6. MONETARY AND FINANCIAL DEVELOPMENTS

According to the Bank's FCI, in the second quarter of 2024, financing conditions remained loose from a historical perspective.

In June, Maltese residents' deposits with MFIs in Malta increased from their year-ago level, reflecting higher balances belonging to households and insurance companies.[1] The annual rate of change exceeded that recorded in the first quarter of 2024. Credit to Maltese residents rose at a faster rate, as both credit to general government and credit to other residents picked up.

The weighted average interest rate on outstanding deposits stood above its year-ago level, while the rate on loans decreased compared to a year earlier. Thus, the spread between the two rates narrowed over this period.

In June, the primary market yield on Treasury bills increased from that prevailing three months earlier. Meanwhile, secondary market yields on five and ten-year MGS also rose. As the increase in the domestic ten-year yield was more pronounced than that in the corresponding euro area benchmark, the spread between the two widened slightly. Domestic share prices fell between March and June and were also marginally lower compared with a year earlier.

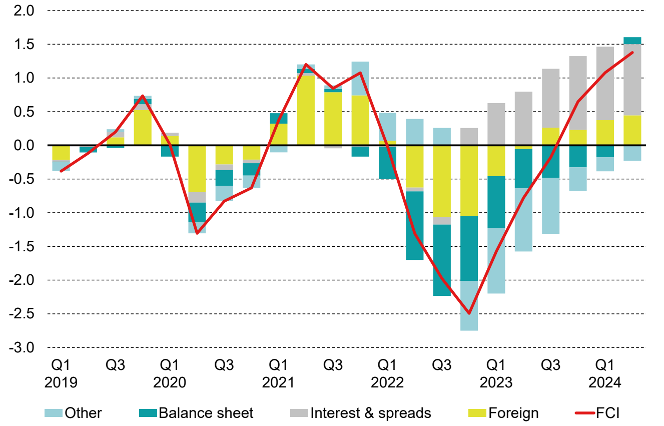
Monetary and financial conditions

Financial conditions continue to loosen[2]

In the second quarter of 2024, the Bank's FCI continued to signal loose financial conditions from a historical perspective. Moreover, these loosened when compared to the previous quarter (see Chart 6.1). As a result, financial conditions according to the FCI are the most accommodative since 2021.

The recent loosening in financial conditions was mainly driven by domestic factors, although foreign factors also contributed. The higher loosening effect of domestic factors mainly reflects improvements in the 'balance sheet' component, which was affected by a smaller negative contribution in real credit and deposits and a positive contribution from the banks' return on equity.

Chart 6.1
CONTRIBUTIONS TO THE FCI
(contributions to the index)



Source: Central Bank of Malta estimates.

The 'interest and spread' component recorded a marginally lower positive contribution, driven by a lower positive contribution from the lending rate to policy

[1] Monetary data analysed in this chapter are compiled on the basis of the statistical standards found in the Statistics section of the Bank's website.

[2] This index is composed of various financial indicators, which are available at a high frequency. This section is based on quarterly averages for each indicator.

spread and from interest rates on deposits. Meanwhile the 'other' component had a slightly higher negative contribution compared to the first quarter, mostly reflecting developments in equity prices.

Foreign factors also showcased a looser stance compared to the previous quarter, reflecting some decline in uncertainty during the second quarter of 2024.

Financial conditions have become significantly more loose compared to the second quarter of 2023, reflecting developments in both domestic and foreign factors, with domestic factors contributing the most.

The stronger loosening effect of domestic factors mostly reflected an increase in the issues of NFC securities (part of the 'other' component) and lower negative contributions from real credit and real deposits (part of the 'balance sheet' component). The loosening effect in foreign factors reflect lower uncertainty.

Maltese residents' deposits continue to increase

Total deposits held by Maltese residents with MFIs in Malta increased by 2.2% in the year to June, a faster rate of increase than the 1.7% growth observed in the year to March (see Table 6.1). The latest increase reflects higher balances belonging to households and insurance companies, offsetting lower balances belonging to other financial intermediaries.

Table 6.1
DEPOSITS OF MALTESE RESIDENTS

	EUR millions	Annual percentage changes				
	2024	2023			2024	
	June	June	Sep.	Dec.	Mar.	June
Overnight deposits	**20,211**	**1.1**	**-3.6**	**-0.2**	**-0.7**	**-0.5**
of which						
Households	14,464	5.0	0.0	1.8	1.2	2.3
NFCs	3,292	-5.2	-6.2	-5.2	-1.7	-2.6
Deposits redeemable at notice of up to three months	**79**	**-10.5**	**9.4**	**-26.0**	**-23.5**	**-33.4**
of which						
Households	0	-0.2	-5.5	-98.6	-99.0	-99.3
NFCs	61	-12.0	28.9	30.4	43.2	23.0
Deposits with an agreed maturity of up to two years	**2,724**	**0.3**	**12.1**	**25.7**	**28.9**	**30.7**
of which						
Households	2,124	3.9	22.9	34.0	36.9	30.7
NFCs	317	10.6	-12.3	23.1	39.3	45.1
Deposits outside M3[(1)]	**1,011**	**-9.2**	**-2.8**	**0.8**	**0.8**	**2.9**
of which						
Households	902	-5.4	-3.1	-4.5	-5.5	-3.1
NFCs	34	-20.3	-6.4	-2.8	3.8	5.7
Total residents deposits[(2)]	**24,025**	**0.5**	**-2.2**	**1.7**	**1.7**	**2.2**
of which						
Households	17,490	4.2	1.8	3.8	3.7	4.5
NFCs	3,705	-4.6	-6.2	-3.4	1.3	0.6

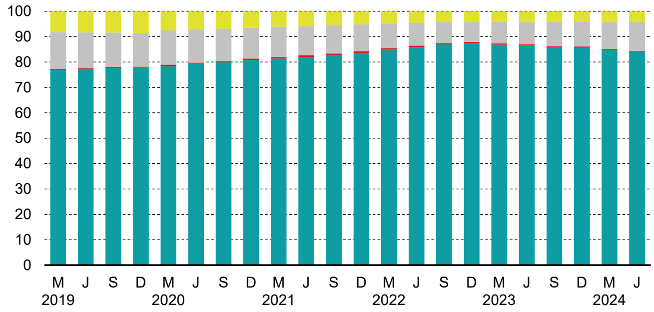
Source: Central Bank of Malta.

(1) Deposits outside M3 include deposits redeemable at notice of more than three months and deposits with an agreed maturity of over two years.

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

During the 12 months to June, overnight deposits, which are the most liquid component, decreased by 0.5%, following a 0.7% year-on-year decline recorded three months prior. This contraction reflected a decline in the balances held by financial intermediaries and NFCs, which offset increases in deposits belonging to households. The share of overnight deposits in total deposits decreased to 84.1% in June, compared to 84.7% three months earlier (see Chart 6.2).

Chart 6.2
DISTRIBUTION OF TOTAL RESIDENT DEPOSITS[(1)]
(percentage points)



Source: Central Bank of Malta.
[(1)] Deposits exclude those belonging to central government.
[(2)] Deposits outside M3 include deposits redeemable at notice of more than three months and deposits with an agreed maturity of over two years.

Deposits with an agreed maturity of up to two years – the second largest component of total deposits – continued to register robust growth of 30.7% in the year to June, compared with 28.9% in March. As a result, their share in overall deposits continued to increase, reaching 11.3% from 10.7% three months prior. The latest increase was driven by higher balances belonging to NFCs, although strong increases were also recorded in balances held by households. This outcome possibly reflects the more attractive terms on fixed deposit accounts being offered by certain credit institutions, in response to the current tight monetary policy stance.

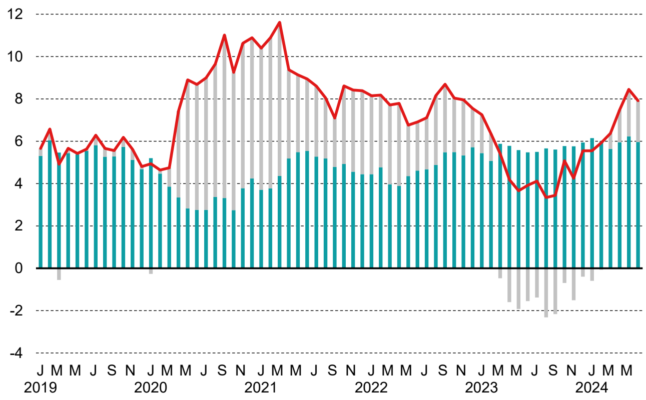
Deposits with an agreed maturity of up to three months declined by around a third year-on-year, following a decrease of 23.5% in the year to March. Consequently, their share of total deposits decreased to 0.3%, from 0.4% recorded three months earlier.

Meanwhile, deposits classified outside M3 – which are mainly composed of deposits with agreed maturity of over two years – recorded an annual growth rate of 2.9% in June, compared to 0.8% growth registered three months earlier. Their share in total resident deposits remained unchanged from March, standing at 4.2%.

Credit to residents grows at a faster pace

Credit to Maltese residents increased by 7.9% in the year to June, exceeding the 6.4% recorded in March. Faster growth was driven by both credit to general government and credit to other residents (see Table 6.2 and Chart 6.3).

Chart 6.3
CONTRIBUTIONS TO GROWTH IN CREDIT TO MALTESE RESIDENTS
(percentage points; annual percentage change)



Source: Central Bank of Malta.

Table 6.2
MFI CREDIT TO MALTESE RESIDENTS

	EUR millions	Annual percentage changes				
	2024	2023			2024	
	June	June	Sep.	Dec	Mar.	June
Credit to general government	**4,875**	**-5.8**	**-8.1**	**-1.5**	**2.9**	**8.0**
Credit to residents outside general government	**15,189**	**7.5**	**7.7**	**8.0**	**7.6**	**7.9**
Securities and equity	304	-2.6	-3.3	-4.6	-4.3	-4.7
Loans	14,884	7.7	7.9	8.4	7.8	8.2
of which:						
Loans to households	8,739	7.9	7.3	8.2	9.0	9.1
Mortgages	8,061	7.9	7.2	7.9	8.7	8.8
Consumer credit and other lending	677	7.2	8.5	12.2	12.4	13.4
Loans to NFCs[1]	5,086	8.1	9.1	8.8	5.4	6.3
Total credit to residents	**20,064**	**3.9**	**3.4**	**5.5**	**6.4**	**7.9**

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

Credit to general government grew by 8.0% in the year to June, following an increase of 2.9% over the year to March. The latest increase was driven by an increase in MFI holdings of Government stocks, which grew by 14.8% over the 12 months to June. By contrast, MFI holdings of Treasury bills declined in the year to June.

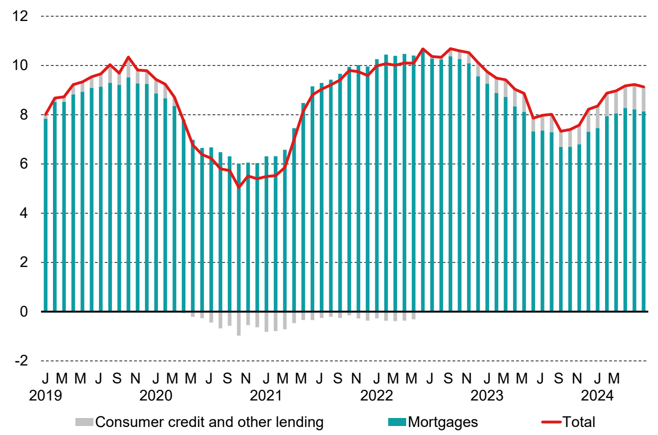
The annual growth of credit to residents outside general government remained strong, increasing to 7.9%, from 7.6% three months prior. Meanwhile, MFI holdings of securities issued by the private sector decreased by 4.7%, following a decline of 4.3% in March.

Annual growth in loans to households reached 9.1%, compared to 9.0% three months earlier (see Chart 6.4). Mortgage lending grew by 8.8% in June, from 8.7% in March. Consumer credit also rose at a faster pace. Growth in this credit component reached 13.4% year-on-year, after 12.4% in March.

Meanwhile, loans to NFCs rose at an annual rate of 6.3%, higher than the 5.4% recorded three months earlier (see Chart 6.5). The higher growth reflected an increase in credit issued to private NFCs, although partially offset by a decline in credit to public NFCs.

Sectoral data show that the growth in loans to NFCs in the year to June, was largely driven

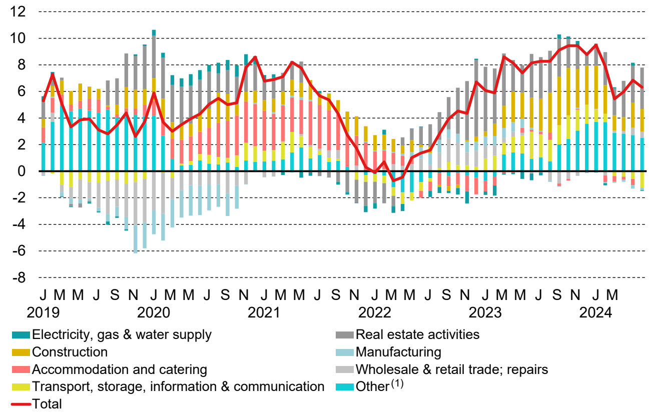
Chart 6.4
CONTRIBUTIONS TO GROWTH IN LOANS TO HOUSEHOLDS
(percentage points; annual percentage change)



Source: Central Bank of Malta.

by increased lending to the real estate sector and the construction sector. Loans to the sector comprising of professional, scientific and technical activities and the trade and repair sector also increased. On the other hand, credit to the sector comprising information, communication, transportation and storage decreased. This was followed by smaller declines in credit to the energy sector and, the manufacturing sector, while credit to the accommodation and food sector was broadly stable.

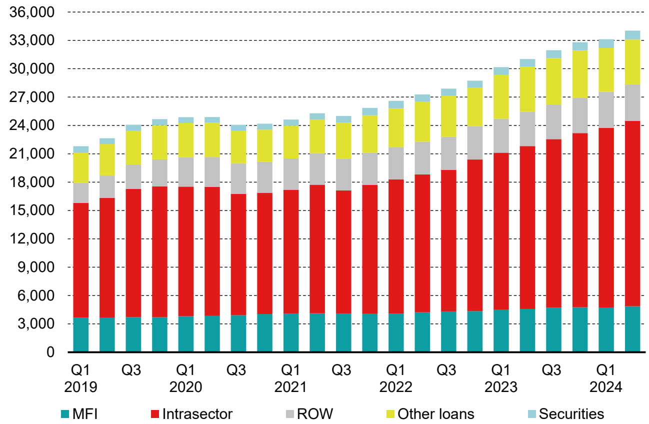
Chart 6.5
LOANS TO NFCs BY SECTOR
(percentage points; annual percentage change)



Source: Central Bank of Malta.
(1) Mainly includes entertainment, health, education, professional services, and administration.

Financial accounts data show that the share of bank lending in total NFC debt remained unchanged, at 14.3%, compared to March, albeit lower than the share of 14.8% recorded a year earlier (see Chart 6.6).

Chart 6.6
NFC DEBT BY SOURCE
(end-of-period stocks in EUR millions)



Source: Financial Accounts.

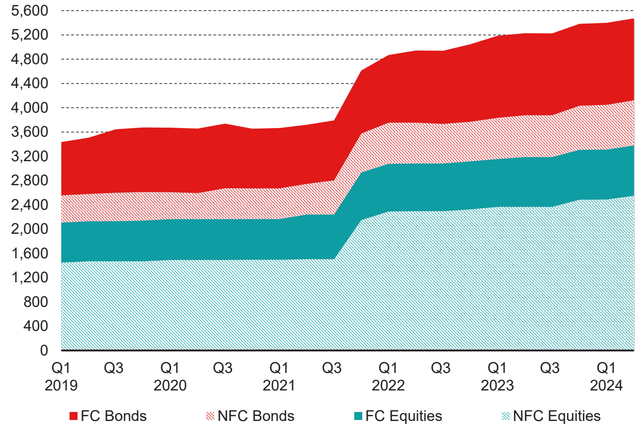
The share of intra-sectoral lending in total NFC debt stood at 57.6%, above the 57.4% recorded in March. This was also 2.1 percentage points higher than the share registered a year earlier. Besides, this component continued to account for most of NFCs external financing.

The share of loans from non-residents decreased marginally to 11.3%, from 11.5% recorded in March, and from 11.7% recorded last year. Meanwhile, the share of ‘other loans’ remained unchanged compared to March, at 14.0%. It stood below the 15.4% recorded in the second quarter of 2024. This component largely reflects loans from financial institutions other than MFIs and households.

The share of securities increased to 2.7%, from 2.6% recorded a year earlier.

Stock of securities of NFCs and financial corporations (FCs) listed on Malta Stock Exchange (MSE) increases

Chart 6.7
OUTSTANDING SECURITIES OF NFCs AND FCs LISTED ON MSE
(EUR millions outstanding as at end-period)



Sources: MSE; Central Bank of Malta estimates.

By June 2024, around €2,094.1 million in outstanding corporate debt securities were listed on the MSE, 2.7% higher than the amount listed a year earlier (see Chart 6.7).[3] 64.5% of the amount was issued by financial entities, other than credit institutions, whilst the rest was issued by NFCs.

Meanwhile, the outstanding amount of equity listed on the MSE increased by 6.0% in annual terms, to reach €3,378.7 million. Over three fourths of this volume was issued by NFCs, with FCs playing a secondary role. The increase over the year to June, was mostly driven by NFCs that operate within the real estate sector. The total amount of outstanding listed equity as of June 2024, exceeded that of bonds by 61.3%.[4]

Spread between deposit and lending rate narrows in annual terms

Interest rates on outstanding resident deposits with MFI increased in June compared to their year-ago level. In particular, the weighted average deposit rate to households and NFCs on outstanding balances increased by 13 basis points to 0.37% (see Table 6.3). This was largely driven by higher rates on time deposits belonging to NFCs and households, as well as by rates on household deposits redeemable at notice up to three months.

At the same time, the weighted average lending rate paid by households and NFCs on outstanding loans decreased by 7 basis points, to 3.51%. This decrease was driven by lower rates charged to both households and NFCs. Rates charged to households decreased by 9 basis points to 2.81%. Both rates for mortgage lending and consumer credit decreased, by 5 and 43 basis points, to 2.66% and 4.15%, respectively.

The spread between the weighted average lending rate and the deposit rate for the second quarter closed at 314 basis points. This was higher than the spread recorded in the previous quarter although still below the spread of 334 basis points recorded a year earlier.

During the year to June, the deposit rates offered on new balances held by households and NFCs in Malta both increased. On the other hand, lending rates to these sectors declined. By June, the weighted average deposit rate for households and NFCs reached 2.88%, while the lending rate to these two sectors declined to 3.09%.

[3] MSE data may differ from financial accounts data due to differences in valuation methodology and coverage. In particular, financial accounts data are at market value and include both listed and privately-placed securities. MSE data on corporates presented in Chart 6.7 are based on the official MSE list and thus exclude securities listed through Prospects. Chart 6.7 includes data on NFCs and FCs other than MFIs.

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

Table 6.3
INTEREST RATES ON DEPOSITS AND LOANS
Percentages per annum to residents of Malta; weighted average rates as at end of period

	2021	2022	2023	2023		2024	
	June	June	June	Sep.	Dec.	Mar.	June
Total deposits[(1)]	**0.18**	**0.15**	**0.24**	**0.27**	**0.30**	**0.35**	**0.37**
of which							
Overnight deposits							
Households	0.02	0.02	0.04	0.05	0.05	0.05	0.05
NFCs	0.01	0.03	0.07	0.07	0.10	0.10	0.12
Savings deposits redeemable at notice							
Households	0.44	0.38	0.15	0.15	0.31	0.31	0.30
NFCs	0.11	0.08	0.41	0.45	0.47	0.74	0.60
Time deposits (less than two years)							
Households	0.54	0.50	1.32	1.58	1.79	2.05	2.07
NFCs	0.53	0.47	1.15	1.58	1.85	2.28	2.12
Time deposits (more than two years)							
Households	1.79	1.78	1.76	1.77	1.79	1.82	1.89
NFCs	1.15	1.36	1.26	1.38	1.74	1.83	2.00
Total loans[(1)]	**3.30**	**3.18**	**3.58**	**3.61**	**3.58**	**3.52**	**3.51**
of which							
Households and NPISH	3.12	2.95	2.90	2.87	2.85	2.82	2.81
NFCs	3.62	3.59	4.87	4.98	4.95	4.83	4.81
Spread[(2)]	**3.12**	**3.03**	**3.34**	**3.34**	**3.28**	**3.17**	**3.14**
ECB MROs rate	0.00	0.00	4.00	4.50	4.50	4.50	4.25

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.

Compared to the first quarter of 2024, interest rates on outstanding deposits with MFIs increased by 2 basis points for households and remained unchanged for NFCs, to 0.39% and 0.27% respectively. The increase in rates for households was driven by higher remuneration on time deposits. Over this period, rates on outstanding loans to NFCs decreased by 2 basis points to 4.81%, while those on loans to households decreased by 1 basis point to 2.81%.

In June, the weighted average deposit rate offered on new balances held by households and NFCs in Malta remained unchanged compared to March. Meanwhile, the weighted average lending rate paid to them decreased by 33 basis points.

Liquidity support measures

By the end of June 2024, 468 facilities were approved and still outstanding under the Malta Development Bank's (MDB) COVID-19 Guarantee Scheme (CGS). These covered total sanctioned lending of €362.3 million, down from €380.3 million, covered by 524 facilities in March.[5] By end-June, the outstanding value of disbursed loans stood at €169.8 million, down from €195.9 million at end-March 2024. Almost all these loans will mature within the next four years.

[5] The MDB CGS provided guarantees to commercial banks with the aim of enhancing access to new working capital loans for businesses. The scheme received applications until 30 June 2022.

The sector comprising wholesale and retail activities had the largest number of outstanding facilities benefitting from the scheme, followed by the sector comprising accommodation and food service activities. The latter had the highest value of sanctioned loans in value terms.

In 2022, the MDB launched additional support measures in response to the war in Ukraine and high inflation. These schemes were closed for new borrowers in December 2023. Three facilities for a total value of €14.2 million, which had been approved under the Subsidised Loans Scheme (SLS), have been paid in full by June 2024.[6] Moreover, a total of €24.5 million was approved and disbursed under the Liquidity Support Guarantee Scheme (LSGS).[7]

Bank Lending Survey (BLS) mostly indicates unchanged credit standards, terms and conditions

According to the July BLS, in the second quarter of 2024, all participating banks reported unchanged credit standards and terms and conditions for lending to NFCs, consumer credit and other lending in Malta. The majority of participating banks also reported unchanged credit standards for lending for house purchase, while all banks reported unchanged terms and conditions for these types of loans. For the third quarter, no bank foresaw changes in credit standards for all types of credit.

As regards the demand for credit by NFCs, the majority of respondent banks claimed that it had remained unchanged during the quarter under review. Moreover, all surveyed banks did not anticipate changes in demand in the third quarter of 2024.

Demand for loans for house purchases, was assessed to have remained unchanged by half of the surveyed banks, while the results were mixed for the other half. The majority of surveyed banks did not anticipate changes in demand in the third quarter of 2024.

In the case of consumer credit and other lending, all participating banks reported unchanged demand during the second quarter and were expecting no changes in the following quarter.

The July BLS also posed ad hoc questions on changes in banks' access to wholesale and retail funding, and in their risk transfer capacity as a result of the prevailing situation in financial markets. No impacts were reported as regards access to interbank unsecured money markets, debt securities, securitisation, and the ability to transfer risks off balance sheet in the preceding three months. However, some tightening effect was reported in terms of access to retail deposit funding. This assessment was also reflected in expectations for the third quarter.

Participating banks claimed that their non-performing loan (NPL) ratio and other indicators of credit quality had not affected their lending policies in the preceding six-month period and expected no effects in the six months ahead.

Respondent banks were also asked to state how their credit standards, terms and conditions on new loans, and demand for loans have changed across the main sectors of economic activity – namely manufacturing, construction, services, wholesale and retail trade, and real estate. The

[6] The SLS provided temporary urgent liquidity support, backed by government guarantees, to importers and wholesalers of grains and animal feed, thereby ensuring the security of supply of such products.

[7] This LSGS consisted of two measures: LSGS-A provides bank financing support to all undertakings affected by the extraordinary circumstances caused by the war in Ukraine, while LSGS-B was specific to fuel and oil importers. A total portfolio of €100 million and €50 million in working capital loans were available under LSGS-A and LSGS-B, respectively. Government guarantees cover 90% of each working capital loan under LSGS-A and 80% under LSGS-B.

majority of banks reported no change in credit standards and the terms and conditions in the past six months and were foreseeing no changes in the next six months for all the five sectors. With regards to demand for loans, half of the surveyed banks experienced no changes over the past six months and foresaw no changes in the upcoming six-month period. The other half witnessed some changes. These included an increase in demand for loans from firms that operate in the manufacturing sector, and somewhat lower demand from firms active in the construction sector. Their expectations for the fourth quarter were also mixed and included lower demand in the construction and manufacturing sectors and higher demand in the services sector.

Participating banks were also asked whether climate-related risks and measures to cope with it led to changes in the bank's credit standards, terms and conditions and demand for loans to enterprises. Some easing in credit standards for green and transition firms was reported to have taken place in the 12 months preceding the survey. By contrast credit terms and conditions for brown firms had tightened or was expected to tighten according to some banks.[8]

As regards credit terms and conditions, half of the banks reported no changes as a result of climate change factors, while the other half reported more mixed effects. In the coming year, most banks anticipated some changes to credit terms and conditions.

Turning to demand for loans, half of the banks said that due to climate change, the demand for loans by green firms and by firms in transition had increased, driven by fiscal support related to climate change. The remaining half said that they experienced no such changes. Looking at demand in the coming 12 months, half of the banks expected climate change to be reflected in an increase in demand for loans in the case of green firms and firms in transition.

Finally, when asked whether the change in banks' excess liquidity held with the Eurosystem had led to a change in their bank's lending conditions and loan volumes, all banks reported no changes. For the next six months, the situation was expected to remain the same, compared with the previous six-month period.

The money market

During the second quarter of 2024, the Government issued €461.3 million in Treasury bills (net of redemptions), €150.6 million more than the amount issued in the first quarter of 2024.

In the domestic primary market, the yield on three-month Treasury bills rose to 3.56% by the end of June, from 2.92% at end-March.

The capital market

There were no new MGS issues in the second quarter of 2024. Two private sector institutions launched new bond issues on the MSE. Best Deal Properties Holding plc and Burmarrad Group Assets plc issued secured bonds worth €15.0 million and €16.0 million, respectively.

By the end of June, 19 firms had bonds that were listed on the MSE through Prospects, an unchanged number compared with three months earlier.[9] There was also one company which had shares issued through Prospects.

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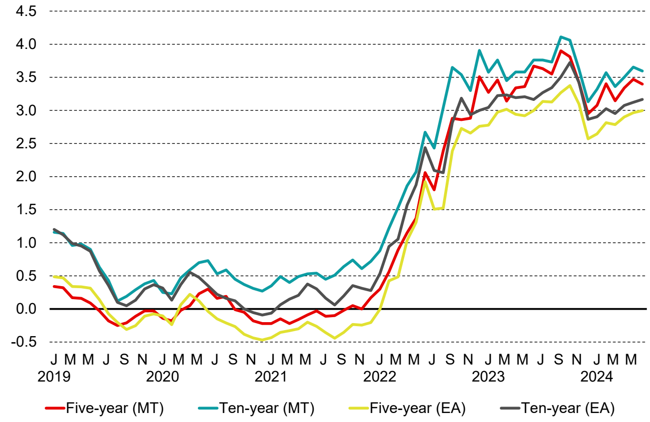
[8] The BLS uses the following terms: "Green firms" – Firms that do not contribute or contribute little to climate change; "Firms in transition" – Firms that contribute to climate change, which are making considerable progress in the transition; "Brown firms" – Firms that highly contribute to climate change, which have not yet started or have so far made only little progress in the transition.

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

In the secondary market, turnover in government bonds increased to €37.0 million, from €27.7 million in the first quarter of 2024. Meanwhile, turnover in corporate bonds increased to €36.5 million from €24.5 million, previously.

Chart 6.8
GOVERNMENT BOND YIELDS
(percentages per annum; end of month)



Sources: Central Bank of Malta; ECB.

The yield on five-year Government bonds rose to 3.40% at the end of June, from 3.15% three months earlier (see Chart 6.8). The yield on ten-year bonds also increased, reaching 3.60% from 3.36% in March. Meanwhile, the euro area benchmark yield on five-year bonds rose to 3.00% from 2.79%, and that on ten-year bonds increased to 3.17% from 2.95%. As the rise in the domestic ten-year yield was larger than that in the euro area benchmark, the spread between the two widened to 43 basis points from 41 basis points in March.

MSE Equity Price Index declines during the quarter

Share prices in Malta declined further during the second quarter of 2024. The MSE Equity Price Index ended the quarter 1.5% below its level at end-March and was also 0.5% lower than its reading a year earlier (see Chart 6.9). On the other hand, the MSE Equity Total Return Index, which accounts for changes in equity prices and dividends, was 0.3% higher than its level at end-March.

Chart 6.9
MSE EQUITY PRICE INDEX
(end of month)

Source: MSE.

Equity turnover fell to €10.1 million during the second quarter of 2024, from €15.8 million in the previous quarter.

BOX 3: MALTA GOVERNMENT STOCKS MARKET: 2023 IN REVIEW[1]

Global economic recovery and tighter monetary policy by major central banks to tame high inflation characterised financial markets in 2023. Such circumstances pushed yields on fixed income securities higher, reaching levels last seen a decade ago, for which the local market was no exception.

The analysis examines the primary and secondary markets for MGS throughout the year 2023. The issued MGS for the year are detailed in terms of wholesale and retail participation, as well as the allotment amounts across both investor types. Participating patterns are examined, showcasing the varying levels of demand across five different investor categories. The Treasury received robust demand from both retail and wholesale investors, across four issuances and one private placement,[2] offering €1.59 billion out of the €1.60 billion borrowing plan targeted for 2023. This analysis also sheds light on wholesale investor's return appetite as revealed through the Average Weighted Yield (AWY) of individual issues held during the year. The choice of maturity terms and coupons by the issuer are explored, before delving into the secondary market. The local sovereign paper emerged as the most traded security on the secondary market, supported by the Central Bank of Malta's role as market maker. Turnover in this paper is further evaluated for 2023 and for a ten-year period, where on-exchange trading slightly surpassed levels recorded in the previous three years though remaining well below peak figures. Lastly, movements in MGS holdings across investor categories are analysed.

Primary market developments

During 2023, the Treasury targeted to raise up to a maximum of €1.60 billion through MGS issuance. The market responded with strong demand, for nine new fixed rate MGS spread across four regular issuances and a rollover in a 62+ Malta Government Savings Bond (MGSB). Applications reached a total of €1.73 billion, out of which €1.46 billion were allotted, underscoring the strong appetite among investors for Maltese government paper.

Trends in applications varied throughout the year with the highest bid-to-cover ratio of 2.11 times observed in the July issuance, showing the highest number of applications submitted from both retail and wholesale investors. In contrast, the September issuance was the least popular, with a bid-to-cover ratio of 1.26 which was mostly held back by the limited interest of retail investors, placing only €81.62 million in this particular issuance. More information on the MGS issuances of 2023 can be viewed in Table 1.

Wholesale investors accounted for 70.5% of total participation across the year, while retail investors applied for 29.5% of total applications. At a glance, one may depict retail participation as weak. However, when analysing take up of amounts offered to both the retail and wholesale sector in combined issuances, it can be noted that demand levels in 2023 reached those seen earlier in the presented decade (see Chart 1). Retail issuances were halted for

1 This box is a summary of "The Malta Government Stocks Market - 2023 in Review", a report published on the Bank's website. It is prepared by Kimberley C. Agius, Emmanuel Farrugia and Therese Lethridge, Senior Research Analysts within the Monetary Operations and Government Securities Department. The views expressed are those of the authors and do not necessarily reflect those of the Central Bank of Malta. Any remaining errors are the sole responsibility of the authors.

2 Private placement refers to the rollover of the 62+ MGSB.

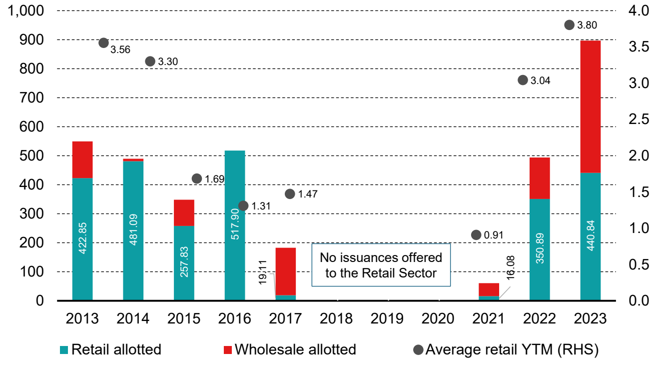
Table 1
LIST OF 2023 ISSUANCES

	February	June	July	September	October	
	3.50% MGS 2028 VI	62+ MSGB Issue 2023[1]	3.55% MGS 2026 V	4.00% MGS 2033 IV	3.85% MGS 2026 VI	
	4.00% MGS 2043 I		3.75% MGS 2033 III	4.30% MGS 2038 II	3.95% MGS 2028 VII	
			4.00% MGS 2038 I			Totals
	EUR	EUR	EUR	EUR	EUR	EUR
Total amount on offer	**350,000,000**	**85,971,100**	**400,000,000**	**400,000,000**	**350,000,000**	**1,585,971,100**
Original issue	200,000,000	85,971,100	270,000,000	260,000,000	200,000,000	1,015,971,100
Overallotment option	150,000,000	-	130,000,000	140,000,000	150,000,000	570,000,000
Total applications	**415,679,500**	**70,092,200**	**569,049,000**	**327,115,400**	**351,900,000**	**1,733,836,100**
Retail	179,179,500	70,092,200	180,049,000	81,615,400	-	510,936,100
Wholesale	236,500,000	-	389,000,000	245,500,000	351,900,000	1,222,900,000
Total amount allotted[2]	**349,179,500**	**70,092,200**	**399,549,000**	**303,615,400**	**341,900,000**	**1,464,336,100**
Bid-to-cover ratio[3]	**2.08**	**-**	**2.11**	**1.26**	**1.76**	**1.71**

[1] Eligible bondholders of this security were offered to rollover their maturing holdings in the new savings bond issue.
[2] Total applications from Retail Investors were fully allotted.
[3] Bid-to-cover ratio is applied on the original issue amount.
Source: Malta Treasury Department.

a three-year period due to ultra-low yields prevailing at the time. Following the increase in returns given by rising yields, the Treasury reopened applications for retail investors in mid-2021 for only one issuance. Furthermore, the low participation rate of 29.5% may be attributed to a significant increase in the Treasury's debt supply, with the volume of debt offered to the retail sector in 2023 reaching its highest level since 2013.

Chart 1
RETAIL PARTICIPATION IN COMBINED MGS ISSUANCES[1]
(EUR millions; percentage)



Source: Malta Treasury Department.
[1] The chart aggregates only issuances offered to the retail sector on a yearly basis, thus omitting issuances offered exclusively to wholesale investors. The wholesale allotment is shown to depict the magnitude of the retail vis-à-vis the wholesale participation. The 62+ MGSB rolled over in 2023 is not included for comparability reasons.

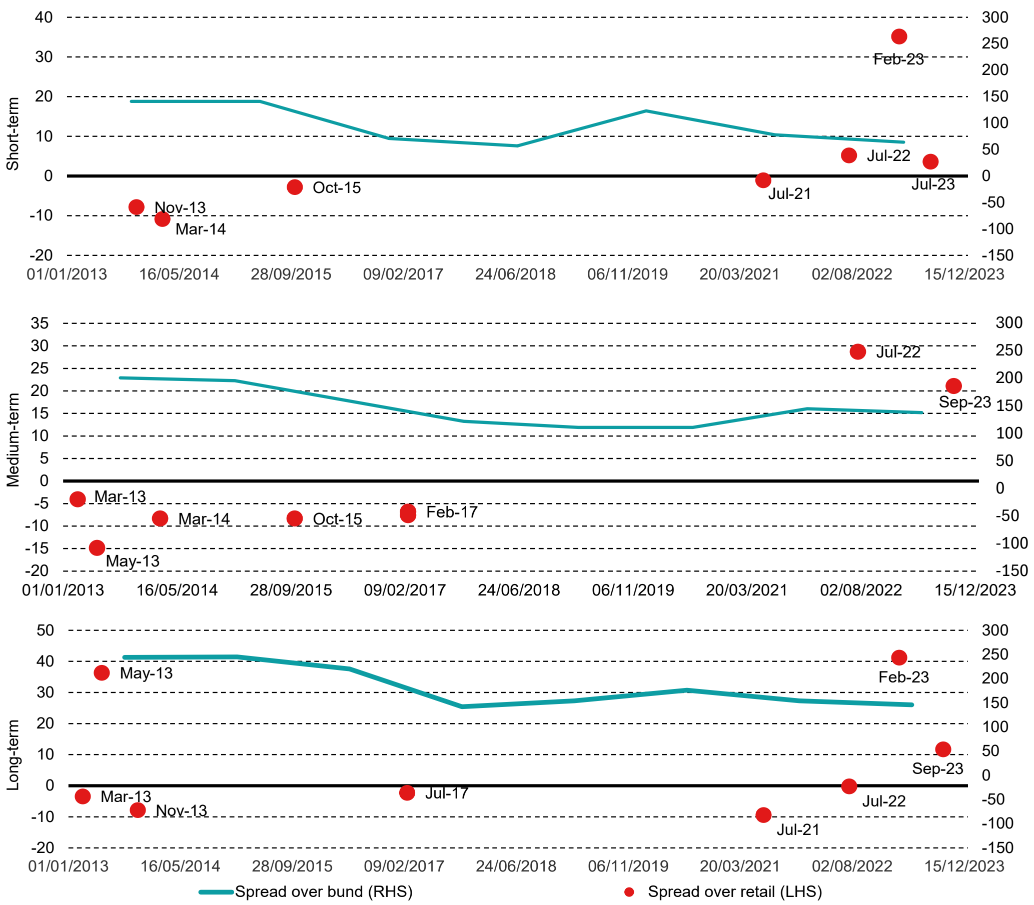
At issuance, participants are classified into five investor categories, of which financial companies showed most interest in the MGS offerings, applying for a total amount of €1.11 billion, or 67.1% of total submissions. The individual and household, and non-profit entity[3] categories followed with €299.45 million and €134.74 million, respectively in applications. The final two categories, namely government[4] and non-financial companies, collectively represented 14.9% of total applications.

Analysing the resulted AWYs by wholesale investors over the set retail yield to maturity (YTM) gives insight on wholesale investors' yield requirements. In the issuances opened

3 The largest portion of the non-profit entity classification is made up of Resident Nominees who are not necessarily non-profit. These investors do not hold a direct account with the MSE and place their applications through a broker. In the secondary market, this category also includes movements in both resident and non-resident nominees.
4 The government category refers mainly to government agencies and public sector entities.

to both investor types, wholesale investors demanded higher yields than those offered to retail investors, as per price setting published by the Treasury. The most notable premium was seen in the first issuance of the year for the 4.00% MGS 2043 I, with 41 basis points in AWY over that locked in by retail investors. The income goals of the investor could provide one explanation for this premium. However the possibility of yield fluctuations between the publication of retail prices and the opening of the wholesale auction could potentially contribute to the higher AWY. Moreover, the Government's increased borrowing needs from 2020 onwards may have also signalled investors the opportunity to request higher returns and constrain the Treasury to entertain such bids. This becomes more pronounced after considering that the deviations across a ten-year period were persistently negative between the years 2013 and 2017, with only one exception in the long-term bracket, as seen in Chart 2. Deviations in spreads turned positive after 2020 even though the Maltese risk premium over the German bund[5] declined over this ten-year period by 77 basis points, 63 basis points, and 98 basis points in the short, medium and long-term, respectively in line with other euro area sovereigns that share similar economic fundamentals. This may signal

Chart 2
DEVIATION OF SUCCESSFUL AWY FROM RETAIL YTM



Sources: Malta Treasury Department; Central Bank of Malta.
Note: Only issuances which were open to both wholesale and retail investors are shown.

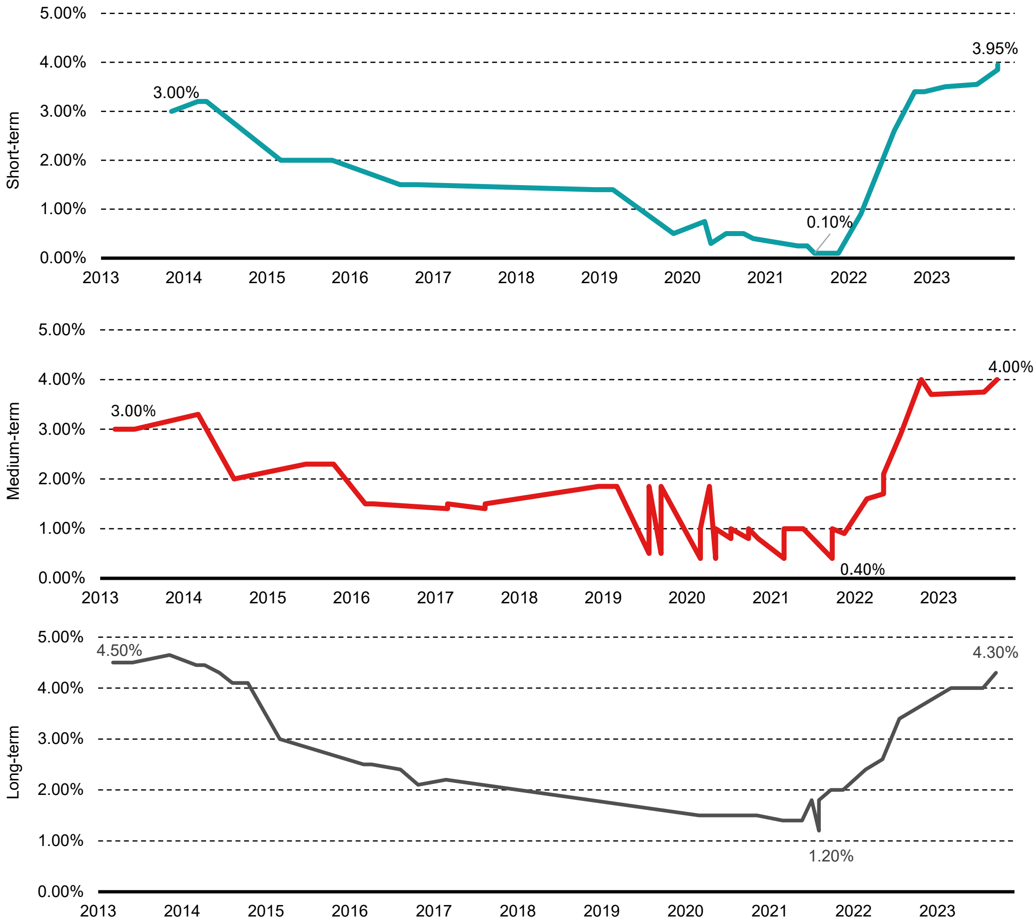
[5] Based on Indicative Secondary Market prices published by the Central Bank of Malta.

that wholesale investors require a higher return premium over the bund than that indicated through secondary market pricing. Nevertheless, confidence in the secondary market does not seem to be waning as such prices were utilised by brokers in secondary market trading in 2023, with most of the traded prices having only slight deviations.

All issuances in 2023 introduced new bonds in the central government's portfolio, having different maturities[6] spanning from three to 21 years paired with coupons that ranged from 3.50% to 4.30%. MGS coupons across all tenors in 2023 approached or exceeded those seen a decade ago as global yields surged, reflecting the high inflation rates in 2022. Restrictive monetary policy to tame inflation inevitably pushed interest rates higher.

As illustrated in Chart 3, MGS coupons were relatively high in 2013, declined gradually and rose again over the last two years. The downward trend in coupon rates after 2013

Chart 3
COUPONS ACROSS A TEN-YEAR PERIOD



Source: Malta Treasury Department.

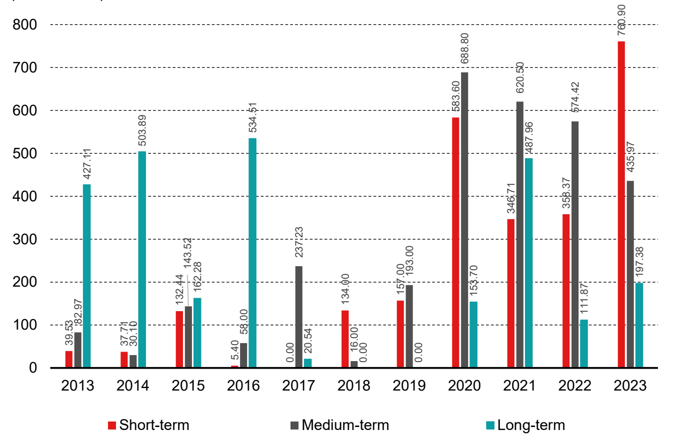
[6] Maturity terms between one and six years are categorised as short-term bonds, including both years. Those of seven till 14 years are medium-term tenors, whilst those of 15 years and higher are considered long-term issues.

was influenced by several factors, mostly by the ECB’s monetary policy decisions, including negative interest rates starting in mid-2014 and the Quantitative Easing Programme introduced in March 2015 amid a period of disinflation. Coupon rates continued to decline, reaching their lowest point in 2021 during the COVID-19 pandemic, as negative interest rates were maintained to counter the sharp economic contraction. Since the end of 2021 yields started to increase, reaching high levels in 2023.

The choice of maturity terms for new issues reflects issuers’ strategic objectives and financial planning. Issuing longer-dated debt when yields are low allows for the collection of funds locked at lower borrowing costs. Given the high yields in 2023, the Treasury only allotted €197.38 million over three long-term bonds as shown in Chart 4. The issuance of long-term debt was preferred until 2016, possibly due to lower interest rates, which is also noted in 2021 when issuances in the medium maturity bracket reached €620.50 million. Short-term bonds, however, gained prominence in the primary market from 2020, with the largest amount allotted in 2023. Given the general expectation of a drop in short-term interest rates, issuing short-term debt during 2023 may have been strategic to reissue at lower rates in the near future.

Debt sustainability also takes a role, whereby considerations towards maintaining low debt servicing costs whilst ensuring long-term feasibility, are taken. Additionally, an issuer should seek to evenly distribute debt across years to avoid large redemptions within a short timeframe, and therefore curbing what is known as refinancing risk. The chart displays that generally issuances always included different maturity terms, irrespective of the yield environment. The variable in each case, however, was the amount to be allotted.

Chart 4
TENORS ISSUED ACROSS A TEN-YEAR PERIOD
(EUR millions)



Source: Malta Treasury Department.

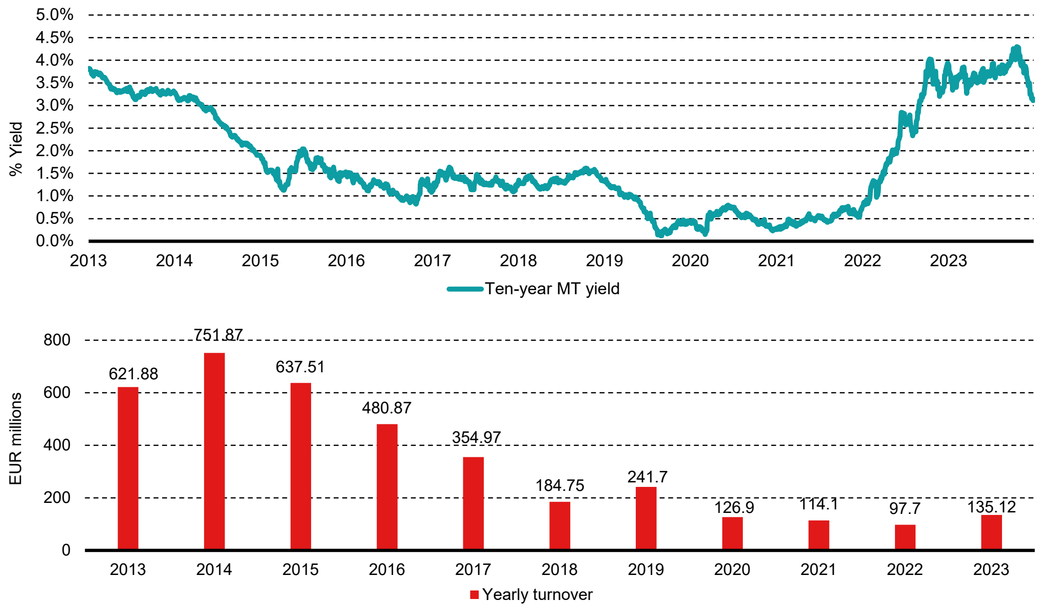
The secondary market

A total market value of €169.26 million was traded in local sovereign debt securities, equivalent to 51.3% of total on-exchange turnover in all prominent security types. More specifically, 40.1% of total market value trading (€132.36 million) was exchanged in MGS alone, with an additional 11.2% (€36.90 million) dealt in Malta Treasury Bills (MTBs). Corporate bonds were the second most traded security type overall (30.2%), followed by Ordinary Shares (17.6%), with Prospects and Preference Shares trailing behind accounting for less than 1% of the total market value traded throughout the year.

Chart 5 visualises the trading activity in MGS during the last decade. Throughout the earlier years of the timeline, expansionary monetary policy decisions were needed to support slowing economies, directly contributing to a lower yield environment. Yields dropped between 2013 and 2016, as shown through the ten-year MT-yield curve in Chart 5, with sharp drops in 2014, which may have created avenues for profit and in turn, offloads on the secondary market. In fact, turnover touched a peak in 2014 for a nominal amount of €751.87 million. Yields kept tumbling thereafter, following the introduction of the Public Sector Purchase Programme by the ECB in 2015 and continued to fall to their lowest points between 2019 and 2020. Due to such low yields and in turn low coupon rates, the Treasury refrained from opening applications to the retail sector between 2018 till 2020. This could possibly partly explain the low turnover volumes in these respective years. Yields sharply reversed their trajectory in 2022, reaching levels last seen in 2013, supported with the release of high inflation prints, pushing bond prices lower. Turnover picked up in 2023, surpassing volumes seen in the previous three years.

The Central Bank of Malta maintained its role as a market maker by providing liquidity on the secondary market for MGS and MTBs. The Bank continues to operate in the local secondary market, taking guidance from its indicative prices published daily on its official website. The Bank accounted for 41.2% (€55.70 million) of total on-exchange transactions in MGS during the year and acted on behalf of public entities for another 18.3% (€24.78 million). The Bank was relatively more active in MTBs trading, responsible for 83.8% (€30.95 million) of the security's total on-exchange turnover, with only one other broker purchasing the remaining 16.2% (€6.00 million). Total outstanding government debt by the end of 2023

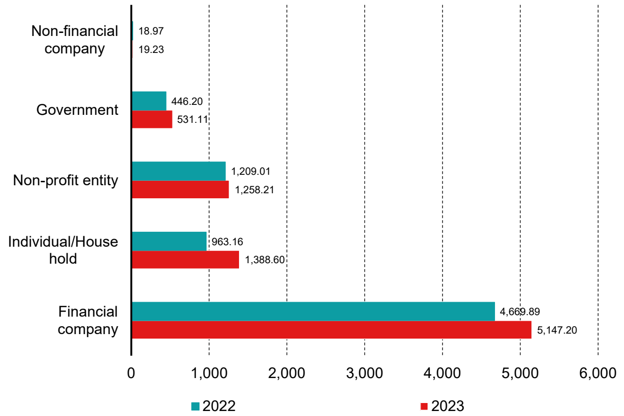
Chart 5
TEN-YEAR MT YIELDS AND MGS TURNOVER



Sources: MSE; Central Bank of Malta.

reached €8.34 billion following a net issuance of €1.01 billion. As a result, all five main category groupings grew in volume as shown in Chart 6. The investor base in the secondary market was primarily composed of financial institutions, holding 61.7% of the total outstanding amount. The individuals and households' category increased their holdings by €425.44 million over the previous year, taking over the non-profit entities category placing with the second-highest volume in holdings.

Chart 6
TOTAL MALTA GOVERNMENT SECURITIES HOLDINGS BY CATEGORY
(EUR millions)



Source: MSE.

Concluding remarks

The Treasury's plan to issue up to €1.60 billion in MGS was received with robust demand. Higher coupons were necessary to attract substantial interest from both wholesale and retail investors, fulfilling the original allotment in every issuance. Financial companies dominated applications throughout the year in those issues opened to wholesale bidders. Individuals and households also demonstrated strong participation, indicating a particular interest in short-term MGS, closely followed by long-term bonds. Through the analysis of the AWY emanating from wholesale bidding revealed that the highest requested premium reached 41 basis points above the yield offered to the retail investor, indicating a rise in the cost of borrowing for the Government in recent years. The MGS secondary market experienced a modest recovery in 2023, when compared to recent years. The Bank's involvement as a market maker was crucial, accounting for a substantial portion of the total on-exchange transactions, underscoring its importance in the local financial market. Data on the distribution of MGS holdings across various investor categories showed financial companies as the dominant holder category of MGSs, followed by Individual and household and non-profit entities investors.

The insights gained from the 2023 market performance coupled with considerations of the prevailing market conditions may provide a solid foundation for future borrowing strategies, ensuring that Malta can effectively manage its public debt while fostering a robust investment environment. Further monitoring of such trends and patterns could provide valuable insights that contributes towards maintaining the local sovereign debt security's stability and attractiveness among a wide investor base.

BOX 4: THE TRANSMISSION OF MONETARY POLICY IN MALTA: A FOCUS ON RETAIL BANK INTEREST RATES[1]

The setting of policy interest rates is typically the conventional tool for central banks to achieve their monetary policy objectives. Following a number of years characterised by a low-interest rate environment, the ECB embarked on a cycle of tightening monetary policy as of July 2022. In the following months, interest rates were consistently raised in response to high inflation in the euro area (EA), largely resulting from fast-accelerating demand, supply shortages, and higher energy prices. This period of rapidly tightening monetary policy continued until May 2024, by which time the DFR had increased from the -0.50% rate applicable until 26 July 2022 to 4.00% until 11 June 2024.

The effectiveness of policy rate changes to achieve monetary policy objectives depends on the ability to affect money market rates, commercial banks' refinancing costs and retail bank rates (Lane, 2022).[2] For instance, a hike in interest rates by the ECB increases the borrowing costs for commercial banks. If this additional cost is passed on in the form of higher lending and deposit rates charged to customers, customer borrowing becomes more expensive and savings more attractive. In turn, these developments affect the consumption and investment decisions of households and firms, and consequently aggregate activity and prices (Altavilla et al., 2020).[3] As such, the effectiveness of policy rate changes depends on the extent to which monetary policy decisions trickle down to households and firms.

In this light, this study analyses the extent to which lending rates and deposit rates charged by Maltese banks have changed in response to the recent cycle of tightening monetary policy implemented by the ECB. Moreover, this study also begins to shed light on the potential sources of heterogeneity between the extent of this transmission in Malta and that observed in the EA.[4]

Developments in retail lending and deposit rates in Malta

Chart 1 illustrates the evolution of two key lending rates in Malta between January 2008 and May 2024 – the month before which policy rates were cut by 25 basis points by the ECB Governing Council. The rates considered are those charged on (1) lending to households for house purchases (measured by the *annual percentage rate of charge [APRC]*), and (2) lending to non-financial corporations (NFCs).[5] Mortgage rates have generally been lower and less volatile than rates charged on NFCs' lending. In addition, while both rates have,

1 Prepared by Nathaniel Debono, a Senior Research Economist within the Modelling Office. Helpful comments by Mr Alexander Demarco, Dr Aaron G. Grech, Mr Noel Rapa and Mr Owen Grech are gratefully acknowledged. The views expressed are those of the author and do not necessarily reflect those of the Central Bank of Malta. Any errors are the author's own.

2 Lane, P. R. (2022). "Monetary policy and the money market", Speech at Meeting of the Money Market Contact Group.

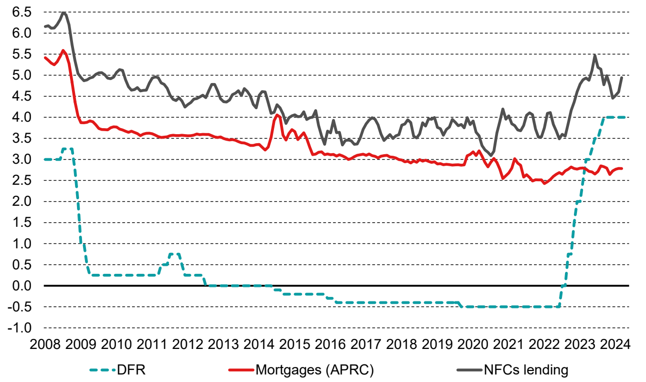
3 Altavilla, C., Canova, F. and Ciccarelli, M. (2020). "Mending the broken link: Heterogeneous bank lending rates and monetary policy pass-through", *Journal of Monetary Economics*, 110, pp. 81-98.

4 This study can be considered an update to the work conducted in Debono, N. (2024). "The transmission of monetary policy in Malta: a focus on retail bank interest rates", Central Bank of Malta *Policy Note*. This article extends the analyses until May 2024 (i.e. the month before the key ECB interest rates were lowered), compared to the August 2023 cut-off date considered in the *Policy Note*.

5 The respective retail interest rates charged by MFIs in Malta are the MFI interest rate statistics (MIR) on new business volumes with residents of the euro area.

in large part, followed a downward trend, rates applied to NFCs' lending somewhat stabilised as of 2016 and picked up from the second half of 2022.

Chart 1
RETAIL LENDING RATES IN MALTA
(% per annum; three-month moving average of new business volumes)

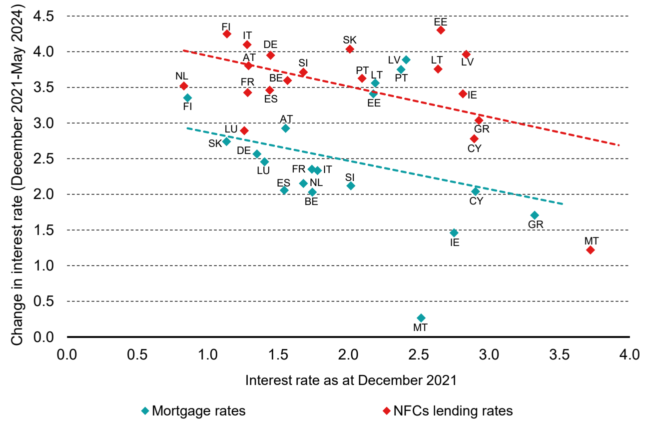


Source: Central Bank of Malta.
Notes: All retail bank lending rates refer to MFIs' interest rates on new business volumes with euro area residents. Mortgage rates reflect the annual percentage rate of charge (APRC), covering the total cost of a loan, comprising the interest rate component and other related charges.

These developments begin to shed light on the transmission of monetary policy to lending rates in Malta. In an indication of weak pass-through during a time characterised by expansionary monetary policy, the spread between the DFR and the respective lending rates widened by 60 basis points for mortgages and 106 basis points for NFCs' lending between January 2008 and December 2021. The tightening of monetary policy experienced from July 2022 onwards did not really affect the mortgage rates set by commercial banks in Malta. In fact, mortgage rates rose by just 27 basis points in response to a 450 basis point hike in the DFR between December 2021 and May 2024. The change in NFCs' lending rates has been slightly more pronounced at 122 basis points, but this is still markedly less than the hike in the policy rate during the same period.[6]

Chart 2 plots the cumulative change in mortgage rates and NFCs' lending rates between December 2021 and May 2024 in the EA, vis-à-vis the respective interest rates charged as at December 2021. In December 2021, average mortgage rates in Malta stood at 2.52%, among the highest in the EA, where mortgage rates averaged 1.60%. However, cross-country divergences in the reaction of mortgage rates to the subsequent cycle of tightening monetary policy, led to Malta having the lowest

Chart 2
CHANGES IN MORTGAGE RATES AND NFCs LENDING RATES
(percentage points; % per annum (three-month moving average of new business volumes))



Sources: ECB SDW; author's calculations.

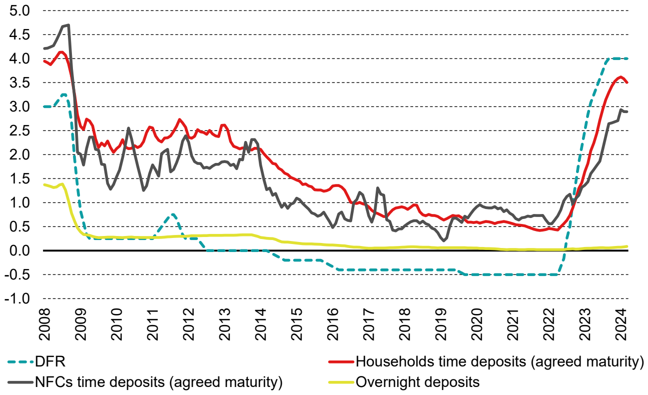
6 The respective changes in mortgage rates and the lending rates charged to NFCs are estimated on the basis of interest rates calculated on a three-month moving average basis.

mortgage rates as of May 2024, standing at 2.78%. Similar to the patterns observed in the case of mortgage rates, the reaction of rates charged to NFCs by Maltese banks in the recent tightening cycle was also much less pronounced than in other EA countries. Indeed, while such rates rose by an average of 3.75 percentage points in the EA, the corresponding increase in Malta was limited to 1.22 percentage points. As a result, NFCs' lending rates in Malta were among the lowest in the EA by May 2024. This represents a marked shift from the position at the end of 2021, when rates charged by Maltese banks were the highest among all EA countries.

Assessing the cumulative changes in bank lending rates relative to the initial interest rate levels, Chart 2 exhibits a negative relationship, with countries that had relatively high retail bank interest rates in December 2021 generally recording smaller subsequent hikes in their lending rates. However, even when accounting for initial lending rate levels, the subsequent rise in lending rates in Malta remains exceptionally low. Particularly in the case of mortgages, the increase in rates charged in Malta even lagged behind other EA countries that started off with even higher lending rates. These patterns suggest that although the initial levels of lending rates are important, there are likely other considerations which might also explain the relative stability in the lending rates charged by Maltese banks.

Turning to developments in deposit rates, Chart 3 shows the evolution of the interest rates offered by Maltese banks on time deposits and overnight deposits. Notwithstanding some volatility in the NFCs' time deposits, time deposit rates have generally followed movements in the policy rate set by the ECB. Among the main developments in recent years, the rate offered on new households' time deposits in Malta increased from 0.42% in December 2021 to 3.50% in May 2024. The increase in NFCs' time deposit rates was slightly more muted, increasing from 0.73% to 2.89% over the same period. Rates offered on overnight deposits remained practically unchanged during the latest cycle of monetary policy tightening. Indeed, the rate on such deposits, which are overwhelmingly the largest class held by Maltese banks, moved only marginally from the 0.02% rate applied in December 2021, and were remunerated at less than 0.1% by May 2024.

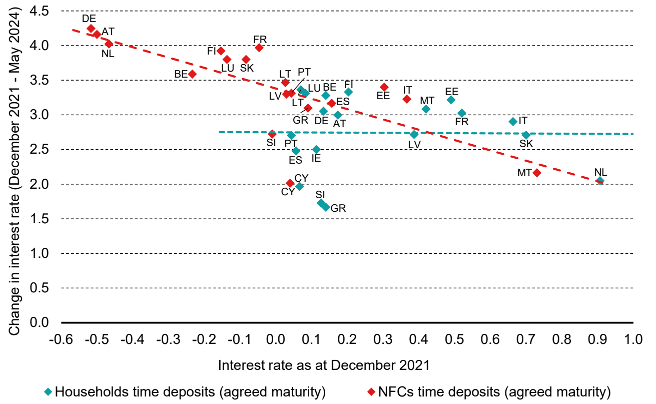
Chart 3
RETAIL TERM AND OVERNIGHT DEPOSIT RATES IN MALTA
(% per annum; three-month moving average of new business volumes)



Sources: Central Bank of Malta; ECB SDW.
Notes: Retail bank deposit rates refer to MFIs' interest rates on new business volumes with euro area residents.

Analysing the movements in term deposits in the EA, Chart 4 shows that changes in the rates offered on households' time deposits between December 2021 and May 2024 have been largely unrelated to the corresponding rates offered before the start of the tightening period of monetary policy. In contrast, countries that offered relatively high rates on NFCs' time deposits in December 2021 generally had a smaller subsequent increase in this rate in response to policy rate hikes. The analysis elicited from Chart 4 indicates that recent developments in the time deposit rates offered by Maltese banks have been in line with the rest of the EA, when accounting for the level of interest rates set by banks prior to the recent policy rate hikes.

Chart 4
CHANGES IN HOUSEHOLDS' AND NFCs' TIME DEPOSIT RATES
(percentage points; % per annum (three-month moving average of new business volumes))



Sources: ECB SDW; author's calculations.
Note: Overnight deposits are not shown because there is minimal cross-country variation in the interest rate setting on such class of deposits.

Monetary policy pass-through estimates for Malta

The descriptive evidence discussed above highlights the limited pass-through onto bank lending rates, especially mortgage rates, in Malta during the recent tightening of monetary policy. In contrast, movements in local time deposit rates have been somewhat stronger, while demand deposit rates have persisted at the very low levels observed over previous years. The relatively small movements in the overnight deposit rates offered by Maltese banks since 2022 are in line with those observed in many other EA countries. The following analysis seeks to formalise this evidence through an empirical estimation of pass-through rates in Malta, and an assessment of how these compare to those observed in the EA bloc.

The baseline specification used is adapted from the work of Holton and Rodriguez d'Acri (2018), taking the following general form:[7]

$$\Delta ir_t = \sum_{j=1}^{n} \alpha_j \, \Delta ir_{t-j} + \sum_{j=0}^{n} \beta_j \, \Delta mr_{t-j} + \theta \, ir_{t-1} + \delta \, mr_{t-1} + \sum_{j=0}^{n} \gamma_j \, \Delta X_{t-j} + \epsilon_t \qquad (1)$$

and is estimated separately on monthly interest rate data for Malta and the EA between December 2021 and May 2024. Under this framework, monthly changes in lending and deposit rates (Δir_t) depend on their respective lagged changes (Δir_{t-j}), contemporaneous and past changes in the monetary policy stance, captured by the three-month EURIBOR (Δmr_{t-j}), and deviations from the long-run relationship between retail rates (ir_{t-1}) and the

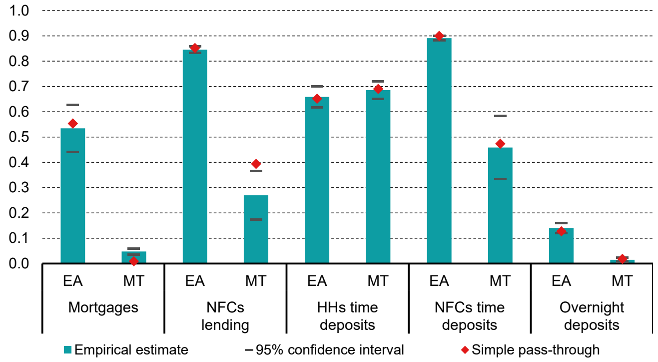
[7] Holton, S. and Rodriguez d'Acri, C. (2018). "Interest rate pass-through since the euro area crisis", *Journal of Banking and Finance, 96* (2018), pp. 277-291.

three-month EURIBOR in the previous period (mr_{t-1}). The vector X captures important macroeconomic variables that may independently also influence the setting of lending and deposit rates by banks, namely a country's HICP inflation rate, unemployment rate and ten-year government bond yield.[8]

This work focuses on the overall pass-through of monetary policy in Malta and the EA. The overall pass-through can be straightforwardly estimated from the specification in equation (1) through the calculation of $-\frac{\delta}{\theta}$, where a value of 1 reflects a full and complete pass-through of changes in monetary policy onto retail bank rates. This exercise is applied to two lending rates, namely those on *mortgages* and *NFCs' lending*, and three deposit rates, namely those in relation to *households' time deposits, NFCs' time deposits* and *overnight deposits*. The estimated long-run pass-through estimates are presented in Chart 5. The robustness of the pass-through estimates is assessed by computing the ratio of the change in the respective bank rate to the change in the three-month EURIBOR between December 2021 and May 2024.

Results presented in Chart 5 confirm that the transmission of the restrictionary policy in Malta has been markedly low in the case of mortgage rates. Estimated at 0.05 between December 2021 and May 2024, this reflects the decision of Maltese banks to maintain mortgage rates at very stable levels despite progressive hikes in the policy rates set by the ECB. The extent of transmission in Malta is much weaker than that observed across the EA, which stood at 0.53 over the same period. Moreover, the 'simple pass-through' estimates show the pass-through onto mortgage rates in Malta to be the weakest among all countries in the EA. The overall pass-through onto lending rates charged to NFCs in Malta has been slightly stronger than that onto mortgage rates, estimated at just below 0.30.[9] Nonetheless, this still lagged well behind other EA countries, where the pass-through over the same time horizon typically exceeded 0.70 and averaged 0.85. These cross-country divergences are congruent to the descriptive statistics shown previously and are in part driven by the initial lending rate conditions. As already illustrated, lending rates in Malta were relatively high up to December 2021. Then,

Chart 5
LONG-RUN PASS-THROUGH OF MONETARY POLICY ONTO RETAIL BANK RATES: DECEMBER 2021 – MAY 2024



Source: Author's calculations.
Note: The empirical pass-through figures represent the overall pass-through estimated via equation (1). The associated 95% confidence interval is also shown. "Simple pass-through" estimates are obtained from a calculation of the ratio of the change in the respective retail bank interest rate to the change in the three-month EURIBOR between December 2021 and May 2024.

8 When estimating the model in equation (1), standard errors are adjusted for heteroscedasticity, autocorrelation, and cross-sectional correlation.

9 While the point estimate is subject to some uncertainty, the "simple" calculation of the pass-through yields a value of around 0.40, which is still around half of that recorded in the EA.

as monetary policy started tightening, lending rates charged by Maltese banks were moving from higher initial levels than their EA counterparts. As a result, hikes in lending rates by Maltese banks in response to rising policy rates were always likely to be less pronounced than other EA countries. Nonetheless, the initial interest rate levels charged by Maltese banks do not fully explain the difference in the pass-through of Maltese banks compared to that in the EA.

Turning to the transmission of monetary policy onto deposit rates, Chart 5 also shows that the pass-through onto households' term deposit rates has been highly comparable (in the range of 0.65-0.70) to that in other EA countries over the recent tightening cycle. In contrast, the pass-through onto the rates offered to NFCs on their time deposits between December 2021 and May 2024 has been relatively low, when compared to the rest of the EA. Indeed, while the pass-through onto NFCs' time deposit rates in Malta hovered around 0.50, the average in the EA approached 0.90. The pass-through onto overnight deposit rates has been largely limited in the EA, just exceeding 0.10 on average, while in Malta, this pass-through is recorded at 0.01. These results reflect the developments in deposit rates offered by Maltese banks, as illustrated in Chart 3. Indeed, the somewhat pronounced movements in time deposit rates over the recent tightening cycle, compared to overnight deposit rates, are reflected in a stronger pass-through estimate for time deposit rates, relative to that on demand deposit rates.

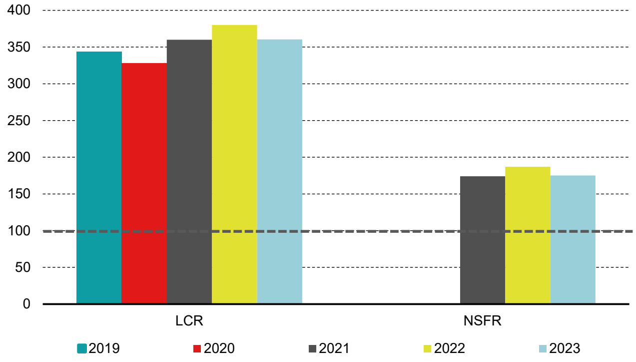
Overall, these empirical results reaffirm the descriptive evidence of Malta being a clear outlier in the EA in terms of the pass-through of tightening monetary policy onto its retail bank lending rates. In contrast, the pass-through onto deposit rates, especially households' time deposits, has been much more in line with other EA countries, although changes in the rates offered on demand deposits and NFCs' time deposits have been comparatively quite low.

Maltese banks' characteristics and their potential role in explaining the low pass-through onto lending rates

Previous economic research has shown that the extent of monetary policy transmission onto retail bank lending rates depends to some extent on particular characteristics of the banking sector and individual commercial banks. In this light, this section analyses the main features of the Maltese banking sector in order to better understand whether these features could explain, at least in part, the low pass-through of monetary policy onto bank lending rates in Malta over recent months.

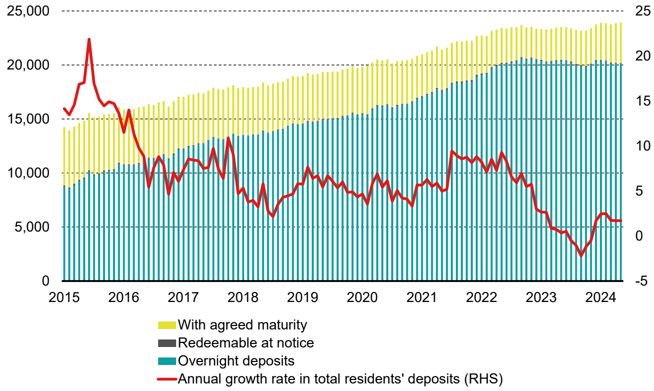
The Maltese banking sector is characterised by relatively high liquidity, enhancing banks' ability to insulate their lending behaviour from monetary policy changes. In an indication of the excess liquidity enjoyed by Maltese banks, the share of funds held with the Central Bank of Malta to satisfy minimum reserve requirements as of May 2024 stood at just 6.6% of all amounts deposited with the Bank. Maltese banks also perform well in terms of regulatory liquidity indicators, such as the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). As shown in Chart 6, the levels recorded by core Maltese banks in recent years have comfortably exceeded the current 100.0% minimum requirement set for both ratios. Compared to other EA countries, Maltese core banks had the third highest LCR and the fourth highest NSFR in the EA in 2023.[10]

Chart 6
LIQUIDITY INDICATORS OF MALTESE BANKS
(per cent)



Source: Central Bank of Malta *Financial Stability Report* 2023.
Notes: Figures cover the respective ratios among core Maltese banks. Credit institutions must maintain a LCR and NSFR of at least 100%. The NSFR became mandatory in the EU in the second half of 2021 and therefore data for previous years is not available.

Chart 7
RESIDENTS' DEPOSITS HELD WITH MFIs IN MALTA
(EUR millions; per cent)



Source: Central Bank of Malta.
Notes: Deposits by EA residents are not shown due to their volatility and their relatively small size compared to the deposits of Maltese residents.

Maltese banks have also continued to benefit from a large inflow of customer deposits in recent years (see Chart 7). In fact, total resident deposits with credit institutions in Malta grew at an average annual rate of 6.6% between the start of 2015 and May 2024. This increase has largely been driven by the rapid rise in overnight deposits, which grew by 130% over the same period. As a result, overnight deposits now constitute 84% of Maltese banks' total resident deposits and, in light of the very low interest rates offered on overnight deposits, they represent a source of very cheap liquidity for Maltese banks. The strong accumulation of customer deposits also allows Maltese banks to comfortably support their loan commitments, with the loans-to-deposits ratio of core Maltese banks averaging less than 60% in 2023, well below the 94% figure recorded in the EA.[11]

Overall, the low pass-through onto lending rates charged by Maltese banks in recent months could potentially also be explained by signs of their healthy balance sheet positions. In theory, healthy balance sheets should afford banks the opportunity to limit the extent of lending rate hikes. Among the main indicators of the healthy balance sheets in the domestic banking sector, Maltese banks consistently record strong capital positions,

[10] Figures for other EA countries are based on ECB SDW data [Consolidated Banking Data] on domestic banking groups and stand-alone banks.
[11] Figures for core Maltese banks are derived from Central Bank of Malta (2024), "Sixteenth *Financial Stability Report* 2023". See also footnote 10.

with data published by the Central Bank of Malta showing that the Tier 1 capital ratio of Maltese core banks stood at 21.0% at the end of 2023, higher than the 17.0% average in the EA.[12,13] Core Maltese banks are also not overly exposed to non-performing loans (NPLs). Indeed, their total NPLs expressed as a share of their total gross loans stood at 2.52% at the end of 2023, and has declined consistently in recent years.[14] Moreover, core Maltese banks also enjoy high profitability with their Return on Equity (ROE) and Return on Assets (ROA) reaching 18.2% and 1.6%, respectively, by the end of 2023.[15] These figures represent a marked improvement over the respective 8.19% and 0.66% levels recorded a year earlier. These developments were further complemented by higher net interest income (NII) received in recent months, largely owing to increased lending activities and the remuneration of banks' excess liquidity at the DFR as from 2022 (Central Bank of Malta, 2024).[16] Maltese banks' performance under these indicators of credit risk and profitability compares favourably to banks operating in other EA countries.[17]

Concluding remarks

In the light of commercial banks' crucial role in the transmission of monetary policy onto the real economy, this analyses revisited the pass-through of monetary policy decisions onto retail bank lending and deposit rates in Malta. The analysis clearly shows that the transmission of policy tightening via lending rate setting has been rather muted in recent months. Mortgage rates, in particular, have barely moved despite the rapid increase in policy rates, while movements in the interest rate on lending to NFCs have also lagged behind other EA countries. This study also shows that lending rates charged by Maltese banks were among the highest prior to any of the recent hikes in the policy rate by the ECB, which suggests a relatively weak pass-through in Malta even during years characterised by accommodative monetary policy. On the other hand, the transmission of tightening monetary policy onto time deposit rates, particularly those of households, is closer to that witnessed in the EA. Rates offered on overnight deposits have remained stable at very low levels during the latest cycle of tightening monetary policy, although similar developments were also observed in other countries within the EA.

Among the main factors that could potentially explain the low pass-through of monetary policy onto lending rates in Malta, this study shows that Maltese banks enjoy ample liquidity and have a strong accumulation of retail deposits, the vast majority of which are remunerated at very low rates. This allows banks to rely on this source of funding instead of borrowing from the ECB at higher rates, while concurrently being able to comfortably maintain their lending portfolios. In addition, Maltese banks also enjoy rising profitability, strong capital buffers and are subject to relatively low risk associated with non-performing loans. Moreover, lending rates in Malta were already relatively high before the recent tightening of monetary policy. These considerations, alongside others such as a possible desire by

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12 Financial Soundness Indicators – Core Banks 2015 onwards. See also footnote 10.

13 Tier 1 capital comprises common shares and stock surplus, retained earnings, other comprehensive income, qualifying minority interest and regulatory adjustments (Common Equity Tier 1) plus capital instruments meeting the criteria for 'Additional Tier 1' capital. See Bank for International Settlements, "Definition of capital in Basel III – Executive Summary" for more details.

14 See footnote 12.

15 See footnote 12.

16 See footnote 11.

17 See footnote 10.

Maltese banks to preserve long-standing client relationships, could all be plausible explanations of the limited transmission of tightening monetary policy onto lending rates in Malta.

This analyses focused exclusively on one channel of monetary policy, namely the transmission of tightening monetary policy via retail bank rates. However, there exist other channels, such as the *exchange rate* and *asset price* channels which, while not addressed in this note, might also be relevant channels of monetary policy in Malta. In addition, the Maltese economy may also be affected indirectly through spillovers from the effects of tighter monetary policy in other countries, in the form of weaker foreign demand for Malta's output and lower import prices, which might lead to downward pressures on export demand and local prices. Therefore, a true understanding of the full extent of overall monetary policy transmission in Malta necessitates an analysis of the effectiveness of such other channels in the local context.