



1. 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, offers standing facilities and administers the minimum reserve requirement system. During 2023, the Central Bank of Malta also participated in the Asset Purchase Programme (APP) and the PEPP.

Open market operations

Open market operations are 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 longer-term refinancing operations (LTROs), which consist of liquidity-providing reverse transactions at a monthly frequency and with a maturity of three months.

During 2023, 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 2023, the ECB conducted 52 MROs. Credit institutions established in Malta participated in these operations with a total cumulative amount of €65.0 million, €120.0 million lower when compared to 2022 (see Table 1.1).

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

Type of operation ⁽¹⁾	2022	2023
MROs (EUR millions)	185.0	65.0
Three-month LTROs (EUR millions)	159.0	102.0
TLTRO-IIIIs (EUR millions)		
Early repayments	513.5	-
Maturities	40.0	50.0
US dollar collateralised operations (USD millions)		
- Seven-day	8,027.6	11,013.9

Source: Central Bank of Malta.

⁽¹⁾ In these Eurosystem operations, the figures shown are the allotted ones which are equivalent to the amounts bid, due to the full allotment policy.

¹ For a description of the monetary policy decisions taken by the Governing Council, please refer to Box 1 "Chronology of ECB monetary policy decisions in 2023", 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 €102.0 million in these operations, €57.0 million less when compared to 2022 (see Table 1.1).

As from September 2021 and one year after the settlement of each TLTROs, credit institutions, on a quarterly basis,² have the possibility to partially or fully repay the amounts allotted in such operations. During 2023, Maltese credit institutions with outstanding TLTROs did not participate in these early repayments. However, the outstanding balance in such operations decreased by €50.0 million due to maturing amounts.

During 2023, the ECB continued to conduct weekly liquidity-providing operations of US dollars with a one-week tenor through collateralised lending in conjunction with the US Federal Reserve. Between 20 March and end April, the seven-day USD operation was performed on a daily basis, to enhance the provision of liquidity via the standing US dollar liquidity swap line arrangements. During the year under review, credit institutions established in Malta participated regularly, for a total cumulative amount of USD 11,013.9 million, higher than the USD 8,027.6 million taken up in the previous year.

During 2023, the Central Bank of Malta purchased a bidding system that allowed eligible credit institutions in Malta to participate in Eurosystem open market operations in an automated manner. The automated tender bidding system went live at the end of September. The system was acquired from *Oesterreichische Nationalbank*.

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 €5,517.9 million, an increase of €3,819.9 million compared to the 2022 average. This increase results from credit institutions established in Malta utilising the overnight deposit facility instead of the current accounts given the positive overnight deposit facility rate throughout the year. Similar to 2022, Maltese credit institutions did not resort to the marginal lending facility in 2023.

The interest rates on the MROs, the marginal lending facility and the overnight deposit facility increased six times throughout the year standing at 4.50%, 4.75% and 4.00% respectively as at end-2023. The increase in the policy rates amounted to a total of 200 basis points throughout the year. The first increase of 50 basis points was effective as from the 8 February, followed by another 50 basis points increase as from 22 March. This was followed by four consecutive rate hikes of 25 basis points each effective as from 10 May, 21 June, 2 August, and 20 September.

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 2023, this reserve requirement ratio remained unchanged at 1.0%. The average balance required as minimum reserve deposits by credit institutions established in Malta amounted to €300.2 million in 2023, compared to €305.9 million in 2022. The average daily balances held in the current accounts with the Central Bank of Malta amounted to €435.5 million in 2023, compared to €5,074.7 million in 2022. As explained, credit institutions established in Malta utilised the overnight deposit facility, thereby decreasing their current account balances with the Central Bank of Malta as excess reserves in the current account balances were not remunerated.

² During 2023, there were two additional voluntary early repayment dates with settlement on 25 January and 22 February 2023.

On 27 July 2023, the Governing Council decided to set the remuneration of minimum reserves at 0%, effective as of the beginning of the reserve maintenance period starting on 20 September 2023.

Asset purchase programme

During the first half of the year, the Central Bank of Malta continued to participate in the Public Sector Purchase Programme (PSPP), which is part of the APP.

On 2 February 2023, the Governing Council confirmed its communication of December 2022, that from the beginning of March 2023, the APP portfolio will be declining at a measured and predictable pace, as the Eurosystem will not reinvest all the principal payments from maturing securities. The decline amounted to €15.0 billion per month on average until the end of June 2023.

On 15 June 2023, the Governing Council announced that it will discontinue the reinvestments under the APP as of July 2023.

During 2023, the Central Bank of Malta purchased €18.9 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 €1,534.5 million at the end of 2023.³ The Central Bank of Malta's PSPP holdings had a weighted average remaining maturity of 10.10 years as at last trading day for December 2023.

During the year, the Central Bank of Malta also purchased €1.0 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 €277.2 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.

During the year, the Governing Council confirmed the intention to reinvest the principal payments from maturing securities purchased under the PEPP until at least the end of 2024 and the future roll-off of the PEPP portfolio will be managed to avoid interference with the appropriate monetary policy stance. Subsequently, on 14 December 2023, the Governing Council announced the intention to continue to reinvest, in full, the principal payments from maturing securities purchased under the PEPP during the first half of 2024. Over the second half of 2024, it intends to reduce the PEPP portfolio by €7.5 billion per month on average and intends to discontinue reinvestments under the PEPP at the end of 2024.

During 2023, the Central Bank of Malta purchased €1.1 million worth of Maltese sovereign securities under the PEPP. Since the inception of this programme, the Central Bank of Malta bought €549.7 million worth of Maltese sovereign securities.⁵ The Central Bank of Malta's PEPP holdings had a weighted average remaining maturity of 9.99 years as at the last trading day for December 2023.

During the same period, the Central Bank of Malta did not transfer any Maltese sovereign bonds to the ECB's own PEPP portfolio, with total securities bought since inception in this portfolio remaining at €79.2 million.⁶

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

³ This figure does not reflect the amortisation of securities held under the PSPP portfolio. Purchases of securities which matured until 2023 are also included in this figure.

⁴ See footnote 3.

⁵ See footnote 3.

⁶ This figure does not reflect the amortisation of securities held under the PEPP portfolio. There were no maturities in this portfolio during 2023.

Transmission Protection Instrument

The Transmission Protection Instrument remained available to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across all euro area countries, thus allowing the Governing Council to deliver on its price stability mandate more effectively. However, this instrument was not used throughout 2023.

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 2023, the nominal outstanding value of eligible domestic marketable securities amounted to €9,016.0 million, compared with €8,153.9 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 €1,459.5 million. This consisted of both domestic and foreign assets, with the share of debt instruments issued by the Maltese government accounting for around 66.6% of the securities pledged.

On 2 November 2023, the Governing Council decided to accept the credit rating agency Scope Ratings GmbH as a new external credit assessment institution for the purposes of the Eurosystem Credit Assessment Framework. The go-live date of Scope Ratings' usability for monetary policy purposes will be pre-announced on the ECB's website.

Additionally, on the 30 November 2023, the Governing Council decided to reschedule the launch of the Eurosystem Collateral Management System (ECMS) from 8 April 2024 to 18 November 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 forecasts of items on its balance sheet 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.

Remuneration of government deposits

On 7 February 2023, the ECB Governing Council decided to adjust the ceiling for the remuneration of euro area government deposits held with the Eurosystem, to provide incentives for a gradual and orderly reduction of those holdings, thereby minimising the risk of adverse effects on market functioning and ensuring the smooth transmission of monetary policy. This decision reflects the intention to encourage market intermediation, with the changes to the remuneration regime providing incentives for depositors to gradually phase out their holdings with the Eurosystem. Accordingly, as from 1 May 2023, the ceiling for the remuneration of government deposits was equivalent to the €STR minus 20 basis points. The remuneration of deposits held under the Eurosystem Reserve Management Services framework was adjusted accordingly.

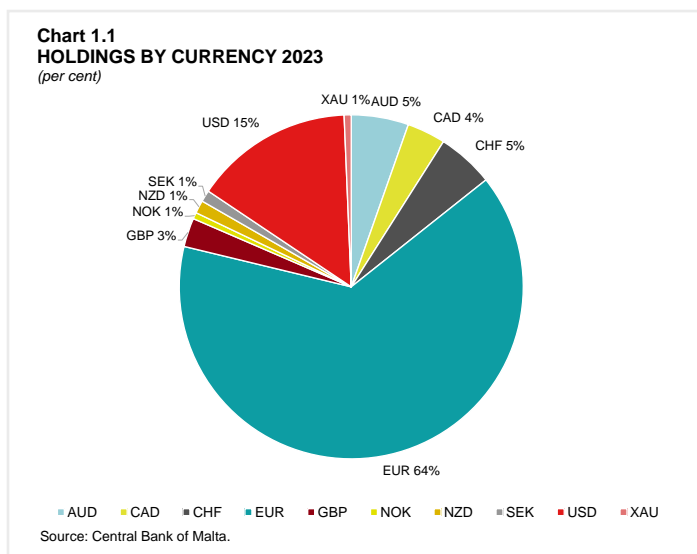
Euro money market statistics and the €STR

On the 21 April 2023, the ECB decided to expand the reporting population for Money Market Statistics Reporting (MMSR) by adding 24 new banks to the 47 banks currently reporting as from 1 July 2024. The ECB, as the administrator of €STR, decided that the inclusion of the MMSR data from the new reporting agents in the calculation of the €STR will take place at a later stage to ensure that the newly reported data is of sufficiently good quality. The increase in the reporting population will further support the robustness and reliability of the benchmark.

Non-monetary policy operations

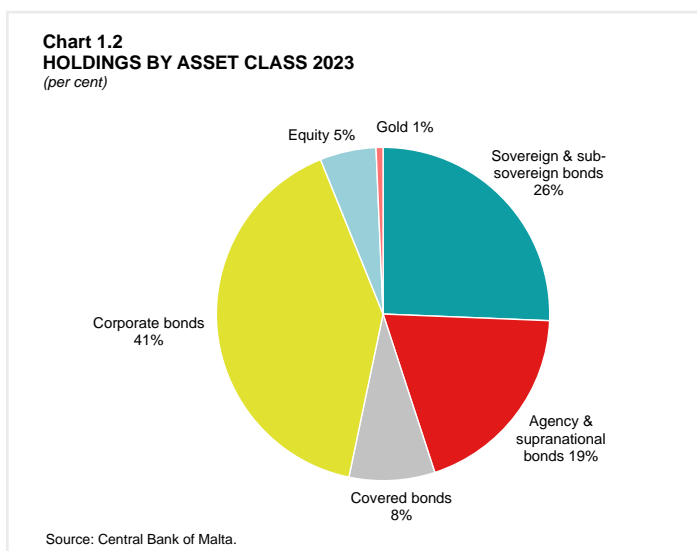
Management of the Bank's financial assets

The Central Bank of Malta's own investment portfolio amounts to circa EUR 2,600 million⁷ and holds financial assets denominated in both euro and foreign currency. The currency composition of the internally managed portfolios was kept close to last year's, whereas the continued investment in externally managed funds resulted in 64.0% of assets under management denominated in EUR (see Chart 1.1).⁸ The remaining 34.0% are predominantly invested in the other G10 currencies, with the largest allocation to the USD. The Bank seeks to limit its foreign exchange (FX) 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 2023, 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 bonds of banks and financial institutions. 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 Bank officials. 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 Bank



⁷ Amount shown in nominal terms as at end of December 2023. These exclude monetary policy portfolios and the Malta Government securities market-making portfolio.

⁸ The EUR holdings include some exchange-traded funds (ETFs) and mutual funds which have underlying foreign currency holdings which are converted to EUR.

has also approved sustainability as a fourth investment pillar, and thus climate and sustainability implications are considered when defining the Bank's strategic asset allocation. 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 on a monthly basis the Tactical Benchmark for the internally active managed portfolios. During 2023, the Committee continued to meet every month, 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 (FSB) Task Force for Climate-related Financial Disclosures were discussed.

During 2023, given the generally higher global bond yields compared to previous years, the Bank increased the size of its internally managed euro and foreign currency fixed income mark-to-market portfolios. In addition, the Bank continued to reinvest in its held-to-maturity portfolio and benefited from the higher yields available during the year. The Bank liquidated part of its externally managed global equity fund and gradually switched to other equity portfolios with sustainable and responsible investment (SRI) metrics that better align with the Bank's NMPPs long-term climate neutrality objective. The strategic exposure to equities and other diversified fixed income assets continued during the year to benefit from regional differences in fixed income markets whilst ensuring that such investments remain predominantly invested in high-quality financial assets.

In 2023, portfolios regained the lost ground of 2022, as even though the fixed income allocations suffered from elevated volatility and steeper yield curves, re-investments in fixed income securities took place at more attractive yields compared to previous years. In addition, the equity portions provided support to the value of these portfolios. Moreover, in contrast to last year's sell-off in virtually all the asset classes, the portfolios benefited from diversification among the different asset classes in 2023.

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 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.

In 2023, the Bank organised a virtual dealing room experience in FX and fixed income for university students with interest to start a career in investments and related areas. The students were engaged to implement their simulated investment strategies while benefiting from daily mentoring by the Bank's portfolio managers, traders and other professionals.

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 Bank worked closely with the Central Bank of Ireland to review the investment strategy, discuss trades and analyse the portfolio's performance. In addition, the Bank's portfolio managers paid an official visit to the Central Bank of Ireland to discuss the management of the pooling portfolio and other reserve management practices being adopted by both NCBs.

Foreign Exchange and Money Markets

The Bank continued to enter spot/outright foreign currency transactions with the activity being higher during 2023 compared to the previous year. Activity in FX swap purchases and sales as part of the management of its own FX positions decreased when compared to 2022. The Central Bank of Malta pursued the repoing out of fixed income holdings, mainly in the general collateral pooling repo market and the special repo

market. This activity level was similar to previous years and continued to enhance the return of the Bank's fixed income portfolios.

Third-party portfolios

The Bank continued to manage the Investor Compensation Scheme (ICS) and Depositor Compensation Scheme (DCS) on behalf of the Management Committee of the Schemes. During the year, the Bank's portfolio managers gave periodic updates on the management of the portfolios to the Management Committee.

The Bank also continued to fulfil its obligations related to the administration of part of the National Development and Social Fund's financial assets. In addition to the portfolio that is administered by the Bank since 2018, last year two additional portfolios, namely an international equity and a local multi-asset portfolio, were added to the Bank's responsibility. Multiple meetings were held between the relevant stakeholders during the year to discuss the positioning, performance and investment strategies of the respective portfolios.

Treasury Management System

Since November 2022, the Bank has been using Market Activities Processing System (MAPS) which is the treasury management system for central banks, developed by *Banque de France* and *Banco de España*. 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 broadened further the MAPS user community, putting MAPS as a common treasury management solution within the community of Eurosystem central banks.

Malta Government Securities market-making operations

The Bank is the only market-maker for the Malta Government Securities in Malta. During 2023, the Bank continued to quote daily indicative bid and offer prices and provided two-way trading for all listed Malta Government Securities on the MSE. Additionally, the Bank also acted as an agent on behalf of public institutional clients.

In 2023, the Bank purchased a total of €80.5 million worth of nominal MGS on the on-exchange market. This amount includes trades performed on behalf of public entities. Purchases were higher by €16.1 million than those recorded in 2022. On the other hand, sales were considerably lower, as the bank sold only €5,000 during 2023 in comparison to the €7.8 million effected in 2022. As a percentage of the total market turnover, the Bank was accountable for 59.6% of the trades, when taking into consideration deals executed for public institutional clients. The amount is lower when compared to the percentage recorded in 2022 where turnover by the Bank alone reached around 73.8%. This is mainly due to an overall increase in market turnover, whereas the Bank's participation remained relatively stable. Nevertheless, the Central Bank of Malta was a main counterparty in the local market, active in more than half of the transacted volumes.

Total on-exchange turnover in MGSs rose to €135.1 million by the end of 2023, from €97.7 million recorded in 2022. This halted a downward trend persisting in the previous three years, yet volumes were still below those seen before 2020. The Treasury of Malta tapped the capital market four times throughout the year, whilst also rolling over the maturing 62+ Malta Government Savings Bond for a total amount of €1.5 billion. Three of the issuances were offered to both the retail and wholesale sectors, whereas the last auction was reserved only to the wholesale sector. The retail sector funded around 31.6% of the total debt borrowing through MGSs in 2023, which is approximately equivalent to the participation by the same sector in 2022. This increase in holdings by retail investors might be a primary reason behind the pick-up in total turnover for 2023.

In the treasury bills on-exchange market, total turnover remained relatively low, with total nominal trades amounting to €36.9 million. Unlike the previous year, there was inter-broker trading in this security during 2023, amounting to around 16.2% of total turnover. The remaining 83.8% of the trades involved the Bank.

The Bank also offered advisory services to the Treasury Department relating to primary issuances throughout the year. Such advice centres around the annual funding needs of the Government and the appeal of these issuances for the domestic investor, both retail and wholesale. Market expectations until the third quarter of the year were bolstered by monetary policy paths taken by global central banks and economic data, pushing yields higher. This backdrop supported the allure of government bonds as these securities were being offered at higher coupons. The Bank provided the Treasury Department with the latest market fixed income movements, auction data of other euro area countries, assistance in selecting the suitable maturities and coupons, as well as various pricing scenarios.

During the year under review, the Bank continued to improve its operational systems and processes. In fact, the Bank finalised the second phase of the Front Office System launched in 2022, with the aim to perform the unique market-making role more efficiently and effectively.

As part of the effort to inform and educate the public, the Bank published research on financial matters during the year. In the second half of the year, an article highlighting developments in sovereign bond markets was published on an online portal of a local media house. The article analysed the increased volatility in yield movements and the main drivers behind such moves.