BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

THE CONSTRUCTION SECTOR IN 2015

Article published in the Quarterly Review 2016:2, pp. 25-32

BOX 2: THE CONSTRUCTION SECTOR IN 2015[1]

This Box reviews developments in the construction and real estate sectors during 2015 using various measures of activity.[2] It also looks at developments in sentiment in the construction sector as reported in a monthly survey published by the European Commission. Overall, the information available suggests that, during 2015, the construction and real estate sectors extended their recovery following a period of declining or stagnant activity. Government measures aimed at supporting the sector in recent years may have contributed to this improvement. The recovery occurred despite a continued reduction in bank borrowings, possibly reflecting the sector's access to financing arrangements outside the banking sector.

Activity accelerates in 2015

As regards activity indicators, business demographic data published by the NSO show that in 2015 there were 10,444 units registered in construction-related activities (see Table 1). This represented around 12% of the total 87,971 business units registered in Malta that year. The construction sector accounted for around two-thirds of all units active in construction-related activities, with a further third active in real estate. Only a small number of firms were active in the mining and quarrying sector.

Following a decline in 2012, the overall number of business units in construction-related activities recovered consistently until 2015. This recovery is evident in both construction and real estate, though somewhat faster in the latter case.[3] In 2015, the number of business units in construction and real estate rose by 749, or 7.8%. This compares with a 10.9% increase in the whole economy.

Table 1
LEGAL BUSINESS UNITS REGISTERED IN MALTA 2010-15
Number of business units

	2010	2011	2012	2013	2014	2015	2015 Annual change
Construction	6,901	6,884	6,372	6,445	6,519	6,782	263
Mining and quarrying	108	103	106	114	126	127	1
Real estate	3,068	3,103	2,830	2,877	3,049	3,535	486
Construction-related activities	**10,077**	**10,090**	**9,308**	**9,436**	**9,694**	**10,444**	**750**
Total economy	**73,116**	**76,043**	**71,864**	**74,709**	**79,356**	**87,971**	**8,615**

Source: NSO.

[1] Prepared by Rita Schembri, Manager Economic Analysis Office. The views expressed in this Box are the author's own and do not necessarily represent the views of the Bank. This Box is based on a presentation with the same theme delivered during the National Conference on the State of the Construction Sector in Malta, organised by the Building Industry Consultative Council on 24 June 2016.

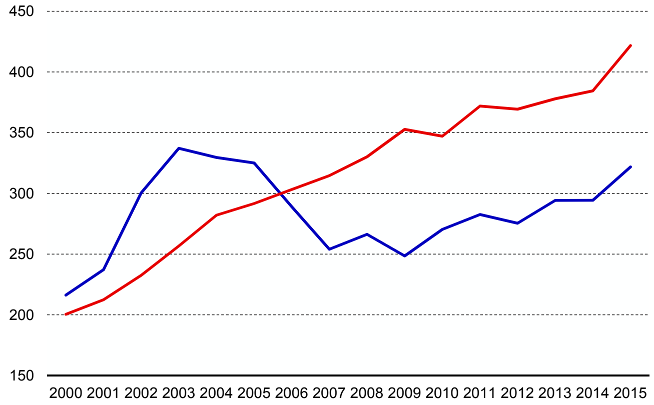
[2] The definition of construction and real estate is based on Eurostat's NACE Rev 2. statistical classification of economic activities. Further information is available at: http://ec.europa.eu/eurostat/documents/3859598/5902521/KS-RA-07-015-EN.PDF/dd5443f5-b886-40e4-920d-9df03590ff91?version=1.0.

[3] Data for 2015 are not strictly comparable to previous years, as on 1 January 2015 new VAT Regulations came in force affecting the threshold for turnover which determines whether one needs to register for VAT purposes.

The recovery in business demographic data is also reflected in GVA and employment. National accounts data show that, in 2015, GVA in the construction sector amounted to around €322 million, while real estate activities generated an additional €422 million, up by 9.3% and 9.7%, respectively over the previous year.[4] Although the rate of growth is still below that recorded in the early 2000s, both construction and real estate have now expanded for the past three consecutive years (see Chart 1).

The two sectors have a significant influence on the Maltese economy, together accounting for 9.7% of the economy's overall GVA, marginally up from 9.6% in 2014. Although this share had been declining in recent years, it stabilised in 2015 as growth in these sectors was broadly in line with that in the economy as a whole (see Chart 2).

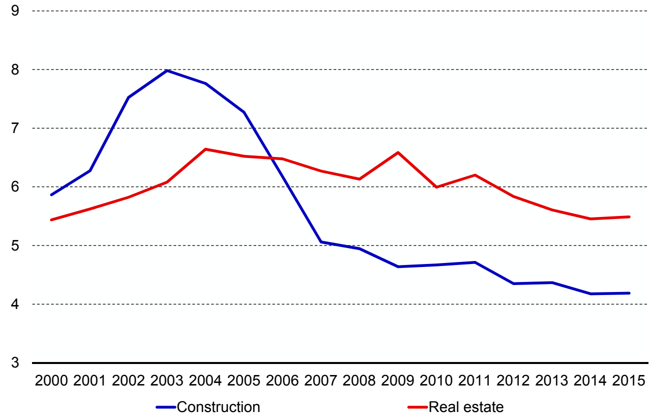
Chart 1
GROSS VALUE ADDED: CONSTRUCTION AND REAL ESTATE
(current prices; EUR millions)



Source: NSO.

The decline in the share of construction and real estate in earlier years largely reflects developments in construction. Thus, the share of construction in overall GVA fell from a peak of 8.0% in 2003, to 4.2% in 2014 and remained at that level in 2015. The share of real estate declined to a lesser extent, going from a peak of 6.6% in 2004 to 5.5% in 2015. These declines partly reflected developments within these two sectors, but also the diversification of the economy into new areas such as remote gaming, professional services and finance.

Chart 2
SHARE OF REAL ESTATE AND CONSTRUCTION IN TOTAL GROSS VALUE ADDED
(per cent of total economy)



Source: NSO.

While the construction and real estate sectors directly account for less than a tenth of total GVA, they affect activity in other sectors given their

[4] National accounts data in this Box are consistent with NSO *News Release* 091/2016 published on 8 June 2016.

Table 2
DISTRIBUTION OF OUTPUT IN CONSTRUCTION SECTOR
EUR millions

	2015
Output at basic prices	974.1
Total intermediate consumption	652.3
Value added at basic prices	321.8
of which:	
Compensation of employees	138.0
Operating surplus, gross	181.4

Source: NSO.

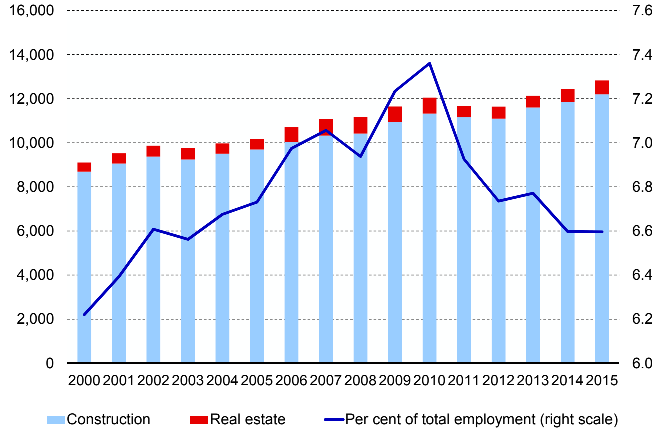
extended supply chain. Thus, for example, in 2015 the construction sector produced output with a value of €974 million, using material and services from within the industry and other industries worth around €652 million. This was more than twice the sector's €322 million direct contribution to GVA (see Table 2).

Additional data which, however, date back to 2010, suggest that the construction sector obtains only around 18% of inputs classified as intermediate consumption from within the industry itself. An additional 30% of the construction sector's inputs are sourced from firms producing non-metallic minerals including chemicals, gypsum, asphalt and bitumen. Metals and other manufactured items each account for just below a tenth of inputs, while quarrying and real estate account for a further 9%. Approximately another fifth comes from services other than real estate, such as architectural, legal and financial services.

Employment recovers while average wage remains below national average

The recent recovery in GVA is also mirrored in employment data and in the wage bill of the two sectors. In 2015 the two sectors employed 12,832 persons. The number of employed persons in these two sectors thus fully recovered from the declines of 2011 and 2012 (see Chart 3).

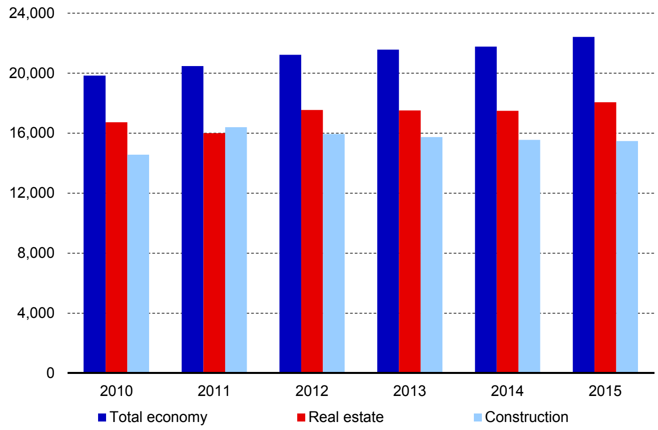
Chart 3
EMPLOYMENT IN CONSTRUCTION AND REAL ESTATE
(thousand persons; per cent of total employment)



Source: NSO.

A recovery in employment was evident in both sectors, though the number of employed in real estate remains below that recorded in 2010. In 2015, the two sectors jointly accounted for 6.6% of total employment in Malta, with the majority of job holders working in construction.[5]

Chart 4
COMPENSATION PER EMPLOYEE RELATIVE TO ECONOMY AVERAGE
(EUR per annum)



Source: NSO.

As a result of the rise in headcount, compensation of employees also recovered. In 2015 alone, it rose by €5.1 million, or 3.6%, of which an increase of €4.1 million was recorded in construction while an increase of €1.0 million was recorded in real estate. Gross operating surplus recorded even faster gains. The more rapid growth in gross operating surplus relative to the wage bill may reflect the availability of a growing pool of foreign workers, which has put downward pressure on the average wage in the construction sector, with compensation per employee in this sector declining for the fourth consecutive year (see Chart 4). The construction sector, moreover, benefited from lower energy costs following the cut in electricity tariffs for businesses during the year. The resulting savings boosted profitability relative to wages.

Average wage per head in fact remains low in relation to the average for whole economy. Thus while in 2015, compensation per employee for the whole economy stood at €22,421, it stood at €15,476 in construction and €18,064 in real estate. This implies gaps of around 30% and 20%, respectively, against the national average. In part, the gap in the construction sector could reflect relatively low productivity, as shown by the fact that GVA per employee in the sector lies below the economy-wide average. Such gaps, which have persisted for a number of years, may in turn have reduced the attractiveness of jobs in these sectors, encouraging operators in the construction sector to take advantage of an increased supply of foreign labour. Foreign workers account for 18% of the workforce in the real estate sector, and for 13% of that in the construction sector, as against 10% in the overall economy.[6]

Construction benefits from increased investment

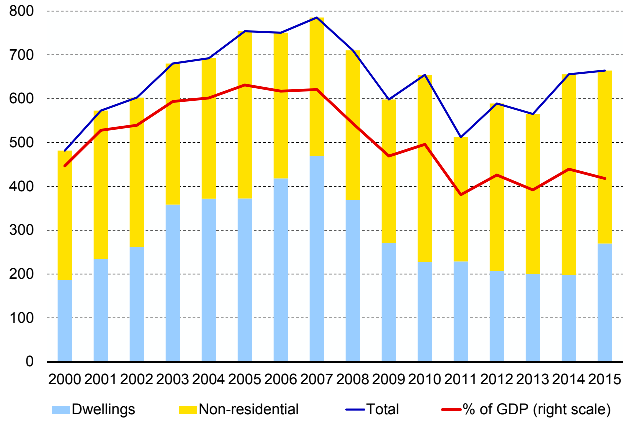
The recovery in construction activity in recent years coincides with increased investment in dwellings and non-residential buildings. In 2015, in real terms, overall construction investment is estimated to have amounted to €664 million after having risen for two consecutive years. This largely reflected a recovery in investment in dwellings, following a sequence

[5] Employment data in this Box are sourced from national accounts data supplementing NSO *News Release* 091/2016.

[6] See Grech, A. *Understanding the macroeconomic impact of migration in Malta*, Central Bank of Malta Policy Note, December 2015. This policy note also notes that in construction “there is evidence that the growth in employment since the downturn of 2009 was mainly taken up by migrant workers”.

of declines. In contrast, investment in non-residential infrastructure declined, after having increased very strongly in 2014. Notwithstanding the decline in 2015, the volume of non-residential construction investment remained close to the recent peak recorded in 2010 (see Chart 5). In 2015, this component of construction investment was boosted by increased government investment, partly as a result of the increased use of EU funds under the 2007-13 EU financing programme, which failed to outweigh a decline in private non-residential construction.[7]

Chart 5
CONSTRUCTION INVESTMENT
(chain-linked volumes in EUR millions; per cent of GDP)



Source: NSO.

Mirroring these developments, the share of overall construction investment in GDP, which had fallen from a peak of 12.6% in 2005 to 7.6% in 2011, began to increase again in recent years, standing at 8.4% in 2015. When expressed as a share of total investment in the economy, construction investment amounted to less than 40%.

An increase in the number of permits issued for residential dwellings and commercial property supported the recovery in investment. Permits for residential units began to recover in 2014 and continued to increase in 2015. They went up from 2,705 in 2013 to 2,937 in 2014 and further to 3,947 in 2015. The increase in permits may have been aided by a number of administrative reforms, fiscal incentives for first-time buyers and favourable expectations in anticipation of schemes targeting high-end investors.

The number of commercial permits, which includes permits for minor works, has stabilised following a decline.

Sentiment in construction improves during most of 2015

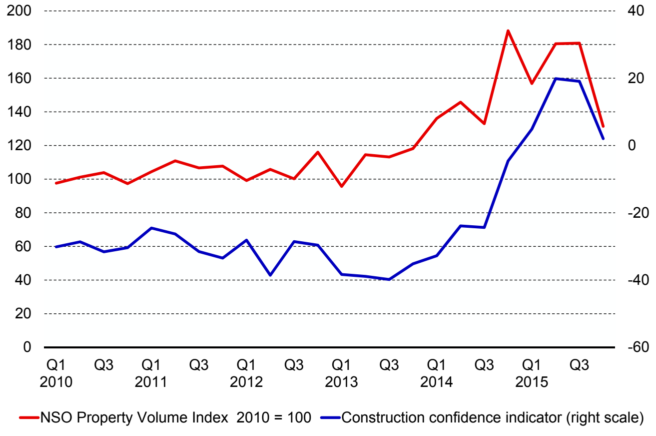
The positive performance signalled by hard data was also mirrored in sentiment in the construction sector, as measured on the basis of a monthly survey administered by the European Commission. The survey shows that sentiment was positive on average during 2015, though with considerable monthly volatility. This indicator, which is based on a simple average of respondents' assessments of their current order book levels and employment expectations

[7] The large scale of certain projects and differences in their profile over time introduces a degree of volatility in the data on investment. In particular, the coming on stream of the electricity interconnector in 2015 partly explains the drop in non-residential construction investment that year.

over the next 3 months, was positive during most of 2015, reaching a high in August.[8] Since then, sentiment weakened again, turning negative in November 2015. This deterioration notwithstanding, sentiment was less pessimistic compared with its long-term average.

The upturn in confidence and subsequent decline reflects developments in both order books and employment expectations. This pattern may partly reflect slower growth in the NSO's Property Volume Index, which is based on the number of transactions in certain categories of residential property recorded by the Inland Revenue Department.[9] This Index grew by 7.7% in 2015, after an exceptionally strong rise of 36.6% in 2014, the first full year following the reduction of stamp duty for first-time buyers (see Chart 6).

Chart 6
CONSTRUCTION CONFIDENCE AND NSO PROPERTY VOLUME INDEX
(percentage points; index 2010 = 100)



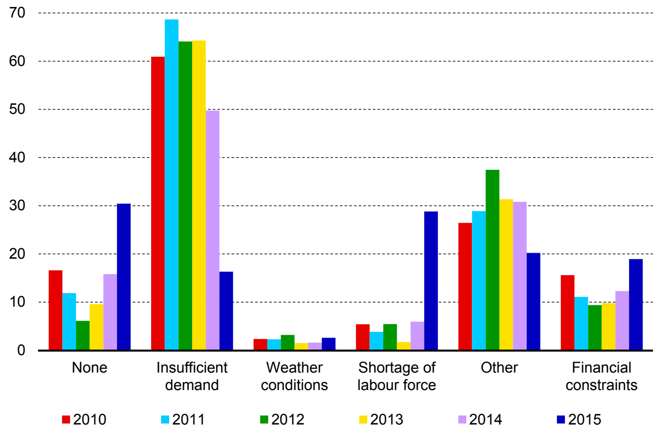
Sources: European Commission; NSO.

Labour shortages and financing constraints were key concerns in 2015

The European Commission survey also looks at firms' views on the main factors hindering production. Chart 7 reports annual results for the period from 2010 to 2015.

In line with the general improvement in activity indicators, the share of respondents reporting no obstacles to production increased in 2015. The significance of specific impediments to growth changed over time, however. While insufficient demand was the main problem cited by Maltese respondents until 2014, in 2015 labour shortages and financing constraints were mentioned more

Chart 7
FACTORS LIMITING PRODUCTION IN CONSTRUCTION IN MALTA
(per cent of respondents)



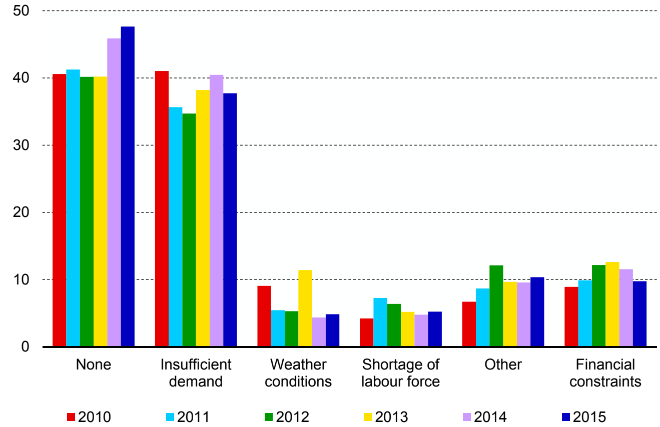
Source: European Commission.

8 Further information about this survey is available in European Commission, *The joint harmonised EU programme of business and consumer surveys - User Guide*, March 2016.
9 The Property Volume Index covers apartments, maisonettes and terraced houses.

often. The importance of these factors was also significantly higher compared with recent years.

Comparable results for the euro area as a whole suggest that operators in Malta feel more constrained than their euro area counterparts. The share of respondents reporting no obstacles to production in construction in 2015 was 30% in Malta, compared with 48% in the euro area (see Chart 8). The results also show that while insufficient demand remained the key concern in the euro area, labour shortages were less prominent. The latter were mentioned by 29% of Maltese respondents, but by only 5% of euro area respondents. Similarly, while the share of respondents flagging financing constraints as an issue was 10% in the euro area, in Malta this share rose to 19%. When compared against individual euro area countries, Malta stands out with one of the highest incidences of labour shortages as measured in this survey. Financial constraints also assumed greater importance in 2015, with the share of respondents flagging this issue in Malta also being relatively high.

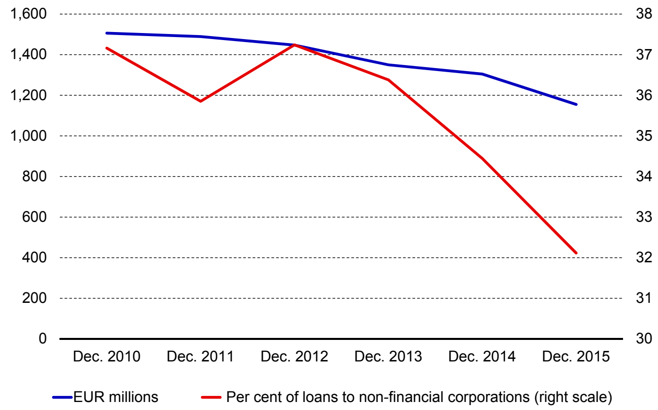
Chart 8
FACTORS LIMITING PRODUCTION IN CONSTRUCTION IN EURO AREA
(per cent of respondents)



Source: European Commission.

Further information on the access to finance of the construction sector can be obtained from data on bank lending. Indeed, while activity and profitability in construction and real estate improved in 2015, lending to these sectors continued to decline in the aggregate. As a result, the share of these loans in overall bank loans to the non-financial corporate sector extended its decline, falling to 32% in December 2015 from 37% in the same month of 2010 (see Chart 9).

Chart 9
BANK LENDING TO CONSTRUCTION AND REAL ESTATE FIRMS IN MALTA
(EUR million; per cent)



Source: Central Bank of Malta.

This decline may reflect the repayment of outstanding loans but also banks' efforts to diversify their lending and reduce their exposure to the construction sector. At the same time, in the context of a buoyant housing market, the sector itself may have been in a stronger position to tap internal sources of finance. Anecdotal evidence, moreover, indicates increased recourse to new forms of external financing, including pre-financing through prospective buyers and a greater use by larger companies of bond issues and private placements of securities.

Conclusion

Overall, during 2015 the construction and real estate sectors continued to recover from the declines recorded in earlier years. This is evident in data on GVA, investment and permits. The improved performance of these sectors was aided by a number of supportive measures, including the first-time buyers' scheme, administrative reforms aimed at streamlining procedures for the granting of development permits, as well as schemes targeting high-value foreign investors.

The recovery in activity has in turn been reflected in employment growth and an increase in the wage bill. The average wage in the two sectors, however, has grown only moderately and continues to fall short of the national average. While relatively low labour costs may have been beneficial for the sector's recovery, a persistent negative wage gap in relation to other sectors may reduce the sector's attractiveness to potential job seekers.

Indeed, notwithstanding the increased availability of foreign workers, labour shortages have assumed greater importance recently. Such shortages may have been amplified by the acceleration in construction-related investment in recent years. Financing constraints pose another challenge. This may reflect banks' ongoing efforts to limit their exposure to the sector as well as operators' ability to tap alternative sources of funding.

The construction sector stands to benefit from incentives for potential job seekers to develop the skills needed by the industry. As skills are upgraded, however, firms may have to review remuneration terms, to render them sufficiently attractive for job seekers to take up employment in construction-related activities.

Going forward, an extension of the positive performance seen recently rests on the ability of the sector to identify new, sustainable growth opportunities, as government investment spending moderates and large private sector projects under way reach completion.