



BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

ECONOMIC UPDATE 9/2015

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ECONOMIC UPDATE 9/2015

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 remain contained. The annual rate of inflation, based on the Harmonised Index of Consumer Prices (HICP), edged up to 1.4% in August. In July, Maltese residents' deposits continued to expand at a rapid annual rate, while the annual rate of growth of credit to residents accelerated. As regards fiscal developments, the general government deficit widened in the first quarter of 2015. However, during the first seven months of the year, the deficit on the Consolidated Fund decreased compared with the same period of 2014. On the external side, the current account of the balance of payments was in surplus in the first 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, when annual growth had been almost

Table 1
GROSS DOMESTIC PRODUCT⁽¹⁾

Annual percentage changes

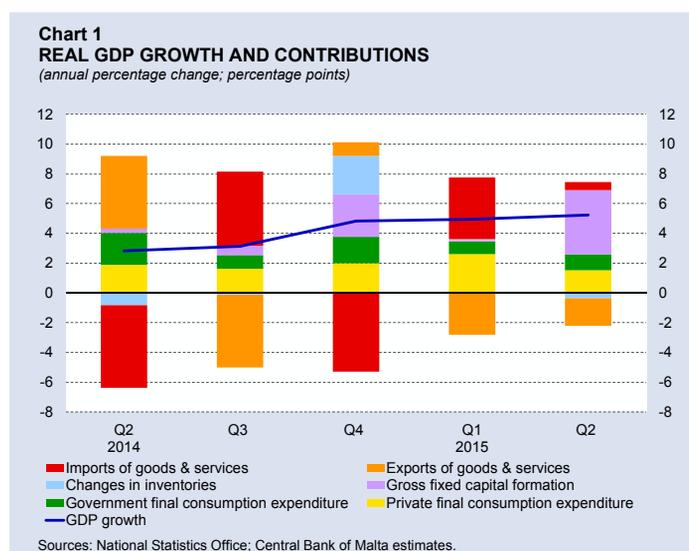
	2014			2015	
	Q2	Q3	Q4	Q1	Q2
Private final consumption expenditure	3.3	3.0	3.5	4.6	2.8
Government final consumption expenditure	10.7	5.2	9.0	3.9	5.0
Gross fixed capital formation	1.6	4.3	15.1	0.3	24.3
Domestic demand	3.7	3.6	10.0	3.6	6.9
Exports of goods & services	3.1	-3.1	0.5	-1.7	-1.2
Imports of goods & 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 18 September 2015.

nil. Most of the increase in investment can 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). Data in nominal terms indicate that around fourth-fifths of the increase in investment was due to the private sector.



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 & scientific activities and from that incorporating public administration, health & education. Robust contributions were also recorded from the sector comprising wholesale & 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 7.1% in year-on-year terms during July 2015, following a 5.0% increase in June.³ As a result, the three-month moving average

² Changes in inventories include acquisitions and disposals of valuables as well as the statistical discrepancy. In the absence of data from the National Statistics Office (NSO), 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.

of the index increased by 7.4% on a year earlier. This expansion was driven by the pharmaceutical sector and by firms involved in the production of computer, electronic and optical products. Growth was also driven by firms that operate in the food and energy sectors, as well as those involved in the printing and reproduction of recorded material.

Turning to tourism, in July arrivals rose by 4.7% on a year earlier. Nights stayed and expenditure also increased, by 7.2% and 8.6%, respectively. As a result, during the first seven months of the year, tourist numbers increased by 5.2% on a year earlier, while nights stayed and total spending went up by 4.2% and 6.7%, respectively. Although all major expenditure components increased on year-ago levels, spending on package holidays saw the largest gain.

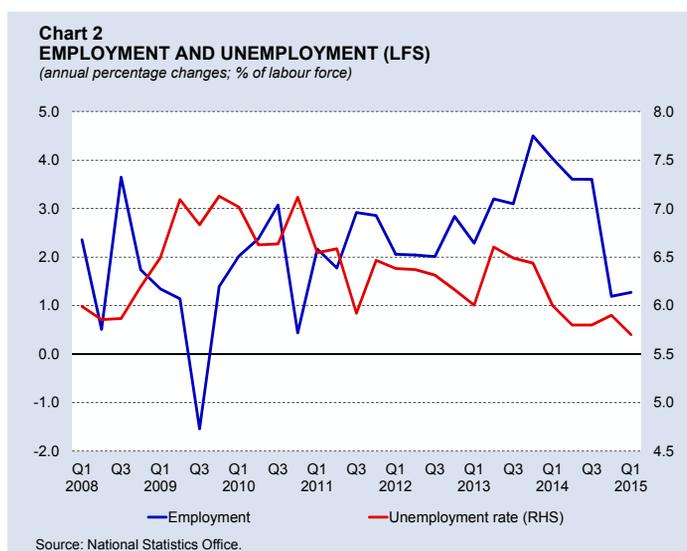
Meanwhile, in the second quarter of 2015 the number of cruise liner calls stood at 108, up by 19 from a year earlier. As a result, the total number of foreign cruise liner passengers amounted to 203,105, an increase of over 80,000 passengers on the same quarter of 2014.

As regards the labour market, according to the Labour Force Survey (LFS) employment expanded by 1.3% during the first quarter of 2015 compared with the same period of 2014, a slight pick-up from 1.2% in the previous quarter (see Chart 2). The increase in the first quarter largely reflected a rise in full-time employment, although part-time employment also went up slightly. On the other hand, the number of 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 April 2015 the gainfully occupied population rose by 4.3% on a year earlier, the same rate as in March.⁴

According to the LFS, the unemployment rate stood at 5.7% in the first quarter of 2015, compared with 6.0% a year earlier.⁵ This is the lowest rate since the inception of the survey in 2000.

The available information suggests that labour market conditions continued to improve in more recent months. Eurostat's estimate of the seasonally-adjusted unemployment rate for the second quarter of 2015 stood at 5.4%, 0.3 percentage points lower than in the preceding quarter. This fell further to 5.1% in July 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.

ETC data also show a further fall in the number of registered unemployed. In July 2015 the number of people on the unemployment register decreased by 1,772 compared with a year earlier, to 5,062.

Prices, costs and competitiveness

In August, the annual rate of HICP inflation rose to 1.4%, from 1.2% a month earlier. Consequently, the twelve-month moving average rate edged up to 0.9%, from 0.8% in July (see Chart 3).

This pick-up in the annual inflation rate was mainly driven by an acceleration in non-energy industrial goods price inflation, from 0.8% in July to 1.2% in August. This mainly reflected faster growth in the prices of garments.

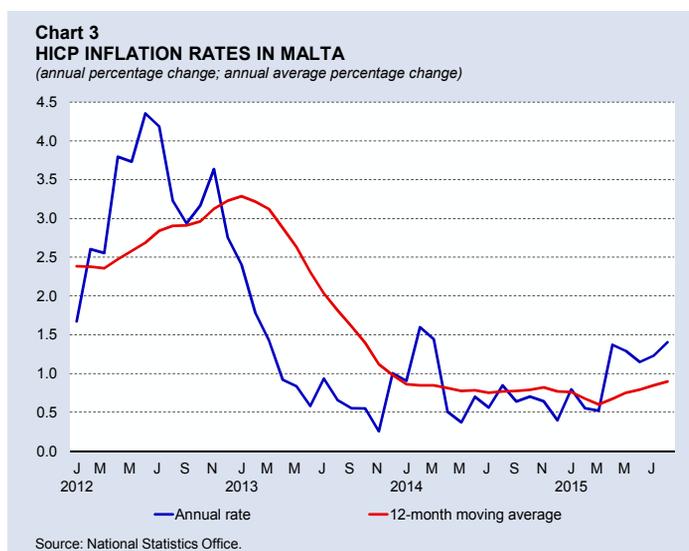
Moreover, food price inflation edged up by 0.1 percentage point to 2.9%, due to developments in the prices of processed foods. The latter rose by 2.2% year-on-year, compared with an increase of 2.0% in July, mainly reflecting faster growth in alcohol prices. Unprocessed food price inflation remained unchanged at 4.2% in August, masking counteracting movements in fish and seafood prices, which rose at a slower rate, and an increase in vegetable prices.

Additionally, services price inflation rose marginally from 1.6% in July to 1.7% in August. This masked offsetting movements in the various services sub-indices. There was a smaller year-on-year drop in communications prices and stronger increases in accommodation rates, whereas airfares decreased.

Finally, energy prices declined by 4.7% on a year earlier, a further decrease from the 4.4% seen in July due to lower gas prices. On the other hand, the prices of electricity and transport fuels remained unchanged in the month under review.

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 0.1% 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 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.

Deposits, credit and financial markets

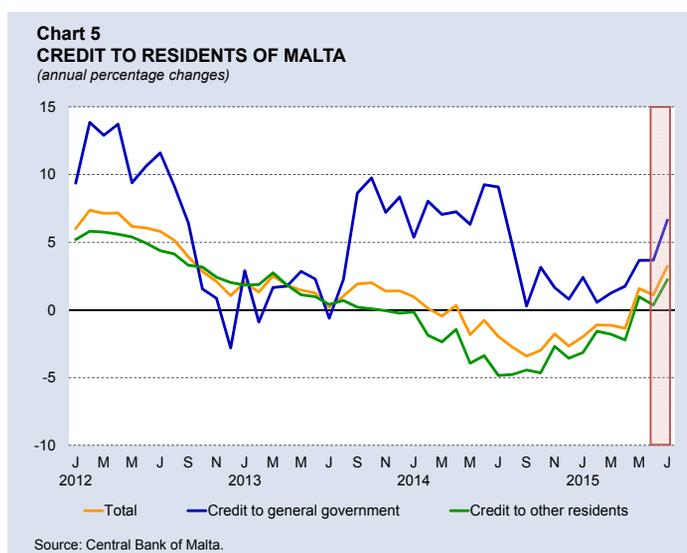
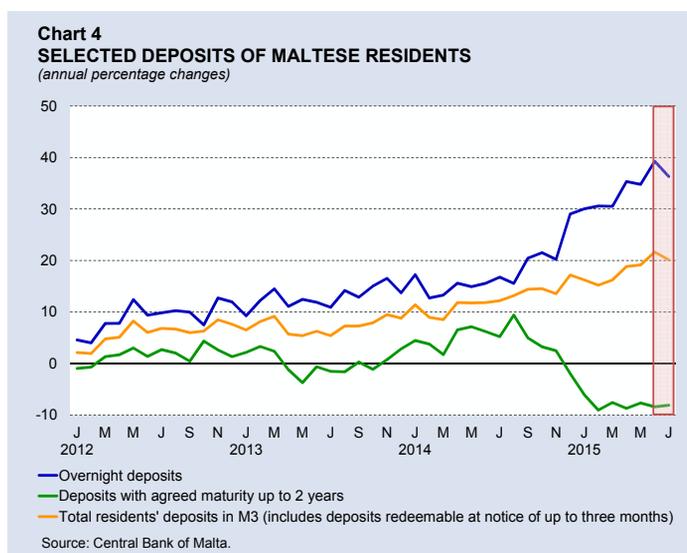
In July, residents' deposits forming part of broad money (M3) contracted. As a result, their annual growth rate decelerated from 21.6% in June to 20.1% in July.

The deceleration stemmed mainly from overnight deposits. These contracted by €27.3 million during the month, taking the annual growth rate to 36.3% from 39.3% in June (see Chart 4). The monthly decline in absolute terms was driven by falls in overnight deposits belonging to other financial intermediaries and non-financial corporations (NFC), which were only partly offset by increases in household deposits.

Moreover, deposits with an agreed maturity of up to two years contracted by €3.2 million during July. However, as this drop was smaller than that in the previous month, the annual rate of change became less negative, going to -8.1% in July, from -8.4% in June. Meanwhile, the annual rate of change of deposits redeemable at up to three months' notice slowed down from 3.3% in June to 1.7% in July.

On the asset side of banks' balance sheets, credit to Maltese residents expanded by €57.2 million in July. Consequently, the annual rate of credit growth picked up from 1.1% in June to 3.2% in July, as both credit to general government and credit to other residents gathered momentum (see Chart 5).

The annual growth rate of credit to general government rose from 3.7% in June to 6.6% in July, reflecting increased holdings of Malta Government Stocks (MGS) by the banking sector.



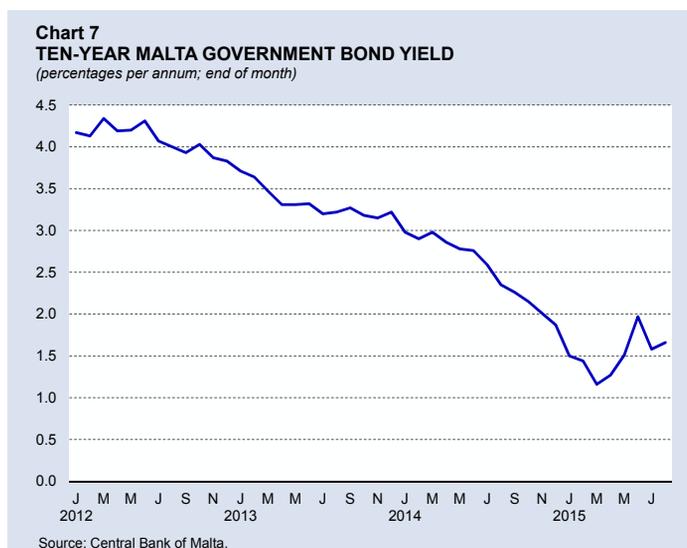
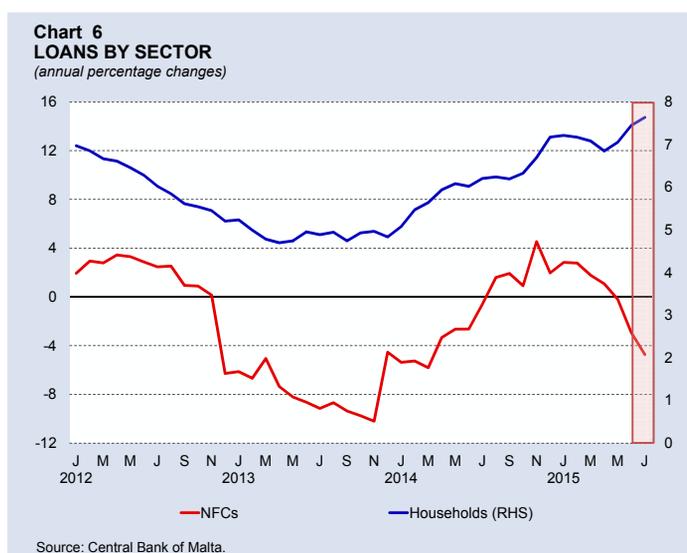
Meanwhile, credit to all other residents grew by 2.2% year-on-year, following an increase of 0.4% in the previous month. The acceleration reflected faster annual growth in loans granted to other financial intermediaries and households, which offset a steeper annual decline in loans to NFCs. The annual growth rate of loans to households reached 7.6%, from 7.4% in the previous month. House loans grew at a faster pace, whereas consumer and other credit continued to contract. In contrast, following a 2.9% drop in the year to June, loans to NFCs contracted by 4.7% during the year to July (see Chart 6). The year-on-year decline in July was mainly driven by property-related loans, which were only partly offset by a rise in loans to the accommodation sector.

Bank lending and deposit rates fell marginally in July. The composite interest rate paid by MFIs on all euro-denominated deposits belonging to resident households and NFCs dropped by 2 basis points to 0.83%. Meanwhile, the comparable rate charged on outstanding loans to them stood at 3.87%, 3 basis points lower than in June.

The composite deposit rate in July was 44 basis points below its level a year earlier, while the corresponding lending rate was 24 basis points lower.

In the domestic capital market, in August the yield on ten-year government bonds increased by 8 basis points to 1.66% at the end of the month (see Chart 7).

In August, the Malta Stock Exchange (MSE) index remained broadly unchanged when compared to July.



Public finance⁶

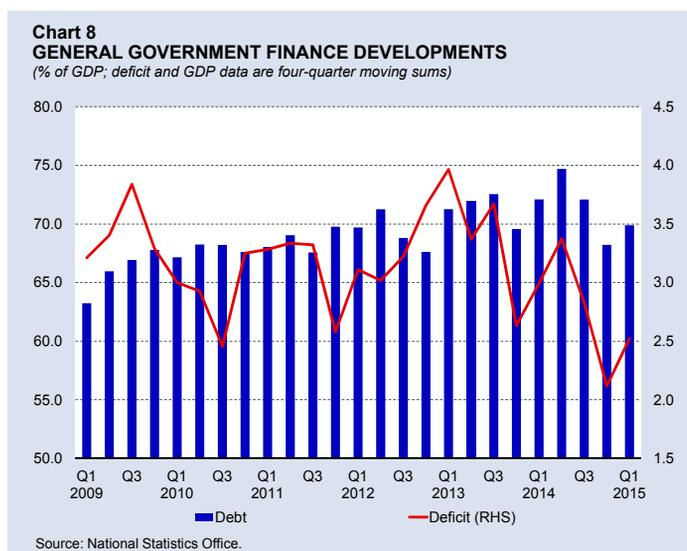
In the first quarter of 2015 the general government deficit expanded by €35.5 million compared with the same period a year earlier, to reach €172.3 million. As a result, the deficit-to-GDP ratio, computed on the basis of four-quarter moving sums, rose to 2.5% from 2.1% at end-2014.

During the first quarter of 2015, total revenue grew by 8.5%, buoyed by higher tax revenue, which was spurred by positive developments in the Maltese economy. Inflows from taxes on production and imports grew by 12.0%, supported by growth in private consumption and tourist spending. Current taxes on income and wealth rose by 8.5%, driven by higher inflows from income taxes paid by companies. At the same time, income from social contributions grew by 6.7%, reflecting continued favourable labour market developments. Meanwhile, receipts from capital and current transfers grew by 7.1%.

General government expenditure rose by 11.4% on a year earlier, mostly reflecting higher capital outlays. Capital transfers more than doubled, reflecting the higher equity injection into Air Malta compared with the same period of the previous year. Concurrently, spending on gross fixed capital formation rose by 41.9%. Growth in current expenditure was mainly driven by increased outlays on compensation of employees and intermediate consumption. These rose by 6.7% and 8.7% respectively, mainly due to increased spending on public administration, education and health.

In the first quarter of 2015, the general government debt-to-GDP ratio stood at 69.9%, compared with 68.2% at end-2014, though it remained below its level a year earlier (see Chart 8).⁷

In July 2015 the Consolidated Fund deficit stood at €16.9 million, down from €44.3 million in July 2014. Overall, the Consolidated Fund deficit in the first seven months of the year narrowed by €134.6 million compared with the same period last year, to €174.9 million. Revenue surged by 15.5% due to higher EU grants and proceeds from indirect taxes and income tax. Total expenditure rose by 5.6%, reflecting higher current and capital spending.



⁶ 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.

⁷ These ratios are based on deficit and debt levels published in NSO *News Release* 128/2015 and GDP data published in NSO *News Release* 163/2015.

Balance of payments

During the first quarter of 2015, the current account of the balance of payments showed a surplus of €106.1 million as opposed to a deficit of €77.1 million in the same period of 2014.⁸ This swing was mainly driven by a €106.5 million narrowing of the merchandise trade deficit and a €79.9 million drop in net outflows on the primary income account (see Table 2).⁹ At the same time, net inflows of secondary income increased by €30.8 million when compared with a year earlier. These favourable developments were partly offset by a decline of €34.1 million in the surplus on services.

The capital account posted net inflows of €123.5 million, up from €29.2 million in the first quarter of 2014.

Meanwhile, consistent with the improvement in the current and capital accounts, net borrowings on the financial account decreased. Net borrowings of €11.0 million were registered during the quarter reviewed, considerably less than net borrowings of €537.7 million in the comparable quarter of 2014.

Customs data indicate that in July 2015 the merchandise trade deficit narrowed to €222.3 million, €77.4 million less than in the same month of 2014.¹⁰ This reflected both an increase in exports, predominantly driven by fuel re-exports, and a drop in imports, on account of a significant decline in the fuel bill and, to a lesser extent, a drop in food imports.

Nevertheless, between January and July, the merchandise trade deficit widened by €410.5 million compared with the same period of 2014, to €1,700.2 million. Exports contracted whereas imports increased on a year earlier. The drop in exports was principally due to fuels whereas the increase in imports was predominantly attributable to a sharp rise in registrations of ships and aircraft.

	2013 Q1-Q4	2014 Q1-Q4	2014 Q1	2015 Q1
Current account	239.1	261.7	-77.1	106.1
Goods	-1,091.3	-1,094.7	-264.6	-158.1
Services	1,522.3	1,626.6	300.4	266.3
Primary income	-330.7	-469.9	-143.4	-63.5
Secondary income	138.9	199.6	30.5	61.4
Capital account	129.9	138.0	29.2	123.5
Financial account¹	-388.7	-370.5	-537.7	-11.0

⁽¹⁾ Net lending (+) / net borrowing (-).
Source: National Statistics Office.

⁸ 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.

⁹ 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.

¹⁰ 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	2014	2015	2015	2014	2015	2015	2015	2015	2015	2015	2015	2015
			Q1	Q2	Q3	Q4	Q1	Q2	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.
Prices and costs																	
HICP	1.0	0.8	1.3	0.5	0.7	0.6	0.6	1.3	0.4	0.8	0.6	0.5	1.4	1.3	1.1	1.2	1.4
Unit labour costs, whole economy ⁽¹⁾	2.0	1.2	1.3	1.7	1.5	1.2	1.1	0.1	-	-	-	-	-	-	-	-	-
Compensation per employee ⁽¹⁾	0.4	0.3	-0.3	-0.1	-0.3	0.3	0.8	1.0	-	-	-	-	-	-	-	-	-
Labour productivity (per person) ⁽¹⁾	-1.6	-0.9	-1.6	-1.9	-1.8	-0.9	-0.4	0.8	-	-	-	-	-	-	-	-	-
Residential property prices	2.1	7.0	6.7	8.9	7.6	4.7	5.3	4.8	-	-	-	-	-	-	-	-	-
Economic activity																	
Nominal GDP	4.6	5.4	5.2	4.4	4.9	7.0	7.0	7.3	-	-	-	-	-	-	-	-	-
Real GDP	2.6	3.5	3.4	2.8	3.1	4.8	4.9	5.2	-	-	-	-	-	-	-	-	-
Real private consumption	1.9	2.9	1.5	3.3	3.0	3.5	4.6	2.6	-	-	-	-	-	-	-	-	-
Real government consumption	0.2	7.5	5.1	10.7	5.2	9.0	3.9	5.0	-	-	-	-	-	-	-	-	-
Real gross fixed capital formation	-0.7	9.1	14.3	1.6	4.3	15.1	0.3	24.3	-	-	-	-	-	-	-	-	-
Real exports of goods and services	-0.2	-0.3	-1.3	3.1	-3.1	0.5	-1.7	-1.2	-	-	-	-	-	-	-	-	-
Real imports of goods and services	-1.2	0.6	-1.0	3.7	-3.6	3.6	-2.3	-0.3	-	-	-	-	-	-	-	-	-
Tourist arrivals	9.6	6.8	7.9	9.0	7.2	2.5	7.7	4.2	1.4	6.8	14.1	4.1	2.5	6.4	3.6	4.7	-
Labour market developments (LFS)																	
Unemployment rate (% of labour force)	6.4	5.9	5.9	5.8	5.8	5.9	5.7	-	-	-	-	-	-	-	-	-	-
Total employment	3.3	3.1	4.0	3.6	3.6	1.2	1.3	-	-	-	-	-	-	-	-	-	-
Balance of payments																	
Current account (as a % of GDP) ⁽²⁾	3.2	3.3	2.9	3.5	2.8	3.3	5.5	-	-	-	-	-	-	-	-	-	-
Credit and financial indicators																	
Maltese residents' deposits and loans																	
Overnight deposits	13.7	29.0	13.3	15.6	20.4	29.0	30.5	39.3	29.0	30.0	30.6	30.5	35.3	34.8	39.3	36.3	-
Deposits with agreed maturity up to 2 years	2.8	-2.0	1.7	6.2	4.9	-2.0	-7.6	-8.4	-2.0	-6.1	-9.1	-7.6	-8.7	-7.7	-8.4	-8.1	-
Total residents' deposits in M3	8.8	17.2	8.5	11.8	14.4	17.2	16.2	21.6	17.2	16.2	15.2	16.2	18.8	19.1	21.6	20.1	-
Credit to general government	8.3	0.8	7.1	9.2	0.3	0.8	1.2	3.7	0.8	2.4	0.6	1.2	1.7	3.7	3.7	6.6	-
Credit to other residents	-0.2	-3.6	-2.4	-3.4	-4.4	-3.6	-1.8	0.4	-3.6	-3.2	-1.6	-1.8	-2.2	1.0	0.4	2.2	-
Total credit	1.4	-2.7	-0.5	-0.8	-3.4	-2.7	-1.1	1.1	-2.7	-2.0	-1.1	-1.1	-1.4	1.6	1.1	3.2	-
10-year interest rate (%) ⁽³⁾	3.4	2.6	3.0	2.9	2.5	2.1	1.5	1.5	1.9	1.7	1.5	1.3	1.2	1.5	1.8	1.8	1.6
Stock prices: Malta Stock Exchange Index ⁽⁴⁾	14.8	-9.6	-7.1	-3.7	1.1	-0.1	13.4	8.3	1.8	2.7	0.8	9.5	-0.2	2.9	5.5	2.9	0.0
General government finances (% of GDP)																	
Surplus (+) / deficit (-) ⁽²⁾	2.6	2.1	3.0	3.4	2.8	2.1	2.5	-	-	-	-	-	-	-	-	-	-
Gross debt ⁽⁵⁾	69.6	68.2	72.1	74.7	72.1	68.2	69.9	-	-	-	-	-	-	-	-	-	-

⁽¹⁾ Four-quarter moving averages.

⁽²⁾ Four-quarter moving sums.

⁽³⁾ Period averages.

⁽⁴⁾ Period-on-period percentage changes.

⁽⁵⁾ GDP data are four-quarter moving sums.

Sources: Central Bank of Malta; European Commission; Malta Stock Exchange; National Statistics Office.