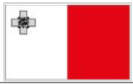
Euler Hermes Economic Research

Country Report

Malta

Economic performance remains robust, but dependency on the banking sector is a significant vulnerability

General Information



GDP	USD9.643bn (World ranking 139, World Bank 2014)
Population	0.43mn (World ranking 171, World Bank 2014)
Form of state	Republic
Head of government	Joseph MUSCAT
Next elections	2018, legislative

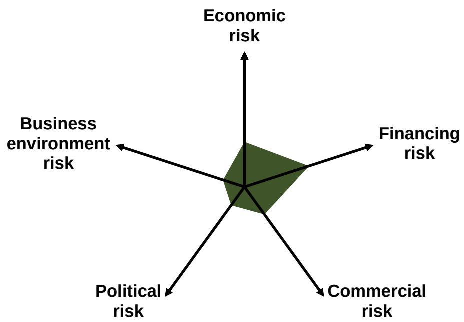
Strengths

- Stable and pro-market political environment
- EU and Eurozone membership
- Investor-friendly tax regime with considerable tax exemptions and incentives for investment that compensate the relatively high corporate tax rate of 35%
- Strong business environment
- English speaking workforce, relatively low labor costs compared to other EU members

Weaknesses

- Large banking sector
- Enormous external debt due to large foreign banks assets on the local market
- High export dependence, especially on electrical machinery and equipment (mainly semiconductors) and on tourism
- High import dependence as it produces only about 20% of its food needs, has limited freshwater supplies and no domestic energy source

Country Rating A1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
South Korea	10%	1	24%	Russia
China	9%	2	15%	China
Germany	8%	3	12%	Italy
Egypt	4%	4	5%	Turkey
Italy	4%	5	5%	France

By product (% of total)

Exports		Rank		Imports
Refined Petroleum Products	42%	1	43%	Refined Petroleum Products
Electronic Components	19%	2	18%	Ships
Pharmaceuticals	7%	3	4%	Electronic Components
Ships	4%	4	3%	Toiletries
Electrical Apparatus	3%	5	2%	Knitwear

Source: Chelem (2013)

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Economic Overview

Above +3% GDP growth since 2014

Annual real GDP growth reached +3.6% in 2014, the highest rate of growth since 2010. The resilience of the Maltese economy when compared to the Eurozone is attributable to a spur in private consumption, stronger investment, high government expenditure and the attempt to diversify exports. During the first 9 months of 2015, GDP grew at the strong pace of +4.4% y/y on average. Euler Hermes forecasts +4% growth in 2015 before slightly moderating to +3.5% and to +3.2% in 2016 and 2017, respectively. The main drivers of growth for the next two years are projected to be investment, benefitting from a number of large scale construction and energy projects, EU funding absorption (mostly in 2015) and domestic demand, on the back of increasing disposable incomes and favorable consumer sentiment. Continued strong performance of the tourism industry is also expected to support growth.

Deflationary pressures less of a concern

Price inflation in Malta is expected to exceed that in the Eurozone over the 2015-2017 time horizon on the back of rising services inflation and Malta's higher dependency on services compared to goods. The moderation of the effect of the pass-through of lower oil prices, the base effects linked to the decline in electricity tariffs for households in March 2014 and the euro depreciation are expected to support inflation (+1.2% in 2015 and +1.3% in 2016, well above the Eurozone inflation level of +0.1% in 2015 and +0.9% in 2016).

Fiscal sustainability reliant on the banking sector

The sustained growth helped lowering the fiscal deficit to -2.7% of GDP in 2014 and debt has declined to 68.4% of GDP. Fiscal consolidation will continue during the next three years thanks to the reforms introduced by the Fiscal Responsibility Act (FRA) in 2014. The fiscal deficit is projected to decrease to -2.3% of GDP in 2015 and the government's aim is obtaining an annual fiscal consolidation of about 0.6pps of GDP. We expect the fiscal deficit to stand at -1.4% of GDP and the public debt to settle close to 65% of GDP by 2017, far below the Eurozone average debt of 93% of GDP. However, the size of the Maltese financial sector and its steady growth over the past years – bank assets close to 7 times of GDP and non-bank financial institutions' assets around twice the size of GDP – is the biggest downside risk for fiscal sustainability, given that the banking sector is the major Maltese tax payer. Financial sector vulnerabilities also stem from the relatively high level of non-performing loans and the high exposure to the real estate market.

Current account surplus since 2012

The current account surplus registered in 2014 and 2015 will persist (+1.2% of GDP in 2016, +2.0% in 2017), supported by lower oil prices, the continued recovery in external demand due to the high responsiveness to the euro depreciation, and Malta's competitiveness in the services sector.

Figure 1: Key economic forecasts

	2014	2015f	2016f	2017f
GDP growth (% change)	3.6	4.0	3.5	3.2
Inflation (%, average)	0.8	1.0	1.4	1.8
Fiscal balance (% of GDP)	-2.7	-2.3	-1.9	-1.4
Public debt (% of GDP)	68.6	68.0	67.3	66.4
Current account (% of GDP)	3.3	1.5	1.2	2.0
External debt (% of GDP)	1173	1120	1115	1110

Sources: National sources, IMF, IHS, Euler Hermes

Figure 2: Real GDP growth (%)

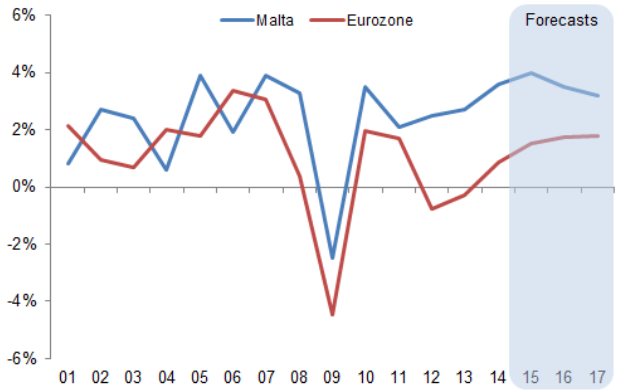
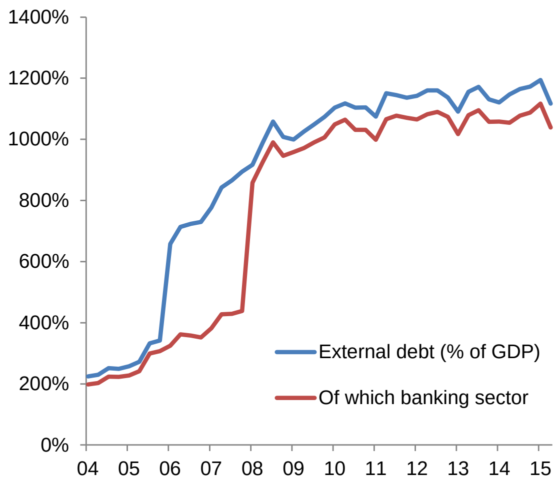


Figure 3: External debt, % of GDP



Sources: National sources, IHS, Euler Hermes

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