

1. State of the Economy

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The unfavourable global economic environment prevailing since 2001 has impinged significantly on domestic economic conditions, particularly in view of the high degree of openness of the Maltese economy. However, during 2004, some positive developments were recorded in the domestic sphere, even if, by historical growth rates, local economic activity remained relatively subdued.

Although the negative real growth registered in Gross Domestic Product (GDP) during 2003 was reversed, the increase in real GDP during the first nine months of 2004 remained low at 0.6 per cent. Domestic demand was relatively weak, with a marginal advance in gross fixed capital formation and relatively subdued growth in private final consumption expenditure, whilst general Government final consumption expenditure rose by 2.1 per cent. On the other hand, exports of goods and services increased in real terms, even if international pressures on prices pushed down the absolute nominal value of exports during the Survey period.

In the labour market, the drops registered in the labour supply and the gainfully occupied population in January-September 2003 were halted. However, it is notable that a sustained increase in part-time activity is also being registered. It is not surprising that, against the backdrop of a weak economic environment, the increase in labour supply was accompanied by an increase in the number of unemployed persons. The number of unemployed persons under Part I of the Register rose by 149 between September 2003 and the corresponding month in 2004, whilst the unemployment rate rose marginally to 5.1 per cent.

Despite the prevailing economic conditions, the Survey period was characterised by a gradual rise in the inflation rate, which stood at 2.57 per cent in September 2004, from 1.10 per cent a year earlier. This increase was primarily due to domestic factors, as the inflation rate in Malta exceeded that in the main trading partners during the period under review. Meanwhile, a review of collective agreements currently in force shows a relatively modest increase in average weekly wages between September 2003 and September 2004.

Exports by the manufacturing industry advanced by 1.2 per cent during the January-September 2004 period, being underpinned by the gradual recovery in the global market for electronic components as well as successful efforts by domestic based manufacturing concerns to exploit business opportunities abroad. On the other hand, local sales by the domestic manufacturing industry dropped

by 4.9 per cent, being affected by the dismantling of the remaining levies on imports and the prevailing general domestic economic conditions. As a result of these developments, total turnover by the manufacturing industry declined marginally by 0.2 per cent. Investment rose by 10.3 per cent, as a number of sectors increased their capital outlays. In contrast, employment income declined by 2.4 per cent, reflecting the job shedding being undertaken by specific sectors in the domestic manufacturing industry.

In the tourism industry, the declines registered since 2001 were reversed during the first nine months of 2004, when tourist departures advanced by 2.3 per cent. Nevertheless, the level of tourist departures remained below the 2001 level. Whilst gross earnings from tourism also improved, employment in hotels and catering establishments was stable, while the number of nights spent declined. As business operators re-assessed their operations in the Mediterranean region, a drop in cruise passenger arrivals was recorded.

Despite the improvement in merchandise exports as well as in gross foreign exchange earnings from tourism, the current account deficit deteriorated to 10.3 per cent of GDP during the first nine months of 2004, from 4.4 per cent in the corresponding 2003 period. This mainly reflected a deterioration in net re-invested earnings and an increase in merchandise imports. Lower net interest receipts from abroad and higher net outflows of current transfers also affected the current account deficit.

On the fiscal front, the Survey period was characterised by consolidation efforts with the Government's structural deficit amounting to Lm109.9 million during the Survey period, which is Lm25.9 million lower than that registered during the corresponding 2003 period. This outcome was underpinned by higher recurrent revenue, as well as by a contraction in capital expenditure and a slowdown in the rate of growth of recurrent expenditure. Nevertheless, further efforts need to be undertaken to meet Government's medium-term fiscal targets and to ensure a stable macroeconomic framework.

The developments in the domestic economy during the first nine months of 2004 continue to highlight the structural challenges which the Maltese economy is currently facing. In particular, the increasingly competitive global environment in which the economy is operating calls for increased efforts to improve competitiveness. This applies to all sectors of the economy. Domestic-oriented enterprises are now also operating within a liberalised and hence more competitive environment. The improvement in the competitiveness edge of domestic-based enterprises, together with the attainment of a stable

macroeconomic framework, particularly the adoption of the necessary structural reforms to Government's fiscal position, are crucial for the creation of more job opportunities and for the further improvement to the standard of living of the domestic population.

Local Scene

Economic Growth

Real Gross Domestic Product (GDP) increased marginally by 0.6 per cent during the Survey period. In nominal terms, GDP advanced by 2.1 per cent to reach Lm1,404.0 million. In real terms, improvements were recorded within private and general Government final consumption expenditure, whilst marginal increases were also recorded in gross fixed capital formation. Improvements were also registered in exports of goods and services, but the significant increase in imports of goods and services served to dampen the positive impact of the increase in exports on GDP growth. Consumers' expenditure advanced by Lm36.0 million or 4.3 per cent in nominal terms. In real terms, this component grew by 1.2 per cent. Household disposable income increased by Lm7.2 million, or 0.8 per cent. The growth registered in household disposable income was lower than that registered for private final consumption expenditure. As a result, during the Survey period the savings ratio stood at 2.4 per cent.

General Government final consumption expenditure advanced by Lm15.3 million, or 5.2 per cent during the Survey period to Lm309.0 million. In real terms, this category of expenditure increased by 2.1 per cent. Gross fixed capital formation, recorded an increase of 1.6 per cent in nominal terms and stood at Lm287.7 million. In real terms a marginal increase of 0.6 per cent in this category of expenditure was registered.

Exports of goods and services in nominal terms stood at Lm1,055.6 million, representing a marginal drop of 0.3 per cent over the comparable January-September 2003 period. In real terms, exports of goods and services increased by 3.6 per cent. However, it is pertinent to note that the recovery recorded in real exports of goods and services was underpinned by a drop in average export prices. Imports of goods and services in nominal terms registered an increase of 1.2 per cent, to reach Lm1,152.7 million. This increase was underpinned by an increase in imports of goods which more than offset the fall in imports of services. In real terms, imports of goods and services advanced by 3.2 per cent.

Sectoral Contribution to Gross Value Added

Gross Value Added (GVA) at basic prices rose by 1.8 per cent in nominal terms during the first nine months of 2004. The main contributors to economic growth as measured by GVA were the financial intermediation, wholesale and retail trade (including repair of motor vehicles, motorcycles and personal and household goods), real estate, renting and business activities, public administration and defence (including compulsory social security), health and social work and education. The growth rates registered in these sectors, together with other minor increases in other sectors, served to counteract the declines registered in manufacturing and electricity, gas and water supply sectors.

Gross national income (GNI) is the aggregate of the Gross Domestic Product at market prices, net compensation received from the rest of the world, subsidies less taxes from/to the rest of the institutions of the European Union and net property income from the rest of the world. During the nine months to September 2004, GNI at market prices declined by Lm31.6 million or 2.2 per cent to Lm1,374.7 million. This decline was mainly due to lower net property income received from the rest of the world since GDP at market prices increased by 2.1 per cent during the same period.

Furthermore, during the Survey period decreases were recorded in net property income from the rest of the world, in net compensation of employees from the rest of the world and also in subsidies less taxes to the rest of the EU.

Compensation of employees rose by 1.1 per cent to Lm647.4 million, when compared to the same period of 2003. Average weekly compensation per employee in nominal terms stood at Lm123.51, an increase of 2.0 per cent or Lm2.43 over January-September 2003. In real terms average weekly compensation per employee declined by 0.8 per cent. Gross operating surplus and mixed income registered a marginal decline of Lm0.3 million during the Survey period to reach Lm584.6 million. Taxes on products and imports increased by Lm16.1 million, whilst subsidies registered a decrease of Lm5.6 million. The developments in these components during the January-September 2004 period contributed to an increase in nominal GDP at market prices of 2.1 per cent.

Labour Market

The contraction in the labour supply and the gainfully occupied population registered in January-September 2003 were reversed during the Survey period, but unemployment continued to rise though at a slower rate than that recorded

last year. At the end of September 2004 the labour supply stood at 145,414, representing an increase of 492 persons over the same period last year, whilst the gainfully occupied population increased by 294 to 137,274. The number of unemployed persons registering under Part I of the Register increased by 149 to 7,382 at the end of September 2004. As a consequence, the unemployment rate stood at 5.1 per cent, a marginal increase of 0.1 percentage points over the same period of 2003.

In line with the trends noted over the recent years, the private sector, especially the private market services was the main source of employment creation in Malta during the Survey period. On the other hand, employment in manufacturing registered a further decrease during the period under review, albeit the decrease was significantly below that registered in the twelve months to September 2003. Additionally, employment in the public sector continued to decline and at the end of September 2004, the share of employment in the public sector in total employment stood at 34.0 per cent, 0.5 percentage points less than the level recorded during the same period last year. This development is attributed to the implementation of restructuring exercises and in particular, voluntary early retirement schemes in a number of public enterprises.

Productive Activities

During the Survey period, the performance of the local manufacturing industry was affected on the one hand, by the trade liberalisation process as well as the increasingly competitive international environment, and on the other hand, by an improved global economic scenario, and in particular the continued recovery of the electronic components market. Within this context, exports increased by 1.2 per cent, reflecting an improved performance by the radio, TV and communication equipment sector, medical, precision and optical instruments sector and textiles and textile products sector. On the other hand, local sales declined by 4.9 per cent. As a result, the local manufacturing industry registered a 0.2 per cent decline in total turnover in the Survey period. Capital outlays continued to follow the upward trend registered in recent years, reaching Lm40.0 million in the nine months to September 2004. On the other hand, employment income dropped by 2.4 per cent, reflecting the job-shedding in a number of manufacturing sectors.

Average weekly sales per capita registered an increase of 4.9 per cent and stood at Lm982.06 in the period under review. Average weekly exports per capita rose by 6.4 per cent and reached Lm771.75. Per capita weekly

compensation levels advanced by 2.6 per cent to Lm116.63. These developments reflect the lower level of employment within the manufacturing industry.

The agriculture and fisheries sector is undergoing a reform programme aimed at enabling the sector to maintain a sustainable rate of economic activity. As from 1st May 2004, the remaining import levies on agricultural and agro-industrial products were dismantled. During the Survey period, a decline was registered in the volume of slaughtered livestock. Whilst the volume of fruit and vegetables sold through official markets rose by 8.5 per cent, the wholesale value of fruit and vegetables declined by 5.0 per cent. Fish landings increased by 1.8 per cent over the January-September 2003 period, whilst the wholesale value of fish remained at the same level registered a year earlier. Furthermore, the volume of exported fish rose by 3.2 per cent during the period under review, while the value of fish exports increased by 26.6 per cent to reach Lm3.3 million.

The ship repair and shipbuilding industry has undergone major changes since the unfolding of the restructuring plan which commenced in 2002. In November 2003 Malta Shipyards Ltd was set up and employed around 1,700 workers. The remaining shipyards employees either took up the voluntary early retirement or resignation schemes or were absorbed by Industrial Projects and Services Ltd and offered placements within the public sector. Malta Shipyards Ltd aims at strengthening the industry's competitiveness in order to change the industry from a net beneficiary of state aid into a commercially viable enterprise.

Services Activities

The services category is a major pillar in the Maltese economy. While the largest contributor is the tourism industry, financial service activities and transshipment related activities are growing in importance. Following the declines in tourist departures registered during 2002 and much smaller fall in 2003, an improvement of 2.3 per cent was registered in the first nine months of 2004. Nonetheless, at 919,728, tourist departures remain below the level recorded in 2001. On the other hand, total nights spent dropped by 3.9 per cent. Gross earnings from tourism increased by 3.5 per cent over the corresponding period of 2003, to Lm203.5 million. Per capita earnings increased to Lm221.3 during the first nine months of 2004, from Lm218.8 in the same period of 2003, whilst earnings per night spent increased from Lm20.9 to Lm22.5 during the same period. Employment in tourism related activities remained practically unchanged and amounted to 9,590 employees as at September 2004. Meanwhile, the number of cruise liner tourists declined by 31.7 per cent during the Survey period, to 196,358.

Throughout the Survey period, the Malta Financial Services Authority (MFSA) continued to promote Malta as a destination for financial services. A positive performance was registered with respect to Malta Freeport, as transhipment throughput increased by 10.7 per cent to 995,778 Twenty Equivalent Units (TEUs). Meanwhile, as from January 2004, Malta Enterprise Corporation assumed the responsibility previously carried out by Malta Development Corporation, Malta Export Trade Corporation and the Institute for the Promotion of Small Enterprises.

Prices and Incomes

Percentage changes in the 12-month moving average for the Retail Price Index (RPI) provide the official measure of inflation in Malta. During the period under review, the inflation rate increased gradually to reach 2.57 per cent in September 2004, from 1.10 per cent in September 2003. The upward trend followed by the 12-month moving average inflation rate was mainly due to higher prices registered within the Beverages and Tobacco sub-index and the Other Goods and Services sub-index. All the sub-indices that compose the RPI recorded percentage increases, with the exception of the Clothing and Footwear sub-index which declined during the twelve months to September 2004.

A study concerning average wage levels in 204 enterprises shows that the average weekly wage rate increased by Lm1.46 or by 1.6 per cent during the twelve months to September 2004. It is pertinent to note that the mandatory cost-of-living compensation stood at Lm0.75 for 2004. The analysis also shows that the highest wage rises in percentage terms were recorded in the Transport Equipment sub-sector, followed by the Machinery sub-sector. The largest share of employees for all firms (51.0 per cent) earned on average a weekly wage that fell within the over Lm92.25 wage bracket. Furthermore, 64.1 per cent of employees in market services earned an average weekly wage that exceeded Lm92.25, compared to 37.8 per cent of employees engaged in direct production.

Foreign Trade and Payments

During the first nine months of 2004, the current account deficit increased by Lm83.4 million to Lm144.4 million. A variety of factors underpinned this deterioration in the current account balance. In particular, a substantial increase in profits by foreign owned companies, particularly in the banking sector, led to a significant outflow of Lm37.2 million in the investment income account. Most of these earnings were however re-invested in the Maltese economy and will feature as an inflow of foreign direct investment in the capital and financial

account of the balance of payments. In addition, a decline of Lm24.2 million was recorded in net interest receipts from abroad during the Survey period. Net outflows of current transfers also increased by Lm10.2 million.

Furthermore, developments in the merchandise account have also contributed towards a higher current account imbalance. Imports of goods, as recorded in the balance of payments, registered a substantial increase of Lm18.1 million. In fact, higher imports of consumer and capital goods were recorded. This increase partly reflects the removal of the remaining levies on imports as well as higher capital outlays. Imports of fuel also increased as a result of the significant increase in international oil prices registered during the Survey period. The effect of higher oil prices was however partly mitigated by lower volumes of oil imports as a major company in the oil-bunkering services ceased operations. Meanwhile, a decline in imports of industrial supplies was registered during the Survey period. The sources of higher imports during the Survey period were the EU and the Asian continent whilst imports from America declined.

Export performance remained modest, registering an increase of Lm1.9 million. Higher exports to the EU and the American continent were recorded whilst exports to the Asian continent declined. The breakdown of exports by economic category indicates that the manufacturing base is still undergoing a period of structural change. Sectors that typically generate high value added per capita recorded an increase in exports. Such sectors included the machinery and transport equipment sector and the chemical and pharmaceutical sector. This positive development made up for the fall in exports by the clothing sector and the food, beverages and tobacco sector.

Moreover, tourist earnings increased by Lm6.8 million over the Survey period. This was partly offset by a Lm3.6 million increase in payments on transportation, partly reflecting the increase in imports and possibly higher transport costs due to the increase in international oil prices. Meanwhile net flows from other services improved by Lm1.3 million.

Financial Developments

The first nine months of 2004 were characterised by budgetary consolidation whereby the structural deficit declined from Lm135.8 million to Lm109.9 million. The decline in the fiscal imbalance was underpinned by an expansion of Lm41.6 million in recurrent revenue to reach Lm538.2 million. This was attributable to an increase in both tax and non-tax revenue. The implementation of various measures as announced in the Budget Speech for 2004 contributed to this result.

Meanwhile, total expenditure increased by Lm15.7 million to Lm648.1 million. Higher recurrent expenditure and interest on public debt more than offset the decline in capital outlays. However, the expansion in total expenditure, and in particular in recurrent expenditure, was significantly lower than that registered in previous years. Recurrent expenditure increased from Lm499.4 million to Lm518.2 million during the period first nine months of 2004. Meanwhile, capital outlays, which constitute around 12 per cent of total expenditure, declined from Lm84.2 million to Lm75.6 million. Interest on public debt accounted for around 8 per cent of total expenditure, rising by Lm5.5 million to Lm54.3 million. The decline in the structural deficit coupled with higher extraordinary receipts lowered the public sector borrowing requirement to Lm107.3 million as compared to Lm139.9 million during the corresponding 2003 period.

During the Survey period, broad money, (M3), continued to expand, mainly attributable to more rapid growth in domestic credit which is the main counterpart of broad money. A slower growth in net foreign assets of the banking system was partly offset by a similar slowdown in the growth of the other counterparts of broad money.

Following an easing of the Central Bank's monetary policy stance during 2003, the central intervention rate was left unchanged at 3.0 per cent during the first nine months of 2004. During the first nine months of 2004, the value of the Maltese lira vis-à-vis the Euro as well as against the US dollar remained practically unchanged from the level recorded at the end of 2003. Meanwhile, the Maltese lira weakened against the Sterling but appreciated against the Japanese yen.

International Scene

The pace of global economic growth in 2004 is anticipated to be brisker than that registered in the past two years. This is mainly driven by a stronger recovery in the United States (US), continued growth in China and acceleration in Japan.

Nevertheless, indicators are pointing towards moderating world trade growth and a slowdown in global growth in the near-term due to the negative supply shock caused by rising oil prices as costs of production increase. Furthermore, if oil price increases are fed into price inflation and eventually wages, monetary policy may have to be tightened. Thus, it remains uncertain to what extent a persistence of rising oil prices will further dent current projections of world GDP.

World GDP growth in real terms reached 3.5 per cent in 2003 surpassing growth in 2001 and 2002. This increased growth was reflected in the growth rates of the industrialised countries namely the US and Japan as well as other economies namely Russia and China as shown in Table 1.1. The table also shows that despite these positive results, growth in 2003 within the Euro Area and the European Union (EU) remained weak, even slowing down further from the growth rates attained during 2002 and 2001 especially for countries as Germany, France and Italy. Relevant macroeconomic indicators are displayed in Tables 1.1 to 1.6 and Charts 1.1 and 1.2.

Growth in the first quarter of 2004 was much stronger than earlier expected. Thereafter, growth fell below expectations in several major economies, notably the US, Japan and China, mainly in the wake of a sharp rise in oil prices.

Outlook for Industrialised Economies

Growth in industrialised countries should reach 3.5 per cent in 2004 representing the fastest growth since 2001. The low level of interest rates has helped in sustaining growth. Average valuations in the equity markets are close to historical averages, though there is a downside risk of growth vacillating. Following the record peaks of the Euro against the dollar in February and monetary policy tightening in the US, major currencies have been relatively stable and currency volatility has diminished. Charts 1.1 and 1.2 indicate stable or falling unemployment rates for the EU 25, US and Japan between 2003 and 2004 and higher inflation rates in 2004 than 2003 for the US but lower inflation in the EU.

The European Commission anticipates growth in the EU 25 to increase from 1.0 per cent in 2003 to 2.5 per cent in 2004. A stronger growth rate in 2004 as compared to 2003 is also foreseen for the Euro Area. This growth will be mainly driven by increased exports.

Inflation is expected to increase above 2.0 per cent in 2004 in the EU 25 and Euro Area mainly due to the developments in the oil and energy prices.

The increased exports for the EU 25 will not have a significant impact on the unemployment rate, as this is projected to remain stable at the 2003 level of 9.1 per cent also in 2004. A similar development is expected in the Euro Area.

The increased world imports of 7.4 per cent in 2003 and a projected 9.9 per cent increase in 2004, have had a positive impact on EU exports being projected

World GDP, Volume
annual percentage change

Table 1.1

	2001	2002	2003	2004*
World	2.4	2.7	3.5	5.0
Industrialised Countries	1.2	1.4	2.1	3.5
EU 25	1.8	1.1	1.0	2.5
Euro Area	1.6	0.9	0.6	2.1
Germany	0.8	0.1	-0.1	1.9
France	2.1	1.2	0.5	2.4
Italy	1.8	0.4	0.3	1.3
United Kingdom	2.3	1.8	2.2	3.3
United States	0.8	1.9	3.1	4.4
Japan	0.4	-0.3	2.4	4.2
Canada	1.9	3.3	2.0	3.0
Others	3.9	4.2	5.2	6.8
Russia	5.1	4.7	7.3	7.4
China	7.5	8.3	9.1	9.2

*Projections

Source: European Commission

Inflation: Harmonised Index of Consumer Prices*
percentage change on preceeding year

Table 1.2

	2001	2002	2003	2004**
EU 25	2.5	2.1	1.9	2.2
Euro Area	2.4	2.3	2.1	2.1
Germany	1.9	1.3	1.0	1.7
France	1.8	1.9	2.2	2.3
Italy	2.3	2.6	2.8	2.3
United Kingdom	1.2	1.3	1.4	1.4
United States	2.8	1.6	2.3	2.6
Japan	-0.6	-0.9	-0.3	-0.2

*National index if not available

**Projections

Source: European Commission

Unemployment Rate*
percent of labour force

Table 1.3

	2001	2002	2003	2004**
EU 25	8.5	8.9	9.1	9.1
Euro Area	8.0	8.4	8.9	8.9
Germany	7.8	8.7	9.6	9.7
France	8.4	8.9	9.4	9.6
Italy	9.4	9.0	8.6	8.3
United Kingdom	5.0	5.1	5.0	4.9
USA	4.8	5.8	6.0	5.5
Japan	5.0	5.4	5.3	4.8

*Series following Eurostat definition, based on the labour force survey

**Projections

Source: European Commission

Current Account Balance
percent of GDP

Table 1.4

	2001	2002	2003	2004*
EU 25	0.6	1.1	0.9	0.8
Euro Area	1.8	2.5	2.0	2.2
Germany	4.9	6.5	6.3	7.9
France	0.2	0.5	0.2	-0.6
Italy	1.8	1.6	1.1	0.8
United Kingdom	-4.1	-4.5	-4.3	-4.8
USA	-4.3	-4.7	-5.1	-5.7
Japan	1.7	2.4	2.7	2.8

*Projections

Source: European Commission

to increase by a record 7.4 per cent in 2004. Notwithstanding the increased exports for 2004, the EU 25 current account balance as a percentage of GDP is projected to remain at similar levels as at 2003.

Germany's growth is expected to reach 1.9 per cent in 2004 following anemic growth since 2001 and negative growth in 2003. As in the EU 25 and Euro Area growth will be mainly driven by increased exports. Inflation is expected to increase in Germany mirroring development in the EU 25 and Euro Area during 2004 due to higher oil prices. Unemployment figures for Germany indicate a projected marginally increased unemployment rate in 2004 though this increase is attributable to the tightening of social benefit eligibility criteria which will force persons to register as unemployed in order to continue receiving social benefits. The main contributor towards the EU 25 and Euro Area increased exports are Germany's exports which are projected to increase by a notable 11.9 per cent in 2004. This led to projecting even higher surplus on current account for Germany in 2004 than 2003.

Growth in France during 2004 should also be the best growth rate recorded since 2001 reaching 2.4 per cent. Contrary to what was observed in the Euro Area as a whole, the French recovery was supported by domestic demand, especially by private consumption. The improvement in equity markets and the increase in housing prices may have encouraged households to free up some savings. Inflation in France should increase marginally over 2003 again due to higher energy prices. The latest surveys in the manufacturing and service sectors reveal that hiring intentions remain at a relatively low level thus a higher unemployment rate is expected in France in 2004 than 2003. A worsening of the current account balance as a percentage of GDP is expected in France during 2004.

Growth in Italy should be faster than that recorded since 2002 reaching 1.3 per cent. Gross fixed capital formation seems to have been the main motor for increased growth. Despite weak economic performance inflation remained over 2 per cent in Italy. As a reaction the Government decided to freeze a series of controlled prices in 2004 and reached agreement with large retailers to keep prices of certain products unchanged until the end of the year. The labour market improved, with a decrease in the unemployment rate to reach 8.3 per cent in 2004. Though Italy's exports is expected to increase after decreases in 2002 and 2003, the growth in imports in 2004 should outpace the growth in exports during the year leading to a decline in the current account surplus as a percentage of GDP.

Exports of Goods, Volume
percentage change on preceeding year

Table 1.5

	2001	2002	2003	2004*
EU 25	3.3	2.0	1.5	7.4
Euro Area	3.1	1.9	0.6	7.6
Germany	5.4	3.2	2.6	11.9
France	2.1	2.3	-1.5	4.5
Italy	1.5	-2.9	-4.3	4.5
United Kingdom	2.7	-1.7	-0.5	1.0
USA	-6.1	-4.1	2.2	8.8
Japan	-6.2	8.1	10.1	15.7

*Projections

Source: European Commission

Imports of Goods, Volume
percentage change on preceeding year

Table 1.6

	2001	2002	2003	2004*
EU 25	1.6	1.4	3.0	7.4
Euro Area	0.8	0.6	2.6	7.1
Germany	-0.2	-1.5	5.8	8.1
France	1.0	3.2	-0.1	8.2
Italy	0.0	-1.1	-1.3	6.3
United Kingdom	5.4	4.1	1.5	5.5
USA	-3.2	3.7	4.7	10.5
Japan	0.1	1.1	5.0	8.9

*Projections

Source: European Commission

Chart 1.1

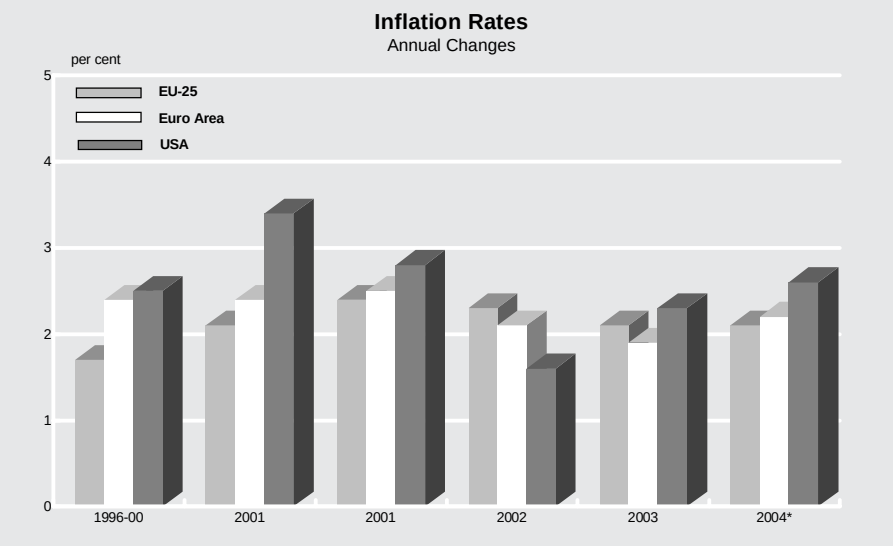
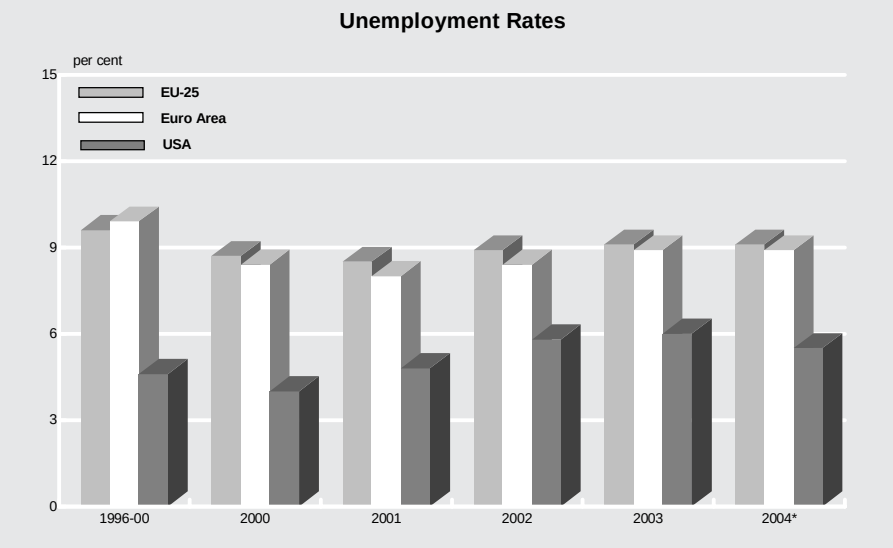


Chart 1.2



Growth in the United Kingdom (UK) should reach 3.3 per cent in 2004 representing the highest growth rate since 2001. Domestic demand is the main driver of this performance. Inflation in the UK should remain at 1.4 per cent during 2004, the same level as 2003. The effect of improved average earnings is expected to be offset by the tightening of monetary policy. Unemployment in 2004 should remain at relatively low levels of 4.9 per cent. A sustained appreciation of the Sterling dented the export growth leading to lower growth rates than most other European counterparts. The continued increase in imports led to a worsening of the current account balance as a percentage of GDP.

Growth in the US is expected to reach 4.4 per cent in 2004 from 3.1 per cent in 2003. Notwithstanding the current expansion in investment, consumption growth is expected to slowdown, as fiscal policy may not accommodate any further stimulus to growth while monetary policy becomes more neutral. Inflation is expected to increase to 2.6 per cent in 2004 due to higher energy prices. The unemployment rate should fall to 5.5 per cent in 2004, from 6.0 per cent in 2003. The current account deficit is expected to continue worsening in 2004 as the growth in exports is outpaced by the growth in imports.

The Japanese economy is projected to grow by a significant 4.2 per cent in 2004. This growth is underpinned not only by external demand but also by structural improvements in the corporate and financial sectors. It seems very likely however, that the growth will slow down as the peak of the upturn seems to be over. Deflation in Japan is expected to continue also in 2004, but to diminish marginally due to increased energy prices. The unemployment rate in Japan is expected to fall to 4.8 per cent in 2004. The current account balance as a per cent of GDP should remain very close to the level registered in 2003 in 2004 as export increases continue to outpace import increases.

Growth figures in Russia and China are expected to remain high in 2004, the latter driven by strong fixed investment and exports. Meanwhile, the Russian economy is expected to gain from sustained high prices for hydrocarbons while consumption and investment are also expected to underpin growth in 2004.

Commodity Markets

Oil prices have risen by more than 50 per cent both in US dollar and Euro terms since the beginning of the year. This was due to surging demand and concerns over political developments in major oil exporting countries that have adversely affected supply conditions. Stronger than expected demand for oil, mainly in the United States and China, has eliminated most of the excess oil production

capacity. Moreover, oil producing countries, including OPEC, are unable to increase capacity in the short-term, whilst stock levels in industrial countries remain low by historical standards.

The situation in Iraq, terrorist attacks in Saudi Arabia, political tensions and instability in Russia, Nigeria and Venezuela have contributed to the risks of a possible further shortage in oil supply further increasing the risk premium in oil prices.

As a result of the above developments, oil prices are expected to remain high over the medium term. The European Commission is expecting oil prices to be 38 per cent higher in 2004 than 2003.

Following the substantial increases in non-energy commodity prices during the second half of 2003, further but more modest gains were experienced in the first eight months of 2004. The slower increases coincided with China's move to cool down the pace of its economic expansion and the tightening of US monetary policy. Non-energy prices are expected to remain flat or decline marginally in the coming months as world growth is expected to slow down.

Sales in the semiconductor markets strengthened further during the first half of 2004, following the recovery in 2003. Experts expect 2004 to be a very strong year for semiconductor sales in terms of higher sales volumes rather than increased prices as demand for wireless goods continues to increase. Some analysts are expressing reservations about the market's prospects after 2004 as extra investment and higher production, that is outpacing demand, will lead to increased inventories and lower prices.

Future Economic Prospects

World economic activity is expected to remain strong as despite the tightening of highly expansionary monetary policies in some countries, real interest rates remain very low. The main downside risks to the robust growth are uncertainties about the impact of the higher oil prices on the world economy, worsening of external and internal imbalances in the United States, as well as the risk of a slowdown in China. Household indebtedness in the US is still at record levels, while the current account deficit continued to widen. Correction of these imbalances may imply a slowdown of the US economy with significant negative implications for the world economy.

EU 25 Projections

Table 1.7

	2003	2004*	2005*
Real GDP (% change)	1.0	2.5	2.3
Inflation (% change)	1.9	2.2	2.1
Unemployment Rate (% of labour force)	9.1	9.1	9.1

*Projections

Source: European Commission

As shown in Table 1.7, the European Commission anticipates growth within the EU 25 to slow marginally during 2005 to reach 2.3 per cent. This is mainly due to slower world increase in imports in 2005 which is expected to be translated in more modest increased exports for the EU 25 and Euro Area in 2005. Oil prices are expected to increase again by 15 per cent in 2005 maintaining pressure on inflation. Thus, this is projected to remain above 2 per cent in the EU 25 also in 2005. The unemployment rate should remain at 9.1 per cent for the EU 25 during 2005, that is, at the same level since 2003.