7. Foreign Trade and Payments

International developments underpinned the increase in the current account deficit recorded during the Survey period. In particular, a significant decline in the value of exports can be attributable to the semi-conductor sector, which is still being influenced by the decline in semi-conductor prices. A decline in the volume of exports also reflects subdued demand in this sector.

Meanwhile, despite lower export activity, the decline in imports of industrial supplies during the period under analysis was relatively more modest. In addition the rising oil prices contributed to a higher import bill, although due to the termination of bunkering services by a major operator, the recorded increase in fuel imports was marginal compared to the January-September period of 2004. However, the termination of bunkering services also contributed to a decline in exports of fuel. In addition, imports of consumer goods continued on a positive trend, partly reflecting the substitution of local sales with imported goods. Meanwhile, imports of capital goods remained at the level registered last year, after account is taken of the one-off imports of yachts in 2004.

Trade activity during the Survey period was marked by lower exports and imports to and from Malta's major trading partners, including Asia and the USA. Only trade activity with Italy registered an increase. On the other hand, a significant increase in trade with north-African countries was registered during the Survey period.

These developments underpinned the deterioration in the goods balance in the current account. The services balance partly offset the worsening of the goods balance during the period under review. This was due to lower net payments on transport services and higher net receipts on other services such as communications and business services. Meanwhile, tourism earnings were marginally higher than the receipts recorded in the January-September period of 2004.

Higher receipts, primarily in the form of interest income were offset by higher payments resulting from the improved profitability of foreign-owned companies during the Survey period. As a result, the balance on the income account remained stable at the comparable levels in the January-September period of 2004. On the other hand, net outflows by way of current transfers increased, partly reflecting Malta's contribution to the EU budget.

Box 7.1

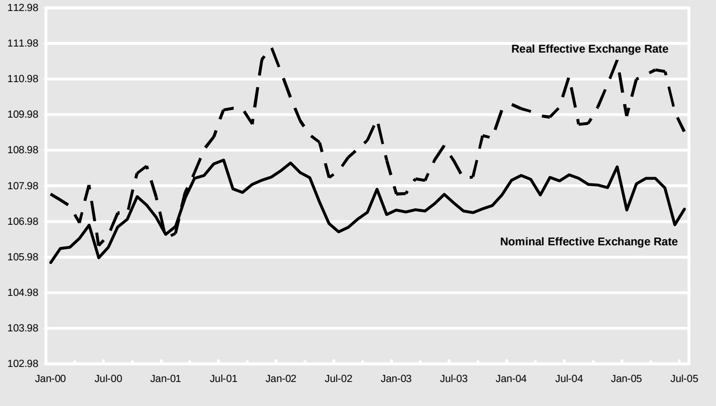
International Competitiveness

An indicator of a country's international price competitiveness is provided by the real effective exchange rate. The real effective exchange rate (REER) is calculated as the product of the nominal effective exchange rate (NEER) and the relative foreign to domestic prices. In turn, the nominal effective exchange rate is an average of exchange rates weighted by bilateral trade shares. A decline in the real effective exchange rate is indicative of improved international competitiveness

Data published by the Central Bank of Malta indicate that the real effective exchange rate in July 2005 depreciated by 1.8 per cent since December 2004. Meanwhile, the nominal effective exchange rate depreciated by 1.1 per cent over the same period. This indicates an improvement in the price competitiveness of Maltese products and services on the international markets, reflecting lower domestic inflation relative to inflation abroad. A comparison of IMF/Eurostat estimates of consumer price inflation for 2005 suggest that inflation in Malta is expected to be slightly above that of its main trading partners but below that of its major competitors in Europe and North Africa.

A note of caution on the interpretation of effective exchange rates is however warranted. Estimates of the REER and the NEER are based on the consumer price index as a measure of prices. Alternative price measures could include unit labour costs, export deflators or the GDP deflators.

International Competitiveness



Foreign Trade

Trade developments during the first nine months of 2005 were severely influenced by international events. External shocks to the Maltese economy included the significant increase in international oil prices compounded by the strengthening of the US Dollar in the second and third quarter of 2005, the continuing decline in semi-conductor prices on the international market and their effect on an international firm in the semi-conductor sector which represents a major share of Malta's export portfolio. In addition, economic activity in Malta's main trading partners remained below potential.

All these factors contributed to a decline in the value of Maltese exports. The decline in imports, partly reflecting lower industrial supplies, was not enough to compensate for the loss in export revenue, leading to a deterioration in the trade deficit from Lm273.3 million in the first nine months of 2004 to a deficit of Lm338.5 million in the comparable period of 2005. Further details are provided in Table 7.1 and Chart 7.1. As illustrated in Chart 7.2, the rate of import cover declined from 71.4 per cent in the Survey period of 2004 to 63.8 per cent in the comparable period of 2005.

Exports

During the Survey period, exports declined by Lm86.1 million to Lm595.3 million. This represents a decline of 12.6 per cent. The machinery and transport equipment sector contributed to 9.9 percentage points of the decline in total exports. Another 3.1 percentage points was the result of the decline in fuel exports. The commodity breakdown of exports is provided in Table 7.2.

The fall of Lm67.5 million in exports of machinery and transport equipment was the result of the persistent fall in semiconductor prices and a decline in the volume of exports. The first nine months of 2005 should also be viewed in the context of a period of consolidation and restructuring of a major international operator in the sector at a time of modest growth in demand for semi-conductors.

The second major development during the Survey period related to a decline of Lm21.3 million in exports of fuel. This is due to the termination of bunkering services by a major operator since the third quarter of 2004.

If one were to exclude exports of fuel and machinery and transport equipment sectors, it is interesting to note that exports in the first nine months of 2003, 2004 and 2005 remained stable at around Lm215 million. This occurred despite

Chart 7.1

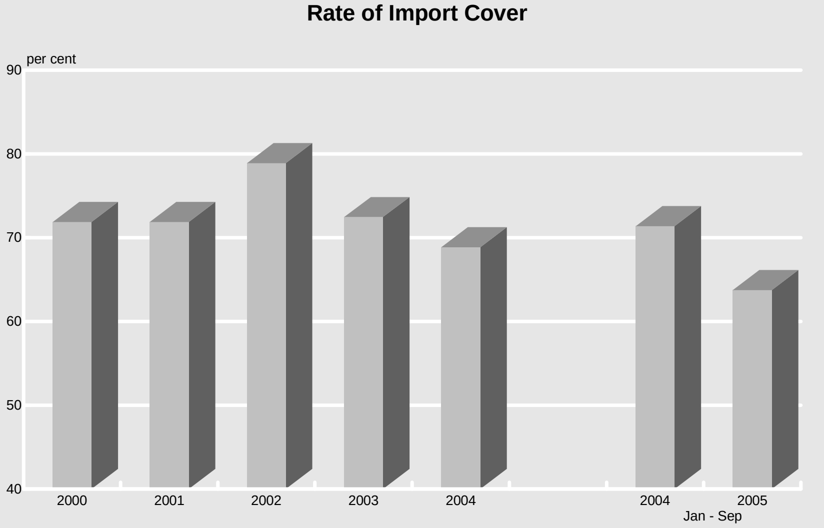
Foreign Trade

Table 7.1 | Lm million

	2002 Jan/Sep	2002 Oct/Dec	2003 Jan/Sep	2003 Oct/Dec	2004 Jan/Sep	2004 Oct/Dec	2005 Jan/Sep
Imports (c.i.f.)	906.3	321.2	960.4	320.8	954.7	358.8	933.8
Total Exports (f.o.b.)	719.9	248.5	684.6	243.7	681.4	223.2	595.3
Trade Gap	-186.4	-72.7	-275.8	-77.1	-273.3	-135.6	-338.5
of which:							
Exceptional Item (Exports)	50.1	-	-	-	-	-	-
Exceptional Item (Imports)	-	-	2.1	-	-	-	-

Source: National Statistics Office

Chart 7.2



Commodity Breakdown of Exports

Table 7.2 Lm million

	2002 Jan/Sep	2002 Oct/Dec	2003 Jan/Sep	2003 Oct/Dec	2004 Jan/Sep	2004 Oct/Dec	2005 Jan/Sep
Total Exports							
Food, Beverages and Tobacco	31.4	25.2	31.3	19.4	29.8	15.5	27.3
Chemicals	14.4	4.2	13.1	5.9	18.3	5.6	23.2
Semi-manufactures	36.5	12.5	36.0	12.8	36.8	13.8	42.2
Machinery and Transport Equipment	455.5	146.3	427.4	149.3	437.0	136.6	369.5
Clothing	51.9	17.1	47.4	14.6	36.0	10.7	29.6
Fuels	39.0	13.2	38.8	12.8	32.4	7.6	11.1
Printed Matter	19.5	8.3	24.3	7.5	24.1	8.3	23.3
Toys and Games	22.2	7.2	21.1	7.1	22.3	7.2	22.4
Scientific Instruments	19.9	5.4	20.1	7.8	18.4	6.7	19.5
Other Manufactures	29.6	9.1	25.1	6.5	26.3	11.2	27.2
Total Exports	719.9	248.5	684.6	243.7	681.4	223.2	595.3

Source: National Statistics Office

the trend decline in exports of clothing, traditionally the second major exporting sector. This indicates that exports in other sectors compensated for the decline in exports of clothing. Of particular relevance is the increase in exports of chemical products, particularly in 2004 and 2005. In the first nine months of 2005, this category of exports increased by a further Lm4.9 million and now represents around 4 per cent of Maltese exports, compared to 2 per cent in 2002.

During the period under review, a significant increase of Lm5.4 million in exports of semi-manufactures was also recorded. On the other hand, exports of food, beverages and tobacco declined by Lm2.5 million during the Survey period. Exports of clothing also declined by Lm6.4 million during the Survey period. Further details are provided in Chart 7.3 and Chart 7.4.

Geographical Distribution – Exports

Exports during the first nine months of 2005 partly reflected the subdued economic activity of Malta's main trading partners. Table 7.3 provides a detailed analysis of the geographical distribution of exports. A decline in exports to France of Lm14.8 million and a decline in exports to the UK of Lm11.3 million were registered during the Survey period. Exports to Germany also decreased by Lm2.3 million. Among Malta's main trading partners, only exports to Italy increased by Lm3.8 million during the same period. An increase of Lm5.3 million

Chart 7.3

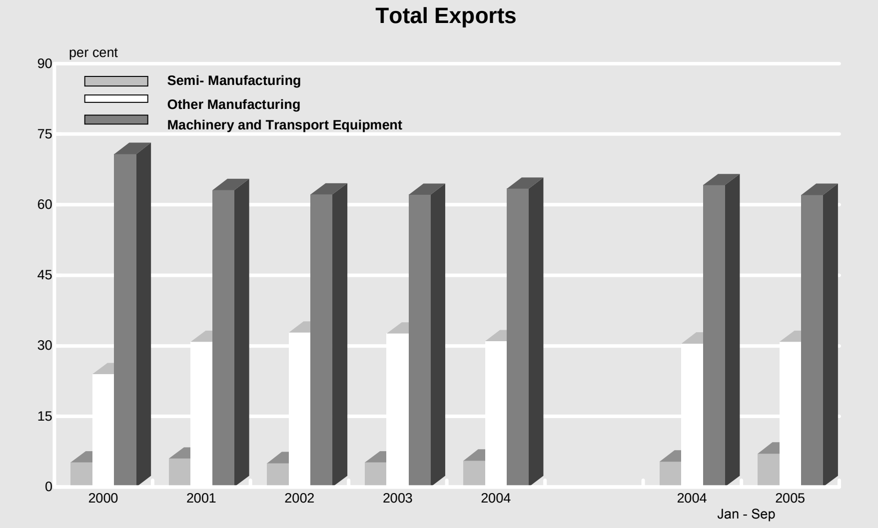
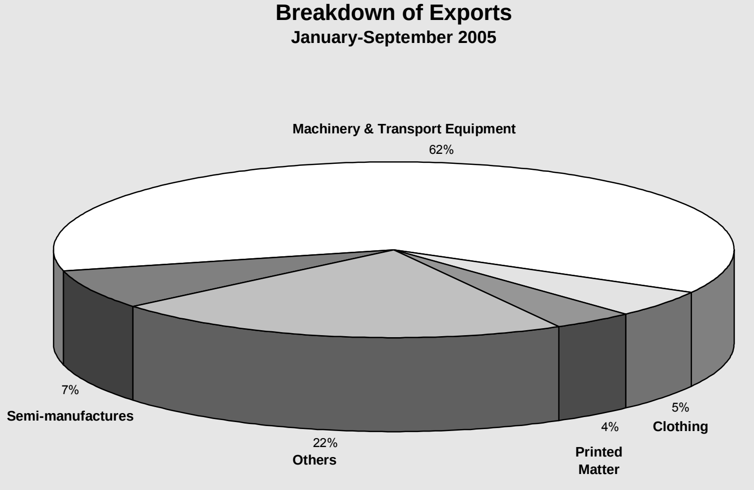


Chart 7.4



Total Exports by Main Geographical Areas

Table 7.3 Lm million

	2002		2003		2004		2005
	Jan/Sep	Oct/Dec	Jan/Sep	Oct/Dec	Jan/Sep	Oct/Dec	Jan/Sep
Europe	332.8	116.1	327.3	108.2	330.8	108.7	310.1
EU*	327.4	113.4	323.3	106.7	325.7	106.7	303.6
Italy	25.1	7.6	24.5	7.0	20.6	6.4	24.4
Germany	70.3	23.3	70.8	24.4	73.0	24.5	70.7
France	87.6	32.4	89.4	30.8	104.2	36.4	89.4
U.K.	82.1	30.1	80.7	28.3	79.2	22.1	67.9
Netherlands	8.4	1.9	5.6	1.2	5.5	1.9	5.5
Belgium	23.7	7.0	21.6	4.0	9.3	2.5	14.6
Others	30.2	11.2	30.6	11.0	33.9	12.9	31.1
Euro Area	235.6	77.8	224.2	71.9	230.3	77.3	217.7
Other European countries	5.4	2.6	4.0	1.5	5.1	2.0	6.5
Africa	34.2	10.6	25.2	9.9	32.1	14.6	45.8
America	131.4	32.3	98.6	44.6	114.2	36.5	96.1
USA	128.3	31.1	92.1	42.1	108.7	33.1	85.0
Others	3.0	1.3	6.5	2.5	5.5	3.4	11.1
Oceania	0.5	0.1	0.4	0.1	0.7	0.2	1.1
Asia	174.8	72.9	189.1	66.1	170.5	55.6	135.0
Japan	20.1	21.5	20.5	16.6	14.2	11.6	11.7
Singapore	116.0	35.9	121.9	34.0	101.5	29.9	73.3
Others	38.7	15.5	46.7	15.5	54.8	14.1	50.0
Ships & Aircraft	46.3	16.5	44.0	14.8	33.1	7.6	7.2
Total Exports	719.9	248.5	684.6	243.7	681.4	223.2	595.3
EU Exports as % of Total	45.5	45.7	47.2	43.8	47.8	47.8	51.0

*As from 2004 considered by country of consignment

Source: National Statistics Office

in exports to Belgium was recorded, whilst exports to other EU countries declined by Lm2.8 million.

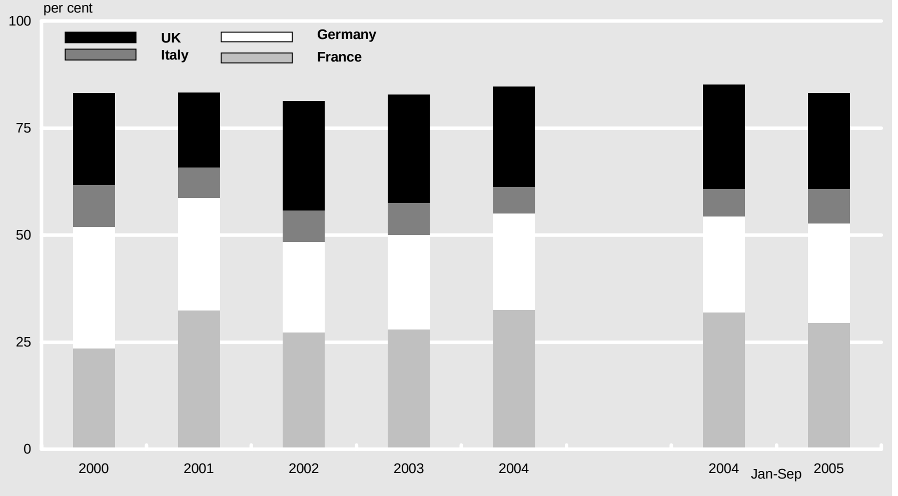
As a result of these developments, exports to the EU declined by Lm22.1 million. Nevertheless, the share of total exports to the EU continued on its upward trend reflecting further trade integration with the EU. In the first nine months of 2005, exports to the EU represented 51.0 per cent of total exports. Chart 7.5 illustrates the share of Maltese exports to the EU directed to the four main trading partners.

Exports to the USA registered a decline of Lm23.7 million during the first nine months of 2005. Exports to Asia in the first nine months of 2004 were also Lm35.5 million lower compared to the same period in 2005. The decline in the Asian market reflected lower exports to Singapore, Japan and other Asian economies.

In contrast, an exceptional increase in exports of Lm13.7 million to Africa, particularly to Libya was registered. This primarily includes a substantial increase in exports of electrical apparatus. Following the lifting of the UN sanctions against Libya and the rise in oil prices, this important fast-growing market has become more accessible. Apart from Libya, there are a number of potential, fast-growing economies in North Africa. These include Tunisia, Algeria and

Chart 7.5

Geographical Distribution - Exports to EU



Morocco. The IMF is projecting a growth of 5.9 per cent in 2006 for these economies, which thus represent a potential growing market for Maltese exports.

A decline of Lm25.9 million was also registered in exports to Ships and Aircraft. This reflected the termination of bunkering operations and therefore is not expected to repeat itself in 2006.

Imports

Imports during the first nine months of 2005 declined by Lm20.9 million, or 2.2 per cent to Lm933.8 million. The decline in imports of capital goods and industrial supplies contributed to 2.4 percentage points and 1.3 percentage points of the decline in imports respectively. Table 7.4 provides a detailed analysis of imports by broad economic category.

Meanwhile, imports of consumer goods continued on a positive trend, increasing by a further Lm11.6 million to Lm257.0 million during the January-September period of 2005. This included an increase of Lm3.8 million in imports of food and beverages, an increase of Lm12.6 million in imports of durable goods and a decline of Lm4.8 million in imports of other consumer goods. This partly reflects the effects of trade liberalization with imports substituting local production in

Imports by Broad Economic Category

Table 7.4 Lm million

	2002		**2003**		**2004**		**2005**
	Jan/Sep	Oct/Dec	Jan/Sep	Oct/Dec	Jan/Sep	Oct/Dec	Jan/Sep
Consumer Goods							
Food and Beverages	72.6	27.0	75.4	28.7	83.1	35.4	86.9
Durable Goods	85.4	34.8	90.3	37.0	95.9	40.1	108.5
Others	55.6	18.7	59.4	20.3	66.4	23.3	61.6
Total	213.6	80.4	225.1	86.0	245.4	98.8	257.0
Industrial Supplies							
Primary	18.3	5.2	14.5	3.0	10.9	5.4	14.2
Semi-finished	432.7	147.2	459.7	152.6	407.1	168.8	391.8
Finished	11.1	6.8	14.3	6.8	16.1	7.3	15.7
Total	462.1	159.2	488.5	162.4	434.1	181.5	421.7
Capital and Others							
Capital Goods	148.7	49.9	156.4	49.5	183.1	56.2	160.0
Fuel	73.8	29.0	81.8	20.1	85.7	21.4	88.6
Non-specified and Gold	8.1	2.6	8.6	2.8	6.4	0.9	6.5
Total	230.6	81.5	246.8	72.4	275.2	78.5	255.1
Total Imports	906.3	321.2	960.4	320.8	954.7	358.8	933.8

Source: National Statistics Office

some sectors which were protected by the import levies. The composition of consumer imports is illustrated in Chart 7.6. A breakdown of imports into consumer goods, industrial supplies and capital goods is provided in Chart 7.7.

Despite the decline in exports of around Lm86 million, imports of industrial supplies only declined by Lm12.4 million. This suggests that production continued despite a fall in demand. Such developments seem to confirm the increase in inventories registered in the national accounts data. These figures may suggest that the deterioration in the trade balance experienced in the last two years will not necessarily persist and an improvement in the trade balance may possibly materialise in 2006.

Imports of capital goods for the first nine months of 2005 stood at Lm160.0 million. This represents a decline of Lm23.1 million, mainly attributable to exceptional sea-craft imports last year.

Despite the termination of bunkering services of a major operator in the sector, imports of fuel continued to increase by Lm2.9 million to Lm88.6 million. This was primarily related to the substantial increase in oil prices on the international market.

Chart 7.6

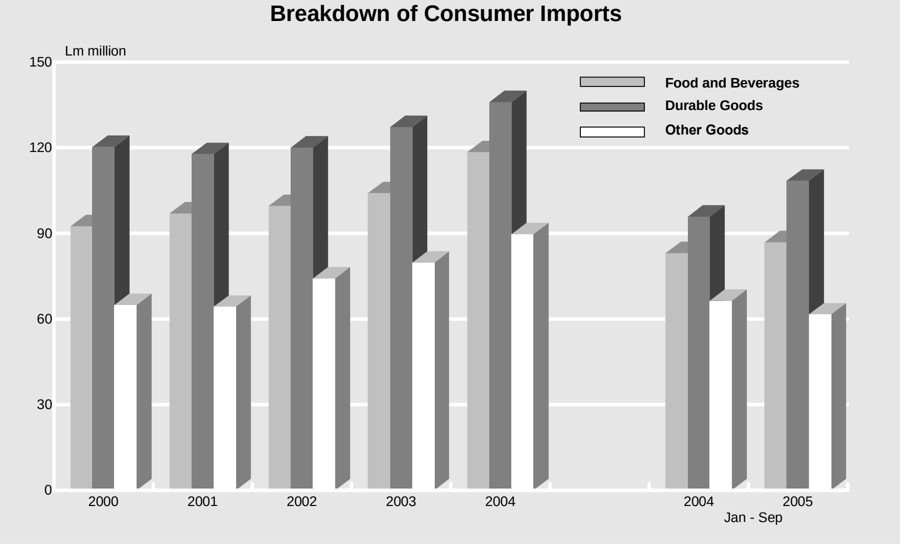
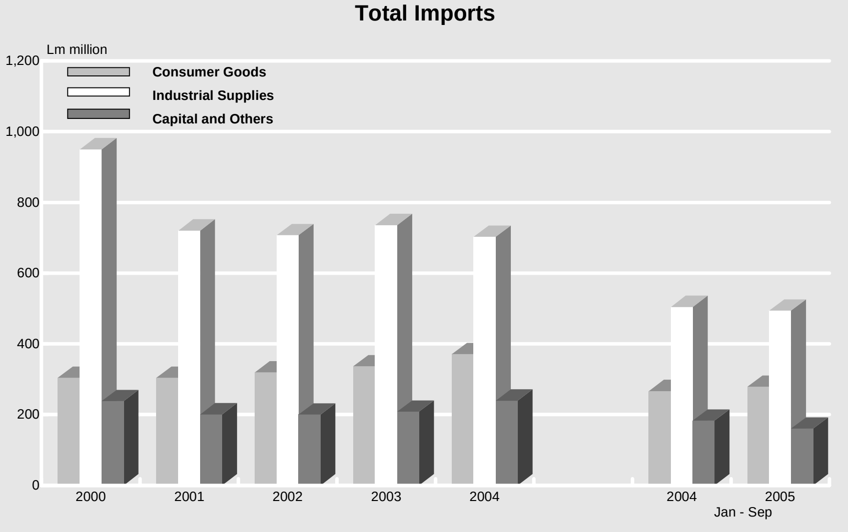


Chart 7.7

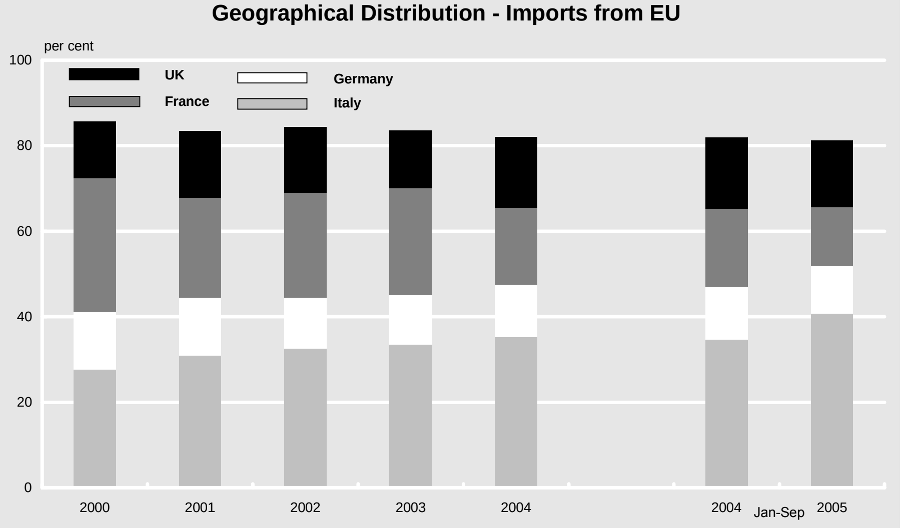


Geographical Distribution – Imports

During the period under review, imports from the African market registered the highest increase in both absolute and in relative terms. Indeed, imports from Africa during the Survey period exceeded the value of imports from the USA, Netherlands and Singapore amongst others. Imports from this region increased significantly by Lm29.6 million. Higher imports of fuel from Egypt were recorded in the first nine months of 2005 and accounted for most of the increase in imports from Africa.

Imports from the EU recorded a significant drop of Lm42.2 million during the period under review. Major declines were registered in the UK (-Lm13.4 million) and Germany (-Lm12.5 million). Within the EU market, imports from France continued on a downward trend, and during the Survey period a decrease of Lm39.2 million was registered. On the other hand, Italy continued to gain importance as a major trading partner. The upward trend in imports from Italy continued, increasing by Lm26.1 million to Lm269.8 million by September 2005. Imports from Italy now account for around 40 per cent of total imports from the EU. Chart 7.8 illustrates the share of Maltese imports to the EU directed to the four main trading partners. Imports from the EU now represent more than 70 per cent of total imports.

Chart 7.8



Imports from the USA stood at Lm42.1 million in the January-September 2005 period, down from Lm47.9 million a year earlier. Reflecting the downward trend in the last few years, these represented around half their level in the comparable period of 2002. Meanwhile, imports from Asia remained stable at Lm137.3 million. Higher imports from Singapore (+Lm8.6 million) were offset by lower imports from Japan (-Lm3.5 million) and other Asian economies (-Lm5.5 million). Table 7.5 analyses imports by main geographical areas in more detail.

Geographical Distribution – Trade Balances

The trade balance with the EU has improved by Lm20.1 million during the Survey period. Apart from Italy, Malta's trade balance with major economies within the EU improved. The trade deficit with France declined by Lm24.4 million, whilst the trade deficit with Germany declined by Lm10.2 million. On the other hand, the trade deficit with Italy deteriorated by a further Lm22.3 million. The positive trade balance with Singapore and the USA deteriorated by Lm36.8 million and Lm17.9 million respectively, reflecting lower exports of machinery and transport equipment. A substantial improvement in the positive trade balance with Libya of Lm9.1 million was also registered during the Survey period. Further details are provided in Table 7.6.

Imports by Main Geographical Areas

Table 7.5 — Lm million

	2002 Jan/Sep	2002 Oct/Dec	2003 Jan/Sep	2003 Oct/Dec	2004 Jan/Sep	2004 Oct/Dec	2005 Jan/Sep
Europe	661.6	230.0	700.1	237.4	737.2	261.4	696.0
EU*	616.4	216.9	649.6	227.4	703.6	248.1	661.4
Italy	197.7	74.0	218.1	76.3	243.7	92.2	269.8
U.K.	93.8	33.9	89.7	28.9	116.8	40.6	103.4
Germany	74.3	24.2	75.7	25.3	86.2	30.2	73.7
France	155.3	49.8	159.6	59.3	129.6	41.8	90.4
Netherlands	20.8	7.7	22.2	7.5	34.5	11.4	32.1
Others	74.4	27.2	84.3	30.1	92.8	31.9	92.0
Euro Area	504.9	176.0	540.9	191.6	565.9	199.3	538.2
Other European Countries	45.1	13.1	50.5	10.0	33.6	13.3	34.6
Africa	12.3	5.0	9.1	1.7	17.6	8.1	47.2
America	94.0	33.4	91.2	24.7	59.7	23.3	50.6
USA	84.7	30.6	81.7	22.2	47.9	20.1	42.1
Others	9.3	2.8	9.5	2.5	11.8	3.2	8.5
Oceania	4.9	1.3	5.6	1.2	2.5	0.9	2.7
Asia	133.5	51.5	154.4	55.8	137.7	65.1	137.3
Japan	21.0	6.9	21.1	8.2	24.3	8.5	20.8
Singapore	37.2	14.6	47.5	12.1	32.0	21.4	40.6
Others	75.3	30.0	85.8	35.5	81.4	35.2	75.9
Total Imports	906.3	321.2	960.4	320.8	954.7	358.8	933.8
EU Imports as % of Total	68.0	67.5	67.6	70.9	73.7	69.1	70.8

*As from 2004 considered by country of consignment

Source: National Statistics Office

Trade Balances with Various Countries

Table 7.6 — Lm million

	2002	2003	2004	2004 Jan/Sep	2005 Jan/Sep
EU*	-392.5	-447.1	-519.3	-377.9	-357.8
Belgium	-10.4	3.8	-9.7	-6.2	-3.1
France	-85.1	-98.7	-30.8	-25.4	-1.0
Germany	-5.0	-5.8	-18.9	-13.2	-3.0
Italy	-239.1	-262.9	-308.9	-223.1	-245.4
Netherlands	-18.3	-22.9	-38.5	-29.0	-26.6
United Kingdom	-15.5	-96.2	-56.1	-37.6	-35.5
Other EU	-19.0	35.6	-56.4	-43.4	-43.2
Other Countries					
USA	44.1	30.3	73.8	60.8	42.9
Japan	13.6	7.8	-7.0	-10.1	-9.1
Singapore	100.2	96.3	78.0	69.5	32.7
Libya	24.0	20.9	28.4	20.0	29.1
China	-25.2	-33.5	-20.0	-14.6	-12.7

*As from 2004 considered by country of consignment

Source: National Statistics Office

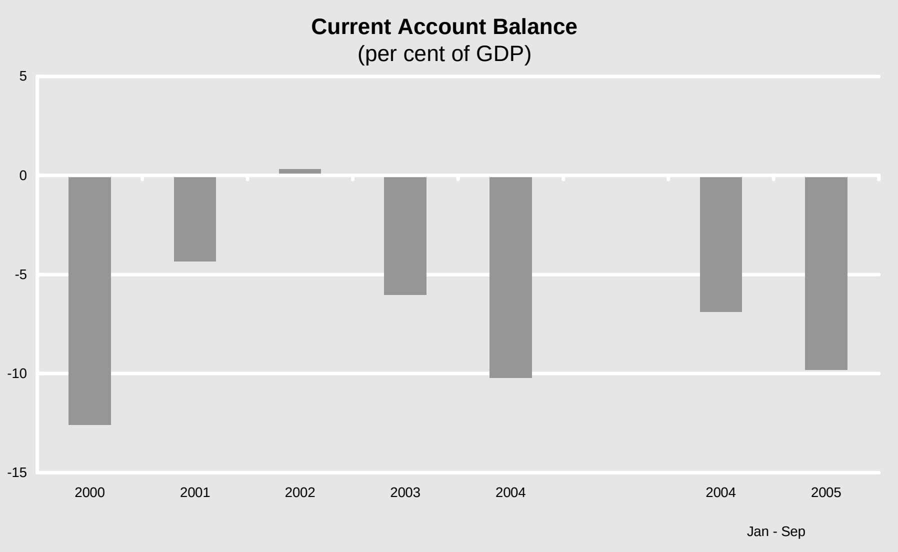
Balance of Payments

The widening of the current account deficit experienced since 2003 continued during the first nine months of 2005. This suggests that domestic absorption continued to exceed national income. Whilst imports of goods and services decreased, a significant decline in exports of goods and services occurred during the Survey period. The analysis of trade flows in 2005 underlines the challenges being faced by the semi-conductor sector of the economy and its contribution to this imbalance. Rising international oil prices are another important element contributing to a persistent current account deficit in the last two years.

The high level of domestic absorption relative to the income level is also indicative of low national savings relative to investment. It is important to highlight that the imbalance between savings and investment is the result of an imbalance in both the public and the private sector of the economy. Indeed, given the decline in the budget deficit during the last two years in line with Government's fiscal consolidation exercise, the increase in the current account deficit should be primarily attributable to the decline in private savings. Chart 7.9 shows the current account balance as a percentage of GDP since 2000.

The deficit in the first nine months of 2005 stood at 9.8 per cent of GDP. A deficit in the current account has been registered throughout this period with the exception of a surplus of 3.7 per cent of GDP in the January-September period of 2002. Developments in the goods, services and income account are

Chart 7.9



Balance of Payments

Goods, Services and Income Account (Net)

Table 7.7 — Lm million

	2002		2003		2004		2005
	Jan/Sep	Oct/Dec	Jan/Sep	Oct/Dec	Jan/Sep	Oct/Dec	Jan/Sep
GOODS							
General Merchandise Transactions	-133.0	-58.5	-231.8	-63.2	-208.2	-112.0	-257.2
Nonmonetary Gold	-7.0	-2.2	-6.7	-2.1	-5.9	-1.0	-4.8
Others	34.4	12.1	32.2	12.5	30.8	6.9	2.5
Total Goods	-105.6	-48.6	-206.3	-52.8	-183.3	-106.1	-259.5
SERVICES							
Transportation	-1.2	-4.9	-3.5	-6.9	-11.7	-11.6	5.3
Travel	133.2	46.2	137.3	43.3	139.9	41.2	139.2
Other Services	1.7	-1.8	12.4	-1.2	-1.3	-5.2	7.9
Total Services	133.7	39.5	146.2	35.2	126.9	24.4	152.4
Total Goods and Services	28.1	-9.1	-60.1	-17.6	-56.4	-81.7	-107.1
INCOME							
Compensation to employees	0.1	-0.1	0.8	0.1	0.1	1.2	2.9
Investment Income	30.6	-28.0	9.4	-21.5	-21.3	-2.8	-24.7
Total Income	30.6	-28.1	10.3	-21.4	-21.2	-1.6	-21.8
Total Goods, Services and Income	58.7	-37.2	-49.8	-39.0	-77.6	-83.3	-128.9

Source: National Statistics Office

Balance of Payments

Current Account

Table 7.8 — Lm million

	2002		2003		2004		2005
	Jan/Sep	Oct/Dec	Jan/Sep	Oct/Dec	Jan/Sep	Oct/Dec	Jan/Sep
GOODS AND SERVICES							
Exports of Goods and Services	1,117.3	375.3	1,085.3	361.4	1,049.1	337.2	988.8
Imports of Goods and Services	1,089.2	384.4	1,145.5	379.0	1,105.5	418.9	1,095.9
Goods and Services Account	28.1	-9.1	-60.1	-17.6	-56.4	-8.2	-107.1
INCOME							
Income Received	281.9	79.3	245.2	86.1	235.6	90.8	293.0
Income Paid	251.3	107.3	235.0	107.6	256.8	92.4	314.8
Income Account	30.6	-28.1	10.3	-21.4	-21.2	-1.6	-21.8
CURRENT TRANSFERS (Net)							
General Government Transfers	1.8	1.4	7.3	1.6	2.7	-3.4	-7.1
Private Transfers	-12.5	-6.8	-18.3	-9.7	-19.2	-6.0	-3.5
Total Net Current Transfers	-10.7	-5.4	-11.0	-8.1	-16.5	-9.4	-10.6
Balance on Current Account	48.0	-42.6	-60.9	-47.2	-94.2	-92.7	-139.5

Source: National Statistics Office

presented in Table 7.7 whilst Table 7.8 provides a further analysis of the current account developments.

The Current Account

During the first nine months of 2005, the current account deficit continued to increase, reaching Lm139.5 million from Lm94.2 million a year earlier. The trade deficit accounts for most of the current account imbalance. A positive services balance offset part of the trade imbalance registered during the Survey period. The deterioration in the current account is primarily attributable to the goods account. The income account also contributed to the deterioration in the current account whilst the services and current transfers all contributed to a reduction in the current account deficit during the Survey period.

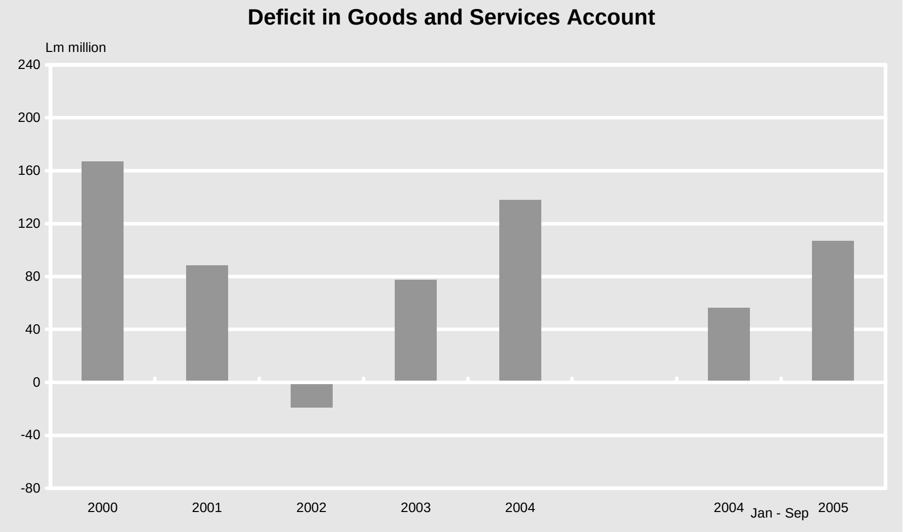
The Goods and Services Account

The goods and services account in the first nine months of 2005 registered a deficit of Lm107.1 million compared to a deficit of Lm56.4 million in the corresponding 2004 period. The deterioration in the goods and services balance is primarily attributable to Lm60.3 million lower exports of goods and services during the Survey period. Lower imports of goods and services of Lm9.6 million partly offset the decline in exports. Chart 7.10 shows the deficit in the goods and services account since 2000.

A higher negative balance in the goods account resulting from lower receipts from goods exports was the main contributors to the deterioration in the goods and services balance. The goods balance declined by Lm76.2 million to a deficit of Lm259.5 million. Further details are provided in the section on international trade in this Chapter.

Meanwhile, the balance in the services account improved by Lm25.5 million to Lm152.4 million during the Survey period. Receipts from services increased by Lm16.2 million whilst payments declined by Lm9.3 million. Higher receipts (+Lm9.2 million) and lower payments (-Lm7.8 million) from transport services improved the balance in the transportation account by Lm17.0 million. Around 60 per cent of the increase in transportation receipts was due to freight transport. Payments for freight and passenger transport increased. These were more than offset by Lm12 million lower payments on other transport services.

Chart 7.10



Receipts from tourism rose by Lm2.6 million during the Survey period. Further detail is provided in Chapter 5 of the Economic Survey. The increase in tourism earnings were offset by a higher expenditure by Maltese tourists travelling abroad. As a result of these developments, net inflows from the travel account remained stable at Lm139.2 million during the first nine months of 2005.

An improvement of Lm9.2 million in the other services balance was also recorded during the period under analysis. Receipts increased by Lm4.4 million. This included higher receipts from communications services and business services of Lm2.6 million and Lm5.1 million, respectively. On the other hand receipts on Government services declined by Lm3.9 million. Lower payments on insurance and other business services of Lm1.3 million and Lm3.7 million respectively were also recorded.

The Income Account and Current Transfers

Higher receipts in the income account were offset by higher payments such that the balance remained at a net outflow of Lm21.8 million, in line with last year's levels. Direct investment income flows account for most of the flows in the income account.

Receipts on investment stood at Lm286.4 million, or Lm53.8 million higher than the comparable nine months of 2004. This primarily reflects higher interest receipts from abroad. Meanwhile, payments in the investment income account stood at Lm311.0 million, or Lm57.2 million higher than the Survey period of 2004. Profits registered by foreign owned companies during the Survey period amounted to Lm109.3 million, up from Lm80.5 in the first nine months of 2004. Higher profits registered by foreign-owned companies contributed to an increase of Lm44.2 million in dividends and distributed branch profits. On the other hand, re-invested earnings declined by Lm15.3 million. It is important to note that a significant increase in re-invested earnings was recorded last year, partly reflecting higher profits in the banking sector. An increase in interest payments of Lm28.2 million over the Survey period of 2004 was also registered.

During the Survey period, inflows by way of employee compensation more than doubled to Lm6.6 million. As a result, net inflows by way of employee compensation increased by Lm2.8 million to Lm2.9 million during the period under analysis.

Net outflows by way of current transfers were Lm5.9 million less in the period under review compared to the January-September 2004 period. During the first nine months of 2005, Government received Lm24.2 million and paid Lm31.3 million by way of current transfers. Net inflows to Government registered in the Survey period of 2004 turned into a net outflow of Lm7.1 million. Outflows by way of worker's remittances sent abroad increased by Lm0.9 million to Lm1.4 million. Net outflows by way of other transfers improved by Lm16.5 million to a net outflow of Lm2.2 million.

The Capital and Financial Account

This section provides an analysis of the capital and financial flows which financed Malta's current account deficit in 2004. Data for the January-September period of 2005 were not yet available by the time of publication of this Economic Survey. Table 7.9 shows the capital and financial flows as a percentage of GDP.

The current account deficit stood at 10.2 per cent of GDP in 2004. Around 15 per cent of the current account deficit was financed through capital transfers. These amounted to 1.6 per cent of GDP compared to 0.4 per cent in 2003. Included in this figure is the inflow of funds from the Italian financial protocol and EU funds on capital projects.

Current, Capital and Financial Flows*
(per cent of GDP)

Table 7.9

	2001	2002	2003	2004
Current Account	-4.3	0.3	-6.0	-10.2
Capital Account	–	0.2	0.4	1.6
Financial Account excl. Reserves	3.5	5.2	4.9	–
Net Foreign Direct Investment	6.3	-10.4	8.5	8.0
Net Portfolio Investment Equity Flows	-4.3	1.5	-0.7	-0.3
Net Portfolio Debt Flows	-8.6	-10.7	-32.8	-31.0
Net Financial Derivatives	...	...	0.5	0.1
Net Other Investment Flows	10.2	24.7	29.3	23.3
Reserve Assets	-6.8	-7.0	-3.1	3.8
Net Errors and Omissions	7.6	1.3	3.9	4.8

* A positive sign represents a decrease in assets or increase in liabilities.
A negative sign represents an increase in assets or a decrease in liabilities

Source: National Statistics Office

Net foreign direct investment financed around 80 per cent of the current account deficit in 2004. Indeed, net foreign direct investment flows represented 8.0 per cent of GDP. Direct investment in Malta during 2004 represented 9.6 per cent of GDP. Around 60 per cent of new direct investment in Malta was made up of new equity investment whilst another 33 per cent was made up of re-invested earnings. Meanwhile, investment abroad by Maltese companies increased, reaching 1.6 per cent of GDP in 2004.

The outflow of funds by way of portfolio investments continued in 2004, reaching 31.3 per cent of GDP. Most of this investment is made up of debt instruments, particularly foreign assets in the form of bonds held by banks. On the other hand, net other investment inflows represented 23.3 per cent of GDP. Assets which are primarily made up of loans by domestic banks to foreign residents represented 21.4 per cent of GDP. The ratio of new liabilities to GDP, primarily made up of deposits held by foreigners in domestic banks and long-term loan advances by foreign banks, stood at 44.6 per cent of GDP in 2004.

Financial derivative assets and liabilities both recorded a significant increase. However, net inflows in the form of financial derivatives stood at 0.1 per cent of GDP in 2004. As a result of these developments, inflows in the financial account excluding reserve assets equaled outflows. Net errors and omissions represented a further 4.8 per cent of GDP. In other words, at 6.4 per cent of

GDP, capital and financial flows, including errors and omissions and excluding reserve assets financed two-thirds of the current account deficit. The rest was financed through foreign reserves which occurred primarily in the last quarter of 2004.

The latest data published by the NSO up till June 2005 suggests that the loss of foreign reserves continued in the first quarter of 2005. However, following Malta's entry into the ERM II, the pegging of the Maltese Lira to the Euro and the prevailing discount rate in Malta, the decline in reserves in the second quarter proceeded at a much lower rate. Data on the capital and financial flows in the balance of payments and the stock of assets and liabilities held by Maltese nationals is not yet available. However, provisional data on the stock of reserves indicates a considerable increase between June and September 2005. Indeed reserves continued to cover more than seven and a half months of the import bill during the Survey period.