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EUROSISTEMA
CENTRAL BANK OF MALTA

ECONOMIC UPDATE 10/2015

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ECONOMIC UPDATE 10/2015

Summary¹

Economic activity in Malta continued to expand robustly in the second quarter of 2015, with real gross domestic product (GDP) increasing by 5.2% on a year earlier. Growth was driven by domestic demand. Indicators for manufacturing and tourism point to further expansion in the third 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 are mildly increasing. The annual rate of inflation, based on the Harmonised Index of Consumer Prices (HICP), edged up to 1.6% in September. Maltese residents' deposits continued to expand at a rapid annual rate in August, while the annual rate of growth of credit to residents accelerated. As regards fiscal developments, the general government deficit narrowed in the second quarter of 2015. During the first eight months of the year, the deficit on the Consolidated Fund also decreased compared with the same period of 2014. On the external side, the current account of the balance of payments remained in surplus in the second quarter of 2015.

Output, demand and the labour market

Economic activity in Malta continued to grow strongly during the second quarter of 2015, with real GDP rising at an annual rate of 5.2%. This represents an acceleration from an upwardly-revised rate of 4.9% in the previous quarter (see Table 1).

During the quarter under review, growth was driven by domestic demand, which rose by 6.9% on a year earlier, almost double the increase in the previous quarter. The main driver was a rise in gross fixed capital formation, which grew sharply when compared with the second quarter of 2014. The other major components of final domestic demand also expanded. As a result, domestic demand contributed 6.5 percentage points to real GDP growth.

Table 1
GROSS DOMESTIC PRODUCT⁽¹⁾

Annual percentage changes

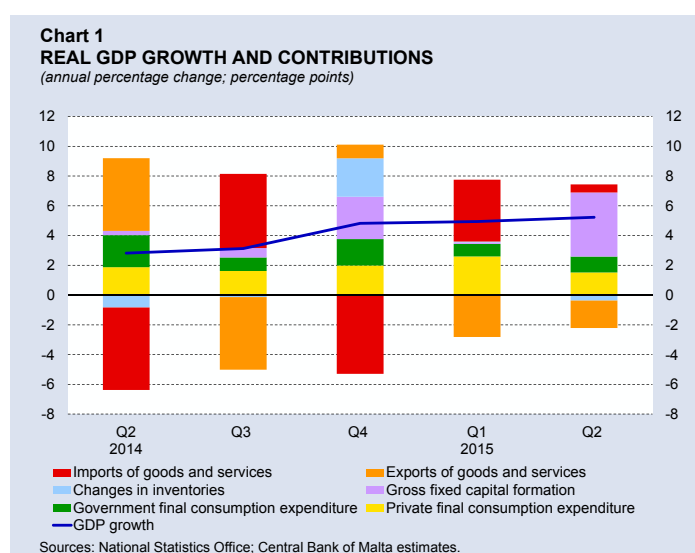
	2014			2015	
	Q2	Q3	Q4	Q1	Q2
Private final consumption expenditure	3.3	3.0	3.5	4.6	2.8
Government final consumption expenditure	10.7	5.2	9.0	3.9	5.0
Gross fixed capital formation	1.6	4.3	15.1	0.3	24.3
Domestic demand	3.7	3.6	10.0	3.6	6.9
Exports of goods and services	3.1	-3.1	0.5	-1.7	-1.2
Imports of goods and services	3.7	-3.6	3.6	-2.3	-0.3
Gross domestic product	2.8	3.1	4.8	4.9	5.2

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

Source: National Statistics Office.

¹ The cut-off date for information in this note is 23 October 2015.

Gross fixed capital formation rose by 24.3% on a year earlier. This sharp rise in investment followed the slowdown registered in the previous quarter. Most of the increase in investment can be attributed to higher spending on machinery and equipment, although investment on dwellings and transport equipment also rose. Conversely, non-dwelling construction investment declined. Overall, investment contributed 4.3 percentage points to real GDP growth (see Chart 1).



In addition, government consumption rose at an annual rate of 5.0%, after having eased in the previous quarter, and contributed 1.1 percentage points to GDP growth. Both compensation of employees and, to a lesser extent, intermediate consumption rose on their year-ago levels.

Private consumption also went up on its year-ago level, sustained by continued, though slower, growth in employee compensation. At 2.8%, the annual growth rate of private consumption was weaker than in the previous quarter. However, private consumption still contributed 1.5 percentage points to GDP growth.

Changes in inventories had a slight negative impact on growth.²

Exports dropped by 1.2% year-on-year, entirely owing to lower foreign sales of services, whereas goods exports increased. Imports fell by 0.3%, entirely due to a drop in services imports. As a result, net exports dampened real GDP growth by 1.3 percentage points.

Nominal GDP expanded at a faster pace in the second quarter of 2015, with the annual growth rate climbing to 7.3% compared with 7.0% in the first quarter of 2015. This reflected a pick-up in the annual rate of growth of gross value added (GVA), which increased to 7.7% from 6.3% in the previous quarter. Services continued to be the main contributor to GVA growth. In turn, the strongest contributions came from the sector incorporating professional and scientific activities and from that incorporating public administration, health and education. Robust contributions were also recorded from the sector comprising wholesale and retail trade. In addition, GVA increased substantially in utilities and manufacturing and, to a lesser extent, in the construction sector.

The available information for the third quarter of 2015 indicates continued growth in manufacturing and tourism.

² Changes in inventories include acquisitions and disposals of valuables as well as the statistical discrepancy. The contribution of changes in inventories to GDP growth is based on the Bank's calculations.

As regards manufacturing, the index of industrial production rose by 8.9% in year-on-year terms during August 2015.³ As a result, on a three-month moving average basis, industrial production increased by 6.9% on a year earlier. This expansion was driven by pharmaceuticals and food. In contrast, output of the computer, electronic and optical products sector declined.

Turning to tourism, in August arrivals rose by 4.8% on a year earlier, while nights stayed and expenditure also increased. As a result, during the first eight months of the year, tourist numbers increased by 5.1% on a year earlier, while nights stayed and total spending went up by 4.4% and 6.8%, respectively. Although all major expenditure components increased on year-ago levels, spending on package holidays and accommodation saw the largest gain.

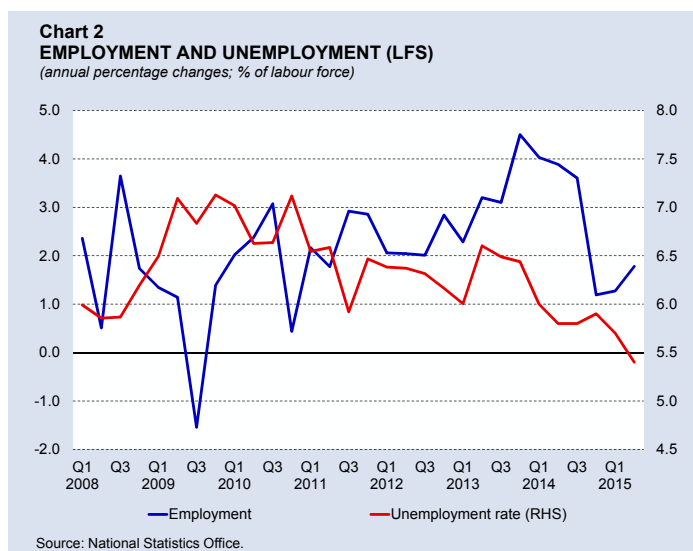
Meanwhile, in the third quarter of 2015 the number of cruise liner calls increased to 102, 11 more than a year earlier. As a result, the number of foreign cruise liner passengers rose to 192,570, an increase of 39,522 over the same quarter of 2014.

As regards the labour market, according to the Labour Force Survey (LFS) employment expanded by 1.8% during the second quarter of 2015 compared with a year earlier, following a 1.3% increase in the previous quarter (see Chart 2). The rise in the second quarter solely reflected growth in full-time employment, as the number of part-time employees and those working on reduced hours fell.

On the basis of records maintained by the Employment and Training Corporation (ETC) employment increased even more strongly. In April 2015 the gainfully occupied population rose by 4.4% on a year earlier, slightly up from 4.3% in March.⁴

According to the LFS, the unemployment rate stood at 5.4% in the second quarter of 2015, compared with 5.8% a year earlier.⁵ This is the lowest rate since the inception of the survey in 2000.

The available information suggests that labour market conditions continued to improve in more recent months. Eurostat's estimate of the seasonally-adjusted unemployment rate fell further in August, standing at 5.1%. Moreover, ETC data also show a further fall in the number of registered unemployed. In September 2015 the number of people on the unemployment register decreased by 1,675 compared with a year earlier, to 4,924.



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

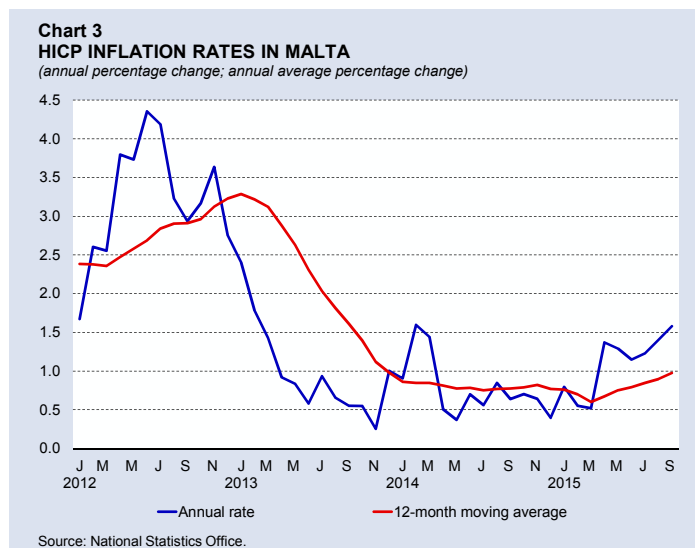
⁴ The LFS is a household survey conducted by the NSO on the basis of definitions set by the International Labour Organization and Eurostat. ETC data are based on administrative records according to definitions established by domestic legislation on employment and social security benefits.

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 September, the annual rate of HICP inflation rose to 1.6%, from 1.4% a month earlier. Consequently, the twelve-month moving average rate edged up to 1.0%, from 0.9% in August (see Chart 3).

This pick-up in the annual inflation rate was mainly driven by an acceleration in food and services prices.



Unprocessed food price inflation rose from 4.2% in August to 5.2%

in September. This mainly reflected an increase in vegetable prices. In annual terms, processed food inflation rose to 2.4% in September, from 2.2% in the previous month.

Services price inflation also accelerated, going from 1.7% in August to 1.9% in September. This reflected upward movements in most of the services sub-indices, including restaurants and accommodation, which offset slower growth in the prices of transport services.

In contrast, non-energy industrial goods inflation remained unchanged at 1.2%, as faster growth in the prices of furniture was offset by a drop in the prices of garments.

Finally, energy prices declined by 4.7% on a year earlier, unchanged from August, as prices of gas, electricity and transport fuels remained unchanged during the month under review.

As regards cost indicators, during the second quarter of 2015 Malta's unit labour costs (ULC), measured as a four-quarter moving average, increased by just 0.2% on a year earlier. This represents a slowdown in ULC growth compared to outcomes in recent quarters, and a marked drop from 1.1% in the first quarter. The deceleration was the result of a swing from negative to positive productivity growth. In the second quarter, productivity increased by 0.8% on a year earlier. Meanwhile, compensation per employee continued to increase, rising by 1.0%.

Based on the Central Bank of Malta's advertised property price index, the price of residential properties rose at an annual rate of 4.8% in the second quarter of 2015, following a 5.3% increase in the first quarter. The increase in house prices during the second quarter reflected movements in the prices of all major property types, except terraced houses. Although they indicate trends, advertised property prices may not accurately reflect the prices at which sales actually take place.

Deposits, credit and financial markets

In August, residents' deposits forming part of broad money (M3) increased over July. Nonetheless, their annual growth rate decelerated from 20.1% in July to 17.3% in August.

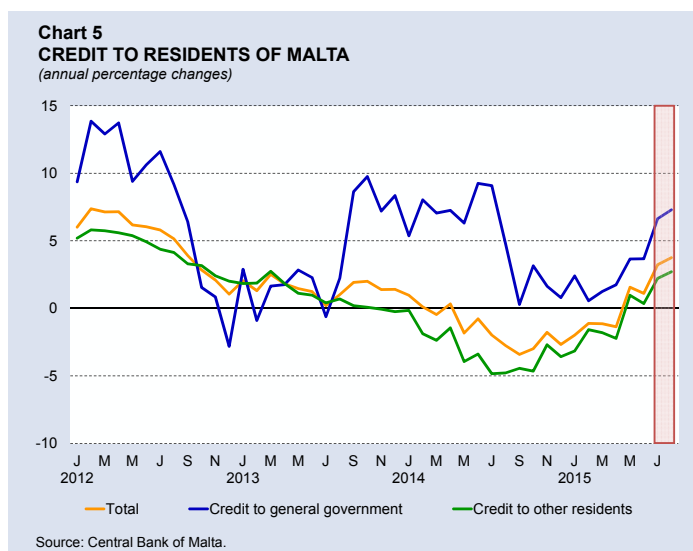
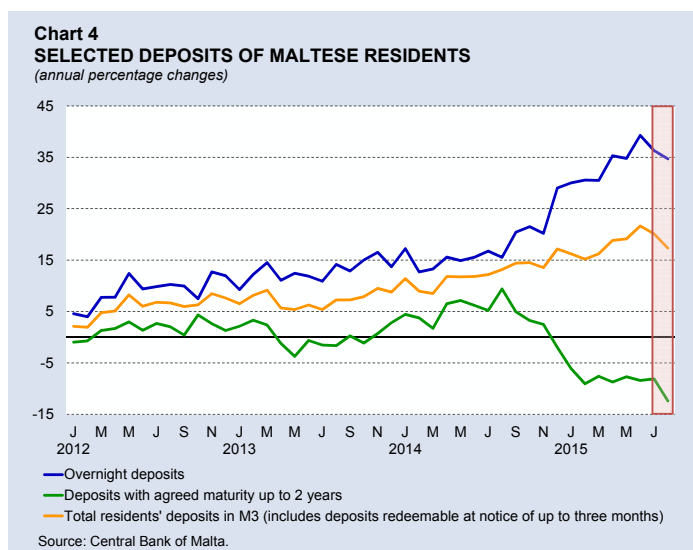
The slowdown in the annual rate of growth reflected developments in both overnight deposits and deposits with an agreed maturity of up to two years. Although overnight deposits grew by €83.6 million during the month, their annual growth rate eased to 34.7%, from 36.3% in July. Rapid growth in overnight deposits partly reflects the low opportunity cost of holding liquid assets in an environment of low interest rates.

Deposits with an agreed maturity of up to two years contracted by €32.6 million during the month, taking the annual rate of change down to -12.4% from -8.1% in July (see Chart 4). At the same time, the annual rate of change of deposits redeemable at notice of up to three months, the smallest component of M3, turned negative, standing at -1.7%.

On the asset side of banks' balance sheets, credit to Maltese residents expanded by €76.5 million in August. Consequently, the annual rate of credit growth extended its upward trend, picking up to 3.8%, from 3.2% in July, as both credit to general government and credit to other residents increased at a faster pace (see Chart 5).

The annual growth rate of credit to general government rose from 6.6% in July to 7.3% in August.

Meanwhile, credit to all other residents grew by 2.7% year-on-year, following an increase of 2.2% in the previous month. This acceleration reflected faster annual growth in loans granted to other financial intermediaries and households, which offset a steeper annual decline in loans to NFCs. The annual growth rate of loans to households reached 7.7%, from 7.6% in the previous month. Loans for house purchase grew at a marginally faster pace, whereas consumer and other credit continued to contract.



In contrast, following a 4.7% drop in the year to July, loans to NFCs contracted by 7.4% during the year to August (see Chart 6). The year-on-year decline reflected developments in loans to NFCs in the transport, energy and construction sectors.

Bank deposit rates fell marginally in August. The composite interest rate paid by MFIs on all euro-denominated deposits belonging to resident households and NFCs dropped by 3 basis points to 0.80%. On the other hand, the comparable rate charged on outstanding loans to them stood at 3.87%, unchanged from July.

However, both the composite deposit and lending rate were down on a year earlier. The composite deposit rate was 39 basis points below its level in August 2014, while the corresponding lending rate was 22 basis points lower.

In the domestic capital market, in September the yield on ten-year government bonds decreased by 17 basis points to 1.49% at the

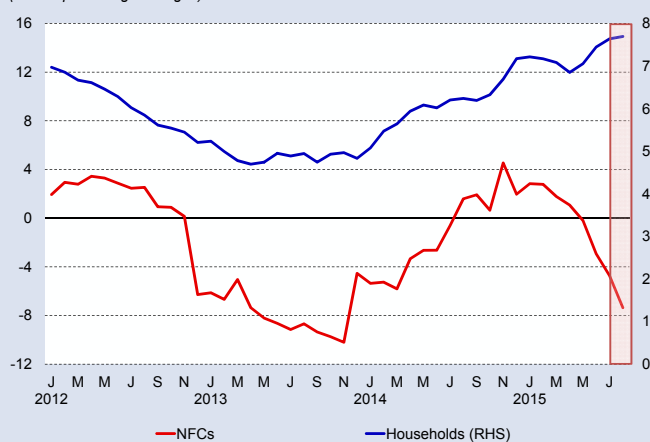
end of the month, after they had increased in August (see Chart 7). These movements were broadly in line with those in euro area benchmark yields. Meanwhile, equity prices rose, with the Malta Stock Exchange (MSE) index gaining 3.0% in September.

Public finance⁶

In the second quarter of 2015, the general government deficit narrowed by €24.4 million compared with the same period a year earlier, to €47.5 million. As a result, the deficit-to-GDP ratio, computed on the basis of four-quarter moving sums, fell to 2.2% from 2.5% in the previous quarter.

During the second quarter of 2015, revenue grew by 7.5%, boosted by higher tax revenue. In particular, income tax receipts rose by 12.7%. Inflows from taxes on production and imports and

Chart 6
LOANS BY SECTOR
(annual percentage changes)



Source: Central Bank of Malta.

Chart 7
TEN-YEAR MALTA GOVERNMENT BOND YIELD
(percentages per annum, end of month)



Source: Central Bank of Malta.

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.

social security contributions rose to a lesser extent. Meanwhile, receipts from capital and current transfers went up by 19.4% on the back of higher capital transfers receivable.

General government expenditure rose by 4.1% on a year earlier, mainly reflecting higher current expenditure. In turn, this was mainly driven by increased outlays on compensation of employees and higher current transfers payable which rose by 7.0% and 22.9%, respectively. Growth in the former mainly reflected increased outlays on public

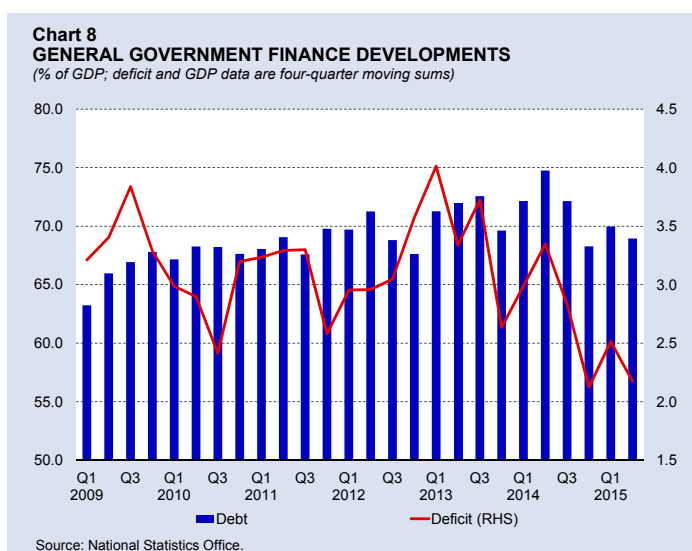
administration, health and education. Expenditure on social benefits and intermediate consumption also rose, but moderately. Spending on gross fixed capital formation was significantly higher during the quarter under review. However, this was partly offset by a decline in capital transfers payable.

In the second quarter of 2015, the general government debt-to-GDP ratio stood at 68.9% down from 70.0% in the previous quarter (see Chart 8).⁷

In August 2015 the Consolidated Fund showed a surplus of €33.8 million, down from €99.6 million in August 2014. Nonetheless, in the first eight months of 2015, the Consolidated Fund deficit narrowed by €68.9 million when compared with the same period last year, to €141.0 million. Revenue surged by 12.3%, mainly due to higher intakes from both direct and indirect taxes. Non-tax revenue also rose during the period under review, on the back of higher grants received. Total expenditure grew by 7.7%, mostly reflecting higher current spending.

Balance of payments

During the second quarter of 2015, the surplus on the current account of the balance of payments widened by €67.0 million, to €246.1 million.⁸ This increase was driven by a swing of €100.5 million on the primary income component, as well as an increase of €88.5 million in net services receipts. These favourable developments were partly offset by a widening of €111.8 million in the merchandise trade deficit, and by a €10.2 million decrease in net secondary income inflows (see Table 2).⁹ At the same time, the capital account posted net inflows of €23.0 million, down from €66.6 million in the second quarter of 2014.



⁷ These ratios are based on deficit and debt levels published in NSO News Release 191/2015 and GDP data published in NSO News Release 163/2015.

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

EUR millions

	2014 Q2	2015 Q2	2014 Q1-Q2	2015 Q1-Q2
Current account	179.1	246.1	73.5	222.8
Goods	-269.3	-381.1	-536.4	-634.9
Services	429.6	518.1	714.0	800.8
Primary income	-43.7	56.8	-195.4	-47.8
Secondary income	62.6	52.4	91.3	104.7
Capital account	66.6	23.0	96.2	146.9
Financial account¹	203.9	536.3	93.0	567.2

¹ Net lending (+) / net borrowing (-).

Source: National Statistics Office.

The financial account showed net lending of €536.3 million, markedly more than the €203.9 million in the comparable quarter of 2014.

During the first half of 2015, the current account surplus widened by €149.4 million to €222.8 million, as an increase in the deficit on the goods account was offset by improvements on the other components. At the same time, inflows on the capital account rose by €50.7 million, whereas net lending was €474.2 million higher.

Customs data indicate that in August 2015 the merchandise trade deficit was €171.6 million, €121.6 million less than in the same month of 2014.¹⁰ This mainly reflected a drop in imports, on account of a significant decline in the fuel bill and in purchases of capital goods. Exports increased marginally on a year earlier.

Nevertheless, between January and August, the merchandise trade deficit widened by €303.7 million compared with the same period of 2014, to €1,886.8 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	2015	2015	2015	2015	2015	2015	2015	2015	2015	2015	2015	2015	2015
			Q2	Q3	Q4	Q1	Q2	Q3	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	
Prices and costs																		
HICP	1.0	0.8	0.5	0.7	0.6	0.6	1.3	1.4	0.8	0.6	0.5	1.4	1.3	1.1	1.2	1.4	1.6	
Unit labour costs, whole economy ⁽¹⁾	2.1	1.3	1.7	1.7	1.3	1.1	0.2	-	-	-	-	-	-	-	-	-	-	
Compensation per employee ⁽¹⁾	0.4	0.3	-0.1	-0.3	0.3	0.8	1.0	-	-	-	-	-	-	-	-	-	-	
Labour productivity (per person) ⁽¹⁾	-1.6	-1.0	-1.9	-1.8	-1.0	-0.4	0.8	-	-	-	-	-	-	-	-	-	-	
Residential property prices	2.1	7.0	8.9	7.6	4.7	5.3	4.8	-	-	-	-	-	-	-	-	-	-	
Economic activity																		
Nominal GDP	4.6	5.4	4.4	4.9	7.0	7.0	7.3	-	-	-	-	-	-	-	-	-	-	
Real GDP	2.6	3.5	2.8	3.1	4.8	4.9	5.2	-	-	-	-	-	-	-	-	-	-	
Real private consumption	1.9	2.9	3.3	3.0	3.5	4.6	2.8	-	-	-	-	-	-	-	-	-	-	
Real government consumption	0.2	7.5	10.7	5.2	9.0	3.9	5.0	-	-	-	-	-	-	-	-	-	-	
Real gross fixed capital formation	-0.7	9.1	1.6	4.3	15.1	0.3	24.3	-	-	-	-	-	-	-	-	-	-	
Real exports of goods and services	-0.2	-0.3	3.1	-3.1	0.5	-1.7	-1.2	-	-	-	-	-0.3	-	-	-	-	-	
Real imports of goods and services	-1.2	0.6	3.7	-3.6	3.6	-2.3	-0.3	-	-	-	-	-	-	-	-	-	-	
Tourist arrivals	9.6	6.8	9.0	7.2	2.5	7.7	4.2	-	6.8	14.1	4.1	2.5	6.4	3.6	4.7	4.8	-	
Labour market developments (LFS)																		
Unemployment rate (% of labour force)	6.4	5.9	5.8	5.8	5.9	5.7	5.4	-	-	-	-	-	-	-	-	-	-	
Total employment	3.3	3.1	3.9	3.6	1.2	1.3	1.8	-	-	-	-	-	-	-	-	-	-	
Balance of payments																		
Current account (as a % of GDP) ⁽²⁾	3.7	2.7	3.7	2.6	2.7	3.7	4.5	-	-	-	-	-	-	-	-	-	-	
Credit and financial indicators																		
Maltese residents' deposits and loans																		
Overnight deposits	13.7	29.0	15.6	20.4	29.0	30.5	39.3	-	30.0	30.6	30.5	35.3	34.8	39.3	36.3	34.7	-	
Deposits with agreed maturity up to 2 years	2.8	-2.0	6.2	4.9	-2.0	-7.6	-8.4	-	-6.1	-9.1	-7.6	-8.7	-7.7	-8.4	-8.1	-12.4	-	
Total residents' deposits in M3	8.8	17.2	11.8	14.4	17.2	16.2	21.6	-	16.2	15.2	16.2	18.8	19.1	21.6	20.1	17.3	-	
Credit to general government	8.3	0.8	9.2	0.3	0.8	1.2	3.7	-	2.4	0.6	1.2	1.7	3.7	3.7	6.6	7.3	-	
Credit to other residents	-0.2	-3.6	-3.4	-4.4	-3.6	-1.8	0.4	-	-3.2	-1.6	-1.8	-2.2	1.0	0.4	2.2	2.7	-	
Total credit	1.4	-2.7	-0.8	-3.4	-2.7	-1.1	1.1	-	-2.0	-1.1	-1.1	-1.4	1.6	1.1	3.2	3.8	-	
10-year interest rate (%) ⁽³⁾	3.2	1.9	2.8	2.3	1.9	1.2	2.0	1.5	1.5	1.4	1.2	1.3	1.5	2.0	1.6	1.7	1.5	
Stock prices: Malta Stock Exchange Index ⁽⁴⁾	14.8	-9.6	-3.7	1.1	-0.1	13.4	8.3	5.9	2.7	0.8	9.5	-0.2	2.9	5.5	2.9	0.0	3.0	
General government finances (% of GDP)																		
Surplus (+) / deficit (-) ⁽²⁾	2.6	2.1	3.3	2.8	2.1	2.5	2.2	-	-	-	-	-	-	-	-	-	-	
Gross debt ⁽⁵⁾	69.6	68.3	74.8	72.1	68.3	70.0	68.9	-	-	-	-	-	-	-	-	-	-	

(1) Four-quarter moving averages.
(2) Four-quarter moving sums.
(3) End of period.
(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.