BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

Economic Update 3/2015

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ECONOMIC UPDATE 3/2015

Summary[1]

Economic activity in Malta continued to expand robustly in the fourth quarter of 2014, with real gross domestic product (GDP) increasing by 4.0% on a year earlier, driven entirely by domestic demand. Growth in economic activity is being reflected in the labour market, with employment expanding and the unemployment rate remaining at historically low levels. Price pressures remain contained, with the annual rate of inflation standing at 0.8% in January 2015. Maltese residents' deposits continued to expand in January, 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, while in January 2015 it posted a surplus compared to a deficit a year earlier. 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 at a steady pace during 2014, with real GDP growth rising to 3.5% in the year as a whole.

The pace of activity was particularly strong in the fourth quarter, when real GDP growth accelerated to 4.0% on an annual basis, from 3.7% in the previous quarter. All the major domestic demand components increased robustly during the fourth quarter. However, with exports falling and imports rising, net exports contributed negatively to GDP growth (see Table 1).

Looking closer at the components of domestic demand, during the fourth quarter the largest contributor remained investment. Gross fixed capital formation rose by 16.5% on an annual basis and contributed 3.0 percentage points to overall GDP growth (see Chart 1). Around three-fourths of the increase in investment was driven by non-residential construction.

Table 1
GROSS DOMESTIC PRODUCT(1)

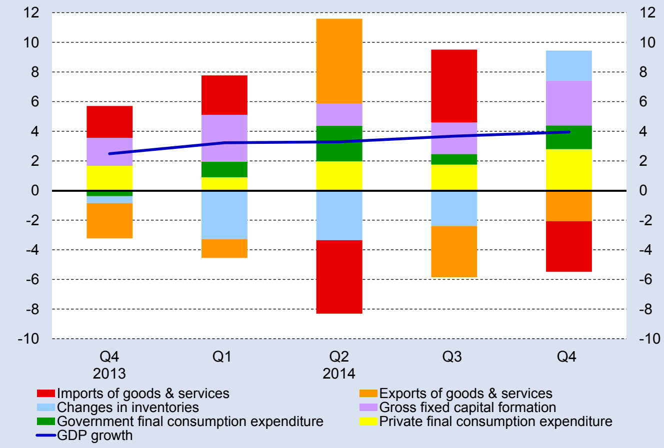
	2014				
	Q1	Q2	Q3	Q4	2014
	Annual percentage changes				
Private final consumption expenditure	1.5	3.5	3.2	5.0	3.4
Government final consumption expenditure	4.8	12.1	4.0	8.3	7.3
Gross fixed capital formation	16.5	8.5	14.1	16.5	14.0
Domestic demand	**1.8**	**2.6**	**2.5**	**10.2**	**4.3**
Exports of goods & services	-0.7	3.7	-2.2	-1.5	-0.2
Imports of goods & services	-1.3	3.3	-3.5	2.3	0.1
Gross domestic product	**3.2**	**3.3**	**3.7**	**4.0**	**3.5**

(1) Chain-linked volumes; reference year 2010.
Source: National Statistics Office.

[1] The cut-off date for information in this note is 9 March 2015.

Both private and government consumption supported economic activity, and gathered momentum over the third quarter. Private consumption increased by 5.0% on a year earlier, and boosted real GDP growth by 2.8 percentage points. Government consumption went up by 8.3%, reflecting increases in both intermediate consumption and compensation of employees. It contributed a further 1.6 percentage points to growth.

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



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

Contrary to outcomes in the previous four quarters, changes in inventories increased on a year earlier, adding an estimated 2.0 percentage points to GDP growth.[2]

The impact of strong domestic demand growth on real GDP during the fourth quarter of 2014 was partly dampened by net exports. These decreased during the quarter reviewed as imports increased and exports dropped. Imports expanded at an annual rate of 2.3%, entirely driven by goods, as imports of services declined. Customs data indicate that the increase in merchandise imports was mainly due to an increase in capital goods, reflecting buoyant investment spending. Exports were down by 1.5% in annual terms, reflecting drops in both goods and services exports. As a result, net exports lowered GDP growth by 5.5 percentage points.

In nominal terms, annual GDP growth reached 5.8%. From a sectoral perspective, services continued to drive the expansion in gross value added (GVA) during the fourth quarter of the year. In particular, strong contributions came from the sectors incorporating wholesale & retail trade; public administration, health & education; as well as professional & scientific activities. Gross value added in the construction and manufacturing sectors remained broadly stable, whereas GVA in utilities increased marginally on a year earlier.

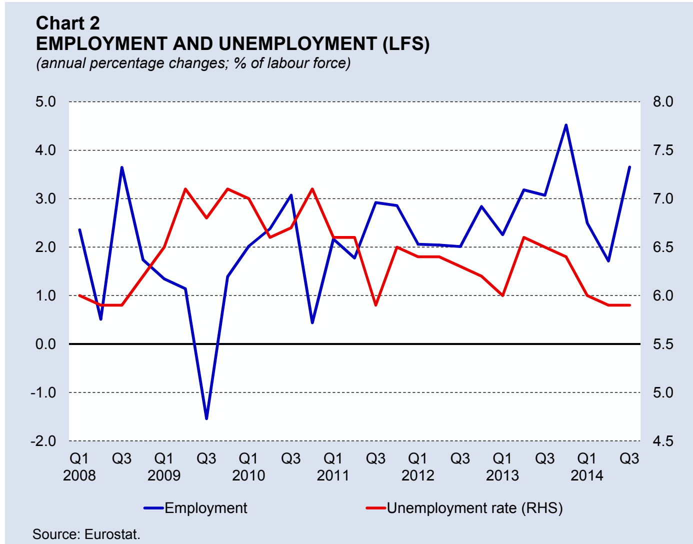
Information on industrial production for the fourth quarter of 2014 points to a weak, though improving, performance in manufacturing. In fact, industrial production rose modestly in the final quarter of the year, adding 0.8% on a year earlier.[3] Production of food, pharmaceuticals and rubber & plastic products increased, whereas output in the textiles and energy sectors fell.

As regards tourism, 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%.

The positive performance of the tourism industry extended into 2015. Tourist arrivals rose at an annual rate of 6.8% in January 2015, with total nights spent going up by 5.4%. At the same time,

[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.

expenditure grew by 8.8% on a year earlier, mainly reflecting increased spending on package holidays.



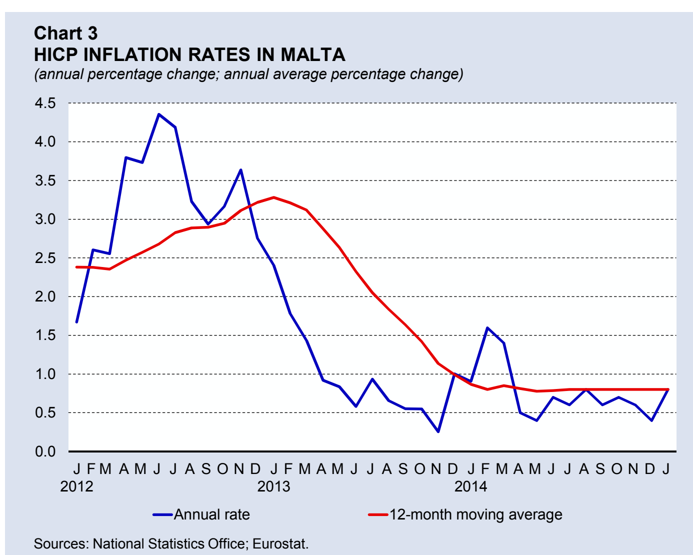
Growth in economic activity is being reflected in a positive labour market performance. Labour Force Survey (LFS) data for the third quarter of 2014 indicate an increase of 3.7% in employment compared with the same period of 2013. This followed a rise of 1.7% in the previous quarter (see Chart 2). ETC records show that in October the gainfully occupied population rose by 3.8% on a year earlier, following a 4.1% increase in September.

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 edged down to 5.8% in December, but rose to 6.0% in January 2015.

ETC data show that in January 2015 the number of people on the unemployment register fell by 1,405 compared with a year earlier, to 6,384.

Prices, costs and competitiveness

In January, the annual rate of HICP inflation, while still at a very low level, picked up to 0.8%, from 0.4% in December. Meanwhile, the twelve-month moving average inflation rate remained constant at 0.8%, unchanged since February 2014 (see Chart 3).



This acceleration in the annual rate of HICP inflation in January was mainly due to the food and services components, partly offset by drops in energy and non-energy industrial goods (NEIG).

The annual rate of change in food prices rose to 2.5% in January, up significantly from 0.5% a month earlier. Unprocessed food price inflation surged to 4.1%, from -0.8% in December, largely reflecting developments in the prices of vegetables. Processed food inflation also picked up, rising to 1.6% in January from 1.2% in the month before. This was mostly on the back of movements in tobacco prices, as the effect of the latest rise in excise duty continued to feed in. Services price inflation also picked up in January, rising to 2.2%, from 1.8% in December, largely driven by prices for transport services.

On the other hand, energy prices fell further in January, as diesel and petrol prices were reduced. As a result, energy prices contracted by 10.0% on a year earlier, compared with a decline of 8.9% in December. Meanwhile, NEIG price inflation slowed down marginally, from 0.8% to 0.6% in the month under review, mainly reflecting developments in the prices of garments.

Unit labour costs (ULC) are an indication of domestic cost pressures. During the fourth quarter of 2014, Malta's ULC, measured as a four-quarter moving average, increased by 1.5% on a year earlier. The increase was the result of higher compensation per employee, which was up by 0.9%, coupled with a drop of 0.6% in labour productivity.

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%, compared with 8.9% in the previous quarter. This marks the fourth consecutive quarter of strong growth in advertised prices. Such prices, however, may not accurately reflect the actual prices at which sales are concluded.

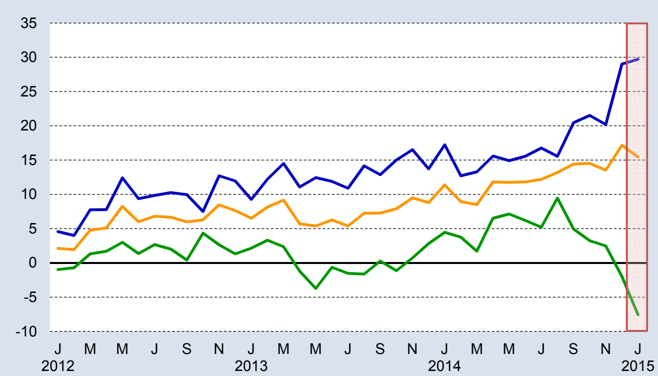
Deposits, credit and financial markets[4]

Residents' deposits held with Monetary Financial Institutions (MFI) grew at a slower rate in January. Deposits forming part of broad money (M3) grew by €198.8 million, or 1.6%, on the previous month. The annual growth rate of these deposits slowed down to 15.4%, from 17.1% in December (see Chart 4).

Deposit growth stemmed from overnight deposits, which expanded by €299.9 million, or 3.6%, on the previous month. The increase mainly reflected higher balances belonging to households and non-bank financial intermediaries. Consequently, the annual growth rate of overnight deposits rose from 29.0% in December to 29.7% in January.

On the other hand, deposits with an agreed maturity of up to two years decreased by €100.4 million, or 2.6%. The drop was

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

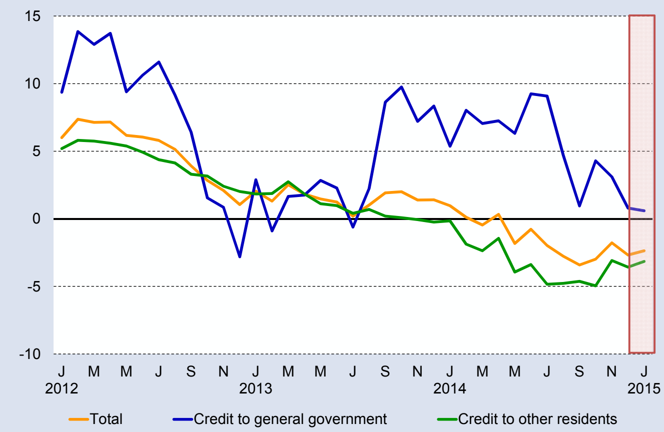


Source: Central Bank of Malta.

[4] Monetary data for the period from June 2010 onward have been revised to comply with ESA 2010 methodology. The main revisions stem from 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.

mostly in balances belonging to households, non-financial corporations (NFCs) and non-bank financial intermediaries. As a result, these deposits contracted by 7.6% year-on-year, following a 2.0% drop in December. Meanwhile, deposits redeemable at a notice of up to three months declined by €0.7 million, or 0.6%.

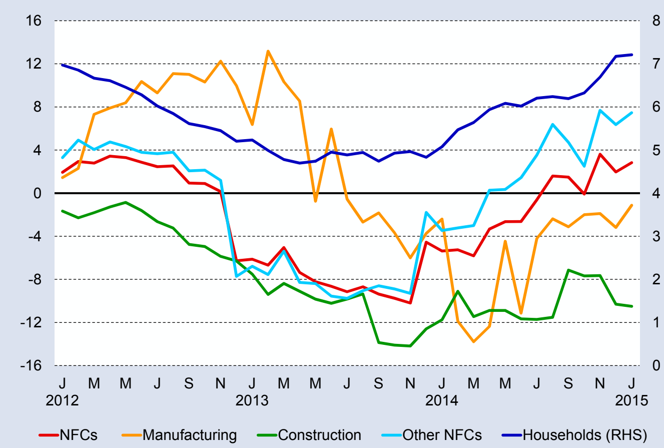
Chart 5
CREDIT TO RESIDENTS OF MALTA
(annual percentage changes)



Source: Central Bank of Malta.

On the asset side of MFI balance sheets, credit to Maltese residents grew by €91.1 million, or 0.8%, between December and January. As a result, the annual rate of change rose from -2.7% in December to -2.4% (see Chart 5).

Chart 6
LOANS BY SECTOR
(annual percentage changes)



Source: Central Bank of Malta.

Credit to general government expanded by €69.9 million, or 2.8%, in January following a rise in MFIs' holdings of government securities. Nonetheless, the annual growth rate slowed down to 0.6% from 0.8% in the previous month.

Meanwhile, credit to all other residents, which comprises mainly private sector borrowers, rose by €21.2 million, or 0.2%, on the previous month, on the back of higher lending to households and private NFCs. As a result, the annual rate of change of credit to other residents rose to -3.2% in January from -3.6% in December.

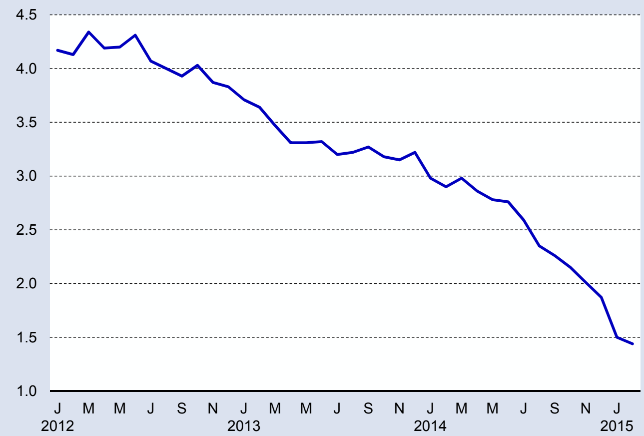
The annual rate of growth of loans to NFCs rose to 2.8% from 2.0% in December (see Chart 6). The increase stemmed mainly from higher loans granted to firms operating in the energy sector. Meanwhile, lending to households grew at an annual rate of 7.2%, the same as in December. While lending for house purchase accelerated during the year to January, other lending to households continued to contract.

Bank lending and deposit rates

Bank lending and deposit rates edged down in January. The weighted average interest rate paid by MFIs on all euro-denominated deposits belonging to resident households and NFCs stood at 0.97%, 6 basis points below its December level and 40 basis points lower than a year earlier.

The comparable rate charged by MFIs on outstanding loans to resident households and NFCs fell by three basis points, to 3.99%. At this level, it was 22 basis points lower than in January 2014.

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



Source: Central Bank of Malta.

In the domestic capital market, the yield on ten-year government bonds declined by 6 basis points between January and February, to close the month at 1.44% (see Chart 7). By 9 March, the yield fell by a further 5 basis points to 1.39%.

The Malta Stock Exchange (MSE) Index gained 0.8% during February, standing at 3,447.2 at the end of the month. By 9 March, the MSE Index had risen further, to 3,558.1.

Public finance[5]

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 outturns. 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.

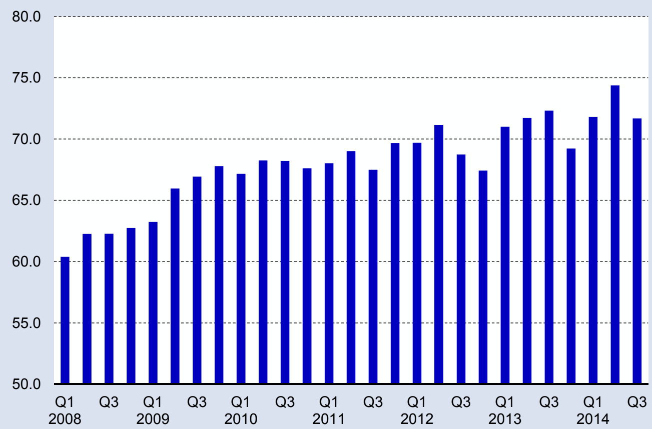
General government expenditure increased by 7.7% in the first three quarters, mainly on the back of higher recurrent spending. In particular, compensation of employees grew by 7.9% reflecting increased outlays especially in the health and education sectors. Intermediate consumption went up by 10.3%, reflecting higher spending on public administration and health. At the same time, social benefit payments rose by 3.4%, driven by retirement pensions and social assistance.

Meanwhile, spending on gross fixed capital formation grew by 18.9%, owing to higher outlays 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.

[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.

Data for the Consolidated Fund also show an improvement in the fiscal position.[6] 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.

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



Source: National Statistics Office.

In January 2015 the Consolidated Fund balance swung into a surplus of €12.1 million, compared with a €89.0 million shortfall in January 2014. Revenue surged by 39.5%, largely due to higher EU grants. On the other hand, expenditure decreased by 7.9%, due to the timing of certain social payments, lower spending on medicine and surgical materials and a decline in capital spending.

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 71.7% 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.

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'.

[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.

[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.

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.

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.

[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

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

	2013	2014	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2014 Aug.	2014 Sep.	2014 Oct.	2014 Nov.	2014 Dec.	2015 Jan.	2015 Feb.
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	0.8	-
Unit labour costs, whole economy[(1)]	1.0	1.5	1.0	0.8	1.4	1.3	1.5	-	-	-	-	-	-	-
Compensation per employee[(1)]	-0.4	0.9	-0.4	-0.5	0.0	0.1	0.9	-	-	-	-	-	-	-
Labour productivity (per person)[(1)]	-1.4	-0.6	-1.4	-1.3	-1.4	-1.1	-0.6	-	-	-	-	-	-	-
Residential property prices	2.1	-	6.4	6.7	8.9	7.6	-	-	-	-	-	-	-	-
Economic activity												-	-	-
Nominal GDP	4.8	5.2	5.0	4.9	4.5	5.4	5.8	-	-	-	-	-	-	-
Real GDP	2.7	3.5	2.5	3.2	3.3	3.7	4.0	-	-	-	-	-	-	-
Real private consumption	1.6	3.4	3.0	1.5	3.5	3.2	5.0	-	-	-	-	-	-	-
Real government consumption	-0.2	7.3	-1.9	4.8	12.1	4.0	8.3	-	-	-	-	-	-	-
Real gross fixed capital formation	2.7	14.0	11.3	16.5	8.5	14.1	16.5	-	-	-	-	-	-	-
Real exports of goods and services	-1.0	-0.2	-1.6	-0.7	3.7	-2.2	-1.5	-	-	-	-	-	-	-
Real imports of goods and services	-1.1	0.1	-1.5	-1.3	3.3	-3.5	2.3	-	-	-	-	-	-	-
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	6.8	-
Labour market developments (LFS)														
Unemployment rate (% of labour force)	6.4	-	6.4	6.0	5.9	5.9	-	5.9	5.9	5.9	5.9	5.8	6.0	-
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	5.0	7.3	-	-	-	-	-	-	-	-
Credit and financial indicators														
Maltese residents' deposits and loans														
Overnight deposits	13.7	29.0	13.7	13.3	15.6	20.4	29.0	15.5	20.4	21.5	20.2	29.0	29.7	-
Deposits with agreed maturity up to 2 years	2.8	-2.0	2.8	1.7	6.2	4.9	-2.0	9.5	4.9	3.2	2.5	-2.0	-7.6	-
Total residents' deposits in M3	8.8	17.1	8.8	8.5	11.8	14.4	17.1	13.2	14.4	14.5	13.5	17.1	15.4	-
Credit to general government	8.3	0.8	8.3	7.1	9.2	0.9	0.8	4.7	0.9	4.3	3.1	0.8	0.6	-
Credit to other residents	-0.2	-3.6	-0.2	-2.4	-3.4	-4.6	-3.6	-4.8	-4.6	-5.0	-3.1	-3.6	-3.2	-
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	-2.4	-
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	1.50
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	0.8
General government finances (% of GDP)														
Surplus (+) / deficit (-)[(4)]	-2.7	-	-2.7	-3.0	-3.3	-2.5	-	-	-	-	-	-	-	-
Gross debt[(5)]	69.2	-	69.2	71.8	74.4	71.7	-	-	-	-	-	-	-	-

(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.