MISSION STATEMENT

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

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

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

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

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

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

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

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

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

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

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

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

Finally, as a member of the Eurosystem, the Bank continues to subscribe to the Eurosystem’s mission, strategic intents and organisational principles.
**Board of Directors**

Dr Mario Vella  
**Governor and Chairman**

Mr Alexander Demarco  
**Deputy Governor**

Mr Oliver Bonello  
**Deputy Governor**

Monetary Policy

Ms Philomena Meli  
**Director**

Dr Peter J. Baldacchino  
**Director**

Dr Romina Cuschieri  
**Director**

Professor Frank Bezzina  
**Director**

---

**Executive Committee**

Dr Mario Vella  
**Governor and Chairman**

Mr Alexander Demarco  
**Deputy Governor**

Mr Oliver Bonello  
**Deputy Governor**

Mr Markus Alefelder  
**Chief Officer**  
**Investments**

Mr Raymond A. Bonnici  
**Chief Officer**  
**Corporate Services**

Mr Francis Bugeja  
**Chief Officer**  
**Internal Audit**

Mr Alan Cassar  
**Chief Officer**  
**Financial Stability**

Mr Paul Farrugia  
**Chief Officer**  
**Human Resources**

Mr Raymond Filletti  
**Chief Officer**  
**Financial Control and Risk**

Mr Jesmond Gatt  
**Chief Officer**  
**Banking Operations**

Dr Aaron G. Grech  
**Chief Officer**  
**Economics**

---

**Investments Policy Committee**

Dr Mario Vella  
**Governor and Chairman**

Mr Alexander Demarco  
**Deputy Governor**

Mr Oliver Bonello  
**Deputy Governor**

Mr Markus Alefelder  
**Chief Officer**  
**Investments**

Mr Raymond Filletti  
**Chief Officer**  
**Financial Control and Risk**

Mr Robert Caruana  
**Head**  
**Financial Control Department**

Mr Denis A. Micallef  
**Head**  
**Risk Management Department**

Mr André Psaila  
**Head**  
**Investments and Government Securities Department**

Mr Damien Ferrito  
**Manager**  
**Finance Office**

Mr Gerard Grant  
**Manager**  
**Financial Risk Management Office**

---

**Management Committee**

**Heads of Departments**

Mr Jesmond Pulé  
**Chairman**  
**Statistics**

Mr Stephen Attard  
**Financial Stability**

Mr Alexander Borg  
**Administration**

Mr Saviour Busuttil  
**Information Systems and Knowledge Management**

Mr John Caruana  
**Monetary Policy & Operations and Eurosystem Relations**

Mr Robert Caruana  
**Financial Control**

Mr Herman Ciappara  
**Payments and Banking**

Mr Silvio Galea  
**International Relations**

Dr Pauline Lanzon  
**Legal**

Mr Aidan Massa  
**Internal Audit**

Mr Denis Micallef  
**Risk Management**

Mr André Psaila  
**Investments and Government Securities**

Ms Rita Schembri  
**Economic Analysis**

Mr Peter Paul Tabone  
**Currency Services and Security**

Ms Wendy Zammit  
**Financial Stability Surveillance, Assessment and Stress Testing, and Risks Models**

---

**Audit Committee**

Dr Peter J. Baldacchino  
**Chairman**

Professor Frank Bezzina  
**Member**

Dr Romina Cuschieri  
**Member**

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*as at 30 March 2019*
THE BOARD OF DIRECTORS*  

(left to right)

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

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

*as at 30 March 2019
29 March 2019

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

Dear Minister

LETTER OF TRANSMITTAL

In terms of article 21 of the Central Bank of Malta Act (Cap. 204), I have the honour to transmit to you, in your capacity as Minister responsible for finance, a copy of the Annual Report of the Bank for the financial year ended 31 December 2018.

Yours sincerely

Dr Mario Vella
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<td>ABSPP</td>
<td>Asset-backed Securities Purchase Programme</td>
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<td>AllI</td>
<td>Asian Infrastructure Investment Bank</td>
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<td>AML/CFT</td>
<td>anti-money laundering and countering the financing of terrorism</td>
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<td>APP</td>
<td>Asset Purchase Programme</td>
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<td>Bank Lending Survey</td>
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<td>Covered Bond Purchase Programme</td>
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<td>countercyclical capital buffer</td>
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<td>Central Credit Register</td>
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<td>Capital Requirements Directive</td>
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<td>CPI</td>
<td>Consumer Price Index</td>
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<td>credit reference agency</td>
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<td>CRR</td>
<td>Capital Requirements Regulation</td>
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<td>Corporate Sector Purchase Programme</td>
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<td>European Commission</td>
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<td>effective exchange rate</td>
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<td>Euro OverNight Index Average</td>
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<td>European System of Central Banks</td>
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<td>European system of financial supervision</td>
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<td>Euro short-term rate</td>
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<td>Euro Interbank Offered Rate</td>
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<td>Federal Open Market Committee</td>
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<td>Financial Sector Assessment Programme</td>
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<td>Foreign Exchange</td>
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<td>gross domestic product</td>
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<td>General Data Protection Regulation</td>
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<td>General Resources Account</td>
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<td>Government Securities Office</td>
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<td>GVA</td>
<td>gross value added</td>
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<td>HCI</td>
<td>harmonised competitiveness indicator</td>
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<td>HFCS</td>
<td>Household Finance and Consumption Survey</td>
</tr>
<tr>
<td>HICP</td>
<td>Harmonised Index of Consumer Prices</td>
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<td>IIP</td>
<td>Individual Investor Programme</td>
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<td>ILO</td>
<td>International Labour Organization</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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</table>
GOVERNOR’S STATEMENT

In 2018 the global expansion weakened. At the same time, unemployment in several advanced economies remained low from a historical perspective. In the second half of the year, disappointing macroeconomic data in some of the larger euro area countries, concerns about a US government shutdown, a possible further escalation of trade tensions and increased uncertainty surrounding relations between the European Union and the United Kingdom was reflected in weaker sentiment globally, renewed financial market volatility and downward revisions in global growth projections. Against this background, although some of the major central banks raised interest rates, as the year drew to a close they signalled a more cautious approach towards the prospect of further monetary policy normalisation in the coming years.

The slowdown in global trade negatively affected the euro area, where growth in real gross domestic product (GDP) eased to 1.8%, from a post-crisis high of 2.4% in 2017. Political uncertainty in Italy, bottlenecks in the car industry in Germany and social unrest in France also contributed to the slowdown. Despite slowing activity, the labour market continued to improve, with the unemployment rate averaging 8.2%, the lowest yearly reading since 2008. The ongoing expansion, and tighter labour markets, contributed to some upward pressure on wage costs. However, wage growth remained contained compared to pre-crisis averages, which helped contain increases in consumer prices. Although the annual average rate of consumer price inflation in the euro area edged up slightly compared with 2017, at 1.8%, it nevertheless remained below the price stability objective of the European Central Bank (ECB).

Against this background, the ECB maintained an accommodative monetary stance. The interest rates on main refinancing operations (MROs), the marginal lending facility and the deposit facility were held at 0.00%, 0.25% and -0.40%, respectively. The Governing Council noted on several occasions that it expected them to remain at present levels for an extended period of time, and well past the horizon of the net asset purchases. In June, the Council clarified that interest rates are expected to remain unchanged at least through the summer of 2019 and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with the current expectations of a sustained adjustment path.

In March 2019, the Council announced that ECB interest rates are expected to remain at current levels at least through the end of 2019 and that it would launch a new series of quarterly targeted longer-term refinancing operations (TLTROs), starting in September 2019. Furthermore, the Council extended its full allotment policy for liquidity-providing operations at least until the end of the reserve maintenance period starting in March 2021.

The asset purchase programme (APP) was extended, although as had been announced in 2017, the monthly pace of purchases was reduced to €30 billion from January 2018 and further to €15 billion from October. Although net purchases ended in December, the Council intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

Despite the softer external environment and elevated uncertainty, the domestic economy continued to expand at a brisk pace, with real GDP growth standing at 6.6%, only marginally below the rate of 6.7% recorded in 2017. The expansion was largely driven by domestic demand, particularly private consumption, which continued to benefit from strong growth in disposable income in the context of very favourable labour market conditions. Government consumption and changes in inventories contributed to the expansion in a more limited way. In contrast, investment contracted. Meanwhile, the positive contribution of net exports decreased, as exports grew at a slower pace, while imports picked up.
The Bank estimates that the fiscal balance remained in surplus during the year, although this is expected to have narrowed somewhat compared with 2017. The debt-to-GDP ratio edged down further, standing at 45.7% in September.

Annual inflation based on the Harmonised Index of Consumer Prices (HICP) rose to 1.7% from 1.3% in 2017, mainly reflecting an upward revision in the weight of accommodation services at the start of the year. By contrast inflation based on the Retail Price Index (RPI), which excludes such services, eased to 1.2%, from 1.4% a year earlier.

The Bank continued to implement the Eurosystem’s monetary policy decisions in Malta, through standing facilities, liquidity-providing operations and the Public Sector Purchase Programme (PSPP). As liquidity remained ample, domestic credit institutions did not participate in the Eurosystem’s MROs and in the long-term refinancing operations (LTROs). At the same time, recourse to the deposit facility continued to increase. During the year, the Bank purchased €94.2 million worth of Maltese sovereign bonds through the PSPP, bringing total purchases before amortisation to €1,042.3 million by the end of 2018. In addition, the Bank continued to purchase securities for the ECB’s PSPP portfolio.

In 2018, the Bank’s balance sheet continued to expand, reaching €8,853.9 million at the end of 2018, from €8,582.9 million a year earlier. Operating profit before transfer to provisions decreased to €38.3 million, from €51.6 million in 2017. This was mainly due to a reduction in net gains on the disposal of financial instruments and a lower amount of income in respect of the remaining balance of Maltese lira fifth series currency notes, which were redeemable until the end of January 2018. Lower net interest income further contributed to the decline in operating profit. Following the transfer of €10.3 million to provisions, the amount of €28.0 million is payable to the Government of Malta.

In the area of financial stability, the Bank continued to advise Government on EU legislative proposals affecting the financial sector. It also continued to monitor closely the financial system, partly using stress tests, and to implement macroprudential and crisis management policies, including those recommended by the Joint Financial Stability Board (JFSB) and the Domestic Standing Committee tasked with managing a financial crisis situation. The Bank’s risk assessments, stress tests results and work related to macroprudential policy were published in two Financial Stability Reports. These showed that despite a challenging environment, the domestic financial system continued to be resilient, supported by robust economic growth, with the banking sector showing strong capital buffers, ample liquidity and a low incidence of non-performing loans (NPLs). Additionally, the Bank continued to monitor the lending standards of core domestic banks and private sector demand for credit. On the basis of its quarterly assessments of potential risks caused by excessive credit growth, the Bank kept the countercyclical capital buffer (CCyB) rate unchanged at 0% throughout 2018. During the year, the Bank launched a consultation on a proposed Directive on Borrower-Based Measures targeting mortgages, and which seeks to enhance the resilience of banks and household balance sheets to possible house price corrections and interest rate reversals.

Apart from participating in ECB and European Systemic Risk Board (ESRB) meetings related to the financial sector, meetings of the European Banking Authority (EBA) and the Single Supervisory Mechanism (SSM), in 2018 the Bank participated in a MONEYVAL on-site evaluation and in another evaluation carried out in terms of the United Nations (UN) Convention against Corruption. In order to enhance compliance with the regulatory framework related to anti-money laundering and countering the financing of terrorism (AML/CFT), the Bank set up a Financial Crime Compliance Unit. The Bank also co-ordinated the International Monetary Fund (IMF) Financial Sector Assessment Programme (FSAP) for Malta and was involved in discussions on the implementation of the ESRB recommendation on real estate data gaps with the National Statistics Office (NSO). Financial stability issues as well as the general economic situation were regularly discussed with the European Commission (EC), IMF staff and the rating agencies.

As in 2017, the Bank continued to sound out private sector firms and public sector institutions in Malta to gain a better understanding of economic conditions. These meetings were supplemented by a new initiative that involves on-site visits to industrial estates for Bank staff that permit a close on-the-ground experience of
the operational activities in specific sectors. Further work was carried out to develop additional forecasting tools, while the Bank’s publications began to include commentaries on a number of variables estimated by the Bank, in addition to official data. The Bank also launched a Research Bulletin. As part of events commemorating the Bank’s 50th anniversary, the Bank issued a publication on its first half century and held a number public lectures in economics and finance, economic history and law, with contributions from both Bank staff and external foreign speakers.

In April, the Bank and the School of Economics and Finance of Queen Mary University of London held an international conference in London on the theme The euro: Voices from the Commonwealth, which provided an opportunity to academics and policy makers from Commonwealth countries to reflect on the role of the euro in the global financial system.

The Bank added further processes to the statistical solution that it has been developing in collaboration with Banca d’Italia and began to implement the AnaCredit project, which aims to provide a harmonised set of credit and credit risk data across participating euro area countries. The Bank transmitted the results of the 2017 wave of the Household Finance and Consumption Survey (HFCS) to the ECB and started to prepare for new statistical requirements related to pension funds.

Other key developments during the year included the amendment of a number of directives implementing the revised Payment Services Directive (PSD2) and the Central Securities Depositories Regulation (CSDR). The Bank carried out preparatory work related to the licensing and supervision of credit reference agencies (CRAs) and signed an agreement enabling the Bank to administer part of the portfolio of the National Development and Social Fund (NDSF). Apart from switching to a new accounting system at the start of the year, the Bank upgraded a number of IT systems that connect the Bank to the rest of the European System of Central Banks (ESCB) and continued to invest in the payments infrastructure. The Bank reviewed its processes in the light of the EU’s General Data Protection Regulation (GDPR).

The Bank continued to monitor the social context and the impact of economic growth and to prepare itself for an enhancement of its research capability in this field.

On behalf of the Board I would like to congratulate Mr Alexander Demarco for his re-appointment as Deputy Governor responsible for monetary policy, as well as Dr Romina Cuschieri and Dr Peter J. Baldacchino on their re-appointment as Board members. I seize this opportunity to express my appreciation for the Bank staff’s dedication and hard work.

Dr Mario Vella
1. THE EXTERNAL ENVIRONMENT AND THE EURO AREA

During 2018, GDP growth in the United States expanded at a faster pace compared with the preceding year, while economic activity in the United Kingdom slowed down. Price pressures increased initially, before retreating in the last quarter of the year. In the United States, the annual rate of consumer price inflation exceeded the 2.0% central bank’s target during most of the year, averaging 2.4% during the year as a whole, while in the United Kingdom it stood at 2.1%. During the year, the Federal Reserve raised the official federal funds rate target on four occasions, while the Bank of England increased the Bank Rate in August.

In the euro area, real growth in GDP eased to 1.8% in 2018, from 2.4% in the previous year. Labour market conditions continued to improve, with the unemployment rate edging down to 7.8% by December. Consumer price inflation, measured on the basis of the HICP also increased strongly, averaging 1.8% for the whole year, up from 1.5% in 2017.

The ECB’s Governing Council maintained an accommodative monetary policy stance during 2018, with the key interest rates on MROs, the marginal lending facility and the deposit facility remaining at 0.00%, 0.25% and -0.40%, respectively over the year. The Governing Council noted on several occasions that it expected them to remain at present levels for an extended period of time, and well past the horizon of the net asset purchases. In June, the Council clarified that interest rates are expected to remain unchanged at least through the summer of 2019 and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with the current expectations of a sustained adjustment path. In March 2019, the Council announced that ECB interest rates are expected to remain at current levels at least through the end of 2019 and that it would launch a new series of quarterly TLTROs in September 2019. It also extended the full allotment policy for liquidity-providing operations at least until the end of the reserve maintenance period starting in March 2021.

In line with the Council’s decisions, the ECB continued to make asset purchases under the APP, albeit at a diminishing pace as the year progressed. These purchases continued until December 2018 and then ended. However, in December, the Governing Council clarified that it intended to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

Brent crude oil prices rose to USD 85.2 per barrel in October, before dropping to USD 50.5 per barrel at the end of 2018.

Key advanced economies

US economy expands at a faster pace

During 2018, real GDP growth in the United States accelerated to 2.9%, from 2.2% in 2017 (see Table 1.1). The acceleration in real GDP primarily reflected faster growth in domestic demand. Government expenditure recovered from the small contraction recorded a year earlier, while private consumption and non-residential fixed investment rose at a faster pace. These offset a small contraction in residential investment. Net exports continued to dampen GDP growth, although they contributed less negatively in 2018.

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

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>1.8</td>
<td>2.5</td>
<td>2.9</td>
<td>1.6</td>
<td>2.2</td>
<td>2.9</td>
</tr>
<tr>
<td>Euro area</td>
<td>-0.3</td>
<td>1.4</td>
<td>2.1</td>
<td>2.0</td>
<td>2.4</td>
<td>1.8</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2.0</td>
<td>2.9</td>
<td>2.3</td>
<td>1.8</td>
<td>1.8</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Sources: Bureau of Economic Analysis, US; Eurostat; Office for National Statistics, UK.
In the labour market, the participation rate averaged 62.9% in 2018, unchanged compared with the preceding year. Meanwhile, employment grew at a faster pace, with the annual rate of increase accelerating to 1.6% from 1.3% in 2017. Non-farm payroll data suggest that there was a pick-up in the pace of job creation in manufacturing, construction, transportation and storage, mining and logging as well as in professional and business services. The average unemployment rate in 2018 stood at 3.9%, down from 4.4% in 2017 (see Chart 1.1).

The annual rate of inflation based on the Consumer Price Index (CPI) averaged 2.4% in 2018, up from 2.1% in 2017. The rise in the inflation rate in 2018 was mainly driven by increases in services price inflation and food price inflation. On the other hand, energy inflation decelerated. Inflation excluding food and energy accelerated. It averaged 2.1% during the year, up from 1.8% in 2017.

US inflation exceeded the 2% target of the Federal Reserve in most months, peaking at 2.9% in June and July (see Chart 1.2). However, by December, the inflation rate fell to 1.9%.

During 2018, the Federal Open Market Committee (FOMC) raised the target for the federal funds rate further, as the labour market continued to strengthen and economic activity expanded at a strong pace. It increased the federal funds target range on four occasions, in March, June, September and December. By the end of the year the range was widened to between 2.25% and 2.50% from a range of between 1.25% and 1.50% at the end of 2017 (see Chart 1.3). The FOMC stated that the timing and size of future adjustments to the target range for the federal funds rate will depend on the Committee’s assessment of realised and expected economic conditions.
conditions relative to its maximum-employment objective and its symmetric 2% inflation objective. Meanwhile, the Committee maintained its existing policy of reinvesting principal payments from its agency debt and mortgage-backed security holdings, and rolling over maturing Treasury securities at auction.

**UK economy slows down**

Economic growth in the United Kingdom moderated from 1.8% in 2017, to 1.4% in 2018, partly reflecting slower activity abroad and effects from Brexit uncertainties. This is the lowest reading since 2012 (see Table 1.1). A slowdown in private consumption and investment impacted growth. In addition, the contribution from net trade turned negative. On the other hand, government consumption increased.

Despite the slowdown in economic activity, in the labour market, employment rose by 1.2% in 2018, following a 1.0% increase in 2017. The unemployment rate fell further and averaged 4.1%, against 4.4% a year earlier (see Chart 1.1).

Inflation in the United Kingdom, as measured by the CPI, averaged 2.5% in 2018, down from 2.7% in 2017. This was mainly a result of developments in the prices of food and beverages, services and non-energy industrial goods (NEIG). On the other hand, energy inflation rose. The inflation rate started the year at 3.0%, before moderating to 2.4% in the second quarter and further to 2.1% by the end of the year (see Chart 1.2). The annual rate of inflation based on the CPI excluding food and energy fell to an average of 2.1%, from 2.4% in 2017.

In 2018, the Bank of England’s Monetary Policy Committee maintained the Bank Rate unchanged at 0.50% until July, before increasing it to 0.75% in August as the slowdown in UK output was believed to be only temporary, the labour market had continued to tighten, unit labour cost growth had firmed and inflation was projected to remain slightly above 2% for some time (see Chart 1.3). The Bank Rate was kept unchanged for the rest of the year. The Committee maintained the stock of sterling non-financial investment-grade corporate bond purchases, and the stock of UK government bond purchases, financed by the issuance of central bank reserves, at GBP 10 billion and GBP 435 billion, respectively.

**Economic and financial developments in the euro area**

**Euro area GDP growth moderates**

Real GDP in the euro area increased by 1.8% in 2018, after it had grown by 2.4% in 2017 (see Table 1.2).

<table>
<thead>
<tr>
<th>Table 1.2</th>
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<tbody>
<tr>
<td>REAL GDP GROWTH IN THE EURO AREA</td>
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<tr>
<td>Chain-linked volumes</td>
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<table>
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<td><strong>Annual percentage changes</strong></td>
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</tr>
<tr>
<td>Private consumption</td>
<td>0.4</td>
<td>0.9</td>
<td>1.8</td>
<td>2.0</td>
<td>1.6</td>
<td>1.3</td>
</tr>
<tr>
<td>Government consumption</td>
<td>-0.7</td>
<td>0.7</td>
<td>1.3</td>
<td>1.8</td>
<td>1.1</td>
<td>1.0</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>-2.4</td>
<td>1.6</td>
<td>4.9</td>
<td>4.0</td>
<td>2.6</td>
<td>3.0</td>
</tr>
<tr>
<td>Exports</td>
<td>2.1</td>
<td>4.8</td>
<td>6.6</td>
<td>3.0</td>
<td>5.2</td>
<td>3.0</td>
</tr>
<tr>
<td>Imports</td>
<td>1.5</td>
<td>4.9</td>
<td>7.6</td>
<td>4.2</td>
<td>3.9</td>
<td>2.9</td>
</tr>
<tr>
<td>GDP</td>
<td>-0.3</td>
<td>1.4</td>
<td>2.1</td>
<td>2.0</td>
<td>2.4</td>
<td>1.8</td>
</tr>
</tbody>
</table>

| **Percentage point contributions** |
| Private consumption | 0.1  | 0.5  | 1.0  | 1.1  | 0.9  | 0.7  |
| Government consumption | -0.4 | 0.2  | 0.3  | 0.4  | 0.2  | 0.2  |
| Gross fixed capital formation | -0.5 | 0.3  | 1.0  | 0.8  | 0.5  | 0.6  |
| Changes in inventories | 0.2  | 0.3  | 0.1  | 0.1  | 0.0  | 0.1  |
| Exports | 1.0  | 2.1  | 2.9  | 1.4  | 2.4  | 1.4  |
| Imports | -0.6 | -2.0 | -3.1 | -1.7 | -1.6 | -1.2 |
| GDP | -0.2 | 1.4  | 2.1  | 2.0  | 2.4  | 1.8  |

Source: Eurostat.

1 The cut-off date for data on GDP in this Chapter is 7 March 2019.
Economic activity in the euro area was primarily supported by domestic demand, as net exports contributed to a lesser extent. The contribution of domestic demand was unchanged from that in 2017. Although private consumption and government consumption registered a more moderate rate of growth, gross fixed capital formation accelerated and the contribution of changes in inventories turned positive. In contrast, the contribution from net exports was lower than that registered in 2017, as export growth decelerated at a faster rate than imports. In fact, net exports were the main factor behind slower GDP growth in 2018.

**HICP inflation rises**

The annual rate of HICP inflation in the euro area increased during 2018, with the average reading for the year as a whole standing at 1.8% in 2018, up from 1.5% in 2017 (see Chart 1.4). This rise in the inflation rate largely reflected faster growth in the prices of energy and processed food. Furthermore, services inflation edged up marginally. By contrast, unprocessed food edged down, whilst NEIG inflation was unchanged from 2017. The overall inflation rate edged up from around 1.3% during the first four months of 2018, to above 2.0% between May and October, before retreating to 1.5% in December, with these movements largely reflecting developments in energy prices. HICP excluding energy and food stood at 1.0%, unchanged from 2017. This reflected the very subdued NEIG inflation and relatively low services prices.

**Labour market improves further**

The labour market continued to improve during the 2018. Employment growth fell marginally to 1.5%, following a 1.6% increase in 2017. The rate of unemployment averaged 8.2% during the year, down from 9.1% in 2017 (see Chart 1.1). By December, it had fallen to 7.8%.

Cross-country data show that the unemployment rate fell across all euro area countries. Nevertheless, wide disparities across countries persisted, with the unemployment rate standing above 15.0% in Greece and Spain and only 3.4% in Germany.

**ECB staff projections point towards significantly weaker growth in the short term**

According to the ECB staff macroeconomic projections published in March 2019, real GDP growth in the euro area is expected to weaken substantially in 2019 to 1.1%, before picking up to around 1.5% in 2020 and 2021 (see Table 1.3).

The weakness in 2019 reflects carry-over effects from an unexpected sluggish fourth quarter of 2018, with more recent indicators, such as sentiment indicators, suggesting that this weakness will also persist in the first half of 2019. In particular, in the short run, a combination of global uncertainties, notably the intensification of protectionist measures and a disorderly Brexit, as well as adverse domestic factors in the euro area, are expected to further weigh down on euro area activity. In the medium-term, however, economic activity is projected to pick-up, as adverse factors gradually fade out and factors supporting euro area activity gain

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2 The cut-off date for oil prices and other technical assumptions was 12 February, whilst that for other information in this projection exercise was 21 February.

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traction. In particular, the euro area economy should continue to benefit from the ECB’s accommodative monetary policy stance, rising wages, a recovery in foreign demand and some fiscal loosening.

The rise in real GDP growth after 2019 also reflects favourable lending conditions to the private sector in the context of a low-interest environment and from increasing private consumption and residential investment, which should benefit from rising wages and net worth. Rising profit margins, high capacity utilisation and labour-saving investment against the background of increasing labour shortages should also support a further expansion in business investment. Nonetheless, the fading out of some tailwinds are expected to constrain economic recovery over the latter half of the projected horizon as financing conditions become less favourable, growth in employment decelerates and labour shortages become increasingly binding across some countries.

Domestic demand is projected to remain the main driver behind euro area growth over the projected horizon.

Private consumption growth is set to remain stable in 2019, before picking up in 2020. In the near term, private consumption is expected to benefit from relatively favourable consumer confidence and further improvements in labour market conditions, including increasing real wages per employee. Fiscal loosening in some countries also suggests stronger consumption growth over time. However, uncertainties in some euro area countries are forecasted to weigh on private consumption in the coming quarters.

Over the medium term, private consumption growth should be supported by favourable financing conditions and rising household net worth, which partly reflects the recovery in house prices. Despite the increase in bank lending rates, gross interest payments are expected to remain low, owing to the long maturity of household debt and the relatively low share of variable rate debt on households’ balance sheets. Nonetheless, household gross indebtedness remains at levels prevailing before the start of the global financial crisis in 2008.

Confidence in the construction sector and an increase in building permits allude to a continued expansion in housing investment. Nonetheless, the momentum of expansion in housing investment is expected to ease as financing conditions are set to tighten slightly over the projection horizon. Increasing binding capacity constraints in the construction sector and adverse demographic trends in some economies will also condition residential investment.

Business investment is expected to continue recovering over the projected horizon, albeit at a subdued pace, as persistent concerns about trade protectionism, a no-deal Brexit and a hard landing in China weigh on business sentiment across countries. However, on balance, a number of fundamental factors are expected to further support business investment. These include relatively elevated capacity utilisation levels,

### Table 1.3
MACROECONOMIC PROJECTIONS FOR THE EURO AREA

<table>
<thead>
<tr>
<th>Annual percentage changes</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>1.1</td>
<td>1.6</td>
<td>1.5</td>
</tr>
<tr>
<td>Private consumption</td>
<td>1.3</td>
<td>1.6</td>
<td>1.4</td>
</tr>
<tr>
<td>Government consumption</td>
<td>1.7</td>
<td>1.6</td>
<td>1.4</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>2.1</td>
<td>2.4</td>
<td>2.0</td>
</tr>
<tr>
<td>Exports</td>
<td>2.8</td>
<td>3.6</td>
<td>3.2</td>
</tr>
<tr>
<td>Imports</td>
<td>3.7</td>
<td>4.1</td>
<td>3.5</td>
</tr>
<tr>
<td>HICP</td>
<td>1.2</td>
<td>1.5</td>
<td>1.6</td>
</tr>
</tbody>
</table>

Source: ECB.

(1) ECB staff macroeconomic projections (March 2019).
favourable financing conditions and rising profit mark-ups. Labour-related supply-side constraints may also trigger increased capital expenditure.

Extra-euro area export growth is projected to remain subdued in the short term, whilst still growing slightly faster than foreign demand for 2019, partly reflecting some improvement in price competitiveness and a normalisation in car exports. Eventually, exports should grow more in line with foreign demand. Extra-euro area imports are expected to grow broadly in line with aggregate demand. As imports are expected to outpace exports initially, this should result in a slightly negative contribution to real GDP growth from net exports during 2019, and a neutral contribution thereafter.

Compared with the Eurosystem staff projections published in December 2018, euro area GDP growth was revised down substantially in 2019 (by 0.6 percentage point), mainly due to the weaker than expected outturn in the fourth quarter of 2018 and a less favourable assessment of the short-term outlook amid heightened geopolitical uncertainties. GDP growth in 2020 was revised down by 0.1 percentage point, reflecting the view that recent headwinds should dissipate.

According to the March 2019 ECB staff projections HICP is envisaged to ease to 1.2% in 2019, before rising across the remainder of the projection horizon, reaching 1.6% in 2021. Energy inflation is expected to rise at subdued rates consistent with a relatively flat oil price future curve, while food inflation is projected to be relatively flat at around 1.9%. HICP excluding energy and food is set to rise gradually, to reach 1.6% in 2021. The pick-up in this measure is largely underpinned by the more gradual but continued economic growth, as well as rising non-energy commodity prices and increasing underlying global prices. Additionally, tightening labour markets should lead to faster growth in wages.

Compared with the December 2018 projections, HICP inflation was revised down over the entire projection horizon, reflecting the sharp decline in energy inflation following the recent drop in oil prices as well as a downward revision in HICP excluding food energy and food, which partly reflects weaker than expected outturns, the softer outlook for activity and a reassessment of the link between wages and consumer prices.

**The ECB maintains its accommodative monetary policy stance**

The ECB’s Governing Council maintained an accommodative monetary policy stance during 2018. The interest rate on MROs, the marginal lending facility and the deposit facility were maintained at 0.00%, 0.25% and -0.40%, respectively throughout the year (see Chart 1.3). The Council announced that it expected them to remain at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term.

The Governing Council also retained the current comprehensive package of non-standard measures. In line with the Council’s decisions, the ECB continued to offer liquidity through MROs and three-month refinancing operations as fixed-rate tender procedures with full allotment. In the June meeting, the Governing Council announced that it expects interest rates to remain unchanged at present levels at least through the summer of 2019, and in any case for as long as needed to ensure that inflation evolves at an aligned pace with current expectations of a sustainable adjustment.

On 7 March 2019, the Governing Council announced that key ECB interest rates are expected to remain on hold until at least the end of 2019 and that it will also launch a new series of quarterly targeted long-term refinancing operations (TLTRO-III) starting in September 2019 and ending in March 2021. It also extended the full allotment procedure for its lending operations at least until the end of the reserve maintenance period starting in March 2021.

The Eurosystem continued to make asset purchases through the APP. As had been communicated in 2017 the monthly pace of these purchases was reduced to €30 billion from January, until the end of September

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3 On 26 October 2017, the Governing Council had announced that the policy of full allotment will continue for as long as necessary, and at least until the end of the last reserve maintenance period of 2019.
As of October 2018, net asset purchases were carried out at an average monthly pace of €15 billion. Net purchases continued at this pace until the end of December and then ended.

Initially, the Council noted that it intended to reinvest principal payments from maturing securities purchased under the APP for an extended period of time after the end of the net asset purchases. In December, though, it clarified that it intends to maintain its policy of fully reinvesting the principal payments from maturing securities past the date when the ECB starts raising its interest rates, and in any case for as long as needed to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

**Money market rates reach historical lows**

In the light of the accommodative monetary policy stance, money market rates in the euro area declined further, remaining at historical lows during 2018. The Euro OverNight Index Average (EONIA) overnight deposit rate remained unchanged at -0.36% throughout the year, whilst the three-month Euro Interbank Offered Rate (EURIBOR) started at -0.33% in January and edged up marginally to -0.31% by December.

Meanwhile, the 12-month EURIBOR reached -0.13% in December, up from -0.19% 12 months earlier (see Chart 1.5).

**Euro area bond yields generally decline**

Yields on ten-year government bonds in the euro area generally fell or were flat during 2018, except in Italy and Ireland. Yields in Greece and Germany recorded the strongest declines. These fell by 16 and 11 basis points over the year, to stand at 4.28% and 0.19%, respectively in December. Greek yields fell to 3.88% in July in anticipation of the end of the international bailout programme, which was then announced in August, but returned on an upward path subsequently. Yields in Portugal and Spain followed a similar pattern, falling by 10 and 2 basis points, respectively, from their level in December 2017. Bond yields in France ended the year broadly unchanged from their level 12 months earlier.

On the other hand, Ireland and Italy saw increases of 37 and 119 basis points in their yields, to 0.91% and 2.98%, respectively. Ireland’s increase in bond yields reflects high levels of public debt, estimated at over 100% of gross national income (GNI). This was notably driven by the cancelled liquidation of the Irish Bank Resolution Corporation, whereby Government debt reaches highest levels since 2013, increasing the economy’s vulnerability to economic shocks. Italy’s ten-year yield reached levels last seen in 2014, as the announcement of fiscal loosening plans heightened concerns about the sustainability of government debt.

As a result of the above, spreads between yields on ten-year German bonds and on those on bonds issued by other euro area governments generally broadened over

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4 EURIBOR is an interest rate benchmark indicating the average rate at which principal European banks lend unsecured funds on the interbank market in euro for a given period. The EONIA is an effective overnight interest rate, measured as the weighted average of the interest rates on unsecured overnight lending transactions, in euro denomination, as reported by a panel of contributing banks.
the year, with the exception of Greek bonds which edged down by 5 basis points (see Chart 1.6). Italy and Ireland recorded the most significant widening in spreads, of 130 and 48 basis points, respectively.

**The euro depreciates marginally**

After rising by 5.4% during 2017, the euro exchange rate depreciated slightly over 2018 in nominal effective terms, with the effective exchange rate against 19 trading partners (EER-19) down by 0.6% since its end-2017 level.5

On a bilateral basis, the euro fell by 6.8% against the Japanese yen and by 4.5% against the US dollar amid signs of weakening economic growth in the euro area (see Chart 1.7). It also weakened against a number of other currencies, including the Swiss franc and the Croatian kuna. On the other hand, the euro strengthened against the Chinese yuan renminbi, the Pound sterling and the Swedish krona.

**Commodities**

**Oil prices end the year at a lower level**

The price of Brent crude oil rose during most of the year, going from USD 67.1 per barrel at the end of 2017 to USD 85.2 in October, before retreating to USD 50.5 at the end of the year (see Chart 1.8). The initial upward trajectory was propelled by a continued recovery in global demand, renewed geopolitical tensions between the United States and Iran, and a high degree of conformity with supply restrictions targeted by members of the Organization of the Petroleum Exporting Countries (OPEC) and other oil producers. Between October and December, the price of Brent crude oil generally fell on positive news regarding supply, the

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5 The EER-19 is based on the weighted averages of the euro exchange rate against the currencies of Australia, Bulgaria, Canada, China, Croatia, Czech Republic, Denmark, Hong Kong, Hungary, Japan, Norway, Poland, Romania, Singapore, South Korea, Sweden, Switzerland, the United Kingdom and the United States.
announcement by the United States that it would allow some large countries to keep importing oil from Iran and expectations of lower global demand for oil as the international environment softened. Although in December, OPEC and key non-OPEC producers agreed to reduce production further, the proposed cuts were at the lower end of the market's expectations and thus did not have a lasting impact on prices. By the end of the year, the price of Brent crude oil had declined by 24.7% on its level a year earlier, the largest annual loss since 2015.

Non-energy commodity prices increased during 2018, with World Bank data showing a rise of 1.7%. The increase was mainly driven by higher prices for fertilisers and metals and minerals.
2. MONETARY AND FINANCIAL DEVELOPMENTS

According to the Bank’s Financial Conditions Index (FCI), financing conditions during the last six years have been tight by historical standards. Moreover, in 2018 they tightened further when compared with 2017.

The total assets of domestic monetary financial institutions (MFIs) in Malta rose during 2018, contrasting with a drop in the asset holdings of international banks. Meanwhile, Maltese residents’ deposits continued to expand, remaining the main source of funding for resident MFIs. The shift away from longer term deposits towards more liquid overnight deposits persisted, in an environment of low interest rates and robust income growth. At the same time, growth in credit to residents expanded further, driven by faster growth in loans to the private sector. Lending to households was supported by a further expansion in mortgage loans, while lending to non-financial corporations (NFCs) recovered following recent weakness. NFCs also continued to increase their usage of capital markets as an alternative form of financing. Interest rates on both deposits and loans to Maltese residents fell during the year, with the spread between the two rates narrowing slightly from elevated levels.

In the primary market, domestic yields rose during 2018. Similarly, yields on five-year and ten-year Maltese government bonds increased, contrasting with downward movements in the corresponding euro area yields. In 2018, net government bond issues were negative. The private sector’s net issues remained positive, but decreased compared with 2017. In the equity market, the Malta Stock Exchange (MSE) Equity price index rose marginally when compared with the level registered at the end of December 2017.

Monetary aggregates and financial conditions

FCI tightens slightly further

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

According to the Bank’s FCI, financing conditions during the last six years have been tight by historical standards, reflecting negative contributions from domestic factors. Moreover, in 2018 they tightened further when compared with 2017, owing mainly to a lower contribution from foreign factors (see Chart 2.1). In particular, stock prices in the euro area contracted in 2018, amid slower growth. Conversely, domestic influences had a similar tightening effect on overall financing conditions during 2018, as the improvement in real credit was counterbalanced by lower net issues of securities and weaker bank profitability. Notwithstanding the tight financing conditions when compared with historical levels, the FCI remains well within its standard deviation.

**Domestic banks’ assets increase**

Total assets pertaining to the Maltese banking system (including the Central Bank of Malta) stood at €53,477.6 million at the end of 2018, signifying a drop of €3,337.3 million when compared with 2017. This drop masks contrasting developments in the assets of domestic and international banks.

During the year under review, assets pertaining to international banks dropped by €5,265.2 million. On the other hand, assets of core domestic MFIs increased by €1,164.4 million, or 5.1%. As a result, the share of core domestic banks' assets in GDP stood at 195.8% at the end of 2018, down from 202.9% a year earlier (see Chart 2.2).

At the same time, assets pertaining to non-core domestic banks rose by €491.7 million.

**Maltese residents’ deposits continue to expand**

Total deposits held by Maltese residents with MFIs in Malta remained at historical highs during 2018, reaching €18,906.7 million by the end of the year (see Table 2.1). This signifies an increase of €992.8 million, or

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### Table 2.1

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Overnight deposits</td>
<td>15.7</td>
<td>10.2</td>
<td>7.7</td>
<td>14,439.8</td>
<td>1,028.0</td>
</tr>
<tr>
<td><em>of which</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>17.2</td>
<td>15.8</td>
<td>14.5</td>
<td>8,713.4</td>
<td>1,100.2</td>
</tr>
<tr>
<td>NFCs</td>
<td>9.3</td>
<td>4.9</td>
<td>3.8</td>
<td>3,349.5</td>
<td>124.1</td>
</tr>
<tr>
<td>Deposits redeemable at notice up to 3 months</td>
<td>-15.2</td>
<td>-56.2</td>
<td>63.2</td>
<td>73.8</td>
<td>28.6</td>
</tr>
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<td><em>of which</em></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>-16.4</td>
<td>-51.5</td>
<td>-9.9</td>
<td>35.0</td>
<td>-3.8</td>
</tr>
<tr>
<td>NFCs</td>
<td>-49.2</td>
<td>-69.5</td>
<td>530.2</td>
<td>19.7</td>
<td>16.6</td>
</tr>
<tr>
<td>Deposits with agreed maturity up to 2 years</td>
<td>-9.3</td>
<td>-1.6</td>
<td>-5.6</td>
<td>2,937.9</td>
<td>-174.6</td>
</tr>
<tr>
<td><em>of which</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>-8.7</td>
<td>-3.1</td>
<td>-6.3</td>
<td>2,283.7</td>
<td>-154.8</td>
</tr>
<tr>
<td>NFCs</td>
<td>-20.6</td>
<td>23.7</td>
<td>-9.5</td>
<td>257.1</td>
<td>-27.0</td>
</tr>
<tr>
<td>Deposits with agreed maturity above 2 years</td>
<td>-0.4</td>
<td>-17.5</td>
<td>8.2</td>
<td>1,455.2</td>
<td>110.9</td>
</tr>
<tr>
<td><em>of which</em></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>-2.4</td>
<td>-17.7</td>
<td>3.8</td>
<td>1,273.0</td>
<td>46.5</td>
</tr>
<tr>
<td>NFCs</td>
<td>18.2</td>
<td>-29.7</td>
<td>9.9</td>
<td>68.6</td>
<td>6.2</td>
</tr>
<tr>
<td><strong>Total residents’ deposits</strong></td>
<td><strong>8.3</strong></td>
<td><strong>5.0</strong></td>
<td><strong>5.5</strong></td>
<td><strong>18,906.7</strong></td>
<td><strong>992.8</strong></td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.

(1) Total residents’ deposits exclude deposits belonging to Central Government.

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2 The core domestic banks in Malta are APS Bank Limited, Bank of Valletta plc, BNF Bank plc, HSBC Bank Malta plc, Lombard Bank Malta plc, and MeDirect Bank (Malta) plc.
5.5% when compared with December 2017. This high level of deposits mainly reflects robust income and employment growth in recent years, along with a strong preference for liquidity in an environment of low interest rates.

Indeed, overnight deposits remained the preferred category of deposits for residents during 2018. Annual growth in this component, which is the most liquid deposit category and comprises both demand and savings deposits, stood at 7.7% in December 2018, building on the increase of 10.2% registered a year earlier. As a result, by the end of the year, the share of overnight deposits in total deposits had risen to 76.4%, from 74.9% 12 months earlier (see Chart 2.3). This share has increased almost consistently since the end of 2012, when it stood at 51.4%, driven by a surge in demand from households.

In contrast to overnight deposits, time deposits with a maturity of less than two years contracted further in 2018, decreasing by 5.6%. Meanwhile, time deposits with a maturity above two years grew by 8.2% when compared with their end-2017 levels. Nonetheless, the share of time deposits in total deposits remained small, standing at 15.5% in the case of deposits with maturities of up to two years and 7.7% with respect to deposits with maturities of over two years. The share of deposits redeemable at notice of up to three months remained very small.

**Credit to residents expands**

Credit to Maltese residents expanded at a faster pace during 2018, reaching €13,531.3 million by the end of the year (see Table 2.2). This signifies an increase of €587.4 million over 2017 levels, or 4.5% in percentage

![Chart 2.3 DISTRIBUTION OF TOTAL RESIDENT DEPOSITS(1)](chart)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit to general government</td>
<td>1.4</td>
<td>0.2</td>
<td>-2.0</td>
<td>2,906.9</td>
<td>-60.6</td>
</tr>
<tr>
<td>Credit to residents outside general government</td>
<td>2.9</td>
<td>2.4</td>
<td>6.5</td>
<td>10,624.4</td>
<td>647.9</td>
</tr>
<tr>
<td>Securities and Equity</td>
<td>6.1</td>
<td>-4.9</td>
<td>5.1</td>
<td>442.1</td>
<td>21.6</td>
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<tr>
<td>Loans</td>
<td>2.7</td>
<td>2.7</td>
<td>6.6</td>
<td>10,182.3</td>
<td>626.4</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans to households</td>
<td>5.8</td>
<td>6.6</td>
<td>7.8</td>
<td>5,525.3</td>
<td>398.8</td>
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<tr>
<td>Mortgages</td>
<td>7.7</td>
<td>8.2</td>
<td>8.8</td>
<td>4,955.5</td>
<td>401.0</td>
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<tr>
<td>Consumer credit and other lending</td>
<td>-5.5</td>
<td>-4.2</td>
<td>-0.4</td>
<td>569.8</td>
<td>-2.2</td>
</tr>
<tr>
<td>Loans to NFCs(1)</td>
<td>-4.5</td>
<td>-1.8</td>
<td>7.1</td>
<td>3,830.4</td>
<td>254.2</td>
</tr>
<tr>
<td><strong>Total credit to residents</strong></td>
<td><strong>2.5</strong></td>
<td><strong>1.9</strong></td>
<td><strong>4.5</strong></td>
<td><strong>13,531.3</strong></td>
<td><strong>587.4</strong></td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.

(1) NFCs include sole proprietors and non-profit institutions serving households (NPISH).
terms. This expansion was wholly driven by developments in credit to residents outside general government (see Chart 2.4). On the other hand, after increasing marginally in 2017, credit to general government contracted by 2.0%, reflecting a drop in banks’ holdings of Malta Government Stocks (MGS). This is in line with a significant negative net issuance of MGS by Government during 2018 (see Table 2.4).

The acceleration in credit outside general government was mainly driven by a faster expansion in loans. Loans to residents grew by 6.6% during the year, as lending to households remained robust and loans to NFCs recovered strongly.

During the 12 months to December 2018, loans to households rose by 7.8% (see Chart 2.5). This component has grown continuously for a number of years, driven by lending for house purchases. Indeed, mortgage lending grew by 8.8% during 2018. On the other hand, consumer credit and other lending contracted once more, falling by 0.4% over the previous year’s level.

Following three years of contraction, loans to NFCs recovered during 2018, growing by 7.1%. A sectoral breakdown suggests that the recovery was supported by the extension of credit to various sectors of the economy, including construction and real estate, the accommodation and catering sector as well as professional and scientific activities (see Chart 2.6).

At the same time, supplementary data suggest that NFCs are also making use of alternative sources of finance, such as internal funding and capital markets.³ NFC

financing through the issuance of listed debt securities has grown in recent years, albeit from low levels. By the end of 2018, EUR 1,261.1 million in corporate debt was outstanding on the MSE, 10.2% higher than the listed amount 12 months earlier (see Chart 2.7). Issuance of equity capital has also increased.4

**Interest rates fall**

Interest rates on residents’ deposits with MFIs in Malta declined further in 2018, with the weighted average deposit rate offered to households and NFCs going down by 5 basis points to 0.33% by the end of the year (see Table 2.3).5 This was mainly driven by a drop in rates on households’ time deposits, partly offset by higher rates on shorter-term time deposits held by NFCs.

### Table 2.3

**INTEREST RATES ON DEPOSITS AND LOANS**

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total deposits</strong></td>
<td>0.69</td>
<td>0.48</td>
<td>0.38</td>
<td>0.37</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Overnight deposits</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>0.12</td>
<td>0.06</td>
<td>0.07</td>
<td>0.06</td>
</tr>
<tr>
<td>NFCs</td>
<td>0.11</td>
<td>0.03</td>
<td>0.04</td>
<td>0.06</td>
</tr>
<tr>
<td><strong>Time deposits (less than 2 years)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>1.11</td>
<td>0.79</td>
<td>0.78</td>
<td>0.75</td>
</tr>
<tr>
<td>NFCs</td>
<td>0.85</td>
<td>0.65</td>
<td>0.54</td>
<td>0.59</td>
</tr>
<tr>
<td><strong>Time deposits (more than 2 years)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>2.99</td>
<td>2.64</td>
<td>2.41</td>
<td>2.28</td>
</tr>
<tr>
<td>NFCs</td>
<td>2.26</td>
<td>2.03</td>
<td>1.98</td>
<td>2.04</td>
</tr>
<tr>
<td><strong>Total Loans</strong></td>
<td>3.81</td>
<td>3.68</td>
<td>3.64</td>
<td>3.64</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households and NPISH</td>
<td>3.60</td>
<td>3.52</td>
<td>3.48</td>
<td>3.46</td>
</tr>
<tr>
<td>NFCs</td>
<td>4.10</td>
<td>3.93</td>
<td>3.91</td>
<td>3.93</td>
</tr>
<tr>
<td><strong>Spread</strong></td>
<td>3.12</td>
<td>3.20</td>
<td>3.26</td>
<td>3.28</td>
</tr>
<tr>
<td>ECB MROs rate</td>
<td>0.05</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
</tbody>
</table>

*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.

---

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

5 Basis points are rounded to the nearest whole number.
Meanwhile, the weighted average lending rate paid to resident MFIs by households and NFCs fell by 9 basis points, reaching 3.55%. Both households and NFCs paid lower rates, though lending rates to NFCs remained above those charged to households, possibly reflecting differences in credit risk.

As a result, the spread between the weighted average lending rate and the deposit rate narrowed to 322 basis points at the end of 2018, from 326 basis points a year earlier. Nonetheless, the level of the spread remains elevated, suggesting that the transmission of the ECB’s monetary policy easing measures to retail lending rates remains weaker than that to deposit rates.

*Credit market conditions remain largely stable*

Results from the Bank Lending Survey (BLS) show that credit standards, and credit terms and conditions on loans to NFCs in Malta, remained largely unchanged in 2018. Only one bank reported some tightening in terms and conditions during the first quarter of the year. By contrast, the assessment of NFCs demand for credit was mixed. In the first quarter of the year half of the respondent banks reported an increase in demand, whilst the remaining banks reported a decline. During the second and third quarters of the year, the majority of banks reported stable demand. Increased demand however, was reported by most banks during the last quarter of the year.

Credit standards, terms and conditions for house purchases were mostly unchanged during the year. The majority of banks reported increased demand for credit for house purchases in the last three quarters of 2018.

Participating banks generally reported no changes to credit standards, terms and conditions for consumer credit and other lending to households during the year, though some easing was reported in the second quarter. Increased demand was reported by most banks in the first and last quarters of the year.

In reply to a series of ad hoc questions, the majority of banks participating in the BLS stated that their market access to wholesale and retail funding and their risk transfer capability did not change as a result of the situation in financial markets. Only one bank reported some impact on selected segments of its retail funding operations and the unsecured segment of its inter-bank money market.

Participating banks reported that the expanded APP as well as the reinvestment of the principal payments from maturing APP securities did not impact their financial situation and assets as well as their operations. Furthermore, most of the participating banks reported no impact on their credit standards, lending volumes and terms and conditions, though one bank reported some easing and an improvement in its overall liquidity position and financing conditions.

As regards the impact of the new regulatory or supervisory requirements relating to capital, leverage, liquidity, or provisioning on their assets, capital and funding conditions as well as on their lending policies, the majority of banks reported no impact. One bank however, reported a slight increase in its assets, capital and retained earnings in the first half of the year.

Banks participating in the BLS also reported that their NPL ratio did not impact their credit standards, and credit terms and conditions during 2018.
BOX 1: ACCESS TO FINANCE IN 2018

The Maltese economy has historically relied on SMEs. These have been the backbone of the rapid economic expansion in recent years. In fact, official statistics show that recently growth in value added of SMEs in the business economy sector was more than double that observed in the European Union (EU) as a whole. In contrast, larger business economy firms grew at a slower pace than their counterparts in the EU. The significant share of growth generated by domestic SMEs in recent years shows that the impression that Malta’s economic growth is exclusively driven by sectors such as remote gaming is not correct.

The latest Small Business Act (SBA) Factsheet also indicates that in 2017, Maltese SMEs generated significantly higher shares of value added and employment than SMEs in the EU. In that year, only 112 firms in Malta employed more than 250 persons. In contrast, micro firms which employ less than ten persons accounted for 97.3% of all firms, while small firms which employ between ten and 49 workers made up 2.2% of all enterprises. A further 0.5% of firms were medium-sized and employed between 50 and 249 persons.

In 2017 domestic SMEs generated 81.0% of value added and 80.9% of employment in the ‘non-financial business economy’. The corresponding figures in the EU stood at 66.4% and 56.8%, respectively. Despite their size, the value added of small and medium-sized enterprises increased by 62.7% between 2013 and 2017, while employment rose by 24.0%. Over this period, SME value added and employment in the EU increased by 15.1% and 7.1% respectively.

Several studies have shown that smaller firms are more likely to experience financial constraints such as transaction costs and information asymmetries, when compared with larger sized firms. Access to finance prevails as a critical determinant for the development of enterprises, in particular SMEs, which tend to have limited access to capital markets. As financing challenges affect the performance and growth of firms, it remains imperative to assess developments in the financial situation of enterprises including their ability to obtain finance when required. For this purpose, the ECB and the EC jointly conduct the bi-annual Survey on the Access to Finance of Enterprises (SAFE).

Results from the latest SAFE, which covered the period between April and September 2018, are presented in this Box and compared with those of previous waves with the aim of analysing the behaviour and expectations of domestic SMEs and compare them with those across other European economies.

Financial situation of SMEs

On balance, 29% of SMEs perceived an improvement in the general economic outlook, marginally higher than 27% a year earlier. In line with developments across the EU, the financial situation of domestic SMEs also improved. A larger proportion of SMEs in Malta (35% in 2018) reported net
increases in turnover compared with 33% a year earlier. The net balance of SMEs reporting higher profits rose to 12%, in contrast with the net balance of -1% in 2017. On balance, the proportion of SMEs that reported higher labour costs stood at 59% in 2018, significantly lower than 77% a year earlier, though the net balance of those reporting higher costs of materials and energy, amongst others edged up to 49% in 2018 from 29% in the preceding year.

Sources of finance utilised by SMEs
The financing sources deemed relevant by SMEs in Malta and in the EU are illustrated in Chart 1. The strong preference for bank-related products such as bank loans, overdrafts and credit lines as opposed to other market-based products and other sources of finance, persisted, though the share of domestic SMEs which used bank loans or expected to use them in the future fell compared with 2017. Nonetheless, SMEs in Malta continued to attach greater reliance on bank financing when compared with SMEs across the EU. In 2018, 74% and 53% of domestic SMEs considered overdrafts and bank loans respectively, as being highly relevant, in comparison with around 52% and 47% of firms respectively, across the EU.

Meanwhile, the proportion of SMEs that resorted to credit lines, bank overdrafts or credit card overdrafts declined from 64% in 2017 to 47% in 2018, though this share was still relatively higher than that of 35% across the EU (see Chart 2). The share of SMEs that used bank loans in both Malta and in the EU stood largely unchanged at 17%, when compared with a year earlier. Half of the surveyed SMEs in the EU and 39% of those in Malta considered bank loans as being irrelevant. Around three quarters of those SMEs that believed that bank loans were not relevant to their enterprise stated that they did not need this type of financing. Such SMEs mostly attributed this to insufficient collateral, too high interest rates, excessive paperwork or the unavailability of bank loans. In the EU, the share of SMEs claiming that this type of financing was not required stood much higher, at 75%.
During 2018 the share of SMEs which made use of retained earnings rose to 33% from 21% a year earlier, double the rate recorded in the EU. Across the EU, the relative number of enterprises that retained earnings or sold assets increased with the size of the enterprise, with a third of large enterprises (having at least 250 employees) making use of retained earnings in 2018 as opposed to just 15% of SMEs. Survey results also indicate that innovative, exporting SMEs which operate in industry are more likely to retain earnings or use proceeds from the sale of assets than those in services.

In contrast, the share of firms which resorted to trade credit fell to 29%, from 44% in 2017. Hence, trade credit, which had consistently represented the second most important source of credit for domestic SMEs after bank debt, was replaced by retained earnings. The share of SMEs in Malta that used trade credit and retained earnings was still higher than that across the EU. A significant degree of heterogeneity continued to prevail across counties as only 6% of firms in Germany and the Czech Republic obtained trade credit against 55% in Cyprus and 42% in the United Kingdom.

Malta had by far the largest proportion of SMEs that made use of this type of credit across the EU, with 28% of SMEs in Cyprus and as little as 7% of firms in Denmark resorting to this type of credit.

The latest survey tends to confirm that past patterns that have been observed with regard to the use of other sources of finance such as leasing or hire-purchase, grants or subsidised bank loans, and equity capital did not vary over time. For example, substantial divergence between SMEs in Malta and across the EU continued to prevail in 2018, with only 8% of SMEs using leasing or hire purchase compared with a quarter of SMEs across the EU. Debt securities, factoring and equity capital remained the three sources of finance that were least used in Malta and across the EU.

In 2018, more than half of the SMEs in Malta used external financing to finance inventory and working capital, while 45% of firms used it to finance fixed investment (see Chart 3). Whereas a larger proportion of SMEs in the EU (41%) resorted to external financing to fund fixed investment, EU firms were less likely than Maltese firms to use external funding for inventory and working capital (37%) and for the hiring and training of their employees (22%). Meanwhile, 45% of domestic SMEs used external finance for fixed investment in property, plant or equipment. Over time a larger proportion of SMEs has been obtaining external finance and investing it in human capital. In fact, whereas only 7% of domestic firms spent external funding on the hiring and training of employees in 2015, this share rose to 33% in 2018. This compares with 22% in the EU. Domestic and EU SMEs however, were more or less equally likely to use external finance to develop or launch new products, and refinance or pay off obligations.

![Chart 3: Uses of External Finance](source: SAFE (2018))
Most pressing problems facing SMEs

In addition to the often cited financial barriers, there are also a range of non-financial barriers that affect the growth of SMEs. These include problems with finding the right human capital as limited knowledge and skills can undermine firm growth, strong market competition, a burdensome regulatory framework, as well as costs of production or labour.

SMEs in Malta and across the EU cited the availability of skilled staff or experienced managers as the most pressing problem (see Chart 4). At 34%, the share of domestic SMEs which found it difficult to find the right staff has constantly exceeded the EU average. The latter stood at 25% in 2018. This partly reflects faster economic growth and lower unemployment in Malta. The share of firms citing labour shortages as a problem is comparable with that in Germany (35%), Austria (36%) and Finland (39%). In contrast, the proportion of SMEs that considered the shortage of skilled staff as their most concerning challenge was lower in France (28%), Italy (15%) and Greece (9%). Nonetheless, at an aggregate EU level, this challenge has become more pressing, with a quarter of SMEs considering it as their most challenging problem in 2018, up from 14% in 2013. Hence, unlike 2017, the problem with finding customers was not the most pressing one in 2018. Similar results were obtained from EIB Group Survey on Investment and Investment Finance (EIBIS) 2018, which confirmed that in Malta and across the EU, the availability of skilled staff was considered the main long-term barrier to investment, though the degree of concern of EU firms was lower than that amongst Maltese firms (77% of EU firms as opposed to 90% of domestic firms).

Meanwhile in Malta, competition stood as the second most pressing problem. This was highlighted by 14% of domestic SMEs. This compares with 11% of SMEs in the EU, though in both areas, the share of SMEs that considered this specific problem to be the most pressing has dropped over time. Domestically, the decline was more abrupt, halving from 30% in 2015 to 14% in 2018. This may reflect the fact that a growing economy tends to dampen the impact of competition as increased demand makes up for revenue lost to competitors.

Survey results show that in 2018, only 8% of domestic SMEs considered the ability of finding customers as their most challenging problem, down from 16% in 2017. This share was smaller than 12% and 11% of SMEs that viewed the costs of production and regulation as pressing issues, respectively. The share of SMEs that considered these latter issues to be most important problems increased when compared with a year ago and as at 2018 stood largely in line with shares observed across the EU.

Only 8% of domestic SMEs considered access to finance as a major problem. Hence, this issue retained its position as the least pressing problem for the third consecutive year. Similarly, across the EU, access to finance has steadily declined in importance throughout the years. Whereas in 2013 it was the second-most important problem, since 2015 it has...
become the least urgent problem reported by SMEs. Meanwhile, 17% of SMEs in Greece continued to view access to finance as their most challenging problem, though lower than 23% a year earlier.

**Terms and conditions of bank loan financing**

The survey shows that 55% of domestic SMEs believe that the availability of bank loan financing remained unchanged during 2018, substantially lower than 73% a year earlier and 64% of firms across the EU. At the time of survey, 62% of domestic SMEs in Malta as well as in the EU anticipated unchanged availability of such financing in the six months ahead.

Table 1 shows firms’ assessments of interest rates and other costs of financing. The proportion of domestic SMEs which reported an increase in interest rates fell to 13%, as a larger number of SMEs reported unchanged interest rates. Only 1% of firms in Malta reported a decline. The resulting effect was that of a net increase in interest rates, though lower than that observed in the preceding year.

In contrast, 57% of participating firms in the EU claimed that interest rates had remained largely stable compared with a year earlier. On balance, the net share of firms reporting higher interest rates in the EU was also positive in 2018. Around 23% of SMEs reported an increase in the level of interest rates, whereas 15% were faced with lower interest rates by banks. The resulting net effect amounts to a net increase of 7%, which contrasts with the negative net balance recorded in recent years.

With regards to developments in the cost of financing other than interest rates, just over half of domestic SMEs reported an unchanged level of costs such as charges, fees and commissions, largely unchanged from the proportion registered a year earlier, but significantly below 74% of participating SMEs in 2015. By contrast, the share that reported higher costs more than doubled from 22% to 47% over the same period. No domestic firms reported falling costs. As a result the net balance of SMEs reporting higher non-interest rate costs also doubled. In the EU the increase in this share was less pronounced.

<table>
<thead>
<tr>
<th>Table 1</th>
<th>INTEREST RATES AND COST OF FINANCING OTHER THAN INTEREST RATES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over the preceding six months; per cent of responding firms</td>
<td>Malta 2015</td>
</tr>
<tr>
<td><strong>Level of interest rates</strong>&lt;sup&gt;(1)&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>Increased</td>
<td></td>
</tr>
<tr>
<td>Unchanged</td>
<td></td>
</tr>
<tr>
<td>Decreased</td>
<td></td>
</tr>
<tr>
<td>Net balance&lt;sup&gt;(2)&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td><strong>Level of cost of financing other than interest rates (e.g. charges, fees, commissions)</strong>&lt;sup&gt;(1)&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>Increased</td>
<td></td>
</tr>
<tr>
<td>Unchanged</td>
<td></td>
</tr>
<tr>
<td>Decreased&lt;sup&gt;(2)&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>Net balance&lt;sup&gt;(2)&lt;/sup&gt;</td>
<td></td>
</tr>
</tbody>
</table>

Source: SAFE.

<sup>(1)</sup> ‘Do not know/not available’ replies are not included in the Table. Hence, figures for the ‘increased’, ‘unchanged’ and ‘decreased’ do not add up to 100 in some cases.

<sup>(2)</sup> The ‘net balance’ is the difference between those respondents reporting an increase and those claiming a decrease in interest rates and cost of financing, respectively.
In 2018, the mean interest rate on bank overdraft and credit lines paid by SMEs across the EU amounted to 3.65%, higher than that of 2.04% reported a year ago. A significant degree of heterogeneity across countries prevails. The mean interest rate stood at 4.02% in Malta, below that registered in Greece (5.93%) and the United Kingdom (5.69%). Meanwhile, the lowest rates were observed in Finland (1.71%), Belgium (1.88%) and Austria (2.00%). Almost half of the EU countries registered an increase in interest rates charged to SMEs in 2018.

Credit demand and supply

A salient feature of the SAFE is the information it provides on the supply (availability of financing) and demand (need for financing). Table 2 shows the number of firms that applied for bank loans, trade credit, overdrafts and credit lines since 2015. The proportion of SMEs that applied for these facilities increased significantly in 2018 when compared with preceding years, though the rise in the share of those that applied for bank loans was more moderate. Meanwhile, the percentage of respondents that applied for trade credit increased substantially.

This survey round re-affirmed past trends: only a very small proportion of firms chose not to apply for these types of financing because they feared a possible rejection. The proportion of SMEs that chose not to apply because of sufficient internal funds rose only marginally. In contrast, as in the EU, a substantial increase was reported in the percentage of domestic SMEs which did not apply for bank loans of trade credit because they had sufficient internal funds.

SAFE results shed light on developments in the credit standards applied by banks to their customers by asking participating firms that had applied for the various financing instruments whether their application had been accepted or rejected. In the case where an application was accepted, firms are asked to specify whether the full amount or a part of it was given, or else whether the offer was refused because the cost was too high.

Table 3 shows the success rate of loan applications between 2015 and 2018. In 2018, nine out of every ten firms that applied for bank overdraft, credit lines and cards, got everything. This share edged up compared with the preceding years. A similar proportion was reported in the case of trade credit. In contrast, the proportion of firms that were given the full amount of bank loans that they applied for dropped to 44% from 65% a year earlier. None of the domestic firms participating in the survey refused to take any of the financing items listed in Table 3 because the cost was too high.

<table>
<thead>
<tr>
<th></th>
<th>Bank overdraft, credit line or credit card overdrafts</th>
<th>Bank loans</th>
<th>Trade credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applied over the past 6 months</td>
<td>26</td>
<td>27</td>
<td>16</td>
</tr>
<tr>
<td>Did not apply because of possible rejection</td>
<td>0</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Did not apply because of sufficient internal funds reasons</td>
<td>51</td>
<td>45</td>
<td>31</td>
</tr>
<tr>
<td>Source: SAFE.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Whereas no SMEs in Malta were rejected when applying for bank overdrafts or trade credit, slightly more than a tenth of firms that applied for bank loans had their application rejected.

**Conclusion**

SMEs have historically played a dominant role in the Maltese economy both in terms of value added generation as well as in the creation of employment. Hence, they have been significantly beneficial in making the economy less susceptible to idiosyncratic shocks. Looking forward into 2019, growth in SME value added is predicted to remain strong, increasing by an annual average of 9.0% between 2017 and 2019.

The pace of growth of SMEs however, depends on a number of challenges. EIBIS 2018 reports that almost seven in ten firms (69%) in Malta reported operating at or above maximum capacity, above the EU average of 54%. This implies that firms need to invest more to meet higher production expectations in the future. Although the last survey round confirms that access to finance is the least pressing problem for domestic SMEs, improved access remains desirable, as support from retained earnings is bound to diminish as economic activity normalises. Labour shortages, moreover, remain a pressing problem, which firms have sought to address by increasing investment in human resources. The need for such investment can be expected to persist in a dynamic economy.

Survey results also show that although a smaller net share of firms reported a rise in interest rates, the net share of firms reporting increases in non-interest costs of financing increased markedly. Moreover, while the success rate of credit lines, bank overdrafts, credit cards and trade credit has increased, the share of respondents that applied for a bank loan and received the full amount was the lowest since 2015. In this regard, the Malta Development Bank can assist in the provision of funding at affordable costs for SMEs that may not be familiar with credit institutions.

### Table 3

<table>
<thead>
<tr>
<th>Applied and got everything</th>
<th>Bank overdraft, credit line or credit card overdrafts</th>
<th>Bank loans</th>
<th>Trade credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applied and got most of it (1)</td>
<td>69 54 60 90</td>
<td>72 68 65 44</td>
<td>56 61 62 90</td>
</tr>
<tr>
<td>Applied but only got a limited part of it (2)</td>
<td>6 10 0 0</td>
<td>15 14 0 6</td>
<td>14 10 19 7</td>
</tr>
<tr>
<td>Applied but refused because cost too high</td>
<td>7 0 5 0</td>
<td>0 0 6 12</td>
<td>20 5 8 0</td>
</tr>
<tr>
<td>Applied but was rejected</td>
<td>0 5 0 0</td>
<td>0 0 0 0</td>
<td>0 0 0 0</td>
</tr>
<tr>
<td>Source: SAFE.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1) between 75% and 99%.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(2) between 1% and 74%.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The money market

The ECB continued with its accommodative monetary policy stance during 2018. The interest rate on the MRO, on the marginal lending facility and the deposit facility stood unchanged at 0.00%, 0.25% and -0.40%, respectively. Consequently, money market rates in the euro area remained in negative territory, with the three-month EURIBOR ending 2018 at -0.31%, marginally higher than the rate of -0.33% at the end of 2017 (see Chart 2.8).

In the domestic primary market, the yield on three-month Treasury bills also rose. It was -0.35% at the end of 2018, up from -0.38% 12 months earlier.

In total, the Treasury issued €1,209.4 million worth of bills in 2018, a significantly larger amount compared with issues of €588.6 million in 2017. Nonetheless, the amount of Treasury bills issued was lower than the amount of maturing bills, which stood at €1,041.3 million in 2018. The majority of bills issued had a maturity of three months, followed by those with a maturity of six months. New bills issued with a longer maturity made up slightly less than a fifth of all bills.

In the secondary market, the yield on three-month German government securities, which acts as a benchmark for euro area yields, decreased by 4 basis points, to -0.87% in December 2018 from -0.82% at the end of 2017. Consequently the spread between the domestic rate and the euro area benchmark widened to 51 basis points from 44 basis points a year earlier.

The capital market

In the capital market, total issues of long-term debt by the Government and the private sector fell further to €267.5 million in 2018, from €597.5 million in 2017. Net issues during the year were negative at €209.0 million, compared with positive net issues of €151.9 million in 2017, largely as the Government reduced its issuance of MGS, while recording higher redemptions. Although still positive, net issues by the private sector decreased.

MGS issues fall substantially

In 2018 the Government issued €150.3 million in long-term debt, but redeemed €391.0 million, such that net issues for the year were negative (see Table 2.4). Two main bond issues took place in December, with maturity dates of six and 11 years. Both of these were oversubscribed and taken up by credit institutions.
The amount of outstanding MGS fell to €4,852.7 million at the end of 2018, of which 88.4% were held domestically. Resident credit institutions remained the main holders of outstanding MGS, though their share edged down marginally to 45.4% in December. The share of MGS held by resident individuals stood at 22.9%. Holdings of non-residents comprised 11.6% of total outstanding MGS (see Chart 2.9).

Secondary market turnover of MGS fell further during 2018. It stood at €212.7 million, compared with €403.8 million a year earlier.

Secondary market yields on domestic MGS rose during 2018, with the five and ten-year yields rising by 25 and 13 basis points, respectively, to 0.44% and 1.33% at end-December (see Chart 2.10). By contrast, in the euro area, the benchmark five-year yield fell by 7 basis points on its end 2017 level, closing the year at -0.27%. The euro area ten-year yield edged down by 18 basis points to 0.25%. Consequently, the spread between the five-year and ten-year yields in Malta and their euro area benchmark widened during the year. At the end of 2018, the spread on the five-year and ten-year yields stood at 70 and 108 basis points, respectively.
Corporate bond issues fall markedly

In the corporate bond market, new issues of long-term private debt listed on the MSE stood at €117.3 million in 2018. As the amount of redemptions and buybacks amounted to €85.5 million, net issues stood at €31.8 million, €129.7 million lower than those in the preceding year. Six private companies had new bonds listed on the MSE during 2018. By the end of December 2018, 12 firms had listed bonds through Prospects, up from four a year earlier. Hence, €51.0 million were issued through this facility in 2018.6

Turnover in the secondary corporate bond market rose significantly during 2018, up to €93.7 million from €76.5 million in the previous year.

MSE index rises

In 2018, turnover in the equity market fell marginally to €86.3 million, from €88.0 million a year earlier. Around 40% of turnover was dominated by the banking sector. The MSE Equity Price Index rose marginally by 0.1% during 2018, and ended the year at 4,514.4 (see Chart 2.11). Almost half of the 25 equities in the index registered an increase in prices in 2018.

Meanwhile, the MSE Equity Total Return Index, which accounts for changes in equity prices and dividends, stood 3.8% higher than its level at end-December 2017.

BOX 2: OVERVIEW OF THE FINANCIAL ASSETS AND LIABILITIES OF THE MALTESE ECONOMY BY INSTITUTIONAL SECTOR1,2

The Central Bank of Malta has been compiling Malta’s Financial Accounts statistics since 2004. The latest available statistics in this regard refer to September 2018. Financial accounts statistics provide comprehensive information on the financial assets and liabilities of the Maltese economy classified by institutional sectors, namely households, NFCs, financial corporations (including credit institutions), the general government, and the ‘rest-of-the-world’ sector.3,4

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

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

2 For the purpose of this Box, the term ‘Maltese economy’ is used interchangeably with the term ‘resident sectors/economy’.


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

6 Prospects is a multi-lateral trading facility operated by the MSE with the aim of facilitating access to capital markets for SMEs.
Net financial wealth of the Maltese economy

Sectoral level balance sheet statistics on net financial wealth show that overall, the resident economic sectors continued to be net lenders in September 2018 (see Chart 1). Their net financial wealth of the total resident economy amounted to €6,281.1 million compared with €6,943.6 million in December 2017. The decrease was mainly driven by a drop in the net financial wealth of financial corporations and NFCs which offset the improvement in net financial wealth of both households and the general government sector.

Financial assets and liabilities of the financial corporations sector

The aggregate net financial wealth of Malta’s financial corporations, including the credit institutions, amounted to -€1,229.4 million in September 2018, down from €418.9 million at the end of 2017. The decrease since December 2017 was mainly due to a higher level of liabilities, largely in the form of equity, which exceeded the growth in financial assets.

Chart 2 shows the main contributors to net financial wealth of the financial sector. Over the period December 2017 to September 2018, net holdings of debt securities decreased significantly, even if this category continued to show a net asset position. Loans, which explain most of the net asset position of this sector, were broadly flat. The decrease in holdings of debt securities offset smaller decreases in net liabilities arising from deposits held with this sector and from accounts payable.

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5 Net financial wealth is defined as the difference between financial assets and liabilities. It shows which sectors are net lenders and which are net borrowers.

6 In line with the European System of Accounts (ESA) 2010, financial corporations include the central bank, depositary-taking corporations except the central bank, money market funds, non-money market funds, insurance corporations, pension funds, other financial intermediaries, financial auxiliaries and captive financial institutions and money lenders.
Financial assets and liabilities of the general government

The net financial wealth of the general government has been persistently in negative territory since 2004, although this negative position has been narrowing since 2016, reflecting the improvement in the government’s fiscal position. In September 2018 this stood at €3,630.0 million, improving by €281.8 million or 7.2%, when compared with December 2017. Chart 3 shows that the general government remained a net asset holder of equity and currency and deposits and a net liability holder, mainly of debt securities. The smaller net liability position since end 2017 was driven by a decrease in debt securities outstanding, which offset an increase in accounts payable and, on the asset side, a small decrease in deposits.

Financial assets and liabilities of NFCs

Chart 4 shows the net financial wealth of NFCs. These had net financial liabilities of €8,968.6 million as at September 2018, an increase of €376.2 million or 4.4% since December 2017. This was due to an increase in liabilities outstripping the increase in financial assets. In September 2018, NFCs continued to be net asset holders of currency and deposits and net liability holders mainly of loans, equity and other accounts payable. When compared with December 2017, the increase in NFCs’ net liability position is due to the increase in their financing through loans and equity which offset a rise in holdings of currency and deposits.

Financial assets and liabilities of households

In September 2018, households’ net financial wealth reached €20,089.1 million. It thus increased by 5.6%, or €1,060.3 million, when compared with December 2017. This was due to an increase in holdings of financial assets, which surpassed the increase in liabilities. Chart 5 shows that households maintained large net assets in the form of currency and deposits, and equity, but also held smaller net asset positions related to insurance products as well as bonds. By contrast, this sector was a net liability holder of loans and other accounts payable. The improved net financial wealth position since 2017
Central bank of Malta

was driven by an increase in currency and deposits, and equity, which offset an increase in loans mainly for mortgage purposes.

Malta’s private sector debt

Financial accounts statistics also shed light on Malta’s private sector debt. In line with the methodology prescribed by the EC’s MIP which inter alia produces such indicators on an annual basis, Chart 6 shows Malta’s consolidated private sector debt split by sector and compares it to the consolidated private sector debt of the euro area. The chart shows that in total, up to 2016, Malta’s consolidated private sector debt as a per cent of GDP has been relatively higher than the threshold of 133% prescribed by the EC under the MIP although this ratio has been constantly falling since 2012.7,8 In 2017, the indicator decreased below the set threshold and was at its lowest level since 2012. The indicator stood at 129.3%, down from 134.4% in 2016. The fall in private sector debt as a proportion of GDP between 2016 and 2017 was principally driven by a decrease in NFCs’ debt ratio, which fell by 3.6 percentage points, although households’ debt also decreased, from 51.0% of GDP in 2016 to 49.5% in 2017.

Up to 2014, Malta’s consolidated private sector debt was also higher than that of the euro area, though it then fell at a faster rate than the latter. By 2017, it stood 7.7 percentage points lower than the euro area average.

While household debt in Malta has been typically lower than that of the euro area, the consolidated debt of the resident NFCs was higher than its euro area counterpart for the period between 2012 and

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

2014. Since 2015 the resident NFCs debt ratio was consistently lower than that in the euro area. In 2017, the private sector debt indicator for Malta reached 79.8% of GDP, which is marginally below the debt ratio of NFCs within the euro area, which stood at 80.1%.

Generally, corporate debt constitutes more than half of the consolidated private sector debt in Malta. Chart 7 shows the debt of NFCs in the form of debt securities and loans by creditor sectors, that is, financial corporations, households, NFCs, general government and the rest of the world. From this perspective, the largest exposures stemmed from liabilities to financial corporations and the NFC sector itself.

Firms in Malta rely significantly more on loans than on debt securities. Even though the issuance of debt securities increased over the years, this still remained relatively low, amounting to 4.3% of total NFCs’ debt in the third quarter of 2018. Over the years, bank credit has been one of the main sources of financing for NFCs, although the importance of this source of funding has been declining over the last few years. In turn, non-bank financing became more significant, particularly taking the form of intra-group lending or lending from related parties. In fact, as at September 2018 loans from other corporates amounted to €6,531.2 million, or 40.4% of total NFCs’ debt while loans from financial corporations, mainly bank loans, amounted to €3,587.7 million or 22.2% of total NFCs’ debt. Another important source of finance for resident corporates were loans from abroad which amounted to €3,129.3 million in September 2018, reflecting the number of foreign-owned subsidiaries operating in Malta. Meanwhile, loans from households (mainly from directors and shareholders) amounted to €1,023.6 million in September 2018.

Chart 8 shows that households’ debt as at end September 2018 stood at

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€5,881.9 million, increasing by €289.9 million since end December 2017 primarily due to an increased take-up of loans from credit institutions. Households’ debt is in fact composed mainly of loans from credit institutions. These amounted to 96.8% of households’ debt. The remaining debt mainly consists of directors/shareholders’ loans, which amounted to around €177.4 million. Nonetheless, household debt as a ratio of their total assets declined marginally from 21.8% in December 2017 to 21.6% in September 2018, reflecting lower leverage and hence a strengthening of this sector’s financial resilience.

**Financial interlinkages between resident sectors**

Financial accounts identify financial linkages among economic sectors, whereby one sector is an asset holder while the counterpart sector is the borrower. Such accounts are also referred to as the from-whom-to-whom accounts. Chart 9 shows the interlinkages between the resident sectors as at September 2018. The largest holders of assets of the financial sector are intra-sectoral holdings, that is, holdings with other financial corporations, mainly in the form of equity and investments funds and deposits. This amounted to 61.0% of their total domestic holdings in the third quarter of 2018, a marginal decrease from 61.5% in December 2017. Chart 9 also shows that the financial sector has significant interlinkages with households and NFCs mainly through banks’ funding. Moreover, the general government holds around 48.6% of its total domestic financial assets with the financial sector, which decreased from 53.1% in December 2017, primarily in the form of deposits. With regards to NFCs, the majority of their assets are held by other NFCs. They rose marginally to 63.8% of their total domestic assets from 63.6% over the period December 2017 to September 2018. Finally, households’ domestic financial asset holdings with the financial sector increased to 82.2% in September from 81.6% in December 2017. These were mainly in the form of deposits, showing the importance of households’ assets for funding and liquidity of banks.

Further statistical information can be found on the website of the Central Bank of Malta at: [www.centralbankmalta.org/financial-accounts](http://www.centralbankmalta.org/financial-accounts).

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10 The comparison with interlinkages between resident sectors as at December 2017 are not being shown graphically since there were no major changes.
3. OUTPUT, EMPLOYMENT AND PRICES

Potential output growth of the Maltese economy eased from 7.0% in 2017 to 5.7% in 2018, mainly reflecting a smaller contribution from capital. Nonetheless, it remained high from a historical perspective. The output surplus is estimated to have widened to 1.0%, from 0.2% in 2017, but remained well below the most recent high estimated for 2015. Similarly the Bank’s Business Conditions Index (BCI) continued to indicate above-average conditions in 2018, but the index was down marginally from the previous two years.

GDP continued to grow at a fast pace. In 2018 it rose by 6.6%, following a 6.7% increase in 2017. The expansion was largely driven by domestic demand, although the contribution from net exports was also positive. Nominal gross value added (GVA) data show that the expansion continued to be largely supported by services, although the manufacturing and construction sectors also expanded.

Labour Force Survey (LFS) data for the first three quarters of 2018 show that, against the backdrop of a buoyant economy, employment continued to rise. Eurostat data for 2018 show that the unemployment rate decreased further and remained well below that in the euro area. It was also lower than the Bank’s estimate of the structural measure.

These favourable labour market developments are corroborated by data based on administrative sources, which show that in 2018 the average number of registered unemployed fell by 653, to 1,847 persons, with the number in December standing even lower, at 1,765.

Annual inflation based on the HICP rose to 1.7% in 2018, from 1.3% in 2017. This was similar to the rate registered in the euro area. In contrast, inflation measured by the RPI eased to 1.2%, from 1.4% in the previous year. These contrasting developments mainly reflected the inclusion of tourist expenditure in the HICP basket.

Meanwhile, domestic cost pressures accelerated further, with the annual average rate of change of the industrial producer price index reaching 4.6% in 2018. Malta’s harmonised competitiveness indicators (HCIs) continued to indicate a deterioration in international price competitiveness, on account of unfavourable euro exchange rate and relative price movements. Malta’s unit labour cost (ULC) index registered moderate growth of 0.9% during the year.

Potential output and BCI

Positive output gap widens

In 2018, potential output growth eased to 5.7%, from 7.0% in 2017 (see Chart 3.1). Notwithstanding this deceleration, potential output growth remained elevated from a long-term perspective. Meanwhile, GDP growth edged down marginally, from 6.7% in 2017 to 6.6% during the year under review.

Reflecting these developments, the positive output gap is estimated to
have reached 1.0%, from 0.2% in 2017. Even after this widening, the degree of overutilization of the economy’s productive capacity remains well below that in 2015, when the output gap was 2.4%. Potential growth continues to be boosted by an increasing number of foreign workers and higher labour participation, with the labour contribution remaining close to its historical high. On the other hand, the contribution of capital during 2018 was less pronounced than in the previous three years.

BCI improves

The Bank’s BCI continued to signal above-average conditions (see Chart 3.2). The index averaged 0.9 during 2018, compared with 1.0 in 2017. This marginal deterioration reflected the contraction in industrial production, though the index was buoyed upwards by a decrease in unemployment and the continued strong growth in tourism. Economic conditions appear to have been broadly similar to those prevailing in 2016 and 2017, but much less buoyant relative to 2015.

GDP and industrial production

Real economy continues to grow at a fast pace

The Maltese economy continued to grow at a brisk pace in 2018. Real GDP rose by 6.6%, following a 6.7% increase in 2017. This rate was more than three times that registered in the euro area.

The expansion was underpinned by domestic demand, although net exports also had a positive contribution (see Table 3.1). Domestic demand contributed 5.1 percentage points to GDP growth, reflecting strong increases in private and in government consumption. At the same time, the contribution of changes in inventories turned positive. Conversely, gross fixed capital formation declined. With exports rising almost twice as fast as imports, the contribution of net exports remained positive, although it was weaker than that registered a year earlier.

Private consumption increased by 7.3%, after growing by 3.6% in 2017, and contributed 3.2 percentage points to GDP growth. Nominal data show higher spending across all main expenditure categories, as households continued to benefit from strong, if moderating, growth in compensation of employees in the context of very favourable employment prospects.

Government consumption rose sharply in 2018. It increased by 11.7%, following a 2.1% expansion in 2017. The recent increase mainly reflected growth in the two principal components of government consumption, intermediate consumption and compensation of employees, as well as a decrease in sales. The latter, which are netted against expenditure in the national accounts, had been boosted by exceptionally large inflows related to the Individual Investor Programme (IIP) in 2017.

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

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

4 The analysis of GDP in this Chapter is based on data published in NSO News Release 038/2019 published on 8 March 2019.
Gross fixed capital formation decreased by 3.7% in 2018, lowering GDP growth by 0.8 percentage point. Although dwelling investment rose strongly, this was offset by lower outlays on non-residential investment and machinery, which mostly reflected some normalisation from the heavy outlays of 2017 observed in the printing and aviation sectors.

Changes in inventories also supported activity, adding 0.9 percentage point to GDP growth in 2018.

Exports rose by 2.1% while imports added 1.3% on a year earlier. As a result, net exports contributed 1.4 percentage points to overall GDP growth, with this positive contribution driven by a further widening in the surplus from services. Although the goods deficit continued to narrow, this narrowing was far more limited compared to 2017.

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

Nominal GDP rose by 8.9% in annual terms in the year under review, after increasing by 9.4% in the previous year (see Table 3.2). The deceleration was entirely due to slower growth in GVA, which rose at an annual rate of 8.3%, after growing by 9.2% in 2017. In 2018, GVA contributed 7.4 percentage points to nominal growth.\(^5\)

Services remained the main driver of activity, accounting for 6.1 percentage points of nominal GDP growth. The largest additions within the services sector came from arts and entertainment, from the sector comprising public administration and from professional and scientific activities. Together, these three sectors contributed 4.1 percentage points to nominal GDP growth. Wholesale and retail trade, financial and insurance activities, real estate as well as information and communication jointly added a further 2.0 percentage points. The contribution from manufacturing stood at 0.6 percentage point, while that from construction was relatively lower, at 0.3 percentage point. The agriculture and fishing sector and the sector comprising utilities each contributed 0.2 percentage point to nominal GDP growth.

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\(^5\) The difference between nominal GDP and GVA is made up of taxes on products, net of subsidies.
GDP data by income distribution show that gross operating surplus grew at a more moderate pace of 9.7%, following a 10.5% increase in 2017. Gross operating surplus contributed 4.6 percentage points to nominal GDP growth (see Chart 3.3). Compensation of employees also decelerated, although to a limited extent, with growth standing at 7.2% in 2018, after 7.6% in 2017. The latter added 2.9 percentage points to nominal growth. Net taxes on production and imports explain the remaining 1.3 percentage points of nominal GDP growth.

Almost all sectors registered higher gross operating surplus when compared with a year earlier. The largest increases in absolute terms were recorded in arts, entertainment and recreation and in the real estate and manufacturing sectors.

Compensation of employees continued to grow strongly in all sectors, with the largest absolute increases registered in public administration, professional, scientific and technical activities, the arts, entertainment and recreation sector and the sector comprising wholesale and retail trade.

**Industrial production declines**

Industrial production declined by 1.6% in 2018, following an expansion of 4.0% in 2017 (see Table 3.2).
The decrease was entirely driven by the manufacturing sector, which has the largest weight in the index of industrial production. The volume of production in this sector dropped by 1.9% in 2018, following an increase in 2017. Production in the energy sector rose at a slower pace compared with the preceding year. On the other hand, output in the quarrying sector rose sharply after declining in 2017, although this sector holds a minor share in the overall indicator.

The fall in manufacturing activity in 2018 was broad-based across sectors. Production fell by 14.4% in the pharmaceuticals sector and by 14.0% among firms that produce computer, electronic and optical products. Meanwhile, firms producing rubber and plastics recorded a fall of 11.1%. Similarly, production fell among food and beverage producers, declining by 7.7% and 3.1% respectively. On the other hand, production expanded sharply among firms involved in the printing and reproduction of recorded media, although these increases offset only part of the falls in other sectors.

Data on manufacturing sales point to an expansion in turnover of 3.8% in 2018, following a rise of 1.8% in 2017. This rise in turnover reflects increased sales to both the domestic and export markets.

**Construction**

*Construction sector continues to expand*

The number of permits for residential units issued by the Planning Authority continued to increase strongly. In 2018, permits rose for the fifth consecutive year, reaching the highest level since 2007. Permits issued stood at 12,885, up from 9,822 in the previous year (see Table 3.4).

The largest increase was recorded in permits for the construction of apartments, which is the largest category and accounted for 87.0% of total residential permits issued in 2018. Permits issued for maisonettes and terraced houses also rose during the year under review and accounted for 9.0% and 3.1% respectively of all residential permits issued during the year. On the other hand, permits issued for other dwellings declined marginally over the year and reached a four-year low.

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

7 Data on manufacturing sales are sourced from Eurostat.
Construction investment increased by 4.1% in nominal terms, following an increase of 26.0% in 2017. The increase was entirely driven by residential buildings, which rose by 22.5%, following an increase of 46.0% in the previous year. Meanwhile, non-dwelling investment declined by 11.8%, after rising by 12.7% in 2017.

GVA in the construction sector also increased at a slower pace during 2018. It rose by 10.3% following an increase of 11.1% in the preceding year (see Table 3.5). Jobsplus data for the first nine months of 2018 show that the number of persons employed in the construction sector rose by 517, or 4.6%, compared with the same period of 2017. This followed a 4.5% increase in 2017. Private sector employment increased by 5.4%, but was partly offset by a fall in employment in the public sector. Meanwhile, according to national accounts data for the full year, compensation of employees increased by 5.8%, following an increase of 5.1% in the preceding year.

The construction sector’s share in the total gainfully occupied population fell marginally to 5.8%, from 5.9% in 2017. Growth in headcount remained below that in the economy as a whole, which averaged 6.1% between January and September 2018.

The labour market

Employment continued to grow in the first three quarters of 2018

During the first three quarters of 2018, employment expanded at an average annual rate of 6.5%, as against 5.4% during the corresponding period of 2017 (see Table 3.6). Following this acceleration in the pace of job creation, employment growth has risen further above the long run average of 2.9% (see Chart 3.4).

The increase in the number of jobs during the first three quarters of the year was underpinned by a rise in full-time employment, which went up by 12,443 persons. Part-time employment also increased, although to a lesser extent, rising by 1,628 persons in annual terms.

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*This section draws mainly on labour market statistics from two sources: the LFS, which is a household survey conducted on a quarterly basis by the NSO on the basis of definitions set by the International Labour Organization (ILO) and Eurostat, and administrative records compiled monthly by Jobsplus (previously, the Employment and Training Corporation), according to definitions established by domestic legislation on employment and social security benefits.*
The labour force expanded by 6.2% on average in the first nine months of 2018. As a result, the activity rate went up by 2.2 percentage points on a year earlier, to 73.9%, exceeding the euro area average of 73.3%.

The female activity rate posted the strongest gain, rising by 3.1 percentage points to 62.9%. Notwithstanding this increase, the female rate remained below the euro area average of 67.9%, reflecting low activity rates among older women. The male activity rate edged up by 1.3 percentage points to 84.2%, standing higher than the euro area average of 78.7.

Meanwhile, the overall employment rate rose by 2.3 percentage points to 71.0%.

Apart from buoyant economic conditions, additions in activity and employment rates partly reflect the continuation of active labour market policies. These were aimed at increasing employment among the more challenged jobseekers, as well as encouraging inactive persons to join the labour market.
Unemployment rate reaches a new low
The unemployment rate edged down as job creation outpaced growth in the supply of labour. The seasonally adjusted unemployment rate published by Eurostat, which takes into account LFS data up to the third quarter as well as more recent developments in administrative data, averaged 3.8% in 2018, lower than the average of 4.0% recorded in 2017 (see Chart 3.5).\(^1\) It also remained below the Bank’s estimate of the structural measure and thus continued to suggest a degree of tightness in the labour market during the year under review. Furthermore, Malta’s unemployment rate remained well below the average rate for the euro area, which stood at 8.2% in 2018.

Indeed, on average in 2018 the number of unemployed based on Jobsplus data fell by 653 persons over 2017 (see Chart 3.6). Apart from a growing demand for labour in the context of robust economic growth, the drop in the number of registered unemployed reflected the extension of previously introduced measures aimed at facilitating the transition from inactivity to activity and improving the employability of specific target groups. Such schemes include the Tapering of Benefits Scheme, the Access to Employment Scheme, the Bridging the Gap Scheme, the Youth Guarantee Scheme, the Mature Workers Scheme and the Work Programme Initiative.

The drop in the number of unemployed was broad-based across all age groups, but the greatest decrease was registered among those aged 30 and over. Indeed, the number of unemployed aged between 30 and 44 fell by 256 persons to 528, while those aged 45 and over fell by 251 to 919. The fall was also broad-based across all duration categories, although the largest declines were registered among the long-term unemployed who would have been on the unemployment register for one year or more.

Business and consumer surveys

Economic sentiment remains broadly unchanged at a high level in 2018
During 2018 the EC’s Economic Sentiment Indicator (ESI) for Malta averaged 112.0, from 112.5 in 2017 (see Table 3.7).\(^1\) Confidence edged down marginally in industry and in the retail sector. On the other hand, confidence in the services sector continued to rise, reaching a healthy 121.4 in 2018.

\(^1\) According to the LFS, the unemployed comprise persons above 15 years of age who are without work, available for work and who have actively sought to work during the four weeks preceding the survey. In contrast, the number of unemployed on the basis of Jobsplus data includes only those persons registering for work under Part 1 and Part 2 of the unemployment register.

\(^2\) The ESI summarises developments in confidence in five surveyed sectors (industry, services, construction, retail and consumers).
hand, sentiment increased in the construction and services sectors as well as among consumers. The overall ESI indicator remained above its long-term average of 100.0, and at a relatively high level from a historical perspective (see Chart 3.7). Malta’s ESI also remained above that in the euro area which stood at 111.2.

Chart 3.7 shows that the ESI started the year at a high of 118.0. The indicator stood above 110.0 during most of the year, but edged below 110.0 in April, October and December, mainly reflecting bouts of negative sentiment in industry and among retailers.

Table 3.7 presents the annual average and the absolute change in the confidence indicator for each sector included in the ESI. The strongest gain was recorded in construction. Sentiment within the services sectors and among consumers also rose. On the other hand, confidence among manufacturing firms and retailers declined marginally compared with 2017.

Table 3.7

<table>
<thead>
<tr>
<th>SENTIMENT INDICATOR BY SECTOR</th>
<th>Annual average; absolute change</th>
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<td></td>
<td>2017</td>
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<tr>
<td>ESI</td>
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<tr>
<td>Industrial confidence indicator</td>
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<td>Retail trade confidence indicator</td>
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<tr>
<td>Consumer confidence indicator</td>
<td>8.5</td>
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</tbody>
</table>

Source: EC.

Industrial confidence edges down marginally

Sentiment among manufacturing firms experienced a minor decline, but still stood above its long-term mean of -3.0. This decline was solely driven by firms’ assessment of stock levels, which were deemed to be above normal (see Chart 3.8). On the other hand, on balance fewer firms assessed order books to be below normal, while more firms expected production to rise in the months ahead.

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

The industrial confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to a subset of survey questions relating to expectations about production over the subsequent three months, current levels of order books and stocks of finished goods (the last with inverted sign).

A rise in the stock levels indicates lower turnover and affects the overall indicator in a negative way. Such decreases are thus represented by bars below the 0 mark in Chart 3.8.
Supplementary data indicate that the average share of respondents foreseeing a rise in employment was higher in 2018 than in 2017. On the other hand, a smaller share of respondents anticipated a decline in selling prices.

**Confidence in the retail sector subsides**

The retail confidence indicator edged down marginally to 8.2 in 2018, from 8.5 in the preceding year, but still remained above its long-term average of 2.6 (see Chart 3.9). Compared with 2017, a higher share of retailers reported above normal stock levels. This explains entirely the lower reading in this sector. On the other hand, more respondents anticipated improved business activity in the months ahead, while, the share of respondents reporting improved sales in the preceding months also edged up in 2018.

Additional survey data indicate that on balance retailers reported unchanged order book levels while more respondents anticipated selling prices to rise. Meanwhile a larger share of respondents expected employment to increase in the following months.

**Confidence in construction rises further**

Sentiment in the construction sector averaged 21.3 during 2018, up from 12.8 in the preceding year, and remained above its long-term average of -15.5 (see Chart 3.10). Both order book levels and employment expectations contributed to the increase in confidence during the year.

Compared with the previous year, operators were on average significantly more optimistic with regards

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

17 The construction confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to two survey questions, namely those relating to order books and employment expectations over the subsequent three months.
to order books levels whilst the share of respondents anticipating a rise in employment in the subsequent months increased marginally.

Additional survey data show that on balance, more respondents recorded improved building activity. Meanwhile, during 2018, fewer respondents on average anticipated increased selling prices for the months ahead.

**Services confidence further improves**

In line with developments among consumers and in the construction sector, confidence within the services sector rose. It reached 34.6 in 2018 from 30.8 in the preceding year (see Chart 3.11).

Firms’ demand expectations for the three months ahead and their assessment of the business situation were the main contributors to the rise in confidence. Respondents’ assessment of demand also edged up.

Supplementary data indicate that both the assessment of prevailing employment conditions and expectations improved in 2018. Similarly, on balance, more firms expected their selling prices to increase in the following three months.

**Consumer confidence reaches a new record high**

The consumer confidence indicator increased in 2018. Over the year as a whole the index averaged 10.1, up from the previous year’s average of 8.5, and continued to stand well above its long-term average of -12.4 (see Chart 3.12).

All sub-components contributed to the improved sentiment, except for respondents’ expectations in respect of their major purchases. Indeed a larger share of respondents indicated that they would spend less money on major purchases in the subsequent 12 months.

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18 The services confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to survey questions relating to the business climate, the evolution of demand in the previous three months and demand expectations for the subsequent three months.

19 The consumer confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to a subset of survey questions relating to households’ assessment and expectations of their financial situation, their expectations about the general economic situation and their intention to make major purchases over the subsequent 12 months. The computation of this indicator was changed as reflected in the January 2019 release of the EC – [www.ec.europa.eu/info/sites/info/files/esi_2019_01_en.pdf](http://www.ec.europa.eu/info/sites/info/files/esi_2019_01_en.pdf).
Additional survey information suggests that the share of consumers that considered the timing to make major purchases appropriate, given the existing economic situation, declined compared with 2017. Also, a larger share of respondents indicated that they expect unemployment to fall in the subsequent 12 months. Overall, the number of consumers who expected inflation to rise during the year ahead fell, while a smaller share of consumers perceived inflation to have increased in the preceding 12 months.

Residential property prices

Residential property prices grow at a marginally higher pace

Residential property prices continued to increase during the first three quarters of 2018. The NSO’s Property Price Index (PPI), which is based on actual transactions involving apartments, maisonettes and terraced houses, increased at an average annual rate of 5.4% during the first nine months, marginally higher than the 5.3% recorded in 2017 as a whole (see Chart 3.13). House price inflation in Malta was higher than that in the euro area, where it averaged 3.9% in 2017 as a whole and 4.4% in the first three quarters of 2018.

Residential property prices are being supported by a number of factors, including the low-interest rate environment and Government measures. These incentives, as well as the buoyant disposable income and the increase in foreign workers, are making the property market a more attractive investment opportunity.

Misalignment index suggests house prices rose slightly above fundamentals in 2018

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

Based on the latest data for the NSO’s PPI, house prices were slightly above the level consistent with fundamentals in the third quarter of 2018 (see Chart 3.14). The extent of misalignment in house prices, however, remains modest, especially when compared to the pre-crisis housing boom.

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20 ‘Apartments’ are defined as dwellings with self-contained rooms or a suite of rooms that have a separate entrance accessible from a common passage way, landing or stairway. ‘Maisonettes’ have a separate entrance that is accessible from the street and are either at ground-floor level with overlying habitation, or at first-floor level with underlying habitation. ‘Terraced houses’ are dwellings with at least two floors, own access at street level and airspace and with no underlying structures that are not part of the house itself. They are attached to other structures on both sides. Further information is available in NSO News Release 105/2018.

21 The Government scheme for first-time buyers, introduced in 2014 and subsequently extended, provides relief from the duty on documents due on the first €150,000 of the total paid for the purchase of eligible property. The scheme for second-time buyers, first introduced in 2018, provides a €3,000 stamp duty refund to eligible households.


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

The slight overvaluation is mainly driven by the increase in housing investment-to-GDP ratio above its long-term average, as well as by the fact that property prices have been increasing in excess of consumer price inflation for a number of years. As the recent increase in permits translates into additional supply of property on the market, house price inflation should moderate, leading to a normalisation of the housing investment-to-GDP ratio. By contrast, the affordability indicator is still contributing to lower the misalignment, reflecting increases in income, a higher share of two wage-earning households and the prevailing low interest rate environment.

Consumer price inflation

**HICP inflation picks up**

Annual HICP inflation picked up during 2018, averaging 1.7% from 1.3% in 2017 (see Chart 3.15 and Table 3.8). HICP inflation in the euro area also averaged 1.7% during the year under review.

Services were the main contributor to the pick-up in HICP inflation in 2018, as the annual rate of change of services prices rose to 2.1% from 1.2% in 2017 (see Table 3.8 and Chart 3.16). In particular,

<table>
<thead>
<tr>
<th>Table 3.8</th>
<th>HICP INFLATION RATES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average annual rate of change</strong></td>
<td>2013</td>
</tr>
<tr>
<td>Unprocessed food</td>
<td>6.4</td>
</tr>
<tr>
<td>Processed food including alcohol and tobacco</td>
<td>3.7</td>
</tr>
<tr>
<td>Energy</td>
<td>-0.7</td>
</tr>
<tr>
<td>NEIG</td>
<td>0.5</td>
</tr>
<tr>
<td>Services (overall index excluding goods)</td>
<td>-0.2</td>
</tr>
<tr>
<td>HICP (annual average inflation rate)</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Source: ECB.

25 The HICP weights are revised on an annual basis to reflect changes in household consumption patterns. In 2018 the weight allocated to energy stood at 6.3%, while that of NEIG was 27.1%. Services accounted for 46.6% of the index, while the share allocated to food stood at 20.0%.
the contribution of recreational and personal services increased strongly during the second and third quarters of the year (see Chart 3.17). This was mainly a statistical effect related to a large increase in the weight of tourist accommodation in overall private consumption in Malta. In contrast, the contributions of the remaining components of services inflation were generally contained and broadly similar to those estimated for 2017.

Energy inflation also accelerated during 2018, reaching 1.3% from 1.1% in 2017. This mainly reflected increases in the prices of gas and transport fuels, which came into effect in January and August, respectively. At the same time, prices of NEIG rose by 0.5% in 2018, marginally faster than the 0.4% registered in 2017. The relatively low reading for this component mainly reflected weakness in external price pressures.

Meanwhile, the contribution of food inflation to overall HICP fell. This mainly reflected a deceleration in unprocessed food inflation, which eased from 2.6% in 2017 to 1.2% in 2018. In particular, vegetable prices contracted strongly in the first half of the year when compared with 2017, offsetting a pick-up in meat inflation (see Chart 3.18). On the other hand, processed food inflation remained unchanged at 2.4%, in part supported by price increases for bread and dairy products during the second half of the year.

Despite the acceleration in overall HICP inflation, the core measure, which is based on the Bank’s “trimmed mean” approach, remained moderate. During 2018 it stood at 0.9%, only marginally above 0.8% a year earlier (see Chart 3.16).
This led to a wedge between core and overall HICP inflation, suggesting that a large portion of overall inflation was driven by strong growth in a small number of volatile subcomponents. In part, this also relates to the aforementioned statistical impact of the increase in the weight of accommodation services in the HICP basket for 2018.

**RPI inflation eases**

Annual inflation based on the RPI decelerated during 2018, averaging 1.2% from 1.4% a year earlier. Food inflation remained the main driver of overall RPI inflation, although its contribution fell marginally (see Table 3.9). The contributions of the other components forming the index remained weak, with drops observed in the contributions of beverages, household equipment and maintenance, and recreation and culture.

The large differential between the overall HICP and RPI inflation rates during 2018 mainly reflects differences in the consumption baskets and weights assigned in the measurement process for the two indices. In particular, the RPI basket excludes tourist expenditure on accommodation services, which was a main contributor to the acceleration in HICP inflation during 2018.

![Chart 3.19](image)

**Table 3.9**

**CONTRIBUTIONS TO RPI INFLATION(1)**

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>1.0</td>
<td>0.1</td>
<td>0.6</td>
<td>0.5</td>
<td>0.7</td>
<td>0.6</td>
</tr>
<tr>
<td>Beverages and tobacco</td>
<td>0.3</td>
<td>0.3</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Clothing and footwear</td>
<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
<td>-0.1</td>
<td>-0.2</td>
<td>-0.2</td>
</tr>
<tr>
<td>Housing</td>
<td>0.1</td>
<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Water, electricity, gas and fuels</td>
<td>0.0</td>
<td>-0.5</td>
<td>-0.2</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Household equipment and maintenance</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Transport and communications</td>
<td>-0.5</td>
<td>-0.1</td>
<td>-0.3</td>
<td>-0.5</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>Personal care and health</td>
<td>0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Recreation and culture</td>
<td>0.2</td>
<td>0.3</td>
<td>0.2</td>
<td>0.1</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Other goods and services</td>
<td>0.0</td>
<td>0.0</td>
<td>0.2</td>
<td>0.1</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>RPI (annual average inflation rate)</strong></td>
<td><strong>1.4</strong></td>
<td><strong>0.3</strong></td>
<td><strong>1.1</strong></td>
<td><strong>0.6</strong></td>
<td><strong>1.4</strong></td>
<td><strong>1.2</strong></td>
</tr>
</tbody>
</table>

Source: NSO.

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

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

**Producer prices pick up**

Producer cost inflation, as measured by the industrial producer price index, accelerated to 4.6% during 2018, from 1.7% a year earlier. This mainly reflected a strengthening of price pressures within the intermediate goods component, which includes electronics and computers, a large share of which is exported. This component remained the main contributor to overall producer cost inflation during the year. On the other hand, inflation within the remaining subcomponents of the index, such as consumer goods, capital goods, and energy, remained contained throughout the year.

**HCIs indicate a deterioration in external competitiveness**

Malta’s HCIs pointed towards a deterioration in international price competitiveness during 2018 (see Chart 3.20). The nominal HCI, which is determined by developments in trade-weighted exchange rates, grew at an average rate of 3.6%, following a 1.7% increase in 2017. The real HCI, which also takes into account changes in price inflation relative to trading partners, grew by 5.1%, up from 1.9% in 2017. This suggests that both movements in the euro exchange rate and in relative prices vis-à-vis trading partners had a negative impact on Malta’s competitiveness over the past year.

**Unit Labour Costs grow moderately**

Malta’s ULC increased at a moderate pace of 0.9% in 2018, slightly up from 0.7% in 2017 (see Chart 3.21). The latest increase was driven by growth in compensation per employee, which rose by 1.7% following a small decrease in the previous year. Labour productivity also grew during 2018, though to a lesser extent, with the annual rate of change reaching 0.9%, from -1.0% in 2017.

---

28 The industrial producer price index measures the prices of goods at the factory gate and is commonly used to monitor inflationary pressures at the production stage.

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

30 Annual growth in ULC, compensation per employee, and labour productivity is measured on a four-quarter moving average basis. A rise (drop) in productivity contributes negatively (positively) to ULC growth.
BOX 3: ECONOMIC PROJECTIONS

Economic outlook

The Central Bank's latest economic projections show that economic growth is expected to remain strong from a historical perspective, though somewhat lower than in 2018 (see Table 1). Growth is expected to average 4.2% over the period 2019 to 2021.

Domestic demand is foreseen to be the dominant driver of economic growth over the projection horizon, underpinned by all domestic demand components.

In the context of favourable labour market conditions, private consumption growth is envisaged to remain robust throughout the projection horizon. Government consumption is also expected to affect domestic demand growth significantly, aided by the expected increase in fiscal space. Investment growth is forecast to rise sharply in 2019 and 2020, partly due to the planned expenditure on infrastructure and health.

Table 1

PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES FOR MALTA (1)

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real economic activity (% change)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>4.8</td>
<td>4.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Private consumption expenditure</td>
<td>4.9</td>
<td>4.1</td>
<td>3.8</td>
</tr>
<tr>
<td>Government consumption expenditure</td>
<td>8.3</td>
<td>6.2</td>
<td>4.8</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>9.6</td>
<td>13.2</td>
<td>3.0</td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>2.7</td>
<td>2.9</td>
<td>3.0</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>3.7</td>
<td>4.4</td>
<td>3.1</td>
</tr>
<tr>
<td><strong>Contribution to real GDP growth (in percentage pts)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Final domestic demand</td>
<td>5.5</td>
<td>5.6</td>
<td>3.5</td>
</tr>
<tr>
<td>Net exports</td>
<td>-0.6</td>
<td>-1.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Changes in inventories</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Labour market (% change)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total employment</td>
<td>4.1</td>
<td>3.4</td>
<td>2.9</td>
</tr>
<tr>
<td>Unemployment rate (% of labour supply)</td>
<td>3.8</td>
<td>3.9</td>
<td>4.0</td>
</tr>
<tr>
<td><strong>Prices and costs (% change)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Overall HICP</td>
<td>1.8</td>
<td>1.9</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>Public Finances (% of GDP)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General government balance</td>
<td>1.6</td>
<td>1.8</td>
<td>1.9</td>
</tr>
<tr>
<td>General government debt</td>
<td>41.5</td>
<td>38.1</td>
<td>34.9</td>
</tr>
</tbody>
</table>

(1) Data on GDP were sourced from NSO News Release 193/2018 published on 6 December 2018.
(2) Data on the number of employed are consistent with national accounts data. The unemployment rate is based on the number of unemployed and employed as reported in the LFS.

The Bank’s outlook for the Maltese economy is based on information available up to 31 January 2019. A more detailed outline of these projections was released on 8 February 2019 and can be found on the Bank's website: www.centralbankmalta.org/economic-projections. The HICP projections in this Box differ slightly from those published in February as they take into account the December 2018 HICP outcome. All projections were carried out prior to the latest national accounts release of 8 March 2019 and the NSO News Release 027/2019 of 21 February 2019.
On the other hand, net exports are set to dampen GDP growth in 2019 and 2020 due to the expected recovery in import shares and the pick-up in capital-intensive investment growth. The net export contribution is projected to then contribute positively in 2021, as some investment projects are expected to reach completion by 2020 and investment in the aviation sector normalises after a period of rapid expansion.

In line with the expected moderation in economic activity, the pace of employment growth is projected to ease somewhat. The unemployment rate is expected to rise marginally but remain low from a historical perspective.

HICP inflation is set to pick up gradually over the projection horizon, and reach 2.0% by 2021. This primarily reflects an expected pick-up in the price of services due to the envisaged intensification of wage pressures.

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

Risks to the GDP growth projections are slightly tilted to the downside in 2019 and broadly balanced thereafter. In the short to medium-term, the main downside risks are external, such as the recent weaknesses exhibited in Malta’s main trading partners, trade tensions, and the possibility of a disorderly Brexit. On the other hand, domestic risks are tilted to the upside, as the savings ratio could decrease faster than assumed in the baseline. Moreover, the large projects that have been announced but are still in the planning stage are not included in our baseline. Finally, the assumed normalisation in import shares may progress more slowly than assumed, in which case the contribution of net exports would be higher than projected.

Risks to inflation are slightly to the downside. They relate to renewed downward pressures on prices if the deterioration in the world economic outlook persists, as well as the possible impact of Brexit on the EUR/GBP exchange rate. On the other hand, labour tightness could bring about stronger than expected increases in wage pressures, while an escalation of trade protectionism would likely push up import costs.

Finally, risks to the public finances are tilted on the upside (i.e. balance-improving). These stem from possible slippages in the implementation of locally-financed investment projects.
4. BALANCE OF PAYMENTS

During the first three quarters of 2018 the surplus on the current account of the balance of payments widened when compared with the corresponding period of 2017. This improvement was primarily attributable to a rise in net services receipts and, to a lesser extent, to lower net outflows related to primary income. Together, these offset a widening merchandise trade gap and marginally higher net outflows related to secondary income.

Between January and September, net inflows on the capital account increased marginally on a year earlier, while lower net lending was recorded on the financial account. Net errors and omissions turned negative when compared with the comparable period of 2017.

When measured as a four-quarter moving sum, the current account registered a surplus equivalent to 10.6% of GDP, 0.5 percentage point higher than in the year ending in September 2017 and above the 3.3% recorded in the euro area. The cyclically-adjusted current account balance was also estimated to stand at 10.6% during the period under review (see Chart 4.1).

The current account

Between January and September 2018, the current account recorded a surplus of €1,100.7 million, a rise of €99.7 million on the same period of 2017 (see Table 4.1). This improvement was largely driven by a rise in net services exports and, to a lesser extent, by lower net inflows on the primary income

| Table 4.1 |
| BALANCE OF PAYMENTS |
| EUR millions |
| | 2015 | 2016 | 2017 | 2017 Q1-Q3 | 2018 Q1-Q3 |
| Current account | 226.6 | 356.7 | 1,173.9 | 1,001.0 | 1,100.7 |
| Goods | -1,969.5 | -1,959.6 | -1,478.1 | -1,119.3 | -1,152.1 |
| Services | 2,835.4 | 3,321.1 | 3,841.8 | 2,993.4 | 3,100.6 |
| Primary income | -547.9 | -893.8 | -1,061.8 | -778.6 | -751.8 |
| Secondary income | -91.3 | -111.0 | -128.0 | -94.5 | -96.0 |
| Capital account | 268.8 | 32.3 | 60.2 | 28.8 | 29.9 |
| Financial account(1) | 263.1 | 835.1 | 1,288.8 | 1,141.1 | 827.6 |
| Errors and omissions | -232.3 | 446.1 | 54.8 | 111.3 | -303.0 |

Source: NSO.

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

---

1. Following the adoption of Balance of Payments Manual 6, increases in both assets and liabilities are recorded with a positive sign. Conversely, decreases in assets and liabilities are recorded with a negative sign.
2. Negative net errors and omissions imply an overestimation of the current and capital account surplus and/or an underestimation of net lending.
3. Data shown in Chart 4.1 are based on information published up to the end of February 2019 and thus are not consistent with the latest GDP figures used in the rest of this Report.
account, which offset a widening in the merchandise trade gap. At the same time, outflows on the secondary income account were marginally above the level recorded a year earlier.

In the four quarters to September 2018, the surplus on the current account stood at €1,273.6 million, or 10.6% of GDP, up from 10.1% of GDP a year earlier. This improvement was on account of a higher surplus from trade in services and a lower merchandise trade deficit. Over the same period, net outflows on the secondary account remained largely unchanged, while net outflows on the primary account were slightly lower as a share of GDP (see Chart 4.2).

Malta’s cyclically-adjusted current account balance stood at 10.6% of GDP, down from 12.8% in the year to September 2017 (see Chart 4.1). The cyclically-adjusted and the unadjusted current account balances for the Maltese economy tracked each other closely in recent quarters. This suggests that movements in Malta’s current account are being driven largely by structural, rather than cyclical factors.

**Goods deficit widens**
Balance of payments data show that in the first three quarters of 2018 the merchandise trade deficit widened by €32.8 million on the corresponding period of 2017 and stood at €1,152.1 million. This was due to a contraction of €34.1 million in exports; as imports declined by €1.8 million.

However, when expressed as a four-quarter moving sum, the merchandise trade gap stood at 12.5% of GDP, down from 13.8% in the year to September 2017, as exports grew at a faster pace than imports (see Chart 4.3).

**Surplus on services widens**
The positive balance on services increased further in the first nine months of 2018, adding €107.2 million on the same period of 2017, reaching €3,100.6 million. This arose as higher services receipts offset a rise in payments. The improvement was broad based across all main services sub-sectors. Nonetheless, the "other..."
services” component explains approximately half of the increase in net services receipts. Movements in this component were driven by higher net receipts from remote gaming and, to a lesser extent, from the financial services sector.

A buoyant tourism sector also continued to boost the services balance. During the first three quarters of 2018 the net surplus on travel stood at €937.6 million, €27.9 million more than a year earlier, as tourism receipts continued to outpace Maltese residents’ expenditure abroad. Higher net exports were also registered on the transport account. Largely reflecting the further expansion of the aviation sector, the net balance in transportation reached €291.1 million in the first three quarters of 2018, €27.3 million higher than a year earlier.

Partly reflecting these developments, the surplus on the services account in the year to September 2018 climbed to €3,949.0 million. Nonetheless, its share in GDP decreased to 32.8%, reflecting a relatively faster growth in nominal GDP (see Chart 4.4).

Net outflows related to primary income decrease

Between January and September 2018, net primary income outflows were down by €26.8 million on the same period of 2017, at €751.8 million. Movements on the primary income account continued to be strongly influenced by internationally-oriented firms, including subsidiaries of foreign banks, which transact predominantly with non-residents.

When measured on a four-quarter cumulative basis, net outflows on this component reached 8.6% of GDP, 0.5 percentage point less than in the four-quarters to September 2017. Lower net outflows were predominantly driven by higher net interest earnings on the ‘other investment’ income component which offset both a rise in distributed profits of foreign owned firms operating in Malta and lower net income receipts on portfolio investment.

Net outflows from secondary income edge up

During the first nine months of 2018, net outflows on the secondary income account amounted to €96.0 million, up by €1.5 million on the comparable period of a year earlier.

When measured over the four quarters to September 2018, net outflows on the secondary income account stood at €129.6 million, or 1.1% of GDP, unchanged when compared with the four quarters to September 2017.

Tourism

The positive performance in the tourism sector persisted in 2018. Tourist arrivals and expenditure continued to grow strongly, albeit at a slower pace compared with the preceding year, while nights stayed rose at a faster pace.

Tourist arrivals were up by 14.3% after increasing by 15.7% in 2017 (see Chart 4.5). The total number of visitors exceeded 2.5 million.

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6 The primary income account shows income flows related mainly to cross-border investment and compensation of employees. The secondary income account shows current transfers between residents and non-residents.
The increase in arrivals was entirely driven by tourists visiting Malta for leisure purposes. These rose by 0.4 million or 18.2% in 2018 and reached nearly 2.3 million. On the other hand, those travelling for business purposes declined marginally by 0.2%, after reporting strong gains in the previous year on the back of Malta’s EU Presidency. The number of persons that visited Malta for other purposes contracted by 18.1%.

Increases were reported from most markets. However, the United Kingdom and Italy remained Malta’s most important source markets, accounting for 24.6% and 15.0% of total visitors, respectively.

The number of tourist nights spent in Malta reached 18.6 million in the year under review, a rise of 12.5% on 2017. Nights spent in private accommodation accounted for around two-thirds of this increase. These were up by 19.7% on the preceding year. At the same time, nights spent in collective accommodation increased by 7.1%. As private accommodation continued to gain popularity, its share in overall nights spent by tourists in Malta increased from 43.0% in 2017 to 45.7% in 2018.

Tourist expenditure rose at a slower pace during 2018. After a 13.9% increase in 2017, tourist spending was up by 8.0% in 2018, reaching €2,101.8 million. Higher expenditure was registered in both the package and non-package categories, which were up by 16.6% and 13.3%, respectively. These increases were partly offset by a decline in the “other” category, which fell by 2.2%. As tourist expenditure increased at a slower pace compared with arrivals, expenditure per capita fell further. It decreased to €809 in 2018 from €856 in 2017. This partly reflected a shorter length of stay, which fell to 7.1 nights from 7.3 nights in 2017.

The continuous efforts to promote Malta as a year-round destination, together with a fuller winter schedule featuring increased frequency of flights to several destinations and the extension of certain summer routes into the winter season all had a positive impact on the tourism sector during 2018. According to Malta International Airport (MIA) data, seat capacity increased by 14.2% in comparison with 2017 (see Chart 4.6).²

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² Private accommodation includes self-catering apartments, farmhouses, and private residences. As per Eurostat recommendation, time-share accommodation is classified as “private accommodation”. Collective accommodation comprises hotels, aparthe...
Malta’s performance compared positively with other countries and gained market share. According to the World Tourism Barometer, arrivals in Southern and Mediterranean European countries grew by an annual rate of 7.0%, while the global tourism industry registered a 5.6% increase in 2018.

The total average occupancy rate in collective accommodation establishments edged up further to 67.6% in 2018, from 65.6% a year earlier (see Chart 4.7). Two-star and three-star establishments and the “other” collective accommodation category reported the largest increases while occupancy in four-star and five-star hotels increased marginally.

After reporting strong increases in previous years, the number of foreign cruise liner passengers fell by 5.3% to 0.6 million in 2018 (see Chart 4.8). The decline stemmed from passengers coming from the EU, which fell by 10.4% to 0.4 million. The only EU country that registered an increase in passengers was Spain. In contrast, non-EU passengers increased by 6.8%, to just above 0.2 million. The number of cruise liner calls in 2018 totalled 310, 32 less than in 2017, partly reflecting the fact that unfavourable weather conditions impeded a number of cruise liners from entering the Valletta Cruise Port. This decrease was concentrated in the first half of the year, with the number of cruise liner calls in the second half only marginally below that in the corresponding period of 2017.

The capital and financial accounts
The capital account recorded net inflows of €29.9 million in the first three quarters of 2018, up by €1.1 million on a year earlier (see Table 4.1). A significant increase was also observed on a four-quarter moving sum basis. This expansion was mostly attributable to higher transfers to government, which in turn reflected the timing of funds received under EU financing programmes.

Meanwhile, the financial account showed a net lending flow of €827.6 million. This compares with net lending of €1,141.1 million in the same period of 2017. When the balance on this account is expressed as a four-quarter sum, net lending flows were also lower on the year ending in September 2017. Movements on this account continued to be heavily influenced by transactions of internationally-oriented financial institutions.
5. GOVERNMENT FINANCE

In the first three quarters of 2018, the general government surplus increased compared with the same period a year earlier. In the four quarters up to September 2018, the headline and cyclically-adjusted general government surplus-to-GDP ratios remained broadly unchanged compared with those in 2017. Meanwhile, general government debt as a share of GDP continued to decline.

General government accounts

General government surplus increases in the first three quarters of 2018

In the first three quarters of 2018, the general government registered a surplus of €241.4 million, up by €35.2 million compared with the corresponding period of 2017. This was due to a strong increase in revenue offsetting higher primary expenditure. As a result, the primary surplus increased by €23.3 million, to €383.3 million (see Table 5.1).

Higher tax receipts support revenue

Government revenue grew by €257.6 million, or 8.1% in annual terms, reaching €3,445.2 million. Growth in revenue was mainly driven by higher tax receipts (see Table 5.1).

Receipts from taxes on production and imports registered the largest increase in absolute terms, of €119.6 million. This was due to higher intakes from VAT and duties on the transfer of property, reflecting buoyant private consumption and a dynamic property market. Inflows from current taxes on income and wealth and social contributions also rose significantly, reflecting favourable labour market conditions.

Overall, developments in non-tax revenue had a negligible impact on general government finances during the quarter under review. “Other” government revenue, which accounts for developments in sales and

<table>
<thead>
<tr>
<th>Table 5.1</th>
<th>REVENUE, EXPENDITURE AND DEBT</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR millions</td>
<td>2013</td>
</tr>
<tr>
<td>Revenue</td>
<td>3,021.4</td>
</tr>
<tr>
<td>Taxes on production and imports</td>
<td>988.7</td>
</tr>
<tr>
<td>Current taxes on income and wealth</td>
<td>1,043.3</td>
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<tr>
<td>Social contributions</td>
<td>524.8</td>
</tr>
<tr>
<td>Capital and current transfers receivable</td>
<td>182.3</td>
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<tr>
<td>Other(1)</td>
<td>282.3</td>
</tr>
<tr>
<td>Expenditure</td>
<td>3,206.9</td>
</tr>
<tr>
<td>Compensation of employees</td>
<td>977.8</td>
</tr>
<tr>
<td>Intermediate consumption</td>
<td>471.0</td>
</tr>
<tr>
<td>Social benefits</td>
<td>964.2</td>
</tr>
<tr>
<td>Subsidies</td>
<td>80.3</td>
</tr>
<tr>
<td>Interest</td>
<td>219.1</td>
</tr>
<tr>
<td>Other current transfers payable</td>
<td>176.4</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>219.8</td>
</tr>
<tr>
<td>Capital transfers payable</td>
<td>95.4</td>
</tr>
<tr>
<td>Other(2)</td>
<td>3.0</td>
</tr>
<tr>
<td>Primary balance</td>
<td>33.6</td>
</tr>
<tr>
<td>General government balance</td>
<td>-185.5</td>
</tr>
<tr>
<td>General Government debt</td>
<td>5,226.6</td>
</tr>
</tbody>
</table>

Source: NSO.

(1) “Other” revenue includes market output as well as income derived from property and investments.

(2) “Other” expenditure principally reflects changes in the value of inventories and in the net acquisition of valuables and other assets.
property income increased, reflecting higher inflows from dividends and rents. By contrast, sales revenue, which had increased strongly in 2017 on the back of higher IIP flows, was broadly unchanged. Meanwhile, revenue from current and capital transfers receivable declined.

**Current and capital expenditure increase**
Government expenditure increased by €222.3 million or 7.5%, due to an increase in both recurrent and capital expenditure items.

Outlays on compensation of employees recorded the largest increase in absolute terms, as they rose by €76.7 million. This increase, equivalent to just under half of the increase in recurrent expenditure, was driven by higher wages in the public administration, education and health sectors. Spending on intermediate consumption rose, led by higher outlays in the public administration, health and residential care sectors. Outlays on social benefits also increased, mainly due to higher pension outlays, while ‘other current transfers’ were boosted by the income tax rebate distributed to households which had been announced in the Budget 2018.

Amongst the main current expenditure items, only interest payments declined in the period under review, reflecting lower financing needs.

Meanwhile, capital expenditure rose at a strong pace, reflecting higher outlays on gross fixed capital formation and capital transfers. The latter partly rose due to the Government’s acquisition of landing rights from Airmalta in the first quarter of the year. Meanwhile, spending on investment increased on the back of road construction and other infrastructural projects, with most of this increase concentrated in the third quarter of the year.

**Debt decreases**
The stock of general government debt was down by €158.6 million since the end of 2017, standing at €5,512.0 million in September. This was largely due to a €410.7 million decrease in the stock of long-term securities (composed of MGS), whose share in total government debt declined by 4.9 percentage points to reach 82.8%.

Meanwhile, the stock of short-term securities outstanding (composed of Treasury Bills) rose by €148.5 million, while its share in total debt rose by 2.8 percentage points and reached 5.9%. Currency and deposits outstanding rose by €98.6 million, largely due to a new issue of 62+ Government Savings bonds, which are classified as deposits according to ESA methodology. Consequently, its share in total debt rose by 1.9 percentage points to reach 5.0%. Meanwhile, the stock of loans increased by €5.0 million, such that its share in total debt rose by 0.3 percentage point to reach 6.2%.

**Headline and cyclically-adjusted developments**

*Headline surplus improves slightly while debt ratio declines*

On a four-quarter moving sum basis, the general government surplus-to-GDP ratio reached 3.6% in the third quarter of 2018, marginally higher than the surplus of 3.5% posted in 2017.

During this period, the ratio of total revenue in GDP declined slightly, by 0.3 percentage point (see Chart 5.1). This was mainly due to a 0.2 percentage point decline in the

![Chart 5.1](chart.png)

**Chart 5.1**

**IMPACT ON GENERAL GOVERNMENT BALANCE**(1)

(percentage points)

<table>
<thead>
<tr>
<th>Year</th>
<th>Current revenue(2)</th>
<th>Current expenditure(3)</th>
<th>General government balance (change in ratio)</th>
<th>Capital revenue</th>
<th>Capital expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td></td>
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<tr>
<td>2014</td>
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<td>2015</td>
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<td>2016</td>
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<td>2017</td>
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</tr>
<tr>
<td>2018</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

(1) Revenue items: +ve sign represents higher revenue and vice versa. Expenditure items: +ve sign represents lower expenditure and vice versa.
(2) Four-quarter moving sums up to Q3.
(3) The term ‘current revenue’ represents most tax revenue as well as income from investments and sales. ‘Capital revenue’ mainly represents capital taxes and grants received.
(4) The term ‘current expenditure’ mainly represents spending on wages, social benefits and operational and maintenance expenses. ‘Capital expenditure’ mainly represents spending on investment and capital transfers.
current revenue ratio. At the same time, the ratio of total expenditure in GDP declined by 0.3 percentage point, as a 0.7 percentage point decrease in the share of current spending items offset a 0.3 percentage point increase in the ratio of capital spending.

At the same time, the government debt-to-GDP ratio declined by 4.4 percentage points, to 45.7%. Although the deficit-debt adjustment (DDA) raised the debt ratio by 0.7 percentage point, the primary surplus and the interest-growth differential exerted a much stronger negative effect (see Chart 5.2). The latter contributed towards a 1.9 percentage point decline, as the rate of GDP growth surpassed the effective rate of interest paid by the government on its debt. Meanwhile, the high primary surplus posted in this period contributed to a 3.2 percentage points drop in the debt ratio.

**Public finances compare favourably with the euro area**

Developments in Maltese public finances continue to compare favourably with the euro area (see Chart 5.3). By the third quarter of 2018, the euro area general government deficit declined to 0.4% of GDP, from 1.0% in 2017. In the same period, the euro area debt ratio also edged down. It fell to 86.1% from 86.8% in 2017. However, in Malta, the general government balance was in surplus, and the debt ratio was almost half that in the euro area and well below the 60% threshold reference value in the Stability and Growth Pact.

**Cyclically-adjusted balance**

In the four quarters up to September 2018, the cyclically-adjusted surplus was lower than the headline surplus (see Chart 5.4). This is mainly due to comparatively smaller rates of growth in cyclically-adjusted tax revenue items relative to the headline items, which in turn reflects the fact that the underlying macroeconomic variables were growing above trend.

In this period, the cyclically-adjusted surplus amounted to 2.9% of GDP, marginally lower than the 3.0% ratio posted in 2017. This shows that the fiscal surplus reached in 2017 and in 2018 was largely driven by factors other than the economic cycle.

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1. The cyclically-adjusted balance is corrected for the impact of the economic cycle on government tax revenue and unemployment assistance. To compute this adjustment, the Bank applies a different methodology from the one used by the EC. For an overview of the methodologies currently in use, see Farrugia, J. (2014). “Estimating the Cyclically Adjusted Budget Balance,” Quarterly Review 2014(2), pp. 59-66, Central Bank of Malta.
The slight decrease in the cyclically-adjusted balance ratio between December 2017 and September 2018 was driven by a drop in the share of revenue in GDP, which outweighed a decline in the expenditure-to-GDP ratio (see Table 5.2). The share of cyclically-adjusted revenue in GDP decreased by 0.4 percentage point, mainly on account of lower inflows from the IIP. In contrast, cyclically-adjusted inflows from taxes increased broadly in line with GDP growth.

The share of cyclically-adjusted expenditure in GDP declined by 0.3 percentage point. Spending on social benefits grew at a slower pace than GDP, partly due to the impact of a one-year increase in the retirement age for pension beneficiaries born between 1956 and 1958. The decreasing share of social benefits in GDP can also be attributed to the extension of measures aimed at reducing dependency on unemployment benefits and incentivising people to seek employment.

Meanwhile, the share of interest payments in GDP declined as the prevailing low interest rate environment, coupled with lower financing requirements, led to a level decrease in spending. Concurrently, the share of intermediate consumption and compensation of employees in GDP also declined slightly.

On the other hand, the share of ‘other’ expenditure in GDP rose, due to a pickup in capital transfers as outlined above. Meanwhile, in the same period, gross fixed capital formation increased in line with GDP.

### Table 5.2

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018(1)</th>
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<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Revenue</td>
<td>0.4</td>
<td>-0.7</td>
<td>-1.8</td>
<td>-0.9</td>
<td>1.7</td>
<td>-0.4</td>
</tr>
<tr>
<td>Taxes on production and imports</td>
<td>-0.2</td>
<td>0.1</td>
<td>-1.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Current taxes on income and wealth</td>
<td>0.7</td>
<td>-0.5</td>
<td>-1.5</td>
<td>0.7</td>
<td>0.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Social contributions</td>
<td>-0.2</td>
<td>-0.3</td>
<td>-0.5</td>
<td>0.0</td>
<td>0.0</td>
<td>-0.1</td>
</tr>
<tr>
<td>Other(2)</td>
<td>0.1</td>
<td>0.1</td>
<td>1.2</td>
<td>-1.6</td>
<td>1.0</td>
<td>-0.4</td>
</tr>
<tr>
<td><strong>Expenditure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compensation of employees</td>
<td>-0.9</td>
<td>-0.9</td>
<td>-1.4</td>
<td>-3.0</td>
<td>-0.7</td>
<td>-0.3</td>
</tr>
<tr>
<td>Intermediate consumption</td>
<td>-0.1</td>
<td>-0.4</td>
<td>-0.8</td>
<td>-0.2</td>
<td>-0.1</td>
<td>-0.1</td>
</tr>
<tr>
<td>Social benefits</td>
<td>-0.4</td>
<td>-0.7</td>
<td>-1.0</td>
<td>-0.2</td>
<td>-0.4</td>
<td>-0.4</td>
</tr>
<tr>
<td>Interest payments</td>
<td>-0.1</td>
<td>-0.2</td>
<td>-0.4</td>
<td>-0.3</td>
<td>-0.3</td>
<td>-0.2</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>-0.4</td>
<td>0.7</td>
<td>0.6</td>
<td>-1.7</td>
<td>-0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Other(3)</td>
<td>0.7</td>
<td>-0.1</td>
<td>-0.1</td>
<td>-0.6</td>
<td>0.0</td>
<td>0.5</td>
</tr>
<tr>
<td><strong>Primary balance</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>General government balance</strong></td>
<td>1.3</td>
<td>0.2</td>
<td>-0.8</td>
<td>1.8</td>
<td>2.1</td>
<td>-0.3</td>
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<td></td>
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</tr>
</tbody>
</table>

Sources: NSO; Central Bank of Malta estimates.
(1) Change between December 2017 and September 2018 (based on four-quarter moving sums).
(2) Includes market output, income derived from property and investments and current and capital transfers received.
(3) Mainly includes subsidies, current and capital transfers.
BOX 4: THE SUSTAINABILITY OF MALTESE GOVERNMENT DEBT

Introduction
This Box assesses the sustainability of Maltese general government debt over different horizons. It updates previous debt sustainability analyses (DSA) published by the Bank.  

The term ‘sustainability’ as used throughout this study is in line with the IMF’s definition; sovereign debt is sustainable if the country is able to finance its policy objectives and service the resulting debt, without resorting to unduly large adjustments which could otherwise compromise its stability.

DSAs examine the sustainability of government debt in the short term (in terms of the ability to finance the government balance and maturing debt) and in the medium-to-long term (via risks stemming from contingent liabilities, the macro economy and financial linkages).

Scenario analyses
Scenario analyses offer a medium-term assessment of debt sustainability and form the basis of all conventional DSA exercises. This Box outlines the resulting debt paths from 2017 to 2027 under two different scenarios, which explore different fiscal policies the Government may pursue over this horizon.

This analysis applies scenario specific assumptions up to 2021. However, common assumptions determine the forecast path of selected variables across both scenarios from 2022. Firstly, real GDP growth from 2022 onwards is set according to the following formula:

\[ y_t = c_1 y_{t-1} + (1 - c_1) y^p_t + c_2 \Delta sp b_t - c_3 og_{t-1} \]

where \( y_t \) represents the real GDP growth rate and is a function of potential output growth \( y^p_t \), the change in the structural primary balance \( \Delta sp b_t \) and the lagged output gap \( og_{t-1} \). Parameters \( c_1 \) and \( c_3 \) ensure that real GDP growth eventually converges with potential output and hence the output gap is closed. Parameter \( c_2 \) represents the short-term fiscal multiplier, i.e. the degree to which fiscal policy affects economic growth.

From 2022 onwards the path of inflation, which in this Box is measured by growth in the GDP deflator, is assumed to remain at just below two per cent, in line with the ECB’s target for inflation over the medium term, while the level of the DDA is assumed to revert to its long run average.

Forecasts for government debt exist for different types of maturity: short-term debt (that is, debt which matures within one year), long-term debt maturing in one year and non-maturing long-term debt. Maturing debt is assumed to be rolled over. The share of each category of debt is assumed to eventually return to its long-run average.

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1 Prepared by John Farrugia, a Principal Economist within the Economic Analysis Department of the Central Bank of Malta. The views expressed are those of the author and do not necessarily reflect the views of the Central Bank of Malta. Any errors are the author’s own.
2 This study uses the national accounts and general government vintages up to the third quarter of 2018, published in December 2018 and January 2019, respectively. Therefore, this exercise makes use of an additional year of data compared with the assessment in the 2017 Annual Report.
4 This formula is in line with the approach detailed in ECB Occasional Paper 185(2017).
For each maturity category of debt, dedicated interest payment projections are based on separate interest rate forecast paths. Interest rates for short-term and debt maturing in one year are computed by applying a spread on euro area interest rate projections provided by the ECB. Interest rates on non-maturing debt are based on the maturity profile of Malta Government Bonds outstanding at end September 2018.

No temporary fiscal measures are assumed to take place throughout the extended forecast horizon.

**Scenario 1 – assuming government fiscal targets are met**

This scenario explores the outcome on the debt if Government adheres to its fiscal target – ensuring an annual surplus in structural terms, excluding inflows from the IIP. Forecasts for macro and fiscal items in the period 2018-2021 are in line with the Government’s latest projections, set out in the 2019 Budget and Draft Budgetary Plan. The primary balance path post 2021 is set such that, overall, the structural balance net of IIP receipts remains in surplus.\(^5\) The forecast path for the main determinants of debt is shown in Table 1.

On the basis of these assumptions, the general government debt is expected to decline from 50.2% of GDP in 2017 to 24.5% by 2027 (see Chart 1, Table 1).

---

**Table 1**

<table>
<thead>
<tr>
<th>BASELINE SCENARIO ASSUMPTIONS: MAIN DETERMINANTS OF DEBT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Per cent</strong></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Real GDP growth rate</td>
</tr>
<tr>
<td>Inflation (GDP deflator growth rate)</td>
</tr>
<tr>
<td>Interest rate applied to</td>
</tr>
<tr>
<td>Short-term debt</td>
</tr>
<tr>
<td>Long-term debt maturing within a year</td>
</tr>
<tr>
<td>Non-maturing long-term debt</td>
</tr>
<tr>
<td>DDAs (% of GDP)</td>
</tr>
<tr>
<td>Primary balance (% of GDP)</td>
</tr>
</tbody>
</table>

Source: Author’s calculations.

---

\(^1\) The euro area interest rate projections were provided by the ECB as part of the common set of assumptions underlying the Eurosystem’s December 2018 Eurosystem staff projections.

\(^6\) IIP revenue is forecast separately and is assumed to decline gradually over time.
baseline scenario). Since this scenario assumes that Government maintains its policy of fiscal consolidation, the debt ratio exhibits a clear downward trend throughout the forecast period.

The resulting baseline debt projections were also subjected to a series of shocks (see Table 2). Overall, the debt ratio is expected to remain on a downward trajectory, except in the case of the combined shock, where the debt-to-GDP ratio would stabilise for some years. The highest debt ratio results from the combined shock, when Government is assumed to loosen fiscal policy in response to slowing economic growth. However, as the scenario assumes that Government remains committed to a surplus in structural terms, the overall level of debt remains low, standing at 34.6% in 2027.

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

**Scenario 2 – assuming fiscal policy reacts to changes in indebtedness**

This scenario assumes that, following the improvement in public finances and decline in the debt ratio observed in recent years, Government relaxes its stance and adopts a looser fiscal policy after 2021. The degree with which the fiscal balance varies in response to changes in the debt ratio is governed by a fiscal reaction function.\(^7\) Forecasts for macro and fiscal items in the period 2018-2021 are based on the Bank’s latest forecasts, published in February 2019. Following this period, the primary balance is assumed to react to previous years’ debt levels and the output gap according to the fiscal reaction function.

In the baseline scenario, the decline in the debt ratio is arrested and even reversed by the end of the forecast period. The resulting debt ratio is thus significantly higher compared with the forecast

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\(^7\) Fiscal reaction functions are based on the idea that fiscal policy is likely to react to changes in the debt ratio, with governments generally countering rising debt levels by improving the primary balance, and vice-versa. In this exercise, the function is estimated under an error-correction framework, in which the long run reaction of the primary balance to the debt ratio is also conditioned by short term changes in lagged public debt and the output gap. The regression results provide evidence of a positive and significant fiscal reaction to rising indebtedness.
outcome in baseline scenario 1. However, by 2027, the resulting debt ratio – at 35.8% – is still significantly below the 2017 starting point (see Chart 2). According to other scenarios as detailed in Table 2, shocks to real GDP growth and the combined shock exert the largest impact on the debt ratio profile. This is in line with the forecast shocks under scenario 1. However, the resulting debt ratios in this scenario are more elevated, reaching 45.9% of GDP in the combined shock scenario.

Heat map of indicators
This section assesses a number of indicators which, according to the literature, are highly relevant for debt sustainability in the short and long term. For ease of analysis, the threat each indicator poses to the debt ratio is colour coded – red indicates a high threat, yellow indicates a medium threat and a green signals a low threat to sustainability. The heat map is presented in Table 3. Most of the thresholds used to grade these indicators are sourced from the EC’s Fiscal Sustainability Report series.

Overall, the degree of risks from these indicators is limited, even when viewed from a historical perspective. The share of short-term debt in the total is low, averaging 6.5% between 2016 and 2017. Consequently, debt needs to be rolled over at less frequent intervals and thus refinancing risks are limited. Government also benefits from lower interest payments, resulting from ‘locking in’ a larger share of debt at the prevailing (low) coupon rates for a longer period of time.

As government debt is mainly held by Maltese residents, is issued in euro and largely issued at a fixed coupon rate, it is not vulnerable to sudden changes in investor appetite, exchange rate risks or interest rate risks. At the same time, the spread on Maltese ten-year bonds is not deemed to be excessively high and is hence regarded as safe by the market.

The heat map also includes a series of indicators on macro-financial risks and competitiveness risks. These indicators are also used by the Commission when determining whether the country suffers from excessive macroeconomic imbalances. If left unchecked, such imbalances can adversely affect the rate of economic growth and the health of the Maltese financial sector, thereby requiring some form of Government assistance.

From a macro-financial perspective, the main risks stem from the relatively high share of NPLs in the total loans extended by the core domestic banks. Nevertheless, it is encouraging to note that this share has been on a declining path since 2014. This partly reflects cyclical factors, but also measures by Maltese banks to reduce their expose to such risks.
Implicit liabilities, in the form of ageing costs (pensions, healthcare and long-term care), form another significant risk to sustainability. According to the Commission’s latest *Ageing Report* projections, Malta is set to have the second highest increase in age-related spending in the European Union between 2016 and 2070. In this period, pension spending is expected to increase by 2.9 percentage points of GDP, while healthcare and long-term care costs are expected to rise by 2.7 points and 1.4 points, respectively, for a total increase in ageing costs of 6.8 points. This is 5.6 percentage points higher than the EU average. However, Malta’s current spending on social security as a proportion of GDP is currently well below the EU average and is expected to remain so till at least 2040.\(^8\)

Government-guaranteed debt in Malta has been relatively high over the past couple of decades. In 2017, it stood at 9.6% of GDP, above the average ratio of guaranteed debt amongst euro area countries. In addition, around half of this debt is concentrated in the energy sector.\(^9\) However, the share of guaranteed debt has declined somewhat recently.

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\(^8\) In Malta, spending on social benefits excluding those in kind amounted to 9.5% of GDP in 2017, whereas the figure for the EU average stood at 15.8%.

Conclusion: Is government debt sustainable?
According to the scenario analysis, the government debt-to-GDP ratio is expected to remain low in the medium term. It would embark on an upward path if Government adopts a looser fiscal policy compared with the current targets, especially if this takes place in a period of slower economic growth. Nevertheless, if this is the case, the trajectory of the debt path is not deemed explosive – that is, it does not increase at a sudden and extraordinary pace.

According to the heat map of additional indicators, government debt is considered low risk from a liquidity perspective, with risks arising from the high level of implicit and contingent liabilities, as well as the level of NPLs of credit institutions, though these risks have diminished somewhat in recent years.

Overall, the updated DSA shows that Maltese government debt is sustainable according to the definition set out at the start of this Box. However, a more positive assessment can be achieved if Government reduces its level of guarantees and carries out periodic reviews of the pension system to balance adequacy needs with sustainability considerations. The authorities should remain vigilant and act decisively if any additional competitiveness and macro-financial risks arise. At the same time, Government should adhere to its commitment towards fiscal discipline, particularly during economic upturns, as this enables the creation of sufficient fiscal space that would allow room for fiscal manoeuvre to counter potential adverse shocks in the future.
PART II

BANK POLICIES,
OPERATIONS AND ACTIVITIES
1. THE CONDUCT OF MONETARY POLICY AND FINANCIAL MARKET OPERATIONS

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

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

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

Throughout 2018, the Eurosystem continued to offer liquidity to eligible credit institutions established in Malta via fixed-rate tender procedures with full allotment, through both MROs and LTROs.

During 2018, the ECB conducted 51 MROs. In the context of ample excess liquidity, credit institutions established in Malta did not participate in the MROs, whereas they had obtained €270.9 million in aggregate through such operations in 2017 (see Table 1.1).

The ECB also conducted 12 regular three-month LTROs with full allotment, and at a fixed rate equal to the average of the MRO rate during the lifetime of the operations. Similar to 2017, credit institutions established in Malta did not participate in the three-month LTROs during 2018 (see Table 1.1).

During 2018 the ECB continued the weekly provision of US dollar liquidity-providing operations with a one-week tenor through collateralised lending in conjunction with the US Federal Reserve. During the year under review, credit institutions established in Malta participated regularly, for a total amount of $1,438.1 million.

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.

<table>
<thead>
<tr>
<th>Table 1.1</th>
<th>PARTICIPATION OF ELIGIBLE MALTESE CREDIT INSTITUTIONS IN EUROSYSTEM OPEN MARKET OPERATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR millions</td>
<td>2017</td>
</tr>
<tr>
<td>Type of operation(^{(1)})</td>
<td></td>
</tr>
<tr>
<td>MROs</td>
<td>270.9</td>
</tr>
<tr>
<td>LTROs</td>
<td></td>
</tr>
<tr>
<td>Three-month LTROs</td>
<td>-</td>
</tr>
<tr>
<td>US dollar collateralised operations (USD millions)</td>
<td></td>
</tr>
<tr>
<td>Seven-day</td>
<td>301.0</td>
</tr>
</tbody>
</table>

\(^{(1)}\) In these Eurosystem operations, the amounts shown are the amounts allotted. These are equivalent to the amounts bid, owing to the full allotment policy.

\(^{1}\) For a description of the monetary policy decisions taken by the Governing Council, please refer to the Chapter titled “The euro area and the external environment”, which can be found in Part 1 of this Report.
In the context of rising liquidity, during 2018 counterparties continued to place excess funds with the Eurosystem through the overnight deposit facility. Recourse to this facility by Maltese credit institutions amounted to a daily average of €3,510.1 million in 2018, an increase of €630.3 million compared to the 2017 average. On the other hand, Maltese credit institutions used the marginal lending facility sparingly during 2018 for a total amount of €11.4 million.

The rates on the deposit facility, the MROs and the marginal lending facility remained unchanged throughout the year at -0.40%, 0.00% and 0.25%, respectively.

**Reserve requirements**

The ECB requires credit institutions established in the euro area to hold reserve deposits with their respective national central bank (NCB). The objective of the Eurosystem’s minimum reserve system is to contribute to the stability of money market interest rates and to help ensure the efficient operation of the Eurosystem as a liquidity supplier. Each credit institution established in Malta is accordingly obliged to hold minimum reserve deposits, equivalent to a fraction of certain liabilities, mainly deposits, with the Central Bank of Malta. During 2018 this reserve requirement ratio remained unchanged at 1.0%. The average balance required to be held as minimum reserve deposits in 2018 amounted to €303.6 million compared to €286.6 million in 2017.

**APPs**

Throughout the year, the Central Bank of Malta participated in the PSPP, which is part of the APP. During 2018 the Bank purchased €94.2 million worth of Maltese sovereign bonds. This was a lesser amount than that bought during 2017, partly because the Governing Council reduced the monthly pace of purchases twice during the year. In addition, the Bank carried out more purchases for the ECB’s PSPP portfolio when compared with 2017. Since inception, the total securities purchased by the Bank for its PSPP portfolio amounted to €1,042.3 million at the end of the year. The Bank’s holdings had a weighted average remaining maturity of 9.75 years at end-December 2018.

During the year, the Bank also purchased €55.5 million worth of Maltese sovereign bonds on behalf of the ECB PSPP portfolio, with total securities bought since inception in this portfolio amounting to €186.1 million. The Bank did not participate in the private-sector programmes, which also form part of the APP, owing to the absence of eligible securities in the domestic markets.

**Collateral management**

All Eurosystem credit operations take place against collateral. The Central Bank of Malta is responsible for assessing the eligibility of domestic marketable securities that can be used as collateral in Eurosystem monetary operations and for reporting them to the ECB. As at end-December 2018, the nominal outstanding value of eligible domestic marketable assets amounted to €5,182.7 million, compared with €5,376.2 million a year earlier.

At the end of the year the market value, after haircuts, of securities pledged by eligible Maltese counterparties with the Central Bank of Malta stood at €406.8 million. This consisted of both domestic and foreign securities, though debt instruments issued by the Maltese government accounted for the bulk of the securities pledged.

On 8 February 2018, the ECB implemented the Decision on the collateral eligibility criteria for unsecured bank bonds which was announced on 14 December 2017. Meanwhile, the ECB adjusted haircuts for floating rate assets and risk control measures for retained covered bonds with extendible maturities. It also amended

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This figure does not reflect the amortisation of securities held under the PSPP portfolio. Purchases of securities which matured during 2017 and 2018 are included in the presented figure.

This figure does not reflect the securities’ amortisation under the ECB PSPP portfolio. Until 31 December 2018, there were no redemptions from this portfolio.
the criteria on interest payment structures for eligible credit claims and introduced other technical changes related to the collateral framework.

**Liquidity management**
The Bank continued to provide the ECB with daily forecasts of items on its balance sheet that are unrelated to monetary policy instruments, such as banknotes in circulation, government deposits, net foreign assets and net assets denominated in euro. This information enables the Eurosystem to determine liquidity needs, even if the current full allotment policy ensures ample liquidity.

**Euro short-term rate (€STR)**
On 28 June 2018, the Governing Council of the ECB decided on the final methodology for calculating €STR, which is an overnight unsecured interest rate based entirely on money market statistical reporting. €STR will be produced by the ECB and will start to be published by October 2019.

Furthermore, on 13 September 2018, the private sector working group on euro risk-free rates recommended €STR as the new euro risk-free rate. The working group recommended, in particular, replacing EONIA with the new euro risk-free rate. This is because EONIA as it stands will no longer meet the criteria set out in the EU Benchmarks Regulation.

**Reserve management**
The Central Bank of Malta manages an investment portfolio of approximately €2,300.0 million, comprising both euro and foreign currency denominated assets. The EUR portfolio represents approximately 65.0% of assets under management, while the remaining 35.0% are predominantly invested in USD denominated securities. The Bank's main investment objective is to maximize the return on the foreign reserve assets within the safety and liquidity parameters approved by the Board of Directors and the Investment Policy Committee (IPC). The investment portfolio comprises money market instruments, fixed income securities and fixed income derivatives. The fixed income asset classes include sovereign bonds, securities issued by supranational and national government agencies, bank covered bonds and senior unsecured debt.

Since the start of 2018 the Bank has launched a third external investment management mandate, whereas two other externally managed portfolios that were initiated in 2013 were continued in 2018. The parameters of the two latter external mandates were gradually shifted to focus on asset classes beyond the core competence of internal resources in order to achieve more diversification in reserves management. With the new mandate the Bank has added further asset classes which will further increase diversification. The Bank has continued its investment in the Bank for International Settlements Investment Pool Sovereign China Fund.

The IPC, which formulates the investment strategy of the Bank’s investment portfolios, is chaired by the Governor and includes the Deputy Governors and senior officials of the Bank. The IPC monitors the performance of the Bank’s financial assets, evaluates the implementation of investment strategies, reviews reserve-management practices and assesses the overall investment policy. The Committee is also responsible to set the tactical benchmark for the actively-managed funds. The IPC met on a monthly basis during 2018.

In order to further strengthen the portfolio’s diversification, the Bank has this year once again increased its exposure to foreign assets denominated in other G10 currencies, apart from EUR and USD. Further on the Bank started investments in new asset classes to improve diversification and make the portfolio more robust.

The Bank continued to co-manage its portion of US dollar reserves on behalf of the ECB by way of a pooling mechanism jointly with the Central Bank of Ireland. During the year, International Asset Management Office worked closely with our colleagues from the Central Bank of Ireland to review the investment strategy, discuss trades and analyse the portfolio’s performance. The Bank continued to transmit to the ECB information on its foreign-exchange transactions and holdings as well as on the EUR denominated portion of the investment portfolio.
There were no changes related to the Exchange Rate Mechanism II intervention regime.

The Bank continued to manage the Investor Compensation Scheme (ICS) and Depositor Compensation Scheme (DCS) on behalf of the Malta Financial Services Authority (MFSA). During the year, the Bank has entered into a bilateral agreement with the NDSF to administer part of the NDSF’s portfolio.

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

**Market-making operations**

The Bank’s Government Securities Office (GSO) continued to provide market-making facilities by quoting daily bid and offer prices for the listed MGS on the MSE.

The Central Bank of Malta remained the main market player in the Maltese sovereign bond market, when compared with the other individual stockbrokers. In fact, the Bank market-making function effected 50.6% of the total on-exchange deals, whilst the inter brokers effected the remaining 49.4% between them. The percentage is slightly lower than that registered in 2017 at 56.1%.

In nominal terms, the Central Bank of Malta market-making function effected a total of €93.4 million (€69.3 million purchases; €24.1 million sales), which is less than half the €199 million registered in 2017. Interbroker dealing also decreased substantially from €156 million in 2017 to €91.4 million in 2018.

This substantial decrease in turnover can be mainly attributed to the lack of supply in the primary market by the Treasury of Malta given that the Maltese government is currently recording a surplus which has reduced its financial needs. As a result, only one major primary issue was conducted during this year apart from the savings bonds which are non-marketable securities. This major issue took place during the last quarter of 2018.

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

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

As from January 2018, the MSE extended the trading hours for the MGS market from 14:30 until 15:30. The Central Bank of Malta, through GSO, revised its processes in order to cater for such an extension, with prices being reviewed during the day when necessary. Furthermore, staff began to operate on a shift basis in order to cater for the longer trading hours.

The Bank assisted the Treasury in the selection of maturities to offer in the primary market in order to attract sufficient demand while at the same time limiting the refinancing risk to the lowest possible level.
2. FINANCIAL STABILITY

The Financial Stability Departments fulfil the Central Bank of Malta’s statutory mandate of ensuring financial stability and implementing macroprudential policy. The Financial Stability Surveillance, Assessment and Stress Testing, and Risk Models Department carried out surveillance and assessment of the financial sector in Malta, backed by stress tests to gauge the level of vulnerabilities, risks and the resilience of the system to severe, yet plausible, shocks. In turn, the Financial Stability Policy and Crisis Management Department is responsible for the formulation and implementation of macroprudential and crisis management policies, including the policies recommended by the JFSB.

The Bank published its risk assessments, stress test results and work related to macroprudential policy in its Financial Stability Report 2017 and its Interim Report covering the first half of 2018. These reports evaluated the key risks that could adversely affect the stability of the Maltese financial system, with the aim of pre-empting the build-up of potential systemic risks. Although the international geopolitical environment was challenging, the domestic financial system continued to be resilient, supported by robust economic growth.

The operations of the banking sector remained healthy on the back of strong capital buffers and ample liquidity. The asset quality of the banking sector has also stabilised as evidenced by the low NPL ratio which stood at 3.0% in December 2018. Core domestic banks, which have the strongest links with the Maltese economy, continued with their de-risking process, while maintaining adequate profitability levels. The univariate stress tests reaffirmed the robustness of the core and non-core domestic banks’ solvency and liquidity buffers. The domestic insurance companies continued to report strong underwriting performance and healthy capital levels. The domestically-focused investment funds continued to operate with conservative investment strategies, despite the rising global uncertainties, which could affect market sentiment.

Towards the end of the year, the EBA published detailed individual bank data on capital positions and leverage, risk exposure amounts and asset quality for a sample of 130 European banks, including three domestic credit institutions, as part of the 2018 EU-wide Transparency Exercise. The domestic significant institutions formed part of the ECB’s sample of banks for the 2018 EU-wide stress testing exercise since the ECB conducted its own stress test for the significant institutions under its direct supervision and which were not covered by the EBA stress test. The aim of this exercise was for the stress test results to be integrated in 2018 Supervisory Review and Evaluation Process (SREP) to determine the supervisory capital demand on banks.

The Bank, acting as an agent of the ECB, conducted four rounds of the BLS with the objective to monitor developments in lending standards and credit demand by non-financial corporates and households. The survey is conducted among the four large core domestic banks which capture about 92% of domestic lending. The main survey results were published in the Financial Stability Report.

In accordance with the Central Bank of Malta Directive No. 11, the Bank publishes on its website a quarterly assessment of potential risks caused by excessive credit growth. Given that the credit gap to GDP is still in negative territory, the CCyB rate was kept unchanged at 0% throughout 2018.

With regards to the capital conservation buffer, Article 160 of the Capital Requirements Directive (CRD) sets a transitional period from 1 January 2016 to 31 December 2018. The MFSA after consulting the JFSB, decided to implement a phased approach, ending in 2018. As from 2019, all institutions subject to the CRDIV/Capital Requirements Regulation framework will have to hold 2.5% of risk-weighted assets to cater for the capital conservation buffer.

Apart from setting the domestic CCyB rate, the Bank is also responsible to identify material third countries to prevent an uneven level playing field and any resulting incentives for regulatory arbitrage by recognising CCyB rates set by third-country authorities. Independently, the ESRB undertakes such exercise for the EU. In this respect, neither the Bank nor the ESRB requested domestic banks to recognise CCyB rates set by third-country authorities, nor did they set or lower CCyB rates for exposures to third countries.
The Bank, in conjunction with the MFSA, applied the established methodology with respect to the identification of Other Systemically Important Institutions (O-SII). The exercise established the same three credit institutions as identified in the previous year to set the O-SII capital for 2018. Following a recommendation by the JFSB, a consultation on the introduction of a proposed Directive on Borrower-Based Measures under the Central Bank of Malta Act (Cap. 204) was launched by the Bank in October 2018. The proposed Directive intends to strengthen the existing menu of credit risk mitigation tools adopted by domestic credit institutions. The deployment of macroprudential limits on mortgages in the form of borrower-based measures (such as loan-to-value, stressed debt service to income ratios and maturity limits) will enhance the resilience of banks' and households' balance sheets to possible house price corrections and interest rate reversals. The proposed Directive will be officially published in the first quarter of 2019 and expected to be effective as from July 2019.

During the year, the Bank co-ordinated at a national level Malta’s FSAP. This is an exercise conducted by the IMF upon the Government’s invitation to comprehensively analyse a country’s financial system within the context of the local regulatory and supervisory framework, as well as within the broader European framework insofar as it is relevant for the country in question. An FSAP Scoping Mission in March 2018 was followed by a mission-team visit between 10 and 26 September 2018. The Mission included meetings with the Ministry for Finance, the Parliamentary Secretary for Financial Services, Digital Economy and Innovation, the Central Bank of Malta, the MFSA, the Financial Intelligence Analysis Unit (FIAU), NSO and also with representatives from the ECB. Meetings were also held with representatives of domestic banks, investment firms, insurance companies, other financial institutions, industry associations, and representatives from the auditing, accounting and legal profession. The assessment is expected to be concluded in early 2019.

The Financial Stability Committee met three times in 2018 and also circulated a number of written procedures. Among the main topics, the Committee discussed the structure and content of the Financial Stability Report 2017 and the Interim Report for 2018; pursued considerations on the implementation of borrower-based policy tools in Malta; developments in the banking sector; and also intra-company lending.

The JFSB met ten times in 2018 to discuss specific developments in the domestic banking sector, including a recommendation for a directive on borrower-based measures applicable to all domestic lenders in Malta. The Board set out a national co-ordination strategy for Malta’s FSAP Mission which included the appointment of a Steering Committee and a Programme Management Officer from the Bank.

The Domestic Standing Committee tasked with managing a financial crisis situation is composed of representatives from the Bank, the MFSA and the Ministry for Finance. During the year, it also held regular meetings with discussions mainly focused on the new Emergency Liquidity Assistance Framework, Creditor Hierarchy, the status of the simulation exercise and the domestic crisis management framework. It also discussed the implications of the crisis in emerging markets, particularly Turkey and Argentina on the domestic financial system, as well as scenarios on interest rate shocks and their impact on banks’ banking books.

The Forum for Financial Stability met in December 2018 and exchanged views on the main developments and the salient risks faced by the global and the domestic financial systems. Discussions also revolved around the global regulatory and supervisory framework as well as the remaining challenges in completing the implementation of the reform agenda. Participants were also briefed on the ESRB’s recommendation on addressing real estate data gaps which suggests a set of indicators for the residential real estate and the commercial real estate sectors.

During the year staff from the Bank and the MFSA held a series of technical meetings, mainly related to the drafting of the Directive on Borrower-Based Measures. The Bank also provided contributions to the Ministry

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1. The Financial Stability Committee is chaired by the Governor and includes the two Deputy Governors, the Chief Officer Economics, the Chief Officer Financial Control and Risk, the Chief Officer Financial Stability, the Head Financial Stability, Policy and Crisis Management and the Head Financial Stability Surveillance, Assessment and Stress Testing, and Risk Models.

2. The JFSB is chaired by the Governor and includes two other representatives of the Bank and two representatives of the MFSA. The Minister for Finance and Parliamentary Secretary for Financial Services, Digital Economy and Innovation attend the meetings as observers.
for Finance on the EU dossiers on financial services legislation in the areas of recovery and resolution, capital framework and the review of European System of Financial Supervision (ESFS) amongst others. In addition, Bank experts participated directly in six EU Council meetings on the ESFS review. Furthermore, during the year, Bank officials participated in various meetings and workshops of the ESRB and the ECB, as well as in the activities of their related sub-structures. The Bank participated as a representative member on the EBA’s Board of Supervisors and as a member on the Supervisory Board of the SSM alongside the MFSA. Bank representatives are provided with all relevant documentation and briefing notes prepared by staff from Financial Stability Departments to facilitate their participation in the discussions. Discussions on financial stability issues were also held with the EC, various credit rating agencies and the IMF in terms of the Article IV Mission. Moreover, the Bank participated and contributed to the MONEYVAL on-site evaluation which was undertaken between 5 and 16 November 2018. The Bank also participated in an evaluation meeting undertaken by the UN Convention against Corruption as part of their regular evaluation of UN countries.

The Bank, together with other relevant authorities such as the NSO will also continue to work to address real estate data gaps identified by the ESRB recommendation.³

³ Recommendation of 31 October 2016 on closing real estate data gaps (Recommendation ESRB/2016/14).
3. ECONOMIC ANALYSIS AND RESEARCH

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

Staff provided input on monetary and other economic issues for internal briefings with the Governor ahead of his participation in the Governing Council and the General Council of the ECB, as well as in relation to contacts with external bodies, such as the EC, the IMF and credit rating agencies. Staff also exchanged views with the Bank’s financial stability experts and with the IMF as part of the FSAP.

Four projection exercises were conducted, two of which undertaken as part of the Eurosystem’s Broad Macroeconomic Projection Exercise. Further work was carried out to develop additional tools to supplement the Bank’s core macro-econometric model in the forecasting process. Progress was also made to build a suite of Bayesian Vector Autoregression models. Staff also continued to meet companies and public sector institutions to obtain a better gauge of domestic economic conditions and prospects.

The Bank published its analysis of domestic and foreign economic and financial developments in its Quarterly Review and Annual Report.1 As of 2018, these publications include commentaries on a number of internally developed indicators, including the Bank’s estimate of potential output, its BCI, a measure of structural unemployment, the FCI as well as cyclically-adjusted fiscal and current account balances. Meanwhile, the Bank continued to publish its monthly Economic Update.

The Economic Analysis Department worked closely with statistical compilers in other institutions and participated in the work of the ECB’s Statistics Committee. Staff also participated in discussions with the IMF in relation to the 2018 Fiscal Transparency Evaluation exercise for Malta on issues related to the compilation and dissemination of government finance statistics.2 Together with representatives of the Government and the NSO, the Department also participated in a Eurostat Excessive Deficit Procedure dialogue visit. The Department also transmitted the results of the 2017 HFCS to the ECB and began to plan the next wave of this Survey.3

Bank staff undertook specialised research, which resulted in six working papers, two policy notes and seventeen articles in the Bank’s publications. The working papers dealt with labour market flows, inflation-linked bonds, income distribution and job mobility, a new model for short-term forecasting purposes, the inflation process in the euro area and a theoretical model of the relationship between macroprudential policies and the housing market. The policy notes focused on Malta’s first ten years in the Economic and Monetary Union and on the contribution of SMEs to the Maltese economy.

Research was also presented internationally. Seven articles were published in foreign peer-reviewed journals, including a contribution to an ECB Occasional Paper on structural policies in the euro area. Staff also gave inputs to a number of ECB task forces on the exchange rate pass through, low wages and potential output growth. A total of six presentations were delivered by staff in conferences in the United Kingdom, Austria, Germany, Italy and Canada.

In 2018, the Bank hosted a conference to commemorate its 50th anniversary, with a policy panel that focused on the policy challenges faced by central banks after the financial crisis. Foreign speakers featured Vítor Constâncio, the Vice-President of the ECB, Professor Charles Goodhart from the London School of Economics and Political Science, Már Guðmundsson, the Governor of the Central Bank of Iceland and Sharon Donnery and Lawrence Schembri, the Deputy Governors of the Central Banks of Ireland and Canada.

1 The Bank’s publications can be found at: www.centralbankmalta.org/publications.
respectively. During the conference, the Bank launched the publication *The Central Bank of Malta’s first fifty years: A solid foundation for the future*, which documents the fundamental changes which transformed Malta’s economic and financial landscape over the last fifty years and the changing role of the Central Bank of Malta.

The Bank also organised its Annual Research Symposium. Two academics from prominent UK and US universities, Margarita Rubio and Professor Andrew Ellul, delivered presentations on topics related to financial stability while two economists from the Research Department, Noel Rapa and Luca Brugnolini, discussed the latest structural modelling activities at the Bank. During this workshop, the Bank launched its first *Research Bulletin*, with articles on the effects of energy reforms, the housing market, revisions to GDP data and income distribution, inequality and job mobility in Malta.

As part of a series of events to commemorate its 50th anniversary, the Bank launched a number of public lectures in Economics and Finance. These lectures, three of which were delivered by external speakers, dealt with Malta’s experience in the first decade in the euro area (Rita Schembri from the Central Bank of Malta), macroeconomic developments in the European economy (Reuben Borg from the EC), the welfare state (Professor Nicholas Barr from the London School of Economics and Political Science) and unconventional monetary policy in the euro area (Stefano Siviero from the *Banca d’Italia*).

The Bank held regular internal seminars and in 2018, five of these were delivered by speakers from outside the Bank, including by two foreign academics (Professor Andrew Narwold from the University of San Diego and Sean Brocklebank from the University of Edinburgh) and another one by two experts from the UK’s National Institute for Economic and Social Research (Garry Young and Ian Hurst). Staff members presented their research to external stakeholders, such as the Malta Fiscal Advisory Council, Malta Enterprise (ME) and the Secretariat of the Parliamentary Secretary for Social Accommodation. These presentations focused on a new structural model with a rich fiscal block, an analysis of the manufacturing sector and the rental market. Staff also delivered presentations on the Bank’s macro-econometric model in seminars organized by the Economic Policy Department and Jobsplus. Staff represented the Bank in the Advisory Committee and Property Working Group of the Building Industry Consultative Council.

In collaboration with the Ministry for Foreign Affairs and Trade Promotion, staff delivered a week-long training programme on money and banking for nine central bankers from the Central Bank of The Gambia. The lectures covered a range of topics such as money and banking, statistics and economic forecasting. This initiative represents a further step in building a strategic partnership between Malta and African states.

Research plans for 2019 include studies on particular aspects or sectors of the Maltese economy, demographics, macro-financial linkages and fiscal policy. The Bank will continue to allocate resources to develop econometric and structural models to complement its forecasting toolkit and enhance its research capacity.
4. STATISTICS

The Central Bank of Malta is primarily responsible for the compilation of monetary, financial stability, financial, payments’, securities’ and financial institutions’ statistics in Malta. The Bank also collects other statistical information, such as prudential supervisory and macroeconomic statistics, for internal policy making purposes. These statistics are also used by public authorities, financial market participants, the media and general public. The Bank also contributes to the compilation of the balance of payments/international investment position statistics and financial accounts statistics in cooperation with the NSO. The Bank fulfils international statistical reporting obligations, mainly to the ECB and the IMF. The Bank participates in the IMF’s Special Data Dissemination Standard and the General Data Dissemination System, as well as in various surveys conducted by the IMF. During the year the Bank shared statistical information with the IMF’s FSAP delegation which visited Malta in September.

The Bank continued to operate its Central Credit Register (CCR) so as to provide credit risk information relating to borrowers to both credit institutions and natural and legal borrowers. This is in line with Directive No. 14 which empowers the Bank to organise and operate the Register in pursuit of its objectives regarding the financial system stability, monetary policy research and analysis and processing of statistical information. The availability of a CCR in Malta also addresses a key requirement of the World Bank in its Doing Business report. Since its inception in April 2016, credit institutions made ample use of the register, with queries on prospective and existing clients more than doubling in 2018 when compared to the previous year. The Bank is currently also having discussions with the Malta Development Bank (MDB) and making the necessary preparations to enable the MDB to populate and access the Bank’s register. Meanwhile, the Bank continued to prepare the necessary legal, technical and organisational requirements to cater for the Bank’s regulatory and supervisory role of CRAs. The Bank had a number of meetings with prospective licence holders and stakeholders such as the Trading Licence Unit within the Commerce Department of the Ministry for the Economy, Investment and Small Business.

Participation in other Eurosystem-related work involved the implementation of the ESCB’s AnaCredit project. This ESCB project aims to provide a harmonised set of credit and credit risk data across participating euro-area countries. The first phase of the AnaCredit project dealt with the counterparty reference data which switched to the live environment in March 2018. The second phase of the project consisted of the implementation of the credit data which was completed in November 2018. Seminars for the reporting credit institutions and a dedicated AnaCredit webpage were regularly updated for use by respondents and their IT consultants. Moreover, the Bank continued to enhance the quality of the Maltese securities’ data held within the ECB’s Centralised Securities Database while data on securities holding statistics continued to be transmitted to the ECB on a quarterly basis. Following the amendment of the respective ECB regulation, Malta started to collate security-by-security data held by the reporting banking groups. During the year, the Bank also continued to collaborate with the NSO to enhance the quality of balance of payments’ data, particularly to fulfil the recommendations of the ECB and Eurostat.

In preparation for the forthcoming ECB Regulation on the statistical reporting requirements for pension funds, the Central Bank of Malta and the MFSA resumed collaboration through the sharing of information of mutual interest. The Bank meanwhile continued to collect and process the European Insurance and Occupational Pensions Authority’s Solvency II regulatory returns, mainly for financial stability purposes. The data being collected also includes the statistical reporting requirements for insurance corporations in line with the related ECB Regulation.

The Bank enhanced the data required for the MIP Scoreboard indicators which are based on the Bank’s financial accounts statistics. “From Whom-to-Whom” tables, which explain the financial linkages between the country’s institutional sectors, continued to be published on the Bank’s website. During the year, the Bank focused also on inter-company lending with the aim of enhancing further the related statistics.
Collaboration with Banca d’Italia focused on the implementation of a number of new statistical processes in INFOSTAT (the Bank’s statistical solution), notably in respect of the BR06 returns which cater for data received from various respondents within the credit and financial sector. The remaining processes, including newly identified statistical projects, will continue to be migrated in 2019. An essential part of the INFOSTAT project involved the creation of an integrated data dictionary and the development of a specific extensible mark-up language generator which was embedded into the main returns. As a result of more business processes migrating to INFOSTAT, more capacity is being freed for enhanced, more value adding, statistical analysis. During 2019, additional diagnostic checks will be implemented for all business processes. In order to enhance users’ knowledge, a number of courses in basic SQL and the INFOSTAT’s inquiry tool were delivered. At the same time the help-desk continued to provide on-going technical assistance and has become a single point of contact to both internal and external users, particularly for registering in INFOSTAT and data uploads as well as general queries received from respondents.

The internal Statistics Committee, supported by its sub-structure, continued to meet to define and implement the policy on statistical information within the Bank. The Forum for Central Bank of Malta Statistics, which is chaired by the Bank and includes representatives from credit institutions, MFSA, NSO and the Malta Bankers’ Association, continued to meet to promote dialogue on monetary and financial statistics among stakeholders. Concurrently, Bank officials participated in the Statistics Committee in ESCB and SSM composition, and in its various sub-structures, in the development of statistics which are needed to support the euro area monetary policy, supervisory functions of the ECB, various other tasks of the ESCB and tasks of the ESRB.
5. CURRENCY, PAYMENT SYSTEMS AND BANKING SERVICES

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

Currency operations
Currency Operations Office is tasked with providing an adequate supply of banknotes and coins to meet the demand of the banking system and ensure the high quality and authenticity of the currency in circulation (see Tables 5.1 and 5.2). All currency returned to the Bank is processed by the ECB accredited machines. Counterfeit banknotes and coins are withdrawn while those found to be unfit for circulation are destroyed. Data on stocks and flows of banknotes and coins are reported on a daily and monthly basis to the ECB through the Currency Information System.

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

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

Circulation of notes and coins
During 2018, the notes inspected by the Bank numbered 100.1 million compared with 91.8 million in 2017. The inspected notes had a value of approximately €2,423.9 million, which was €319.9 million higher than in 2017. The proportion of banknotes destroyed increased from 11.3% in 2017 to 15.2% in 2018. This increase

| Table 5.1 | BANKNOTES ISSUED BY AND PAID INTO THE CENTRAL BANK OF MALTA IN 2018 |
|---|---|---|---|---|
| | EUR millions | | | |
| | Issued by Central Bank of Malta | Paid into Central Bank of Malta | Net issue | Issued and outstanding |
| January | 181.9 | 201.9 | -20.0 | 1,147.7 |
| February | 171.8 | 156.7 | 15.1 | 1,162.8 |
| March | 219.9 | 169.2 | 50.7 | 1,213.5 |
| April | 195.0 | 197.8 | -2.8 | 1,210.7 |
| May | 214.9 | 205.6 | 9.3 | 1,220.0 |
| June | 209.3 | 185.0 | 24.3 | 1,244.3 |
| July | 234.2 | 223.5 | 10.7 | 1,255.0 |
| August | 218.8 | 221.3 | -2.5 | 1,252.5 |
| September | 194.5 | 182.5 | 12.0 | 1,264.5 |
| October | 211.5 | 213.2 | -1.7 | 1,262.8 |
| November | 205.0 | 189.6 | 15.4 | 1,278.2 |
| December | 242.7 | 187.2 | 55.5 | 1,333.7 |
| Total 2017 | 2,384.0 | 2,250.8 | 133.3 | 1,167.7 |
| Total 2018 | 2,499.5 | 2,333.5 | 166.0 | 1,337.7 |

Source: Central Bank of Malta.
is mainly related to the fact that in 2018 the Bank adopted a stricter sorting policy at the Note Examination Room in order to enhance the quality of the €5 banknotes in circulation.

During 2018 no new series of banknotes were issued. The outstanding volume of euro coins rose by 8.4%. By the end of 2018, there were 324.5 million euro coins issued and outstanding, equivalent to €87.9 million. A total of 62.0 million coins, equivalent to €36.8 million, were processed by the Bank. The number of coins examined increased by 4.7% from 59.2 million coins to 62.0 million coins in 2018.

During 2018, the Bank continued to use the Cash Single Shared Platform system as the cash management system for banknotes and for coins.

In 2018, Currency Operations Office carried on with the certification of professional cash handlers. Various employees involved in cash handling from different credit institutions, financial institutions and casinos have renewed their certificate by taking the online test modules, while a number of new cash handlers were enrolled in the online platform for the first time. By the end of 2018 there were 1,500 professional cash handlers enrolled.

Moreover, Currency Operations Office continued its collaboration with the Ministry for Education and Employment. During 2018, the Money Matters programme was offered to Year six pupils together with their teachers and Learning Support Educators from all three sectors – State, Church and Independent schools.

Collection and disposal of Maltese lira banknotes
A total of 42,794 Maltese lira banknotes with a value of €961,837.9 were exchanged at the Bank during 2018. Deposits on the last day of exchange, 31 January 2018, amounted to €182,108.1 equivalent to 18.9% of the total amount deposited in January.

Numismatic and commemorative coins
In March 2018, a gold and silver numismatic coin depicting Giuseppe Mazzuoli’s statuary group The Baptism of Christ was issued. The coins were issued under the Europa Programme with the theme Baroque and Rococo and bear the Europa Star logo. The coins feature the monumental white marble sculpture executed in Rome by Giuseppe Mazzuoli and installed in the apse of St John’s Co-Cathedral in 1703.
To celebrate its 50th anniversary, the Central Bank of Malta, on 17 April 2018 issued numismatic coins in gold and silver. The coins carry a representation of the façade of the Central Bank of Malta’s newly-built premises, Binja Laparelli, located within St James Counterguard in Valletta. The gold coins bear a 50th Anniversary logo while the same logo on the silver coins is reproduced in gold-plating. It is the first time that such a technique has been used on Maltese numismatic coins.

In May 2018 a silver coin to celebrate Valletta as the European Capital of Culture was issued. The coin depicts a personification of Valletta, a fortress-city, represented as a woman wearing armour. During the same month the Central Bank of Malta and MaltaPost issued a joint numismatic product consisting of a silver coin and a silver foil stamp replica to mark the same occasion. The MaltaPost silver foil stamp depicts the 26 cents postage stamp from the Valletta 2018 European Capital of Culture collection of stamps.

A euro coin set dated 2018 was issued in May, consisting of the eight Maltese euro circulation coins including a €2 commemorative coin Mnajdra.

In July 2018, a €2 commemorative coin featuring the Mnajdra temples was issued. This was the third in a series of seven coins featuring Maltese prehistoric structures, listed as UNESCO World Heritage Sites. The coin was issued in rolls of 25 coins each as well as individually in coin cards.

A euro coin blister pack dated 2018 was issued in October, consisting of the eight Maltese euro circulation coins. This was the third and last blister pack in a series of three in preparation of the voyage towards Valletta, the European Capital of Culture 2018.

Another €2 commemorative coin featuring, Cultural Heritage, the winning design of a competition for students, was issued in November 2018. The coin was issued in rolls of 25 coins each as well as individually in coin cards.

During the same month, the Central Bank of Malta and Malta Post jointly issued a Philatelic Numismatic Cover consisting of a €5 coin and a €2 postage stamp commemorating the centenary of the end of World War I. The coin features a nurse assisting a wounded soldier while the postage stamp depicts the hospital ship HMHS Rewa in the Grand Harbour.

On 30 November 2018 the Central Bank of Malta, in collaboration with Lombard Bank plc, issued three gold bullion coins. The coins, which are legal tender in Malta, were issued in three different weights and denominations. The coins are struck in 0.999 gold (24 carats) by PAMP S.A. Mint in Switzerland and rank among the purest official bullion coins available worldwide.

Anti-counterfeit measures
A total of 100.1 million banknotes with a value of €2,424.0 million were examined at the Bank, where 84.9 million banknotes with a value of €1,898.7 million were found suitable for re-issue. At the same time, 15.2 million banknotes with a value of €523.9 million were destroyed. During 2018 a total of 61.9 million euro coins, with a value of €36.8 million were examined by the Bank. There were no significant changes in the volume of coins examined from the previous year.

During the year, the Central Bank of Malta continued to closely monitor the credit institutions and other professional cash handlers. Monitoring tests were performed on each type of banknote handling machine. A number of unannounced inspections at branches of commercial banks were also undertaken to ensure compliance with the ECB directive on authenticity and recirculation of banknotes. Data on recirculation was collected and sent to the ECB.

Quarterly meetings with credit institutions continued to be held during 2018 to keep members updated on currency matters.

The Currency Operation Office is responsible for the co-ordination of counterfeit awareness in Malta. During 2018 677 banknotes and 448 coins were analysed and confirmed as counterfeits and the findings were
uploaded into the ECB’s Counterfeit Monitoring System. The Currency Operation Office personnel were also asked to provide expert evidence during seven court sittings.

The implementation of the Central Bank of Malta Directive No. 10 continued during 2018 through further monitoring tests of banknote handling machines and devices held at the commercial banks and other ‘professional cash handlers’. Assistance was also provided to those institutions or retailers with the upgrading of their machines.

During 2018, Currency Operations issued two press releases to inform the public on the status of counterfeit notes in the Eurosystem in general and more specifically on the local situation.

Counterfeit awareness was also raised, through participation in various television and radio programmes and also by setting up a dedicated section during the annual Notte Bianca event in which two colleagues from the communications department of the ECB participated and this in conjunction with the ongoing educational campaign.

**Payment and securities settlement systems**

The Bank’s responsibility to carry out regulation and oversight activities stems from Article 34 of the Central Bank of Malta Act, whereby the Bank, also as part of the Eurosystem, is responsible for regulating and overseeing the operation of payment systems and clearing and securities settlement systems (SSS). Besides participating in Oversight Assessments carried out on TARGET2 (T2), TARGET2-Securities (T2S) and TARGET Instant Payment Settlement (TIPS), the Bank is responsible to oversee MaltaClear, the MSE SSS, as well as the Malta Clearing House (MCH) which is designated as Other Retail Payment System (ORPS) by the ECB following an annual payment system classification exercise as indicated in the Systemically Important Payment System (SIPS) Regulation.

The two major regulatory developments relating to payment services as well as payment and settlements systems during 2018 were the implementation of the revised PSD2 and the CSDR.

**The revised PSD2**

On 9 January 2018, the Bank published the final text of the revised Central Bank of Malta Directive No. 1 on the Provision and Use of Payment Services which transposed the provisions of Titles III and IV of the revised PSD2. The other two Titles fall within the mandate of the MFSA. The PSD2, which supersedes the original PSD, is designed to strengthen consumer protection, foster innovation, promote competition and regulate new market players.

Throughout 2018, the EBA published a number of Guidelines to support the objectives of PSD2, while the regulatory technical standards for strong customer authentication and common and secure open standards of communication (RTS) were published in the Official Journal of the European Union on 14 March 2018. The latter RTS will become applicable on 14 September 2019 and mandate payment service providers to implement stronger customer authentication mechanisms and provide access to payment accounts to third party payment providers.

With such developments taking place in the market, the Bank organised numerous meetings with market players and led an initiative on Application Programming Interface Standardisation in Malta. The Bank also attended various regulatory convergence workshops held by the EBA. It is envisaged that these meetings will continue during 2019 especially in light of the regulatory technical standards on strong customer authentication and common and secure open standards of communication becoming applicable in September 2019.

**CSDR**

Following the implementation of the regulatory technical standards on authorisation, supervisory and operational requirements for Central Securities Depositories stemming from the CSDR, the MSE submitted its...
authorisation application during 2018 after which the National Competent Authority (NCA) had six months to either grant or reject authorisation. To this effect, the MFSA, as the NCA for CSDR, requested the view of the Central Bank of Malta, as a Relevant Authority, on the features of the SSS. In this respect, the Bank carried out an assessment from a central bank of issue and cash-leg perspective providing its views to the MFSA on whether the MSE should be authorised to continue its operations. Following a thorough assessment and consultation with the Bank, the MFSA provided the MSE with the initial authorisation as a CSD under Article 16 of the CSDR on the 17 October 2018. Furthermore, the MFSA, in consultation with the Central Bank of Malta, will re-assess on an annual basis the MSE’s compliance to the requirements outlined under the CSDR as stipulated in Article 22 of the CSDR.

With the introduction of the authorisation process, the Eurosystem concluded that the current User Assessment Framework (UAF) will be phased out in order to avoid any additional burden on the relevant Financial Market Infrastructures (FMIs). Following a mapping exercise between the UAF and CSDR, the ECB decided to include requirements which are not covered by the CSDR in the General Documentation. Such requirements were included in the Central Bank of Malta Directive No. 8 as Annex 6A which lays down the *Eligibility criteria for the use of the SSSs and links between SSSs in Eurosystem credit operations*. In addition, the Central Bank of Malta Directive No. 12 (Administrative Measures and Penalties for Infringements) was updated including penalties which the Central Bank of Malta may enforce if the MSE does not abide by the requirements outlined in the Central Bank of Malta Directive No. 8.

**Oversight assessments**
The oversight assessment on the MCH, which was done as part of the obligations to carry out assessment procedures on payments systems under the ECB SIPS Regulation, was presented to the operators in 2017. The operators provided a status update to the overseers at the end of 2018 outlining the measures taken by the MCH to address certain issued recommendations.

**Other Assessments**
The Central Bank of Malta has also been involved in the Eurosystem Cyber Resilience exercise which was carried out on relevant FMIs. The Bank presented an assessment report to the MSE during 2018 outlining the main findings on the currently implemented cyber resilience measures and issued a set of recommendations in order to cater for today’s ever-growing cyber threats. This is an ongoing process and is being followed-up on a regular basis.

**MCH**
The MCH meets every morning at the Bank’s premises to physically exchange the cheques negotiated during the previous working day by each participant of the MCH on behalf of the other participants. During the year, a financial institution joined the MCH, while another institution had its license withdrawn by the MFSA, leaving the total number of direct participants to 12.

There was a marginal increase in the total number of cheques cleared whilst the total value increased by 6.5% over the previous year, as shown in Table 5.3.

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of cheques cleared</th>
<th>Value (EUR millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>4,758,008</td>
<td>9,582.9</td>
</tr>
<tr>
<td>2018</td>
<td>4,758,599</td>
<td>10,204.6</td>
</tr>
<tr>
<td>Change</td>
<td>591</td>
<td>621.7</td>
</tr>
<tr>
<td>Percentage change</td>
<td>n/a</td>
<td>6.5</td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.
TARGET2 - Malta

During 2018, the operation of TARGET2 - Malta continued to be stable in terms of performance and availability. The number of direct participants went down from 11 to ten resulting from a suspension of one direct participant during the year.

TARGET2 payment traffic in 2018 registered a 1.7% increase in terms of volume and an increase of 24.6% in terms of value, when compared to 2017. Although, both customer payments and inter-bank payments registered an increase in volume and value, this increase was mainly related to a higher number of inter-bank payments. The total volume of payments processed during 2018 was 115,929 for a total value of €1,046,596.3 million. The volume of customer payments was 94,318 for a total value €7,792.7 million, and the volume of inter-bank payments was 21,611 for a total value of €1,038,803.6 million.

Banker to the public sector

The range of banking services provided by the Bank to the Government remained unchanged during the year under review. These mainly consisted of the maintenance of various accounts in euro and foreign currencies, the encashment of cheques drawn on the Central Bank of Malta and issued by Government Departments, deposits of cash and cheques, SEPA2 Credit Transfers, safe deposit facility, safe custody and payments through TARGET2.

During 2018, the number of cheques drawn on the Bank by the public sector increased by 20.6%, whilst their value decreased by 12.3% (see Table 5.4). This shift was mainly due to a Budget measure, whereby Government issued around 200,000 cheques amounting between €40 and €68 each as a tax rebate measure. If one had to exclude these cheques, which in total amount to approximately €10.6 million, then there would be a percentage decrease in the volume of cheques of 11.2% and a percentage decrease in value of 13.9%.

During the year, SEPA Credit Transfers (SCT) continued to increase. As at end 2018, the Bank processed 2.6 million SCTs, for a total value of €3,921.1 million, representing a 2.7% and 22.2% increase respectively over the 2017 figures.

The range of foreign exchange services offered to the Government and public sector organisations during 2018 remained unchanged and included the sale and purchase of foreign currency, outward and inward payments by SWIFT, encashment of drafts in foreign currency, and the maintenance of foreign currency accounts.

Throughout 2018, the Bank continued to effect payments, related to the servicing of the Government’s external debt. The amount of capital repayments was similar to the 2017 one. The associated interest paid in 2018 decreased by 42.9% when compared to 2017.

<table>
<thead>
<tr>
<th>Table 5.4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NUMBER AND VALUE OF CHEQUES DRAWN ON THE CENTRAL BANK OF MALTA BY THE PUBLIC SECTOR</strong></td>
</tr>
<tr>
<td><strong>Number of cheques</strong></td>
</tr>
<tr>
<td>2017</td>
</tr>
<tr>
<td>2018</td>
</tr>
<tr>
<td>Change</td>
</tr>
<tr>
<td>Percentage change</td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.

2 SEPA stands for Single Euro Payments Area.
**Banker to the banking system**  
The Central Bank of Malta continued to act as banker to the rest of the banking system by providing deposit facilities to credit institutions. These institutions maintain balances at the Bank mainly to meet their reserve deposit requirements. They generally hold reserve accounts, margin call accounts and accounts pledged in favour of the ICS and DCS.

**Other financial services**  
In 2018 the Bank maintained its portfolio management services to the ICS and DCS on the parameters set by the respective Management Committees appointed by the MFSA.

During 2018 TIPS went live. TIPS is the new market infrastructure service launched by the Eurosystem which enables payment service providers to offer fund transfers to their customers in real time on a 24/7/365 basis. Individuals and firms can transfer money between each other within seconds, irrespective of the opening hours of their local bank. TIPS was developed as an extension of TARGET2 and settles payments in central bank money in euro. TIPS is also designed to settle in other currencies should the market request this functionality. As at the end of 2018, there were no local direct participants in TIPS.

During 2018, Regulation and Oversight Office carried out the analysis of data gathered through a Payment Habits Survey. Fieldwork of this Survey was undertaken by the NSO in the first quarter of 2018. A summary of this survey is being reported in this Annual Report while the report of the survey is expected to be published during 2019.

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**BOX 5: AN ANALYSIS OF MALTESE PAYMENT HABITS IN 2018**

**Introduction**  
Payment habits can be defined as the pattern of use by society of different payment instruments to effect payments. The analysis of such habits sheds light on the coexistence of cash and other means of payment methods in society. Given that central banks seek to promote more effective and efficient payment methods, the survey on Maltese payment habits is beneficial for providing an insight into the behaviour of households in Malta in this regard.

**The 2018 Payment Habits Survey**  
Following the first Payment Habits Survey in 2013, the Central Bank of Malta conducted a second survey in 2018, with the aim of better understanding trends and developments of payment habits in Malta.

The study is based on a systematic sample of 500 Maltese households, covering 1,118 respondents. The survey took place in the first quarter of 2018. Similar to the previous survey, it was spearheaded by the Regulation and Oversight Office within the Payments and Banking Department of the Central Bank of Malta. The fieldwork and the grossing up of statistics was carried out by the NSO. Survey data were weighted using the post-stratification method to correct for any bias which would be present in the final sample of participating units arising from different response rates observed in different categories.

The survey was designed in two sections:

a) a questionnaire;

b) a payment diary where respondents were asked to keep record of all their purchases made during five days (Monday to Friday) and which payment instrument was used for making such purchases.

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1 Prepared by Mr Charles Saliba and Ms Mary Ann Muscat. Mr Saliba is Manager within Regulation and Oversight Office and Ms Muscat is a Senior Officer in the same Office. Ms Satoya Dimech, Officer II in Regulation and Oversight Office also contributed to this paper.
Data collected comprised the demographic characteristics of each respondent, such as gender, age, region of residence, education level, employment status, and income. Other information focused on the current usage of payment instruments and their usage in the next five years. Survey results confirm that even though the use of modern payment instruments has increased, cash remains the preferred payment instrument of Maltese households for the purchase of groceries, consumables, non-consumables as well as the payment of utility bills and wellness services. Both the survey as well as additional information based on ECB payments statistics suggest that when it comes to the relative importance of the main payment instruments other than cash, cards are more important than cheques. At the same time, ECB payment statistics for 2017 show that cheques are used to a greater extent in Malta than in the EU.

**Payment instrument access and use**

The survey aims to identify the accessibility that a person has to particular payment instruments. Accessibility is defined as the person’s ability to have direct access to a payment instrument and the knowledge to use it. Though the use of a payment instrument might be highly correlated with its availability, access does not necessarily mean that an instrument is widely utilised by households, as usage is also influenced by factors such as processing costs and perceptions about efficiency and security.

In general, accessibility to the different payment instruments/channels increased across all instruments between 2013 and 2018 (see Chart 1). The most significant increases were observed for online payments, direct debits and prepaid cards. However, these instruments were still perceived to be less accessible than debit cards, credit cards and cheques.

When it comes to actual use, 56.0% of households reported making the same use of payment instruments other than cash and cheques as they did five years ago, while 41.2% of households indicated that they made greater use of such instruments. When asked about what makes them use a particular payment instrument alternative to cash or cheques, the majority of respondents (60.2%) answered that they would consider convenience first, followed by efficiency (36.7%) and safety and security (30.7%). Other reasons included payment history (15.5%) and availability of electronic point of sales (EPOS) (10.6%).

Chart 2 presents information on the payment instrument/channel used when acquiring different goods and/or services. It shows that cash usage still leads as a payment instrument for all the goods and services whether these are groceries,

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2 According to the Payment Habits Survey 2018, groceries include payments for grocer, supermarket, butcher, fish-monger, bakery and confectionery; consumables include payments at clothes shops, shoe shops, stationeries and book shops; non-consumables include payments for white goods, furniture, gold, cars, hi-fi, electronics, and computers; utility bills include payments for water and electricity, internet, telephony, mobile phone, gas, petrol and diesel; and wellness includes payments to hairdressers, beauticians and the gym.

consumables, non-consumables, utility and wellness. Thus, even though there has been progress in the payments landscape, cash is still the preferred payment instrument amongst Maltese households. The study shows that 86.7%, 69.1% and 46.0% of households used cash to pay for groceries, consumables and non-consumables, respectively. Furthermore, 59.3% of households paid utility bills in cash and 95.6% paid for wellness services using this instrument. It is also interesting to note that cards were the next important instrument used by households for groceries while mobile payments were the second most frequently mentioned instrument for consumables and the preferred choice for non-consumables. However, only a small percentage of households used cards and mobile instruments to pay for utilities and wellness services. This low usage may indicate a lack of POS devices in outlets offering wellness services. Furthermore, a significant share of utilities bills is settled by means of online payments, with 37.1% of households using them as a means to settle utility bills.

The survey also reveals that cheques were mostly used to pay for non-consumables and, to a lesser extent, for utilities. However, only a small percentage of households reported using this instrument to pay for groceries, consumables and wellness services.

On balance, the survey indicates that although consumers have been presented with a number of new and enhanced payment instruments that are efficient and secure, and although there is some shift towards less traditional instruments, Maltese households still use to a large extent paper-based products which may reflect consumer preferences but may also be due to lack of provision of alternative means of payment by suppliers or service providers.

**Expected use of alternative payment channels in the next five years**

Respondents were also asked to give an indication of their expected use of payment instruments in the forthcoming five years. The responses are summarised in Chart 3.

A significant share of households across all age groups indicated that they intend to still use cash over the next five years, with this share ranging from 61.3% for those in the 45-54 age bracket, to 75.3% for those aged 55 and over (see Chart 3). The survey also reveals that a significant percentage of households intends to make greater use of debt and credit cards in future. This is most evident among households with a young reference person.

Such households also appear to have a higher predisposition than other households to increase the use of all non-paper instruments. For example, two-thirds of households in the 25-34 age bracket indicated that they intend to increase the use of online payments. This share falls to 17.4% among households with a reference person aged 55 and over. Similarly, while over 60.0% of households in the 25-34 age group intend to increase their use of direct debits, this percentage drops markedly in households with an older reference person. This pattern is visible across several other instruments.
Chart 3 also suggests that cheques are less likely to record higher usage over the next five years, compared to debit cards and credit cards.

As highlighted in Chart 3, the results of this survey indicate that cash usage is predominant and the most popular payment instrument among all age groups. However, among the lowest age bracket there are relatively smaller differences in usage across all kind of payment instruments. Amongst the other three age brackets which follow, that is those aged 35-44, 45-54 and 55-64, usage of cash is more predominant relative to other instruments, most notably direct debit, credit cards, and mobile and online payment. As use of the internet has increased, so too has customer preference to use internet banking and online payments.

The importance of cards relative to other non-cash instruments in Malta is also confirmed by payments statistics published by the ECB. Chart 4 compares the data for Malta with the EU average in terms of the relative importance of key payment instruments.

Data show that in 2017, cards were used for 54.2% of non-cash transactions in Malta, while credit transfers and cheques were used for 22.7% and 17.3% of such transactions, respectively.

At the same time, the use of cheques in Malta is quite high when compared with the EU average of 1.7%. Malta had the highest share, ahead of Cyprus with 12.0% and France with 8.8%. This contrasts with a number of other countries, where cheques were hardly used. Although cheques are not an efficient payment method due to the long clearing cycle and the very labour intensive and costly processing involved, these may be attractive mainly due to the fact that cheques are free and negotiable instruments which could allow some form of anoniminity.

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4 The data was extracted from the ECB payment statistics for 2017 which can be viewed through the following link [www.ecb.europa.eu/press/pr/stat/paysec/html/ecb_pis2017_en.html](http://www.ecb.europa.eu/press/pr/stat/paysec/html/ecb_pis2017_en.html). The data represent transactions reported by local Payment Service Providers (PSP) for payment instruments issued locally.
Malta also registered a very low usage of direct debits. These accounted for 2.8% of transactions, which is lower than EU average of 10.2%. The limited use of this payment instrument may be due to lack of knowledge and trust. The importance of this payment instrument could increase as people learn to use it and experience its benefits.

**Security of payment instruments**

The survey also reveals that there seems to be lack of knowledge with regards to the security element of each payment instrument against permanent financial loss or unwanted disclosure of personal information. For example, 46.0% of households in this survey said that cash is a secure or very secure payment instrument. Furthermore 27.4% answered that cash was neither risky nor secure, when actually cash is exposed to risks of theft and counterfeiting. When asked about the security of cheques, 50.0% of households said that cheques are secure or very secure and only 4.8% considered cheques to be risky or very risky, with the remaining 45.0% of households being either unsure or did not know. Meanwhile, 53.0% of households said that debit cards are secure or very secure, 35.4% did not really know how risky they are, and 11.6% said that they were either risky or very risky. This picture broadly also holds for credit cards although households perceive them to be less secure than debit cards. When households were asked to answer about prepaid cards, direct debits, credit transfers, mobile and online payments, a significant share were unable to identify the extent of risk and security in these payment instruments.

**Conclusion**

Similar to the previous survey, the latest one shows that cash usage by Maltese households remains the primary payment method. This attitude may partly be due to the reluctance of the general public to change habits, but could also reflect lack of availability of alternative electronic means of payment by suppliers or service providers. Although electronic payment instruments/channels are highly efficient and convenient, there may also be constraints from the business community in accepting non-paper means of payment. Maltese households also seem to underestimate the costs involved in maintaining and processing traditional paper based payment instruments. At the same time, while cash payments dominate, one can also detect some shift towards non-paper based payments instruments, particularly cards. Moreover, younger groups tend to have a greater predisposition to use multiple payment instruments.

This may reflect the fact that unlike the older cohorts, younger ones have been exposed to different payment instruments from a young age. Their spending patterns also differ from those of other groups. In particular, they tend to spend more on leisure goods and services rather than on energy or housing, which also influences the use of different payment instruments. Furthermore expenditure patterns can differ across households depending on a number of demographic and economic factors, such as disposable income, standard of living and age.

Finally the survey indicates that there is lack of information on the various payment instruments and their benefits. This could explain why some households have a strong preference for using the traditional payment instruments such as cash, which they are conversant with. A nationwide educational campaign that would inform the general public and the business community on the features, advantages and risks associated with the various payment instruments/channels could better assist economic agents to make more informed decisions and better choices when effecting payments. However, this would need to also be accompanied by policies aimed at increasing the diffusion of electronic means of payments by suppliers and service providers to their customers.

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6. CORPORATE GOVERNANCE

Governance

Board of Directors
The Board of Directors of the Central Bank of Malta is composed of Dr Mario Vella as Governor and Chairman, Mr Alexander Demarco and Mr Oliver Bonello as Deputy Governors, Dr Peter J. Baldacchino, Professor Frank Bezzina, Dr Romina Cuschieri and Mrs Philomena Meli as non-executive Directors. All members of the Board are appointed for a statutory term of five years and are eligible for reappointment. In terms of the Central Bank of Malta Act (Cap. 204) the Governor and the Deputy Governors are appointed by the President of Malta upon the recommendation of the Prime Minister while the other non-executive Directors of the Board are appointed by the Prime Minister. The term of office of Mr Alexander Demarco as Deputy Governor responsible for Monetary Policy expired in December 2018. Mr Demarco was reappointed as Deputy Governor Monetary Policy for another term with effect from 1 January 2019. The term of office of Dr Peter J. Baldacchino as a member of the Board of Directors expired and he was reappointed as Director for another term in April 2018. The term of office of Dr Romina Cuschieri as a member of the Board of Directors expired in December 2018 and she was reappointed as Director for another term with effect from 17 December 2018. Mr Herbert Zammit LaFerla acted as Secretary to the Board. 12 Board meetings were held during 2018.

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

Management and Internal Organisation
In January, the Board of Directors approved a proposal to split the Economic and Research Department into two Departments responsible for Economic Analysis and for Research respectively to be managed separately by a Head of Economic Analysis and a Head of Research. The Economics Division was restructured so as to include three departments, namely, the Economic Analysis Department; the Research Department; and the Monetary Policy & Operations and Eurosystem Relations Department. The Economic Analysis and Research Departments continued to also report to the Governor. During the same month, the Board approved the re-designation of the Legal Office and the Internal Audit Office to Legal Department and Internal Audit Department and the re-instatement of the positions of Head Legal Department/Senior Legal Counsel and Head of Internal Audit Department.

In April, the Board approved the upgrading of the Human Resources Department to the level of a Division under the responsibility of a new Chief Officer.

In May 2018, the Board approved the amalgamation of the Business Systems and Financial Reporting Office and the Budgeting and Accounts Management Office into one Office – Finance Office within the Financial Control Department.

In July 2018, the Board resolved that the Credit Register and AnaCredit Unit within the Statistics Department’s Monetary and Financial Statistics & Central Credit Register Office be renamed as Credit Register Regulation and Oversight Unit, to be entrusted with the responsibility of assisting the Commerce Department to licence CRAs and with the responsibility of supervising all licensed CRAs initially once a year.

Following the recruitment of a Chief Investments Officer, the Investments Division comprised the Investments and Government Securities Department which includes three offices: International Asset Management Office, Market Analysis Office and GSO.

In September 2018, the Board of Directors approved a change to the Bank’s organisational structure within Communications and International Relations Department. The Board approved the separation of the two
functions in two separate departments, each reporting to a Head of Department. The Communications Department will be made up of six sections, namely: Publications, Website and Social Media, Media Monitoring and Analysis, Media Intervention, Social and Institutional Outreach and Event Organisation. The International Relations Department will consist of two main sections, namely: International Organisations and Non-ESCB, Bilateral and Commonwealth Relations.

The Bank set up a Financial Crime Compliance Unit within Payment and Banking Operations Office in order to enhance its compliance with the AML/CFT regulatory framework. The scope of this Unit is to perform the required KYC screening and due diligence on customers and to monitor customer transactions in terms of AML/CFT risks, in line with the strategy and risk-tolerance of the Bank, as well as the existing regulatory framework and the Bank’s Internal Handbook on the Prevention of Money Laundering and Funding of Terrorism.

During 2018 the Governor continued to be supported by the Governor’s Office and by the two Deputy Governors.

**Governor’s activities in Malta**

The Governor served as a member of the Board of Governors of the MFSA during the year. He participated in the proceedings of the Malta Council for Economic and Social Development, and the Research, Innovation and Development Trust of the University of Malta.

In 2018, the Governor made the following interventions:

- Presentation, Central Bank of Malta’s Annual Report 2017 press launch.
- Presentation, 10 years on: How has Malta benefitted from euro adoption?, delivered during the event The Economic & Monetary Union: How has Malta benefitted and what does the future hold?, organised by the EC Representation in Malta in collaboration with the Bank on the 10th anniversary of Malta’s adoption of the euro.

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

**Governor’s international engagements**

In 2018, the Governor made the following international interventions:

- Concluding remarks, The euro: Voices from the Commonwealth, joint event by the Central Bank of Malta and Queen Mary University of London, London.
- A preliminary organisational seminar for a research project on populism with leading academics in the field of discourse analysis at Queen Mary University of London, London.
- Speech, Would you recognise it if you see it? The indeterminacy of “populism” in central banking discourse today, University of Warwick Graduate Conference in Security Studies Post-truth politics and the rise of populism, Coventry.

**Social Research Unit (SRU)**

The SRU was set up in mid-2017 with a staff complement of two sociologists. The Board’s decision to establish it reflected the Bank’s keen awareness of the social dimensions of its remit, a dimension that had not been given sufficient attention in the past. The SRU is transitionally located for administrative purposes amongst those functions for which the Governor is directly responsible.
During 2018 the SRU focussed its attention on poverty, access to credit by low income earners, rent affordability, gender equality and inclusiveness. The choice of Ms Sharon Donnery, Deputy Governor of the Central Bank of Ireland, as a speaker at the Bank’s 50th Anniversary Conference on 4 May 2018, with a paper on Diversity: A Central Banking Perspective, reflects the Bank’s increased concern with issues of inclusiveness in society and in the Bank.

In mid-2018 one of the two members of the SRU proceeded to the University of Edinburgh to work on a PhD. Two University of Malta sociology students were recruited as trainees.

The SRU was also involved in the implementation of a new initiative, Getting to know the real economy, whereby Bank staff visit important industrial sites and meet key management. The focus in 2018 was on aviation maintenance, repair and overhaul. The Unit was also involved in researching and creating a section on the Bank’s website dedicated to Malta’s traditions of excellence in medical and health care, and medical education, factors which provide a solid foundation for the country’s ambitions in economic activities related to this sector. The 100th Anniversary of the First World War – during which Malta earned the reputation of Nurse of the Mediterranean – provided a good opportunity to launch this website section.

**Audit Committee**

The Audit Committee, chaired by Dr Peter J. Baldacchino and comprising also Professor Frank Bezzina and Dr Romina Cuschieri, convened eleven times during 2018. At each meeting, Chief Officer Internal Audit briefed the Committee mostly on governance, risk management and control matters whilst the Chief Risk Officer was invited to give an update on both operational and financial issues. The meetings were at times also attended by the Bank’s external auditors, PricewaterhouseCoopers (PwC) when their presence was considered necessary.

**External Auditors**

During 2018 PwC carried out the statutory audit for the financial year ending 31 December 2017. They expressed their opinion on the financial statements and presented their Management Letter to the Board.

**Internal Audit Department**

Internal Audit continued to provide assurance through the conduct of risk-based audits carried out in line with the Annual Audit Plan as approved by the Audit Committee and noted by the Board of Directors. The vast majority of such engagements assessed the effectiveness of governance, risk management and control processes implemented across a number of business areas. As aspects of methodological developments introduced in recent years, the internal auditors continued to tender opinions not just on risk-sensitive operational effectiveness but also on the level of efficiency demonstrated in the use and deployment of resources applied during the discharge of processes reviewed. A number of audits were also conducted on areas which are deemed more inherently susceptible to fraud.

Quarterly status reports, providing opinions both bank-wide and at divisional and individual business area level, were provided on perceived risks and presented to the Audit Committee and Board of Directors by way of high-level assurance reporting.

As a member of the Internal Auditors Committee (IAC) in Eurosystem, ESCB and SSM compositions, Internal Audit performed three IAC audits, and continued to participate in the Audit Task Force on Information Technology, which is one of the IAC substructures.

In the second half of the year, the internal audit function underwent an External Quality Assessment which amongst other aims confirmed its conformity both in form and substance to the Institute of Internal Auditors Standards and Code of Ethics as regards its set-up and all activities undertaken during the review period. The results of this Quality Assessment were communicated to the Audit Committee and the Board of Directors and ultimately made available to the IAC.
The internal audit function was involved in a number of consultancy engagements covering different aspects and business areas within the Bank. These included a major assignment at the Malta Coin Centre within Currency Operations Office; review of a good number of Policies and Procedures which required revamping; and continued involvement with the recently established Compliance Committee, mostly in the capacity of observers. As part of its fraud awareness programme, internal auditors continued to regularly deliver presentations to staff members, especially new recruits, on the Bank’s anti-fraud policy.

**Risk Management**

The Risk Committee met seven times during 2018. A regular review of all risks was performed by the Committee members, focusing on risks related to the Bank’s operations, financial assets under management, the PSPP portfolio, the Malta Government Securities portfolio and other relevant issues. Mitigation measures related to identified risks and arising incidents were discussed and their implementation monitored. The Chief Risk Officer also updated the Audit Committee members with the activities of the Risk Committee and highlighted any issues requiring their attention.

The second cycle of the Operational Risk Management (ORM) exercise was presented to the Board of Directors. The third cycle is currently underway and will be finalised during the second quarter of 2019. The operational risk status of the various business areas was reported on a regular basis to the Risk and Audit Committees.

During 2018, each business area continued with its review of the Business Continuity Plans of critical and important operations. Regular resilience testing was carried out by the business areas together with members from the ORM office. A review of the Business Continuity Policy and Framework was carried out. These will be submitted to the Board of Directors for approval in the first quarter of 2019.

Monthly Investment Policy meetings were held, during which performance measurement of assets under management was presented and compared to the tactical benchmark which in turn is compared to the strategic benchmark. The Strategic Asset Allocation exercise for 2019 was carried out and presented to the Board of Directors.

**Legal issues**

During 2018, the Bank’s Legal Department was involved in amending or drafting new legislation as follows:

- Amendments to the Central Bank of Malta Act (Cap. 204 of the Laws of Malta) intended to empower the Central Bank to act as a supervisory authority of CRAs licenced under the Trading Licences Regulation (S.L. 441.07), to strengthen the Central Bank’s powers to promote the stable and sustainable development of the payments landscape in Malta, as well as to conduct a general update of the Act. The Bill amending the Central Bank of Malta Act is set to be tabled in Parliament during the first half of 2019.
- Amendments to Central Bank of Malta Directives No. 6 and No. 7 were also necessary to transpose the Guideline ECB/2018/20 amending Guideline ECB/2012/27 on a Trans-European Automated Real-time Gross settlement Express Transfer system. The amending Guideline was issued as a result of a decision of the Governing Council of 21 June 2017 to launch the TIPS service. The new TIPS service will enable the settlement of individual instant payment orders in central bank money 24 hours a day any calendar day of the year, with immediate or close to immediate processing.
- Central Bank of Malta Directive No. 8 was amended following the annual update of the General Documentation.
• Central Bank of Malta Directive No. 5 was amended to cater for the obligation of pension funds licensed in Malta to report statistical information to the Bank in accordance with the reporting requirements established under Regulation (EU) 2018/231 of the ECB of 26 January 2018 on statistical reporting requirements for pension funds (ECB/2018/2).

The Bank’s in-house lawyers advised on diverse legal, contractual and operational matters, as well as on issues related to the Bank’s governance structure, including:

• General legal advice to the Board of Directors.
• Legal advice to the Governor and Deputy Governors on the various aspects of the Bank’s functions and operations.
• Legal advice concerning CRAs in Malta.
• Support to relative business areas in revising a number of the Bank’s policies and procedures.
• Review of several tenders issued by the Bank and advice on the procurement process.
• Extensive legal advice and vetting of contracts entered into by the Bank with service providers and other third parties.
• The initiation of consultation processes with the ECB in terms of Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union.
• A Data Protection stocktake exercise was undertaken to assess compliance in all business areas with respect to the GDPR. Internal policies were also revised to be brought in line with the GDPR. Moreover, bank-wide training sessions on the implications of this regulation were also delivered to staff.

The Legal Department was involved in the organisation of two public lectures to mark the 50th anniversary of the establishment of the Central Bank of Malta.

The first lecture was held on 11 May 2018 and was delivered by Professor Rosa María Lastra, Chair in International Financial and Monetary Law at the Centre for Commercial Law Studies, Queen Mary University of London. Professor Lastra discussed the theme Regulatory developments impacting central banking.

Ms Sabine Lautenschläger, member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the SSM, gave the second public lecture on 12 October 2018. Ms Lautenschläger chose the theme Guardians of stability – central banks, supervisors and the quest for financial stability.

The Legal Department continues to participate in a number of the Bank’s committees, including the Management Committee, the Risk Committee and the ESCB Committee.

An important part of the work carried out by the Bank’s Legal Department relates to the ECB, the ESCB and the Eurosystem. In 2018, the legal team continued to participate in various ESCB committees and sub-committees, amongst which the ECB’s Legal Committee, the Financial Law Experts Group, the Ethics Framework Task Force, and the Network of NCB/NCA Data Protection Officers and Experts. The Bank’s lawyers were also involved in a number of ECB-related activities and projects, including the annual ECB Legal Conference and the Annual Conference on European Data Protection Law.

**Human resources**

As at end 2018, the Bank employed 347 full-timers, including employees on reduced hours and ten part-timers. On the basis of full-time equivalence (FTE), this corresponds to 324 FTE. Table 6.1 shows the number of Bank employees who hold an academic qualification at Malta Qualifications Framework (MQF) level five and above as at the end of 2018.
During 2018, the Bank recruited 25 employees (two Chief Officers, two Assistant Executives, 18 Officers II and three Officers I). 22 employees resigned from the Bank.

In 2018, six employees were seconded to offices within the public sector; another employee was seconded on a part-time basis with a non-governmental organisation while one employee was seconded to a charitable organisation. One staff member was seconded to the ECB for a period of nine-and-a-half months between May 2018 and February 2019 within the Directorate General Finance. During the year, 16 university students were offered temporary summer work experience between mid-July and mid-September, while ten interns were offered work placements at the Bank on a nine-month internship programme starting in October 2018 to coincide with their final year at University. The Bank also offered an internship of 160 hours to a Malta College of Arts, Science and Technology (MCAST) student pursuing a course in Information and communications technology.

**Training and development**

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

A total of 308 employees attended 34 different in-house courses mainly in the areas of finance, IT, economics, econometrics, statistics and first aid. An information session on the new GDPR which came into force in May 2018 was also organised for all employees of the Bank. Induction programmes were also organised for all new employees.

As shown in Table 6.2, 280 staff members participated in external, both local and overseas, training programmes in 2018. These courses were provided by local training organisations and professional institutions, the ECB, other central banks and financial institutions.

During the year a number of employees continued to benefit from the Bank’s study programmes (see Table 6.3). Four staff members completed their postgraduate education, while a total of 43 employees continued to follow postgraduate degree programmes.

**Table 6.1**

<table>
<thead>
<tr>
<th>Qualification</th>
<th>No. of employees</th>
<th>% of total employees(1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>MQF 8</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>MQF 7</td>
<td>99</td>
<td>32</td>
</tr>
<tr>
<td>MQF 6</td>
<td>87</td>
<td>29</td>
</tr>
<tr>
<td>MQF 5</td>
<td>47</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td><strong>237</strong></td>
<td><strong>77</strong></td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.

(1) Excluding support staff.

**Table 6.2**

<table>
<thead>
<tr>
<th>Type of training</th>
<th>Number of courses/seminars</th>
<th>Number of participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal</td>
<td>34</td>
<td>308</td>
</tr>
<tr>
<td>External</td>
<td>181</td>
<td>280</td>
</tr>
<tr>
<td>Local</td>
<td>128</td>
<td>226</td>
</tr>
<tr>
<td>Foreign</td>
<td>53</td>
<td>54</td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.
During 2018, four employees were awarded a full-time study sponsorship to read a postgraduate course in UK universities in areas directly related to the Bank.

Another employee commenced a doctorate programme in Social Policy with the University of Bristol, while another employee continued to pursue his studies at the same level with the University of Nottingham. Both doctorate courses currently supported by the Bank are undertaken on a part-time basis.

During 2018, the Bank also offered support to staff who wished to read the Master of Science in Economics on a full-time basis at the University of Malta. The support provided by the Bank included release to attend lectures and payment of tuition fees.

During 2018, the Bank in collaboration with MCAST designed an Undergraduate Certificate in Accounting at MQF Level 5 which will run until the end of December 2019. Two foundation modules at MQF Level 4 were delivered during the summer months before embarking on the MQF 5 qualification in October. Eight employees are following this course. Also during the year, four employees continued to attend the Undergraduate Certificate in Computer Systems and Networks that had been designed in 2017 with MCAST. The course will be completed in 2019.

The Heading for Leadership Programme, which is one of the ECB’s open training events, was again hosted by the Bank. In 2018, the Bank hosted Module A of the Heading for Leadership Programme. One staff member attended this learning event. The programme was attended by 15 participants from 14 different NCBs, including the ECB.

Corporate Social Responsibility
In 2018, the Bank reaffirmed its policy of planting trees in various parts of the island. As part of the Central Bank of Malta’s 50th Anniversary celebrations, the Bank sponsored 50 trees through the 34U Campaign. These were planted during the inauguration of Ġnien Joseph Farrugia in Dingli. Moreover as part of the Bank’s 50th anniversary celebrations two concerts were organised for a good cause. The main event took place at the Manoel Theatre where attendees voluntarily contributed funds towards id-Dar tal-Providenza. The second concert was held at St. Vincent de Paul Residence with the aim to reach out to the residents of this home for the elderly.

As part of its 50th Anniversary celebrations, the Sports Committee of the Central Bank of Malta organised a swimming competition, EuroSwim 2018, which brought together European central banks and financial institutions. The Bulgarian National Bank, Deutsche Bundesbank, Banca d’Italia, Central Bank of Malta, Oesterreichische Nationalbank, EIB, Central Bank of the Republic of Turkey and the ECB participated in the event.

The Bank continued to provide financial support through donations and sponsorships to institutions and various philanthropic non-government organisations. The Bank sponsored once again the Central Bank of Malta Chair in Economics at the University of Malta through the Research, Innovation and Development Trust. The Bank extended its sponsorship to the part-time Masters Course in Economics. In the cultural sphere, the Bank assisted various heritage organisations. Assistance was also provided to various entities, particularly

<table>
<thead>
<tr>
<th>Type of degrees</th>
<th>Number of employees</th>
<th>Completed degrees</th>
<th>Ongoing studies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Postgraduate</td>
<td>4</td>
<td>4</td>
<td>43</td>
</tr>
<tr>
<td>Undergraduate (Honours)</td>
<td></td>
<td></td>
<td>4</td>
</tr>
<tr>
<td>Diploma</td>
<td>1</td>
<td></td>
<td>14</td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.

Table 6.3
ACADEMIC AND PROFESSIONAL COURSES DURING 2018

During 2018, four employees were awarded a full-time study sponsorship to read a postgraduate course in UK universities in areas directly related to the Bank.

Another employee commenced a doctorate programme in Social Policy with the University of Bristol, while another employee continued to pursue his studies at the same level with the University of Nottingham. Both doctorate courses currently supported by the Bank are undertaken on a part-time basis.

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to the Malta Community Chest Fund and Caritas. The Bank entered into a partnership agreement with the Malta Philharmonic Orchestra.

The Bank also participated in the Pink October campaign, with the funds collected donated to the Marigold Foundation which was entrusted with the national Pink October Campaign. Moreover, the Bank sponsored the participation of staff members in the 2018 edition of the President’s Charity Fun Run.

The Staff Social Club continued to contribute towards the Bank’s Corporate Social Responsibility programme through charitable donations. The Social Club organised three Blood Drive events during 2018.

During the year, the Cultural sub-committee within the Bank’s Staff Social Club organised mid-day talks for staff members on various topics. Staff members voluntarily contributed donations which were then given to a charity organisation at the discretion of the guest speaker. Another event sponsored by the Social Club was a gathering for refugee and homeless children during a philanthropic event organised by a staff member.

The Central Bank of Malta Foundation
The Bank’s Foundation is being established by the Bank to administer funds intended to support educational, cultural and other initiatives. An autonomous Board of Administrators is being set up. Its objectives, functions and the powers are defined in the Central Bank of Malta Foundation Statute.

Information Systems and Knowledge Management
The department’s remit covers information in both electronic and documentary formats. Technology related offices manage the Bank’s Information Technology infrastructure to deliver Information Services based on bespoke software applications developed in-house or off-the-shelf software solutions. Such services support most of the Bank’s business processes whilst also delivering specialised services to external stakeholders. The department also manages enterprise documents and the library.

Information Systems
IT Services is responsible for the provision and support of all the technology infrastructure services at the Bank including networking, telephony, server provisioning and maintenance, end-user desktop environments and service desk. To this end, the Bank continued to leverage and expand its established virtualised platform to provide the required resources in a cost effective and timely manner. One area of focus throughout 2018 was a complete upgrade of the ESCB-Net infrastructure which is the critical component that securely connects the Central Bank of Malta to the rest of the ESCB.

The Projects and Applications Development Office supports Bank’s business areas in fulfilling their technology requirements through in-house developed applications. During the migration to the core financial application several solutions were re-engineered to align with the new functionality. The office also embarked on several major upgrades including the SEPA and the CCR applications. The Projects and Applications Development Office continued to add new applications to its portfolio, such as the Business Registrar. As part of the continuous support, the office is also providing flexible migration solutions for Statistics Department to ease effort during the data migration process to INFOSTAT. Moreover, team members attended specialised training on secure programming and latest industry related trends. This enabled staff to follow latest business standards and compliance while adding additional business value in product delivery.

The main function of the Core Applications Office is to maintain and administer the Bank’s main accounting system, its reporting tool, respective databases and payment system infrastructure. The year 2018 set an important milestone since all core components went live on 1 January 2018 utilising a new infrastructure based on Flexcube 12.2 on top of latest Oracle technology databases and middleware platforms. The project involved IT teams and business users supported by external consultants who ensured minimal downtime and smooth switchover to the new platform. The payment infrastructure also underwent a complete SWIFT platform update. The solution now resides in an enhanced secure environment compliant with the SWIFT Customer Security Controls Framework.
The Office is actively monitoring new developments at the Bank with specific focus on future projects which may have direct impact on the core applications suite. These include a new interface with Eurex, the possibility to implement internet banking facilities to customers, the adoption of ISO 20022 SWIFT standards and other ECB driven projects such as the interface with the Eurosystem Collateral Management System.

Information security continued to play a very important role in 2018 owing to the continual threats faced throughout the financial services sector. The Bank upgraded its Security Information and Event Management system in a bid to strengthen its logging and monitoring capabilities. It also hosted a security training event on this platform at its new premises at Binja Laparelli, which event attended by external participants. The IT security team performed various reviews of information security-related policies and conducted a number of security-related risk assessments, particularly focusing on compliance with international ISO standards and best practices.

Knowledge Management
The Library of the Central Bank of Malta specialises in banking, finance and economics. Information services are available in print and electronic form. The Library continued to provide comprehensive information resources and services in support of the research and information needs of the Bank’s employees in the pursuit of the Bank’s mission and objectives. During the year under review the library was relocated to Binja Laparelli. The role of the Bank’s Librarian was formally established in line with the library’s new vision of becoming Malta’s main depository of banking, economic, financial and social scholarship and as a hub of debate and research in these fields. The mission has also been enhanced to provide expertise, services and make use of technology to support users to effectively access, manage and share quality information and knowledge in their pursuit of the Bank’s business.

The Library continued to build its specialised collections whilst also digitalising various Bank and other publications related to the Maltese economy. It also embarked on a programme of on the economic history of Malta. For the first time the library participated in the National Book Festival held at the Mediterranean Conference Centre in Valletta.

Knowledge Management Office was relocated to Binja Laparelli and together with the Library now forms the Bank’s Knowledge Services Office. This move involved the transfer of thousands of physical documents and files into state-of-the-art depository furniture. The office continued to implement efficient and effective records management practices that assist the Bank in meeting its statutory objectives and overall business responsibilities. The protection of confidential documents and records in all formats is emphatically prioritised.

The Archives Management section provided for the secure storage of and controlled access to archived documents and for the disposal of records as per designated retention periods stipulated by the Management Committee on the recommendations of the Archives Standing Committee. A bank-wide exercise was carried out to update the retention policies in view of the GDPR. All the archive boxes are now physically stored in a secure state-of-the-art archives at Binja Laparelli.

The ninth ESCB/SSM Meeting on Information Management was held in Malta at the Binja Laparelli between 27 and 28 September 2018. The mandate of the ESCB/SSM Information Management Network is to allow and to foster the sharing of knowledge, information, best practices, methods and tools among archivists, librarians, and document and records managers across the ESCB.

The Library will begin to adopt the Library’s three year strategy while Knowledge Management continues to implement the Bank’s Knowledge Management strategy whereby SharePoint Portals will be developed into an Enterprise Content Management system.

Premises and procurement
During 2018 the Bank continued with its programme of maintenance, upgrading and embellishment works. These included, among others, the continuation of waterproofing works at the main building and its annexe.
The installation of moveable storage systems at the Binja Laparelli was completed during the year, thus enabling the transfer of archived material to the new building. The Bank also commenced discussions with the newly appointed consultant architects and engineers regarding the proposed new projects and upgrades of the Bank’s infrastructure.

With regard to procurement, the Bank issued five calls for tenders and 29 calls for quotations during the year. The tenders were related to the procurement of IT goods and services, the leasing of vehicles and independent external auditing services. In all its procurement processes the Bank always sought to obtain the most economically advantageous terms and conditions.

Late in 2018 the Bank took the decision to commence utilising the national electronic public procurement portal for its tendering procedures.

During 2018, the Bank continued to participate at the semi-annual meetings of the ESCB Heads of Administration Conference, where various topics relating to facility and environmental management were discussed.

The Bank also continued to participate in the Eurosystem Procurement Coordination Office, which enables Eurosystem members to benefit from efficiencies in joint procurement exercises, primarily in the areas related to hardware, software, rating agency services and market data provision.

The Bank expects to undertake a number of projects in its other buildings, where the refurbishment or replacement of some services is required. These projects will be undertaken within the Bank’s commitment towards environmental efficiency and cost savings.

**Information and public relations**

The Bank provides the general public with information on its policies, operations and activities, both in printed and electronic form on its website. The Communications Department is also responsible for the desktop publishing and distribution of the Bank’s official publications: the *Annual Report*, the *Financial Stability Report*, the *Quarterly Review*, the *Monthly Economic Update* and the *Economic Projections*.

The main developments related to the Bank’s website during 2018 were the following: the redesign of the website header to include 50th anniversary logo, a new section on regulatory compliance and the creation of a new rotating banner, the inclusion of an additional subscription item for events and the Weekly Bulletin Report, developments to the Market Operations section which include the automated notification alert for MGS and the Weekly Bulletin Report. A new section, dedicated to public lectures was created on the Bank’s website. A presentation consisting of the late Gabriel Caruana’s works of art at the Bank and a new webpage to commemorate the 100th anniversary of the end of World War I were uploaded.

Communications Department responds to media requests and coordinates interviews with the Governors and senior management.

During the year under review the Bank celebrated its 50th anniversary and organised a number of events to celebrate this important milestone. These events included a concert by the Malta Philharmonic Orchestra, held at the Manoel Theatre under the auspices of Her Excellency the President of Malta, and a concert of light music at St. Vincent de Paul Residence. As part of these celebrations the Bank organised a conference entitled *Central Banks in Historical Perspective: What Changed after the Financial Crisis?* Speakers included the then Vice President of the ECB, Vítor Constâncio, governors and deputy governors of the central Banks of Canada, Iceland, Ireland and Malta. 14 foreign speakers delivered lectures at the Bank during 2018, compared to seven in 2017 and two in 2016. These lectures covered mainly three areas: economics and finance, economic history and law. Moreover, during the same year the Bank co-hosted with the Ministry for Finance the European Bank for Reconstruction and Development (EBRD) constituency meeting. Once again the Bank organised its *Annual Research Workshop*. Speakers included staff members and two distinguished academics who delivered presentations. The first *Research Bulletin* was launched. In 2018,
the Bank published an ad hoc publication *The Central Bank of Malta’s First Fifty Years: A solid foundation for the future*.

The Bank supported an exhibition dedicated to Willie Apap (1918-1970) organised by Fondazzjoni Patrimonju Malti between 18 October and 30 November. The exhibition consisted of a selection of works exhibited in the Victor Pasmore Gallery courtesy of the Victor Pasmore Foundation and a walk-through presentation of the biographical and contextual highlights of the artist’s life.

In 2018 the Bank participated once again in the Notte Bianca, with an exhibition of works from the Bank’s art collection including works by the late Gabriel Caruana.
7. INTERNATIONAL RELATIONS

In 2018 the Central Bank of Malta maintained strong relations with international institutions which it is affiliated.

**Eurosysten and ESCB**

The Governor is a member of the Governing Council of the ECB. The Governing Council is made up of the members of the ECB’s Executive Board and the Governors of the euro area NCBs. The Governing Council is responsible for monetary policy in the euro area and decides on the implementation of tasks entrusted to the Eurosystem, which comprises the ECB and the euro area NCBs.

During 2018 the Governing Council held 21 physical meetings, with eight being focused on monetary policy. Furthermore, a significant number of Governing Council decisions were taken by means of written procedures. In addition, in connection with the ECB’s responsibilities in the area of bank supervision, the Governing Council approved numerous draft supervisory decisions prepared by the ECB’s Supervisory Board.

The Governor is also a member of the General Council of the ECB, which meets on a quarterly basis. The General Council is made up of the President and Vice-President of the ECB, and the NCB governors of all Member States of the EU. The Governor or, in his absence, a Deputy Governor, also participated in the four sessions dedicated to the *Macroprudential Forum* held jointly by the Governing Council and the ECB’s Supervisory Board.

Moreover, the Deputy Governor for Financial Stability sits on the ECB’s Supervisory Board together with the Director responsible for banking supervision at the MFSA.

Following several decisions taken by the Governing Council, during 2018 the Governor signed a number of agreements on behalf of the Bank, including a Collective Agreement between the NCBs operating a TAR-GET2 Component and the Central Securities Depositories participating in TARGET2-Securities, an updated agreement on TARGET2-Securities, an agreement on the financial envelope for TARGET2 covering the period between 2019 and 2023, and three agreements related to TARGET2 to cater for the establishment of the new TIPS service. He also signed a letter of intent, addressed to the European Payments Council, informing it that the Bank intended to operate a fully compliant clearing and settlement mechanism, related to the SEPA Instant Credit Transfer Scheme.

The Governing Council and the General Council are supported by a number of committees, working groups and other structures, in which various Bank officials participated actively throughout the year. These officials play a key role in briefing the Governor on issues being discussed in both the Governing Council and the General Council.

**ESRB**

The Governor took part in the meetings of the ESRB’s General Board.

During the year the Board discussed various issues of a macroprudential nature largely revolving around potential vulnerabilities and risks within the EU financial system, proposing policy options when necessary. Senior officials of the Bank also participated in meetings of the ESRB’s Advisory Technical Committee and its substructures.

Throughout the year, the ESRB continued to publish its risk dashboard, occasional papers, working papers and macroprudential commentaries.

**Other EU institutions**

During 2018, the Governor and the Deputy Governor for Monetary Policy participated in the informal meetings of the Economic and Financial Affairs Council held in April and September in Sofia and Vienna respectively. Furthermore, the Deputy Governor for Monetary Policy and the Deputy Governor for Financial Stability
regularly participated in meetings of the Economic and Financial Committee (EFC) when issues relevant to central banks were discussed.

In particular, during 2018, the Bank engaged in EFC discussions on issues related to developments in financial markets and the regular monitoring of risks to financial stability in the EU prior to the formulation of appropriate policy responses. Other discussions related to strengthening the Banking Union, accelerating the Capital Market Union, Money Laundering and sovereign debt related issues.

The EFC continued to play a crucial role in the preparation of common European positions at the G-20 meetings and other international fora, such as the IMF and the Financial Stability Board.

Other officials also participated in meetings of a number of EFC sub-committees, where matters of relevance to central banks, such as sovereign debt, currency issues and IMF-related issues were discussed.

Apart from participating in the EFC and its sub-structures, Bank staff took part in a number of other EU committee structures related to central banking functions. Bank officials also accompany the representatives of the MFSA at meetings of the EBA and the Supervisory Board of the SSM. The Bank is also a participant in the ESRB where the Governor is a voting member of the General Board. The Bank also continued to contribute extensively, through consultations on matters of an economic and financial nature, to the participation of Malta’s representatives within various EU decision making bodies.

**EBRD**

In view that the Governor of the Central Bank of Malta is the Alternate Governor for Malta on the Board of Governors of the EBRD, the Bank continued to collaborate closely with the Ministry for Finance on issues related to Malta’s membership of this institution. In particular, the Bank provided advice to the Ministry on various resolutions, which required decisions by the EBRD’s Board of Governors.

The EBRD constituency of which Malta forms part is led by Austria and includes Bosnia & Herzegovina, Cyprus, Kazakhstan and Israel. In March, the annual constituency meeting was held in Malta to discuss current developments ahead of the EBRD Annual Meeting with the main focus being the Southern and Eastern Mediterranean Region. During this meeting, the Central Bank of Malta was represented by the Deputy Governor for Financial Stability. In May, the Deputy Governor for Monetary Policy accompanied the Minister for Finance to the 2018 Annual Meeting and Business Forum EBRD in Jordan. The over-arching theme of the meeting was *Energising Economies*, during which discussions focussed on various topics from business climate to economic growth, from targeted, profitable investment to environmental protection.

**IMF**

In the IMF, Malta forms part of the constituency headed by Italy and which also includes Albania, Greece, Portugal and San Marino. In 2018 Domenico Fanizza was elected as the Executive Director heading the constituency.

In February 2018 the Governor in his capacity as Malta’s Alternate Governor on the Board of Governors of the IMF, attended the joint IMF/World Bank Constituency meeting in Lisbon. The Minister for Finance as the Governor of the IMF for Malta attended the joint IMF/World Bank Spring meetings in Washington in April and the Annual Meetings in Bali in October. On both occasions the Minister was accompanied by the Deputy Governor for Monetary Policy. During the year the Central Bank of Malta advised the Ministry for Finance on a number of Resolutions proposed by the Fund’s Executive Board.

Following a request by the Maltese Government, the IMF initiated Malta’s FSAP procedure with a Scoping Mission starting on 20 March. The IMF FSAP on-site mission ended on 26 September 2018 and the assessment is expected to be concluded in February 2019. In October, IMF staff members conducted an interim visit in connection with the 2018 Article IV consultation. The IMF mission held a number of meetings with
senior officials of the Central Bank of Malta, the Government, the MFSA and other entities. The consultation was concluded on 16 January 2019.

During 2018 Malta’s net cumulative allocation of SDRs, which is computed in proportion to its quota share, remained unchanged at SDR95.4 million. The Bank’s SDR holdings also remained broadly unchanged at SDR87.3 million.

The Bank also continued to carry out transactions related to the IMF’s operational budget. During 2018, Malta’s reserve tranche position increased on a year earlier by SDR1.8 million to SDR28.7 million as new loans extended exceeded repayments in the General Resources Account (GRA). Correspondingly the Fund’s holdings of the national currency with the Bank decreased to the equivalent of SDR139.7 million by the end of the year from SDR141.5 million a year earlier.

The current bilateral loan agreement between the Bank and the Fund was endorsed by the Governor in September 2017. The loan is for an SDR-denominated amount of up to the equivalent of €0.26 billion, the amount being the same as that for the previous loan agreement which expired in January 2017. No drawings were affected during 2018.

World Bank Group

Although Malta is represented on the World Bank by the Minister for Finance, the Bank continued to assist the Ministry in monitoring developments within the World Bank Group and by providing advice on particular initiatives from the Group. During 2018, the Bank provided the Ministry with background documentation and recommendations on various resolutions that required to be voted upon.

Asian Infrastructure Investment Bank (AIIB)

The Bank, together with the Ministry for Finance, started monitoring developments in the AIIB, following the acceptance of the instrument of ratification for Malta in January 2016. The Maltese Parliament had approved the ratification of the articles of agreement which establish the AIIB as an international organisation in December 2015.

Malta is represented on the AIIB’s Board of Governors by the Minister for Finance, with the Governor of the Central Bank of Malta as the Alternate Governor. Malta forms part of the euro area constituency which also includes Austria, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Portugal, Spain, Cyprus and Ireland.

During the year the Bank advised the Ministry for Finance on a number of AIIB resolutions related to the formation and administration of the recently set up AIIB including applications for new membership.

In 2018 a number of constituency meetings were also held, on which occasions Malta was represented by officials from the Ministry for Finance with the support of the Bank. At the AIIB Annual Meeting which was held in Mumbai between 25 and 26 June, Malta was represented by the Minister for Finance in his capacity as the Governor of the AIIB, accompanied by the Deputy Governor for Monetary Policy.

Commonwealth Small States Trade Finance Facility

One Bank official continued to form part of a Working Group set up to establish a trade finance facility for the small states of the Commonwealth. The Commonwealth Small States Trade Finance Facility is expected to play an important role in enhancing trade and investment finance particularly for small and vulnerable Commonwealth States with limited access to international trade finance. The Facility became operational in Autumn 2018 and the inaugural meeting of the Facility’s Supervisory Board was held in Malta in October.

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1 The GRA is the principal account of the IMF, consisting of a pool of currencies and reserve assets, representing paid subscriptions of members’ country quotas. The GRA is the account from which the regular lending operations of the IMF are financed.

2 Figures for the reserve tranche position and the Fund’s holdings of national currency do not add up to SDR168.3 million (quota) due to rounding.
Under the chairmanship of the Right Honourable Patricia Scotland, Commonwealth Secretary General. The Central Bank of Malta provides some banking services to the Facility.

**Other international institutions**

The Bank’s internal task force, chaired by the Governor, set up to monitor developments related to the exit of the United Kingdom from the EU continued to co-ordinate internal work on the economic and financial implications of Brexit. Besides the broader economic impact, Brexit is expected to affect areas of direct interest to the Bank, including financial services and payment systems, as well as its own internal operations.

In April, the Central Bank of Malta and the School of Economics and Finance of Queen Mary University of London successfully organised an international conference in London. The conference, on the theme *The euro: Voices from the Commonwealth* introduced a novel dimension in that issues related to the role of the euro in the global financial system had rarely been tackled by academics and policymakers from Commonwealth countries. Furthermore, the decision of the United Kingdom to withdraw from the EU generated additional interest. The conference was addressed by a range of speakers from international organisations, academic institutions and the private sector. Economists from the Bank and from ME presented original analysis on trade flows between Commonwealth countries and those of the European Union, as well as the Maltese economy’s experience during a decade of the euro area membership. The Minister for Finance, Professor Edward Scicluna, and the Governor also addressed the conference.
PART III

FINANCIAL STATEMENTS

FOR THE YEAR ENDED

31 DECEMBER 2018
Directors’ report

The Directors present their report and the audited financial statements of the Central Bank of Malta (the Bank) for the year ended 31 December 2018.

Presentation of the financial statements

These financial statements have been prepared so as to give a true and fair view of the state of affairs of the Bank as at 31 December 2018, and of its profit for the year then ended. The financial statements have been prepared in accordance with the provisions established by the Governing Council of the European Central Bank under Article 26.4 of the Statute of the European System of Central Banks and of the European Central Bank and in accordance with the requirements of the Central Bank of Malta Act (Cap. 204). The provisions established by the Governing Council of the European Central Bank are outlined in the Guideline of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2016/34).

Financial results

The Bank’s financial statements for the year ended 31 December 2018 are set out on pages A-8 to A-42 and disclose a profit for the year of €28.0 million (2017: €35.0 million) which is payable to the Government of Malta.

Board of Directors

The members of the Board of Directors during the year ended 31 December 2018 and up to the date of authorisation for issue of the financial statements were:

- Dr Mario Vella – Governor
- Mr Alexander Demarco – Deputy Governor Monetary Policy (re-appointed 1 January 2019)
- Mr Oliver Bonello – Deputy Governor Financial Stability
- Ms Philomena Meli
- Dr Peter J. Baldacchino (re-appointed 14 April 2018)
- Dr Romina Cuschieri (re-appointed 17 December 2018)
- Professor Frank Bezzina (appointed 1 January 2018)

During the financial year under review, Mr Herbert Zammit LaFerla was Secretary to the Board.

Statement of Directors’ responsibilities in respect of the financial statements

The Board of Directors is responsible for ensuring that the financial statements are drawn up in accordance with the requirements of the Central Bank of Malta Act (Cap. 204). The Bank is required to prepare financial statements in accordance with the requirements of the Guideline of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2016/34).

The Board of Directors is responsible for ensuring that these financial statements give a true and fair view of the state of affairs of the Bank as at 31 December 2018 and of the profit for the year then ended.

In preparing the financial statements, the Directors are responsible for selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.
The Directors are also responsible for designing, implementing and maintaining internal controls relevant to the preparation and the fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error, and that comply with the requirements set out above. They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The financial statements of the Central Bank of Malta for the year ended 31 December 2018 are included in the Annual Report 2018, which is published in printed form and is made available on the Bank’s website. The Directors are responsible for the maintenance and integrity of the Annual Report on the website in view of their responsibility for the controls over, and the security of, the website. Access to information published on the Bank’s website is available in other countries and jurisdictions, where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

**Auditors**

PricewaterhouseCoopers were the Bank’s auditors up to the financial year ended 31 December 2018. The Bank is in the process of appointing new auditors as from financial year ending 31 December 2019, following the expiry of PricewaterhouseCoopers’ five year term.

By order of the Board.

Dr Mario Vella  
Governor

Mr Alexander Demarco  
Deputy Governor

Mr Oliver Bonello  
Deputy Governor

Central Bank of Malta  
Pjazza Kastilja  
Valletta VLT 1060  
Malta

18 March 2019
Independent Auditor’s report

To the Board of Directors of the Central Bank of Malta

Report on the audit of the financial statements

Our opinion
In our opinion the Central Bank of Malta’s financial statements:

- give a true and fair view of the Bank’s financial position as at 31 December 2018, and of the Bank’s financial performance for the year then ended in accordance with the requirements of the Accounting Guideline of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2016/34); and
- have been prepared in accordance with the requirements of the Central Bank of Malta Act (Cap. 204).

What we have audited
The Central Bank of Malta’s financial statements, set out on pages A-8 to A-42, comprise:

- the Balance Sheet as at 31 December 2018;
- the Profit and Loss account for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor’s responsibilities for the audit of the financial statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence
We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements of the Accountancy Profession (Code of Ethics for Warrant Holders) Directive issued in terms of the Accountancy Profession Act (Cap. 281) that are relevant to our audit of the financial statements in Malta. We have fulfilled our other ethical responsibilities in accordance with these Codes.

Other Information
The Directors are responsible for the Other Information. The Other Information comprises the Directors’ report, but does not include the financial statements and our auditor’s report thereon, which we obtained prior to the date of this auditor’s report, and:

- Governor’s Statement;
- Financial and Economic Developments;
- Bank Policies, Operations and Activities;

which are expected to be made available to us after that date.

Our opinion on the financial statements does not cover the Other Information, including the Directors’ report.
Independent auditor’s report – continued

In connection with our audit of the financial statements, our responsibility is to read the Other Information identified above and, in doing so, consider whether the Other Information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We are required to report if we have identified material misstatements in the Directors’ report and Other Information that we obtained prior to the date of this auditor’s report. We have nothing to report in this regard.

When we read Other Information not yet received, referred to and listed above, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance in accordance with the requirements of ISAs.

Responsibilities of the Directors and those charged with governance for the financial statements
The Directors are responsible for the preparation of financial statements that give a true and fair view in accordance with the provisions established by the Governing Council of the European Central Bank outlined in the Accounting Guideline of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2016/34) and in accordance with the requirements of the Central Bank of Malta Act (Cap. 204). The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for using the going concern basis of accounting in accordance with article 4 of the Accounting Guideline of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2016/34).

Auditor’s responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank’s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.
Independent auditor’s report – continued

- Conclude on the appropriateness of the Directors’ use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

PricewaterhouseCoopers
78, Mill Street
Qormi
Malta

Fabio Axixa
Partner
18 March 2019
### Balance Sheet as at 31 December 2018

<table>
<thead>
<tr>
<th>Assets</th>
<th>2018</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A 1 Gold and gold receivables</strong></td>
<td>3,484</td>
<td>3,363</td>
</tr>
<tr>
<td><strong>A 2 Claims on non-euro area residents denominated in foreign currency</strong></td>
<td>829,626</td>
<td>630,038</td>
</tr>
<tr>
<td>A 2.1 Receivables from the IMF</td>
<td>140,956</td>
<td>135,477</td>
</tr>
<tr>
<td>A 2.2 Balances with banks and security investments, external loans and other external assets</td>
<td>688,670</td>
<td>494,561</td>
</tr>
<tr>
<td><strong>A 3 Claims on euro area residents denominated in foreign currency</strong></td>
<td>60,207</td>
<td>114,205</td>
</tr>
<tr>
<td><strong>A 4 Claims on non-euro area residents denominated in euro</strong></td>
<td>683,087</td>
<td>674,682</td>
</tr>
<tr>
<td>A 4.1 Balances with banks, security investments and loans</td>
<td>683,087</td>
<td>674,682</td>
</tr>
<tr>
<td>A 4.2 Claims arising from the credit facility under ERM II</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>A 5 Lending to euro area credit institutions related to monetary policy operations denominated in euro</strong></td>
<td>80,010</td>
<td>113,310</td>
</tr>
<tr>
<td>A 5.1 Main refinancing operations</td>
<td>-</td>
<td>30,000</td>
</tr>
<tr>
<td>A 5.2 Longer-term refinancing operations</td>
<td>80,010</td>
<td>83,310</td>
</tr>
<tr>
<td>A 5.3 Fine-tuning reverse operations</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>A 5.4 Structural reverse operations</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>A 5.5 Marginal lending facility</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>A 5.6 Credits related to margin calls</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>A 6 Other claims on euro area credit institutions denominated in euro</strong></td>
<td>13,609</td>
<td>2,609</td>
</tr>
<tr>
<td><strong>A 7 Securities of euro area residents denominated in euro</strong></td>
<td>1,459,172</td>
<td>1,570,840</td>
</tr>
<tr>
<td>A 7.1 Securities held for monetary policy purposes</td>
<td>946,040</td>
<td>914,579</td>
</tr>
<tr>
<td>A 7.2 Other securities</td>
<td>513,132</td>
<td>656,261</td>
</tr>
<tr>
<td><strong>A 8 General government debt denominated in euro</strong></td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>A 9 Intra-Eurosystem claims</strong></td>
<td>4,588,041</td>
<td>4,386,821</td>
</tr>
<tr>
<td>A 9.1 Participating interest in ECB</td>
<td>15,859</td>
<td>15,859</td>
</tr>
<tr>
<td>A 9.2 Claims equivalent to the transfer of foreign reserves</td>
<td>37,552</td>
<td>37,552</td>
</tr>
<tr>
<td>A 9.3 Claims related to the issuance of ECB debt certificates*</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>A 9.4 Net claims related to the allocation of euro banknotes within the Eurosystem</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>A 9.5 Other claims within the Eurosystem (net)</td>
<td>4,534,630</td>
<td>4,333,410</td>
</tr>
<tr>
<td><strong>A 10 Items in course of settlement</strong></td>
<td>13,586</td>
<td>8,280</td>
</tr>
<tr>
<td><strong>A 11 Other assets</strong></td>
<td>1,123,036</td>
<td>1,078,752</td>
</tr>
<tr>
<td>A 11.1 Coins of euro area</td>
<td>31</td>
<td>114</td>
</tr>
<tr>
<td>A 11.2 Tangible and intangible fixed assets</td>
<td>37,382</td>
<td>38,323</td>
</tr>
<tr>
<td>A 11.3 Other financial assets</td>
<td>1,030,416</td>
<td>953,864</td>
</tr>
<tr>
<td>A 11.4 Off-balance sheet instruments revaluation differences</td>
<td>3,010</td>
<td>41,380</td>
</tr>
<tr>
<td>A 11.5 Accruals and prepaid expenses</td>
<td>30,917</td>
<td>34,211</td>
</tr>
<tr>
<td>A 11.6 Sundry</td>
<td>21,280</td>
<td>10,860</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>8,853,858</td>
<td>8,582,900</td>
</tr>
</tbody>
</table>

* Only an ECB balance sheet item
## Financial Statements for the year ended 31 December 2018

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>2018</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>L 1 Banknotes in circulation</strong></td>
<td>1,046,464</td>
<td>995,109</td>
</tr>
<tr>
<td>**L 2 Liabilities to euro area credit institutions related to monetary</td>
<td></td>
<td></td>
</tr>
<tr>
<td>policy operations denominated in euro</td>
<td>5,265,242</td>
<td>4,922,080</td>
</tr>
<tr>
<td><strong>L 2.1 Current accounts (covering the minimum reserve system)</strong></td>
<td>1,651,432</td>
<td>1,103,678</td>
</tr>
<tr>
<td><strong>L 2.2 Deposit facility</strong></td>
<td>3,613,810</td>
<td>3,818,402</td>
</tr>
<tr>
<td><strong>L 2.3 Fixed-term deposits</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>L 2.4 Fine-tuning reverse operations</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>L 2.5 Deposits related to margin calls</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>**L 3 Other liabilities to euro area credit institutions denominated in</td>
<td></td>
<td></td>
</tr>
<tr>
<td>euro currency</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>L 4 Debt certificates issued</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>L 5 Liabilities to other euro area residents denominated in euro</strong></td>
<td>1,335,125</td>
<td>1,653,528</td>
</tr>
<tr>
<td><strong>L 5.1 General government</strong></td>
<td>585,414</td>
<td>797,840</td>
</tr>
<tr>
<td><strong>L 5.2 Other liabilities</strong></td>
<td>749,711</td>
<td>855,688</td>
</tr>
<tr>
<td><strong>L 6 Liabilities to non-euro area residents denominated in euro</strong></td>
<td>72</td>
<td>18,271</td>
</tr>
<tr>
<td><strong>L 7 Liabilities to euro area residents denominated in foreign currency</strong></td>
<td>279,275</td>
<td>140,798</td>
</tr>
<tr>
<td>**L 8 Liabilities to non-euro area residents denominated in foreign</td>
<td></td>
<td></td>
</tr>
<tr>
<td>currency</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>L 8.1 Deposits, balances and other liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>L 8.2 Liabilities arising from the credit facility under ERM II</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>L 9 Counterpart of special drawing rights allocated by the IMF</strong></td>
<td>115,951</td>
<td>113,299</td>
</tr>
<tr>
<td><strong>L 10 Intra-Eurosystem liabilities</strong></td>
<td>287,254</td>
<td>172,482</td>
</tr>
<tr>
<td><strong>L 10.1 Liabilities equivalent to the transfer of foreign reserves</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>L 10.2 Liabilities related to the issuance of ECB debt certificates</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>L 10.3 Net liabilities related to the allocation of euro banknotes within</strong></td>
<td>287,254</td>
<td>172,482</td>
</tr>
<tr>
<td><strong>L 10.4 Other liabilities within the Eurosystem (net)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>L 11 Items in course of settlement</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>L 12 Other liabilities</strong></td>
<td>24,204</td>
<td>67,625</td>
</tr>
<tr>
<td><strong>L 12.1 Off-balance sheet instruments revaluation differences</strong></td>
<td>434</td>
<td>651</td>
</tr>
<tr>
<td><strong>L 12.2 Accruals and income collected in advance</strong></td>
<td>4,388</td>
<td>10,105</td>
</tr>
<tr>
<td><strong>L 12.3 Sundry</strong></td>
<td>19,382</td>
<td>56,869</td>
</tr>
<tr>
<td><strong>L 13 Provisions</strong></td>
<td>97,228</td>
<td>86,820</td>
</tr>
<tr>
<td><strong>L 14 Revaluation accounts</strong></td>
<td>7,331</td>
<td>16,405</td>
</tr>
<tr>
<td><strong>L 15 Capital and reserves</strong></td>
<td>367,712</td>
<td>361,483</td>
</tr>
<tr>
<td><strong>L 15.1 Capital</strong></td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td><strong>L 15.2 Reserves</strong></td>
<td>347,712</td>
<td>341,483</td>
</tr>
<tr>
<td><strong>L 16 Profit for the year</strong></td>
<td>28,000</td>
<td>35,000</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>8,853,858</td>
<td>8,582,900</td>
</tr>
</tbody>
</table>

* Only an ECB balance sheet item
# Profit and Loss account for the year ended 31 December 2018

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€’000</td>
<td>€’000</td>
</tr>
<tr>
<td>1.1 Interest income</td>
<td>55,333</td>
<td>57,149</td>
</tr>
<tr>
<td>1.2 Interest expense</td>
<td>4,830</td>
<td>6,104</td>
</tr>
<tr>
<td>1 Net interest income</td>
<td>60,163</td>
<td>63,253</td>
</tr>
<tr>
<td>2.1 Realised gains/losses arising from financial operations</td>
<td>3,644</td>
<td>9,012</td>
</tr>
<tr>
<td>2.2 Write-downs on financial assets and positions</td>
<td>(2,198)</td>
<td>(4,885)</td>
</tr>
<tr>
<td>2.3 Transfer to/from provisions for foreign exchange rate, interest rate, credit and gold price risks</td>
<td>(10,323)</td>
<td>(16,647)</td>
</tr>
<tr>
<td>2 Net result of financial operations, write-downs and risk provisions</td>
<td>(8,877)</td>
<td>(12,520)</td>
</tr>
<tr>
<td>3.1 Fees and commissions income</td>
<td>394</td>
<td>207</td>
</tr>
<tr>
<td>3.2 Fees and commissions expense</td>
<td>(792)</td>
<td>(597)</td>
</tr>
<tr>
<td>3 Net income/expense from fees and commissions</td>
<td>(398)</td>
<td>(390)</td>
</tr>
<tr>
<td>4 Income from equity shares and participating interests</td>
<td>1,361</td>
<td>1,118</td>
</tr>
<tr>
<td>5 Net result of pooling of monetary income</td>
<td>(6,630)</td>
<td>(6,182)</td>
</tr>
<tr>
<td>6 Other income</td>
<td>3,685</td>
<td>9,117</td>
</tr>
<tr>
<td></td>
<td>49,304</td>
<td>54,396</td>
</tr>
<tr>
<td>7 Staff costs</td>
<td>(12,547)</td>
<td>(12,155)</td>
</tr>
<tr>
<td>8 Administrative expenses</td>
<td>(7,067)</td>
<td>(5,893)</td>
</tr>
<tr>
<td>9 Depreciation of tangible and intangible fixed assets</td>
<td>(1,348)</td>
<td>(1,058)</td>
</tr>
<tr>
<td>10 Banknote production services</td>
<td>(342)</td>
<td>(290)</td>
</tr>
<tr>
<td>11 Other expenses</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>28,000</td>
<td>35,000</td>
</tr>
<tr>
<td>Transfer to reserves for risks and contingencies</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Payable to the Government of Malta in terms of article 22(2) of the Central Bank of Malta Act (Cap. 204)</td>
<td>28,000</td>
<td>35,000</td>
</tr>
</tbody>
</table>

The financial statements on pages A-8 to A-42 were approved for issue by the Board of Directors on 18 March 2019 and are signed on its behalf by:

Dr Mario Vella  
Governor

Mr Alexander Demarco  
Deputy Governor

Mr Oliver Bonello  
Deputy Governor

Mr Raymond Filletti  
Chief Officer  
Financial Control and Risk

Mr Robert Caruana  
Head  
Financial Control
Notes to the financial statements for the year ended 31 December 2018

General notes to the financial statements

1 The Eurosystem
On 1 January 2008, the Central Bank of Malta (the Bank) became part of the Eurosystem and took over joint responsibility for monetary policy and for exercising the common strategic goals of the European System of Central Banks (ESCB).1

2 Basis of preparation
The Bank is required under article 21(5) of the Central Bank of Malta Act (Cap. 204) (the Act) to prepare its financial statements in accordance with the provisions established by the Governing Council of the ECB under Article 26.4 of the Statute of the European System of Central Banks and of the European Central Bank (the Statute). These provisions are outlined in the Guideline of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2016/34) (Guideline ECB/2016/34 (recast)). In the absence of requirements and guidance provided by Guideline ECB/2016/34 (recast), that specifically apply to transactions, other events or conditions, the requirements of International Financial Reporting Standards (IFRS) as adopted by the EU are applied.

These financial statements have been drawn up so as to give a true and fair view of the state of affairs of the Bank as at 31 December 2018 and of its profit for the year then ended. The accounts have been prepared on a historical cost basis, modified to include the revaluation of gold, foreign currency instruments, securities (other than securities classified as held-to-maturity, non-marketable securities, and securities held for monetary policy purposes that are accounted for at amortised cost), as well as other financial instruments, both on-balance sheet and off-balance sheet, at mid-market rates and prices.

3 Accounting policies

(a) Basic accounting principles and assumptions
The basic accounting principles and assumptions applied by the Eurosystem and the Bank in the preparation of these financial statements are:

- economic reality and transparency;
- prudence;
- materiality;
- consistency and comparability;
- going concern;
- accruals principle; and
- post-balance sheet events.

(b) Recognition of assets and liabilities
An asset or liability is only recognised in the balance sheet when it is probable that any associated future economic benefit will flow to or from the Bank, substantially all of the associated risks and rewards have been transferred to or from the Bank, and the cost or value of the asset or liability can be measured reliably.

1 The European Central Bank (ECB), together with national central banks (NCBs), shall constitute the European System of Central Banks (ESCB). The ECB together with the NCBs of the Member States whose currency is the euro, which constitute the Eurosystem, shall conduct the monetary policy of the Union, as per Article 282.1 of the Treaty of the Functioning of the European Union. The Eurosystem and the ESCB will co-exist as long as there are EU Member States outside the euro area.
(c) Recording of transactions

Foreign exchange transactions, comprising spot and forward deals in gold and foreign currencies, are recorded off-balance sheet on trade date at the prevailing spot exchange rate for ascertaining the average acquisition costs and the realised gains and losses. Accordingly, purchases and sales of foreign currency affect the net foreign currency position on the trade date and realised gains and losses arising from the net reduction in foreign currency positions are calculated on trade date. On settlement date, these transactions are recorded on-balance sheet at the original spot exchange rates. In the case of foreign exchange swaps, spot and forward amounts are translated to euro at the same exchange rate, and accordingly these contracts do not affect foreign currency positions.

All security transactions in foreign currencies are recorded on-balance sheet on settlement date at the applicable exchange rate. Accrued interest, premiums and discounts related to financial assets and liabilities are calculated and booked daily from the settlement date at daily exchange rates, as applicable, and the foreign currency position is affected daily by these accruals denominated in foreign currency.

All other transactions are recorded in the balance sheet at market exchange rates prevailing on the day of the transaction.

(d) Balance sheet valuation rules

Financial assets and liabilities denominated in foreign currency, including off-balance sheet positions, are revalued at the prevailing mid-market exchange rates at the balance sheet date. Securities and Treasury bills other than those classified as held-to-maturity, non-marketable securities, and securities held for monetary policy purposes that are accounted for at amortised cost, are revalued at the prevailing mid-market prices at the balance sheet date.

Gold balances are revalued at market prices prevailing at the year-end. No distinction is made between price and currency revaluation differences for gold, but a single gold revaluation difference is accounted for on the basis of the euro price per defined unit of weight of gold derived from the euro/US dollar exchange rate at the balance sheet date.

Foreign currency positions (including off-balance sheet transactions) are revalued on a currency-by-currency basis. In the case of securities, revaluation is carried out on a code-by-code basis (same ISIN number/type) and is treated separately from exchange rate revaluation.

All other assets and liabilities are presented at purchase price or, where applicable, at their nominal value. The Bank’s participating interest in the ECB is measured at cost.

(e) Cost of transactions

The average cost method is used on a daily basis for calculating the acquisition cost of assets and liabilities that are subject to price and/or exchange rate movements. The average cost price of securities and/or the average rate of the foreign currency position are adjusted by unrealised losses taken to the profit and loss account at the end of the year.

All securities are initially recorded at acquisition cost. For the purpose of calculating the average purchase cost of a security, all purchases made during the day are added to the cost of the previous day’s holding to produce a new weighted average price before applying the sales for the same day.

In the case of long foreign currency or gold positions, net inflows made during the day are added, at the average rate or gold price of the inflows of the day for each respective currency and gold, to the previous day’s holding, to produce a new weighted average cost. Where a short position exists, the reverse treatment applies whereby the average cost is affected by net outflows.
(f) **Income recognition**

Income and expenses are recognised in the period in which they are earned or incurred.

(i) **Interest income and expense**

Interest income and expense are recognised in the profit and loss account for all interest-bearing assets and liabilities. With the onset of negative interest rates in the past years, certain financial assets give rise to interest expense rather than interest income and certain financial liabilities give rise to interest income rather than interest expense.

With effect from the financial year ended 31 December 2016, the Eurosystem harmonised the presentation of interest income and interest expense arising from monetary policy operations to report interest on a net basis such that positive and negative interest stemming from monetary policy are netted off on a balance sheet (sub-) item level. Net positive interest arising on monetary policy liabilities is presented within interest income and net negative interest on monetary policy assets is presented within interest expense. The Bank has adopted the Eurosystem harmonised presentation format to report interest on a net basis, under either ‘Interest income’ or ‘Interest expense’ depending on whether the net amount is positive or negative.

Premiums or discounts arising from the difference between the average acquisition cost and the redemption price of securities are presented as part of interest income and amortised over the remaining term of the security using either the straight-line method or the internal rate of return method. The internal rate of return method is used in the case of discount securities with a remaining maturity of more than one year at the time of acquisition. Interest accruals on foreign currency assets and liabilities are converted at the mid-market rate on each business day and are included in the respective foreign currency position to determine the average book value, as applicable.

Accordingly, interest income includes coupons earned on securities and amortised premiums or discounts on Treasury bills and other instruments. In respect of forward exchange contracts, the difference between the deemed spot exchange rate of the forward contract and the deal rate is considered as interest income or expense and is amortised on a straight-line basis from the trade date to settlement date.

(ii) **Gains and losses arising from foreign exchange, gold and securities**

Realised gains and realised losses can only arise in the case of transactions leading to a reduction in foreign currency positions or on the sale of securities.

In the case of foreign currency or gold positions, inflows and outflows are compared against each other to determine any realised gains or losses. The resulting net inflow or outflow, apart from changing the foreign currency position or gold, will give rise to either a change in the average rate of that currency or the average price of gold. It may also give rise to the realisation of a further profit or loss depending on whether the Bank has a long or short position in a particular currency or gold respectively. On a daily basis, a weighted average rate for foreign currencies and a price for gold are calculated, firstly on inflows and then on outflows. The realised gain or loss is calculated by applying the difference between these average rates and prices to the lower of the day’s inflows or outflows.

For long positions, where outflows exceed inflows, a second realised gain or loss is calculated, equating to the difference between the net outflows of the day valued at the average outflow price and at the average cost of the day’s opening position. Where inflows exceed outflows, the net inflow is added to the position held at the beginning of the day, thus changing the average cost of the position. For short positions, the reverse accounting treatment is applied.

In the case of securities, realised gains or losses are derived by comparing the transaction value with the average cost of the respective security.

Realised gains and losses are taken to the profit and loss account.
Unrealised revaluation gains and losses arise as a result of the revaluation of assets and liabilities by comparing the market value with the average book value. Unrealised gains are not recognised as income but are transferred directly to a revaluation account. Unrealised losses, except as explained in accounting policy (h) (ii), are taken to the profit and loss account when they exceed previous unrealised gains registered in the corresponding revaluation account. Unrealised losses recorded in the profit and loss account in previous years are not reversed against new unrealised gains in subsequent years. Unrealised losses in any one security or in any foreign currency (including gold holdings) are not netted against unrealised gains in other securities or foreign currency.

(g) Off-balance sheet instruments
Spot and forward foreign exchange contracts and daily changes in the variation margins of future contracts are included in the net foreign currency position for the purpose of calculating the average cost of currencies and determining realised foreign exchange gains and losses. Futures are accounted for and revalued on an item-by-item basis. Daily changes in the variation margins of open futures contracts, representing realised gains and losses, are recognised in the profit and loss account.

Gains and losses arising from off-balance sheet instruments are recognised and treated in a similar manner to on-balance sheet instruments. Realised and unrealised gains and losses are measured and accounted for in the manner outlined in the accounting policy for (f) ‘Income recognition’ above.

Unrealised valuation gains or losses on spot and forward foreign exchange contracts are recorded from the trade date to the settlement date under asset sub-item A11.4 ‘Off-balance sheet instruments revaluation differences’ and under liability sub-item L12.1 ‘Off-balance sheet instruments revaluation differences’ as applicable.

(h) Securities
(i) Securities held for monetary policy purposes
Securities currently held for monetary policy purposes are accounted for at amortised cost subject to impairment.

(ii) Securities held for other than monetary policy purposes
Marketable securities classified as held-to-maturity are measured at amortised cost subject to impairment. Held-to-maturity securities are securities with fixed or determinable payments and a fixed maturity, which the Bank intends to hold until maturity. Securities classified as held-to-maturity may be sold before their maturity in any of the following instances:²

- if the quantity sold is considered not significant in comparison with the total amount of the held-to-maturity securities portfolio;
- if the securities are sold during the month of the maturity date;
- under exceptional circumstances, such as a significant deterioration of the issuer’s creditworthiness.

Marketable securities other than those held-to-maturity and similar assets are valued either at the mid-market prices or on the basis of the relevant yield curve prevailing at the balance sheet date, on a security by security basis. Options embedded in securities are not separated for valuation purposes. For the year ended 31 December 2018, mid-market prices at that date were used.

The Bank holds financial instruments which are designated as part of an earmarked portfolio comprising investments held as a counterpart to the Bank’s capital and statutory reserves. The Bank also holds securities forming part of another earmarked portfolio comprising Malta Government Stocks (MGS) and Treasury

bills purchased on the secondary market in its role as a market maker. These two earmarked portfolios are measured at mid-market prices prevailing at the balance sheet date. Unrealised gains are reflected on-balance sheet under liabilities sub-item L12.3 ‘Sundry’, while unrealised losses are recognised under assets sub-item A11.6 ‘Sundry’.

(i) **Sale and repurchase agreements and lending of securities**
Securities sold subject to repurchase agreements (repos) are retained in the financial statements in the appropriate classification on the assets side of the balance sheet; the counterparty liability is included as a collateralised inward deposit on the liabilities side of the balance sheet, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as a collateralised outward loan on the assets side of the balance sheet, as appropriate. The difference between the sale and repurchase price is treated as interest and is accrued in the profit and loss account over the term of the agreement on a straight-line basis. Securities lent to counterparties are also retained in the financial statements.

(j) **Claims on the International Monetary Fund (IMF)**
The IMF Reserve Tranche Position, Special Drawing Rights (SDR) and other claims on the IMF are translated into euro at the year-end ECB euro/SDR exchange rate. The IMF euro holdings are revalued against the SDR at the prevailing representative rate for the euro as quoted by the IMF at the close of business on the last working day of the year.

The IMF reserve tranche position is presented on a net basis representing the difference between the national quota and the holdings in euro at the disposal of the IMF. The euro account for administrative expenses is included under item L6 ‘Liabilities to non-euro area residents denominated in euro’.

(k) **Euro coins**
Subsequent to the agency agreement between the Bank and the Government of Malta, euro coins issued by the Bank give rise to a reserve in the form of a capital contribution by the Government. Deposits of euro coins with the Bank constitute a reversal of the capital contribution.

(l) **Demonetised Maltese lira currency notes**
Demonetised Maltese lira currency notes were redeemable by the Bank on demand for euro over a period of ten years until 31 January 2018 at the conversion rate of the Maltese lira for the euro of 0.4293 as established by Council Regulation (EC) No 1134/2007 of 10 July 2007 and without charge. The ten year period commenced on 1 February 2008, as mentioned in the notice of demonetisation, following the expiry of the period when the Maltese lira currency notes were deemed as legal tender, and ended on 31 January 2018.

In accordance with article 62(3) of the Act, after the expiry of one year following the end of the period established in the notice, any unpresented demonetised Maltese lira currency notes ceased to be included in the Bank’s currency liabilities on 1 January 2009. The value of such notes, after deducting therefrom the value of any notes which were redeemed until 31 January 2018, has been apportioned to the profits of the Bank over the remaining period until the expiry of the ten-year period.

(m) **Tangible and intangible fixed assets**
Tangible and intangible fixed assets are stated at historical cost less depreciation or amortisation, with the exception of land and works of art which are stated at historical cost and not depreciated. Historical cost includes expenditure that is directly attributable to the acquisition of the asset. Subsequent costs are included in the carrying amount of the asset or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the
item can be measured reliably. All repairs and maintenance costs are charged to the profit and loss account during the financial period in which they are incurred.

Depreciation is calculated using the straight-line method to allocate the cost of the assets to their residual values over their estimated useful lives as follows:

- **Freehold buildings**: 2%
- **Leasehold property**: over the remaining term of the lease
- **Computer equipment and other fixed assets**: 10 to 25%

Tangible and intangible fixed assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying amount of an asset is written down immediately to its recoverable amount if that carrying amount is greater than its estimated recoverable amount.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Gains and losses arising on derecognition are determined by comparing sale proceeds with the carrying amount. These are included in the profit and loss account in the year when the asset is derecognised.

**Provisions**

Provisions are recognised by the Bank in accordance with Guideline ECB/2016/34 (recast). Taking into due consideration the nature of its activities, the Bank has established a provision for foreign exchange rate, interest rate, credit and gold price risks and for other purposes within its balance sheet. The Bank decides on the size and use of the provision on the basis of a reasoned estimate of its risk exposure.

**Fixed income investment funds**

Fixed income investment funds are measured on a net asset value basis. The underlying assets and liabilities are measured at fair value. Gains and losses arising on measurement of these investment funds are accounted for in accordance with Guideline ECB/2016/34 (recast) in the manner outlined in the accounting policy 3 (f) 'Income recognition' above.

**Post-balance sheet events**

The values of assets and liabilities shall be adjusted for events that occur between the annual balance sheet date and the date on which the financial statements are approved by the relevant bodies if they affect the condition of assets or liabilities at the balance sheet date. No adjustment shall be made for assets and liabilities, but disclosure shall be made of those events occurring after the balance sheet date if they do not affect the condition of assets and liabilities at the balance sheet date, but which are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.

**Capital key**

The capital key determines the allocation of the ECB share capital to the NCBs on the basis of population and gross domestic product in equal share. It is adjusted every five years and whenever a new member state joins the European Union in accordance with the requirements of the Statute. The capital key of the Bank during the financial years ended 31 December 2017 and 2018 was 0.0648%.

The Eurosystem capital key, which is the respective NCB’s share of the total share capital held by euro area NCBs, is used as the basis for the allocation of monetary income and the financial results of the ECB among
the nineteen Eurosystem NCBs. The Bank’s Eurosystem capital key during the financial years ended 31 December 2017 and 2018 stood at 0.0921%.

5  Change to the capital key
On 1 January 2019, the ESCB experienced a quinquennial capital key change in accordance with Article 29.3 of the Statute. As a result, the Bank’s share in the share capital of the ECB increased from 0.0648% to 0.0732%.

6  Banknotes in circulation
The ECB and the euro area NCBs, which together comprise the Eurosystem, issue euro banknotes. The total value of euro banknotes in circulation is allocated to the Eurosystem central banks on the last working day of each month in accordance with the banknote allocation key.

The ECB has been allocated a share of 8% of the total value of euro banknotes in circulation, whereas the remaining 92% has been allocated to the NCBs according to their weightings in the capital key of the ECB. During the financial years ended 31 December 2017 and 2018 the Bank had a 0.0850% share of the euro banknotes in circulation in accordance with the banknote allocation key. The share of banknotes allocated to each NCB is disclosed in the balance sheet under liability item L1 ‘Banknotes in circulation’.

On 1 January 2019, as a result of the ESCB quinquennial capital key change, the Bank’s share in euro banknotes changed from 0.0850% to 0.0965%.

The difference between the value of the euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the euro banknotes that it actually puts into circulation, as reduced by banknotes withdrawn from circulation, gives rise to intra-Eurosystem balances remunerated on a daily basis at the latest available marginal interest rate used by the Eurosystem in its tenders for main refinancing operations. If the value of the euro banknotes actually issued is greater than the value according to the banknote allocation key, the excess is recognised in the balance sheet under liability sub-item L10.3 ‘Net liabilities related to the allocation of euro banknotes within the Eurosystem’. If the value of the euro banknotes actually issued is less than the value according to the banknote allocation key, the shortfall is recognised in the balance sheet under asset sub-item A9.4 ‘Net claims related to the allocation of euro banknotes within the Eurosystem’.

In the cash changeover year and in the subsequent five years, the intra-Eurosystem balances arising from the allocation of euro banknotes are adjusted in order to avoid significant changes in the NCB’s relative income positions as compared to previous years. The adjustments are effected by taking into account the differences between the average value of the banknotes which the NCB had in circulation in the reference period, and the average value of banknotes which would have been allocated to it during that period in accordance with its capital key. The adjustments are reduced in annual stages until the first day of the sixth year after the cash changeover year, when income on banknotes will be allocated fully in proportion to the NCB’s paid-up shares in the ECB’s capital.

The interest income and expense on these balances is cleared through the accounts of the ECB and is disclosed in the profit and loss account under item 1 ‘Net interest income’.

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4 Banknote allocation key means the percentages that result from taking into account the ECB’s share in the total euro banknote issue and applying the subscribed capital key to the NCBs’ share in such total.
6 Cash changeover year refers to the year in which the euro banknotes are introduced as legal tender in the respective Member State.
7 The reference period refers to 24 months which start 30 months before the day on which euro banknotes become legal tender in the respective Member State.
7 ECB profit distribution
The Governing Council of the ECB has decided that the seigniorage income of the ECB, which arises from the 8% share of euro banknotes allocated to the ECB, as well as income arising from the securities held under (a) the securities markets programme (SMP), (b) the third covered bond purchase programme (CBPP3), (c) the asset-backed securities purchase programme (ABSPP) and (d) the public sector purchase programme (PSPP) is distributed in January of the following year by means of an interim profit distribution, unless otherwise decided by the Governing Council. It is distributed in full unless it is higher than the ECB’s net profit for the year and subject to any decisions by the Governing Council of the ECB to make transfers to the provision for foreign exchange rate, interest rate, credit and gold price risks. The Governing Council of the ECB may also decide to charge costs incurred by the ECB in connection with the issue and handling of euro banknotes against income earned on euro banknotes in circulation.

The amount distributed to the Bank is disclosed in the profit and loss account under item 4 ‘Income from equity shares and participating interests’.

8 Intra-Eurosystem balances/Intra-ESCB balances
Intra-Eurosystem balances result mostly from cross-border payments in the EU that are settled in central bank money in euro. They are primarily settled in the Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET2) and give rise to bilateral balances in the TARGET2 accounts of EU central banks. These bilateral balances are netted out and then assigned to the ECB on a daily basis, leaving each NCB with a single net bilateral position vis-à-vis the ECB only. Intra-Eurosystem balances of the Bank vis-à-vis the ECB arising from TARGET2, as well as other intra-Eurosystem balances denominated in euro (e.g. interim ECB profit distributions to NCBs and monetary income results), are presented on the balance sheet of the Bank as a single net asset or liability position and disclosed under A9.5 ‘Other claims within the Eurosystem (net)’ or L10.4 ‘Other liabilities within the Eurosystem (net)’. Intra-ESCB balances versus non-euro area NCBs not arising from TARGET2 are disclosed either under A4 ‘Claims on non-euro area residents denominated in euro’ or L6 ‘Liabilities to non-euro area residents denominated in euro’.

Intra-Eurosystem claims arising from the Bank’s participating interest in the ECB are reported under A9.1 ‘Participating interest in ECB’.

Intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem are reported as a single net asset or liability under A9.5 ‘Other claims within the Eurosystem (net)’ or L10.4 ‘Other liabilities within the Eurosystem (net)’ as appropriate (see 6 ‘Banknotes in circulation’ in these general notes).

Intra-Eurosystem balances arising from the transfer of foreign reserve assets to the ECB by the Bank at the time of joining the Eurosystem are denominated in euro and reported under A9.2 ‘Claims equivalent to the transfer of foreign reserves’.

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Notes to the balance sheet

Assets

A 1  Gold and gold receivables
The Bank’s gold balances consist of correspondent accounts with foreign banks and holdings with counterparties. On 31 December 2018, gold was revalued at €1,120.961 (2017: €1,081.881) per fine troy ounce. The unrealised valuation gains of €646,654 (2017: €654,831) are disclosed under L14 ‘Revaluation accounts’.

<table>
<thead>
<tr>
<th></th>
<th>€’000</th>
<th>Fine troy ounces</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance as at 31 December 2017</strong></td>
<td>3,363</td>
<td>3,108</td>
</tr>
<tr>
<td><strong>Net effect of transactions during the year</strong></td>
<td>129</td>
<td>-</td>
</tr>
<tr>
<td><strong>Decrease in valuation on 31 December 2018</strong></td>
<td>(8)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Balance as at 31 December 2018</strong></td>
<td>3,484</td>
<td>3,108</td>
</tr>
</tbody>
</table>

A 2  Claims on non-euro area residents denominated in foreign currency
These claims consist of receivables from the IMF and claims on counterparties resident outside the euro area denominated in foreign currency as follows:

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
<th>€’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australian dollar</td>
<td>21,112</td>
<td>18,611</td>
<td>2,501</td>
<td></td>
</tr>
<tr>
<td>Canadian dollar</td>
<td>91,978</td>
<td>60,927</td>
<td>31,051</td>
<td></td>
</tr>
<tr>
<td>Great Britain pound</td>
<td>41,220</td>
<td>17,442</td>
<td>23,778</td>
<td></td>
</tr>
<tr>
<td>Norwegian krone</td>
<td>37,536</td>
<td>-</td>
<td>37,536</td>
<td></td>
</tr>
<tr>
<td>Special drawing rights</td>
<td>140,956</td>
<td>135,477</td>
<td>5,479</td>
<td></td>
</tr>
<tr>
<td>Swedish krona</td>
<td>63,930</td>
<td>33,498</td>
<td>30,432</td>
<td></td>
</tr>
<tr>
<td>US dollar</td>
<td>427,569</td>
<td>359,705</td>
<td>67,864</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>5,325</td>
<td>4,378</td>
<td>947</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>829,626</td>
<td>630,038</td>
<td>199,588</td>
<td></td>
</tr>
</tbody>
</table>

A 2.1  Receivables from the IMF

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
<th>€’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserve tranche position (net)</td>
<td>34,827</td>
<td>31,893</td>
<td>2,934</td>
<td></td>
</tr>
<tr>
<td>SDR holdings</td>
<td>106,129</td>
<td>103,584</td>
<td>2,545</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>140,956</td>
<td>135,477</td>
<td>5,479</td>
<td></td>
</tr>
</tbody>
</table>
(a) IMF quota
Malta’s membership subscription to the IMF as at 31 December 2017 and 2018 was SDR168,300,000.

Up to 25% of the quota must be paid in SDRs (IMF’s unit of account) or foreign currencies acceptable to the IMF, while the remainder of the membership subscription is paid in the member’s own currency. The former portion constitutes the reserve tranche as a claim on the IMF, while the residual represents balances in euro at the disposal of the Fund. Hence, the reserve tranche position represents the difference between the quota of SDR168,300,000 and the balance in euro at the disposal of the IMF.

During the financial year ended 31 December 2018, the reserve tranche position increased by SDR1,800,000 to SDR28,654,776 (2017: SDR26,854,776) as drawings by the Fund exceeded repayments under the IMF Financial Transaction Plan.

(b) Malta’s SDR position in the IMF
In November 2009, the Bank entered into a two-way voluntary trading arrangement with the IMF, whereby the Bank stands ready to buy and sell SDRs against euro, subject to certain limits, in transactions that the IMF arranges between prospective buyers and sellers of SDRs. During 2018, no transactions were effected under this agreement. As a result, the increase in SDR holdings from the previous year is mainly attributable to interest received. Malta’s SDR holdings, as at 31 December 2018, including interest received thereon, amounted to SDR87,320,495 (2017: SDR87,221,165).

The total SDRs allocated to Malta remained unchanged from 2010 at SDR95,401,757 against which a corresponding liability exists in the form of a restricted demand deposit of the Government of Malta included under liability item L9 ‘Counterpart of special drawing rights allocated by the IMF’ together with other SDRs acquired in accordance with IMF requirements and procedures. SDRs allocated to Malta cannot be withdrawn unless such advice is received from the IMF.

(c) IMF interest on the SDR position
The net reserve tranche position, SDR holdings and the SDR allocation are subject to SDR interest rates quoted by the IMF on a weekly basis. The IMF current accounts are not subject to interest.

(d) Bilateral Borrowing Agreement
In September 2017, a bilateral borrowing agreement with the Fund was endorsed by the Governor of the Bank. The agreement is for an SDR-denominated amount of up to the equivalent of €260,000,000 which as at 31 December 2018 was not utilised.

A 2.2 Balances with banks and security investments, external loans and other external assets
These assets principally include security investments issued by non-euro area residents and balances with banks.

<table>
<thead>
<tr>
<th>Type of Asset</th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Held-to-maturity debt securities</td>
<td>274,604</td>
<td>244,930</td>
<td>29,674</td>
</tr>
<tr>
<td>Current accounts and overnight deposits with banks</td>
<td>8,117</td>
<td>16,504</td>
<td>(8,387)</td>
</tr>
<tr>
<td>Other external assets</td>
<td></td>
<td>-</td>
<td>(379)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>688,670</strong></td>
<td><strong>494,561</strong></td>
<td><strong>194,109</strong></td>
</tr>
</tbody>
</table>
A 3  Claims on euro area residents denominated in foreign currency
These foreign currency assets mainly comprise investments in marketable debt securities issued by euro
area residents and balances with banks within the euro area as follows:


\[
\begin{array}{ccc}
\text{US dollar} & 2018 & 2017 \\
& €'000 & €'000 \\
& 54,224 & 111,625 \\
\hline
\text{Others} & 5,983 & 2,580 \\
\text{Total} & 60,207 & 114,205 \\
\hline
\end{array}
\]

During 2017 and 2018, the ECB conducted regular US dollar liquidity-providing operations with maturities
of one week. Under this programme, the US dollars were provided by the Federal Reserve to the ECB by
means of a temporary swap line with the aim of offering short-term US dollar funding to Eurosystem counter-
parties. The ECB simultaneously entered into back-to-back swap transactions with euro area NCBs, which
used the resulting funds to conduct liquidity-providing operations with the Eurosystem counterparties in the
form of reverse and swap transactions.

During 2018, credit institutions established in Malta participated for a total amount of US$1,438,100,000
(2017: US$301,000,000) in these operations. The outstanding amount of US dollar liquidity providing opera-
tions as at 31 December 2018 amounted to US$10,000,000 (2017: US$105,000,000).


\[
\begin{array}{ccc}
\text{Marketable debt securities other than those held-to-maturity} & 2018 & 2017 \\
& €'000 & €'000 \\
& 41,161 & 23,859 \\
\hline
\text{Held-to-maturity debt securities} & 10,250 & 2,444 \\
\text{US dollar liquidity-providing operations} & 8,733 & 87,551 \\
\text{Current accounts and overnight deposits with banks} & 63 & 351 \\
\text{Total} & 60,207 & 114,205 \\
\hline
\end{array}
\]

A 4  Claims on non-euro area residents denominated in euro
These claims include marketable debt securities issued by non-euro area residents and balances with banks
outside the euro area.


\[
\begin{array}{ccc}
\text{Marketable debt securities other than those held-to-maturity} & 2018 & 2017 \\
& €'000 & €'000 \\
& 233,284 & 227,503 \\
\hline
\text{Held-to-maturity debt securities} & 448,185 & 445,197 \\
\text{Current accounts and overnight deposits with banks} & 1,618 & 1,982 \\
\text{Total} & 683,087 & 674,682 \\
\hline
\end{array}
\]
A 5  Lending to euro area credit institutions related to monetary policy operations
denominated in euro

This item reflects operations carried out by the Bank within the framework of the single monetary policy of
the Eurosystem.

The total Eurosystem holding of monetary policy assets amounts to €734,380,815,361 (2017:
€764,309,630,000) of which the Bank holds €80,010,000 (2017: €113,310,000). In accordance with Article
32.4 of the Statute, losses from monetary policy operations (if they were to materialise) would be shared,
by decision of the Governing Council, in full by the Eurosystem NCBs in proportion to the prevailing ECB
capital key shares.

Losses can only materialise if both the counterparty fails and the recovery of funds received from the reso-
lution of the collateral provided by the counterparty is not sufficient. It should be noted that in relation to
specific collateral which can be accepted by NCBs at their own discretion, risk sharing has been excluded
by the Governing Council of the ECB.

A 5.1  Main refinancing operations

Main refinancing operations (MROs) are regular liquidity-providing reverse transactions carried out by the
Eurosystem NCBs with a weekly frequency and a maturity of normally one week, on the basis of standard
tenders. Since October 2008, these operations were conducted as fixed rate tender procedures with full
allotment. These operations play a key role in achieving the aims of steering interest rates, managing market
liquidity and signalling the monetary policy stance.

All counterparties that fulfil the general eligibility criteria may submit bids within a specified timeframe. Par-
ticipation in MROs requires the availability of eligible collateral.

During 2018, credit institutions established in Malta did not participate in the MROs. In 2017, the aggregate
MROs carried out with the Bank amounted to €270,900,000. The outstanding amount of these operations as
at 31 December 2017, amounting to €30,000,000, matured during 2018.

Throughout the financial years ended 31 December 2017 and 2018, the MRO rate remained unchanged at
the level of 0.00%.

A 5.2  Longer-term refinancing operations

Longer-term refinancing operations (LTROs) are regular liquidity-providing reverse transactions aimed at
providing counterparties with additional longer-term refinancing liquidity. In 2018, LTROs were conducted
with a three-month maturity. Participation in LTROs requires the availability of eligible collateral. During
2018, the three-month LTROs were conducted as fixed rate tender procedures with full allotment, with the
rate fixed at the average rate of the MROs over the life of the respective operation.

During the years ended 31 December 2017 and 2018, credit institutions established in Malta did not partici-
pate in the three-month LTROs.

Additionally, in 2016 the Governing Council of the ECB introduced a new series of four targeted longer-term
refinancing operations (TLTRO II). These operations have a four-year maturity, with a possibility of repay-
ment after two years. According to the decisions taken by the Governing Council of the ECB, the final interest
rate applicable to each TLTRO II operation depended on the lending behaviour of the counterparties for the
period between 1 February 2016 and 31 January 2018 and would be between the MRO rate and the deposit
facility rate at the time of the allotment. Given that the actual rate could only be known in 2018 and a reli-
able estimate was not possible, the deposit facility rate was used for calculating the TLTRO II interest up to
the end of 2017, as this was deemed a prudent approach. Interest income for the period mentioned above,
resulting from the difference between the deposit facility rate and the actual rate, was recorded in the profit and loss account under interest expense in 2018.

During 2018, there were no new participations in TLTROs. In 2017, the aggregate TLTROs carried out with the Bank amounted to €39,740,000. The outstanding amount of these operations amounted to €80,010,000 (2017: €83,310,000) at the end of the current year.

A 5.3 Fine-tuning reverse operations
Fine-tuning reverse operations aim to regulate the market liquidity situation and steer interest rates, particularly to smooth the effects on interest rates caused by unexpected market fluctuations. Owing to their nature, they are executed on an ad hoc basis. No fine-tuning reverse operations were conducted by the ECB during the years ended 31 December 2017 and 2018.

A 5.4 Structural reverse operations
These are reverse open-market transactions through standard tenders to enable the Eurosystem to adjust its structural liquidity position vis-à-vis the financial sector. No structural operations were conducted by the ECB during the years ended 31 December 2017 and 2018.

A 5.5 Marginal lending facility
Marginal lending facilities may be used by counterparties to obtain overnight liquidity from Eurosystem NCBs at a pre-specified interest rate against eligible assets. During 2018, the aggregate volume of such transactions with the Bank amounted to €11,400,000 (2017: nil). There were no outstanding transactions as at 31 December 2017 and 2018.

Throughout the financial years ended 31 December 2017 and 2018, the marginal lending facility rate remained unchanged at the level of 0.25%.

A 5.6 Credits related to margin calls
This sub-item refers to cash paid to counterparties in those instances where the market value of the collateral exceeds an established trigger point implying an excess of collateral with respect to outstanding monetary policy operations.

Since the Bank operates a general pooling system, no payments to counterparties are effected.

A 6 Other claims on euro area credit institutions denominated in euro
This item includes claims on credit institutions within the euro area which do not relate to monetary policy operations, consisting mainly of current accounts and overnight deposits with banks which as at 31 December 2018 amounted to €13,608,657 (2017: €2,609,461).

A 7 Securities of euro area residents denominated in euro
This item consists of securities held for monetary policy purposes as well as other securities.

A 7.1 Securities held for monetary policy purposes
Securities held for monetary policy purposes by the Eurosystem were within the scope of the CBPP, SMP, CBPP2, CBPP3, ABSPP, PSPP and the corporate sector purchase programme (CSPP).
Purchases under the CBPP\textsuperscript{9} were completed on 30 June 2010, while purchases under CBPP\textsuperscript{2,10} ended on 31 October 2012. The SMP\textsuperscript{11} was terminated on 6 September 2012.

In 2018 the Eurosystem continued its securities purchases under the expanded asset purchase programme (APP),\textsuperscript{12} which includes the CBPP\textsuperscript{3,13} the ABSPP,\textsuperscript{14} the PSPP\textsuperscript{15} and the CSPP.\textsuperscript{16}

The monthly pace of combined net APP purchases by the NCBs and the ECB was €30,000,000,000 on average until September 2018 and €15,000,000,000 from October 2018 until the end of year when the net purchases ended. The Governing Council of the ECB intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

The Bank participated in the SMP and PSPP. The Bank’s PSPP related purchases comprised MGS from the secondary market. The amortised cost of these securities as well as their market values,\textsuperscript{17} are as follows:

\begin{tabular}{|c|c|c|c|c|c|c|}
\hline
 & \textbf{2018} & & \textbf{2017} & & \textbf{Change} & \\
 & \textbf{Amortised cost} & \textbf{Market value} & \textbf{Amortised cost} & \textbf{Market value} & \textbf{Amortised cost} & \textbf{Market value} \\
\hline
Securities markets programme & 33,879 & 19,792 & & 53,189 & 28,811 & (19,310) & (9,019) \\
Public sector purchase programme & 912,161 & 929,168 & 861,390 & 874,693 & 50,771 & 54,475 \\
\hline
Total & 946,040 & 948,960 & 914,579 & 903,504 & 31,461 & 45,456 \\
\hline
\end{tabular}

The Governing Council of the ECB assesses on a regular basis the financial risks associated with the securities held for monetary policy purposes. Annual impairment tests are conducted on the basis of the estimated recoverable amounts as at the end of the year and are approved by the Governing Council of the ECB. The total Eurosysterm NCBs’ holding of such securities amounts to €2,399,625,021,945 (2017: €2,157,626,031,851).

In accordance with the decision of the Governing Council of the ECB taken under Article 32.4 of the Statute, losses from holdings of SMP, CBPP\textsuperscript{3}, ABSPP, PSPP (issued by international organisations and multilateral development banks) and CSPP securities if they were to materialise, would be shared in full by the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares.

As a result of the impairment tests conducted as at 31 December 2018 on securities purchased under the SMP and the PSPP, the Governing Council of the ECB decided that future cash flows on such securities were expected to be received in full.

\begin{footnotesize}
\textsuperscript{9} ECB Decision of 2 July 2009 on the implementation of the covered bond purchase programme (ECB/2009/16), OJ L 175, 4.7.2009, p. 18.
\textsuperscript{10} ECB Decision of 3 November 2011 on the implementation of the second covered bond purchase programme (ECB/2011/17), OJ L 297, 16.11.2011, p. 70.
\textsuperscript{12} Further details for the APP can be found on the ECB’s website (https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html).
\textsuperscript{13} ECB Decision of 15 October 2014 on the implementation of the third covered bond purchase programme (ECB/2014/40), OJ L 335, 22.10.2014, p. 22.
\textsuperscript{15} Under this programme, the ECB and the NCBs may purchase, in the secondary market, euro-denominated securities issued by euro area central, regional or local governments, recognised agencies located in the euro area and international organisations and multilateral development banks located in the euro area.
\textsuperscript{16} Under this programme, the NCBs may purchase investment-grade euro-denominated bonds issued by non-bank corporations established in the euro area.
\textsuperscript{17} Market values are indicative and were derived on the basis of market quotes. When market quotes were not available, market prices were estimated using internal Eurosystem models.
\end{footnotesize}
An impairment test was carried out as at 31 December 2018 on securities purchased under the ABSPP. The Governing Council of the ECB identified an impairment indicator relating to two securities for which significant deterioration of the credit quality was observed. The Governing Council of the ECB considered that the identified impairment indicator had not affected the estimated future cash flows.

In the context of the impairment test conducted as at the end of 2018 on securities purchased under the CBPP3, the Governing Council of the ECB identified one impairment indicator in particular, relating to the holdings of a security issued by a credit institution which encountered significant financial difficulties in the course of 2018. The Governing Council of the ECB considered that the identified impairment indicator had not affected the estimated future cash flows. No impairment losses were therefore recorded in respect of securities acquired under the CBPP3.

As a result of an impairment test conducted on the CSPP portfolio, the Governing Council of the ECB has deemed it appropriate to establish a buffer against credit risks in monetary policy operations during 2018 (see L13 ‘Provisions’ in the notes to the balance sheet).

### A 7.2 Other securities

This sub-item comprises all the Bank’s holdings of debt securities issued by euro area residents that are not used in monetary policy operations and are not part of investment portfolios earmarked for specific purposes.

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€’000</td>
<td>€’000</td>
<td>€’000</td>
</tr>
<tr>
<td>Marketable debt securities</td>
<td>161,920</td>
<td>170,217</td>
<td>(8,297)</td>
</tr>
<tr>
<td>other than those held-to-maturity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Held-to-maturity debt securities</td>
<td>351,212</td>
<td>486,044</td>
<td>(134,832)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>513,132</td>
<td>656,261</td>
<td>(143,129)</td>
</tr>
</tbody>
</table>

During 2018, the Bank disposed of securities with a carrying amount of €11,222,029 from its held-to-maturity portfolio, due to adjustments to a limit framework necessitating such transactions. The quantity sold is considered insignificant and the disposed transaction is attributable to exceptional circumstances.

### A 9 Intra-Eurosystem claims

This item consists of claims arising from the Bank’s share in the ECB’s net equity and claims equivalent to the transfer of foreign reserves to the ECB. It may also include net claims related to the allocation of euro banknotes within the Eurosystem and other net claims within the Eurosystem.

#### A 9.1 Participating interest in ECB

Pursuant to Article 28 of the Statute, the ESCB NCBs are the sole subscribers to the capital of the ECB. Subscriptions depend on shares which are fixed in accordance with Article 29 of the Statute and are subject to adjustment every five years. The most recent adjustment took effect on 1 January 2019. As a result, the Bank’s share in the share capital of the ECB increased from 0.0648% to 0.0732% on 1 January 2019.

As at 31 December 2018, the share that the Bank held in the subscribed capital of the ECB, remained unchanged from 31 December 2017 at 0.0648%. As at 31 December 2017 and 2018 the share that the Bank held in the subscribed capital of the ECB amounted to €7,014,605.
Sub-item A9.1 ‘Participating interest in the ECB’, also includes the Bank’s share in the ECB’s accumulated net profits amounting to €8,844,497, with no change compared to 31 December 2017.

A 9.2 Claims equivalent to the transfer of foreign reserves
This asset represents the Bank’s claims arising from the transfer of foreign reserve assets to the ECB, when the Bank joined the Eurosystem. The remuneration of these claims is calculated daily at the latest available marginal interest rate used by the Eurosystem in its tenders for main refinancing operations, adjusted to reflect a zero return on the gold component.

The claim of the Bank with respect to the foreign reserve assets transferred to the ECB as at 31 December 2017 and 2018 was €37,552,276.

A 9.4 Net claims related to the allocation of euro banknotes within the Eurosystem
This sub-item reflects claims which would arise from application of the banknote allocation key (see 6 ‘Banknotes in circulation’ in the general notes to the financial statements). As at the end of 2017 and 2018, the Bank had no claims in this respect but had a liability which is presented in liability sub-item L10.3 ‘Net liabilities related to the allocation of euro banknotes within the Eurosystem’.

A 9.5 Other claims within the Eurosystem (net)
As at 31 December 2018, the claim of €4,540,078,216 (2017: €4,338,619,928) related to balances attributable to the transfers issued and received through TARGET2 by the ESCB NCBs, including the ECB, plus the balances held with the Eurosystem NCBs through correspondent accounts. Also included are balances resulting from the pooling and allocation of monetary income within the Eurosystem pending settlement (see 5 ‘Net result of pooling of monetary income’ in the notes to the profit and loss account), and balances with the ECB in respect of any amounts receivable or refundable, including the amount due to the Bank in respect of the ECB’s interim profit distribution (see 4 ‘Income from equity shares and participating interests’ in the notes to the profit and loss account).

The remuneration of the debit balance in respect of TARGET2 is calculated daily at the latest available interest rate used by the Eurosystem in its tenders for MROs.

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€’000</td>
<td>€’000</td>
<td>€’000</td>
</tr>
<tr>
<td>TARGET2 balance</td>
<td>4,540,078</td>
<td>4,338,620</td>
<td>201,458</td>
</tr>
<tr>
<td>Net result from pooling of monetary income</td>
<td>(6,545)</td>
<td>(6,119)</td>
<td>(426)</td>
</tr>
<tr>
<td>ECB profit distribution</td>
<td>1,097</td>
<td>909</td>
<td>188</td>
</tr>
<tr>
<td>Total</td>
<td>4,534,630</td>
<td>4,333,410</td>
<td>201,220</td>
</tr>
</tbody>
</table>

A 10 Items in course of settlement
These assets comprise transactions which were not yet settled as at the end of the financial year.
A 11  Other assets

A 11.1  Coins of euro area
This sub-item represents the Bank’s holdings of euro coins issued by euro area countries.

A 11.2  Tangible and intangible fixed assets
Tangible and intangible fixed assets principally comprise the Bank’s premises, equipment, computer hardware and software.

<table>
<thead>
<tr>
<th>Cost</th>
<th>Land and buildings</th>
<th>Computer equipment and other assets</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>As at 31 December 2017</td>
<td>35,742</td>
<td>12,775</td>
<td>48,517</td>
</tr>
<tr>
<td>Additions</td>
<td>78</td>
<td>748</td>
<td>826</td>
</tr>
<tr>
<td>Derecognition of assets</td>
<td>(494)</td>
<td>(5,243)</td>
<td>(5,737)</td>
</tr>
<tr>
<td>Disposal of assets</td>
<td>-</td>
<td>(24)</td>
<td>(24)</td>
</tr>
<tr>
<td>As at 31 December 2018</td>
<td>35,326</td>
<td>8,256</td>
<td>43,582</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Accumulated depreciation</th>
<th>Land and buildings</th>
<th>Computer equipment and other assets</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>As at 31 December 2017</td>
<td>3,366</td>
<td>6,828</td>
<td>10,194</td>
</tr>
<tr>
<td>Charge for the year</td>
<td>480</td>
<td>868</td>
<td>1,348</td>
</tr>
<tr>
<td>Derecognition of assets</td>
<td>(192)</td>
<td>(5,136)</td>
<td>(5,328)</td>
</tr>
<tr>
<td>Disposal of assets</td>
<td>-</td>
<td>(14)</td>
<td>(14)</td>
</tr>
<tr>
<td>As at 31 December 2018</td>
<td>3,654</td>
<td>2,546</td>
<td>6,200</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Net book value</th>
<th>Land and buildings</th>
<th>Computer equipment and other assets</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>As at 31 December 2017</td>
<td>32,376</td>
<td>5,947</td>
<td>38,323</td>
</tr>
<tr>
<td>As at 31 December 2018</td>
<td>31,672</td>
<td>5,710</td>
<td>37,382</td>
</tr>
</tbody>
</table>

During the year ended 31 December 2018, the Bank derecognised various items of computer equipment and other assets which were predominantly already fully depreciated, as these assets were no longer utilised by the Bank.

The net book value as at 31 December 2018 includes an amount of €49,172 (2017: €15,967,641) related to assets which are not yet available for use and which are not being depreciated.

A 11.3  Other financial assets
Other financial assets comprise debt securities and investments held by the Bank as part of an earmarked portfolio as a counterpart to the Bank’s capital and statutory reserves (see 3 (h) (ii) ‘Securities held for other than monetary policy purposes’ in the general notes to the financial statements).

The Bank also holds another earmarked portfolio comprising MGS purchased on the secondary market by the Bank in its role as market maker.

As at 31 December 2018, the Bank held investments in two fixed income investment programmes managed by external asset managers in the form of contractual funds. During the years ended 31 December 2017
and 2018, the Bank’s overall investment in these two funds remained unchanged. In January 2019, the Bank decided to substantially reduce its investment in these two fixed income investment programmes. This decision has no implications on the valuation of the Bank’s investment in these programmes as at 31 December 2018, based on the fair value of the underlying instruments.

The contractual funds are measured in the balance sheet at the net asset value of the respective fund.

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€’000</td>
<td>€’000</td>
<td>€’000</td>
</tr>
<tr>
<td>Earmarked investments</td>
<td>352,766</td>
<td>232,654</td>
<td>120,112</td>
</tr>
<tr>
<td>Earmarked Malta Government Stocks</td>
<td>323,961</td>
<td>359,339</td>
<td>(35,378)</td>
</tr>
<tr>
<td>Fixed income investment funds</td>
<td>353,689</td>
<td>361,871</td>
<td>(8,182)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,030,416</td>
<td>953,864</td>
<td>76,552</td>
</tr>
</tbody>
</table>

**A 11.4 Off-balance sheet instruments revaluation differences**

This sub-item reflects revaluation gains arising on off-balance sheet positions, mainly foreign exchange forward transactions outstanding as at the balance sheet date. As at 31 December 2018, these gains amounted to €3,009,987 (2017: €41,379,914).

**A 11.5 Accruals and prepaid expenses**

As at 31 December 2018, this sub-item includes accrued interest income of €30,829,150 (2017: €34,211,084) on income-earning assets. At the end of the current financial year, there was no interest attributable to intra-Eurosystem claims.

**A 11.6 Sundry**

Sundry assets consist mainly of loans amounting to €7,475,160 (2017: €6,575,178), unrealised losses attributable to the earmarked portfolio amounting to €5,087,789 (2017: €409,637), and realised gains attributable to off-balance sheet positions, principally foreign exchange forward transactions outstanding at the year-end, amounting to €4,931,767 (2017: nil), which gains arose from the conversion of such transactions into their euro equivalent at the respective currency’s average cost on the balance sheet date, compared with the euro amounts at which the transactions were initially recorded.
Liabilities

L 1  Banknotes in circulation
This item consists of the Bank’s share of the total euro banknotes in circulation (see 6 ‘Banknotes in circulation’ in the general notes to the financial statements).

During 2018, the total value of banknotes in circulation within the Eurosystem increased by 5.2% from €1,170,716,347,615 at 31 December 2017 to €1,231,133,605,720 at 31 December 2018. According to the banknote allocation key, the Bank had an allocated amount of euro banknotes in circulation of €1,046,463,900 at the end of the year compared to €995,108,600 at the end of 2017.

The value of the euro banknotes actually issued by the Bank in 2018 increased by 14.2% from €1,167,590,490 to €1,333,717,400 at year-end. As this is more than the allocated amount, the difference of €287,253,500 (2017: €172,481,890) is shown under liability sub-item L10.3 ‘Net liabilities related to the allocation of euro banknotes within the Eurosystem’.

L 2  Liabilities to euro area credit institutions related to monetary policy operations denominated in euro
These interest-bearing liabilities arise from the monetary policy operations conducted by the Bank on behalf of the Eurosystem.

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€'000</td>
<td>€'000</td>
<td>€'000</td>
</tr>
<tr>
<td>Current accounts</td>
<td>1,651,432</td>
<td>1,103,678</td>
<td>547,754</td>
</tr>
<tr>
<td>(covering the minimum</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>reserve system)</td>
<td>3,613,810</td>
<td>3,818,402</td>
<td>(204,592)</td>
</tr>
<tr>
<td>Total</td>
<td>5,265,242</td>
<td>4,922,080</td>
<td>343,162</td>
</tr>
</tbody>
</table>

L 2.1  Current accounts (covering the minimum reserve system)
Current accounts contain the credit balances of credit institutions that are required to hold minimum reserves. The minimum reserve requirements have to be met on average over the reserve maintenance period in accordance with the schedule published by the ECB. These balances are currently remunerated at the MRO rate. Since June 2014, the reserve holdings exceeding the required minimum reserves are remunerated at zero per cent or the deposit facility rate, whichever is lower.

L 2.2  Deposit facility
The overnight deposit facility is available to eligible counterparties to make overnight deposits with Eurosystem NCBs at pre-specified rates. Under normal circumstances, the interest rate on the facility provides a floor for the overnight market interest rate. During 2018, the aggregate volume of such transactions with the Bank amounted to €895,079,824,476 (2017: €734,341,573,142). The outstanding balance as at year-end amounted to €3,613,809,679 (2017: €3,818,401,851).

Throughout the financial years ended 31 December 2017 and 2018, the overnight deposit facility rate remained unchanged at the level of -0.40%.
**L 2.3 Fixed-term deposits**

These liabilities relate to liquidity-absorbing fine-tuning operations for a fixed-term at variable rate tenders. No liquidity-absorbing fine-tuning operations were conducted by the ECB during the years ended 31 December 2017 and 2018. Accordingly, there were no outstanding liquidity-absorbing fine-tuning operations as at 31 December 2017 and 2018.

**L 2.4 Fine-tuning reverse operations**

Fine-tuning liquidity-absorbing reverse operations are executed on an ad hoc basis with the purpose of managing the liquidity situation in the market and setting interest rates. Liquidity-absorbing fine-tuning reverse operations are executed, as a rule, through bilateral procedures. Moreover, their frequency and maturity are not standardised. No fine-tuning absorption reverse operations were conducted during the years ended 31 December 2017 and 2018, and accordingly there were no outstanding operations as at 31 December 2017 and 2018.

**L 2.5 Deposits related to margin calls**

This sub-item refers to cash received from counterparties in those instances where the market value of the collateral pledged has fallen below an established trigger point, implying a shortfall of collateral to cover the outstanding monetary policy operations. No instances of deposits related to margin calls were recorded during the years ended 31 December 2017 and 2018.

**L 5 Liabilities to other euro area residents denominated in euro**

**L 5.1 General government**

This liability includes current and sinking fund accounts denominated in euro held by the Government of Malta. These balances are repayable on demand and are remunerated in accordance with the provisions established by the Governing Council of the ECB.  

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€’000</td>
<td>€’000</td>
<td>€’000</td>
</tr>
<tr>
<td>Current accounts</td>
<td>479,033</td>
<td>627,080</td>
<td>(148,047)</td>
</tr>
<tr>
<td>Sinking fund accounts</td>
<td>106,381</td>
<td>170,760</td>
<td>(64,379)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>585,414</td>
<td>797,840</td>
<td>(212,426)</td>
</tr>
</tbody>
</table>

**L 5.2 Other liabilities**

This sub-item includes current accounts which are repayable on demand and fixed-term deposits denominated in euro held by Maltese public sector corporations and other entities amounting to €178,360,917 (2017: €150,655,435). This amount includes balances of former credit institutions amounting to €30,646,737 (2017: €24,816,499). These balances are remunerated in accordance with the provisions established by the Governing Council of the ECB.  

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19 See footnote 18.
This sub-item includes collateralised inward deposits, which as at 31 December 2018 amounted to €571,317,830 (2017: €705,000,000). These liabilities are attributable to securities sold subject to repurchase agreements entered into by the Bank (see 3 (i) ‘Sale and repurchase agreements and lending of securities’ in the general notes to the financial statements).

L 6 Liabilities to non-euro area residents denominated in euro
As at 31 December 2018, there were no outstanding collateralised inward deposits attributable to securities sold under repurchase agreements entered into by the Bank (2017: €18,203,291).

This item also includes balances denominated in euro held by international and supranational organisations and by non-Eurosystem central banks, including the IMF No. 2 current account for administrative expenses (see 3 (j) ‘Claims on the International Monetary Fund’ in the general notes to the financial statements). Whereas the IMF account is non-interest bearing, the other balances are remunerated in accordance with the provisions established by the Governing Council of the ECB.

L 7 Liabilities to euro area residents denominated in foreign currency
Balances held by the Government of Malta which are repayable on demand and other customer deposits are included in this item. Deposits by banks are subject to fixed interest rates. All other balances are remunerated in accordance with the provisions established by the Governing Council of the ECB.

Other current accounts and fixed-term deposits include balances of former credit institutions amounting to €71,129,168 (2017: €9,647,637).

L 9 Counterpart of special drawing rights allocated by the IMF
This item represents the counterpart of special drawing rights allocated by the IMF to Malta (see A2.1 (b) ‘Receivables from the IMF’ in the notes to the balance sheet).

L 10 Intra-Eurosystem liabilities
This item represents the Bank’s liabilities to the ECB and to the other Eurosystem NCBs.

L 10.3 Net liabilities related to the allocation of euro banknotes within the Eurosystem
This sub-item consists of the liability of the Bank vis-à-vis the Eurosystem relating to the excess of euro banknotes issued by the Bank over and above the amount allocated to the Bank by the ECB in accordance with the banknote allocation key (see L1 ‘Banknotes in circulation’ in the notes to the balance sheet).

<table>
<thead>
<tr>
<th>Item</th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government of Malta current accounts</td>
<td>56,323</td>
<td>38,409</td>
<td>17,914</td>
</tr>
<tr>
<td>Government of Malta sinking fund accounts</td>
<td>82</td>
<td>100</td>
<td>(18)</td>
</tr>
<tr>
<td>Liabilities to banks</td>
<td>149,258</td>
<td>83,952</td>
<td>65,306</td>
</tr>
<tr>
<td>Other current accounts and fixed-term deposits</td>
<td>73,612</td>
<td>18,337</td>
<td>55,275</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>279,275</td>
<td>140,798</td>
<td>138,477</td>
</tr>
</tbody>
</table>

Other current accounts and fixed-term deposits include balances of former credit institutions amounting to €71,129,168 (2017: €9,647,637).

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20 See footnote 18.

21 See footnote 18.
The increase in the excess euro banknotes reflects the relatively higher increase (14.2%) in additional banknotes issued by the Bank during 2018, as compared to the increase in banknotes put into circulation by the Eurosystem as a whole (5.2%).

**L 10.4 Other liabilities within the Eurosystem (net)**

As at 31 December 2017 and 2018, the Bank had a net claim within the Eurosystem as reported under asset sub-item A9.5 'Other claims within the Eurosystem (net)'.

**L 12 Other liabilities**

**L 12.1 Off-balance sheet instruments revaluation differences**

This sub-item reflects revaluation losses arising on off-balance sheet positions, mainly foreign exchange forward transactions outstanding as at the balance sheet date.

**L 12.2 Accruals and income collected in advance**

As at 31 December 2017, these liabilities included the balance of demonetised Maltese lira currency notes which were not yet presented, as adjusted for amounts recognised as income in the profit and loss account (see 3 (i) 'Demonetised Maltese lira currency' in the general notes to the financial statements and (e) 'Demonetised Maltese lira currency notes' in the other notes to the financial statements). Subsequent to 31 January 2018, demonetised Maltese lira currency notes were no longer exchangeable at the Bank. Consequently, the balance of deferred income, adjusted for demonetised currency notes presented in January 2018, was recognised as income in the profit and loss account for the year ended 31 December 2018.

This sub-item also includes accrued interest expense on interest-bearing liabilities, and other accrued expenses.

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred income in respect of demonetised Maltese Lira currency notes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accrued interest payable</td>
<td>1,711</td>
<td>777</td>
<td>934</td>
</tr>
<tr>
<td>Others</td>
<td>2,677</td>
<td>5,438</td>
<td>(2,761)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>4,388</td>
<td>10,105</td>
<td>(5,717)</td>
</tr>
</tbody>
</table>

**L 12.3 Sundry**

Sundry liabilities mainly include unrealised revaluation gains attributable to MGS held as part of the earmarked portfolio amounting to €9,644,460 (2017: €12,607,164) and unrealised revaluation gains attributable to other earmarked portfolios and other investments amounting to €2,540,017 (2017: €2,344,205).

As at 31 December 2017, these liabilities included realised losses attributable to off-balance sheet positions, principally outstanding foreign exchange forward transactions, amounting to €35,519,843, which losses arose from the conversion of such transactions into their euro equivalents at the respective currency’s average cost on the balance sheet date, compared with the euro amounts at which the transactions were initially recorded. In 2017, this sub-item also included unrealised revaluation gains on marketable debt securities which formed part of the earmarked portfolio and were transferred to held-to-maturity portfolios amounting to €406,359. The balance of these unrealised gains is being amortised on a straight line basis over the term

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22 Comprising investments held as a counterpart to the Bank’s capital and statutory reserves.
of the respective security and is recognised within net interest income in sub-item 1.1. As at 31 December 2018, there were no outstanding balances in this regard.

L 13 Provisions
This item includes a provision of €97,079,853 (2017: €86,757,056) approved by the Board of Directors in accordance with Guideline ECB/2016/34 (recast). In 2015, the Board of Directors resolved to modify the model utilised to calculate this provision to cover risks of adverse economic valuations resulting from shocks in interest rates, credit quality and foreign exchange. The calculations are based on the universe of investment assets and monetary policy assets using the Expected Shortfall (ES) technique – a risk measure applied in the evaluation of market and credit risks of a portfolio that derives the expected loss at the 99% level of confidence in the worst 1% of cases. The model applies the Monte Carlo simulation technique whereby around ten thousand simulations of systemic and non-systemic returns are generated with the inherent advantage that the output is not reliant on either the normal distribution of returns or on historical data. The underlying distribution chosen to model the simulations is the t-distribution which can be calibrated to have heavier tails than those for the normal distribution. This methodology is the base case scenario adopted by the Eurosystem NCBs and the ECB annually, in order to measure total economic risk and corresponding financial buffers\(^\text{23}\) that could be absorbed in the event of such shocks. Full coverage for the resultant shortfall will have to include the Bank’s capital and reserves, until sufficient above-the-line buffers have been accumulated.

In 2017, a provision amounting to €68,870,710 against losses in monetary policy operations was established in relation to a security held by an NCB of the Eurosystem. In accordance with Article 32.4 of the Statute, this provision was funded by all the NCBs in proportion to their subscribed capital key shares in the ECB prevailing in 2017. As a result, a provision for €63,400 equivalent to 0.0921% of the total provision was created. The size of the provision in the financial statements of 2017 was calculated taking into account the information regarding the sale of the security in January 2018 and therefore the loss realised in 2018 was fully covered by usage of the provision.

As a result of the impairment test conducted on the CSPP portfolio, the Governing Council of the ECB has deemed it appropriate to establish a provision amounting to €161,074,918 against credit risks in monetary policy operations during 2018. In accordance with Article 32.4 of the Statute, this provision is funded by all the NCBs in proportion to their subscribed capital key shares in the ECB prevailing in 2018. As a result, a provision for €148,280 equivalent to 0.0921% of the total provision was recognised in these financial statements.

L 14 Revaluation accounts
The revaluation accounts include the unrealised revaluation gains arising from the valuation of foreign currency on and off-balance sheet positions, gold, marketable securities and other instruments at year-end.

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€’000</td>
<td>€’000</td>
<td>€’000</td>
</tr>
<tr>
<td>Gold</td>
<td>647</td>
<td>655</td>
<td>(8)</td>
</tr>
<tr>
<td>Foreign currency positions</td>
<td>389</td>
<td>1</td>
<td>388</td>
</tr>
<tr>
<td>Securities and other instruments</td>
<td>6,295</td>
<td>15,749</td>
<td>(9,454)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>7,331</td>
<td>16,405</td>
<td>(9,074)</td>
</tr>
</tbody>
</table>

\(^{23}\) Above-the-line buffers include provisions, profit for the year and revaluation accounts. Below-the-line buffers include capital and reserves.
L 15   **Capital and reserves**  
The following table analyses the movement in capital and reserves of the Bank:

<table>
<thead>
<tr>
<th></th>
<th>Capital €’000</th>
<th>General reserve fund €’000</th>
<th>Reserves for risks and contingencies €’000</th>
<th>Capital contribution €’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance as at 31 December 2017</td>
<td>20,000</td>
<td>75,505</td>
<td>187,776</td>
<td>78,202</td>
</tr>
<tr>
<td>Net issuance of euro coins</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Balance as at 31 December 2018</td>
<td>20,000</td>
<td>75,505</td>
<td>187,776</td>
<td>84,431</td>
</tr>
</tbody>
</table>

**L 15.1 Capital**  
In terms of article 19(1) of the Act, the Bank shall have an authorised capital of €20,000,000. This is fully paid-up and is held exclusively by the Government of Malta.

**L 15.2 Reserves**  

(a) **General reserve fund**  
In terms of article 19(2) of the Act, the Bank shall also maintain a general reserve fund which shall be of not less than €20,000,000 and which shall be available for any purpose as may be determined by the Board of Directors. Whenever amounts are drawn from the general reserve fund, these shall be replaced as may be decided by the Board.

(b) **Reserves for risks and contingencies**  
Reserves for risks and contingencies are maintained in terms of article 22(1) of the Act to cover the broad range of risks to which the Bank is exposed. The major risks in this regard arise from potential movements in market values of the Bank’s holdings of domestic and foreign securities and other investments, losses which could arise from support of the financial system in the Bank's role as a lender of last resort and other non-insured losses.

(c) **Capital contribution**  
This reserve represents the capital contribution made by the Government of Malta to the Bank in respect of the agency agreement between the Bank and the Government relating to the issuance of euro coins. The Bank shall act as agent of the Government and shall retain full responsibility for procurement, storage and issuance of euro coins. This reserve represents seigniorage revenue arising from the issue of euro coins. In terms of the agency agreement, the Government has agreed not to withdraw such revenue and retain these amounts in a reserve account held at the Bank. Allocation of revenue to the reserve account shall be deemed as a capital contribution to the Bank by the Government.
Notes to the profit and loss account

1 Net interest income
This item represents the net result of interest income and interest expense. With the onset of negative interest rates in the past years, certain financial assets have given rise to interest expense rather than interest income and certain financial liabilities have given rise to interest income rather than interest expense.

As from the financial year ended 31 December 2016, the Bank adopted the Eurosystem harmonised presentation format in respect of interest income and interest expense arising from monetary policy operations so as to report interest on a net basis, such that positive and negative interest stemming from monetary policy operations are netted off on a balance sheet (sub-) item level. Net positive interest arising from monetary policy liabilities is presented within interest income and net negative interest on monetary policy assets is presented within interest expense (see 3 (f) (i) ‘Interest income and expense’ in the general notes to the financial statements).

1.1 Interest income
Interest income includes income on foreign reserve assets and euro-denominated portfolios, as well as interest income on intra-Eurosystem claims and monetary policy instruments. Negative interest income generated from financial assets, other than financial instruments attributable to monetary policy operations, is netted off within the amounts presented in the table below. The net negative interest expense attributable to monetary policy operations for the current year amounted to €15,323,831 (2017: €12,615,712).

Other interest income for 2018 includes an amount of €1,656,264 received from the investment in a fixed income fund which is considered by the Bank as interest in nature.

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>- In euro</td>
<td>21,587</td>
<td>27,901</td>
<td>(6,314)</td>
</tr>
<tr>
<td>- In foreign currency</td>
<td>14,893</td>
<td>10,699</td>
<td>4,194</td>
</tr>
<tr>
<td>Current accounts and overnight deposits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- In euro</td>
<td>(30)</td>
<td>(27)</td>
<td>(3)</td>
</tr>
<tr>
<td>- In foreign currency</td>
<td>76</td>
<td>50</td>
<td>26</td>
</tr>
<tr>
<td>IMF</td>
<td>124</td>
<td>98</td>
<td>26</td>
</tr>
<tr>
<td>Monetary policy operations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Minimum reserves</td>
<td>1,084</td>
<td>910</td>
<td>174</td>
</tr>
<tr>
<td>- Overnight deposits</td>
<td>14,240</td>
<td>11,706</td>
<td>2,534</td>
</tr>
<tr>
<td>- Securities acquired under the SMP</td>
<td>2,983</td>
<td>3,714</td>
<td>(731)</td>
</tr>
<tr>
<td>- Securities acquired under the PSPP</td>
<td>11,295</td>
<td>9,590</td>
<td>1,705</td>
</tr>
<tr>
<td>Forward foreign exchange contracts</td>
<td>(12,601)</td>
<td>(7,515)</td>
<td>(5,086)</td>
</tr>
<tr>
<td>Other interest income</td>
<td>1,682</td>
<td>23</td>
<td>1,659</td>
</tr>
<tr>
<td>Total</td>
<td>55,333</td>
<td>57,149</td>
<td>(1,816)</td>
</tr>
</tbody>
</table>

Other interest income for 2018 includes an amount of €1,656,264 received from the investment in a fixed income fund which is considered by the Bank as interest in nature.

1.2 Interest expense
Interest expense arises from interest on Government of Malta and other customer accounts and liabilities to euro area credit institutions related to monetary policy operations. Negative interest expense generated from financial liabilities, other than financial instruments attributable to monetary policy operations, is netted off
within the amounts presented in the table below. The net negative interest income attributable to monetary policy operations for the current year amounted to €201,274 (2017: €282,147).

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€’000</td>
<td>€’000</td>
<td>€’000</td>
</tr>
<tr>
<td>Government accounts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- In euro</td>
<td>(3,004)</td>
<td>(3,771)</td>
<td>767</td>
</tr>
<tr>
<td>Other customer accounts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- In euro</td>
<td>(666)</td>
<td>(499)</td>
<td>(167)</td>
</tr>
<tr>
<td>- In foreign currency</td>
<td>1,535</td>
<td>621</td>
<td>914</td>
</tr>
<tr>
<td>Monetary policy operations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Longer-term refinancing operations</td>
<td>201</td>
<td>282</td>
<td>(81)</td>
</tr>
<tr>
<td>Other interest expense</td>
<td>(2,896)</td>
<td>(2,737)</td>
<td>(159)</td>
</tr>
<tr>
<td>Total</td>
<td>(4,830)</td>
<td>(6,104)</td>
<td>1,274</td>
</tr>
</tbody>
</table>

### 2 Net result of financial operations, write-downs and risk provisions

#### 2.1 Realised gains/losses arising from financial operations

This sub-item includes realised gains/losses arising from the disposals of financial instruments, mainly debt securities, and transactions leading to reductions in foreign currency positions.

This item also includes realised gains stemming from sales of securities from a held-to-maturity portfolio due to adjustments to a limit framework (see A7.2 ‘Other securities’ in the notes to the balance sheet).

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€’000</td>
<td>€’000</td>
<td>€’000</td>
</tr>
<tr>
<td>Net gains on disposal of financial instruments</td>
<td>2,011</td>
<td>9,148</td>
<td>(7,137)</td>
</tr>
<tr>
<td>Net gains/(losses) on foreign currency positions</td>
<td>1,633</td>
<td>(136)</td>
<td>1,769</td>
</tr>
<tr>
<td>Total</td>
<td>3,644</td>
<td>9,012</td>
<td>(5,368)</td>
</tr>
</tbody>
</table>

#### 2.2 Write-downs on financial assets and positions

This sub-item comprises unrealised revaluation losses arising from the price revaluation of debt securities and the exchange rate revaluation of foreign currency assets and liabilities, including off-balance sheet positions, by comparing the market value at balance sheet date with the average book value.

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€’000</td>
<td>€’000</td>
<td>€’000</td>
</tr>
<tr>
<td>Write-downs on debt securities</td>
<td>2,197</td>
<td>1,200</td>
<td>997</td>
</tr>
<tr>
<td>Write-downs on foreign currency positions</td>
<td>1</td>
<td>3,685</td>
<td>(3,684)</td>
</tr>
<tr>
<td>Total</td>
<td>2,198</td>
<td>4,885</td>
<td>(2,687)</td>
</tr>
</tbody>
</table>
2.3 **Transfer to/from provisions for foreign exchange rate, interest rate, credit and gold price risks**

This sub-item consists of movements in provisions (see L13 ‘Provisions’ in the notes to the balance sheet).

3 **Net income/expense from fees and commissions**

Fees and commissions receivable mainly arise from banking services provided by the Bank. Fees and commissions payable include correspondent account charges, handling fees on cheques drawn on the Bank and TARGET2 connection and participation fees.

4 **Income from equity shares and participating interests**

During 2018, the Bank received €264,231 (2017: €208,852) representing its relative share of the ECB’s distributable remaining profits for 2017 in proportion to the Bank’s subscribed capital key (see 4 ‘Capital key’ in the general notes to the financial statements).

Also included under this caption is the amount of €1,096,727 (2017: €909,271) due to the Bank with respect to the ECB’s 2018 interim profit distribution (see 7 ‘ECB profit distribution’ in the general notes to the financial statements).

5 **Net result of pooling of monetary income**

This item contains the net result of pooling of monetary income for 2018 amounting to an expense of €6,544,768 as compared to an expense of €6,118,776 in 2017. This item also includes the Bank’s share in the realised loss pertaining to the sale in 2018 of a security held by an NCB of the Eurosystem in its CSPP portfolio amounting to €63,400, as well as the reversal of the provision of the same amount established in 2017 against such losses (see L13 ‘Provisions’ in the notes to the balance sheet). Also included within this item is the Bank’s share in the provision against losses in monetary policy operations amounting to €148,280, which was established in relation to securities held by an NCB of the Eurosystem in its CSPP portfolio (see L13 ‘Provisions’ in the notes to the balance sheet).

The amount of each Eurosystem NCB’s monetary income is determined by measuring the actual annual income that is derived from the earmarkable assets held against the liability base. The liability base consists mainly of the following items: banknotes in circulation; liabilities to euro area credit institutions related to monetary policy operations denominated in euro; net intra-Eurosystem liabilities resulting from TARGET2 transactions; net intra-Eurosystem liabilities related to the allocation of euro banknotes within the Eurosystem, accrued interest recorded at quarter-end by each NCB on monetary policy liabilities the maturity of which is one year or longer; and liabilities vis-à-vis the ECB backing the claim in relation to swap agreements that earn net income for the Eurosystem. Any interest paid on liabilities included within the liability base is to be deducted from the monetary income to be pooled.

The earmarkable assets consist mainly of the following items: lending to euro area credit institutions related to monetary policy operations denominated in euro; securities held for monetary policy purposes; intra-Eurosystem claims equivalent to the transfer of foreign reserve assets to the ECB; net intra-Eurosystem claims resulting from TARGET2 transactions; net intra-Eurosystem claims related to the allocation of euro banknotes within the Eurosystem; claims on euro area counterparties related to swap agreements between the ECB and non-Eurosystem central banks that earn net income for the Eurosystem; accrued interest recorded at quarter-end by each NCB on monetary policy assets the maturity of which is one year or longer; and a limited amount of each NCB’s gold holdings in proportion to each NCB’s capital key share.

The amount of each NCB’s monetary income shall be determined by measuring the actual income that is derived from the earmarkable assets recorded in its books. As an exception to this, gold is considered to generate no income and the following are considered to generate income at the latest available marginal
interest rate used by the Eurosystem in its tenders for main refinancing operations: (i) securities held for monetary policy purposes under Decision ECB/2009/16 of 2 July 2009 on the implementation of the covered bonds purchase programme, (ii) securities held for monetary policy purposes under Decision ECB/2011/17 of 3 November 2011 on the implementation of the second covered bond purchase programme and (iii) debt instruments issued by central, regional and local governments and recognised agencies and substitute debt instruments issued by public non-financial corporations under Decision ECB/2015/10 of 4 March 2015 on the implementation of the secondary markets public sector asset purchase programme.

Where the value of an NCB’s earmarkable assets exceeds or falls short of the value of the liability base, the difference shall be offset by applying to the value of the difference the latest applicable marginal rate for the Eurosystem main refinancing operations.

The monetary income pooled by the Eurosystem is allocated among NCBs according to the subscribed ECB capital key. The pooling and reallocation of monetary income to NCBs leads to certain net reallocation effects. One reason is that the yields earned on certain earmarkable assets and the interest expense paid on certain liability base items may differ to a varying degree among the Eurosystem NCBs. In addition, usually each Eurosystem NCB’s share of earmarkable assets and the liability base deviates from its share in the subscribed capital of the ECB. The net result arising from the calculation of monetary income for 2017 and 2018 was a payment by the Bank. This net result is the difference between the net monetary income pooled by the Bank amounting to €18,035,471 (2017: €16,047,986) and the redistributed amount of €11,236,939 (2017: €9,931,975). In 2018, an income of €253,764 was received in relation to an adjustment for the previous two years. In 2017, a marginal expense of €2,765 was paid in relation to an adjustment for the previous year.

6 Other income
Other income includes an amount of €2,928,484 (2017: €8,000,000), reflecting the recognition of income in respect of the balance of unredeemed Maltese lira fifth series currency notes, which after the expiry of the 10 year period, 31 January 2018, amounted to €36,428,484 (2017: €37,390,322). These currency notes were still exchangeable at the Bank until 31 January 2018. The value of unredeemed currency notes, after deducting therefrom the amount of currency notes which have been redeemed until that date, has been apportioned as income in the profit and loss account over the period until 31 January 2018. This accounting treatment is in accordance with the provisions of article 62(3) of the Act (see 3(l) ‘Demonetised Maltese lira currency notes’ in the general notes to the financial statements).

This item also includes the income from the issuance of numismatic coins.

7 Staff costs
Staff costs include salaries and other ancillary costs.

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€’000</td>
<td>€’000</td>
<td>€’000</td>
</tr>
<tr>
<td>Staff salaries</td>
<td>10,141</td>
<td>10,008</td>
<td>133</td>
</tr>
<tr>
<td>Other staff costs</td>
<td>1,235</td>
<td>1,219</td>
<td>16</td>
</tr>
<tr>
<td>Training, welfare and other related expenditure</td>
<td>1,171</td>
<td>928</td>
<td>243</td>
</tr>
<tr>
<td>Total</td>
<td>12,547</td>
<td>12,155</td>
<td>392</td>
</tr>
</tbody>
</table>
The full-time equivalent average number of staff employed by the Bank during the year was as follows:

<table>
<thead>
<tr>
<th></th>
<th>2018 Number</th>
<th>2017 Number</th>
<th>Change Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governors</td>
<td>3</td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td>Chief Officers</td>
<td>7</td>
<td>7</td>
<td>-</td>
</tr>
<tr>
<td>Heads and executives</td>
<td>125</td>
<td>116</td>
<td>9</td>
</tr>
<tr>
<td>Officers II and I</td>
<td>161</td>
<td>167</td>
<td>(6)</td>
</tr>
<tr>
<td>Non-clerical staff</td>
<td>33</td>
<td>33</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>329</td>
<td>326</td>
<td>3</td>
</tr>
</tbody>
</table>

8 Administrative expenses
This item consists of operating expenditure incurred by the Bank.

Administrative expenses of €7,066,863 (2017: €5,892,783) mainly comprise maintenance expenditure, professional fees, travelling costs and other services or expense items which are incurred in the course of the Bank’s operations. Auditors’ remuneration, inclusive of VAT, for the year ended 31 December 2018 amounted to €104,480 (2017: €62,000).

Compensation to the members of the Board of Directors for the financial year ended 31 December 2018 amounted to €271,896 (2017: €255,057). The Governor and Deputy Governors are entitled to such benefits as health insurance cover and refund of certain other expenses. The other members of the Board of Directors are entitled to health insurance cover and the refund of certain other expenses.

9 Depreciation of tangible and intangible fixed assets
Depreciation of buildings, equipment, computer hardware and software was charged to the Bank’s profit and loss account according to the depreciation rates disclosed in 3 (m) ‘Tangible and intangible fixed assets’ in the general notes to the financial statements.

10 Banknote production services
This item includes expenditure relating to the procurement and transportation of euro banknotes and other ancillary costs. Accrued expenditure also reflects the expected costs attributable to the consumption of banknotes issued.
Other notes

(a) Off-balance sheet instruments
As at 31 December 2018, the Bank had outstanding foreign exchange forward and swap contracts which relate to the forward purchases of €841,073,469 (2017: €732,074,943) against the sale of other currencies (principally the US dollar), and forward sales of €342,950,000 (2017: €187,500,000) against the purchase of other currencies (principally the US dollar). As at 31 December 2017 and 2018 there were no outstanding foreign exchange contracts for the forward sale or purchase of SDR.

Unsettled net spot transactions as at 31 December 2018 were €54,850,000 (2017: nil).

At the balance sheet date, the Bank had outstanding interest rate future contracts linked to German government securities (net short positions with a notional amount of €95,565,800) and US treasury notes (short positions with a notional amount of US$141,533,752).

(b) Contingent liabilities and commitments
The Bank’s contingent liabilities as at 31 December 2017 and 2018 consisted of outstanding guarantees, which amounted to €100,110. The Bank’s customers with respect to guarantees are mainly public sector corporations and government departments.

As at 31 December 2018, the Bank also had commitments in respect of tangible/intangible fixed assets which extended beyond the balance sheet date. Capital commitments, which amount to €2,610,200 (2017: €4,430,700), are expected to be incurred during the forthcoming financial year and relate mainly to capital expenditure attributable to buildings and investment in IT.

(c) Transactions with Government
In the course of its operations, the Bank conducts banking transactions with, and provides several banking services to, the Government of Malta, government departments, public sector corporations and other entities owned by the Government. The Bank holds the principal accounts of the Government and maintains accounts for the other entities. Balances held with the Bank by the Government and the other entities as at the balance sheet dates, together with the terms of such instruments, are disclosed in L5 ‘Liabilities to other euro area residents denominated in euro’ and L7 ‘Liabilities to euro area residents denominated in foreign currency’ in the notes to the balance sheet. The principal impact of banking transactions entered into with the Government and the entities referred to above on the Bank’s profit and loss account is net interest on deposits as disclosed in 1.2 ‘Interest expense’ in the notes to the profit and loss account. The Bank provides these entities with foreign exchange and related services, which do not have a significant impact on the Bank’s profit and loss account.

(d) Market maker in Malta Government securities
The Bank acts as market maker in MGS and Treasury bills and ensures their liquidity in the secondary market by being ready to trade in such securities on the initiative of the market (see A11.3 ‘Other financial assets’ in the notes to the balance sheet). Income earned by the Bank from these assets amounting to €4,238,119 (2017: €5,507,359) is included in 1.1 ‘Interest income’ in the notes to the profit and loss account and presented within income from euro marketable debt securities.

(e) Demonetised Maltese lira currency notes
Maltese lira currency notes were replaced by euro banknotes when Malta became part of the euro area on 1 January 2008. Consequently, Maltese lira currency notes remained legal tender until 31 January 2008.
and continued to be redeemed at the conversion rate of the Maltese lira for the euro of 0.4293 and without charge until 31 January 2018.

Demonetised Maltese lira currency notes amounting to €961,838 were redeemed during the month of January 2018. The amount of unredeemed Maltese lira currency notes as at 31 January 2018 amounted to €36,428,484, which amount was recognised in the profit and loss account in a systematic manner over the financial years 2011 to 2018. These unredeemed demonetised Maltese lira notes are no longer exchangeable by the Bank.

(f) Investment securities pledged as collateral
As at 31 December 2018, investment securities have been pledged as collateral against the provision of credit lines by a counterparty up to an amount of US$65,000,000 or approximately €57,000,000 (2017: US$65,000,000 or approximately €54,000,000). No amounts were borrowed under these facilities at the balance sheet dates.

(g) Assets held in custody
As at 31 December 2018, assets held in custody by the Bank in terms of the Insurance Business Act (Cap. 403) amounted to the equivalent of €22,124,834 (2017: €22,989,443).

(h) Management of funds belonging to the Investor and Depositor Compensation Schemes
In 2003, the Bank was appointed investment manager in respect of funds belonging to the Investor and Depositor Compensation Schemes. The Bank manages these funds on a discretionary basis in accordance with the investment parameters set by the Management Committees of the respective Schemes. As at 31 December 2018, the Investor and Depositor Compensation Schemes had deposits of €741,131 (2017: €382,671) and €9,081,122 (2017: €8,774,215) respectively, with the Bank.
### Statement of the Bank’s investments as at 31 December 2018

<table>
<thead>
<tr>
<th>EUR ’000</th>
<th>USD ’000</th>
<th>Others ’000</th>
<th>Total ’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and balances with banks</td>
<td>24,438</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold balances</td>
<td>3,484</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Securities by issuer category:**

<table>
<thead>
<tr>
<th>EUR ’000</th>
<th>USD ’000</th>
<th>Others ’000</th>
<th>Total ’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government</td>
<td>1,716,375</td>
<td>91,551</td>
<td>42,717</td>
</tr>
<tr>
<td>Insurance</td>
<td>3,082</td>
<td>9,892</td>
<td>-</td>
</tr>
<tr>
<td>Monetary financial institutions</td>
<td>762,450</td>
<td>314,504</td>
<td>182,878</td>
</tr>
<tr>
<td>Other financial institutions</td>
<td>166,149</td>
<td>81,310</td>
<td>26,129</td>
</tr>
<tr>
<td>Non-financial institutions</td>
<td>17,114</td>
<td>14,819</td>
<td>9,214</td>
</tr>
<tr>
<td>Supranational</td>
<td>34,907</td>
<td>6,914</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total investments</strong></td>
<td>2,700,077</td>
<td>518,990</td>
<td>260,938</td>
</tr>
<tr>
<td>Claims on the International Monetary Fund</td>
<td>140,956</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Participating interest in the European Central Bank</td>
<td>15,859</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfer of foreign reserves to the European Central Bank</td>
<td>37,552</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed income investment funds</td>
<td>353,689</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other foreign currency assets</td>
<td>69,327</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total investments</strong></td>
<td>4,125,310</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>