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Economic Projections For 2012 And 2013

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ECONOMIC PROJECTIONS FOR 2012 AND 2013

Outlook for the Maltese economy[1]

The Bank's latest projections for the Maltese economy show a slowdown in 2012, followed by an acceleration in 2013. However, in contrast with earlier projections, this year the recovery of the economy is expected to be weaker than forecast earlier.[2]

The Bank is thus estimating real gross domestic product (GDP) growth at 1.0% in 2012. In 2013 GDP growth is set to accelerate slightly to 1.1% (see Table 7.1). This compares with growth rates of 1.4% and 2.2% in 2012 and 2013, respectively, in the previous forecast undertaken in May 2012.

The downward revisions to the economic outlook were partly prompted by the release of GDP data covering the first half of 2012, which revealed negative or subdued growth in domestic demand components excluding government consumption. The deteriorating economic outlook in Malta's main trading partners in the context of persistent uncertainty about the euro area, as well as weak global business and consumer sentiment, also contributed to this revision.

Net exports expected to have driven growth in 2012, final domestic demand behind the recovery in 2013

According to the Bank's latest estimates, growth in 2012 was expected to have been driven by net exports. This estimate was supported by GDP data for the first half of the year, which showed a significant expansion in exports and a negative impact of changes in inventories on GDP. In the second half of the year export growth was expected to have moderated in the context of a weak global environment. Overall, however, net exports were expected to have contributed positively to GDP.

Final domestic demand, on the other hand, was expected to have lowered GDP during 2012 as private demand responded to weak growth in disposable income and to a more modest pace of job creation, as well as to uncertainty on the impact of subdued global prospects on the Maltese economy. At the same time, general government consumption was expected to have grown more slowly than in the previous year, as Government sought to meet its fiscal targets.

The recovery in 2013 is mainly expected to be driven by private consumption and investment. The latter is set to benefit from two specific large projects, one of which is expected to be completed during the year. Government consumption is expected to have a small upward impact on GDP as expenditure restraint is assumed to continue. Net exports are projected to contribute marginally to growth, in response to a fragile, though improving, external environment.

After expanding strongly in 2011, private consumption was expected to have contracted by 0.6% in 2012, reflecting weak growth in real disposable income, and the impact of uncertainty on consumer spending. It is projected to increase by 0.6% in 2013, as employment income accelerates and uncertainty subsides.

[1] The Bank's latest macroeconomic estimates for 2012 and projections for 2013 were prepared in the context of the Eurosystem's December 2012 Broad Macroeconomic Projection Exercise. They are based on information available up to 23 November 2012 and are conditional on technical assumptions included in Table 7.1. The projections do not take into account the GDP data for Malta that were published on 7 December 2012.

[2] See *Quarterly Review 2012:2*, pages 66-70.

Table 7.1
PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES FOR MALTA

	2011[1]	2012[2]	2013[3]
Real economic activity (% change)			
GDP	1.9	1.0	1.1
Private consumption expenditure	4.0	-0.6	0.6
Government consumption expenditure	3.2	2.5	1.1
Gross fixed capital formation	-14.6	-4.1	2.6
Inventories (% of GDP)	-2.3	-2.3	-2.1
Exports of goods & services	2.5	6.3	3.1
Imports of goods & services	0.1	5.2	3.4
Contribution to real GDP growth (in percentage pts)[4]			
Final domestic demand	0.5	-0.5	1.0
Net exports	2.3	1.4	0.0
Changes in inventories	-0.9	0.1	0.1
Balance of payments (% of GDP)			
Goods and services balance	5.7	6.7	6.6
Current account balance	-0.3	-2.4	-2.3
Labour market (% change)			
Total employment	2.5	1.5	1.1
Unemployment rate (% of labour force)	6.4	6.3	6.3
Prices and costs (% change)			
Overall HICP	2.5	3.2	2.4
HICP excluding energy	1.8	3.1	2.5
Compensation per employee	0.8	1.0	1.6
ULC	1.3	1.6	1.6
Public finances (% of GDP)			
General government balance	-2.7	-2.6	-2.8
General government debt	70.9	72.2	73.1
Technical assumptions			
EUR/US$ exchange rate	1.392	1.281	1.275
Oil price (US$ per barrel)	111.0	111.7	105.0
10-year euro area bond yield (%)	4.3	3.8	3.6

[1] Data on GDP were sourced from NSO News Release 173/2012 published on 6 September 2012.
[2] Central Bank of Malta estimates.
[3] Central Bank of Malta projections.
[4] 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*, where contributions are calculated on the basis of volume increases based on a fixed year's price.

The Bank's estimate for private investment shows that, after a further contraction in 2012, a recovery is expected in 2013. This updated forecast takes into account revised 2011 data and the outcome reported by the National Statistics Office (NSO) in the first half of 2012, which pointed to weaker than expected outturns in most categories of investment. The latest projections also take into account information concerning expenditure on two large projects (the City Gate project in Valletta and the installation of a link between the domestic electricity grid and that in Sicily) that are classified under private investment. Overall expenditure on these two projects was expected to have peaked in 2012. Real government investment was expected to have slowed down in 2012 and to continue to decelerate in 2013 as a critical mass of infrastructure projects should have been completed by the end of 2012.

Public consumption growth was expected to have moderated in 2012 and is set to decelerate further in 2013 on the assumption that Government would make further progress in achieving its medium-term objective of a balanced budget. Relatively high growth in 2012 partly reflected substantial outlays on intermediate consumption, most notably on health, and compensation to government employees during the first half of the year.

The Bank's estimates for exports in 2012 are based on strong export growth in the first half of the year, as published by the NSO, and an expected weakening in the last six months of the year. The estimate for 2012 was also influenced by a base effect in non-fuel goods exports, which were rather low in 2011 and were assumed to normalise in 2012, as well as by the favourable performance of the tourist sector, which continued to respond to an increase in new air routes serving Malta and higher seat capacity utilisation. The remaining service exports were expected to have dropped slightly, under the impact of subdued external demand.

Exports are projected to increase by 3.1% in 2013, driven by developments in services, particularly tourism. Other service exports are also expected to expand in response to improved economic conditions in the countries of the relevant trading partners.

In 2013 imports are expected to rise by 3.4%, following an estimated increase of 5.2% in 2012. This profile reflects the expectation that imports in the second half of 2012 would have picked up to match at least part of the strong outturn in exports in the first half of the year. The deceleration in 2013 mainly reflects slower growth in fuel imports, as imports of non-fuel goods and services are set to accelerate underpinned by a recovery in private consumption and investment.

Wage and employment growth expected to moderate

The resilience of employment levels in the first half of 2012, notwithstanding the weak GDP outturn during that period, was expected to have prompted slower employment growth in the rest of the year. Thus, employment growth was expected to have decelerated from 2.5% in 2011 to 1.5% in 2012 and is set to ease further, to 1.1% in 2013. The unemployment rate was expected to have edged down to 6.3% in 2012 and is expected to remain at that level in 2013.

After relatively large increases in private sector wages in the first half of 2012, nominal compensation per employee was expected to have slowed down in the second half of the year. As a result growth in unit labour costs (ULC) was expected to have moderated.

As GDP growth begins to recover in 2013, compensation per employee is expected to accelerate. Nonetheless, since a recovery in productivity is also anticipated as employment growth slows, ULC growth is expected to stabilise at 1.6% in 2013.

Inflation estimated to have accelerated in 2012, set to ease in 2013

The Bank estimated that inflation based on the Harmonised Index of Consumer Price (HICP) inflation rose to 3.2% in 2012. It is expected to fall to 2.4% in 2013. These projections reflect higher than anticipated inflation during the first ten months of 2012, notably in prices for services, but they also take into account technical factors, such as movements in international food commodity prices and exchange rates.

In 2012 inflation excluding energy was expected to have risen to 3.1% from 1.8% in 2011, owing to accelerating services inflation. On the other hand, energy price inflation was projected to have eased to 4.5% in line with a deceleration in international oil prices.

In 2013 HICP inflation is expected to decrease, as food price inflation is set to moderate somewhat and energy prices are projected to decline. The projections also reflect the assumption that water and electricity tariffs will remain unchanged in 2013. Meanwhile, the services inflation rate is also expected to ease. In contrast, the weakening of the euro during 2012 is anticipated to contribute to a pick-up in non-energy goods inflation. As a result, HICP excluding energy inflation is expected to fall to 2.5%.

Current account deficit set to have widened in 2012

The surplus on the goods and services account was expected to have increased as a percentage of GDP in 2012, mainly as a result of an improvement in the services balance. In nominal terms, service exports were expected to have expanded more rapidly than imports, reflecting the buoyant performance of the tourist industry.

In 2013 the trade surplus is expected to fall slightly as a percentage of GDP, as non-fuel goods imports pick up in line with the recovery foreseen in domestic demand. This is anticipated to offset most of the improvement on the services account, which continues to be supported by relatively high inflows from tourism activity.

With the income account expected to record sizeable net outflows, the current account balance is projected to register a deficit in both 2012 and 2013. In 2012 such outflows were expected to have outweighed the increase in the trade surplus. As a result, the current account deficit was estimated to have widened to 2.4% of GDP. The higher outflows on the income account may be linked to Malta's relatively strong export performance, which resulted in higher profits for export-oriented firms of non-resident owners operating in Malta. In 2013 the share of these net outflows in GDP is projected to decline as export growth moderates. As a result, the current account deficit is expected to narrow slightly to 2.3% of GDP.

Temporary narrowing of fiscal deficit expected

With regard to fiscal indicators, the Bank's projections show a narrowing of the general government deficit-to-GDP ratio to 2.6% in 2012.

Revenue growth in 2012 was expected to have been partly driven by temporary factors, while more restrained expenditure growth would have reflected tighter control on government spending. The deficit ratio is projected to widen to 2.8% in 2013, unless consolidation measures are taken to replace the contribution of one-off receipts to the deficit reduction in 2012, and to offset transfers to the national airline and the national energy provider.

The general government debt-to-GDP ratio is expected to increase over the projection horizon. Partly as a result of increased borrowing associated with European Union commitments to extend financial support to International Monetary Fund programme countries, the debt ratio was estimated to have risen from 70.9% in 2011 to 72.2% in 2012. The Bank projects a further rise to 73.1% in 2013.

Apart from taking into account new data that became available during 2012, the latest fiscal projections also reflect a downward revision in macroeconomic forecasts. The upward revision in the deficit ratios for 2012 and 2013 also reflects the impact of these factors.

Risks to the projections

On balance, risks to the GDP projections are broadly balanced. With regard to 2012, the Bank assumed that the incipient economic recovery apparent in the second quarter would be sustained in the second half of the year. It should be emphasized, however, that quarterly macroeconomic data are volatile and idiosyncratic shocks at sector level, and sometimes even at the level of individual firms, may have significant impact on the domestic economy, both in an upward or downward direction.

The still fragile situation in the euro area and the possibility that demand in Malta's main trading partners turns out to be weaker than expected acts as a negative risk. This could cause exports to grow less strongly than foreseen, with an adverse impact on private investment. On the other hand, exports growth may accelerate, underpinned by positive developments in services.

With regard to the inflation outlook, risks are judged to be broadly balanced. There are upward risks to the projections stemming from possible increases in the price of energy or possibly higher indirect taxes as fiscal consolidation continues. A higher than assumed impact of the rise in food commodity prices presents an additional upside risk. On the other hand, a weaker than expected recovery in aggregate demand would dampen price pressures.