

**FOR
AGENDA**

SM/07/259
Correction 1

August 23, 2007

To: Members of the Executive Board
From: The Acting Secretary
Subject: **Malta—Selected Issues**

The attached corrections to SM/07/259 (7/13/07) have been provided by the staff:

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Page 13, para. 23, first line: for “Malta is widely expected to join EMU in 2008,
highlighting”
read “The Council of the European Union (EU) decided on
July 10 to allow Malta to join EMU on January 1, 2008,
highlighting”

Questions may be referred to Mr. Chelsky (ext. 37362) and Mr. Danninger (ext. 34468) in EUR, and Mr. Perrelli, FIN (ext. 38782).

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Department Heads

good telecommunications infrastructure and the English language proficiency of its population. These activities have generated significant employment growth, which has helped offset job losses in traditional sectors. However, these activities tend to be mobile and their long-term potential remains uncertain.

IV. CONCLUSIONS

23. The Council of the European Union (EU) decided on July 10 to allow Malta to join EMU on January 1, 2008, highlighting the importance of restoring competitiveness.

After a decade of broadly balanced external accounts, the current account turned into deficit in the 1990s. Languishing growth during this decade and a sequence of adverse shocks seriously tested the economy's competitiveness. Malta's traditional export industries—semiconductors and tourism—gradually lost market share and have only recently begun to recover.

24. External weakness could trigger a period of prolonged adjustment and slow growth. A formal analysis of Malta's overall competitiveness based on estimates of equilibrium real exchange rates indicates that the REER is overvalued by between 10 and 15 percent. While assessments of equilibrium exchange rates are subject to wide margins of error, this estimate is not out of line with earlier estimates by the Central Bank of Malta showing overvaluation of no more than 6 percent in 2004, given REER appreciation since. The experience of other countries shows that regaining competitiveness within monetary union can trigger a prolonged period of slow growth, especially in the absence of far-reaching structural reforms.

25. Structural change in the export sector and the emergence of new activities are possible signs of a turnaround, but it is too early to judge whether they herald a permanent improvement. New activities in business services, pharmaceutical production, and remote gaming have supported growth in the last two years. In the tourism sector, a rapid increase in cruise ship traffic, consolidation of hotel capacity, and an opening of Malta's skies to low-cost airlines also offer new opportunities for growth. These are important developments, but they are at an early stage so that it is difficult to assess whether they indicate a lasting structural improvement.

References

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