



BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

ECONOMIC UPDATE 7/2015

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ECONOMIC UPDATE 7/2015

Summary¹

Economic activity in Malta continued to expand robustly in the first quarter of 2015, with real gross domestic product (GDP) increasing by 4.0% on a year earlier. Growth was driven by net exports, as domestic demand declined. Indicators for manufacturing and tourism point to further expansion in the second 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), eased to 1.1% in June. In May, Maltese residents' deposits expanded further on a year earlier, while the annual rate of growth of credit to residents turned positive. As regards fiscal developments, the general government deficit widened in the first quarter of 2015. However, during the first five 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 first quarter of 2015, with real GDP rising at an annual rate of 4.0%, a slight deceleration from 4.2% in the previous quarter (see Table 1).

Growth was driven by net exports. While exports fell on a year earlier, imports declined at an even faster pace. As a result, net exports turned positive and contributed 4.2 percentage points to real GDP growth, outweighing a drop in domestic demand.

Exports dropped by 5.5%, year-on-year, mostly due to lower foreign sales of goods, while services exports dropped only slightly. Reflecting the reduction in exports and weaker domestic demand, total imports fell by 7.9%. This drop also stemmed largely from imports of goods.

Table 1
GROSS DOMESTIC PRODUCT⁽¹⁾

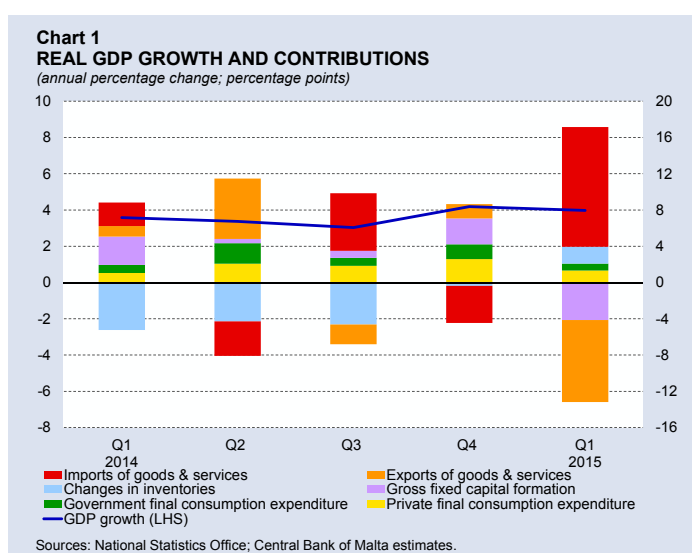
	2014				2015
	Q1	Q2	Q3	Q4	Q1
	<i>Annual percentage changes</i>				
Private final consumption expenditure	1.8	3.6	3.4	4.6	2.3
Government final consumption expenditure	4.1	11.2	5.0	8.3	3.6
Gross fixed capital formation	15.4	2.6	5.2	14.8	-18.3
Domestic demand	-0.1	0.6	-1.3	7.2	-0.3
Exports of goods & services	0.8	4.3	-1.4	1.0	-5.5
Imports of goods & services	-1.2	2.5	-4.5	2.8	-7.9
Gross domestic product	3.6	3.4	3.0	4.2	4.0

⁽¹⁾ Chain-linked volumes, reference year 2010.

Source: National Statistics Office.

¹ The cut-off date for information in this note is 17 July 2015.

Domestic demand contracted by 0.3% on a year earlier, dampening real GDP growth by 0.2 percentage points. Investment fell by 18.3% when compared with the first quarter of 2014, reversing the increases registered in the previous five quarters. Thus, investment reduced real GDP growth by 4.1 percentage points (see Chart 1). The fall in investment can be largely attributed to lower spending on non-residential construction and machinery. Conversely, investment in dwellings rose, as did expenditure on transport equipment.



The decrease in investment offset growth in the other components of domestic demand.

Private consumption continued to rise, sustained by further growth in employee compensation, contributing 1.3 percentage points to GDP growth. However, at 2.3%, the annual growth rate of private consumption halved compared with the previous quarter.

Government consumption growth also slowed down significantly, with the annual growth rate dropping to 3.6% from 8.3% in the previous three month period. The deceleration reflected more moderate growth in both compensation of employees and intermediate consumption.

At the same time, changes in inventories had a large positive impact on growth.²

Nominal GDP growth moderated slightly in the first quarter of 2015, with the annual rate edging down to 6.0%, compared with 6.4% in the last quarter of 2014. The annual rate of growth of gross value added (GVA) remained unchanged, at 5.2%. Services continued to drive the expansion in GVA. The strongest contributions came from the sectors incorporating professional & scientific activities and public administration, health & education, which together accounted for almost half of the increase in GVA. Strong increases were also recorded from the sectors comprising wholesale & retail trade, financial services and utilities. Meanwhile, GVA in the construction sector increased marginally, whereas that in manufacturing declined.

The available information for the second quarter of 2015 shows signs of recovery in manufacturing and continued growth in tourism.

As regards manufacturing, the index of industrial production rose by 8.9% in year-on-year terms during May 2015.³ As a result, the three-month moving average of the index increased by 5.8% compared to a year earlier. The improvement in industrial production reflected output increases

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 is based on the Bank's calculations.

³ Based on the industrial production index adjusted for working days.

in all major manufacturing categories, notably in pharmaceuticals. Manufacturing of computer, electronic & optical products, printing & reproduction of recorded media, rubber & plastic and food products also increased, but at a more modest pace.

Turning to tourism, in May arrivals rose by 6.4% on a year earlier, with nights stayed and expenditure also increasing. As a result, during the first five months of 2015, tourist numbers increased by 5.9% on a year earlier, while nights stayed and total spending went up by 4.2% and 7.2%, respectively. All major expenditure components increased on year-ago levels.

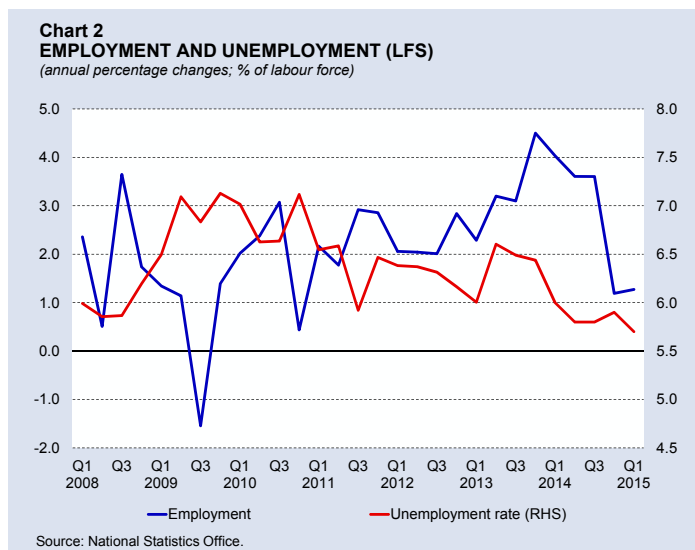
In the first three months of 2015, however, the number of foreign cruise passengers amounted to 20,652, a decrease of 45.8% over the exceptionally high number of visitors a year earlier.

As regards the labour market, Labour Force Survey (LFS) data for the first quarter of 2015 indicate an increase of 1.3% in employment 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 strongly. In January and February 2015 the gainfully occupied population rose by 3.9% and 4.1% on a year earlier, respectively. These growth rates exceeded the 3.8% increase recorded in December 2014.⁴

According to the LFS, the unemployment rate stood at 5.7% in the first quarter of 2015, compared with 5.9% a year earlier.⁵ This is the lowest rate since the inception of the survey in 2000. Eurostat's estimate of the seasonally-adjusted unemployment rate for the first quarter of 2015 stood at 5.9%. By May, the unemployment rate based on this measure fell to 5.6%.

ETC data show that in May 2015 the number of people on the unemployment register fell by 1,808 compared with a year earlier, to 5,333.



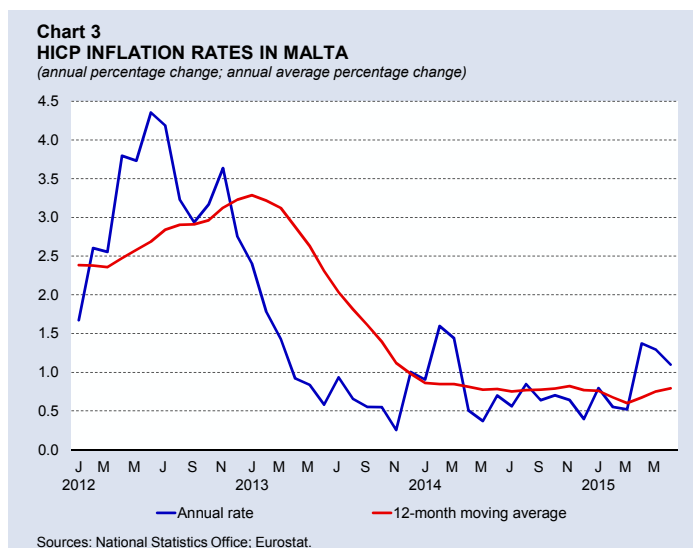
⁴ The LFS is a household survey conducted by the NSO on the basis of definitions set by the International Labour Organization and Eurostat. ETC data are based on administrative records according to definitions established by domestic legislation on employment and social security benefits.

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.

Prices, costs and competitiveness

In June, the annual rate of HICP inflation fell slightly to 1.1%, from 1.3% a month earlier. The twelve-month moving average rate remained constant at 0.8% (see Chart 3).

The slowdown in annual inflation was primarily the result of a deceleration in non-energy industrial goods price inflation from 1.4% to 0.9% in the month under review. In addition, services prices also rose at a slower pace, increasing by 1.4% in June, compared with 1.7% in May, largely on the back of weaker growth in prices charged by hotels and restaurants and in airfares.



On the other hand, unprocessed food price inflation picked up to 4.3% in June, from 2.8% a month earlier, driven by developments in the prices of fruit, vegetables and fish.

Meanwhile, processed food price inflation remained constant at 1.8%, as faster growth in alcohol prices was offset by developments in the prices of other food items. Finally, energy prices declined by 4.4% on a year earlier - the same drop registered in May. Prices of gas, electricity and transport fuels all remained unchanged on a month earlier.

As regards cost indicators, during the first quarter of 2015 Malta's unit labour costs, which track the labour cost of a unit of output, continued to rise. When measured as a four-quarter moving average, they increased by 1.1% on a year earlier, up from 1.0% in the previous quarter. Compensation per employee rose by 0.7%, while productivity fell by 0.5%.

Based on the Central Bank of Malta's advertised property price index, the price of residential properties rose at an annual rate of 5.3% in the first quarter of 2015, following a 4.7% increase in the last quarter of 2014. The increase in house prices during the first quarter reflected movements in the prices of apartments and maisonettes. Although they indicate trends, advertised property prices may not accurately reflect the prices at which sales actually take place.

Deposits, credit and financial markets

The annual rate of growth of residents' deposits forming part of broad money (M3) accelerated from 18.8% in April to 19.1% in May. This follows an increase in residents' deposits of €209.2 million during the month.

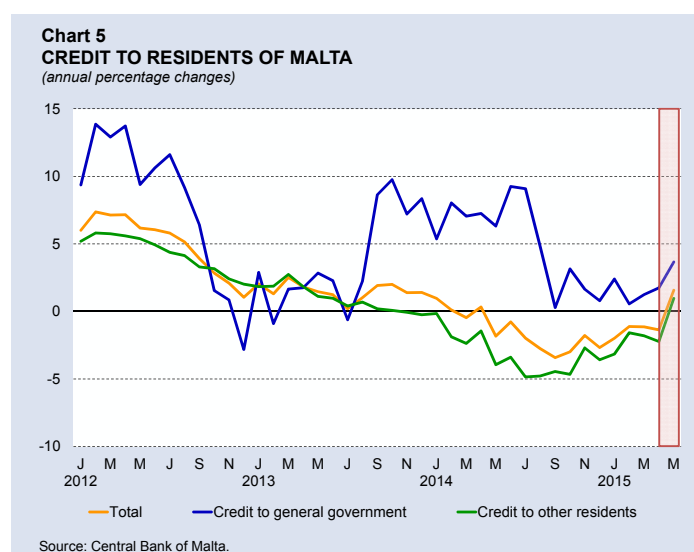
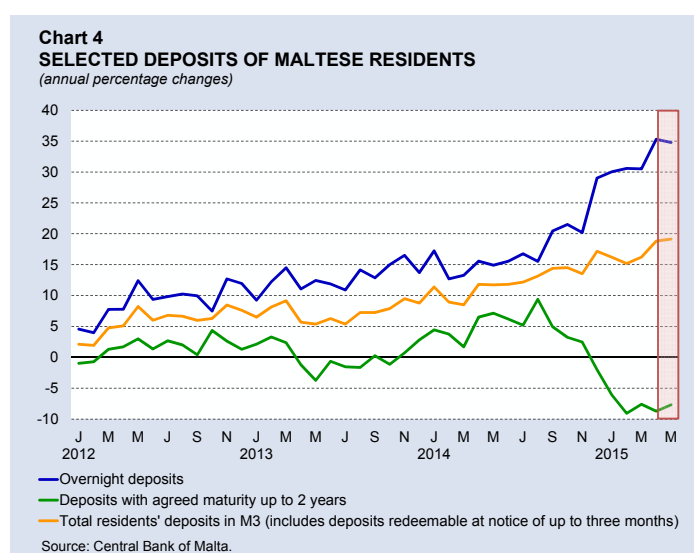
Overnight deposits accounted for most of the monthly rise. Nonetheless, the annual growth rate of overnight deposits fell to 34.8% in May, from 35.3% in April (see Chart 4). Households accounted for more than half of the annual increase in absolute terms.

During May, deposits with an agreed maturity of up to two years expanded, following a period of monthly declines. Consequently, their annual rate of change turned less negative in May, reaching -7.7% from -8.7% in April. Meanwhile, the annual rate of change of deposits redeemable at a notice of up to three months slowed down from 11.8% in April to 6.5% in May.

On the asset side of MFI balance sheets, credit to Maltese residents expanded by €80.3 million between April and May. Consequently, the annual rate of credit growth swung from -1.4% in April to 1.6% in May. Credit to general government increased at a faster pace, though the swing in overall credit growth largely mirrored movements in credit to other residents (see Chart 5).

The annual growth rate of credit to general government rose from 1.7% in the previous month to 3.7% in May, reflecting increased holdings of Malta Government Stocks (MGS) by the banking sector. Meanwhile, credit to all other residents grew by 1.0% year-on-year, following a drop of 2.2% in the previous month. The acceleration reflected the fact that a sharp fall in MFI holdings of corporate equity that occurred in May 2014 fell out of the annual growth rate.

Loans to NFCs decreased slightly in May, mainly driven by loans to firms operating in the wholesale & retail trade and accommodation & food services activities sectors. These declines offset increases in loans to the energy and manufacturing sectors. Consequently, loans to NFCs contracted by 0.2% during the year to May, following growth of 1.1% in April (see Chart 6). On the other hand, lending to households expanded more rapidly, with the annual rate of growth edging up to 7.1%, from 6.8% in the previous month. House loans grew at a faster pace, whereas consumer and other credit continued to contract.



Bank lending and deposit rates fell slightly in May. The composite interest rate paid by MFIs on all euro-denominated deposits belonging to resident households and NFCs dropped by 3 basis points to 0.87%. Meanwhile, the comparable rate charged by MFIs on outstanding loans to resident households and NFCs stood at 3.91%, 2 basis points lower than in April.

The composite deposit rate in May was 43 basis points below its level a year earlier, while the corresponding lending rate was 27 basis points lower.

In the domestic capital market, in June the yield on ten-year government bonds rose by 46 basis points to 2.0% (see Chart 7). The increase was in line with developments in sovereign bond yields in the euro area.

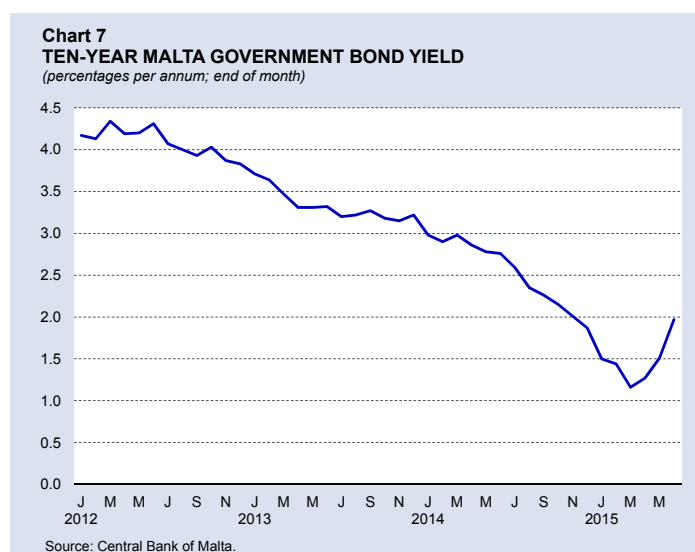
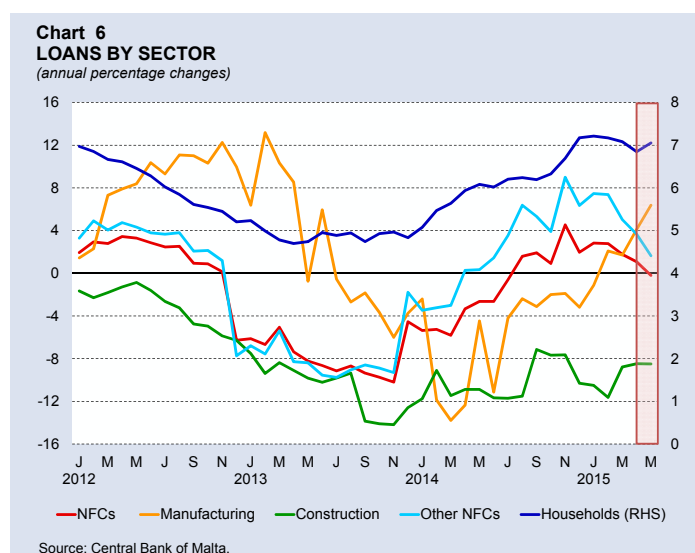
In June, the Malta Stock Exchange (MSE) index gained 5.5%.

Public finance⁶

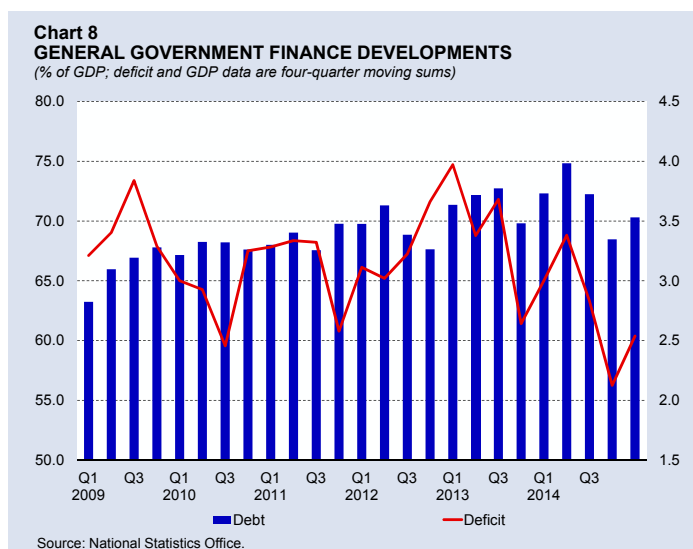
In the first quarter of 2015 the general government deficit expanded by €35.5 million compared with the same period a year earlier, to €172.3 million. As a result, the deficit-to-GDP ratio, computed on the basis of four-quarter moving sums, rose to 2.5% from 2.1% at the end of 2014.

During the first quarter of 2015, total revenue grew by 8.5% on a year earlier, buoyed by higher tax revenue, spurred by positive economic developments. 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 corporate income tax. At the same time, income from social contributions put on 6.7%, reflecting continued favourable labour market developments, while receipts from capital and current transfers grew by 7.1%.

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.



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 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 within the public administration, education and health sectors.



At the end of the first quarter of 2015, the general government debt-to-GDP ratio stood at 70.3%, compared with 68.5% at end-2014 (see Chart 8).

In May 2015 the Consolidated Fund deficit stood at €10.3 million, up from €0.7 million in May 2014. However, over the first five months of the year, the Consolidated Fund deficit declined by €120.0 million, compared with the same period last year, to €118.8 million. Revenue surged by 16.9% mainly due to higher grants from the EU and proceeds from indirect taxes and income tax. Total expenditure rose by 4.7%, following higher current and capital spending.

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 2014.⁷ 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).⁸ At the same time, net inflows of secondary income also increased, up 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

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
EXTERNAL TRANSACTIONS

EUR millions

	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.

quarter reviewed, considerably less than net borrowings of €537.8 million in the comparable quarter of 2014.

Customs data indicate that in May 2015 the merchandise trade deficit widened to €386.9 million, €258.4 million more than in the same month of 2014.⁹ This reflected both a decline in exports, predominantly driven by lower fuel re-exports, and a rise in imports, almost entirely on account of a rise in registrations of ships.

During the first five months of 2015, Customs data show that exports contracted whereas imports increased on a year earlier. As a result, the merchandise trade deficit widened by €549.0 million to €1,181.4 million. The increase in imports is predominantly attributable to a sharp rise in registrations of ships and aircraft. The negative balance from trade in fuel narrowed on a year earlier, as a decline in fuel imports outweighed a drop in related exports. Excluding fuel, aircraft and ships, the trade gap narrowed as imports contracted, while exports expanded moderately.

⁹ 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	2015	2014	2014	2015	2015	2015	2015	2015	2015
			Q4	Q1	Q2	Q3	Q4	Q1	Q2	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
Prices and costs																	
HICP	1.0	0.8	0.6	1.3	0.5	0.7	0.6	0.6	1.3	0.6	0.4	0.8	0.6	0.5	1.4	1.3	1.1
Unit labour costs, whole economy ⁽¹⁾	2.0	1.0	2.0	1.3	1.5	1.2	1.0	1.1	-	-	-	-	-	-	-	-	-
Compensation per employee ⁽¹⁾	0.1	0.1	0.1	-0.5	-0.3	-0.5	0.1	0.7	-	-	-	-	-	-	-	-	-
Labour productivity (per person) ⁽¹⁾	-1.9	-0.9	-1.9	-1.8	-1.8	-1.7	-0.9	-0.5	-	-	-	-	-	-	-	-	-
Residential property prices	2.1	7.0	6.4	6.7	8.9	7.6	4.7	5.3	-	-	-	-	-	-	-	-	-
Economic activity																	
Nominal GDP	4.2	5.4	4.1	5.5	5.0	4.8	6.4	6.0	-	-	-	-	-	-	-	-	-
Real GDP	2.3	3.5	1.6	3.6	3.4	3.0	4.2	4.0	-	-	-	-	-	-	-	-	-
Real private consumption	1.8	3.4	3.2	1.8	3.6	3.4	4.6	2.3	-	-	-	-	-	-	-	-	-
Real government consumption	-0.3	7.1	-2.0	4.1	11.2	5.0	8.3	3.6	-	-	-	-	-	-	-	-	-
Real gross fixed capital formation	1.1	9.7	9.7	15.4	2.6	5.2	14.8	-18.3	-	-	-	-	-	-	-	-	-
Real exports of goods and services	-0.9	1.1	-1.6	0.8	4.3	-1.4	1.0	-5.5	-	-	-	-	-	-	-	-	-
Real imports of goods and services	-1.0	-0.2	-1.8	-1.2	2.5	-4.5	2.8	-7.9	-	-	-	-	-	-	-	-	-
Tourist arrivals	9.6	6.8	13.4	7.9	9.0	7.2	2.5	7.7	-	3.0	1.4	6.8	14.1	4.1	2.5	6.4	-
Labour market developments (LFS)																	
Unemployment rate (% of labour force)	6.4	5.9	6.4	5.9	5.8	5.8	5.9	5.7	-	-	-	-	-	-	-	-	-
Total employment	3.3	3.1	4.5	4.0	3.6	3.6	1.2	1.3	-	-	-	-	-	-	-	-	-
Balance of payments																	
Current account (as a % of GDP) ⁽²⁾	3.2	3.3	3.2	3.0	3.5	2.8	3.3	5.5	-	-	-	-	-	-	-	-	-
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	30.5	-	20.2	29.0	30.0	30.6	30.5	35.3	34.8	-
Deposits with agreed maturity up to 2 years	2.8	-2.0	2.8	1.7	6.2	4.9	-2.0	-7.6	-	2.5	-2.0	-6.1	-9.1	-7.6	-8.7	-7.7	-
Total residents' deposits in M3	8.8	17.2	8.8	8.5	11.8	14.4	17.2	16.2	-	13.5	17.2	16.2	15.2	16.2	18.8	19.1	-
Credit to general government	8.3	0.8	8.3	7.1	9.2	0.3	0.8	1.2	-	1.6	0.8	2.4	0.6	1.2	1.7	3.7	-
Credit to other residents	-0.2	-3.6	-0.2	-2.4	-3.4	-4.4	-3.6	-1.8	-	-2.7	-3.6	-3.2	-1.6	-1.8	-2.2	1.0	-
Total credit	1.4	-2.7	1.4	-0.5	-0.8	-3.4	-2.7	-1.1	-	-1.8	-2.7	-2.0	-1.1	-1.1	-1.4	1.6	-
10-year interest rate (%) ⁽³⁾	3.4	2.6	3.2	3.0	2.9	2.5	2.1	1.5	1.5	2.1	1.9	1.7	1.5	1.3	1.2	1.5	1.8
Stock prices: Malta Stock Exchange Index ⁽⁴⁾	14.8	-9.6	7.8	-7.1	-3.7	1.1	-0.1	13.4	8.3	-0.9	1.8	2.7	0.8	9.5	-0.2	2.9	5.5
General government finances (% of GDP)																	
Surplus (+) / deficit (-) ⁽²⁾	2.6	2.1	2.6	3.0	3.4	2.8	2.1	2.5	-	-	-	-	-	-	-	-	-
Gross debt ⁽⁵⁾	69.8	68.5	69.8	72.3	74.8	72.2	68.5	70.3	-	-	-	-	-	-	-	-	-

⁽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.