



BANK ĊENTRALI TA' MALTA  
EUROSISTEMA  
CENTRAL BANK OF MALTA

## ECONOMIC UPDATE 5/2015

Date of issue: 26 May 2015

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*The cut-off date for information in this publication is 15 May 2015 unless otherwise indicated. Figures in tables may not add up due to rounding.*

ISSN 2410-8294 (online)

## ECONOMIC UPDATE 5/2015

### Summary<sup>1</sup>

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. Indicators for manufacturing and tourism point to further growth in the first quarter of 2015. 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, though the annual rate of inflation rose to 1.4% in April 2015. In March, Maltese residents' deposits increased on a year earlier, but credit to residents fell. As regards fiscal developments, the general government deficit narrowed to 2.1% of GDP during 2014. In the first quarter of 2015, the deficit on the Consolidated Fund also decreased compared with the same period of 2014. 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).

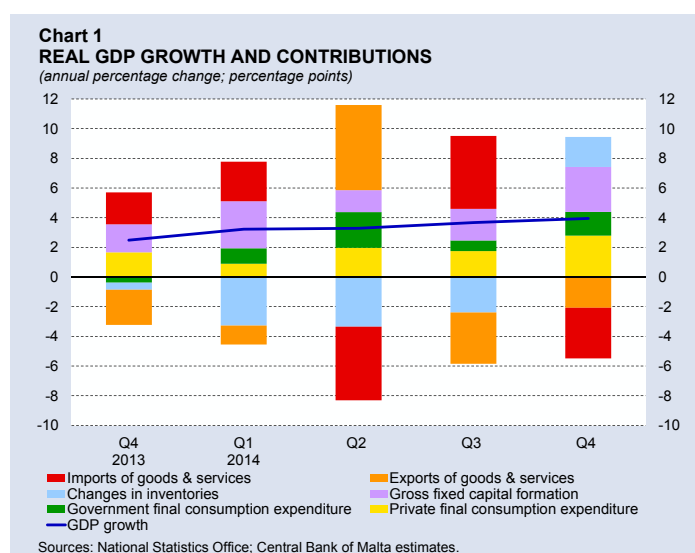
Looking closer at the components of domestic demand, during the fourth quarter the largest contributor remained investment (gross fixed capital formation). This rose by 16.5% on an annual basis and contributed 3.0 percentage points to overall GDP growth (see Chart 1). Non-residential construction accounted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

	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
<b>Domestic demand</b>	<b>1.8</b>	<b>2.6</b>	<b>2.5</b>	<b>10.2</b>	<b>4.3</b>
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
<b>Gross domestic product</b>	<b>3.2</b>	<b>3.3</b>	<b>3.7</b>	<b>4.0</b>	<b>3.5</b>

<sup>(1)</sup> Chain-linked volumes, reference year 2010.  
Source: National Statistics Office.

<sup>1</sup> The cut-off date for information in this note is 15 May 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.<sup>2</sup>

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 reduced 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.

More recent data covering the first quarter of 2015 show signs of recovery in manufacturing and continued growth in tourism.

As regards manufacturing, the index of industrial production fell by 1.0% in year-on-year terms during March 2015.<sup>3</sup> However, during the first quarter as a whole, industrial production increased by 3.3% compared with the corresponding period of 2014. The increase mainly reflects a strong pick-up in the production of pharmaceuticals and increases in the output of the non-metallic

<sup>2</sup> 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.

<sup>3</sup> Based on the industrial production index adjusted for working days.

minerals sector and the printing and reproduction of recorded media sector. The energy sector also contributed positively. These developments outweighed drops in the production of textiles, electrical equipment and computer, electronic & optical products.

Turning to tourism, the positive performance observed in 2014 extended into 2015. In March, tourist arrivals rose at an annual rate of 4.1%, with nights spent and expenditure also increasing. Consequently, during the first quarter of 2015, tourist numbers

increased by 7.7% on a year earlier, while nights stayed and total spending went up by 5.8% and 8.9%, respectively. The rise in expenditure was mostly influenced by spending on package holidays.

In the first three months of 2015, however, the number of foreign cruise passengers amounted to 20,652, a decrease of 45.8% over the exceptionally high number of visitors a year earlier.

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 went up. In 2014 as a whole, employment expanded by 3.1%.

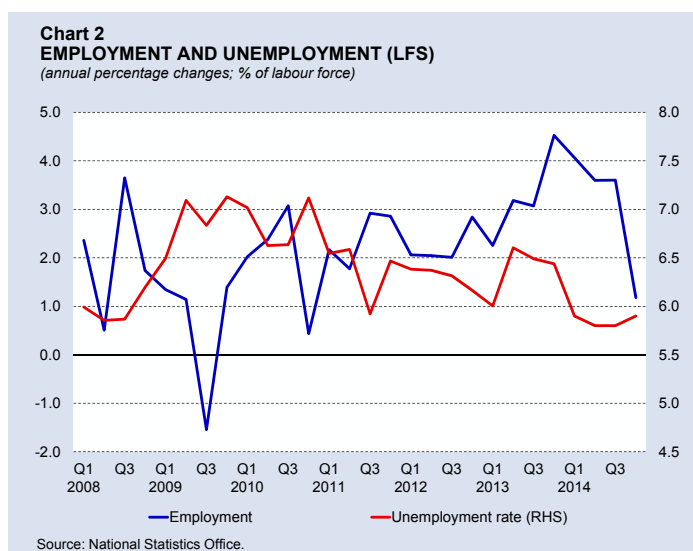
ETC records show that in December the gainfully occupied population rose by 3.8% on a year earlier, the same increase registered in November.<sup>4</sup>

According to the LFS, the unemployment rate stood at 5.9% in the fourth quarter of 2014, compared with 6.4% a year earlier. Eurostat's estimate of the seasonally-adjusted unemployment rate for the first quarter of 2015 also stood at 5.9%.

ETC data show that in March 2015 the number of people on the unemployment register fell by 1,750 compared with a year earlier, to 5,894.

## Prices, costs and competitiveness

In April, the annual rate of HICP inflation rose to 1.4%, from 0.5% a month earlier. As a result, the twelve-month moving average rate edged up to 0.7% from 0.6% in March (see Chart 3).



<sup>4</sup> The LFS is a household survey conducted by the National Statistics Office (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.

This significant pick-up in the annual rate of change of the HICP was primarily the result of a base effect on energy price inflation, as the electricity tariff cut in April 2014 no longer affects the annual inflation rate. In fact, energy price inflation in April 2015 rose from -13.0% in March to -5.1%. The continued, though smaller, decline in energy prices reflects falling transport fuel prices.

The acceleration in inflation in April was also due to an increase in non-energy industrial goods inflation, which rose by 0.2 percentage point to 1.6%.

This was mainly the result of a faster rise in prices of garments. In addition, services price inflation edged up marginally to 1.6%, from 1.5% in March, mainly due to transport.

Meanwhile, food price inflation remained largely stable around its March level, as a minor pick-up in processed food inflation was offset by a marginal slowdown in unprocessed food inflation.

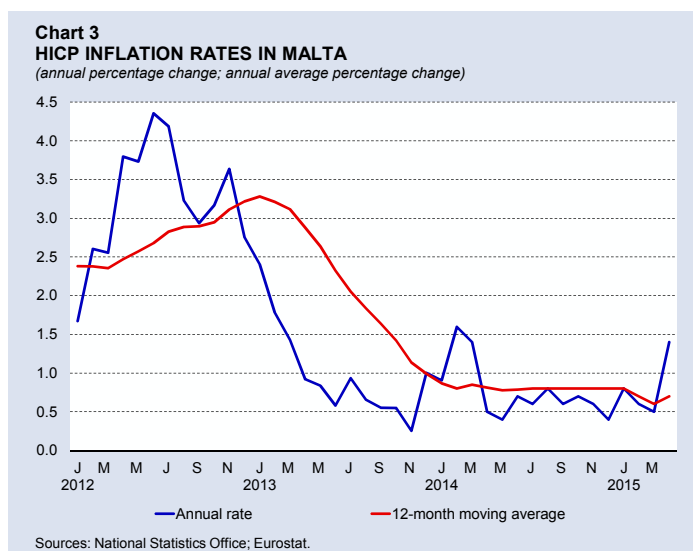
Looking at measures of domestic costs, during the fourth quarter of 2014, Malta's unit labour costs, measured as a four-quarter moving average, increased by 1.5% on a year earlier, up from 1.3% in the previous quarter. Compensation per employee rose by 0.9%, whereas productivity fell by 0.6%.

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, mainly driven by developments in prices of apartments. As a result, on average residential property prices rose by 7.0% in 2014. Although they indicate trends, advertised prices may not accurately reflect the actual prices at which sales take place.

### Deposits, credit and financial markets<sup>5</sup>

Residents' deposits held with monetary financial institutions (MFI), and forming part of broad money (M3), grew by €354.9 million, between February and March, reversing the previous month's decline. As a result, the annual rate of growth of residents' deposits in M3 rose to 16.2% in March, from 15.2% in the previous month (see Chart 4).

Growth stemmed mainly from overnight deposits, which reversed the previous month's decline and added €356.7 million, or 4.2%, during the month. The rise stemmed mainly from higher balances belonging to households. Overnight deposits continued to grow at a substantial annual pace, increasing by 30.5%, from 30.6% in February.



<sup>5</sup> 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.

On the other hand, deposits with an agreed maturity of up to two years contracted marginally in March, as a decline in households' balances offset a rise in NFCs' holdings. Given that this monthly decline was smaller than that registered twelve months earlier, their annual rate of change rose, but remained negative at -7.6%. Meanwhile, deposits redeemable at a notice of up to three months went down by €0.6 million, or 0.5%, month-on-month.

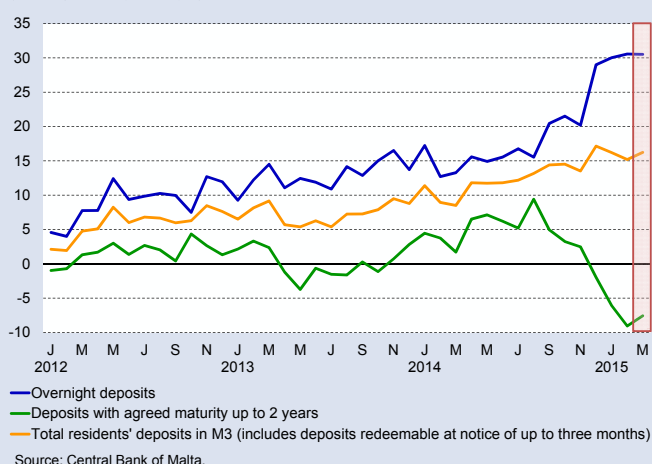
On the asset side of MFI balance sheets, credit to Maltese residents expanded by €62.2 million, or 0.5%, between February and March. Nonetheless, credit contracted by 1.1% year-on-year, the same rate as in the previous month (see Chart 5).

Credit to general government grew by €42.6 million, or 1.6%, in March, as MFIs increased their holdings of MGS. Consequently, the annual growth rate rose to 1.2% from 0.6% in the previous month.

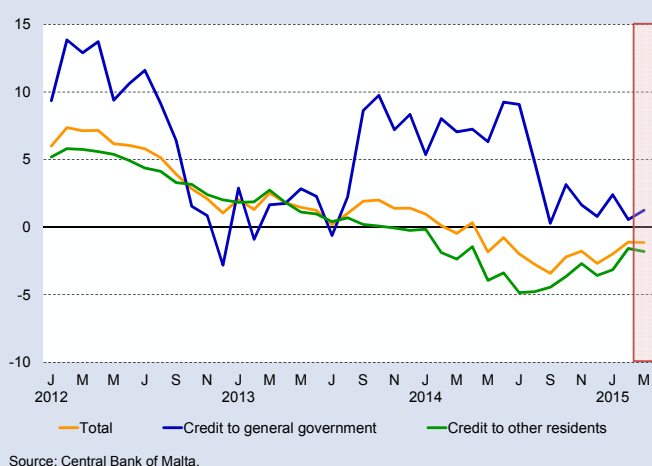
Meanwhile, credit to all other residents went up by €19.6 million, or 0.2%, on the previous month. Nonetheless, it contracted by 1.8% year-on-year, following a drop of 1.6% in the previous month.

Loans to NFCs decreased by 0.3% month-on-month, as loans to the energy sector fell. Consequently, the annual growth rate slowed down to 1.8% from 2.8% in February (see Chart 6). Meanwhile, lending to households grew by 0.5% during the month, driven by higher lending for house

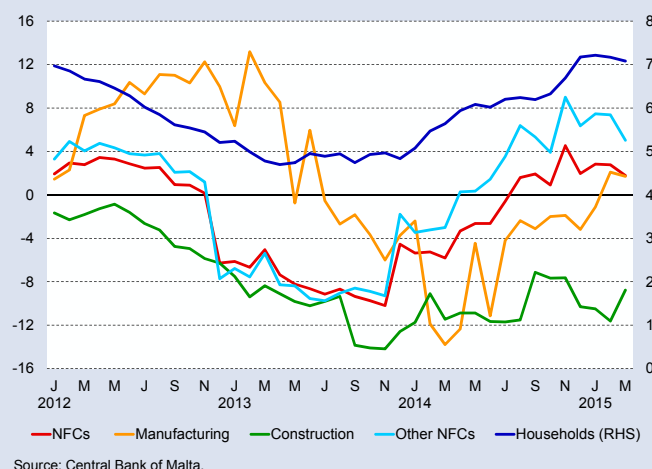
**Chart 4  
SELECTED DEPOSITS OF MALTESE RESIDENTS**  
(annual percentage changes)



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

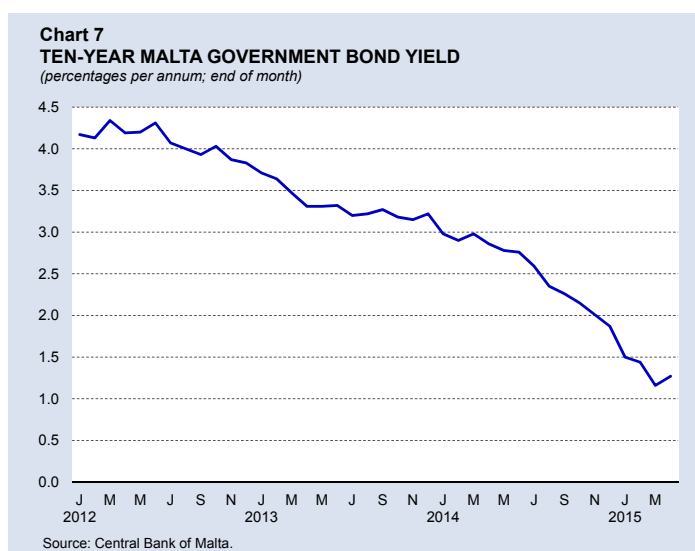


**Chart 6  
LOANS BY SECTOR**  
(annual percentage changes)



purchases. The annual rate of growth of loans to households was 7.1%, broadly unchanged over the previous month.

Bank lending and deposit rates fell slightly during the month. The weighted average interest rate paid by MFIs on all euro-denominated deposits belonging to resident households and NFCs dropped by 5 basis points to 0.93% in March. Meanwhile, the comparable rate charged by MFIs on outstanding loans to resident households and NFCs stood at 3.98%, 1 basis point lower than in February.



The weighted average deposit rate was 41 basis points below its level a year earlier, while that charged on loans was 22 basis points lower.

In the domestic capital market, the yield on ten-year government bonds rose by 11 basis points in April to 1.27%. The increase, which was in line with developments in sovereign bond yields in the euro area as a whole, brought to a halt the downward trend seen in recent months (see Chart 7).

The Malta Stock Exchange (MSE) index lost 0.2% in April, ending the month at 3,767.7.

## Public finance<sup>6</sup>

In the final quarter of 2014 the general government balance improved on a year-on-year basis. As a result, over the year as a whole, the deficit decreased to €168.3 million from €194.4 million in 2013. The deficit to GDP ratio declined, from 2.6% in 2013 to 2.1% in 2014.

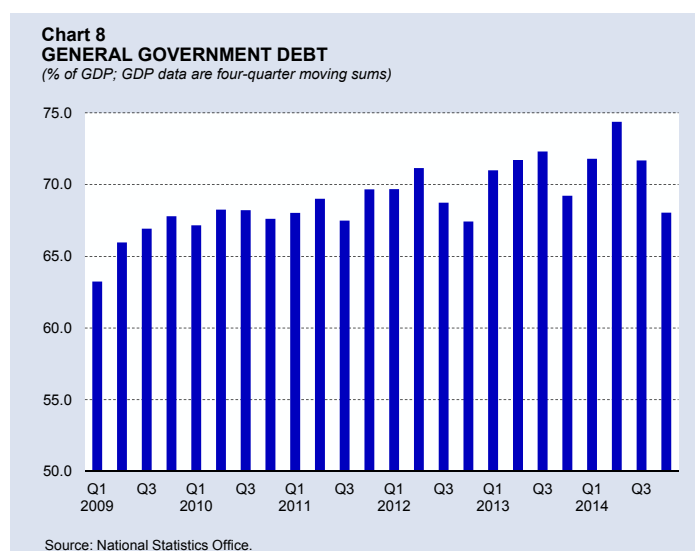
Total revenue grew by 10.5% in 2014, buoyed by higher tax revenue, reflecting positive developments in the Maltese economy as well as fiscal measures. Current taxes on income and wealth surged by 10.8%, partly due to revenue from the Investment Registration Scheme, which allowed Maltese residents to regularise their position with regard to undeclared assets held abroad. Inflows from taxes on production and imports grew by 10.7%, driven by growth in domestic and tourist consumption, as well as increased excise duty rates. At the same time, income from social contributions grew by 6.8%, reflecting continued positive labour market developments.

Meanwhile, receipts from capital and current transfers grew by 33.2%, owing to grants received from the European Union.

<sup>6</sup> 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.



General government expenditure rose by 9.1%, with recurrent spending accounting for just under three-fourths of the increase. Compensation of employees grew by 7.6%, mainly reflecting increased outlays in the health and education sectors. Intermediate consumption went up by 11.6%, as spending on public administration and health rose. At the same time, outlays on social benefits rose by 4.6%, due to higher spending on retirement pensions and social assistance.



Meanwhile, spending on gross fixed capital formation surged by 43.2%, owing to higher expenditure on infrastructural projects partly funded by the European Union. On the other hand, capital transfers declined by 7.1%, as the equity injection into Air Malta was smaller than in the previous year.

The general government debt-to-GDP ratio stood at 68.0% in 2014, down from 69.2% in 2013 (see Chart 8).

In the month of March 2015 the Consolidated Fund deficit stood at €135.0 million, down from €151.1 million in March 2014. As a result, in the first quarter as a whole, the Consolidated Fund deficit declined by €140.2 million, to €85.3 million, compared with the same period last year. Revenue surged by 22.8%, mainly due to higher EU grants and proceeds from indirect taxes. On the other hand, expenditure declined by 0.4%, as capital outlays fell, while recurrent spending rose only marginally.

## 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.<sup>7</sup> This increase was mainly driven by an €81.2 million decline in net outflows on the primary income account.<sup>8</sup> The services balance 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.

<sup>7</sup> 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.

<sup>8</sup> 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	2014	2013	2014
	Q4	Q4	Q1-Q4	Q1-Q4
<b>Current account</b>	<b>1.0</b>	<b>10.9</b>	<b>234.8</b>	<b>215.1</b>
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.<sup>9</sup> 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.

During the first quarter of 2015, Customs data show that exports continued to fall whereas imports increased on a year earlier. As a result, the merchandise trade deficit widened by €300.7 million on a year earlier, to €675.0 million. The increase in imports is attributable to a sharp rise in registrations of aircraft and boats. The balance from trade in fuel was largely unchanged on a year earlier, as a decline in fuel imports was broadly matched by a drop in related exports. Excluding fuel, aircraft and boats, the trade gap narrowed as imports contracted, while exports expanded slightly.

<sup>9</sup> 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	2013	2014	2014	2014	2014	2015	2014	2014	2014	2015	2015	2015	2015	2015
			Q4	Q1	Q2	Q3	Q4	Q1	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	
<b>Prices and costs</b>																
HICP	1.0	0.8	0.6	1.3	0.5	0.7	0.6	1.9	0.7	0.6	0.4	0.8	0.6	0.5	1.4	
Unit labour costs, whole economy <sup>(1)</sup>	1.0	1.5	1.0	0.8	1.4	1.3	1.5	-	-	-	-	-	-	-	-	-
Compensation per employee <sup>(1)</sup>	-0.4	0.9	-0.4	-0.5	0.0	0.1	0.9	-	-	-	-	-	-	-	-	-
Labour productivity (per person) <sup>(1)</sup>	-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	-	-	-	-	-	-	-	-	-
<b>Economic activity</b>																
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	2.7	3.0	1.4	6.8	14.1	4.1	-	-
<b>Labour market developments (LFS)</b>																
Unemployment rate (% of labour force)	6.4	5.9	6.4	5.9	5.8	5.8	5.9	-	-	-	-	-	-	-	-	-
Total employment	3.3	3.1	4.5	4.0	3.6	3.6	1.2	-	-	-	-	-	-	-	-	-
<b>Balance of payments</b>																
Current account (as a % of GDP) <sup>(1)(2)</sup>	3.1	2.7	3.1	-	-	-	2.7	-	-	-	-	-	-	-	-	-
<b>Credit and financial indicators</b>																
Maltese residents' deposits and loans																
Overnight deposits	13.7	29.0	13.7	13.3	15.6	20.4	29.0	30.5	21.5	20.2	29.0	30.0	30.6	30.5	-	-
Deposits with agreed maturity up to 2 years	2.8	-2.0	2.8	1.7	6.2	4.9	-2.0	-7.6	3.2	2.5	-2.0	-6.1	-9.1	-7.6	-	-
Total residents' deposits in M3	8.8	17.2	8.8	8.5	11.8	14.4	17.2	16.2	14.5	13.5	17.2	16.2	15.2	16.2	-	-
Credit to general government	8.3	0.8	8.3	7.1	9.2	0.3	0.8	1.2	3.1	1.6	0.8	2.4	0.6	1.2	-	-
Credit to other residents	-0.2	-3.6	-0.2	-2.4	-3.4	-4.4	-3.6	-1.8	-3.7	-2.7	-3.6	-3.2	-1.6	-1.8	-	-
Total credit	1.4	-2.7	1.4	-0.5	-0.8	-3.4	-2.7	-1.1	-2.2	-1.8	-2.7	-2.0	-1.1	-1.1	-	-
10-year interest rate (%) <sup>(3)</sup>	3.4	2.6	3.2	3.0	2.9	2.5	2.1	1.5	2.2	2.1	1.9	1.7	1.5	1.3	1.2	-
Stock prices: Malta Stock Exchange Index <sup>(4)</sup>	14.8	-9.6	7.8	-7.1	-3.7	1.1	-0.1	13.4	-0.9	-0.9	1.8	2.7	0.8	9.5	-0.2	-
<b>General government finances (% of GDP)</b>																
Surplus (+) / deficit (-) <sup>(5)</sup>	-2.6	-2.1	-2.6	-3.0	-3.5	-2.7	-2.1	-	-	-	-	-	-	-	-	-
Gross debt <sup>(6)</sup>	69.2	68.0	69.2	71.8	74.4	71.7	68.0	-	-	-	-	-	-	-	-	-

<sup>(1)</sup> Four-quarter moving averages.

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

<sup>(3)</sup> Period averages.

<sup>(4)</sup> Period-on-period percentage changes.

<sup>(5)</sup> Four-quarter moving sums.

<sup>(6)</sup> GDP data are four-quarter moving sums.

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