



BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

ECONOMIC UPDATE 8/2015

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Address

Pjazza Kastilja
Valletta VLT 1060
Malta

Telephone

(+356) 2550 0000

Fax

(+356) 2550 2500

Website

<http://www.centralbankmalta.org>

E-mail

info@centralbankmalta.org

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ECONOMIC UPDATE 8/2015

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), edged up to 1.2% in July. In June, Maltese residents' deposits expanded at a faster pace, while the annual rate of growth of credit to residents moderated. As regards fiscal developments, the general government deficit widened in the first quarter of 2015. However, during the first six 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⁾

Annual percentage changes

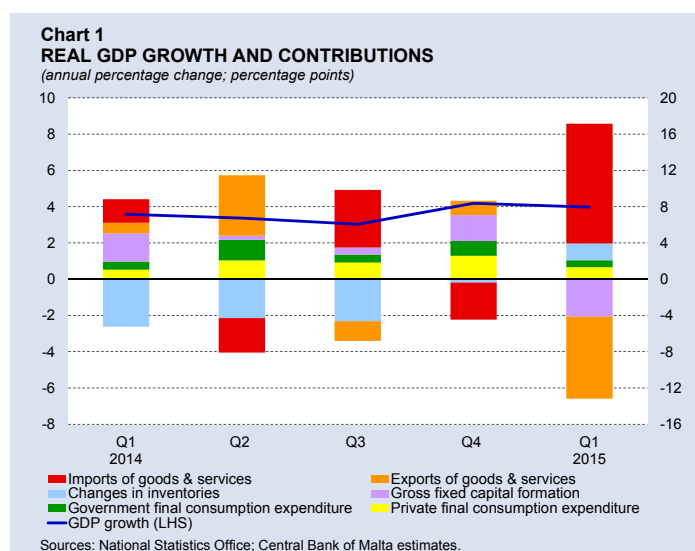
	2014				2015
	Q1	Q2	Q3	Q4	Q1
Private final consumption expenditure	1.8	3.6	3.4	4.6	2.3
Government final consumption expenditure	4.1	11.2	5.0	8.3	3.6
Gross fixed capital formation	15.4	2.6	5.2	14.8	-18.3
Domestic demand	-0.1	0.6	-1.3	7.2	-0.3
Exports of goods & services	0.8	4.3	-1.4	1.0	-5.5
Imports of 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 18 August 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, with the latter having been boosted a year earlier by exceptional outlays on equipment in the energy sector. 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 3.3% in year-on-year terms during June 2015.³ Consequently, during the second quarter of 2015 the index increased by 7.2%

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.

on a year earlier. This expansion in output was driven by the pharmaceutical sector, firms involved in printing and reproduction of recorded material and manufacturers of computer, electronic & optical products. In contrast, energy production decreased marginally.

Turning to tourism, in June arrivals rose by 3.6% on a year earlier. Nights stayed and expenditure also increased, albeit more slowly. As a result, during the first half of 2015, tourist numbers increased by 5.3% on a year earlier, while nights stayed and total spending went up by 3.2% and 6.0%, respectively. Although all major expenditure components increased on year-ago levels, spending on package holidays saw the largest gain.

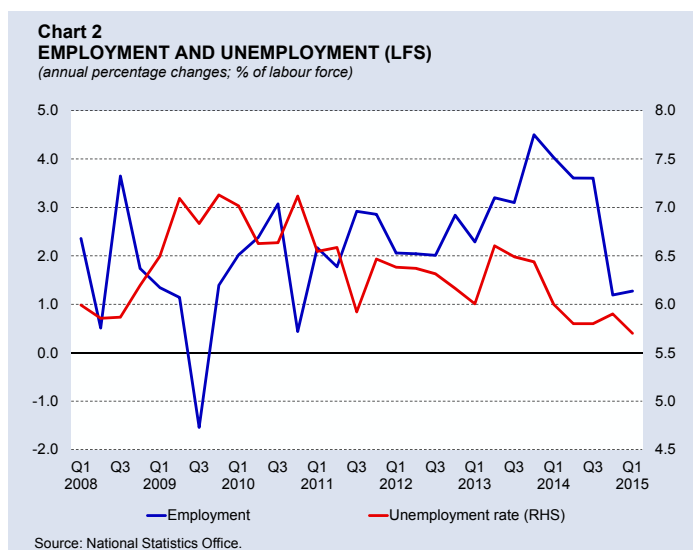
Meanwhile, in the second quarter of 2015 the number of cruise liner calls stood at 108, up by 19 from a year earlier. As a result, the total number of foreign cruise liner passengers amounted to 203,105, an increase of over 80,000 passengers on the same quarter a year earlier.

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 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.

The available information for the second quarter suggests that labour market conditions continued to improve. Eurostat's estimate of the seasonally-adjusted unemployment rate for the second quarter of 2015 stood at 5.6%, 0.3 percentage points lower than in the preceding quarter.



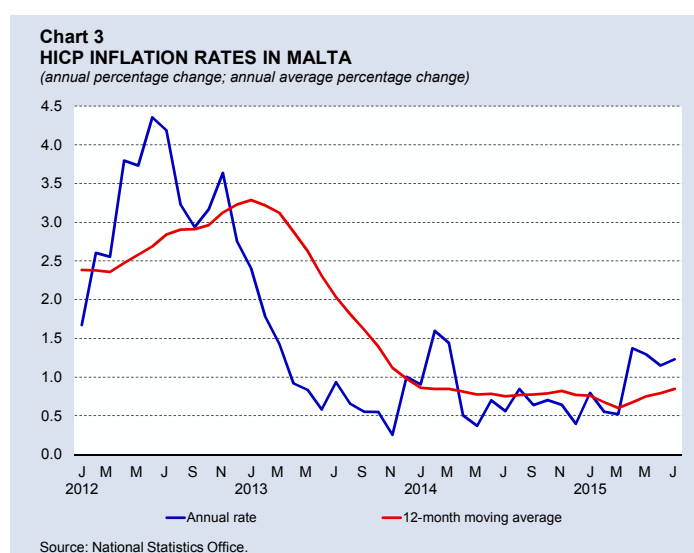
⁴ The LFS is a household survey conducted by the NSO on the basis of definitions set by the International Labour Organization and Eurostat. ETC data are based on administrative records according to definitions established by domestic legislation on employment and social security benefits.

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 June 2015 the number of people on the unemployment register decreased by 1,542 compared with a year earlier, to 5,209.

Prices, costs and competitiveness

In July, the annual rate of HICP inflation rose to 1.2%, from 1.1% a month earlier. The twelve-month moving average rate was 0.8% (see Chart 3).



This marginal pick-up in the annual inflation rate was mainly driven by an acceleration in services price inflation from 1.4% in June to 1.6% in July. In turn, this was mainly the result of stronger increases in accommodation rates, as well as faster housing and miscellaneous services price inflation. These offset slower growth in prices charged by restaurants and larger drops in communications prices.

Meanwhile, food price inflation edged up by 0.1 percentage point to 2.8%, on the back of developments in processed food prices. The latter rose by 2.0% year-on-year, compared with an increase of 1.8% in June, reflecting faster growth in prices of bread & cereals and alcohol. Unprocessed food price inflation remained robust at 4.2% in July, although it declined by 0.1 percentage point from the previous month.

On the other hand, non-energy industrial goods price inflation declined for the fourth consecutive month, edging down to 0.8% in July from 0.9% in June. This was mainly because prices of garments rose by 1.5% in annual terms, as against a 3.6% rise in June.

Finally, energy prices declined by 4.4% on a year earlier, the same pace as in June, as the prices of gas, electricity and transport fuels all remained unchanged in the month under review.

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 slightly 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 19.1% in May to 21.9% in June, with the acceleration driven by faster growth in overnight deposits. These grew by €365.4 million during the month, pushing their annual growth rate up from 34.8% in May to 39.6% (see Chart 4). Households accounted for almost half of the annual increase in absolute terms. Rapid growth in overnight deposits partly reflects demand for liquid assets in an environment of low interest rates.

On the other hand, deposits with an agreed maturity of up to two years contracted during the month. Consequently, their annual rate of change fell further, reaching -8.4% in June from -7.7% in May. Meanwhile, the annual rate of change of deposits redeemable at up to three months' notice slowed down from 6.5% in May to 3.3% in June.

On the asset side of banks' balance sheets, credit to Maltese residents expanded by €75.7 million between May and June. Nonetheless, the annual rate of credit growth slowed down from 1.6% in May to 1.2% in June as a larger increase was recorded in June 2014. Whereas credit to general government grew at a faster annual pace, credit to other residents slowed down (see Chart 5).

The annual growth rate of credit to general government rose from 3.7% in the previous month to 4.0% in June, reflecting increased holdings of Malta Government Stocks (MGS) by the banking sector.

Meanwhile, credit to all other residents grew by 0.4% year-on-year, following an increase of 1.0% in the previous month. This deceleration reflected developments in loans granted to non-financial corporations (NFC), which contracted during the month, partly driven by property-related loans

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

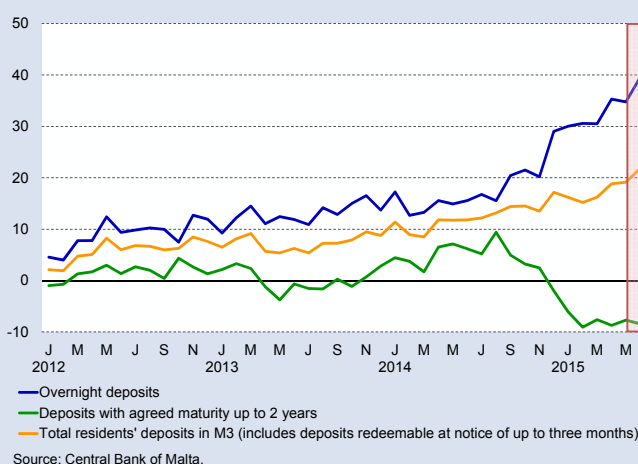
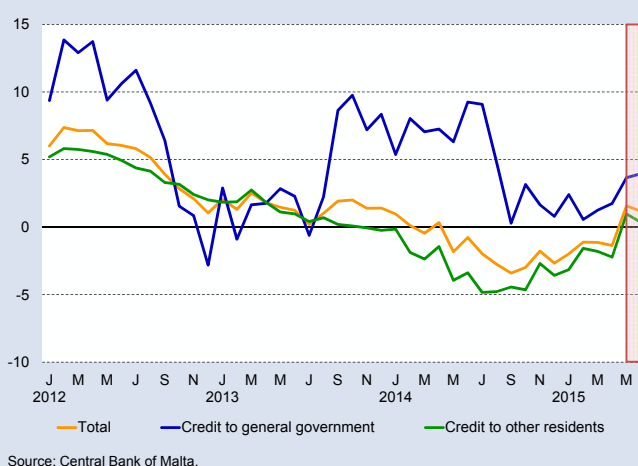
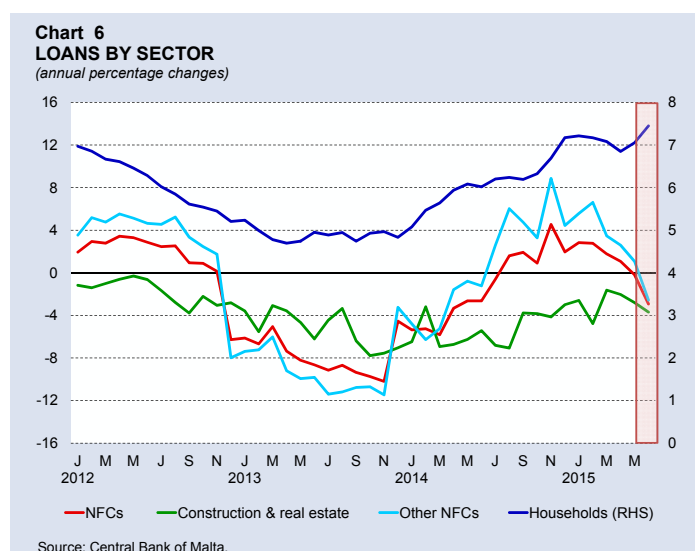


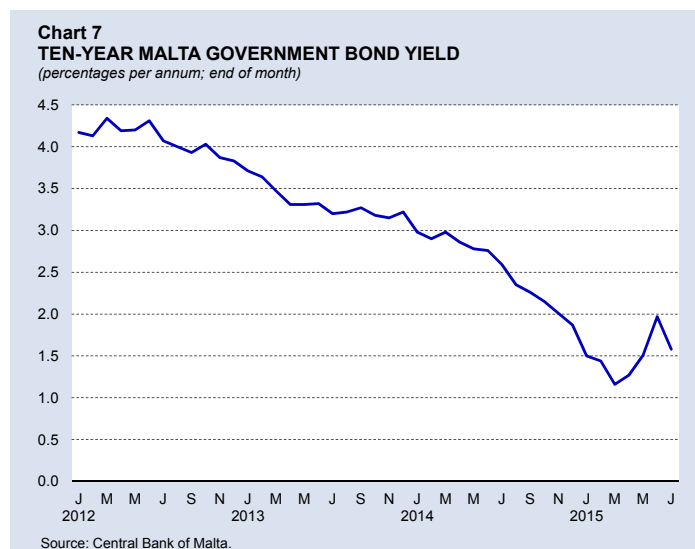
Chart 5
CREDIT TO RESIDENTS OF MALTA
(annual percentage changes)



and loans to firms in the accommodation & food service activities sector. Consequently, the annual rate of change of loans to NFCs dropped from -0.2% in May to -2.9% in June (see Chart 6). On the other hand, lending to households expanded more rapidly, with the annual rate of growth reaching 7.4%, from 7.1% 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 marginally in June. The composite interest rate paid by MFIs on all euro-denominated deposits belonging to resident households and NFCs dropped by 2 basis points to 0.85%. Meanwhile, the comparable rate charged by MFIs on outstanding loans to resident households and NFCs stood at 3.90%, 1 basis point lower than in May.



The composite deposit rate in June was 45 basis points below its level a year earlier, while the corresponding lending rate was 25 basis points lower.

In the domestic capital market, in July the yield on ten-year government bonds fell by 39 basis points to 1.6% (see Chart 7). The drop was in line with developments in sovereign bond yields in the euro area.

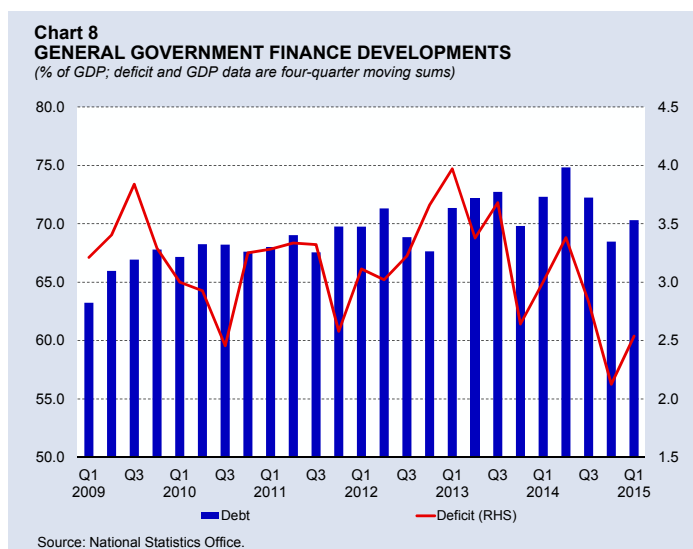
In July, the Malta Stock Exchange (MSE) index gained 2.9%.

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.

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.

During the first quarter of 2015, total revenue grew by 8.5% on a year earlier, buoyed by higher tax revenue, which was in turn 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%.



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 June 2015 the Consolidated Fund deficit stood at €39.1 million, up from €26.3 million in June 2014. However, over the first half of the year, the deficit narrowed by €107.2 million, compared with the same period last year, to €158.0 million. Revenue surged by 14.3% mainly due to increased proceeds from indirect taxes and income tax as well as higher grants from the EU.⁷ Total expenditure rose by 5.1%, driven by higher current spending, and, to a lesser extent, capital expenditure.

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,

⁷ Government contributions to the social security account in terms of the Social Security Act 1987 are excluded from both revenue and expenditure.

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.

Table 2				
EXTERNAL TRANSACTIONS				
<i>EUR millions</i>				
	2013	2014	2014	2015
	Q1-Q4	Q1-Q4	Q1	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.

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 June 2015 the merchandise trade deficit narrowed to €253.3 million, €104.1 million less than in the same month of 2014.¹⁰ This reflected both an increase in exports, driven by fuel re-exports, and a drop in imports, almost entirely on account of a decline in the fuel bill and in registrations of ships and aircraft.

Nevertheless, during the first half of 2015 the merchandise trade deficit widened by €459.9 million to €1,449.9 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.

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	2014	2015	2015	2015	2015	2015	2015	2015
			Q1	Q2	Q3	Q4	Q1	Q2	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July
Prices and costs																	
HICP	1.0	0.8	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	1.2
Unit labour costs, whole economy ⁽¹⁾	2.0	1.0	1.3	1.5	1.2	1.0	1.1	-	-	-	-	-	-	-	-	-	-
Compensation per employee ⁽¹⁾	0.1	0.1	-0.5	-0.3	-0.5	0.1	0.7	-	-	-	-	-	-	-	-	-	-
Labour productivity (per person) ⁽¹⁾	-1.9	-0.9	-1.8	-1.8	-1.7	-0.9	-0.5	-	-	-	-	-	-	-	-	-	-
Residential property prices	2.1	7.0	6.7	8.9	7.6	4.7	5.3	-	-	-	-	-	-	-	-	-	-
Economic activity																	
Nominal GDP	4.2	5.4	5.5	5.0	4.8	6.4	6.0	-	-	-	-	-	-	-	-	-	-
Real GDP	2.3	3.5	3.6	3.4	3.0	4.2	4.0	-	-	-	-	-	-	-	-	-	-
Real private consumption	1.8	3.4	1.8	3.6	3.4	4.6	2.3	-	-	-	-	-	-	-	-	-	-
Real government consumption	-0.3	7.1	4.1	11.2	5.0	8.3	3.6	-	-	-	-	-	-	-	-	-	-
Real gross fixed capital formation	1.1	9.7	15.4	2.6	5.2	14.8	-18.3	-	-	-	-	-	-	-	-	-	-
Real exports of goods and services	-0.9	1.1	0.8	4.3	-1.4	1.0	-5.5	-	-	-	-	-	-	-	-	-	-
Real imports of goods and services	-1.0	-0.2	-1.2	2.5	-4.5	2.8	-7.9	-	-	-	-	-	-	-	-	-	-
Tourist arrivals	9.6	6.8	7.9	9.0	7.2	2.5	7.7	4.2	3.0	1.4	6.8	14.1	4.1	2.5	6.4	3.6	-
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	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	13.3	15.6	20.4	29.0	30.5	39.6	20.2	29.0	30.0	30.6	30.5	35.3	34.8	39.6	-
Deposits with agreed maturity up to 2 years	2.8	-2.0	1.7	6.2	4.9	-2.0	-7.6	-8.4	2.5	-2.0	-6.1	-9.1	-7.6	-8.7	-7.7	-8.4	-
Total residents' deposits in M3	8.8	17.2	8.5	11.8	14.4	17.2	16.2	21.9	13.5	17.2	16.2	15.2	16.2	18.8	19.1	21.9	-
Credit to general government	8.3	0.8	7.1	9.2	0.3	0.8	1.2	4.0	1.6	0.8	2.4	0.6	1.2	1.7	3.7	4.0	-
Credit to other residents	-0.2	-3.6	-2.4	-3.4	-4.4	-3.6	-1.8	0.4	-2.7	-3.6	-3.2	-1.6	-1.8	-2.2	1.0	0.4	-
Total credit	1.4	-2.7	-0.5	-0.8	-3.4	-2.7	-1.1	1.2	-1.8	-2.7	-2.0	-1.1	-1.1	-1.4	1.6	1.2	-
10-year interest rate (%) ⁽³⁾	3.4	2.6	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	1.8
Stock prices: Malta Stock Exchange Index ⁽⁴⁾	14.8	-9.6	-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	2.9
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⁾	69.8	68.5	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.