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EUROSISTEMA
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ECONOMIC UPDATE 4/2015

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ECONOMIC UPDATE 4/2015

Summary¹

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 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 0.6% in February 2015. Maltese residents' deposits contracted in February, whereas credit to residents expanded. 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 in 2014 also narrowed, while in the first two months of 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 fourth 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).

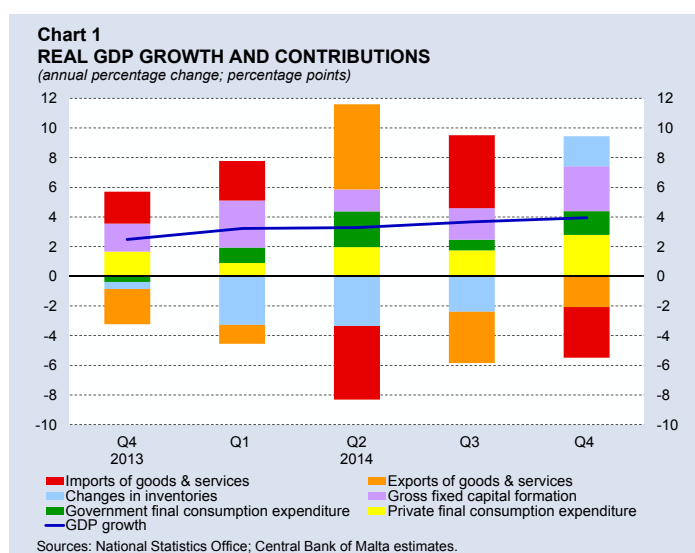
Looking closer at the components of domestic demand, during the fourth quarter the largest contributor remained investment (gross fixed capital formation). This rose by 16.5% on an annual basis and contributed 3.0 percentage points to overall GDP growth (see Chart 1). Non-residential construction accounted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

Table 1					
GROSS DOMESTIC PRODUCT⁽¹⁾					
	2014				
	Q1	Q2	Q3	Q4	2014
	<i>Annual percentage changes</i>				
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 10 April 2015.

Both private and government consumption supported economic activity, and gathered momentum during the 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.



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 driven by capital goods, reflecting buoyant investment spending. Exports were down by 1.5% in annual terms, reflecting drops in exports of both goods and services. The drop in exported services was driven by lower receipts generated by special purpose entities, which form part of the financial sector. As a result, net exports lowered GDP growth by 5.5 percentage points.

In nominal terms, annual GDP growth reached 5.8% during the fourth quarter of the year. From a sectoral perspective, services continued to drive the expansion in gross value added (GVA). 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.

The index of industrial production rose by 3.8% in year-on-year terms during February 2015.³ In the three months to February, industrial production went up by 2.8% on average, compared with the corresponding period to February 2014. This increase mainly reflected developments in the pharmaceuticals, paper, printing and chemicals sectors. On the other hand, output of textiles, electrical equipment as well as computer, electronic & optical products declined.

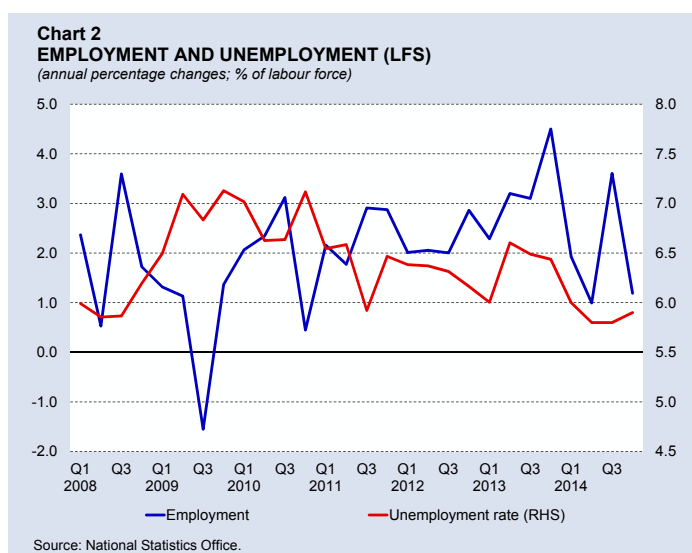
The positive performance of the tourism industry observed in 2014 extended into 2015. Tourist arrivals rose at an annual rate of 14.1% in February, with total nights spent going up by 6.6%. At

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.

the same time, expenditure grew by 12.8% on a year earlier, mainly reflecting spending on package holidays.

As regards the labour market, Labour Force Survey (LFS) data for the fourth quarter of 2014 indicate an increase of 1.2% in employment compared with the same period of 2013, slowing down from 3.6% in the previous quarter (see Chart 2). The increase in the fourth quarter mainly reflected a rise in part-time employment, although full-time employment also rose.



ETC records show that in November the gainfully occupied population rose by 3.8% on a year earlier, the same increase recorded in October.

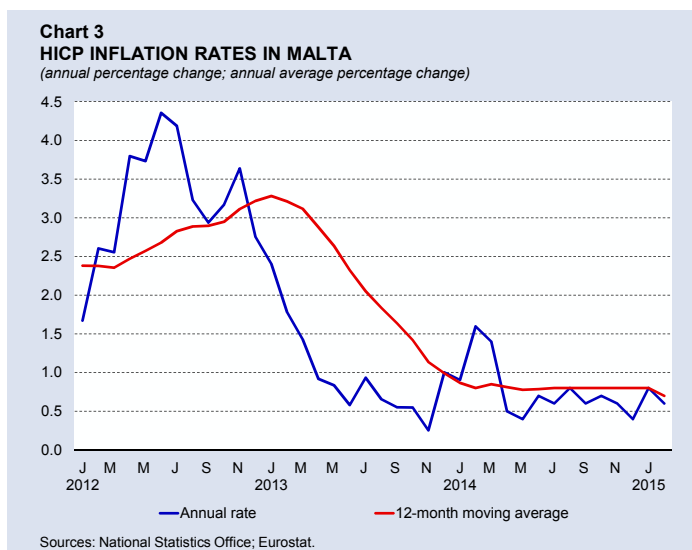
According to the LFS, the unemployment rate stood at 5.9% in the fourth quarter of 2014, compared with 6.4% a year earlier. More recently, Eurostat's estimate of the seasonally-adjusted unemployment rate dropped to 5.9% in February 2015 from 6.1% in January.

ETC data show that in February 2015 the number of people on the unemployment register fell by 1,563 compared with a year earlier, to 6,190.

Prices, costs and competitiveness

In February, the annual rate of HICP inflation stood at 0.6%, down from 0.8% in January. Meanwhile, the twelve-month moving average inflation rate fell by 0.1 percentage point to 0.7% (see Chart 3).

This deceleration in the annual rate of HICP inflation in February was mainly due to developments in services and energy prices. These were partly offset by marginal increases in food and non-energy industrial goods (NEIG) price inflation.



The annual rate of change in services prices fell to 1.8% in February, compared with 2.2% a month earlier. This largely reflected smaller increases in the prices charged by restaurants and hotels. Prices relating to transport services also increased more slowly in February, mainly due to airfares.

Another contributing factor to the slowdown in inflation was the drop in fuel prices, which resulted in a decline of 4.0% in energy prices on a year earlier.

On the other hand, food price inflation edged up marginally, from 2.5% in January to 2.6% in February, as unprocessed food prices rose more rapidly than in the previous month. This largely reflected developments in prices of vegetables. Prices of non-energy industrial goods rose by 0.7%, up slightly from 0.6% in January.

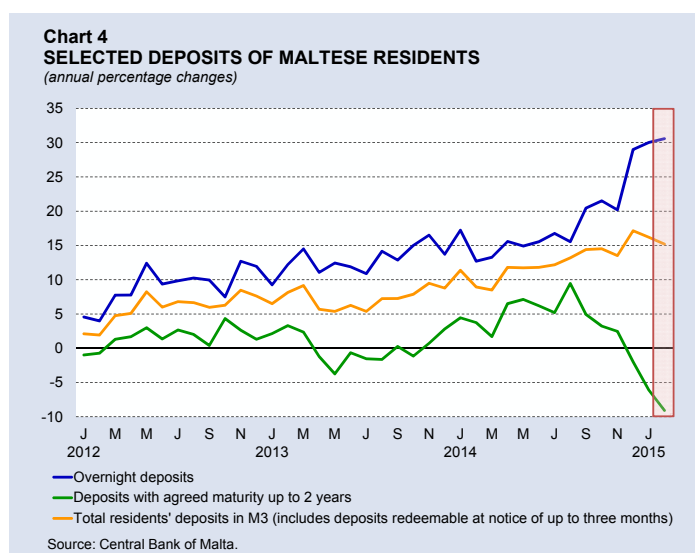
Unit labour costs (ULC) are an indication of domestic cost pressures. During the fourth quarter of 2014, Malta's ULC, measured as a four-quarter moving average, increased by 1.5% on a year earlier. The increase was the result of higher compensation per employee, which went up by 0.9%, coupled with a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

Based on the Central Bank of Malta's advertised property price index, the price of residential properties rose at an annual rate of 4.7% in the fourth quarter of 2014. This was below the increases recorded in the previous three quarters, with the average for 2014 standing at 7.0%. Such prices, however, may not accurately reflect the actual prices at which sales are concluded.

Deposits, credit and financial markets⁴

Residents' deposits held with monetary financial institutions (MFI), and forming part of broad money (M3), contracted by €326.5 million between January and February. As a result, the annual rate of growth of residents' deposits in M3 slowed down from 16.2% in January to 15.2% in February (see Chart 4).

Overnight deposits fell by €195.1 million, or 2.2% in February, partly reversing the previous month's increase. The decline, which stemmed mainly from lower balances belonging to households and private non-financial corporations (NFC), was related to new issues of Malta Government Stocks (MGS) that were launched during the month. Nonetheless, the annual growth



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.

rate of overnight deposits rose marginally to 30.6%, from 30.0% in January, as a similar drop in such deposits was recorded in February 2014.

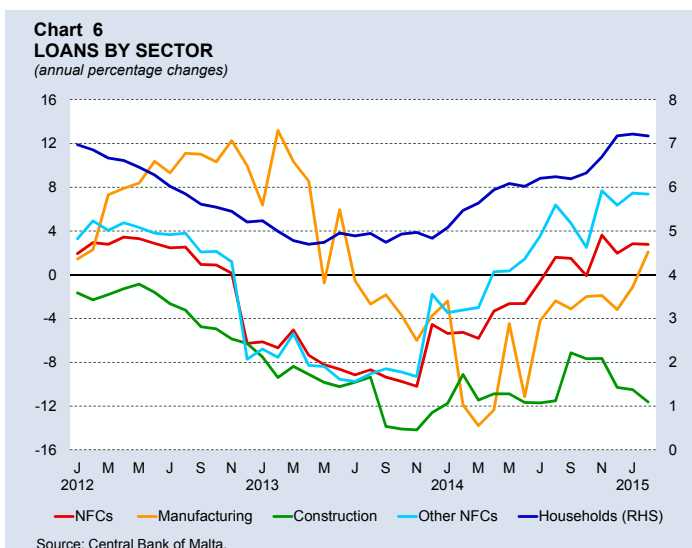
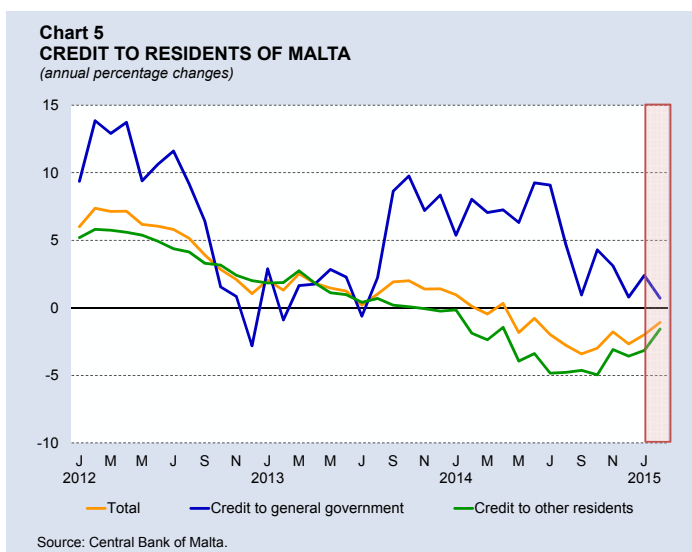
At the same time, deposits with an agreed maturity of up to two years decreased by €129.8 million, or 3.3%. The drop was broad-based across categories of deposit-holders. As a result, these deposits contracted at a faster annual pace, falling by 9.1% following a 6.1% decline in January. Meanwhile, deposits redeemable at a notice of up to three months went down by €1.6 million, or 1.3%.

On the asset side of MFI balance sheets, credit to Maltese residents grew by €72.2 million, or 0.6%, between January and February. As a result, credit contracted at a slower annual pace, falling by 1.1% following a 2.0% drop in January (see Chart 5).

Credit to general government grew by €21.3 million, or 0.8%, in February as MFIs increased their holdings of both MGS and Treasury bills. Nonetheless, the annual growth rate slowed down to 0.7% from 2.4% in the previous month as a larger increase had been recorded twelve months earlier.

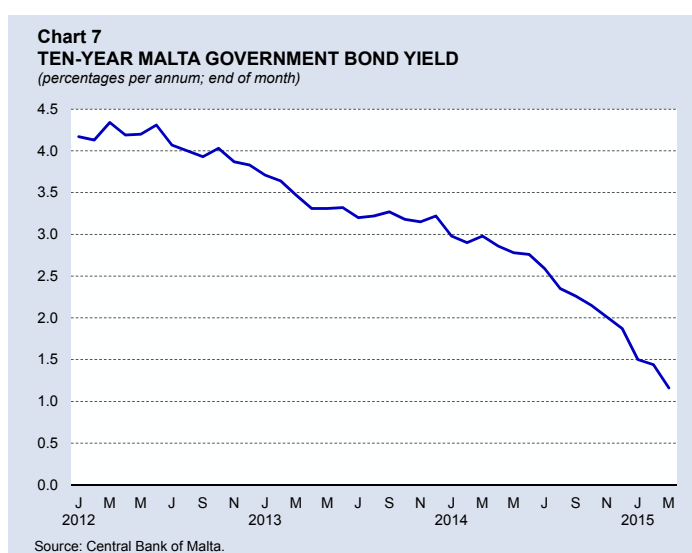
Meanwhile, credit to all other residents, which comprise mainly private sector borrowers, went up by €50.9 million, or 0.5%, on the previous month, following a rise in loans to NFCs and households. As a result, the annual rate of decline in credit to other residents eased to -1.6% from -3.2% in January.

Loans to NFCs grew at an unchanged annual rate of 2.8% in February (see Chart 6). The annual increase stemmed mainly from lending to the energy sector, while lending to the manufacturing sector increased on the year-ago level for the first time since mid-2013. Meanwhile, lending to households grew at an annual rate of 7.2%, as in the previous two months. Loans for house purchase, the main component of lending to households, grew at a stable rate of 9.5% in February. Conversely, consumer credit and other lending to households declined.



Bank lending and deposit rates remained unchanged in February, when compared to the previous month. However, they declined on a year earlier.

Thus, the weighted average interest rate paid by MFIs on all euro-denominated deposits belonging to resident households and NFCs stood at 0.98%, 39 basis points lower than a year earlier. The comparable rate charged by MFIs on outstanding loans to resident households and NFCs stood at 3.99%, 20 basis points lower than in February 2014.



In the domestic capital market, the yield on ten-year government bonds fell by 28 basis points in March, reaching 1.16% by the end of the month (see Chart 7).

The Malta Stock Exchange (MSE) index gained 9.5% during this period, ending March at 3,776.1.

Public finance⁵

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, partly mirroring the rise in consumption. Revenue 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.

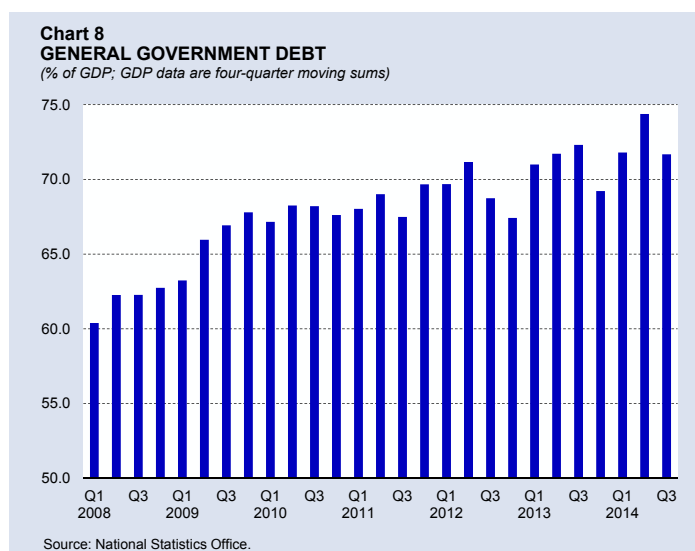
General government expenditure increased by 7.7% in the first three quarters, mainly on the back of higher recurrent spending. In particular, compensation of employees grew by 7.9%, reflecting increased outlays especially in the health and education sectors. Intermediate consumption went up by 10.3%, 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.

According to the Government's most recent estimates, as presented in the Budget Speech in November 2014, 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).



Overall, between January and December 2014 the deficit on the Consolidated Fund declined

by €126.9 million on a year earlier, to €136.3 million.⁶ Revenue rose by 13.6%, on the back of the extraordinary receipt of excise duty arrears, as well as higher tax revenue in general. Meanwhile, expenditure rose by 8.2%, with recurrent and capital spending rising by 7.9% and 10.3%, respectively.

During the first two months of 2015, the Consolidated Fund posted a surplus of €49.7 million, as against a deficit of €74.5 million in the same period last year. Revenue surged by 27.2%, mainly due to higher EU grants, as well as increased inflows from income tax and VAT. On the other hand, expenditure rose by just 0.5%, due to low growth in both current and capital spending.

Balance of payments

During the last quarter of 2014, the current account of the balance of payments recorded a surplus of €10.9 million, up from €1.0 million in the same period of 2013.⁷ This increase was mainly driven by an €81.2 million decline in net outflows on the primary income account.⁸ The services balances also improved by €31.5 million when compared with a year earlier. These favourable developments were partly offset by a widening of €90.5 million in the trade gap in goods and a €12.3 million drop in net secondary income receipts.

The capital account posted net inflows of €9.2 million, down from €49.6 million in the same period of the previous year. Meanwhile, the financial account registered net borrowing of €130.2 million as opposed to net lending of €77.5 million in the last quarter of 2013.

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 Q4	2014 Q4	2013 Q1-Q4	2014 Q1-Q4
Current account	1.0	10.9	234.8	215.1
Goods	-220.6	-311.1	-1,090.7	-1,120.0
Services	322.4	353.9	1,513.9	1,627.3
Primary income	-158.5	-77.2	-327.4	-484.3
Secondary income	57.6	45.3	138.9	192.0

Source: National Statistics Office.

In 2014 as a whole, the surplus on the current account stood at €215.1 million, down from €234.8 million in 2013 (see Table 2). This decline was primarily driven by higher net outflows on the primary income account, though a larger merchandise trade deficit also contributed. Combined, these components offset the positive developments registered on services and the secondary income account. Meanwhile, net inflows on the capital account increased to €138.0 million. The financial account showed net borrowings of €659.1 million, compared with €382.4 million in 2013.

Customs data indicate that in 2014 the merchandise trade deficit widened to €2.6 billion, €0.9 billion more than in 2013.⁹ This reflected a decline in exports, mainly driven by lower sales of electrical machinery, though other categories, such as fuel and pharmaceuticals, also fell. At the same time, imports rose, predominantly on account of a rise in fuels and capital goods, including purchases (and registrations) of ships and boats.

Customs data for the first two months of 2015 show that the merchandise trade gap widened by €230.5 million when compared with the first two months of 2014, to €472.9 million. This widening reflected both an increase in imports, driven by registration of aircraft, and a drop in exports, notably of fuels.

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															
<i>(annual percentage changes; non-seasonally adjusted data)</i>															
	2013	2014	2013	2014	2014	2014	2014	2014	2014	2014	2014	2014	2015	2015	2015
			Q4	Q1	Q2	Q3	Q4	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	
Prices and costs															
HICP	1.0	0.8	0.6	1.3	0.5	0.7	0.6	0.6	0.7	0.6	0.4	0.8	0.6	-	
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	7.0	6.4	6.7	8.9	7.6	4.7	-	-	-	-	-	-	-	
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	5.1	2.7	3.0	1.4	6.8	14.1	-	
Labour market developments (LFS)															
Unemployment rate (% of labour force)	6.4	5.9	6.4	6.0	5.8	5.8	5.9	-	-	-	-	-	-	-	
Total employment	3.3	1.9	4.5	1.9	1.0	3.6	1.2	-	-	-	-	-	-	-	
Balance of payments															
Current account (as a % of GDP) ⁽¹⁾⁽²⁾	3.1	2.7	3.1	-	-	-	2.7	-	-	-	-	-	-	-	
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	20.4	21.5	20.2	29.0	30.0	30.6	-	
Deposits with agreed maturity up to 2 years	2.8	-2.0	2.8	1.7	6.2	4.9	-2.0	4.9	3.2	2.5	-2.0	-6.1	-9.1	-	
Total residents' deposits in M3	8.8	17.1	8.8	8.5	11.8	14.4	17.1	14.4	14.5	13.5	17.1	16.2	15.2	-	
Credit to general government	8.3	0.8	8.3	7.1	9.2	0.9	0.8	0.9	4.3	3.1	0.8	2.4	0.7	-	
Credit to other residents	-0.2	-3.6	-0.2	-2.4	-3.4	-4.6	-3.6	-4.6	-5.0	-3.1	-3.6	-3.2	-1.6	-	
Total credit	1.4	-2.7	1.4	-0.5	-0.8	-3.4	-2.7	-3.4	-3.0	-1.8	-2.7	-2.0	-1.1	-	
10-year interest rate (%) ⁽³⁾	3.36	2.61	3.21	3.01	2.87	2.49	2.08	2.32	2.18	2.11	1.94	1.69	1.50	1.31	
Stock prices: Malta Stock Exchange Index ⁽⁴⁾	14.8	-9.6	7.8	-7.1	-3.7	1.1	-0.1	1.1	-0.9	-0.9	1.8	2.7	0.8	9.5	
General government finances (% of GDP)															
Surplus (+) / deficit (-) ⁽⁵⁾	-2.7	-	-2.7	-3.0	-3.3	-2.5	-	-	-	-	-	-	-	-	
Gross debt ⁽⁶⁾	69.2	-	69.2	71.8	74.4	71.7	-	-	-	-	-	-	-	-	

⁽¹⁾ Four-quarter moving averages.

⁽²⁾ Quarterly data consistent with the latest balance of payments release are unavailable.

⁽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 Statistics Office.