosystem repo facility for central banks until 15 January 2023. Furthermore, the Governing Council extended several existing temporary bilateral swap and repo lines with non-euro area central banks.⁸

Remuneration of government deposits

On 8 September 2022, the ECB decided to temporarily remove the 0% interest rate ceiling for remunerating government deposits held with national central banks. As from 14 September 2022, the ceiling is the lower of either the Eurosystem's deposit facility rate or the €STR, also under a positive deposit facility rate. The

⁸ In December 2022, the Governing Council further extended the bilateral repo and swap lines with non-euro area central banks and the EUREP facility until 15 January 2024.

measure is intended to remain in effect until 30 April 2023 and aims to preserve effectiveness of monetary policy transmission and safeguard orderly market functioning.

Non-monetary policy operations

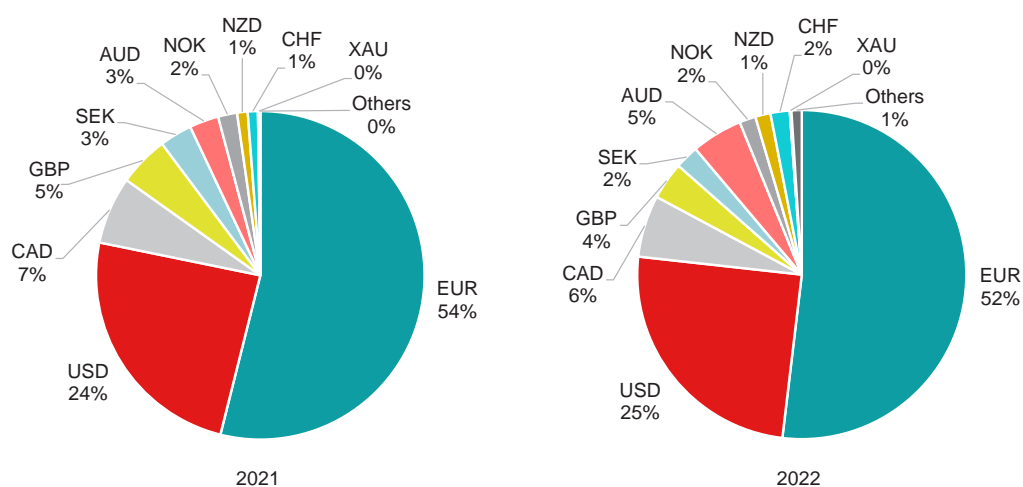
Management of the Bank's financial assets

The Central Bank of Malta's own investment portfolio amounts to circa €2,400 million⁹ and holds financial assets denominated in both euro and foreign currency. There were no significant changes in the currency composition compared to 2021, with the EUR portfolio representing approximately 52.0% of assets under management in 2022 (see Chart 1.1), while the remaining 48.0% are predominantly invested in the other G10 currencies, with the largest allocation to the USD. The Bank seeks to limit its foreign exchange risk by hedging the foreign currency holdings in the internally and externally managed portfolios and giving preference, where possible, to funds that hedge the foreign currency exposure back to euro.

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 2022, the investment portfolio continued to be spread across several asset classes including fixed income securities, equities, derivatives and gold (see Chart 1.2). 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 Financial Markets Division, and the Financial Control and Risk Division. Its mandate is to set the investment strategy upon which the management of the Bank's financial assets will be based, as well to monitor the performance of such assets. When defining its investment policy, the Bank aims at optimising returns, preserving capital and ensuring sufficient liquidity in line with pre-set financial risk parameters which 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. The Committee is also responsible to set the Tactical

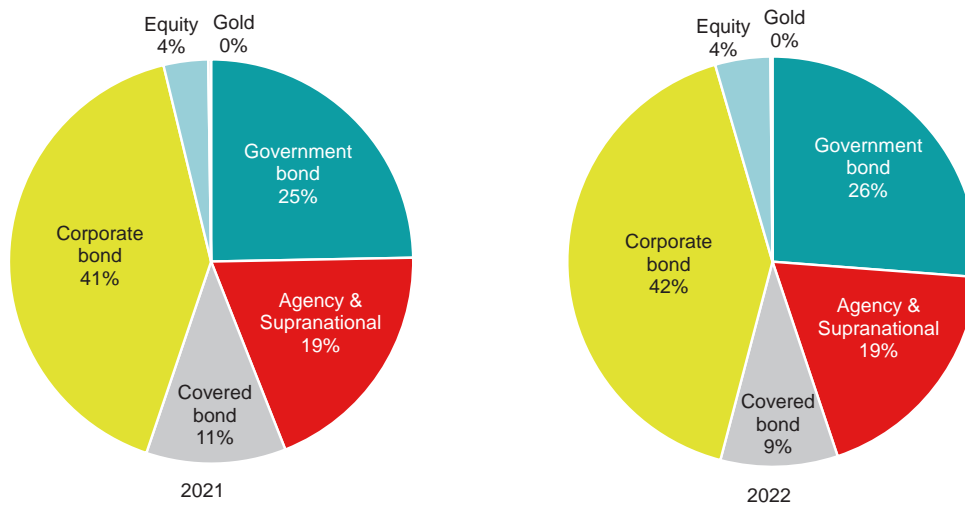
Chart 1.1
HOLDINGS BY CURRENCY



Source: Central Bank of Malta.

⁹ Amount shown in nominal terms as at end of December 2022. These exclude monetary policy portfolios.

**Chart 1.2
HOLDINGS BY ASSET CLASS**



Source: Central Bank of Malta.

Benchmark for the internally active managed funds monthly. During 2022, the Committee continued to meet monthly, with additional meetings held to address the strategic asset allocation as well as climate-related financial considerations and disclosures where the recommendations of the Financial Stability Board’s Task Force for Climate-related Financial Disclosures were discussed.

This year was a challenging one in terms of investments, as several headwinds tested the financial markets. These included supply chain disruptions from China’s COVID zero policy, the war in Ukraine and ultra-hawkish policy shift by central banks as they sought to address the inflation shock. Additionally, the correlation between asset classes increased in 2022, which meant that the portfolios did not benefit from diversification and experienced negative returns. Indeed, for the first time since 1871, both US stocks and bonds lost more than 10% during the year. During 2022, given the significant rise in global bond yields, the Bank increased the size of its internally managed euro and foreign currency fixed income held-to-maturity portfolios, with the latter also contributing to an increase in official reserves. The Bank liquidated part of its externally managed corporate bond portfolio as well as one of the unconstrained fixed income funds in anticipation of a further rise in yields, whilst increasing the strategic exposure to inflation-linked bonds and equities at better valuations. The Bank continued to diversify its fixed income component geographically, whilst ensuring that such investments remain predominantly invested in high-quality financial assets.

In its bid to comply with the Eurosystem’s common stance for climate change-related SRI principles for euro-denominated non-monetary policy portfolios (NMPPs), as well as with the Network for Greening the Financial System (NGFS)¹⁰ recommendation to integrate sustainability factors in the management of own portfolios, the Bank has continued incorporating climate change considerations in these portfolios alongside liquidity, capital preservation and return. In this regard, the Bank has adopted several SRI practices in its investment decisions, whilst looking into ways to improve the quality of analysis and disclosures related to climate change related risks and opportunities.

The Bank will continue to gradually invest in several asset classes approved by the Board of Directors to maintain an adequate level of diversification and thus risk adjusted returns. The diversified investment strategy is expected to strengthen the Bank’s capital over the longer term, which, in turn, would contribute to the Bank’s ability to maintain financial independence. Sustainability and climate considerations would increasingly become an integral part of the Bank’s investment decisions. As part of the Eurosystem, the Bank will

¹⁰ The Central Bank of Malta has been a member of the NGFS since July 2019.

keep on complying with the common stance adopted for climate-related disclosures of the NMPPs and thus will be also guided by any developments at Eurosystem level in this regard.

Joint management of the ECB's Foreign Reserves

Upon the introduction of the euro in 2008, the Bank transferred its share in the ECB's foreign reserves according to the country's capital key in line with Article 30 of the Treaty on the Functioning of the European Union. The ECB foreign reserves ensure an adequate level of liquidity for the Eurosystem foreign currency interventions. The Bank has a pooling arrangement with the Central Bank of Ireland to manage the foreign reserves on behalf of the ECB. 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.

Foreign Exchange

The Bank continued to enter spot/outright foreign currency transactions with the activity being higher during 2022 compared to the previous year. Activity in foreign exchange swap purchases and sales as part of the management of its own foreign exchange positions, also increased compared to the previous year. The Central Bank of Malta remains a participant in the European Exchange Rate Mechanism. The Central Bank of Malta pursued the repoing out of fixed income holdings in general collateral pooling market and the special repo market. This activity was higher in 2022 when compared to the previous year due to an increase in eligible papers. This translated into higher returns from this activity.

Third-party portfolios

The Bank continued to manage the Investor Compensation Scheme and Depositor Compensation Scheme on behalf of the single Management Committee of the Schemes appointed by the MFSA. During the year, the Bank continued to fulfil its obligations related to the administration of part of the National Development and Social Fund financial assets. In addition to the portfolio that has been administered by the Bank since 2018, this year two additional portfolios, namely an international equity and a local multi-asset portfolio, were added to the Bank's responsibility. These portfolios also faced headwinds and registered negative returns due to the same factors affecting the Bank's own portfolios, as explained above.

Treasury Management System

The MAPS went live in November 2022. MAPS is the Treasury Management System for Central Banks which was developed by *Banque de France* and *Banco de España*. It has been developed using the software base solution of Adenza, who are the global leaders in treasury management systems. MAPS integrates with the main trading platforms, offering a straight through process spanning from front to back-office, risk management, accounting, and financial reporting functions. The participation of the Central Bank of Malta has broadened further the MAPS user community, putting MAPS as a common treasury management solution within the community of Eurosystem central banks.

Government securities market-making operations

Throughout the year, the Central Bank of Malta continued to fulfil its duty as a market-maker by quoting daily indicative bid and offer prices and providing a two-way trading for all listed Malta Government Securities (MGSs) on the MSE. Additionally, the Bank also acted as an agent on behalf of public institutional clients.

During 2022, the Bank's market making function was accountable for 73.8% of the total on-exchange deals. This percentage rose significantly when compared with the 46.5% recorded in the previous year. The Bank bought a total of €64.4 million and sold €7.8 million, amounting to a total Bank turnover of €72.2 million. The purchases for the year are almost threefold the amount purchased by the Bank in 2021, whilst the amount sold on the market is significantly lower than that registered last year, with the overall turnover surpassing that of 2021 by €19.7 million. The MGSs issuances for the retail sector together with the end of the net purchase phase of the PSPP and PEPP could account for the higher purchases.

In the secondary market for Malta Government Bonds, the total turnover activity in 2022 stood at €97.7 million in nominal terms, down from €114.1 million registered last year. For the third consecutive year, the total turnover has declined even though the amount of government debt outstanding rose. The Treasury of Malta tapped the bond market five times during 2022, with two issuances also targeting the retail investors apart from institutional investors. A potential factor contributing to a lower secondary market turnover could be attributed to the fact that retail investors only hold a small percentage of the debt issued during the past three years. Furthermore, the tendency of the wholesale sector to hold instruments until maturity also dampened total turnover in the secondary market. In addition, figures show that inter-broker activity pursued its downward trend, falling from 53.5% in 2021 to 26.2% during the year under review.

During 2022, the Bank purchased €44.0 million worth of Treasury bills in the secondary market, which is almost double the amount bought the previous year.

As the Government of Malta funding needs remained high in 2022, issuances of MGSs amounted to €1.0 billion. The impact of the COVID-19 pandemic, albeit diminishing, was still on the agenda of the Treasury's annual debt management plan. The onset of the Ukraine war also had an impact on the financing requirements for the year, inducing the government to subsidize energy prices. The Bank continued to assist the Treasury in selecting the appropriate maturities and coupons to be offered in the primary market, to attract sufficient demand by the retail and institutional investors.

During the year under review, the Government Securities Office embarked on the first phase of a new system which will enable the Bank to perform the unique market-making role more efficiently and effectively.

Furthermore, in 2022, the Bank published on its website a paper titled *Green Finance in The Local Capital Markets*. Accordingly, the Bank conducted a survey investigating the local market's perspective towards the issuance of green bonds and awareness related to the topic. Local investors' perspectives were also sought to provide a holistic view and thereby, evaluate potential demand for these securities in the event of future issuances.