Euler Hermes Economic Research

Country Risk Analysis

Malta

Fiscal consolidation has lost momentum

General Information

GDP	USD 8.7 billion (World ranking 136, World Bank 2012)
Population	0.42 million (World ranking 171, World Bank 2012)
Form of state	Republic
Head of government	Joseph MUSCAT
Next elections	2014, presidential

Strengths

- Low inflation
- Current account shifted into surplus in 2012
- Stable and pro-market political environment
- EU and Eurozone membership
- Low taxes (though regulatory and tax reform at the EU level may adversely affect this advantage in the longer term)
- Strong business environment

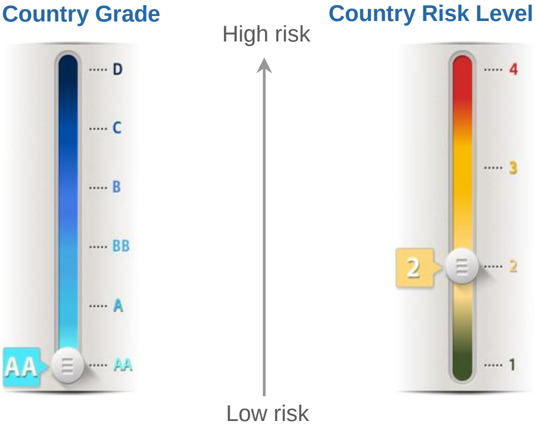
Weaknesses

- Large banking sector
- Continued elevated fiscal deficits and rising public debt
- High export dependence, especially on electrical machinery etc. and on tourism

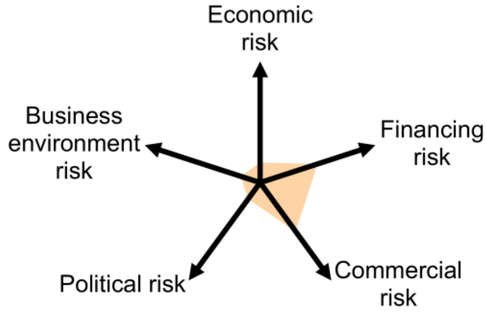
Country Rating

AA2

Country Grade **Country Risk Level**



Risk Dimensions



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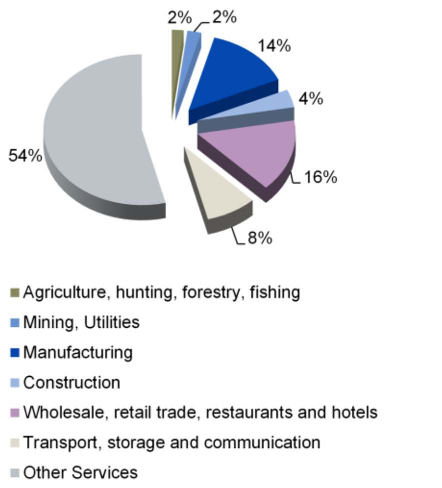
Economic Structure

GDP breakdown (% of total, 2011)



Trade structure (% of total, 2011)

Exports		Rank		Imports
Singapore	15%	1	15%	Korea, Republic of
Germany	11%	2	14%	China
United States	11%	3	12%	Italy
France	10%	4	9%	Russian Federation
China, Hong Kong SAR	9%	5	6%	Singapore

Exports		Rank		Imports
Electrical machinery, apparatus and appliances, n.e.s.	50%	1	26%	Petroleum, petroleum products and related materials
Miscellaneous manufactured articles, n.e.s.	9%	2	14%	Other transport equipment
Medicinal and pharmaceutical products	7%	3	11%	Electrical machinery, apparatus and appliances, n.e.s.
Petroleum, petroleum products and related materials	5%	4	3%	Miscellaneous manufactured articles, n.e.s.
Fish, crustaceans, molluscs and preparations thereof	4%	5	2%	Other industrial machinery and parts

Sources: UnctadStat, IHS Global Insight, Euler Hermes

Economic Forecast

	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	-2.9	3.2	1.8	1.0	1.0	1.2
Inflation (%, end-year)	-0.4	4.0	1.5	2.8	2.0	2.2
Fiscal balance (% of GDP)	-3.8	-3.6	-2.7	-3.3	-4.2	-3.9
Public debt (% of GDP)	66.4	67.4	70.3	72.1	73.9	74.9
Current account (% of GDP)	-8.9	-5.4	-1.0	1.1	-0.2	-0.5
External debt (% of GDP)	517.9	526.7	471.6	506.9	516.7	506.3

Source: IHS Global Insight, national sources, Euler Hermes

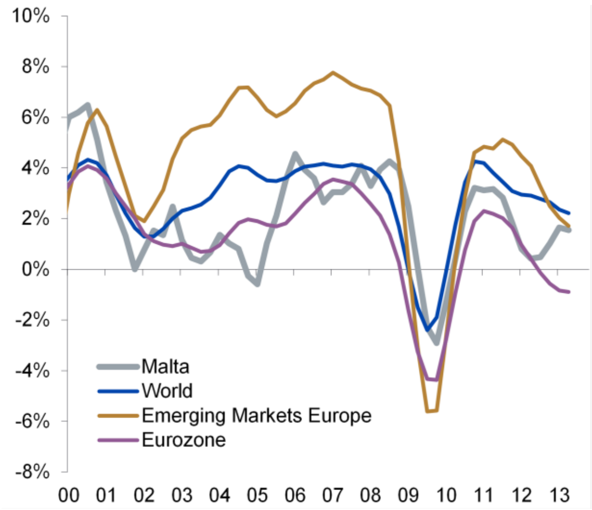
Economic Growth

GDP Growth to remain sluggish

Real GDP grew by +0.8% in 2012, driven by external demand and public consumption. The latter rose by +5% while private consumption contracted by -0.2%. Gross capital formation fell by -12.8%, reflecting a sharp fall in inventories as fixed investment declined by -3.9%. Exports increased by +7%, faster than imports at +5.5%, such that net trade made a positive contribution to full-year 2012 growth.

In H1 2013, real GDP expanded by +1.7% y/y. Strangely, most demand-side components of GDP posted declines, except for public consumption, which increased by just +0.9% y/y, and gross capital formation which inched up by +0.5% y/y. Private consumption contracted by -1.4% y/y, fixed investment by -9.1% y/y, exports by -5.9% y/y and imports by -8.1% y/y. This indicates that net exports were the main growth driver in H1, owing to the sharper decline of imports as compared to exports. These figures do not provide the foundation for overly optimistic forecasts. EH expects full year GDP growth of about +1% in 2013 and a modest acceleration in 2014.

GDP growth (% y/y, 4 qtrs cumulated)



Sources: IHS Global Insight, national sources, Euler Hermes

Economic Policies

Inflation is in check

Headline consumer price inflation has been moderate since 2009, posting annual averages of 2.4% in 2011 and 3.2% in 2012. Recently, it eased from 2.8% y/y at end-2012 to 0.6% y/y in June 2013 before picking up slightly to 0.9% y/y in July. EH expects inflation to increase to about 2% at end-2013 and to remain around that level until end-2014.

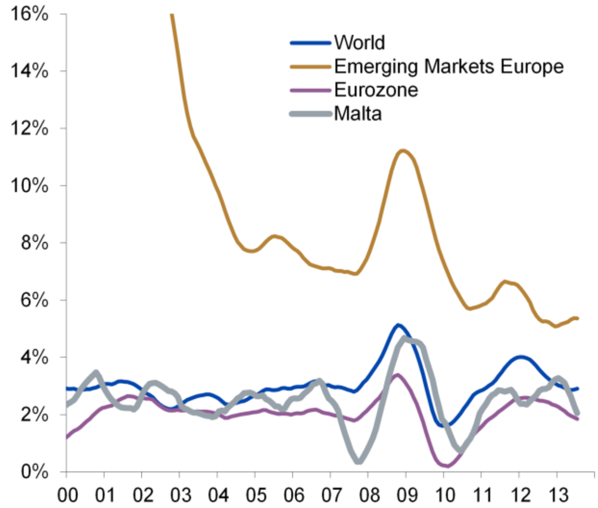
Large banking sector

Malta's financial sector has weathered the global financial and the Eurozone sovereign debt crises relatively well so far. On aggregate, banks have remained adequately capitalised, profitable and liquid. However, the banking sector's pure size (total assets account for about eight times of GDP, more than in Ireland or Cyprus) has raised concerns about financial stability and fiscal sustainability, as recent events in the Eurozone (especially the Cyprus crisis) have highlighted the potential risks of having a large banking sector in a small country. But in the case of Malta these risks appear contained. The exposure of Malta's banks to EU sovereign debt is very low and diversified. Moreover, the large international banking segment (attracted by low taxes; with assets about five times of GDP) has limited exposure to the country's economy. Nonetheless, continued caution is warranted. The international banks as well as the non-core domestic banks (catering mostly to non-residents; with assets of 77% of GDP) could be exposed to liquidity risk if perceptions of risks facing these creditors deteriorate and lead to rising funding costs. The segment of core domestic banks (with assets of 220% of GDP) – dominated by the foreign-controlled HSBC (Malta) Ltd. and the Bank of Valletta is vulnerable to credit risk related to high exposure to the real estate market. The share of non-performing loans in total loans has slightly risen for core domestic banks (from 6.2% in 2009 to 8.1% in 2012) and non-core domestic banks (from 2.4% in 2009 to 4.1% in 2012) but not for international banks (0.5%). In the longer term, regulatory and tax reform at the EU or Eurozone level may negatively affects Malta's attractiveness as a financial centre.

Fiscal consolidation has lost momentum

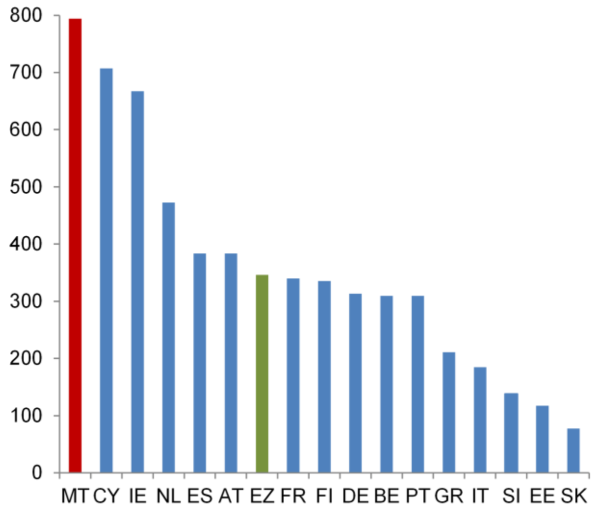
Malta's fiscal position deteriorated in the wake of the 2008-2009 global economic crisis, reflected in an average annual fiscal deficit of 3.4% of GDP in 2009-2012. EH expects deficits of about 4% of GDP in 2013-2014. Total public debt has risen from 62% of GDP in 2008 to 72% in 2012 and is forecast to increase further. However, this was still well below the Eurozone average of 93%. And in contrast with most other EU member states, 96% of public debt is held by residents, limiting financial spillovers. Nonetheless, in the longer term fiscal consolidation should be brought back on track.

Inflation rate (%)



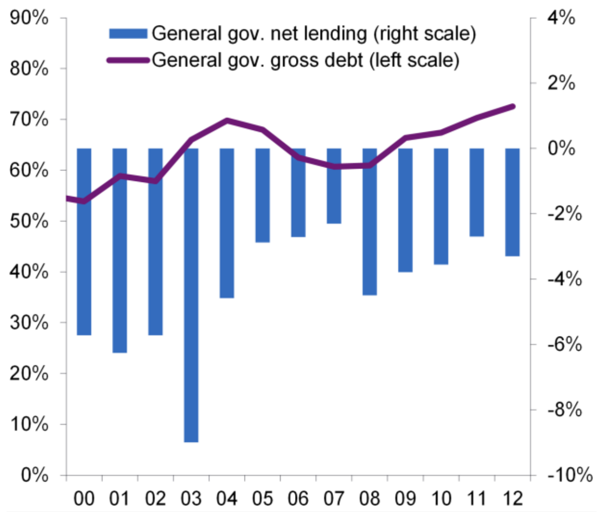
Sources: IHS Global Insight, national sources, Euler Hermes

Total banking sector assets (% of GDP)



Sources: ECB, Eurostat, Euler Hermes

Fiscal balance and public debt (% of GDP)



Sources: IHS Global Insight, European Commission, Euler Hermes

External Sector

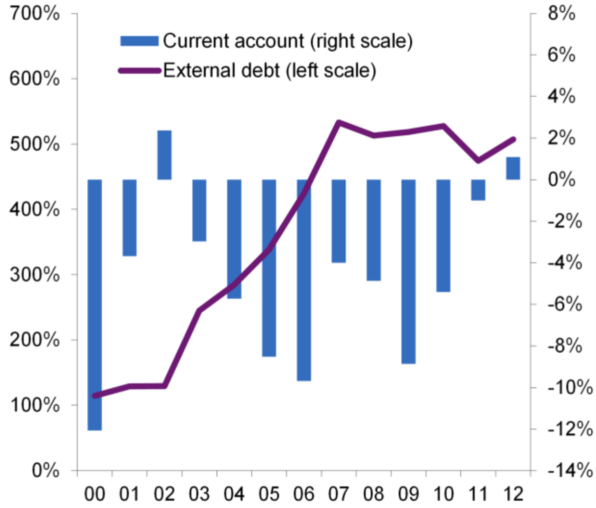
Current account

The current account deficit narrowed from a large 9% of GDP in 2009 to 1% in 2011 and shifted to a surplus of 1.1% in 2012, as export growth outpaced imports. EH forecasts small annual current account deficits of less than 1% of GDP in 2013-2014.

External debt

Malta is a net external creditor, but its huge gross external debt level—estimated at around 500% of GDP, stemming from non-resident deposits held by internationally oriented banks—is a source of some external vulnerability, especially in the context of the Eurozone debt crisis, even though the IMF states that external liabilities are backed by matching assets.

Current account and external debt (% of GDP)



Sources: IHS Global Insight, national sources, Euler Hermes

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