

# Malta: Sustaining rapid growth necessitates strong investment

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# Outline of the presentation

- **Malta's recent macroeconomic performance and current outlook**
- **Investment trends in Malta and future prospects**
- **Financing investment in Malta**
- **Conclusions**



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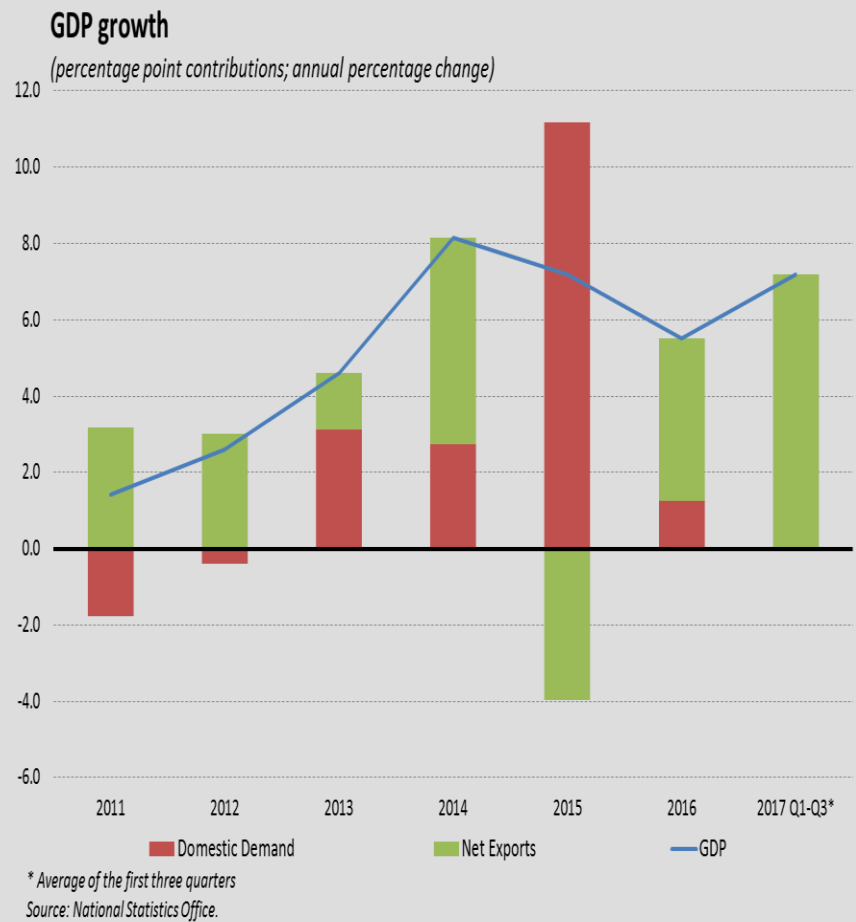


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# **Malta's recent macroeconomic performance and current outlook**

# The Maltese economy continued to grow robustly during 2017

- Malta's GDP growth has been very robust, accelerating from under 2% in 2011 to over 7% in first three quarters of 2017.
- Malta was relatively unaffected by the sovereign debt crisis, amongst other factors due to the strong liquidity and profitability of its banking sector.
- The economy is benefitting from a rapid expansion of export-oriented services, attracted to Malta by its business friendly environment and access to the EU market.

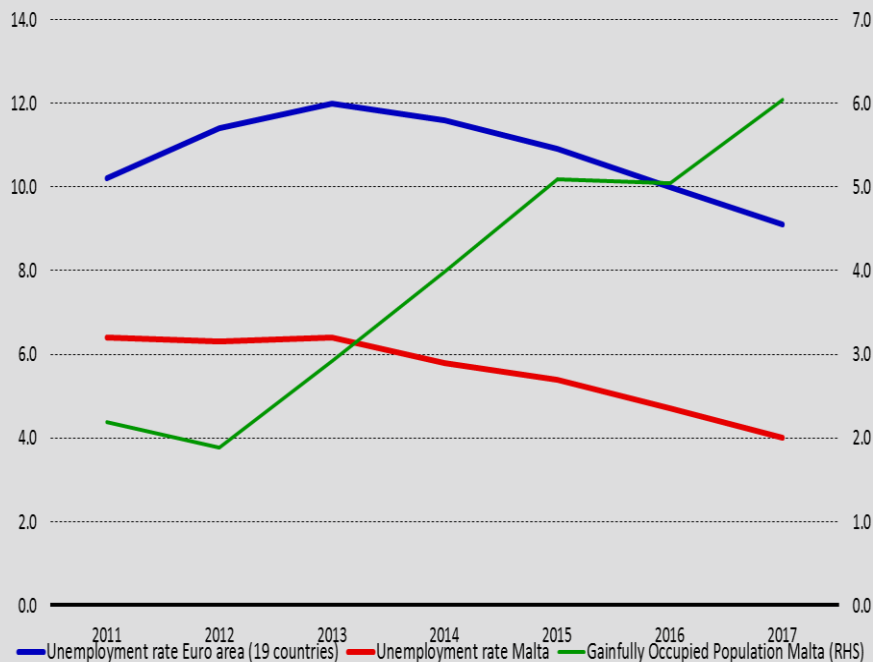


# Employment increased further and unemployment reached a record low

- Economic growth has been very job-rich, with employment growth rising to 6% in 2017. Malta has had the highest rate of employment growth in the EU since 2012.
- Unemployment fell to 4% in 2017, while the participation rate converged to the EU average. The economy is also growing more dependent on foreign workers.

## Labour market developments<sup>1</sup>

(seasonally adjusted, per cent; percentage change)

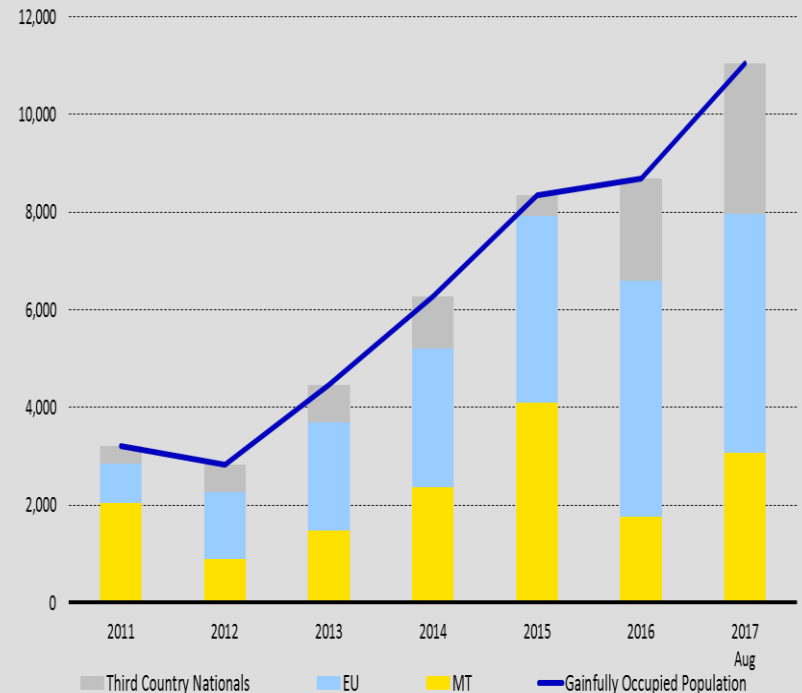


Source: Eurostat; National Statistics Office.

<sup>1</sup> Gainfully Occupied data for 2017 is based on August

## Increase in Gainfully Occupied Population by nationality

(persons)



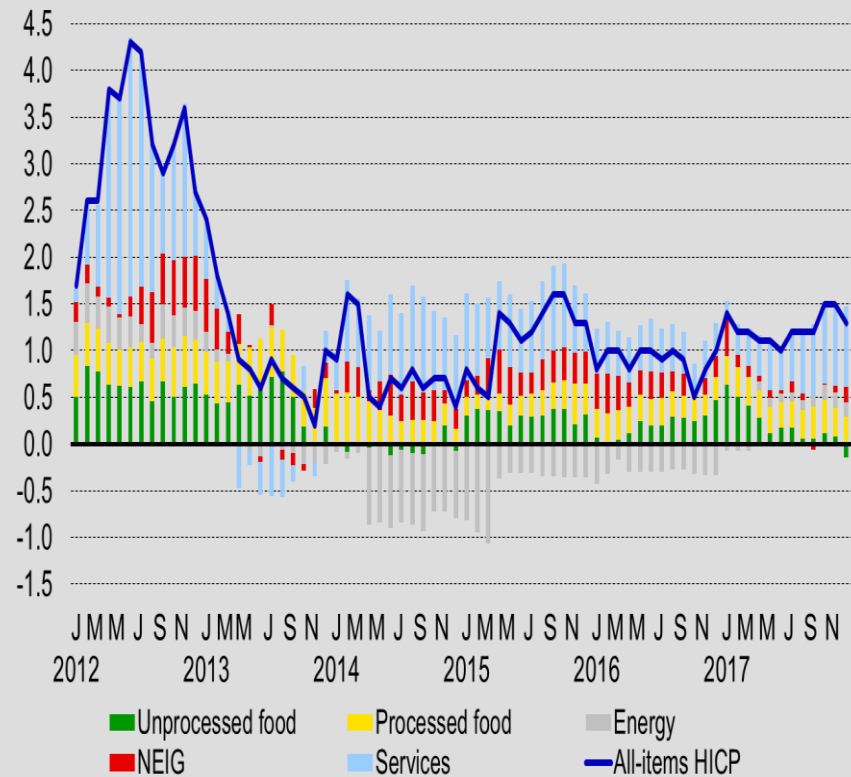
Source: National Statistics Office, Jobsplus.

# Notwithstanding a tight labour market, price pressures remain contained

- The acceleration in economic activity has coincided with a reduction in inflation.
- This paradox reflects the fact that imported inflation was relatively weak from a historical perspective.
- Moreover the increase in labour demand was met by the significant rise in migrant workers.
- Investment in energy production also meant that energy prices contributed negatively to inflation in recent years.

## CONTRIBUTIONS TO YEAR-ON-YEAR HICP INFLATION

(percentage points; annual percentage change)

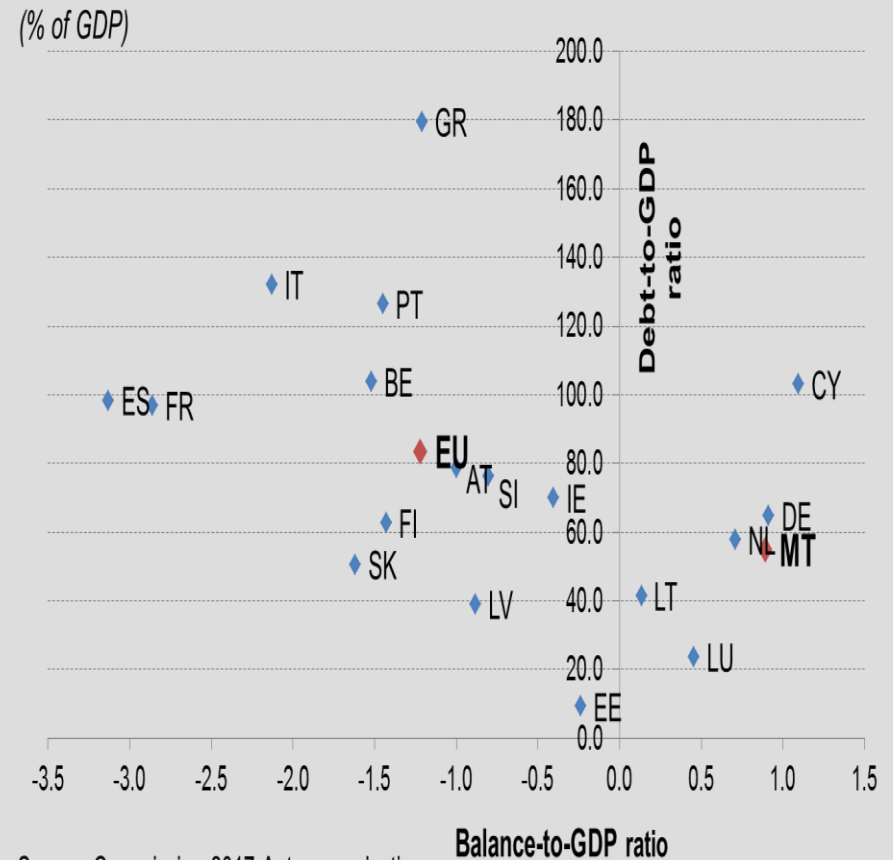


Source: Eurostat.

## The fiscal position has improved considerably

- Since joining the EU in 2004, the country was subject three times to the excessive deficit procedure, with the last procedure being abrogated in 2015.
- Since 2013, the fiscal position shifted from a deficit of 3.5% of GDP to a surplus of 1.1% in 2016.
- According to the latest EU Commission forecasts, Malta's fiscal performance is among the best in the EU.
- In coming years, debt to GDP is forecast to fall to nearly 40%. This has resulted in the country's credit rating being upgraded.

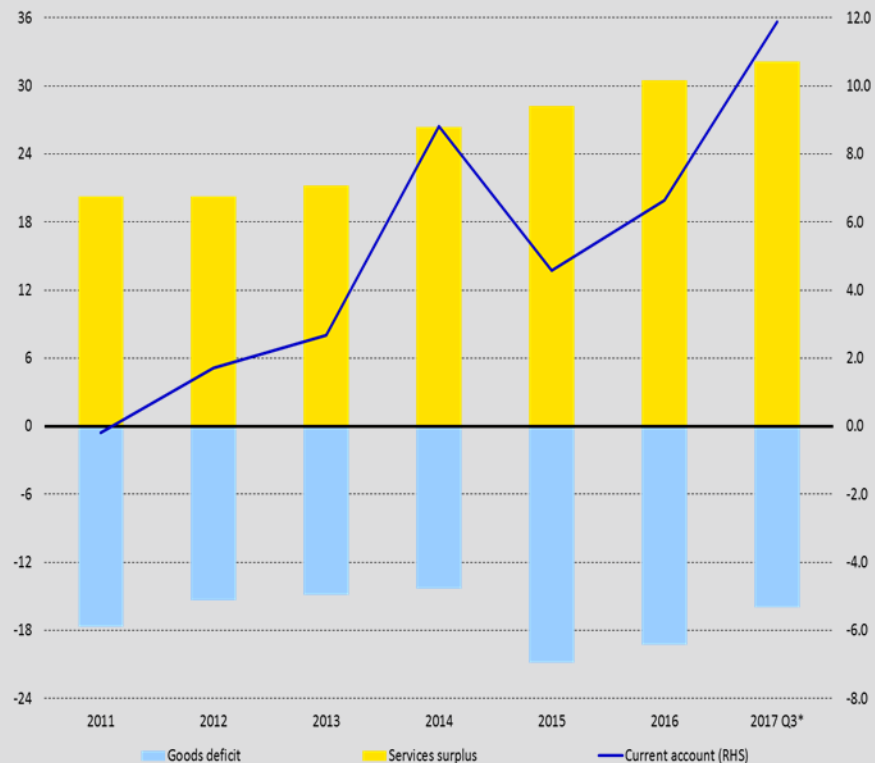
### 2017 FORECAST GOVERNMENT BALANCE AND DEBT



## A similar turnaround was observed in the current account

- Malta has historically registered a strong deficit in the current account of the balance of payments.
- Since 2012, however, the position has always been in considerable surplus.
- This primarily reflected the buoyancy of the export oriented services sector, though there has also been a decline in the import intensity of consumption and investment.

Current account and the external balance  
(as a percentage of GDP)



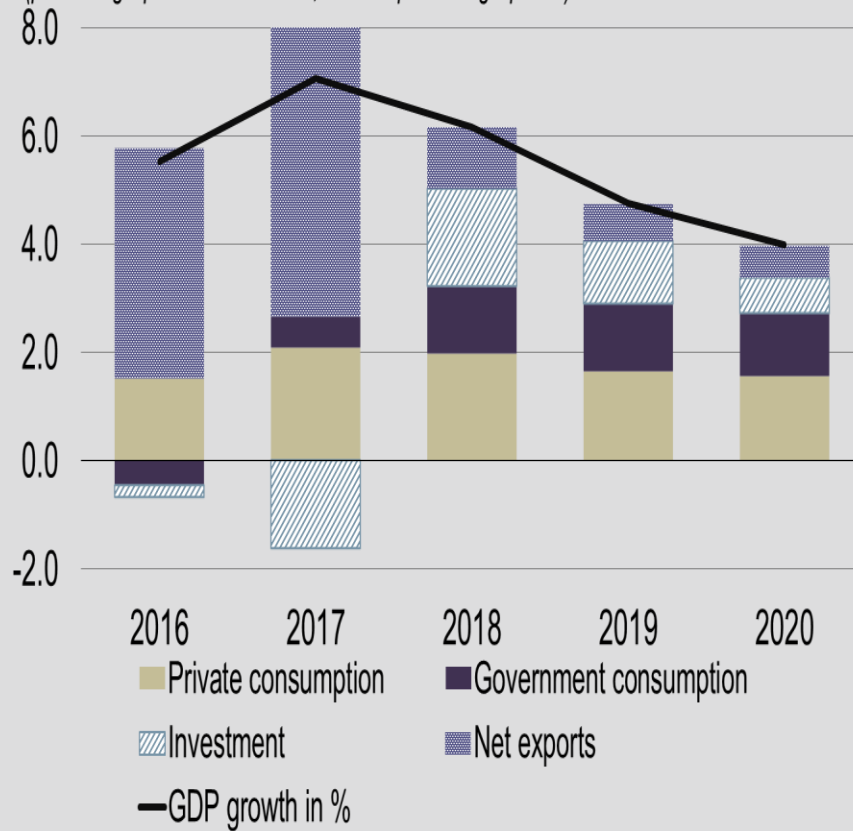
\* Four quarter-moving sum  
Source: National Statistics Office.

## Economic growth is expected to remain strong, but decelerate from high levels

- After exceeding 7% in 2017, Malta's GDP growth rate is forecast to ease to just over 6% in 2018 and just under 5% in 2019.
- Between 2018 and 2020, domestic demand is envisaged to become the main source of growth. It will be supported by a recovery in private investment from a dip in 2017, and continued strength in private and government consumption.
- Employment growth is expected to decelerate in line with economic activity, but remain well above its historical average. Unemployment will rise slightly, while wage inflation should push inflation upwards.

### GDP growth over the projection horizon

(percentage point contributions; annual percentage points)



## Risks to current outlook are broadly balanced

### Risks to GDP growth are balanced:

- **Upside:** further buoyancy in services exports and private consumption; continued declines in import shares.
- **Downside:** slower than expected growth in trading partners and environmental/infrastructural constraints may become binding in the medium-term

### Risks to inflation are on the upside:

- **Upside:** acceleration in wages could be faster than projected.
- **Downside:** stronger euro, and impact of weak imported inflation on goods prices.

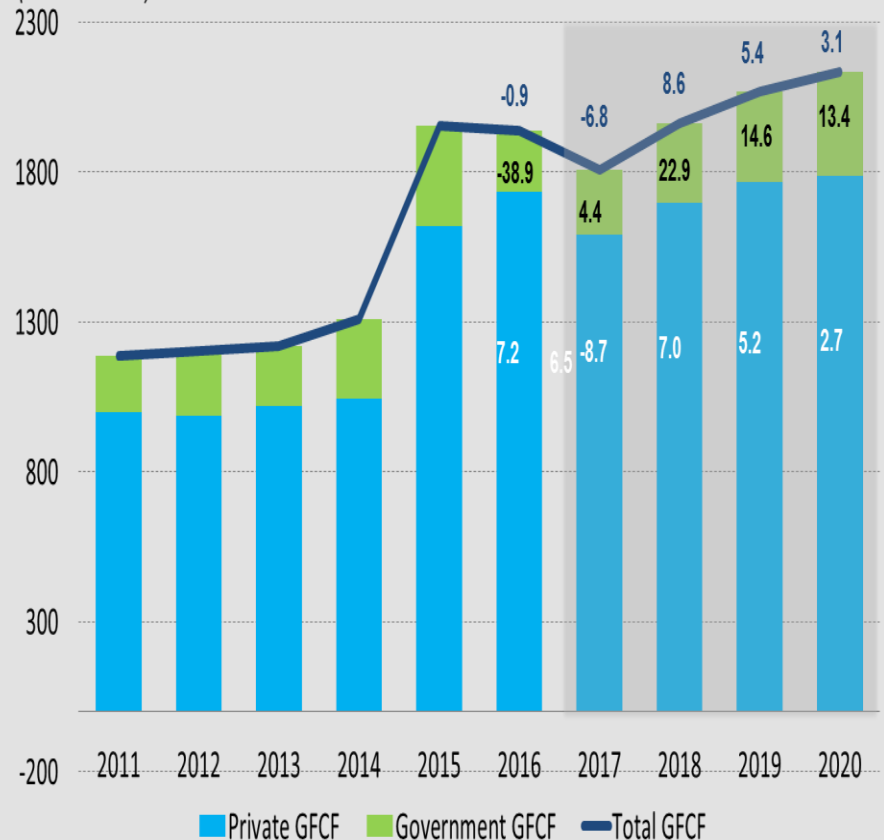
# Investment trends in Malta and future prospects

# Investment rose substantially in 2015 and is expected to remain sustained in the next three years

- The significant rise in the relative size of the services sector initially led to investment declining somewhat.
- However in 2015 investment rose substantially reflecting two main factors – investment in the energy sector and the strong expansion of the aviation sector. Public investment also surged due to higher absorption of EU funds.
- Going forward, investment is expected to remain sustained. There are a number of major education and health-related large projects. Public investment is also due to rise, due to infrastructure works.

## GROSS FIXED CAPITAL FORMATION

(EUR millions)



## In recent years, there was considerable investment in the energy sector

- The table below indicates the marginal costs of electricity production pre-connection to EU energy grid (EPS 2010), post-connection to the grid (EPS 2015) and post-conversion to natural gas (EPS 2015NG).
- The effective reduction in marginal costs depends on the level of the price of oil, but after the completion of the conversion to natural gas, under all scenarios there are significant cost savings.

**RESULTS FOR MARGINAL COST OF ELECTRICITY PRODUCTION FOR DIFFERENT SCENARIOS**

	Baseline Oil Prices (BOPS)			Low Oil Prices (LOPS)			High Oil Prices (HOPS)		
	EPS 2010	EPS 2015	EPS 2015 NG	EPS 2010	EPS 2015	EPS 2015 NG	EPS 2010	EPS 2015	EPS 2015 NG
Marginal cost of electricity (€MWh <sup>-1</sup> )	140	105	95	80	85	70	205	125	110
% change in Marginal cost vs baseline		-25.0	-32.1		6.3	-12.5		-39.0	-46.3

Source: Ries et al (2016)

## This investment in the long run will yield very substantial benefits to Malta

- The fall in marginal costs, together with the size of investment outlays, is projected to boost Malta's GDP by between 1.0% and 3.5%, depending on the level of oil prices.

### LONG-RUN MACROECONOMIC EFFECTS OF ELECTRICITY GENERATION REFORMS

*% deviation from baseline*

	Baseline Oil Prices		Low Oil Prices		High Oil Prices	
	EPS 2015		EPS 2015		EPS 2015	
	EPS 2015	NG	EPS 2015	NG	EPS 2015	NG
<b>Real activity</b>						
GDP	2.1	2.5	-0.4	1.0	3.3	3.5
Consumption	1.5	1.1	-0.6	-0.1	2.9	2.1
Investment	0.6	0.7	-0.1	0.2	1.2	1.1
Exports	2.0	2.4	-0.3	1.1	2.8	3.3
Imports	1.5	1.8	-0.2	0.8	2.3	2.6
<b>Labour market</b>						
Real Wages	1.7	1.8	-0.4	0.5	2.7	2.6
Employment	0.1	0.2	-0.1	0.2	0.0	0.2

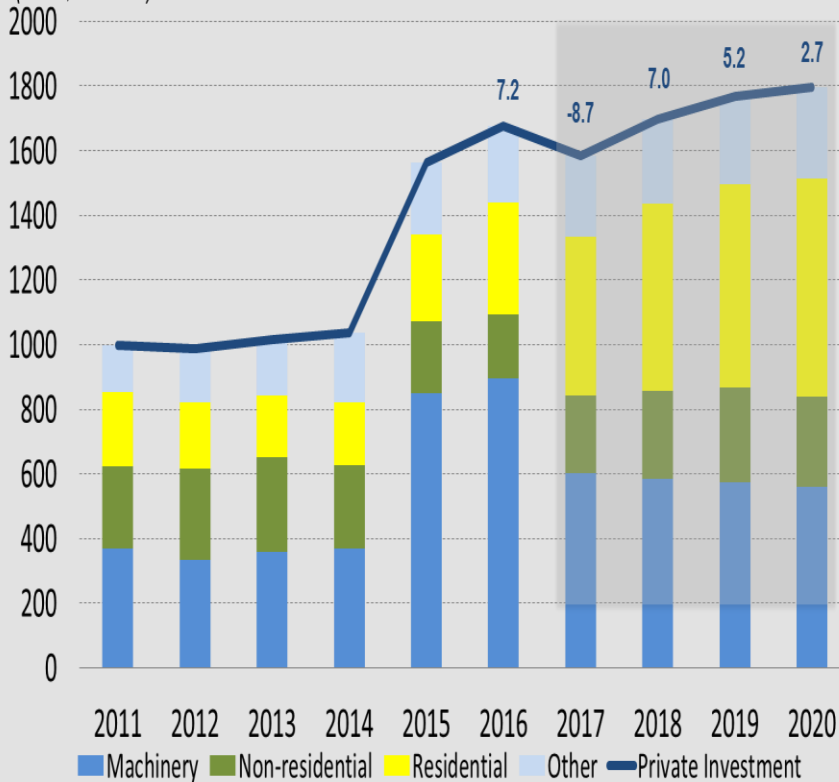
Source: Rapa (2017)

## Private investment in future years will be more involving construction rather than machinery

- After the surge in investment in machinery in 2015 and 2016, private investment is expected to shift more to construction.
- On the one hand, residential construction should rise very substantially to address the large increase in the population following strong migration flows.
- On the other hand, large non-residential construction projects are going to be launched in the coming years, mostly in the private education and health sectors.

### Private Investment

(EUR, millions)

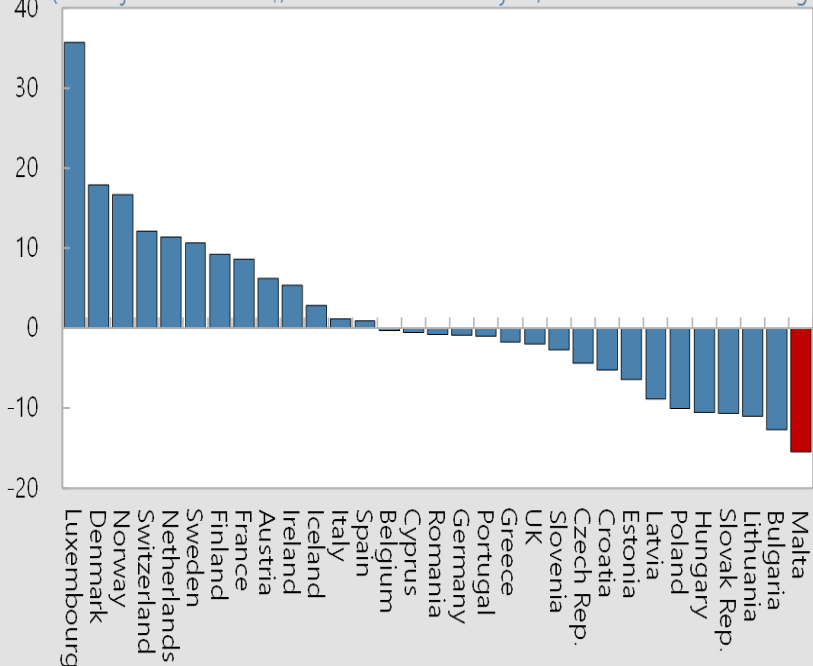


# Focusing public investment on infrastructure could yield significant results

- The IMF estimates that Malta's public capital stock stands at 20% of GDP, and is quite low compared to other EU countries. Their research suggests that there is a considerable gap in terms of road infrastructure.
- They estimate that the planned boost to the road network could boost GDP by 8%.

## Public Capital Stock Per Capita Gap

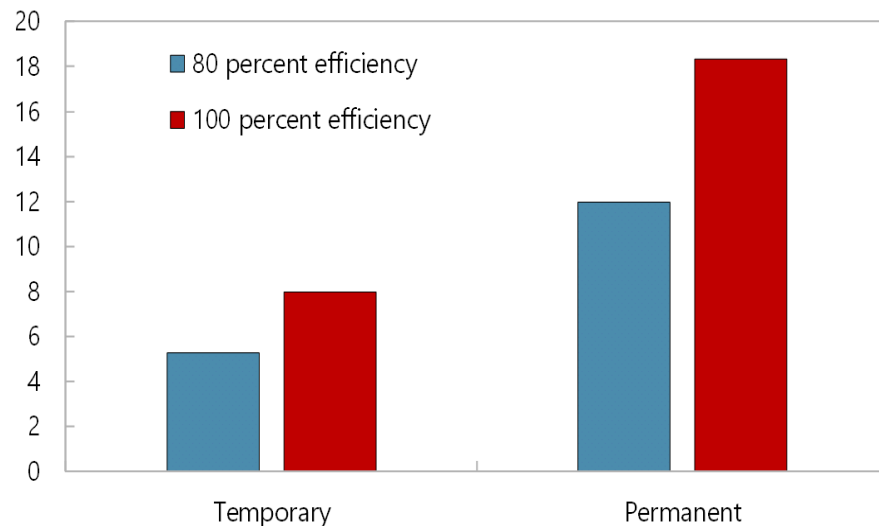
(PPP-adjusted thousand \$, 2015 or latest available year, difference vis-à-vis EU average)



Source: IMF Investment and Capital Stock Dataset.

## GDP Impact of Public Investment Boost

(net present value effect on GDP, in percent)



Source: IMF staff.

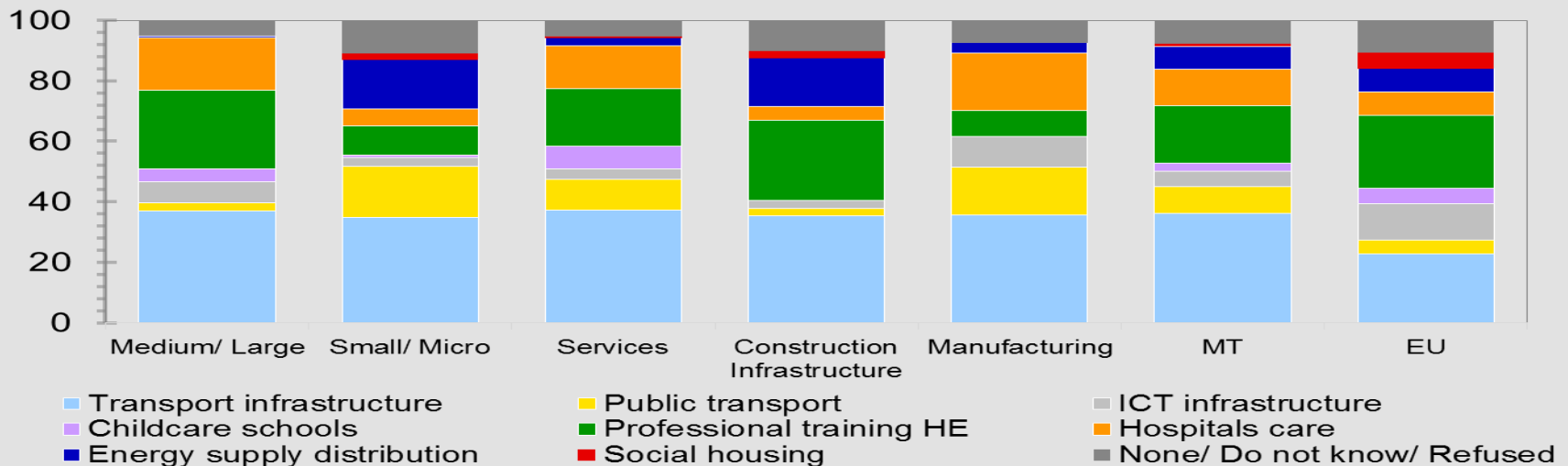
Note: The temporary shock denotes a public investment increase by 1 percent of GDP over 7 years. It remains at the elevated level in the permanent shock scenario. The NPV is discounted over 30 years at a 3 percent interest rate. Efficiency refers to public investment efficiency.

# EIBIS survey confirms that infrastructure investment is the key priority

- The European Investment Bank Group Survey on Investment and Investment finance confirms the perceived need for more investment in infrastructure.
- More than one third of firms cited transport infrastructure as the key priority – one of the highest results in the EU, followed by training. Compared to EU, more focus on public transport and hospitals.

## PERCEIVED PUBLIC INVESTMENT PRIORITIES \*

(per cent)



Question: From your business' perspective, if you had to prioritise one area of public investment for the next 3 years, which one would be?

Source: EIB.

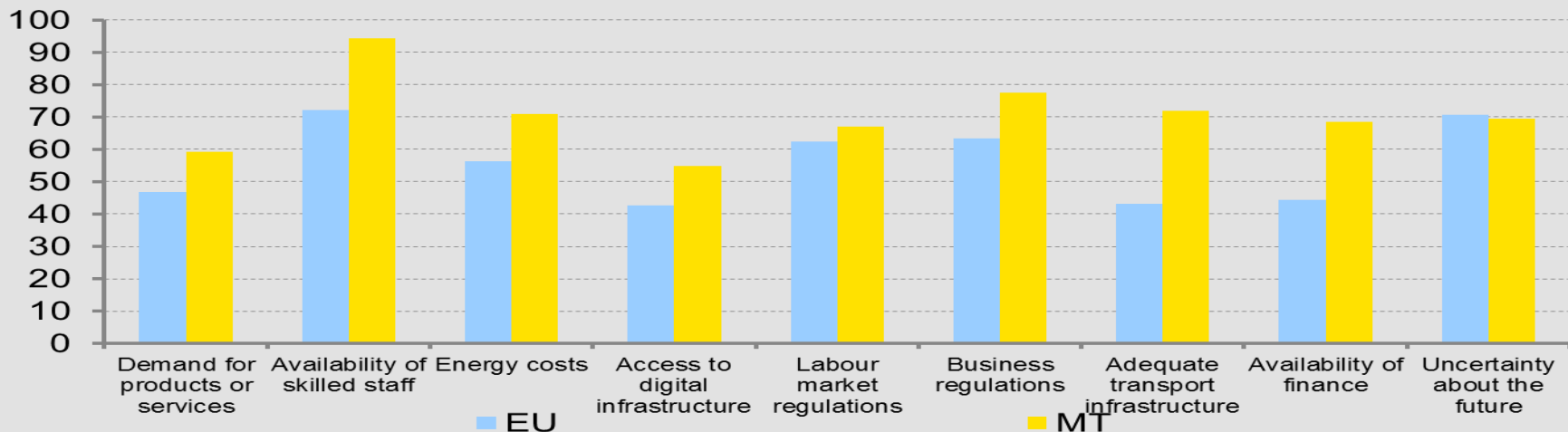
# Financing investment in Malta

## Shortage of labour seen as main obstacle to investment, but access to finance also an issue

- EIBIS 2017 suggests that 84% of firms invested during 2016, 6% more than in the previous year. This was similar to the EU, though investment intensity was higher.
- Investment prospects are somewhat more conservative than in the EU. 94% see labour shortages as a barrier (as against 72% in the EU). Availability of finance is also an issue that affects more Maltese firms than EU ones (69% vs 44%).

### LONG TERM BARRIERS TO INVESTMENT \*

(per cent)



\* Question: Thinking about your investment activities in Malta, to what extent is each of the following an obstacle? Is it a major obstacle, a minor obstacle or not an obstacle at all?

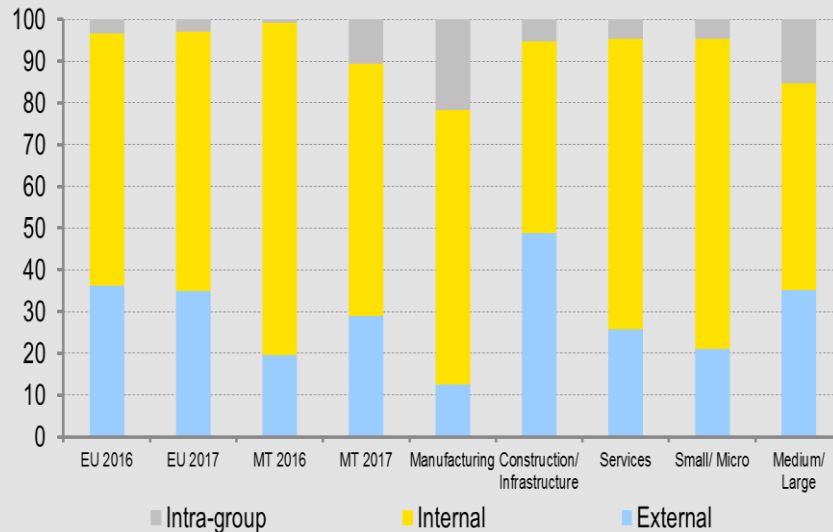
Source: EIB.

# Firms in Malta rely more on internal and intra-group financing, but bank loans remain important

- The EIBIS indicates that Maltese firms depend more on internal and intra-group finance than EU firms do (external finance just 29% of investment as against 35%). This is especially true in manufacturing, but also in services.
- Turning to external finance, Maltese firms resort mostly to bank finance (90% as against 67% for EU firms). However there is rising use of corporate bonds.

## SOURCE OF INVESTMENT FINANCE \*

(per cent)

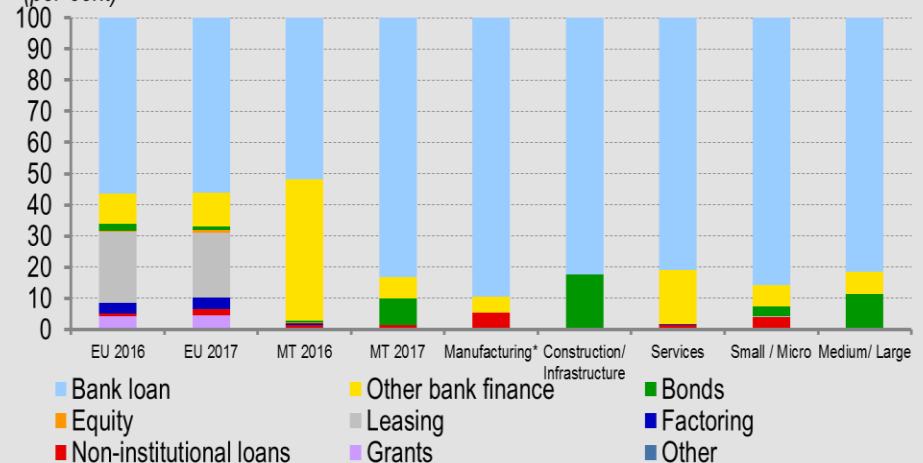


\* Question: What proportion of your investment was financed by each of the following?

Source: EIB.

## TYPE OF EXTERNAL FINANCE USED FOR INVESTMENT ACTIVITIES \*

(per cent)



\* Question: Approximately what proportion of your external finance does each of the following represent?

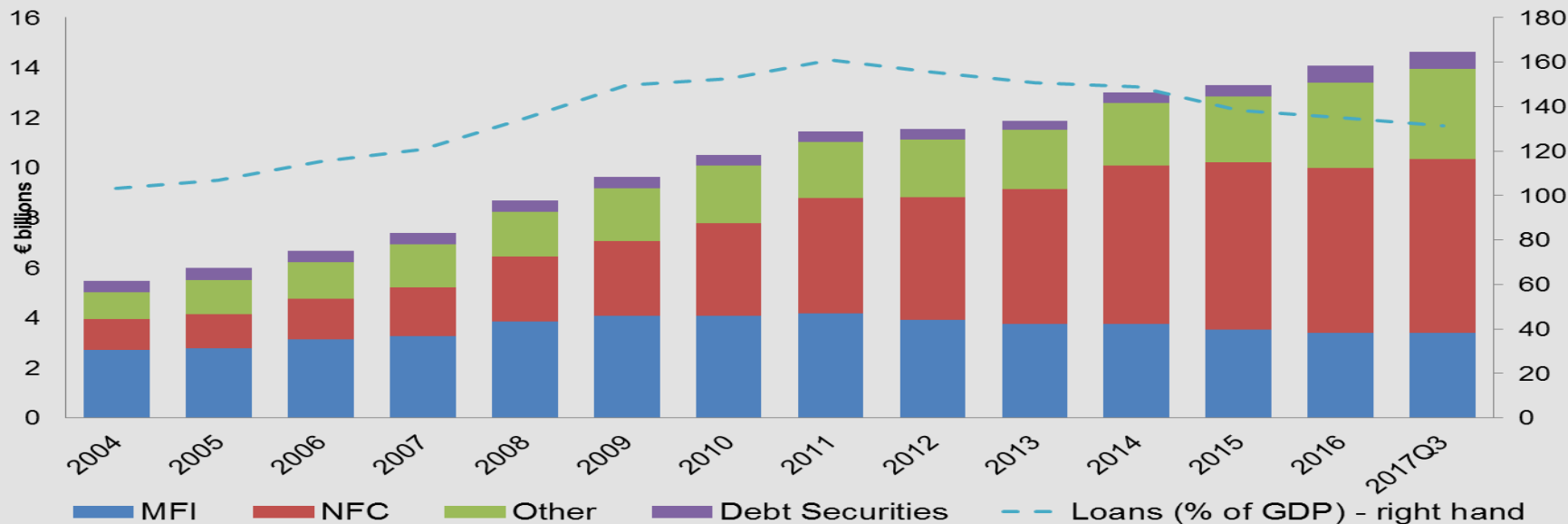
Source: EIB.

## Financial accounts data confirm relative decline in bank lending

- Financial accounts data confirms the indications from EIBIS. Bank lending to NFCs contracted by 19% between 2011 and 2017.
- The importance of intra-sectoral lending has increased. Bond financing stands at 5% in Malta as against nearly 12% in EU.

### LOANS TO NFCs BY SOURCE

(end-of-year stocks)



Source: Financial Accounts.

# Financial disintermediation reflects supply-side and demand-side factors

- **Supply-side factors:**
  - **Fallout from crisis; tightening of credit standards and conditions;**
  - **Shift in bank portfolio towards house loans;**
  - **Inability of new sectors to provide collateral.**
- **Demand-side factors:**
  - **Changing structure of the Maltese economy (less capital-intensive sectors);**
  - **Increased ability of firms to fund themselves.**
- **If the level of credit to NFCs since 2012 had been in line with past trends, the Central Bank of Malta estimates that Malta's GDP would have been nearly 1% higher, with the largest positive impact on gross fixed capital formation.**

## Many initiatives are underway to improve access to finance

- The Malta Development Bank was set up in 2017 to address gaps and failures in the domestic financial infrastructure, particularly when private commercial banks fail to make appropriate financing available, or if financing is not being offered at normal market rates.
- In the same year, the Malta Stock Exchange launched a National Capital Markets Strategic Plan to help develop a liquid and efficient securities market. An example is the Prospects Multilateral Trading Facility, which provides a cost-effective opportunity for SMEs to raise capital.
- Government is also taking advantage of EU-financed initiatives, such as JAIME, providing SMEs financing for capital investment and related working capital at advantageous interest rates and reduced collateral obligations.

# Conclusions

## Conclusions

- **Malta's economic growth is expected to remain one of the strongest in Europe, leading to rapid income convergence towards the European Union average.**
- **In 2017 more firms increased their investment and this positive outlook is expected to continue, albeit at a slower rate.**
- **Addressing the issue of labour shortages, as well as reducing the infrastructure gap remain the key policy priorities to sustain investment and promote inclusiveness.**
- **Demand for funds, to an extent, is not being met by bank finance, though internal funds are accommodating this at present.**
- **Addressing the funding gap, however, remains important as relying on internal funds hampers resilience to future economic shocks, as these impact more heavily internal funds rather than bank financing. Too high a reliance on internal funds also weakens the transmission mechanism of monetary policy, which mainly occurs through the banking channel.**



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