BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

FORTY-SECOND ANNUAL REPORT
AND
STATEMENT OF ACCOUNTS
2009

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THE MISSION AND OBJECTIVES OF THE CENTRAL BANK OF MALTA

Our Mission

The Central Bank of Malta is an independent institution which seeks to carry out its statutory responsibilities in the public interest. As a member of the Eurosystem, the Bank's primary objective is to maintain price stability, thereby contributing to sustainable economic development.

Our Objectives

We seek to achieve this mission by:-

Promoting price stability in the euro area

The Bank promotes price stability in the euro area through participation by the Governor in the Governing Council of the European Central Bank (ECB). For this purpose the Bank conducts economic analysis and research. The Bank is also responsible for the implementation in Malta of the Governing Council's monetary policy decisions.

Contributing to the stability of the financial system

The Bank contributes to the stability of the financial system through ongoing macro surveillance of the infrastructure, financial institutions and markets and by monitoring and assessing the implications for financial stability of economic and financial developments, both domestically and in the euro area. As part of its early warning system, the Bank analyses data to identify sources of risk and tests the resilience of the financial sector to withstand eventual shocks. This approach is supported by the development of a sound framework for the management of crisis situations and of contingency procedures. Ultimately, in order to safeguard financial stability, the Bank acts as lender of last resort.

Promoting, regulating and overseeing sound and efficient payment and securities settlement systems

The Bank promotes, oversees and regulates the operation of, and the participation in, domestic payment systems as well as any form of cash or security transactions, whether domestic or cross-border. This role relates both to retail and wholesale payment systems, including the instruments used, and involves the establishment of policy and the monitoring of payment and securities settlement developments. In exercising its oversight role, the Bank promotes a competitive, safe and efficient payment services environment.

Supporting the development of financial markets

The Bank promotes and supports the further development of the domestic financial market with the aim of facilitating its smooth and effective integration into the Pan-European market.

Providing and promoting efficient currency services

The Bank issues euro bank notes and coins in accordance with the Treaty establishing the European Community and in line with the Statute of the European System of Central Banks (ESCB) and of the ECB. The Bank is responsible for providing notes and coins to meet demand from the public. The Bank also ensures the authenticity and quality of currency in circulation through the withdrawal of counterfeit and damaged notes and coins.

Optimising the returns on financial assets through prudent investment practices

The Bank holds and manages a portfolio of foreign and domestic financial assets. It seeks to maximise the return on financial assets subject to prudent investment practices. The Bank is also responsible for managing its share of the pooled portion of the ECB's own foreign reserves.

Collecting, compiling, disseminating and publishing statistics

The Bank compiles economic and financial statistics in accordance with international standards. These are provided to the ESCB and other international and domestic users. Statistics are made available through the Bank's regular publications, its website, the publications of the ECB and other international organisations.

Advising the Government generally on financial and economic matters

The Bank acts as an advisor to the Government on financial and economic matters. In offering independent advice, the Bank contributes to sound policy-making. The Bank is able to do this on the strength of its expertise, its reputation and its independent status. The Bank also acts as banker and agent to the Government.

In support of the above objectives, the Bank commits itself:

(a) to actively participate in the Eurosystem, the ESCB and other relevant European Union bodies, including their sub-structures, and in meetings of international organisations; and

(b) to maintain effective support and control functions, which include:

- Motivating and developing skilled staff. To this end the Bank adopts appropriate recruitment and reward strategies and provides its staff with opportunities for training and development.
- Procuring the necessary resource inputs and maintaining the organisation's physical infrastructure in a cost-effective manner to ensure a congenial and secure working environment.
- Maintaining a sound financial control system capable of delivering accurate and timely statutory and management information and designed to ensure that the Bank's needs are effectively met within established budgets.
- Enhancing the flow of information both within and outside the Bank. This is made possible through the sustained development of information and document-handling systems, and of the appropriate information technology infrastructure.
- Maintaining a risk management framework which provides a common methodology for the identification, assessment, reporting, monitoring and treatment of risks. This is complemented by a sound business continuity management programme.
- Operating an independent and objective assurance and consultancy function designed to add value and improve the Bank's operations.

The Bank also seeks to be transparent and publicly accountable. This is achieved through the publication of its financial statements, effective communications and announcements through its website, other publications and regular reporting to Parliament on its policies and operations.

As a member of the Eurosystem, the Bank subscribes to the Eurosystem's Mission, Strategic Intents and Organisational Principles.

BOARD OF DIRECTORS*

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Manager
Middle Office

Angele Camilleri Agius
Manager
Investments and Reserves Office

**as at 31 December 2009*

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(left to right) Victor Busuttil (Director), Mario Micallef (Director), Antoinette Caruana (Director), Michael C. Bonello (Governor & Chairman), David A. Pullicino (Deputy Governor), Stephanie Sciberras (Secretary).

**as at 31 December 2009*

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- Governor
  Michael C. Bonello
- Deputy Governor
  David A. Pullicino
  - Director
    Economics & External Relations Division
    Alfred Demarco
    - Economic Research Department
      - Economic Analysis Office
      - Research Office
      - Statistics Office
    - Library & External Relations Department
      - Library
      - External Relations Office
      - Governors' Secretariat
  - Director
    Finance & Banking Division
    Godfrey Huber
    - Banking & Issues Department
      - Retail Banking Office
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    Financial Markets Division
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    - Domestic Markets Department
      - Monetary Operations & Collateral Management Office
      - Government Securities Office
    - Reserve Management Department
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      - Financial Stability Office
    - Internal Audit & Risk Assessment Department
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    Resource Management Division
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    - Resources Department
      - Human Resources Office
      - Administration Office
      - Security Office
    - Information Systems Department
      - IT Services Office
      - Software Development Office
      - Records Management Services Office

**as at 31 December 2009*

BANK ĊENTRALI TA' MALTA

Il-Gvernatur

CENTRAL BANK OF MALTA

The Governor

30 March 2010

The Hon Tonio Fenech
Minister of Finance, Economy and Investment
Maison Demandols
South Street
Valletta VLT 2000

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 2009.

Yours sincerely

Michael C Bonello

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ABBREVIATIONS

BIS	Bank for International Settlements
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
EEA	European Economic Area
EMU	Economic and Monetary Union
EONIA	Euro OverNight Index Average
ERM II	exchange rate mechanism II
ESA 95	European System of Accounts 1995
ESCB	European System of Central Banks
ETC	Employment and Training Corporation
EU	European Union
EURIBOR	Euro Interbank Offered Rate
FI	fungibility issue
GDP	gross domestic product
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
LFS	Labour Force Survey
MIGA	Multilateral Investment Guarantee Agency
MFEI	Ministry of Finance, the Economy and Investment
MFI	Monetary Financial Institution
MFSA	Malta Financial Services Authority
MGS	Malta Government Stock
MRO	Main Refinancing Operation
MSE	Malta Stock Exchange
NACE Rev. 1	Statistical classification of economic activities in the European Community
NCB	national central bank
NPISH	Non-Profit Institutions Serving Households
NSO	National Statistics Office
OECD	Organisation for Economic Co-operation and Development
OMFI	Other Monetary Financial Institution
OPEC	Organisation of Petroleum Exporting Countries
RPI	Retail Price Index
ULC	Unit Labour Costs

GOVERNOR'S STATEMENT

During 2009 the economic downturn that began in the previous year in the wake of the financial crisis bottomed out, bringing to an end the most severe contraction in the global economy since World War II. A gradual return to more stable conditions also became apparent in financial markets, but as the year end approached the economic recovery appeared slow and fragile while financial markets were tense and volatile as a new dimension of the crisis manifested itself in the shape of heightened perceptions of sovereign credit risk.

An even worse scenario was averted in large part due to the adoption of accommodative monetary and fiscal policies worldwide. The former provided the first line of defence. Interest rates were cut to historically low levels and a number of unconventional measures were deployed by central banks to support the flow of credit to the real economy. In the euro area, the ECB cut its key policy rate by 150 basis points in 2009 to an unprecedented level of 1.0% and expanded its liquidity-providing measures. At the same time, governments supported systemically important financial institutions and introduced fiscal packages to stimulate demand while allowing automatic stabilisers full play.

These timely interventions proved effective. By the second half of 2009, global production and trade had recovered some lost ground while confidence levels improved steadily. Emerging economies were the main engine behind the turnaround. The latest IMF projections suggest that world output growth is expected to rebound to 3.9% in 2010, after a contraction of around 0.8% in 2009. In the developed world, however, growth promises to be less robust.

While countercyclical fiscal policies helped to limit the output contraction, they came at a heavy cost in terms of excessively high government deficit and debt levels. As a result, markets have become increasingly concerned about long-term fiscal sustainability, especially with respect to countries that had entered the recession already burdened with precarious public finances. This will have to be taken into account when deciding on the timing and speed of exit strategies, since a hasty withdrawal may undermine confidence and the incipient recovery itself. It also needs to be recognised that the deterioration in fiscal positions is not entirely cyclical in origin.

In the euro area, the recession was the longest and deepest on record. By the second quarter of 2009, GDP had contracted by 4.7% from its early 2008 peak level, reversing all the gains achieved since 2006. Sharp declines were registered in industrial production and exports. In the second half of the year, however, a recovery in external demand, an improvement in business confidence and a reversal in the inventory cycle contributed first to a stabilisation, and later to some growth in economic activity. As a result, the contraction in the euro area economy for the whole year was contained at 4.1%.

Going forward, however, the pace of the recovery in the euro area will be conditioned, among others, by the ongoing process of balance sheet adjustment by financial institutions and households. Output growth is therefore expected to remain sluggish and uneven in 2010, with GDP expanding by only 0.8% according to the latest ECB projections.

The global recession predictably impacted the Maltese economy with a lag through the trade channel, given its high degree of openness and its increased synchronization with the business cycle of its major trading partners. The slowdown that started in the last quarter of 2008 was followed by negative growth in the first three quarters of 2009, but the downtrend was reversed in the last quarter. In fact the recession proved shorter and less severe than in most countries of the euro area, with a peak-to-trough gap of 3.0% and a decline in GDP over the full year of 1.9%. On the basis of current projections, the output lost in the process should be recovered by mid-2011.

Three factors in the main were instrumental in mitigating the effects of reduced external demand on the mainstays of the economy, manufacturing and tourism. These were the fiscal stimulus in the shape of targeted government support to export-oriented enterprises, estimated at 0.6% of GDP; the increased diversification towards higher value-added service activities; and the resilience of the domestic banking system, which continued to respond to a steady demand for credit .

On the inflation front, weak consumer demand, excess productive capacity and falling commodity prices kept pressures in check in most countries in 2009. In the euro area, inflation fell from an average of 3.3% in 2008 to 0.3%. Negative inflation rates were recorded for a few months in 2009, primarily due to base effects from higher energy prices the previous year, before a return to low, positive rates in the last two months. The outlook for 2010 is for inflation to remain subdued at around 1.2%. Long-term inflation expectations meanwhile remained firmly anchored, in line with the ECB's medium-term objective.

Consumer price trends in Malta in 2009 again did not fully reflect those in the euro area. A divergence during the first half of the year was mainly due to higher domestic food price inflation. This peaked in the first quarter, whereas in the euro area it had done so in mid-2008. In the second half of the year, however, a slower rate of growth of domestic prices of food and services, together with a decline in energy prices, led to a gradual easing of inflationary pressures. Thus, over the year as a whole inflation in Malta fell to 1.8% from 4.7% in 2008.

The global contraction in economic activity also left its mark on labour markets. In the euro area the unemployment rate reached its highest level since the start of EMU in 1999, averaging 9.4%, with some countries experiencing double-digit rates. Conditions in the domestic labour market also deteriorated in 2009, though to a much lesser extent, with the average unemployment rate rising to 7.0%.

On the fiscal front, the state of public finances worsened significantly in 2009, reflecting both the subdued economic activity and the fiscal stimulus packages. In the euro area, the average general government deficit ratio is estimated to have risen from 2% of GDP in 2008 to 6.4% in 2009. In contrast, in Malta, the ratio is projected by the Government to have fallen to 3.8% in 2009 from 4.7% the previous year, but this largely reflects the non-repetition of exceptional deficit-increasing expenditures in 2008.

Looking ahead to 2010, with external demand expected to grow only modestly, the Bank's projections point to a small pick-up in Malta's GDP growth rate to 1.2%. Domestic demand is seen to be the main contributor, driven by higher investment outlays on infrastructure projects and, to a lesser extent, by a moderate expansion in private consumption. The recovery in Malta's main foreign markets is expected to have a positive impact on domestic exports; but since imports are projected to grow faster, boosted mainly by gross fixed capital formation, net exports are likely to contribute negatively to GDP growth.

On the inflation front, the Bank expects continued moderate pressures with consumer prices forecast to rise by 1.6% in 2010. While the prices of energy and industrial goods are forecast to accelerate, these will be attenuated by modest increases in the food and services indices. At the projected level, however, domestic inflation would still be above the rate forecast for the euro area. A persistent inflation differential in a monetary union is a matter of concern because it invariably translates into a loss of international competitiveness.

The Bank's output projections are subject to a high degree of uncertainty, mainly associated with the outlook for demand in Malta's main trading partners and possible movements in exchange rates and commodity prices. Furthermore, domestic rigidities and imbalances that have accumulated in previous years, if not addressed, may also harm the recovery process. Recent experience abroad has demonstrated that beyond a certain point such imbalances become unsustainable, with serious consequences for a country's creditworthiness and its long-term growth prospects.

In Malta's case, the determined pursuit of the commitment to bring the budget deficit ratio to below the 3% limit by 2011 should continue to be an overarching priority if the economy is to consolidate the substantial benefits derived from the adoption of a stable international currency, particularly evident during the recent period of severe financial turbulence.

Achieving the required fiscal consolidation at a time of slow economic growth represents a major challenge. The room for manoeuvre is already limited by the fact that more than two-thirds of government revenue is cyclically sensitive, while a slightly larger proportion of expenditure consists of fixed commitments, which are furthermore being increasingly burdened by age-related costs, particularly pensions and health care.

The latest update of Malta's Stability Programme sets out a broad strategy for reducing the deficit. This should now be complemented by specific measures designed in particular to cut recurrent spending, as well as by further structural reforms. Experience shows that expenditure-based fiscal consolidation has the most beneficial effects on long-run economic growth. The final objective should be to release sufficient resources to finance the investments necessary for the modernization of the economy and for income convergence with the euro area.

One of the main lessons to emerge from the recent crisis is that there must be a more responsible, forward-looking debate about the allocation of scarce national resources in the context of a social market economy. This is particularly relevant to Malta. The time is long overdue to rebalance the discussion: it must be focussed less on subsidies, benefits and other transfer payments and more on who is to pay for them and how; less on the distribution of wealth and more on creating value.

The size of public resources and the efficiency with which they are used can also have an impact on the economy's external balance. Though the current account deficit has tended to decline in recent years, its persistence remains a source of concern as it may be symptomatic of a progressive loss of international competitiveness in some important economic sectors. Moreover, the recent combination of current account deficits and relatively low investment rates could be an indication that part of Malta's external borrowing is being used to finance consumption rather than to expand productive capacity.

The economy's strong growth performance in the years preceding the recession indeed owed more to domestic consumption than to exports. Since the start of the new century Malta's export record has tended to lag behind that of the euro area, with a consequent loss of world market share. As exports are a vital source of sustainable growth for a small, open economy, this failure to increase market share partly explains why Malta's income gap with the euro area has not narrowed in recent years.

This experience also suggests that while the incipient recovery in external demand represents an opportunity for export growth, it cannot be taken for granted. Cost containment is a necessary condition for remaining competitive. Ensuring that production costs, particularly their predominant wage component, do not grow faster than productivity is essential at all times, but more so at the current juncture when export markets are subdued and nominal wages are being frozen or cut in a number of competitor countries. Addressing this challenge requires a cooperative effort. It should include the replacement of the national wage indexation mechanism with a productivity-linked wage adjustment system at the enterprise level.

Malta's recent productivity performance has not been encouraging. In fact, between 2000 and 2008 compensation growth has outpaced productivity growth by a ratio of about seven to one. The resultant erosion in the economy's cost competitiveness shows up as a loss of around 15% when measured by the harmonized competitiveness indicator, of which two-thirds reflects exchange rate appreciation and the other third higher unit labour costs relative to Malta's trading partners. This lost ground needs to be recovered.

During 2009 the Maltese economy followed the euro area into recession and is now slowly returning to growth. All the available evidence, however, suggests that the road ahead is fraught with challenges in the context of what promises to be a gradual and uneven recovery. The external environment will be characterised by more competitive markets, the production of goods will be less labour intensive, and in the delivery of services the quality of human capital will be of paramount importance.

These new realities of the post-crisis world must be faced with pragmatism and a clear understanding of the issues. Malta's ability to compete, and thus secure better living standards for its people, will depend increasingly on a more cost-effective use of human and physical resources, higher rates of investment and sustained efficiency gains in both the private and public sectors. The achievement of these objectives entails difficult policy choices that can no longer be postponed.

Bank policies and operations

Throughout 2009 the conduct of monetary policy in the euro area was shaped by the response to the international economic crisis. As part of the Eurosystem, the Central Bank of Malta contributed to the formulation and implementation of this policy, which was characterized by cuts in official interest rates to a historical low and the adoption of further credit support measures. In this context, the Bank over the year injected EUR6.2 billion worth of liquidity on a cumulative basis into the domestic banking system through open market operations. In this way, resident credit institutions had access to ample funds at very low rates of interest, allowing them, in turn, to reduce their lending and deposit rates.

The global crisis also highlighted the role that central banks play in ensuring financial stability. In 2009 the Bank maintained a close watch over the domestic financial system to identify potential sources of risk and stepped up its cooperation with the MFSA, the MFEI and the ECB. For the first time, the Bank's assessment of risks was published in a comprehensive *Financial Stability Report*. It also continued to enhance its macro stress-testing capacity and its early warning system.

The Maltese banking system emerged from the global crisis largely intact, thanks to a prudent approach to funding and cautious lending behaviour. Capital adequacy ratios remained well above the statutory thresholds, and the banks continued to hold high levels of liquidity. In the capital market there continued to be a strong uptake of primary debt issues. Nevertheless, areas of vulnerability remain: these are mainly related to credit risk, the high level of concentration and relatively low levels of loan loss provisions. Banks should, therefore, continue to strengthen their capital base to be in a better position to withstand any future adverse shocks.

In the wake of the crisis, the Bank also participated in international discussions to strengthen the resilience of the international financial system. As part of a co-ordinated European response, the Maltese Government, through the Bank, agreed to contribute to strengthening the IMF's lending capacity.

The increased globalization of finance in recent decades has highlighted the importance of payment and settlement systems. The smooth functioning of such systems in the euro area is crucial for the proper functioning of an integrated area-wide financial market, as well as for the development of a single market for goods and services. In Malta the Bank continued to reinforce the regulatory framework governing payment and securities settlement systems to enhance their efficiency and reliability. In particular, a directive was issued to transpose into Maltese law part of the European Payment Services Directive, which is aimed at making payments quicker and safer.

In a similar context, the Bank continued to participate in TARGET2, which is the system used by the Eurosystem for the settlement of central bank operations, large-value euro interbank transfers and other euro payments. The value of such transactions processed through TARGET2 in Malta in 2009 rose sharply as a result of a substantial increase in activity related to monetary policy operations.

As regards other means of payment, the Bank continued to fulfil its responsibility for issuing euro banknotes and coins in Malta and for ensuring their integrity. During 2009 the Bank also participated in the issue of a joint tender for the production of euro currency notes together with four other Eurosystem central banks.

Towards the end of the year it launched an awareness campaign about the withdrawal of Maltese lira coins, which ceased to be legal tender in February 2010.

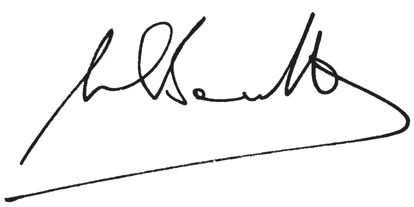
Another important activity during 2009 involved the updating of domestic statistical systems within the Bank's areas of competence in line with European regulations. Also in the statistical domain, the Bank in cooperation with the NSO was involved in the transition to the IMF's Special Data Dissemination Standard, which Malta adhered to in December.

As this *Report* demonstrates, the adoption of the euro in 2008 has had an ongoing impact on all the Bank's operations. Throughout 2009, moreover, the Bank continued to strengthen its links with the Eurosystem and its staff contributed to the work of the ESCB in a wide range of technical areas. At the same time, the Bank also recognised the need to align its structures and priorities even more closely with those of the Eurosystem. With this in mind, it launched an internal process to assess its regular activities and set up a mechanism for strategic planning and project prioritization. Together with the adoption of appropriate institutional changes, this should ensure greater focus and coherence in the Bank's operations.

At the same time, the Bank is preparing for a period of transition, as several members of its senior management – some of whom had joined the Bank at its inception – retire or approach retirement. As part of these preparations, internal training programmes for middle management were stepped up during the year.

The Bank's operating profit for the year amounted to EUR58.6 million, as against EUR48.6 million in 2008.

On behalf of the Board of Directors, I would like to thank the Bank's staff for their dedication and hard work, which contributed to the Bank's achievements during the year.



Michael C Bonello

PART I

FINANCIAL AND ECONOMIC DEVELOPMENTS

1. INTERNATIONAL ECONOMIC DEVELOPMENTS AND THE EURO AREA ECONOMY

Following the intensification of the international financial crisis in the second half of 2008, economic activity in the major industrialised countries contracted significantly in 2009. Output growth in the main emerging market economies also slowed down sharply. The resultant slack in productive capacity and the decline in commodity prices reduced inflationary pressures worldwide and several countries experienced negative inflation rates during the year.

Economic activity in the euro area fell sharply in 2009, even if there were some signs of recovery towards the end of the year. Private consumption remained subdued, while investment and both exports and imports contracted noticeably. Conditions in euro area labour markets responded with a lag to the drop in output and continued to deteriorate throughout the year. Meanwhile, in line with the global pattern, inflationary pressures in the euro area eased considerably compared with the previous year. Thus, for the first time since the introduction of the euro, annual HICP inflation in the area turned negative.

As the threat of inflation subsided and the pace of economic activity slowed markedly, the ECB followed up on the interest rate cuts carried out in late 2008 with additional reductions in the MRO rate of 150 basis points in the course of the year. Besides, the ECB also implemented several non-standard measures to support the financial system and, hence, the broader economy.

The international economy

United States

Economic output in the United States contracted during 2009 as the global recession deepened. The fall was most pronounced during the first half of the year, but it moderated in the second half, as year-on-year growth turned slightly positive in the fourth quarter. Over 2009 as a whole, real GDP fell by 2.4%, after having expanded by 0.4% in 2008 (see Table 1.1). Private investment and consumption, together with changes in inventories, contributed negatively to growth and to a greater extent than in the previous year. On the other hand, government consumption contributed positively – reflecting ongoing fiscal stimulus initiatives – as did net exports. In line with the decline in economic activity, the labour market continued to deteriorate, with the unemployment rate rising to an average of 9.3% in 2009, from 5.8% in 2008.

The downward trend in consumer price inflation that began mid-way in 2008 was extended into 2009 (see Chart 1.1). The annual inflation rate turned negative in March and then fell further, reaching -2.1% in July, reflecting base effects related to energy prices. Subsequently, as these effects faded away and energy prices began to rise, downward price pressures abated. Consequently, at year end, inflation stood at 2.7% compared with 0.1% a year earlier.

Table 1.1
REAL GDP GROWTH
Annual percentage changes, seasonally adjusted data

	2007	2008	2009	2009			
				Q1	Q2	Q3	Q4
United States	2.1	0.4	-2.4	-3.3	-3.8	-2.6	0.1
Euro area[1]	2.7	0.6	-4.1	-5.1	-4.9	-4.1	-2.1
United Kingdom	2.6	0.5	-4.8	-5.2	-5.8	-5.1	-3.2
Japan	2.4	-1.2	-5.0	-8.4	-5.9	-4.9	-0.9

[1] The cut-off date for euro area GDP statistics was extended to 4 March 2010.

Sources: Eurostat; Bureau of Labor Statistics, US; Statistics Bureau, Japan.

After reducing the federal funds rate target to a range from zero to 0.25% in the last quarter of 2008, the US Federal Reserve kept it unchanged throughout 2009 (see Chart 1.2). Additionally, it continued to use quantitative easing measures to support credit markets and stimulate economic activity. Towards the end of the year, however, the Federal Reserve began to scale back the extent of its intervention.

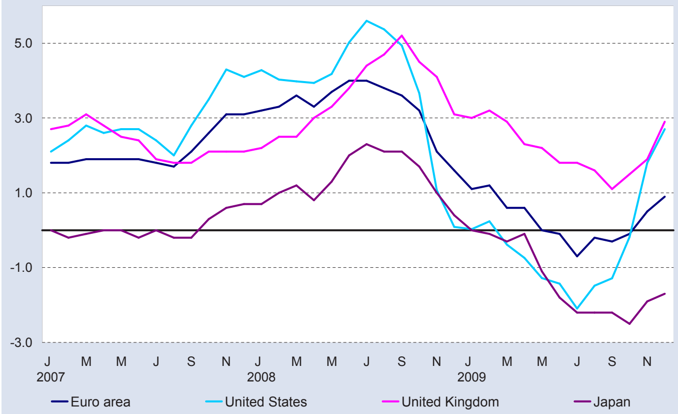
US long-term government bond yields rose during 2009 (see Chart 1.3). Yields were on a general upward trend during the first half of the year, mainly because improved economic prospects and increased investor confidence prompted portfolio flows away from government debt and into riskier assets. Subsequently, however, concerns about the sustainability of the recovery led to declining yields, though better economic news pushed them up again towards the end of the year. Over the year as a whole, the yield on ten-year US government bonds increased by 161 basis points, ending December at 3.84%.

US equity prices, as measured by the S&P 500 index, recovered from the considerable fall registered in 2008, rising by around 23% during 2009 (see Chart 1.4). Equity prices extended their downward trend during the first quarter of the year. However, except for a short interval in July, equities generally rose throughout the rest of the year, driven by an improving outlook for the economy, which in turn increased investor risk appetite.

United Kingdom

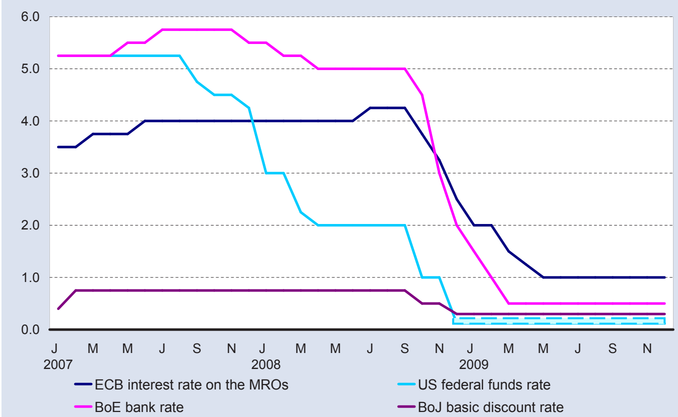
In the United Kingdom the decline in economic activity that began late in 2008 continued in 2009. Real GDP fell by 4.8% during the year, following a 0.5% increase in 2008. Domestic demand decreased substantially, with both investment and household consumption declining. Exports also

Chart 1.1
CONSUMER PRICE INFLATION
(annual percentage changes)



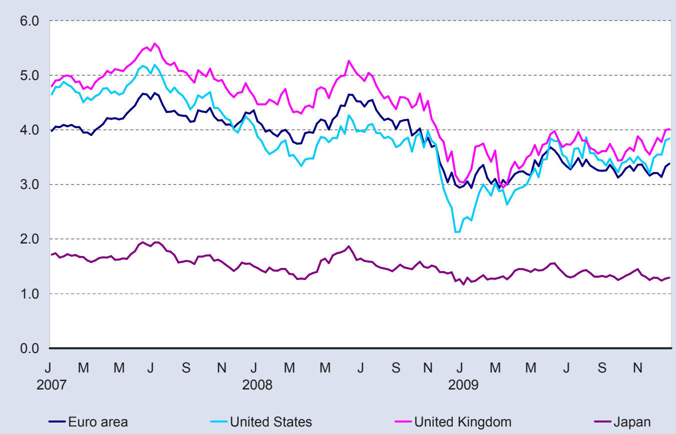
Sources: Eurostat; Bureau of Labor Statistics, US; Statistics Bureau, Japan.

Chart 1.2
OFFICIAL INTEREST RATES
(percentages per annum, end of month)



Sources: ECB; Federal Reserve; Bank of England; Bank of Japan.

Chart 1.3
TEN-YEAR GOVERNMENT BOND YIELDS
(percentages per annum, end of week)

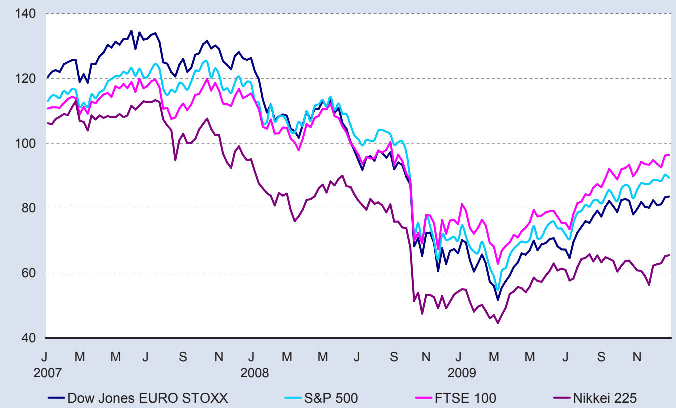


Source: Reuters.

fell sharply, though this was offset by an even larger fall in imports, which resulted in net exports contributing positively to growth. Labour conditions worsened, with average unemployment rising from 5.6% of the labour force in 2008 to 7.6% in 2009.

HICP inflation generally fell during the first three quarters of 2009, reaching 1.1% in September, as a result of falling food and energy prices. However, price pressures resurfaced in the final quarter, reflecting higher transport costs and the effects of the re-establishment of the standard, higher VAT rate. The annual inflation rate ended the year at 2.9%.

Chart 1.4
STOCK PRICE INDICES
(end of week index, 1 Jan. 2006=100)



Source: Reuters.

Against this backdrop, the Bank of England initiated a series of cuts in the official bank rate, bringing it down to 0.50% in March. During the same month the central bank announced a programme of asset purchases to boost the supply of money and credit. Although official interest rates were subsequently left unchanged, the size of the asset purchase programme was increased on three other occasions during the year.

UK long-term government bond yields rose by around 100 basis points during 2009, to end the year at 4.01%. In line with developments in other stock markets, UK equity prices, as measured by the FTSE 100, rose during 2009, gaining around 22% after having fallen dramatically in the last part of the previous year.

Japan

The Japanese economy contracted by 5.0% in 2009, compared to a decline of 1.2% in the previous year. Domestic demand shrank as a result of a fall in both investment and household consumption, while government expenditure rose, contributing positively to growth. Japanese exports fell significantly, acting as a drag on growth. Labour market conditions deteriorated, with the unemployment rate rising to an average of 5.1% during 2009, from 4.0% in the previous year. Inflation fell, turning negative in February and reaching a low of -2.5% in October before rising to end the year at -1.7%.

After having cut the basic discount rate to 0.3% in December 2008, the Bank of Japan left it unchanged throughout 2009. In addition, monetary policy was eased further through the adoption of non-standard measures – including outright purchases of corporate debt instruments – to support financial market stability and facilitate corporate financing.

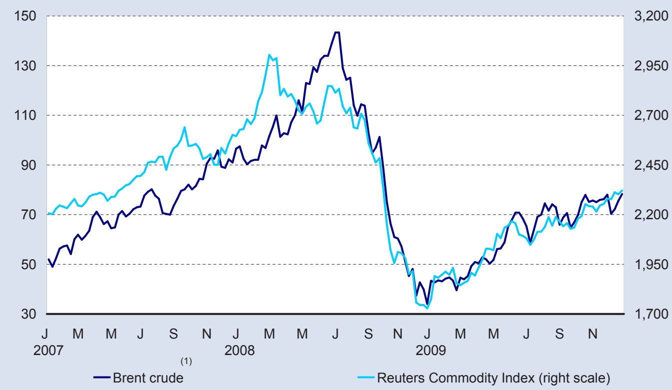
Japanese long-term government bond yields followed a similar trend to those in the United States, although they remained relatively low and were less volatile. The yield on ten-year bonds rose by 12 basis points during 2009, and ended the year at 1.29%. Equity prices, as measured by the Nikkei 225, also rose, and ended December 19.0% higher than a year earlier.

Emerging Asia

Economic activity in the main emerging Asian countries grew at a slower pace than in the previous year during 2009. In China, real economic growth decelerated to 8.7%, from 9.6% in 2008. Growth was sustained by domestic demand, particularly investment, which was driven by the fiscal stimulus measures implemented by the Chinese government. On the other hand, exports suffered from weak external demand. In India, real GDP expanded by 5.6%, down from 7.3% in the previous year.

In China annual CPI inflation turned negative in the course of 2009, reaching its lowest level in July, at -1.8%. But it turned positive in the last quarter of the year, ending December at 1.9%, up from 1.2% a year earlier. In India, wholesale price inflation entered negative territory in June, before sharply rising food prices pushed it up again to end the year at 7.3%, up from 6.1% twelve months earlier.

Chart 1.5
COMMODITY PRICES
(end of week)



(1) US dollars per barrel.
Source: Reuters.

Commodities

Oil

After having fallen to USD36.17 per barrel at the end of 2008 as a result of the financial market turmoil in that year, the price of Brent crude, a key benchmark, started to recover at the beginning of 2009 (see Chart 1.5). The rise was initially driven by the supply restrictions agreed upon by OPEC in December 2008, which offset the downward pressure resulting from lower global demand. Going forward, more optimistic expectations for the world economy helped push up the price of oil. Brent crude dipped in early July, to USD58.50, due to buoyant stocks and weaker-than-expected demand from emerging economies, but it subsequently recovered and stabilised between USD70 and USD80 per barrel in the last two months of the year, ending December at USD78.26, more than double its level a year earlier.

Other commodities

Prices of non-energy commodities, as measured by the Reuters Commodity Index, mirrored developments in the price of oil and rose by around 33% during 2009 (see Chart 1.5).[1] Metal prices generally increased, driven by strong Chinese demand. Towards the end of the year improved global economic prospects and expectations that stocks in industrial economies would be rebuilt supported metal prices. Agricultural commodity prices also rose during the year, driven mainly by improving global economic conditions, by social unrest in some Latin American countries and by adverse weather conditions.

Chart 1.6
GOLD
(US dollars per ounce, end of week)

Source: Reuters.

Gold

After having risen by 5.4% during 2008, to USD878.20 per ounce at the end of the year, the price of gold generally moved on a steep upward trend during 2009 (see Chart 1.6). At the beginning of the year the rise in the gold price was driven by concerns about the stability of the global financial system, which boosted demand. Later, the metal acted as a safe haven for investors amid fears of higher inflation and concerns

[1] The Reuters Commodity Index is a weighted index of the prices of seventeen commodities that include food, beverages, vegetable oils, agricultural raw materials and metals, but exclude oil and gold.

about the weakness of the US dollar. Over the year as a whole, the price of the metal rose by around 25%, ending December at USD1,095.70 per ounce.

The euro area

Real GDP[2]

After having grown by 0.6% in 2008, real GDP in the euro area contracted by 4.1% during the year under review (see Table 1.2). The quarterly profile points to sharp falls in output at the beginning of the year, with the first signs of recovery becoming apparent only in the third quarter. Hence, the annual rate of decline, which exceeded 4.0% in each quarter until September, edged up to a less steep -2.1% in the final quarter of the year.

The drop in GDP in 2009 was largely driven by lower domestic demand, as this contributed 3.3 percentage points to the decline. The pick-up in growth towards the end of the year, however, resulted mainly from a positive contribution from net exports, while the negative contribution from falling domestic demand eased.

Domestic demand declined throughout the year. This contraction stemmed mostly from lower investment, which fell by 11.1%. But private consumption and inventory changes also had a dampening effect. In fact, government consumption was the only domestic demand component which expanded steadily throughout the year. Meanwhile, on the external front, both exports and imports contracted in 2009, falling by 13.4% and 12.0%, respectively. Over the year, however, as the decline in exports began to moderate more rapidly than that of imports, the negative contribution of net exports to growth became less pronounced, and it turned positive in the final quarter.

Table 1.2
REAL GDP GROWTH IN THE EURO AREA
Seasonally adjusted

	2008	2009	2009			
			Q1	Q2	Q3	Q4
			Annual percentage changes			
Private consumption	0.4	-1.1	-1.4	-1.0	-1.1	-0.6
Government consumption	2.1	2.2	2.4	2.2	2.5	1.8
GFCF	-0.4	-11.1	-11.6	-11.9	-11.6	-8.7
Domestic demand	**0.5**	**-3.4**	**-3.5**	**-3.7**	**-3.4**	**-2.8**
Exports	1.0	-13.4	-16.4	-17.0	-13.5	-5.2
Imports	1.0	-12.0	-13.1	-14.7	-12.3	-6.9
GDP	**0.6**	**-4.1**	**-5.1**	**-4.9**	**-4.1**	**-2.1**
			Percentage point contributions			
Private consumption	0.2	-0.6	-0.8	-0.6	-0.7	-0.3
Government consumption	0.4	0.5	0.5	0.5	0.5	0.4
GFCF	-0.2	-2.4	-2.6	-2.6	-2.5	-1.8
Changes in inventories	0.1	-0.8	-0.6	-1.0	-0.8	-1.0
Domestic demand	**0.5**	**-3.3**	**-3.5**	**-3.7**	**-3.4**	**-2.8**
Exports	0.4	-5.5	-7.0	-7.2	-5.7	-2.0
Imports	-0.4	4.8	5.4	6.0	5.0	2.7
Net exports	**0.0**	**-0.7**	**-1.6**	**-1.2**	**-0.7**	**0.7**
GDP	**0.6**	**-4.1**	**-5.1**	**-4.9**	**-4.1**	**-2.1**

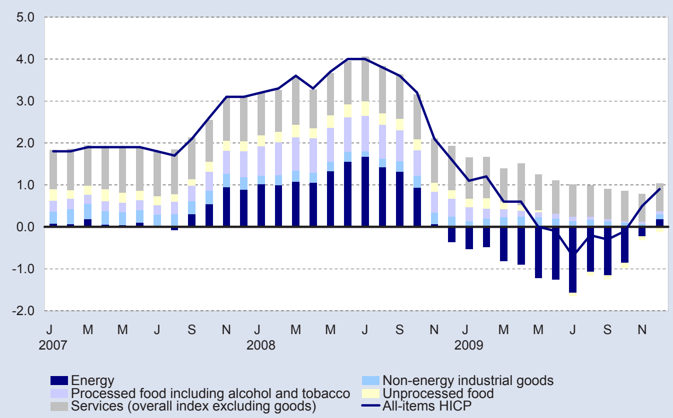
Source: Eurostat.

[2] The cut-off date for euro area GDP statistics was extended to 4 March 2010.

Inflation

Euro area HICP inflation fell to an average of 0.3% during 2009 from 3.3% in 2008 (see Chart 1.7). Inflationary pressures eased markedly in the first half of the year, with annual HICP inflation turning negative for the first time since the introduction of the euro in June and reaching an all-time low of -0.7% in the following month. The decline in inflation mainly resulted from lower energy prices, reflecting base effects related to the spike in oil prices in the previous summer. Subsequently, however, inflation started to pick up again, turning positive in November and ending the year at 0.9%. This increase in the annual area-wide inflation rate was largely attributable to energy prices, which began to rise again.

Chart 1.7
CONTRIBUTIONS TO YEAR-ON-YEAR HICP INFLATION IN THE EURO AREA
(percentage points; annual percentage change)



Source: Eurostat.

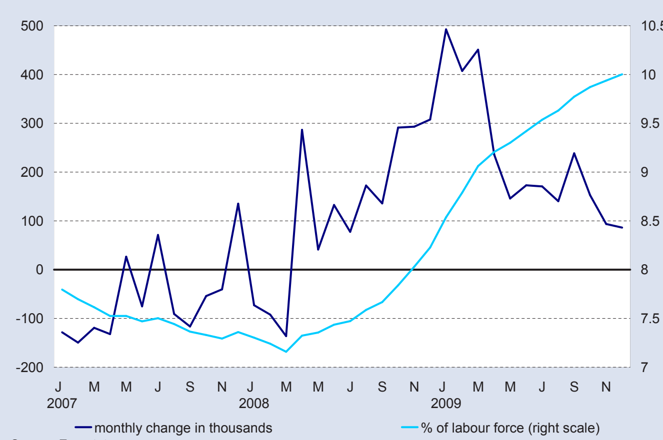
Labour market

In response to the decline in economic activity throughout the euro area, conditions in the labour market deteriorated in the course of 2009. Whereas area-wide employment was stable during 2008, it declined on a year-on-year basis during the first three quarters of 2009, with an annual drop of 2.1% being recorded in the September quarter. Conversely, the unemployment rate rose consistently throughout the year, going up by 1.8 percentage points to end the year at 10.0%, its highest level in ten years (see Chart 1.8).

Monetary policy

After having cut its main refinancing rate to 2.50% by the end of 2008, the Governing Council of the ECB reduced it on four occasions during 2009, bringing it down by a total of 150 basis points over the year, to 1.00%. In May, apart from cutting the interest rate on the MRO by 25 basis points, the ECB reduced the interest rate on the marginal lending facility by 50 basis points to 1.75%, while leaving the rate on the deposit facility unchanged at 0.25%. This easing of the monetary policy stance took into account the expectation that inflationary pressures would remain subdued amid a marked weakening of economic activity. The ECB then left official interest rates unchanged until the end of the year, on the grounds that inflation was expected to remain moderate over the policy relevant horizon, despite increasing signs that the significant contraction in economic activity in the euro area had come to an end.

Chart 1.8
UNEMPLOYMENT IN THE EURO AREA
(monthly data; seasonally adjusted)



Source: Eurostat.

The ECB's existing monetary policy measures were reinforced by the introduction, during the year, of several non-standard enhanced credit support measures. Foremost among them was the decision taken in May to conduct liquidity-providing longer-

Table 1.3
MONETARY AGGREGATES IN THE EURO AREA
Annual percentage changes, seasonally adjusted. Annual and quarterly data are averages.

	2008	2009	2009			
			Q1	Q2	Q3	Q4
M1	**2.4**	**9.9**	**5.8**	**8.7**	**12.8**	**12.2**
Currency in circulation	9.1	11.5	13.7	13.0	12.7	6.5
Overnight deposits	1.1	9.6	4.3	7.8	12.7	13.4
M2-M1 (Other short-term deposits)	18.1	-0.5	8.2	2.0	-4.0	-8.3
Deposits with an agreed maturity of up to two years	36.4	-7.7	10.3	-2.8	-15.1	-23.2
Deposits redeemable at notice of up to three months	-1.7	11.0	5.4	9.3	13.6	15.8
M2	**9.6**	**4.6**	**7.0**	**5.4**	**4.2**	**1.9**
M3	**9.5**	**3.0**	**5.7**	**4.2**	**2.4**	**-0.1**

Source: ECB.

term refinancing operations (LTROs) with a maturity of one year, at a fixed interest rate and with full allotment. The ECB also decided that the Eurosystem would buy euro-denominated covered bonds issued in the euro area. At the beginning of December, however, the ECB announced that the twelve-month LTRO held on 16 December 2009, the third such operation, would be the last one, and that the rate charged would be fixed at the average minimum bid rate on the MROs over the life of the operation. This signalled the beginning of a gradual withdrawal of emergency liquidity support.

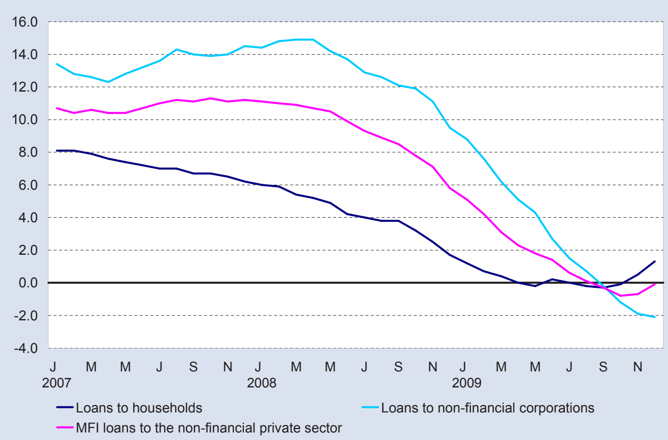
Money and credit

Annual M3 growth in the euro area fell consistently almost throughout the year, turning negative in November and ending the year at -0.3%. In average terms, the annual growth rate of broad money declined to 3.0%, from 9.5% in the preceding year (see Table 1.3).

The drop in M3 took place despite a sharp increase in the annual growth rate of M1, which rose to an average of 9.9% from 2.4% in 2008. Annual M1 growth was on an upward trend in the first eight months of 2009, peaking at 13.4% in August before stabilising at these high levels. In contrast, other short-term deposits included in M3 contracted, shedding an average of 0.5% during the year. These movements in the components of broad money were heavily influenced by the low interest rate environment, which reduced the opportunity cost of holding the more liquid monetary assets that make up M1 while prompting shifts out of other short-term deposits into longer-term assets outside broad money categories that offered higher returns.

On the counterparts side, annual credit growth in the euro area slowed significantly during 2009, as the drop in economic activity and the uncertain outlook depressed loan demand. In addition, banks tightened credit standards. The annual rate of change of MFI loans to the private sector declined throughout the first nine months of the year, turning negative in September before ending the year at -0.1% (see Chart 1.9). As the Chart shows, the annual rates of growth of MFI loans to non-financial corporations and to households both

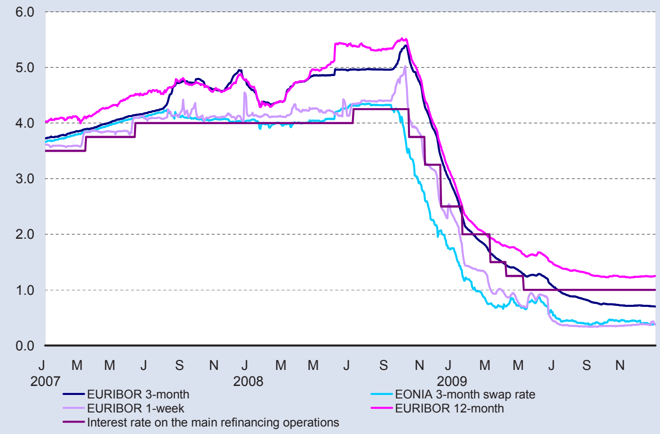
Chart 1.9
MFI LOANS TO THE NON-FINANCIAL PRIVATE SECTOR IN THE EURO AREA
(annual percentage changes)



Source: ECB.

slowed down and turned negative. Subsequently, however, the annual rate of growth of MFI loans to non-financial corporations fell further, whereas that of loans to households picked up. They ended the year at -2.2% and 1.3%, respectively.

Chart 1.10
KEY MONEY MARKET INTEREST RATES
(percentages per annum; daily data)



Sources: ECB; Euribor FBE.

The money market

Unsecured money market interest rates in the euro area, as measured by EURIBOR, declined during 2009 (see Chart 1.10).[3] This mainly reflected the cuts in key ECB interest rates and the ample provision of liquidity by the Eurosystem to stabilise financial market conditions. Therefore, the three-month and twelve-month EURIBOR ended 2009 at 0.70% and 1.25%, or 219 basis points and 180 basis points, respectively, below the levels prevailing at end-2008. Hence, with the three-month EURIBOR dropping more rapidly than the twelve-month rate, the money market yield curve steepened.

As money market tensions moderated, the spread between the unsecured EURIBOR and secured rates, such as those derived from the three-month EONIA swap index, generally continued to narrow in the course of the year.[4] By the end of December, the differential at the three-month maturity narrowed to 32 basis points, as opposed to 114 basis points at the end of 2008.

The one-week EURIBOR remained below the interest rate on the ECB's MROs throughout 2009. The gap between the two rates widened considerably towards the end of June, as the ECB injected substantial amounts of liquidity into money markets, which in turn caused interbank rates to fall sharply. In effect, the ECB's overnight deposit rate acted as the floor for euro area money market interest rates.

Bond yields

After having decreased substantially towards the end of 2008, ten-year government bond yields in the euro area were broadly stable at the beginning of 2009.[5] Weakening economic activity and heightened risk aversion weighed down on long-term bond yields, especially in the first months of the year. At the same time, however, rising budget deficits in a number of euro area Member States, such as Greece and Ireland, appear to have led to an increase in the compensation demanded by investors. After the first quarter, bond markets were characterised by a general improvement in market sentiment and risk appetite which, combined with the release of positive economic data, pushed up government bond yields towards the middle of the year. Thereafter, yields fluctuated around a gradual downward trend, ending the year on 3.38%, 44 basis points above their level a year earlier. Across the euro area yields diverged, with those on ten-year Greek bonds standing at 5.81% at the end of December.

Equity prices

Euro area equity prices broadly moved in line with global trends during 2009. Until mid-March, equity prices, as measured by the Dow Jones EURO STOXX index, generally extended the downward trend seen in 2008 on concerns about the prospects for the global economy and the health of the banking system. Thereafter, however, stock prices rebounded as growth prospects for the euro area were revised upwards and risk

[3] EURIBOR refers to the rates at which a prime bank is willing to lend funds to another prime bank in euro on an unsecured basis.
[4] EONIA is a measure of the effective interest rate prevailing in the euro interbank overnight market. The EONIA swap rate is the fixed rate that banks are willing to pay in exchange for receiving the average EONIA rate over the lifetime of a swap contract.
[5] Data refer to German ten-year government bond yields, which are taken as the benchmark for the euro area.

appetite among investors increased amid signs that the worst of the global recession was over. Overall, euro area equity prices rose by around 23% in 2009, though they remained below their pre-crisis levels.

Exchange rates

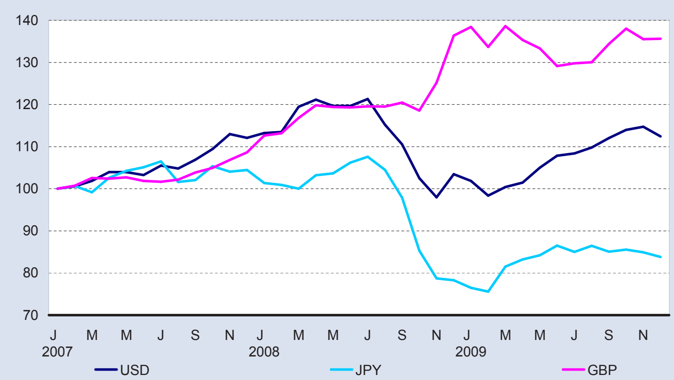
The euro strengthened against the US dollar during 2009, reversing the depreciation which took place in 2008 (see Chart 1.11). The appreciation was mainly a result of concerns relating to the US fiscal outlook and better-than-expected data releases for the euro area. A return of confidence in capital markets, which led investors to shift away from safe-haven currencies such as the US dollar, also contributed. The euro peaked against the dollar at the beginning of December, before declining until the end of the year. Over the year as a whole, the single currency strengthened by 8.7% against the dollar.

In the first half of 2009, the euro/yen exchange rate broadly followed the pattern of the euro/US dollar rate. The euro's appreciation against the yen was reinforced by the severity of the economic downturn in Japan. This trend was, however, reversed in the second half of the year, when the euro lost some ground. Overall, the euro strengthened by 7.1% against the yen during 2009.

After reaching its highest level ever against the pound sterling towards the end of 2008, the euro fluctuated against sterling throughout 2009. It lost ground against the pound during the first half of the year, but subsequently recovered. Compared with its end-2008 level, the euro had depreciated by 0.5% in terms of the UK currency by the end of 2009.

The nominal effective exchange rate (NEER) of the euro, as measured against the currencies of 21 of the euro area's main trading partners, fell by 1.0% during 2009. The NEER declined up to early March, mainly due to the depreciation of the euro against the US dollar and sterling (see Chart 1.12). It then embarked on a general upward trend, reaching its highest level at the end of October, driven by developments in the bilateral exchange rates against the US dollar and the pound sterling which were only partly offset by the euro's depreciation against the Japanese yen and the currencies of some EU Member States that are not members of the euro area. This appreciation of the euro in nominal effective terms was entirely reversed in the final two months of the year as a result of a broad-based depreciation of the currency.

Chart 1.11
EXCHANGE RATE MOVEMENTS OF THE EURO AGAINST OTHER MAJOR CURRENCIES
(index of average monthly rates; Jan. 2007=100; a rise in the index implies euro appreciation)



Source: Eurostat.

Chart 1.12
EURO NOMINAL EFFECTIVE EXCHANGE RATE
(index of daily effective exchange rate; Q1 1999=100)

Source: ECB.

2. MONETARY AND FINANCIAL DEVELOPMENTS

The contribution of Maltese MFIs to the euro area broad money stock declined during 2009 as residents' deposits contracted following moderate growth in the previous year. Nevertheless, credit to residents continued to expand, albeit at a decelerating pace.[1] Reductions in official interest rates during the year were reflected in domestic money market yields, which continued to trend downwards. In the capital market, meanwhile, 5-year government bonds yields fell, while those on 10-year government bonds rose. Domestic equity prices – which had registered heavy losses in 2008 – started to recover.

Residents' deposits

The Maltese MFIs' contribution to the euro area broad money stock, M3, stood at EUR8.6 billion at the end of December 2009. This was EUR48.3 million, or 0.6%, less than at the end of the previous year (see Table 2.1).

Table 2.1
CONTRIBUTION OF RESIDENT MFIs TO EURO AREA MONETARY AGGREGATES(1)
EUR millions; annual percentage changes.

	2008	2009	Change	
	Dec.	Dec.	Amount	%
Currency issued(2)	669.2	639.8	-29.5	-4.4
Overnight deposits(3)	3,180.4	3,721.5	541.1	17.0
Narrow money (M1)	**3,849.6**	**4,361.3**	**511.6**	**13.3**
Deposits redeemable at notice up to 3 months(3)	114.3	111.7	-2.6	-2.3
Deposits with agreed maturity up to 2 years(3)	4,860.7	4,271.1	-589.6	-12.1
Intermediate money (M2)	**8,824.5**	**8,744.0**	**-80.5**	**-0.9**
Repurchase agreements	0.0	0.0	0.0	0.0
Debt securities issued with up to 2 years initial maturity(4)	-144.3	-112.0	32.2	-22.4
Broad money (M3)	**8,680.3**	**8,632.0**	**-48.3**	**-0.6**

(1) Figures show the contribution of Maltese MFIs to the euro area totals. Data on monetary aggregates include deposit liabilities to both residents of Malta and other euro area residents.
(2) This is not a measure of currency in cirulation in Malta. It comprises the Central Bank of Malta's share of euro banknotes issued by the Eurosystem, plus coins issued by the Bank on behalf of the Treasury, less euro banknotes and coins held by the MFI sector.
(3) Deposits with MFIs exclude interbank deposits and deposits held by central government.
(4) Debt securities up to 2 years issued by MFIs in Malta less holdings by MFIs in Malta of such securities issued by MFIs anywhere in the euro area. This row shows net amounts and may be negative. Figures also include money market fund shares/units.
Source: Central Bank of Malta.

Table 2.2
RESIDENTS' DEPOSITS (1)
Annual percentage changes; EUR millions

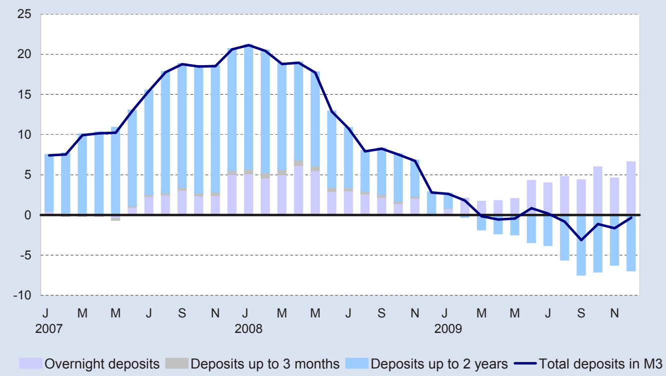
	2007	2008	2009	2009	
	Dec.	Dec.	Dec.	Amount outstanding	Absolute change
Overnight deposits	11.7	0.4	16.5	3,635.3	515.4
Deposits redeemable at notice up to 3 months	46.8	8.5	-2.3	111.6	-2.6
Deposits with agreed maturity up to 2 years	27.1	4.3	-11.6	4,128.4	-539.6

(1) Data only include deposits belonging to residents of Malta.
Source: Central Bank of Malta.

[1] Unless otherwise specified, 'residents' in this Chapter refers to residents of Malta only.

During 2009 overnight deposits grew at a much faster pace than in 2008, expanding by EUR515.4 million, or 16.5%, as opposed to 0.4% in the previous year (see Table 2.2). This acceleration stemmed mainly from an increase in balances belonging to households and private non-financial companies. A reduction in the opportunity cost of holding liquid monetary assets in an environment of low interest rates increased the attractiveness of such deposits throughout the year. However, deposits redeemable at up to three months' notice, which account for a negligible proportion of the total, declined moderately in absolute terms, falling by EUR2.6 million. At the same time, after having risen by 4.3% in 2008, deposits with an agreed maturity of up to two years contracted sharply, dropping by EUR539.6 million, or 11.6%, primarily on account of lower holdings belonging to households. Apart from the above-mentioned shift into more liquid monetary assets, the sharp decline in these deposits may have been influenced by investors' turning to longer-term assets outside M3 in the quest for higher returns. In fact, deposits with terms to maturity of over two years, which do not form part of M3, expanded by EUR180.6 million during the year. Considerable issues of corporate bonds also played a role in diverting funds away from monetary assets.

Chart 2.1
CONTRIBUTION OF DEPOSIT CATEGORIES TO ANNUAL GROWTH IN RESIDENTS' DEPOSITS
(percentage points; annual percentage changes)



Source: Central Bank of Malta.

Thus, growth in total resident deposits turned negative, falling from 2.8% at the end of 2008 to -0.3% twelve months later (see Chart 2.1). This was almost entirely driven by the drop in deposits with an agreed maturity

Table 2.3
MFI INTEREST RATES ON DEPOSITS BELONGING TO RESIDENTS OF MALTA[(1)]
Percentages per annum; weighted average rates for the period

	2007 Dec.	2008 Dec.	2009 Dec.
New business			
Households and NPISH			
Overnight deposits[(2),(3)]	1.10	0.57	0.30
Savings deposits redeemable at notice up to 3 months[(2),(4)]	3.55	2.09	1.70
Time deposits with agreed maturity			
Up to 1 year	3.87	3.06	1.95
Over 1 and up to 2 years	4.25	4.60	3.00
Over 2 years	3.49	5.54	3.39
Non-financial corporations			
Overnight deposits[(2),(3)]	1.43	0.64	0.23
Time deposits with agreed maturity	4.17	2.60	0.85

[(1)] Annualised agreed rates (AAR) on euro-denominated deposits belonging to households and non-financial corporations held with credit institutions resident in Malta (data before 2008 also include rates on business denominated in Maltese lira).
[(2)] For these instrument categories, interest rates are compiled on outstanding amounts but treated as new business indicators due to the large number of inflows and outflows.
[(3)] Overnight deposits include current accounts and savings withdrawable on demand.
[(4)] Households and non-financial corporations are merged, since deposits in this category held by non-financial corporations are negligible.
Source: Central Bank of Malta.

of up to two years, although these still accounted for just over half of residents' deposits at the end of the year.

Movements in deposits were influenced by falling deposit interest rates, as MFIs responded promptly to cuts in the ECB's main refinancing rate by lowering rates on newly-opened accounts during the year. In particular, interest rates on households' time deposits with agreed maturities up to 1 year, between 1 and 2 years, and over 2 years all dropped considerably, falling by 111, 160 and 215 basis points, respectively (see Table 2.3).[2]

A weighted average of all deposit categories also showed a notable decline of 112 basis points in the deposit rate, to 1.45% by the end of December. Within these categories, the average interest rate on time deposits fell by a significant 145 basis points to 2.29%, while those on savings and demand deposits declined by 40 and 22 basis points, respectively, ending December at 0.33% and 0.29%.[3]

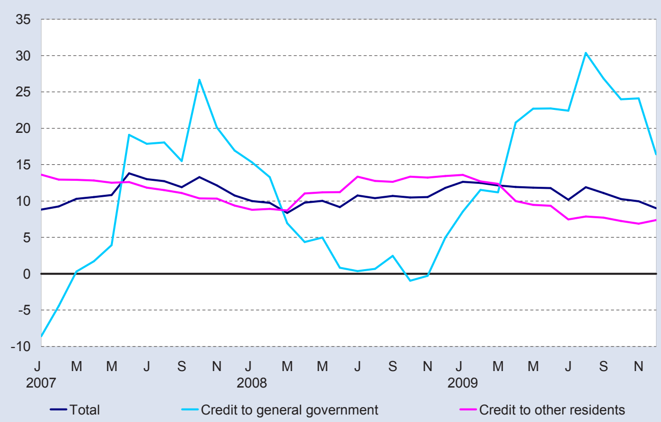
Credit

During 2009 credit to residents continued to expand, rising by 9.0%, as opposed to 11.8% during the preceding twelve months (see Chart 2.2). In absolute terms, growth stemmed primarily from a substantial increase in credit to non-financial corporations and households, though a rise in credit to general government also contributed (see Table 2.4). The deceleration in credit growth during the year reviewed mainly reflected the domestic economic slowdown in the wake of the international recession and a growing tendency to resort to the capital market for funding in a scenario characterised by tighter bank lending standards.

As the Government tapped the domestic market to meet its borrowing needs, credit to general government picked up considerably during the year, expanding by 16.4%, following a 5.0% rise in 2008. This acceleration primarily reflected an increase in the amount of Treasury bills held by the banking sector, although a rise in banks' holdings of long-term securities (MGSs) also contributed.

In contrast, credit to other residents expanded at a slower pace during 2009, with the annual rate of growth halving to 7.4%. Loans accounted for around 97% of total credit outstanding at the end of the year, with demand stemming predominantly from the non-bank private sector (see Table 2.5). Loans to the latter expanded by 6.8%, driven mainly by credit to households for house purchases, which, together with lending to the real estate, renting & business activities sector, continued to rise strongly. Nevertheless, credit growth slowed down across almost all categories of borrower, with lending to the construction industry hardly rising at all. Running counter to the general trend, however, credit to the hotels & restaurants sector picked up, turning positive after two consecutive years of decline. Meanwhile, credit to the non-bank public sector also grew, primarily reflecting a sharp rise in lending to the electricity, gas & water

Chart 2.2
CREDIT TO RESIDENTS
(annual percentage changes)



Source: Central Bank of Malta.

[2] MFI interest rates (MIR) cover all interest rates that credit institutions apply to euro-denominated deposits and loans from/to households and non-financial corporations resident in euro area Member States. The household sector also includes NPISH. Non-financial corporations include all enterprises except banks, insurance companies and other financial institutions. Hence, MIR statistics do not cover all institutional sectors, as is the case with the weighted average deposit and lending rates.

[3] In this context, savings deposits include those that are withdrawable on demand, which are included with overnight deposits in MIR statistics.

Table 2.4
CREDIT TO MALTESE RESIDENTS
Annual percentage changes; EUR millions

	2007 Dec.	2008 Dec.	2009 Dec.	2009 Amount outstanding	2009 Absolute change
Total credit	**10.8**	**11.8**	**9.0**	**9,661.5**	**798.5**
Credit to general government	17.0	5.0	16.4	1,863.4	263.0
Credit to other residents	9.4	13.4	7.4	7,798.1	535.5

Source: Central Bank of Malta.

supply sector, though this was substantially counterbalanced by a drop in credit to public sector manufacturing firms that reflected the repayment of loans formerly taken out by the shipyards.

Although growth in credit to the private sector decelerated on a year-on-year basis, it remained relatively buoyant. This may reflect the positive response by the domestic banking system to the demand for loans, lower lending rates, and the relatively muted impact of the economic downturn on credit demand, particularly from the household sector. These factors offset the impact of a tightening in bank lending conditions during the first half of the year as well as the increased recourse to the domestic capital market to raise funds. In contrast, in the euro area as a whole credit to the private sector rose only marginally during the year under review.

Mortgages continued to register double-digit growth rates during 2009, and remained the dominant form of bank borrowing by residents (see Chart 2.3). They accounted for just over half the growth in overall credit to the private sector during the year. Thus, overall loans to households, together with loans to the real estate, renting & business activities sector and to the construction industry, made up more than two-thirds of the total.

Table 2.5
CREDIT TO OTHER RESIDENTS[1]
Annual percentage changes; EUR millions

	2007 Dec.	2008 Dec.	2009 Dec.	2009 Amount outstanding	2009 Absolute change
Total credit	**9.4**	**13.4**	**7.4**	**7,798.1**	**535.5**
Credit to the non-bank private sector	10.2	10.2	6.8	7,122.7	453.4
Credit to the non-bank public sector	-4.1	69.5	13.8	675.4	82.0
Total loans	**9.4**	**13.4**	**7.5**	**7,571.6**	**527.3**
Electricity, gas & water supply	4.1	69.4	29.7	432.1	99.1
Transport, storage & communication	-5.3	33.1	11.8	480.0	50.8
Agriculture & fishing	-2.4	15.4	44.2	37.2	11.4
Manufacturing	13.8	13.6	-13.0	296.4	-44.2
Construction	15.5	7.8	0.3	732.8	2.5
Hotels & restaurants	-3.8	-3.6	6.2	485.8	28.4
Wholesale & retail trade; repairs	2.4	3.4	1.3	767.2	10.0
Real estate, renting & business activities	18.9	28.4	10.9	1033.2	101.9
Households & individuals	14.5	10.8	9.8	3144.2	281.6
Other[2]	-10.9	-1.2	-8.0	162.6	-14.2

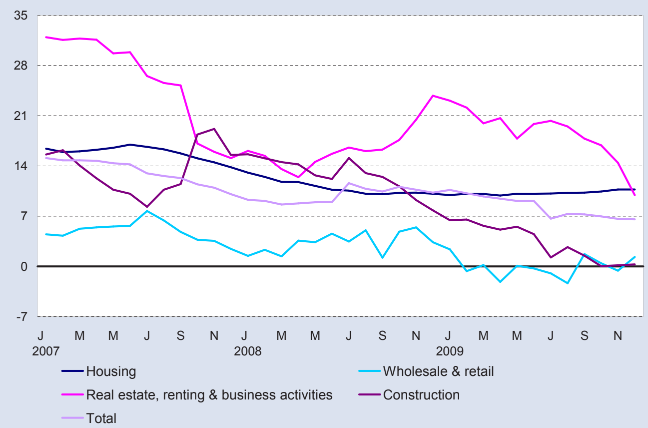
[1] Credit to other residents consists mainly of loans and holdings of securities, including equities, issued by the non-bank private sector and public non-financial companies, and financial derivatives. Interbank claims are excluded. Data only include credit to residents of Malta.

[2] Includes mining & quarrying, public administration, education, health & social work, community recreation & personal activities, extra-territorial organisations & bodies and non-bank financial institutions.

Source: Central Bank of Malta.

After having fallen during the previous year, bank lending rates continued to decline in 2009 as official interest rates were reduced further. The weighted average interest rate on loans to residents dropped by 50 basis points in the course of the year, to 4.46% in December. Similarly, MFI interest rates on new loans to residents fell significantly, particularly those on overdrafts and 'other lending' granted to households (see Table 2.6). Rates on lending for house purchases, which had already fallen sharply in the previous year, decreased at a slower pace. But those charged on new lending to non-financial corporations declined significantly, with rates on overdrafts and loans falling by 22 and 55 basis points, respectively, reaching 5.08% and 4.95% by end-December.

Chart 2.3
ANNUAL PRIVATE SECTOR LOAN GROWTH
(annual percentage changes)



Source: Central Bank of Malta.

Developments in credit to residents were also influenced by changes in credit standards and in the demand for loans, as revealed by the quarterly Bank Lending Surveys.[4] During the first half of the year, credit standards in respect of lending to households and enterprises were tightened somewhat, as banks responded to the economic downturn and a perceived increase in credit risk. At the same time, a decline in the demand for loans was also reported by some banks. During the last two quarters, however, credit standards were not tightened further. At the same time, while the demand for loans by enterprises and by households for housing finance remained broadly stable, the demand by the latter for loans to finance consumption declined.

Table 2.6
MFI INTEREST RATES ON LOANS TO RESIDENTS OF MALTA(1)
Percentages per annum; weighted average rates for the period

	2007 Dec.	2008 Dec.	2009 Dec.
New business			
Households and NPISH			
Overdrafts(2)	6.64	7.16	6.44
Loans			
Lending for house purchases	5.45	3.84	3.52
Consumer credit	6.19	6.12	6.02
Other lending	6.34	6.44	5.56
Non-financial corporations			
Overdrafts(2)	5.33	5.30	5.08
Loans	5.91	5.50	4.95

(1) Annualised agreed rates (AAR) on euro-denominated loans taken up by households and non-financial corporations from credit institutions resident in Malta (data before 2008 also include rates on business denominated in Maltese lira).
(2) For these instrument categories, interest rates are compiled on outstanding amounts but treated as new business indicators due to the large number of inflows and outflows.
Source: Central Bank of Malta.

[4] The Bank Lending Surveys gauge credit demand and supply conditions. The Central Bank of Malta began to survey a sample of Maltese banks in 2004. From January 2008 Bank Lending Surveys are being carried on a quarterly basis as part of an exercise across the entire euro area.

Table 2.7
EXTERNAL AND OTHER COUNTERPARTS[1]
EUR millions; annual percentage changes

	2008 Dec.	2009 Dec.	Change Amount	%
External counterparts	**7,379.0**	**6,673.7**	**-705.3**	**-9.6**
Claims on non-residents of the euro area	26,971.2	24,918.0	-2,053.2	-7.6
Liabilities to non-residents of the euro area	19,592.2	18,244.3	-1,347.9	-6.9
Other counterparts (net)[2]	**10,791.2**	**11,184.5**	**393.3**	**3.6**

[1] Figures show the contribution of Maltese MFIs to the euro area totals.
[2] Includes net interbank claims/liabilities.
Source: Central Bank of Malta.

Indeed, the domestic situation in 2009 was broadly in line with developments in the euro area as a whole and elsewhere, where credit standards were tightened.

Meanwhile, credit granted by resident MFIs to other residents of the euro area contracted during the year, dropping by EUR515.6 million to EUR2.2 billion. This mainly reflected a further decline in lending to non-bank financial intermediaries.

Net claims on non-residents of the euro area

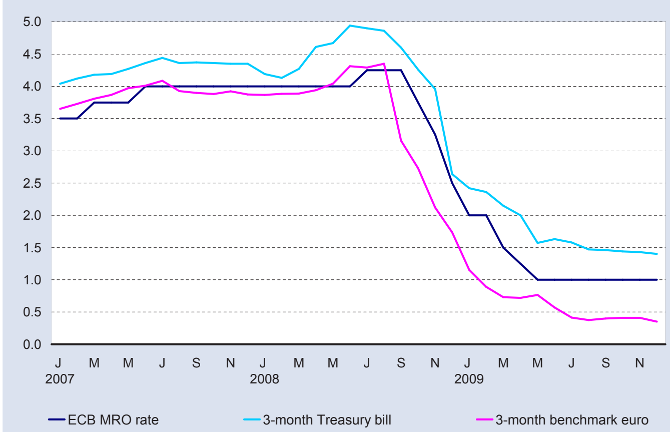
During 2009 the external counterpart of resident MFIs' contribution to euro area broad money, which consists of their net claims on non-residents of the euro area, contracted by EUR705.3 million, or 9.6% (see Table 2.7). Claims on non-residents of the euro area fell significantly, mainly on account of a drop in loans to the non-bank private sector. This outweighed a rise in resident MFIs' holdings of government securities issued outside the euro area. Meanwhile, their liabilities to non-residents of the euro area also fell, though to a lesser extent.

Other counterparts (net) increased by EUR393.3 million, or 3.6%, during 2009. This was mainly because resident banks strengthened their balance sheets by increasing their longer-term financial liabilities, mostly in the form of reserves and retained earnings.

The money market

During 2009 the money market continued to be dominated by transactions in short-term bills issued by the Government Treasury. The latter in fact made more extensive use of such instruments to finance its operations. It issued EUR1.6 billion worth of bills, up from EUR1.0 billion in the previous year. Three-month bills accounted for two-thirds of total issues during the year, with the rest consisting mainly of six-month bills. In 2009 resident banks participated more heavily in Treasury bill auctions than in the previous year, taking up 64% of the amount issued, while insurance companies subscribed to most of the remainder. Almost 2% of the bills issued was taken up by

Chart 2.4
MONEY MARKET INTEREST RATES
(percentages per annum; end of month)



Source: Central Bank of Malta.

investors resident elsewhere in the euro area. In an overall context of diminishing money market rates, the primary market yield on three-month Treasury bills finished the year well below its end-2008 level, ending the year 225 basis points lower, at 1.40%.

Turnover in the secondary market for Treasury bills also increased considerably during the year, rising to EUR263.4 million, from EUR168.4 million in the previous year. Almost all trading involved the Central Bank of Malta in its role as market-maker, with its purchases and sales amounting to EUR203.8 million and EUR28.6 million, respectively. Secondary market yields moved in line with those in the primary market, with that on the three-month bill, for instance, falling by 124 basis points to 1.40% in December. However, yields on the latter declined by less than the euro area benchmark yield. As a result, the differential between the two, which stood at 91 basis points at the end of 2008, widened to 105 basis points by the end of the year (see Chart 2.4).[5]

Resident banks continued to borrow and lend short-term funds among themselves in 2009, although turnover in the interbank market fell to EUR1.2 billion during the year, as against EUR1.7 billion in 2008.

The capital market

Net issues of long-term debt securities in the primary market amounted to EUR492.1 million in 2009, up from EUR246.8 million in the previous year (see Table 2.8). On a net basis, government issues were up by EUR54.0 million to EUR248.2 million, while securities issued by other residents surged by EUR191.3 million to EUR243.9 million. The substantial rise in corporate issues primarily reflected a shift towards market-based financing as bank lending conditions tightened, while the prevailing interest rate conditions offered opportunities to borrow at relatively cheap rates compared to previous years.

The Government issued securities in March, April, June, August and November, with a combined value of EUR456.2 million. Terms to maturity ranged from four to twelve years, whereas coupon rates varied from 3.6% to 5.2%. As part of the November issue, the Government, for the first time, issued securities with a coupon rate linked to a floating rate, namely the 6-month EURIBOR. Until April 2010, this issue's coupon rate will amount to 1.79%. More than two-thirds of the bonds issued were sold by auction. Of these, almost

Table 2.8
ISSUES OF LONG-TERM DEBT SECURITIES[(1)]
EUR millions

	2007	2008	2009
Government			
Total issues [(2)]	289.1	287.4	456.2
Redemptions [(3)]	163.1	93.2	208.0
Net issues	126.0	194.2	248.2
Corporate sector			
Total issues	119.8	62.0	284.5
Redemptions [(3)]	7.3	9.4	40.6
Net issues	112.6	52.6	243.9
Total net issues	**238.6**	**246.8**	**492.1**

[(1)] Includes public issues of listed debt securities by residents in Maltese liri and foreign currencies, with the spot rate at time of issue used for conversion of foreign currencies to Maltese liri. Banks, non-monetary financial institutions and public non-financial companies are included with corporate issuers. Long-term securities are those with an original term to maturity exceeding one year, and include preference shares.

[(2)] Data exclude MGSs that were issued directly to the Foundation for Church Schools. These amounted to EUR11.0 million in 2007, EUR6.9 million in 2008 and EUR13.7 million in 2009.

[(3)] Redemptions include debt securities bought back by the issuer.

Sources: Central Bank of Malta; MSE; Treasury.

[5] Yields on three-month French government securities are taken as the benchmark for the euro area.

Table 2.9
SECONDARY MARKET TRADING IN GOVERNMENT STOCKS
EUR millions

	2007	2008	2009
Central Bank of Malta purchases	205.7	141.9	90.7
Central Bank of Malta sales	45.2	67.4	112.0
Other deals(1)	75.0	56.2	56.3
Total	**326.0**	**265.5**	**259.0**

(1) Including deals effected by the Bank's broker on behalf of Government Sinking Funds, the Maltese Episcopal Conference and the MSE.
Sources: Central Bank of Malta; MSE.

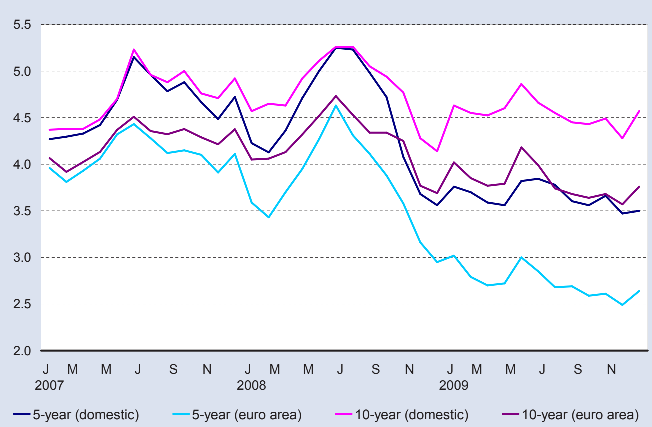
77% were taken up by banks, with insurance companies acquiring most of the remainder. Meanwhile, bonds sold at fixed prices were purchased by retail investors, predominantly households. Overall, non-resident investors took up just under 3% of the government securities issued.

At the same time, the value of debt securities issued by the corporate sector rose even more sharply. Ten bonds were issued during the year, with a combined value of EUR284.5 million. While 28% of the total was issued by banks, firms in the hotel industry issued an additional 26%. The rest were launched by firms in various sectors, including property development. Terms to maturity ranged between three and ten years and coupon rates varied between 5.35% and 7.15%. All issues were well-received, with over-allotment options being fully exercised in each case.

Despite increased activity in the primary market, turnover in the secondary market for government bonds was down slightly compared to the previous year, falling from EUR265.5 million to EUR259.0 million (see Table 2.9). During 2009, the Central Bank of Malta, acting as market-maker, accounted for around three-quarters of the value traded. This was concentrated in securities with maturities of up to five years.

Domestic government bond yields moved very much in line with those in the euro area. During the first half of the year, yields on 5- and 10-year government securities rose, peaking at 3.84% and 4.86% respectively in June and May, with both following a downward trend thereafter before ending the year at 3.50% and 4.57% (see Chart 2.5).[6] Overall, yields on 5-year government securities declined by 6 basis points during 2009, while those on 10-year securities moved in the opposite direction, rising by 43 basis points. The decline in 5-year yields possibly reflected the increased demand for safe, short-term assets in an environment characterised by high uncertainty and extremely low bank deposit rates. In contrast, however, expectations of higher future interest rates may have dampened demand for long-term government securities, leading to higher long-term yields. Since movements in euro area government bond yields were more contained compared to those of their domestic counterparts, the spreads between the two widened. The spread on 5-year bonds increased to 25 basis

Chart 2.5
LONG-TERM INTEREST RATES
(percentages per annum; end of month)



Sources: Central Bank of Malta; ECB.

6 Euro area yields are computed on the basis of AAA-rated euro area central government bonds.

points by end-December, while that on 10-year bonds reached 36 basis points.

Activity in the secondary market for corporate bonds increased during 2009, with turnover rising by EUR8.0 million to EUR34.5 million. Trading mostly involved eleven bonds (out of a total of 45 listed securities), which contributed to more than two-thirds of total turnover. On average, corporate bond yields rose slightly during the first half of 2009, before declining in the second half, resulting in a small fall over the year as a whole.

Chart 2.6
MSE SHARE INDEX
(end of month)

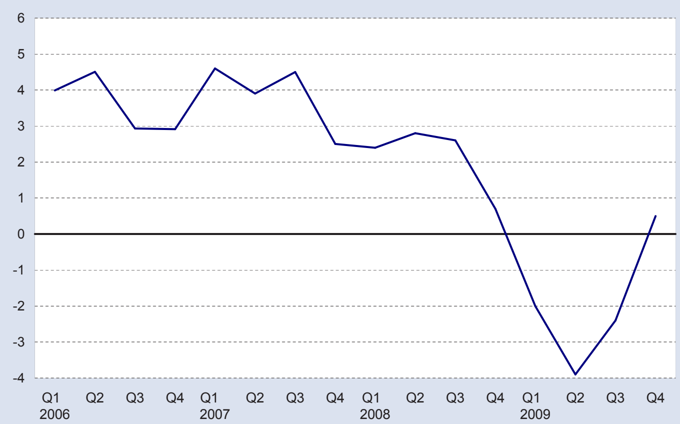
Source: MSE.

In contrast, turnover in the equity market continued to decline, falling from EUR49.1 million in 2008 to EUR25.4 million in 2009. Bank shares accounted for most transactions. After having lost 35% of its value in 2008, the MSE share index fell further during the first quarter of the year. But subsequently it recovered, gaining 7.9% over the year as a whole, to end December at 3,460.55 (see Chart 2.6).

3. OUTPUT, EMPLOYMENT AND PRICES[1]

Reflecting developments abroad, the Maltese economy contracted during 2009, mostly owing to a decline in investment, weaker external demand and, particularly in the first half of the year, cautious consumer spending behaviour. This weak level of activity was accompanied by a decline in the inflation rate and a deterioration in labour market conditions.

Chart 3.1
REAL GDP GROWTH
(annual percentage change)



Source: NSO.

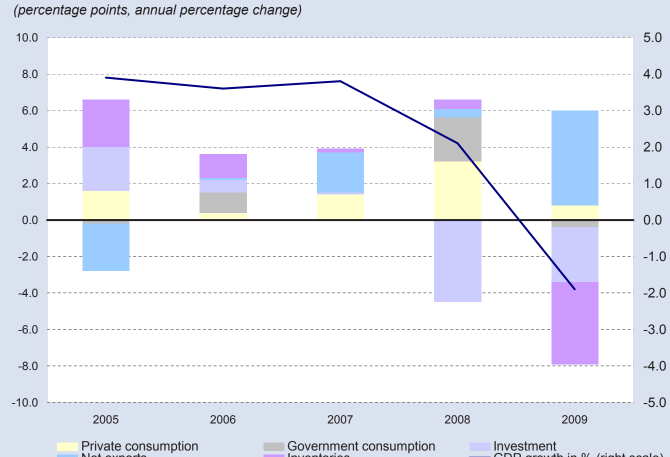
At a sectoral level, turnover in manufacturing was sharply down from the previous year's level, owing in part to the worldwide slump in the electronics industry. Activity in tourism was also sluggish through most of the year, even if recent data signalled a recovery both in terms of tourist numbers and of their spending. These negative developments were partly offset by sustained gains in other service sectors, particularly financial intermediation and business services.

Gross Domestic Product

The Maltese economy contracted by 1.9% in 2009, with the rate of decline intensifying up to the second quarter when it dipped to -3.9% on a year-on-year basis. After a more moderate drop in output in the third quarter, growth resumed, albeit somewhat tentatively, in the final quarter of the year (see Chart 3.1).

Domestic demand was sluggish throughout the year, with investment declining further and growth in private consumption moderating. In addition, inventories made a negative contribution too. Consistently with the drop in global demand, exports were a drag on the economy, though this was compensated for by lower imports. In fact, net exports contributed positively to GDP growth (see Chart 3.2 and Table 3.1).

Chart 3.2
REAL GDP GROWTH AND ITS COMPONENTS
(percentage points, annual percentage change)



Source: NSO.

Among the components of domestic demand, private consumption contracted during the second quarter but rebounded in the latter half of the year. For 2009 as a whole, private consumption grew at a less rapid pace than in the previous two years, rising by only 1.2% and adding slightly less than 1 percentage point to growth. The deceleration in consumption growth was in line with the slow overall rate of growth in employee compensation and concerns about employment prospects expressed in surveys of consumer confidence, although growth in con-

[1] The cut-off date for data included in this Chapter is 11 March 2010.

Table 3.1
GROSS DOMESTIC PRODUCT AT CONSTANT PRICES

	2006	2007	2008	2009
	Annual percentage changes			
Private consumption expenditure	0.6	2.2	5.0	1.2
Government consumption expenditure	5.9	0.0	12.9	-1.9
Gross fixed capital formation	3.2	0.4	-21.9	-19.3
Inventories (% of GDP)	1.6	1.7	2.1	-2.5
Domestic demand	**3.2**	**1.5**	**1.5**	**-6.8**
Exports of goods & services	10.5	2.7	-7.2	-3.1
Imports of goods & services	9.5	0.4	-7.4	-8.7
Gross domestic product	**3.6**	**3.8**	**2.1**	**-1.9**
	Percentage point contributions			
Private consumption expenditure	0.4	1.4	3.2	0.8
Government consumption expenditure	1.1	0.0	2.4	-0.4
Gross fixed capital formation	0.7	0.1	-4.5	-3.0
Changes in inventories	1.3	0.2	0.5	-4.5
Domestic demand	**3.5**	**1.7**	**1.6**	**-7.1**
Exports of goods & services	9.5	2.6	-6.9	-2.7
Imports of goods & services	-9.4	-0.4	7.4	7.9
Net exports	**0.1**	**2.2**	**0.5**	**5.2**
Gross domestic product	**3.6**	**3.8**	**2.1**	**-1.9**

Source: NSO.

sumer credit remained robust throughout the year. According to nominal data, expenditure on food & beverages, communication and household goods & related maintenance were down from the previous year. On the other hand, spending was up on various other items, including utilities, transport and education.

After having rebounded in 2008, government consumption contracted by just under 2% in 2009, knocking 0.4 percentage points off growth. Government consumption grew during the first half of the year but fell in the second half, with the rate of decline becoming more pronounced in the final quarter. The overall reduction in public consumption reflected drops in intermediate consumption and – to a lesser extent – in employee compensation on account of base effects related to the retirement schemes for dockyard workers in 2008.

Gross fixed capital formation (GFCF) fell by 19.3%, reducing GDP growth by 3 percentage points. Having declined steadily since the first quarter of 2008, investment rose in the third quarter of 2009 owing to the importation of quayside cranes and sea vessels. However, capital spending fell back again in the final quarter of the year.

Nominal data show that the 2009 drop in GFCF was mostly attributable to a fall in private residential investment in response to the ongoing decline in house prices. This was reflected in fewer building permits issued by the Malta Environment and Planning Authority (MEPA). Spending on machinery and equipment also declined significantly in 2009. Factors influencing the drop in corporate investment included a general reduction in business profitability and tighter financing conditions, especially for the construction sector, along with increased spare capacity. In fact, capacity utilisation fell to 70.8% in 2009, from 77.7% a year earlier.

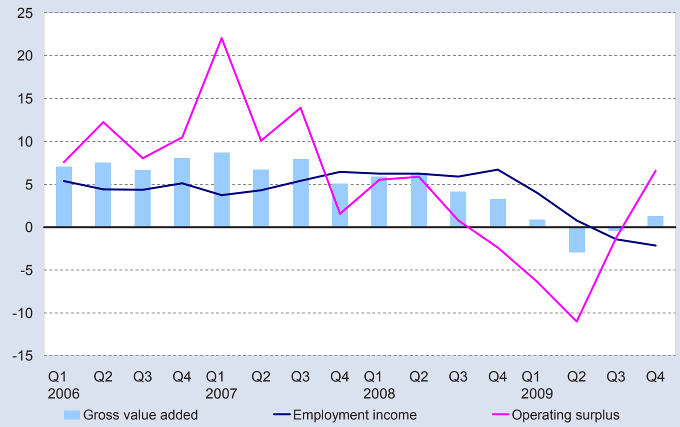
In part reflecting the weakness of external demand, a drawdown of inventories equivalent to 2.5% of GDP was recorded in 2009, wiping 4.5 percentage points off growth.[2]

On the external side, exports of goods and services dropped by 3.1%, a smaller decline than in 2008. Exports fell during the first two quarters, but bounced back to a modest growth rate in the second half

[2] The figure for inventories also includes acquisitions and disposals of valuables as well as statistical adjustments which arise from the reconciliation of the three methods of measuring GDP, namely the production, income and expenditure methods.

of the year. Since imports fell at a faster rate, however, particularly during the first half of the year, net exports made a positive 5.2 percentage point contribution to real GDP growth. These developments mainly reflected the reduced activity in tourism and manufacturing – especially in the electronics industry – the slowdown in consumption and the decline in investment, the latter in relation to the drop in imports.

Chart 3.3
GROSS VALUE ADDED, EMPLOYMENT INCOME AND OPERATING SURPLUS
(annual percentage changes)



Source: NSO.

An analysis of the income side of Malta's GDP shows that gross value added (GVA) declined marginally in 2009, as gains recorded in the March and December quarters were wiped out during the two intermediate quarters. These movements reflected a contraction in employee compensation in the second half of the year coupled with sharp drops in operating surplus, notably in the first half of the year. Towards the end of the year, however, profits recovered, rising in the December quarter (see Chart 3.3). For the year as a whole, employee compensation increased by 0.3%, while operating surplus declined by 3.1%.

Sectoral data reveal a sharp contrast between the ongoing difficulties faced by the traditional sectors and healthy growth in various newer types of service industries. Among the latter, strong growth was registered in the financial intermediation category, whose GVA expanded by a third and contributed 1.3 percentage points to nominal GDP growth. Similarly, the other community, social & personal services sector, which includes the gaming industry, also recorded positive results, rising by 10.1% and adding almost a full percentage point to nominal growth (see Table 3.2).

The real estate, renting & business activities sector added 0.6 percentage points to growth, with the business activities segment being the most important contributor. Nevertheless, although residential property prices remained on a downward path, the GVA of the real estate segment also grew during the year, possibly because the correction in property prices encouraged some buyers to enter the market. This is further corroborated by the reported growth, of around 10%, in the value of mortgage loans in 2009.

In contrast, the largest traditional sectors of the economy, tourism and manufacturing, both contributed negatively to growth. Thus, the GVA of hotels & restaurants declined by 11.8%, leading to a negative contribution of 0.5 percentage points by this sector. Similarly, the GVA of the manufacturing sector declined by 18.3%, lowering overall nominal GDP growth by 2.6 percentage points.

Overall growth was also reduced by lower value added in a number of other service industries, particularly transport, storage & communication. This sector recorded double-digit declines in value added in the last three quarters of 2009 and, as a consequence, made a negative contribution of 0.9 points to nominal growth over the year. In line with the moderate growth in consumption, the GVA of the wholesale & retail trade shrank by 8.5%, although the decline moderated in the second half of the year. As a result, this sector reduced overall nominal growth by a further 0.9 points.

However, other types of services that made a positive contribution included public administration, health & social work and education, which together added almost a full percentage point to nominal growth.

Meanwhile, the contribution of the electricity, gas & water supply sector amounted to a strong 1.1 percentage points, as the drop in output was outweighed by the decline in intermediate consumption, which reflected the

Table 3.2
CONTRIBUTION OF SECTORAL GROSS VALUE ADDED TO NOMINAL GDP GROWTH
Percentage points

	2006	2007	2008	2009
Agriculture, hunting & forestry	0.1	-0.2	-0.1	0.1
Fishing	0.1	0.2	-0.5	0.1
Manufacturing	0.2	1.1	0.9	-2.6
Electricity, gas & water supply	0.6	0.0	-0.9	1.1
Construction	0.3	0.0	0.1	-0.2
Wholesale & retail trade	0.0	0.3	0.2	-0.9
Hotels & restaurants	-0.2	0.4	0.1	-0.5
Transport, storage & communication	0.4	0.6	0.7	-0.9
Financial intermediation	0.4	-0.3	0.3	1.3
Real estate, renting & business activities	1.8	1.3	1.2	0.6
Public administration	0.1	0.4	0.3	0.3
Education	0.1	0.2	0.2	0.2
Health & social work	0.4	0.4	0.6	0.4
Other community, social & personal services	2.0	1.9	1.0	0.9
Gross value added	**6.3**	**6.1**	**4.2**	**-0.3**
Net taxation on products	**0.5**	**0.7**	**0.2**	**0.6**
Annual nominal GDP growth (%)	**6.8**	**6.8**	**4.4**	**0.3**

Source: NSO.

sharp decline in oil prices from the previous year's level. As a result, this sector's GVA more than doubled, while its operating losses were significantly lower than in 2008.

Manufacturing

During 2009 manufacturing output in Malta declined further as the global recession depressed external demand. In line with the sharp fall in the sector's GVA, the NSO's sample surveys of manufacturing firms showed a contraction in turnover of EUR302.8 million, or 13.7%, during the year (see Table 3.3).[3] This followed a 7.5% fall in 2008 and a smaller decrease in the previous year.

The drop in turnover during 2009 was mainly attributable to a decline in exports, as domestic sales grew for the second consecutive year. The divergence in performance between the export and domestic sectors, which widened further in 2009, was largely due to changing patterns within the pharmaceutical sector. Whereas the latter used to sell most of its output directly abroad, some of it is now being sold to domestic intermediaries outside the manufacturing sector, which then export it themselves. These shifts reinforced the reported drop in exports by the sector, which were down by 18.7% from the previous year's level, and accounted for the growth in domestic sales, which over the same period went up by 4.1%. Overall, exports accounted for less than three-quarters of manufacturing sales in 2009, down from over 78% in 2008.

As in 2008, the contraction in export sales was largely attributable to a significant drop in sales by the radio, TV & telecommunications sub-sector, which includes the key electronics industry.[4] This sub-sector's export sales were down by 25.5%, or EUR230.9 million, but still accounted for almost half of the exports reported by the sampled firms. This highlights the extent to which output trends in manufacturing industry are dominated by the electronics industry. But even if the latter's results are excluded, exports fell by 11.2%, or EUR91.4 million. Pharmaceutical firms, former contributors to export growth, reported a decline in exports of EUR89.4 million, partly due to the shift mentioned earlier. As a result, this sector posted an overall drop in sales of 20.7%, or EUR40.2 million. Meanwhile, other significant declines were registered by firms in the rubber &

[3] These results are compiled from a quarterly survey of a sample of around 385 manufacturing enterprises conducted by the NSO. The survey results are not grossed up to the total population.

[4] The decline in the sector's output reflected global developments. According to the Semiconductor Industry Association, a trade body representing leading US manufacturers, worldwide semiconductor sales in 2009 were down by 9% from 2008. (Press Release, 1 February 2010).

Table 3.3
MANUFACTURING PERFORMANCE - SELECTED INDICATORS
EUR millions

	2007	2008	2009
Total turnover	**2,383.6**	**2,203.9**	**1,901.2**
Change in exports	**-2.0**	**-211.9**	**-322.3**
Radio, TV & telecommunications equipment	-75.9	-197.4	-230.9
Pharmaceuticals	44.7	10.2	-89.4
Electrical machinery	29.6	-10.7	47.7
Other transport equipment	-2.5	-1.4	20.8
Clothing, textiles & leather	-16.0	-11.3	-11.9
Rubber & plastic products	6.5	-7.1	-24.8
Others	11.6	5.8	-33.7
Change in local sales	**-50.2**	**32.2**	**19.5**
Food & beverages	4.2	14.2	-16.9
Other non-metallic minerals	-1.8	12.6	-0.9
Publishing & printing	5.0	-1.2	0.1
Fabricated metal products	4.4	6.9	-8.0
Furniture	-4.7	-6.4	3.6
Pharmaceuticals	1.3	-0.6	49.2
Others	-58.6	6.7	-7.7
Change in investment	**36.7**	**-26.8**	**-79.0**
Change in employment [1]	**-587**	**-642**	**-1,042**
Change in wages per employee (%)	**5.0**	**3.2**	**2.2**

[1] Figures represent differences in average employment levels between the respective periods.
Source: NSO.

plastic products and the clothing, textiles & leather industries. In contrast, overseas sales by firms in the electrical machinery and other transport sub-sectors rose by EUR47.7 million and EUR20.8 million, respectively. In the latter case, this reflected the ongoing growth in the aircraft maintenance industry. However, the increased foreign sales of electrical machinery were partly due to higher re-export activity rather than domestic production.

As explained above, the rise in domestic sales of manufactured goods in 2009 was almost entirely driven by the pharmaceuticals sub-sector, which reported an increase of EUR49.2 million, as against a contraction of EUR0.6 million in 2008. In contrast, domestic sales by firms in the food & beverages industry contracted in 2009, falling by 7.6% over the period. In addition, lower local sales of fabricated metal products and, to a lesser extent, of other non-metallic minerals were also reported.

In line with the economic downturn, investment by manufacturing firms dropped sharply in 2009, falling by EUR79.0 million to EUR70.4 million. This decrease, which followed a smaller drop in 2008, was mainly due to reduced capital outlays by the radio, TV & telecommunications, the food & beverages and the printing & publishing industries.

With regard to employment, this fell substantially, but less rapidly than output, possibly because other measures, such as a reduction in working hours, were also put in place. Average employment levels in manufacturing declined by 1,042 persons, or 6.0%, as job losses in the radio, TV & telecommunications and the food & beverages sub-sectors, among others, outweighed gains in the other transport equipment category, which includes the rapidly expanding aircraft maintenance industry. Although the reduction in employment lowered the manufacturing sector's overall wage bill, wages per employee in the sector rose by 2.2%. This was a slower rate of growth than that registered in the previous year, suggesting that wage pressures may have eased.

Tourism

During 2009 the tourism industry continued to face a difficult external environment, as Malta's major source markets were severely affected by the global recession. This was reflected in a substantial 8.4% fall in tourist arrivals to around 1.2 million. The decline was especially pronounced in the first half of the year, but moderated thereafter, with the number of arrivals actually rising, year-on-year, in December (see Chart 3.4). This weak performance is generally consistent with developments in the Southern Mediterranean region as a whole. According to the United Nations World Tourism Organisation (UNWTO), tourist arrivals in this region were on average down by 4.7% during 2009.[5]

The number of visitors from the United Kingdom, which accounts for a third of total arrivals, contracted by 8.6% in 2009, with both the recessionary climate and the sharp depreciation of sterling contributing to the drop. At the same time, arrivals from Germany and France were down by 18.6% and 10.5%, respectively. On the other hand, arrivals from Italy were up by 10.1%, boosted by the introduction of additional air routes from that country (see Table 3.4).

The total number of nights stayed, at just under 10 million, was down by 9.0% from the 2008 level, although the average length of stay was unchanged at 8.5 nights. The overall decline was mostly experienced by hotels, as the number of nights spent in private accommodation was virtually the same as in the previous year.

The downtrend in tourist expenditure continued into 2009, with an estimated fall of 12.0%, following a 1.6% decline in the previous year. The largest drop in spending was registered by the package holiday category, extending a trend that had been in evidence for some years. A factor which is contributing to the drop in tourist expenditure is the falling cost of air fares, as low-cost airlines expanded their operations during the year (see Chart 3.4).

On the basis of data published by Malta International Airport, air passenger arrivals, including residents,

Chart 3.4
TOURISM INDICATORS
(annual percentage changes)

Source: NSO.

Table 3.4
DEPARTING TOURISTS BY COUNTRY OF RESIDENCE
Thousands

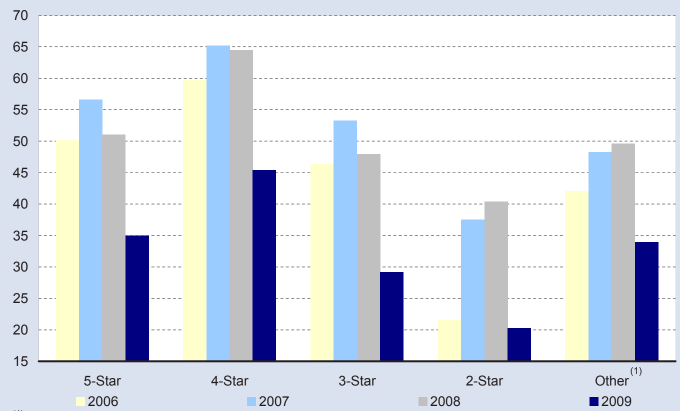
	2006	2007	2008	2009
Tourist departures by air & sea	**1,124.2**	**1,243.5**	**1,290.9**	**1,183.0**
UK	431.3	482.4	454.4	415.2
Germany	125.8	130.0	150.8	122.8
Italy	112.5	113.7	144.5	159.0
France	73.4	75.1	81.2	72.6
Others	381.1	442.3	460.1	413.3

Source: NSO.

[5] UNWTO World Tourism Barometer Volume 8. No. 1 – Jan. 2010.

dropped by 6.1% during 2009, while the number of aircraft landings was down by 2.8%.

Chart 3.5
AVERAGE OCCUPANCY RATES
(percent)

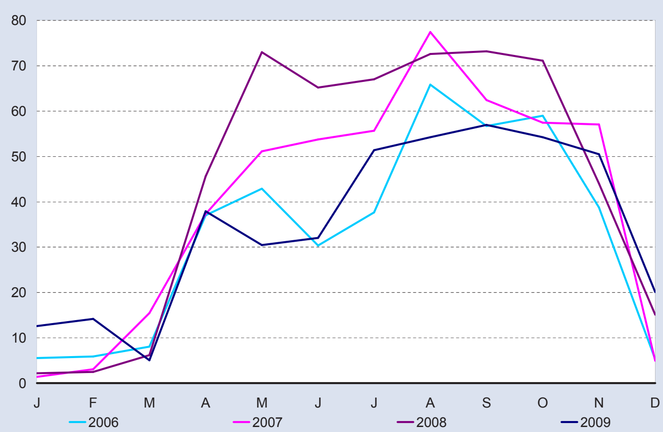


(1) Includes guesthouses, hostels & holiday complexes.
Source: NSO.

As bed capacity remained more-or-less unchanged from the previous year, the fall in the number of nights stayed was reflected in a double-digit drop in occupancy rates across the entire accommodation spectrum. Thus, the 5-, 4- and 3-star hotel categories reported declines in occupancy rates of 16.1, 19.1 and 18.8 percentage points, respectively, during 2009 (see Chart 3.5).

Data on cruise passenger arrivals show that this market was also affected by the global economic downturn. Cruise passenger traffic dropped by 22.0% to just below 420,000. The number of port calls by cruise ships, at 261, was also down substantially, by 34.3%. Towards the end of the year, however, there were signs of a recovery as cruise passenger arrivals in the last two months were up on the previous year (see Chart 3.6).

Chart 3.6
CRUISE PASSENGERS
(in thousands)



Source: NSO.

Almost three-fourths of cruise passengers arriving in Malta in 2009 originated from the EU, with considerable variations being observed in arrivals from the various Member States. While French and German passengers were up by 30.1% and 20.2%, respectively, the number of passengers from the Spanish and UK markets declined substantially. The number of passengers originating from outside the EU, particularly from Canada and the United States, was also down.

Construction

Reflecting a decline in investment in housing and commercial property, the construction sector registered a fall in production during 2009. National income data show that, in nominal terms, its GVA declined by 5.7%, leading to a further reduction of the sector's share in nominal GDP. In terms of the distribution of this GVA, employee compensation dropped by 5.1%, following the 1.7% rise reported in the previous year. The profit element dropped by 9.7%, after having increased by 2.2% in 2008.

Data on GFCF from the expenditure side of GDP show an 18.5% drop in construction investment in 2009. The residential building component accounted for 92.2% of the decline, while the remainder was attributable to other construction types, as both the Government and the private sector reduced their level of investment spending.

Table 3.5
CONSTRUCTION ACTIVITY INDICATORS[(1)]

	2006	2007	2008	2009
Gross value added (EUR millions)	**172.7**	**174.4**	**178.1**	**168.0**
Share of gross value added in GDP (%)	3.4	3.2	3.1	2.9
Total employment	**11,212**	**11,660**	**11,931**	**12,595**
Private employment	8,168	8,571	8,764	8,757
Share of private sector in total construction employment (%)	72.9	73.5	73.5	69.5

(1) Employment data are averages for the first nine months of the year.

Source: NSO.

Table 3.6
PERMITS ISSUED FOR THE CONSTRUCTION OF DWELLING UNITS BY TYPE

	2006	2007	2008	2009
Flats	8,961	10,252	6,184	4,616
Maisonettes	932	696	361	400
Terraced houses	375	257	164	182
Other	141	138	127	100
Total	**10,409**	**11,343**	**6,836**	**5,298**

Source: MEPA.

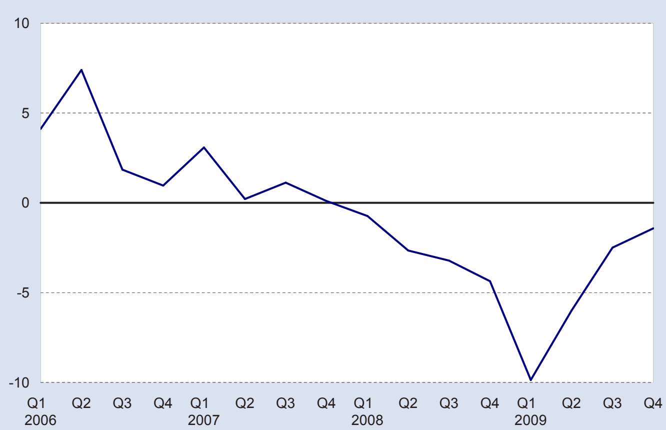
Average employment in the construction sector increased in the first nine months of the year compared to the corresponding period of 2008. However, this was almost entirely due to a reclassification involving the shift of a substantial number of public sector employees from the ‘agriculture, hunting & related services activities’ category to the construction category following changes to ministerial portfolios. Meanwhile, employment in private sector construction was virtually unchanged from a year earlier (see Table 3.5).

A key indicator of developments in the construction sector, the number of permits issued by MEPA, showed that for the second year running there was a significant reduction in the issue of such permits for dwellings. Overall, the number of permits dropped by 22.5% to 5,298, in line with the drop in prices for residential property experienced since 2008 (see Table 3.6). Permits for the largest category, apartments, fell by 25.4%. However, permits for the construction of maisonettes and terraced houses each increased by almost 11%, to 400 and 182, respectively.

Residential property prices[6]

The Bank’s index of advertised residential property prices registered a decline of 5.0% in 2009. While this contraction was more pronounced than the previous year’s decline of 2.7%, signs of a stabilisation in prices began to emerge towards the end of the year. Thus, after the index recorded a drop of 9.9% in the first quarter, the decline in property prices became less pronounced as the year progressed (see Chart 3.7).

Chart 3.7
RESIDENTIAL PROPERTY PRICES
(annual percentage change)



Source: Central Bank of Malta.

6 The Bank’s property price index is derived from advertised real estate prices, using observations collected on a monthly basis. The index is divided into eight categories: finished and unfinished flats, finished and unfinished maisonettes, terraced houses, town houses, houses of character and villas. The index is a Fisher chained index, which is the geometric mean of the chained Laspeyres and chained Paasche indices.

Disaggregated results show that the fall in asked prices was spread across six of the eight property categories contained in the index. Prices for flats, both finished and in shell form, which together made up 57% of the sampled properties, were down by 5.3% and 10.2%, respectively. Those for finished maisonettes and maisonettes in shell form, which accounted for 18% of the sample, dropped by 4.5% and 4.9%, respectively. Meanwhile, asked prices for houses of character and townhouses fell by 7.5% and 2.6%, respectively.

On the other hand, higher prices were being asked for the two remaining categories: terraced houses, whose prices rose by 3.2%, and villas, where the increase was only marginal. These two categories together represented 11% of the sample.

A further indicator of sluggish conditions in the housing market was the number of advertised properties, which dropped by 20.6% compared with 12.6% in 2008. This notwithstanding, data for the last two quarters of 2009 showed a moderation in the rate of decline of this indicator.

The labour market[7]

The labour market was characterized by weaker conditions during the first three quarters of 2009, in contrast to the corresponding period of the previous year. As a result, the unemployment rate rose more markedly while employment growth decelerated before turning slightly negative in the third quarter. The slowdown was attributable to a decline in public sector employment, as jobs in the private sector continued to increase.

Employment

Data based on the LFS point to a deterioration in labour demand in the first three quarters of 2009. The annual growth rate of employment decelerated progressively during the period, turning negative and reaching -0.2% in the third quarter. Over the first three quarters as a whole, it grew by an average rate of 0.9% on the same period of 2008.[8] With the number of unemployed persons rising substantially, the labour supply posted a larger gain of 1.8% (see Table 3.7).

According to the LFS, the deceleration in employment growth was entirely attributable to the public sector, where the workforce declined by 4.2%. In contrast, employment in the private sector rose by 3.1%, with both full-time and part-time work categories registering an increase. In fact, the number of full-time employees across the economy increased by 1.2%, while part-time employment was 1.4% higher.

Table 3.7
LABOUR MARKET INDICATORS BASED ON THE LABOUR FORCE SURVEY[(1)]
Persons, annual percentage changes

	2008 Jan.-Sep.	2009 Jan.-Sep.	Annual change %
Labour force	**170,471**	**173,505**	**1.8**
Unemployed	10,212	11,787	15.4
Employed	160,259	161,719	0.9
By type of employment:			
Full-time	141,787	143,496	1.2
Full-time with reduced hours	3,350	2,887	-13.8
Part-time	15,122	15,336	1.4
By ownership:			
Private	112,975	116,437	3.1
Public	47,284	45,281	-4.2

(1) Figures are based on averages for the first three quarters.

7 This section draws mainly on labour market statistics that are obtained from two sources. The LFS is a household survey conducted by the NSO on the basis of definitions set by the International Labour Organization and Eurostat, while the ETC's findings are computed from administrative records compiled according to definitions set by domestic legislation on employment and social security benefits.

8 An alternative statistical series, the seasonally-adjusted national accounts indicator of total employment, fell by 0.5% in the first three quarters of 2009, following an increase of 2.7% during the same period of 2008.

Nevertheless, reflecting faster growth in the working age population, the overall employment rate, which measures the proportion of the working-age population in employment, declined to 55.0%, from a high of 55.4% in 2008, while the participation rate remained virtually unchanged at 59.0%.

At the same time, data for the first nine months of the year based on the ETC's administrative records showed an overall contraction of 0.4% in full-time employment, reflecting developments in the public sector complement (see Table 3.8). In fact, the ETC's records reveal that, in line with government policy, the public sector complement contracted by an average rate of 3.1% compared with the corresponding period of 2008. The termination of employment of most employees at the government-owned Malta Shipyards accounted for around 85% of the drop.

Meanwhile, the rate of job creation in the private sector decelerated to 0.8% in the first nine months of 2009, compared with 3.9% in the previous year. Redundancies in hotels & restaurants contributed to a slowdown in the growth rate of employment in the services sector to 2.4%. Within the sector, the largest gains were recorded in 'other business activities', which include accountancy services and the provision of call-centre facilities. In contrast, employment in direct production was down by 857, mainly reflecting the continued slowdown in manufacturing activity. Jobs were shed mainly in the radio, TV & telecommunications and the rubber & plastic products sub-sectors.

The ETC's administrative records also show that, while full-time employment was down marginally, the part-time category continued to increase steadily. The latter rose by 4.6%, with more than half of the increase representing primary employment for the job holders.

Table 3.8
LABOUR MARKET INDICATORS BASED ON ADMINISTRATIVE RECORDS(1)
Persons, annual percentage changes

	2008 Jan.-Sep.	2009 Jan.-Sep.	Annual change %
Labour supply	**151,255**	**151,866**	**0.4**
Registered unemployed	**6,124**	**7,267**	**18.7**
Gainfully occupied	**145,132**	**144,598**	**-0.4**
Public sector	**41,889**	**40,573**	**-3.1**
Private sector	**102,493**	**103,320**	**0.8**
Private direct production(2)	**32,700**	**31,843**	**-2.6**
Manufacturing	21,281	20,450	-3.9
Construction	8,768	8,757	-0.1
Private market services	**69,793**	**71,477**	**2.4**
Wholesale & retail	21,774	22,044	1.2
Hotels & restaurants	10,033	9,697	-3.3
Transport, storage & communication	8,929	9,183	2.8
Financial intermediation	5,093	5,156	1.2
Real estate, renting & business activities	12,116	13,103	8.1
Other	11,848	12,294	3.8
Temporary employed	**749**	**705**	**-5.9**
Part-time employees	**46,985**	**49,144**	**4.6**
Part-time as a primary job	26,467	27,632	4.4
Part-time holding a full-time job	20,518	21,512	4.8

(1) Figures are based on averages for the first nine months.
(2) This also includes employment in agriculture, fishing, mining & quarrying and electricity, gas & water supply.
Source: NSO.

Unemployment

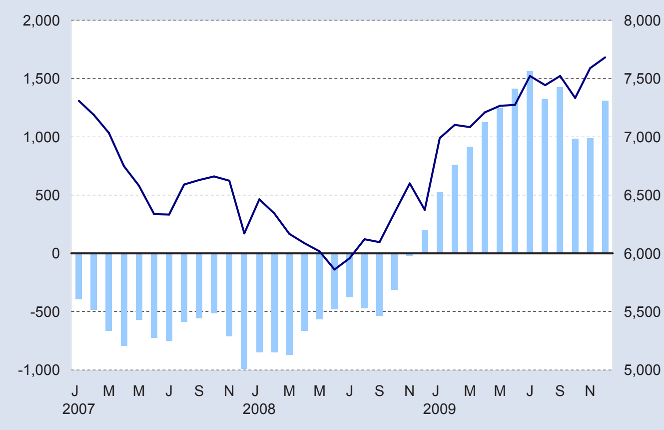
The LFS measure of the unemployment rate rose to an average of 6.8% in the nine months to September 2009, up from 6.0% in the comparable period of 2008. Meanwhile, the seasonally-adjusted unemployment rate based on Eurostat's estimates averaged 7.0% for the whole of 2009, 1.1 percentage points higher than in 2008 but still 2.4 points below the euro area average (see Chart 3.8).

Chart 3.8
UNEMPLOYMENT RATE
(seasonally adjusted, percent)

Source: Eurostat.

The upward trend in unemployment was also confirmed by ETC data. Thus, the rate of unemployment during the first nine months of 2009 averaged 4.8%, compared with 4.0% in the same period of 2008. The ETC's records show an almost uninterrupted increase in the number of registrants during the year (see Chart 3.9). On average these rose to 7,335 in 2009, an increase of 1,127 over the previous year.

Chart 3.9
REGISTERED UNEMPLOYED
(annual changes, persons)



Source: NSO (based on ETC records).

Service workers, clerks and those seeking elementary occupations accounted for more than half of the total number of job seekers in 2009, with the first two categories recording the largest increases in absolute terms during the year. With regard to the age distribution of the unemployed, there was a rise across all brackets, with the largest increase in the over-45 category, which accounted for 36% of job seekers during the year. In terms of duration of registration, there was an increase in short-term unemployment, with the number of persons registering for less than a year standing at around two-thirds of the total.

Consumer prices

HICP

The annual rate of HICP inflation followed a generally declining path during 2009, with the twelve-month moving average dropping to 1.8% from 4.7% in the previous year. The movement of the annual average inflation rate reflected trends in year-on-year inflation which, after peaking at 4.0% in April, eased gradually over the following five months, before turning negative in the fourth quarter (see Chart 3.10). Thus, year-on-year inflation stood at -0.4% in December, compared to 5.0% a year earlier.

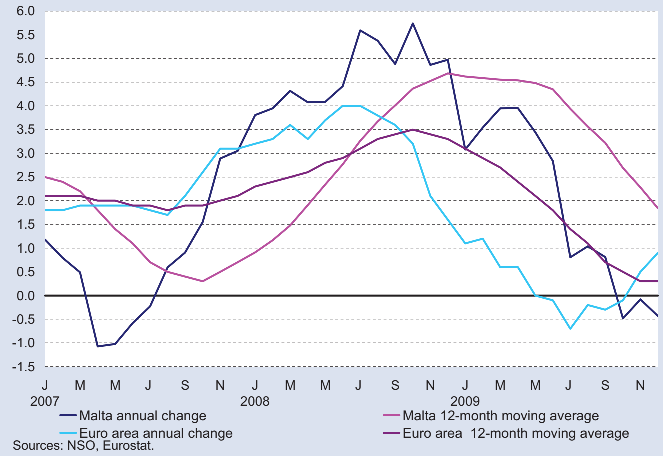
As in 2008, food prices played a significant role in the inflationary process during 2009, contributing 1.4 percentage points to the overall twelve-month moving average rate, whereas the contribution of energy prices was negative, at -0.1 percentage points, in contrast to the previous year, when it was substantially positive. Despite a deceleration during the second half of the year, the services component accounted for 0.7 percentage points for the year as a whole (see Chart 3.11).

The unprocessed and processed food components, which together account for 23.5% of the overall HICP index, rose at average annual rates of 8.8% and 4.1%, respectively, during 2009.[9] Within the unprocessed food component, fruit and vegetable prices registered a considerable increase, although these eased off by the end of the year. Meat and bread & cereals, which are included in the processed food component, also registered significant price increases (see Chart 3.12).

Meanwhile, the energy component of the index peaked in February but tapered off thereafter, ending the year 6.7% lower than a year earlier. This decline stemmed from a reduction in fuel prices, which were set at lower levels throughout the year, reflecting the decline in international oil prices. The drop in energy prices also resulted from base effects as utility prices had been increased substantially during the second half of 2008.

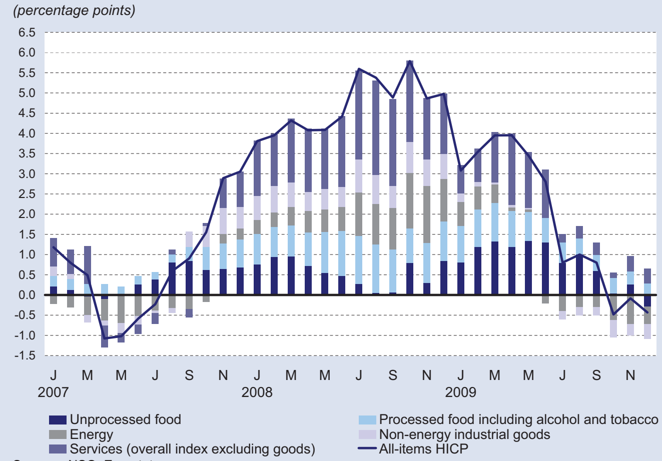
Services sector inflation contributed significantly to the overall rise in the index during the first six months of 2009 but eased during the second half of the year (see Chart 3.11). As a result, the average annual rate of increase in the prices of services dropped to 1.9%, from 4.4% a year earlier (see Chart 3.13). This mainly reflected a deceleration in the prices charged by hotels & restaurants and in those of services related to package holidays. To a large extent these developments reflected the slowdown in the tourism sector, which induced hotel companies to lower their room rates and airlines to reduce airfares.

Chart 3.10
HICP INFLATION RATES IN MALTA AND THE EURO AREA
(annual percentage changes; annual average percentage changes)



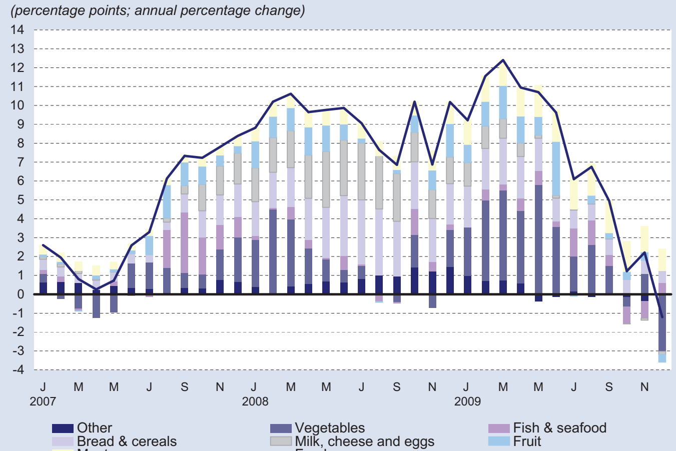
Sources: NSO, Eurostat.

Chart 3.11
CONTRIBUTIONS TO YEAR-ON-YEAR HICP INFLATION
(percentage points)



Sources: NSO, Eurostat.

Chart 3.12
CONTRIBUTIONS TO YEAR-ON-YEAR CHANGES IN FOOD PRICES [(1)]
(percentage points; annual percentage change)



(1) Excluding beverages and tobacco.
Sources: NSO, Eurostat.

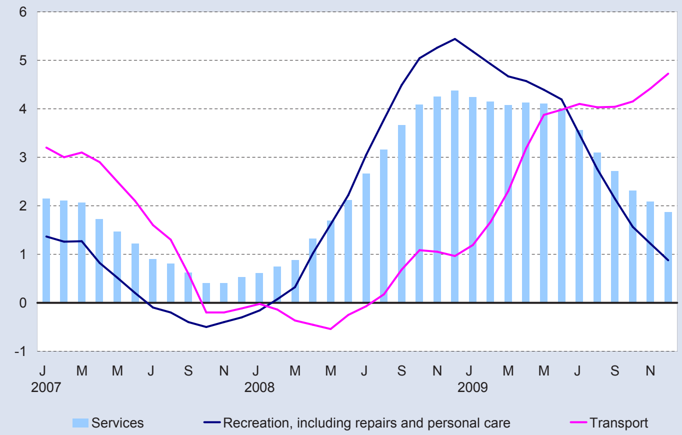
9 The processed food category includes alcohol and tobacco.

For most of the year HICP inflation in Malta exceeded that in the euro area, but the sharp deceleration in prices in the final quarter of the year pushed Malta's inflation rate below that of the euro area. The divergence between price movements in Malta and the euro area was most noticeable in the food component, as domestic food prices rose rapidly in the early months of 2009. Thereafter food prices declined substantially, reaching full convergence with the euro area at the end of the year. Meanwhile, even though energy prices in Malta were determined by the authorities after taking into consideration international oil price developments, energy-related inflation tended to follow that in the euro area with a lag (see Chart 3.14).

RPI and core inflation

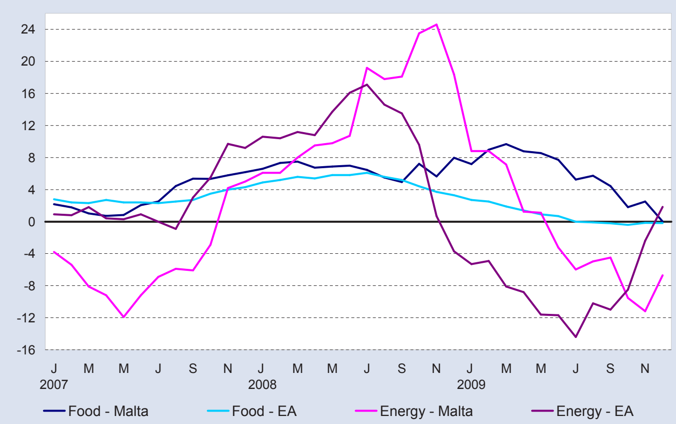
The path followed by RPI inflation generally mirrored that of the HICP.[10] Thus, the twelve-month moving average inflation rate of the RPI dropped from 4.3% in 2008 to 2.1% during the year under review, while the year-on-year rate fell to -0.7% in December (see Table 3.9 and Chart 3.15). Food and energy prices remained the main drivers of RPI inflation, contributing 1.6 and 0.6 points, respectively, to

Chart 3.13
INFLATION IN SERVICES
(annual average percentage changes)



Sources: NSO, Eurostat.

Chart 3.14
FOOD AND ENERGY PRICE INFLATION IN MALTA AND THE EURO AREA
(annual percentage changes)



Sources: NSO, Eurostat.

Table 3.9
CONTRIBUTIONS TO RPI INFLATION
Percentage points

	Weights	2007	2008	2009
Food	23.82	1.0	1.9	1.6
Beverages & tobacco	6.11	0.1	0.2	0.3
Clothing & footwear	8.24	0.0	0.3	0.0
Housing	7.57	0.2	0.3	0.2
Water, electricity, gas & fuels	2.25	-0.2	0.6	0.6
Household equipment & house maintenance costs	7.65	0.0	0.0	0.0
Transport & communications	23.13	-0.3	0.6	-0.9
Personal care & health	6.22	0.1	0.1	0.2
Recreation & culture	8.84	0.1	0.1	0.1
Other goods & services	6.17	0.0	0.2	0.1
RPI	**100.00**	**1.3**	**4.3**	**2.1**

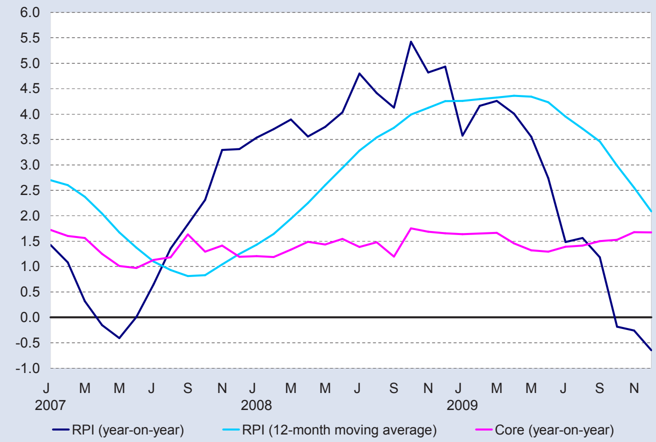
Source: NSO.

[10] RPI inflation rates are similar to concurrent HICP rates, except for differences resulting from the composition of the two indices. Unlike the HICP, the RPI excludes hotel accommodation prices and allocates a larger weight to the food component.

the annual average inflation rate. On the other hand, the transport & communications category, which includes fuel, made a negative contribution of -0.9 percentage points during 2009.[11]

The divergence in inflationary trends as recorded by the two indices was mainly due to movements in hotel accommodation prices, which are not included in the RPI. Thus, during the first half of the year the RPI inflation rate was below the concurrent HICP rate, as room rates in hotels tended to rise. In the latter part of the year, however, the trends were reversed in response to a fall in hotel accommodation prices.

Chart 3.15
RPI AND CORE INFLATION
(annual percentage changes; annual average percentage changes)



Sources: Central Bank of Malta estimates, NSO.

During 2009, the core inflation rate remained relatively stable, ending the year at 1.7%, unchanged from the previous year's level.[12] The largest contributor to core inflation in 2009 was the personal care & health category, which accounted for 0.6 percentage points of the change in the core index.

Costs and competitiveness

Labour costs

Indicators of wage developments point towards an easing of wage pressures during 2009, reflecting slack conditions in the labour market.

Central Bank of Malta estimates based on collective agreements point to a decline in wage growth to 3.8% from a peak of 4.7% in 2008.[13] Despite the overall slowdown, wages in the public sector rose sharply, by 7.2%, from 5.0% in 2008. This partly reflected the outcome of wage negotiations with the University's academic staff and the back-loaded nature of wage increases negotiated for civil service employees under a collective agreement covering a six-year period, from 2005 to 2010. As a result, the average negotiated wage

Table 3.10
ESTIMATED CHANGE IN AVERAGE NEGOTIATED WAGES (1)
Annual percentage changes

	2006	2007	2008	2009
Private sector	4.1	4.1	4.6	2.7
Public sector	2.4	3.6	5.0	7.2
Overall	3.6	4.0	4.7	3.8

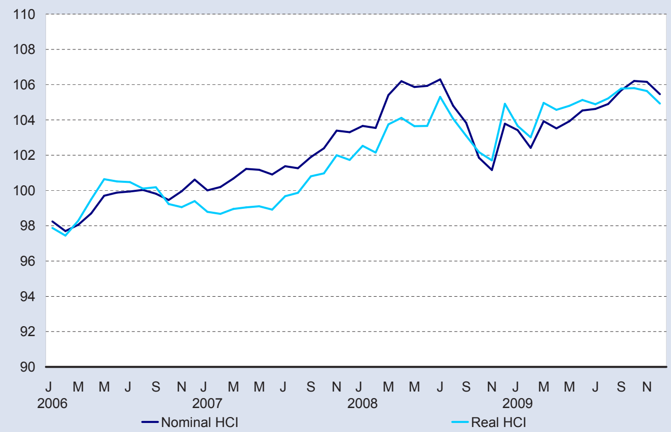
(1) The average wage is computed as a weighted mean of the minimum average wage and the maximum average wage.
Sources: Central Bank of Malta; Department of Employment & Industrial Relations; MFEI.

11 In the RPI, fuel prices are included in the transport and communications category, while in the HICP they are included in the energy component.
12 The core inflation rate, as measured by the Bank, excludes one-off fluctuations and reflects developments only in those sub-indices of the RPI that show persistent price increases. These are the housing, the durable household goods, the personal care & health, the transport & communications and the clothing & footwear sub-indices.
13 These figures include only unionised employees covered by collective agreements. Since such employment constitutes just under half of the gainfully occupied population, these estimates may not be representative of developments in the overall economy. Wage estimates incorporate cost-of-living adjustments but exclude overtime pay, production bonuses and all other allowances and income in kind.

in the public sector surpassed that of the private sector, which eased to 2.7% in 2009 from 4.6% in 2008.

Other measures of labour remuneration also confirm a moderate trend in wage setting. An indicator based on national accounts data shows that growth in overall compensation per employee slowed down considerably to 1.3% in 2009, from 3.8% in 2008.[14] Meanwhile data on gross annual salaries obtained from the LFS show a similar trend. Thus, according to the LFS, growth in average wages and salaries for the first nine months of 2009 slowed down sharply, to 2.2%, from 4.8% in the corresponding period of 2008.

Chart 3.16
HARMONISED COMPETITIVENESS INDICATORS
(May 2005 = 100)



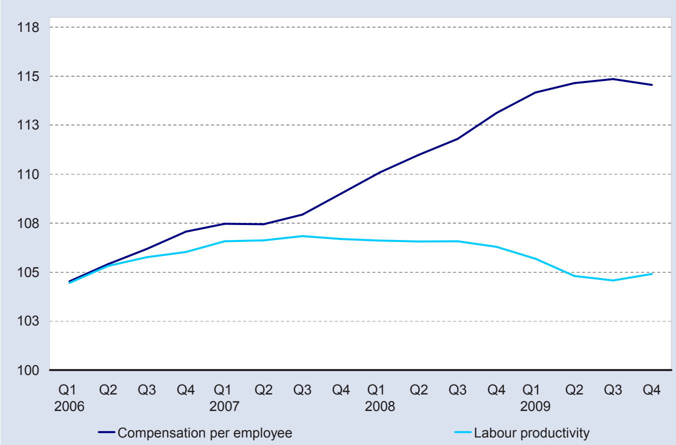
Source: ECB.

External competitiveness

Two key indicators of external competitiveness are the harmonised competitiveness indicator (HCI) and unit labour costs (ULC).

Malta's nominal and real HCI exhibited considerable fluctuations during 2009, mainly on account of exchange rate volatility.[15] However, a reduction in competitiveness was evident during the first three quarters in the generally upward path followed by both the real and the nominal index. These reflected the appreciation of the euro, while Malta's relatively high rate of inflation accounted for the gap between the two indices (see Chart 3.16). However, in the final quarter of the year the trends were reversed in line with the depreciation of the euro. Thus, the real index fell at a faster rate than the nominal index, as Malta's inflation rate fell below that of its trading partners. The nominal index ended the year up by 1.6%, while the real index eased down to the same level as a year earlier.

Chart 3.17
EMPLOYEE COMPENSATION AND PRODUCTIVITY IN MALTA
(four-quarter moving sum indices; 2003 Q4 = 100)



Source: ECB.

Data published by the ECB show that Malta's ULC rose at an annual rate of 2.6% in 2009, when compared to 4.2% in 2008, as the gap between the paths followed by its two components, compensation per employee and labour productivity, narrowed slightly (see Chart 3.17). Despite a 1.3% drop in productivity, employee

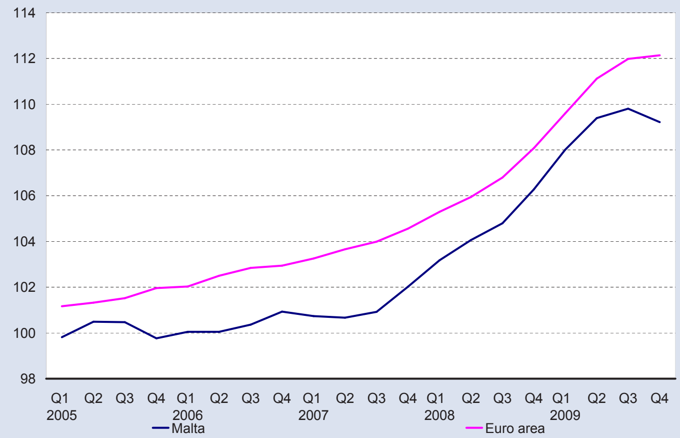
[14] Compensation of employees includes overtime payments.

[15] A higher (lower) score in the HCI indicates a deterioration (improvement) in a country's international competitiveness. The nominal HCI tracks movements in the country's exchange rate against the currencies of its main trading partners, while the real HCI incorporates both exchange rate changes and the relative inflation of a country vis-à-vis its main trading partners. In the computation of the indices, exchange rate and price changes are weighted according to the direction of trade in manufactured goods only. Therefore the HCI should only be considered as a partial measure of Malta's international competitiveness. Changes in the HCI have to be interpreted with caution, as the index is subject to considerable month-to-month fluctuations

compensation grew at a positive rate of 1.3%. This decline in productivity appeared to be due to the contraction in economic activity.

The rise in Malta's ULC observed during 2009 was below that observed in the euro area, where an annual increase of 3.9% was registered in the index (see Chart 3.18). This reflected an increase in compensation of 1.5%, and a drop in productivity of 2.3%.

Chart 3.18
UNIT LABOUR COSTS IN MALTA AND IN THE EURO AREA
(four-quarter moving sum indices; 2003 Q4 = 100)



Source: ECB.

Economic projections for 2010 and 2011

While projections for the Maltese economy are inherently subject to uncertainty due to its small size and wide exposure to international markets, the Bank's forecasts for this year and the next are surrounded by an unusually high degree of uncertainty associated with the ongoing global economic and financial crisis and the still fragile recovery in Malta's major trading partners.

Assumptions

In preparing these forecasts, the following assumptions have been made about key international indicators such as exchange rates, oil prices, interest rate spreads and external demand conditions:

- The exchange rates of the US dollar and the pound sterling against the euro are assumed to remain constant at their mid-February 2010 levels of 1.378 and 0.875, respectively, throughout the forecast horizon.
- The average price of oil is expected to rise from about $62 per barrel in 2009 to $75 in 2010 and to just under $80 in 2011.
- Interest rate spreads between long-term bonds in Malta and the euro area are assumed to remain constant throughout the two-year period.
- Demand conditions in Malta's main trading partners are expected to improve somewhat in 2010. Thus, it is assumed that the larger euro area countries, as well as the United Kingdom and the United States, will experience a strong rebound, albeit from low levels, in their external trade, although the recovery in consumption is assumed to be more gradual. In 2011 economic growth in these countries is expected to gain more traction, although private consumption is likely to remain less buoyant than in pre-crisis years, while exports and imports are expected to slow down from rapid growth in 2010, partly reflecting base effects.
- Consumer price inflation in Malta's main trading partner countries is expected to pick up in 2010 and 2011, although it will still remain low by historical standards.
- Export prices of Malta's main trading partners are expected to follow a similar path to consumer prices as global trade is thought to remain below pre-crisis levels throughout the forecast horizon.
- Domestic inventory levels are expected to contribute positively to economic growth both in 2010 and, to a lesser extent, in 2011, following the strong inventory depletion recorded in 2009.

Economic growth

After the contraction of just under 2% in 2009, the Maltese economy is seen to recover gradually over the two-year forecast horizon, although output is expected to remain below its potential. GDP growth is projected at a modest 1.2% in 2010 before picking up to 1.8% in 2011.

Table 3.11
PROJECTIONS OF THE MAIN MACROECONOMIC AGGREGATES FOR MALTA[1]

	2009	2010[2]	2011[2]
Real economic activity (% change)			
GDP	(1.9)	1.2	1.8
Private consumption expenditure	1.2	1.2	1.8
Government consumption expenditure	(1.9)	(2.2)	1.0
Gross fixed capital formation	(19.3)	6.8	3.7
Inventories (% of GDP)	(2.5)	(0.7)	(0.5)
Exports of goods & services	(3.1)	4.6	4.0
Imports of goods & services	(8.7)	5.3	4.2
Contribution to real GDP growth (in percentage pts)			
Domestic demand	(2.6)	1.3	1.9
Net exports	5.2	(0.5)	(0.2)
Inventories	(4.5)	0.4	0.1
Balance of payments (% of GDP)			
Goods and services balance	2.6	(0.1)	(0.6)
Current account balance[2]	(3.7)	(2.4)	(3.1)
Labour market (% change)			
Total employment	(0.6)	0.3	0.6
Unemployment rate (% of labour supply)	7.0	7.2	7.1
Prices and costs (% change)			
Overall HICP	1.8	1.6	2.0
HICP excluding energy	2.1	1.0	1.9
RPI	2.1	1.8	1.8
Compensation per employee	1.3	2.2	2.4
ULC	2.6	1.2	1.1
Public finances (% of GDP)			
General government balance[2]	(3.8)	(4.0)	(4.0)
Government debt[2]	67.4	69.3	70.9
Technical assumptions			
EUR/USD exchange rate	1.394	1.382	1.378
Oil price (USD per barrel)	61.9	75.1	79.8
10-year euro area bond yield	4.03	4.00	4.45

(1) Brackets around figures denote a negative sign.
(2) Central Bank of Malta projections.

The recovery in 2010 is expected to be driven mainly by domestic demand, with net exports contributing negatively on account of the stronger increase in imports as domestic demand picks up.

Nevertheless, exports are projected to grow by 4.6% in 2010, mainly driven by manufactured goods, reflecting the recovery in external demand and, to a lesser extent, the overall positive impact of a lower euro on exports of both goods and services. This notwithstanding, tourism is expected to recover more gradually, as private consumption in Malta's major source markets, in particular the UK and Germany, is likely to remain sluggish. Other export-oriented services, such as business and financial services, which had grown rapidly in the pre-crisis years but slowed down in 2009, are also expected to recover gradually over the forecast horizon.

As stated above, imports are expected to rebound strongly in 2010, rising by 5.3%. This will reflect the recovery in demand for imported inputs as the volume of exports expands; higher household consumption; and increased investment by both the private and the public sectors. In contrast, in 2011 the growth of both imports and exports is projected to slow down to around 4%, mirroring less rapid expansion in foreign demand.

The rebound in domestic demand in 2010 mainly reflects GFCF, which is projected to grow by 6.8% after declining sharply in the previous two years. Investment by the Government, in particular, is projected to rise strongly from the low level of the previous year. Private investment is also expected to recover, reflecting increased outlays on both machinery and equipment and construction, as the larger construction companies are involved in major infrastructure works, such as the Smart City project. Expenditure on the construction of dwellings, however, which had declined sharply during the previous two years, is not expected to recover in 2010.

In 2011 growth in GFCF is expected to decelerate, mainly because the pace of public sector investment spending slows significantly compared with the exceptionally rapid pace forecast for 2010. Investment by private corporations is also expected to fall back from the high levels of 2010, although house building is expected to pick up.

During the forecast horizon, private consumption is expected to recover modestly. This will be largely underpinned by higher real disposable income, as household net earnings from financial investment activity improve in response to the recovery in financial markets and portfolio shifts from low-yielding bank deposits into bonds. Nevertheless, this may be offset to some extent by weaker growth in wage income, reflecting an anticipated rise in unemployment. In fact, the uncertain labour market conditions and their implications for job security, coupled with the negative wealth effects of a weak housing market, are factors that may give rise to higher precautionary saving, slowing down the pace of recovery in private consumption.

As regards public consumption, this is projected to decline by 2.2% in 2010, following the winding down of activity at the shipyards and a one-off expenditure in the health sector in 2009. In 2011 public consumption is expected to grow once again, but only by a modest 1.0%, as the Government tightens its control of key expenditure items in order to narrow the fiscal deficit in line with the targets of its Stability Programme 2009-2012.

External account

The downturn in economic activity during 2009 brought with it a significant correction in the goods and services account of the balance of payments. In nominal terms, the deficit in the goods and services account of 3.2% of GDP in 2008 was reversed, resulting in a surplus of 2.6% of GDP. In 2010, however, due to the recovery in economic activity, especially in GFCF, imports are projected to rise substantially, thus contributing to a marginal negative balance of 0.1% of GDP. In 2011 the goods and services deficit is expected to widen to 0.6% of GDP as a result of the pick-up in private consumption. Another factor contributing to this result is an expected slight deterioration in the terms of trade, as growth in domestic export prices is expected to trail that of import prices.

Employment/unemployment

The decline in economic activity in 2009 brought with it a fall in employment levels and higher unemployment. The recovery projected for 2010 is expected to yield a modest rise in employment that will be smaller than the expected increase in the labour supply. The unemployment rate is, therefore, projected to rise further to an average of 7.2%. The outlook for employment is seen to improve further in 2011, with unemployment easing slightly to 7.1%. Thus, during the forecast horizon, slack in the labour market is expected to persist, with unemployment remaining at relatively high levels because of spare capacity, as indicated by a negative, if narrowing, output gap.

Inflation

After falling to 1.8% in 2009, HICP inflation is projected to remain at a relatively low level, easing further to 1.6% in 2010, as smaller increases in food and service prices are expected to more than offset a more marked rise in the prices of industrial goods and energy. In 2011 inflation is forecast to rise to 2.0%, as the recovery in economic activity gains momentum. Apart from energy, all the major components of the HICP are expected to register an increase, particularly unprocessed food and services.

ULC

After recording relatively high growth rates of over 4% in 2008 and 2.6% in 2009, ULC are expected to decelerate over the forecast period, growing by 1.2% in 2010 and 1.1% in 2011. Subdued labour demand is expected to be the main factor, especially in the private sector, as compensation per employee, which rose by 1.3% in 2009, is forecast to increase by a slightly higher rate of 2.2% in 2010, largely reflecting the cost-of-living adjustment. In 2011 compensation per employee is expected to maintain an upward trend, rising by 2.4%. At the same time, the recovery in output throughout the forecast horizon, coupled with low growth in employment, should boost productivity. The latter, after falling in 2008 and 2009, is anticipated to rise by 0.9% in 2010 and by a further 1.2% in 2011.

Public finance[16]

The general government deficit is projected to remain at 4.0% of GDP in 2010, slightly higher than the Government's corresponding budget forecast. On the basis of the current economic outlook, and in the absence, at this stage, of information about specific fiscal measures planned for 2011, the Bank is projecting an unchanged deficit-to-GDP ratio for that year.

As regards revenue trends, ordinary revenue in 2010 is projected to grow at roughly the same pace as in the previous year, before picking up in 2011 in line with the recovery in economic activity. Meanwhile, capital expenditure is projected to rise steeply in 2010, reflecting base effects, as public sector investment fell sharply in 2009. In 2011 it is expected to decelerate somewhat. The increase in capital expenditure over the forecast horizon should have only a minor impact on the deficit, since most major projects will be largely financed by EU funds. With regard to recurrent expenditure, this is expected to resume growing in 2010 and to expand in line with nominal GDP in 2011. Higher debt servicing costs, and a gradual pickup – albeit from a low growth rate – in the public sector wage bill, are expected to be the main factors underpinning this expansion.

The projected deficits are expected to be financed by new borrowing. Hence, the public debt-to-GDP ratio is anticipated to rise from 67.4% in 2009 to 70.9% by 2011.

Risks to the projections

As mentioned above, these projections are characterised by a higher-than-usual degree of uncertainty. Nevertheless, risks to economic growth in 2010 and 2011 appear to be evenly balanced. On the one hand, there are upside risks stemming from a possible quicker-than-expected recovery in world trade that could boost activity in Malta's trading partners and hence increase domestic exports to a greater extent than anticipated. A further depreciation of the euro would also benefit competitiveness in Malta's export markets outside the euro area, which are quite significant in view of the large domestic semiconductor industry and the importance of the UK market for Malta's tourism industry. On the other hand, these positive aspects may be offset by downside risks stemming from the ongoing fragility in financial markets overseas and the need for fiscal consolidation in the advanced economies, which could weaken consumer spending, with negative consequences for external demand. Further downside risks arise from possible increases in international commodity prices, especially in 2010. This could affect consumer confidence in Malta and have a dampening impact on household expenditure.

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[16] The Bank's fiscal projections deviate from the Government's forecasts for two main reasons. First, there are differences between the underlying macroeconomic projections on which the fiscal forecasts are based. Second, the Bank's projections include its own assessment regarding revenue and expenditure developments in the light of policy measures announced by the Government. More specifically, the Bank's projections can only include measures that are well-specified and that are likely to be implemented.

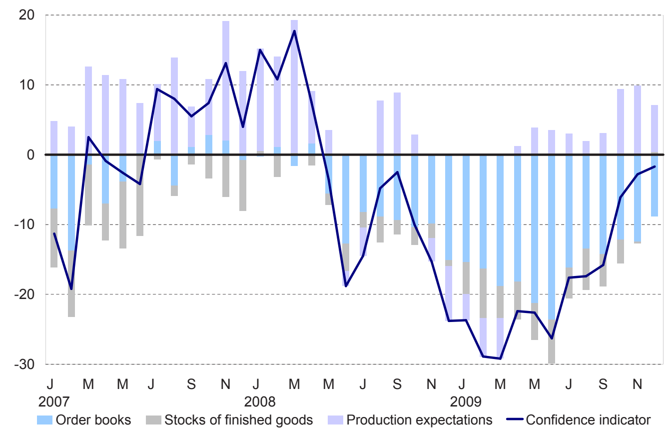
As regards inflation, risks during the forecast horizon seem to be tilted towards the upside. These mainly stem from the probable increase in international energy and food commodity prices and their effects on domestic prices. On the other hand, a downside risk for inflation is related to movements in hotel accommodation prices, which have a significant weight in the HICP. These may be subject to further downward pressure due to strong competition for Malta's tourist industry from other Mediterranean destinations and overall sluggish external demand.

BOX 1: BUSINESS AND CONSUMER SURVEYS

Industrial confidence surveys[1]

Surveys conducted in Malta for the European Commission indicate that sentiment in the manufacturing sector was significantly negative during the first half of 2009 but improved almost uninterruptedly thereafter, with all three components of the index – production expectations, order book levels, and stocks of finished goods – showing a net improvement (see Chart 1). In fact, the seasonally-adjusted confidence indicator added 22 percentage points in the course of the year, rising to a level of -2 in December. This was mainly attributable to positive production expectations, which, after fluctuating in a negative range during the first quarter moved into positive territory in April and remained there for the rest of the year. Meanwhile, order book levels continued to decline during the first six months of the year, bottoming at -71 in June before recovering to end December at -26. Similarly, there was an accumulation of stocks of finished goods in the first ten months of the year, but these fell to acceptable levels by November.

Chart 1
INDUSTRIAL CONFIDENCE INDICATOR
(seasonally adjusted, percentage points)

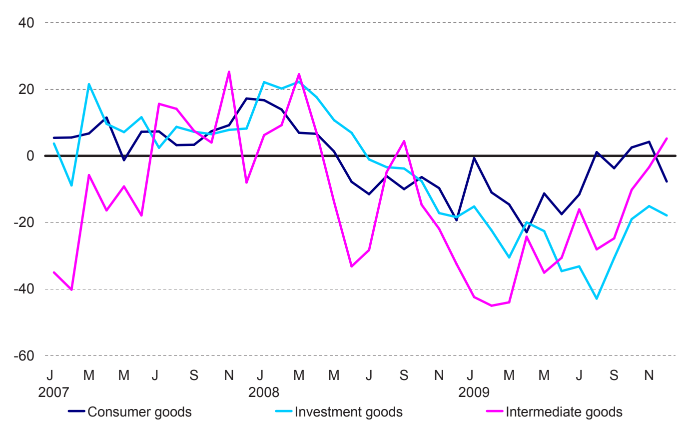


Source: European Commission.

Supplementary indicators, however, showed that employment growth expectations remained negative throughout the year, while respondents anticipated further downward pressure on selling prices, particularly during the first nine months of the year. Respondents also pointed to weak demand as the main factor limiting production.

A breakdown by main industrial groupings, presented in Chart 2, shows that on a net basis confidence among manufacturers of consumer goods and intermediate goods improved over the year, mainly because of more optimistic production expectations across the two sectors. In fact, the sentiment indicator for producers of consumer goods gained 11 percentage points over the year, while that of intermediate goods producers broke into positive territory in December.

Chart 2
CONFIDENCE INDICATORS BY MAIN INDUSTRIAL GROUPINGS
(seasonally adjusted, percentage points)



Source: European Commission.

In the first nine months of the year, producers in the investment goods sector expressed caution, particularly with regard to order book levels,

[1] The industrial confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to the subset of survey questions, namely those relating to expectations about production over the subsequent 3 months, current order book levels, and stocks of finished goods.

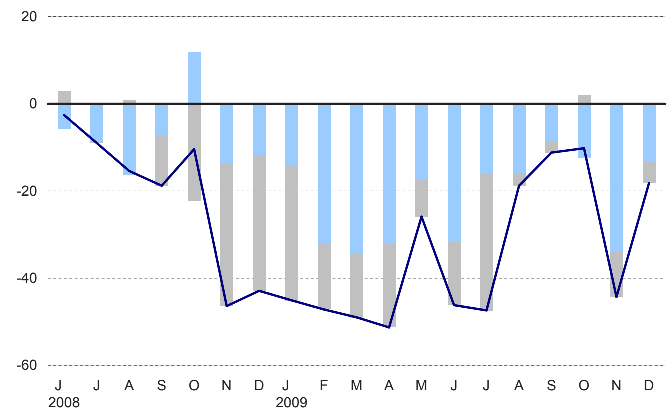
but sentiment became more optimistic in the final quarter, reflecting improved production expectations. This notwithstanding, manufacturers in this sector were the most pessimistic, especially in the latter half of 2009.

Further sectoral information shows improved confidence among manufacturers of semiconductors, with a significant improvement in production expectations, higher order book levels and a run down of stocks. More optimistic sentiment was also recorded in the pharmaceuticals sector and among manufacturers of metal products.

Construction industry confidence surveys[2]

Meanwhile, sentiment among construction firms was rather volatile during 2009, partly because of the relatively small number of respondents participating in the survey. However, sentiment in the industry generally improved in the course of the year, although down swings were registered in June, July and November (see Chart 3). In fact, seasonally-unadjusted survey results showed a significant improvement in sentiment over the year as a whole, with a net gain of 25 points, mainly reflecting better expectations about employment growth. On average, operators in the industry pointed to weak demand as the main factor inhibiting building activity.

Chart 3
CONSTRUCTION CONFIDENCE INDICATOR
(non-seasonally adjusted, percentage points)



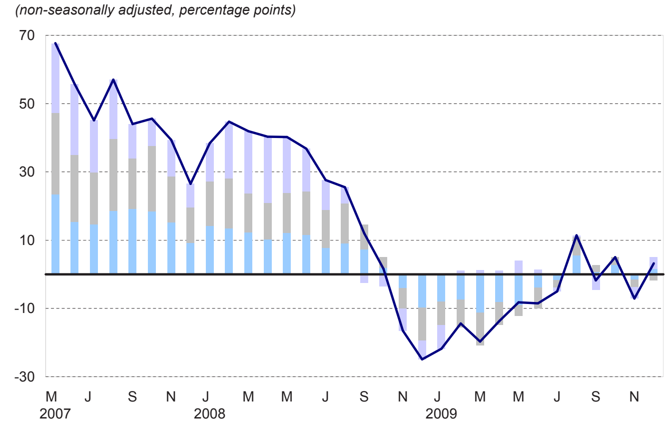
Source: European Commission.

Services confidence surveys[3]

Within the services sector sentiment improved throughout the first half of the year, reversing part of the deterioration observed in 2008. However, in the last six months of the year business confidence fluctuated around zero (see Chart 4). The seasonally-unadjusted indicator showed a net addition of 28 percentage points over the twelve months to December, ending the year in positive territory. For the year as a whole, however, the average value of the confidence indicator for service providers was below the 2008 level.

The rebound in the services confidence indicator during 2009 reflected optimism with regard to the business situation and improved expectations regarding demand in the following quarter. Perceptions regarding the evolution of demand in the previous

Chart 4
SERVICES CONFIDENCE INDICATOR
(non-seasonally adjusted, percentage points)



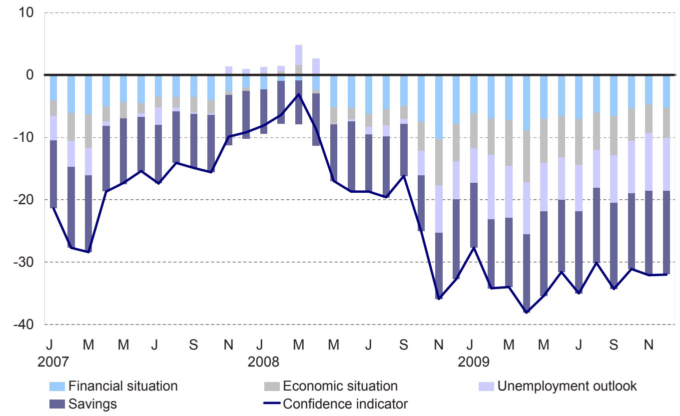
Source: European Commission.

[2] The construction confidence indicator is the arithmetic average of the balances (in percentage points) of the replies to the subset of survey questions, namely those relating to order books and employment expectations over the subsequent 3 months. The overall indicator is not seasonally adjusted.

[3] The services confidence indicator is the arithmetic average of the balances (in percentage points) of the replies to the subset of survey questions, namely those relating to the business climate and the recent and expected evolution of demand. The indicator is non-seasonally adjusted.

three months also improved when compared to December 2008, but remained negative. However, supplementary information provided by respondents showed that there was increased pessimism with respect to employment expectations, while financial considerations and, to a lesser extent, insufficient demand were indicated as the main factors limiting business expansion.

Chart 5
CONSUMER CONFIDENCE INDICATOR
(seasonally adjusted, percentage points)



Source: European Commission.

A more detailed sectoral breakdown shows that, on average, the tourism industry and "other services" remained pessimistic about business prospects throughout the year, while the financial intermediation sector continued to be generally optimistic. Meanwhile, firms in the real estate sector, while expressing concern about the business outlook at the beginning of the year, reported improving sentiment as the year progressed.

Consumer confidence surveys[4]

Survey results show that, after deteriorating in 2008, consumer sentiment stabilized during 2009, albeit at a very negative level (see Chart 5).

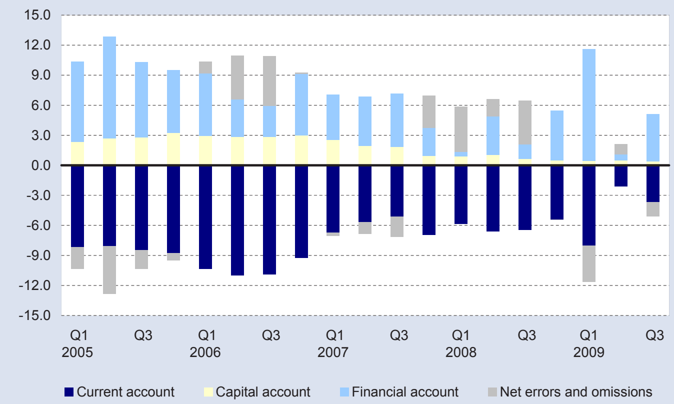
Consumers expected an amelioration of their own financial situation over the subsequent twelve months, but on balance replies remained negative throughout the year. Consumers also expressed a greater degree of concern, relative to a year earlier, about their ability to save over the next twelve months and opportunities in the labour market. Furthermore, their perception of the general economy in the following twelve months became more pessimistic during the first three quarters of the year, before improving slightly in the last quarter. Supplementary indicators show that respondents' spending intentions with regard to major purchases, such as new cars and homes, were on average marginally higher than in the previous year.

[4] The consumer confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of the replies to the subset of survey questions, namely those relating to households' financial situation, including saving, the general economic situation, and unemployment expectations for the subsequent 12 months.

4. BALANCE OF PAYMENTS

Over the year to September 2009 the deficit on the current account of the balance of payments narrowed to 3.7% of GDP, down from 6.4% of GDP in the previous twelve-month period (see Chart 4.1). This improvement was propelled by a sizeable contraction in the visible trade gap, which offset higher net outflows on the income account and a drop on the surplus on services.

Chart 4.1
COMPOSITION OF BALANCE OF PAYMENTS
(four-quarter moving sums as a percentage of GDP)



Source: NSO.

Meanwhile, net inflows on the capital and financial account stood at 5.1% of GDP, up by three percentage points compared to the same period in 2008. This increase was entirely attributable to higher net inflows on the financial account, since the surplus on the capital account declined. On a four-quarter cumulative basis, negative net errors and omissions were recorded.

The current account

Current account developments during the first three quarters of 2009 displayed similar patterns to those outlined for the twelve-month period to September. Thus, during the January-September period, the current account deficit contracted markedly, falling to EUR33.0 million, from EUR131.7 million in the comparable period of 2008 (see Table 4.1). This reflected a substantial narrowing of the merchandise trade gap, which outweighed increased net outflows on the income component and a smaller surplus on services.

Table 4.1
BALANCE OF PAYMENTS
EUR millions

	2006	2007	2008	2008 Q1-Q3	2009 Q1-Q3
Current account	**-472.0**	**-379.2**	**-309.1**	**-131.7**	**-33.0**
Goods	-966.2	-981.4	-1,139.2	-916.0	-647.0
Services	713.1	827.0	965.1	816.4	763.1
Transport	79.5	89.7	136.6	112.7	115.8
Travel	354.1	392.4	349.4	335.3	271.7
Other services	279.4	344.9	479.2	368.4	375.6
Income	-212.5	-168.9	-168.3	-143.4	-258.4
Current transfers	-6.4	-55.8	33.3	111.3	109.4
Capital and financial account	**466.3**	**203.0**	**309.4**	**64.7**	**46.4**
Capital account	153.1	51.4	27.6	17.6	13.1
Financial account	313.2	151.6	281.9	47.1	33.2
Errors and omissions	5.7	176.2	-0.4	67.1	-13.4

Source: NSO.

Merchandise trade

On the basis of balance of payments data, merchandise trade flows declined considerably during the first nine months of 2009.[1] This contraction reflected the global economic downturn and its impact on world trade. As a result, exports of electronics were hit significantly, leading to a concomitant reduction in imports of industrial supplies. At the same time, owing to the drop in international oil prices, the fuel bill fell considerably. Overall, since the fall in imports during the period outweighed the drop in exports, the merchandise trade gap narrowed by EUR269.0 million, or 29.4%, to EUR647.0 million.

Chart 4.2
GOODS BALANCE
(four-quarter moving sums in EUR millions)

Source: NSO.

As a result, on a four-quarter moving sum basis the visible trade gap also contracted (see Chart 4.2). In fact, after having peaked during the four quarters ending in September 2008, the goods deficit declined steadily thereafter, so that by September 2009 it was 27.2% below its level a year earlier. This was due to a drop of EUR802.5 million in imports as against a EUR478.0 million fall in exports.

Meanwhile, Customs data for the entire year reveal that the merchandise trade deficit fell by 16.9% in 2009, as against an increase of 6.0% in the previous year. The narrowing of the trade gap reflected a marked decline in imports across a wide range of commodities that exceeded the contraction in exports (see Table 4.2).

During 2009 the value of imported goods was down by EUR663.7 million, or 19.3%, compared with the previous year. This was attributable to significantly lower purchases of industrial supplies, fuels and, to a lesser extent, consumer goods. The first declined by 27.2% as a result of lower imports of electrical machinery, particularly electronic components, which constitute the bulk of the category. In addition, the fuel import bill

Table 4.2
MERCHANDISE TRADE
EUR millions; annual percentage changes

	2007	2008	2009(1)	2008	2009
Imports	**3,580.5**	**3,431.6**	**2,767.9**	**-4.2**	**-19.3**
Industrial supplies	1,610.6	1,428.7	1,040.2	-11.3	-27.2
Capital goods & others	636.3	494.3	573.6	-22.3	16.0
Consumer goods	915.8	948.9	849.5	3.6	-10.5
Fuel & lubricants	417.8	559.7	304.6	34.0	-45.6
Exports	**2,287.5**	**2,061.3**	**1,628.5**	**-9.9**	**-21.0**
Trade deficit	**-1,293.0**	**-1,370.3**	**-1,139.4**	**6.0**	**-16.9**

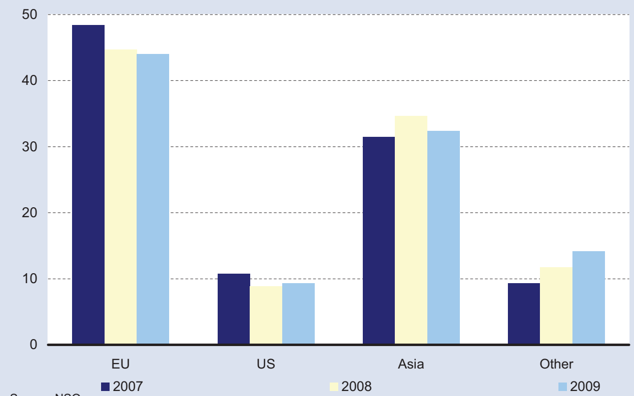
(1) Provisional
Source: NSO.

[1] Data on trade in goods reported in the balance of payments statistics are compiled by adjusting Customs data on merchandise trade for coverage, valuation and timing. In particular, during the period reviewed, the Customs data showed significant imports of aircraft, which were not recorded in the balance of payments statistics since no transfer of ownership was involved.

was down by 45.6%, mainly reflecting the fall in international oil prices, while imports of durable consumer goods were down by 10.5% from the year-ago level. In contrast, imports of capital goods rose by 16.0% compared to 2008, mostly on account of imports of aircraft and the purchase of machinery and equipment by the maritime transport sector.

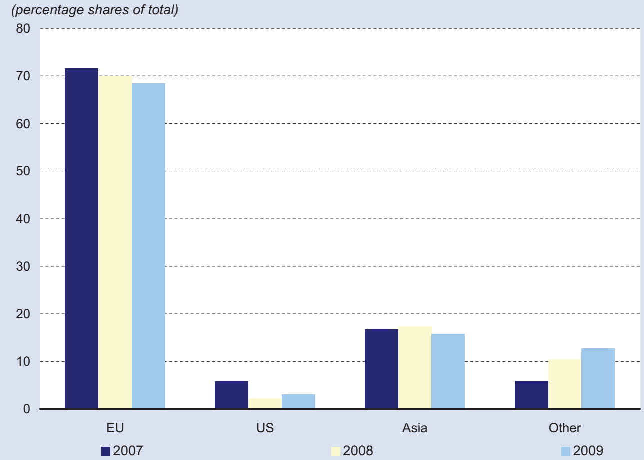
Concurrently, the value of exports of electronic goods declined by EUR235.1 million, accounting for over half of the overall fall in the value of visible exports. Nevertheless, a considerable decline in exports of food, particularly fish, together with lower foreign sales of pharmaceuticals and a drop in re-exports of fuels also contributed. Running counter to this trend, foreign sales of beverages and tobacco increased slightly.

Chart 4.3
DIRECTION OF EXPORTS
(percentage shares of total)



Source: NSO.

Chart 4.4
DIRECTION OF IMPORTS
(percentage shares of total)



Source: NSO.

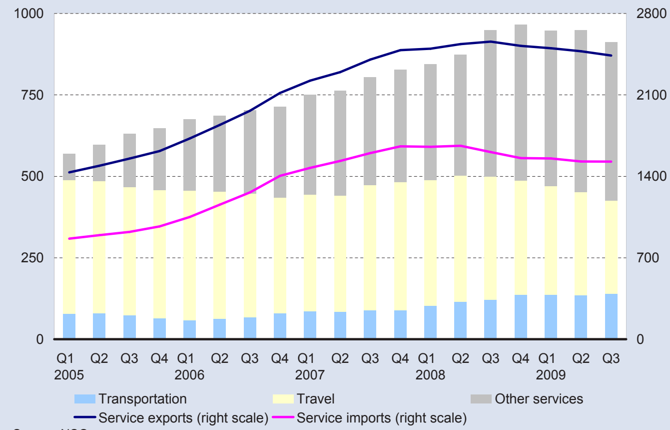
As regards the direction of merchandise trade, the EU remained Malta's most important trading partner during 2009, accounting for almost 70% of total imports and nearly 45% of exports (see Charts 4.3 and 4.4). Trade with the euro area alone accounted for 54.3% and 34.5% of imports and exports, respectively. Nevertheless, on account of the intensification of the economic crisis, particularly during the first half of the year, total trade flows between Malta and its European partners declined significantly in absolute terms during 2009. In particular, exports of semi-conductors to France, Germany and the United Kingdom fell markedly, as did re-exports of motor vehicle components to the United Kingdom. At the same time, imports of electronic components from Italy dropped sharply. Trade with Asian countries also declined, with notable drops being recorded in imports of electronic components and exports of semi-conductors, as well as in sales of fish to Japan. On the other hand, while exports to the United States declined slightly, imports rose by 11.5%.

Services

Developments in the services balance also reflected the negative impact of the global recession, as travel-related net earnings were the main factor behind a decline in the surplus on this account. Thus, during the first three quarters of 2009, the services account registered a reduced surplus of EUR763.1 million, a drop of EUR53.3 million compared with the same period of 2008. Overall receipts declined by 4.3% while payments fell by a more modest 2.6%. As mentioned above, this year-on-year drop was attributable to a EUR63.6 million contraction in the surplus on travel-related services. This, in turn, reflected a decline of 10.2% in spending by inbound tourists and a 5.0% increase in expenditure by residents of Malta travelling abroad.

In contrast, net receipts from transportation and 'other services' edged up by EUR3.1 million and EUR7.2 million, respectively. The increase in the transportation surplus was due to a considerable fall in payments for freight, which reflected the contraction in merchandise trade flows referred to earlier and lower freight rates. This outweighed a drop in receipts from passenger air transport. Meanwhile, financial services generated substantial net inflows, as against net outflows during the first nine months of 2008, boosting the 'other services' component. These inflows were, however, partly offset by lower net receipts on merchanting, a shift to net outflows on telecommunications and higher net payments for professional services.

Chart 4.5
SERVICES BALANCE
(four-quarter moving sums in EUR millions)



Source: NSO.

As a result of these developments, the trend increase in the services balance measured on a four-quarter moving sum basis levelled off during the period (see Chart 4.5). Indeed, during the year to September 2009 the positive balance on the services account declined by EUR37.9 million, or 4.0%, compared to a year earlier.

During the first nine months of 2009, net outflows on the income component of the current account rose by EUR115.0 million, or 80.2%, compared with the same period a year earlier. This was attributable to a combination of lower interest earnings on residents' portfolio investment abroad – reflecting lower international interest rates – and higher profits registered by foreign-owned firms in Malta. Banks engaged predominantly in international business accounted for most of these flows. They also reported a substantial drop in interest payments on foreign borrowings, owing to a combination of falling interest rates and a substantial reduction in outstanding debt. Consequently, during the twelve months to September 2009, net outflows on the income account almost doubled on a year earlier, increasing by EUR135.6 million.

During the first three quarters of 2009, the positive balance on current transfers, which is heavily influenced by tax payments effected by companies engaged in international business, stood at EUR109.4 million, down marginally from the corresponding period of 2008. Nevertheless, during the twelve months to September 2009 the surplus on current transfers was up by EUR2.2 million on a year earlier.

The capital and financial account

As the current account deficit narrowed, net inflows on the capital and financial account dropped during the first nine months of 2009, standing at EUR46.4 million, or EUR18.3 million lower than in the corresponding months of 2008 (see Table 4.1). Net inflows on the financial account were down by EUR13.9 million, while the surplus on the capital account fell by EUR4.4 million.

The smaller surplus on the financial account during the January to September 2009 period was driven by sharply lower net inflows on the 'other investment' component, which fell to EUR710.0 million, from EUR2.1 billion a year earlier. Inflows resulted from the repayment of loans granted to non-residents by internationally-oriented resident banks. At the same time, however, outflows increased, as short-term foreign loans were repaid while residents' deposits held abroad rose. Moreover, higher net outflows on transactions involving financial derivatives contributed negatively to the financial account.

In contrast, net portfolio investment outflows during the first three quarters of 2009 amounted to EUR1.1 billion, down by EUR1.2 billion on a year earlier. This drop was mainly due to a contraction in resident banks' foreign holdings of debt and equity securities. In addition, reinvested earnings generated by the banking sector and, to a lesser extent, the non-financial sector boosted net inward direct investment to EUR431.5 million, from EUR200.6 million in the corresponding three quarters of 2008. Meanwhile, gross direct investment outflows stood at EUR25.4 million. This was considerably lower than the EUR146.1 million recorded a year earlier, when they were exceptionally high, driven by investments abroad in the telecommunications and tourism industries.

During the same period, external reserve assets declined by EUR27.1 million, as against a EUR18.9 million drop in the comparable period of 2008. At the same time, errors and omissions were negative and amounted to EUR13.4 million.[2]

[2] Negative net errors and omissions imply an underestimation of the current account deficit and/or an overestimation of the net inflows on the capital and financial account.

5. GOVERNMENT FINANCE

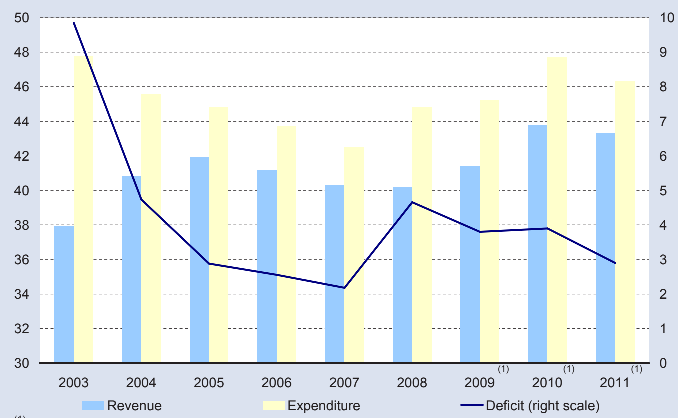
On the basis of the latest official projections, the general government deficit declined to 3.8% of GDP in 2009, from 4.7% in the previous year, as the Government's financial position recovered from the impact of one-off expenditures incurred in 2008.[1] As a result, the primary deficit, the difference between revenue and expenditure excluding interest payments, narrowed. The Government foresees a slight widening in the deficit ratio in 2010, followed by a sharp reduction in the following year to just below 3%. The general government debt-to-GDP ratio is set to rise to 68.6% in 2010 before declining in 2011.

According to the latest Financial Estimates, the negative balance in the Consolidated Fund increased in 2009 as a result of substantial rises in both current and capital expenditure.

General government balance and debt [2]

The projected drop in the general government deficit-to-GDP ratio in 2009 is due to a substantial increase in revenue which is expected to exceed a more contained rise in expenditure (see Chart 5.1). According to the Stability Programme, revenue as a share of GDP increased by more than one percentage point during the year, whereas the expenditure ratio went up by just over a half percentage point (see Table 5.1). The projected increase in revenue is attributed to a surge in receipts from taxes on income and wealth and higher inflows of EU funds, which should offset a decline in revenue from taxes on production and imports. Expenditure growth is expected to stem mainly from higher

Chart 5.1
GENERAL GOVERNMENT REVENUE AND EXPENDITURE
(percentages of GDP)



(1) Forecast
Sources: NSO; MFEI.

Table 5.1
GENERAL GOVERNMENT FISCAL INDICATORS
As a percentage of GDP

	2008	2009	2010	2011
Total revenue	40.2	41.4	43.8	43.3
Total expenditure	44.8	45.2	47.7	46.3
Interest payments	3.3	3.3	3.3	3.3
Overall balance	-4.7	-3.8	-3.9	-2.9
Primary balance	-1.4	-0.5	-0.6	0.3
Cyclically-adjusted budget balance	-5.1	-3.2	-3.4	-2.8
Public debt	63.6	66.8	68.6	68.0

Source: *Malta: Update of Stability Programme 2009-2012,* MFEI.

[1] The latest official projections regarding developments in general government finances can be found in Malta: Update of Stability Programme 2009 – 2012, published by the MFEI in February 2010. This describes the Government's medium-term policy framework and includes forecasts of macroeconomic variables and budgetary objectives for the period.

[2] The general government balance captures all transactions of the central government, including extra-budgetary units, and of the local councils, on an accrual basis. In contrast, the Consolidated Fund captures most transactions of the central government only, excluding extra-budgetary units, on a cash basis.

outlays on social benefits and gross fixed capital formation, although the rise will be dampened by lower payments in connection with the early retirement schemes for shipyard workers and the removal of subsidies to the energy sector.

In view of the uncertainty surrounding the economic environment, the general government deficit is projected to rise to 3.9% of GDP in 2010. While tax revenues are expected to increase, expenditure is projected to rise at a faster pace due to higher outlays on social assistance, selective support to industries and infrastructure investment. The latter will be partly financed from the EU's Cohesion and Structural Funds.

According to the Stability Programme, expenditure in 2011 is set to grow at a slower pace than revenue. In fact, Government plans to cut expenditure on intermediate consumption – among other items – and to curb growth in employee compensation. The Programme indicates that this should be achieved through the winding down of temporary support measures for the economy and restricting recruitment in the public sector. Consequently, even though tax revenues and grants from overseas are expected to grow at a slower pace, the deficit ratio for 2011 is expected to contract to 2.9%.

The cyclically-adjusted budget deficit, which attempts to correct for the impact of the business cycle on public finances, is expected to widen in 2010 but to fall to 2.8% of GDP in 2011, reflecting the fiscal consolidation projected for that year.

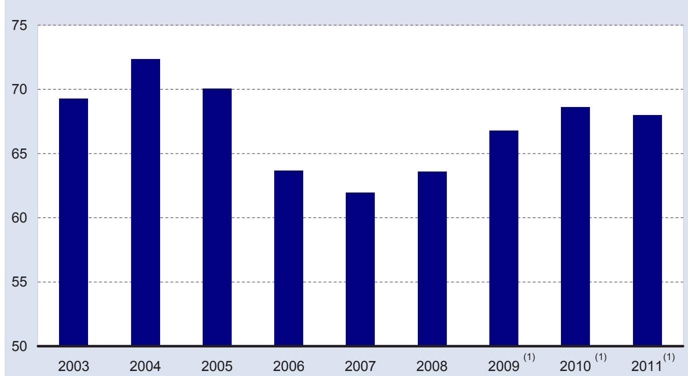
As a result of these developments, the general government debt-to-GDP ratio is set to rise to 68.6% in 2010 from 66.8% in 2009, before easing to 68.0% in 2011 (see Chart 5.2). This means that over the period 2008-2011, the debt ratio will have risen by 4.4 percentage points.

Actual data for the first three quarters of the year show that the general government deficit had reached EUR222.5 million by the end of September, up by EUR3.4 million from the position a year earlier (see Table 5.2). With interest payments remaining broadly stable, the primary deficit reached EUR88.2 million, up from EUR85.7 million in the nine months to September 2008.

Total revenue fell by EUR45.7 million, or 2.7%, compared to the same period of 2008, largely due to a drop in receipts from taxes on production and imports. These went down by EUR46.6 million in response to weak growth in private consumption and a slowdown in property sales. In fact, Consolidated Fund data for the period also show lower takings from VAT, Customs and Excise duties and duty on documents. 'Other' revenue also decreased, by EUR37.9 million, as the winding down of the Malta Shipyards led to a lower intake from productive activity. Further declines were recorded in capital and current transfers – due to lower EU grants – as well as in income receivable from investments, which includes dividends, rent and interest.

In contrast, inflows from taxes on income and wealth during the first nine months of the year were up by EUR36.4 million on a year earlier. Income tax receipts rose, especially from the corporate sector, offsetting lower yields from taxation on capital gains, mainly related to the property market. Increasing employment income also had a favourable effect on revenues. In addition, changes in the structure of motor vehicle licenses boosted takings from this revenue

Chart 5.2
GENERAL GOVERNMENT DEBT
(percentages of GDP)



(1) Forecast
Sources: NSO; MFEI.

Table 5.2
GENERAL GOVERNMENT BALANCE
EUR millions

	2008	2009(1)	2008 Q1-Q3	2009 Q1-Q3	Change Q1 - Q3 Amount	Change Q1 - Q3 %
Revenue	**2,291.5**	**2,384.5**	**1,670.4**	**1,624.7**	**-45.7**	**-2.7**
Taxes on production and imports	830.2	789.1	611.1	564.5	-46.6	-7.6
Current taxes on income and wealth	742.8	852.4	527.8	564.2	36.4	6.9
Social contributions	432.0	437.7	311.4	313.9	2.5	0.8
Other	286.5	305.3	220.0	182.1	-37.9	-17.2
Expenditure	**2,556.9**	**2,603.4**	**1,889.5**	**1,847.2**	**-42.3**	**-2.2**
Intermediate consumption	382.6	391.7	281.1	268.7	-12.5	-4.4
Gross fixed capital formation	141.9	201.6	109.1	70.8	-38.2	-35.0
Compensation of employees	831.9	829.4	611.3	627.6	16.3	2.7
Subsidies	121.7	74.9	107.1	50.6	-56.5	-52.8
Interest	187.7	190.1	133.5	134.3	0.9	0.7
Social benefits	758.0	806.4	545.3	580.4	35.1	6.4
Other	133.1	109.4	102.1	114.7	12.6	12.4
Primary balance	**-77.6**	**-28.8**	**-85.7**	**-88.2**	**-2.5**	**-**
General government balance	**-265.4**	**-218.9**	**-219.2**	**-222.5**	**-3.4**	**-**

(1) Data for 2009 are estimates taken from *Malta: Update of Stability Programme 2009-2012*.
Sources: MFEI; NSO.

category. Higher levels of employee compensation also led to a small pick-up in receipts from social contributions.

General government expenditure went down by EUR42.3 million, or 2.2%, on a year-on-year basis in the first three quarters of 2009. Spending on subsidies was cut by EUR56.5 million, reflecting the termination of transfers to Enemalta Corporation following the revision of tariffs. Gross fixed capital formation was down by EUR38.2 million due to lower outlays in the health sector and in spending on the environment. In addition, the drop in activity at the shipyards led to a EUR12.5 million reduction in intermediate consumption.

On the other hand, spending on social benefits, especially pensions, expanded by EUR35.1 million in the first three quarters of 2009 compared to the same period in 2008. Compensation of employees was up by EUR16.3 million, mainly reflecting the final payment related to the early retirement schemes to former shipyard workers in the first quarter of the year. 'Other' expenditure went up by EUR12.6 million due to higher contributions to the EU budget and to Church schools. Higher capital transfers related to the sewage treatment project were also recorded. However, despite the increase in general government debt, interest payments rose by a modest EUR0.9 million, reflecting a further decline in the level of interest rates.

Consolidated Fund

Consolidated Fund data for the first eleven months of 2009 show a sharper deterioration in the fiscal position. The Consolidated Fund deficit expanded by EUR139.5 million compared with the same period a year earlier, reaching EUR410.5 million (see Table 5.3). Similarly, the primary shortfall increased by EUR141.1 million to EUR231.0 million over the period.

Between January and November 2009 revenue fell by 2.2%, as higher inflows from direct taxes and increased non-tax revenues were offset by sharply lower yields from indirect taxes. At the same time, expenditure rose by 4.8%, a lower rate of growth than in the same period of 2008, as recurrent spending expanded at a slower pace. Meanwhile, capital expenditure rose by a substantial 8.4%.

Table 5.3
CONSOLIDATED FUND BALANCE
EUR millions

	2008	2009(1)	2008 Jan.-Nov.	2009 Jan.-Nov.	Change Amount	Change %
Revenue	**2,132.2**	**2,288.0**	**1,812.8**	**1,772.7**	**-40.0**	**-2.2**
Direct tax	**1,076.1**	**1,170.3**	**867.3**	**889.2**	**21.9**	**2.5**
Income tax	735.9	813.0	579.3	589.1	9.7	1.7
Social security contributions(2)	340.2	357.3	287.9	300.1	12.2	4.2
Indirect tax	**852.3**	**876.7**	**772.8**	**701.2**	**-71.6**	**-9.3**
Value Added Tax	455.3	454.0	410.9	392.1	-18.8	-4.6
Customs and excise duties	177.8	181.6	161.7	92.7	-69.0	-42.7
Licences, taxes and fines	219.1	241.1	200.2	216.4	16.2	8.1
Non-tax(3)	**203.8**	**241.0**	**172.6**	**182.3**	**9.7**	**5.6**
Expenditure	**2,365.3**	**2,546.0**	**2,083.7**	**2,183.2**	**99.5**	**4.8**
Recurrent(2)	**2,143.2**	**2,242.8**	**1,889.2**	**1,972.4**	**83.2**	**4.4**
Personal emoluments	519.3	541.9	437.2	456.6	19.4	4.4
Programmes and other operational expenditure(4)	1,271.6	1,331.3	1,125.7	1,187.7	62.0	5.5
Contributions to entities	163.3	174.3	145.2	148.6	3.4	2.4
Interest payments	189.0	195.3	181.1	179.5	-1.6	-0.9
Capital	**222.1**	**303.2**	**194.5**	**210.8**	**16.3**	**8.4**
Primary balance(5)	**-44.0**	**-62.7**	**-89.8**	**-231.0**	**-141.1**	**-**
Consolidated Fund balance	**-233.1**	**-258.0**	**-271.0**	**-410.5**	**-139.5**	**-**

(1) Data for 2009 are estimates, as shown in the *Financial Estimates 2010* and the *Budget Speech 2010* published in November 2009.

(2) Government contributions to the social security account in terms of the Social Security Act 1987 are excluded from both revenue and expenditure.

(3) Includes grants but excludes proceeds from sale of assets, sinking funds of converted loans and borrowings.

(4) Includes programmes & initiatives and operational & maintenance expenditure.

(5) Revenue less expenditure including interest payments.

Sources: MFEI; NSO.

Gross government debt

As the Government increased its borrowings to finance the deficit on the Consolidated Fund, the level of government debt continued to increase, reaching EUR4.0 billion by the end of November. This implies a rise of EUR425.8 million since the beginning of the year (see Table 5.4).

Table 5.4
CHANGES IN GOVERNMENT DEBT
EUR millions

	2008	2008 Jan.-Nov.	2009 Jan.-Nov.
Gross government debt(1)	**227.0**	**222.6**	**425.8**
Euro coins issued in name of the Treasury(2)	22.9	22.0	5.5
Malta Government Stocks	201.1	201.1	262.1
Treasury bills	10.9	3.6	168.8
Local loans	-0.6	-0.2	0.0
Foreign loans	-7.2	-3.9	-10.7

(1) Excluding government debt held by Sinking Funds.

(2) Following euro adoption, Maltese euro coins issued are being considered as a currency liability pertaining to the Government.

Source: Central Bank of Malta.

Over the year the composition of the debt shifted towards short-term instruments, in the form of Treasury bills, and away from MGS, which have longer maturities. At end-November, the latter were up by EUR262.1 million and made up 81.5% of the total debt outstanding, as against 84.0% a year earlier. On the other hand, Treasury bills in issue were up by EUR168.8 million, which brought their share in the total up to 13.5% from 10.2% at end-November 2008. Over the same period foreign loans decreased by EUR10.7 million, while the value of euro coins issued, which represent a liability for the Government, increased by EUR5.5 million.

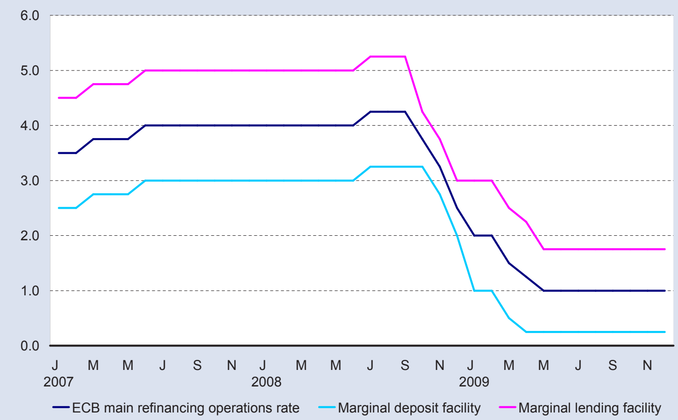
PART II

BANK POLICIES,
OPERATIONS AND ACTIVITIES

1. THE CONDUCT OF MONETARY POLICY

Following the adoption of the euro on 1 January 2008, the Central Bank of Malta became a member of the Eurosystem, which consists of the ECB and the NCBs of the EU Member States that have adopted the euro. The Bank contributes to the formulation of monetary policy for the euro area through the Governor's participation in the Governing Council of the ECB. It is also responsible for the implementation, in Malta, of the Governing Council's monetary policy decisions.

Chart 1.1
OFFICIAL INTEREST RATES
(percentages per annum, end of month)



Source: ECB.

The Bank's primary objective, as a member of the Eurosystem, is the maintenance of price stability, which is defined as annual price increases in the euro area of below, but close to 2%, over the medium term. Price stability remains the ultimate goal of monetary policy as it is essential for the creation of a stable business environment that will contribute to sustainable economic growth and a high level of employment.

Throughout 2009 the conduct of monetary policy in the euro area was shaped by the response to the international economic crisis. Faced with the severe deterioration of the economic outlook and the reduction in risks to price stability, the Governing Council of the ECB reduced the interest rate on its MROs on four occasions in the course of the year. In January and March the Council cut the main refinancing rate by 50 basis points on both occasions and it reduced it by another 25 points in each month in April and May (see Chart 1.1). Overall the rate was brought down from 2.50% at the end of December 2008 to 1.00% in May 2009, a cumulative reduction of 150 basis points over five months. After that, amid signs that the downturn was moderating with inflationary pressures in the euro area remaining subdued, official rates were left unchanged until the end of the year.

Monetary policy operations

The Central Bank of Malta implements the single monetary policy of the Eurosystem in accordance with the guidelines laid down by the ECB's Governing Council. To this end, the Bank regularly conducted open market operations with local credit institutions during the year.

Open market operations

Open market operations are the basic instrument used to manage the levels of liquidity in the market with a view to steering short-term interest rates close to the ECB's official rates. The Eurosystem has various types of open market operations at its disposal. It signals its monetary policy stance by changing the minimum bid rate on the MROs. The latter are short-term liquidity-providing reverse transactions with a weekly frequency and a maturity, normally, of one week, which are executed according to a pre-specified calendar. At the longer end the Eurosystem undertakes longer-term refinancing operations (LTROs), which are reverse transactions with a monthly frequency and a normal maturity of three months. These too are executed according to a pre-specified calendar. The Eurosystem also makes use of fine-tuning operations to deal with unexpected liquidity fluctuations in the market. They can be either liquidity-providing or liquidity-absorbing.

In order to address the tensions in the money market related to the financial turmoil experienced during 2009, the Governing Council enhanced its credit support measures. Thus, while the fixed rate full allotment tender procedure – which was introduced in October 2008 for all MROs, special-term refinancing operations, and regular and supplementary LTROs – was maintained throughout the year, in May the Governing Council decided to conduct for the first time liquidity-providing LTROs with a maturity of one year. As a result, more than EUR442 billion worth of liquidity was injected into the euro area money market in the first such auction in June. In addition, the Eurosystem initiated a covered bond purchase programme, which commenced on 6 July 2009. In terms of this programme EUR60 billion worth of euro-denominated covered bonds issued in the euro area were to be purchased by the end of June 2010. Participation in this programme is voluntary. In fact, the Central Bank of Malta opted out of the covered bond purchase programme since the liquidity situation in the local market did not call for such support.

During the year the ECB conducted 52 MROs, all at a fixed rate and with full allotment. Eligible domestic credit institutions participated in 39 of these operations, bidding for EUR4.9 billion, as opposed to EUR3.0 billion in 2008 (see Table 1.1). During the same period, the ECB conducted 51 operations providing liquidity at a longer-term horizon, up to the one-year tenor. The ECB doubled the frequency of the three-month LTROs and conducted twelve six-month longer-term operations. Moreover, special refinancing operations with a duration equivalent to the length of the relevant reserve maintenance period were also carried out. These too were conducted through a fixed rate tender with full allotment.

The ECB also undertook three twelve-month operations in June – as mentioned above – September and December. The first two were conducted at a fixed rate equivalent to the applicable main refinancing rate, which was 1.00%, while the rate on the third operation, which will mature on 23 December 2010, will be calculated on the average minimum bid rate of the MROs over the life of the operation. During 2009 local credit institutions obtained longer-term liquidity at the various tenors to the tune of EUR1.2 billion, two-thirds of which were in the form of one-year funding (see Table 1.1).

Table 1.1
PARTICIPATION OF ELIGIBLE RESIDENT CREDIT INSTITUTIONS IN EUROSYSTEM OPEN MARKET OPERATIONS
EUR billions

Type of operation	Amount bid and allotted[1]
Main refinancing operations	4.93
Longer-term refinancing operations	
3-month	0.15
6-month	0.22
12-month	0.82
Maintenance period	0.04
Liquidity-absorbing fine tuning operations	0.26
(TAF) Operations conducted in USD	
7-day	-
28-day	0.02
84-day	0.13
CHF swap operations (7-day)	-

[1] During 2009, the amount allotted in Eurosystem open market operations is equal to the amount bid due to the ECB's full allotment policy.
Source: Central Bank of Malta.

These credit support measures resulted in considerable liquidity injections into the banking system in the euro area. To remove the resultant excess liquidity that had built up by the last day of each reserve maintenance period, the ECB launched liquidity-absorbing fine-tuning operations in the form of variable rate tenders with a maximum bid rate and without pre-set amounts. Local banks deposited EUR0.3 billion through these overnight fine-tuning operations while the rest of the liquidity surplus was largely placed in the overnight deposit facility.

During 2009 the Eurosystem, in conjunction with the US Federal Reserve, continued to offer US dollar liquidity to credit institutions in the euro area by means of Term Auction Facility (TAF) operations. However, due to limited demand and improved conditions in funding markets, US dollar operations with a term of 28 days were discontinued following the one held on 28 July, while those with a tenor of 84 days were terminated following the 6 October operation. Resident credit institutions participated in these US dollar operations. In addition, the Eurosystem conducted Swiss franc liquidity-providing operations in terms of the arrangement between the ECB and the Swiss National Bank, but resident credit institutions did not participate.

Standing facilities

During 2009 the Eurosystem also continued to make use of standing facilities – together with its other monetary policy instruments – to steer market rates, to regulate liquidity in the banking system and to signal the general stance of monetary policy. Standing facilities are administered in a decentralised manner by euro area NCBs. Credit institutions with temporary liquidity needs may use the marginal lending facility on their own initiative to obtain overnight liquidity from their NCB against eligible assets. Conversely, institutions with surplus liquidity may use the deposit facility to place overnight deposits with their NCB.

The full allotment policy adopted by the ECB, coupled with frictions in the money market following the financial turmoil, resulted in large amounts of excess liquidity building up in the domestic banking system, which in turn led to significant use of the deposit facility. Indeed, credit institutions deposited EUR72.7 billion with the Central Bank of Malta during the year, as opposed to EUR8.0 billion in 2008. To a lesser extent, interbank market frictions also led to increased use of the marginal lending facility, with the amount borrowed by resident banks rising from EUR0.1 billion in 2008 to EUR1.1 billion in 2009.

The interest rate on the marginal lending facility and that on the deposit facility form a corridor, acting as the upper and lower boundaries, respectively, for euro interbank overnight rates. Between January and April 2009, while the interest rate charged on the marginal lending facility was set at 100 basis points above the minimum bid rate, that on the overnight deposit facility was set 100 basis points below the rate, continuing the established pattern. However, following the cut in the MRO rate in May, the interest rate corridor was reduced from 200 to 150 basis points, with the interest rate on the marginal lending facility being cut to 1.75%, while that on overnight deposits was kept unchanged at 0.25%.

All Eurosystem liquidity-providing operations have to be backed by adequate collateral. In this regard, the Eurosystem accepts a wide range of assets which can be used as collateral. However, to protect the Eurosystem from incurring losses in its monetary policy operations, and to ensure the equal treatment of counterparties and enhance operational efficiency and transparency, underlying assets have to meet certain criteria. During 2009, the ECB changed its collateral management framework several times. The first set of changes announced by the ECB in September 2008, but which came into force on 1 February 2009, incorporated some technical refinements in the risk control framework, such as the introduction of a new liquidity category for marketable assets, the revision of haircuts for uncovered bank bonds and further measures concerning asset-backed securities (ABSs).[1]

Subsequently, as from 1 March, additional risk control measures for newly issued ABSs and uncovered bank bonds became effective. These included the requirement for an AAA-rating at issuance from an accepted credit rating agency for all ABSs issued as from that date and the maintenance of a single A minimum rating

[1] Valuation haircuts are risk control measures applied to underlying assets that are being used as collateral, implying that the value of the underlying assets is calculated as the market value of the assets less a certain percentage. The size of the haircut reflects the perceived risk associated with holding the assets.

threshold over the lifetime of an ABS. In addition, the Eurosystem introduced limits on the use of uncovered bank bonds, whereby a counterparty cannot have in its pool of collateral more than 10% of uncovered bank bonds of a particular issuer, or an entity with which the issuer has close links. Furthermore, in November 2009, the ECB announced additional amendments to rating requirements for new and existing ABSs. These will become effective in 2010 and 2011, respectively.

The Central Bank of Malta is responsible for assessing the eligibility of domestically-issued debt instruments and reporting them to the ECB for inclusion in the Eurosystem's Eligible Assets Database. As at end-December 2009, the nominal amount of eligible domestic marketable assets outstanding amounted to EUR3.7 billion.

The market value, after haircuts, of securities that eligible domestic counterparties – that is, eligible resident banks – had pledged with the Central Bank of Malta as their pool of collateral at end-December 2009 stood at EUR1.6 billion. Domestic securities made up 41.5% of this amount, while the remainder consisted of cross-border securities.

During 2009 the Central Bank of Malta contributed to the determination of the Eurosystem's liquidity needs through daily forecasts of autonomous factors.[2]

Reserve requirements

The ECB requires credit institutions established in the euro area to hold reserve deposits with their respective NCBs. The Eurosystem's minimum reserve system aims at stabilising money market interest rates and helps ensure that the Eurosystem operates efficiently as a supplier of liquidity. Indeed, the requirement for credit institutions to hold reserves with the NCBs increases the demand for central bank refinancing which, in turn, makes it easier for the ECB to steer money market rates to the desired level through its open market operations.

Hence, each credit institution established in Malta is obliged to hold minimum reserve deposits with the Central Bank of Malta. The reserve requirement of each credit institution is determined as a proportion of its reserve base. The reserve ratio applied to certain categories of deposits and debt securities issued by banks remained unchanged at 2% throughout 2009, while that on the remainder continued to be set at zero. However, the minimum reserve framework of the Eurosystem enables credit institutions to make use of averaging, such that compliance is determined on the basis of average closing balances in reserve requirement accounts over the maintenance period, approximately one month. The remuneration rate paid on holdings of required reserves, which is linked to the interest rate charged on the MROs, stood at 1.00% at the end of December 2009.

Reserve management

The Central Bank of Malta owns and manages reserve assets, as well as other foreign and domestic financial assets that are denominated in euro.[3] The reserve asset component, together with those of the ECB and the other NCBs of the euro area, forms part of the Eurosystem's reserves. The Bank's main investment objective is to maximise the return on its portfolio within the parameters approved by the Bank's Board of Directors and the Investment Policy Committee (IPC).

Furthermore, under the foreign currency specialisation framework, the Bank continued to manage an amount of US dollar reserves on behalf of the ECB by way of a pooling mechanism jointly with the Central Bank and Financial Services Authority of Ireland.[4] During the year, the Central Bank of Malta worked closely with the Irish dealing desk to review strategy, discuss operational modalities and analyse the portfolio's performance.

[2] Autonomous factors are items on the Eurosystem's balance sheet that are not related to monetary policy instruments and are not normally under the direct control of the Eurosystem's liquidity management. These include banknotes in circulation, government deposits with the NCBs and net foreign assets.

[3] The Bank's reserve assets consist of claims on non-euro area residents denominated in foreign currencies.

[4] The agreement between the two banks, which is formalised in a bilateral Memorandum of Understanding, builds upon a long-established relationship between the two institutions and certain operational similarities between them. Such arrangements to pool operational activities are contemplated in the relevant ECB guideline.

Within the Bank, the management strategy relating to the Bank's own portfolio remained the competence of the IPC, which is chaired by the Governor and includes senior officials of the Bank. The IPC assessed the Bank's overall investment policy, set investment parameters, monitored the performance of the Bank's financial assets, evaluated the implementation of investment strategies and reviewed the operational and risk framework of reserve management practices. The IPC operates within the parameters set by the Board of Directors, which include the review of eligible financial instruments and counterparty limits. The Committee met monthly throughout 2009.

The Bank uses extensive quantitative and qualitative techniques to ensure that the risk of possible losses arising from market and credit risk exposures are kept within the levels prescribed by the IPC and the Board, respectively. Against the background of the ongoing financial crisis, the Board and IPC authorised measures during 2009 to mitigate credit exposures with a number of eligible debt issuers and bank counterparties. In addition, the Bank successfully introduced bond futures in its eligible list of financial instruments in order to use such instruments to actively manage interest rate risk.

In terms of the ERM II agreement, and as an NCB acting on behalf of the ECB, the Bank may conduct interventions in those currencies participating in the ERM II regime.[5] No such interventions were necessary during the year.

During 2009 the value of foreign currency spot purchases which the Central Bank of Malta undertook amounted to EUR596 million, as opposed to EUR234 million in 2008. Meanwhile, spot foreign currency sales rose to EUR645 million from EUR335 million in the previous year. In contrast, swap sales declined to EUR1.9 billion, significantly below the EUR2.6 billion recorded in 2008 as the Bank reduced its foreign currency exposure and, hence, its need to hedge positions using these instruments. During the year the Bank continued to transmit to the ECB information on its own foreign exchange transactions and holdings, as well as on the euro-denominated portion of its investment portfolio.

During the year foreign exchange transactions effected locally between domestic credit and financial institutions amounted to EUR21.1 million. At the same time, the value of foreign exchange transactions between resident banks and financial institutions and unrelated third parties stood at EUR15.4 billion, up from EUR13.0 billion in 2008. This turnover largely stemmed from transactions with credit institutions resident outside the euro area. Well over half of these transactions consisted of new swaps, new forwards and other financial derivatives. The remaining transactions consisted of spot deals carried out by banks with resident firms and households. These largely reflected sales relating to current account payments in connection with trade, tourism and personal transfers as well as financial portfolio flows.

Throughout the year the Bank continued to publish euro reference rates of exchange, as well as other exchange rates, for use by business operators and the general public. In addition, it continued to provide advisory services to the Government and public sector entities regarding sovereign debt funding and the credit standing of counterparties. It also provided market services to selected public sector entities.

Market-making operations

In 2009 the Central Bank of Malta again acted as market-maker in the secondary market for MGS and Treasury bills. In this way, the Bank provided adequate liquidity to the market and enhanced investor confidence in market trading. In line with the Central Bank of Malta Act and Articles 123 and 124 of the Treaty on the Functioning of the European Union (TFEU), the Bank did not participate in the primary market for government securities and did not provide any other form of financing to the Government.

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[5] ERM II is an exchange arrangement that provides the framework for exchange rate policy co-operation between the euro area countries and those EU Member States that have not adopted the euro. Non-euro area Member States participating in ERM II peg their currencies to the euro at a central exchange rate, limiting exchange rate volatility. Malta ceased to be a member of ERM II upon adoption of the euro.

The Bank continued to publish daily opening bid prices and yields of all listed MGS as well as daily buying and selling rates of Treasury bills. In addition, the Bank also quoted International Securities Market Association (ISMA) redemption yields on MGS on a daily basis.[6]

During 2009 the Central Bank of Malta continued to collect and analyse data on government debt so as to be able to fulfil better its role as advisor to the Government on debt management matters. In particular, the Bank provided technical advice to the Government on the issue of securities with floating rates that were launched for the first time in the primary market in November.

The Financial Markets Committee (FMC), which provides a forum for regular discussions between the Bank and all credit institutions operating in Malta on various market-related issues, met six times during 2009. Discussions mainly revolved around the Eurosystem's monetary policy operations, the non-standard measures adopted to alleviate liquidity pressures in the euro area, collateral management and the risk control framework.

[6] ISMA yields represent an annualisation of the yields-to-maturity, hence making yields on MGS, which pay interest on a semi-annual basis, comparable to those on bonds that pay interest annually.

2. FINANCIAL STABILITY

The Central Bank of Malta is charged by law with the task of ensuring the stability of the financial system in Malta. The Bank fulfils this responsibility through its on-going monitoring and analysis of the system so as to identify any vulnerabilities and risks to which it may be exposed. This is supplemented by a continuous assessment of the non-financial sector and the channels through which this might affect the financial sector, as well as an evaluation of the resilience of the banking system in the face of adverse conditions. The Bank discusses its findings with the MFSA and the MFEI in order to ensure that timely remedial action is taken as and when required.

In developing further its surveillance and assessment tools to better evaluate the risks to financial stability, the Bank in 2009 continued to enhance its macro stress-testing capacity. It also pursued its review of its early warning system to take into account lessons learned from the international financial crisis. In addition, it continued to assess market and risk conditions that could affect financial stability through surveys of both the financial and the non-financial sector.

In recognition of the importance of financial stability issues, particularly in the light of the international financial crisis, the Bank in 2009 published its first comprehensive Financial Stability Report, covering 2008, together with a mid-year update of its analysis and conclusions. The Report was published in an electronic format and can be viewed on the Bank's website.

In the international sphere, a number of new initiatives designed to strengthen the resilience of the global financial system were discussed during 2009. The Bank participated in a number of these initiatives, in line with its external obligations, and with the aim of strengthening domestic standards and practices so as to bring them in line with the best international norms. These issues were discussed within the regular and *ad-hoc* meetings of the Standing Committee and, where appropriate, within the Domestic Standing Group.[1,2] During the year, in conjunction with the MFSA and the MFEI, the Bank continued to review and enhance the crisis management framework in Malta. The objective of this framework is to enable the authorities to manage potential crisis situations in a structured manner. Within this context a simulation exercise was carried out to test the authorities' capacity to apply a systemic impact assessment in a crisis situation, and this was followed by another exercise focused on the operational level. Both exercises were undertaken in the light of decisions taken at the EU level and were based on the systemic impact assessment methodology drawn up by the ESCB Banking Supervision Committee's (BSC) Task Force on Crisis Management, in which the Bank actively participates.

In the course of the year, the Bank, together with the MFSA, held a number of meetings with credit institutions to gain a better understanding of their risk management practices and capabilities. As a follow-up, these institutions were asked to carry out a number of bottom-up stress tests during 2010.

During the year, the Bank also continued to participate in the IMF project on financial stability indicators through the submission of regular quarterly data that are now being published by the Fund. The Bank also carried out preparatory work to launch a more structured forum where it can discuss issues related to financial stability with financial institutions. It will be examining ways of better integrating the macro-prudential and the micro-supervisory frameworks to strengthen its capacity to safeguard financial stability.

With regard to macro-prudential developments, the Bank, through its participation in the ESCB structures, continued to contribute to the review of the EU supervisory architecture, including the establishment of the European Systemic Risk Board.

During 2009 the Bank continued to participate actively in the work of the BSC of the ESCB and its substructures, and in the meetings of the Committee of European Banking Supervisors (CEBS) jointly with the MFSA.

[1] The Standing Committee was established in terms of the Memorandum of Understanding (MoU) between the Bank and the MFSA signed in February 2003.

[2] The Domestic Standing Group (DSG) is chaired by the Deputy Governor of the Bank and includes a senior official from the Bank, the MFSA and the MFEI. The DSG forms part of the domestic structure under the crisis management framework.

3. CURRENCY, PAYMENT SYSTEMS AND BANKING SERVICES

Since the euro became the national currency in January 2008, the Central Bank of Malta has been issuing euro banknotes and coins in accordance with the legal framework governing the ESCB and the ECB and has been responsible for ensuring that the supply of euro currency in Malta meets the needs of the public. The Bank, meanwhile, remained responsible for ensuring that the banknotes and coins in circulation were fit for use and that any counterfeits were quickly detected. At the same time, the Bank continued to collect and destroy Maltese lira banknotes and coins that were exchanged for euro throughout the year.

In addition, as the authority responsible for the regulation and oversight of payment systems in Malta, the Bank continued to develop the infrastructure of the domestic payment and securities settlement systems to enhance their efficiency. Meanwhile, as banker to the Government and to the rest of the banking system, the Bank continued to provide the public sector and credit and financial institutions with various banking services.

Currency operations

The Bank continued to issue currency in line with the demands of the banking system and to take in currency surplus to requirements. It also examined euro banknotes and coins regularly to safeguard the integrity of the currency. Any of these that were deemed unfit for circulation were withdrawn and destroyed.

Collection and disposal of the Maltese lira

During 2009, the second year after the euro changeover, the Bank continued to collect and destroy Maltese lira banknotes and coins. In total, over 300,000 bank notes denominated in Maltese lira and with a face value of Lm3.4 million (equivalent to EUR8.0 million) were collected during the year. In addition, 5.2 tonnes of coins with a face value of over Lm0.1 million (EUR0.3 million) were returned. Hence, the Bank altogether collected Maltese lira banknotes and coins with a value equivalent to EUR8.3 million (see Table 3.1). By the end of 2009, the value of Maltese lira banknotes and coins that remained in circulation totalled Lm35.3 million, equivalent to EUR82.2 million. Coins accounted for around one-third of this amount, despite the fact that they ceased to have any monetary value after 1 February 2010.

Table 3.1
MALTESE LIRA CURRENCY COLLECTED AND OUTSTANDING
Lm thousands

	Notes[1]		Coins[2]		Total	
	Collected	Outstanding	Collected	Outstanding	Collected	Outstanding
Jan.	366.4	27,026	11.3	11,439	377.7	38,465
Feb.	405.0	26,622	13.0	11,426	418.0	38,047
Mar.	339.0	26,282	9.4	11,416	348.5	37,699
Apr.	337.4	25,945	9.2	11,407	346.6	37,352
May	291.4	25,654	6.7	11,400	298.2	37,054
June	245.7	25,408	5.5	11,395	251.2	36,803
July	239.4	25,169	6.9	11,388	246.2	36,557
Aug.	236.6	24,932	6.0	11,382	242.6	36,314
Sep.	213.0	24,719	7.8	11,374	220.8	36,093
Oct.	226.9	24,492	30.8	11,343	257.7	35,835
Nov.	241.9	24,250	12.2	11,331	254.1	35,581
Dec.	291.2	23,959	17.3	11,314	308.5	35,273
2009	**3,433.8**	**23,960**	**136.3**	**11,314**	**3,570**	**35,273**
2009 (EUR thousands)	**7,998.6**	**55,812**	**317.5**	**26,355**	**8,316.2**	**82,164**

(1) The notes are of the following denominations: Lm20, Lm10, Lm5, and Lm2.

(2) The coins are of the following denominations: Lm1, 50c (cents), 25c, 10c, 5c, 2c and 1c.

Source: Central Bank of Malta.

Table 3.2

CURRENCY NOTES AND COINS ISSUED BY AND PAID INTO THE BANK IN 2009[(1)]

EUR thousands

		Notes and coins		Issued and
	Issued	Paid in	Net issue	outstanding[(2)]
Jan.	89,727	97,535	-7,808	707,272
Feb.	100,347	81,425	18,922	726,193
Mar.	109,727	93,940	15,787	741,980
Apr.	123,995	111,500	12,495	754,475
May	109,096	105,269	3,826	758,302
June	129,897	117,890	12,007	770,308
July	130,549	132,181	-1,633	768,676
Aug.	112,926	127,137	-14,211	754,465
Sep.	118,851	119,647	-796	753,668
Oct.	128,167	124,175	3,993	757,661
Nov.	122,748	112,162	10,586	768,247
Dec.	160,231	122,875	37,356	805,603
2009	**1,436,260**	**1,345,737**	**90,523**	**805,603**

(1) Data exclude Maltese lira banknotes and coins still in circulation.

(2) Includes currency in circulation and currency held by the banking system.

Source: Central Bank of Malta.

Circulation of notes and coins

The value of euro currency in issue increased consistently in the first half of 2009. However, it fell during the September quarter before picking up again in the last three months of the year to end December at EUR805.6 million (see Table 3.2). As a result, euro currency in issue increased by almost 15% over the year as a whole. Apart from seasonal fluctuations, as in other euro area countries the demand for cash appears to have been influenced by the international financial crisis.

In the course of the year, the Bank was allocated a share in the printing of euro banknotes for the first time. The new banknotes are to be used mainly to refund to the Eurosystem the amount of notes the Bank had borrowed in 2008 in connection with the currency changeover. In this context, and in order to benefit from economies of scale, the Bank participated in the issue of a joint tender for the production of notes together with the central banks of Cyprus, Luxembourg, the Netherlands and Slovenia.

During 2009 the Bank examined a total of 85.1 million banknotes, with a face value of EUR1.7 billion. These consisted almost entirely of euro banknotes, though a small amount of Maltese lira notes was also processed. Out of the total euro banknotes examined, slightly more than 14% were deemed unfit for re-issue. A relatively large volume of euro banknotes was processed to eliminate a backlog brought about by the currency changeover in 2008.

Apart from banknotes, 3.5 million coins, specifically 2.7 million euro coins and 0.8 million Maltese coins, with a face value of EUR1.6 million and Lm0.1 million, respectively, were examined in 2009. This gives a total face value of around EUR1.9 million, less than the amount examined in 2008.

Furthermore, the Bank regularly updated local circulation statistics in the Eurosystem's Currency Information System (CIS). By the end of the year, the Bank was preparing to start reporting such statistics on a daily, rather than a monthly basis, as proposed by the ECB following the financial crisis.

In October 2008 the Bank had issued Directive No. 10 on the recycling of euro banknotes by banks and other professional cash handlers.[1] The directive prohibits banks, other financial institutions and professional cash handlers from reissuing any banknotes they receive from the public without first subjecting them to stringent authenticity and quality tests according to Eurosystem standards. In this context, during 2009 the Bank gave preliminary training in authentication and fitness sorting to trainers from various credit institutions. In June and October meetings were also held with officials from credit institutions to explain the principles underlying the banknote recycling framework, while a handbook illustrating standards on manual sorting was made available to professional cash handlers.

Commemorative coins

In January 2009 the Bank issued its first €2 commemorative coin, recalling the establishment of EMU. On this occasion, each euro area country issued a coin bearing the same design, but with the name of the country and the legend shown in the respective language. In June the Bank also issued a numismatic coin depicting the Castellania building, which has served as the Medical and Public Health Head Office since 1895. The coin, which is available either in silver or in gold, was issued under the Europa Programme 2009, which was dedicated to cultural heritage, and bears the Europa Star, the official logo of the programme, on the reverse side.

Anti-counterfeit measures

During 2009 the Bank`s Currency Surveillance Unit, which is responsible for coordinating counterfeit awareness measures in Malta and for analysing any suspected counterfeit currency, processed over 2,000 banknotes and a small number of coins suspected to be counterfeit. The findings were reported to the ECB.

Payment and securities settlement systems

In terms of the Central Bank of Malta Act, the Bank is responsible for the regulation and oversight of payment and securities settlement systems in Malta. An overview of the main regulatory developments during 2009 is given in Box 2.

BOX 2: CENTRAL BANK OF MALTA DIRECTIVES ON PAYMENT SERVICES

During 2009 the Bank amended the regulatory framework governing payment services in Malta as a result of changes introduced at the European level.

In November the Bank repealed its Directive No. 3 on cross-border credit transfers, since this was replaced by EC Regulation 924/2009 of the European Parliament. The regulation introduces measures facilitating the automation of payments. It also ensures that charges for cross-border payments are clear and that they correspond to those for domestic payments. Moreover, it regulates charges between service providers for payments through the direct debiting of bank accounts. The regulation also mandates issuers of invoices or requests for payment to quote specific codes to identify individual banks or bank accounts into which these can be paid and obliges payers to quote the same when executing payments.

During the same month the Bank issued Directive No. 1 to transpose parts of the Payment Services Directive, which applies to all EU/EEA Member States.[1] The latter lays down rules concerning transparency of conditions and information requirements for payment services, such as money remittances, credit transfers and card payments. The directive also sets out the respective rights and obligations of payment service users and providers in relation to the provision of such services. In this regard, the Bank's directive establishes a set of rules applicable to all payment services provided by a payment service provider, or its agent, in Malta. In this way, it guarantees a high level of customer protection and efficiency, which should make payments quicker and more reliable.

[1] Directive 2007/64/EC of the European Parliament and of the EU Council of 13 November 2007 on payment services in the internal market.

[1] This Directive granted banks and professional cash handlers a transitional period, ending in January 2010, to comply with its provisions.

As regards the operation of the payment system, during 2009 the Bank continued to participate in TARGET2, which is the payment system used by the Eurosystem for the settlement of central bank operations, large-value euro interbank transfers and other euro payments.

During the year no new participants joined the TARGET2 system. However, the value of payments processed through TARGET2 in Malta rose sharply to EUR90.0 billion, from EUR26.2 billion in 2008. The increase reflected changes that occurred in settlement services as a result of the financial crisis. In particular, there was a substantial increase in activity related to monetary policy operations on account of the non-standard monetary policy measures adopted by the ECB, including an increase in the use of the overnight deposit facility.

The Bank was also engaged on a number of projects related to the TARGET2 system during the year. These included the mobilisation of the TARGET2 Securities system and the development of the CCBM2 system. The latter is designed to set up a shared platform for the management of collateral across the Eurosystem. Besides, new options for extending eligible collateral to be used in contingencies were also examined.

The Bank also continued to manage the Malta Clearing House, through which most cheques issued in Malta are settled. The downward trend in the usage of cheques by the general public persisted. Consequently, during 2009 the amount of cheques cleared continued to diminish, decreasing by 4.5% to 5.6 million, with their value falling by 3.2% to EUR7.1 billion. The daily average number and value of cheques processed during the year fell to 22,299 and EUR28.7 million, respectively.

The past year also saw the Bank furthering its participation in the Single Euro Payments Area (SEPA) project, which is designed to increase the efficiency of payments in the euro area through the adoption of a single standard for credit transfer, direct debits and payment cards. The project is also intended to make retail cross-border payments as safe as domestic payments and with similar charges. As in the rest of the euro area, however, the SEPA project in Malta experienced a slow take off. In fact, only one product, the SEPA credit transfer, was made available to consumers and businesses during the year. In the area of credit and debit cards, however, significant progress was registered as a result of the migration of automated teller machines (ATMs), points of sale (POSs) and cards to SEPA standards, although at the end of the year substantial work in this area still needed to be done.

Banker to the public sector

The Bank continued to act as a banker to the Government, maintaining accounts for the Treasury, other government departments and a number of public corporations. It also offered various foreign exchange services to government departments and public sector entities.

During 2009 the number of government cheques drawn on the Bank and presented for settlement by the rest of the banking system continued to decline, falling by 3.1% from the previous year's level. The value of cheques also dropped, albeit moderately, falling by 0.4% from the 2008 level, to EUR904.1 million. During the year the Bank continued to cash government cheques drawn on the Bank and presented by the general public.

Conversely, the volume of payments effected by direct credit rose by 4.4%, with the value of such payments rising by 8.0% during the year. Pensions accounted for most of the increase in these payments, followed by salaries, dividends on MGSs and other social security payments.

The provision of foreign exchange services, including documentary letters of credit, inward and outward bills for collection, guarantees and inter-bank transfers, is another important function of the Bank. Additionally, it continued to buy and sell foreign exchange, and to purchase travellers' cheques. Most of the foreign exchange transactions were carried out using SWIFT transfers, the standardised service for transferring payments between banks and other financial institutions overseas. The value of foreign exchange receipts processed by the Bank on behalf of the Government and public sector entities increased by EUR47.7 million to EUR391.0 million in 2009. The value of foreign exchange payments effected on behalf of the Government and public sector entities also increased, going up to EUR354.2 million from EUR312.8 million in 2008.

The Bank continued to administer the Foreign Pension Subsidy Scheme on behalf of the Government. In 2009 the scheme cost EUR8,495.36, and covered thirty-three beneficiaries.

During 2009 the Bank again effected payments in connection with the Government's external debt servicing. Capital repayments amounted to EUR12.8 million, up from EUR7.2 million a year earlier, while the associated interest payments amounted to EUR5.0 million.

Banker to the banking system

The Bank acts as a banker to the rest of the banking system by providing deposit facilities to credit institutions. As described in more detail elsewhere in this Report, credit institutions maintain balances at the Bank to meet the reserve deposit requirements laid down by the Eurosystem.

The Bank continued to provide portfolio management services to the Investor Compensation and Depositor Compensation Schemes during the year on the basis of the parameters laid down by their Management Committees, which are appointed by the MFSA.[2] The Bank also performs financial accounting and other related support services in connection with their activities. The Bank also reported regularly on these Schemes' asset positions.

In addition, as the designated custodian of assets held abroad under the Insurance Business Act, the Bank also held in its name, on behalf of insurance companies, certain specified assets representing funds guaranteed by the latter. The Bank, once again, reported regularly in this regard to the relevant authorities.

[2] The Investor Compensation Scheme protects clients of licensed investment service providers that are unable to satisfy their obligations towards investors while the Depositor Compensation Scheme compensates depositors in the event of a bank failure. These two schemes were established by Legal Notice 7 of 2003. Through this legal notice, the Bank was appointed as investments manager for both schemes.

4. INTERNAL MANAGEMENT

Administration

Board of Directors
The Board of Directors is responsible for the policy and general administration of the Bank except for certain functions that the Bank carries out directly in terms of the provisions of the Treaty on the Functioning of the European Union (TFEU) and the Statute of the ESCB.

In 2009 the Board was composed of Michael C Bonello, Governor and Chairman, David A Pullicino, Deputy Governor and Victor Busuttil, Antoinette Caruana and Mario Micallef as non-executive directors. Mr Micallef was appointed on 23 March 2009 for a period of five years, replacing Charles J Falzon, whose term expired on 6 February. Stephanie Sciberras served as Secretary to the Board. The Board met twelve times during the year.

During the year the Bank launched an integrated planning process to assess its regular activities and set priorities for new projects as it aligns its structures, policies and activities more closely with those of the Eurosystem. This will actively link all initiatives being undertaken across the Bank to the overall strategy. The exercise, which is ongoing, should also result in a more systematic and focused internal planning process.

Audit Committee
During 2009 the Audit Committee, which is established in terms of article 13 of the Central Bank of Malta Act, was chaired by Victor Busuttil, with Mario Micallef and David A Pullicino as members. The Committee reports and makes recommendations to the Board regarding financial reporting, internal audit and control, external audit and risk management.

During 2009 the Committee met eleven times. It addressed various topics, including the quarterly internal audit reports, the six-monthly risk assessment reports and the appointment of the external auditors. The Committee also agreed on the mid-year review of the 2009 annual internal audit plan and authorised that for 2010. It also reassessed risk management issues. Moreover, the Committee met the outgoing external auditors to review the results of the 2008 statutory audit and discussed the 2009 statutory audit with the Bank's new external auditors.

Management
The Executive Management Committee (EMC) is responsible for the day-to-day management of the Bank in accordance with the policies established by the Board. It includes the Governor as Chairman, the Deputy Governor and the five Division Directors.

During the year, the EMC decided to alter the organisational structure of the Bank to incorporate the payment systems function within the Financial Control Department. It also decided to merge the two offices formerly responsible for government debt analysis and money & capital markets into a new Government Securities Office.

Governor's official activities in Malta
In July the Governor appeared before the Public Accounts Committee of the House of Representatives in terms of the Central Bank of Malta Act to report on the conduct of monetary policy and the general economic situation.

During the year the Governor also addressed various conferences. In April he gave a presentation on the Bank's *Annual Report 2008* at a business breakfast. In May he delivered two speeches: the first, during a conference organised by the University of Malta, dealt with the Maltese experience of EU membership and the other, which addressed the challenges facing the Maltese banking system, was given during a conference organised by FinanceMalta. In the following month the Governor addressed the Malta Chamber of

Commerce, Enterprise and Industry about the global recession and its impact on the Maltese economy. In November he delivered a speech at the re-launch of the Mediterranean Bank p.l.c. and was once again the main speaker at the annual dinner of the Institute of Financial Services, where he focused on how Malta could achieve sustainable growth after the recession.

In the course of the year, the Governor also gave a number of interviews to the local and foreign media.

Governor's activities overseas

Apart from his regular participation in meetings of the ECB's Governing Council and General Council, the Governor also attended the informal ECOFIN meetings held in April and October in Prague and Stockholm, respectively. In January he attended the State celebrations organised by the Republic of Slovakia in Bratislava to mark the adoption of the euro in that country at the beginning of the year. He also delivered a speech on Malta's economic performance and outlook during a seminar on financial services in Malta held at the London Stock Exchange in March.

Legal issues

The Central Bank of Malta Act empowers the Bank to issue directives governing activities falling under its responsibility. Thus, during the year the Bank issued Directive No. 1 on the provision and use of payment services. This directive transposes parts of the European Union's Directive 2007/64/EC, which regulates payment services in the internal market.

The Bank amended Directive No. 5 on statistical reporting requirements, extending these to other reporting agents apart from credit institutions and deleting references to reserve deposit requirements. It also revised Directive No. 6 on the harmonised conditions regarding TARGET2 to implement changes made in ECB Guideline 2009/9 amending the definition of a credit institution. Similar amendments were made to Directive No. 7 on the provision of intraday credit.

Another directive amended by the Bank was Directive No. 8 on documentation related to monetary policy instruments and procedures. The changes reflected the various guidelines issued by the ECB to fine tune the general documentation on monetary policy in the light of the global financial crisis.

Economic analysis and research

Bank staff continued to analyse economic and financial developments in Malta and abroad, providing inputs into briefing papers for the Governor on developments in the euro area ahead of his participation in both the Governing Council and the General Council of the ECB. Projections and analysis related to the Maltese economy were also prepared regularly for presentation to the Board of Directors and the Bank's senior management. The Bank continued to publish an analysis of economic and financial developments in Malta and abroad in its *Quarterly Review* and *Annual Report*.

During the year the Bank contributed to a Eurosystem project on energy markets and the economy, as well as to the Malta section of an ECB report on competitiveness issues across the euro area. Together with economists from other central banks, Bank staff also participated in a study on the optimal design of fiscal policy measures.[1] The Bank continued to participate in a harmonised survey of bank lending conditions, the Bank Lending Survey, which is carried out on a quarterly basis across the euro area. Other work of an analytical nature was undertaken on a variety of economic and financial issues. Bank staff also began work on a study concerning the reliability of first estimates of GDP and its components, which is to be concluded in 2010. In addition, the Bank resumed the issue of a regular commentary on monetary statistics in Malta.

During the year the Bank began to participate in the work of a group set up under the ESCB's Working Group on Econometric Modelling to develop a multi-country Dynamic Stochastic General Equilibrium model. It is expected that a similar model will in the coming years be developed for the Maltese economy, thus providing an additional tool for policy simulation exercises.

[1] This study was later published in the Bank of Spain's Economic Bulletin and as a Central Bank of Luxembourg Working Paper.

The Bank continued to prepare its main macroeconomic projections within the context of the Eurosystem's Broad Macroeconomic Projection Exercise on a bi-annual basis, and the Narrow Inflation Projection Exercise on a quarterly basis. These serve as inputs to the production of euro area-wide projections. In addition, fiscal forecasts continued to be prepared twice a year for the General Council as part of the regular ESCB forecasting exercises.

Statistics

The Bank continued to collect, compile and disseminate a wide range of monetary, financial and other economic statistics for internal policy, analytical and research purposes and for release in its publications and on its website. At the same time, the Bank continued to transmit a considerable amount of statistics to the ECB, while an array of such data was prepared in connection with the Governor's attendance at Governing Council meetings. It also stepped up its efforts to broaden coverage and contribute to the development of euro area statistics in line with the ESCB's statistical work programme.

In addition, the Bank continued to provide various statistics to the IMF. On 1 December 2009, Malta subscribed to the Fund's Special Data Dissemination Standard (SDDS) following the NSO's fulfilment of the required standards.[2] Membership carries a commitment, on the part of both the Bank and the NSO, to observe the Standard by providing statistics and information about the practices adopted in disseminating data. The Bank is obliged to post such information on the Fund's Dissemination Standards Bulletin Board.

In the area of monetary statistics, the Bank, in cooperation with the MFSA and the NSO, carried out substantial work to revise reporting requirements under its Directive No. 5. In February the Bank began transmitting to the ECB data on investment fund balance sheet stocks and flows in line with the respective ECB regulation. Meanwhile, as from the first quarter of 2009 the Bank started collecting an integrated set of statistical returns from insurance companies in line with the recommendations of an *ad hoc* euro area task force.

During the year the Bank stepped up its efforts to collect security-by-security statistics from investment funds and insurance companies. In addition, the Bank participated in an ESCB network designed to undertake a Eurosystem-wide survey on household finance and consumption and undertook preparatory work on a corporate survey on wages and price setting.

Throughout the year Bank officials regularly participated in ESCB statistical committees, working groups and task forces, and in the work of the Committee on Monetary, Financial and Balance of Payment Statistics (CMFB).

Meanwhile, at the national level, the Bank intensified its cooperation with the NSO to improve concepts and methods of collecting macroeconomic statistics. Together with the NSO and the MFEI, the Bank continued to participate in the Government Finance Statistics Committee, which was set up to improve standards in the compilation of government finance statistics and to calculate government deficit and debt levels under the Excessive Deficit Procedure. It also worked with the NSO to refine the methods used in the compilation of property price indices.

The Technical Committee on Financial Statistics, which is chaired by the Bank and includes representatives from credit and financial institutions, the MFSA, the NSO and the Malta Bankers Association, continued to meet regularly during the year. The Committee helps co-ordinate the transition to new reporting systems and supports the enhancement of existing ones.

Internal audit

On the basis of the Internal Audit Charter, the Bank's internal audit function provides an independent assurance and consultancy to its senior management, the Audit Committee and, ultimately, the Board of Directors. This assurance covers the efficiency and effectiveness of governance, risk management and internal control processes deployed by the Bank. Similarly, in fulfilling its responsibilities to the ESCB, the internal

[2] The SDDS is part of the Fund's data standards initiatives for the compilation and dissemination of statistical data to support the pursuit of sound macroeconomic policies.

audit function provides assurances to it through the work undertaken on behalf of the ESCB Internal Auditors Committee (IAC).

The Director responsible for internal audit continued to report to the Audit Committee on internal audit operations and policy matters throughout 2009. In accordance with the Internal Audit Plan, the Bank's internal auditors concluded fifteen risk-based audit engagements during the year. Several procedural audits were also undertaken. Moreover, in consultation with the Bank's respective Divisions, the Management Letter of the external auditors for 2008 was assessed and recommendations to the Audit Committee were made.

Further to these assignments, during 2009 the internal auditors carried out a Bank-wide general follow-up audit to ensure the satisfactory implementation of recommendations made at both the local and the ESCB level and to close all outstanding audit findings. As a result of this exercise, most of these findings were closed, while action was planned with regard to the rest.

The Bank continued to participate in the ESCB Internal Auditors Committee during the year. In this regard four additional audit assignments were conducted on behalf of the ESCB. The Bank continued to revise its internal audit reference documents, with particular revisions being carried out on its Audit Manual to ensure harmonisation with the standards and best practices of the International Institute of Internal Auditors. Other policy documents, such as the Internal Audit Charter, were also under review.

Risk assessment

During 2009 the Bank updated its policies and procedures covering new business processes and existing work practices. These changes had implications for the Bank's Business Continuity Management processes, leading to further updating and testing of several continuity plans for critical business processes. Following a crisis scenario exercise carried out under the direction of the Bank's Operational Crisis Committee (OCC), the Bank's Management of Operational Crisis Situations framework was amended. These changes included a refinement of the crisis operational structure and the development of an Internal Communications Policy to establish the internal communications route through which the OCC would communicate with management and staff in a crisis situation.

Due to the influenza pandemic, the OCC ensured that adequate steps were being taken in terms of preparedness, in accordance with the Bank's *Pandemic Contingency Plan*, to monitor the situation and to assess any possible impact on the Bank's operations. The Bank also continued to participate actively in the work of the Forum on Pandemic Preparedness in the Financial Services Sector, which was set up by the Bank and the MFSA to ensure collaboration and effective communication between financial institutions and the National Pandemic Steering Committee.

At the ESCB level, the Bank continued to participate actively in two risk management-related Task Forces – the Operational Risk Management Task Force (ORM) and the Business Continuity Management Task Force. A senior Bank official was assigned on a four-month attachment with the ECB to work specifically on the ORM project, which has the mandate to roll out the ESCB ORM framework across all ESCB tasks and processes.

Data protection and freedom of information

The Bank continued to periodically verify and update the Data Protection Register on the processing of personal data used within the Bank and to notify the Data Protection Commissioner accordingly. During 2009 the Bank's Data Protection Office (DPO) did not receive any requests for personal information. With the enactment and the coming into force of the Freedom of Information Act in July, the Bank integrated the new role of Freedom of Information Officer with that of the DPO. Preparatory work for the Bank to meet its obligations under the new law was launched later in the year for implementation in 2010.

Human resources

By end-2009 the Bank employed a total of 322 full timers, seven more than a year earlier, while the number of part timers stood at ten, unchanged from end-2008. Taking into consideration justified absences, resignations and recruitment, the staff complement in terms of full-time equivalents edged up to 302 from 298 a year earlier.

During 2009 the Bank recruited nine Economic Officers, a Quantitative Analyst, three Security Officers and five clerks. At the same time, seven employees resigned from the Bank, two retired on medical grounds and one retired on reaching pensionable age. In addition, during the year, the Bank terminated the employment of one member of the staff. In 2009 the Bank again seconded staff to external entities. In all, four employees were seconded to other institutions: three to the MFEI and one to the Office of the Prime Minister. A further five employees were granted permission to take up short- to medium-term contracts with the ECB in areas related to risk management, financial stability and information systems.

During the summer months, the Bank offered temporary employment to eight university students majoring in economics, mathematics and statistics. It offered short-time employment to two students reading for a Higher National Diploma at the ICT Institute and, in addition, participated in a scheme administered by the Malta College of Arts Science and Technology (MCAST), offering a four-week work placement to four students. The Bank also entered into a mutual agreement with MCAST for the temporary exchange of library staff. Furthermore, the Bank launched an Internship Scheme during 2009 to encourage young graduates from Malta and other EU member states to obtain practical experience in central banking and to enhance their analytical skills. In this respect, the Bank granted one ten-month internship in the Economic Analysis Office to a Hungarian national.

Over the year, Bank officials continued to participate in the Human Resources Conference and the Organisational Analysis Working Group. The former discussed training activities, knowledge management and intra-ESCB mobility, while the latter focused on organisational planning, collaboration exercises and the assessment of performance indicators.

Meanwhile, the Bank concluded three-year collective agreements with the Malta Union of Bank Employees (MUBE) and the Union Ħaddiema Bank Ċentrali (UĦBC), representing the executive and clerical grades, respectively. An important novelty in these agreements was the inclusion of clauses to encourage environmental awareness, with financial incentives being attached to the attainment of agreed environmental targets.

Training and development

During the year the Bank continued to invest in staff training, both through in-house programmes and through external courses organised by local and foreign institutions. As Table 4.1 shows, a significant number of employees participated in external courses on a wide range of topics, mostly related to central banking, financial stability, economics, IT and accounting. Most of these were organised by the ESCB. When compared to the previous year, a larger number of staff attended external courses, both in Malta and overseas.

Table 4.1
STAFF TRAINING

Type of training	Number of courses/seminars		Number of participants	
	2008	2009	2008	2009
In-house	31	43	511	781
External	124	151	280	282
Local	71	91	220	218
Overseas	53	60	60	64

Source: Central Bank of Malta.

Table 4.2
ACADEMIC AND PROFESSIONAL COURSES
Number of employees

Type of programme	Programmes completed		Programmes being pursued	
	2008	2009	2008	2009
Postgraduate courses	4	12	21 (1)	14 (1)
Honours first degree courses	2	2	10	6
Diploma courses	5	1	3	2

(1) Includes two employees on unpaid study leave abroad to pursue doctoral programmes, and one employee at the London School of Economics under the Bank's newly introduced Learning, Research and Development Study Programme.
Source: Central Bank of Malta.

An active in-house training programme was also pursued. Forty-three courses were delivered, mainly in the areas of statistics, monetary policy, leadership, stress management, money markets, security, IT and health & safety. Furthermore, staff members delivered a number of lunchtime presentations covering such diverse topics as the Bank's anti-fraud policy, applied econometrics and principles of investment. In March a number of managers attended a residential leadership development programme, while in September a seminar for staff on mental well-being at the workplace was organised by the Richmond Foundation.

During 2009 the Bank approved participation in the ESCB's External Work Experience Scheme, which is intended to promote the exchange of staff between the affiliated NCBs through the secondment of staff members on a temporary and reciprocal basis. One staff member took up a secondment under the scheme and worked in the ECB's Statistics Directorate-General during the first half of the year. In a reciprocal arrangement, during the same period an ECB expert worked at the Bank to help it improve the methods used in the compilation of financial accounts statistics.

Academic and professional courses

In order to encourage employees to further their studies, the Bank in 2009 introduced a Learning, Research and Development Study Programme. Under this programme, the Bank offered to provide financial support to staff members wishing to pursue professional development at a reputable foreign university in areas of interest to it. Staff members selected under the programme are also granted unpaid leave of absence for the duration of their studies. One staff member took up the offer to participate in the scheme during 2009.

Increasing numbers of employees benefited from the Bank's other study scheme, which covers all other study programmes (see Table 4.2). Over the course of the year, 15 staff members successfully completed their studies, while a further 22 embarked on approved courses, mostly on a part-time basis. The vast majority of staff members benefiting from this scheme have either completed, or are pursuing, postgraduate courses.

Health and safety

Following the outbreak of the H1N1 influenza pandemic, the Bank stepped up measures related to medical support and hygiene. As another health and safety measure the Bank restructured some offices to increase the working space and introduced new safety & exit signage and emergency lights.

Corporate social responsibility

During 2009 the Bank took a number of initiatives in both the social and the environmental field. In the former area, the Bank decided to grant a maximum of three days' paid leave to staff members providing support to local voluntary organisations. In addition, the Bank continued to support the Arka Foundation in Gozo through the secondment of one of its employees. With respect to the environment, the Bank launched an internal strategy to encourage waste separation, light efficiency and the undertaking of environment-friendly procurement, among others.

As in past years, the Bank supported various philanthropic organisations through donations and sponsorships in 2009.

Premises, procurement and security

During the year, the St. James' Counterguard premises and the porch area in the main building were refurbished. The Bank also entered into an agreement for the cleaning of the bastions surrounding its premises.

During 2009 the Bank participated in the Eurosystem Procurement Coordination Office (EPCO). EPCO is designed to enable member central banks of the Eurosystem to benefit from efficiencies in the procurement of supplies and services. The Bank participated in EPCO procurement arrangements for air travel, hotels and packaging material for banknotes.

The Bank continued to participate fully in the ECB Security Working Group, which deals with the security aspects related to the production, processing, storage and transport of banknotes. It also participated in the Heads of Security Forum, which is composed of security experts from European central banks and the G-10 countries, and took part in a forum on cross-border transport.

Information technology

During 2009 the Bank's focus with regard to IT was on consolidation and minimising risk, particularly in matters of information security. Through the enhancement of its security regime, internet-based threats, among others, were minimised, thus protecting the Bank's information assets and IT infrastructure. The Bank also carried out a review of IT governance, management and security in the course of the year. Some recommendations regarding the Bank's planning process had already been implemented by the end of the year.

The Bank upgraded the infrastructure connecting it with the rest of the Eurosystem in 2009. For the next phase of this project, the Bank began the local procurement of the necessary components in conformity with common technical specifications. The SWIFT system was also upgraded, thus providing the baseline infrastructure for SEPA payments. In addition, the Bank's SEPA application was successfully developed and was ready to be launched by the end of the year.

In the course of the year a new application system was created to cater for the ECB's reporting requirements vis-à-vis investment funds. At the same time, the statistics and the financial accounts applications were further refined and upgraded.

Initial work was also carried out on the redevelopment of the Bank's website, new statistical databases and the Bank's internal information management database platform.

Information and public relations

The Bank keeps the public informed about its operations and activities through regular press and statistical releases, its publications and its website. During 2009 the Bank also continued to distribute a considerable amount of euro-related information materials to the public. In addition, towards the end of the year it embarked on a media campaign to raise awareness of the planned final withdrawal from circulation of all Maltese lira coins.

In 2009 the Bank published its *Financial Stability Report* for the first time, in electronic format, on its website. Apart from continuing to upgrade the latter, the Bank introduced a new on-line magazine for its own staff.

During the year staff members began participating fully in the Eurosystem structures and sub-structures relating to communications. The Bank also participated in meetings of the Directors of Communication organised by the Directorate General Economic and Financial Affairs of the European Commission. In addition, the Bank hosted three ESCB meetings in the course of the year.

An important development in 2009 was the introduction of an initial set of corporate identity guidelines designed to establish the Bank's image as a member of the Eurosystem. Finally, the Bank also handled various requests for information and interviews from both the local and the international media.

Library

The Central Bank of Malta library continued to enhance both its print and its electronic collections in the field of economics and finance. Apart from servicing the needs of the Bank's staff, the library met requests by external users pursuing research activities in these areas. It also maintained its comprehensive newspaper clippings service. The Bank's library continued to serve as a depository for the World Bank Group's publications.

Cultural and educational activities

In 2009 the Bank took part in the ECB's cultural days programme, which was dedicated to Romania. The Bank also participated in a sports tournament organised by the National Bank of Belgium. Educational visits continued to be organised at the Bank throughout the year, with a focus on audiovisual material related to the Eurosystem's role and functions.

5. INTERNATIONAL RELATIONS

The Central Bank of Malta contributes to the implementation of the tasks and activities of the Eurosystem and the ESCB. In particular, the Governor participates in meetings of the Governing Council and the General Council of the ECB. During the year the Bank continued to align its procedures and operating systems with those of the Eurosystem and to strengthen its relationship with the ECB and the other NCBs of the ESCB. It also collaborated with the IMF in the implementation of its crisis response package and developed further its relations with the World Bank Group and the EBRD.

European System of Central Banks

During the year, the Governor participated in the proceedings of the Governing Council of the ECB, which consists of the ECB's Executive Board and the Governors of the NCBs of the euro area Member States. The Council formulates monetary policy for the euro area and decides on the implementation, across the euro area, of the tasks entrusted to the Eurosystem. The Governor also continued to perform duties as a member of the General Council of the ECB, which is composed of the President and Vice-President of the ECB and the central bank Governors of all the EU Member States, and which mainly performs an advisory role.

In their work, the Governing Council and the General Council are assisted by a number of committees and working groups. Senior Bank officials participate in the activities of the Eurosystem/ESCB committees, which are listed in Table 5.1. In addition, staff with technical expertise contribute to the work of 58 working groups and task forces that provide support to these committees. This work is described in more detail elsewhere in this *Report*.

In 2009 the Governor also signed a number of agreements that regulate the operations of the ESCB. These include a renewed agreement on gold sales and an agreement authorizing the ECB to enter into a separate agreement with the European Commission for the joint provision of technical assistance to central banks and supervisory authorities in the western Balkans and Turkey.

As in previous years, Bank officials continued to attend seminars and conferences organised by the ESCB. In 2009 the Bank's participation in these events focused on the management of legal risk and information technology; payment and settlement issues; financial stability; and central banks' communication with the public. The Bank also benefited from technical advice from the Central Bank and Financial Services Authority of Ireland, in the context of the agreement between the two central banks concerning the operational management of foreign reserves.

Other EU institutions

During the year, the Governor attended two informal meetings of the ECOFIN Council. As in previous years, the Deputy Governor and other senior officials of the Bank took part in meetings of the Economic and Financial Committee (EFC) and its sub-committees when issues relevant to central banks were discussed.

In particular, the Bank participated in EFC discussions on the response of the international community to the global economic and financial crisis. It also took part in the review of the Stability Programme for Malta covering the period from 2009 to 2012, which was prepared by the MFEI. It co-operated with both the Ministry and the NSO in preparing reports on the Excessive Deficit Pro-

Table 5.1
EUROSYSTEM/ESCB COMMITTEES

Accounting and Monetary Income Committee (AMICO)
Banking Supervision Committee (BSC)
Banknote Committee (BANCO)
Budget Committee (BUCOM)
Committee on Cost Methodology (COMCO)
Eurosystem/ESCB Communications Committee (ECCO)
Eurosystem IT Steering Committee (EISC)
Human Resources Conference (HRC)
Information Technology Committee (ITC)
Internal Auditors Committee (IAC)
International Relations Committee (IRC)
Legal Committee (LEGCO)
Market Operations Committee (MOC)
Monetary Policy Committee (MPC)
Payment and Settlement Systems Committee (PSSC)
Statistics Committee (STC)

cedure and discussed projections on the Maltese economy with the European Commission as part of the latter's economic forecasting process.

Senior Bank officials continued to attend meetings of the European Anti-Fraud Office of the European Commission (OLAF) on anti-counterfeiting measures, and those of the Committee of European Bank Supervisors, which discusses issues related to the regulation and supervision of the financial sector and financial stability.

In May a Bank official also attended a European Commission conference assessing the experience with the euro changeover in Slovakia.

The Bank also co-operated with the MFSA, the MFEI and the Ministry of Foreign Affairs to ensure the timely transposition into Maltese law of EU financial sector legislation and the notification of the corresponding national implementing provisions to the ECB and the European Commission. During 2009, the Bank's work in this area focused on legislation concerning payment services.

International Monetary Fund

The Governor continued to serve as Governor for Malta on the Board of Governors of the IMF, while the Deputy Governor acted as Alternate Governor. In this capacity, and in consultation with the MFEI, the Governors voted on resolutions proposed by the Fund's Executive Board.

In August, the Fund's Board of Governors approved a resolution on a new general SDR allocation which was distributed later in the month. Consequently, as a participant in the Fund's SDR Department, the Bank received SDR75.6 million. In September, the Bank received an additional SDR8.5 million in the context of a special one-time allocation of SDRs that had been approved in 1997 to render the distribution of SDRs among IMF members more equitable, but which could only become effective when the required majority of IMF members in favour of the resolution had been achieved.

Mainly as a result of these two allocations, the Bank's SDR holdings rose from SDR11.7 million at the start of the year to around SDR96 million by the end of December.[1] In addition, the Bank entered into a two-way voluntary SDR trading arrangement with the IMF. Under this arrangement the Bank stands ready to buy and sell SDRs against euro, subject to certain limits, in transactions that the Fund arranges between prospective buyers and sellers of SDRs.

The Bank also carried out a number of transactions in the context of the IMF's operational budget. As a result, the Fund's holdings of the national currency with the Bank rose from SDR61.7 million to SDR68.9 million by the end of the year. Malta's reserve tranche declined from SDR40.3 million to around SDR33.1 million, as the amount received in repayment for previous loans exceeded the amount extended by the Bank in new lending.

As part of a consolidated effort by EU countries to strengthen the lending capacity of the Fund following the global financial crisis, the Maltese Government agreed to lend resources to the IMF through the Bank. Consequently, towards the end of the year the Bank and the IMF reached agreement on the terms of a bilateral loan arrangement. The Bank will thus make available an SDR-denominated loan, up to the equivalent of EUR120 million, over a maximum of four renewable one-year periods. By means of this agreement Malta contributed to the implementation of the EU's pledge to immediately contribute EUR75 billion to IMF resources. The agreement was signed in February 2010.

In June an Article IV Consultation Mission visited Malta to carry out the Fund's regular assessment of the economy. The Mission met the Minister of Finance, the Economy and Investment, the Governor and other key officials, as well as representatives of the Opposition, the private sector, social partners and academics.

[1] Further information on the counterpart to this asset, which represents a claim on the IMF, is included in the notes to the financial statements.

The resultant Staff Report on Malta, together with a Public Information Notice summarising the views of the IMF's Executive Board, were published in September. Moreover, the Bank continued to co-operate with the IMF on statistical matters and, in December, assumed new obligations under the IMF's Special Data Dissemination Standard (SDDS).

Meanwhile, the Bank continued to monitor ongoing discussions on the reform of the IMF. It also followed closely discussions on the international policy response to the financial crisis and the global economic slowdown and on economic policies in the euro area that took place at the level of the IMF's Executive Board.

World Bank Group

The Bank assists the MFEI in monitoring developments in the World Bank Group. As in past years, it advised the MFEI and the Ministry of Foreign Affairs on proposals originating from the Group that were of interest to them.

The Bank also continued to provide administrative support to the Small States Network for Economic Development and to act as fiduciary agent for the account of the Network's Board of Trustees. During the year, it signed a grant agreement with the World Bank defining the objectives and laying down safeguards on the use of funding provided in support of the Network. A Country Director of the World Bank paid a courtesy visit to the Bank in July.

European Bank for Reconstruction and Development

The Bank also monitors developments at the EBRD and collaborates with the MFEI on issues related to Malta's membership of this institution. With the Ministry, it examined a number of project proposals and resolutions that required a decision by the EBRD's Board of Governors. In May, the Deputy Governor and the Permanent Secretary of the MFEI represented Malta at the 18th annual meeting of the EBRD in London.

Others

The Bank continued to monitor developments related to initiatives endorsed by the BIS in the field of financial stability and took part in seminars organised by the Financial Stability Institute, which is a joint institution of the BIS and the Basel Committee on Banking Supervision.

A senior Bank official continued to participate in the meetings of the Council of Europe Select Committee of Experts on the evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) as part of the Maltese delegation. In 2009 the same official also participated in a training seminar of the Committee to prepare evaluators for the Fourth Round of Mutual Evaluations of member states on their compliance with international standards on anti-money laundering (AML) and countering the financing of terrorism (CFT).

Another senior official of the Bank contributed to this seminar in his capacity as a scientific expert, advising the Committee on preventive and financial sector matters. He also formed part of the team of evaluators that visited Bosnia and Herzegovina during the year to assess the country's AML/CFT framework and its progress in achieving compliance with relevant international standards. In his capacity as scientific expert to the Council of Europe committee that drafted the *Council of Europe Convention on laundering, search, seizure and confiscation of the proceeds from crime and on the financing of terrorism*, the same official also presented an overview of the preventive measures in the Convention and their relationship to other international AML/CFT standards during the first meeting of the Parties to the Convention that was held in Strasbourg in April.

ECONOMIC AND FINANCIAL POLICY CALENDAR 2009

This calendar lists important policy developments in the monetary, fiscal and exchange rate fields during the year

15 January: Convention on the avoidance of double taxation and the prevention of fiscal evasion between Malta and Ireland comes into force

The convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income between the governments of Malta and the Republic of Ireland that had been signed on 14 November 2008 comes into force. In this regard a legal notice, entitled Double Taxation Relief (Taxes on Income) (Ireland) Order 2009 is issued on 10 March under the Income Tax Act.

16 January - 1 March: Central Bank of Malta amends Directives No. 5 (Statistical Reporting Requirements) and No. 8 (Documentation on Monetary Policy Instruments and Procedures)

On 16 January the Central Bank of Malta amends Directive No. 5. The amendment mainly consists in the splitting into two of the Directive. Part I henceforth applies to credit institutions only, while Part II applies to other reporting agents.

On 1 February, and again on 1 March, the Central Bank of Malta amends Directive No. 8. These amendments reflect guidelines issued by the ECB, which mainly amend the list of eligible assets that counterparties in Eurosystem monetary policy operations may offer as collateral. Other amendments deal with technical aspects of the general documentation regulating monetary policy operations within the Eurosystem.

16 January: Legal Notice 20 declares 13 April and 26 December 2009 and 2 January 2010 to be bank holidays

This legal notice, issued under the Banking Act (Cap. 371) and entitled Declaration of Bank Holidays, declares 13 April 2009, 26 December 2009 and 2 January 2010 to be bank holidays.

11 February: Scheme to help businesses improve energy efficiency is launched

The Minister of Finance, the Economy and Investment launches a EUR 10 million scheme to help businesses improve their energy efficiency. The scheme, which is to be co-financed by the European Regional and Development Fund and the Government, is to be administered by Malta Enterprise and is intended to support two types of investments: those in energy saving measures and those designed to tap alternative sources of energy. Projects are to be completed within 18 months and should have a minimum value of EUR25,000.

24 February: Banks suspend hotel loan repayments

In order to ease the impact of the current economic slowdown on the tourism sector, a number of Malta's commercial banks reach an agreement with the Government to suspend capital loan repayments by hotels for one year. The aim of this moratorium is to increase the cash flow in the hospitality industry.

1 March: Eco-tax on plastic bags comes into effect

The tax on plastic bags announced in the Budget for 2009 comes into effect. This tax does not differentiate between degradable and biodegradable bags, aiming to eradicate the use of plastic bags altogether. The eco tax on a bag to be charged to consumers is EUR0.15 plus VAT.

10 March: Derogation of zero-rated VAT on food and medicines extended

At the ECOFIN meeting in Brussels, the derogation of zero-rated VAT on food and medicines, which Malta had benefited from since EU accession and which was meant to expire in 2009, is extended. Malta is to keep its current zero-rated VAT regime on food and medicines as long as the UK and Ireland keep theirs.

13 March: Double taxation treaty between Malta and Italy amended

A protocol amending the agreement between the governments of Malta and Italy for the avoidance of double taxation with respect to taxes on income and the prevention of fiscal evasion is signed in Rome. The protocol amends some articles in the agreement, which had entered into force in July 1981, including those that refer to the taxes covered, the elimination of double taxation and the exchange of information.

23 March: Appointment of Central Bank of Malta Board Director

The Prime Minister appoints Mr. Mario Micallef CPAA, FIA as Director of the Board of the Central Bank of Malta for a period of five years in terms of the Central Bank of Malta Act (Cap. 204).

14 April: Malta and Lebanon sign protocol amending double taxation convention

During a visit to the Middle East by the Minister of Foreign Affairs, the governments of Malta and Lebanon sign a protocol amending the convention between the two countries on the avoidance of double taxation and the prevention of fiscal evasion.

30 April: Legislation related to banking and finance

Legal Notice 138 sets out requirements for the operation of a central securities system

This legal notice, issued under the Financial Markets Act (Cap. 345) and entitled Central Securities Depository (Authorisation Requirements) Regulations 2009, sets out the requirements for the authorisation and operation of a central securities depository.

Legal Notice 139 sets out regulations governing the control of assets by persons authorised to operate as a central securities depository

This legal notice, issued under the Financial Markets Act (Cap. 345) and entitled Central Securities Depository (Control of Assets) Regulations, 2009, regulates the control of assets by persons authorised to operate as a central securities depository.

Legal Notice 140 lists the classes of financial instruments which are considered "designated financial instruments" for the purposes of the Financial Markets Act

This legal notice, issued under the Financial Markets Act (Cap. 345) and entitled Designated Financial Instruments Regulations, 2009, lists the categories or classes of financial instruments whose register is maintained in a central securities depository and which are considered as "designated financial instruments" for the purposes of Part IV of the Financial Markets Act.

20 May: European Commission approves the Maltese Government's request to provide assistance to businesses

The European Commission approves the Maltese Government's request to allow it to provide financial assistance up to a maximum of EUR500,000 over 2009 and 2010 to businesses facing difficulties on account of the current economic and financial crisis. Only businesses that were not in financial difficulty before 1 July 2008 are eligible for such aid.

5 June: Central Bank of Malta issues document on the implementation of EU Directive on Payment Services

In order to transpose the EU Directive on payment services in the internal market, the Central Bank of Malta issues a pre-implementation document in terms of Central Bank of Malta Directive No. 1. The Bank's document lays down rules governing transparency of information and the rights and obligations of payment service users and providers in relation to the provision of payment services as a regular occupation or business activity. It is the Banks' intention to bring the proposed Directive into force on 1 November 2009.

5 June: Central Bank of Malta amends Directive No. 6 (Harmonised Conditions for Participation in TARGET2) and Directive No. 7 (Provision of Intraday Credit)

The Central Bank of Malta amends its Directive No. 6 and Directive No. 7 to bring definitions in line with ECB guidelines ECB/2009/9.

17 June: Government launches scheme to help tourist industry

As a further measure to ease the impact of the economic slowdown on the tourism sector the Government launches a scheme worth EUR3 million to help hotels and restaurants wanting to upgrade their facilities. The assistance takes the form of a 1.5% interest rate subsidy.

24 June: European Commission recommends that Malta should bring its budget deficit below the 3% of GDP reference value by 2010

Following the validation of the data notified by the Maltese authorities, which showed that the 2008 general government deficit had reached 4.7% of GDP, the European Commission considers that an excessive deficit exists in Malta and recommends that the country should correct its budget deficit by the end of 2010.

7 July: European Council decides that an excessive deficit exists in Malta and issues recommendations on action to be taken

On the basis of the European Commission's recommendation of 24 June, the Council of the EU decides that an excessive deficit exists in Malta. It also issues recommendations on action to be taken to correct the excessive deficit situation, setting 7 January 2010 as the deadline for such action to be taken and calling on Malta to reduce the deficit to below 3% of GDP at the latest by 2010.

7 July: Standard and Poor's affirms Malta's ratings

Standard & Poor's affirms it's 'A' long-term and 'A-1' short-term sovereign credit ratings for Malta and its Transfer and Convertibility assessment of the country at 'AAA'. The agency says that the stable outlook for Malta balances its expectation of continued fiscal consolidation in the medium term against the challenges of the economic reform agenda and a high debt burden.

7 August: Legislation related to banking and finance

Legal Notice 227 raises coverage level of Depositor Compensation Scheme to EUR100,000 and sets payout delay at twenty working days

This legal notice, issued under the Banking Act (Cap. 371), amends the Depositor Compensation Scheme Regulations, 2003. The objective of these amendments is to implement Directive 2009/14/EC as regards coverage level and payout delay. As a result, the coverage level is raised to EUR100,000 while the payout delay is set at twenty working days from the date of determination (i.e. the day when a credit institution fails to repay deposits that fall due and become payable).

Legal Notice 228 obliges Investor Compensation Scheme to publish its financial statements within five months from its financial year-end as against three months previously

This legal notice, issued under the Investment Services Act (Cap. 370), amends the Investor Compensation Scheme Regulations, 2003. The amended regulations oblige the Scheme to publish its financial statements within five months from its financial year-end as against three months previously.

21 August: Fitch Ratings affirms Malta's rating

Fitch Ratings affirms Malta's long-term foreign currency and local currency Issuer Default Ratings (IDRs) at 'A+', with both ratings being given stable outlooks. Fitch affirms Malta's Short-term IDR at 'F1' and its Country Ceiling at 'AAA', the common country ceiling for the euro area.

The agency says that it is affirming these ratings because they reflect Malta's modest success during its first year in the euro area and its ability to ride the global economic downturn.

28 August: Malta receives Special Drawing Rights (SDRs)

The Central Bank of Malta, as agent for the Maltese Government at the IMF, receives SDR75.6 million from the Fund as Malta's share of a general SDR allocation and a further SDR8.5 million as its share of a special SDR allocation.

4 September: Government launches scheme granting an amnesty to income tax defaulters
The Minister of Finance, the Economy and Investment launches a scheme whereby individuals facing penalties for non-payment of income tax are offered a 90% reduction on such fines and accrued interest charges. The scheme is to run till 15 January 2010, and in order to benefit from it individuals must settle the full amount of tax due by that date.

10 September: Malta and San Marino sign protocol amending double taxation convention
The governments of Malta and San Marino sign a protocol amending the convention with respect to taxes on income that was signed by the two states in May 2005.

14 September: IMF publishes staff report on Malta following visit by Article IV Consultation Mission
The IMF publishes its staff report on Malta after an Article IV Consultation Mission had visited the island between 11 and 22 June.

18 September: Government announces privatisation of Marsa Ship Repair Facility
The Government announces that it has accepted the recommendations of the Evaluation Committee with regards to the privatisation of the Marsa Ship Repair Facility and has awarded the facility to Palumbo S.p.A of Italy.

30 October: Central Bank of Malta revises Directive No.1 (the transposition and use of payment services)
The Central Bank of Malta revises Directive No. 1 to bring into effect related EU legislation on payment services in the internal market. The Directive lays down rules governing transparency of conditions and information requirements of payment services and sets out the respective rights and obligations of payment service users and providers in relation to the provision of such services.

30 October: Government issues stocks
The Government, through Legal Notice 316, launches EUR80,000,000 MGS comprising a 3.6% MGS 2013 (IV) Fungibility Issue, a 4.6% MGS 2020 (II) and a Floating Rate Euribor MGS 2015 (V) linked to the 6-month Euribor. The issue is oversubscribed and an over-allotment option for an additional sum of EUR20,000,000 is exercised.

9 November: Measures introduced in the Budget for 2010
The Minister of Finance, the Economy and Investment presents the Budget for 2010 to Parliament.

The main measures include:

Fiscal
- The removal of the EUR16.31 levy on credit cards.
- A EUR5.82 weekly cost-of-living increase; pensioners to receive this increase in full.

Financial assistance to companies
- Selective grants to enterprises.
- Credit of up to EUR25,000 to micro firms at advantageous rates of interest and with easier terms to encourage investment.

Social welfare assistance
- Child-in-care benefit to rise to EUR70 a week and the age to qualify for assistance to rise to 21 years.
- Families that consume less than 10,000 units of electricity to receive compensation and low income families to receive an energy benefit.

Economy / labour market

- The setting up of a new entity to educate and protect consumers against unjustified price levels and to strengthen the price watch mechanism.
- Job seekers to be given full-time training in basic skills and the establishment of new schemes to give unemployed persons work experience.
- Incentives aimed at attracting more women to the labour market.

Infrastructure measures

- The maintenance and reconstruction of many residential roads and the construction of arterial roads.
- New bus terminals to be established as part of the reform of public transport.

17 November: 5 April 2010 declared a Bank Holiday

Legal Notice 340, issued under the Banking Act (Cap. 371) and entitled Declaration of Bank Holiday, establishes 5 April 2010 as a bank holiday.

24 November: Malta-Montenegro Double Taxation Relief Convention comes into force

Legal Notice 343, issued under the Income Tax Act (Cap. 123) and entitled Double Taxation Relief (Taxes on Income) (Montenegro) Order, 2009, affords relief from double taxation in respect of taxes on profit and income specified in the attached Convention. The latter relates to a double taxation agreement signed by the governments of Malta and Montenegro on 4 November 2008.

1 December: Malta subscribes to the IMF's Special Data Dissemination Standard (SDDS)

Malta subscribes to the IMF's SDDS. This standard was established by the IMF in March 1996 and is intended to guide members in the publication of economic and financial data. Subscription to the SDDS is expected to enhance the availability of timely and comprehensive statistics, thereby contributing to the pursuit of sound macroeconomic policies and the improved functioning of financial markets in the subscribing country.

A member country's participation in the SDDS is voluntary. However, it obliges that country to observe the Standard's conditions on the publication of the specified statistics and to provide certain information to the IMF about its practices in disseminating economic and financial data.

9 October – 24 December: Legislation related to banking and finance

9 October: Legal Notice 259 amends schedule to regulations regarding submission of business statement fees

This legal notice, issued under the Insurance Business Act (Cap. 403) and entitled the Insurance Business (Fees) (Amendment) Regulations, 2009 amends the schedule to the principal regulations regarding the submission of business statement fees.

9 October: Legal Notice 260 amends schedules to regulations governing insurance business related to monetary amounts

This legal notice, issued under the Insurance Business Act (Cap. 403) and entitled the Insurance Business (Assets and Liabilities) (Amendment) Regulations, 2009 amends certain schedules to the principal regulations related to monetary amounts.

9 October: Legal Notice 264 exempts certain persons, when receiving property upon trust, from the requirement for authorisation to act as trustees by the MFSA

This legal notice, issued under the Trusts and Trustees Act (Cap. 331) and entitled Trusts and Trustees Act (Exemption) Regulations, 2009 exempts certain persons, when receiving property upon trust, from the requirement for authorisation to act as a trustee by the MFSA and that of appointing a qualified person.

6 November: Legal Notice 328 amends definition of "relevant financial business" in prevention of money laundering and funding of terrorism regulations

This legal notice, issued under the Prevention of Money Laundering Act (Cap. 373) and entitled Prevention of Money Laundering and Funding of Terrorism (Amendment) Regulations, 2009 amends the definition of "relevant financial business" in the principal regulations and makes other amendments to the said regulations.

11 December: Legal Notice 355 adds regulation regarding "tied agents" to regulations governing European passport rights for credit institutions

This legal notice, issued under the Banking Act (Cap. 371) and entitled the European Passport Rights for Credit Institutions (Amendment) Regulations, 2009 adds a new regulation regarding "tied agents" to the principal regulations.

11 December: Legal Notice 356 amends several regulations governing investment services and adds a new one to the list

This legal notice, issued under the Investment Services Act (Cap. 370) and entitled the Investments Services Act (Tied Agents) (Amendment) Regulations, 2009 amends several of the principal regulations and adds a new regulation, regulation 12, to the list.

24 December: Legal Notice 368 amends rule 5 of the Finance Leasing rules

This legal notice, issued under the Income Tax Act (Cap. 123) and entitled the Finance Leasing (Amendment) Rules, 2009, amends rule 5 of the Finance Leasing Rules, 2005.

PART III

FINANCIAL STATEMENTS

FOR THE YEAR ENDED

31 DECEMBER 2009

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 2009.

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 2009, 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 are outlined in the Accounting Guideline (ECB/2006/16 as amended) on the legal framework for accounting and financial reporting in the European System of Central Banks adopted by the Governing Council on 10 November 2006.

Financial results

The Bank's financial statements for the year ended 31 December 2009 are set out on pages A-6 to A-46 and disclose an operating profit of €58.6 million (2008: €48.6 million). The amount payable to the Government of Malta is €45.6 million (2008: €41.6 million).

Board of Directors

The members of the Board of Directors during the year ended 31 December 2009 and up to the date of authorisation for issue of the financial statements were:

Mr Michael C. Bonello - Governor
Mr David A. Pullicino - Deputy Governor
Mr Victor Busuttil
Ms Antoinette Caruana
Mr Mario Micallef (appointed on 23 March 2009)
Mr Charles Falzon (appointment expired on 6 February 2009)

During the financial year under review, Dr Stephanie Sciberras was the Secretary to the Board.

Auditors

KPMG have been appointed as the Bank's auditors with effect from the financial year ending 31 December 2009 and have signified their willingness to continue in office.

By order of the Board

M. C. Bonello
Governor

D. A. Pullicino
Deputy Governor

Pjazza Kastilja
Valletta
Malta
26 March 2010

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 Accounting Guideline (ECB/2006/16 as amended) on the legal framework for accounting and financial reporting in the European System of Central Banks adopted by the Governing Council of the European Central Bank on 10 November 2006.

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 2009 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.

Independent auditors' report

To the Board of Directors of the Central Bank of Malta

Report on the financial statements

We have audited the financial statements of the Central Bank of Malta ("the Bank") as set out on pages A-6 to A-46, which comprise the balance sheet as at 31 December 2009, the profit and loss account for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The responsibility of the Central Bank of Malta's Board of Directors for the financial statements

As explained more fully in the Directors' Responsibilities Statement set out on page A-3, the Directors are responsible for the preparation and fair presentation of these financial statements in accordance with the provisions established by the Governing Council of the European Central Bank, which are set out in Decision ECB/2006/16 issued on 10 November 2006 as amended by subsequent Accounting Guidelines and the requirements of Central Bank of Malta Act (Chapter 204, Laws of Malta). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit.

In addition, we read the Directors' Report and consider the implications for our report if we become aware of any apparent material misstatements of fact.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion on the financial statements

In our opinion, the financial statements:

- give a true and fair view of the financial position of the Bank as at 31 December 2009 and of its financial performance for the year then ended in accordance with the provisions established by the Governing Council, which are set out in Decision ECB/2006/16 as amended by subsequent Accounting Guidelines; and
- have been properly prepared in accordance with the Central Bank of Malta Act (Chapter 204, Laws of Malta).

Noel Mizzi (Partner) for and on behalf of

KPMG
Registered Auditors
Portico Building
Marina Street
Pieta'   PTA 9044
Malta

26 March 2010

Balance sheet as at 31 December 2009

	Assets	2009 €'000	2008 €'000
A 1	**Gold and gold receivables**	**5,174**	**4,141**
A 2	**Claims on non-euro area residents denominated in foreign currency**	**375,025**	**251,436**
A 2.1	Receivables from the IMF	140,528	57,385
A 2.2	Balances with banks and security investments, external loans and other external assets	234,497	194,051
A 3	**Claims on euro area residents denominated in foreign currency**	**237,965**	**435,407**
A 4	**Claims on non-euro area residents denominated in euro**	**95,666**	**259,973**
A 4.1	Balances with banks, security investments and loans	95,666	259,973
A 4.2	Claims arising from the credit facility under ERM II	-	-
A 5	**Lending to euro area credit institutions related to monetary policy operations denominated in euro**	**1,252,500**	**454,000**
A 5.1	Main refinancing operations	319,000	164,000
A 5.2	Longer-term refinancing operations	933,500	290,000
A 5.3	Fine-tuning reverse operations	-	-
A 5.4	Structural reverse operations	-	-
A 5.5	Marginal lending facility	-	-
A 5.6	Credits related to margin calls	-	-
A 6	**Other claims on euro area credit institutions denominated in euro**	**625**	**164,004**
A 7	**Securities of euro area residents denominated in euro**	**626,196**	**460,194**
A7.1	Securities held for monetary policy purposes	-	-
A7.2	Other securities	626,196	460,194
A 8	**General government debt denominated in euro**	**-**	-
A 9	**Intra-Eurosystem claims**	**48,297**	**47,322**
A 9.1	Participating interest in ECB	11,890	11,491
A 9.2	Claims equivalent to the transfer of foreign reserves	36,407	35,831
A 9.3	Claims related to promissory notes backing the issuance of ECB debt certificates *	-	-
A 9.4	Net claims related to the allocation of euro banknotes within the Eurosystem	-	-
A 9.5	Other claims within the Eurosystem (net)	-	-
A 10	**Items in course of settlement**	**5,212**	**5,008**
A 11	**Other assets**	**597,032**	**641,031**
A 11.1	Coins of euro area	378	23
A 11.2	Tangible and intangible fixed assets	20,557	21,669
A 11.3	Other financial assets	448,143	461,528
A 11.4	Off-balance sheet instruments revaluation differences	7,969	308
A 11.5	Accruals and prepaid expenses	29,407	38,576
A 11.6	Sundry	90,578	118,927
Total Assets		**3,243,692**	**2,722,516**

* Only an ECB balance sheet item

	Liabilities	2009 €'000	2008 €'000
L 1	**Banknotes in circulation**	**673,353**	**629,289**
L 2	**Liabilities to euro area credit institutions related to monetary policy operations denominated in euro**	**584,599**	**483,475**
L 2.1	Current accounts (covering the minimum reserve system)	447,596	474,475
L 2.2	Deposit facility	137,000	9,000
L 2.3	Fixed-term deposits	-	-
L 2.4	Fine-tuning reverse operations	-	-
L 2.5	Deposits related to margin calls	3	-
L 3	**Other liabilities to euro area credit institutions denominated in euro**	-	-
L 4	**Debt certificates issued***	-	-
L 5	**Liabilities to other euro area residents denominated in euro**	**397,690**	**366,314**
L 5.1	General government	392,912	361,949
L 5.2	Other liabilities	4,778	4,365
L 6	**Liabilities to non-euro area residents denominated in euro**	**86,785**	**80,371**
L 7	**Liabilities to euro area residents denominated in foreign currency**	**71,582**	**33,793**
L 8	**Liabilities to non-euro area residents denominated in foreign currency**	**9**	**65**
L 8.1	Deposits, balances and other liabilities	9	65
L 8.2	Liabilities arising from the credit facility under ERM II	-	-
L 9	**Counterpart of special drawing rights allocated by the IMF**	**103,854**	**12,471**
L 10	**Intra-Eurosystem liabilities**	**908,761**	**721,127**
L 10.1	Liabilities equivalent to the transfer of foreign reserves*	-	-
L 10.2	Liabilities related to promissory notes backing the issuance of ECB debt certificates	-	-
L 10.3	Net liabilities related to the allocation of euro banknotes within the Eurosystem	95,073	54,547
L 10.4	Other liabilities within the Eurosystem (net)	813,688	666,580
L 11	**Items in course of settlement**	**-**	**-**
L 12	**Other liabilities**	**98,259**	**106,682**
L 12.1	Off-balance sheet instruments revaluation differences	-	2,738
L 12.2	Accruals and income collected in advance	67,397	86,590
L 12.3	Sundry	30,862	17,354
L 13	**Provisions**	**3,579**	**5,119**
L 14	**Revaluation accounts**	**16,545**	**8,135**
L 15	**Capital and reserves**	**253,042**	**234,060**
L 15.1	Capital	20,000	20,000
L 15.2	Reserves	233,042	214,060
L 16	**Profit for the year**	**45,634**	**41,615**
Total Liabilities		**3,243,692**	**2,722,516**

Profit and loss account for the year ended 31 December 2009

		2009	2008
		€'000	€'000
1.1	Interest income	69,917	126,486
1.2	Interest expense	(10,521)	(57,888)
1	**Net interest income**	**59,396**	**68,598**
2.1	Realised gains / (losses) arising from financial operations	5,168	808
2.2	Write-downs on financial assets and positions	(1,498)	(8,564)
2.3	Transfer (to) / from provisions for foreign exchange rate, interest rate, credit and gold price risks	-	-
2	**Net result of financial operations, write-downs and risk provisions**	**3,670**	**(7,756)**
3.1	Fees and commissions income	80	56
3.2	Fees and commissions expense	(511)	(511)
3	**Net income / (expense) from fees and commissions**	**(431)**	**(455)**
4	**Income from equity shares and participating interests**	**817**	**1,076**
5	**Net result of pooling of monetary income**	**803**	**(7,902)**
6	**Other income**	**9,443**	**11,814**
	Total net income	**73,698**	**65,375**
7	**Staff costs**	**(8,790)**	**(9,304)**
8	**Administrative expenses**	**(3,440)**	**(3,545)**
9	**Depreciation of tangible and intangible fixed assets**	**(1,386)**	**(1,468)**
10	**Banknote production services**	**(1,069)**	**(2,338)**
11	**Other expenses**	**(379)**	**(105)**
	Profit for the year	**58,634**	**48,615**
	Transfer to reserves for risks and contingencies	**(13,000)**	**(7,000)**
	Payable to the Government of Malta in terms of article 22(2) of the Central Bank of Malta Act (Cap. 204)	**45,634**	**41,615**

The financial statements on pages A-6 to A-46 were approved for issue by the Board of Directors on 26 March 2010 and were signed on its behalf by:

M. C. Bonello Governor	D. A. Pullicino Deputy Governor	G. Huber Director Finance and Banking	R. Filletti Financial Controller

Notes to the financial statements for the year ended 31 December 2009

General notes to the financial statements

1 Introduction of the euro

Malta introduced the euro as the new legal tender on 1 January 2008. As of that date, 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 Central Bank of Malta is required under article 21(5) of the Central Bank of Malta Act (Cap. 204) to prepare its financial statements in accordance with the provisions established by the Governing Council of the European Central Bank (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 Accounting Guideline (ECB/2006/16 as amended) on the legal framework for accounting and financial reporting in the European System of Central Banks adopted by the Governing Council of the ECB on 10 November 2006. The Bank adopted the Accounting Guideline on 1 January 2008 and from the year ended 31 December 2008, its financial statements have been prepared in accordance with the requirements of this Guideline. In the absence of requirements and guidance provided by the Accounting Guideline that specifically apply to transactions, other events or conditions, the requirements of International Financial Reporting Standards 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 2009 and of its profit for the year then ended. The accounts have been prepared on a historical cost basis, modified to include market valuation of marketable securities classified as other than held-to-maturity, gold and all instruments, on-balance sheet and off-balance sheet.

3 Accounting policies

(a) Basic accounting principles

The following accounting principles have been applied in the preparation of these financial statements:

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

(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 the Bank, and the cost or value of the asset or the amount of the obligation can be measured reliably.

[1] The "European System of Central Banks (ESCB)" comprises the ECB and the national central banks (NCBs) of all EU Member States (Article 107.1 of the Treaty) whether they have adopted the euro or not. The "Eurosystem" comprises the ECB and the NCBs of those countries that have adopted the euro. 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 transactions 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-balance sheet recording of these transactions is carried out on settlement date 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 securities transactions 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 are revalued at the prevailing mid-market prices at the balance sheet date.

Gold balances are valued 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 in the case 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 is 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 cost of the inflows for each respective currency or 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. Premiums or discounts arising from the difference between the average acquisition cost and the redemption price on securities are presented as part of interest income and are 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 discounted securities. 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, any 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 position in that currency, will give rise to a change in the average cost of that currency or to the realisation of a further profit or loss depending on whether the Bank has a long or short position in that currency respectively. Every day, a weighted average price is calculated, firstly on inflows and secondly on outflows. The realised gain / loss is calculated by applying the difference between these average prices to the lower of the day's inflows or outflows.

For long positions, where outflows exceed inflows, a second realised gain / 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 book value using the average cost method.

Realised gains and losses are taken to the Profit and loss account.

Unrealised revaluation gains and unrealised revaluation 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 within the Bank's liabilities. Unrealised losses 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 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.

Gains and losses arising from spot and forward foreign exchange contracts 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 Accounting policy (f) *"Income recognition"* above. Unrealised valuation gains / 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

Following the decisions of the Governing Council of 7 May and 4 June 2009, the ECB and the national central banks ("NCBs") started to purchase for monetary policy purposes euro-denominated covered bonds issued in the euro area. These securities are valued at amortised cost and are subject to impairment tests.

(ii) Securities held for other than monetary policy purposes

Marketable securities classified as held-to-maturity are measured at amortised cost less provisions for impairment. Held-to-maturity securities are securities with fixed or determinable payments and a fixed maturity, which the Bank intends to hold until maturity.

Marketable securities other than those held-to-maturity are carried at mid-market prices prevailing at the balance sheet date, on a security by security basis. Unrealised gains and losses in respect of such securities are measured and recognised as outlined in Accounting policy (f) *"Income recognition"* above.

Securities which are designated as part of an earmarked portfolio comprising earmarked investments held on the assets side of the Balance sheet as a counterpart to the Bank's capital and statutory reserves are classified as held-to-maturity investments.

Securities forming part of an earmarked portfolio comprising Malta Government securities and Treasury bills purchased on the secondary market by the Bank in its role as a market maker are measured at mid-market prices prevailing at the balance sheet date. Unrealised gains are reflected on-balance sheet in the liability sub-item L12.3 *"Sundry liabilities"* whilst unrealised losses are recognised in asset sub-item A11.6 *"Sundry assets"*.

(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 and Special Drawing Rights (SDR) 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 Fund at the close of business on 31 December 2009. Adjustments on revaluation of the IMF holdings are reflected in the corresponding asset *"Currency Subscription"* disclosed in asset sub-item A11.6 *"Sundry assets"*.

(k) Accounting for euro coins

Subsequent to the agency agreement between the Bank and the Government of Malta, the face value of the euro coins issued by the Bank gives 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 as disclosed in Note L15.2 *"Reserves"* in the Notes to the Balance sheet.

(l) Demonetised Maltese lira currency notes and coins

(i) Demonetised Maltese lira currency notes

Demonetised Maltese lira currency notes shall, until ten years following the expiration of the period mentioned in the notice of demonetisation, be redeemable by the Bank on demand for euro currency at the conversion rate of the Maltese lira for the euro established in terms of the Treaty and without charge.

In accordance with article 62 of the Central Bank of Malta Act (Cap. 204), after the expiration of one year following the end of the period established in the notice, any unpresented demonetised Maltese lira currency notes cease to be included in the Bank's currency liabilities. The value of such notes, after deducting therefrom the value of any notes which are subsequently redeemed, are recognised in the Profit and loss account of the Bank up to the expiration of ten years from the end of the period above mentioned. After the expiry of ten years from the notice of demonetisation, demonetised currency notes not yet presented are not redeemed by the Bank.

(ii) Demonetised Maltese lira currency coins

Demonetised Maltese lira currency coins shall, until two years following the expiration of the period mentioned in the notice of demonetisation, be redeemable by the Bank on demand for euro currency at the conversion rate of the Maltese lira for the euro established in terms of the Treaty and without charge.

In accordance with article 63 of the Central Bank of Malta Act (Cap. 204), after the expiration of six months following the end of the period established in the notice, any unpresented demonetised Maltese lira currency coins cease to be included in the Bank's currency liabilities. The value of such coins, after deducting therefrom the value of any coins which are subsequently redeemed, are recognised in the Profit and loss account of the Bank until the expiration of two years from the end of the period above mentioned. After the expiry of two years from the notice of demonetisation, demonetised coins not yet presented are not redeemed by the Bank.

(m) Tangible and intangible fixed assets

All tangible and intangible fixed assets are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount 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 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 - 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. An asset's carrying amount is written down immediately to its recoverable amount if the asset's 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 proceeds with the carrying amount. These are included in the Profit and loss account in the year the asset is derecognised.

(n) Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

4 Capital key

The capital key determines the allocation of the ECB's share capital to the NCBs. It is determined on the basis of population and gross domestic product data. It is adjusted every five years and every time that 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 year ended 31 December 2009 was 0.0632% (2008: 0.0622%). The Eurosystem capital key is the respective NCB's share of the total share capital held by Eurosystem members in the ECB and is utilised as the basis for allocation of monetary income, banknotes in circulation and the ECB's results.

5 Change to ECB capital key on 1 January 2009

On 1 January 2009, the ESCB experienced a quinquennial capital key change in accordance with article 29.3 of the Statute. As explained in paragraph 4 *"Capital key"* above, the Bank's share in the fully paid up capital of the ECB increased from 0.0622% to 0.0632%. As at the same date, the Eurosystem also expanded due to the accession of Národná banka Slovenska which paid its capital share in full.

6 Euro banknotes in circulation

Euro banknotes are issued by the ECB and the sixteen[2] participating NCBs, which together comprise the Eurosystem. The total value of euro banknotes in circulation is allocated on the last working day of each month in accordance with the banknote allocation key[3].

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 capital key. In the year under review, the Bank had a 0.0906% share (2008: 0.0892%) in the fully paid-up capital of the ECB, (referred also as Eurosystem capital key), and a 0.0835% share (2008: 0.0825%) of the euro banknotes in circulation in

[2] Národná banka Slovenska joined the Eurosystem on 1 January 2009.

[3] 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 Eurosystem capital key to the NCBs' share in such total.

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"*.

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 at the main refinancing operations rate. If the value of the euro banknotes actually issued is greater than the value according to the banknote allocation key, the excess is recorded 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 recorded 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[4] and in the following five years following the cash changeover year, 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[5], 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 Eurosystem capital key. The Bank's adjustment period started on 1 January 2008 and will end on 31 December 2013.

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 of the Bank under item 1 *"Net interest income"*.

Furthermore, 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, shall be due to the NCBs in the same financial year it accrues and distributed on the second working day of the following year in the form of an interim distribution of profit[6]. It shall be so distributed in full, unless the ECB's net profit for the year is less than its income earned on euro banknotes in circulation and subject to any decision by the Governing Council to reduce this income in respect of costs incurred by the ECB in connection with the issue and handling of euro banknotes. The Governing Council may also decide to transfer part or all of the ECB's seigniorage income to a provision for foreign exchange rate, interest rate and gold price risks. With respect to 2009, the Governing Council decided that the seignorage income would be distributed in full (2008: €1,024,801,908 was retained by the ECB). The amount distributed to the Bank is disclosed in the Profit and loss account under item 4 *"Income from equity shares and participating interests"*.

7 Intra-Eurosystem balances

Intra-Eurosystem transactions are cross-border transactions that occur between Eurosystem NCBs. These transactions are processed primarily via TARGET and give rise to the daily net bilateral position vis-à-vis the ECB. This position in the financial statements of the Bank represents the net claim or liability of the Bank against the rest of the ESCB members connected to TARGET. The resulting balance is included as an asset or liability, as appropriate, under the sub-items A9.5 / L10.4 *"Other claims / liabilities within the Eurosystem (net)"*.

[4] Cash changeover year refers to the year in which the euro banknotes are introduced as legal tender in the respective Member State; for Malta this is 2008. Slovakia adopted the euro in 2009.
[5] The reference period refers to the 24 months which start 30 months before the day on which euro banknotes become legal tender in the respective Member State; for Malta this is the period from July 2005 to June 2007.
[6] ECB Decision of 17 November 2005 (ECB/2005/11) on the distribution of the income of the European Central Bank on euro banknotes in circulation to the NCBs of the participating Member States, OJ L 311, 26.11.2005, p. 41.

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 of numismatic coins. On 31 December 2009, gold was revalued at €766.347 (2008: €621.542) per fine ounce. The resultant unrealised valuation gains of €652,087 (2008: €350,770) are disclosed under liability item L14 *"Revaluation accounts"*.

	€'000	Fine troy ounces
Balance as at 31 December 2008	4,141	6,662
Net transactions during the year	732	90
Increase in revaluation on 31 December 2009	301	-
Balance as at 31 December 2009	**5,174**	**6,752**

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:

	2009	2008	Change
	€'000	€'000	€'000
USD	**212,621**	155,150	57,471
JPY	**138**	918	(780)
GBP	**18,110**	32,893	(14,783)
XDR	**140,528**	57,385	83,143
Other	**3,628**	5,090	(1,462)
Total	**375,025**	251,436	123,589

A 2.1 Receivables from the IMF

	2009	2008	Change
	€'000	€'000	€'000
Reserve Tranche Position	**36,039**	44,478	(8,439)
SDR holdings	**104,489**	12,907	91,582
Total	**140,528**	57,385	83,143

(a) IMF quota

Malta's membership subscription to the IMF amounts to SDR102,000,000 (2008: SDR102,000,000). The Bank's financial position relating to this subscription at 31 December 2009 is reflected in the Balance sheet as follows:

(i) Reserve Tranche Position included in the above table is equivalent to SDR33,105,960 (2008: SDR40,259,007). This amount is a claim on the IMF and represents the difference between the quota of SDR102,000,000 and the balances in euro at the disposal of the Fund. During the period under review, Malta's reserve tranche declined by SDR7.2 million due to repayments by borrowing countries under IMF lending arrangements.

(ii) Currency Subscription included within asset sub-item A11.6 *"Sundry assets"* is stated at €74,971,940 (2008: €68,332,103) and represents the balance of the quota in euro. A corresponding liability included in liability item L6 *"Liabilities to non-euro area residents denominated in euro"* exists in the form of IMF current accounts of €74,971,940 or SDR68,894,040 (2008: €68,332,103 or SDR61,740,993).

(b) Malta's SDR position in the IMF

Malta's SDR holdings included in the table above are equivalent to SDR95,984,437 (2008: SDR11,682,189). These include the SDRs allocated to Malta amounting to SDR95,401,757 (2008: SDR11,288,000), to 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 Fund. Other SDRs have no specified maturity. In August 2009, the Fund's Board of Governors approved a resolution on a new general SDR allocation whereby the Bank received SDR75.6 million (2008: nil) to this effect. In addition, the Bank also received SDR8.5 million (2008: nil) as a special one-time allocation. Both allocations are included in the overall SDR holdings and SDR allocation figures cited above. In November 2009, the Bank entered into a two-way voluntary trading arrangement with the IMF. Under this arrangement the Bank stands ready to buy and sell SDRs against euro, subject to certain limits, in transactions that the Fund arranges between prospective buyers and sellers of SDRs.

The Reserve Tranche Position, SDR holdings and the SDR allocation are subject to SDR interest rates quoted by the Fund on a weekly basis. The Currency Subscription and IMF current accounts are not subject to interest.

(c) IMF facilities for low-income countries

Malta committed to make a new contribution of subsidy resources to the Poverty Reduction and Growth Trust (PRGT) in support of the IMF's efforts to assist its low income member countries. To this effect, a commitment of SDR0.2 million was booked under sub-item L12.2 *"Accruals and income collected in advance"*.

(d) Bilateral Borrowing Agreement

In February 2010, the IMF and the Bank signed an agreement to provide the Fund with an SDR denominated amount up to the equivalent of €120 million, as part of a commitment made by the EU in March 2009 to support the IMF's lending capacity. The total term of this interest-bearing agreement shall not exceed four years.

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 outside the euro area.

	2009	2008	Change
	€'000	€'000	€'000
Marketable debt securities other than those held-to-maturity	**144,275**	87,239	57,036
Balances with banks			
Fixed-term deposits	**84,995**	59,639	25,356
Current accounts and overnight deposits	**4,867**	46,816	(41,949)
Other external assets	**360**	357	3
Total	**234,497**	194,051	40,446

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:

	2009	2008	Change
	€'000	€'000	€'000
USD	**237,942**	405,107	(167,165)
GBP	**23**	30,300	(30,277)
Total	**237,965**	435,407	(197,442)

The short-term US dollar liquidity-providing programme (Term Auction Facility) was also availed of in 2009. However, there were no outstanding claims arising from reverse operations with Eurosystem counterparties in connection with this programme as at year end (2008: €258,279,011). Under this programme, US dollars were provided by the Federal Reserve to the ECB by means of a temporary reciprocal currency arrangement (swap line) with the aim of offering short-term US dollar funding to Eurosystem counterparties. The ECB simultaneously entered into back-to-back swap transactions with NCBs that have adopted the euro, which used the resulting funds to conduct liquidity-providing operations with the Eurosystem counterparties in the form of reverse and swap transactions. In the previous year, the back-to-back swap transactions between the ECB and NCBs resulted in intra-Eurosystem balances reported under liability sub-item L10.4 *"Other liabilities within the Eurosystem (net)"* and were not remunerated.

	2009	2008	Change
	€'000	€'000	€'000
Marketable debt securities other than those held-to-maturity	**82,030**	69,789	12,241
Balances with banks			
Fixed-term deposits	**155,907**	107,335	48,572
Current accounts and overnight deposits	**28**	4	24
US dollar Term Auction Facility	**-**	258,279	(258,279)
Total	**237,965**	435,407	(197,442)

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.

	2009	2008	Change
	€'000	€'000	€'000
Marketable debt securities other than those held-to-maturity	**79,291**	94,290	(14,999)
Held-to-maturity debt securities	**15,800**	115,481	(99,681)
Balances with banks			
Fixed-term deposits	**-**	50,000	(50,000)
Current accounts and overnight deposits	**575**	202	373
Total	**95,666**	259,973	(164,307)

As at 31 December 2009, the market value of held-to-maturity debt securities based on mid-market prices, amounted to €16,500,030 (2008: €118,231,390).

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 €749,890 million (2008: €860,312 million) of which the Bank holds €1,253 million (2008: €454 million). In accordance with Article 32.4 of the Statute, any materialised risks from monetary policy operations should eventually be shared in full by the Eurosystem NCBs, in proportion to the prevailing Eurosystem capital key.

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 generally a maturity of one week. These operations are carried out in the form of standard tender operations with a variable or fixed rate tender procedure[7]. All counterparties that fulfil the general eligibility criteria may submit bids within a specified timeframe. Participation in main refinancing operations requires the availability of eligible collateral.

During 2009, all MROs were conducted at a fixed rate full allotment. The aggregate main refinancing operations with the Bank carried out during the year amounted to €4,928,500,000 (2008: €2,412,891,343). The outstanding operations at the end of the year amounted to €319,000,000 (2008: €164,000,000).

The following table discloses the changes in the main refinancing operations rate during 2009 as decided by the Governing Council of the ECB:

With effect from:	Change in bps	Effective rate (%)
1 January	-	2.50
21 January	–50 bps	2.00
11 March	–50 bps	1.50
8 April	–25 bps	1.25
13 May	–25 bps	1.00

[7] Prior to 15 October 2008, main refinancing operations were conducted through a variable rate tender procedure. However, with effect from the operation settled on 15 October 2008, main refinancing operations started being carried out through a fixed rate tender procedure with full allotment.

A 5.2 Longer-term refinancing operations

Longer-term refinancing operations (LTROs) are regular liquidity-providing reverse transactions carried out in the form of variable or fixed rate tender procedure[8], with a monthly frequency and a maturity of three months[9]. These operations aim to provide counterparties with additional longer-term refinancing. Participation in LTROs requires the availability of eligible collateral.

In 2009, all LTROs were conducted at a fixed rate tender procedure with full allotment. During the year, apart from the standard three-month LTROs which are carried out at the end of the month, the ECB continued to conduct the monthly supplementary three-month as well as the six-month LTROs that were introduced in 2008. Furthermore, the maintenance period operations that are conducted on the last day of the reserve maintenance period also remained in use. On 7 May 2009, the ECB further announced three LTROs with a maturity of one year at a fixed rate tender procedure with full allotment. These three one-year operations were conducted in June, September and December 2009. However, the December LTRO was conducted at the average minimum bid rate of the MROs over the life of the one-year operation.

The aggregate LTROs carried out during 2009 amounted to €1,226,700,000 (2008: €525,000,000), whilst the outstanding LTROs at the end of the year amounted to €933,500,000 (2008: €290,000,000).

A 5.3 Fine-tuning reverse operations

Fine-tuning reverse operations are executed on an ad hoc basis with a view of managing the liquidity situation in the market and steering interest rates. The choice of fine-tuning instruments and procedures depends on the type of transaction and its underlying objective. Fine-tuning operations are normally executed through quick tenders or through bilateral procedures. The Governing Council of the ECB may, under exceptional circumstances, empower the ECB to conduct bilateral fine-tuning operations itself. During 2009, the ECB did not conduct any liquidity-providing fine-tuning reverse operations. In 2008, there were eight such operations with no participation by domestic eligible counterparties. Participation in liquidity-providing reverse operations would only be allowed against eligible collateral.

A 5.4 Structural reverse operations

Structural operations can be executed in the form of reverse open market transactions aimed at adjusting the structural position of the Eurosystem vis-à-vis the financial sector. Structural reverse operations are liquidity-providing operations with a non-standardised maturity period. All eligible counterparties may submit bids for such operations and must be backed by underlying eligible assets. No structural operations were conducted by the ECB during 2009.

A 5.5 Marginal lending facility

The marginal lending facility is available to eligible counterparties to obtain overnight liquidity from NCBs at a predetermined interest rate against eligible assets and is intended to satisfy counterparties' temporary liquidity needs. Under normal circumstances, the interest rate on the facility provides a ceiling for the overnight market interest rate. During 2009, the aggregate volume of such transactions with the Bank amounted to €1,050,745,776 (2008: €71,149,226). There were no outstanding balances as at 31 December 2009 (2008: nil).

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[8] On 15 October 2008, the ECB announced that the longer-term refinancing operations will be conducted at a fixed rate with full allotment.
[9] During 2008, the ECB introduced supplementary 3-month longer-term refinancing operations. Additionally, the ECB also introduced the 6-month longer-term refinancing operations and special term refinancing operations with a tenor matching the length of a reserve maintenance period.

The following table discloses the changes in the interest rate on the marginal lending facility during 2009 as decided by the Governing Council of the ECB:

With effect from	Change in bps	Effective rate (%)
1 January	-	3.00
11 March	–50 bps	2.50
8 April	–25 bps	2.25
13 May	–50 bps	1.75

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 relates to claims on credit institutions within the euro area which do not relate to monetary policy operations, consisting mainly of balances and placements with banks.

	2009	2008	Change
	€'000	€'000	€'000
Fixed-term deposits	**-**	163,550	(163,550)
Current accounts and overnight deposits	**171**	-	171
Other claims	**454**	454	-
Total	**625**	164,004	(163,379)

A 7 Securities of euro area residents denominated in euro

This item has been divided into two sub-items: *"Securities held for monetary policy purposes"*, which was introduced in July 2009 to reflect the euro-denominated covered bond portfolio held for monetary policy purposes and *"Other securities"*, which includes marketable and non-marketable securities that are not related to the monetary policy operations of the Eurosystem (which previously accounted for the whole position).

A 7. 1 Securities held for monetary policy purposes

This item contains securities acquired by the NCBs within the scope of the purchase programme for covered bonds announced by the Governing Council on 7 May 2009 (see Note 3 (h) (i) *"Securities held for monetary policy purposes"* in the General notes to the financial statements). The Bank decided not to participate in this programme.

A 7. 2 Other securities

This 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.

	2009	2008	Change
	€'000	€'000	€'000
Marketable debt securities			
other than those held-to-maturity	**262,074**	304,416	(42,342)
Held-to-maturity debt securities	**364,122**	155,778	208,344
Total	**626,196**	460,194	166,002

As at 31 December 2009, the market value of held-to-maturity debt securities based on mid-market prices, amounted to €372,968,259 (2008: €161,871,980).

A 9 Intra-Eurosystem claims

This item consists of claims arising from the Bank's share in the ECB's capital, reserves and provisions 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

On 1 May 2004, Malta joined the European Union and consequently the Bank became a member of the ESCB and in accordance with article 28 of the Statute, it became a subscriber to the capital of the ECB. Subscriptions are determined on the basis of population and gross domestic product data provided by the European Commission in line with article 29.1 of the Statute and which are adjusted every five years and every time that a new member state joins the European Union in accordance with article 49.3 of the Statute. The share of the Bank in the ECB's capital on 1 May 2004 was 0.0647%. With effect from 1 January 2007, the Bank's share in the ECB's capital was determined at 0.0622% pursuant to the decision of the ECB of 15 December 2006. As Malta did not participate in the euro area until 1 January 2008, the transitional provisions of article 48 of the Statute applied. Consequently, the Bank was required to pay-up a contribution of 7% of its allocated share capital in the ECB upon entry into the ESCB on 1 May 2004 amounting to €252,024, which was adjusted to €250,819 on 1 January 2007. The Bank paid up the remaining 93% of its capital subscription amounting to €3,332,307 as at 1 January 2008. Accordingly, the total share of the paid-up share capital in the ECB as at 1 January 2008 was €3,583,126. There were no further changes in the Bank's share capital in the ECB during 2008.

On 1 January 2009, a regular quinquennial change in the share capital of the ECB in accordance with article 29.3 of the Statute took place. In this respect the share of the Bank in the ECB's share capital increased from 0.0622% to 0.0632% amounting to a total share subscription of €3,640,732. Furthermore, on 1 January 2009, the paid up share capital of the ECB increased following the accession of the Národná banka Slovenska which paid its capital share in full.

The capital key shares of NCBs were adjusted on 1 January 2009 as follows:

	Capital key	Capital key
	2009	2008
	%	%
Nationale Bank van België / Banque Nationale de Belgique	**2.4256**	2.4708
Deutsche Bundesbank	**18.9373**	20.5211
Central Bank and Financial Services Authority of Ireland	**1.1107**	0.8885
Bank of Greece	**1.9649**	1.8168
Banco de España	**8.3040**	7.5498
Banque de France	**14.2212**	14.3875
Banca d'Italia	**12.4966**	12.5297
Central Bank of Cyprus	**0.1369**	0.1249
Banque centrale du Luxembourg	**0.1747**	0.1575
Central Bank of Malta / Bank Ċentrali ta' Malta	**0.0632**	0.0622
De Nederlandsche Bank	**3.9882**	3.8937
Oesterreichische Nationalbank	**1.9417**	2.0159
Banco de Portugal	**1.7504**	1.7137
Banka Slovenije	**0.3288**	0.3194
Národná banka Slovenska	**0.6934**	-
Suomen Pankki-Finlands Bank	**1.2539**	1.2448
Subtotal for euro area NCBs	**69.7915**	**69.6963**
Bulgarian National Bank	**0.8686**	0.8833
Česká národní banka	**1.4472**	1.3880
Danmarks Nationalbank	**1.4835**	1.5138
Eesti Pank	**0.1790**	0.1703
Latvijas Banka	**0.2837**	0.2813
Lietuvos bankas	**0.4256**	0.4178
Magyar Nemzeti Bank	**1.3856**	1.3141
Narodowy Bank Polski	**4.8954**	4.8748
Banca Națională a României	**2.4645**	2.5188
Národná banka Slovenska	**-**	0.6765
Sveriges Riksbank	**2.2582**	2.3313
Bank of England	**14.5172**	13.9337
Subtotal for non-euro area NCBs	**30.2085**	**30.3037**
Total	**100.0000**	**100.0000**

The following table discloses information on the 27 NCBs in the capital of the ECB as at 31 December 2009:

	2009 Subscribed capital €'000	2009 Paid-up capital €'000	2008 Subscribed capital €'000	2008 Paid-up capital €'000
Nationale Bank van België / Banque Nationale de Belgique	**139,730**	**139,730**	142,334	142,334
Deutsche Bundesbank	**1,090,912**	**1,090,912**	1,182,149	1,182,149
Central Bank and Financial Services Authority of Ireland	**63,984**	**63,984**	51,183	51,183
Bank of Greece	**113,191**	**113,191**	104,660	104,660
Banco de España	**478,365**	**478,365**	434,918	434,918
Banque de France	**819,234**	**819,234**	828,814	828,814
Banca d'Italia	**719,886**	**719,886**	721,792	721,792
Central Bank of Cyprus	**7,886**	**7,886**	7,195	7,195
Banque centrale du Luxembourg	**10,064**	**10,064**	9,073	9,073
Central Bank of Malta / Bank Ċentrali ta' Malta	**3,641**	**3,641**	3,583	3,583
De Nederlandsche Bank	**229,746**	**229,746**	224,303	224,303
Oesterreichische Nationalbank	**111,855**	**111,855**	116,129	116,129
Banco de Portugal	**100,834**	**100,834**	98,720	98,720
Banka Slovenije	**18,941**	**18,941**	18,400	18,400
Národná banka Slovenska	**39,944**	**39,944**	-	-
Suomen Pankki-Finlands Bank	**72,233**	**72,233**	71,709	71,709
Total euro area NCBs	**4,020,446**	**4,020,446**	**4,014,962**	**4,014,962**
Bulgarian National Bank	**50,037**	**3,503**	50,884	3,562
Česká národní banka	**83,368**	**5,836**	79,958	5,597
Danmarks Nationalbank	**85,459**	**5,982**	87,205	6,104
Eesti Pank	**10,312**	**722**	9,810	687
Latvijas Banka	**16,343**	**1,144**	16,205	1,134
Lietuvos bankas	**24,517**	**1,716**	24,068	1,685
Magyar Nemzeti Bank	**79,820**	**5,587**	75,701	5,299
Narodowy Bank Polski	**282,007**	**19,740**	280,820	19,657
Banca Naţională a României	**141,971**	**9,938**	145,099	10,157
Národná banka Slovenska	**-**	**-**	38,971	2,728
Sveriges Riksbank	**130,087**	**9,106**	134,298	9,401
Bank of England	**836,285**	**58,540**	802,671	56,187
Total non-euro area NCBs	**1,740,206**	**121,814**	**1,745,690**	**122,198**
Total euro area and non-euro area NCBs	**5,760,652**	**4,142,260**	**5,760,652**	**4,137,160**

In accordance with article 49.2 of the Statute, in 2008 the Bank also effected contributions of €7,908,437 to the ECB's reserves and provisions in two tranches. As a result of a difference between the euro equivalent of foreign reserves transferred to the ECB at prevailing exchange rates and the amount determined in accordance with the capital key (disclosed under asset sub-item A9.2 *"Claims equivalent to the transfer of foreign reserves"*), the amount of €722,047 was considered as an advance contribution to the ECB reserves and provisions in January 2008. The balance of the contribution was settled after the approval of the ECB's

Annual Accounts for the year ended 31 December 2007 by the Governing Council of the ECB. Due to the change in the capital key referred to above, in 2009 the Bank had to contribute its respective share to the ECB's reserves and provisions.

	Reserves	Provisions
	€'000	€'000
Balance as at 31 December 2008	5,520	2,388
Contribution during 2009	252	89
Balance as at 31 December 2009	**5,772**	**2,477**

A 9.2 Claims equivalent to the transfer of foreign reserves

This asset includes the Bank's euro-denominated claims arising from the transfer of foreign reserves to the ECB. In accordance with article 30.1 of the Statute, on 2 and 3 January 2008 the Bank transferred foreign reserve assets to the ECB with a total equivalent amount of €36,553,305, being 15% in gold and 85% in US dollars. The Bank's claim according to the capital key amounted to €35,831,258. The difference was utilised as an advance contribution to the ECB reserves (see Note A9.1 *"Participating interest in ECB"* above). As gold does not earn interest, the claim is remunerated at 85% of the applicable rate for the main refinancing operations.

The adjustments to the capital key weightings of the ECB on 1 January 2009, also resulted in the adjustment of the claim of the Bank with respect to the foreign reserve assets transferred to the ECB. In order to reflect its increased capital key share, the euro-denominated claim of the Bank increased by €576,065 to €36,407,323 on 1 January 2009.

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 Note 6 *"Euro banknotes in circulation"* in the General notes to the financial statements). As at 31 December 2009, 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"* (2008: nil).

A 9.5 Other claims within the Eurosystem (net)

As at 31 December 2009, the Bank's claims were netted off from liability sub-item L10.4 *"Other liabilities within the Eurosystem (net)"* (2008: nil).

A 10 Items in course of settlement

These assets comprise payments which had not yet been settled by the end of the financial year.

A 11 Other assets

A 11.1 Coins of euro area

This 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.

	Land and buildings	Computer equipment and other assets	Total
	€'000	€'000	**€'000**
Cost			
As at 31st December 2008	22,761	3,445	**26,206**
Additions	73	201	**274**
As at 31 December 2009	**22,834**	**3,646**	**26,480**
Accumulated depreciation			
As at 31st December 2008	2,366	2,171	**4,537**
Charge for the year	786	600	**1,386**
As at 31 December 2009	**3,152**	**2,771**	**5,923**
Net book value			
As at 31st December 2008	20,395	1,274	21,669
As at 31 December 2009	**19,682**	**875**	**20,557**

A 11.3 Other financial assets

Other financial assets comprise all debt securities held by the Bank as part of an earmarked portfolio. At 31 December 2009, the Bank had an earmarked portfolio comprising held-to-maturity debt securities as a counterpart to the Bank's capital and statutory reserves. The Bank also held another earmarked portfolio comprising of Malta Government securities and Treasury bills purchased on the secondary market by the Bank in its role as market maker. As at 31 December 2008, Malta Government Treasury bills were classified under sub-item A7.2 *"Other Securities".*

	2009	2008	Change
	€'000	€'000	€'000
Malta Government Stocks	**214,173**	256,625	(42,452)
Malta Government Treasury bills	**558**	14,575	(14,017)
Held-to-maturity debt securities	**233,412**	190,328	43,084
Total	**448,143**	461,528	(13,385)

As at 31 December 2009, the market value of held-to-maturity debt securities based on mid market prices, amounted to €243,497,990 (2008: €198,398,234). Malta Government Stocks which are classified as other than held-to-maturity and are accordingly carried at mid-market prices, are subject to fixed interest rates. Malta Government Treasury bills, which are also classified as other than held-to-maturity and are accordingly carried at mid-market prices, are acquired on the secondary market at discounted amounts.

A 11.4 Off-balance sheet instruments revaluation differences

This item reflects unrealised revaluation gains arising on off-balance sheet positions, principally forward foreign exchange contracts outstanding at 31 December 2009. At year end, these unrealised gains amounted to €7,968,885 (2008: €308,345).

A 11.5 Accruals and prepaid expenses

This sub-item consists of accrued interest income on income-earning assets and any prepaid expenditure.

	2009	2008	Change
	€'000	€'000	€'000
Accrued interest income	**29,387**	38,469	(9,082)
Prepaid expenditure	**20**	107	(87)
	29,407	38,576	(9,169)

Accrued interest income at 31 December 2009, includes an amount of €1,711,701 (2008: €6,576,564) attributable to interest on intra-Eurosystem claims.

A 11.6 Sundry

Sundry assets consist of IMF currency subscription and other assets.

	2009	2008	Change
	€'000	€'000	€'000
IMF Currency Subscription (see Note A2.1)	**74,972**	68,332	6,640
Other	**15,606**	50,595	(34,989)
Total	**90,578**	118,927	(28,349)

Liabilities

L 1 Banknotes in circulation

The total value of euro banknotes issued by Eurosystem NCBs is distributed among these banks on the last day of each month in accordance with the key for allocating euro banknotes (see Note 6 *"Euro banknotes in circulation"* in the General notes to the financial statements). In accordance with the banknote allocation key applicable on 31 December 2009, the Bank has a 0.0835% share (2008: 0.0825%) of the value of all euro banknotes in circulation. During the year ended 31 December 2009, the total value of banknotes in circulation within the Eurosystem increased from €762,775 million to €806,411 million. In accordance with the banknote allocation key, the Bank disclosed holdings of euro banknotes amounting to €673,353,185 at the end of the year (2008: €629,289,375). The value of the euro banknotes actually issued by the Bank as at that date was €768,425,860 (2008: €683,836,185). As this amount exceeded the allocated amount, the difference of €95,072,675 (2008: €54,546,810) is presented in liability sub-item L10.3 *"Net liabilities related to the allocation of euro banknotes within the Eurosystem"*.

Maltese lira banknotes ceased to be legal tender on 31 January 2008 following the adoption of the euro on 1 January 2008. During the cash changeover year (2008), Maltese lira banknotes were still included within the banknotes in circulation figure, but have been reclassified to conform to the current year presentation.

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 ESCB.

	2009	2008	Change
	€'000	€'000	€'000
Current accounts			
(covering the minimum reserve system)	**447,596**	474,475	(26,879)
Deposit facility	**137,000**	9,000	128,000
Fixed-term deposits	**-**	-	-
Credit related to margin calls	**3**	-	3
Total	**584,599**	483,475	101,124

L 2.1 Current accounts (covering the minimum reserve system)

These liabilities include deposits by the credit institutions which are utilised to meet the minimum reserve requirement and settlement of payments. The main criterion for including these deposits within this sub-item is that the respective credit institutions must appear in the list of institutions which are subject to the minimum reserve regulations of the Eurosystem. Minimum reserve requirements have to be met on average over the reserve maintenance period in accordance with the schedule published by the ECB. Banks' minimum reserve balances are remunerated at the average of the ECB's rate for the main refinancing operations calculated over the maintenance period and weighted according to the number of calendar days. The outstanding balance as at year end amounted to €447,596,446 (2008: €474,475,134).

L 2.2 Deposit facility

The overnight deposit facility is available to eligible counterparties to make overnight deposits with NCBs at pre-specified rates. Under normal circumstances, the interest rate on the facility provides a floor for the overnight market interest rate. During 2009, the aggregate volume of such transactions with the Bank amounted to €72,697,167,700 (2008: €8,187,300,000). The outstanding balance as at year end amounted to €137,000,000 (2008: €9,000,000).

L 2.3 Fixed-term deposits

These liabilities relate to liquidity-absorbing fine-tuning operations for a fixed-term subject to a fixed rate of interest. During 2009, the aggregate volume of such transactions with the Bank amounted to €264,000,000 (2008: €879,697,237). There were no outstanding fixed-term deposits at the balance sheet date (2008: nil).

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 2009 and 2008.

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 has fallen below an established trigger point implying a shortfall of collateral to cover the outstanding monetary policy operations. Deposits related to margin calls were used by counterparties during 2009, on those instances where their respective pool of collateral fell below the mentioned trigger level. The outstanding balance as at year end amounted to €2,726 (2008: nil).

L 3 Other liabilities to euro area credit institutions denominated in euro

This balance sheet item includes credit institutions' accounts which are unrelated to monetary policy operations.

L 5 Liabilities to other euro 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 subject to variable interest rates linked to the ECB's main refinancing operations rate.

	2009	2008	Change
	€'000	€'000	€'000
Current accounts	**240,387**	214,922	25,465
Sinking fund accounts	**152,525**	147,027	5,498
Total	**392,912**	361,949	30,963

L 5.2 Other liabilities

Current accounts and fixed-term deposits denominated in euro by Maltese public sector corporations are included within this item. Current accounts are repayable on demand and subject to variable interest rates linked to the ECB's main refinancing operations rate. Fixed-term deposits are subject to fixed interest rates.

L 6 Liabilities to non-euro area residents denominated in euro

This sub-item includes balances denominated in euro held by international and supranational organisations and by non-Eurosystem central banks, including the IMF current accounts. These liabilities are principally non-interest bearing.

	2009	2008	Change
	€'000	€'000	€'000
IMF current accounts (see Note A2.1)	**74,972**	68,332	6,640
Others	**11,813**	12,039	(226)
Total	**86,785**	80,371	6,414

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. These balances are principally subject to floating interest rates based on weekly average rates applied to call funds.

	2009	2008	Change
	€'000	€'000	€'000
Government of Malta			
Current accounts	**43,307**	23,648	19,659
Sinking fund accounts	**3,685**	3,946	(261)
Other customers			
Current accounts and fixed-term deposits	**24,590**	6,199	18,391
Total	**71,582**	33,793	37,789

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 Note A2.1 *"Receivables from the IMF"* above).

L 10 Intra-Eurosystem liabilities

This liability 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 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 Note L1 *"Banknotes in circulation"* above). This liability is subject to interest at the ECB main refinancing operations rate, taking cognisance of the adjustments referred to in Note 6 *"Euro banknotes in circulation"* in the General notes to the financial statements in the cash changeover year and in the subsequent five years.

	2009	2008	Change
	€'000	€'000	€'000
Issued banknotes	**768,426**	683,836	84,590
Banknotes allocated as per banknote allocation key	**(673,353)**	(629,289)	(44,064)
Excess of issued banknotes over allocation	**95,073**	54,547	40,526

L 10.4 Other liabilities within the Eurosystem (net)

These liabilities mainly include the TARGET2 balance arising from cross-border euro transfers with other NCBs in the ESCB and the ECB, and correspondent accounts of other Eurosystem NCBs. The TARGET2 balance is subject to interest at the prevailing rate for the ECB main refinancing operations. Moreover, these liabilities include the net liability at year end arising from the difference between monetary income to be pooled and that distributed (see Note 5 *"Net result of pooling of monetary income"* to the Profit and loss account) and the claim arising from the distribution of the ECB's seigniorage income.

	2009	2008	Change
	€'000	€'000	€'000
TARGET2 balance and correspondent accounts	**813,665**	664,873	148,792
Net result from pooling of monetary income	**736**	2,783	(2,047)
Seigniorage income receivable	**(713)**	(1,076)	363
Total	**813,688**	666,580	147,108

L 12 Other liabilities

L 12.1 Off-balance sheet instruments revaluation differences

This item reflects unrealised revaluation losses arising on off-balance sheet positions, primarily forward foreign exchange contracts outstanding at 31 December 2009. At year end, there were no unrealised losses (2008: €2,737,703).

L 12.2 Accruals and income collected in advance

These liabilities include accrued interest expense on interest-bearing liabilities and other accrued expenses. Also included is the balance of demonetised Maltese lira notes and coins which have not yet been presented or recognised in the Profit and loss account. This amount is recognised as deferred income until the final date when such notes and coins cease to be exchangeable at the Bank. During the cash changeover year (2008), Maltese lira banknotes were still included within the banknote in circulation figure under Liability item L1 *"Banknotes in circulation"*.

	2009	2008	Change
	€'000	€'000	€'000
Accrued interest payable	**1,207**	2,790	(1,583)
Deferred income in respect of demonetised			
Maltese Lira currency notes and coins	**65,524**	83,046	(17,522)
Other	**666**	754	(88)
Total	**67,397**	86,590	(19,193)

Accrued interest expense at 31 December 2009 includes an amount of €902,449 (2008: €429,348) attributable to interest on intra-Eurosystem liabilities.

L 12.3 Sundry

Sundry liabilities mainly comprise of unrealised revaluation gains attributable to Malta Government Stocks held as part of an earmarked portfolio amounting to €7,166,078 (2008: €10,838,076). These liabilities also include realised losses attributable to off-balance sheet positions, principally forward foreign exchange contracts outstanding at year end, which are offset by realised profits arising from on-balance sheet positions. The net result is disclosed within Note 2.1 *"Realised gains / losses arising from financial operations"* to the Profit and loss account.

L 13 Provisions

In accordance with article 32.4 of the Statute, the provision against counterparty risks in monetary policy operations is allocated between the NCBs of participating Member States in proportion to their subscribed capital key shares in the ECB, prevailing in the year when the defaults have occurred. In accordance with the general accounting principle of prudence, the Governing Council has reviewed the appropriateness of the volume of this provision and decided to reduce the provision from a total amount of €5,736 million as at 31 December 2008 to an amount of €4,011 million as at 31 December 2009. The Bank's share in this provision amounts to €3,579,416 (2008: €5,118,806).

The respective adjustments are reflected in the NCBs' profit and loss accounts. In the case of the Bank, the resulting income amounted to €1,539,390 (see Note 5 *"Net result of pooling of monetary income"* to the Profit and loss account).

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 and marketable securities at year end.

	2009	2008	Change
	€'000	€'000	€'000
Gold	**652**	351	301
Securities	**15,844**	7,040	8,804
Foreign currency positions	**49**	744	(695)
Total	**16,545**	8,135	8,410

L 15 Capital and reserves

The following table analyses the movement in capital and reserves of the Bank.

	Capital €'000	General reserve fund €'000	Reserves for risks and contingencies €'000	Capital contribution €'000
Balance as at 31st December 2008	20,000	75,505	107,384	31,171
Net issuance of euro coins	-	-	-	5,982
Transfer from profits for the year	-	-	13,000	-
Balance as at 31 December 2009	**20,000**	**75,505**	**120,384**	**37,153**

L 15.1 Capital

In terms of article 19(1) of the Central Bank of Malta Act (Cap. 204), the Bank shall have an authorised capital of €20 million. 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 Central Bank of Malta Act (Cap. 204), the Bank shall also maintain a General reserve fund which shall be of not less than €20 million 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 Central Bank of Malta Act (Cap. 204) 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.

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.

	2009	2008	Change
	€'000	€'000	€'000
Marketable debt securities			
- In euro	**47,061**	39,135	7,926
- In foreign currency	**6,780**	9,400	(2,620)
Fixed-term deposits			
- In euro	**1,187**	31,788	(30,601)
- In foreign currency	**1,412**	9,239	(7,827)
Current accounts and overnight deposits			
- In euro	**10**	166	(156)
- In foreign currency	**48**	197	(149)
IMF	**148**	1,676	(1,528)
Monetary policy operations			
- Main refinancing operations	**1,031**	1,667	(636)
- Longer-term refinancing operations	**4,565**	4,459	106
- Marginal lending facility	**63**	10	53
Intra-Eurosystem claims			
- Claims arising from the transfer of foreign reserves	**401**	1,246	(845)
- Net claims related to the allocation of banknotes within the Eurosystem	**5,685**	24,893	(19,208)
- TARGET2 balances	**631**	-	631
Forward foreign exchange contracts	**793**	2,502	(1,709)
Other interest income	**102**	108	(6)
Total	**69,917**	126,486	(56,569)

Income from *"Net claims related to the allocation of banknotes within the Eurosystem"* principally comprises of interest income arising on a notional amount representing the differences between the average value of the banknotes which the Bank had in circulation in the reference period and the average value of banknotes which would have been allocated to the Bank during that period in accordance with its capital key. Interest is calculated at the prevailing ECB rate for the main refinancing operations. This is in line with the provisions established by the Governing Council as outlined in the ECB Decision on the allocation of monetary income (ECB/2001/16 as amended). The adjustments are reduced in annual stages until the first day of the sixth year after the cash changeover year. The Bank's adjustment period started on 1 January 2008 and will end on 31 December 2013. This item also includes net interest payment on the difference between the euro banknotes allocated to the Bank in accordance with the banknote allocation key and the value of the euro banknotes that the Bank actually puts into circulation, as reduced by banknotes withdrawn from circulation.

1.2 Interest expense

Interest expense arises from interest payable on Government of Malta and other customer accounts, intra-Eurosystem liabilities as well as liabilities to euro area credit institutions related to monetary policy operations.

	2009	2008	Change
	€'000	€'000	€'000
Government accounts			
- In euro	**2,535**	9,338	(6,803)
- In foreign currency	**31**	830	(799)
Other customer accounts			
- In euro	**23**	667	(644)
- In foreign currency	**29**	113	(84)
Monetary policy operations			
- Minimum reserves	**5,882**	16,998	(11,116)
- Overnight deposits	**1,910**	802	1,108
- Fixed-term deposits	**6**	238	(232)
Intra-Eurosystem liabilities			
- TARGET2 balances	**-**	28,713	(28,713)
- Deposits related to margin calls	**3**	-	3
Other interest expense	**102**	189	(87)
Total	**10,521**	57,888	**(47,367)**

2 Net result of financial operations, write-downs and risk provisions

2.1 Realised gains / (losses) arising from financial operations

This item includes gains and losses arising from transactions leading to reductions in foreign currency positions and disposals of financial instruments, mainly debt securities.

	2009	2008	Change
	€'000	€'000	€'000
Net gains / (losses) on disposal of financial instruments	**3,878**	991	2,887
Net gains / (losses) on foreign currency positions	**1,290**	(183)	1,473
Total	**5,168**	808	4,360

2.2 Write-downs on financial assets and positions

This 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.

	2009	2008	Change
	€'000	€'000	€'000
Write-downs on debt securities	**622**	8,497	(7,875)
Write-downs on foreign currency positions	**876**	67	809
Total	**1,498**	8,564	(7,066)

3 Net income / (expense) from fees and commissions

Fees and commissions receivable mainly arise from the provision of banking services. 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

Included under this caption is the distribution of the ECB's income on euro banknotes amounting to €712,813 (2008: €1,075,997) in proportion to the Bank's Eurosystem capital key (see Note 6 *"Euro banknotes in circulation"* in the General notes to the financial statements). In 2009, the ECB's income on euro banknotes in circulation amounted to €787,157,441 (2008: €2,230,477,327) which was distributed in full (in 2008 €1,024,801,908 was retained by the ECB in accordance with the decision of the Governing Council with respect to the establishment of a provision for foreign exchange rate, interest rate and gold price risks). During 2009, the Bank also received €104,039 representing its relative share of the ECB's distributable profits for 2008 in proportion to the Bank's Eurosystem capital key (see Note 4 *"Capital key"* 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 2009 amounting to an expense of €735,899 (2008: €2,783,274); and the Bank's share of the net result from the decrease in the provision against counterparty risks in monetary policy operations of the Eurosystem of €1,539,390 (see Note L13 *"Provisions"* in the Notes to the Balance sheet). The net income shown in this item amounted to €803,491 in comparison to a net expenditure of €7,902,080 in 2008.

In 2008, the Bank's share in the provision against counterparty risks in monetary policy operations of the Eurosystem was reported under the Profit and loss item 2.3 *"Transfer (to) / from provisions for foreign exchange rate, interest rate, credit and gold price risks"*.

The amount of each Eurosystem NCB's monetary income is determined by measuring, on a daily basis, the actual income that is derived from the earmarkable assets held against the liability base.

The liability base consists of the following items: banknotes in circulation; liabilities to credit institutions related to monetary policy operations denominated in euro; net intra-Eurosystem liabilities resulting from TARGET2 transactions; and net intra-Eurosystem liabilities related to the allocation of euro banknotes within 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 of the following items: lending to euro area credit institutions related to monetary policy operations denominated in euro; 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; and a limited amount of each NCB's gold holdings in proportion to each NCB's capital key. Gold is considered to generate no income.

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 applicable rate for the ECB main refinancing operations.

The monetary income pooled by the Eurosystem is allocated among NCBs in relation to the Eurosystem capital key. The net result arising from the calculation of monetary income is a payment by the Bank which is the difference between the monetary income pooled amounting to €11,066,684 (2008: €27,346,802) and the amount redistributed of €10,330,785 (2008: €24,563,528).

6 Other income

Other income includes an amount of €9 milllion (2008: €10 million) relating to the balance of unredeemed Maltese coins, which as at 31 December 2009 amounted to €26,354,400 (2008: €26,780,161). These coins ceased to be exchangeable at the Bank subsequent to 1 February 2010. In accordance with the provisions of article 63(3) of the Central Bank of Malta Act (Cap. 204) (see Note 3(l) *"Demonetised Maltese lira currency notes and coins"* in the General notes to the financial statements), the Board approved the recognition of the said income from the balance of such coins in profits for the year. Other operating income also includes income from numismatic issues of notes and coins.

7 Staff costs

Staff costs include salaries and other ancillary costs.

	2009	2008	Change
	€'000	€'000	€'000
Staff salaries	**7,124**	7,677	(553)
Other staff costs	**864**	885	(21)
Training, welfare and other related expenditure	**802**	742	60
Total	**8,790**	9,304	(514)

The average number of persons employed by the Bank during the year was as follows:

	2009	2008	Change
	Number	Number	Number
Governors	**2**	2	-
Divisional Directors	**5**	5	-
Heads and executives	**90**	83	7
Supervisory and clerical staff	**204**	204	-
Non-clerical staff	**35**	34	1
Total	**336**	328	8

8 Administrative expenses

This item consists of operating expenditure incurred by the Bank.

	2009	2008	Change
	€'000	€'000	€'000
Market information and communication expenses	**514**	568	(54)
Other administrative expenditure	**2,926**	2,977	(51)
Total	**3,440**	3,545	(105)

Other administrative expenses 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 current financial year amounted to €69,500 (2008: €100,000).

Compensation to the members of the Board of Directors for the financial year under review amounted to €208,311 (2008: €204,271). The Governor and Deputy Governor are entitled to such benefits as the use of a leased motor vehicle, health insurance cover and refund of certain other expenses. The other members of the Board of Directors are entitled to health insurance cover and 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 Note 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

At the balance sheet date, the principal outstanding off-balance sheet instruments consisted of forward foreign exchange contracts with a notional amount of €361,200,000 (2008: €352,350,000) involving the forward purchase of euro against the forward sale of other currencies.

The Bank did not have any outstanding net forward liabilities to the ECB in connection with the short-term US dollar liquidity-providing programme Term Auction Facility in agreement with the Federal Reserve (2008: €258,279,011) (see Note A3 – *"Claims on euro area residents denominated in foreign currency"* in the Notes to the Balance sheet).

(b) Contingent liabilities and commitments

	2009	2008	Change
	€'000	€'000	€'000
Contingent liabilities			
Guarantees and letters of credit	**494**	120,755	(120,261)
Financial commitments			
Repayment of foreign loans on behalf of the Government	**5,420**	7,738	(2,318)
Total	**5,914**	128,493	(122,579)

Financial commitments represent foreign loans received by the Bank on behalf of the Government of Malta under Financial Conventions and repayable in due course from funds to be made available by the Government.

The Bank's customers with respect to guarantees and letters of credit are mainly public sector corporations, government departments and other entities owned by the Government. The Bank's currency exposure with respect to these contingent liabilities and commitments is principally in US dollar and euro.

The Bank also has commitments in respect of tangible fixed assets and recurrent expenditure which extend beyond the balance sheet date. In view of the nature and duration of these commitments, their impact on the Bank's financial results and on the assessment of the Bank's state of affairs was not deemed material for disclosure purposes.

(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 Notes L5 *"Liabilities to other euro residents denominated in euro"* and L7 *"Liabilities to euro area residents denominated in foreign currency"* 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 interest payable on deposits as disclosed in Note 1.2 *"Interest expense"* 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. The principal outstanding transactions as at the balance sheet dates are reflected in Note (b) *"Contingent liabilities and commitments"* above. The Bank acts as market maker in Malta Government securities 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 Note A11.3 *"Other financial assets"* to the Balance sheet). Income earned by the Bank from these assets amounting to €10,969,122 (2008: €10,241,827) is included in Note 1.1 *"Interest income"* to the Profit and loss account.

(d) Demonetised Maltese lira currency notes and coins

(i) Demonetised Maltese lira currency notes

Maltese lira banknotes were replaced by euro banknotes when Malta became part of the Eurosystem on 1 January 2008. Consequently, Maltese lira banknotes remained legal tender until 31 January 2008 but will continue to be redeemed at the conversion rate of the Maltese lira for the euro of 0.4293 and without charge until 31 January 2018.

During 2009, demonetised Maltese lira currency notes presented for redemption amounted to €8,095,380 (2008: €149,974,335). At 31 December 2009, the value of unpresented demonetised currency notes amounted to €58,169,513 (2008: €66,264,893) analysed as follows:

	2009	2008	Change
	€'000	€'000	€'000
Ten year period expires in:			
-2010	**2,360**	2,456	(96)
-2018	**55,810**	63,809	(7,999)
Total	**58,170**	66,265	(8,095)

There were no demonetised notes which ceased to be redeemable by the Bank in 2009 (2008: €2,061,971).

(ii) Demonetised Maltese lira currency coins

Maltese lira coins were replaced by euro coins when Malta became part of the Eurosystem on 1 January 2008. Consequently, Maltese lira coins remained legal tender until 31 January 2008 but could be redeemed at the conversion rate of the Maltese lira for the euro of 0.4293 without charge until 1 February 2010.

During 2009, demonetised Maltese lira currency coins presented for redemption amounted to €425,761 (2008: €5,399,385). At 31 December 2009, the value of unpresented demonetised currency coins amounted to €26,354,400 (2008: €26,780,161).

(e) Investment securities pledged as collateral

As at 31 December 2009, investment securities have been pledged as collateral against the provision of credit lines by a counterparty up to an amount of USD45 million or €31 million approximately (2008: USD45 million or €32 million approximately). No amounts were borrowed under these facilities at the balance sheet dates.

(f) Assets held in custody

At 31 December 2009, assets held in custody by the Bank in terms of the Maltese Insurance Business Act amounted to €36,837,491 (2008: €36,260,160).

(g) Management of funds belonging to the Investor and Depositor Compensation Schemes

In 2003, the Bank had been appointed as 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 2009, the Investor and Depositor Compensation Schemes had interest and non-interest bearing deposits of €26,430 (2008: €25,057) and €32,629 (2008: €25,495) respectively, with the Bank.

(h) Financial risk management

The nature of the Bank's operations implies that financial instruments, including derivatives, are extensively used in the course of its activities. The Bank is exposed to a range of financial risks and its operations involve the analysis, evaluation, acceptance and management of some degree of risk. Accordingly, the Bank operates a risk management strategy with the objective of controlling its exposures in this respect. The Bank's operational functions identify, evaluate and hedge financial risks. The Board approves written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments.

(i) Credit risk

The Bank is exposed to credit risk, which is the risk that a counterparty will cause a financial loss for the Bank by failing to discharge an obligation. The Bank's exposures to credit risk arise principally in investment activities that bring placements with banks and marketable debt securities into the Bank's asset portfolio. The Bank's portfolio of securities is composed of listed debt instruments issued mainly by governments and international financial institutions.

The Bank manages, limits and controls concentrations of credit risk where they are identified; in particular, to individual financial institutions or counterparties and groups of financial institutions classified by country of origin. The Bank places limits on the level of credit risk undertaken in relation to any single financial institution or counterparty. The exposure to a counterparty is restricted by specific sub-limits, by amount and term, for exposures arising from the different classes of investments and transactions. The limits are assigned in accordance with external ratings based on Fitch's ratings or their equivalents. The limits on the level of credit risk are reviewed on a regular basis and are approved by the Board of Directors at regular intervals. Actual exposures are monitored against limits on a daily basis.

The Bank places funds with permitted financial institutions having credit ratings within approved thresholds and it invests only in securities or paper with credit quality that falls within specific approved parameters. As outlined above, external ratings such as Fitch's ratings or their equivalents are used by the Bank for managing the credit risk exposures with a view to attaining an adequate credit quality mapping.

The Bank's principal credit risk exposures relating to on-balance sheet assets, reflecting the maximum exposure to credit risk before collateral held or other credit enhancements, are based on carrying amounts as reported in the balance sheet. As at 31 December 2009 and 2008, the Bank did not hold any past due or impaired financial assets.

The Bank's principal exposures, excluding Malta Government securities, as at the balance sheet date, are analysed in the tables below which present an analysis of the principal categories of financial assets by rating agency designation based on Fitch's ratings or their equivalent.

2009

Financial asset category	**AAA**	**AA+**	**AA**	**AA-**	**A+**	**A**	**BBB+**	**Carrying amount**
	%	**%**	**%**	**%**	**%**	**%**	**%**	**€'000**
Investment securities:								
- Other than held-to-maturity	**70**	**12**	**5**	**6**	**3**	**3**	**1**	**567,670**
- Held-to-maturity	**73**	**7**	**17**	**0**	**2**	**0**	**1**	**613,334**
			AA-	**A+**	**A**	**A-**		
			%	**%**	**%**	**%**		
Placements with banks			**7**	**11**	**33**	**49**		**240,902**

2008

Financial asset category	AAA	AA+	AA	AA-	A+	A	Carrying amount
	%	%	%	%	%	%	€'000
Investment securities:							
- Other than held-to-maturity	70	10	10	3	2	5	555,735
- Held-to-maturity	92	8	-	-	-	-	461,587
			AA	AA-	A+	A-	
			%	%	%	%	
Placements with banks			32	52	3	13	380,974

Note (i) *"Statement of the Bank's Investments"* below presents an analysis of the Bank's placements with banks by exposure country and of the Bank's debt securities by issuer category. Whilst no significant concentration is present with respect to the former, the issuers of the Bank's securities are mainly Governments and monetary financial institutions.

(ii) Market risk

The Bank is exposed to market risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices or rates. Market risks arise from open positions in interest rate and currency products, which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads and foreign exchange rates.

Currency risk

The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of net exposure or deviation in net holdings by currency, including contracted amounts under foreign exchange derivatives, which are monitored on an ongoing basis. The Bank is exposed to the risk of currency movements in respect of its holdings denominated in currencies other than euro. For macro-hedging purposes, the Bank uses derivative transactions for the forward purchase of euro and simultaneous forward sale of US dollar or sterling with a view to eliminate foreign currency exposures from holdings in these currencies, such that the Bank's net balance sheet exposure is substantially denominated in euro.

Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates.

The Bank mainly invests in, and places funds under, instruments subject to fixed interest rates. Whilst all placements with banks are subject to fixed interest rates, approximately 87% of the Bank's aggregate portfolio of securities are fixed interest instruments with the remaining portion representing floating rate bonds. Accordingly, it is not exposed to cash flow interest rate risk in respect of placements with banks, investment securities and local government securities. However, the Bank is exposed to fair value interest rate risk particularly in respect of its investment securities other than those held-to-maturity. The Bank has in place techniques, principally based on the concept of modified duration, to measure the sensitivity of the fair value of its fixed-income instruments to changes in market yields.

The Bank's measure of its exposure to fair value interest rate risk as at the balance sheet date in respect of fixed interest other than held-to-maturity investment securities is analysed by currency below:

2009		**Modified duration**	**Shift in fair value with shift of 25 bps in yields**
			€'000
	EUR	**2.21**	**1,856**
	USD	**1.80**	**1,041**

2008		Modified duration	Shift in fair value with shift of 25 bps in yields
			€'000
	EUR	2.61	2,354
	GBP	1.55	163
	USD	0.88	259

Interest rate risk is considered by the Directors to be limited in view of the short periods to maturity of placements with banks and the realisable nature of the Bank's investment securities. Moreover, the Bank's interest-bearing liabilities other than minimum reserve deposits, are mainly repayable on demand or within short time periods from the balance sheet date. All liabilities are repriceable within short time frames, with floating interest rates linked to the ECB's main refinancing operations rate or reference market interest rates. The Bank is exposed to cash flow interest rate risk in respect of such instruments. However, this exposure is offset intrinsically by the Bank's exposure on income earning assets which in substance reprice within short periods of time. The Bank actively manages its net interest income on this basis.

(iii) Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due. The Bank's main liabilities consist of banknotes in circulation and deposits, comprising minimum reserve deposits. Whereas reserve deposits and banknotes in circulation have no specified contractual maturity, other deposits are mainly repayable on demand or mature principally within very short periods of time from the balance sheet date.

The Bank's assets which are available to meet liabilities principally include placements with banks, investment securities and local government securities. The Bank places funds with banks for relatively short periods of time with varying terms and maturities. The Bank's investment securities consist of highly marketable investments which are readily realisable to meet commitments and funding requirements. The Bank's liquidity risk is hence relatively insignificant in view of the short-term maturities or realisable nature of the principal categories of its financial assets and due to the nature of the Bank's main liabilities.

Liquidity risk monitoring focuses on information with respect to the contractual maturity of the financial assets and the interaction of this information with an analysis of the expected or projected maturity of the Bank's financial liabilities. The Bank manages the concentration, terms and profile of its assets in accordance with this monitor, subject to internal benchmarks, to ensure that requirements can be met. The contractual maturity of the Bank's principal income earning assets as at 31 December 2009 is presented in the table below:

	Within one month	Within three months but over one month	Within one year but over three months	Within five years but over one year	Over five years	**Total**
	€'000	€'000	€'000	€'000	€'000	**€'000**
Fixed-term deposits	211,053	29,849	0	0	0	**240,902**
Marketable debt securities other than those held-to-maturity	10,670	14,285	75,020	340,794	126,901	**567,670**
Malta Government Securities	292	383	249	74,119	139,688	**214,731**
Held-to-maturity securities	5,003	20,054	38,516	296,256	253,505	**613,334**
Total	**227,018**	**64,571**	**113,785**	**711,169**	**520,094**	**1,636,637**

(i) Statement of the Bank's investments

The statement of the Bank's investments below is disclosed in accordance with the requirements of article 21(2)(b) of the Central Bank of Malta Act (Cap. 204).

The exposure country is the country of location of the institution or entity with which the Bank's placements and other financial assets are held. The exposure country in respect of assets held with branches of international banks and financial institutions is usually deemed to be the country of location of the parent. In case of subsidiaries of banks and financial institutions, the exposure country is generally determined on the basis of the location of the subsidiary undertaking.

	EUR	GBP	USD	Total
	€'000	€'000	€'000	€'000
Cash and balances with banks				**6,379**
Gold balances				**5,174**
Placements with banks by exposure country:				
Belgium	-	-	19,853	**19,853**
France	-	-	6,942	**6,942**
Italy	-	-	9,718	**9,718**
Malta	-	-	50,674	**50,674**
United Kingdom	-	-	50,187	**50,187**
Other countries	-	17,453	86,075	**103,528**
	-	**17,453**	**223,449**	**240,902**
Securities by issuer category:				
Government	769,190	-	68,456	**837,646**
Insurance	3,048	-	-	**3,048**
Monetary financial institutions	322,523	-	93,743	**416,266**
Non-financial institutions	7,033	-	4,913	**11,946**
Other financial institutions	19,063	-	14,203	**33,266**
Supranational	48,574	-	44,989	**93,563**
	1,169,431	**-**	**226,304**	**1,395,735**
Claims on the International Monetary Fund				**140,528**
Participating interest in the ECB				**11,890**
Transfer of foreign reserves to the ECB				**36,407**
Other foreign currency assets				**138**
Total investments				**1,837,153**