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EUROSISTEMA
CENTRAL BANK OF MALTA

ECONOMIC UPDATE 2/2015

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ECONOMIC UPDATE 2/2015

Summary¹

Economic activity in Malta continued to expand robustly in the third quarter of 2014, with real gross domestic product (GDP) increasing by 3.8% on a year earlier, driven mainly by domestic demand. The available information for the final quarter of the year points to a subdued performance in manufacturing and continued growth in tourism. Growth in economic activity is being reflected in the labour market, with employment expanding and the unemployment rate declining. Price pressures remain contained, with the annual rate of inflation falling to 0.4% in December 2014. Maltese residents' deposits continued to expand robustly in December, while credit contracted further. As regards fiscal developments, the general government deficit narrowed during the first three quarters of 2014, with the ratio to GDP standing at 2.5%. The deficit on the Consolidated Fund between January and November also narrowed. On the external side, the surplus on the current account of the balance of payments increased during the third quarter of the year.

Output, demand and the labour market

Economic activity in Malta continued to grow robustly. In the third quarter of 2014, real GDP growth accelerated to 3.8% on an annual basis, from 3.4% in the previous quarter. As a result, during the first three quarters of the year, growth averaged 3.6%, with significant increases in the major domestic demand components (see Table 1).

During the third quarter, both domestic demand and net exports contributed to economic expansion (see Chart 1). In turn, growth in domestic demand was mainly sustained by private and government consumption. Private consumption increased by 3.2% on a year earlier, and was the largest contributor to real GDP growth, boosting it by 1.7 percentage points. Government consumption went up by 5.9%, principally reflecting an increase in the government wage bill, and contributed

Table 1
GROSS DOMESTIC PRODUCT⁽¹⁾

| | 2014 | | | |
|--|----------------------------------|------------|------------|------------|
| | Q1 | Q2 | Q3 | Q1-Q3 |
| | <i>Annual percentage changes</i> | | | |
| Private final consumption expenditure | 1.3 | 3.3 | 3.2 | 2.6 |
| Government final consumption expenditure | 2.7 | 9.2 | 5.9 | 6.0 |
| Gross fixed capital formation | 14.5 | 4.7 | 4.6 | 8.0 |
| Domestic demand | 4.2 | 2.5 | 3.9 | 3.5 |
| Exports of goods & services | -0.4 | 1.6 | 0.7 | 0.6 |
| Imports of goods & services | 0.2 | 0.9 | 0.3 | 0.5 |
| Gross domestic product | 3.7 | 3.4 | 3.8 | 3.6 |

⁽¹⁾ Chain-linked volumes, reference year 2010.

Source: National Statistics Office.

¹ The cut-off date for information in this publication is 6 February 2015. On 13 February 2015, Eurostat released GDP figures for the European Union and reported annual real GDP growth in Malta of 4.0% for the third quarter of 2014. The latter growth rate is based on seasonally adjusted data, whereas the 3.8% rate of growth cited in this Update refers to non-seasonally adjusted data, as published by the National Statistics Office (NSO).

a further 1.0 percentage point to growth. Gross fixed capital formation also increased, though, at 4.6%, the annual rise was slightly smaller than in the previous quarter. The increase in investment was mainly driven by non-residential construction.

On the other hand, changes in inventories lowered GDP growth by 0.1 percentage point.²

Net exports contributed half a percentage point to real GDP during the third quarter of 2014 as exports increased at a faster

pace than imports. Exports expanded at an annual rate of 0.7%, entirely driven by goods, as exports of services declined. Imports also rose, by 0.3%. As with exports, goods accounted for higher import levels as imports of services fell. The increase in merchandise imports was consistent with the expansion of aggregate demand.

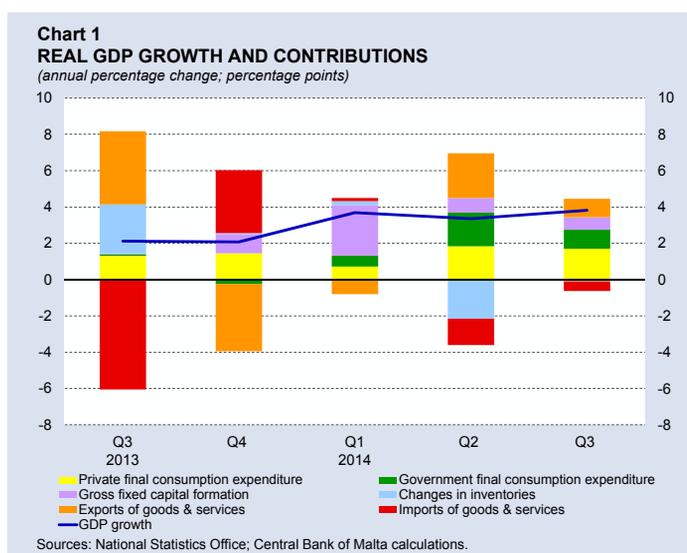
In nominal terms, annual GDP growth reached 5.3%, whereas growth in gross value added (GVA) stood at 4.0%. From a sectoral perspective, services continued to drive the expansion in GVA during the third quarter of the year, with the strongest contributions arising in public administration & defence and professional & scientific activities. However, gross value added in the utilities and construction sectors remained broadly stable, whereas manufacturing GVA decreased.

As regards the fourth quarter of 2014, the available information points to a continued weak performance in manufacturing and sustained growth in tourism.

Industrial production rose modestly in the final quarter of the year, but decreased by 4.6% on average during the twelve months to December 2014.³ The overall drop in output was mainly driven by declines in pharmaceuticals, textiles and computer, electronic & optical products. To a lesser extent, decreases were also recorded in the production of wearing apparel and energy. In contrast, food production increased considerably compared to a year earlier.

Turning to inbound tourism, arrivals rose at an annual rate of 1.4% in December 2014, with total nights spent going up by 3.1%. At the same time, expenditure grew by 4.4% on a year earlier, reflecting increases in spending on package holidays and accommodation. During 2014 as a whole, tourist numbers increased by 6.8% over 2013, while nights spent and expenditure rose by 4.9% and 6.1%, respectively.

In the last quarter of 2014 cruise liner calls went up on a year earlier. As a result, the number of foreign cruise liner passengers increased by 32,716, or 27.4%. Over the year as a whole, the number

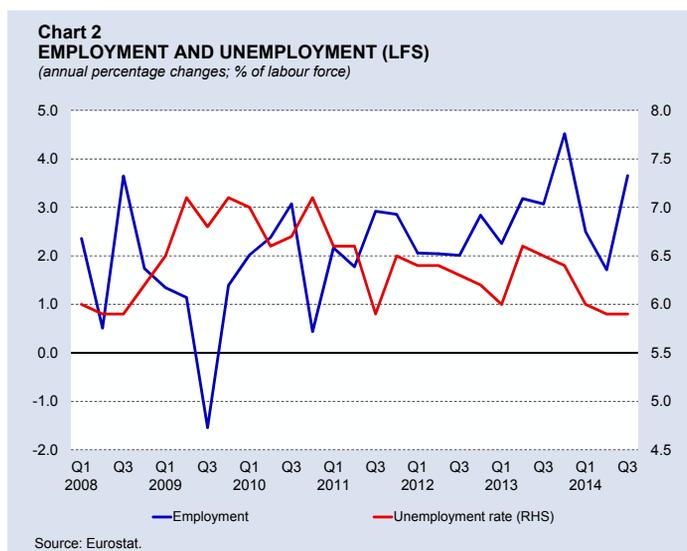


² Changes in inventories include acquisitions and disposals of valuables as well as the statistical discrepancy. In the absence of NSO data, the contribution of changes in inventories is based on the Bank's calculations.

³ Based on the industrial production index adjusted for working days.

of cruise liner calls totalled 303, which resulted in an increase of nearly 10% in the number of passengers over 2013.

Growth in economic activity is being reflected in a positive labour market performance. Labour Force Survey (LFS) data for the third quarter of 2014 indicate an increase of 3.7% in employment compared with the same period of 2013. This followed a rise of 1.7% in the previous quarter (see Chart 2). ETC records show that in August the gainfully occupied population rose by 3.7% on a year earlier, following a 3.6% increase in July.



According to the LFS, the unemployment rate stood at 5.9% in the third quarter of 2014, compared with 6.5% a year earlier. More recently, Eurostat's estimate of the seasonally-adjusted unemployment rate stood unchanged at 5.8% between October and December.

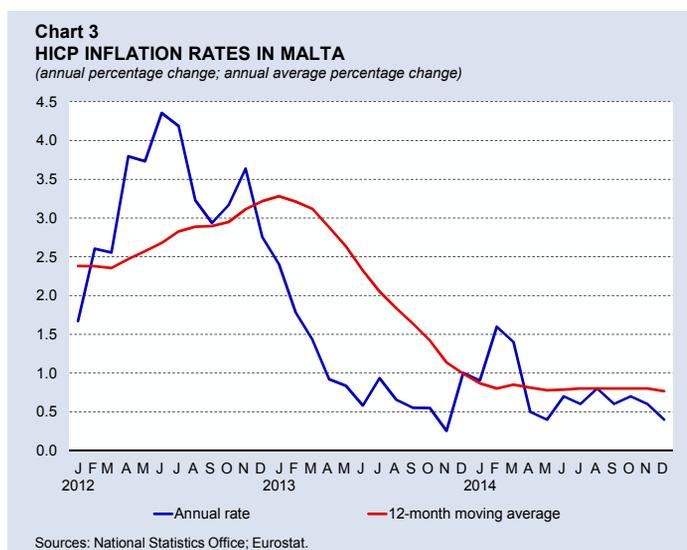
ETC data show that in December the number of persons on the unemployment register fell by 1,114 compared with a year earlier, to 6,287.

Prices, costs and competitiveness

The annual rate of HICP inflation fell from 0.6% in November 2014 to 0.4% in December. The average for the whole year stood at 0.8%, unchanged over the previous month (see Chart 3).

The drop in the annual inflation rate in December was driven by a significant slowdown in food price inflation. This was partly offset by faster growth in prices of non-energy industrial goods (NEIG), albeit still at a low level. The annual rate of change of prices of services and energy remained unchanged between November and December.

The annual rate of change in food prices eased to 0.5% in December, from 2.1% a month earlier, mainly because drops in the prices of fruit and vegetables



caused a swing in the inflation rate of unprocessed food from 2.7% to -0.8%. In addition, inflation in processed food products eased, as tobacco and alcohol prices rose at a slower pace in the month under review.

On the other hand, NEIG prices rose by 0.8% in December, 0.3 percentage point quicker than a month earlier, largely due to faster growth in garments' prices. Meanwhile, services price inflation remained stable at 1.8%. The annual rate of change of energy prices was also unchanged from November, at -8.9%.

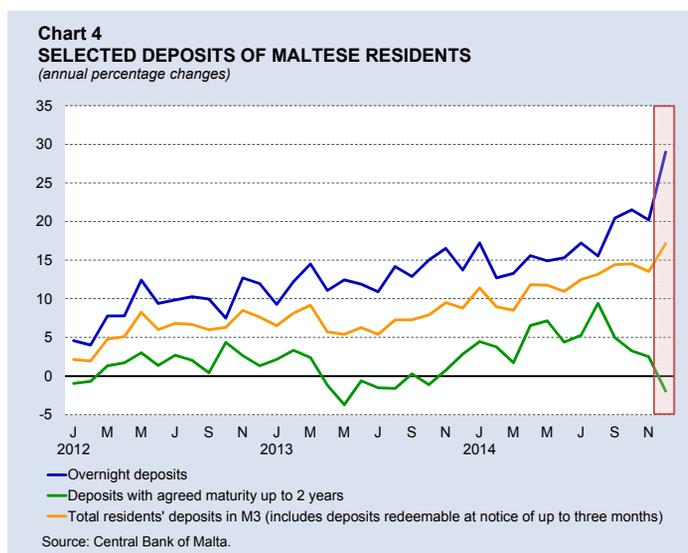
As regards domestic cost pressures, unit labour costs are used to measure the labour costs of producing a unit of output. Unit labour costs increase in line with compensation of employees, but fall in response to productivity gains. During the third quarter of 2014, Malta's unit labour costs, measured as a four-quarter moving average, increased by 1.1% on a year earlier. The increase in unit labour costs was the result of a decline in productivity, which contracted by 0.4%, and growth in compensation per employee, which rose by 0.7%.

The Central Bank of Malta's property price index, which is based on advertised prices, continued to increase strongly during the third quarter of 2014. It rose at an annual rate of 7.6%, down from 8.9% in the previous quarter. This marks the fourth consecutive quarter of strong growth in advertised prices. Advertised prices may not accurately reflect the actual prices at which sales are concluded.

Deposits, credit and financial markets⁴

Residents' deposits held with resident Monetary Financial Institutions (MFI) continued their rapid expansion, growing at a double-digit annual rate. In December, deposits forming part of broad money (M3) grew by €416.3 million, or 3.5%, on the previous month. Consequently, their annual growth rate accelerated to 17.1% from 13.5% in November (see Chart 4).

During the month, there was a shift from time deposits towards overnight deposits. The latter expanded by €528.1 million, or 6.7%, on the previous month, of which around half came from higher balances belonging to non-financial corporations (NFC). The rest was broadly split between households and non-bank financial intermediaries. As a result, the annual growth rate of overnight deposits rose from 20.2% in November to 29.0%.



⁴ Monetary data for the period from June 2010 onward have been revised to comply with ESA 2010 methodology. The main change stemming from this changeover in monetary data is the reclassification of special purpose entities from residents of the rest of the world to residents of Malta. Consequently, residents' deposits, as well as loans to residents, were revised upwards. These revisions also affect the dynamics of these variables.

On the other hand, deposits with an agreed maturity of up to two years went down by €114.1 million, or 2.8%. This drop was broad-based, with NFCs and households experiencing the largest declines. Consequently, these deposits contracted by 2.0% year-on-year, as against a 2.5% increase in November. At the same time, deposits redeemable at a notice of up to three months rose by €2.2 million, or 1.8%.

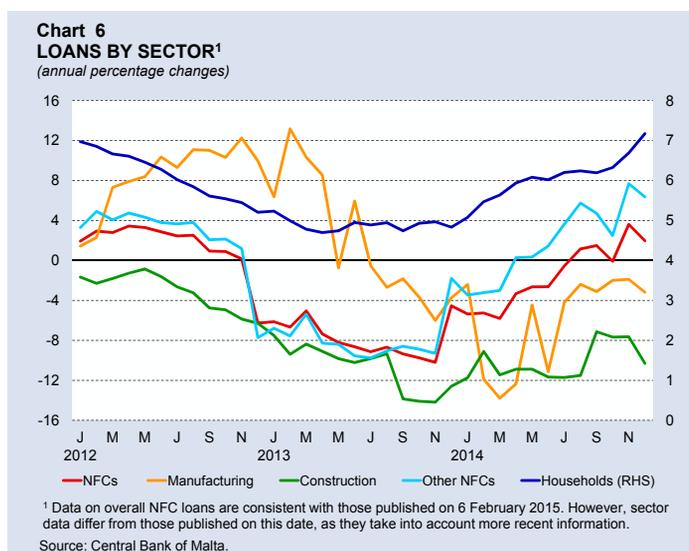
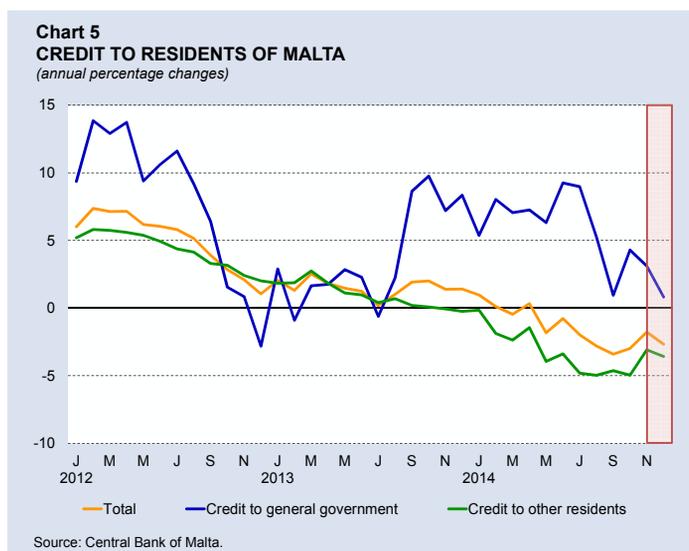
On the asset side of MFI balance sheets, credit to Maltese residents contracted by €191.3 million, or 1.6%, between November and December, with the decline being observed in both of the major components – credit granted to government and to all other resident borrowers. As a result, the annual rate of change fell to -2.7% in December from -1.8% in November (see Chart 5).

Credit to general government contracted by €152.9 million, or 0.8%, in December following a drop in MFIs' holdings of government securities issued as well as in loans. As a result, the annual growth rate slowed down to 0.8%, from 3.1% in the previous month.

Meanwhile, credit to all other residents, which is composed mainly of private sector borrowers, went down by €38.5 million, or 0.4%, on the previous month, on the back of reduced lending to public NFCs, particularly in the energy and transportation & storage sectors. This outweighed a rise in loans to private NFCs. Lending to households rose by €37.2 million, or 0.9%, in December.

The annual rate of growth of total loans to NFCs fell from 3.6% in November to 2.0% (see Chart 6). At the same time, lending to households continued to increase, rising by 7.2% on a year earlier, up from 6.7% in the previous month. This acceleration stemmed from higher lending for house purchases.

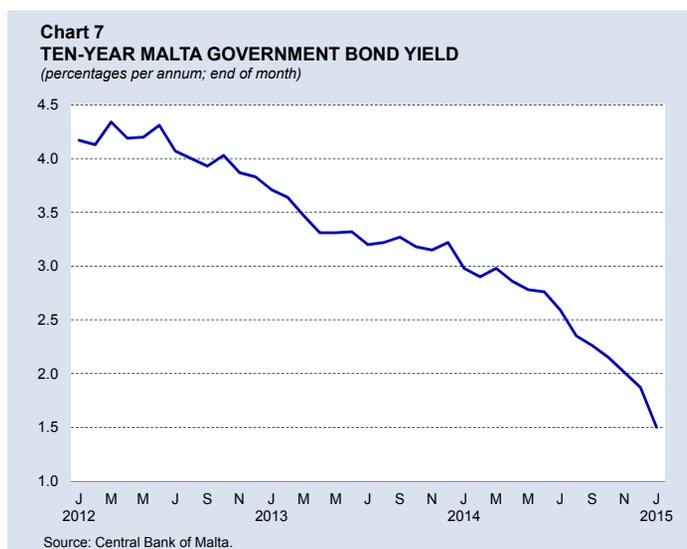
Overall, credit to other residents contracted at a faster annual pace, falling by 3.6% in December, following a 3.1% drop in November.



Bank lending and deposit rates

Bank lending and deposit rates edged down in December. The weighted average interest rate paid by MFIs on all euro-denominated deposits belonging to resident households and NFCs stood at 1.03%, 6 basis points below its November level and 38 basis points less than a year earlier.

The comparable rate charged by MFIs on outstanding loans to resident households and NFCs fell marginally by one basis point, to 4.02%. At this level, it was 22 basis points less than in December 2013.



In the domestic capital market, the yield on ten-year government bonds decreased further, reflecting also the reaction of the international financial markets to the ECB's decision on 22 January on the purchase of sovereign bonds (see Chart 7). It stood at 1.50% as at end-January, down from 1.87% at end-December. The spread on euro area AAA-rated ten-year bonds narrowed from 122 basis points at the end of December to 111 basis points at end-January.

Equity prices generally rose during January. As a result, the Malta Stock Exchange Index increased by 2.7% to 3,420.2 by end-January, reaching a nine-month high.

Public finance⁵

In the third quarter of 2014 the general government deficit narrowed on a year-on-year basis. As a result, over the first three quarters of the year, the deficit decreased to €229.2 million from €238.6 million a year earlier. The deficit to GDP ratio measured as a four-quarter moving sum declined from 3.3% in the second quarter of 2014 to 2.5% in the following quarter.

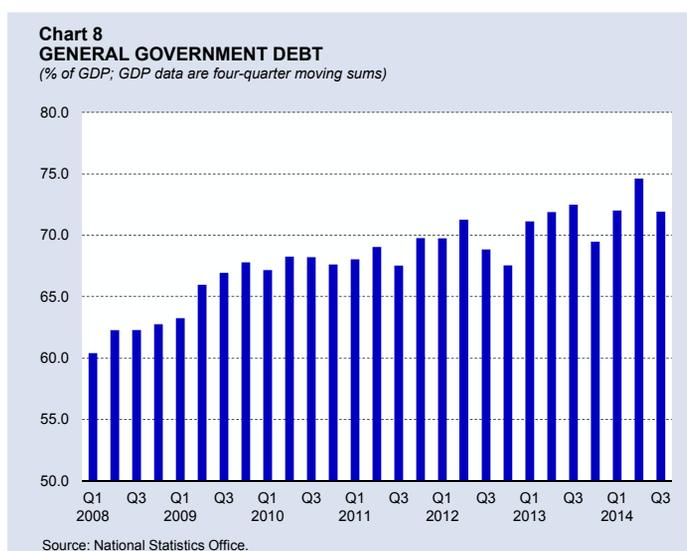
Over the first three quarters of 2014, revenue grew by 9.0%, mainly due to higher indirect tax receipts, in line with a rise in consumption. Income from social contributions grew by 8.5%, reflecting continued positive labour market developments. At the same time, current taxes on income and wealth increased by 3.4%. Receipts from capital and current transfers surged by 36.4%, owing to higher grants received from the European Union.

General government expenditure increased by 7.7%, mainly on the back of higher recurrent spending. In particular, compensation of employees grew by 7.9% reflecting increased outlays especially in the health and education sectors. Intermediate consumption went up by 10.3%,

⁵ The general government accounts, which are compiled in line with the ESA 2010 methodology, cover central government, including extra-budgetary units, as well as local councils, on an accrual basis. The Consolidated Fund captures most of the transactions of general government on a cash basis.

reflecting higher spending in the public administration and health sectors. At the same time, social benefits rose by 3.4%, due to higher spending on retirement pensions and social assistance.

Meanwhile, spending on gross fixed capital formation grew by 18.9%, owing to higher expenditure on infrastructural projects partly funded by the European Union. On the other hand, capital transfers declined by 18.2%, as the equity injection into Air Malta was smaller than in the previous year.



Data for the Consolidated Fund also show an improvement in the fiscal position. Figures for November 2014 show a surplus of €93.7 million, as against a deficit of €21.6 million in November 2013.⁶ Revenue surged as arrears of excise duties were paid, while expenditure increased to a lesser extent.

Overall, between January and November 2014 the deficit on the Consolidated Fund declined by €118.4 million on a year earlier, to €188.9 million. Revenue rose by 13.1%, on the back of the extraordinary receipt of excise duties referred to earlier, as well as higher tax revenue in general. Meanwhile, expenditure rose by 7.2%, with recurrent and capital spending rising by 7.0% and 9.2%, respectively.

According to the Government's most recent estimates, as presented in the Budget Speech in November 2014, the deficit on the Consolidated Fund is expected to have narrowed to €75.5 million during 2014. At the same time, the general government deficit is expected to have decreased to 2.1% of GDP. It is set to decline further to 1.6% of GDP in 2015.

The general government debt-to-GDP ratio, measured on a four-quarter sum basis, stood at 71.9% by end-September 2014 (see Chart 8). The Government expects this ratio to have fallen to 70.1% in 2014, before declining further to 69.0% in 2015.

Balance of payments

During the third quarter of 2014 the current account of the balance of payments posted a surplus of €349.9 million, up from €163.2 million in the same period of 2013.⁷ This improvement was driven by developments on the goods and income sub-components.

⁶ Government contributions to the social security account in terms of the Social Security Act 1987 are excluded from both revenue and expenditure.

⁷ As from September 2014, the NSO started publishing the balance of payments statement according to the guidelines provided in the Sixth Edition of the IMF's BOP and IIP manual (BPM6). The most notable difference resulting from the implementation of the latest manual relates to the inclusion of Special Purpose Entities as residents of Malta.

Table 2
CURRENT ACCOUNT

EUR millions

| | 2013 Q3 | 2014 Q3 | 2013 Q1-Q3 | 2014 Q1-Q3 |
|------------------------|--------------|--------------|---------------|---------------|
| Current account | 163.2 | 349.9 | 134.1 | 481.8 |
| Goods | -334.9 | -220.0 | -870.1 | -766.3 |
| Services | 581.5 | 565.3 | 1,282.8 | 1,312.2 |
| Primary income | -105.5 | -53.6 | -379.6 | -210.0 |
| Secondary income | 22.1 | 58.3 | 101.0 | 145.9 |

Source: National Statistics Office.

The merchandise trade deficit narrowed by €114.9 million on a year earlier, as imports fell and, to a lesser extent, exports rose. Meanwhile, the shortfall on the primary income account, which largely captures investment income flows, narrowed by €51.9 million. In addition, net receipts from secondary income increased by €36.2 million.⁸ Conversely, the overall surplus on services declined by €16.3 million, largely because increased payments for transport services outweighed higher net earnings on travel and ‘other services’.

In the third quarter, the capital account registered net inflows of €34.1 million, down marginally from €35.3 million in the same quarter of 2013. Meanwhile, the financial account recorded net inflows of €72.6 million as opposed to net outflows of €40.7 million a year earlier.

Therefore, during the first nine months of 2014, the current account posted a surplus of €481.8 million, up by €347.7 million on the same period of 2013 (see Table 2). The higher surplus was driven by favourable developments in all the major sub-components. Meanwhile, the positive balance on the capital account increased to €128.9 million, whereas net outflows of €136.5 million were recorded on the financial account.

Because of methodological differences, the picture that emerges from the balance of payments is not directly reflected in Customs data, which track Malta’s cross-border trade.⁹ During 2014 as a whole, the merchandise trade deficit stood at €2.6 billion, €0.8 billion more than in 2013. Exports declined, predominantly due to lower foreign sales of electrical machinery, though other categories, such as fuel and pharmaceuticals, also fell. On the other hand, imports rose, with the increase being driven by fuels and by capital goods, including purchases (as well as registrations) of ships and boats.

⁸ The primary income account shows income flows related mainly to cross-border investment and compensation of employees. The secondary income account shows current transfers between residents and non-residents.

⁹ Goods exports and imports in the balance of payments differ from merchandise data from Customs sources due to adjustments for differences in coverage, valuation and timing. For example, Customs data cover all goods which cross Maltese borders, whereas balance of payments data only include transactions involving changes in ownership. These differences are especially pronounced in the case of trade in fuel, aircraft and ships.

Annex 1

| MACROECONOMIC INDICATORS FOR MALTA | | | | | | | | | | | | | |
|---|------|------|------|------|------|------|------|------|------|------|------|------|------|
| <i>(annual percentage changes; non-seasonally adjusted data unless otherwise indicated)</i> | | | | | | | | | | | | | |
| | 2013 | 2014 | 2013 | 2014 | 2014 | 2014 | 2014 | 2014 | 2014 | 2014 | 2014 | 2014 | 2015 |
| | | | Q4 | Q1 | Q2 | Q3 | Q4 | Aug. | Sep. | Oct. | Nov. | Dec. | Jan. |
| Prices and costs | | | | | | | | | | | | | |
| HICP | 1.0 | 0.8 | 0.6 | 1.3 | 0.5 | 0.7 | 0.6 | 0.8 | 0.6 | 0.7 | 0.6 | 0.4 | - |
| Unit labour costs, whole economy ⁽¹⁾ | 1.2 | - | 1.2 | 0.8 | 1.3 | 1.1 | - | - | - | - | - | - | - |
| Compensation per employee ⁽¹⁾ | -0.3 | - | -0.3 | -0.4 | 0.2 | 0.7 | - | - | - | - | - | - | - |
| Labour productivity (per person) ⁽¹⁾ | -1.5 | - | -1.5 | -1.2 | -1.2 | -0.4 | - | - | - | - | - | - | - |
| Residential property prices | 2.1 | - | 6.4 | 6.7 | 8.9 | 7.6 | - | - | - | - | - | - | - |
| Economic activity | | | | | | | | | | | | | |
| Nominal GDP | 4.6 | - | 4.5 | 5.2 | 4.4 | 5.3 | - | - | - | - | - | - | - |
| Real GDP | 2.5 | - | 2.1 | 3.7 | 3.4 | 3.8 | - | - | - | - | - | - | - |
| Real private consumption | 1.6 | - | 2.6 | 1.3 | 3.3 | 3.2 | - | - | - | - | - | - | - |
| Real government consumption | 0.5 | - | -1.2 | 2.7 | 9.2 | 5.9 | - | - | - | - | - | - | - |
| Real gross fixed capital formation | 2.3 | - | 6.0 | 14.5 | 4.7 | 4.6 | - | - | - | - | - | - | - |
| Real exports of goods and services | -1.2 | - | -2.4 | -0.4 | 1.6 | 0.7 | - | - | - | - | - | - | - |
| Real imports of goods and services | -1.0 | - | -2.4 | 0.2 | 0.9 | 0.3 | - | - | - | - | - | - | - |
| Tourist arrivals | 9.6 | 6.8 | 13.4 | 7.9 | 9.0 | 7.2 | 2.5 | 7.7 | 5.1 | 2.7 | 3.0 | 1.4 | - |
| Labour market developments (LFS) | | | | | | | | | | | | | |
| Unemployment rate (% of labour force) | 6.4 | - | 6.4 | 6.0 | 5.9 | 5.9 | - | 5.9 | 5.8 | 5.8 | 5.8 | 5.8 | - |
| Total employment | 3.3 | - | 4.5 | 2.5 | 1.7 | 3.7 | - | - | - | - | - | - | - |
| Balance of payments | | | | | | | | | | | | | |
| Current account (as a % of GDP) ⁽¹⁾ | 3.0 | - | 3.0 | 3.4 | 5.1 | 7.4 | - | - | - | - | - | - | - |
| Credit and financial indicators | | | | | | | | | | | | | |
| Maltese residents' deposits and loans | | | | | | | | | | | | | |
| Overnight deposits | 13.7 | 29.0 | 13.7 | 13.3 | 15.3 | 20.4 | 29.0 | 15.5 | 20.4 | 21.5 | 20.2 | 29.0 | - |
| Deposits with agreed maturity up to 2 years | 2.8 | -2.0 | 2.8 | 1.7 | 4.4 | 4.9 | -2.0 | 9.4 | 4.9 | 3.2 | 2.5 | -2.0 | - |
| Total residents' deposits in M3 | 8.8 | 17.1 | 8.8 | 8.5 | 11.0 | 14.4 | 17.1 | 13.2 | 14.4 | 14.5 | 13.5 | 17.1 | - |
| Credit to general government | 8.3 | 0.8 | 8.3 | 7.1 | 9.2 | 0.9 | 0.8 | 5.2 | 0.9 | 4.3 | 3.1 | 0.8 | - |
| Credit to other residents | -0.2 | -3.6 | -0.2 | -2.4 | -3.4 | -4.6 | -3.6 | -5.0 | -4.6 | -5.0 | -3.1 | -3.6 | - |
| Total credit | 1.4 | -2.7 | 1.4 | -0.5 | -0.8 | -3.4 | -2.7 | -2.8 | -3.4 | -3.0 | -1.8 | -2.7 | - |
| 10-year interest rate (%) ⁽²⁾ | 3.36 | 2.61 | 3.21 | 3.01 | 2.87 | 2.49 | 2.08 | 2.49 | 2.32 | 2.18 | 2.11 | 1.94 | 1.69 |
| Stock prices: Malta Stock Exchange Index ⁽³⁾ | 14.8 | -9.6 | 7.8 | -7.1 | -3.7 | 1.1 | -0.1 | -2.8 | 1.1 | -0.9 | -0.9 | 1.8 | 2.7 |
| General government finances (% of GDP) | | | | | | | | | | | | | |
| Surplus (+) / deficit (-) ⁽⁴⁾ | -2.7 | - | -2.7 | -3.0 | -3.3 | -2.5 | - | - | - | - | - | - | - |
| Gross debt ⁽⁵⁾ | 69.5 | - | 69.5 | 72.0 | 74.6 | 71.9 | - | - | - | - | - | - | - |

⁽¹⁾ Four-quarter moving averages.

⁽²⁾ Period averages.

⁽³⁾ Period-on-period percentage changes.

⁽⁴⁾ Four-quarter moving sums.

⁽⁵⁾ GDP data are four-quarter moving sums.

Sources: Central Bank of Malta; European Commission; Malta Stock Exchange; National Statistics Office.