



An analysis of the Maltese Economy

The Financial Crisis - A Decade Later

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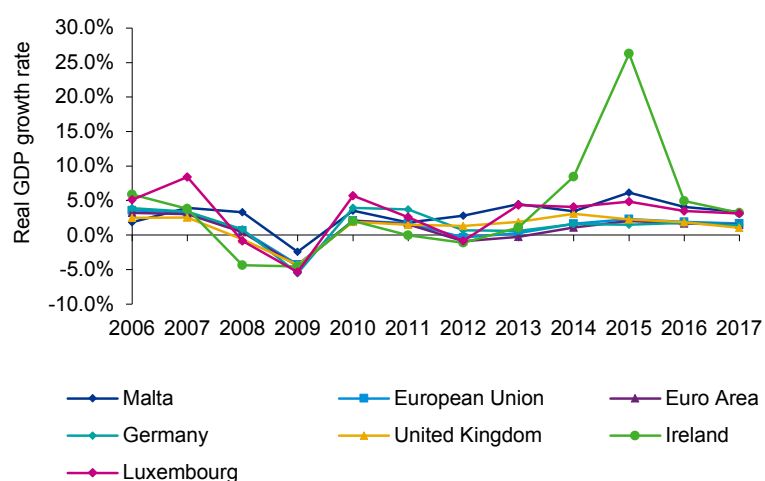
The Maltese islands have long maintained close economic ties with the rest of Europe. These three small islands, former colonies of the Normans, the Aragonese, the French and the British, have been economically linked to Europe since time immemorial. As the 2008 financial crisis wreaked havoc across the economies of Malta's largest trading partners, this small island nation held firm and weathered the storm, emerging stronger than before. A decade on from the final year before the financial crisis, how does Malta's economy compare to its former self and to those of its European partners?



Economic Growth

The International Monetary Fund recently issued a press release¹ following their conclusion of the 2016 Article IV Consultation with Malta. The press release praises the Maltese economy as being “one of the fastest-growing economies in Europe”. In terms of real GDP growth, the Maltese economy has consistently outperformed the European Union and Euro Area averages every year since 2007. Cumulatively, the Maltese economy has grown by around 35% between 2007 and 2017. This compares favourably to both the Euro Area and the wider European Union which have seen cumulative growth of 4.6% and 7.7% respectively during the same period.

Real GDP



Source: IMF

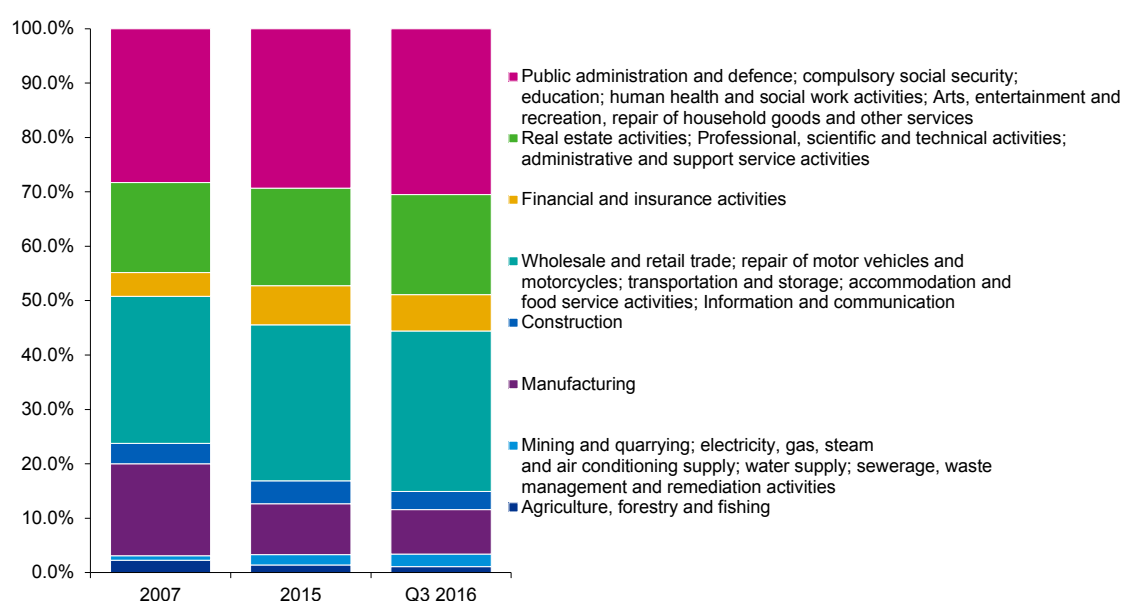
Comparison of real GDP growth

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Malta	3.9%	3.3%	-2.4%	3.5%	1.8%	2.8%	4.5%	3.5%	6.2%	4.1%	3.4%
European Union	3.3%	0.6%	-4.3%	2.1%	1.7%	-0.4%	0.3%	1.6%	2.3%	1.9%	1.7%
Euro Area	3.0%	0.4%	-4.5%	2.1%	1.5%	-0.9%	-0.3%	1.1%	2.0%	1.7%	1.5%

Source: IMF

This growth has been fuelled by significant structural changes in the Maltese economy. Over the past decade there has been a notable shift away from manufacturing activities and a growing focus on services. The main sectors contributing to growth over the past decade have been the value-added knowledge services - financial services, IT, and other professional activities. Local agricultural activity has continued to dwindle, while sectors such as public administration, entertainment, tourism and retail have remained significant elements of the local economy

GVA by sector



Source: Economic Survey 2008, NSOM KPMG analysis

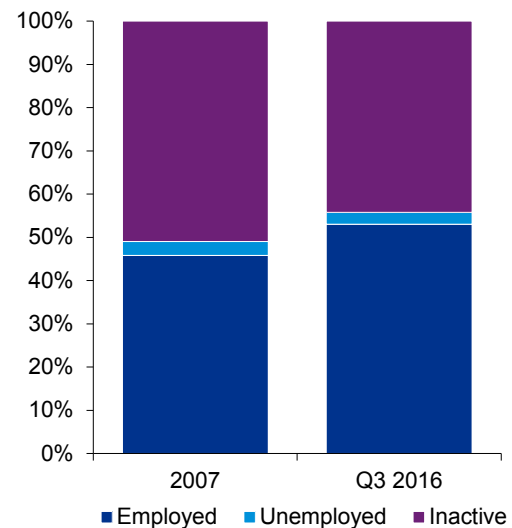
¹ IMF Country Report No. 17/56 “2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALTA,” February 2017

The Labour Market

In recent years the Maltese economy has been approaching a state of full employment. Comparing the profile of the labour market in 2007 and in Q3 2016, one can notice a significant rise in the proportion of employed individuals, up from around 46% to around 53% of the population. What is most interesting to note is that this growth in employment is not primarily driven by a decline in unemployment, but by an increase in the activity rate of the population. To put it in figures, the average unemployment recorded by the NSO in 2007 was of around 3.2%, while the unemployment rate during Q3 2016 was of 2.7%. As regards inactivity, during 2007 the average inactivity rate was 51%; by Q3 2016 this had fallen to 44.3%. The cause of this increase in activity is clear, a rise in female participation in the workforce. Inactivity amongst women has declined from almost 69% to just over 56%.

In terms of job creation, the total number of net new jobs during the period stood at 37,533 - a 24% increase in the gainfully occupied population since 2007.

Employment status



Source: NSO

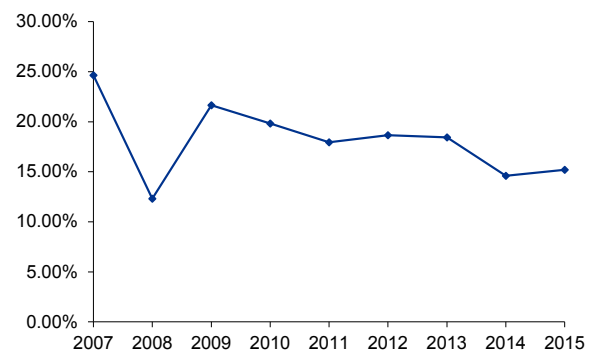
A robust banking system

Over the past decade one factor which became abundantly clear to all, was just how significant the banking sector is to any modern economy. The collapse of a major bank sends a destructive shockwave through the entire economy potentially threatening entire industries. As such it has become more important than ever to monitor the health of the banking industry and to ensure that a responsible approach to risk and liquidity has been adopted.

Traditionally, the Maltese banking sector has always been considered as prudent. This attitude is likely one of the factors which protected the local banks during the financial crisis. Throughout this period profitability took a hit, however core banks were able to maintain respectable returns in the face of global economic turmoil and increasing regulation.

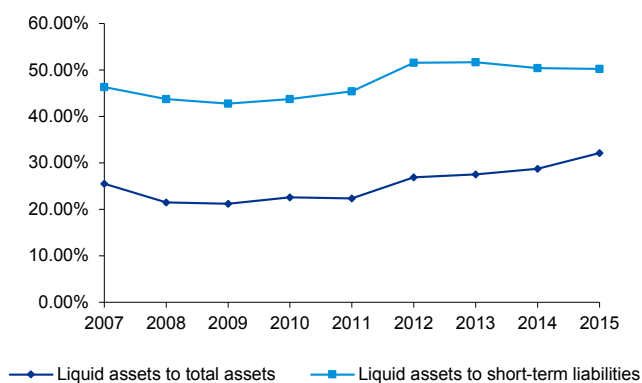
Over the past decade the local banking industry has taken measures to limit risk exposure. Data indicates a trend for increased levels of capital, and increased levels of liquidity.

Return on equity (profits before tax)



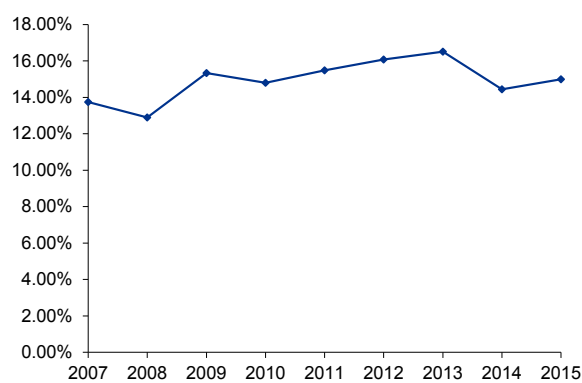
Source: Central Bank of Malta

Liquidity



Source: Central Bank of Malta

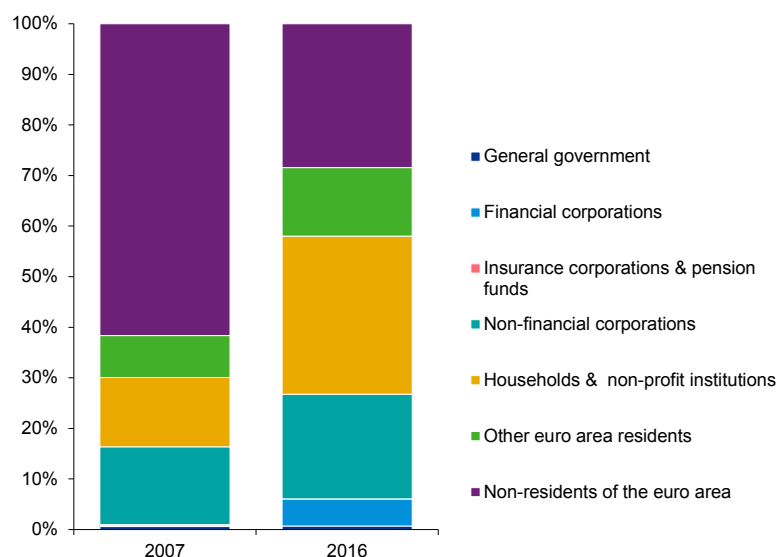
Regulatory Capital to risk weighted assets



Source: Central Bank of Malta

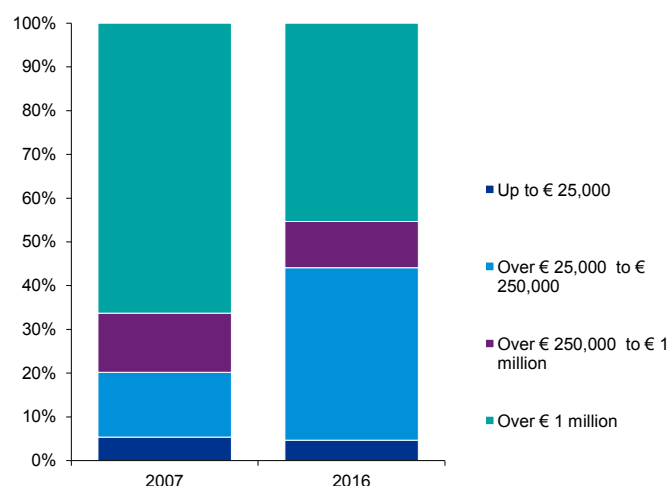
Additionally, a further drill-down into the structure of debt issued by local banks reveals a shift in the both clientele and loan value. Over the past decade, as a greater proportion of bank loans are become held by private households, the proportion of loans valued at over €1 million have decreased significantly.

Total loans by sector



Source: Central Bank of Malta

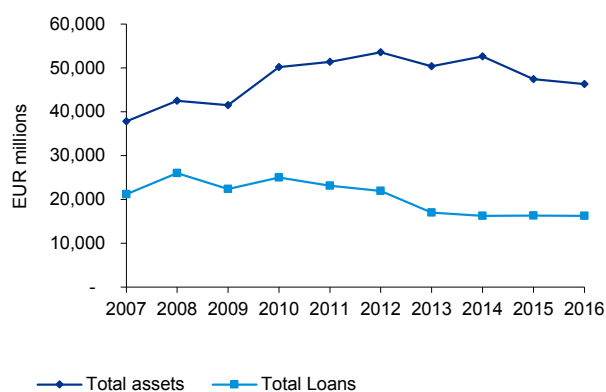
Total loans by size



Source: Central Bank of Malta

The effects of this change in loan profile can be seen when comparing the total value of assets held by banks as compared to the total value of loans they have issued. At the end of 2007, the total value of loans issued by local banking institutions was equivalent to around 56% of their total assets. At the end of 2016 the value of loans issued had fallen in both nominal and proportionate terms to around EUR 16.25 billion, or 35% of assets held.

Total assets and loans



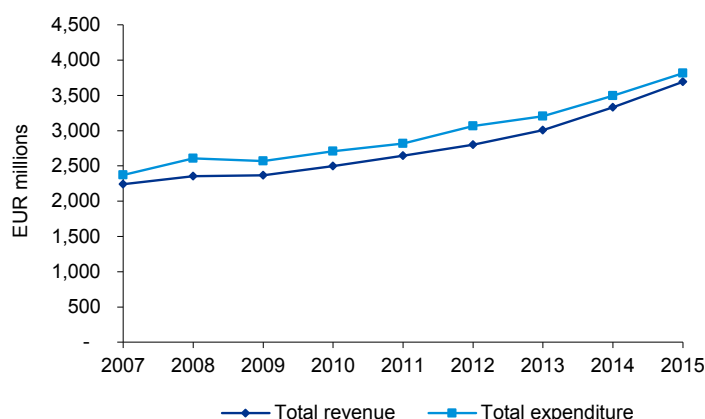
Source: Central Bank of Malta, KPMG analysis

A stable fiscal outlook

The effects of economic growth and low unemployment have been felt by the Maltese Government as reduced pressure on the public purse. Government has succeeded at narrowing the gap between public revenue and expenditure over recent years. This has been achieved through consistent growth in public revenue, enabling Malta to avoid the need for dramatic austerity programmes as seen in other European nations.

When comparing Q3 2016 to the same period the previous year, growth in government revenue can be mainly attributed to a 50% increase in charges levied for goods and services provided by government, as well as growth in tax revenue, most significantly an increase of 14% in current tax revenue and an increase of 9% in net social contributions. It is also pertinent to note that when compared to the previous period, revenue from capital transfers receivable declined by 84%. This largely reflects reductions or timing differences in the cash flows to the credit of the capital account. All-in-all total government revenue grew by 6% when compared to the previous period.

Government revenue and expenditure



Source: Central Bank of Malta

The decline in public spending also reflects a significant reduction in investment, down by 39% over the previous period. Other significant reductions in payments included a 39% reduction in capital transfers, and a 9% reduction in current transfers. The main increase in expenditure can be traced to a 10% increase in intermediate consumption, and a 6% increase in compensation of employees, collectively reflecting an increase in cost of operations. The increasingly ageing population is also reflected in public finances, as expenses linked to the payment of social benefits and government subsidies have recorded increases when compared to the previous period.

Increasing income levels

Economic growth should translate into additional income for the people living within the country. As such, it is important to take into consideration the changes in incomes within Maltese society over the past few years.

In this regard one can note that not only has the average household disposable income grown significantly, but so has the national median income. This suggests that economic growth has not fuelled inequalities, on the contrary it has filtered across Maltese society, stimulating the expansion of the middle class.

Income indicators for Malta			
	2007	2015	% Change
Average household gross income (€)	21,955	31,429	43.2%
Average household disposable income (€)	18,325	25,960	41.7%
Median National Equivalised Income (NEI) (€)	9,129	13,493	47.8%

Source: NSO, KPMG Analysis

A better quality of life

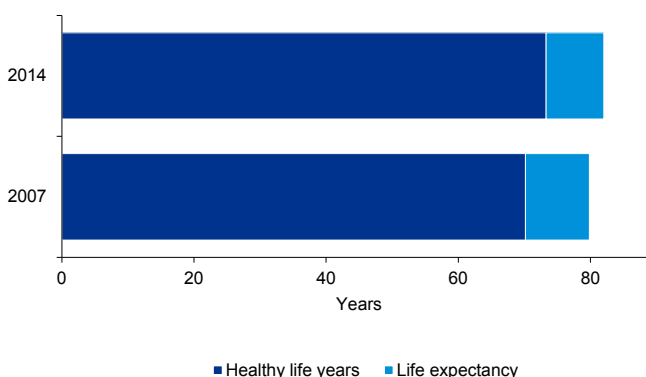
Economic growth is considered to be one of the main drivers behind an improvement in the quality of life for a nation's population. One can look towards certain indicators such as health and education for an idea of the progress being made.

Looking at life expectancy in Malta, one can notice an improvement between 2007 and 2014. In this short time span, the average life expectancy has improved from 80 to 82 years, while the average expected number of healthy life years has improved from 70 to 73 years. A report published by the European Observatory on Health Systems and Policies² praised the progress made by the Maltese health system in reducing avoidable mortality and achieving low levels of unmet medical need. Estimates derived from government budgetary figures indicate that between 2007 and 2015, the Maltese government has invested almost €188 million in capital projects relating to the local health care system. This is equivalent to around 6% of total government capital expenditure during the period.

Efforts have also been made to improve the general standard of education in Malta.

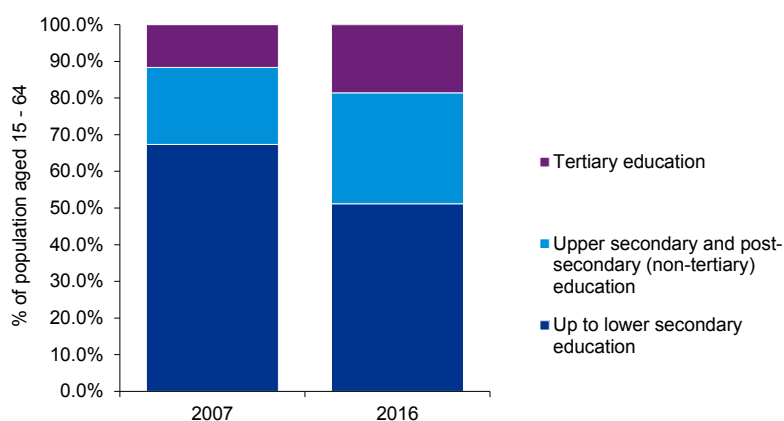
Statistics show that between 2007 and 2016, the proportion of the population holding an upper secondary, post-secondary or tertiary standard of education has increased significantly. In 2007 less than 12% of working age individuals had completed some form of tertiary education, and nearly 70% had only completed up to a lower secondary education. The situation was markedly improved in 2016, with nearly 19% of working aged individuals having completed their tertiary education, and only around 51% of the population possessing up to a lower secondary standard. Malta's lack of natural resources means that economic prosperity rests on the country's ability to generate value through its human resources. For this reason education has always been a priority to Maltese governments. Between 2007 and 2015, over €358 million was invested into capital projects related to education. This is equivalent to around 11% of total government capital expenditure during the period.

Average life expectancy



Source: NSO, KPMG Analysis

Level of education



Source: NSO, KPMG Analysis



² "Health Systems in Transition – Malta Health system review", European Observatory on Health Systems and Policies, 2017

The Future

Over the past ten years Malta has proven itself capable of adapting to changing economic circumstances and successfully forging new industries to ensure that the economy remains competitive on an international level. During the global recession and the public sector debt crises in Europe, Malta was capable of maintaining a healthy level of economic growth and outrunning the economies of larger, more resource-rich nations. Key to this achievement has been the prevailing attitude of conservatism and prudence, coupled with the solid structural foundations of the local economy. Widely-held attitudes have historically generated cautious management in the banking sector, enabling Malta to avoid an indigenous banking crisis. Inherent prudence in public finances has likewise driven the strategic objective of reducing public deficits and debt, enabling Malta to avoid a public finance crisis. Sustained economic growth, the absence of domestic crises during the recession, investment in human capital, and efforts to carefully craft a service oriented economy have made Malta a true global economic player, especially in both the financial services and information technology industries. These small islands, still a critical strategic hub for shipping routes through the Mediterranean, have now positioned themselves a key hub for knowledge and professional services in the European Union.



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