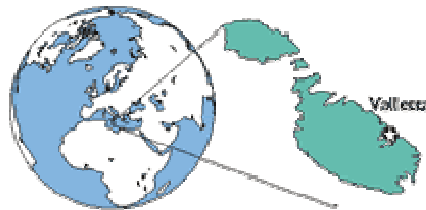


COUNTRY REVIEW

Malta



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EULER HERMES COUNTRY RISK GRADE: AA

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

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Strengths

- Low systemic political risk
- Good regional and international relations; EU membership
- Euro zone membership provides for low transfer and convertibility risk
- Net external creditor
- Strong business environment overall
- Solid banking sector

Weaknesses

- Weakening fiscal position (public debt-to-GDP ratio rose to 69% in 2009)
- High export dependence combined with narrow export structure causes some vulnerability to developments in the global economy
- High level of private-sector bank external debt, including non-resident deposits in the banking sector

ECONOMIC STRUCTURE

Country Profile	
Capital city:	Valetta
Population:	0.413 mn (2008)
GDP:	USD 8331 mn (2008)
Currency:	Euro (EUR)
Form of state:	Parliamentary republic
Head of government:	Prime Minister Lawrence GONZI (since March 2004)
Next elections:	Presidential: 2014 / Legislative: 2013

Major Industries (% of GDP at market prices, 2008)	Global Assumptions	2009	2010	
Services	79.5%	Real GDP grth (% yr/yr) *	-3.9	0.9
Trade, transport & communications	22.5%	Inflation (% av) *	-0.1	1.3
Financial intermediation & real estate	19.0%	Dated Brent (USD/b)	61	80
Industry	18.5%	* Major economies		
Agriculture	2.0%			

Main Exports (% of total, 2008)		Main Imports (% of total, 2008)	
Machinery & transport equipment	37.1%	Machinery & transport equipment	24.9%
Manufactured goods	10.5%	Mineral fuels & lubricants	11.9%
Chemicals	6.9%	Food	8.5%
Food	4.1%	Manufactured goods	8.4%
Lead Export Markets (% of total exports, 2008)		Lead Import Markets (% of total imports, 2008)	
Germany	13.5%	Italy	27.0%
Singapore	13.0%	UK	13.0%
France	12.0%	France	8.0%
US	9.5%	Germany	7.5%

Basic indicators

Selected economic indicators	2006	2007	2008	2009f	2010f
Nominal GDP (USD mn)	6,434	7,499	8,331	7,933	7,305
Population (mn)	0.41	0.41	0.41	0.42	0.42
GDP per capita (USD)	15,846	18,335	20,172	19,069	17,392
Real GDP growth (% yr/yr)	3.6	3.8	2.1	-1.9	0.8
Inflation (HICP%, eop)	0.8	3.1	5.0	-0.4	2.0
Fiscal balance (ESA 95, % of GDP)	-2.6	-2.2	-4.5	-3.8	-4.3
Public debt / GDP (%)	63.6	62.0	63.8	69.1	71.5
Current account balance (% of GDP)	-9.1	-7.1	-5.3	-3.9	-4.9
Gross external debt / GDP (%)	412.7	503.3	556.6	660.0	740.0
Net external debt / GDP (%)	-89.7	-89.2	-76.4	-77.0	-75.0
Foreign exchange reserves (EUR mn)	2,241	2,561	*	*	*
Import cover (months)	5.7	6.1	*	*	*
Exchange rate assumption, EUR:USD (av)	0.80	0.73	0.68	0.72	0.80
f: CRU central forecast					
* Malta adopted the EUR in 2008 and has since access to pooled foreign exchange reserves of the ECB.					

Sources: National sources, IMF, European Commission, ECB, Eurostat, Euler Hermes Economic Studies

Political Stability

Malta is a parliamentary republic that has preserved military neutrality in its constitution. On the domestic front, politics as well as the Maltese people have traditionally been polarised between the two main parties—the Nationalist Party (PN) and the Malta Labour Party (MLP)—which continue to enjoy roughly equal levels of support. This was confirmed once more during the general election in March 2008, which the PN won narrowly with just 0.5 percentage points of the votes ahead of the MLP, resulting in 35 over 34 parliamentary seats. Nonetheless the PN has been in power uninterruptedly since 1998, which has provided for policy continuity, particularly with regard to EU-required reforms.

Malta's international relations are very good. The country has been a member of the EU since May 2004 and joined the euro zone at the start of 2008. The latter was achieved thanks to considerable fiscal austerity measures by the government—a marked reduction in expenditures and some one-off measures—which enabled it to meet the Maastricht fiscal criteria for euro adoption.

Overall, the political system continues to be risk-free for business activities. Malta's accession to the EU and to the euro zone also opens new opportunities for social and economic development and constitutes an important guarantee of political stability.

Economic Stability

Malta is a high income country with estimated GDP per capita of about USD19,000 in 2009. Services account for about 80% of GDP, industry 18% and agriculture 2%. Since the mid-1980s, the island state has become a freight transshipment point, financial centre, and tourist destination. The economy is highly export-intensive, with an export ratio of about 82% in 2008. Manufactured exports, although diversified in terms of market destinations, are mainly produced by one single, large foreign electronics company and exports of services, which account for roughly half of total exports, are highly dependent on tourism. The export structure makes the economy vulnerable to external shocks.

After annual average growth of 3.4% in 2005-2008, real GDP contracted by 1.9% in 2009 owing to the impact of the global economic crisis. But a modest recovery began in H2 2009 and we currently forecast about 0.8% growth in 2010 and 1.5% in 2011. However, potential weaknesses in major euro zone economies pose considerable downside risks to this outlook.

Since Malta's accession to the euro zone in 2008, monetary policy has been conducted by the European Central Bank (ECB). Inflation (EU harmonised measure) peaked at 5.7% yr/yr in October 2008 owing to rises in food and energy prices but eased sharply during 2009 on account of base effects and shrinking domestic demand. The headline rate shifted into negative territory in Q4 2009 but returned into positive in Q1 2010. We expect average inflation of about 1.5% in 2010. The real effective exchange rate is not significantly overvalued. Membership of the euro zone provides for low transfer and convertibility risk (as long as the euro zone remains intact) and has substantially decreased external vulnerabilities related to exchange rate volatility.

Substantial fiscal consolidation in 2004-2007 resulted in sharply reduced ratios of the fiscal deficit (2.2%; ESA 95 standard) and public debt (62%) to GDP in 2007, which enabled euro adoption in the first place. In the wake of the global and domestic economic downturn in 2008-2009, the fiscal deficit increased again to an average 4.2% of GDP in these years and is forecast to reach a similar level in 2010. Public debt rose to 69% of GDP in 2009 which, however, was still below the euro zone average of 79%.

The current account deficit has narrowed from 9.1% of GDP in 2006 to an estimated 3.9% in 2009 but is forecast to widen again to 4-5% in 2010-2011. Positively, net foreign direct investment (FDI) inflows have covered the annual external deficits more than full for many years. The continued strong net FDI inflows have also underpinned Malta's net external creditor position. Nonetheless, gross external debt stood at around 660% of GDP at end-2009, due to rapid expansion of non-resident deposits held by internationally oriented banks. According to the IMF, the external liabilities are backed by matching assets, but still they are a source of external vulnerability such that fiscal and financial buffers are needed.

Structural Business Environment

The Structural Business Environment is very strong. Malta belongs to the highest category in our assessment overall, ranked 23rd out of the 210 economies. The regulatory framework is transparent, largely free of unnecessary bureaucratic procedures, making all aspects of business formation relatively efficient and providing for a flexible commercial environment. The straightforward and business-friendly legal framework is protecting investors well. Further strengths include the high level

of trade freedom, sound infrastructure, the reduced level of transactions costs thanks to euro adoption and the solid banking sector. Remaining weaknesses include government size, burdensome taxes and labour market restrictions. Moreover, even though Malta welcomes foreign investment as witnessed by large scale FDI inflows, all investments are carefully screened for interference with local businesses by the government and restrictions remain in the real estate, wholesale retail trade, public utilities and information technology sectors. Overall, however, these inconveniences do not seem to be serious obstacles for foreign investors.

Malta's banking sector is assessed as sound, well-supervised and increasingly competitive, though quite small. The foreign-controlled HSBC (Malta) Ltd. and the Bank of Valletta, which was floated on the Malta Stock Exchange in 2003 (though the government still holds a 25% stake), dominate the sector, but foreign banks have a significant presence in the market. The banking sector has withstood the global financial crisis relatively well so far because of its limited exposure to structured financial products and generally reasonable lending practices. Nonetheless, profitability has come under pressure, especially at domestically oriented banks.

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Charts

