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An assessment of the macroeconomic forecasts for the Maltese economy prepared by the Ministry for Finance in September 2014

An independent report prepared for the National Audit Office

October 2014

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Abbreviations

CBM	**Central Bank of Malta**
CBM JUNE	**Central Bank of Malta June Forecast 2014**
COM	**European Commission**
COM SPR	**European Commission Spring Forecast 2014**
ECB	**European Central Bank**
EPD	**Economic Policy Department**
ESA	**European System of National and Regional Accounts**
EU	**European Union**
GDP	**Gross Domestic Product**
HICP	**Harmonized Index of Consumer Prices**
LFS	**Labour Force Survey**
MFIN	**Ministry for Finance**
MFIN APR	**Forecast exercise undertaken by the Ministry for Finance in April 2014**
MFIN SEPT	**Forecast exercise undertaken by the Ministry for Finance in September 2014**
NAO	**National Audit Office**
NPISH	**Non-Profit Institutions Serving Households**
NSO	**National Statistics Office**
SGP	**Stability and Growth Pact**
STG	**British Pound**
USD	**United States Dollar**

1. Introduction.

This report overviews the macroeconomic forecasts presented by the Ministry for Finance in the draft budget document dated October 2014. The forecasts have been prepared by the Economic Policy Department (EPD) within the Ministry for Finance (MFIN) following various discussions and meetings with other entities and government agencies. The cut-off date for this forecast has been set to include data available to the EPD up to the 15th of September 2014. In line with the recommendation of the Council directive 2011/85/EU and the Regulation (EU) No.473/2013 the National Audit Office has been given the task by the Minister of Finance to carry out an assessment of the main macroeconomic forecasts within the draft budget document (October 2014) for the forecast years 2014 and 2015. This report is being presented to this effect.

It is important to highlight at the outset the exceptional circumstances under which the forecast analysed in this report has been prepared. The overall preparation of this forecast has been significantly affected by the change in the methodology utilized for the compilation of macroeconomic data for Malta. The official website of the National Statistics Office of Malta (NSO)[1] set the official publication of a new dataset for national accounts, which is based on the ESA 2010[2] methodology, to the 17th of October 2014. Furthermore this new data includes a number of other revisions as part of the 'benchmarking' exercise carried out by national agencies[3]. Eurostat asserts that from September 2014 the official national accounting framework within the European Union is to be based on the ESA 2010 methodology. This report therefore assesses the forecasts prepared by the EPD which, given the date of publication of the draft budget document, had to be undertaken utilizing data based on ESA 2010. It is the considered opinion of the consultants writing this report that such developments have significantly affected the overall running of the forecasting exercise and better co-ordination between the various institutions responsible for the preparation of the forecasts is recommended in such circumstances.

This report will be divided in a number of sections:

a) This introduction is followed by an overview of the methodology used by the Economic Policy Department to generate the macroeconomic forecasts.
b) An assessment of the underlying exogenous assumptions which underpin the current macroeconomic forecast is presented.
c) The main macroeconomic indicators underpinning the forecasts will be assessed for the 2014-2015 period.
d) A comparison of the main contributors to growth in the current forecasting round compared to the expected developments for the Maltese economy back in April 2014 and those of other institutions.

In preparation for this report, a number of meetings have been carried out by the consultants with the relevant personnel preparing the macroeconomic forecasts. In view of the fact that a

[1] Referenced on the 1/10/2014.
[2] ESA 2010 was adopted in the form of a regulation of the European Parliament and of the Council on 21st May 2013. It will be implemented as from September 2014; from that date onwards the data transmission from Member States to Eurostat will follow ESA 2010 rules. The ESA 2010 was published in the Official Journal as Annex A of Regulation (EU) No 549/2013.
[3] The implementation of a benchmark revision is noted within the NSO Annual Report for 2013 published in February 2014.

full set of macroeconomic data and ad-hoc information related to this forecast was made available to the consultants on the 7th of October 2014, this date is thus set as the cut-off date for this report. The preparation of this report is also based on a number of reports, published by reputable organizations, which provide an assessment of the current and expected developments within the Maltese economy.

2. The forecasting methodology.

Given the significant methodological revisions carried out by the NSO, as described within the introduction of this report, the forecasts within the draft budget document (October 2014) are not directly comparable to other forecasts presented in previous forecasting rounds. Keeping in mind these considerations, one acknowledges that the forecasting methodology used for this forecast run (September 2014) has remained relatively similar to that used by the Economic Policy Department in previous forecast rounds over the recent past. The EPD still makes use of a Keynesian structure type macroeconomic econometric model based on quarterly data. This model is the main tool used to generate the yearly forecasts analysed in this report. The model used is mainly expenditure driven and includes a number of identity and behavioural relationships with data ranging from the year 2000 to the second quarter of 2014. A number of variables are specifically treated as completely exogenous to the system. The change in methodology mainly related to the macroeconomic variables has put to the test the economic underpinnings of the macro-econometric model. It is clear from the discussions with the economic experts at the EPD that the revisions expected within certain data components entail changes to the economic parameters which underpin the behavior of the macroeconomic variables. The forecast presented in this report for 2014 and 2015 also reflects the re-modeling and re-estimation of a number of variables to capture such changes.

The data incorporated in the econometric model was provided to the EPD by the National Statistics Office using the new ESA2010 methodology. Due to the timing requirements of this exercise, this forecasting run is based on data which was not officially yet published at the time of the preparation of the forecast. The other revisions to the data, referred to as 'benchmarking' are not specifically related to the change in methodology but given the magnitude of some of these changes appropriate adjustments had to be implemented within the econometric modeling framework. To this effect the EPD has ensured that such changes are taken on board within the modeling framework and that the most recent forecasts reflect the new and updated information. It is clear from the meetings organized with the Economic Policy Department that the staff at the department made every effort to ensure that the current modeling structure reflects all the latest available information both related to historical data and future expectations whilst maintaining the basic overall structure for modeling the economy.

The preparation of this forecast exercise is also based on some element of expert judgement. One notes, that this process is well documented by the department and reflects an internal structured exercise carried out by the economists working on the forecasting model. Although a certain degree of judgement still underpins some of the forecasted variables, the experience and information available to the economists working in the field serves as a prime input into the process. The econometric model itself ensures that all information is translated into data which helps the estimation process.

3. Assessment of the main assumptions underpinning the macroeconomic forecast.

As recorded by the authors in previous reports carried out to assess the macroeconomic forecasts of the Ministry for Finance, the exogenous variables within the system of equations are based on assumptions provided by international reputable institutions. The size of the Maltese economy and its particular openness in terms of the global economy installs an element of volatility and instability which is internationally driven. Such factors are likely to impact on developments within the local Maltese economy and the predetermined variables treated as exogenous to the system are intended to reflect such developments.

The current forecasting exercise is based on a number of variables which are treated as completely exogenous to the economic system. Such variables, although of prime importance to developments in the Maltese economy, are determined internationally and are not affected by factors specifically related to the Maltese economy. Table 1 overleaf provides a list of the main variables which are treated as exogenous together with information on the relative data source used in each case. The main sources of data are the European Central Bank (ECB) and Consensus Economics[4], both international institutions of the highest esteem. One notes particular differences in the assumptions for certain variables treated as exogenous when compared to the previous forecasting round in April 2014.

The use of information made available by international agencies as a base for future expected developments in a number of internationally related variables constitutes a good practice and is to be encouraged. This practice helps in setting out a reliable platform of the international environment on which to base the predictions for the Maltese economy. The assumptions adopted in this forecast round have a cut-off date of September 2014 and reflect an adequate level of prudence. In comparison to the forecasts presented for 2014 and 2015 in April 2014 one notes an expected depreciation of the Euro/Dollar exchange rate and the Euro/Sterling rate for both 2014 and 2015. This assumption is based on expectations provided for this variable of interest by Consensus Economics. Of significant importance to the expected developments in the local economy is the expectation for growth within Malta's main trading partners and the risks associated with the changing geopolitical scenario. Real and nominal Gross Domestic Product (GDP) growth in the main trading partners is expected to grow at a slower rate in the short term period reflecting the current sentiment within a number of EU countries. The forecasted developments in the world price of oil back in April 2014 are expected to remain fairly unchanged for the year of 2014. One notes a reduction in the assumed projection for 2015, with oil prices expected to fall to lower levels compared to the forecasts prepared in April 2014. An assumption which has been maintained in the current forecast round is related to the role played by the inventory component. Given the significant volatility of this component over the recent years the assumption to maintain a constant zero contribution of this variable to GDP growth is considered adequate.

[4] Consensus Economics is a leading international economic survey organization which polls a vast number of forecasts and views by numerous institutions in order to derive projections for a number of key macroeconomic variables.

Table 1: Main macroeconomic forecast assumptions for the September 2014 forecast.

Variable	Data source (2014-2015)	2013 (Actual)	2014	2015
Short-term interest Rate[5] (annual average)	ECB	0.50, 0.25 [6]	0.18	0.05
Long-term interest rate (annual average)	ECB	3.8	3.48	3.35
€/USD exchange rate (annual average)	Consensus Economics	1.33	1.34	1.28
€/STG exchange rate (annual average)	Consensus Economics	0.85	0.81	0.78
Nominal Effective exchange rate	Consensus Economics	1.04	1.02	1.00
Real GDP Growth of main trading partners (Real world GDP)	Consensus Economics	1.20	1.56	1.82
Nominal GDP Growth of main trading partners (Nominal world GDP)	Consensus Economics	2.81	2.49	3.10
Oil Prices (Brent, USD/barrel) (annual average)	Consensus Economics	108.64	106.94	103.70

Sources: Economic Policy Department, Ministry for Finance

It is important to highlight that a number of other variables which are mostly of a domestic nature, are treated as completely exogenous to the system, which variables are based on the best available information to date. Furthermore, the practice of treating particular variables as completely exogenous to the system helps in providing some degree of stability to the model in view of the difficulty in modeling particular components within an open and small economy like Malta. This also allows the model to be calibrated adequately to reflect the impact of government policies and/or other initiatives on the local economy. One also notes that the current forecast values reported in Table 2 of this report reflect a no-policy change scenario.

4. A description of the macroeconomic forecasts presented within the draft budget document 2014.

This section provides an overview and description of the main macroeconomic variables which were forecasted for the period 2014 and 2015 by the Economic Policy Department within the Ministry for Finance. The aim of this section of the report is to provide a comprehensive analysis and assessment of the estimates over the short-term forecast horizon. This evaluation is required to identify and comprehend the main underlying risks associated to the realization of the forecast estimates. The forecasted macroeconomic projections are presented within Table 2. The table also includes the actualized 2013 figures for the variables under consideration, which variables were provided to the authors by the EPD and which thus

[5] If necessary purely technical assumptions.

[6] 0.50% with effect from 8th May 2013 and 0.25% with effect from 13th November 2013.

follow ESA 2010 methodology. These figures serve as a base for the modeling exercise carried out by the EPD.

Following a positive year for 2013 in which nominal GDP grew at 4.6%, nominal GDP is expected to accelerate further in 2014 at a rate of 5.1% and to then grow at a marginally slower pace in 2015 at a rate of 4.8%. Real GDP in 2014 is also expected to grow at a sustained pace of 3.0%, following the actualized growth rate of 2.5% in 2013 and it is expected to accelerate even further in 2015 with a projected rate of real GDP growth of 3.5%. Following the positive overall economic performance in 2013 the EPD anticipates further improvements in the economic environment over both 2014 and 2015. Underpinning these expectations is the anticipated increase in output by a number of manufacturing and service industries within the economy. The projected growth in exports over 2015 is partially supported by an expected depreciation of the Euro.

As observed from within Table 2 overleaf the forecasted increase in nominal GDP growth of 5.1% for 2014 is driven primarily by the components of final domestic demand. Private final consumption expenditure[7] is expected to increase by 2.7% over 2014 and by 4.3% in 2015, following sustained increases in total employment and in compensation per employee over the forecast horizon.

In 2014 general government final consumption expenditure is expected to grow by 7.7%, this growth is expected to be primarily driven by a higher level of expenditure on compensation of employees within the public sector and by a higher level of intermediate consumption expenditure. In 2015 general government final consumption expenditure is expected to grow by 5.7% in line with the government's anticipated fiscal consolidation plan.

Gross fixed capital formation is expected to play a key role within the process of economic growth throughout 2014. Over 2013 nominal gross fixed capital formation grew by 4.3%, in 2014 its pace is expected to pick up significantly and grow by 14.4%. It is thereafter expected to expand further over 2015, even if at a subdued rate of 3.6%. The realization of these projections are supported by the expectation that the level of investment within the Maltese energy sector throughout the remainder of 2014 progresses on the same path as that already experienced over the first two quarters. The growth in 2015 is also assumed to be supported by additional investment expenditure within the energy sector.

Following a contraction of both exports and imports of goods and services in nominal terms over 2013, both these variables are however expected to grow, even if at a slow pace, over 2014 and to gain considerable momentum in 2015. Exports of goods and services in nominal terms are expected to grow marginally by an estimated 0.1% during 2014. This growth is anticipated to be primarily supported by a subdued recovery in nominal world GDP[8] growth and an expected depreciation of the Euro. These two factors are also expected to contribute to the growth for 2015, where exports of goods and services are expected to accelerate further at a rate of 4.9%. Supporting the growth in exports over 2015 is also the expectation of stronger demand within a number of manufacturing and service industries.

[7] It should be noted that within this report the figures presented for private consumption expenditure also include Non-Profit Institutions Serving Households (NPISH) final consumption expenditure.
[8] Within the context of the forecast exercise nominal world GDP is taken to be the average nominal GDP growth of the main trading partners of the Maltese economy.

Table 2: Macroeconomic projections.

	2013 Actual	2014	2015
Nominal **(Annual % Change)**	**ESA2010**		
Private final consumption expenditure	2.8	2.7	4.3
General government final consumption expenditure	3.0	7.7	5.7
Gross fixed capital formation	4.3	14.4	3.6
Exports of goods and services	-1.3	0.1	4.9
Imports of goods and services	-1.8	0.3	4.7
Nominal GDP	**4.6**	**5.1**	**4.8**
Real **(Annual % Change)**			
Private final consumption expenditure	1.7	2.1	2.1
General government final consumption expenditure	0.5	6.0	2.5
Gross fixed capital formation	2.2	14.3	4.8
Exports of goods and services	-1.6	0.7	5.9
Imports of goods and services	-1.7	1.9	5.5
Real GDP	**2.5**	**3.0**	**3.5**
Contributions to growth (Real)			
Final domestic demand	1.5	5.0	2.7
Inventories	N/A	0.0	0.0
Net exports	0.0	-2.0	0.7
Deflators **(Annual % Change)**			
Private final consumption expenditure	1.2	0.5	2.1
General government final consumption expenditure	2.5	1.6	3.2
Gross fixed capital formation	2.1	0.1	-1.2
Exports of goods and services	0.3	-0.5	-1.1
Imports of goods and services	-0.1	-1.5	-0.8
GDP Deflator	**2.1**	**2.0**	**1.2**
Inflation			
HICP	1.0	0.7	1.5
Labour Market			
Employment growth[9]	2.4	2.1	1.9
Unemployment rate	6.4	6.0	5.9
Compensation per employee (Annual % Change)	1.6	4.6	2.3
Labour productivity (Annual % Change)	0.1	0.9	1.5
External Balance			
External goods & services balance (% of GDP)	5.7	5.0	5.3

Sources: Economic Policy Department, Ministry for Finance.

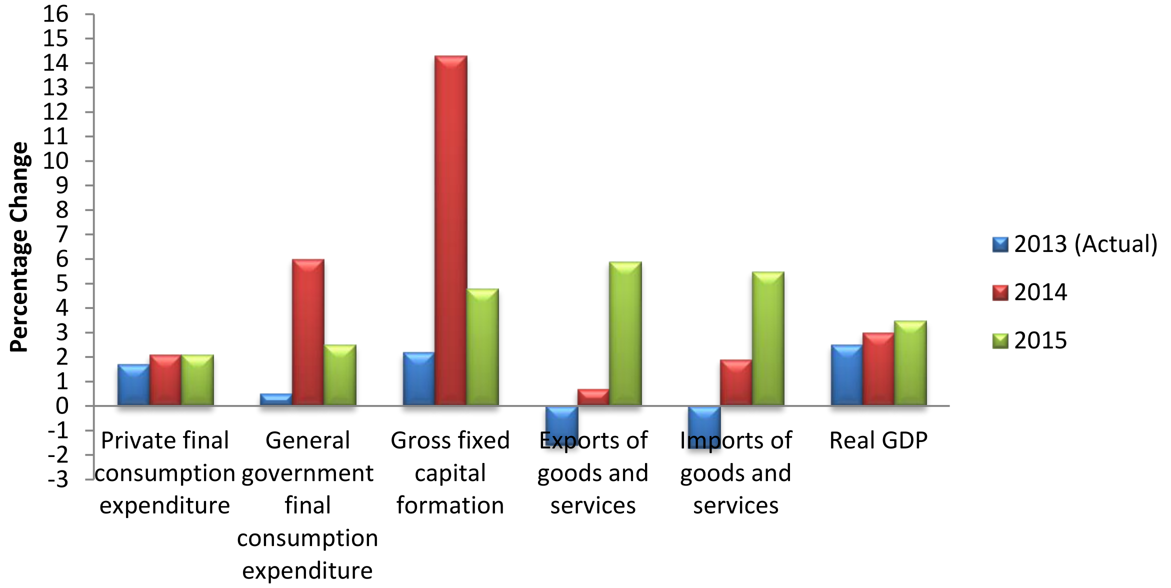
Similarly, after the contraction in the imports of goods and services of 1.8% experienced in 2013, imports are expected to grow at a positive rate of 0.3% in 2014 spurred on by an expected increase in the components of final domestic demand. Imports of goods and

[9] The estimate for the percentage change in total Employment growth is based upon the Eurostat Labour Force Survey (LFS) definition of total employment based on the resident population concept.

services in nominal terms are thus expected to be driven by the importation of capital goods, reflecting the investment within the energy sector, intermediate goods and by the projected increase in private final consumption expenditure. Over 2015 imports of goods and services are expected to grow at a significantly faster pace of 4.7% reflecting the stronger domestic as well as external demand conditions.

Macroeconomic projections valued at constant prices[10] portray the evolution of the estimated variables over the time horizon with the additional benefit of removing any potential distortionary effects which may be attributed to the possible variation in prices. As may be observed from Table 2, following a positive GDP growth rate of 2.5% over 2013, it is projected that the economy will retain its momentum and expand by 3.0% in 2014, followed by a further expansion of 3.5% throughout 2015. Figure 1 below illustrates the actualized 2013 as well as the estimated projections of the individual components of real GDP over the short-term horizon. A factor which is of crucial importance for the attainment of these forecast estimates and which represents an element of risk towards their realization is the overall GDP deflator estimate which is projected to actualize at 2.0% over 2014 and is subsequently assumed to decline to 1.2% over 2015.

Figure 1: Estimates of selected macroeconomic variables valued in real terms over the forecast horizon.



Real GDP growth over 2014 as well as 2015 is expected to be primarily supported by the growth in the components of final domestic demand. The growth in private final consumption expenditure of 2.1% in real terms is spurred on by the expectation of higher employment and higher compensation per employee and is projected to remain stable at 2.1% even in 2015.

[10] For the compilation of the ESA 2010 dataset the NSO has undertaken a revision in the methodology utilized to derive the figures at constant prices.

Over 2014 general government final consumption expenditure is projected to grow by 6.0%, significantly outpacing the growth in real terms of 0.5% experienced over 2013. This expansionary growth is however expected to be curbed during 2015 were general government final consumption expenditure is anticipated to grow by 2.5%. The realization of the 6.0% growth over 2014, as previously explained, is dependent on the higher anticipated wage bill relating to public sector employment coupled with a higher level of intermediate consumption expenditure. The lower real growth expected for 2015 will be dependent on the level of commitment the government will be able to demonstrate with respect to the attainment of its budgetary targets.

As is illustrated within Figure 1, the macroeconomic component with the largest level of volatility is that of gross fixed capital formation. From an expansion of 2.2% in real terms experienced in 2013, it is projected to grow in 2014 by 14.3%. Central to the realization of growth is that the level of the expected investment within the energy sector throughout the final two quarters of 2014 progresses on the same path as what has already been observed within the first two quarters of 2014. Gross fixed capital formation in 2015 is expected to grow by a further 4.8% supported by further investment within the energy sector. Of particular concern to the forecast for gross fixed capital formation is the assumed developments of the deflator component, these developments are clearly surrounded by an element of risk.

Following the contraction in real terms of both imports and exports of goods and services experienced in 2013, these components are expected to grow by a positive rate over the forecast horizon. Imports of goods and services in real terms are expected to grow by 1.9% and 5.5% respectively, over 2014 and 2015. The increase in imports over the forecast horizon is projected to be mainly driven by the final domestic demand components. Exports of goods and services in real terms are also projected to turn positive in 2014 and to marginally expand by 0.7% and to gain further impetus over 2015 with a growth of 5.9%. The positive outlook expected over the forecast horizon for exports of goods and services is driven by the expectation of a currency depreciation coupled with a positive outlook for Malta’s main trading partners. These factors are expected to play a key role within the context of an expected increase in export demand for a number of both manufacturing and service industries operating within the Maltese economy. Assessing the estimates it can be noted that the anticipated growth in imports of goods and services is going to outpace the growth in exports of goods and services in 2014 and that this situation is expected to be reversed in 2015. Additionally it should also be noted that there exists a clear element of risk associated with the realization of both the 2014 and 2015 forecast estimates for both exports and imports of goods and services in real terms which is centered around the developments in both import and export price deflators.

In 2014 the increase in real GDP of 3.0% is projected to be strongly driven by the components of final domestic demand. It should be noted that this result should be evaluated within the context of the assumptions taken by the EPD which assumes that changes in inventories do not contribute materially to GDP growth. This effectively implies a contribution to growth of inventories which is assumed to be zero over the short-term forecast horizon. The contribution to growth of final domestic demand is projected to increase considerably during 2014, from the 1.5 percentage points realized in 2013, to an estimated contribution of 5.0 percentage points. Underpinning the real GDP growth rate of 3.0% is thus the expectation that net exports are to yield a negative contribution to growth in 2014 of 2.0 percentage points. Crucial for the attainment of the contribution to growth of the final domestic demand component, which is to drive economic growth throughout 2014, is thus the actualization of the projected growth in both gross fixed capital formation and general government final consumption expenditure.

The increase in real GDP of 3.5% which is projected for 2015 is expected to be the result of a contribution to growth of final demand of 2.7 percentage points and a positive contribution of net exports of 0.7 percentage points. This implies that final domestic demand is still expected to be the main driver of economic growth however its role has been marginally reduced. The actualization of the expected growth in 2015 therefore crucially depends on the projection that net exports will yield a positive contribution to real GDP growth of 0.7 percentage points. This in turn is dependent on the exogenous assumption for currency depreciation and its impact on the balance of trade.

Following 2013, a year in which inflationary pressures were already markedly subdued, over 2014 the Harmonized Index of Consumer Prices (HICP)[11] is expected to decelerate by a further 0.3 percentage points to 0.7% prior to increasing to 1.5% in 2015. The developments in utility tariffs introduced in April 2014 are expected to have a tangible impact on the HICP over the remainder of 2014. Although the effect of lower energy prices is still expected to influence the HICP in 2015, this is however offset by an anticipated increase in the average price of both processed and unprocessed foods as well as the average price of services.

Employment growth[12] is expected to remain positive but marginally decline over the forecast horizon. Employment growth is expected to rise by 2.1% in 2014 driven by an increase in employment within a number of economic sectors. In 2015, employment growth is expected to retain momentum and grow by 1.9%. Such developments are contingent on the success of the ongoing efforts by the government to increase the female participation rate and improve overall employment flexibility. As a result the unemployment rate is expected to decline from the 6.4%, actualized in 2013, to 6.0% in 2014, prior to marginally decreasing to 5.9% in 2015. Compensation per employee is expected to grow steadily over the forecast horizon, over 2014 it is expected to grow by 4.6% and to increase by a further 2.3% over 2015. This projection is underpinned by the assumed path of wage adjustments within both the private and the public sector. Following the subdued increase in (per capita) labour productivity of 0.1% experienced over 2013 it is anticipated that labour productivity is to marginally regain pace and grow by 0.9% in 2014 and by a further 1.5% over 2015.

5. The main contributors to economic growth – a comparison to other institution's forecasts and to the forecasts presented by MFIN in April 2014.

This section compares the main contributors to GDP growth as forecasted in the draft budget document (October 2014) to a previous forecast presented by the Government of Malta in April 2014. The current forecast is also compared to the projections presented by the Central Bank of Malta (June 2014[13]) and the European Commission (May 2014[14]). It is important to

[11] The HICP is the indicator for inflation and price stability within the economy utilized within the forecast exercise.

[12] Employment growth represents the percentage change of total employment based on LFS definition which applies the resident population concept.

[13] Forecast was published within the Central Bank of Malta quarterly review 2014 Vol 47. No.1, in June 2014. The cut-off date of the data utilized for the June forecast is that of the 21st May 2014.

note that this forecast is not strictly and directly comparable to the mentioned other forecasts due to the fact that this is the only forecast available to date which has incorporated all the changes in data methodology to reflect ESA2010, together with other 'benchmarking' changes. This comparison is being included here to acquire an overview of the main drivers of growth and to assess the difference in views of the various institutions involved in the process of preparing forecast rounds for the Maltese economy over the course of the year 2014. Table 3 below includes the data for the different institutions in question for ease of reference.

Table 3: Comparison of forecast estimates.

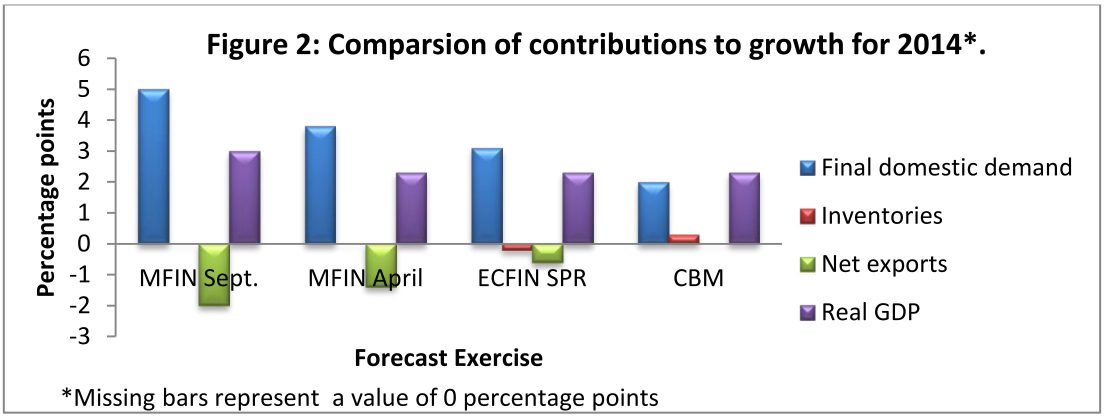
	2014				2015			
	MFIN		COM SPR	CBM (JUNE)	MFIN		COM SPR	CBM (JUNE)
Real (Annual % Change)	SEPT	APR			SEPT	APR		
Private final consumption expenditure	2.1	2.3	2.2	2.2	2.1	2.2	2.3	2.2
General government final consumption expenditure	6.0	1.9	2.4	1.3	2.5	0.9	0.8	0.2
Gross fixed capital formation	14.3	15.6	10.5	3.3	4.8	3.4	3.0	7.4
Exports of goods and services	0.7	2.3	2.7	1.8	5.9	4.2	6.0	3.4
Imports of goods and services	1.9	3.9	3.6	1.6	5.5	4.3	5.7	3.4
Real GDP	**3.0**	**2.3**	**2.3**	**2.3**	**3.5**	**2.1**	**2.3**	**2.6**
Contributions to growth (Real)								
Final domestic demand	5.0	3.8	3.1	2.0	2.7	2.0	2.0	2.4
Inventories	0.0	0.0	-0.2	0.3	0.0	0.0	-0.2	0.3
Net exports	-2.0	-1.4	-0.6	0.0	0.7	0.0	0.5	-0.1
Inflation Rate								
Overall HICP	0.7	1.3	1.2	1.1	1.5	1.8	1.9	1.7
Labour Market								
Employment growth	2.1	2.1	2.1	1.8	1.9	1.8	2.1	1.5
Unemployment rate	6.0	6.5	6.5	6.4	5.9	6.5	6.5	6.4
Compensation per employee (Annual % Change)	4.6	1.1	1.9	1.0	2.3	2.0	2.1	2.0
Labour productivity (Annual % Change)	0.9	0.2	N/A	N/A	1.5	0.3	N/A	N/A
External Balance								
External Goods & Services Balance (% of GDP)	5.0	4.1	2.0	5.6	5.3	4.4	2.7	5.6

Sources: Economic Policy Department, Ministry for Finance, Central Bank of Malta.

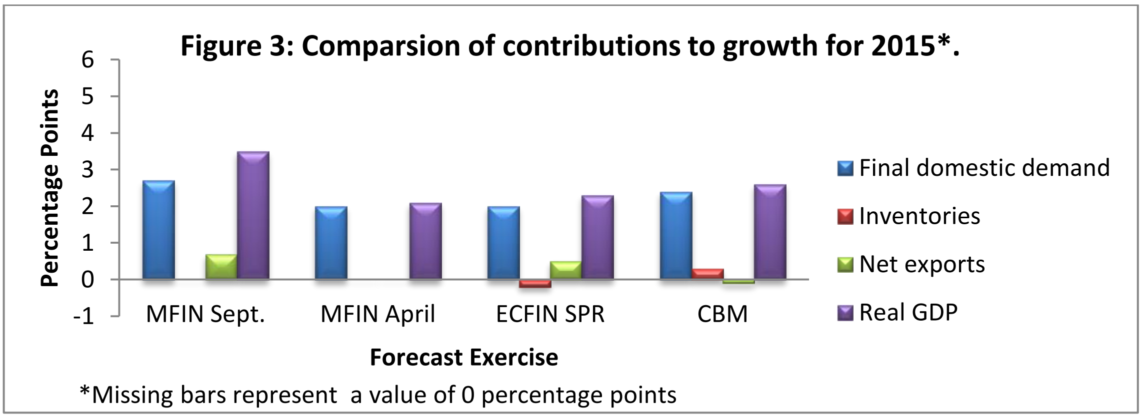
As clearly stated in the previous section of this report, the September 2014 forecast assumes that the main contributor to economic growth for both 2014 and 2015 is to be the domestic demand component of the economy, with a particularly high and positive contribution in 2014 which offsets the drag expected from the external sector. The view provided for 2015 reflects a smaller contribution to GDP growth arising from the relative domestic component which is topped up by a positive net exports contribution.

[14] European Commission Spring Forecast 2014 published on the 5th of May 2014. The cut-off date of the data utilized for this forecast exercise is that of the 24th April 2014.

As illustrated in Figure 2 below, all institutions being considered in this analysis are of the opinion that the forecasted growth in GDP for 2014 will be driven by the final domestic demand component. Whilst forecasting a positive contribution to GDP of 3.8 percentage points back in April 2014 the Ministry for Finance is now expecting a stronger performance for the domestic sector (a contribution of 5.0 percentage points). This stronger performance hinges heavily on the expected growth which is being projected for investment and final government consumption expenditure for 2014 and which is being based on the latest available data up to June 2014. There is also overall agreement between institutions on the expected negative contribution of the external sector to GDP growth. Even though revising downwards the drag in this component to GDP growth the overall GDP growth rates being forecasted by MFIN in September 2014 are still above those of all other institutions.



The projected developments for 2015 are illustrated in Figure 3 below. It is again the domestic demand component of the economy which is expected to be the main driver for growth in 2015. Slightly divergent views exist amongst the various institutions regarding the expected magnitude of developments within the external sector of the economy.



It should be highlighted that the September 2014 forecasts presented by MFIN incorporates the latest international assumptions on expected exchange rate developments and growth prospects for Malta's main trading partners. The sensitivity of the local sector to capitalize on any positives which stem from such developments, together with the uncertainty surrounding the geopolitical scenario, are thus the main risks associated to this forecast.

6. Conclusion.

The realization of the expected growth in real GDP for 2014 and 2015 clearly depends on the risks associated with the projected developments in each of the GDP aggregates, particularly the components for gross fixed capital formation and general government consumption expenditure. Given the latest developments in the first six months of 2014, the trajectory expected for the rest of the year is of particular importance. One notes the relatively strong contribution of the domestic demand component for GDP growth in 2014 and 2015. This has been a characteristic of the Maltese economy for the recent history years. Of significant importance within the current short term forecast is the projected positive contribution expected from the net exports sector in 2015. Indeed, such developments clearly depend on the assumed interlinkages between the developments in the local economy and the international expectations in the short term horizon. In view of the latest available information, the realization of the overall GDP growth rates for 2014 and 2015 may indeed be feasible, although subject to a number of risks. These risks are mainly linked to expectations relating to the implementation of a number of investment projects and developments in the various expenditure component deflators.

This forecast has been prepared under very particular circumstances. In view of the national accounts data publication by the NSO this forecast incorporates the new data methodology adopted (ESA 2010) for the national accounts compilation. This forecast also includes a number of other revisions carried out in the historical data series as part of the benchmarking exercise carried out by the national statistics office. One also acknowledges the efforts undertaken by the EPD and by the other institutions in ensuring that a smooth transition takes place in terms of incorporating the new data within the existing forecasting framework. Nevertheless, one still notes the need for further improvements in the overall planning and co-operation channels between the various institutions involved in the forecast preparation exercise.

To this effect the macro-econometric model used by the EPD incorporates where possible all the new methodology data available up to and including the cut-off date for this forecast. It is positive to note that the structured process adopted in previous forecasting rounds to internalize into the forecast all ad-hoc information available from a number of sources has been maintained. Furthermore, the use of assumptions adopted by international reputable organizations to serve as a base for the exogenous assumptions taken on board by this forecast is also acknowledged as good practice.