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EUROSISTEMA
CENTRAL BANK OF MALTA

Economic Update 1/2015

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ECONOMIC UPDATE 1/2015

As from January 2015, the Central Bank of Malta is issuing a monthly Economic Update, which will cover the latest macroeconomic and monetary developments in Malta. The Economic Update replaces, and expands upon, the Release of Monetary Statistics. It is available on the Bank's website.

Summary[1]

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 0.6% in November 2014. Maltese residents' deposits continued to expand robustly in both October and November. Credit contracted further, though at a slower pace than in previous months. As regards fiscal developments, the deficit on the Consolidated Fund narrowed between January and November. On the external side, the surplus on the current account of the balance of payments increased during the third quarter 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 robust 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

Table 1
GROSS DOMESTIC PRODUCT(1)

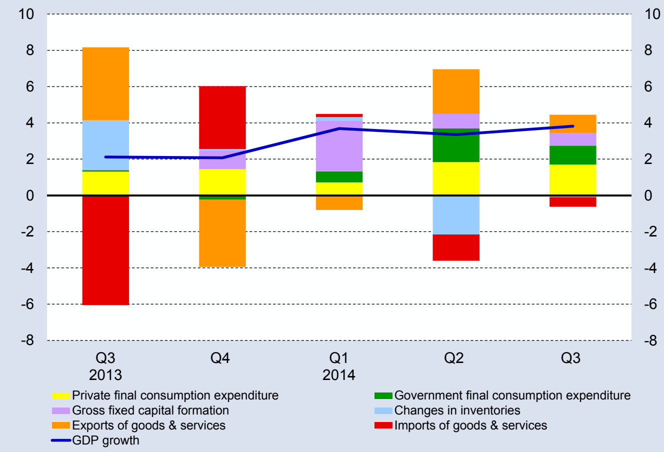
	2014			
	Q1	Q2	Q3	Q1-Q3
	Annual percentage changes			
Private final consumption expenditure	1.3	3.3	3.2	2.6
Government final consumption expenditure	2.7	9.2	5.9	6.0
Gross fixed capital formation	14.5	4.7	4.6	8.0
Domestic demand	**4.2**	**2.5**	**3.9**	**3.5**
Exports of goods & services	-0.4	1.6	0.7	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] Except as otherwise indicated, the cut-off date for information in this publication is 7 January 2015.

government consumption. Private consumption expenditure 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's wage bill, and contributed a further 1.0 percentage point to growth. Investment 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, while expenditure on machinery & transport equipment and information technology rose moderately.

Chart 1
REAL GDP GROWTH AND CONTRIBUTIONS
(annual percentage change; percentage points)



Sources: National Statistics Office; Central Bank of Malta calculations.

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 declined. The increase in merchandise imports was consistent with the expansion of aggregate demand.

In nominal terms, annual GDP growth accelerated to 5.3%, from 4.4% in the second quarter of 2014, whereas growth in gross value added (GVA) slowed down to 4.0% compared to 4.4% in the previous quarter. The difference between growth in GDP and in GVA largely reflects strong growth in revenues from taxes on products.

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, GVA in the utilities and construction sectors remained broadly stable, whereas manufacturing GVA decreased.

Looking beyond the third quarter of 2014, the available information points to a continued weak performance in manufacturing and sustained growth in tourism.

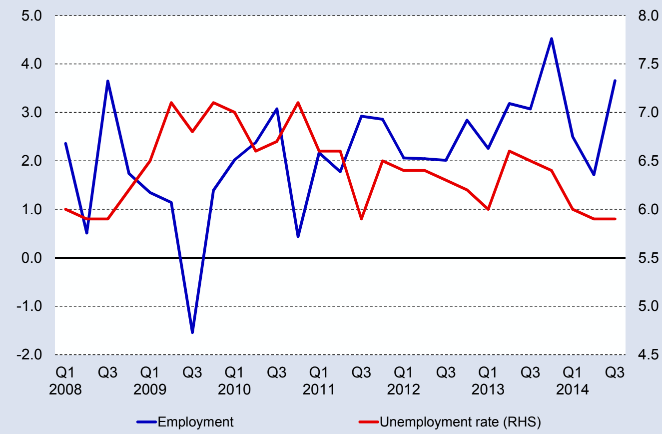
In fact, industrial production fell by 6.1%, on average, during the twelve months to October.[3] This mainly reflects strong declines in the first half of 2014.

Unadjusted data show that this decline was largely driven by lower output in the pharmaceutical sector, although production of textiles and computer, electronic & optical products also declined.

[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.

More moderate declines were recorded in the energy and wearing apparel sectors. In contrast, food production increased. Small increases were also recorded in the production of rubber & plastic products and in the repair and installation of machinery.

Chart 2
EMPLOYMENT AND UNEMPLOYMENT (LFS)
(annual percentage changes; % of labour force)



Source: Eurostat.

Turning to inbound tourism, arrivals increased at an annual rate of 3.0% in November 2014, with total nights spent up by 3.7%. At the same time, expenditure grew by 4.1% on a year earlier, reflecting increases in all main spending categories, particularly package holidays. Overall, between January and November 2014, the number of tourists increased by 7.0% over the same period of 2013, while nights spent and expenditure rose by 5.0% and 6.2%, respectively.

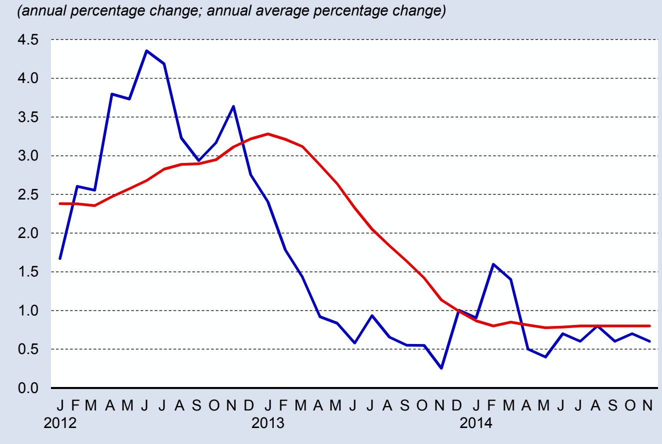
Growth in economic activity is being reflected in a positive labour market performance. Labour Force Survey (LFS) data for the third quarter of 2014 indicate an increase of 3.7% in employment compared with the same period of 2013. This followed a rise of 1.7% in the previous quarter (see Chart 2). ETC records show that in July the gainfully occupied population rose by 3.6% on a year earlier, as against 3.9% in June.

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 at 5.8% in November, unchanged over the previous month. ETC data show that in November the number of registered unemployed fell by 1,138 persons compared with a year earlier, to 6,501.

Prices, costs and competitiveness

In November, the annual rate of inflation, based on the Harmonised Index of Consumer Prices (HICP), edged down to 0.6%, from 0.7% a month earlier. Meanwhile, the twelve-month moving average inflation rate remained constant at 0.8%, unchanged since February (see Chart 3).

Chart 3
HICP INFLATION RATES IN MALTA
(annual percentage change; annual average percentage change)



Sources: National Statistics Office; Eurostat.

The marginal deceleration in annual inflation was driven by a slowdown in prices of non-energy industrial goods (NEIG), partly offset by a faster rise in food prices. The annual rate of change of prices of services and energy remained broadly similar between October and November.

The annual rate of change in NEIG prices slowed to 0.5% in November, from 1.2% a month earlier, mainly driven by developments in the prices of garments. In addition, services price inflation also decelerated marginally to 1.8%. This was largely the result of a decline in airfares, partly offset by an increase in communications prices.

On the other hand, food price inflation accelerated in November, as unprocessed food prices rose by 2.7% in annual terms, compared with a decline of 0.2% a month earlier. This swing was due to developments in the prices of fish & seafood, vegetables and fruit. In contrast, prices of processed food rose at an annual rate of 1.8% during the month under review, down marginally from 1.9% in the previous month. Lastly, energy prices continued to fall at an annual rate of 8.9% in November, unchanged from October.

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, as against a 1.3% rise in the previous quarter. This deceleration was the result of a smaller decline in productivity, which contracted by 0.4%, as opposed to a drop of 1.2% in the second quarter. This offset faster growth in compensation per employee, which rose by 0.7% in the June-September period, up from 0.2% in the previous quarter.

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 markets[4]

Residents' deposits with the banking system continued their rapid expansion, with their year-on-year growth rate peaking in October 2014 but then abating somewhat in November. As in previous months, deposit growth was driven by sharp increases in overnight deposits.

In October, deposits belonging to residents of Malta and held with resident Monetary Financial Institutions (MFIs) grew by €199.6 million, or 1.7%, on the previous month. Consequently, their annual growth rate edged up to 14.5% from 14.4% in September (see Chart 4).

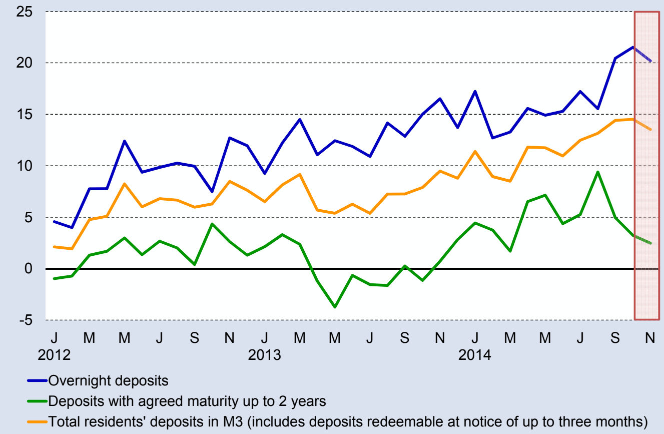
Deposit growth stemmed entirely from overnight balances, which expanded by €246.6 million, or 3.2%. The increase in overnight deposits was broad-based, with balances belonging to households, non-bank financial intermediaries and private non-financial corporations (NFC) rising. As

[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.

a result, the annual growth rate of overnight deposits accelerated to 21.5% from 20.4% in the previous month.

On the other hand, deposits with an agreed maturity of up to two years went down by €46.5 million, or 1.1%, following a drop in most economic sectors' balances. As a result, the annual growth rate of these deposits slowed down to 3.2% from 4.9% in September. At the same time, deposits redeemable at a notice of up to three months fell by €0.5 million, or 0.4%.

Chart 4
SELECTED DEPOSITS OF MALTESE RESIDENTS
(annual percentage changes)



Source: Central Bank of Malta.

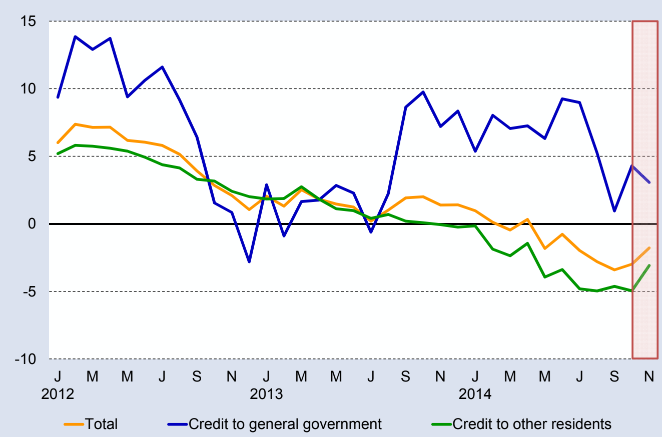
Moving on to November 2014, residents' deposits continued to grow rapidly, although at a slower pace than in the previous month. They added €72.8 million, or 0.6%, during the month, with balances belonging to households accounting for most of the increase. The annual rate of growth of residents' deposits slowed down, however, to 13.5% in November.

The slowdown in deposits mainly reflected slower annual growth in overnight deposits, which grew by 20.2% year-on-year. At the same time, the annual growth rate of deposits with an agreed maturity of up to two years fell to 2.5%. On the other hand, deposits redeemable at a notice of up to three months grew at an annual rate of 10.6% in November, up from 3.1% in October. However, in absolute terms, changes in this type of deposits were relatively small.

On the asset side of MFI balance sheets, credit to Maltese residents contracted by €34.3 million, or 0.3%, in October, despite an increase in credit to general government. Given that a larger contraction was recorded twelve months earlier, however, credit contracted at a slower annual pace. The annual rate of change rose from -3.4% in September to -3.0% in October (see Chart 5).

Credit to general government rose by €24.1 million, or 0.9%, between September and October, due to a rise in MFIs' holdings of Malta Government Stocks

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



Source: Central Bank of Malta.

(MGS), which exceeded a drop in their Treasury bill portfolios. The annual growth rate rose to 4.3%, from 0.9% in the previous month as a result.

Meanwhile, credit to all other residents, mainly borrowers in the private sector, went down by €58.5 million, or 0.6%, on the back of reduced lending to both public and private NFCs, particularly in the energy, accommodation and construction sectors. This outweighed a rise in loans to households. As a result, credit to other residents contracted at a faster pace during the year to October, falling by 5.0% as opposed to a 4.6% drop in the year to September.

In November, credit to residents increased by €113.1 million, or 1.0%, as a sharp rise in credit to other residents during the month offset a contraction in credit to government. Consequently, credit contracted at a slower pace, falling at an annual rate of 1.8%, following a 3.0% drop in October.

Credit to all other residents reversed the drop registered in October, going up by €178.0 million, or 2.0%, during the month. Nevertheless, it still contracted by 3.1% on a year earlier. This year-on-year contraction mainly reflects a drop in credit granted to "other financial intermediaries", which include special purpose entities (SPEs). In contrast, loans to non-financial corporations picked up, with the annual rate of change rising from -0.1% in October to 3.6% in November (see Chart 6). This reflected faster growth in lending to the wholesale & retail trade and the transport & storage sector, among others. At the same time, loans to households continued to increase, rising by 6.7% on a year earlier, up from 6.3% in the previous month.

On the other hand, the annual rate of growth of credit to general government eased to 3.1% in November, from 4.3% in October. The slowdown reflected lower growth in MFIs' holdings of MGS.

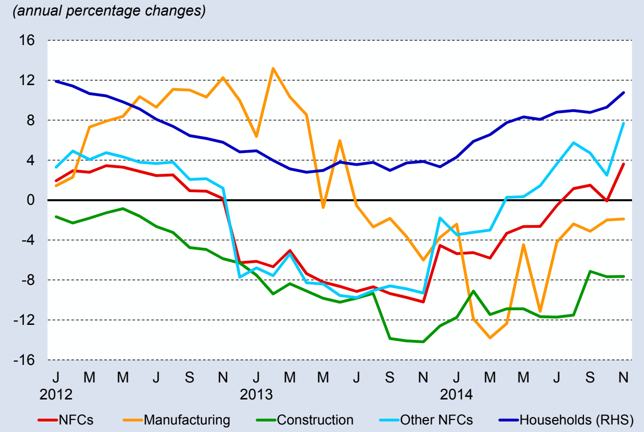
Bank lending and deposit rates edged down. In November the weighted average interest rate paid by MFIs on all euro-denominated deposits belonging to resident households and NFCs stood at 0.94%, 17 basis points below its October level and 46 basis points less than a year earlier.

The weighted average interest charged by MFIs on outstanding loans to resident households and NFCs fell by 2 basis points in November, to 4.03%. At this level, it was 22 basis points less than in November 2013.

In the domestic capital market, the yield on ten-year government bonds decreased further (see Chart 7). It stood at 1.87% as at end-December, down from 2.01% at end-November and from 2.26% at the end of September.

Equity prices moved in a narrow range. The Malta Stock Exchange Index increased

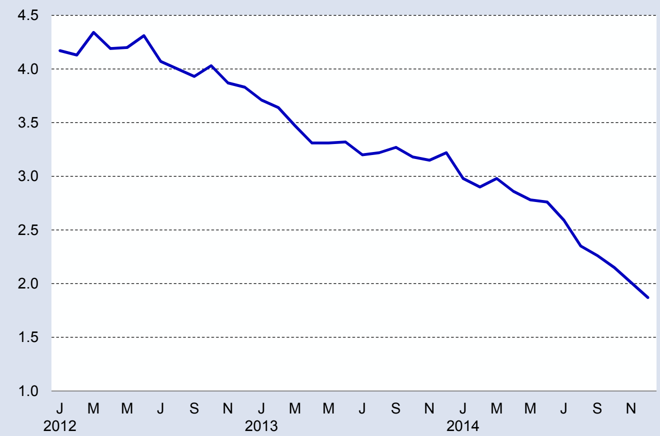
Chart 6
LOANS BY SECTOR[1]
(annual percentage changes)



[1] Data on overall NFC loans are consistent with those published on 8 January 2015. However, sector data differ from those published on this date, as they take into account more recent information.
Source: Central Bank of Malta.

marginally in December, rising by 1.8% to 3,331.1 by 30 December. This rise follows two consecutive monthly drops of 0.9% each in October and November.

Chart 7
TEN-YEAR MALTA GOVERNMENT BOND YIELD
(percentages per annum; end of month)



Source: Central Bank of Malta.

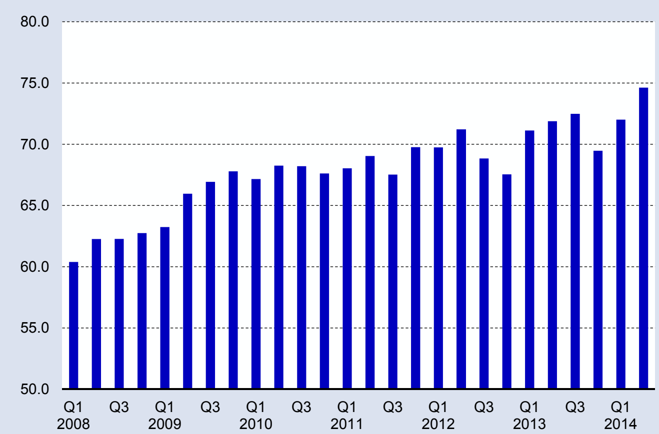
Public finance[5]

Recent data for the Consolidated Fund 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 latest estimates, as presented in the Budget Speech in November 2014, the deficit on the Consolidated Fund is expected to narrow to €75.5 million during 2014. At the same time, the general government deficit is expected to be brought down to 2.1% of GDP. It is set to decline further to 1.6% of GDP in 2015.

Chart 8
GENERAL GOVERNMENT DEBT
(% of GDP; GDP data are four-quarter moving sums)



Source: National Statistics Office.

The general government debt-to-GDP ratio, measured on a four-quarter sum basis, stood at 74.6% by end-June 2014 (see Chart 8). The Government expects this ratio to fall to 70.1% in 2014, before declining to 69.0% in 2015.

[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.

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

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.

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 on the back of increased payments for transport services, which outweighed increased 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 months 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.

The picture that emerges from the balance of payments is not reflected in Customs data, which track Malta's cross-border trade. Between January and October 2014 the merchandise trade deficit stood at €2,149.0 million as against €1,622.4 million in the same months of 2013. Exports declined, predominantly due to lower foreign sales of electrical machinery, though other categories such as pharmaceuticals also fell. On the other hand, imports rose, with the increase being driven by fuels and by purchases (including registrations) of ships and boats.

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.

[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.

[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.

Annex 1

MACROECONOMIC INDICATORS FOR MALTA

(annual percentage changes; non-seasonally adjusted data unless otherwise indicated)

	2013	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 July	2014 Aug.	2014 Sep.	2014 Oct.	2014 Nov.
Prices and costs										
HICP	1.0	0.6	1.3	0.5	0.7	0.6	0.8	0.6	0.7	0.6
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	-	-	-	-	-
Industrial production excluding construction(2)	-5.1	-5.1	-6.0	-7.4	-7.2	-6.2	-6.7	-7.2	-6.1	-
Tourist arrivals	9.6	13.4	7.9	9.0	7.2	8.5	7.7	5.1	2.7	3.0
Labour market developments (LFS)										
Unemployment rate (% of labour force)	6.4	6.4	6.0	5.9	5.9	6.1	6.0	5.9	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	13.7	13.3	15.3	20.4	17.2	15.5	20.4	21.5	20.2
Deposits with agreed maturity up to 2 years	2.8	2.8	1.7	4.4	4.9	5.3	9.4	4.9	3.2	2.5
Total residents' deposits in M3	8.8	8.8	8.5	11.0	14.4	12.5	13.2	14.4	14.5	13.5
Credit to general government	8.3	8.3	7.1	9.2	0.9	9.0	5.2	0.9	4.3	3.1
Credit to other residents	-0.2	-0.2	-2.4	-3.4	-4.6	-4.8	-5.0	-4.6	-5.0	-3.1
Total credit	1.4	1.4	-0.5	-0.8	-3.4	-2.0	-2.8	-3.4	-3.0	-1.8
10-year interest rate (%)(3)	3.36	3.21	3.01	2.87	2.49	2.66	2.49	2.32	2.18	2.11
Stock prices: Malta Stock Exchange Index(4)	14.8	7.8	-7.1	-3.7	1.1	2.8	-2.8	1.1	-0.9	-0.9
General government finances (% of GDP)										
Surplus (+) / deficit (-)(5)	-2.7	-2.7	-2.9	-3.2	-	-	-	-	-	-
Gross debt(6)	69.5	69.5	72.0	74.6	-	-	-	-	-	-

(1) Four-quarter moving averages.
(2) Working day adjusted, twelve-month moving averages.
(3) Period averages.
(4) Period-on-period percentage changes.
(5) Four-quarter moving sums.
(6) GDP data are four-quarter moving sums.
Sources: Central Bank of Malta; European Commission; Malta Stock Exchange; National Stastics Office.