

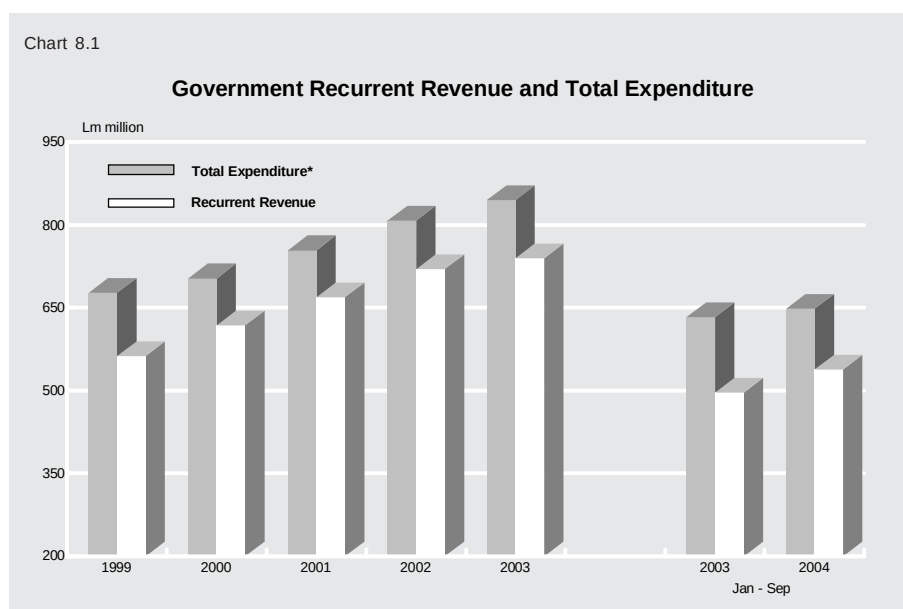
8. Financial Developments

8. Financial Developments

Developments in Government's fiscal position registered in the first nine months of 2004 reflect ongoing efforts to consolidate the public finances. In fact, the structural deficit declined from Lm135.8 million in the first nine months of 2003 to Lm109.9 million during the Survey period. This reduction in the fiscal imbalance was underpinned by an expansion in recurrent revenue which more than offset an increase in total expenditure. Furthermore, the expansion in total expenditure was significantly lower than that registered in previous years. During the Survey period, broad money (M3) continued to expand mainly attributable to more rapid growth in domestic credit which is the main counterpart of broad money. During the first nine months of 2004, the central intervention rate was left unchanged at 3.0 per cent. The Maltese lira remained practically unchanged vis-a-vis the Euro and the US dollars reflecting developments of these currencies on the foreign exchange market. Meanwhile, the Maltese lira weakened against the Sterling but appreciated against the Japanese yen.

Public Finance

Government finance data are based on cash-accounting and thus expenditure and revenue are recorded and contribute to the deficit at the time when cash payments and receipts are effective rather than at the time the underlying



*excluding contributions to Sinking Fund and Direct Loan Repayments

transaction takes place. As a result, caution in the use and interpretation of such data should be exercised since developments in the Government's net financial position may not reflect actual spending and revenue collection. Table 8.1 presents Government's fiscal position during the first nine months of the 2001-2004 period. Meanwhile, recent developments in total expenditure and recurrent revenue are depicted in Chart 8.1.

Revenue

During the Survey period, Government recurrent revenue increased by Lm41.6 million to Lm538.2 million. This expansion in recurrent revenue was attributable to an increase in both tax and non-tax revenue, the latter including grants but excluding extraordinary receipts. Appendix Table 8.1 presents developments in

Government Revenue and Expenditure (January-September)				
Table 8.1	Lm million			
	2001	2002	2003	2004
Recurrent Revenue	466.9	505.6	496.6	538.2
Tax Revenue	408.4	438.9	443.6	472.0
Direct Tax Revenue	234.0	246.8	251.0	258.7
Indirect Tax Revenue	174.4	192.1	192.6	213.3
Non-Tax Revenue	58.5	66.7	53.0	66.2
Total Expenditure	547.9	591.2	632.4	648.1
Recurrent Expenditure	433.6	471.0	499.4	518.2
Interest on Public Debt	45.1	49.2	48.8	54.3
Capital Expenditure	69.2	71.0	84.2	75.6
Productive	27.8	26.4	23.4	17.9
Infrastructure	23.5	21.7	23.6	27.2
Social	17.9	22.8	37.2	30.6
Structural Deficit	(81.0)	(85.6)	(135.8)	(109.9)
Financed by:				
Extraordinary Receipts				
Receipts from sale of shares	0.0	19.0	0.0	0.0
Sinking Funds of Converted Loans	0.0	0.0	2.1	8.9
Sinking Fund Contribution/Direct Loan Repayments	(6.7)	(6.1)	(6.2)	(6.3)
Public Sector Borrowing Requirement	(87.7)	(72.7)	(139.9)	(107.3)
Loans	79.1	0.0	102.1	70.4
Local Loans	79.1	0.0	69.9	70.4
Foreign Loans	0.0	0.0	32.2	0.0

Source: The Treasury

the components of Government revenue for the first nine months of the 2001-2004 period.

Tax revenue, which constitutes around 88 per cent of total recurrent revenue, increased by Lm28.4 million to Lm472.0 million during the first nine months of 2004. This was attributable to both higher direct and indirect tax revenue. Direct tax revenue, which comprises income tax and social security contributions and accounts for around 55 per cent of total tax receipts, increased by Lm7.7 million to Lm258.7 million. Indirect tax revenue constitutes around 45 per cent of total tax receipts and includes customs and excise duties, licences, taxes and fines and Value Added Tax (VAT). During the Survey period, indirect tax revenue increased by Lm20.7 million to Lm213.3 million on account of higher revenue collected from VAT and licences, taxes and fines which exceeded the decline in revenue generated from customs and excise duties.

During the period under review, revenue collected from income tax increased by Lm8.9 million to Lm133.9 million. This increase includes Lm5.6 million as higher capital gains tax partly reflecting changes in the way tax on property is charged announced in the Budget Speech for 2004, particularly with respect to tax on capital transfer. Ongoing efforts to improve efficiency in tax collection also contributed to the increase in income tax revenue. The change in the timing of the payment of salaries to Government employees, as from the beginning of 2004, lowered income tax revenue collection over the first nine months of 2004. This effect on revenue generated from income tax will be reversed by the end of this year.

Social security contributions declined by Lm1.2 million to Lm124.8 million during the Survey period. Higher employment within the private sector resulted in a rise in social security contributions by this sector. However, this increase in revenue was more than offset by lower receipts from contributions during the first nine months of 2004 in relation to public service employees. This was a result of a change in number of payments of their salaries as from the beginning of 2004. However, such lower contributions will be neutralised by year-end.

Revenue generated from customs and excise duties declined by Lm2.5 million to Lm42.4 million. Lower receipts were recorded from import duty on motor vehicles reflecting a fall in imports of motor vehicles. Moreover, revenue collected from excise duties also declined, mainly due to the timing of payments on tobacco products following changes in the duty collection method as from 1st May 2004. Such change in the timing of the inflow of excise duties more than offset additional

revenue generated from an increase in excise duty on tobacco products announced in the Budget Speech for 2004.

During the Survey period, revenue collected from licences, taxes and fines amounted to Lm73.3 million or Lm11.7 million more than that registered in the first nine months of 2003. This increase was mainly underpinned by licence fees received upon the privatisation of the lotteries. Higher receipts from duty on documents on transfer of immovable property following measures as part of the enforcement against tax evasion in the property market also contributed to this outcome. Moreover, higher revenue was collected from airport tax on account of a higher number of Maltese travelling abroad. On the other hand, lower revenue was generated as a result of the complete removal of import levies by 1st May 2004. Moreover, revenue from motor vehicle registration tax also declined reflecting lower imports of motor vehicles.

Revenue collected from VAT increased by Lm11.5 million to Lm97.6 million. The rise of VAT mainly reflects an increase in the standard VAT rate from 15 per cent to 18 per cent as from 1st January 2004 as well as the introduction of a reduced VAT rate of 5 per cent on confectionery and other edible items, printed matter and medical accessories. Moreover, higher imports of yachts linked to a local registration scheme, which provided for a one-off reduction of VAT until the first quarter of 2004, also contributed to higher VAT revenue. Cash inflow from this item of revenue was also influenced by a change in the timing of the collection of VAT on imported products whereby payments are deferred until the point of sale.

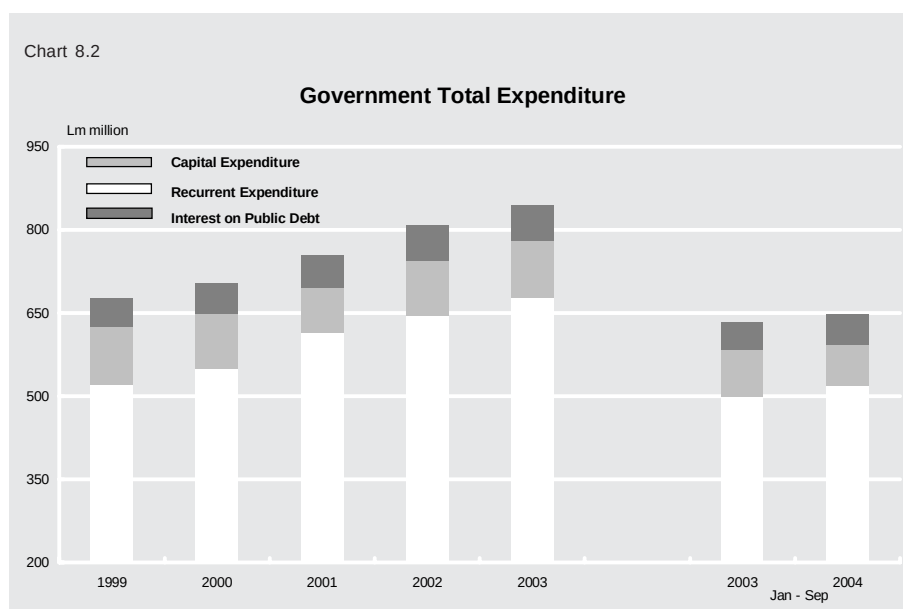
During the Survey period, non-tax revenue increased by Lm13.2 million to Lm66.2 million. The main items of non-tax revenue are the transfer of profits generated by the Central Bank of Malta, rents and grants. Revenue generated by the former declined from Lm24.8 million in the first nine months of 2003 to Lm18.2 million during the period under review. Rents also declined by Lm1.7 million reflecting a change in the timing of cash received in respect of rent of factories. Such delayed payment is expected to be received by the end of this year.

Grants reached Lm15.9 million or Lm13.8 million more than that registered in the first nine months of 2003. This increase mainly comprises funds forthcoming from the European Union on a monthly basis following membership as from 1st May 2004. Additional revenue was generated from dividends on investment, reimbursements and other miscellaneous receipts.

Expenditure

Total Government expenditure comprises recurrent expenditure, capital expenditure and interest on public debt but excludes contribution to the Sinking Fund in respect of local and foreign loans and direct repayment of loans. During the Survey period, total expenditure increased by Lm15.7 million to Lm648.1 million. This was attributable to higher recurrent expenditure and interest on public debt which more than offset a decline in capital outlays. Around 80 per cent of total spending is of a recurrent nature. Recurrent expenditure increased from Lm499.4 million in the first nine months of 2003 to Lm518.2 million during the period under review. This expansion was lower than that registered in previous years. Meanwhile, capital outlays, which constitute around 12 per cent of total expenditure, declined from Lm84.2 million to Lm75.6 million. Interest on public debt accounted for around 8 per cent of total expenditure, rising in absolute terms by Lm5.5 million to Lm54.3 million. Chart 8.2 illustrates trends in total Government expenditure in recent years.

The expansion in recurrent expenditure registered during the Survey period was mainly underpinned by increases in expenditure under Programmes and Initiatives which constitute around 54 per cent of total recurrent expenditure. This category of recurrent expenditure increased by Lm22.0 million to Lm281.6 million. The main items of higher expenditure under this category are social security benefits and a one-time payment by Government to all employees and pensioners as compensation for the increase in the VAT rate announced in the Budget Speech for 2004. Moreover, the introduction for the first time of Malta's



contribution to the EU budget as from 1st May 2004 (which will be more than compensated for by the receipt of funds from the EU) also contributed to this higher expenditure.

The share of Operation and Maintenance expenditure in recurrent outlays stood at around 7 per cent. Approximately half of the expenditure under this category are materials and supplies, most of which relate to the provisions of free medicines under the national health system. Operation and Maintenance expenditure increased by Lm3.1 million, mainly attributable to the provision of free drugs and medicines. Contributions to Government entities, which account for 11 per cent of total recurrent expenditure, increased by Lm1.1 million to Lm57.8 million. This reflects higher expenditure by Government entities such as Malta Enterprise Corporation and the Malta Environment and Planning Authority. Higher expenditure allocated to Industrial Projects and Services Ltd was undertaken in view of lower outlays allocated to the shipyards.

Personal emoluments constitute around 27 per cent of total recurrent expenditure. This category of expenditure declined by Lm7.7 million to Lm138.9 million during the Survey period, reflecting the fact that as from the beginning of this year salaries to public service employees are paid every four weeks rather than on monthly basis. Such impact on expenditure will be neutralised by the end of this year. Moreover, a drop in employment in Government departments also contributed to lower expenditure on personal emoluments. Expenditure registered under the Special Expenditure category amounted to Lm0.5 million during the Survey period, which stays similar to the total recorded during the corresponding 2003 period.

Appendix Table 8.2 presents a detailed breakdown of recurrent expenditure on a cost center basis for the first nine months of the 2001-2004 period. It is pertinent to note that recurrent expenditure is presented according to the cost-centres as prevailing at the beginning of 2004 and thus do not reflect the changes in these cost-centres which took place later on in the year. Developments in capital expenditure are presented in detail in Appendix Table 8.3. The major developments recorded in the separate expenditure categories are discussed below.

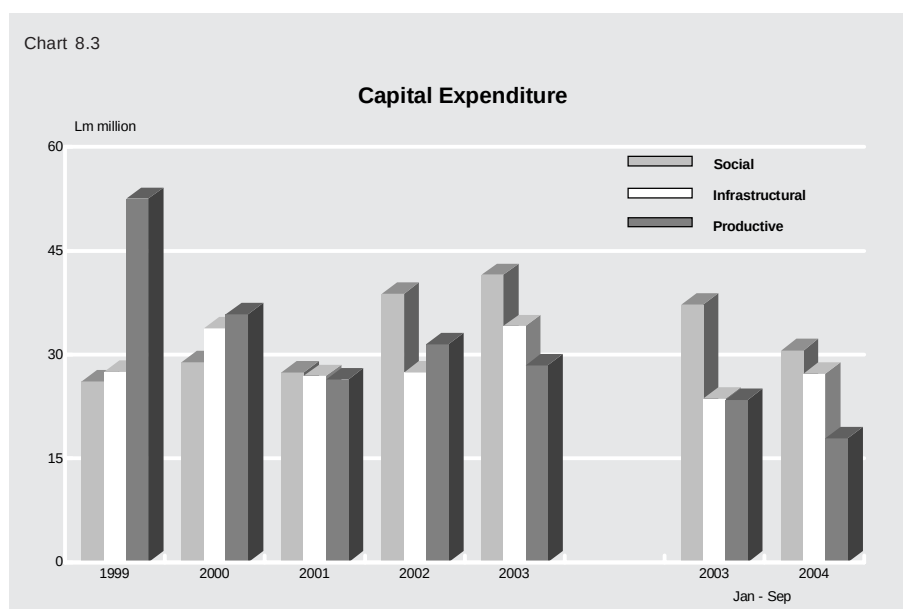
During the Survey period, Government welfare payments increased by Lm5.3 million to Lm155.6 million. This item of expenditure includes retirement pension, children's allowance, social assistance and other benefits and is influenced by developments in wages and cost of living adjustment as well as demographic changes. Expenditure in respect of the Department of Social Security consists

of the State contribution in terms of the Social Security Act, 1987. This item of expenditure declined by Lm0.6 million.

Expenditure by the Treasury Department increased by Lm6.9 million to Lm7.8 million during the first nine months of 2004. This increase was attributable to a one-off payment to compensate for the higher standard VAT rate as announced in the Budget Speech for 2004.

During the first nine months of 2004, expenditure incurred by the Ministry of Finance rose from Lm1.8 million to Lm14.4 million. This higher expenditure reflects Malta's contribution to the EU Budget as from 1st May 2004 which is mitigated by receipt of funds from the EU. Moreover, additional funds were incurred to finance activities of Malta Enterprise Corporation.

Expenditure in respect of Treasury Pensions, which includes outlays in respect of pensions, allowances and gratuities under the Pensions Ordinance (Cap. 39), remained practically unchanged at Lm21.5 million. Expenditure incurred by the Ministry of Gozo declined by Lm1.6 million to Lm13.5 million reflecting lower personal emoluments. The Ministry for Resources and Infrastructure registered a decline of Lm2.1 million in recurrent expenditure. This decline is attributable to lower personal emoluments, which more than offset higher expenditure incurred towards the solid waste management strategy.



During the Survey period, expenditure incurred by the Ministry of Health increased from Lm52.9 million to Lm55.4 million. This rise was mainly attributable to higher expenditure on medicines and medical supplies. Expenditure incurred by the Ministry for Youth and the Arts amounted to Lm3.5 million, mainly consisting of expenditure on culture which was previously included as part of the expenditure by the Ministry of Education.

The Ministry for Social Policy registered a decline of Lm1.6 million in recurrent expenditure during the first nine months of 2004. This reflected the exclusion of expenditure related to the Employment and Training Corporation (ETC) from this cost centre and transferred to the Ministry of Education. Recurrent expenditure by the Ministry of Education remained practically at the levels registered during the corresponding period in 2003. However, it is pertinent to note that this item of expenditure was affected by the exclusion of expenditure related to culture and the inclusion of expenditure related to ETC.

During the first nine months of 2004, capital expenditure decreased by Lm8.5 million to Lm75.6 million. Capital outlays on social development as well as on productive investment declined, offsetting higher investment directed towards infrastructural facilities. The share of investment directed towards social development fell to 40.4 per cent from 44.1 per cent during the first nine months of 2003. Productive investment accounted for 23.6 per cent of total capital expenditure, compared to 27.8 per cent recorded during the corresponding 2003 period. The share of infrastructural investment increased to 35.9 per cent of total capital expenditure, from 28.1 per cent. A detailed breakdown of Government's capital expenditure programme for the first nine months of the 2001-2004 period is presented in Appendix Table 8.3. Meanwhile, Chart 8.3 illustrates developments in capital expenditure.

Capital outlays on productive investment declined by Lm5.6 million and stood at Lm17.9 million. This decline reflected the re-classification to recurrent expenditure of payments to Malta Shipyards Ltd starting in 2004 as part of the restructuring programme for the shipyards. Moreover, the decline in capital expenditure on productive investment also reflected lower capital outlays concerning the development of industries. On the other hand, outlays on public buildings, plant and equipment increased by Lm1.3 million, reflecting capital works and equipment for the Ministry for Rural Affairs and the Environment financed through the Fifth Italian Financial Protocol. Capital outlays on tourism increased by Lm0.3 million to amount to Lm8.6 million.

At Lm27.2 million, capital expenditure on infrastructure was Lm3.6 million higher than the level recorded during the first nine months of 2003. An increase was registered in the funds earmarked for the development of Malta Freeport. Capital outlays allocated under the item Public Buildings, Plant and Equipment increased to Lm18.9 million, up from Lm13.5 million, partly reflecting higher outlays allocated to the Ministry of Foreign Affairs.

Government's capital programme for social investment amounted to Lm30.6 million during the period under review, as compared to Lm37.1 million recorded during the first nine months of 2003. This was underpinned by lower outlays on health expenditure to finance the works carried out in respect of the new hospital. Moreover, capital outlays on education declined by Lm1.1 million to Lm4.1 million, on account of lower capital expenditure by the Foundation for Tomorrow's Schools.

Fiscal Performance

As highlighted above, the first nine months of 2004 were characterised by budgetary consolidation whereby the structural deficit declined from Lm135.8 million to Lm109.9 million. The decline in the structural deficit coupled with higher extraordinary receipts lowered the public sector borrowing requirement

Box 8.1

General Government Statistics based on the European System of Accounts (ESA95)

The Consolidated Fund provides for Government's system of accounting and control for the collection of revenue and the administration of allocated expenditure. Parallel to presenting the statement of the Consolidated Fund periodically, which is the basis of analysis presented in this Chapter, the reclassification of Government finance transactions according to the European System of Accounts (ESA95) is given increasing importance particularly in order to ensure harmonization in the reporting of public finance data at an EU level.

Fiscal data defined according to the ESA95 methodology capture fiscal operations of general Government, which includes the Consolidated Fund, the balances of local councils and extra-budgetary units (EBUs) and other adjustments. EBUs are defined as public non-financial companies having less than 50 per cent of their production costs covered by market sales. These data thus provide a more complete picture of the Government's operations. Moreover, general Government fiscal data are based on accrual-accounting principles rather than cash-based as in the case of the Consolidated Fund.

to Lm107.3 million as compared to Lm139.9 million during the corresponding 2003 period.

Government relies heavily on domestic borrowing to finance the fiscal imbalance. In fact, the proportion of foreign loans to total debt is around 5 per cent with the rest coming from local sources. Resorting to domestic borrowing contributes not only to the development of the local debt market but also in minimising the drawing down of international reserves while limiting exposure to exchange rate risk.

General Government Net Lending (+) or Borrowing (-)
as a percentage of GDP

Table 8.2 per cent

	2001	2002	2003
Austria	0.3	-0.2	-1.1
Belgium	0.6	0.1	0.4
Cyprus	-2.4	-4.6	-6.4
Czech Republic	-5.9	-6.8	-12.6
Denmark	2.1	0.7	0.3
Estonia	0.3	1.4	3.1
Finland	5.2	4.3	2.3
France	-1.5	-3.2	-4.1
Germany	-2.8	-3.7	-3.8
Greece	-3.7	-3.7	-4.6
Hungary	-4.4	-9.2	-6.2
Ireland	0.9	-0.2	0.1
Italy	-2.6	-2.3	-2.4
Latvia	-2.1	-2.7	-1.5
Lithuania	-2.0	-1.5	-1.9
Luxembourg	6.4	2.8	0.8
Netherlands	-0.1	-1.9	-3.2
Poland	-3.8	-3.6	-3.9
Portugal	-4.4	-2.7	-2.8
Slovakia	-6.0	-5.7	-3.7
Slovenia	-2.8	-2.4	-2.0
Spain	-0.4	-0.1	0.4
Sweden	2.8	0.0	0.3
United Kingdom	0.7	-1.7	-3.3
EU 25	-1.2	-2.3	-2.8
Malta	-6.4	-5.9	-9.6

Source: European Commission
National Statistics Office
Ministry of Finance

International Comparison

Table 8.2 presents the budgetary position of the EU Member States for the three years to 2003, whilst Table 8.3 shows the general Government debt position for the EU. It is pertinent to note that the analysis in this section is based on General Government fiscal data according to the ESA95 methodology and is thus not comparable with data presented in other sections of this Chapter.

In 2003, the budgetary position in the EU Member States deteriorated by 0.5 percentage points and reached 2.8 per cent of GDP. The aggregate outcome for the EU 25 results from diverse budgetary performances across Member

General Government Gross Debt as a percentage of GDP			
Table 8.3	per cent		
	2001	2002	2003
Austria	66.1	65.7	64.5
Belgium	108.0	105.4	100.0
Cyprus	64.3	67.4	70.9
Czech Republic	25.3	28.8	37.8
Denmark	49.2	48.8	45.9
Estonia	4.4	5.3	5.3
Finland	43.8	42.6	45.6
France	56.5	58.8	63.7
Germany	59.4	60.9	64.2
Greece	114.7	112.5	109.9
Hungary	53.5	57.2	59.1
Ireland	35.9	32.7	32.1
Italy	110.6	107.9	106.2
Latvia	14.9	14.1	14.4
Lithuania	22.9	22.4	21.4
Luxembourg	5.5	5.7	5.3
Netherlands	52.9	52.6	54.1
Poland	36.7	41.1	45.4
Portugal	55.8	58.4	60.3
Slovakia	48.7	43.3	42.6
Slovenia	28.1	29.5	29.4
Spain	57.5	54.4	50.7
Sweden	54.4	52.6	52.0
United Kingdom	38.8	38.3	39.8
EU 25	62.1	61.6	63.2
Malta	62.2	62.7	70.4
Source: European Commission National Statistics Office Ministry of Finance			

States. In the case of Germany, France, Italy and Portugal the budgetary positions in 2003 remained weak with nominal deficits ranging from 2.4 per cent of GDP in Italy to 4.1 per cent of GDP in France. In 2003, the nominal deficit has also sharply deteriorated in the Netherlands, Greece and the UK. Nevertheless, in spite of a period of low growth, seven EU 15 Member States had nominal budget positions in balance or in surplus. Overall, the nominal budget balances in 2003 did not worsen or did so only marginally compared to the previous year in the case of Belgium, Denmark, Spain, Ireland, Sweden, Italy and Portugal.

In the case of the new Member States, nominal budget balances in 2003 varied from a deficit of 12.6 per cent in the Czech Republic to a surplus of 3.1 per cent in Estonia. The nominal deficit in 2003 of Cyprus, the Czech Republic, Hungary, Poland and Slovakia, was above the 3 per cent of GDP reference value. Relative to 2002, the budget position remained roughly unchanged or improved in four countries, while it deteriorated in Cyprus, Czech Republic, Lithuania and Poland. Malta's budgetary position deteriorated by 3.7 percentage points reaching 9.6 per cent. However, it is pertinent to note that this outcome was heavily influenced by a one-off transaction relating to the restructuring programme of the shipyards. In fact, this one-off transaction influenced the net borrowing-to-GDP ratio by 3.2 percentage points. If the impact of this transaction were excluded, the general Government deficit ratio would have stood at 6.4 per cent.

The general Government debt ratio for the EU Member States increased by 1.6 percentage points to 63.2 per cent of GDP. In 2003, Belgium, Greece and Italy continued to have debt ratios above 100 per cent of GDP. In addition to these three countries, Austria, Cyprus, France, Germany and Portugal registered debt ratios above the 60 per cent reference value. In 2003, general Government debt in Malta reached 70.4 per cent of GDP. This increase in the general Government debt ratio from 62.7 per cent in 2002 reflected developments in the fiscal imbalance as well as the assumption by Government of liabilities of the shipyards as a result of the restructuring implemented at the end of 2003.

Monetary Developments

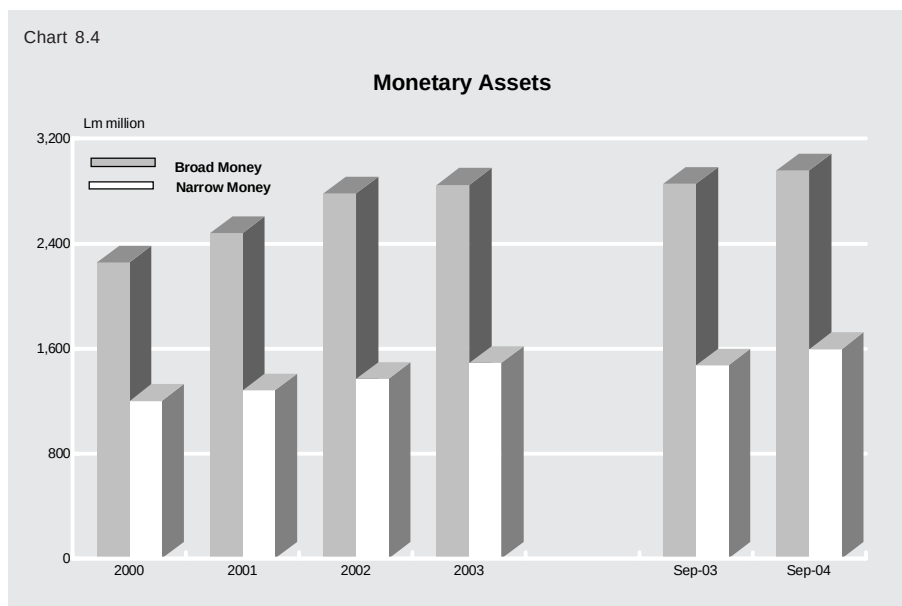
During the Survey period, broad money (M3) continued to expand reflecting the prevailing low interest rate environment and thus the low opportunity cost of holding monetary instruments. The acceleration in monetary growth was mainly attributable to more rapid growth in domestic credit which is the main counterpart of broad money. A slower growth in net foreign assets of the banking system was partly offset by a similar slowdown in the growth of the other

counterparts of broad money. The latter is deducted from broad money thus a lower growth rate contributes to a higher pace of monetary growth.

Monetary Aggregates

During the period under review, broad money, expanded by 3.9 per cent to Lm2,960.2 million, as compared to the 2.7 per cent growth rate registered during the corresponding 2003 period. The relatively higher growth rate in M3 is mainly attributed to the reversal of the decline in residents' time deposits registered in the first nine months of 2004. Table 8.4 presents developments in the monetary

Table 8.4 Monetary Aggregates and Their Counterparts*						
	Lm million					
	2002 (Dec)	2003 (Sep)	Sep 03 - Dec-02 % Change	2003 (Dec)	2004 (Sep)	Sep 04 - Dec-03 % Change
Monetary Aggregates						
Narrow Money (M1)	1,367.4	1,471.2	7.6	1,490.9	1,596.0	7.0
Currency in Circulation	436.8	456.4	4.5	460.4	484.0	5.1
Deposits withdrawable on demand	930.5	1,014.8	9.1	1,030.5	1,111.9	7.9
Intermediate Money (M2)	2,781.5	2,855.5	2.7	2,849.2	2,960.2	3.9
Narrow Money (M1)	1,367.4	1,471.2	7.6	1,490.9	1,596.0	7.0
Savings Deposits redeemable at notice up to 3 months	27.9	29.8	6.6	28.8	29.7	3.1
Time Deposits with agreed maturity up to 2 years	1,386.2	1,354.5	-2.3	1,329.5	1,334.5	0.4
Broad Money (M3)	2,781.5	2,855.5	2.7	2,849.2	2,960.2	3.9
Counterparts of M3						
Domestic Credit	2,401.4	2,476.2	3.1	2,648.7	2,784.2	5.1
Net Claims on central government	539.5	561.7	4.1	568.4	573.4	0.9
Claims on other residents	1,862.0	1,914.5	2.8	2,080.3	2,210.9	6.3
Net Foreign Assets	1,301.3	1,386.1	6.5	1,416.9	1,474.5	4.1
Central Bank of Malta	881.6	943.2	7.0	919.8	928.7	1.0
Banks	419.7	443.0	5.5	497.1	545.9	9.8
Less other counterparts of M3⁽¹⁾	921.3	1,006.9	9.3	1,216.4	1,298.6	6.8
*In October 2003, the definitions of the main monetary aggregates and their counterparts were revised in accordance with ECB Regulation 2001/13. Thus, data prior to October 2003 are estimates based on this regulation						
⁽¹⁾ Other counterparts of M3 include the capital base of the Monetary Financial Institutions sector, longer-term financial liabilities, provisions, interest accrued and unpaid and other liabilities, less fixed and other assets. They are equal to the difference between M3 and the sum of domestic credit and net foreign assets						
Source: Central Bank of Malta						



aggregates and their counterparts, whilst Chart 8.4 illustrates developments in the monetary aggregates.

Narrow money, (M1), which accounts for just over half of M3, increased by a slightly lower rate compared to that for the first nine months of 2003. Indeed, M1, increased by 7.0 per cent to Lm1,596.0 million, compared to the 7.6 per cent growth rate registered during the corresponding 2003 period. The slowdown in the growth of M1 mainly reflects a relatively lower growth rate in deposits withdrawable on demand which more than offset a higher growth rate in currency in circulation. Currency in circulation, which represents just under a third of M1 accelerated, increasing by Lm23.6 million or 5.1 per cent, as compared to a growth rate of 4.5 per cent during the first nine months of 2003. Deposits withdrawable on demand expanded from Lm1,030.5 million to Lm1,111.9 million, an increase of 7.9 per cent. This increase resulted from higher demand deposits which increased by Lm49.9 million to Lm323.6 million. Savings deposits also expanded, increasing by Lm31.5 million to Lm788.3 million.

Intermediate money, M2, consists of M1 and short-term deposits not withdrawable on demand. During the first nine months of 2004, M2 expanded by Lm111.0 million or 3.9 per cent, compared to the 2.7 per cent growth rate registered during the corresponding 2003 period. The relatively higher growth rate in M2 was underpinned by growth in time deposits with an agreed maturity of up to two years, reversing a contraction registered in the corresponding 2003

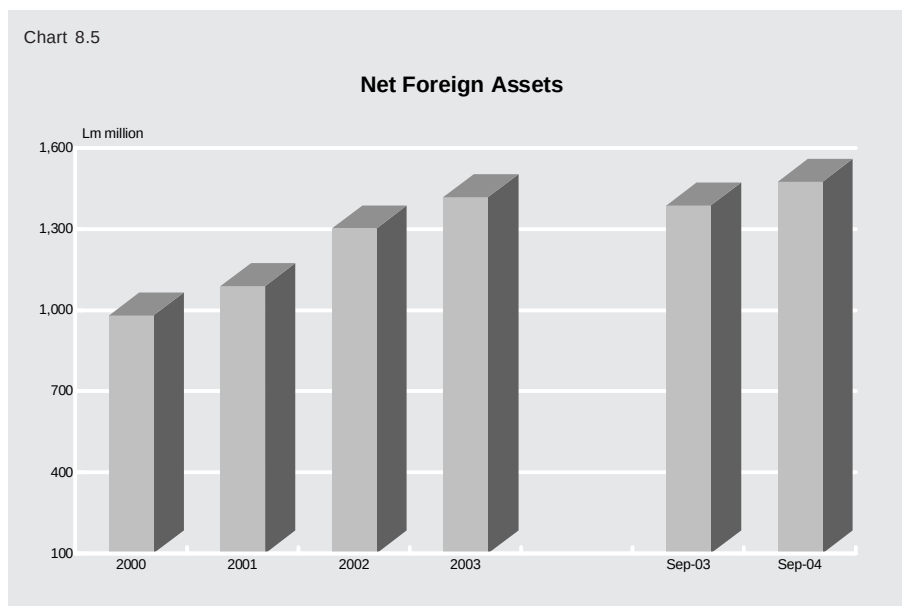
period. This growth in time deposits offset a relatively lower growth in deposits redeemable at notice up to three months and the slowdown in the growth of M1 mentioned earlier. Time deposits increased by Lm5.0 million or 0.4 per cent to Lm1,334.5 million compared to the contraction of 2.3 per cent registered during the first nine months of 2003. Savings deposits redeemable at notice up to three months expanded by 3.1 per cent to Lm29.7 million as compared to an increase of 6.6 per cent during the first nine months of 2003. These developments in M2 were influenced by the prevailing low interest rates which encourage savers to shift funds away from long-term deposits into deposits with a shorter maturity included in this aggregate. On the other hand, this effect was lessened by portfolio shifts from short-term time deposits into alternative assets such as bonds and equities. It is pertinent to note that since the amount of marketable instruments, mainly repurchase agreements and debt securities with maturity up to 2 years, is negligible, currently M2 is equal to M3.

Counterparts of Monetary Expansion

The faster pace in monetary growth registered during the first nine months of 2004, was attributable to a more rapid growth in domestic credit. Moreover, since the other counterparts of M3 category is deducted from broad money the deceleration of the former contributed to the higher pace of monetary growth. On the other hand, during the Survey period, net foreign assets of the banking system increased at a slower rate.

During the first nine months of 2004, domestic credit expanded by Lm135.5 million or 5.1 per cent to Lm2,784.2 million. This growth rate is relatively higher than the 3.1 per cent expansion rate registered during the corresponding period of 2003, attributable to a faster increase in the claims on other residents.

Claims on other residents increased by 6.3 per cent to Lm2,210.9, compared to the 2.8 per cent growth rate registered during the corresponding period in 2003. Claims on other residents consist mainly of loans and advances and holdings of securities, including equities, issued by the non-bank private sector and public non-financial companies. At the end of September 2004, loans and advances (including bills discounted) accounted for around 88 per cent of bank claims on other residents, the rest mainly consisting of bank holdings of corporate debt and equity. The increase in claims on other residents was mainly attributable to private sector credit, while loans and advances to public non-financial companies contributed to this increase only marginally. Meanwhile, net claims on central Government increased by Lm5.0 million or 0.9 per cent to Lm573.4 million. This represented a decline when compared to the 4.1 per cent growth rate



recorded during the corresponding period in 2003. Banks' claims on Government increased marginally by 0.4 per cent as compared to 8.3 per cent growth rate during the corresponding 2003 period, while net claims on central Government by the Central Bank contracted by 3.0 per cent.

During the period under review, net foreign assets of the banking system continued to expand, though at a slower pace than in the corresponding 2003 period as illustrated in Chart 8.5. In fact, net foreign assets of the banking system increased by 4.1 per cent to Lm1,474.5 million, compared to the 6.5 per cent growth rate registered during the corresponding 2003 period. The expansion in the net foreign assets was mainly attributable to higher banks' holdings which increased by 9.8 per cent from Lm497.1 million to Lm545.9 million. The net foreign assets of the Central Bank accounted for around two-thirds of the combined holdings of the entire banking system at the end of September 2004. The Central Bank's net portfolio expanded by Lm8.9 million, or 1.0 per cent to Lm928.7 million, following a growth rate of 7.0 per cent registered during the corresponding 2003 period.

The other counterparts of M3 increased by Lm82.2 million, or 6.8 per cent, dampening monetary growth. Other counterparts of M3 include the capital base of the Monetary Financial Institutions sector, longer-term financial liabilities, provisions, interest accrued and unpaid and other liabilities, less fixed and other assets.

The Money Market

The Central Bank of Malta's monetary policy strategy aims at price stability through the maintenance of a fixed exchange rate, which is pegged to a currency basket. In this regard, the Central Bank engages in open market operations to influence the level of liquidity in the banking system and thus ensures that monetary conditions are compatible with its monetary policy stance. The Central Bank also trades in foreign currency in response to domestic market conditions. Moreover, the Central Bank adjusts the official interest rates to reflect movements in interest rates abroad. Through these operations the Central Bank maintain an adequate level of external reserves to support the exchange rate peg.

Following an easing of the Central Bank's monetary policy stance during 2003, the central intervention rate was left unchanged at 3.0 per cent during the first nine months of 2004. Hence, during this period, domestic money market interest rates remained broadly stable and close to the rates applied by the Central Bank in its open market operations. Given that these developments took place in the context of an international environment characterised by gradual rises in money market rates abroad, the interest rate premium on short-term Maltese lira assets narrowed.

During the period under review, the Central Bank continued to absorb liquidity from the rest of the banking system through weekly auctions of 14-day term deposits. The Central Bank absorbed Lm2,193.1 million, down from Lm2,606.6 million in the first nine months of 2003. The interest rate paid on these deposits remained 2.95 per cent being the floor of the interest rate band (2.95 per cent - 3 per cent) at which the Central Bank conducts its term deposit auctions.

In order to finance its short-term borrowing requirements, Government resorts regularly to the money market. During the period under review, a total of Lm472.6 million worth of Treasury bills were issued, as compared to Lm644.8 million in the corresponding 2003 period. The bulk of the trading was in Treasury bills with a maturity period of 91 days. Yields in the primary market remained relatively stable reflecting the fact that the central intervention rate was left unchanged during the period under review. The yield on the three-month bill increased only marginally from 2.94 per cent to 2.96 per cent while the yield on the six-month Treasury bill remained stable at around 2.94 per cent. The rate for the one-month and one-year Treasury bill stood at 2.96 per cent and 2.97 per cent, respectively.

Turnover in the secondary market for Treasury bills declined from Lm103.2 million to Lm84.2 million during the period under review. The value of

transactions involving the Central Bank increased from Lm18.5 million to Lm42.8 million. As in the primary market, yields in the secondary market remained broadly unchanged, with the interest rate on the three-month Treasury bill standing at 2.99 per cent.

Following a downward trend in the turnover in the inter-bank market registered in the past years, during the first nine months of 2004 activity in this market increased, with the value of inter-bank loans increasing from Lm46.6 million to Lm185.8 million. At a total of 46 deals, overnight inter-bank deals remained the most popular. Meanwhile, 18 deals and 14 deals were transacted on the 7-day and 14-day tenor, respectively. The interest rate on one-week inter-bank loans remained stable at 2.95 per cent.

The Capital Market

During the first nine months of 2004, Government continued to resort to the capital market for financing the deficit by issuing five different stocks with a total value of Lm115 million. In April, Lm18.7 million in Government bonds were redeemed. This was followed by the issue of Lm40 million MGS 2021 (I) and Lm25 million MGS 2016 (II) (fungible) in May. Moreover, a further issue worth Lm25.8 million was redeemed in July. This redemption was followed by a further three new issues – Lm20 million MGS 2022, Lm17 million MGS 2014 (II) and Lm13 million MGS 2010 (IV) – which took place in August. The participation by the small investor in these new stocks was very significant reflecting the liquidity of the general public. Coupon rates offered ranged from 4.8 per cent to 5.4 per cent.

In contrast with the buoyant activity registered during the first nine months of 2003, there was only one bond issue on the primary market during the period under review. This issue was that of an international financial institution, the European Investment Bank, which in February launched Lm10 million worth of bonds maturing in 2009 with a coupon rate of 3.8 per cent. Demand for these triple-A rated bonds was high and the issue was subsequently listed on the Malta Stock Exchange. On the domestic front, no activity in the corporate debt market was registered by the private sector. In April, Lombard Bank plc launched a bonus issue of 61,363 shares.

Following a decline in the turnover in the secondary market for Government bonds registered during the first nine months of 2003, turnover of Government securities increased from Lm27.9 million to Lm41.5 million during the period under review. A total of 2,490 deals were registered on the Malta Stock Exchange

Government Stocks Activity on the Secondary Market				
Table 8.5				
	2004 Jan/Mar	2004 Apr/Jun	2004 Jul/Sep	2004 Jan/Sep
Turnover in Government Stocks:				
Nominal Value (Lm million)	13.4	9.1	15.5	38.0
Market Value (Lm million)	14.8	9.7	17.1	41.5
Number of Transactions	767	715	1,008	2,490
Average Value per Transaction (Lm)*	17,450	12,703	15,401	15,258
Amount sold by CBM (Lm million)**	1.8	0.0	0.0	1.8
Amount bought by CBM (Lm million)**	0.4	0.4	10.3	11.1
* Based on Nominal Values				
** Based on Market Values				
Source: Central Bank of Malta				

resulting in an average value per transaction of Lm15,258. The highest turnover was registered in 4.8 per cent MGS 2016 (II), 7.8 per cent MGS 2018, 5.0 per cent MGS 2021 and 6.6 per cent MGS 2019. The latter includes a block trade of around Lm5 million affected on 20th September. As shown in Table 8.5, the value transacted by the Central Bank amounted to Lm12.9 million of total turnover, while other investors took up the remainder.

During the Survey period, turnover in the corporate secondary bond market decreased from Lm7.8 million to Lm6.1 million. The listed bonds with the highest market value of stock transacted were 3.8 per cent European Investment Bank Bonds (2009), 7.25 per cent HSBC subordinate unsecured loan stock (2005) and Malta Government Privatisation plc bonds (2005). As shown in Table 8.6, the listings of corporate bonds reached 28 companies by the end of September 2004.

Activity in the equity market increased from Lm10.2 million to Lm23.6 million. The bulk of the trading activity during the period under review took place in the HSBC Bank Malta plc shares, Bank of Valletta plc shares and Maltacom plc shares.

The Malta Stock Exchange share index closed at 2,861.3 on 30 September 2004, a 38.1 per cent increase over the end of September 2003. The development

Selected Indicators of the Capital Market

Table 8.6

	2004 Jan/Mar	2004 Apr/Jun	2004 Jul/Sep	2004 Jan/Sep
Corporate Bonds*				
Number of Listings**	28	28	28	28
Turnover (Lm million)	2.0	2.4	1.7	6.1
Turnover/GDP (%)	0.4	0.5	0.3	0.4
Equities*				
Number of Issues Outstanding**	13	13	13	13
Turnover (Lm million)	10.1	5.2	8.3	23.6
Turnover/GDP (%)	2.3	1.1	1.7	1.7
Total Listed Securities*				
Total Turnover	12.1	7.6	10.0	29.7
Total Turnover/GDP (%)	2.7	1.6	2.0	2.1
Market Capitalisation (Lm million)**	1,010.3	938.9	1,038.0	1,038.0
MSE Ord. Share Index**	2,765.4	2,524.3	2,861.3	2,861.3

*Including the Alternative Companies listing

**As at end of period

Source: Malta Stock Exchange

in MSE Share index is reflected in the market capitalisation which increased from Lm784.7 million at the end of September 2003 to Lm1,038.0 million at the end of September 2004.

The Maltese Lira

The Maltese lira is pegged to a basket of currencies of low-inflation countries – the Euro, Sterling and the US dollar – thus minimising the impact of imported inflation on consumer prices. During the period under review, the value of the Maltese lira vis-à-vis the Euro as well as against the US dollar remained practically unchanged from the level recorded at the end of 2003. These developments in the Maltese lira exchange rate reflected the fact that the major currency markets have been broadly stable. Indeed, following the record high of the Euro against the US dollar in February 2004 and the beginning of monetary policy tightening in the US, currency volatility diminished. Meanwhile, the Maltese lira weakened against the Sterling but appreciated against the Japanese yen. The developments of the Maltese lira against the major currencies are presented in Table 8.7 and Chart 8.6.

Movements in the Exchange Rates of the Maltese Lira

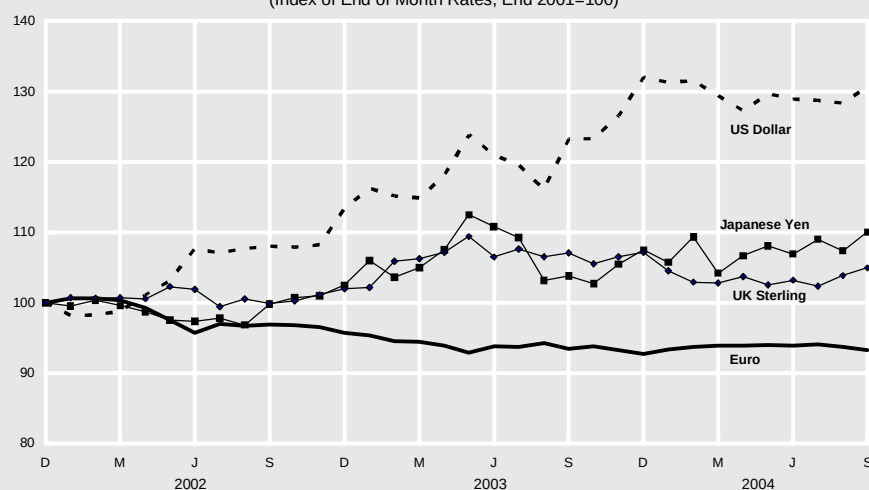
Table 8.7

Currency	End of Period	Exchange Rate	% change over Previous Period
US Dollar	Dec-01	2.2121	-3.16
	Dec-02	2.5074	13.34
	Dec-03	2.9197	16.44
	Sep-04	2.8921	-0.95
Sterling	Dec-01	1.5258	-0.31
	Dec-02	1.5553	0.19
	Dec-03	1.6351	5.13
	Sep-04	1.6012	-2.07
Japanese Yen	Dec-01	290.443	10.75
	Dec-02	297.662	2.49
	Dec-03	312.160	4.87
	Sep-04	319.573	2.37
Euro	Dec-01	2.4989	1.75
	Dec-02	2.3910	-4.32
	Dec-03	2.3163	-3.12
	Sep-04	2.3315	0.66

Source: Central Bank of Malta

Chart 8.6

Exchange Rate Movements of the Maltese Lira (Index of End of Month Rates, End 2001=100)



Given the large dependence of the Maltese lira on the Euro, the currency stability of the Euro against the US dollar caused the Maltese lira to remain relatively stable against these two currencies. The Maltese lira, which stood at EUR2.3163 at the end of 2003, reached a low EUR2.3158 on January 5. Subsequently, the Maltese lira gained ground during the first few months of the year to reach EUR2.3598 on June 18, followed by a drop to end the third quarter at EUR2.3315.

Following an appreciation of the Maltese lira against the US dollar of 16.4 per cent during 2003, minimal movements were registered during the period under review reflecting the stability of this major currency. The Maltese lira declined from a high USD3.0114 on February 18 to a low USD2.7783 on April 26. The Maltese lira recovered slightly to end the third quarter at USD2.8921.

The appreciation of the Maltese lira against the Sterling registered during 2003 was partly reversed as the Maltese lira dropped by 2.1 per cent against this currency. From a high of GBP1.6331 on January 5, the value of the Maltese lira declined to a low GBP1.5462 on April 13 and June 18. By the end of September, the Maltese lira recovered slightly to end the quarter at GBP1.6012.

During the Survey period, the Maltese lira registered an increase of 2.4 per cent against the Japanese yen. The Maltese lira appreciated against the Japanese yen during the beginning of the year to reach a high of Yen325.09 on March 15 but depreciated to reach a low of Yen296.75 on April 5. By the end of September, the Maltese lira strengthened to end the third quarter at Yen319.57.

Government Revenue

(January-September)

Appendix Table 8.1

Lm thousand

	2001	2002	2003	2004
Tax Revenue	408,378	438,895	443,598	472,009
Direct Tax Revenue	234,001	246,818	250,969	258,690
Income Tax	113,447	125,541	125,001	133,894
Social Security	120,554	121,277	125,968	124,796
Indirect Tax Revenue	174,377	192,077	192,630	213,318
Customs and Excise Duties	38,937	44,137	44,942	42,420
Licences, Taxes and Fines	52,125	64,721	61,624	73,325
Value Added Tax	83,315	83,219	86,064	97,573
Non-Tax Revenue	58,514	66,661	52,985	66,208
Fees of Office	4,448	10,571	4,214	4,144
Reimbursements	4,792	4,790	3,525	5,802
Rents	7,955	6,966	8,087	6,354
Dividends on Investments	2,657	13,222	2,616	3,637
Repayment of, and Interest on				
Loans made by Government	1,048	31	66	14
Lotteries	5,337	0	0	0
Miscellaneous Receipts	4,036	2,343	5,696	10,197
Public Corporations	1,883	1,883	1,883	1,883
Central Bank of Malta	25,902	25,682	24,783	18,233
Grants	456	1,173	2,115	15,944
Recurrent Revenue	466,892	505,555	496,583	538,217
Extraordinary Receipts	0	19,048	2,137	8,899
Loans	79,059	0	102,129	70,448
Total Revenue	545,951	524,602	600,849	617,565

Source: The Treasury

Government Recurrent Expenditure*

(January-September)

Appendix Table 8.2

Lm thousand

	2001	2002	2003	2004
Office of the President	525	563	532	597
House of Representatives	737	711	646	824
Office of the Ombudsman	120	150	120	130
National Audit Office	350	550	600	650
Office of the Prime Minister	2,933	3,012	3,098	3,712
Public Service Commission	103	98	100	98
Armed Forces of Malta	8,783	8,961	9,617	9,016
Information	836	865	872	389
Government Printing Press	0	0	0	400
Electoral Office	776	1,151	2,340	1,143
Ministry for Social Policy	4,338	4,586	5,535	3,893
Social Security	39,139	39,024	40,570	39,949
Social Security Benefits	134,341	141,788	150,258	155,561
Family and Social Welfare	421	447	541	487
Care of the Elderly	8,835	9,461	10,170	10,274
Housing	485	561	551	808
Industrial and Employment Relations	452	379	396	421
Ministry of Education	22,897	24,858	27,770	27,843
Education	35,080	35,823	36,984	35,406
Libraries and Archives	455	486	504	474
Ministry of Finance	1,104	1,651	1,841	14,374
Treasury	820	963	902	7,827
Pensions	19,841	20,817	21,088	21,528
Inland Revenue	3,767	3,978	3,549	3,798
Customs	3,817	4,627	3,920	3,648
V.A.T.	2,252	2,333	2,419	2,465
Contracts	258	250	268	271
Ministry for Resources and Infrastructure	17,121	17,413	17,711	15,581
Ministry for Tourism	1,953	1,998	1,958	1,898
Ministry for Transport and Communications	1,980	3,359	3,554	4,416
Civil Aviation	496	588	432	404
Economic Policy	387	582	634	468
Commerce	1,465	1,432	1,782	2,132
Consumer and Competition	268	305	397	327

Government Recurrent Expenditure

(January-September)

Appendix Table 8.2 continued

Lm thousand

	2001	2002	2003	2004
Ministry for Justice and Home Affairs	1,798	1,410	2,845	1,935
Police	10,961	11,181	12,242	11,736
Correctional Services	1,733	1,766	1,819	1,821
Civil Protection	849	944	935	1,028
Government Property Division	658	603	1,885	952
Registration	538	519	633	629
Ministry for Rural Affairs	5,737	6,379	12,313	13,022
Ministry for Gozo	14,267	14,520	15,175	13,532
Ministry of Health	45,522	50,423	52,891	55,409
Local Councils	7,907	5,436	5,541	5,372
Judicial	2,525	2,692	2,722	2,921
Ministry of Foreign Affairs	4,893	5,370	5,709	5,467
Ministry for Information Technology	0	0	0	29,631
Ministry for Youth and the Arts	0	0	0	3,483
[Youth and Sport]	791	783	801	0
[Ministry for Economic Services]	9,943	29,040	30,513	0
[Ministry of Justice and Local Government]	793	1,371	1,700	0
[Museums]	948	1,027	0	0
[Culture and the Arts]	1,061	814	0	0
[Environment Protection]	1,196	443	0	0
[Joint Office]	2,716	2,483	0	0
[Roads]	394	0	0	0
[Licensing and Testing]	395	0	0	0
[Statistics]	846	0	0	0
Recurrent Expenditure	433,601	470,974	499,383	518,150

Note: [] denotes change in name of cost-centres

*Cost-centres as prevailing at the beginning of 2004

Source: The Treasury

Government Capital Expenditure

(January-September)

Appendix Table 8.3

Lm thousand

	2001	2002	2003	2004
Productive Investment	27,830	26,446	23,437	17,860
Ship Repair and Shipbuilding	6,611	10,419	4,459	0
Development of Industries	9,252	3,714	4,694	2,231
Agriculture and Fisheries	193	566	1,379	1,236
Tourism	7,458	7,904	8,351	8,628
Public Buildings, Plant and Equipment	4,184	3,803	4,342	5,663
Capital Expenditure for Gozo	132	41	212	102
Infrastructure	23,473	21,700	23,612	27,190
Roads	4,123	7,089	5,172	3,215
Sewers	1,716	1,836	1,885	1,061
Development of Malta Freeport	7,050	2,872	2,206	3,457
Public Buildings, Plant and Equipment	10,057	9,357	13,469	18,944
Capital Expenditure for Gozo	527	547	880	513
Social	17,917	22,817	37,129	30,583
Education	3,357	3,567	5,144	4,089
Culture	55	287	165	220
Sports	306	500	545	400
Health	11,247	15,489	27,520	22,175
Care of the Elderly	72	54	133	320
Housing	1,747	1,699	1,568	1,297
Public Buildings, Plant and Equipment	960	979	1,843	1,972
Capital Expenditure for Gozo	173	242	211	110
Total Capital Expenditure	69,220	70,963	84,178	75,633

Source: The Treasury