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—EUROSISTEMA—
CENTRAL BANK OF MALTA

ECONOMIC UPDATE 12/2015

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ECONOMIC UPDATE 12/2015

Summary¹

Economic activity in Malta continued to expand robustly in the third quarter of 2015, with real gross domestic product (GDP) increasing by 5.4% on a year earlier. Growth was driven by domestic demand. Indicators for tourism point to further expansion in the fourth quarter of 2015. Buoyant economic activity is being reflected in the labour market, with employment expanding and the unemployment rate remaining at historically low levels. Price pressures were moderate. The annual rate of inflation, based on the Harmonised Index of Consumer Prices (HICP), stood at 1.3% in November. Maltese residents' deposits continued to expand at a rapid annual rate in October, while the annual rate of growth of credit to residents stabilised at 4.8%. As regards fiscal developments, the general government deficit narrowed in the second quarter of 2015, while the deficit on the Consolidated Fund also decreased during the first ten months of the year. On the external side, the current account of the balance of payments remained in surplus in the third quarter of 2015.

Output, demand and the labour market

Economic activity in Malta continued to grow strongly during the third quarter of 2015, with real GDP rising at an annual rate of 5.4%, following a revised growth rate of 5.8% in the previous quarter (see Table 1).

During the quarter under review, growth was driven by domestic demand, which rose by 9.1% on a year earlier. In turn, the main driver was a rise in gross fixed capital formation, which grew sharply when compared with the second quarter of 2014. Private consumption and, to a lesser extent, changes in inventories also had a positive impact. In contrast, government consumption fell. Overall, domestic demand contributed 7.5 percentage points to real GDP growth.

Gross fixed capital formation rose sharply for the second consecutive quarter. In the third quarter it increased by 39.7% on a year earlier. This increase mostly reflected higher spending on

Table 1
GROSS DOMESTIC PRODUCT⁽¹⁾

Annual percentage changes

	2014		2015		
	Q3	Q4	Q1	Q2	Q3
Private final consumption expenditure	3.0	3.5	5.6	2.5	5.1
Government final consumption expenditure	5.9	9.9	4.8	5.7	-5.4
Gross fixed capital formation	3.1	12.2	0.3	28.4	39.7
Domestic demand	2.3	9.1	4.6	6.0	9.1
Exports of goods and services	-2.7	1.6	-0.3	4.3	3.4
Imports of goods and services	-4.1	3.6	-0.6	4.4	5.3
Gross domestic product	3.4	5.8	5.2	5.8	5.4

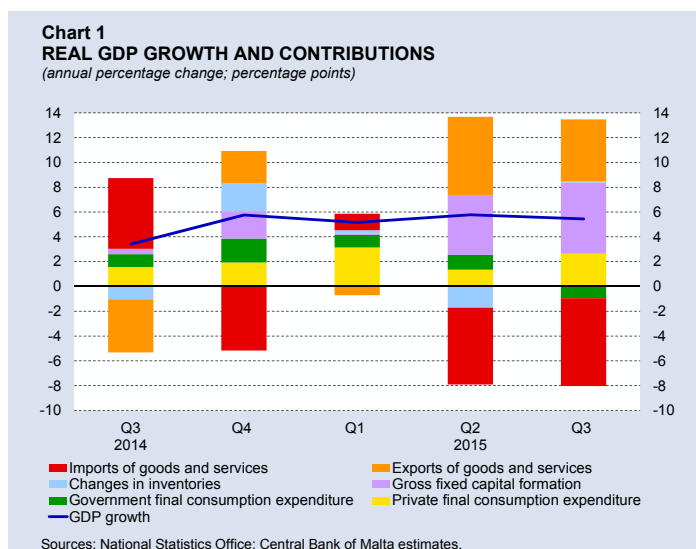
⁽¹⁾ Chain-linked volumes, reference year 2010.

Source: National Statistics Office.

¹ The cut-off date for information in this note is 18 December 2015.

machinery and transport equipment. Spending on dwellings also increased. In contrast, non-residential investment declined, while the other components of investment, which include investment in software, were broadly stable. Overall, investment contributed 5.7 percentage points to real GDP growth (see Chart 1).

Private consumption also went up, expanding at an annual rate of 5.1% in the third quarter, reflecting continued growth in compensation of employees. It added 2.6 percentage points to GDP growth.



In contrast, following several quarters of strong growth, government consumption declined by 5.4% on the third quarter of 2014, lowering GDP growth by 0.9 percentage points. Although government wages and intermediate consumption increased, receipts from sales of government services, which are netted against such expenditure, rose even faster.

Changes in inventories had a slight positive impact on growth.²

Exports rose by 3.4% year-on-year, mainly as a result of an increase in foreign sales of services. Meanwhile, reflecting strong growth in aggregate demand, imports rose by 5.3%, supported by goods imports in particular. With imports growing faster than exports, net exports declined, dampening GDP growth by 2.1 percentage points.

Nominal GDP expanded at an annual rate of 8.0% in the third quarter of 2015, marginally slower than the 8.1% recorded in the second quarter, largely reflecting developments in the annual rate of growth of gross value added (GVA), which eased to 8.4%, from 8.6% in the previous quarter. Services remained the main contributor to growth in GVA. In turn, the strongest contributions came from the sector comprising wholesale and retail trade, the sector incorporating professional and scientific activities and the sector incorporating financial and insurance activities. The GVA of the sector which incorporates public administration, health and education also contributed significantly. Smaller positive contributions were also recorded in utilities, the real estate sector and the sector comprising arts and entertainment. In contrast, GVA in the manufacturing sector fell in annual terms.

The available information for the fourth quarter of 2015 indicates continued growth in tourism and a moderating pace of activity in manufacturing.

² The contribution to GDP growth of changes in inventories, which includes both the statistical discrepancy and acquisitions and disposals of valuables, is based on the Bank's calculations.

As regards manufacturing, the index of industrial production rose by 1.8% in year-on-year terms during October 2015, following 3.6% in September.³ As a result, the three-month moving average growth rate fell to 4.4%, from 6.9% a month earlier. Growth in industrial production during October mostly reflected increased output in pharmaceuticals. Smaller increases were also recorded among firms producing food, beverages, rubber and plastics and in the energy and water supply sectors. In contrast, output fell among firms involved in the manufacturing of computer, electronic and optical products and those involved in the printing and reproduction of recorded material.

Turning to tourism, in October arrivals rose by 10.5% on a year earlier, while nights stayed and expenditure also increased markedly. As a result, during the first ten months of 2015, tourist arrivals increased by 5.6% on a year earlier, while nights stayed and total spending went up by 5.0% and 7.4%, respectively. Although all major expenditure components increased substantially on their year-ago levels, spending on accommodation and “other expenditure” experienced the largest gains.

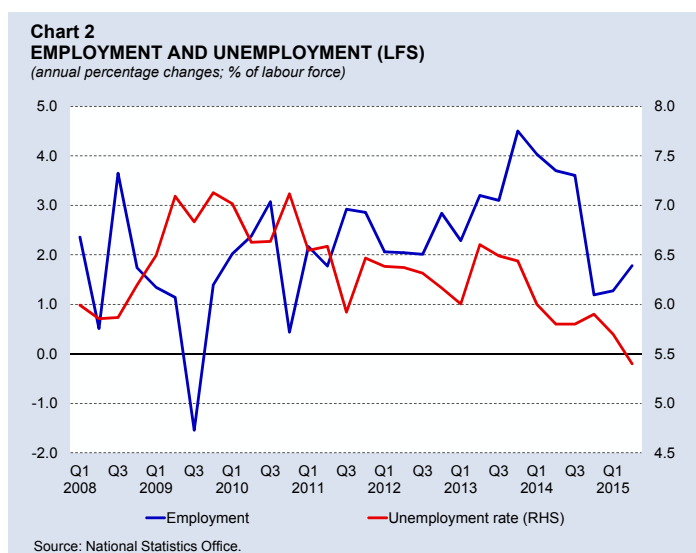
Meanwhile, in the third quarter of 2015 the number of cruise liner calls increased to 102, from 91 a year earlier. As a result, the number of foreign cruise liner passengers rose to 192,570, an increase of 39,522 over the same quarter of 2014.

As regards the labour market, according to the Labour Force Survey (LFS) employment expanded by 1.8% during the second quarter of 2015 compared with a year earlier, following a 1.3% increase in the previous quarter (see Chart 2). The rise in the second quarter solely reflected growth in full-time employment, as the number of part-time employees and those working on reduced hours fell.

On the basis of records maintained by the Employment and Training Corporation (ETC) employment increased even more strongly. In June 2015 the gainfully occupied population rose by 3.9% on a year earlier, which represents a slight slow-down from 4.2% in May.⁴

According to the LFS, the unemployment rate stood at 5.4% in the second quarter of 2015, down from 5.8% a year earlier.⁵

The available information suggests that labour market



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

⁴ The LFS is a household survey conducted by the NSO on the basis of definitions set by the International Labour Organization and Eurostat. ETC data are based on administrative records according to definitions established by domestic legislation on employment and social security benefits.

⁵ This unemployment rate is based on the number of unemployed aged 15 and over, which is consistent with NSO data on employment and the labour force. It may differ slightly from that published by the NSO, which is based on the number of unemployed in the 15-74 age bracket.

conditions continued to improve in more recent months. Indeed, Eurostat's estimate of the seasonally adjusted unemployment rate dropped to an average of 5.1% in the third quarter and remained stable at that rate in October.

ETC data also show a fall in the number of registered unemployed. In October 2015 the number of people on the unemployment register decreased by 1,680 compared with the corresponding month of 2014, to 4,916.

Prices, costs and competitiveness

In November, the annual rate of HICP inflation fell to 1.3%, from 1.6% a month earlier. At 1.1%, the twelve-month moving average rate was 0.1 percentage point higher when compared with October (see Chart 3).

The decline in the annual inflation rate on a month earlier largely reflected slower growth in services and unprocessed food prices, which outweighed an increase in processed food price inflation.

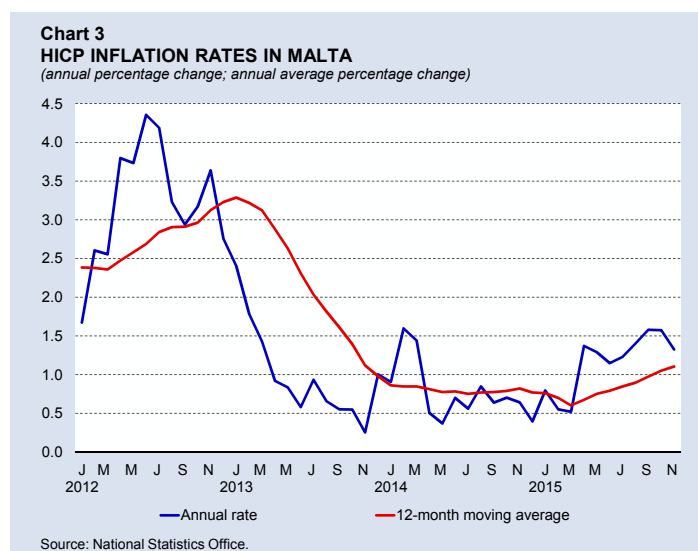
In November, processed food inflation rose to 3.4%, from 2.4% in the previous month. This mostly reflected an increase in excise duties on tobacco following the 2016 Budget. However, unprocessed food price inflation eased considerably, falling to 2.9% from 5.2% in October. This slowdown mainly reflected a month-on-month drop in the prices of vegetables.

Services price inflation also eased in November, falling to 1.6% from 1.9% in October. This mainly reflected weaker growth in the prices of recreational and personal services, which includes hotel accommodation, and a stronger decline in the prices of communication services.

In November, non-energy industrial goods inflation dropped to 1.1%, a slight deceleration on a month earlier. Higher prices for garments were more than offset by an easing in inflation on furniture and furnishings.

Meanwhile, energy prices declined by 4.9% on a year earlier, with the annual rate remaining unchanged on a month earlier.

As regards cost indicators, Central Bank of Malta estimates suggest that during the third quarter of 2015 Malta's unit labour costs (ULC), measured as a four-quarter moving average, fell by 0.4% on a year earlier.⁶ This represents the first decrease in ULC since 2005, and follows the decelerating outcomes seen in recent



⁶ Unit labour costs measure the average labour cost of a unit of output and are based on the ratio of compensation per employee to productivity.

quarters. The decrease in ULC in the third quarter was the result of strong productivity growth. In the third quarter, productivity increased by 2.4% on a year earlier, whereas compensation per employee rose by a more modest 1.9%.

Based on the Central Bank of Malta's advertised property price index, the price of residential properties rose at an annual rate of 4.4% in the third quarter of 2015, following a 4.8% increase in the previous quarter. Prices of apartments – the major component – continued to grow strongly, though at a slower pace than in the previous quarter. Although they indicate trends, advertised property prices may not accurately reflect the prices at which sales actually take place. In fact, the National Statistics Office's Property Price Index, which is based on actual transactions covering apartments, maisonettes and terraced houses, shows a more moderate increase in house prices. Measured on this basis, annual house price inflation in Malta stood at 2.6% in the second quarter.

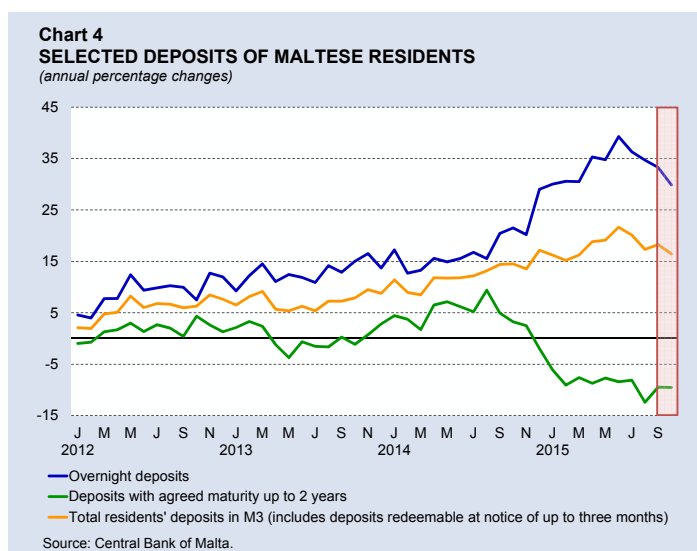
Deposits, credit and financial markets

In October, the annual growth rate of residents' deposits forming part of broad money (M3) decelerated from September, going to 16.4% from 18.3%. Nonetheless, growth remains historically strong.

The year-on-year increase in M3 deposits was supported by continued robust growth in overnight deposits (see Chart 4). On an annual basis, residents' overnight deposits grew by over €2.3 billion. This strong growth continued to reflect the low opportunity cost of holding liquid assets in an environment of low interest rates. While still strong, the annual rate of change of overnight deposits eased further following the peak recorded in June. In October, it stood at 29.9%, down from 33.3% in September.

Meanwhile, deposits with an agreed maturity of up to two years, the other major component of M3, declined for the fifth consecutive month in October. As a result, the annual growth rate remained negative in October, at -9.5%. At the same time, the annual rate of change of deposits redeemable at notice of up to three months, the smallest component of M3, remained unchanged at 6.6%.

On the asset side of banks' balance sheets, credit to Maltese residents dropped by €36.0 million in October, or 0.3%, the first monthly decline in 2015. This mainly reflected movements in MFI holdings of government securities. Nonetheless,



the annual rate of credit growth remained unchanged at 4.8% (see Chart 5).

The annual growth rate of credit to general government fell from 10.0% in September to 8.5% in October.

Meanwhile, credit to all other residents grew by 3.8% year-on-year in October, following an increase of 3.3% in the previous month, with this acceleration reflecting developments in loans to non-financial corporations.⁷ In contrast, loans to households grew at a slower pace.

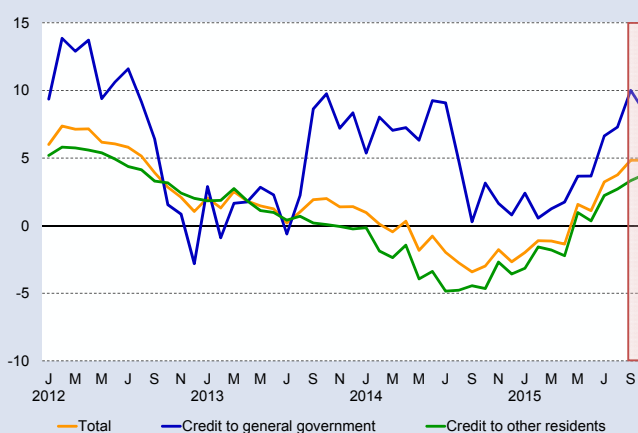
Loans to non-financial corporations (NFCs), which comprise both public and private NFCs, registered a second consecutive monthly increase following a period of decline. As a result, the annual rate of change rose from -6.6% in September to -4.4% in October (see Chart 6). This pick-up mainly reflected developments in loans to the energy sector.

Meanwhile, loans to households grew at an annual rate of 8.1% in October, down from 8.5% in September. Loans for house purchase continued to grow strongly, up by 10.5%, whereas consumer credit and other lending continued to contract.

Loans to other financial institutions also rose year-on-year, though at a slower pace compared to September. The share of this category in total loans is small.

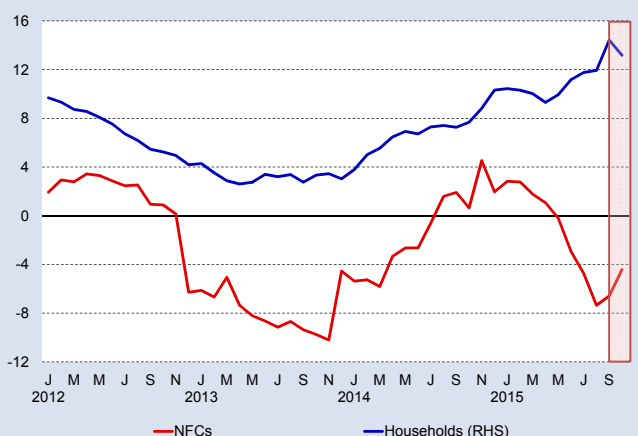
Bank deposit rates fell marginally in October, with the composite interest rate paid by MFIs on all euro-denominated deposits belonging to resident households and NFCs dropping by 2 basis points to 0.74%. Meanwhile, the comparable rate charged on outstanding loans to them edged down by 1 basis point to 3.84%. As a result, the composite deposit

Chart 5
CREDIT TO RESIDENTS OF MALTA
(annual percentage changes)



Source: Central Bank of Malta.

Chart 6
LOANS BY SECTOR
(annual percentage changes)

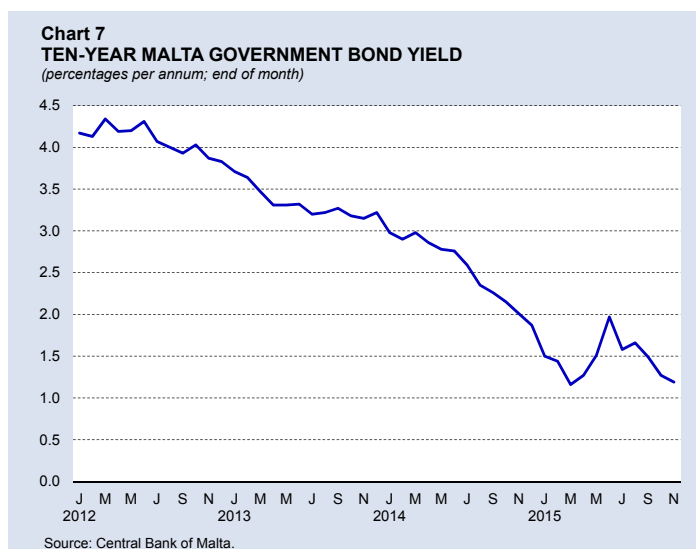


Source: Central Bank of Malta.

⁷ Figures exclude interbank lending.

rate was 37 basis points below its level in October 2014, while the corresponding lending rate went down by 21 basis points.

In the capital market, following two issues of Malta Government Stocks and one corporate bond issue in October, the Maltese Government issued €35.0 million in Malta Government Stocks in November, with a floating interest rate that includes a 35 basis point margin over the six-month EURIBOR. This was only made available through competitive auction. Meanwhile, Bank of Valletta also announced the details of its first tranche (of €75 million) of its Subordinated Debt Issuance Programme.



In the secondary market, the yield on ten-year government bonds extended its downward trend in November, falling by 8 basis points to 1.19% at the end of the month (see Chart 7). This movement was broadly in line with those in euro area benchmark yields. Meanwhile, equity prices rose once more, with the Malta Stock Exchange (MSE) index gaining 3.1%.

Public finance⁸

In the second quarter of 2015, the general government deficit narrowed by €24.4 million compared with the same period a year earlier, to €47.5 million. As a result, the deficit-to-GDP ratio, computed on the basis of four-quarter moving sums, fell to 2.1% from 2.5% in the previous quarter.⁹

During the second quarter of 2015, revenue grew by 7.5%, boosted by tax flows. In particular, income tax receipts rose by 12.7%. Inflows from taxes on production and imports and social security contributions rose to a lesser extent. Meanwhile, receipts from capital and current transfers went up by 19.4% on the back of higher capital transfers.

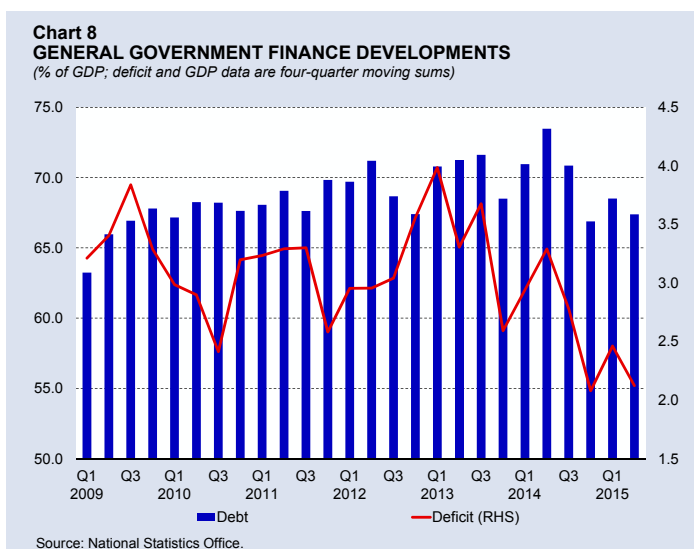
General government expenditure rose by 4.1% on a year earlier, mainly reflecting higher current spending. In turn, this was mainly driven by increased outlays on compensation of employees and current transfers, which rose by 7.0% and 22.9%, respectively. Growth in the former mainly reflected increased outlays on public administration, health and education. Expenditure on social benefits and intermediate consumption also rose, but moderately. Spending on gross fixed capital formation was significantly higher during the quarter under review. However, this was partly offset by a decline in capital transfers payable.

⁸ 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.

⁹ Deficit and debt ratios are based on deficit and debt levels published in NSO *News Release* 191/2015 and GDP data published in NSO *News Release* 224/2015.

In the second quarter of 2015, the general government debt-to-GDP ratio stood at 67.4% down from 68.5% in the previous quarter (see Chart 8).

Consolidated Fund data also show an improvement in the fiscal balance. In the first ten months of 2015, the Consolidated Fund deficit narrowed by €78.1 million when compared with the same period of 2014, to €204.5 million. Revenue grew by 11.0% on the back of higher intakes from taxes as well as non-tax income. Total expenditure went up by 6.8%, mainly reflecting higher recurrent spending.



Balance of payments

During the third quarter of 2015, the surplus on the current account of the balance of payments widened by €199.2 million, to €357.2 million.¹⁰ This increase was driven by an upward swing of €233.8 million on the primary income component, as well as an increase of €130.4 million in net services receipts. These positive developments were partly offset by a widening of €159.7 million in the merchandise trade deficit, and by a €5.2 million decrease in net secondary income inflows (see Table 2).¹¹ The capital account posted net inflows of €2.0 million, down from €34.2 million in the third quarter of 2014.

Table 2
EXTERNAL TRANSACTIONS

EUR millions

	2014 Q3	2015 Q3	2014 Q1-Q3	2015 Q1-Q3
Current account	158.0	357.2	302.2	733.3
Goods	-293.7	-453.5	-832.9	-1,159.6
Services	594.1	724.4	1,381.8	1,699.0
Primary income	-201.0	32.8	-398.7	36.0
Secondary income	58.7	53.5	151.9	157.9
Capital account	34.2	2.0	130.1	149.1
Financial account⁽¹⁾	372.0	-204.4	781.1	542.1

⁽¹⁾ Net lending (+) / net borrowing (-).

Source: National Statistics Office.

¹⁰ 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.

¹¹ 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.

The financial account showed net borrowing of €204.4 million, in contrast to net lending flows of €372.0 million the same period of 2014.

During the first nine months of the year, the current account surplus widened by €431.2 million to €733.3 million, as an increase in the deficit on the goods account was offset by improvements in the other components. At the same time, inflows on the capital account rose by €19.0 million, whereas net lending was €239.0 million lower than it was a year earlier.

More recently, the trade gap narrowed significantly in October, as exports increased slightly whereas imports fell significantly.¹² During the first ten months of the year the merchandise trade deficit narrowed by €90.0 million when compared with the same period of 2014, to €2,095.5 million. Although both imports and exports contracted, the former declined at a faster pace, largely mirroring a reduction in fuel transactions.

¹² Goods exports and imports in the balance of payments differ from merchandise trade 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

(annual percentage changes; non-seasonally adjusted data)

	2013	2014	2014	2014	2014	2015	2015	2015	2015	2015	2015	2015	2015	2015	2015	2015	2015	2015	2015	2015
			Q2	Q3	Q4	Q1	Q2	Q3	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	
Prices and costs																				
HICP	1.0	0.8	0.5	0.7	0.6	0.6	1.3	1.4	0.8	0.6	0.5	1.4	1.3	1.1	1.2	1.4	1.6	1.6	1.3	
Unit labour costs, whole economy ⁽¹⁾	1.1	1.5	1.5	1.6	1.5	1.4	0.4	-0.4	-	-	-	-	-	-	-	-	-	-	-	
Compensation per employee ⁽¹⁾	1.3	0.6	0.5	0.3	0.6	1.0	1.3	1.9	-	-	-	-	-	-	-	-	-	-	-	
Labour productivity (per person) ⁽¹⁾	0.2	-0.9	-1.0	-1.3	-0.9	-0.5	0.8	2.4	-	-	-	-	-	-	-	-	-	-	-	
Residential property prices	2.1	7.0	8.9	7.6	4.7	5.3	4.8	4.4	-	-	-	-	-	-	-	-	-	-	-	
Economic activity																				
Nominal GDP	5.9	5.9	4.7	5.3	8.1	7.2	8.1	8.0	-	-	-	-	-	-	-	-	-	-	-	
Real GDP	4.0	4.1	3.2	3.4	5.8	5.2	5.8	5.4	-	-	-	-	-	-	-	-	-	-	-	
Real private consumption	2.0	2.8	3.3	3.0	3.5	5.6	2.5	5.1	-	-	-	-	-	-	-	-	-	-	-	
Real government consumption	0.2	7.8	10.5	5.9	9.9	4.8	5.7	-5.4	-	-	-	-	-	-	-	-	-	-	-	
Real gross fixed capital formation	-0.2	7.6	-0.4	3.1	12.2	0.3	28.4	39.7	-	-	-	-	-	-	-	-	-	-	-	
Real exports of goods and services	0.8	0.0	1.1	-2.7	1.6	-0.3	4.3	3.4	-	-	-	-	-	-	-	-	-	-	-	
Real imports of goods and services	-0.8	-0.1	1.1	-4.1	3.6	-0.6	4.4	5.3	-	-	-	-	-	-	-	-	-	-	-	
Tourist arrivals	9.6	6.8	9.0	7.2	2.5	7.7	4.2	4.5	6.8	14.1	4.1	2.5	6.4	3.6	4.7	4.8	3.8	10.5	-	
Labour market developments (LFS)																				
Unemployment rate (% of labour force)	6.4	5.9	5.8	5.8	5.9	5.7	5.4	-	-	-	-	-	-	-	-	-	-	-	-	
Total employment	3.3	3.1	3.7	3.6	1.2	1.3	1.8	-	-	-	-	-	-	-	-	-	-	-	-	
Balance of payments																				
Current account (as a % of GDP) ⁽²⁾	3.6	3.9	4.5	3.8	3.9	5.7	6.5	8.7	-	-	-	-	-	-	-	-	-	-	-	
Credit and financial indicators																				
Maltese residents' deposits and loans																				
Overnight deposits	13.7	29.0	15.6	20.4	29.0	30.5	39.3	33.3	30.0	30.6	30.5	35.3	34.8	39.3	36.3	34.7	33.3	29.9	-	
Deposits with agreed maturity up to 2 years	2.8	-2.0	6.2	4.9	-2.0	-7.6	-8.4	-9.5	-6.1	-9.1	-7.6	-8.7	-7.7	-8.4	-8.1	-12.4	-9.5	-9.5	-	
Total residents' deposits in M3	8.8	17.2	11.8	14.4	17.2	16.2	21.6	18.3	16.2	15.2	16.2	18.8	19.1	21.6	20.1	17.3	18.3	16.4	-	
Credit to general government	8.3	0.8	9.2	0.3	0.8	1.2	3.7	10.0	2.4	0.6	1.2	1.7	3.7	3.7	6.6	7.3	10.0	8.5	-	
Credit to other residents	-0.2	-3.6	-3.4	-4.4	-3.6	-1.8	0.4	3.3	-3.2	-1.6	-1.8	-2.2	1.0	0.4	2.2	2.7	3.3	3.8	-	
Total credit	1.4	-2.7	-0.8	-3.4	-2.7	-1.1	1.1	4.8	-2.0	-1.1	-1.1	-1.4	1.6	1.1	3.2	3.8	4.8	4.8	-	
10-year interest rate (%) ⁽³⁾	3.2	1.9	2.8	2.3	1.9	1.2	2.0	1.5	1.5	1.4	1.2	1.3	1.5	2.0	1.6	1.7	1.5	1.3	1.2	
Stock prices: Malta Stock Exchange Index ⁽⁴⁾	14.8	-9.6	-3.7	1.1	-0.1	13.4	8.3	5.9	2.7	0.8	9.5	-0.2	2.9	5.5	2.9	0.0	3.0	0.1	3.1	
General government finances (% of GDP)																				
Surplus (+) / deficit (-) ⁽²⁾	-2.6	-2.1	-3.3	-2.8	-2.1	-2.5	-2.1	-	-	-	-	-	-	-	-	-	-	-	-	
Gross debt ⁽⁵⁾	68.5	66.9	73.5	70.9	66.9	68.5	67.4	-	-	-	-	-	-	-	-	-	-	-	-	

⁽¹⁾ Four-quarter moving averages.

⁽²⁾ Four-quarter moving sums.

⁽³⁾ End of period.

⁽⁴⁾ Period-on-period percentage changes.

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

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