



Central Bank of Malta Annual Report 2016

Dr Mario Vella, Governor

Mr Alfred Mifsud, Deputy Governor

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2 May 2017



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Overview

- International and domestic macroeconomic developments
- Financial market developments and the banking sector
- Central Bank of Malta's operations



The essential story

- During 2016, the Maltese economy continued to outperform European Union peers, as structural reforms in energy, the labour market and the benefit system boosted potential output.
- Prudence in the management of public finances, particularly through further reduction in debt below the 60% to GDP mark and a surplus of 1% of GDP, contributed significantly to stability.
- The Central Bank supported growth through accommodative monetary policy and measures to enhance access to credit.
- Results for 2017 so far confirm these trends.



International and domestic macroeconomic developments

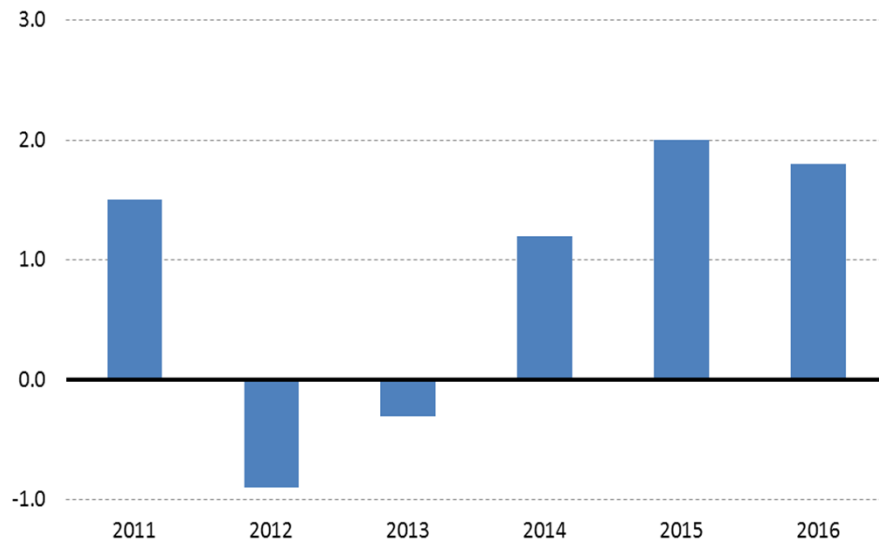


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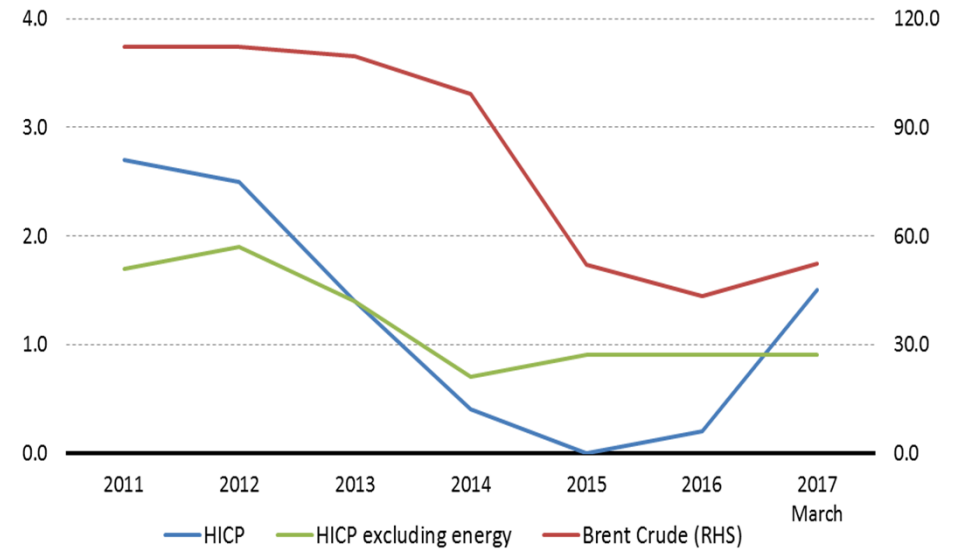
Euro area GDP growth, inflation and oil prices

Real Gross Domestic Product
(annual percentage changes)



Source: Eurostat.

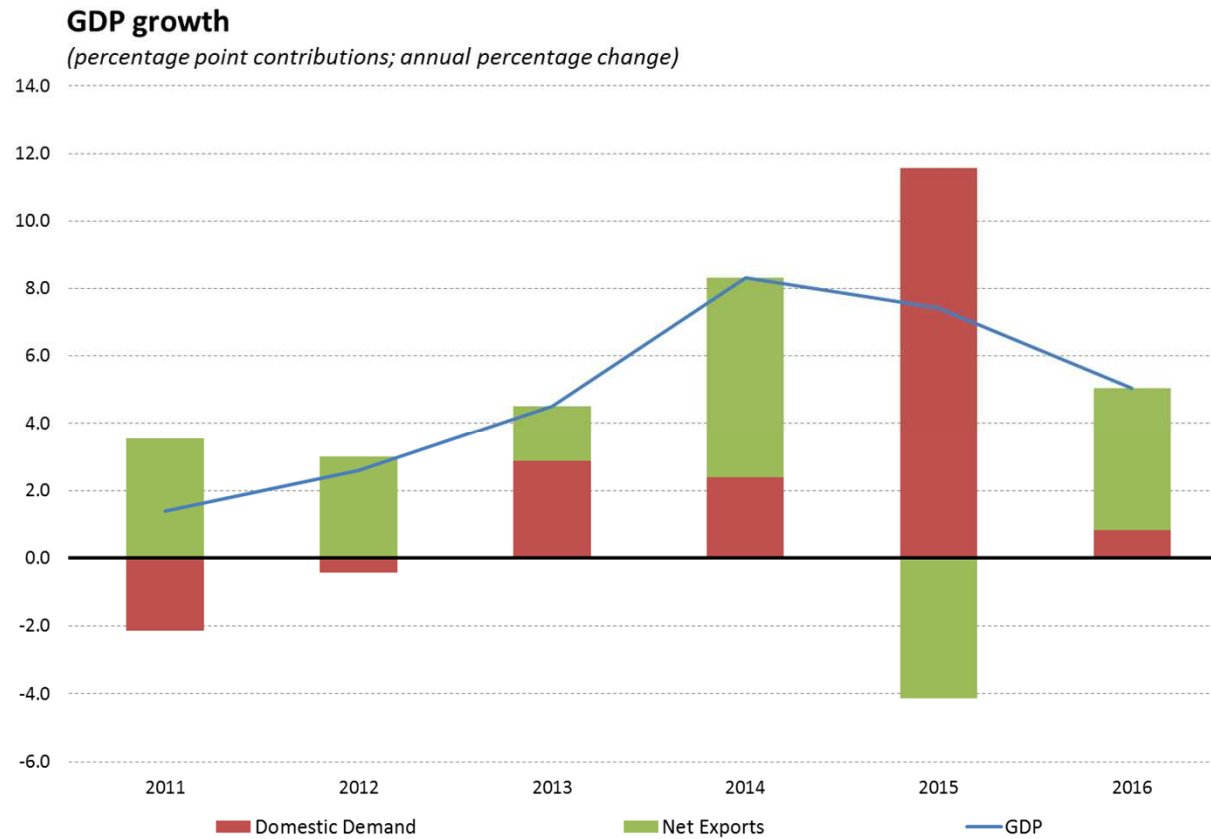
HICP and Brent Crude
(annual percentage changes; US\$)



Source: Eurostat.



Maltese economy continued to grow robustly during 2016



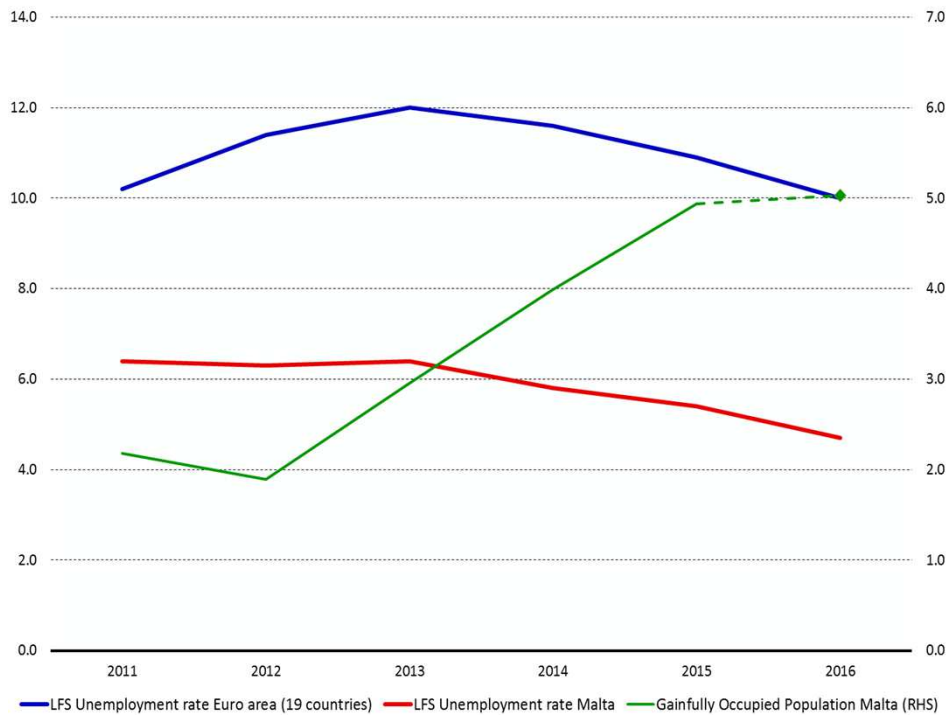
Source: National Statistics Office.



Employment increases further and unemployment rate reaches a new low

Labour market developments¹

(seasonally adjusted, per cent; percentage change)

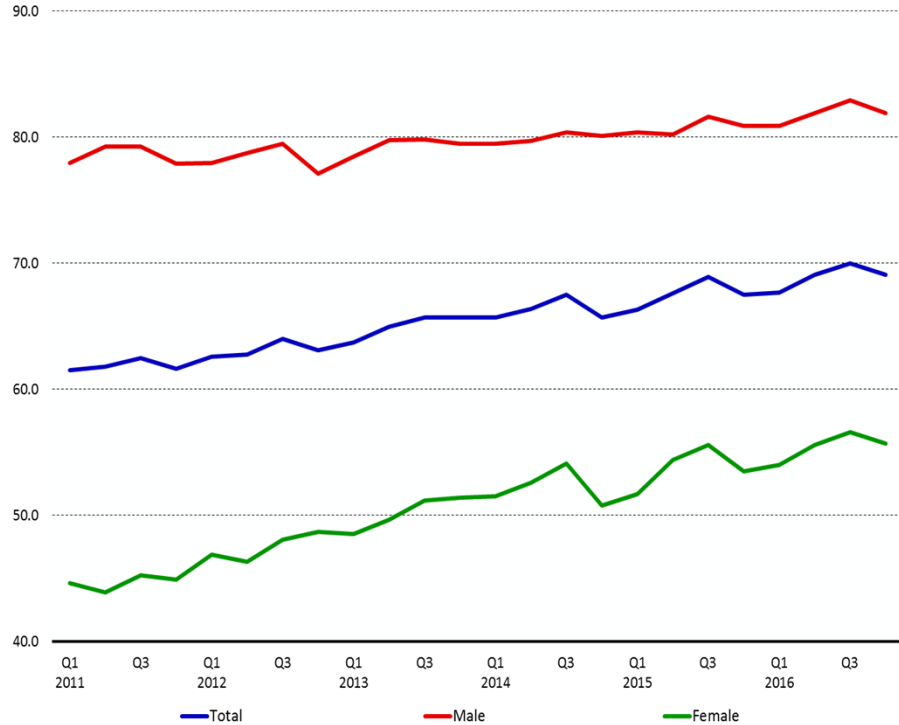


Source: Eurostat; National Statistics Office.

¹ Gainfully Occupied data for 2016 is based on October data

Participation Rate based on the Labour Force Survey

(quarter percentages)

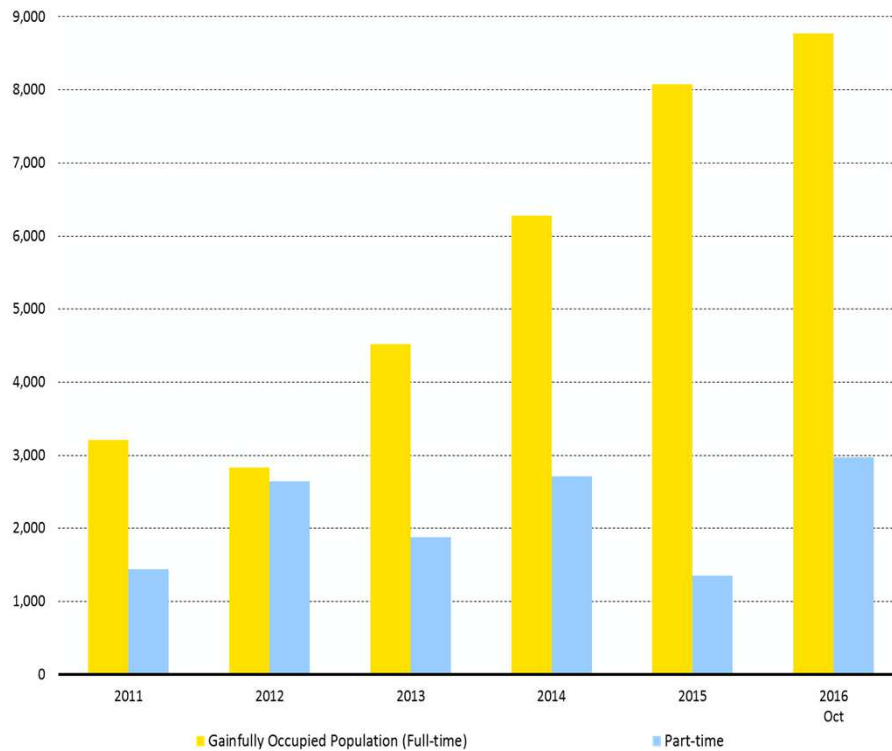


Source: National Statistics Office.



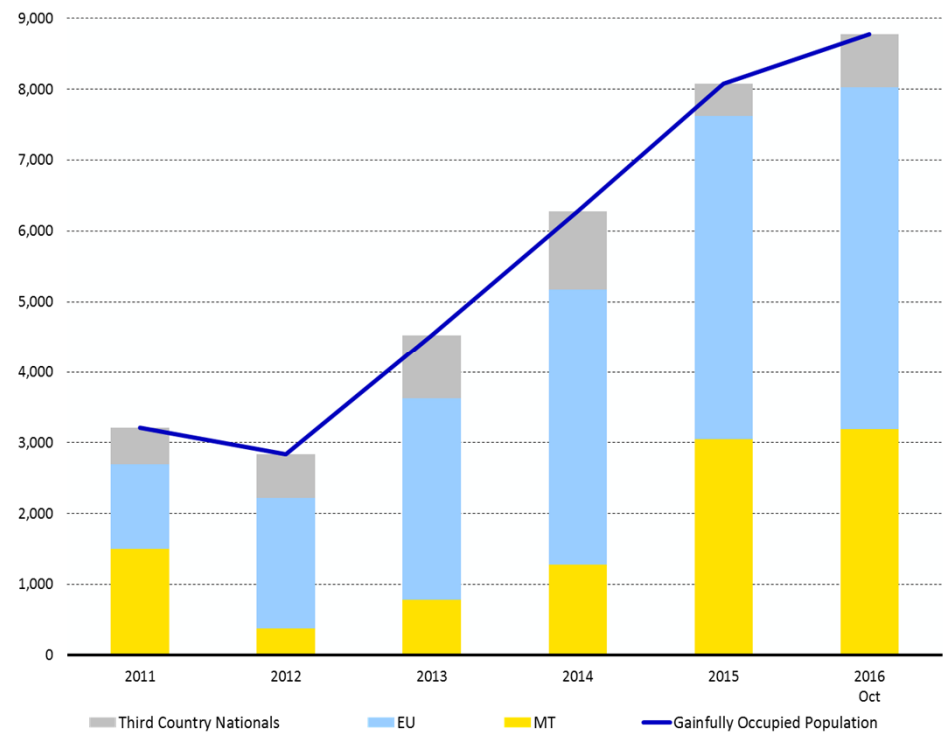
Employment by type and the role of foreign workers

Increase in Jobsplus employment by type
(persons)



Sources: National Statistics Office, Jobsplus.

Increase in Gainfully Occupied Population by nationality
(persons)

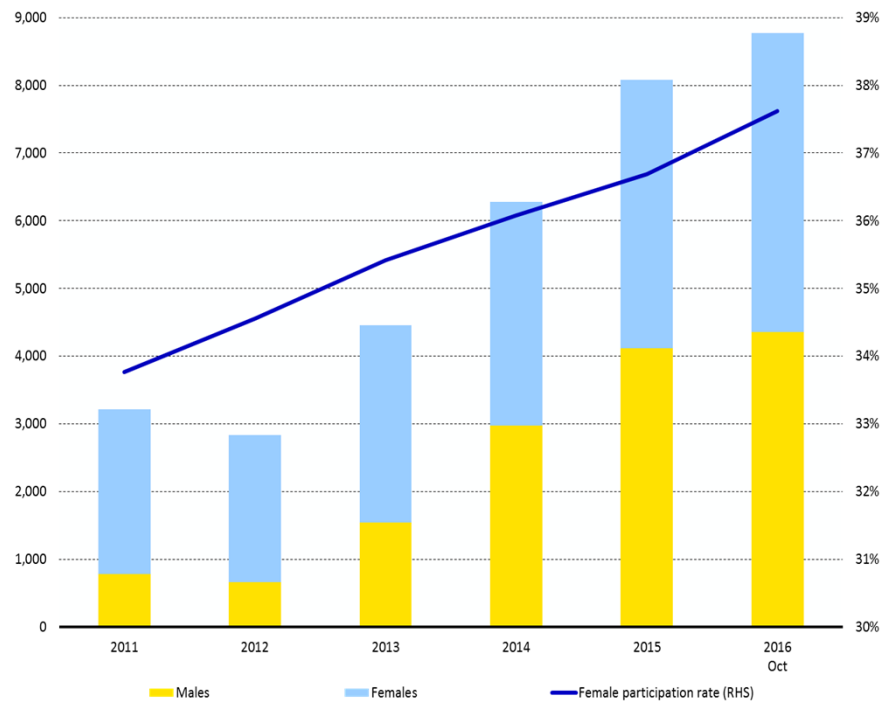


Sources: National Statistics Office, Jobsplus.



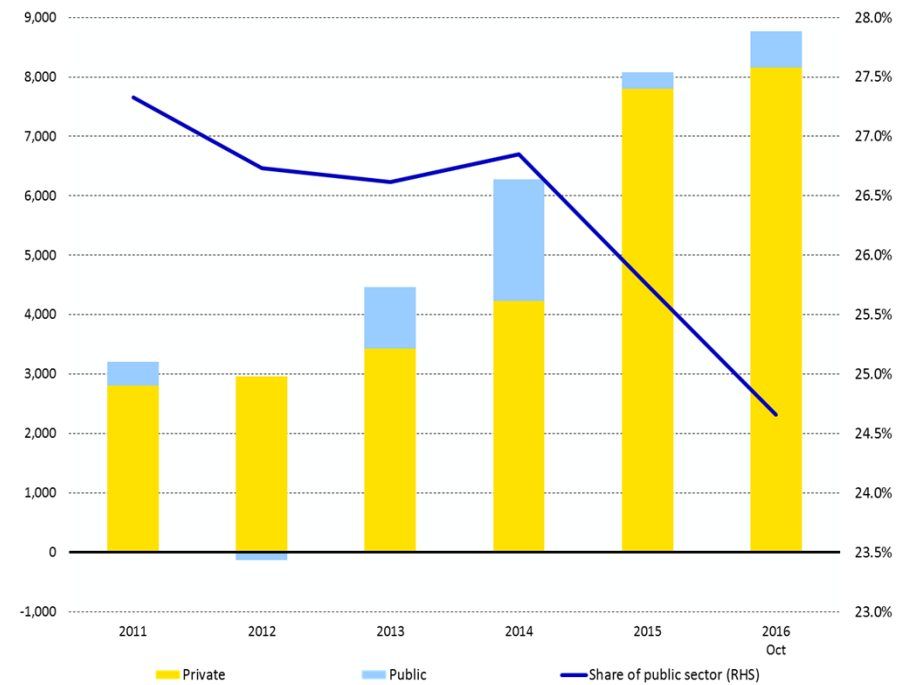
Gender participation and employment by sector

Increase in Gainfully Occupied Population by gender
(persons, share of Gainfully Occupied Population)



Source: National Statistics Office.

Increase in Gainfully Occupied Population by sector
(persons, share of total Gainfully Occupied Population)

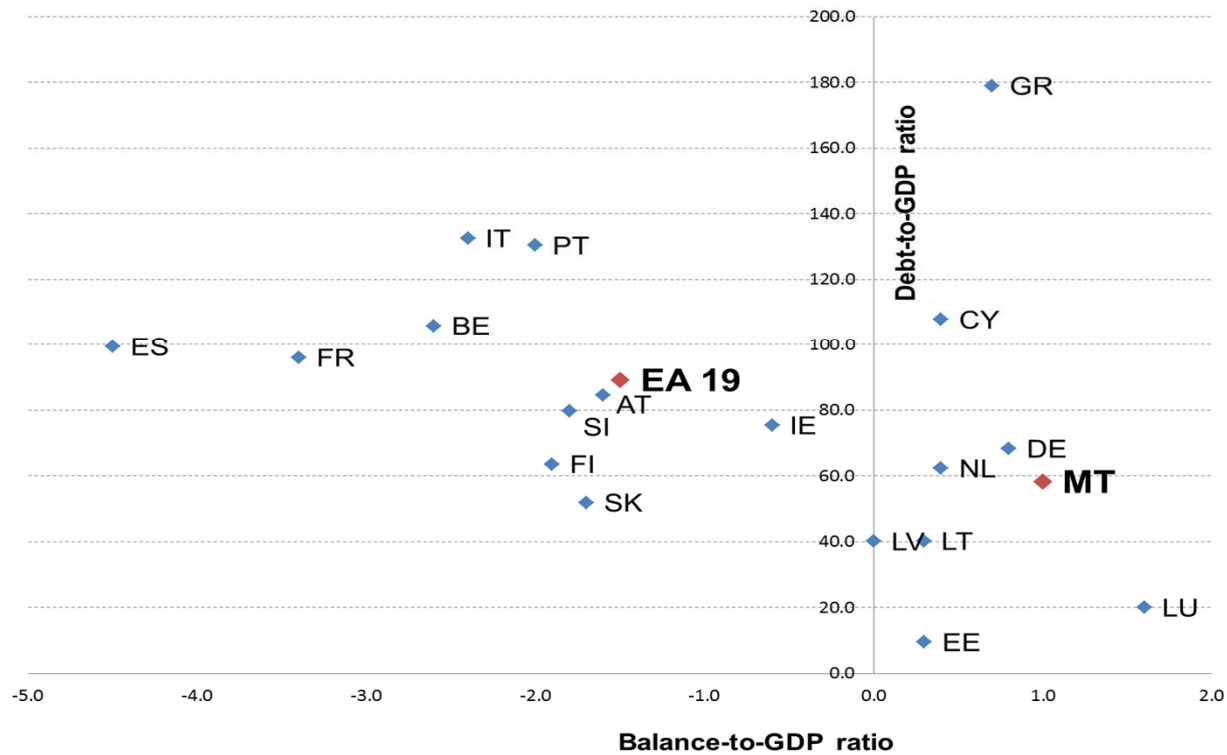


Source: National Statistics Office.



Government balance and debt – euro area comparison

General government balance and debt in 2016
(% of GDP)

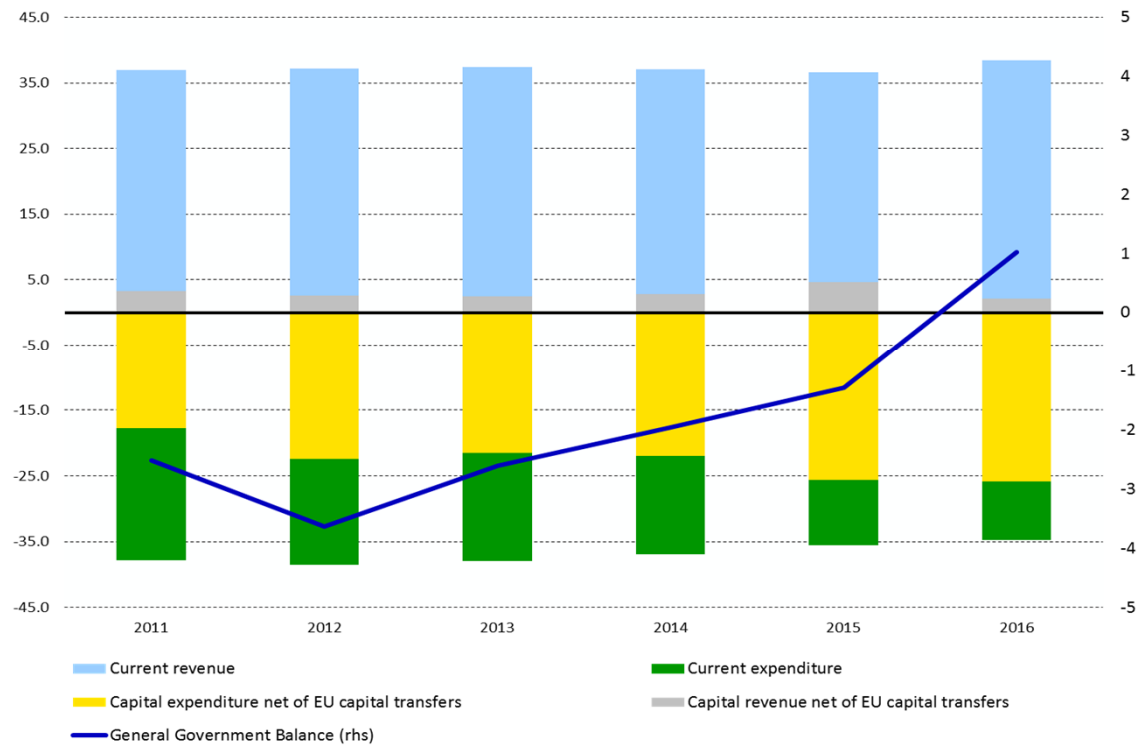


Source: Eurostat.



General government balance improved considerably ...

Impact on general Government balance
(% of GDP)



Sources: National Statistics Office; Eurostat.



... led by current revenue and spending developments

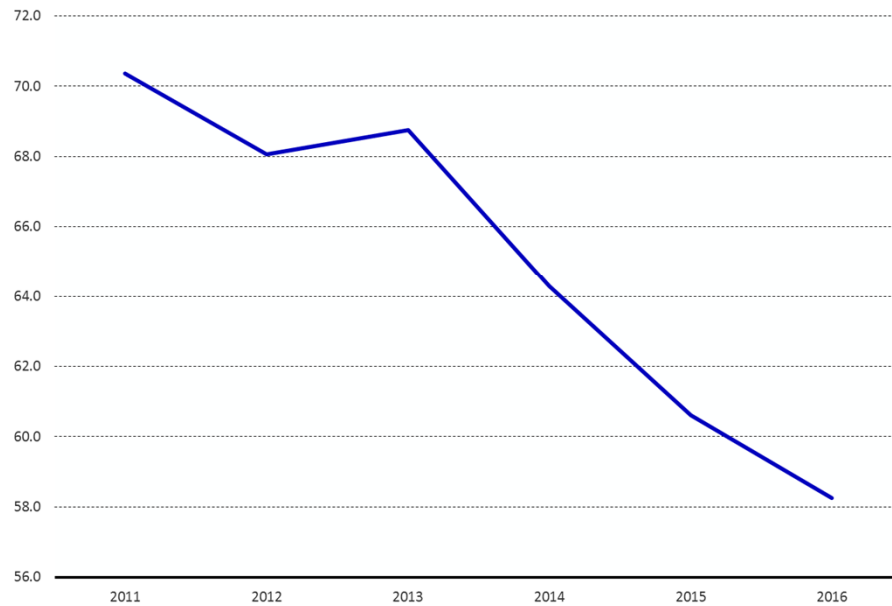
<i>(percentage of GDP)</i>	2015	2016	Change
General Government balance	-1.3	1.0	2.3
Current revenue net of current expenditure	1.0	3.7	2.7
Capital revenue net of capital expenditure	-2.3	-2.7	-0.4
Current Revenue	36.6	38.5	1.9
Direct taxes	13.3	13.9	0.6
Social contributions	6.4	6.5	0.1
Indirect taxes	12.8	12.8	0.0
Other current revenue	4.1	5.3	1.2
Current Expenditure	35.6	34.8	-0.8
Compensation of employees	12.0	12.0	0.0
Social benefits	11.1	10.9	-0.2
Intermediate consumption	6.5	6.4	-0.1
Interest payments	2.5	2.2	-0.3
Other current expenditure	3.5	3.3	-0.2
Capital Revenue	3.3	0.6	-2.7
Capital Expenditure	5.6	3.3	-2.3

Source : National Statistics Office.



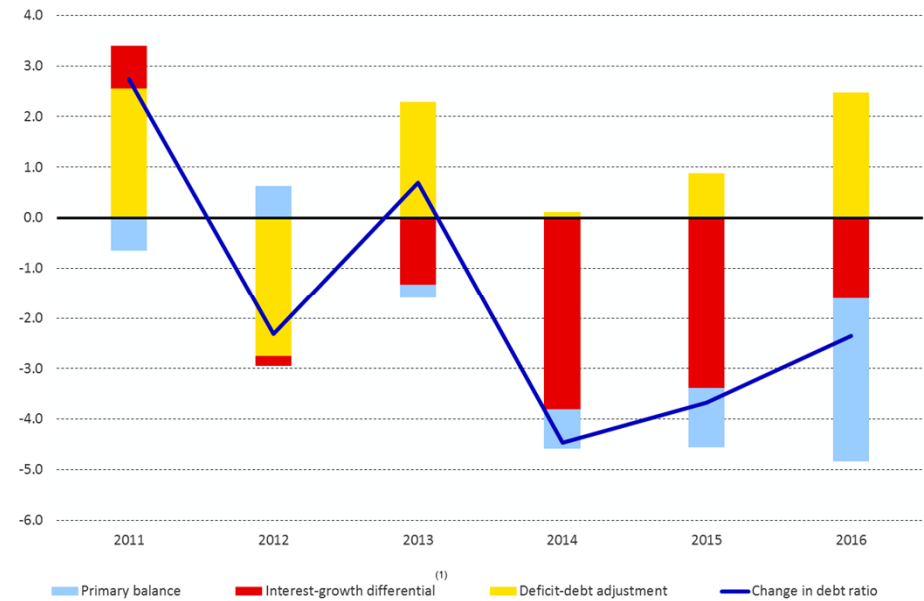
Government debt is on a downward trend

General Government debt ratio
(% of GDP)



Source: National Statistics Office.

Contribution to change in debt
(percentage points)



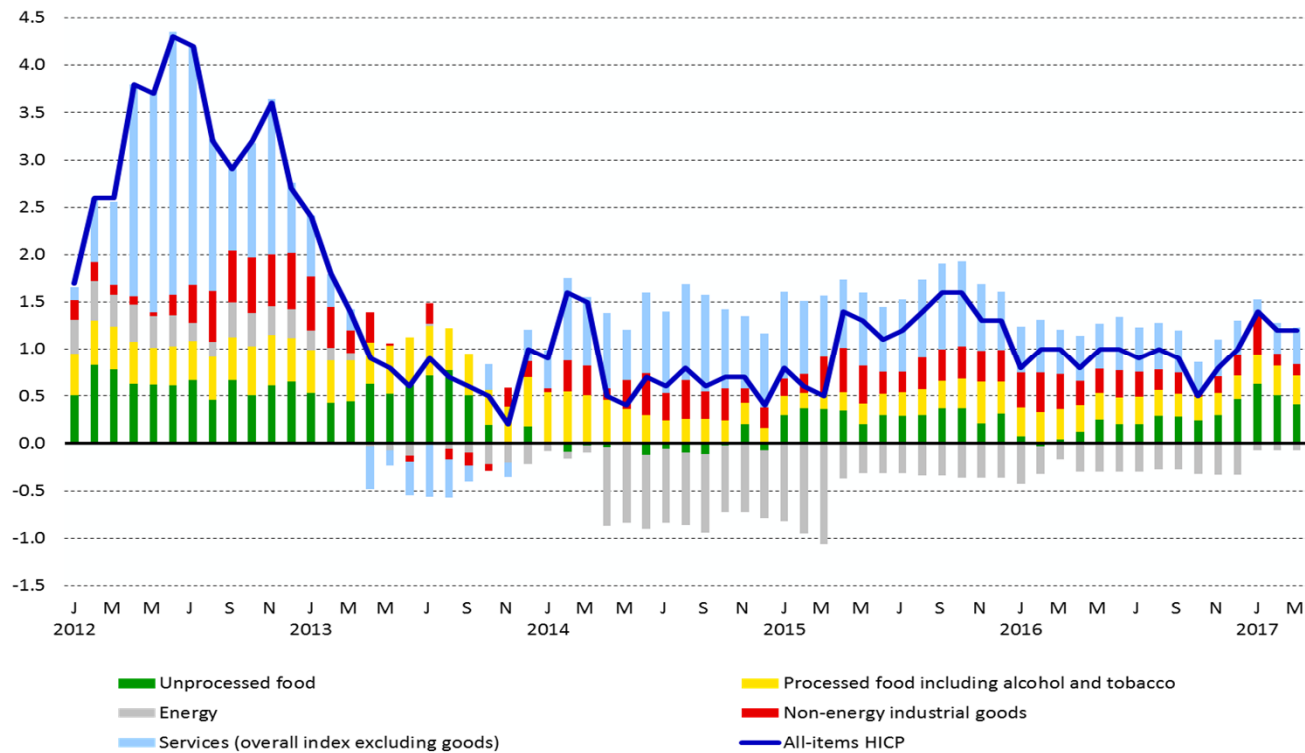
⁽¹⁾ Difference between effective interest rate (interest payments at year t relative to debt outstanding at year t-1) and GDP growth.
Sources: National Statistics Office; Central Bank of Malta.



Inflation remains below the Price Stability objective

Contribution to year-on-year HICP inflation

(percentage points; annual percentage change)

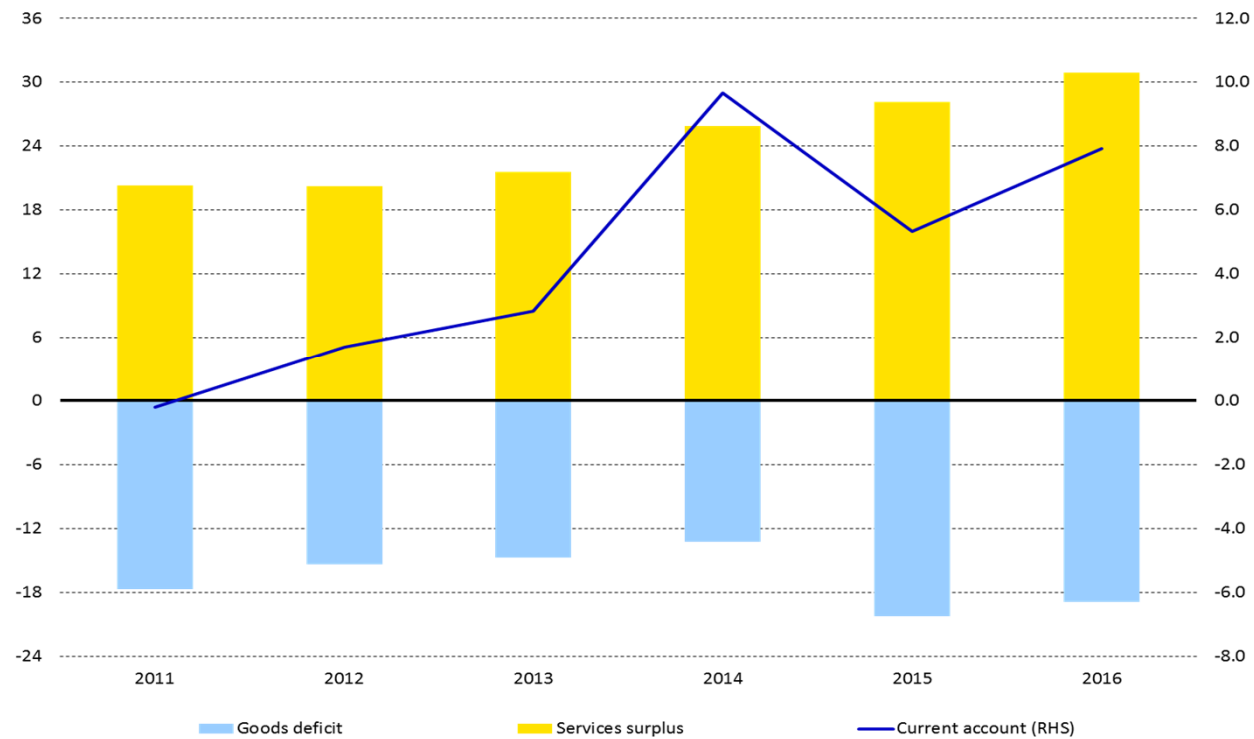


Source: Eurostat.



Current account surplus widens

Current account and the external balance
(as a percentage of GDP)



Source: National Statistics Office.



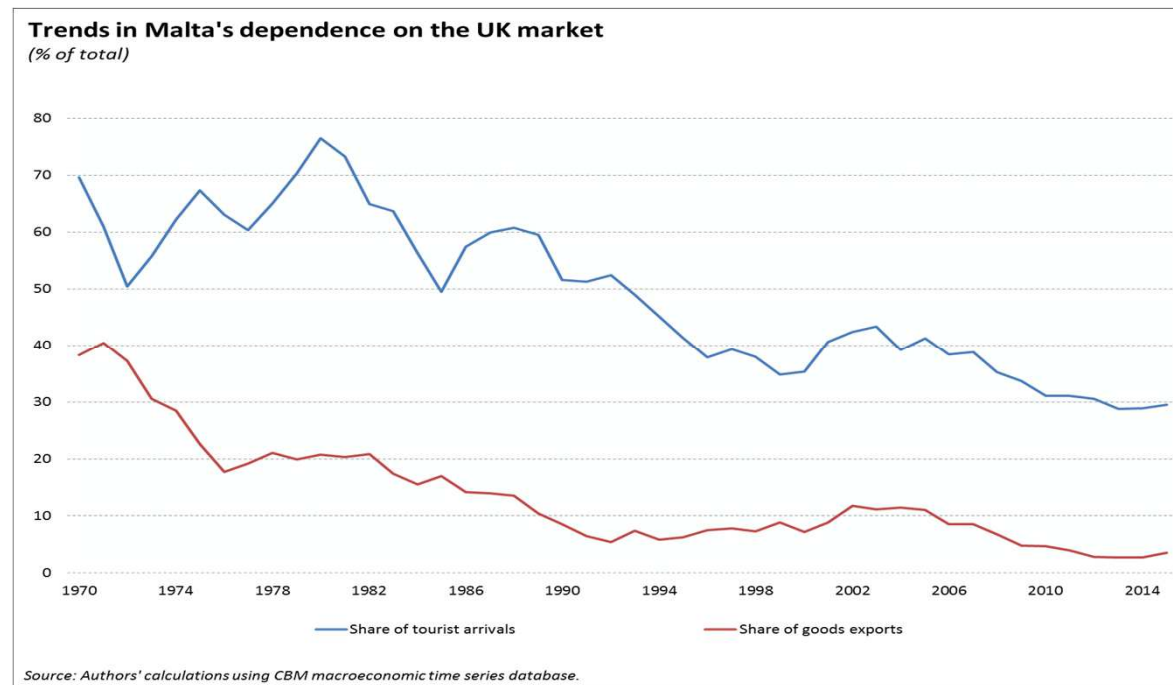
Brexit: possible implications



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How has Malta's economic relation with the UK evolved?



On the other hand, Malta's reliance on UK workers has risen over time. Since EU accession, the number of UK citizens working in Malta has risen by 381%, amounting to around 17.6% of all foreign workers.



What are the likely effects of Brexit on the UK and EU?

- There is a high degree of uncertainty on the terms of the UK exit from the EU.
- The negotiation process may lead to a number of possible outcomes:
 - i. EEA membership – the Norwegian model allows the UK to retain access to the single market. In turn the UK would accept free movement of people.
 - ii. Bilateral agreements – the Swiss model; free-trade within specific categories of goods, but does not feature trade concessions in financial services.
 - iii. WTO rules – Default agreement that would come into place should negotiations fail, where the two parties would trade at fixed maximum tariffs established by WTO.
- Whatever the outcome the likely effects of Brexit on both UK and EU will be negative.



How could this affect the Maltese economy?

- A recent study by the CBM has explored 2 scenarios:
 - Scenario 1: the UK remains part of the EEA
 - Scenario 2: UK and EU trade at WTO rules
- Main impacts through trade and exchange rate channels.

Possible impact on Malta following the UK's exit

Economic activity	Scenario 1			Scenario 2		
	2017	2018	2019	2017	2018	2019
Real GDP	-0.12	-0.19	-0.23	-0.16	-0.4	-0.54
Private consumption	-0.02	-0.08	-0.09	-0.02	-0.14	-0.28
Exports	-0.22	-0.27	-0.3	-0.3	-0.59	-0.71
Imports	-0.13	-0.19	-0.21	-0.18	-0.42	-0.54

Percentage deviations from baseline level
Source: Central Bank of Malta calculations



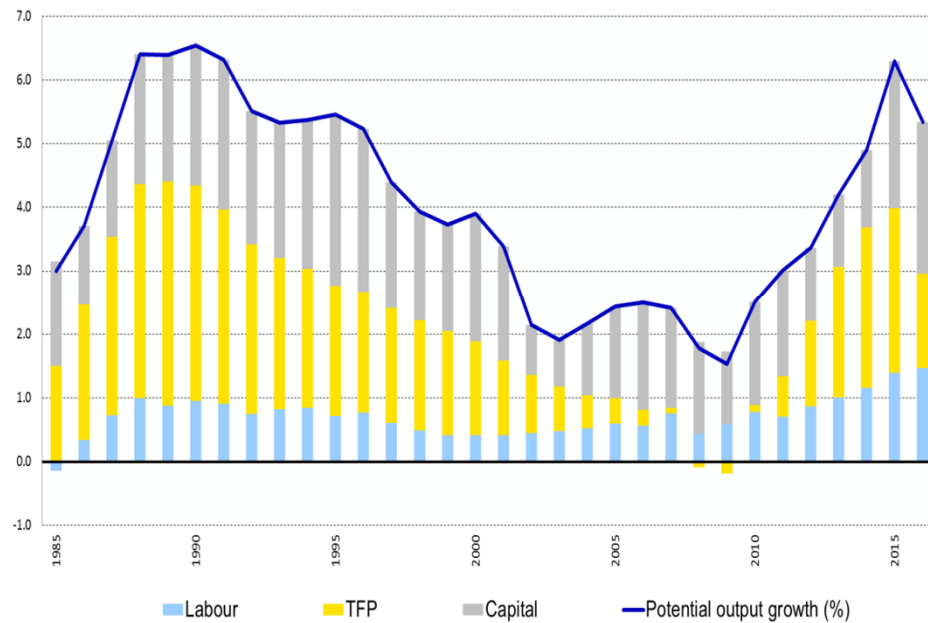
Macroeconomic outlook

- Economic activity is expected to remain robust and above historical averages.
- However, it is set to decelerate from recent highs.
- Domestic demand is projected to remain the major growth contributor reflecting low unemployment rates and a pick-up in wages.
- Net exports are also expected to contribute strongly mainly through services exports.
- Labour shortages will however remain a constraint on economic growth.
- The predicted strong growth in demand is set to be supported by potential output.



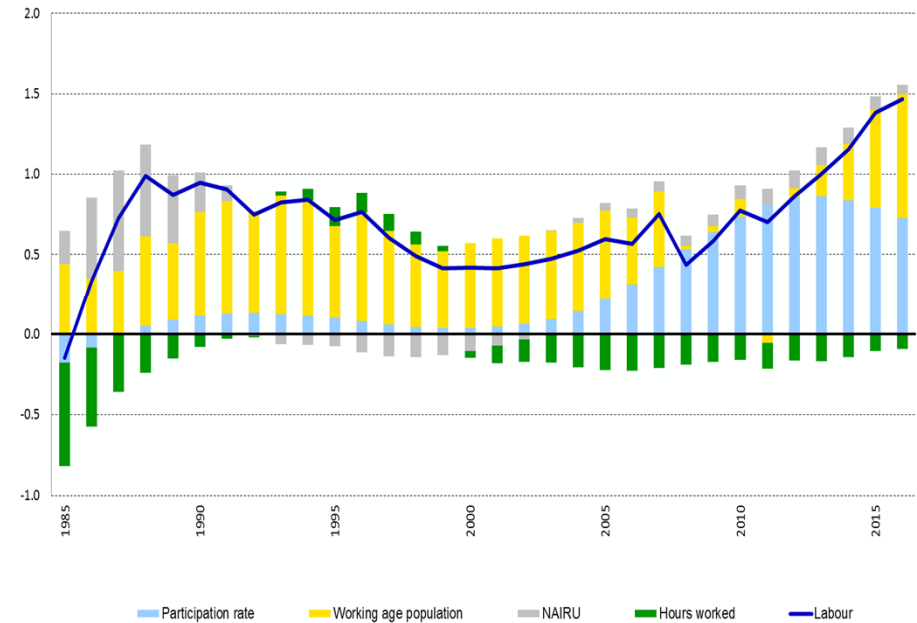
Historical estimates of potential output growth

Decomposition of potential output growth
(percentage points contribution to growth)



Source: Authors' calculations.

Decomposition of labour input
(percentage point contribution to growth)



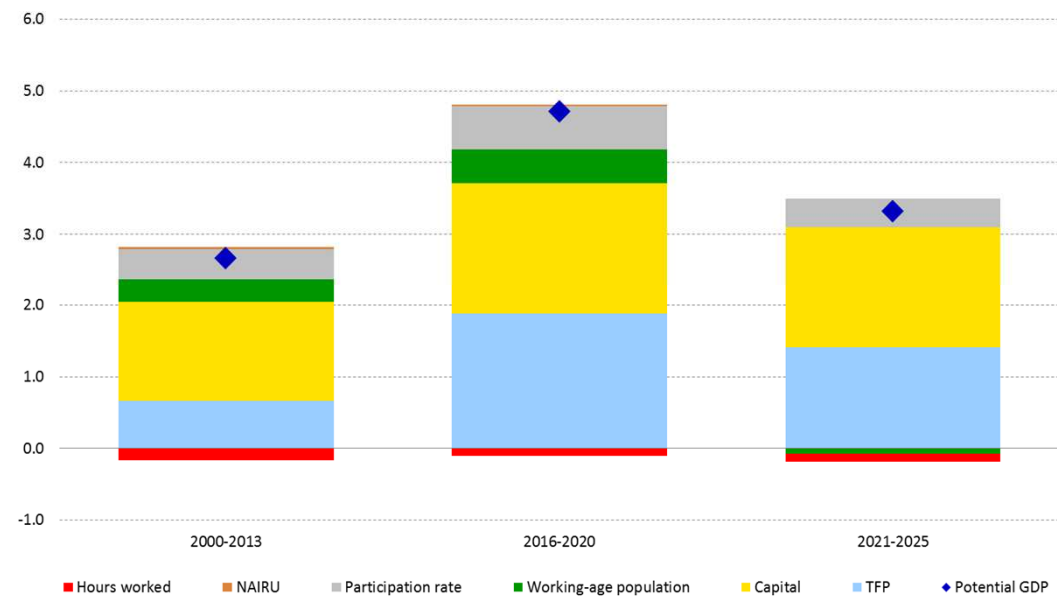
Source: Authors' calculations.



Medium-term projections of potential GDP growth

- Potential output growth to remain above the historical average over the medium-term.
- After 2020, potential output growth is mainly driven by TFP and the capital stock.
- Contribution of labour to decelerate in the medium term due to demographic factors.

Medium term projections of potential output growth
(percentage point contribution to average growth)



Source: Authors' calculations.



Longer term outlook

- Baseline scenario suggests Malta's potential growth will stabilise at around 3.25% between 2021-2025 - above the country's historical growth rate.
- Medium-term outlook is brighter compared to that of the euro area, which should result in further convergence.
- Improves further the sustainability of public debt and current account performance.
- Going forward, economic growth will have to increasingly rely on higher factor productivity gains.



Financial market developments and the banking sector



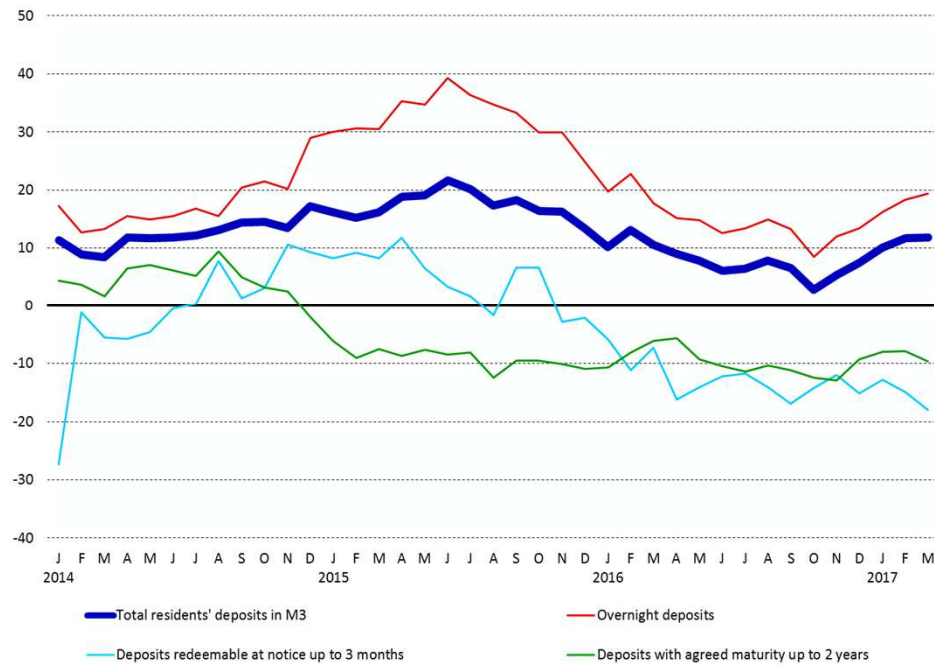
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Credit and deposits of Maltese residents

Selected deposits of Maltese residents

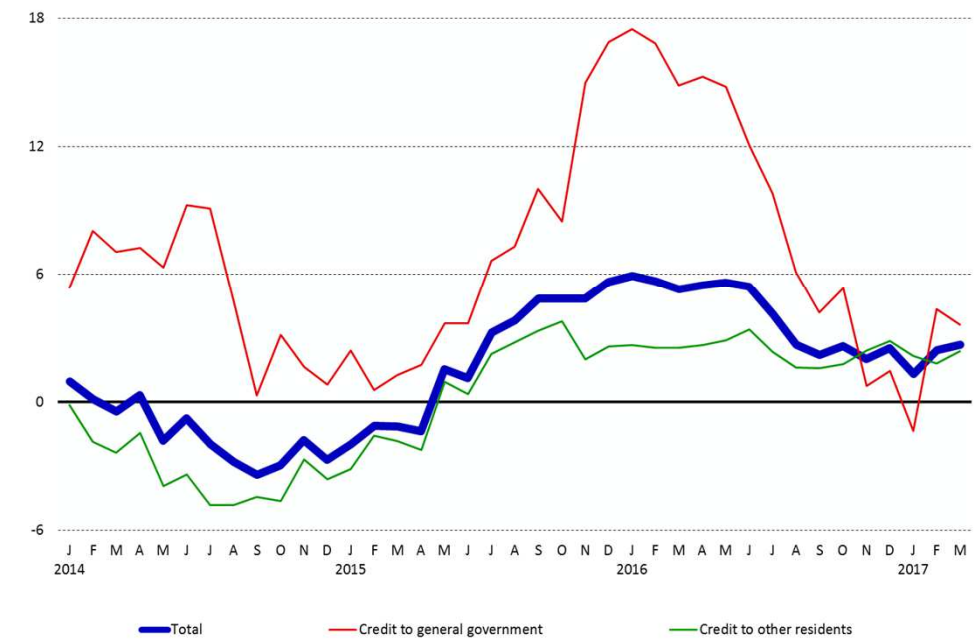
(annual percentage changes)



Source: Central Bank of Malta.

Credit to residents of Malta

(annual percentage changes)



Source: Central Bank of Malta.



Key risk indicators

Indicator	Maltese banks - December 2016				EU banks
	Core domestic banks	Non-core domestic banks	International banks	Total banks	Total banks
Total assets as a % to GDP	219.8	24.6	222.7	467.1	261 ¹
Customer loans-to-deposits ratio (%)	56.0	46.5	108.2	65.7	99.1 ²
Solvency					
<i>CET 1 Ratio</i>	13.4	12.3	42.5	17.6	about 15.3 ³
<i>Tier 1 Ratio</i>	13.4	12.3	47.4	18.4	
<i>Total Capital Ratio</i>	16.0	15.5	50.0	21.1	
Profitability					
<i>Return on assets</i>	0.8	0.4	1.0	0.9	about 0.44 ³
<i>Return on equity</i>	10.2	4.4	3.7	6.9	about 7.1 ³
Liquidity					
<i>Liquid assets to short term liabilities</i>	55.8	62.7	96.3	58.3	about 23.8 ³
<i>Liquid assets to total assets</i>	36.5	31.6	29.7	35.3	
<i>Liquidity coverage ratio</i>	164.5	194.9	332.0	173.4	
Asset Quality					
<i>NPL Ratio</i>	5.3	3.4	1.8	3.8	5.2 ⁴

Sources: Central Bank of Malta, European Central Bank

¹ ECB consolidated banking data and SDW. Data refers to Q3 2016

² SDW - Dec 2016

³ ESRB Risk Dashboard March 2017

⁴ World Bank

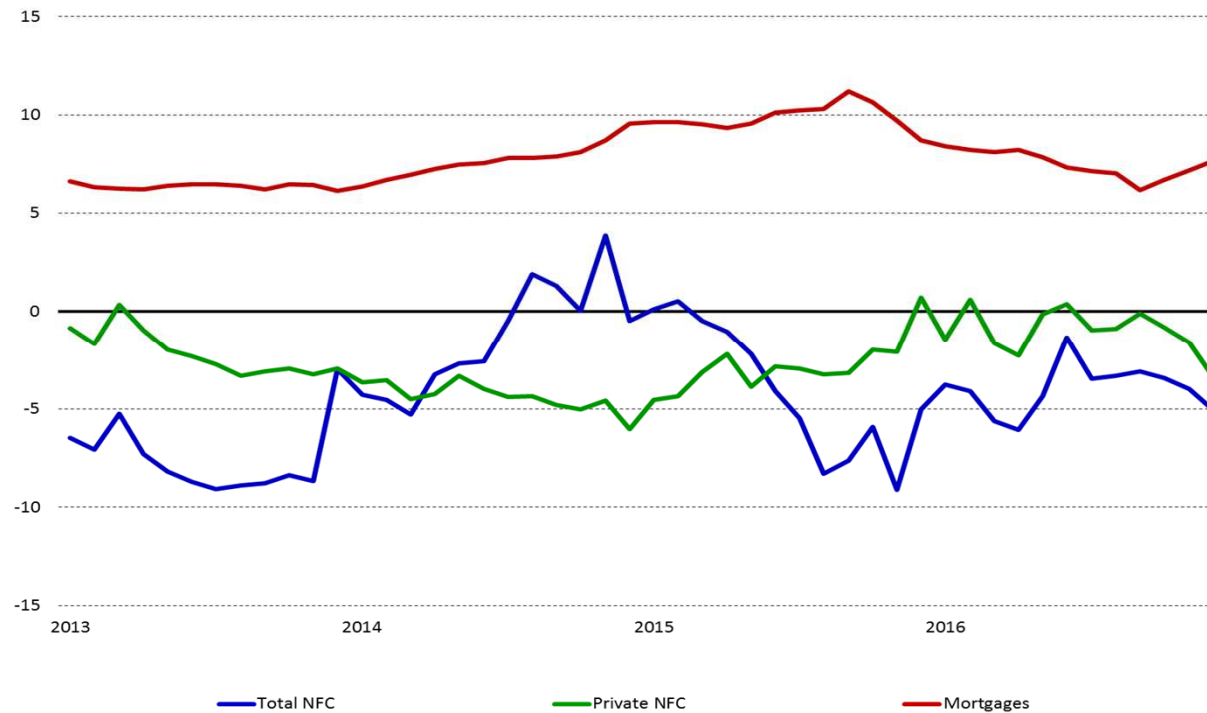
Disclaimer: Data for EU banks may not be strictly comparable with that for Maltese banks



Credit growth – corporate loans and mortgages

Credit growth

(Core domestic banks, resident, monthly data, annual percentage change)



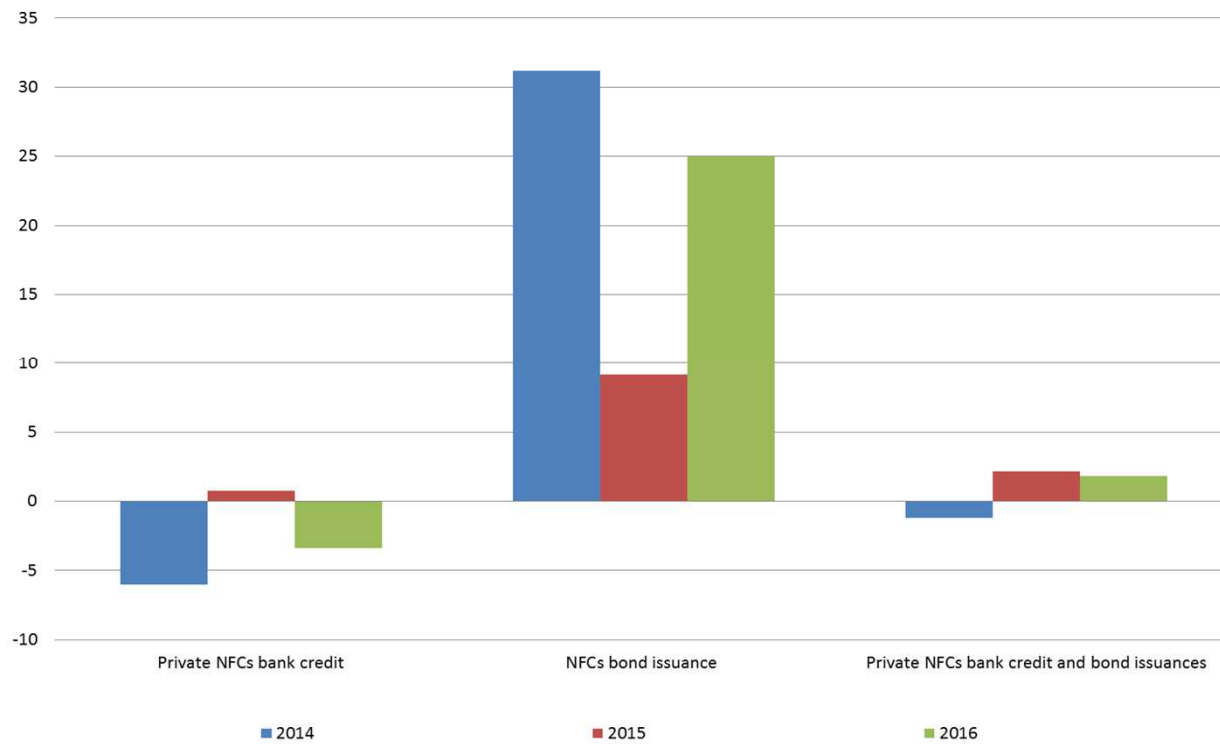
Source: Central Bank of Malta



Credit disintermediation

Annual growth rate

(Core domestic banks, resident, monthly data, annual percentage change)



Source: Central Bank of Malta.



Policy response

- A number of policy measures were undertaken in 2016:
 - Three banks were identified as domestically systemically important and required to maintain higher capital buffers.
 - The countercyclical capital buffer announced on quarterly intervals was set at 0%.
 - Reciprocation of other EU country's systemic risk buffers subject to materiality thresholds.
 - MFSA Banking Rule 09 was amended whereby banks with a NPL ratio exceeding 6% to draw up a plan to reduce NPLs below this threshold over a five-year period.



Central Bank of Malta's operations



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Organisational developments and initiatives

- More prominence to research findings.
- Enhanced contact with a large companies and public sector entities.
- Central Credit Register launched in April 2016.
- Collaboration on matters related to Malta's EU Council Presidency.
- Works on a new building gathered pace.
- The Bank continued to participate in the Public Sector Purchase Programme.



The low interest rate environment continued to weigh on the Central Bank's earning capacity

- Partly reflecting liquidity injections relating to the PSPP the Bank's balance sheet expanded to €5.5 billion, up from €4.5 billion in end 2015.
- Net interest income decreased slightly over the previous year as low-interest rate environment continued to weigh on the Bank's financial performance.
- However, operating profit before transfers to provisions and reserves edged up to €76.4 million, €1.4 million more than in the previous year.
- The Bank added €20.0 million to its provisions and a further €6.4 million to reserves, leaving an unchanged amount of €50.0 million payable to the Government of Malta.



Thank you



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