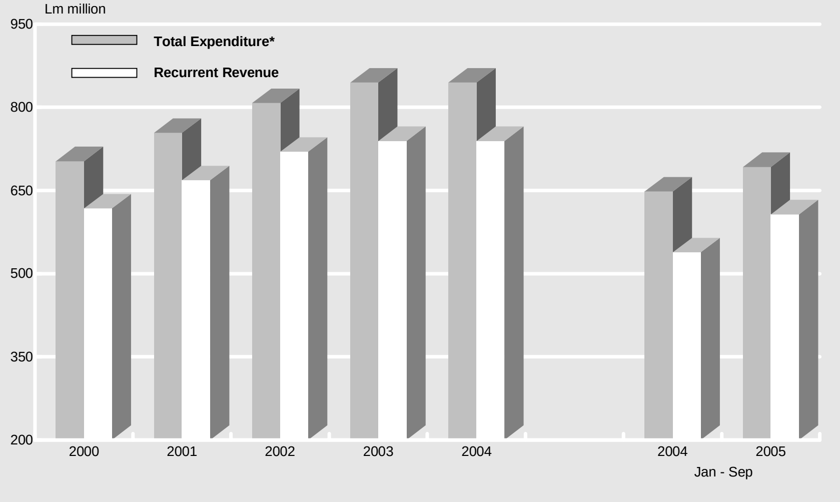
8. Financial Developments

The first nine months of 2005 were characterised by budgetary consolidation reflecting Government's fiscal policy framework which is geared towards ensuring sound public finances in the medium term. Indeed, the structural deficit, when compared to the same period in 2004, declined by Lm24.5 million to Lm85.4 million, underpinned by an expansion in recurrent revenue which significantly exceeded increases in total expenditure. During the Survey period, broad money (M3) expanded at a slower rate when compared to the same period last year. There was however a registered increase in the net foreign assets, especially those of monetary financial institutions other than the Central Bank. During the period under review, there has been a change in the central intervention rate by 25 basis points, up to 3.25 per cent. The Maltese currency weakened against the US dollar, Japanese yen and the UK sterling, however it appreciated against the Euro. Malta joined the ERM II in May and thus, the pegging of the Maltese lira changed from a three currency basket peg to a single currency peg.

Chart 8.1

Government Recurrent Revenue and Total Expenditure



*excluding contributions to Sinking Fund and Direct Loan Repayments

Public Finance

It is pertinent to note that Government finance data should be interpreted with caution since Government's financial transactions as defined in this Chapter are registered on a cash basis rather than on an accrual basis. Thus, Government's financial position is affected by the timing of the cash payments and receipts and may not reflect actual spending and revenue collection. Developments in public finances during the first nine months of the 2002-2005 period are presented in Table 8.1. Meanwhile, Chart 8.1 illustrates trends in total expenditure and recurrent revenue in recent years.

Revenue

Government recurrent revenue, which includes grants but excludes extraordinary receipts, increased by Lm68.7 million to Lm606.9 million during the first nine months of 2005. This expansion in recurrent revenue was driven by both higher

Government Revenue and Expenditure
(January-September)

Table 8.1 Lm million

	2002	2003	2004	2005
Recurrent Revenue	505.6	496.6	538.2	606.9
Tax Revenue	438.9	443.6	472.0	500.0
Direct Tax Revenue	246.8	251.0	258.7	265.7
Indirect Tax Revenue	192.1	192.6	213.3	234.3
Non-Tax Revenue	66.7	53.0	66.2	106.9
Total Expenditure	591.2	632.4	648.0	692.3
Recurrent Expenditure	471.0	499.4	518.1	543.5
Interest on Public Debt	49.2	48.8	54.3	55.8
Capital Expenditure	71.0	84.2	75.6	93.1
Productive	26.4	23.4	17.9	23.2
Infrastructure	21.7	23.6	27.2	32.9
Social	22.8	37.2	30.6	37.0
Structural Balance	(85.6)	(135.8)	(109.9)	(85.4)
Financed by:				
Extraordinary Receipts				
Receipts from sale of shares	19.0	0.0	0.0	1.1
Sinking Funds of Converted Loans	0.0	2.1	8.9	3.8
Sinking Fund Contribution/Direct Loan Repayments	(6.1)	(6.2)	(6.3)	(6.0)
Public Sector Borrowing Requirement	(72.7)	(139.9)	(107.3)	(86.5)
Loans	0.0	102.1	70.4	110.0
Local Loans	0.0	69.9	70.4	110.0
Foreign Loans	0.0	32.2	0.0	0.0

Source: The Treasury

tax and non-tax revenue. A detailed breakdown of Government revenue for the first nine months of the 2002-2005 period is presented in Appendix Table 8.1.

Tax revenue, which comprises the main source of Government revenue, increased by Lm28.0 million to Lm500.0 million. This increase in tax receipts was attributable to expansions in both direct and indirect tax revenue. During the Survey period, direct tax revenue, which accounts for around 53 per cent of total tax revenue, increased by Lm7.0 million to Lm265.7 million. This expansion was mainly attributable to higher receipts from income tax, whilst an increase was also recorded in social security contributions. Meanwhile, indirect tax revenue registered an increase of Lm21.0 million to Lm234.3 million. This expansion reflected higher receipts from customs and excise duties and Value Added Tax which outweighed the drop in receipts from licences, taxes and fines.

Revenue generated from income tax increased by Lm5.8 million to Lm139.7 million. During the first nine months of 2005, ongoing efforts to improve efficiency in tax collection contributed to the increase in income tax revenue. Social security contributions increased by Lm1.2 million to Lm126.0 million during the Survey period, thus remaining essentially at last year's level.

During the Survey period, revenue generated from customs and excise duties increased by Lm4.7 million to Lm47.2 million, reflecting higher revenue from excise duties which outweighed the drop in receipts from import duties. Revenue from import duties declined by Lm1.1 million, reflecting the adoption of the Common External Tariff upon EU membership in May 2004. On the other hand, receipts from excise duties increased by Lm5.9 million. This expansion mainly reflected the increase in excise duty on tobacco products. Moreover, higher excise duty on kerosene as announced in the Budget Speech for 2005 also contributed to higher revenue collected from excise duty. In addition, higher revenue was also generated following the introduction of excise duty on mobile telephony.

Revenue generated from licences, taxes and fines decreased by Lm7.7 million to Lm65.6 million. It is pertinent to note that for the corresponding 2004 period this item of revenue included exceptional licence fees generated by the privatisation of the lotteries. Moreover, the completion of the last phase of the three-year programme for the dismantling of import levies by 1 May 2004, also contributed to lower receipts under this category of revenue. This item of revenue was also affected by the exclusion of receipts related to wireless licences, fixed telephone licence and mobile telephone licence which are instead included under the fees of office category of revenue. On the other hand, receipts from duty on documents increased, following the measure introduced in the Budget Speech for 2005 granting taxpayers the possibility to make adjustments to the declared value of immovable property acquired through inheritance. Moreover, higher revenue was also generated from the passenger departure tax payable on outgoing air fares reflecting the increase in departure tax which came into effect as from 1 August 2005 as well as a higher number of Maltese travelling abroad. In addition, higher receipts from motor vehicle registration tax were also recorded, reflecting higher imports of motor vehicles.

Revenue generated from Value Added Tax amounted to Lm121.5 million or Lm24.0 million more than that registered in the first nine months of 2004. This expansion is partly attributable to the lagged effect of the increase in the standard VAT rate which came into effect as from January 2004, reflecting the fact that payments are made in arrears. Moreover, additional revenue from VAT reflected the implementation of a scheme whereby additional penalties were waived off in cases where timely payment of the balance due is made by a stipulated date. In addition, improved enforcement against tax evasion also contributed to higher revenue from VAT. Cash inflow from this item of revenue was also highly influenced by the change in the timing of the collection of VAT on imported products whereby payments are deferred until the point of sale.

Non-tax revenue increased by a significant Lm40.7 million to Lm106.9 million during the first nine months of 2005. The transfer of Central Bank profits, grants and fees of office comprise the main items of non-tax revenue. The transfer of profits generated by the Central Bank declined by Lm4.2 million to Lm14.0 million, however, this was offset by increases in other items of non-tax revenue.

Fees of office amounted to Lm18.4 million, from Lm4.1 million recorded during January-September 2004. This increase was partly attributable to receipts amounting to Lm6.2 million collected under the investment registration scheme. In addition, around Lm3.1 million were generated from the eco-contribution following the broadening of the products that are subject to eco-contribution as announced in the Budget Speech for 2005. Moreover, revenue generated from fees of office was also affected by the inclusion of wireless licences, fixed telephone licence and mobile telephone licence, previously included under a different category of revenue.

Miscellaneous receipts increased by Lm6.5 million to Lm16.7 million. This increase was mainly attributable to premia from the sale above par of

Government stocks by auction as well as the sale of Government property. Additional revenue was also generated from higher rents from commercial tenements.

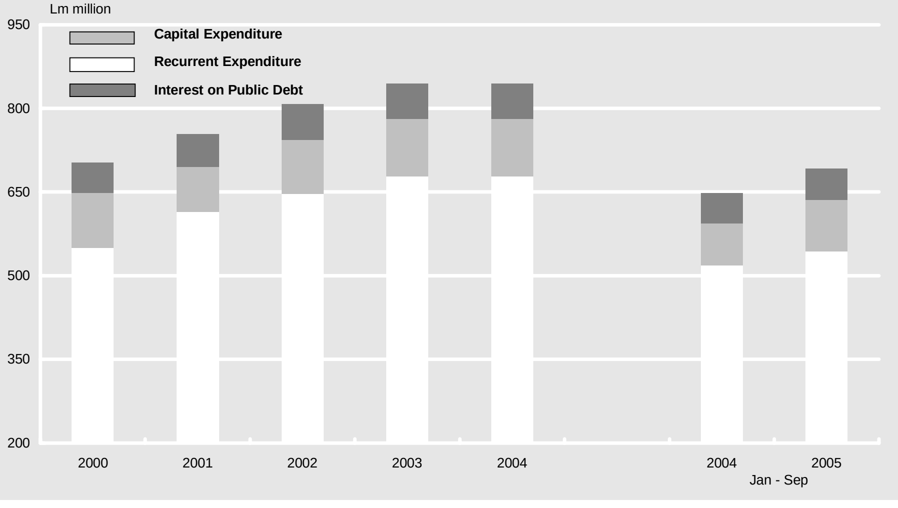
Grants received amounted to Lm40.3 million, or Lm24.4 million higher than that recorded during the first nine months of 2004. This expansion was attributable to higher funds forthcoming from the European Union through a monthly cashflow facility and temporary budgetary compensation. Meanwhile, additional transfers were also received in terms of the Fifth Italian Financial Protocol.

Expenditure

Total Government expenditure comprises recurrent expenditure, capital expenditure and interest payments. Contribution to the Sinking Fund in respect of local and foreign loans and direct repayment of loans are excluded from total Government expenditure. Total Government expenditure increased by Lm44.3 million to Lm692.3 million during the Survey period. This expansion was attributable to both higher recurrent expenditure and capital expenditure. Meanwhile, higher interest on public debt also contributed to this increase. Recurrent expenditure, which constitutes around 79 per cent of total expenditure, increased from Lm518.1 million to Lm543.5 million. The share of expenditure of a capital nature to total expenditure is around 13 per cent. Capital expenditure increased from Lm75.6 million in the first nine months of 2004 to Lm93.1 million during the period under review. Interest payments on public debt, which accounts

Chart 8.2

Government Total Expenditure



for around 8 per cent of total expenditure, increased by Lm1.5 million to Lm55.8 million. Developments in Government expenditure since 2000 are depicted in Chart 8.2.

The increase in recurrent expenditure is attributable to higher outlays on Programmes and Initiatives which more than offset declines in Operations and Maintenance expenditure and Contributions to Government Entities. In fact, expenditure under Programmes and Initiatives, which constitutes around 60 per cent of total recurrent expenditure, increased by Lm41.8 million to Lm323.5 million during the period under review. This increase partly reflected the re-classification of expenditure of medicines and surgical materials, which during the previous year was classified under Operations and Maintenance expenditure. Moreover, the re-classification of other items of expenditure previously categorised as Contributions to Government Entities also contributed to the increase in this category of recurrent expenditure. Meanwhile, Malta's contribution to the EU budget, which is more than compensated for by funds transferred from the EU, was also reflected in higher outlays on Programmes and Initiatives. Higher Government welfare payments as well as a higher contribution to church schools also contributed to the increase in this type of recurrent expenditure. On the other hand, it is pertinent to note that outlays on Programmes and Initiatives registered during the first nine months of 2004 included the one-time payment to all employees and pensioners as compensation of the increase in the VAT rate announced in the Budget Speech for 2004.

At Lm139.4 million, personal emoluments, which account for around 26 per cent of total recurrent expenditure, practically remained at the level recorded during the first nine months of 2004. The share of Contributions to Government entities in recurrent outlays stood at around 10 per cent. Contributions to Government entities decreased by Lm2.6 million to Lm55.2 million. This mainly reflects the re-classification of certain items of expenditure to Programmes and Initiatives. Moreover, while lower expenditure by Government entities such as Water Services Corporation was recorded, higher expenditure was allocated to other entities such as the University of Malta and Malta Enterprise Corporation.

Operation and Maintenance expenditure constitutes around 5 per cent of total recurrent expenditure. This category of expenditure declined by Lm14.3 million to Lm25.0 million during the Survey period, mainly reflecting the re-classification of expenditure related to the national health system to other categories of recurrent expenditure. During the Survey period, expenditure recorded under the Special Expenditure category amounted to Lm0.3 million.

A detailed breakdown of Government recurrent expenditure on a cost centre basis for the first nine months of the 2002-2005 period is presented in Appendix Table 8.2. The major fluctuations registered in the separate expenditure categories are discussed below.

Government welfare payments increased by Lm8.1 million to reach Lm163.7 million, largely attributable to higher outlays with respect to retirement and widows pensions and social assistance. This item of expenditure is affected by factors outside Government control such as demographic changes, wages and inflationary developments. Expenditure by the Department of Social Security which mainly constitutes the State contribution in terms of the Social Security Act (Cap. 318), remained at practically the same level recorded during the corresponding 2004 period.

During the first nine months of 2005, expenditure by the Treasury Department decreased from Lm7.8 million to Lm1.2 million. It is pertinent to note that during the first nine months of 2004, this item of expenditure included a one-off payment to compensate for the higher standard VAT rate as announced in the Budget Speech for 2004.

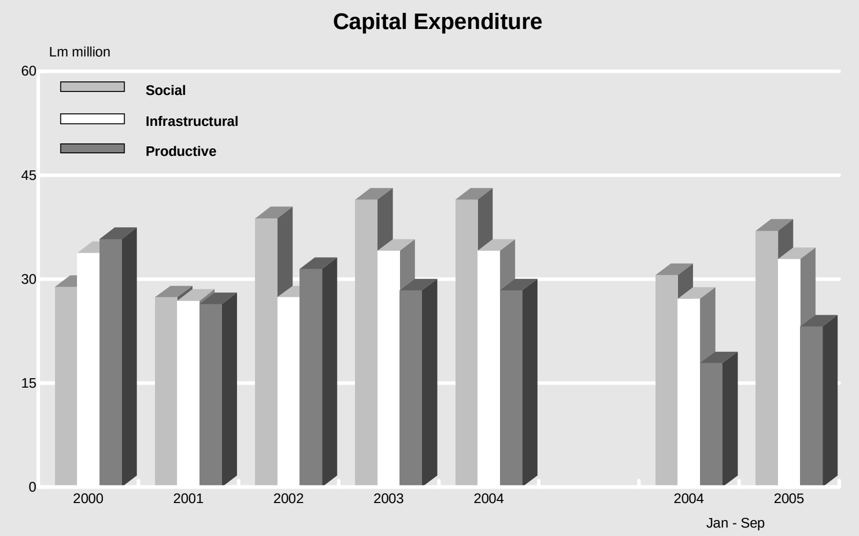
Expenditure under the Treasury pension category reached Lm23.7 million, up from Lm21.5 million. This category of expenditure includes outlays in respect of pensions, allowances and gratuities under the Pensions Ordinance (Cap. 93). Expenditure by the Ministry of Finance increased by Lm8.7 million to Lm23.1 million. This expansion is attributable to Malta's contribution to the EU budget, which is more than compensated for by receipt of funds from the EU. The Ministry for Tourism registered an increase of Lm1.7 million in recurrent expenditure to Lm3.6 million. This increase is attributable to contributions to Government entities which were previously accounted for under other Ministries. Expenditure by the Inland Revenue Department increased by Lm1.1 million to Lm4.9 million during the first nine months of 2005, mainly attributable to repayments in terms of the Income Tax Act (Cap. 123).

The Ministry of Education, Youth and Employment registered an increase of Lm5.7 million in recurrent expenditure, mainly reflecting higher contribution to church schools and students' maintenance grants. The increase in the case of the former is attributable to change in the timing of tranches. Expenditure incurred by the Ministry for Resources and Infrastructure registered a decline of Lm3.5 million in recurrent expenditure. This primarily reflects the exclusion of expenditure related to the solid waste management strategy, which is instead included as part of the expenditure incurred by the Ministry for Rural Affairs and the Environment. During the Survey period, expenditure incurred by the Ministry of Investment, Industry and Information Technology increased from Lm29.6 million to Lm32.9 million. This rise was mainly attributable to higher expenditure with respect to the restructuring of the Public Broadcasting Services as well as increases in other items of expenditure within this cost-centre.

Capital expenditure is classified under three categories, namely capital outlays on social development, investment directed towards infrastructural facilities and productive investment. During the Survey period, the capital expenditure programme increased by Lm17.5 million to Lm93.1 million. This expansion was underpinned by increases in all the three categories of capital expenditure. Productive and infrastructural investment accounted for 24.9 per cent and 35.3 per cent of total capital expenditure respectively, registering minimal changes to the shares recorded during the corresponding 2004 period. Similarly, at 39.8 per cent, the share of investment directed towards social development remained at practically last year's level. These developments are depicted in Chart 8.3 whilst Appendix Table 8.3 presents a breakdown of Government's capital expenditure programme.

During the period under review, Government's capital programme for productive investment increased by Lm5.3 million to Lm23.2 million. This was underpinned by higher outlays allocated under the item public buildings, plant and equipment which increased from Lm5.7 million to Lm11.0 million. This rise was mainly

Chart 8.3



attributable to contributions towards the Treasury Clearance Fund in respect of the repayment of outstanding ex-Malta Drydocks advances. Furthermore, additional funds allocated under this item of capital expenditure have been earmarked to finance capital works and equipment for the Ministry for Rural Affairs and the Environment financed through the Fifth Italian Financial Protocol. Capital outlays concerning the development of industries increased by Lm0.9 million to Lm3.2 million. Meanwhile, capital expenditure on tourism stood at Lm7.9 million. If, however, account is taken of tourism related expenditure under the infrastructure and social headings, the total amounted to Lm8.7 million during the Survey period.

Capital expenditure on infrastructure increased by Lm5.7 million to Lm32.9 million. This was mainly attributable to higher capital outlays allocated under the item public buildings, plant and equipment. In fact, this item of capital expenditure increased by Lm5.4 million to Lm24.3 million. This expansion reflects higher outlays allocated for the modernisation of the road network programme financed through the Fifth Italian Protocol. Moreover, higher outlays earmarked for the Armed Forces of Malta also contributed to this increase. On the other hand, outlays on public buildings, plant and equipment allocated to the Ministry of Foreign Affairs registered a decline following the relatively high outlays incurred last year. While an increase was registered in funds earmarked to improve the sewage infrastructure, lower funds were required by way of debt servicing related to the development of Malta Freeport.

At Lm37.0 million, Government's capital programme for social investment was Lm6.5 million higher than the level recorded during the first nine months of 2004. This increase reflected higher capital expenditure on health incurred on works carried out in respect of the new hospital. Moreover, capital outlays allocated under the item public buildings, plant and equipment increased to Lm2.7 million, up from Lm2.0 million. This increase was mainly attributable to higher funds incurred in respect of waste management services partly financed through the EU Structural Funds. Meanwhile, capital expenditure on education declined by Lm1.1 million to Lm3.0 million, mainly reflecting lower capital expenditure by the Foundation for Tomorrow's Schools. Capital outlays on housing, which are primarily administered by the Housing Authority declined by Lm1.0 million to Lm0.3 million since the Authority utilised own-resourced funding for its projects.

Fiscal Performance

As highlighted above, developments in Government's fiscal position reflected ongoing budgetary consolidation efforts. In fact, the structural deficit declined from Lm109.9 million to Lm85.4 million. Meanwhile, extraordinary receipts declined by Lm4.0 million. As a result, the public sector borrowing requirement declined from Lm107.3 million to Lm86.5 million during the Survey period.

The fiscal imbalance is heavily financed through domestic borrowing. In fact, the share of domestic debt is around 95 per cent of the total debt portfolio

General Government Net Lending (+) or Borrowing (-)

as a percentage of GDP

Table 8.2 per cent

	2002	2003	2004
Austria	-0.2	-1.1	-1.3
Belgium	0.1	0.4	0.1
Cyprus	-4.5	-6.3	-4.2
Czech Republic	-6.8	-11.7	-3.0
Denmark	1.7	1.2	2.8
Estonia	1.4	3.1	1.8
Finland	4.3	2.5	2.1
France	-3.2	-4.2	-3.7
Germany	-3.7	-3.8	-3.7
Greece	-4.1	-5.2	-6.1
Hungary	-8.5	-6.2	-4.5
Ireland	-0.4	0.2	1.3
Italy	-2.6	-2.9	-3.0
Latvia	-2.7	-1.5	-0.8
Lithuania	-1.5	-1.9	-2.5
Luxembourg	2.3	0.5	-1.1
Netherlands	-1.9	-3.2	-2.5
Poland	-3.6	-4.5	-4.8
Portugal	-2.7	-2.9	-2.9
Slovakia	-5.7	-3.7	-3.3
Slovenia	-2.4	-2.0	-1.9
Spain	-0.3	0.3	-0.3
Sweden	-0.3	0.2	1.4
United Kingdom	-1.7	-3.4	-3.2
EU 25	-2.3	-2.9	-2.6
Malta	-5.8	-10.4	-5.1

Source: European Commission
National Statistics Office
Ministry of Finance

implying high resort on the domestic market and thus a limited risk to exchange rate fluctuations.

International Comparison

Developments for the budget balance and public debt of the EU Member States for the three-year period to 2004 are presented in Table 8.2 and Table 8.3 respectively. This data is based on the reportings of Government deficit and debt levels transmitted by EU Member States in September 2005 for the excessive deficit procedure according to Regulation 3605/93. It is pertinent to note that the General Government fiscal data presented in this section is according

General Government Gross Debt
as a percentage of GDP

Table 8.3 per cent

	2002	**2003**	**2004**
Austria	66.7	65.4	65.2
Belgium	105.4	100.0	95.6
Cyprus	65.2	69.8	71.9
Czech Republic	30.7	38.3	37.4
Denmark	47.2	44.7	42.7
Estonia	5.3	5.3	4.9
Finland	42.5	45.3	45.1
France	59.0	63.9	65.6
Germany	60.9	64.2	66.0
Greece	112.2	109.3	110.5
Hungary	55.5	56.9	57.6
Ireland	32.6	32.0	29.9
Italy	108.0	106.3	105.8
Latvia	14.1	14.4	14.4
Lithuania	22.4	21.4	19.7
Luxembourg	7.5	7.1	7.5
Netherlands	52.6	54.3	55.7
Poland	41.2	45.4	43.6
Portugal	58.5	60.1	61.9
Slovakia	43.3	42.6	43.6
Slovenia	29.5	29.4	29.4
Spain	55.0	51.4	48.9
Sweden	52.4	52.0	51.2
United Kingdom	38.3	39.7	41.6
EU 25	61.7	63.3	63.8
Malta	63.2	72.8	75.9

Source: European Commission
National Statistics Office
Ministry of Finance

to the ESA 95 methodology and is thus not comparable with data presented in other sections of this Chapter.

The budgetary position in the EU Member States improved slightly by 0.3 percentage points and reached an average deficit of 2.6 per cent of GDP in 2004. Certainly, the budgetary performance differed across the Member States. Only Belgium, Denmark, Sweden, Ireland, Finland and Estonia had nominal budget positions in balance or in surplus. In 2004, Germany, France, Greece, the UK, Cyprus, Hungary, Poland, Slovakia as well as Malta remained in excessive deficit positions. In the case of Italy and Portugal the budgetary positions in 2004 remained weak. Relative to 2003, a large majority of Member States did not worsen their budget position or did so only marginally, apart from Greece, Luxembourg, Spain, Estonia, Lithuania and Poland.

An improvement was particularly notable in Malta and the Czech Republic. In fact, Malta's budgetary position improved by 5.3 percentage points and reached 5.2 per cent of GDP in 2004. This deficit reduction in 2004 partly reflects a one-off operation related to the restructuring of the shipyards in 2003. Moreover, fiscal consolidation measures undertaken in the budget also contributed to the reduction in the deficit-to-GDP ratio. The notable improvement in the General Government balance of the Czech Republic was also attributable to a one-off operation in the previous year.

In 2004, the aggregate general Government debt-to-GDP ratio in the EU increased by 0.5 percentage points to 63.8 per cent. While Greece and Italy continued to have debt ratios above 100 per cent of GDP, Belgium managed to reduce its debt below this level in 2004. A further six countries, namely Austria, Cyprus, France, Germany, Portugal and Malta have debt ratios above 60 per cent of GDP. General Government debt, including extra-budgetary units, for Malta reached 75.9 per cent of GDP in 2004.

Monetary Developments

During the period under review, broad money (M3) continued to increase albeit at a decreasing rate. The deceleration in monetary growth was attributed to the fact that the more rapid growth in net foreign assets and the slowdown in growth of other counterparts of M3 were offset by a slower growth in domestic credit, the latter compromising the main counterpart of broad money.

Monetary Aggregates

During the period under review, broad money expanded by 2.9 per cent to Lm3,004.1 million, a lower growth rate compared to the same period last year. The relatively slower growth in M3 is mainly attributed to a lower increase in deposits withdrawable on demand. Table 8.4 presents developments in the monetary aggregates and their counterparts, while Chart 8.4 depicts developments in the monetary aggregates.

Narrow money (M1), which reflects demand for liquid balances, increased by 4.2 per cent to Lm1,647.8 million, compared to the 7.1 per cent growth rate registered during the corresponding 2004 period. This slower growth rate in M1 is attributable to a lower growth rate in currency in circulation as well as a

Monetary Aggregates and Their Counterparts

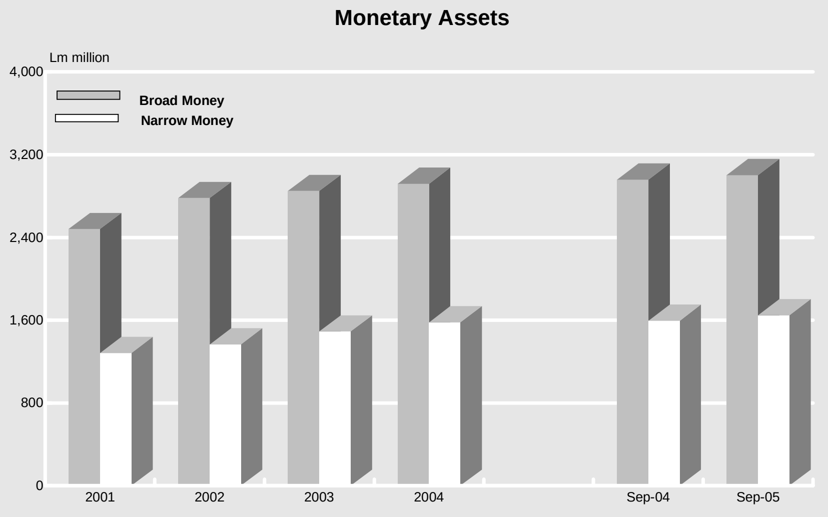
Table 8.4 Lm million

	2003 (Dec)	**2004** (Sep)	Sep 04 - Dec-03 % Change	**2004** (Dec)	**2005** (Sep)	Sep 05 - Dec-04 % Change
Monetary Aggregates						
Narrow Money (M1)	1,490.9	1,596.2	7.1	1,580.9	1,647.8	4.2
Currency in Circulation	460.4	484.0	5.1	486.0	497.2	2.3
Deposits withdrawable on demand	1,030.5	1,112.2	7.9	1,094.9	1,150.5	5.1
Intermediate Money (M2)	2,849.2	2,960.4	3.9	2,918.3	3,004.0	2.9
Narrow Money (M1)	1,490.9	1,596.2	7.6	1,580.9	1,647.8	4.2
Savings Deposits redeemable at notice up to 3 months	28.7	29.7	3.5	30.0	30.3	1.0
Time Deposits with agreed maturity up to 2 years	1,329.5	1,334.5	0.4	1,307.3	1,325.9	1.4
Broad Money (M3)	2,849.2	2,960.4	3.9	2,918.3	3,004.1	2.9
Counterparts of M3						
Domestic Credit	2,648.8	2,783.4	5.1	2,785.3	2,795.0	0.3
Net Claims on central government	568.4	573.0	0.8	545.1	498.8	-8.5
Claims on other residents	2,080.3	2,210.4	6.3	2,240.2	2,296.2	2.5
Net Foreign Assets	1,416.9	1,474.9	4.1	1,443.6	1,546.4	7.1
Central Bank of Malta	919.8	928.7	1.0	870.3	911.7	4.8
Other Monetary Financial Institutions	497.1	546.3	9.9	573.3	634.7	10.7
Less other counterparts of M3[1]	1,216.5	1,297.9	6.7	1,310.6	1,337.4	2.0

[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

Chart 8.4



slowdown in the growth of deposits withdrawable on demand. Deposits withdrawable on demand increased by Lm55.6 million, or 5.1 per cent as compared to a growth rate of 7.9 per cent during the first nine months of 2005. While demand deposits increased by Lm18.6 million to Lm319.4 million, savings deposits also increased from Lm794.1 million to Lm831.1 million. Currency in circulation increased by Lm11.2 million or 2.3 per cent, compared to a growth rate of 5.1 per cent in the first nine months of 2004.

Intermediate money (M2), which consists of M1 and short term-deposits not withdrawable on demand, increased from Lm2,918.3 million at the end of 2004 to Lm3,004.0 million in September 2005. This represents an increase in M2 of 2.9 per cent, a relatively lower growth rate compared to that for the first nine months of 2004. This slowdown in the growth of M2 was attributable to a relatively slower growth rate in narrow money which more than offset a higher growth rate in time deposits with agreed maturity of up to two years. Time deposits with agreed maturity up to two years rose from Lm1,307.3 million at the end of 2004 to Lm1,325.9 million in September 2005. This represents a growth rate of 1.4 per cent compared to the growth rate of 0.4 per cent registered in the first nine months of 2004. The other component of M2, savings deposits redeemable at notice up to three months, increased at a slower pace when compared to the same period last year. In fact, savings deposits redeemable up to a notice of three months increased from Lm30.0 million in December 2004 to Lm 30.3 million in September 2005. This slow growth in savings deposits partly reflects portfolio shifts into alternative financial assets. M3 is essentially equal to M2 given that the amount of marketable instruments, namely repurchase agreements and debt securities with a maturity of up to two years transacted during the Survey period was insignificant.

Counterparts of Monetary Expansion

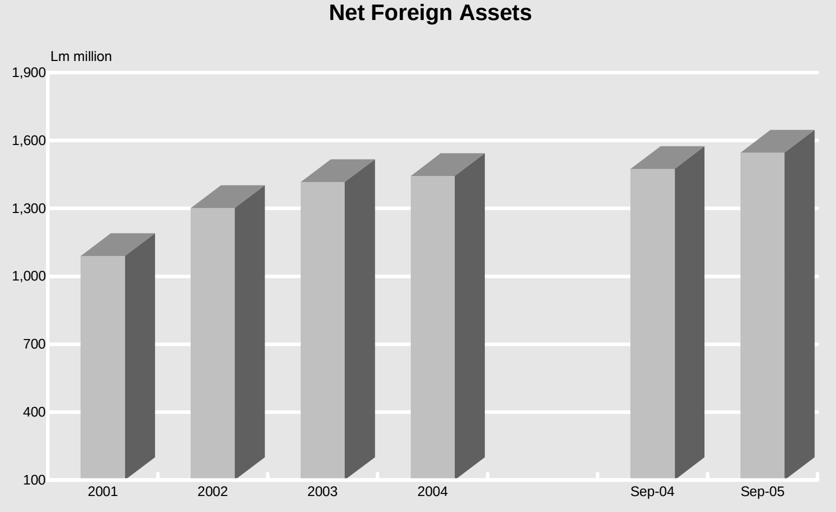
The deceleration of monetary growth registered during the Survey period was attributable to a slowdown in the growth of domestic credit which more than offset the more rapid growth in net foreign assets as well as the deceleration of the other counterparts of M3 category. The latter is deducted from broad money, thus a lower growth rate contributes to a higher pace of monetary growth.

Domestic credit registered only a marginal increase between January and September 2005. In fact, domestic credit expanded by 0.3 per cent during the period under review from Lm2,785.3 million in December 2004 to Lm2,795.0 million in September 2005. This relatively slower growth rate is mainly attributable to a decline in the net claims on central Government. From Lm545.1 million in December 2004, net claims on central Government fell to Lm498.8 million in September 2005. This corresponds to a decline of 8.5 per cent. This decline in the net claims on central Government mainly reflects reductions of claims by the other financial institutions on Treasury bills and loans. There was also a decline in the claims by the Central Bank of Malta on the central Government of 7.7 per cent during the period under review.

Claims on other residents also registered a slower growth rate, although there was still overall absolute growth. In fact, claims on other residents rose from Lm2,240.2 million at the end of 2004 to Lm2,296.2 million in September 2005. This corresponds to a growth rate of 2.5 per cent during the Survey period, as compared to the growth rate of 6.3 per cent registered during the commensurate period last year. This deceleration was mainly attributed to a substantial decrease in the claims on non-bank private sector, which include private non-financial companies, insurance companies, other financial intermediaries and financial auxiliaries, households and non-profit institutions. At the end of September 2005, claims on non-bank private sector amounted to around 94 per cent of total claims on other residents.

Net foreign assets of the banking system, as illustrated in Chart 8.5, expanded at a faster pace when compared to the same period last year. Total net foreign assets rose by 7.1 per cent to Lm1,546.4 million, compared to the 4.1 per cent growth rate registered during the corresponding 2004 period. The expansion in net foreign assets reflects partly the increase in the Central Bank's intervention

Chart 8.5



rate by 25 basis points in April. The major expansion of the net foreign assets was attributed to higher bank's and monetary financial institution's holdings which increased by 10.7 per cent, from Lm573.3 million in December 2004 to Lm634.7 million in September 2005. The Central Bank's net foreign asset holdings also increased substantially over the same period last year. In fact, the Central Bank's net foreign assets increased from Lm870.3 million at the end of 2004 to Lm911.7 million in September 2004. This reflects an increase of 4.8 per cent following a growth rate of 1.0 per cent registered during the corresponding 2004 period.

The other counterparts of M3 amounted to Lm1,337.4 million at the end of September 2005, up by 2.0 per cent compared to the level at the end of 2004. The other counterparts of M3 include the capital base of the Monetary Financial Institutions sector, long-term financial liabilities, provisions, interest accrued and unpaid and other liabilities, less fixed and other assets.

The Money Market

The Central Bank uses short term money market instruments and open market operations, which generally have an original maturity of up to one year in order to pursue monetary policy. These instruments are used in order to influence the level of liquidity in the banking system and consequently the economy. Money markets activity and open market operations also help the Central Bank to keep its main policy strategy of price stability. Activity in the money market includes Treasury bills while open market operations include the repo market, term deposits and the inter-bank market lending. No disruptions to prevailing monetary conditions were noted as Malta entered the ERM II.

Throughout the first quarter of 2005, the Monetary Policy Council of the Central Bank of Malta left the central intervention rate unchanged at 3.0 per cent. However, on April 8, the Bank's central intervention rate was raised by 25 basis points to 3.25 per cent, the first increase since September 2003. There was no other increase in the central intervention rate for the rest of the Survey period. Such increase in the interest rates was primarily intended to mitigate the level of credit and dampen inflationary pressures.

The Central Bank continued to absorb liquidity from the rest of the banking system mainly through weekly auctions of 14-day term deposits. As from September 15, the Central Bank started to issue 7-day maturity auction term deposits and reverse repos, replacing the 14-day term deposit auctions and reverse repos which have been issued since July 1999. The Central Bank absorbed Lm649.6 million, down from Lm2,193.1 million during the commensurate period last year, a reduction of 70.1 per cent. The interest rate paid on these deposits increased during the Survey period from 2.95 per cent to 3.20 per cent reflecting the increase in the Central Bank intervention rate. At 40 deals, 14-day term deposits were the most popular. For the first time since December 2001, the Central Bank also injected liquidity into the system through reverse repo agreements. In fact, the aggregate value of transacted repos reached Lm79.6 million during the Survey period. The interest rate on reverse repost was of 3.27 per cent in September 2005. This rate reflects the corridor linked to the Central Intervention Rate, plus 5 basis points for reverse repos.

During the Survey period, activity in the inter-bank market continued to increase, following the upward trend registered last year. The value of inter-bank loans increased from Lm185.8 million in December 2004 to Lm304.7 million in September 2005. A total of 17 overnight inter-bank deals were conducted between January and September 2005. The interest rate on the seven day inter-bank lending also increased from 2.95 per cent to 3.26 per cent between January and September 2005. Meanwhile 39 deals were transacted in the 7-day term deposits.

A total of Lm331.2 million worth of Treasury bills were issued on the primary Treasury bills market during the Survey period, as compared to Lm472.7 million issued over the same period last year. Treasury bills are mainly used by the

Government to finance short term financing requirements. The bulk of the trading was in Treasury bills with a maturity period of 91 days. Short-term money market rates remained stable during the first three months of the year, before moving up in line with the official rates in April. The yield on the one-month bill and the three-month bill increased from 2.96 per cent in December 2004 to 3.26 per cent in September 2005. In the primary market, the rate for the six-month and one-year Treasury bill stood at 3.26 per cent and 3.40 per cent respectively.

Turnover in the secondary market for Treasury bills increased from Lm84.2 million in September 2004 to Lm111.7 million in September 2005. The value of transactions involving the Central Bank also increased from Lm20.5 million to Lm91.6 million during the period under review. In tandem with the primary markets, yields in the secondary market also increased. The interest rate on the six-month and one-year secondary market Treasury bill stood at 3.28 per cent and 3.42 per cent, up from 2.99 per cent and 3.00 per cent in 2004 respectively.

The Capital Market

Government continued to resort to capital market instruments for the financing of the deficit through seven new issues of stocks and four re-issues. Between January and September 2005, the total value of the new issues amounted to Lm165.3 million. In March, a total of Lm40 million was issued in two separate bonds of different maturities, MGS 2021 FI and MGS 2012 FI. Subsequently, there were three other new issues between May and July, namely MGS 2021 FI Tranche B, MGS 2012 FI Tranche B and MGS 2015 (III). Moreover, in August, there were two new issues amounting to Lm65 million. These were issued under MGS 2012 (III) FI Tranche C and MGS 2021 FI Tranche C. Coupon rates on the new issues ranged between 5.0 per cent and 5.7 per cent. There was a general over subscription to these stocks.

During the Survey period, nine stocks were redeemed, four of which were followed by a re-issue. The total value of the redemptions was Lm209.5 million. Such redemptions were followed by re-issues worth Lm59.5 million. In May, there was the redemption of MGS 2005 totaling Lm23.5 million. Moreover, a further redemption of Lm31.5 million was done in August. During September there were three other redemptions of a total of Lm95 million.

Between January and September 2005, there were no new corporate bond issues registered in the primary market. However, there was a re-issue of Lm20 million worth of the 7.25 per cent HSBC loan stock. This re-issue was registered in June.

Successive to the increase in turnover in the secondary market for Government bonds registered during the first nine months of 2004, the turnover in Government securities continued to increase from Lm41.5 million to Lm58.8 million in the January-September 2005 period. A total of 2,565 deals were recorded on the Malta Stock Exchange with an average value of Lm20,848 per transaction based on the nominal value of the bonds. The highest turnover was registered in the 5 per cent MGS 2021 FIC, 5 per cent MGS 2021 and 7.2 per cent MGS 2008 (II). The highest volume of transactions in Government bonds in the secondary market was recorded in the 5 per cent MGS 2021 FIC with a volume of 5.4 million in 200 deals. Table 8.5 shows selected values of the activity on the secondary market in Government stock. As indicated in this Table, the value transacted by the Central Bank was Lm12.0 million while other investors took up Lm46.7 million.

During the period under review, the turnover in the corporate secondary bond market increased from Lm6.1 million to Lm6.3 million. The listed bonds with the highest turnover were the Malta Government Privatisation plc bonds (2005), 8 per cent Bay Street Finance plc Bonds 2012 and 6.7 per cent Eden Finance

Government Stocks

Activity on the Secondary Market

Table 8.5

	2005 Jan/Mar	**2005** Apr/Jun	**2005** Jul/Sep	**2005** Jan/Sep
Turnover in Government Stocks:				
Nominal Value (Lm million)	21.2	21.6	10.7	53.5
Market Value (Lm million)	23.6	23.8	11.4	58.8
Number of Transactions	744	911	910	2,565
Average Value per Transaction (Lm)*	28,461	23,684	11,785	20,848
Amount sold by CBM (Lm million)**	8.5	0.3	0.0	8.8
Amount bought by CBM (Lm million)**	0.5	2.0	0.7	3.2

* Based on Nominal Values

** Based on Market Values

Source: Central Bank of Malta

Selected Indicators of the Capital Market

Table 8.6

	2005 Jan/Mar	2005 Apr/Jun	2005 Jul/Sep	2005 Jan/Sep
Corporate Bonds*				
Number of Listings**	28	28	28	28
Turnover (Lm million)	3.7	1.5	1.1	6.3
Turnover/GDP (%)	0.8	0.3	0.2	0.4
Equities*				
Number of Issues Outstanding**	13	13	13	13
Turnover (Lm million)	10.6	6.7	10.7	28.0
Turnover/GDP (%)	2.4	1.4	2.1	1.7
Total Listed Securities*				
Total Turnover (Lm million)	14.3	8.2	11.8	34.3
Total Turnover/GDP (%)	3.3	1.7	2.4	2.4
Market Capitalisation (Lm million)**	2,342.4	2,405.9	2,602.2	2,602.2
MSE Ord. Share Index**	3,441.9	3,431.1	3,937.7	3,937.7

*Including the Alternative Companies listing

**As at end of period

Source: Malta Stock Exchange

plc Bonds 2010. Table 8.6 shows selected indicators of the capital market. As indicated, the number of bond listed on the secondary market stood at 28 companies.

Activity on the secondary equity market stood at Lm23.6 million. The highest trading companies on the secondary market for equities were First International Merchant Bank plc, Maltacom plc and HSBC Bank Malta plc.

The Malta Stock Exchange Index closed at a value of 3,937.7 at the end of September 2005. This translates to a 37.6 per cent increase in the Malta Stock Exchange share index over the same period last year. Correspondingly, market capitalization increased from Lm1,038.0 million to Lm 2,602.2 million over the commensurate period last year.

The Maltese Lira

Between January and September 2005, there have been some major developments to the local currency. As from April 2005, the local banks started to quote and publish the exchange rate of the Maltese lira against the Euro only in terms of units of Maltese lira per one Euro. This is in line with the market convention for quotations for the Euro against other currencies.

In May 2005, Malta has officially entered into the ERM II. As a result, the pegging of the Maltese lira was changed from a three currency basket peg to a single currency peg. Thus, the Maltese lira was pegged to the Euro, which already had a 70 per cent weight in the three currency basket pegging. The Maltese lira has entered the ERM II at a central parity rate of EUR/MLT 0.4293. Cyprus and Latvia also joined the ERM II on the same date.

Subsequent to the peak of the US Dollar against the Euro in January 2005, the value of the Euro has pursued a general depreciation trend which also reflects monetary tightening in the US. At the same period, the Maltese Lira depreciated against the major currencies under review except the Euro. 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

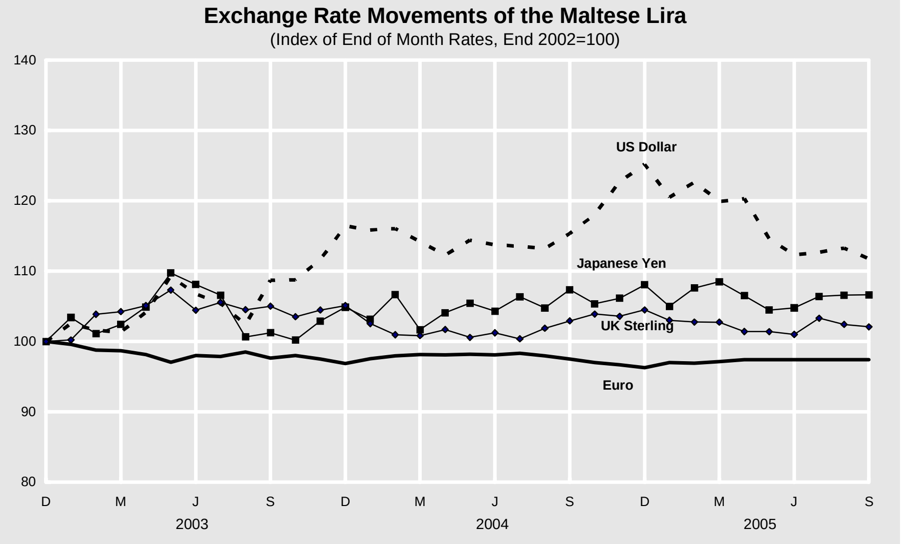
Table 8.7

Currency	End of Period	Exchange Rate	% change over Previous Period
US Dollar (MTL/USD)	Dec-02	2.5074	13.34
	Dec-03	2.9197	16.44
	Dec-04	3.1393	7.52
	Sep-05	2.8019	-10.75
UK Sterling (MTL/GBP)	Dec-02	1.5553	0.19
	Dec-03	1.6351	5.13
	Dec-04	1.6252	-0.61
	Sep-05	1.5879	-2.30
Japanese Yen (MTL/JPY)	Dec-02	297.662	2.49
	Dec-03	312.160	4.87
	Dec-04	321.710	3.06
	Sep-05	317.424	-1.33
Euro (EUR/MTL)	Dec-02	0.4182	4.51
	Dec-03	0.4317	3.22
	Dec-04	0.4343	0.61
	Sep-05	0.4293	-1.16

All the above exchange rates denote units of foreign currency per one Maltese lira, with the exception of the euro, for which the rate denotes units of Maltese lira per one euro. As a result, an increase in the EUR/MTL exchange rate implies a depreciation of the Maltese lira against the euro and vice versa.

Source: Central Bank of Malta

Chart 8.6



The value of the Maltese lira against the Euro rose marginally during the first four months of 2005, when it was then fixed according to the central parity rate of the date of entrance in the ERM II. The Maltese lira stood at Lm0.4343 against the Euro at the end of 2004, reaching a peak of Lm0.4342 on January 4. Thereafter, the value of the Maltese lira against the Euro continued to appreciate reaching a low of Lm0.4291 on April 29.

Following the slower appreciation of the Maltese lira against the US dollar in December 2004 over the previous year, the Maltese lira registered a subsequent depreciation against the US dollar of 10.7 per cent during the Survey period, reflecting the downward trend of the Euro against the dollar. The Maltese lira declined from a high of USD3.1044 on January 3 to a low of USD2.7721 on July 5. The Maltese lira appreciated slightly at the end of the third quarter to USD 2.8019.

The Maltese lira registered a marginal depreciation against the Sterling following the drop of 0.61 per cent at the end of 2004. From a high of GBP1.6301 on January 4, the value of the Maltese lira depreciated to a low of GBP1.5436 on June 24. By the end of September the Maltese lira appreciated slightly to GBP1.5879.

During the period under review, the Maltese lira registered a loss of 1.33 per cent against the Japanese Yen. The Maltese lira registered a high of Yen325.7414 on April 11 and then depreciated to a low of Yen305.0082 on June 23. The Maltese lira strengthened marginally by the end of September to Yen317.424.

Government Revenue

(January-September)

Appendix Table 8.1 Lm thousand

	2002	2003	2004	2005
Tax Revenue	438,895	443,598	472,009	499,994
Direct Tax Revenue	246,818	250,969	258,690	265,698
Income Tax	125,541	125,001	133,894	139,733
Social Security	121,277	125,968	124,796	125,965
Indirect Tax Revenue	192,077	192,630	213,318	234,297
Customs and Excise Duties	44,137	44,942	42,420	47,153
Licences, Taxes and Fines	64,721	61,624	73,325	65,618
Value Added Tax	83,219	86,064	97,573	121,526
Non-Tax Revenue	66,661	52,985	66,208	106,938
Fees of Office	10,571	4,214	4,144	18,380
Reimbursements	4,790	3,525	5,802	5,410
Rents	6,966	8,087	6,354	7,410
Dividends on Investments	13,222	2,616	3,637	2,847
Repayment of, and Interest on Loans made by Government	31	66	14	13
Miscellaneous Receipts	2,343	5,696	10,197	16,670
Public Corporations	1,883	1,883	1,883	1,883
Central Bank of Malta	25,682	24,783	18,233	14,001
Grants	1,173	2,115	15,944	40,324
Recurrent Revenue	505,555	496,583	538,217	606,932
Extraordinary Receipts	19,048	2,137	8,899	4,929
Loans	0	102,129	70,448	110,000
Total Revenue	524,602	600,849	617,565	721,861

Source: The Treasury

Government Recurrent Expenditure

(January-September)

Appendix Table 8.2 Lm thousand

	2002	2003	2004	2005
Office of the President	563	532	597	439
House of Representatives	711	646	824	831
Office of the Ombudsman	150	120	130	130
National Audit Office	550	600	650	575
Office of the Prime Minister	3,012	3,098	3,712	3,493
Public Service Commission	98	100	98	96
Armed Forces of Malta	8,961	9,617	9,016	9,307
Information	865	872	389	333
Government Printing Press	0	0	400	371
Electoral Office	1,151	2,340	1,143	940
Ministry for the Family and Social Solidarity	4,586	5,535	3,893	4,661
Social Security	39,024	40,570	39,949	39,877
Social Security Benefits	141,788	150,258	155,561	163,686
Family and Social Welfare	447	541	486	412
Elderly and Community Care	9,461	10,170	10,273	9,289
Housing	561	551	807	917
Industrial and Employment Relations	379	396	421	398
Ministry of Education, Youth and Employment	24,858	27,770	27,843	33,572
Education	35,823	36,984	35,406	35,714
Libraries and Archives	486	504	472	447
Ministry of Finance	1,651	1,841	14,374	23,064
Treasury	963	902	7,826	1,214
Pensions	20,817	21,088	21,528	23,736
Inland Revenue	3,978	3,549	3,798	4,867
Customs	4,627	3,920	3,648	3,785
V.A.T.	2,333	2,419	2,465	2,381
Contracts	250	268	270	298
Ministry for Resources and Infrastructure	17,413	17,711	15,582	12,053
Ministry for Tourism and Culture	1,998	1,958	1,896	3,575
Civil Aviation	588	432	403	371
Economic Policy	582	634	466	228
Commerce	1,432	1,782	2,132	1,444
Consumer and Competition	305	397	327	376

Government Recurrent Expenditure

(January-September)

Appendix Table 8.2 continued — Lm thousand

	2002	2003	2004	2005
Ministry for Justice and Home Affairs	1,410	2,845	1,936	1,908
Police	11,181	12,242	11,735	11,191
Correctional Services	1,766	1,819	1,821	2,059
Civil Protection	944	935	1,027	1,026
Government Property Division	603	1,885	951	1,012
Registration	519	633	629	743
Ministry for Rural Affairs and the Environment	6,379	12,313	13,021	21,051
Ministry for Gozo	14,520	15,175	13,531	14,106
Ministry of Health, the Elderly and Community Care	50,423	52,891	55,410	54,149
Local Councils	5,436	5,541	5,371	5,615
Judicial	2,692	2,722	2,922	2,797
Ministry of Foreign Affairs	5,370	5,709	5,467	6,079
Ministry for Investment, Industry and IT	0	0	29,630	32,870
[Ministry for Competitiveness and Communications]	0	0	0	2,113
[Ministry for Urban Development and Roads]	0	0	0	3,853
[Ministry for Transport and Communications]	3,359	3,554	4,416	0
[Ministry for Youth and the Arts]	0	0	3,481	0
[Youth and Sport]	783	801	0	0
[Ministry for Economic Services]	29,040	30,513	0	0
[Ministry of Justice and Local Government]	1,371	1,700	0	0
[Museums]	1,027	0	0	0
[Culture and the Arts]	814	0	0	0
[Environment Protection]	443	0	0	0
[Joint Office]	2,483	0	0	0
Recurrent Expenditure	470,974	499,383	518,133	543,452

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

Source: The Treasury

Government Capital Expenditure

(January-September)

Appendix Table 8.3 | Lm thousand

	2002	2003	2004	2005
Productive Investment	26,446	23,437	17,860	23,200
Ship Repair and Shipbuilding	10,419	4,459	0	0
Development of Industries	3,714	4,694	2,231	3,171
Agriculture and Fisheries	566	1,379	1,236	911
Tourism	7,904	8,351	8,628	7,936
Public Buildings, Plant and Equipment	3,803	4,342	5,663	10,966
Capital Expenditure for Gozo	41	212	102	216
Infrastructure	21,700	23,612	27,190	32,860
Roads	7,089	5,172	3,215	3,139
Sewers	1,836	1,885	1,061	2,363
Development of Malta Freeport	2,872	2,206	3,457	2,562
Public Buildings, Plant and Equipment	9,357	13,469	18,944	24,307
Capital Expenditure for Gozo	547	880	513	489
Social	22,817	37,129	30,583	37,046
Education	3,567	5,144	4,089	2,997
Culture	287	165	220	299
Sports	500	545	400	62
Health	15,489	27,520	22,175	30,388
Care of the Elderly	54	133	320	151
Housing	1,699	1,568	1,297	346
Public Buildings, Plant and Equipment	979	1,843	1,972	2,662
Capital Expenditure for Gozo	242	211	110	141
Total Capital Expenditure	70,963	84,178	75,633	93,106

Source: The Treasury