18. MALTA

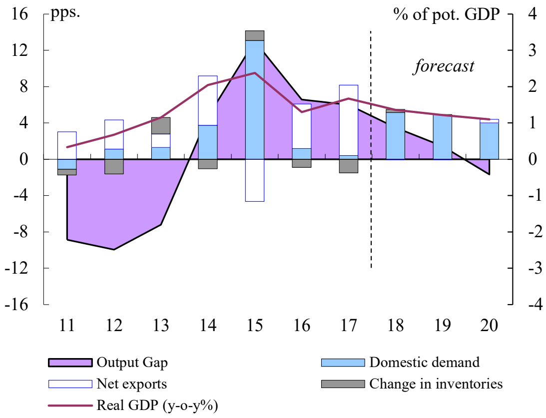
Sustained economic growth

Malta's strong GDP growth is set to continue as domestic demand replaces net exports as the main engine of economic activity. The internationally oriented services sector continues to underpin the large current account surplus. Inflation is expected to pick up as wage pressures start gaining pace. The government balance is projected to moderate but remain in surplus.

Good economic performance in the first half of 2018

Malta's economic growth is projected to remain robust. Real GDP rose by 6.7% in 2017, driven by strong growth in net exports. In the first half of 2018, real GDP growth slowed moderately compared to 2017. Private consumption growth accelerated, while net exports declined as a result of rapid import growth in the second quarter. Business and consumer confidence indicators remain high and real GDP growth is expected to average 5.4% in 2018.

Graph II.18.1: **Malta - Output gap and contributions to real GDP growth**



Domestic demand expected to drive growth

Growth is expected to gradually ease over the forecast horizon to an annual average rate of 4.9% in 2019 and 4.4% in 2020. Domestic demand is set to be the main driver of growth, supported by strong investment growth. Various investment projects co-financed by EU structural funds have started and will boost public investment in the second half of 2018. In 2019, the onset of large-scale projects in the health, tourism and real estate sectors is expected to boost private investment. Private consumption is set to remain dynamic, on the back of increasing labour market participation and disposable income.

Export growth is expected to slow down over the forecast horizon from the high growth rates registered in recent years, in line with the projected moderation in global demand, while imports are expected to rise, driven by investment growth. The current account balance is set to remain at historically high levels, underpinned by the large external surplus of the internationally oriented services sector.

Strong labour market performance to lift wages and prices

Employment growth is expected to remain strong, but to moderate over the forecast horizon as economic growth eases. Increasing labour supply has helped to keep wage pressures contained despite strong employment growth and low unemployment, which is projected to remain around 4% in the next two years. As a result of the tighter labour market, wage pressures are expected to strengthen and lead to higher growth in compensation per employee. As a result, growth in unit labour costs is projected to rise to 1.9% in 2018 and to remain broadly stable over the forecast horizon.

Following a period of moderate price pressures, headline inflation began to accelerate in the second quarter of 2018, partly reflecting an increase in the weight of accommodation services in the price index, as well as the rise in international oil prices. Inflation is set to progressively rise over the forecast horizon on the back of wage growth, and should reach around 2% in 2020.

Broadly balanced risks to the outlook

Risks to the macroeconomic outlook appear broadly balanced. As Malta's trade-to-GDP ratio stands at around 250%, further escalations in global trade tensions would imply particular downside risks to Malta's growth projections. On the upside, domestic demand may exceed growth expectations, if investment rises faster than anticipated and employment growth surprises on the upside, pushing up households' consumption.

Fiscal surplus expected to decline

In 2018, the government surplus is projected to decrease to 1.3% of GDP, from 3.5% in the previous year. Tax revenue growth is expected to be lifted by high nominal GDP, supported by favourable macroeconomic and labour market conditions, high corporate profits and consumer demand. An expected fall in the proceeds from Malta's citizenship scheme compared to last year should contribute to a decrease in the fiscal surplus. Current expenditure is projected to be dynamic in almost all components, only partly mitigated by decreasing interest expenditure. Public investment net of EU funding is projected to increase only slightly, while the implementation of investment projects co-financed by the EU is expected to accelerate. Capital expenditure will increase also on the back of a capital transfer to Air Malta related to the purchase of landing rights (equivalent to around 0.5% of GDP).

In 2019, after incorporating the expected impact of the measures introduced with the 2019 budget, the fiscal surplus is expected to decline marginally to 1.2% of GDP. In line with still robust but moderating macroeconomic conditions, and despite the reduction in taxation (worth 0.2% of GDP), growth in tax revenues is expected to slow down somehow towards the growth rate in nominal GDP. Also, the proceeds from the citizenship scheme are expected to be lower compared to the previous year. In spite of increases in social spending related to the budget measures, current expenditure growth is projected to weaken and interest expenditure is set to marginally decrease. Net public investment is forecast to increase marginally, as the implementation of investment projects co-financed by the EU is forecast to remain dynamic, while other capital expenditure is expected to decrease following the base effect from the previous year. In 2020, under a no-policy-change assumption, the fiscal surplus is expected to further decrease to 0.7% of GDP, on account of slightly lower proceeds related to the citizenship scheme and higher public investment.

The structural balance has reached a surplus of around 3% of GDP in 2017. It is estimated to decrease but to remain in surplus at slightly below 1% of GDP in the period 2018-2020. The government debt-to-GDP ratio is forecast to decline further from 50.9% of GDP in 2017 to 42.1% in 2020.

Table II.18.1:

Main features of country forecast - MALTA

	2017			Annual percentage change						
	mio EUR Curr. prices	% GDP	99-14	2015	2016	2017	2018	2019	2020
GDP	11139.7	100.0	3.0	9.5	5.2	6.7	**5.4**	**4.9**	**4.4**
Private Consumption	5012.2	45.0	2.2	5.0	2.6	3.7	**5.2**	**3.8**	**3.6**
Public Consumption	1746.2	15.7	2.5	3.7	-2.8	2.8	**15.7**	**9.0**	**6.9**
Gross fixed capital formation	2351.6	21.1	2.4	56.8	1.7	-7.3	**1.6**	**8.2**	**5.7**
of which: equipment	826.5	7.4	-	85.5	15.4	-34.7	**-**	**-**	**-**
Exports (goods and services)	15074.8	135.3	5.1	3.7	4.2	3.8	**1.5**	**1.9**	**1.9**
Imports (goods and services)	12912.1	115.9	4.8	7.4	0.7	-1.9	**1.9**	**2.3**	**1.9**
GNI (GDP deflator)	10392.7	93.3	2.8	10.7	2.5	5.9	**5.3**	**4.5**	**4.0**
Contribution to GDP growth:	Domestic demand		2.4	13.1	1.2	0.4	**5.1**	**4.9**	**4.0**
	Inventories		0.0	1.1	-0.9	-1.5	**0.4**	**0.0**	**0.0**
	Net exports		0.6	-4.6	4.9	7.8	**-0.1**	**-0.1**	**0.4**
Employment			1.6	3.9	4.2	5.2	**5.0**	**3.6**	**3.4**
Unemployment rate (a)			7.2	5.9	5.2	4.6	**3.9**	**4.0**	**4.0**
Compensation of employees / head			3.6	5.0	2.8	1.7	**2.3**	**3.2**	**3.1**
Unit labour costs whole economy			2.2	-0.4	1.8	0.2	**1.9**	**1.9**	**2.1**
Real unit labour cost			-0.3	-3.0	0.2	-2.3	**-0.3**	**-0.3**	**-0.1**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			2.5	2.7	1.6	2.6	**2.2**	**2.2**	**2.1**
Harmonised index of consumer prices			2.3	1.2	0.9	1.3	**1.8**	**1.9**	**2.0**
Terms of trade of goods			0.8	0.5	-3.4	5.2	**2.8**	**1.0**	**1.0**
Trade balance (goods) (c)			-15.7	-20.1	-18.2	-12.0	**-11.7**	**-11.5**	**-11.3**
Current-account balance (c)			-2.4	4.5	7.0	13.8	**12.3**	**11.2**	**10.6**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-1.2	6.2	7.4	14.3	**12.9**	**12.0**	**11.5**
General government balance (c)			-4.0	-1.0	0.9	3.5	**1.3**	**1.2**	**0.7**
Cyclically-adjusted budget balance (d)			-3.9	-2.5	0.2	2.8	**0.9**	**1.0**	**0.9**
Structural budget balance (d)			-	-2.6	0.3	3.1	**0.9**	**0.9**	**0.9**
General government gross debt (c)			66.0	58.6	56.3	50.9	**47.9**	**44.8**	**42.1**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.