BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

Economic Projections For 2014 And 2015

Article published in the Quarterly Review 2014:3, pp. 77-81

7. ECONOMIC PROJECTIONS FOR 2014 AND 2015

Outlook for the Maltese economy[1]

The Bank's latest macroeconomic projections indicate that the Maltese economy will expand at a faster pace than in 2013 in both 2014 and 2015. Thus, real gross domestic product (GDP) growth is set to accelerate from 2.5% in 2013 to 3.0% in 2014, before easing slightly to 2.8% in 2015 (see Table 7.1). Compared with the Bank's previous projections, which were issued in June, GDP growth has now been revised upwards for both years.[2]

Thus, in 2014 economic growth is 0.7 percentage point higher than in the previous exercise, which saw GDP expanding by 2.3%. This upward revision is largely driven by outcomes for the first half of the year, when the Maltese economy expanded by 3.2% on the corresponding period of 2013. The contribution from domestic demand is now expected to be stronger, largely reflecting greater than expected government expenditure on consumption and investment. The forecast for private consumption has also been revised upwards, reflecting a higher estimate of disposable income than envisaged earlier. In contrast, the projection for exports is revised downwards compared with the previous exercise, reflecting the decline in exports evidenced by international trade data for 2014 to date, as well as the deteriorating outlook for growth in Malta's main trading partners.

These developments by and large also explain the upward revision in GDP growth for 2015. However, in the latest exercise, growth is set to decelerate slightly in the coming year, rather than accelerate as foreseen earlier. This is because the pick-up in investment is expected to be more gradual, given the strong increase that has been recorded in the first half of the current year and the Bank's view that work on large projects in the energy sector commencing this year will likely extend into 2016.

Domestic demand

The Bank expects economic growth in 2014 and 2015 to be driven by domestic demand, particularly private consumption and investment. Government consumption is expected to decline in 2015, while government investment is projected to rise. Net exports are set to dampen growth in both years, while changes in inventories, which include the statistical discrepancy, are assumed to have a broadly neutral impact on growth.

Private consumption is projected to increase by 2.6% in 2014, before accelerating to 3.1% in 2015, supported by disposable income growth. In turn, the latter is supported by a buoyant labour market and a further reduction in income tax rates for households.

Government consumption is expected to expand in 2014 on the back of higher spending on intermediate consumption and compensation of employees. While expenditure on these items is expected to rise further in 2015, receipts in connection with the Individual Investor Programme (IIP) are expected to offset this increase, resulting in a contraction of government

---

1 The Bank's outlook for the Maltese economy is based on information available up to 19 November 2014 and is conditional on the technical assumptions shown in Table 7.1, which are provided by the European Central Bank. For the first time, these projections are based on ESA 2010 data.

2 See *Quarterly Review* 2014:1, Central Bank of Malta, pp. 66-70.

Table 7.1
PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES FOR MALTA

	2013[1]	2014[2]	2015[2]
Real economic activity (% change)			
GDP	2.5	3.0	2.8
Private consumption expenditure	1.7	2.6	3.1
Government consumption expenditure	0.5	4.2	-0.7
Gross fixed capital formation	2.2	6.6	7.8
Exports of goods & services	-1.6	-1.0	3.4
Imports of goods & services	-1.7	-0.7	3.6
Contribution to real GDP growth (in percentage pts)[3]			
Final domestic demand	1.4	3.5	3.0
Net exports	0.0	-0.4	-0.2
Changes in inventories[4]	1.1	-0.1	0.0
Real disposable household income[5]	2.7	3.5	3.5
Household saving ratio[5]	9.3	10.1	10.5
Balance of payments (% of GDP)			
Goods and services balance	5.7	5.9	5.9
Current account balance	3.1	3.1	2.9
Labour market (% change)			
Total employment	3.8	2.4	1.9
Unemployment rate (% of labour force)	6.3	5.7	5.8
Prices and costs (% change)			
RPI	1.4	0.1	0.8
Overall HICP	1.0	0.8	1.3
HICP excluding energy	1.1	1.5	1.7
Compensation per employee	-0.3	2.4	1.5
ULC	0.9	1.8	0.7
Public finances (% of GDP)			
General government balance	-2.7	-2.3	-1.9
General government debt	69.8	69.5	68.6
Technical assumptions			
EUR/USD exchange rate	1.33	1.33	1.25
Oil price (USD per barrel)	108.8	101.2	85.6

(1) Data on GDP were sourced from NSO *News Release* 195/2014 published on 17 October 2014. Data on the current account balance were sourced from NSO *News Release* 176/2014.
(2) Central Bank of Malta projections.
(3) The contributions to GDP growth in this Table are estimated using chainlinked GDP expenditure aggregates.
(4) Based on Central Bank of Malta estimates.
(5) Data for 2013 are Central Bank of Malta estimates.

consumption. This is because revenue from this programme is netted from government consumption expenditure.[3]

Investment is set to accelerate in 2014, largely driven by government investment. It is expected to gather momentum in 2015, boosted by private investment.

3 The IIP allows non-Maltese high net-worth individuals to obtain Maltese citizenship against a number of conditions. These include the payment of a registration fee and the purchase (or rental) of residential property in Malta.

Government investment is set to surge in 2014 following a contraction in 2013. Its projected rise in 2015 will be less pronounced, as infrastructure projects carried out under the EU financing programme 2007-2013 approach completion.

Private investment growth is set to moderate to 4.3% in 2014, from 4.9% in 2013, before picking up to 8.5% in 2015. A major project underpinning private capital expenditure is the new gas-fired power plant, which is expected to gather pace in 2015 and be completed in the following year. Private dwelling investment is expected to contract in 2014, in line with developments in the first half of the year. In 2015 it is set to grow moderately, in response to a recovery in the number of building permits granted in the third quarter of 2014 and expectations that robust foreign demand for property in Malta will support investment in the luxury segment of the market.

Net exports

After having contracted by 1.6% in 2013, exports are expected to drop by a further 1.0% in 2014, mainly on account of continued weakness in manufacturing exports, particularly semiconductors. Service exports, apart from those related to tourism, are also expected to decline. In contrast, the tourism sector is set to remain buoyant.

Export growth is set to turn positive in 2015 as external demand improves and the sale of manufacturing goods and non-travel services recovers. In 2015 service exports are also expected to be supported by inflows related to the IIP. Moreover, the tourist sector is set to continue to expand, driven by the opening of new airline destinations and additions in tourist accommodation capacity. Largely mirroring developments in exports, imports are also set to decline in 2014, before increasing in 2015, as purchases of imports for the manufacturing sector increase and spending on capital goods is boosted by the construction of the gas power station.

The balance of payments

The surplus on external trade in goods and services is expected to increase slightly above its 2013 level to 5.9% of GDP in 2014, remaining unchanged in the subsequent year. The improved balance reflects an increase in the surplus on services, which offsets a deterioration in the deficit on goods.[4]

The current account balance is expected to remain in surplus over the projection period, though it is expected to decline slightly as a share of GDP. This is due to the fact that a projected increase in net outflows on the primary income account exceeds the improvement in the balance on goods and services.

The labour market

Following a strong increase in 2013, employment is projected to grow at a slower rate in 2014, in line with the moderating trend in private sector employment that emerged in the first half of the year. Employment growth in both the government and private sector is set to decelerate in 2015, as the GDP growth rate slows down.

In 2014 compensation per employee is expected to recover after the decline in 2013. Wages are expected to rise in the private sector and more strongly in the general government sector. In 2015

[4] Data on the trade balance used in this Chapter are consistent with NSO *News Release* 195/2014 and with projections for real exports and imports reported in Table 7.1. The current account projections are based on balance of payments data published in NSO *News Release* 176/2014.

the rate of growth in wages is set to decelerate, partly reflecting the low cost-of-living adjustment foreseen for that year, in response to the very low inflation environment that characterised 2014.

Unit labour cost (ULC) growth is expected to increase substantially in 2014, despite a recovery in productivity, driven by the strong increase in compensation per employee. ULC growth is then expected to fall in 2015, following further gains in productivity and more modest increases in wages.

In line with trends observed in the first half of 2014, the unemployment rate is expected to drop significantly to 5.7%, from 6.3% a year earlier. In 2015 it is expected to increase slightly to around 5.8%, as pressures on the labour market moderately subside in the context of a decelerating rate of GDP growth, and given the exceptionally low level expected over 2014.[5]

Fiscal developments

The general government deficit-to-GDP ratio is expected to narrow from 2.7% in 2013 to 2.3% in 2014 and to 1.9% in 2015.

The decline in the deficit in 2014 is expected to be driven by higher levels of VAT receipts and social security contributions, the latter reflecting the dynamism of the labour market. The increases in excise duties introduced at the beginning of the year are also set to contribute to the rise in government revenue. At the same time, equity injections to the national airline are set to be substantially lower than in 2013.

In 2015 the deficit-to-GDP ratio is set to decline further as the increase in expenditure on wages moderates in response to slower growth in public sector employment, while intakes from the IIP dampen the impact of expenditure growth. Additional increases in excise taxes following the 2015 Budget are expected to boost revenue.[6]

Prices

The annual average rate of inflation, measured by the Harmonised Index of Consumer Prices (HICP), is set to ease to 0.8% in 2014, before picking up to 1.3% in 2015.

The inflation projections are influenced by the technical assumptions reported in Table 7.1, which include a decline in the price of oil in US dollars. Although the exchange rate of the euro is assumed to weaken over the projection horizon, oil prices are set to decline in euro terms.

The deceleration in inflation in 2014 is projected to be driven by slower growth in food prices and by the reduction in utility tariffs for consumers that took effect at the end of March. In contrast, the contributions of non-energy industrial goods and services to inflation are expected to rise, as shown by an acceleration in the annual rate of change of HICP excluding energy.

The increase in overall HICP inflation envisaged in 2015 is largely driven by expectations of a continued pick-up in the prices of services. At the same time, energy inflation is expected to have

[5] In the Bank's projection exercise, the unemployment rate is computed as the ratio of the number of unemployed reported in the Labour Force Survey (LFS) to a measure of the labour force based on the LFS and national accounts data. For this reason, references to the unemployment rate in this Box may differ from those mentioned elsewhere in this *Report*.

[6] The Bank's fiscal projections may differ from those of Government due to differences in the underlying macroeconomic projections and different assessments about the impact of fiscal measures.

less of a negative impact on inflation as the effects of the reduction in energy tariffs for households begin to fade. Food price inflation and non-energy industrial goods inflation are projected to increase marginally.

The latest inflation projections have been revised downwards compared with those issued in the previous exercise, mainly reflecting the weaker than expected trend in food prices up to September 2014, and the lower prices for oil and other international commodities seen in recent months.

Risks to the projections

Risks to the GDP growth projections are balanced. Downside risks relate to the fragility of the global economic recovery and its implications for external demand, particularly if sluggish growth in the euro area persists longer than expected. Exports could also be lowered if the envisaged recovery in the semiconductors industry does not materialise and the situation in the Southern Mediterranean exerts a more negative impact on the Maltese economy than assumed in these projections. Upside risks relate to the possibility of private consumption increasing more strongly than expected, in view of continued strong growth in employment and wages, and to the possible impact of a weaker euro exchange rate on exports.

Risks to the inflation projections are broadly balanced. On the one hand, a prolongation of the currently weak inflation environment in Malta's main trading partners could translate into weaker import prices that may feed into lower consumer prices domestically. On the other hand, a weakening of the euro exchange rate could result in upward pressures on prices.