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EUROSISTEMA
CENTRAL BANK OF MALTA

ECONOMIC UPDATE 11/2015

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ECONOMIC UPDATE 11/2015

Summary¹

Economic activity in Malta continued to expand robustly in the second quarter of 2015, with real gross domestic product (GDP) increasing by 5.2% on a year earlier. Growth was driven by domestic demand. Indicators for manufacturing and tourism point to further expansion in the third 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 are mildly increasing. The annual rate of inflation, based on the Harmonised Index of Consumer Prices (HICP), stood at 1.6% in October. Maltese residents' deposits continued to expand at a rapid annual rate in September, while the annual rate of growth of credit to residents accelerated further. 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 nine months of the year. On the external side, the current account of the balance of payments remained in surplus in the second quarter of 2015.

Output, demand and the labour market

Economic activity in Malta continued to grow strongly during the second quarter of 2015, with real GDP rising at an annual rate of 5.2%. This represents an acceleration from an upwardly-revised rate of 4.9% in the previous quarter (see Table 1).

During the quarter under review, growth was driven by domestic demand, which rose by 6.9% on a year earlier, almost double the increase in the previous quarter. The main driver was a rise in gross fixed capital formation, which grew sharply when compared with the second quarter of 2014. The other major components of final domestic demand also expanded. As a result, domestic demand contributed 6.5 percentage points to real GDP growth.

Gross fixed capital formation rose by 24.3% on a year earlier. This sharp rise in investment followed the slowdown registered in the previous quarter. Most of the increase in investment can

Table 1
GROSS DOMESTIC PRODUCT⁽¹⁾

Annual percentage changes

	2014			2015	
	Q2	Q3	Q4	Q1	Q2
Private final consumption expenditure	3.3	3.0	3.5	4.6	2.8
Government final consumption expenditure	10.7	5.2	9.0	3.9	5.0
Gross fixed capital formation	1.6	4.3	15.1	0.3	24.3
Domestic demand	3.7	3.6	10.0	3.6	6.9
Exports of goods and services	3.1	-3.1	0.5	-1.7	-1.2
Imports of goods and services	3.7	-3.6	3.6	-2.3	-0.3
Gross domestic product	2.8	3.1	4.8	4.9	5.2

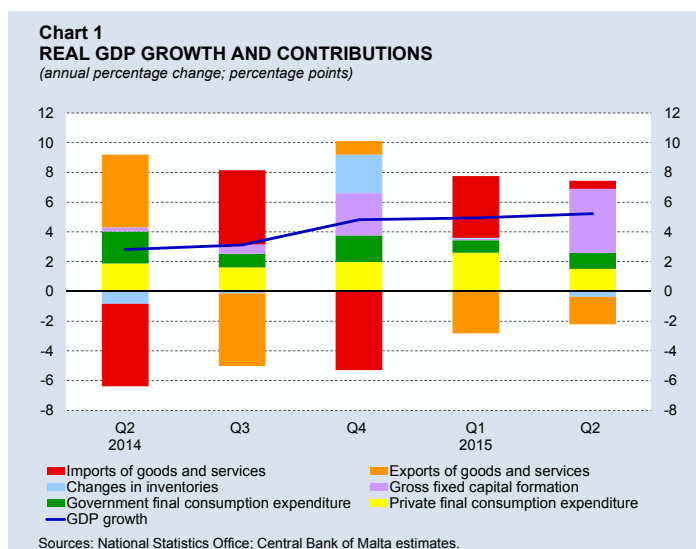
⁽¹⁾ Chain-linked volumes, reference year 2010.

Source: National Statistics Office.

¹ The cut-off date for information in this note is 23 November 2015.

be attributed to higher spending on machinery & equipment, although investment on dwellings and transport equipment also rose. Conversely, non-dwelling construction investment declined. Overall, investment contributed 4.3 percentage points to real GDP growth (see Chart 1).

In addition, government consumption rose at an annual rate of 5.0%, after having eased in the previous quarter, and contributed 1.1 percentage points to GDP growth. Both compensation of employees and, to a lesser extent, intermediate consumption rose on their year-ago levels.



Private consumption also went up on its year-ago level, sustained by continued, though slower, growth in employee compensation. At 2.8%, the annual growth rate of private consumption was weaker than in the previous quarter. However, private consumption still contributed 1.5 percentage points to GDP growth.

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

Exports dropped by 1.2% year-on-year, entirely owing to lower foreign sales of services, whereas goods exports increased. Imports fell by 0.3%, entirely due to a drop in services imports. As a result, net exports dampened real GDP growth by 1.3 percentage points.

Nominal GDP expanded at a faster pace in the second quarter of 2015, with the annual growth rate climbing to 7.3% compared with 7.0% in the first quarter of 2015. This reflected a pick-up in the annual rate of growth of gross value added (GVA), which increased to 7.7% from 6.3% in the previous quarter. Services continued to be the main contributor to GVA growth. In turn, the strongest contributions came from the sector incorporating professional and scientific activities and from that incorporating public administration, health and education. Robust contributions were also recorded from the sector comprising wholesale and retail trade. In addition, GVA increased substantially in utilities and manufacturing and, to a lesser extent, in the construction sector.

The available information for the third quarter of 2015 indicates continued growth in manufacturing and tourism.

As regards manufacturing, the index of industrial production rose by 3.5% in year-on-year terms in September 2015.³ During the third quarter as a whole, industrial production increased by 6.7%

² Changes in inventories include acquisitions and disposals of valuables as well as the statistical discrepancy. The contribution of changes in inventories to GDP growth is based on the Bank's calculations.

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

on a year earlier. The improvement in industrial production during the third quarter mostly reflected increased output in pharmaceuticals. Smaller increases were also recorded among firms producing food, beverages, rubber and plastic products, as well as in the energy and water supply sectors. In contrast, output fell among firms involved in the printing and reproduction of recorded material and in the manufacture of computer, electronic and optical products.

Turning to tourism, in September arrivals rose by 3.8% on a year earlier, while nights stayed and expenditure also increased. As a result, during the first three quarters of 2015, tourist numbers increased by 4.9% on a year earlier, while nights stayed and total spending went up by 4.4% and 6.6%, respectively. Although all major expenditure components increased on 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.

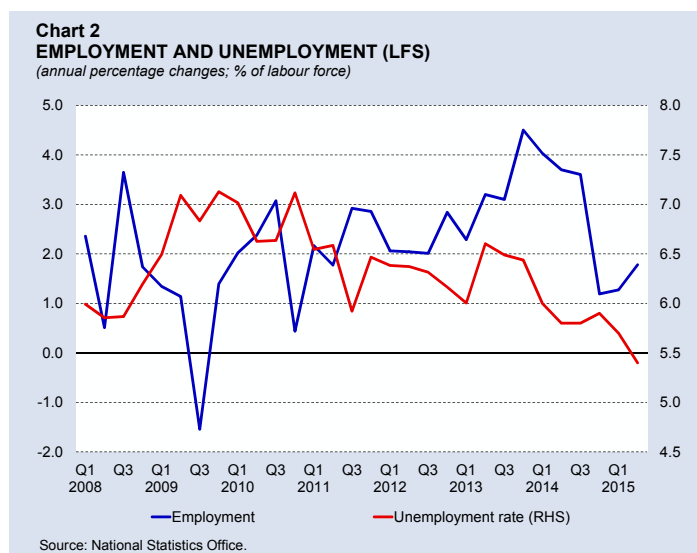
As regards the labour market, according to the Labour Force Survey (LFS) employment expanded by 1.8% during the second quarter of 2015 compared with a year earlier, following a 1.3% increase in the previous quarter (see Chart 2). The rise in the second quarter solely reflected growth in full-time employment, 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 May 2015 the gainfully occupied population rose by 4.2% on a year earlier, marginally down from 4.4% in April.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 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.

ETC data also show a further fall in the number of registered unemployed. In October 2015



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.

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 October, the annual rate of HICP inflation remained at 1.6%, unchanged on a month earlier. At 1.0%, the twelve-month moving average rate was also unchanged compared with September (see Chart 3).

Stability in the annual inflation rate largely reflected unchanged developments, compared to a month earlier, in most of the main components.

In October, both processed and unprocessed food price inflation remained unchanged on a month earlier, at 2.4% and 5.2%, respectively. The latter mainly reflected an increase in vegetable prices.

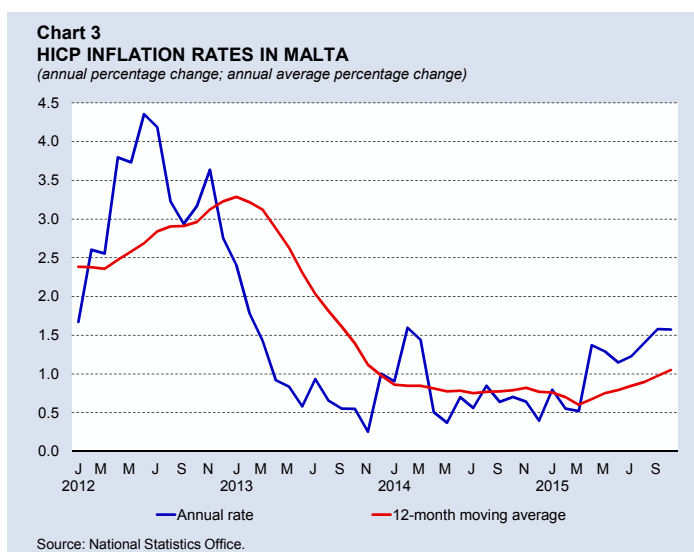
Services price inflation also remained stable in October, at 1.9%. Faster growth in the prices of recreational and personal services was offset by a stronger decline in the prices of communication services and slower increases in the prices of transport services.

Non-energy industrial goods inflation also remained unchanged at 1.2%, as a deceleration in furniture price inflation was offset by slower decrease in the prices of garments.

Meanwhile, energy prices declined by 4.9% on a year earlier, as against a 4.7% drop in September, mainly reflecting developments in gas prices.

As regards cost indicators, during the second quarter of 2015 Malta's unit labour costs (ULC), measured as a four-quarter moving average, increased by just 0.2% on a year earlier. This represents a slowdown in ULC growth compared to outcomes in recent quarters, and a marked drop from 1.1% in the first quarter. The deceleration was the result of a swing from negative to positive productivity growth. In the second quarter, productivity increased by 0.8% on a year earlier. Meanwhile, compensation per employee continued to increase, rising by 1.0%.

Based on the Central Bank of Malta's advertised property price index, the price of residential properties rose at an annual rate of 4.8% in the second quarter of 2015, following a 5.3% increase in the first quarter. The increase in house prices during the second quarter reflected movements in the prices of all major property types, except terraced houses. 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 September, residents' deposits forming part of broad money (M3) increased over August. Their annual growth rate accelerated to 18.3%, from 17.3% in August.

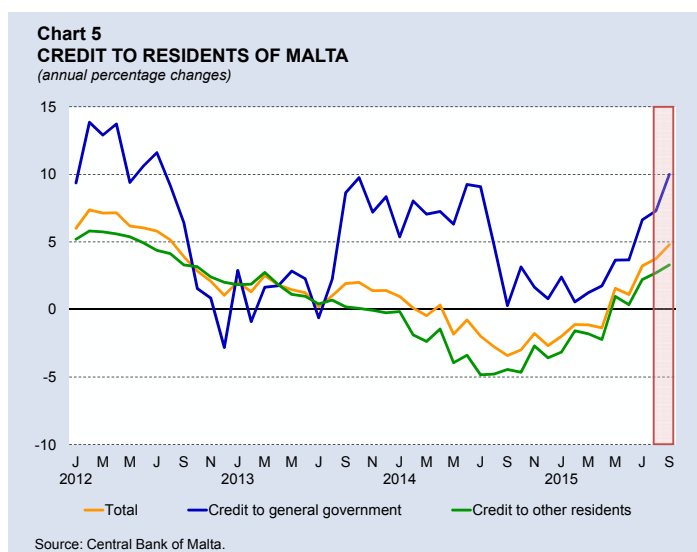
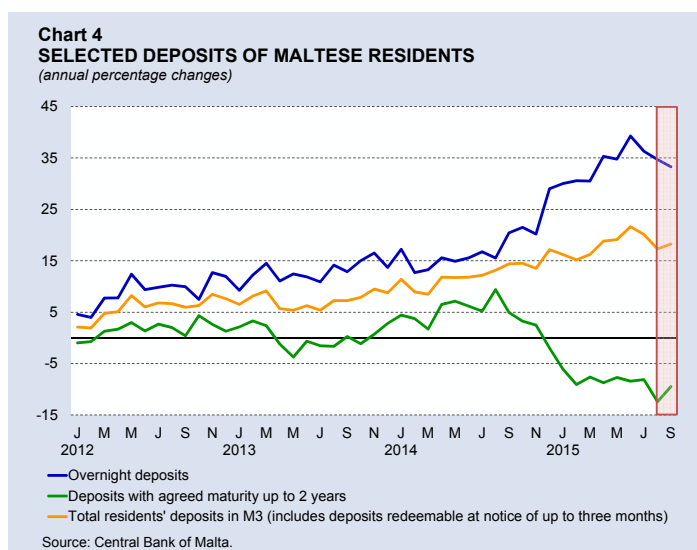
The year-on-year increase in deposits was supported by continued robust growth in overnight deposits (see Chart 4). These expanded by €264.8 million in September, partly reflecting the low opportunity cost of holding liquid assets in an environment of low interest rates. Nonetheless, their annual growth rate eased further following the peak recorded in June, falling to 33.3%.

Deposits with an agreed maturity of up to two years contracted for the fourth consecutive month in September, though the latest drop of €0.4 million was by far the smallest since June. This category of deposits also fell in annual terms. However, the negative annual rate of change eased from -12.4% in August to -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, turned positive in September, rising to 6.6%.

On the asset side of banks' balance sheets, credit to Maltese residents expanded further in September, going up by €118.4 million. Consequently, the annual rate of credit growth extended its upward trend, picking up to 4.8% from 3.8% in August, as both credit to general government and credit to other residents increased at a faster pace (see Chart 5).

The annual growth rate of credit to general government rose



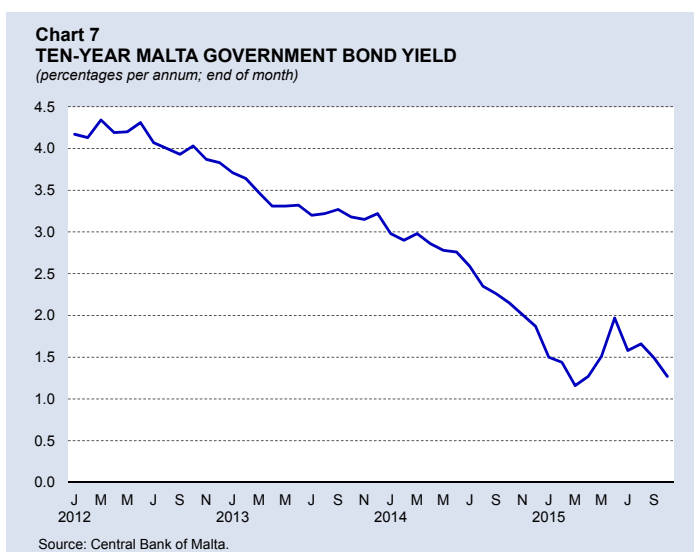
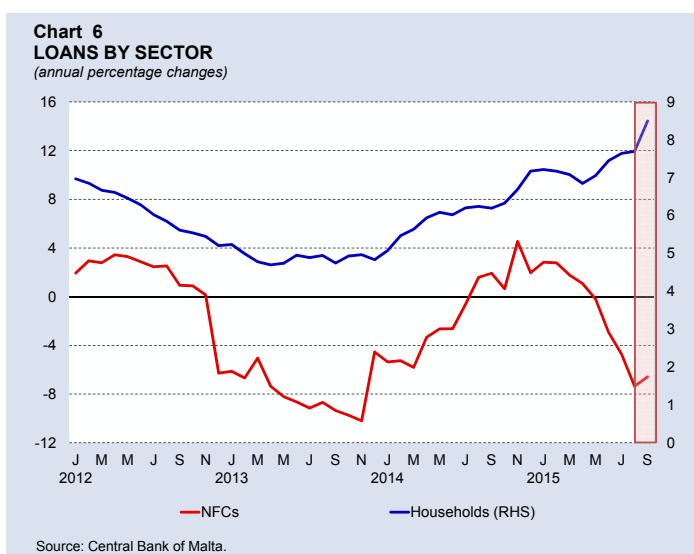
from 7.3% in August to 10.0% in September, as banks' holdings of government debt securities increased.

Meanwhile, credit to all other residents grew by 3.3% year-on-year, following an increase of 2.7% in the previous month.⁶ This acceleration reflected faster annual growth in loans to households and a weaker annual decline in loans to NFCs. The annual growth rate of loans to households reached 8.5% in September, from 7.7% in August. Growth in loans for house purchase continued to accelerate, offsetting a continued contraction in consumer and other credit. In contrast, following a 7.4% drop in the year to August, loans to NFCs contracted by 6.6% in the twelve months to September, reflecting a mildly positive monthly flow (see Chart 6). The annual decline mainly reflected developments in loans to NFCs in the transport, energy and construction sectors.

At the same time, loans to non-bank financial intermediaries continued to grow at a robust pace, with the annual growth rate standing at 16.3% in September.

Bank deposit rates fell marginally in September, with the composite interest rate paid by MFIs on all euro-denominated deposits belonging to resident households and NFCs dropping by 4 basis points to 0.76%. Meanwhile, the comparable rate charged on outstanding loans to them edged down by 2 basis points to 3.85%. As a result, the composite deposit rate was 38 basis points below its level in September 2014, while the corresponding lending rate went down by 21 basis points.

In the capital market, there were two issues of Malta Government Stocks in October as well as one corporate bond issue. In the secondary market, the yield on ten-year government bonds decreased again in October, falling by 22 basis points to 1.27% at the end of the month (see Chart 7). This movement was broadly in line with those in euro area



⁶ Figures exclude interbank lending.

benchmark yields. Meanwhile, equity prices rose slightly, with the Malta Stock Exchange (MSE) index gaining 0.1% in October.

Public finance⁷

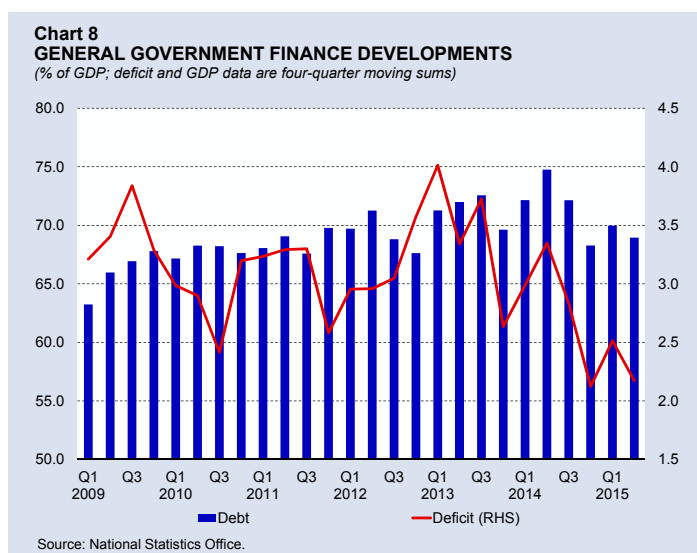
In the second quarter of 2015, the general government deficit narrowed by €24.4 million compared with the same period a year earlier, to €47.5 million. As a result, the deficit-to-GDP ratio, computed on the basis of four-quarter moving sums, fell to 2.2% from 2.5% in the previous quarter.

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.

In the second quarter of 2015, the general government debt-to-GDP ratio stood at 68.9% down from 70.0% in the previous quarter (see Chart 8).⁸

In September 2015 the Consolidated Fund deficit fell to €20.6 million from €74.0 million in September 2014. As a result, in the first nine months of 2015, the Consolidated Fund deficit narrowed by €122.3 million when compared with the same period last year, to €161.6 million. Revenue grew by 13.4% due to higher intakes from both direct and indirect taxes. Grants received also boosted non-tax revenue during the period under review. Total expenditure grew by 6.6%, mostly reflecting higher current spending.



⁷ 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.

⁸ These ratios are based on deficit and debt levels published in NSO News Release 191/2015 and GDP data published in NSO News Release 163/2015.

Balance of payments

During the second quarter of 2015, the surplus on the current account of the balance of payments widened by €67.0 million, to €246.1 million.⁹ This increase was driven by a swing of €100.5 million on the primary income component, as well as an increase of €88.5 million in net services receipts. These favourable developments were partly offset by a widening of €111.8 million in the merchandise trade deficit, and by a €10.2 million decrease in net secondary income inflows (see Table 2).¹⁰ At the same time, the capital account posted net inflows of €23.0 million, down from €66.6 million in the second quarter of 2014.

The financial account showed net lending of €536.3 million, markedly more than the €203.9 million in the comparable quarter of 2014.

During the first half of 2015, the current account surplus widened by €149.4 million to €222.8 million, as an increase in the deficit on the goods account was offset by improvements on the other components. At the same time, inflows on the capital account rose by €50.7 million, whereas net lending was €474.2 million higher.

Customs data indicate that in the third quarter of 2015 the visible trade gap narrowed by €325.4 million on a year earlier.¹¹ This improvement was entirely driven by a decline in imports, predominantly of fuels and of boats (including registrations), as exports edged down marginally on the comparable quarter of 2014.

Nevertheless, between January and September, the merchandise trade deficit widened by €184.6 million compared with the same period of 2014, to €2,049.2 million. Exports contracted, entirely due to lower re-exports of fuels, whereas imports remained broadly unchanged on a year earlier.

Table 2
EXTERNAL TRANSACTIONS

EUR millions

	2014 Q2	2015 Q2	2014 Q1-Q2	2015 Q1-Q2
Current account	179.1	246.1	73.5	222.8
Goods	-269.3	-381.1	-536.4	-634.9
Services	429.6	518.1	714.0	800.8
Primary income	-43.7	56.8	-195.4	-47.8
Secondary income	62.6	52.4	91.3	104.7
Capital account	66.6	23.0	96.2	146.9
Financial account⁽¹⁾	203.9	536.3	93.0	567.2

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

Source: National Statistics Office.

⁹ 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.

¹⁰ 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.

¹¹ 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																		
<i>(annual percentage changes, non-seasonally adjusted data)</i>																		
	2013	2014	2014	2014	2014	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.
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
Unit labour costs, whole economy ⁽¹⁾	2.1	1.3	1.7	1.7	1.3	1.1	0.2	-	-	-	-	-	-	-	-	-	-	-
Compensation per employee ⁽¹⁾	0.4	0.3	-0.1	-0.3	0.3	0.8	1.0	-	-	-	-	-	-	-	-	-	-	-
Labour productivity (per person) ⁽¹⁾	-1.6	-1.0	-1.9	-1.8	-1.0	-0.4	0.8	-	-	-	-	-	-	-	-	-	-	-
Residential property prices	2.1	7.0	8.9	7.6	4.7	5.3	4.8	-	-	-	-	-	-	-	-	-	-	-
Economic activity																		
Nominal GDP	4.6	5.4	4.4	4.9	7.0	7.0	7.3	-	-	-	-	-	-	-	-	-	-	-
Real GDP	2.6	3.5	2.8	3.1	4.8	4.9	5.2	-	-	-	-	-	-	-	-	-	-	-
Real private consumption	1.9	2.9	3.3	3.0	3.5	4.6	2.8	-	-	-	-	-	-	-	-	-	-	-
Real government consumption	0.2	7.5	10.7	5.2	9.0	3.9	5.0	-	-	-	-	-	-	-	-	-	-	-
Real gross fixed capital formation	-0.7	9.1	1.6	4.3	15.1	0.3	24.3	-	-	-	-	-	-	-	-	-	-	-
Real exports of goods and services	-0.2	-0.3	3.1	-3.1	0.5	-1.7	-1.2	-	-	-	-	-	-	-	-	-	-	-
Real imports of goods and services	-1.2	0.6	3.7	-3.6	3.6	-2.3	-0.3	-	-	-	-	-	-	-	-	-	-	-
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	-
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⁾	3.7	2.7	3.7	2.6	2.7	3.7	4.5	-	-	-	-	-	-	-	-	-	-	-
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	-
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	-
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	-
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	-
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	-
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	-
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
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
General government finances (% of GDP)																		
Surplus (+) / deficit (-) ⁽²⁾	-2.6	-2.1	-3.3	-2.8	-2.1	-2.5	-2.2	-	-	-	-	-	-	-	-	-	-	-
Gross debt ⁽⁵⁾	69.6	68.3	74.8	72.1	68.3	70.0	68.9	-	-	-	-	-	-	-	-	-	-	-

⁽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.