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ECONOMIC PROJECTIONS FOR 2013 AND 2014

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ECONOMIC PROJECTIONS FOR 2013 AND 2014

Outlook for the Maltese economy[1]

According to the Bank's latest projections, real gross domestic product (GDP) growth in Malta is expected to accelerate to 1.8% this year from 0.8% in 2012. Economic growth should pick up again in 2014, to 2.0%. These growth rates are higher than those presented in the *Quarterly Review 2013:1*.[2]

Revisions to the previous projections are driven by new data covering the first half of 2013, as well as by a reassessment of investment plans in the energy sector.

Net exports to drive the expansion this year, domestic demand propels growth in 2014

In line with the outcome for the first half of 2013, real GDP growth for the year as a whole is expected to be driven by net exports, with imports set to fall faster than exports.

Overall domestic demand is foreseen to remain weak this year. However, in 2014 it is set to be the main engine of growth as private consumption and investment recover. After increasing strongly in 2012, general government consumption is expected to decelerate this year and grow at a faster, but still moderate, pace in 2014.

Meanwhile, the contribution of net exports to growth turns negative in 2014.

After having contracted by 0.2% in 2012, private consumption is expected to rise by 0.8% during 2013 on the back of a continued rise in employment and estimated growth in real disposable income. The fading hiatus in consumer spending around the time of the general elections in March was accompanied by an improvement in consumer confidence and this is also expected to support the recovery in private consumption. This should accelerate further to 1.9% in 2014, broadly in line with estimated growth in disposable income.

Given the broad-based contraction seen in the first half of 2013, investment is projected to fall by 2.6% over the year as a whole. Investment is set to begin growing again in 2014, rising by 11.1%. Two major projects in the energy sector, including the new gas power plant, are set to drive this recovery, although private investment in other sectors – including housing – is also expected to support the increase in capital spending. Government investment is set to decline this year, reflecting outcomes in the first half of the year, but should recover strongly in 2014 because of work on projects that were delayed in 2013 and as the current EU financial programming period draws to a close.

Given the outcome for the first half of the year, government consumption growth is set to slow down considerably, to 0.6% in 2013. It is set to remain moderate in 2014, at 1.4%, as Government seeks to make further progress in terms of fiscal consolidation, with a view to exit the Excessive Deficit Procedure.

Exports, which increased strongly in 2012, fell during the first half of 2013 and are set to contract by 2.9% over the year as a whole. The overall decline reflects a foreseen drop in exports of goods, particularly fuel and, to a lesser extent, semiconductors. In contrast, exports of services

[1] The Bank's outlook for the Maltese economy is based on information available up to 15 November 2013 and is conditional on the technical assumptions included in Table 7.1.

[2] See *Quarterly Review 2013:1*, pp. 79-82.

Table 7.1
PROJECTIONS FOR THE MAIN MACROECONOMIC VARIABLES FOR MALTA

	2012(1)	2013(2)	2014(2)
Real economic activity (% change)			
GDP	0.8	1.8	2.0
Private consumption expenditure	-0.2	0.8	1.9
Government consumption expenditure	5.0	0.6	1.4
Gross fixed capital formation	-3.9	-2.6	11.1
Inventories (% of GDP)	-1.4	-0.9	-0.6
Exports of goods & services	7.0	-2.9	2.1
Imports of goods & services	5.5	-3.9	3.4
Contribution to real GDP growth (in percentage pts)(3)			
Final domestic demand	0.3	0.2	3.0
Net exports	1.7	0.8	-1.0
Changes in inventories	-1.2	0.7	0.0
Balance of payments (% of GDP)			
Goods and services balance	5.5	6.3	5.5
Current account balance	1.6	1.7	0.7
Labour market (% change)			
Total employment	2.3	2.8	1.7
Unemployment rate (% of labour force)	6.4	6.3	6.3
Prices and costs (% change)			
RPI	2.4	1.5	1.5
Overall HICP	3.2	1.0	1.4
HICP excluding energy	3.1	1.1	2.2
Compensation per employee	2.2	1.2	2.0
ULC	3.7	2.2	1.6
Technical assumptions			
USD/EUR exchange rate	1.29	1.33	1.35
Oil price (USD per barrel)	112.0	108.2	103.9

(1) Data on GDP and the trade balance were sourced from NSO News Release 170/2013, as revised on 21 October 2013. Data on the current account balance were sourced from NSO News Release 180/2013.

(2) Central Bank of Malta projections.

(3) The contributions to GDP growth in this Table are estimated using GDP expenditure aggregates expressed in the previous year's prices. This approach yields different results from those reported elsewhere in this *Review*.

are expected to expand, with earnings from both tourism and non-travel services projected to increase. Overall export growth is set to turn positive in 2014, in line with an improvement in external demand and an expected increase in capacity in the tourism sector.

Imports are set to fall by 3.9% this year, after having expanded markedly in 2012, mainly reflecting a sizeable downscaling in fuel re-exports and overall weakness in aggregate demand. In 2014 import growth is set to turn positive, as the expected recovery in exports and buoyant domestic demand, reflecting higher consumption and investment expenditure, result in a surge of imports.

The current account surplus is to widen slightly in 2013, but narrows in 2014

The trade surplus is expected to widen in 2013, reflecting developments on the services account, with exports outpacing imports.[3] On the other hand, a larger deficit on trade in goods is foreseen, as exports are set to fall more strongly than imports. In 2014 the trade surplus is set to narrow, as imports respond to the recovery in aggregate demand.

Having moved into surplus in 2012, the current account is set to post a slightly higher surplus this year, as the improvement in the goods and services balance and an increase in net transfers receivable are almost fully offset by higher net outflows on the income account. The current account surplus is set to narrow in 2014, mainly reflecting the smaller trade surplus that is expected to be registered during that year.

The labour market

Following relatively strong growth in 2012, employment is set to accelerate in 2013, reflecting the buoyancy of the labour market in the first half of the year. With employment growth foreseen to decelerate in the second half, the projected growth rate for the year as a whole is expected to be 2.8%.

Employment growth is set to slow down to 1.7% the following year. The slowdown is mainly due to the strong outturn in 2013. Although the projections embed a small rise in the number of government employees, the increase in headcount is set to be driven by the private sector, supported by a growing share of part-timers in total employment.

The unemployment rate is expected to drop slightly in 2013, to 6.3%, and remain stable around that level in 2014, as the significant increase in employment is being almost completely matched by a higher labour supply, also reflecting an increasing female participation rate.[4]

Growth in unit labour costs (ULC) is expected to moderate in 2013, mirroring a fall in the growth rate of compensation per employee. Nominal compensation per employee is set to grow more strongly in 2014, as wages react to improvements in productivity. However, as productivity is set to recover, ULC growth should moderate in 2014.

Inflation

Harmonised Index of Consumer Price (HICP) inflation is set to ease from 3.2% in 2012 to 1.0% this year, before edging up to 1.4% next year. The projection for 2013 is largely determined by developments up to October, which entail a drop in inflation across all major sub-components.

The pick-up in 2014 reflects faster growth in prices of services and the impact of increased indirect taxes on alcohol and tobacco that were introduced in the Budget for 2014. These offset the effects of the announced 25% decline in utility tariffs that is set to take effect in March 2014. HICP inflation excluding energy is expected to slow down from 3.1% in 2012 to 1.1% this year. It is

[3] Data on the trade balance in this Box are consistent with *NSO Release 170/2013* and the 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 Release 180/2013*.

[4] 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 the *Review*.

then projected to accelerate to 2.2% in 2014. The projection for 2014 is also influenced by the projected decline in the price of Brent crude oil.

Fiscal deficit is expected to narrow

The general government deficit-to-GDP ratio is set to fall from 3.3% in 2012 to below 3.0% in 2014, as revenue is projected to outpace expenditure.

The narrowing of the deficit over the projection horizon is mainly supported by continued buoyancy in direct taxes paid by corporations, and, in 2014, also by higher revenue from additional indirect taxes announced in the Budget 2014.

The fiscal projections continue to assume restrained growth in selected items of current expenditure, particularly those related to intermediate consumption. The increase in the retirement age in 2013 and a projected slowdown in nominal investment also limit overall expenditure growth in 2013. In 2014 recurrent expenditure is expected to grow moderately as a proportion of GDP, partly because payments arising from the renewal of certain sector wage agreements in 2013 will not be repeated in 2014. This is counterbalanced by the expected acceleration in government investment mentioned earlier.

The general government debt ratio is projected to rise through 2013 and 2014, ending that year at around 72% of GDP.

Risks to the projections

Risks to the GDP projections are on the downside in 2013 and relate mainly to the fact that the baseline projection incorporates an assumed recovery of private consumption and investment. The downside risk would materialise if the recovery in domestic demand does not take place as envisaged. In 2014 risks are broadly balanced. On the one hand, the economic situation in the euro area remains fragile and there could be pressure for further fiscal consolidation. On the other hand, export growth could recover more strongly than the projections suggest.

With regard to prices, risks are balanced in 2013 but slightly on the downside for 2014, reflecting the risks to the demand components referred to above.