MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Economic & Market Overview

December 2013

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Malta Financial Services Authority

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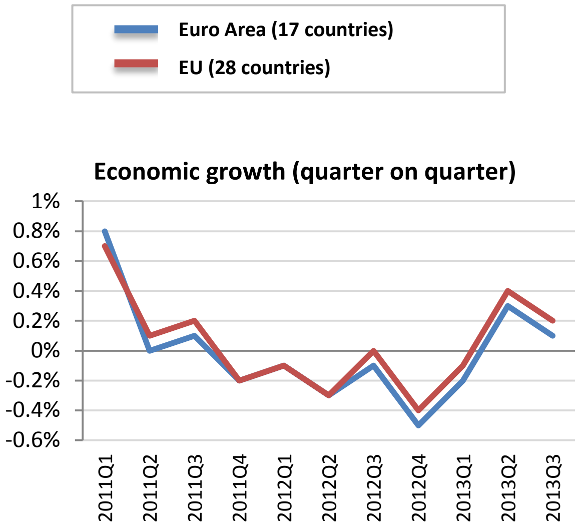
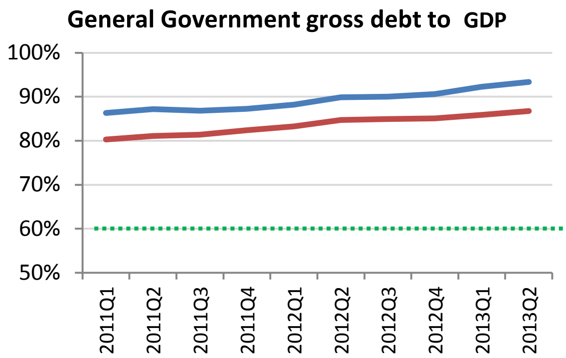
Economic performance in the EU and Euro Area

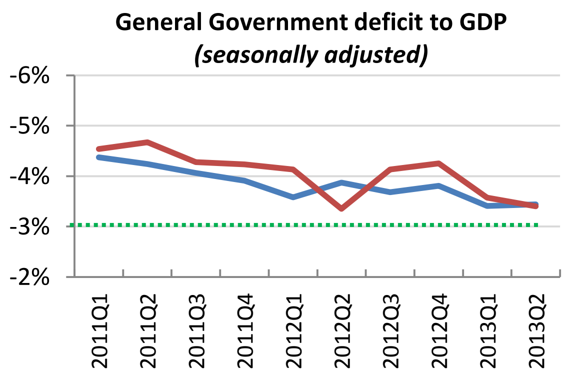
During the second quarter of 2013 the Euro Area emerged from 18 months of negative economic growth, when comparing on a quarterly basis. Modest growth was recorded in numerous member states with some marking an end to the recession. However the uneven economic recovery currently experienced within the bloc together with the growth dip registered during the third quarter of 2013 raises concern on its sustainability.

The average general government gross debt to GDP ratio of Euro Area countries continued to grow during 2013 deviating further from the 60 per cent benchmark established by the Stability and Growth Pact. This trend of debt accumulation may threaten economic stability should unsustainable government spending and sluggish growth continue to persist. Government deficit to GDP is undergoing a downward trend, however is still away from the 3 per cent benchmark.

Unemployment figures continued to increase



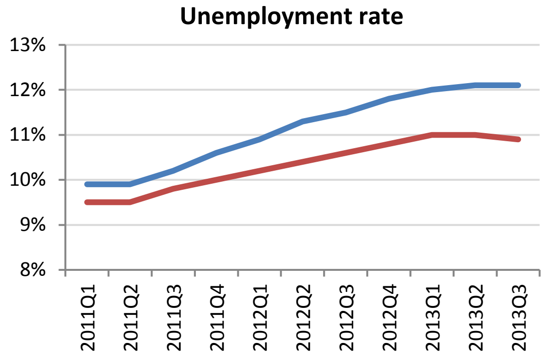


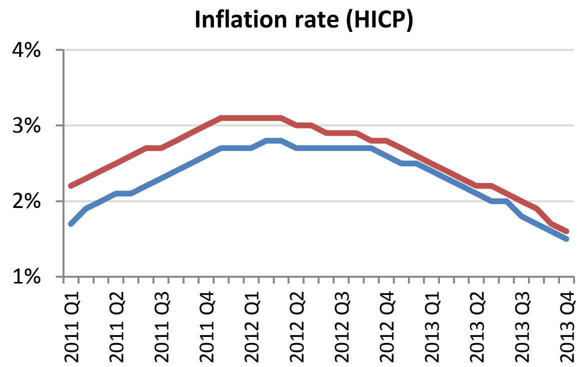


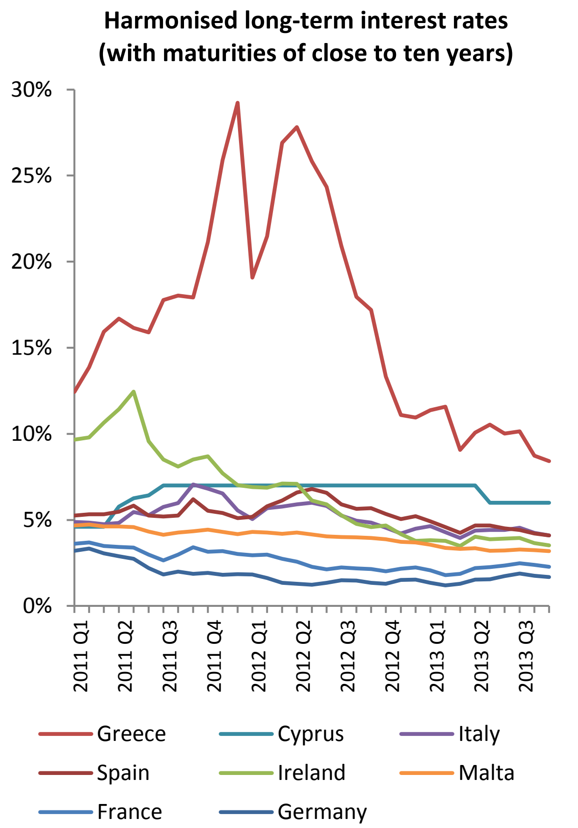
during 2013 reaching historic high rates. Drastic divergence in unemployment rates exist between member states, with Greece and Spain registering the highest number of unemployed within the bloc. Furthermore unemployment amongst youths soared, standing at 24 per cent in the Euro Area and EU average as at third quarter of 2013.

Inflation, calculated through the harmonised index of consumer prices (HICP), fell to its lowest level during the year, with the Euro Area and EU average ending the year at 1.5 and 1.6 per cent respectively. This low rate is attributed by weak domestic demand and decreasing energy prices. Due to the prolonged low inflationary period the ECB maintained its central refinancing rate at a record low of 0.25 per cent and kept the deposit rate at zero.

Spreads between yields on ten-year bonds issued by Euro Area governments and that of Germany narrowed during the year. Member states that registered a large spread during the previous years are now experiencing a drop in yields with the most distinct drop coming from Greek bonds.







Data source: Eurostat

Economic Outlook for the Euro Area

Economies in the Eurozone are showing initial signs of modest recovery after undergoing a prolonged period of financial and sovereign distress marking the recession as historic since the inception of the euro. Confidence in the currency's integrity is gaining strength together with increasing expectations for growth to gain momentum with domestic demand expected to be the main driver. The EU Commission forecasts economic growth in the Euro Area to reach 1.1 per cent in 2014, and is expected to continue increasing to 1.7 per cent the following year.

Numerous governments opted for drastic fiscal consolidation measures during the financial crisis aimed to curb growing deficits. The intensity of fiscal adjustment is expected to diminish in 2014 as temporary tax-increasing measures start to phase out. Debt-to-GDP ratio is projected to peak at a slower pace in 2014 compared to previous years, with the Commission projecting a 90 per cent ratio in the EU and 96 per cent in the Euro Area. Government deficit in the Euro Area is expected to continue with its downward trend falling below the 3 per cent benchmark and forecasted to reach 2.5 per cent of GDP in 2014.

Inflation is forecasted to remain at a low rate also in 2014 with the ECB affirming to have the necessary stimulating tools in case of deflationary risks. The ECB has cut its inflation forecast to 1.1 per cent in 2014 and consequently 1.3 per cent in 2015. Inflation is expected to remain below its 2 per cent target for the coming years as price pressures in the Euro Area are expected to remain subdued.

Unemployment is a major concern in the EU, which is further intensified by the growing unemployment rates amongst youths. The Commission projects unemployment to reach 12.5 per cent in 2014. Policy action to curb unemployment may prove futile if economic growth remains slack such that should this trend continue to persist, Europe's economic recovery may be jeopardised.

Progress is currently overshadowed by the multi-speed recovery currently experienced within the bloc, which is interfering with the aspiration of deepening the integration process. Further reform targeted to improve growth prospects and strengthen economies to be resilient to domestic and external shocks is necessary. The entering into force of the Single Supervisory Mechanism Regulation in 2014 will be a major step in the Eurozone's strives of building a stronger institutional financial framework as that of the Banking Union. The structural reform will also entail the setting up of a single European recovery and resolution framework, the establishment of a single rulebook, and a common system of deposit protection. This robust financial framework will preserve and strengthen governance contributing to a deeper economic and monetary union.

Key Economic statistics

	Malta		Euro area (17 countries)		EU (28 countries)	
	as at 2012 Q3	*as at* 2013 Q3	*as at* 2012 Q3	*as at* 2013 Q3	*as at* 2012 Q3	*as at* 2013 Q3
Economic growth *(with respect to the same quarter of the previous year)*	1.1 %	1.9 %	-0.9 %	0 %	-0.6 %	0.3 %
	as at 2012 Q2	*as at* 2013 Q2	*as at* 2012 Q2	*as at* 2013 Q2	*as at* 2012 Q2	*as at* 2013 Q2
Deficit-to-GDP ***(seasonally adj)***	-1.8 %	-2.2 %	-3.9 %	-3.4 %	-3.4 %	-3.4 %
Debt-to-GDP	75%	76%	90%	93%	85%	87%
	as at 2012 Q3	*as at* 2013 Q3	*as at* 2012 Q3	*as at* 2013 Q3	*as at* 2012 Q3	*as at* 2013 Q3
Inflation	2.7%	2.0%	2.7%	1.9%	2.9%	2.1%
	as at 2012 Q3	*as at* 2013 Q3	*as at* 2012 Q3	*as at* 2013 Q3	*as at* 2012 Q3	*as at* 2013 Q3
Unemployment						
Youth [< 25 yrs]	14.7%	14%	23%	23.4%	22.8%	23.1%
Total [25 to 74 yrs]	5%	5.3%	9.9%	10.5%	8.9%	9.2%
Male [25 to 74 yrs]	4.3%	5.3%	9.6%	10.3%	8.7%	9%
Female [25 to 74 yrs]	6.1%	5.3%	10.2%	10.7%	9.1%	9.4%
	as at 2012 Q2	*as at* 2013 Q2	*as at* 2012 Q2	*as at* 2013 Q2	*as at* 2012 Q2	*as at* 2013 Q2
Employment						
Total	58.5%	60.5%	64%	63.6%	64.2%	64.1%
Male	72.5%	73.9%	69.6%	68.9%	69.7%	69.4%
Female	43.9%	46.5%	58.3%	58.2%	58.6%	58.8%

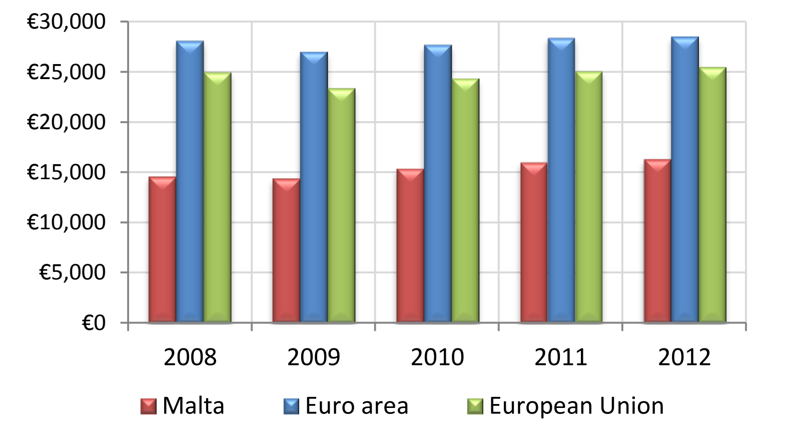
Source: Eurostat

Major Economic trends

This section provides an overview on the major economic trends comparing Malta's economic performance with that of the Euro Area and EU average.

Gross Domestic Product (GDP) per capita

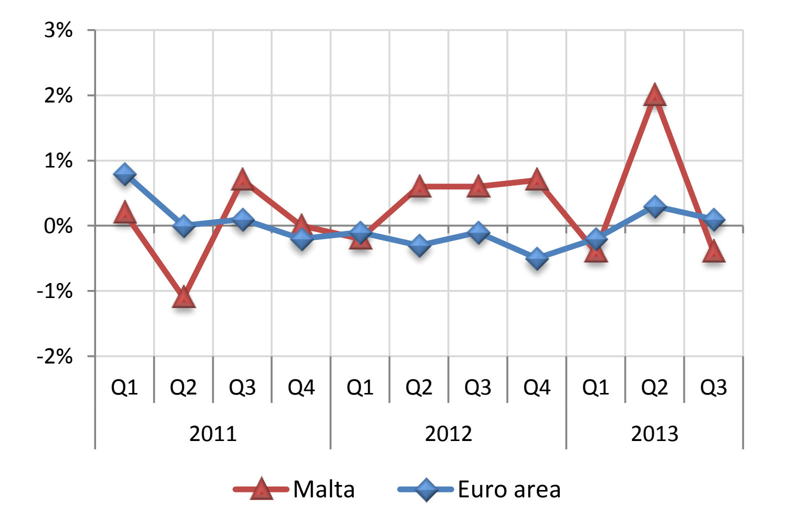
Malta's GDP per capita stood at €16,300 as at the end of 2012, registering a 2 per cent increase from the previous year. GDP per capita for the Euro Area and EU28 average stood at €28,500 and €25,500 respectively. This reflects an increase from the previous year of 0.4 per cent and 1.6 per cent.



Source: Eurostat

Economic growth (quarter-on-quarter)

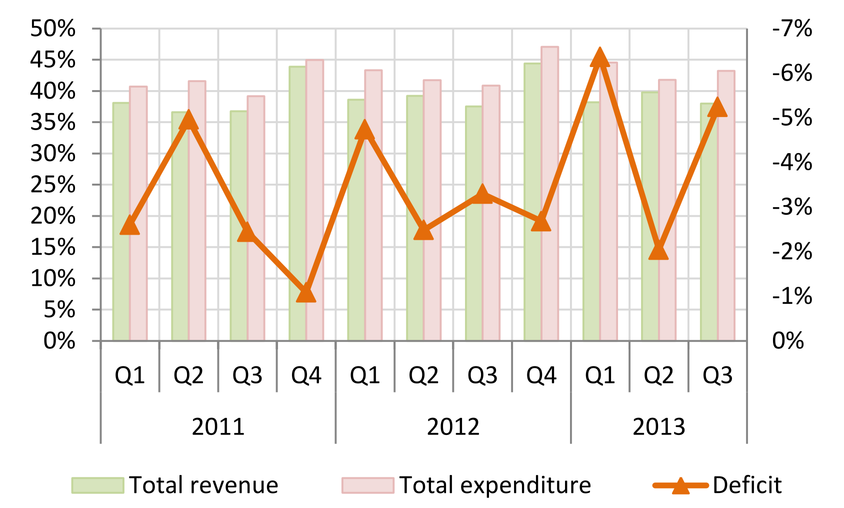
Malta's economic growth contracted by 0.4 per cent during the third quarter of 2013. This contrasts with the sharp increase registered during the second quarter of the same year of 2 per cent. In the Euro Area, economic growth during the second quarter expanded by 0.3 per cent and consequently by 0.1 per cent in the following quarter.



Source: Eurostat

Malta's Government deficit to GDP

Malta's general government deficit to GDP ratio stood at 5.2 per cent as at third quarter of 2013 which is 1.9 percentage points higher than that registered in the same quarter of the previous year. Total revenue increased by

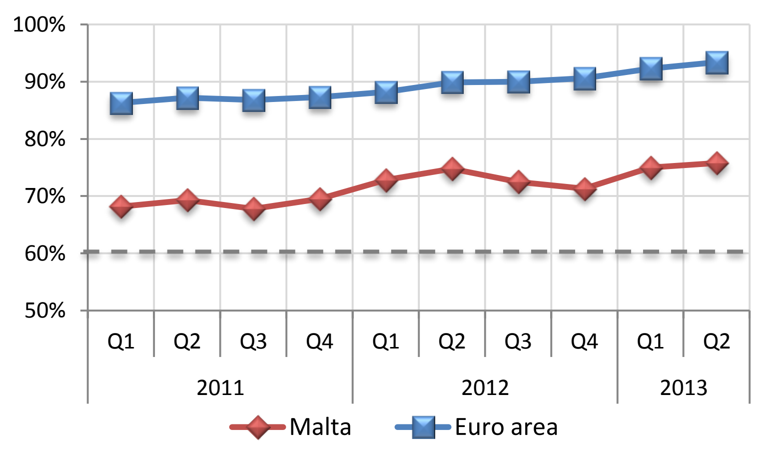


Source: NSO

4.7 per cent when comparing the first three quarters of 2013 with that of the previous year. The increase during the third quarter was mainly due to higher proceeds from taxes on production and imports. Conversely total expenditure increased by 7.2 per cent. The increase registered during the third quarter was a result of increases in social benefits and social transfers in kind, compensation of employees and gross capital formation. Total revenue constitutes 38 per cent of GDP, whereas total expenditure reflects 43.2 per cent of GDP.

General Government gross debt to GDP

Malta's general government debt to GDP together with that of the Euro Area average continued to increase, diverging further from the 60 per cent benchmark. Malta's total general government debt to GDP as at second quarter of 2013

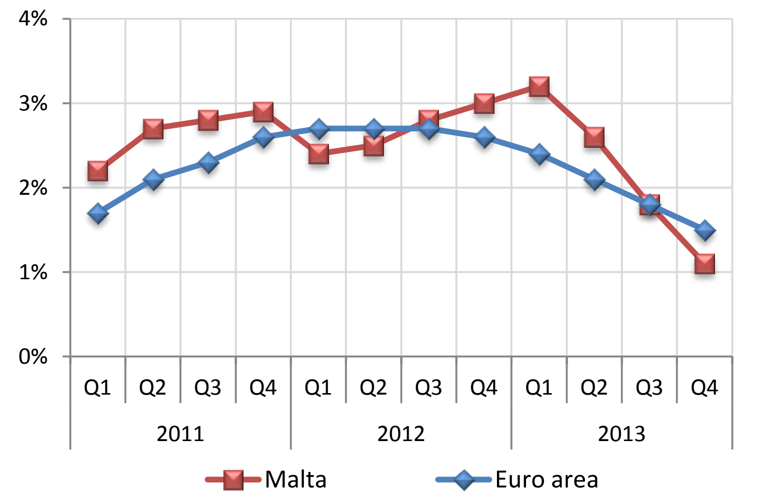


Source: Eurostat

increased to 75.8 per cent. Whereas the Euro Area average stood at 93.4 per cent.

Inflation

Inflation, measured by the harmonised index of consumer prices, continued to decline reaching 1 per cent as at end of 2013. This reflects a drop of 2 percentage points from that registered at the end of the previous year. In the Euro Area

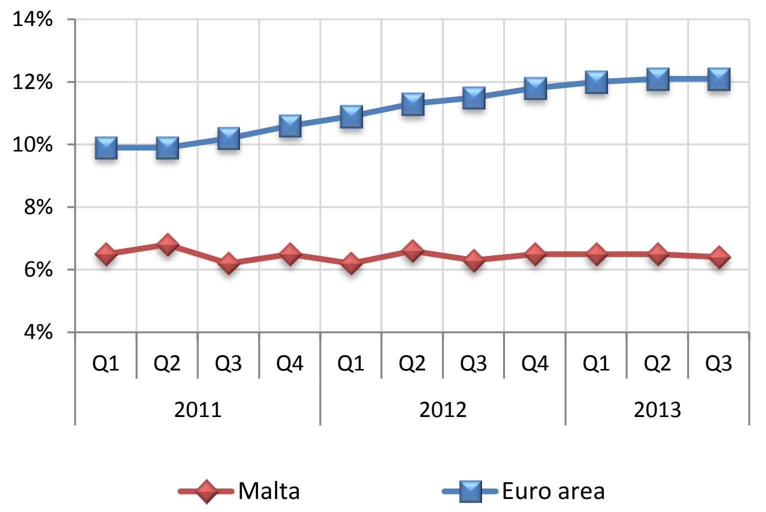


Source: Eurostat

average, inflation stood at 1.5 per cent as at end of year. This trend of decline in the Euro Area has been going on since August 2012, mainly due to slack in the economies.

Unemployment rate

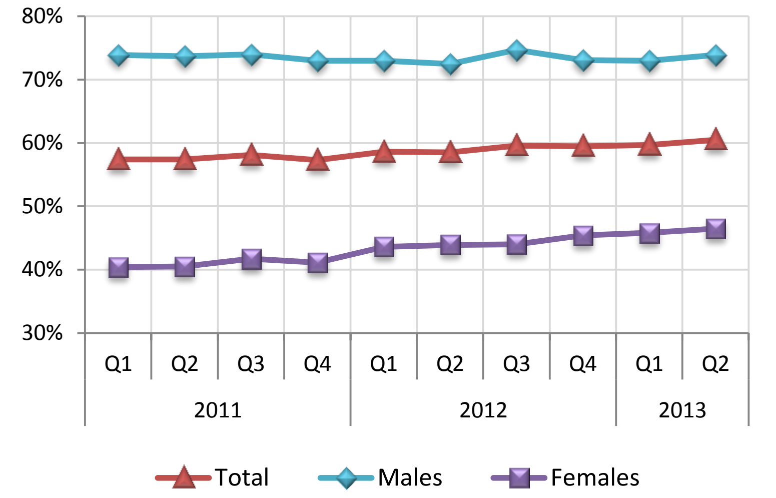
Unemployment in Malta stood at 6.4 per cent as at third quarter of 2013. Compared to the Euro Area average, unemployment in Malta remained relatively constant. The rate registered in the Euro Area stood at an all-time high of 12.1 per cent.



Source: Eurostat

Employment in Malta

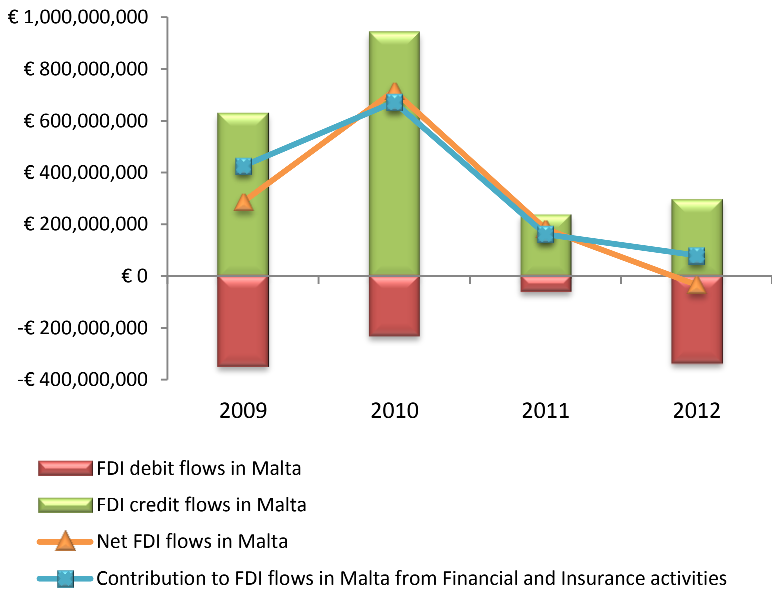
The total employment rate in Malta stood at 61 per cent as at the second quarter of 2013. This reflects 2 percentage points increase when compared to the same quarter of last year. The main increase in employment came from the increase in the participation rate of females. Female employment increased by 2.6 percentage points from the second quarter of last year till that of this year, standing at 46.5 per cent. Whereas male employment stood at 74 per cent, registering 1.4 percentage points increase from the second quarter of the previous year.



Source: Eurostat

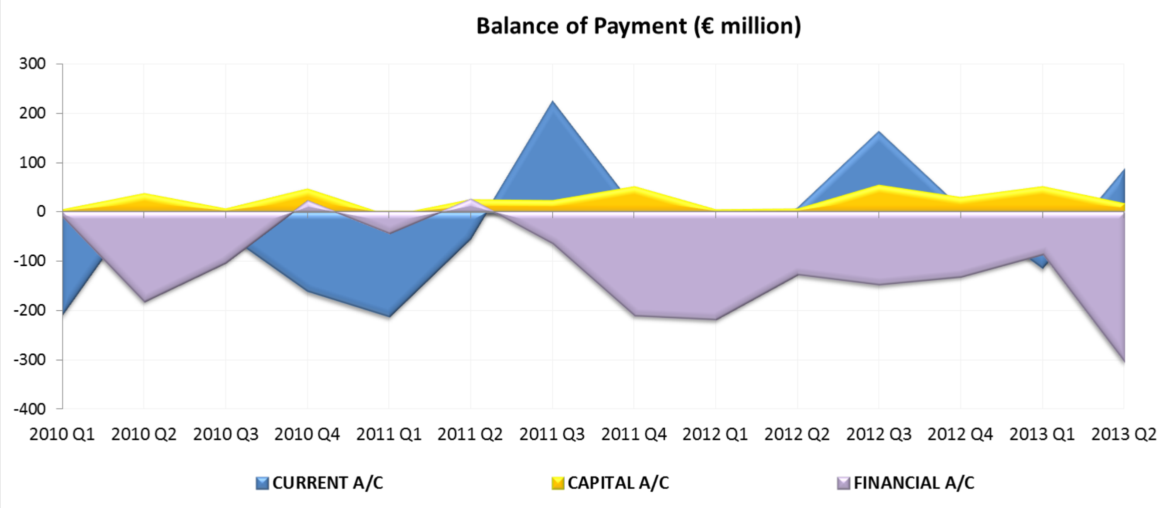
Foreign Direct Investment Flows in Malta

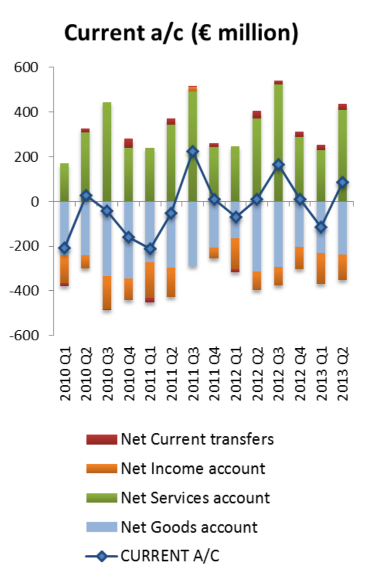
Net Foreign Direct Investment flows in Malta declined in 2012 when comparing to that of the previous year. This drop was mainly due to decreases in equity capital and increases in receivables from direct investors, which were partly counterbalanced by an increase in reinvesting earnings. Contribution to FDI flows in Malta from Financial and Insurance activities totalled to EUR 79.7 million during 2012.

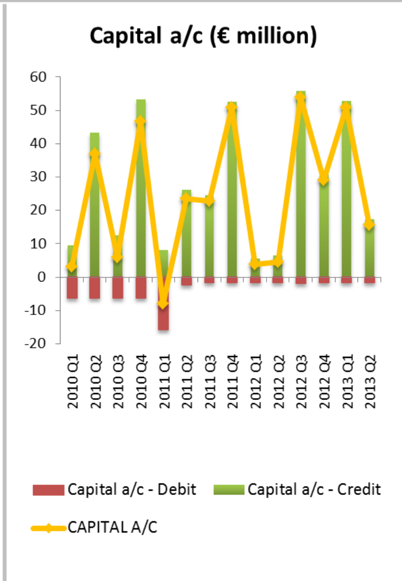


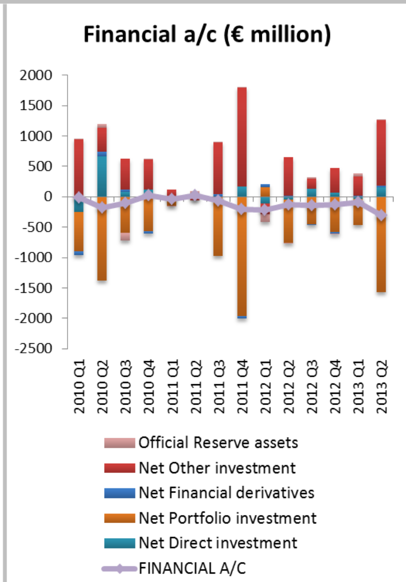
Source: NSO news release (161/2013)

Balance of Payment









The current account provides information on trade in goods, transactions in services, income from employment and investment and current transfers.

The capital account is where all international capital transfers are recorded.

The financial account records an economy's transaction in external financial assets and liabilities, it consists of flow variables since it records changes in the country's asset holdings during the year.

Source: Central Bank of Malta

The current account balance registered a higher surplus during the second quarter of 2013 as compared to that of 2012, registering a surplus of EUR 85.4 million. Trade deficit reduced by EUR 76.5 million compared to the previous year due to incurring a strong drop in imports and exports, whereas the services account increased by EUR 39.9 million. The net negative balance in the income account rose by EUR 30.8 million, whereas the net positive balance in the current transfers account decreased by EUR 8.5 million. The capital account recorded net inflows of EUR 15.7 million as compared to net inflows of EUR 4.6 million registered the previous year. The financial account registered net outflows of EUR 303.6 million as compared to net outflows of EUR 126.7 million during the second quarter of the previous year. Direct investments, financial derivatives and other investments registered net inflows, partly counterbalancing the higher outflows registered on portfolio investments.

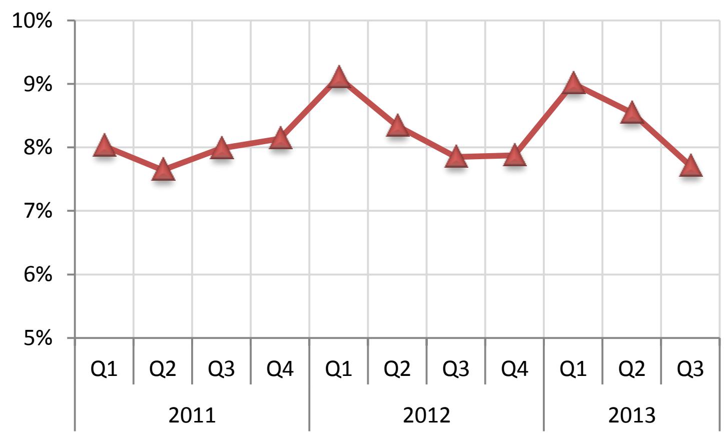
Malta’s financial services sector

Malta’s financial services sector continued to expand during the year increasing its contribution and significance to the economy. In 2013 the MFSA issued a significant number of new licences in all financial services activities. This generated further employment in financial intermediation services and also indirect employment in other professional and business services such as legal and accounting occupations. Furthermore, the regulatory framework is going through rapid overhaul through the transposition of various European Directives and Regulations which aim at enhancing transparency, corporate governance, and also investor and consumer protection. The MFSA also continues to develop various legislations and regulations to enable licensed firms to engage in innovation while ensuring that this is done without exposing consumers to unwarranted risks.

The following trend lines provide an overview on the size and performance of Malta’s financial services sector.

Financial and Insurance activities contribution to total Gross Value Added (GVA)

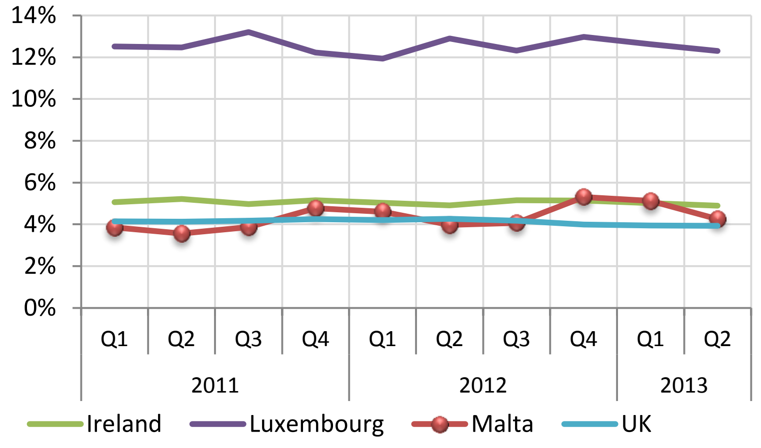
Malta’s financial services sector during the third quarter of 2013 contributed 7.7 per cent to total GVA. The sector grew by 4 per cent when comparing the first three quarters of 2013 with those of the previous year.



Source: Eurostat

Employment in Financial and Insurance activities

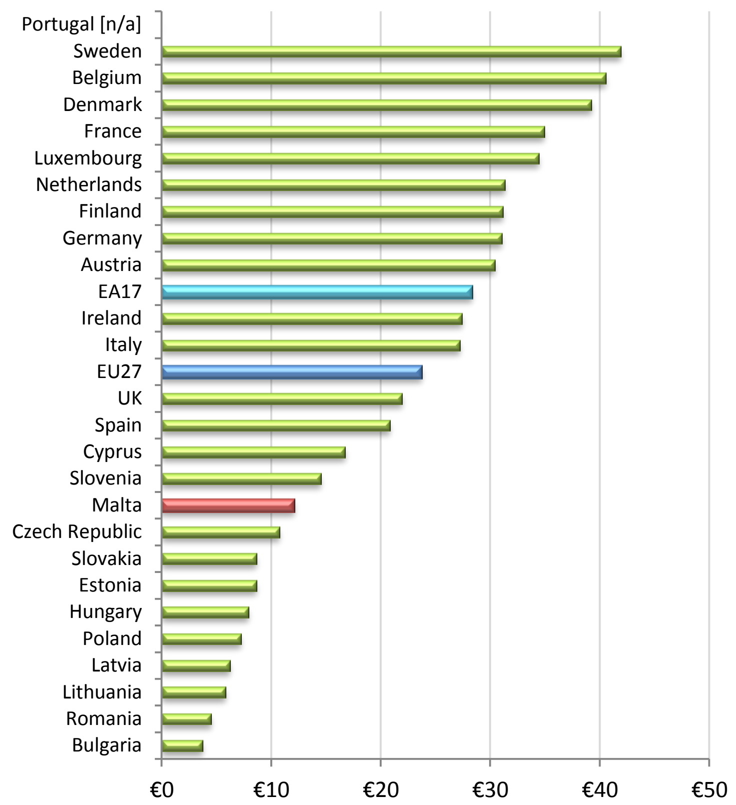
The share of employment in financial and insurance activities in Malta amounted to 4.3 per cent as at second quarter of 2013. Employment in financial and insurance activities on total employment in Ireland, Luxembourg and the UK amount to 4.9 per cent, 12.3 per cent and 3.9 per cent respectively.



Source: Eurostat

Estimated hourly labour cost for the business economy in 2012

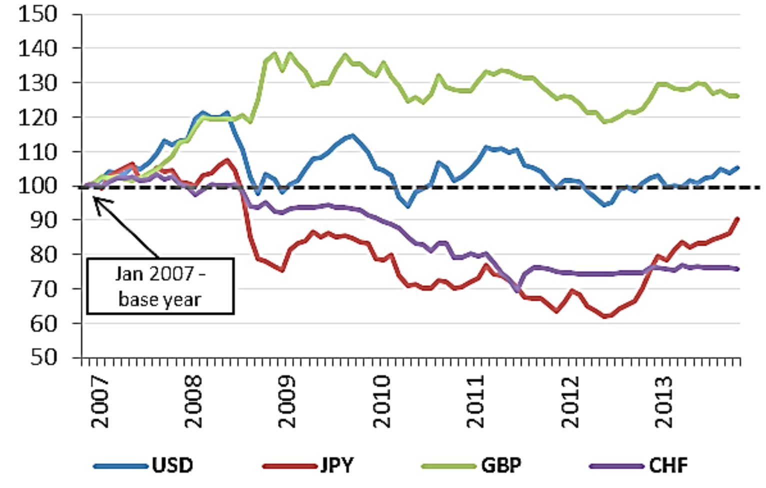
The estimated hourly labour cost for the business economy considers both wages and non-wage costs such as social contributions. In 2012 the hourly labour costs in Malta stood at EUR 12, whereas the average rate in Euro Area and EU27 was EUR 28.20 and EUR 23.60 respectively. Malta's hourly labour cost is less than half that of the Euro Area average.



Source: Eurostat

Exchange rate index movements of EUR against other currencies (Jan 2007 is base year = 100)

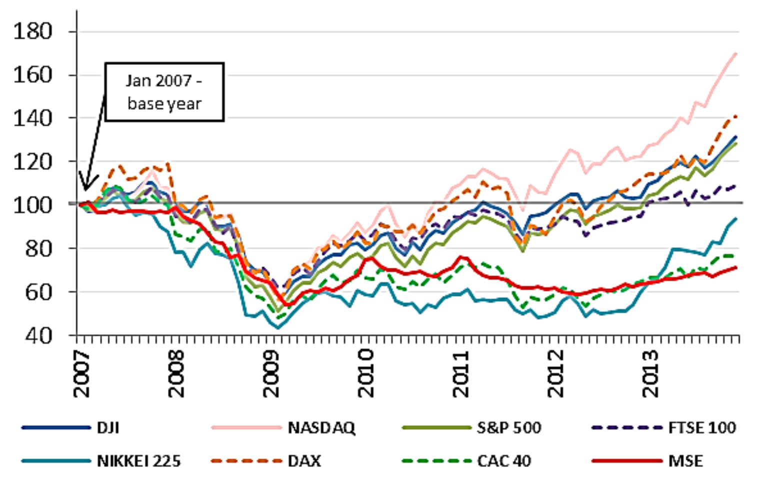
The chart indicates the exchange rate movements of major currencies against the Euro. January 2007 was set as the base year. An increase in the index of another currency implies a euro appreciation whereby euro currency buys more units of the foreign currency; whereas a decrease in another currency index implies a euro depreciation whereby euro currency buys fewer units of the foreign currency.



Source: ECB

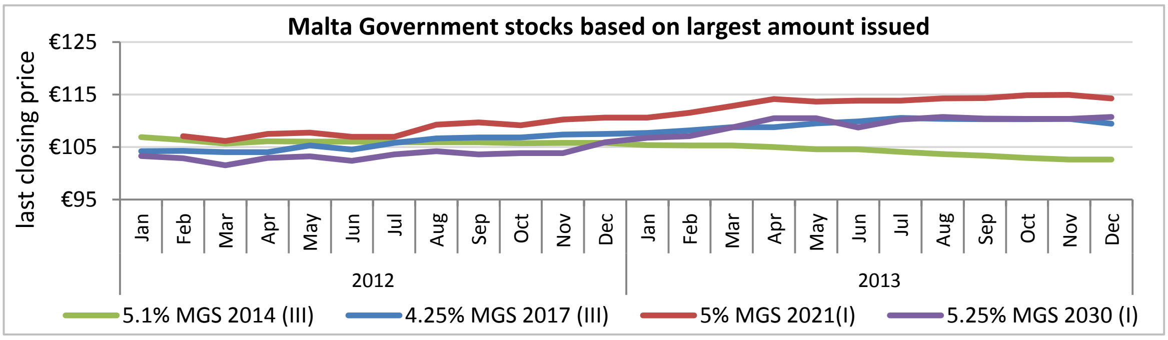
Key stock market indices value (Jan 2007 is base year = 100)

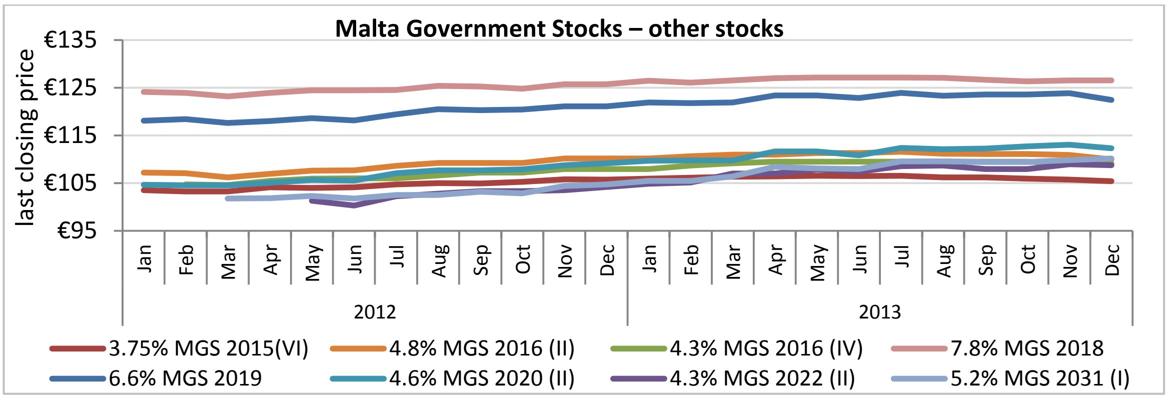
Key stock indices summarises the performance of major groupings of stocks. Each of the indices tracks the performance of a specific basket of stocks representing a particular market or sector. In order to monitor performance of stock indices, a base year at 100 was taken as from January 2007.

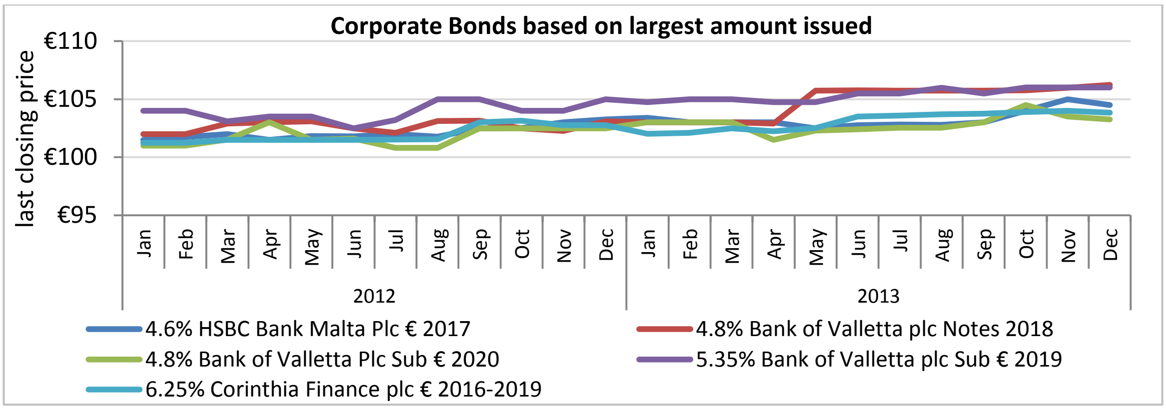


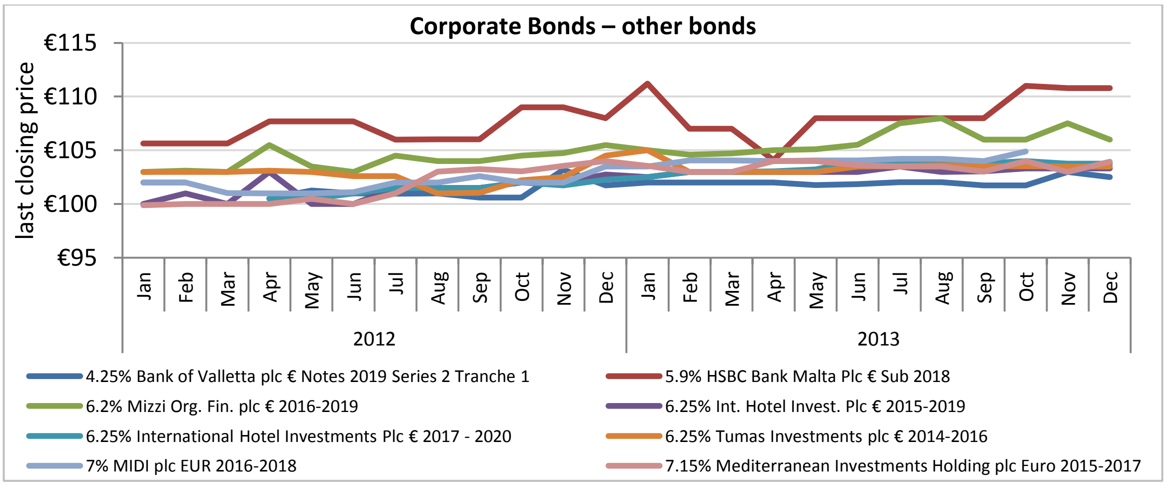
Source: Yahoo! Finance

Malta Government stocks & Corporate Bonds



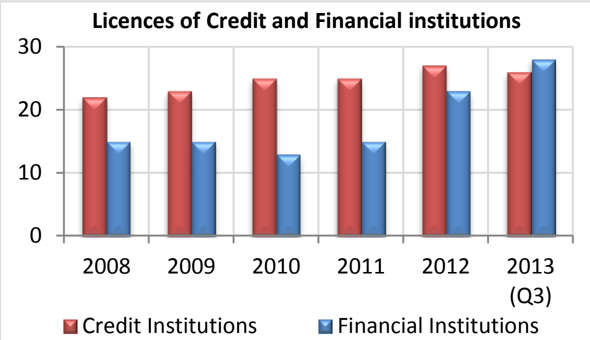


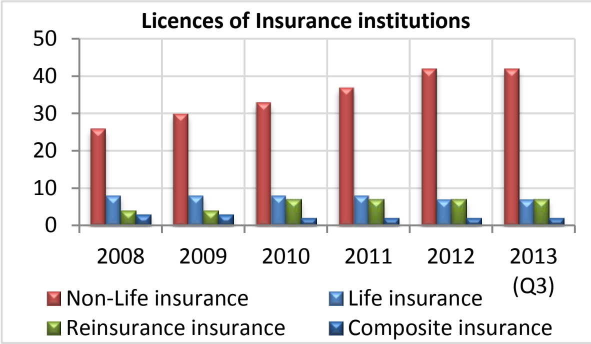


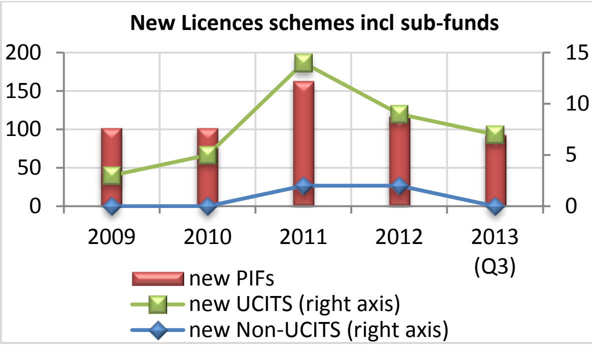


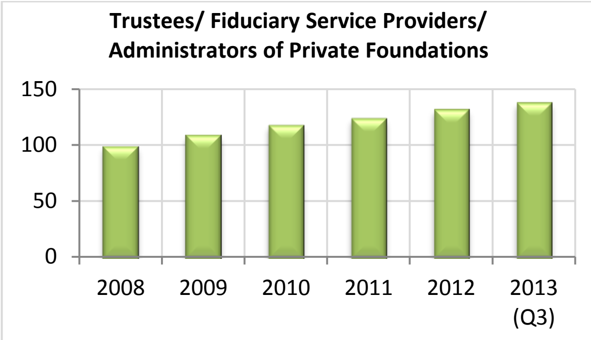
Data source: Malta Stock Exchange

Licences and Assets of Financial institutions

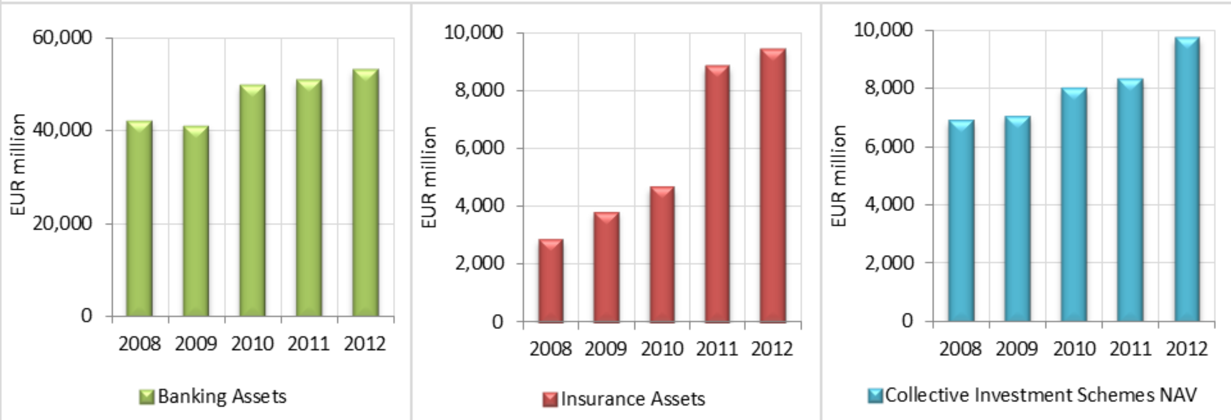








Aggregate Assets in Banking, Insurance and Collective Investment Schemes (NAV)



Data source: MFSA

As at third quarter of 2013 the number of credit institutions totalled to 26. Financial institutions continued to grow with the MFSA licencing 6 new institutions during the year totalling to 28 as at third quarter of 2013. From the financial institutions licenced, 18 are payment institutions and 6 are electronic money institutions. The banking sector retains the largest share of assets within the financial services industry totalling to EUR 52,900 million as at end 2012. This reflects a growth of 4 per cent from the previous year. Over 70% of these assets belong to foreign institutions that have little interaction with the domestic economy.

The insurance sector as at the third quarter of 2013 retained the same amount of licences as that of the previous year, totalling to 58. Insurance undertakings offering non-life business totalled to 42, life and reinsurance business each totalled to 7 undertakings, and 2 offer a composite nature of business. Total assets in the insurance sector grew by 7 per cent in 2012 totalling to EUR 9,400 million.

The number of collective investment schemes (CISs) continued to grow during the year, with the MFSA licencing 102 new CISs (including sub-funds) up until third quarter of 2013. Professional Investor Funds (PIFs) remain the most popular having 93 new PIFs authorised as at third quarter. UCITS increased by 7 licences during the year, and two were new Recognised Private CISs. The aggregate net asset value (NAV) of locally based CISs stood at EUR 9,700 million as at end 2012, reflecting a 17 per cent increase from the previous year.

Authorisations in terms of the Trusts and Trustees Act, which include Trustees; Fiduciary Service Providers; and Administrators of Private Foundations, totalled to 137 as at third quarter of 2013. This reflects a 5 per cent increase over the previous year.

Rating indexes

World Economic Forum - The Global Competitiveness Report – Malta's rankings

	2010-2011	2011-2012	2012-2013	2013-2014
Global Competitiveness Index rank	50	51	47	41
Availability of financial services	33	33	34	27
Affordability of financial services	30	28	32	27
Financing through local equity market	9	23	24	25
Ease of access to loans	12	12	17	15
Soundness of banks	10	12	13	14

Source: World Economic Forum - The Global Competitiveness Report

Malta's Sovereign Credit Rating

	Moody's ratings	Standard & Poor's ratings	Fitch ratings
2008	A1	A	A+
2009	A1	A	A+
2010	A1	A	A+
2011	A2	A	A+
2012	A3	A-	A+
2013	A3	BBB+	A

Source: Central Bank of Malta – Financial Stability report

Economic Outlook for Malta

Europe's slow economic growth, soaring unemployment figures, accumulating sovereigns' debts, and risks emanating from external market sensitivities, strongly dictate on Malta's economic performance and progress. Nevertheless, as experienced during the global recession Malta's economy and financial services sector were robust to withstand the various shocks.

Malta's economy experienced modest growth during 2013 performing better than the previous year and also outperformed the average of the Euro Area. Domestic demand remained weaker than expected during the year however it is projected to pick-up in 2014 with the prospect of being a main driver for economic growth. This recovery is expected to materialise mainly due to improved investor and consumer confidence. However this anticipation may be jeopardised should Malta's main trading partners experience economic difficulties.

General Government deficit remains above the 3 per cent threshold set by the Stability and Growth Pact. As a result Malta has been subject to an Excessive Deficit Procedure as from May 2013. As presented by the finance minister in the 2014 Budget, the deficit to GDP ratio was expected to slip back to 2.7 per cent in 2013 and reduce further to 2.1 per cent in 2014. Although this contrasts with the less optimistic projections set by the European Commission, the government remains committed to consolidate Malta's fiscal position.

Employment outlook remains positive with unemployment figures projected to continue declining in the forthcoming year. Malta ranks ahead of the Euro Area average in terms of both employment growth and low unemployment rate. Growth in employment was predominately due to an increase in the female participation rate in the labour market. Job creation in the tourist sector together with that in the services sector also contributed to employment growth. Inflation, measured by the harmonised index of consumer prices, reduced significantly during the year. The main drop in prices originated from restaurants and hotels. Inflation is forecasted to pick-up during 2014 on basis of undergoing a recovery in domestic demand.

The financial services sector in Malta is one of the fastest growing sectors in the economy and is envisaged to remain so in the coming years. A consistent flow of applications for licences is expected in all areas of the sector. The strongest growth is anticipated to derive from fund services, insurance activities and payment services.

Malta's economy performed fairly well during the year and is also expected to gain momentum in 2014. This performance is a result of various policy and reform implementation throughout the years which gave rise to a resilient and diversified economy built within a sound regulatory environment. Notwithstanding this, it's imperative to continue addressing the economic challenges in order to maintain a stable and growing economy. Further policy measures will be essential to attain sustainable economic growth based on budgetary commitments for fiscal consolidation, together with an ongoing drive to enhance competitiveness. Progress on this front is confirmed by the positive results achieved from the 2013 EY Attractiveness Survey whereby 88 per cent of respondents consider Malta to be attractive for foreign direct investments.