**Periodical Part**

# Quarterly review / Central Bank of Malta. Vol. 56 (2023)

Quarterly review / Central Bank of Malta

*Reference:* In: Quarterly review / Central Bank of Malta Quarterly review / Central Bank of Malta. Vol. 56 (2023) (2023).
https://www.centralbankmalta.org/site/Publications/QR-2023-1.pdf?revcount=5377.
https://www.centralbankmalta.org/site/Publications/QR-2023-2/QR-2023-2.pdf?revcount=9116.

BANK ĊENTRALI TA' MALTA
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CENTRAL BANK OF MALTA

# CENTRAL BANK OF MALTA QUARTERLY REVIEW

2023 Vol. 56 No. 3

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*The cut-off date for statistical information in this Review is as follows: monetary and balance of payments – 2 July; residential property prices – 5 July; government finance – 21 July; external environment – 30 June; other data – 20 June 2023. Figures in tables may not add up due to rounding.*

ISSN 1811-1254 (online)

# CONTENTS

**FOREWORD** 6

**ECONOMIC SURVEY** 8

**1. The External Environment and the Euro Area** 8
Key advanced economies
The euro area
Commodities

**2. Output and Employment** 17
Potential output and Business Conditions Index
Gross domestic product and industrial production
Business and consumer surveys
The labour market
Box 1: Household wealth in Malta – evidence from the latest wave of the Household Finance and Consumption Survey

**3. Prices, Costs and Competitiveness** 39
Inflation
The housing market
Cost indices

**4. The Balance of Payments** 49
The current account
Tourism activity
The capital account

**5. Government Finance** 54
Quarterly developments
Headline and cyclically-adjusted developments
Box 2: Support measures and their impact on public finances

**6. Monetary and Financial Developments** 65
Monetary and financial conditions
Liquidity support measures
The money market
The capital market
Box 3: Liquidity conditions and monetary policy operations from maintenance period 1 to maintenance period 8 of 2022

## ABBREVIATIONS

| | |
|---|---|
| APP | asset purchase programme |
| BCI | Business Conditions Index |
| BLS | Bank Lending Survey |
| CCI | construction cost index |
| COICOP | Classification of Individual Consumption by Purpose |
| COLA | cost-of-living adjustment |
| COVID-19 | coronavirus disease 2019 |
| CGS | COVID-19 Guarantee Scheme |
| CPE | compensation per employee |
| CPI | Consumer Price Index |
| ECB | European Central Bank |
| EEI | Employment Expectations Indicator |
| EER | Effective Exchange Rate |
| ESA | European System of Accounts |
| ESI | Economic Sentiment Indicator |
| EU | European Union |
| EA | Euro Area |
| EU | European Union |
| EUI | Economic Uncertainty Indicator |
| EURIBOR | Euro Interbank Offered Rate |
| €STR | euro short-term rate |
| FC | financial corporation |
| FCI | Financial Conditions Index |
| FOMC | Federal Open Market Committee |
| GDP | gross domestic product |
| GFCF | gross fixed capital formation |
| GVA | gross value added |
| HFCS | Household Finance and Consumption Survey |
| HICP | Harmonised Index of Consumer Prices |
| ILO | International Labour Organization |
| IMF | International Monetary Fund |
| LFS | Labour Force Survey |
| LPG | liquid petroleum gas |
| LSGS | Liquidity Support Guarantee Scheme |
| LTRO | longer-term refinancing operation |
| MDB | Malta Development Bank |
| MFI | monetary financial institution |
| MGS | Malta Government Stocks |
| MIA | Malta International Airport |
| MP | maintenance period |
| MPC | monetary policy committee |
| MRO | main refinancing operation |
| MSE | Malta Stock Exchange |
| MT | Malta |
| NEIG | non-energy industrial goods |
| NFC | non-financial corporation |
| NPISH | non-profit institutions serving households |
| NSO | National Statistics Office |
| PELTRO | pandemic emergency longer-term refinancing operations |
| PEPP | pandemic emergency purchase programme |
| PPI | Property Price Index |

| | |
|---|---|
| PSPP | public sector purchase programme |
| RPI | Retail Price Index |
| SLS | Subsidised Loan Scheme |
| SMP | Securities Markets Programme |
| TLTRO | targeted longer-term refinancing operation |
| UCA | Urban Conservation Areas |
| ULC | unit labour cost |
| UK | United Kingdom |
| US | United States |
| VAT | value added tax |

# FOREWORD

During the first quarter of 2023, the pace of economic expansion moderated, with annual real gross domestic product (GDP) rising by 3.1%, from 5.2% in the preceding quarter. The slowdown in growth was driven by a negative contribution from domestic demand, mostly reflecting lower investment in the aviation sector, which had been exceptionally high a year earlier. On the other hand, net exports contributed positively to growth, in part reflecting the aforementioned decrease in imported aircraft. When adjusting for imports, external trade had the largest positive contribution to growth, but domestic demand also contributed positively.

Potential output growth is estimated to have stood at 6.1% in the first quarter of 2023, below the annual rate of 6.5% estimated for end-2022. On a four-quarter moving average basis, the level increase in potential output relative to the fourth quarter was somewhat stronger than that in GDP, resulting in a narrower positive output gap. This implies that the degree of over-utilisation of the economy's productive capacity has continued to ease.

Meanwhile, the Bank's Business Conditions Index (BCI) indicates that annual growth in business activity remained above but close to its historical average. The index was affected by strong annual increases in several sub-components, particularly in tourist arrivals. Strong annual growth in the index of industrial production as well as low unemployment, also contributed to the above-average BCI level.

Developments in the labour market remained positive, with employment levels and employment rates both rising in annual terms. The unemployment rate remained low from a historical perspective and stood well below that in the euro area. However, indicators for job vacancies and labour market tightness remain at elevated levels.

Consumer price pressures eased somewhat during the quarter under review, but inflation remained high from a historical perspective. Annual inflation, as measured by the Harmonised Index of Consumer Prices (HICP), stood at 7.1% in March, marginally below that of 7.3% recorded in December. The slowdown in inflation reflected a decrease in all major sub-components, except for energy, where prices remained unchanged. Meanwhile, annual inflation based on the Retail Price Index (RPI), which only considers expenditure by Maltese residents, edged down from 7.4% in December to 7.0% in March.

Cost indicators show mixed developments. Industrial producer price inflation declined to 3.9% in the first quarter, from 5.3% in the preceding quarter. The imports goods deflator also rose at a slower pace compared with the last quarter of 2022. Furthermore, Eurostat's construction cost indicator declined in year-on-year terms, while remaining at a high level. On the other hand, Malta's unit labour cost (ULC) index, measured on a four-quarter moving average basis, increased at a faster rate of 3.3% in the first quarter, from 1.8% in the previous quarter.

In the first quarter of 2023, the current account deficit decreased when compared with a year earlier. This was a result of a narrowing of the merchandise trade deficit, higher net receipts from services, and marginally lower net outflows on the secondary income account. These offset higher net outflows on the primary income account. The current account balance registered a deficit equivalent to 2.8% of GDP in the first quarter of 2023.

When measured on a four-quarter moving sum basis, the general government balance registered a deficit of 4.9% of GDP, lower than the 5.8% recorded in the fourth quarter of 2022. The general government debt-to-GDP ratio increased to 53.6% at end-March 2023, from 53.2% at end-2022.

In the period under review, the annual growth rate of Maltese residents' deposits with monetary financial institutions (MFIs) in Malta moderated compared to the previous quarter. Credit to Maltese residents also grew at a slower pace, as growth in credit to general government turned negative. This contrasts with a faster increase in credit to residents outside general government, which largely reflected faster growth in loans to the private sector.

According to the Bank's Financial Conditions Index (FCI), in the first quarter of 2023, financial conditions were tight from a historical perspective, but the degree of tightness diminished when compared to the final quarter of 2022. This improvement was largely driven by a smaller tightening impact from foreign influences, although domestic factors also became less tight than before.

In March, the weighted average interest rate offered to households and non-financial corporations (NFCs) on their outstanding deposits in Malta increased by three basis points on a year earlier, standing at 0.19%. This was largely driven by a further increase in rates paid on households' and NFCs' outstanding fixed deposits with a maturity of up to two years. Meanwhile, the weighted average lending rate paid by households and NFCs to resident MFIs increased by 22 basis points, to 3.41% over the same period. Hence, the spread between the two widened by 19 basis points.

The primary market yield on Treasury bills in March was higher than that prevailing at the end of December. After increasing considerably in previous months, secondary market yields on five-year and ten-year Malta Government Stocks (MGS) declined over this period. Domestic share prices also declined, though marginally.

The European Central Bank's (ECB) Governing Council raised its key interest rates by 50 basis points in February and again in March. Thus, by the end of the first quarter, the interest rates on the deposit facility, the main refinancing operations (MROs), and the marginal lending facility, had risen to 3.00%, 3.50% and 3.75%, respectively. The Governing Council stated that future policy rate decisions would be based on an assessment of the inflation outlook based on incoming data, the dynamics of underlying inflation, and the strength of monetary transmission.

The Governing Council also stated that the Eurosystem's holdings of securities under the asset purchase programme (APP) would decline at an average monthly pace of €15 billion between March and the end of June. In May, the Council announced that reinvestments will end as of July, with this announcement confirmed in June.

Regarding the pandemic emergency purchase programme (PEPP) portfolio, the Governing Council reiterated its intention to continue reinvesting the principal payments from maturing securities purchased under the programme until at least the end of 2024. Redemptions coming due in the PEPP portfolio are being reinvested flexibly, to counter risks to the monetary policy transmission mechanism related to the pandemic.

## ECONOMIC SURVEY

# 1. THE EXTERNAL ENVIRONMENT AND THE EURO AREA

*In the first quarter of 2023, real GDP grew at a slower pace in the United States, while in the United Kingdom it rose at the same modest rate recorded in the preceding quarter. In contrast, in the euro area, real GDP contracted by 0.1% on a quarter-on-quarter basis, as in the fourth quarter of 2022. During the quarter, the unemployment rate remained broadly unchanged in all three economies.*

*While still high from a historical perspective, consumer price inflation eased somewhat, largely reflecting lower energy inflation. In the United States, inflation fell to 5.0% in March, from 6.5% three months before, while in the United Kingdom, inflation fell to 10.1% in March, from 10.5% in December. Meanwhile, in the euro area, annual consumer price inflation declined to 6.9% in March, from 9.2% in December. To address elevated price pressures, during the quarter under review, the Federal Reserve, the Bank of England and the ECB raised their key interest rates further.*

*Brent oil prices fell in the review period, as supply increased notably whereas demand remained subdued. Also, the price of European natural gas fell markedly, mainly on account of a milder-than-normal winter, gas savings measures, and healthy gas storage levels. Non-energy commodity prices also fell, on average, as decreases in prices of fertilizers and agricultural produce outweighed a rise in the prices of metals and minerals.*

## Key advanced economies

### *US economic growth eases slightly further*

In the United States, real GDP grew at a slower pace in the first quarter of 2023, rising at a quarterly rate of 0.5%, following an increase of 0.6% in the preceding quarter (see Table 1.1). Personal consumption and government consumption expenditure grew at a faster pace than in the previous quarter. By contrast, gross private domestic investment contracted again, after having partly recovered in the previous quarter. The trade deficit narrowed as exports outpaced imports.

Meanwhile, in the labour market, employment increased by 1.0% in quarter-on-quarter terms, after having risen by 0.1% in the previous quarter. Non-farm payroll data suggest that employment grew markedly in the government sector, education and health, and leisure and hospitality. On the other hand, jobs contracted in the information sector.

**Table 1.1**
**REAL GDP GROWTH IN SELECTED ADVANCED ECONOMIES**
*Quarter-on-quarter percentage changes; seasonally and working day adjusted*

| | 2021 | | | | 2022 | | | | 2023 |
|---|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 |
| United States | 1.5 | 1.7 | 0.7 | 1.7 | -0.4 | -0.1 | 0.8 | 0.6 | 0.5 |
| Euro area | 0.0 | 1.9 | 2.2 | 0.5 | 0.7 | 0.8 | 0.4 | -0.1 | -0.1 |
| United Kingdom | -1.1 | 6.5 | 1.7 | 1.5 | 0.5 | 0.1 | -0.1 | 0.1 | 0.1 |

Sources: Bureau of Economic Analysis, US; Eurostat; Office for National Statistics, UK.

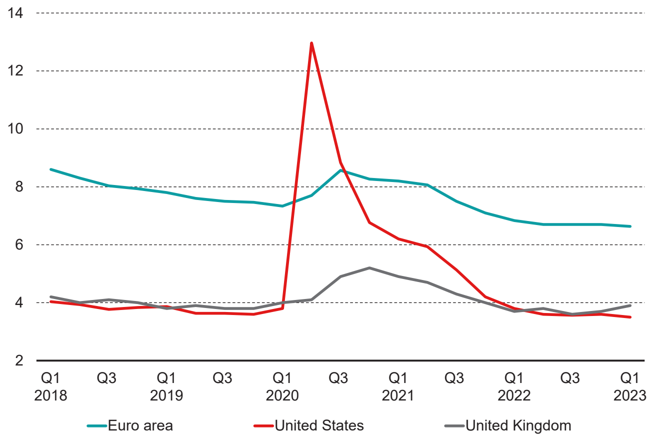
At 3.5%, the average unemployment rate was still low from a historical perspective, and was 0.1 percentage point lower when compared to the fourth quarter 2022 (see Chart 1.1).

Although inflationary pressures remained high from a historical perspective, they showed further signs of moderation in the review period. In fact, the annual inflation based on the consumer price index (CPI) stood at 5.0% in March, down from 6.5% three months earlier (see Chart 1.2). This decline was mainly driven by energy inflation, which fell to 6.4% in March as against 7.3% in December. Meanwhile, food inflation eased to 8.5% from 10.4% in December. Also, prices of commodities, excluding food and energy, rose less rapidly than in December, while services inflation eased marginally. Inflation, excluding food and energy, inched down to 5.6% in March, from 5.7% in December 2022.

During the first quarter of 2023, the Federal Open Market Committee (FOMC) increased the target range for the federal funds rate twice. On 1 February, the target range was raised by 25 basis points. A further 25 basis points increase followed on 22 March. Accordingly, by the end of March, the target range stood between 4.75% and 5.00% (see Chart 1.3).

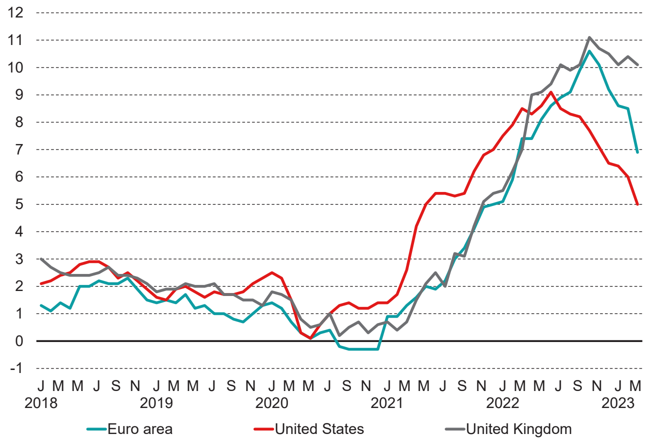
The Committee anticipated that some additional monetary policy tightening might be appropriate to attain a stance of monetary

**Chart 1.1**
**UNEMPLOYMENT RATE**
*(percentage of the labour force; quarterly average; seasonally adjusted)*



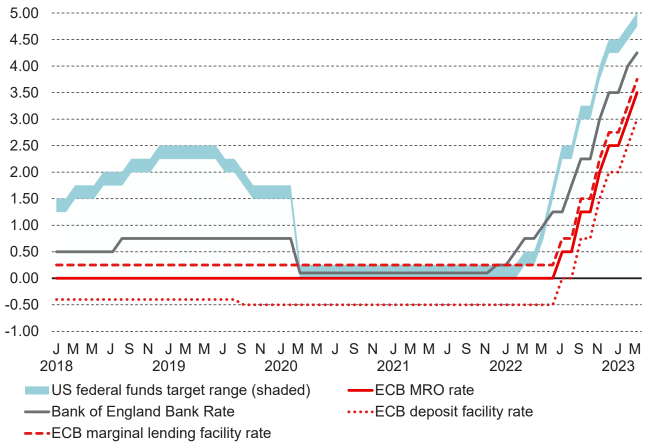

Sources: Bureau of Labor Statistics, US; Eurostat; Office for National Statistics, UK.

**Chart 1.2**
**CONSUMER PRICE INFLATION**
*(annual percentage changes)*




Sources: Bureau of Labor Statistics, US; Eurostat; Office for National Statistics, UK.

**Chart 1.3**
**OFFICIAL INTEREST RATES**
*(percentages per annum; end of month)*




Sources: ECB; Federal Reserve; Bank of England.

policy that would be sufficiently restrictive to return inflation to 2.0% over time. In determining the extent of future increases in the target range, the Committee would consider the cumulative tightening of monetary policy, its lagged transmission to activity and inflation, and economic and financial developments.

Furthermore, the Committee stated that it would continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. The Committee reaffirmed its strong committment of returning inflation to its 2.0% objective.[1]

### *UK economy continues to grow moderately*

Real GDP in the United Kingdom increased at a quarterly rate of 0.1% in the quarter under review, the same rate recorded in the previous quarter (see Table 1.1). Growth was mainly driven by increases in gross fixed capital formation (GFCF), which outweighed declines in government consumption and net exports.

Employment rose by 0.6% on a quarterly basis, following a 0.2% increase in the last quarter of 2022. Meanwhile, the unemployment rate averaged 3.8%, up slightly from 3.7% in the previous quarter (see Chart 1.1).

Consumer price inflation in the United Kingdom eased slightly further from the record high recorded in October 2022. The inflation rate decreased to 10.1% in March, compared to 10.5% in December (see Chart 1.2). Energy inflation fell markedly while services and, to a lesser extent, non-energy industrial goods (NEIG) prices eased slightly when compared to December. By contrast, food prices grew at a faster pace during the review period. The annual rate of inflation based on the CPI excluding energy, food, alcohol and tobacco decelerated to 6.2% in March, from 6.3% in December. Still, it remained high from a historical perspective.

As the labour market remained tight, amid indications of stronger-than-expected employment growth and participation, and against evidence of heightened domestic inflationary pressures, the Bank of England's Monetary Policy Committee (MPC) increased the Bank Rate by 50 basis points, to 4.00%, on 1 February, and by a further 25 basis points, to 4.25%, on 22 March (see Chart 1.3). The Committee also stated that it would adjust the Bank Rate as necessary to return inflation to the 2% target sustainably.[2]

## The euro area

### *GDP in the euro area shrinks slightly again*

Economic activity in the euro area contracted slightly in the first quarter of 2023. In real terms, GDP growth stood at -0.1% on a quarter-on-quarter basis, as in the previous quarter (see Table 1.2). Economic activity during the quarter under review was mainly characterised by a marked drop in domestic consumption, a decline in inventories, and a contraction in imports. These developments mainly reflected subdued consumer and business confidence, persistently elevated inflationary

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[1] In May 2023, the Committee decided to raise the target range for the federal funds rate to between 5.00% and 5.25%. It reiterated that in determining the extent of additional policy firming that may be appropriate to return inflation to 2%, the Committee will take into account the cumulative tightening of monetary policy, the lags with which this affects economic activity and inflation, and economic and financial developments. In June, the FOMC kept the target range unchanged.

[2] In its meetings held in May and June 2023, the MPC increased the Bank Rate to 5.00%. The MPC recognised that the second-round effects in domestic price and wage developments generated by external cost shocks were likely to take longer to unwind than they did to emerge. Indications increasingly suggested more persistence in the inflation process in light of a tight labour market and continued resilience in demand.

**Table 1.2**
**CONTRIBUTIONS TO QUARTERLY REAL GDP GROWTH IN THE EURO AREA**[1]
*Percentage points; quarter-on-quarter percentage change*

| | 2021 | | | | 2022 | | | | 2023 |
|---|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 |
| Private consumption | -1.0 | 1.7 | 2.2 | 0.1 | 0.2 | 0.5 | 0.7 | -0.5 | -0.1 |
| Government consumption | -0.1 | 0.5 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 | 0.2 | -0.3 |
| GFCF | -0.5 | 0.4 | -0.2 | 0.7 | -0.2 | 0.2 | 0.9 | -0.8 | 0.1 |
| Changes in inventories[2] | 0.7 | -0.6 | -0.2 | 0.6 | -0.1 | 0.1 | 0.2 | 0.0 | -0.4 |
| Exports | 0.5 | 1.2 | 0.8 | 1.3 | 0.9 | 0.9 | 0.6 | -0.1 | 0.0 |
| Imports | 0.3 | -1.2 | -0.6 | -2.3 | -0.1 | -0.8 | -1.9 | 1.2 | 0.7 |
| **GDP** | **0.0** | **1.9** | **2.2** | **0.5** | **0.7** | **0.8** | **0.4** | **-0.1** | **-0.1** |

Source: Eurostat.
[1] Data are seasonally and working day adjusted. Figures may not add up due to rounding.
[2] Including acquisitions less disposals of valuables.

pressures, and tighter financing conditions. Net exports contributed positively to growth. Although exports stagnated amid slowing global demand, imports fell, reflecting the drop in domestic demand.

In the first quarter of 2023, domestic demand deducted 0.7 percentage point from GDP growth. Rising inflation lowered real disposable income, leading to a fall in private consumption that lowered GDP growth by 0.1 percentage point. Government consumption decreased, cutting GDP growth by 0.3 percentage point, while changes in inventories deducted a further 0.4 percentage point. Net exports contributed 0.7 percentage point to GDP growth, which mainly reflected a decrease in imports, while exports were practically unchanged.

### *Labour market remains robust*
The labour market in the euro area continued to perform well during the first quarter despite the lacklustre economic conditions. The seasonally adjusted unemployment rate stood at 6.6% in March, slightly down when compared to December. Meanwhile, the three-month average rate in the quarter under review went up marginally to 6.8% from 6.7% in the final quarter, 2022 (see Chart 1.1).

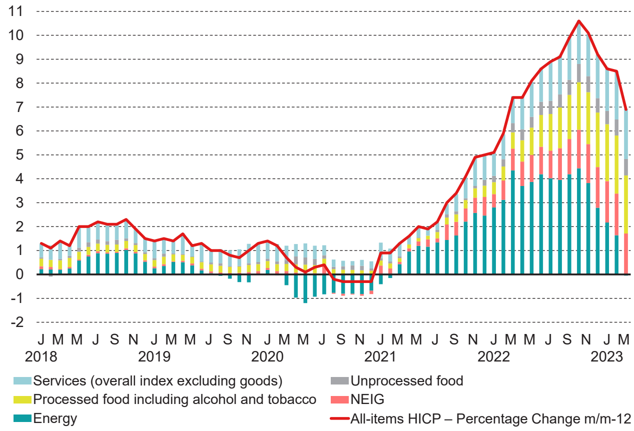
Employment continued to expand, growing at a quarterly rate of 0.6% during the review period, compared to 0.3% in the fourth quarter of last year.[3]

### *Headline inflation eases further but underlying inflation keeps rising*
Although heightened inflationary pressures in the euro area persisted, they eased further in the first quarter. The annual rate of inflation based on the HICP stood at 6.9% in March, compared to 9.2% three months before (see Chart 1.4). This deceleration mainly reflected a sustained drop in energy inflation, which outweighed faster growth in the prices of processed and unprocessed food, services, and, to a lower extent, NEIG. Inflation continued to be fuelled by the gradual pass-through of past cost increases, pent-up demand from the reopening of the economy, and rising wages. By contrast, the impact of supply bottlenecks on consumer prices has diminished.

[3] Employment data refer to the national accounts, total employment domestic concept. Data are seasonally and calendar adjusted.

Turning to the major HICP components, energy price inflation exerted substantial downward pressure on headline inflation, partly reflecting developments in commodity markets. Thus, energy prices dropped by 0.9% in the year to March, whereas they had risen by 25.5% in the twelve months to December 2022. This development outweighed an acceleration in all the other major components during the quarter under review. Unprocessed food inflation rose to 14.7% in March, compared to 12.0% in December, while processed food inflation rose to 15.7%, from 14.3%, over this period. Also, the annual rate of change of services prices rose to 5.1% in March from 4.4% in December. Lastly, the annual rate of NEIG inflation rose to 6.6% in March, compared to 6.4% three months earlier.

**Chart 1.4**
**CONTRIBUTIONS TO YEAR-ON-YEAR HICP INFLATION IN THE EURO AREA**
*(percentage points; annual percentage change)*



Sources: SDW; ECB.

Underlying inflationary pressures continued to build up and did so at a faster pace. The annual rate of HICP inflation excluding energy and food prices reached a historical peak of 5.7% in March, from 5.2% in December.

## *ECB projects a rebound in economic activity amid easing inflation*

According to the Eurosystem staff macroeconomic projections published in June 2023, real GDP in the euro area is estimated to slow down to 0.9% in 2023, from 3.5% in 2022. Real GDP is then expected to expand by 1.5% in 2024, and 1.6% in 2025 (see Table 1.3). Following a slight contraction in real GDP growth in the first quarter of 2023, economic activity in the euro area is projected to recover in the second quarter of 2023, and to remain reasonably strong in the balance of the year, as real income recovers and the negative effects of recent supply shocks wane. Over

**Table 1.3**
**MACROECONOMIC PROJECTIONS FOR THE EURO AREA**[1]
*Annual percentage changes*

| | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|
| **GDP** | **3.5** | **0.9** | **1.5** | **1.6** |
| Private consumption | 4.4 | 0.2 | 1.9 | 1.5 |
| Government consumption | 1.4 | 0.0 | 1.1 | 1.4 |
| GFCF | 3.8 | 1.5 | 1.1 | 2.1 |
| Exports | 7.4 | 2.7 | 3.4 | 3.2 |
| Imports | 8.4 | 1.4 | 3.4 | 3.2 |
| **HICP** | **8.4** | **5.4** | **3.0** | **2.2** |
| HICP excluding energy and food | 3.9 | 5.1 | 3.0 | 2.3 |

Source: ECB.
[1] Eurosystem staff macroeconomic projections (June 2023).

the medium term, GDP growth is projected to increase further, underpinned by a further improvement in real income and strengthening foreign demand. These factors are expected to outweigh downward pressures emanating from tighter financing conditions and a tighter fiscal stance.

Compared to the March 2023 projections, the baseline projections are built on assumptions that include slightly higher interest rates, lower oil prices, significantly lower wholesale gas and electricity prices, and an appreciation of the euro.

Compared to the previous projection exercise, real GDP growth was revised downwards by 0.1 percentage point for both 2023 and 2024. The revision in 2023 reflects a reassessment of the impact of tighter credit standards on activity, as well as a lower contribution from changes in inventories, while weaker net exports contribute to the downward revision in 2024. By contrast, the real economic growth projection for 2025 was kept unchanged, as higher real disposable income and abating uncertainty were expected to mitigate the impact from tighter monetary policy.

Turning to the outlook for prices, according to the June 2023 projections, HICP inflation is foreseen to moderate to 5.4% in 2023, and ease further to 3.0% and 2.2% in 2024 and 2025, respectively. In 2023, this mostly reflects a marked fall in energy prices. A notable easing in food inflation and lower underlying inflation are the factors behind most of the fall in subsequent years. HICP inflation, excluding energy and food, is expected to moderate from 5.1% in 2023 to 3.0% in 2024, and further to 2.3% in 2025, as the indirect effects of recent energy shocks and supply bottlenecks dissipate and monetary policy tightening feeds through consumer prices. Nevertheless, it is expected to exceed its long-term average amid strong growth in wages.

Compared to the March 2023 projections, HICP inflation was revised upwards by 0.1 percentage point for 2023, 2024 and 2025, respectively, mainly underpinned by a strong growth in wages, reflecting inflation compensation, a tight labour market, and increases in minimum wages. Underlying inflation was revised up significantly in 2023 and 2024, and marginally in 2025.

### *ECB continues to raise interest rates steadily*

In February 2023, the Governing Council raised the three key ECB interest rates by 50 basis points and stated that it expected to raise them further in March. The Governing Council also decided on the modalities for reducing the Eurosystem's holdings of securities under the APP. More specifically it stated that these holdings would decline at an average monthly pace of €15 billion between March and the end of June. The subsequent pace of portfolio reduction would be determined over time.

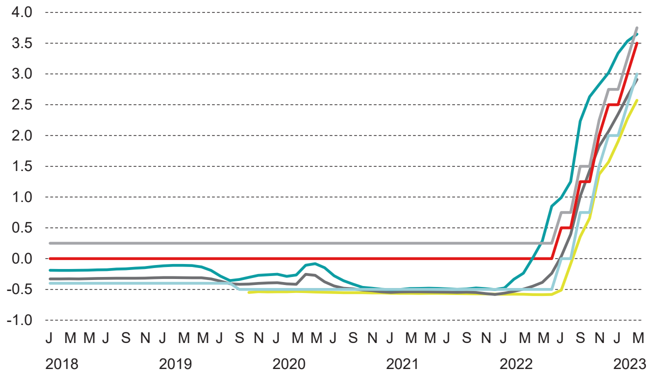
In March 2023, the Governing Council hiked the three policy interest rates by an additional 50 basis points, so that the interest rates on the deposit facility, the MROs and the marginal lending facility reached 3.00%, 3.50% and 3.75%, respectively (see Chart 1.3). The Council also highlighted that elevated uncertainty warranted a data-driven approach to the determination of the policy rate path. In particular, future policy rate decisions will be based on an assessment of the inflation outlook based on incoming data, the dynamics of underlying inflation, and the strength of monetary transmission.

Regarding the PEPP portfolio, the Governing Council reiterated its intention to continue reinvesting the principal payments from maturing securities purchased under the programme until at least the end of 2024. The future roll-off of the PEPP portfolio would be managed to avoid interference with the appropriate monetary policy stance. Redemptions coming due in the PEPP portfolio were being reinvested flexibly, to counter risks to the monetary policy transmission mechanism related to the pandemic.

As to refinancing operations, the Governing Council stated that since banks were repaying the amounts borrowed under the targeted longer-term refinancing operations (TLTRO) III, the Council would regularly assess how targeted lending operations were contributing to its monetary policy stance.[4]

*Money market rates rise further*

**Chart 1.5**
**KEY MONEY MARKET INTEREST RATES**
*(percentages per annum; market rates – monthly averages; ECB rates – end of month)*



Source: ECB.

Money market interest rates in the euro area continued to rise during the quarter under review, reflecting the tightening of the monetary policy stance and expectations of higher key policy rates. The Euro Short-Term Rate (€STR) rose markedly further though it remained below the interest rate on the ECB's deposit facility (see Chart 1.5).[5] It averaged 2.57% in March, compared to 1.57% in December 2022. The three-month euro interbank offered rate (EURIBOR) averaged 2.91% in March, compared to 2.07% three months earlier. Meanwhile, the 12-month EURIBOR continued to increase, with its average reaching 3.65% in March, from 3.03% in December.[6]

*Euro area government bond yields generally continue to rise*

The euro area ten-year benchmark government bond yield rose further during the first quarter. It stood at 3.23% at end-March, compared to 3.00% three months earlier. The increase was underpinned by expectations regarding further tightening of monetary policy in the euro area, and in other major economies.

Individual sovereign bond yields continued to rise in almost all euro area countries. In Germany, ten-year sovereign bond yields went up by 30 basis points to 2.38%. Similarly, yields increased by 30 basis points in France, and by 34 and 27 basis points in Spain and Ireland, respectively. By contrast, Italian and Maltese ten-year sovereign bond yields fell marginally.

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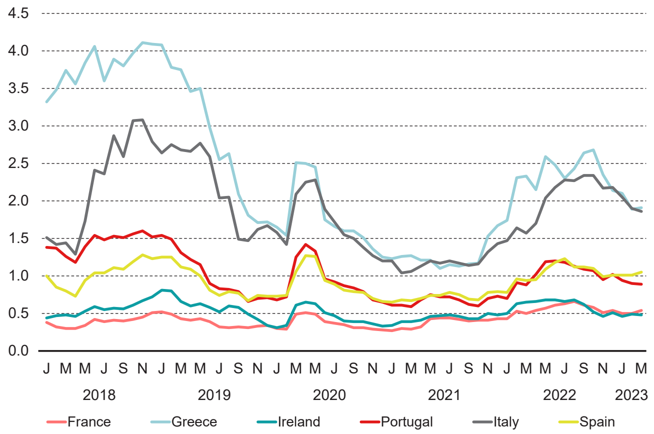
[4] The Governing Council raised the three key ECB interest rates by 25 basis points in May, and again in June, bringing the interest rates on the deposit facility, the MROs and the marginal lending facility to 3.50%, 4.00% and 4.25%, respectively. Regarding the APP, in May, the Council announced that reinvestments will end as of July, and this was confirmed in June.

[5] The €STR reflects the wholesale euro unsecured overnight borrowing costs of banks located in the euro area. The €STR is published on each TARGET2 business day based on transactions conducted and settled on the previous TARGET2 business day. The ECB first published €STR on 2 October 2019.

[6] The EURIBOR is an interest rate benchmark indicating the average rate at which principal European banks lend unsecured funds on the interbank market in euro for a given period.

Spreads between yields on the ten-year German bonds and those on the bonds issued by other euro area sovereigns showed mixed developments (see Chart 1.6). Most notably, the spreads on Italian and Maltese government bond yields narrowed by 32 and 31 basis points, respectively, while the spreads on Lithuanian, Slovenian, Greek, and Cypriot sovereign bonds narrowed to a slightly lower extent. Meanwhile, the spread versus the French sovereign remained unchanged. By contrast, the spreads on the bonds issued by Spain, and a number of smaller jurisdictions, widened to varying degrees.

**Chart 1.6**
**SELECTED EURO AREA GOVERNMENT BOND YIELD SPREADS**
*(difference vis-à-vis German ten-year government bond yields in percentage points)*




Source: ECB.

## *Euro exchange rate appreciates further in effective terms*

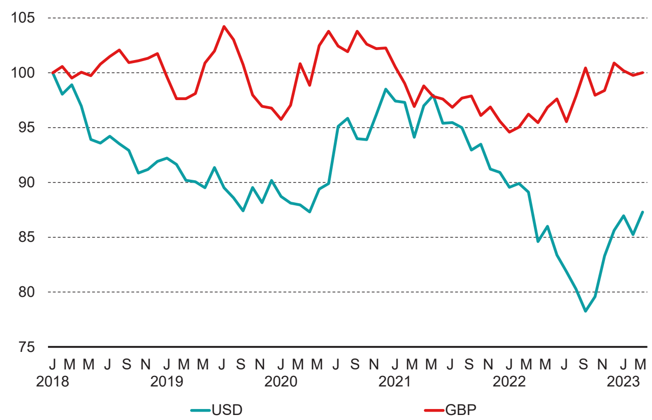
The nominal effective exchange rate (EER) of the euro against the EER-18 group of countries appreciated by 1.0% in the quarter under review.[7]

In the three months to March, the euro rose by 2.0% against the US dollar, extending the recovery which started in the last quarter of 2022 (see Chart 1.7). This mainly occurred in the context of narrowing interest-rate differentials between the euro area and the United States and as investor risk appetite had returned, which normally supports the euro.

During the review period, the euro also recorded gains against other currencies including the Norwegian krone, the Japanese yen, the Swedish krona, the Australian, Canadian and Hong Kong dollars, the Korean won and the Swiss franc.

By contrast, the euro fell by 0.9% against the British pound, as the latter benefitted from indications that UK's political outlook had stabilised, and financial stability was restored.

**Chart 1.7**
**EXCHANGE RATE MOVEMENTS OF THE EURO AGAINST OTHER MAJOR CURRENCIES**
*(index of end of month rates; Jan. 2018=100; an increase in the index implies euro appreciation)*




Source: Eurostat.

[7] The EER-18 is based on the weighted averages of the euro exchange rate against the currencies of Australia, Bulgaria, Canada, China, Czech Republic, Denmark, Hong Kong, Hungary, Japan, Norway, Poland, Romania, Singapore, South Korea, Sweden, Switzerland, the United Kingdom, and the United States.

The euro also fell versus the Hungarian forint, the Czech koruna and, marginally, against the Chinese renminbi.

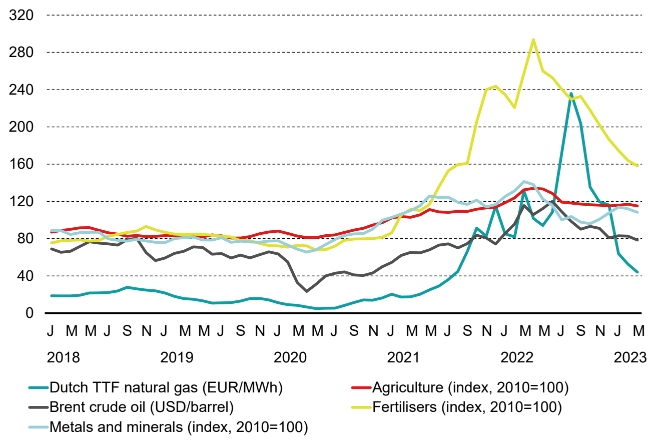
## Commodities

*Commodity prices end the quarter lower*

Oil prices fell in the review period as supply increased notably whereas demand remained subdued. The EU embargoes on Russian exports, implemented in light of the Russia-Ukraine war, led to an overhang of supplies, with Russia attempting to re-direct its crude oil to new export destinations. The price of Brent crude oil ended March 2023 at USD 78.5 per barrel, 2.9% below the level prevailing at the end of December. Also, the price of European natural gas fell markedly, mainly on account of a milder-than-normal winter, gas savings measures and healthy storage levels in the EU. Thus, the price of Dutch TTF natural gas ended March 2023 at €44.0 per megawatt hour, 62.1% lower than three months before (see Chart 1.8).

World Bank data show that non-energy commodity prices fell, on average, during the first quarter of 2023. Decreases in prices of fertilizers and, to a lesser extent, agricultural products outweighed a rise in the prices of metals and minerals in the quarter under review.

**Chart 1.8**
**COMMODITY PRICES**
*(monthly averages)*




Sources: World Bank; Central Bank of Malta estimates.

## 2. OUTPUT AND EMPLOYMENT

*Annual real GDP growth decelerated to 3.1% in the first quarter of 2023, following a 5.2% increase in the previous quarter, due to a negative contribution from domestic demand.*

*Sectoral data show that the expansion in output was primarily driven by the services sector, especially the sector comprising professional, scientific, administrative, and related activities. Gross value added (GVA) also rose in the manufacturing sector. By contrast, it declined in the construction sector.*

*During the first quarter of 2023, developments in the labour market remained positive, with employment levels and employment rates both rising in annual terms. The unemployment rate remained low from a historical perspective, and stood well below that in the euro area. The number of registered unemployed persons fell in annual terms, but rose slightly from very low levels when compared with the fourth quarter of 2022.*

*The job vacancy rate increased slightly compared to the previous quarter, while remaining at the level of the previous year. Another indicator of labour tightness, which is the ratio of the job vacancy rate to the unemployment rate, remained at considerably high levels.*

### Potential output and Business Conditions Index

#### *Potential output grows at a slower rate*

The Bank estimates that potential output growth stood at 6.1% in the first quarter of 2023, below the annual rate of 6.5% estimated for end-2022.

On a four-quarter moving average basis, the level increase in potential output relative to the previous quarter was somewhat stronger than that in GDP, resulting in a narrower positive output gap. The latter is estimated at 1.0%, down from 1.7% in 2022 (see Chart 2.1).

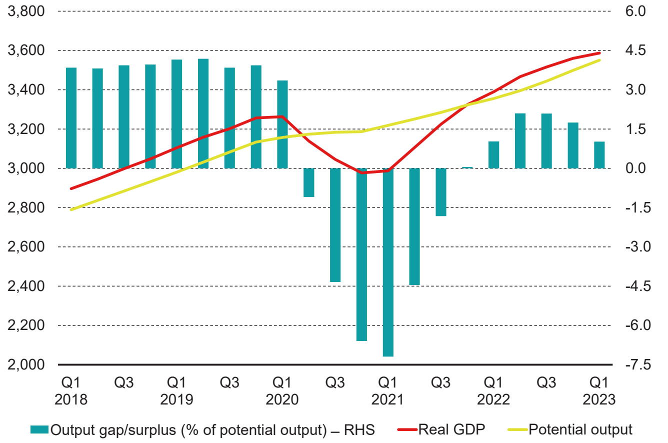
This implies that the degree of over-utilisation of the economy's productive capacity has continued to ease.

#### *BCI consistent with historic average growth*

The Bank's BCI indicates that annual growth in business activity remained close to its historical average in the quarter (see Chart 2.2).[1]

During the quarter under review, the BCI was affected by strong annual increases in several

**Chart 2.1**
**CYCLICAL POSITION OF THE MALTESE ECONOMY**
*(Four-quarter moving averages; EUR millions; as percentage of potential GDP)*

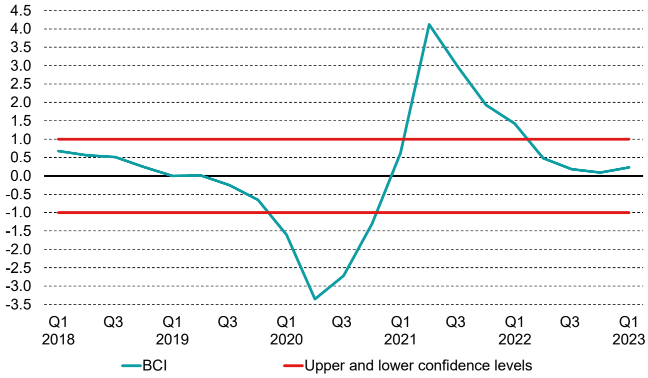



Sources: NSO; Central Bank of Malta estimates.

[1] The BCI is a synthetic indicator, which includes information from a number of economic variables such as the term structure of interest rates, industrial production, an indicator for the services sector, economic sentiment, tax revenues and private sector credit. By construction, it has an average value of zero over the estimation period since 2000. For further details on the methodology underlying the BCI, see Ellul, R., (2016), "A real-time measure of business conditions in Malta," *Working Paper* 05/2016, Central Bank of Malta.

sub-components, particularly in tourist arrivals. Strong annual growth in the index of industrial production as well as low unemployment, also contributed to the above-average BCI level. On the other hand, on average, building permits declined in the first quarter when compared to the same period a year earlier, while annual GDP growth was below its long-term average. Similarly, although the Economic Sentiment Indicator (ESI) remained high, it declined in annual terms, thus pushing down the BCI close to its long-term average.[2]

**Chart 2.2**
**BCI**
*(standardised)*




Source: Central Bank of Malta.
The red lines in the Chart represent the range enclosing one standard deviation on either side of the BCI's long-run value. Repeated readings below the lower band signal that economic activity is significantly below normal economic activity. Readings above the upper band indicate that activity is signficantly above normal levels.

## GDP and industrial production

### *Real GDP increases at a slower pace*

After seven quarters of strong year-on-year growth, the pace of economic expansion moderated in the first quarter of 2023. Real GDP rose by 3.1% on an annual basis, following a 5.2% increase in the previous quarter.[3] The slowdown in growth was driven by a negative contribution from domestic demand. However, in contrast with previous quarters, net exports contributed positively to growth, in part reflecting a correction in import-intensive investment in the aviation sector from recent extraordinary levels (see Table 2.1).

Domestic demand contracted by 2.6%, following a 12.9% increase in the previous quarter. It shed 2.2 percentage points from GDP growth in the quarter under review. Movements in this component were underpinned by a decline in GFCF, and slower growth in private consumption. By contrast government consumption returned to growth.

Private consumption expenditure increased by an annual 3.2% in the first quarter of 2023, following a 6.8% increase in the previous quarter, adding 1.3 percentage points to real GDP growth.

Data on the Classification of Individual Consumption by Purpose (COICOP) show that the increase in private consumption was broad based across most expenditure categories. The strongest increase in absolute terms was recorded in spending on restaurants and accommodation services, followed by higher spending on transport. Expenditure on these items benefitted from the repeal of all restrictions on travel and mobility compared to the first quarter of 2022. Expenditure on 'housing, water, electricity, gas, and other fuels also increased at a strong pace on a year earlier. On the other hand, households reduced spending on furnishings, household equipment and routine household maintenance, with small declines also reported for spending on food and non-alcoholic beverages, as well as clothing and footwear.

[2] Additional information on the interpretation of the BCI is available in the January 2020 edition of the Bank's *Economic Update*.
[3] The analysis of GDP in this chapter of the *Quarterly Review* is based on data published in NSO *News Release* 095/2023, which was published on 30 May 2023.

**Table 2.1**
**GDP[1]**

| | 2022 | | | | 2023 |
|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 |
| | *Annual percentage changes* | | | | |
| Private final consumption expenditure | 11.7 | 13.5 | 7.8 | 6.8 | 3.2 |
| Government final consumption expenditure | -1.4 | 11.9 | 1.3 | -1.4 | 1.1 |
| GFCF | 24.1 | 19.1 | 33.8 | 40.7 | -16.5 |
| **Domestic demand** | **10.5** | **14.4** | **12.5** | **12.9** | **-2.6** |
| Exports of goods and services | 7.8 | 7.1 | 8.7 | 1.4 | -3.0 |
| Imports of goods and services | 9.0 | 9.6 | 12.9 | 5.4 | -6.6 |
| **GDP** | **8.3** | **9.6** | **5.6** | **5.2** | **3.1** |
| | *Percentage point contributions* | | | | |
| Private final consumption expenditure | 4.8 | 5.6 | 3.4 | 2.9 | 1.3 |
| Government final consumption expenditure | -0.3 | 2.4 | 0.2 | -0.3 | 0.2 |
| GFCF | 4.7 | 4.2 | 6.5 | 8.3 | -3.8 |
| Changes in inventories | -0.4 | 0.0 | 0.1 | 0.1 | 0.0 |
| **Domestic demand** | **8.7** | **12.2** | **10.3** | **11.0** | **-2.2** |
| Exports of goods and services | 13.7 | 12.1 | 14.6 | 2.3 | -5.2 |
| Imports of goods and services | -14.2 | -14.7 | -19.3 | -8.2 | 10.5 |
| **Net exports** | **-0.4** | **-2.7** | **-4.7** | **-5.8** | **5.3** |
| **GDP** | **8.3** | **9.6** | **5.6** | **5.2** | **3.1** |

Sources: NSO; Central Bank of Malta calculations.

(1) Chain-linked volumes, reference year 2015.

In the national accounts however, COICOP data measure domestic consumption and thus, include the expenditure of non-residents in Malta while excluding the expenditure of Maltese residents abroad. Given that tourist arrivals exceeded last year’s levels, certain COICOP categories of expenditure were affected by a strong increase in non-residents’ expenditure in Malta. Nonetheless, the remaining part of domestic consumption – the expenditure of Maltese residents in Malta – also rose compared to the same period a year earlier. Meanwhile, the expenditure of Maltese residents abroad increased significantly on its year-ago level, as trips abroad almost doubled over the same period.

Government consumption expenditure increased by 1.1% in annual terms, following a contraction of 1.4% in the fourth quarter of 2022. The latest increase mostly reflects higher spending on social benefits in kind, and on compensation of employees within the public administration, education, and health sectors. Overall, government consumption added 0.2 percentage point to annual GDP growth.

Real GFCF declined by an annual 16.5% in the first quarter if the year, after increasing by 40.7% in the previous quarter. All components declined on a year earlier, except for investment in intellectual properties. The most significant decrease was recorded in expenditure on machinery and equipment, reflecting a decrease in registrations of aircraft from the very high level recorded a year earlier. GFCF shed 3.8 percentage points from real GDP growth.

The contribution of changes in inventories was broadly neutral in the first quarter of 2023, and marginally lower than in the previous quarter.

Meanwhile, exports fell by 3.0% and imports decreased by 6.6% on a year earlier. This marks the first year-on-year decline in exports since 2020, and the first decline for imports since 2014. As imports declined at a faster pace than exports, net exports increased, adding 5.3 percentage points to annual real GDP growth. This mainly reflected a higher surplus in the services balance. Although the goods balance improved slightly on a year earlier, it remained in deficit.

The contributions shown in Table 2.1 are consistent with the approach normally followed in official databases and economic publications. However, they do not account for the variation in import content across different expenditure components and thus, fail to represent the true underlying relative contribution of domestic and external demand to economic growth.

Table 2.2 presents import-adjusted contributions, which address this limitation by apportioning imports to the respective demand components. In the quarter under review, most of the import-adjusted contributions were larger than those based on the traditional approach, reflecting the large decrease in imports (see Table 2.1). This is particularly the case for adjusted exports, which has the largest positive contribution to GDP growth.

After adjusting for imports, domestic demand added 0.6 percentage point to growth in the first quarter of 2023. The main driver behind the growth in domestic demand is private consumption. GFCF retains a negative contribution once adjusted for imports, but its drag on overall GDP growth is much less significant than the traditional contributions suggest.

GDP data based on the output approach show that in the first quarter of 2023, real GVA rose by 3.7% in annual terms, following a 6.8% increase in the fourth quarter of 2022. It added 3.4 percentage points to GDP growth (see Table 2.3).[4]

Services remained the main driver behind the rise in economic activity, adding 3.1 percentage points to real GDP growth. Most of the increase stemmed from the sector comprising professional, scientific, administrative, and related activities, which contributed 1.1 percentage points to GDP growth. This was followed by the sector comprising wholesale and retail trade, transportation, accommodation, and related activities, which added a further 0.8 percentage point to GDP growth. At the same time, the information and communication sector, financial and insurance

**Table 2.2**
**IMPORT-ADJUSTED CONTRIBUTIONS TO GDP GROWTH**(1)

| | 2022 | | | | 2023 |
|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 |
| | *Percentage point contributions* | | | | |
| Private final consumption expenditure | 2.7 | 3.1 | 1.5 | 1.7 | 1.4 |
| Government final consumption expenditure | -0.2 | 1.9 | 0.1 | -0.2 | 0.3 |
| GFCF | 1.5 | 1.3 | 1.8 | 2.7 | -0.8 |
| Changes in inventories | -0.2 | 0.0 | 0.1 | -0.2 | -0.3 |
| **Domestic demand** | **3.8** | **6.3** | **3.5** | **4.1** | **0.6** |
| **Exports of goods and services** | **4.5** | **3.3** | **2.1** | **1.1** | **2.5** |
| **GDP** | **8.3** | **9.6** | **5.6** | **5.2** | **3.1** |

Source: Central Bank of Malta estimates.
(1) Chain-linked volumes, reference year 2015.

4 The difference between GDP and GVA is made up of taxes on products, net of subsidies.

**Table 2.3**
**CONTRIBUTION OF SECTORAL GVA TO REAL GDP GROWTH**
*Percentage points*

| | 2022 | | | | 2023 |
|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 |
| Agriculture, forestry and fishing | 0.0 | 0.3 | -0.2 | 0.0 | -0.1 |
| Mining and quarrying; utilities | 0.2 | -0.1 | 0.1 | 0.1 | 0.0 |
| Manufacturing | -0.2 | 0.4 | 0.8 | 1.3 | 0.9 |
| Construction | -0.2 | -0.2 | -0.3 | -0.4 | -0.6 |
| Services | 8.4 | 9.6 | 7.0 | 5.1 | 3.1 |
| *of which:* | | | | | |
| Wholesale and retail trade; repair of motor vehicles; transportation; accommodation and related activities | 4.0 | 5.2 | 2.7 | 2.0 | 0.8 |
| Information and communication | 1.1 | 0.7 | 0.6 | 0.3 | 0.5 |
| Financial and insurance activities | 0.6 | 0.3 | 0.4 | 0.2 | 0.3 |
| Real estate activities | 0.3 | 0.2 | 0.3 | 0.0 | 0.0 |
| Professional, scientific, administrative and related activities | 1.3 | 1.4 | 2.1 | 1.7 | 1.1 |
| Public administration and defence; education; health and related activities | 0.1 | 0.9 | 0.5 | 0.6 | 0.3 |
| Arts, entertainment; household repair and related services | 1.0 | 0.9 | 0.3 | 0.3 | 0.1 |
| **GVA** | **8.3** | **9.9** | **7.5** | **6.1** | **3.4** |
| **Taxes less subsidies on products** | **0.0** | **-0.3** | **-1.8** | **-1.0** | **-0.2** |
| **Annual real GDP growth (%)** | **8.3** | **9.6** | **5.6** | **5.2** | **3.1** |

Source: NSO.

activities, and the sector comprising public administration and defence, education, health, and related activities, jointly added another 1.1 percentage points. The remaining services sectors together added 0.1 percentage point to growth. The manufacturing sector added 0.9 percentage point to growth, while construction lowered growth by 0.6 percentage point. This marks the sixth consecutive year-on-year decline in the construction sector, with the GVA level in this sector standing around that recorded for 2018.

The contribution of services to GDP growth moderated compared to the fourth quarter of 2022, mostly reflecting slower growth in the sector comprising wholesale and retail trade, transportation, accommodation, and related activities, and in the sector comprising professional, scientific and technical activities. Growth also slowed in the manufacturing and in the arts and entertainment sectors. The contribution of construction stood more negative relative to the previous quarter.

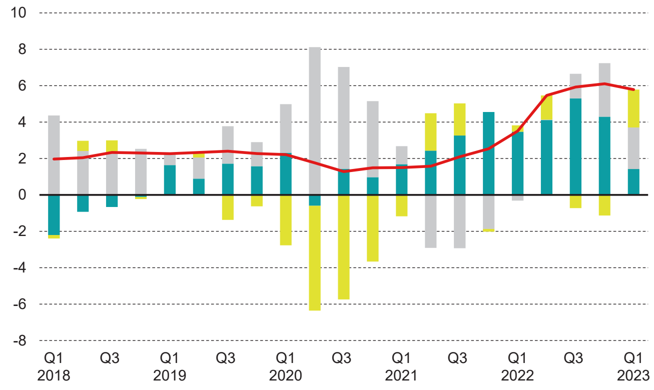
Net taxes on products decreased in annual terms, albeit at a slower pace compared with previous quarters.

### *Nominal GDP growth moderates but remains strong*

Nominal GDP rose by 9.1% in annual terms in the first quarter of 2023, after increasing by 11.6% in the previous quarter. Growth remained strong, reflecting robust contributions from both compensation of employees and operating surplus.

Chart 2.3 shows the developments of the main contributors to growth in the GDP deflator. Annual growth in the latter edged down in the first quarter of 2023 but remained elevated from a historical perspective. It stood at 5.8% in annual terms, compared with 6.1% in the previous three-month period. This primarily reflected a less positive contribution in the unit profit component, which is equivalent to the share of gross operating surplus in real GDP. Meanwhile, the contribution of unit labour costs (ULCs), remained broadly unchanged compared to the last quarter of 2022, at 2.3 percentage points. By contrast, the contribution of unit taxes on production and imports turned positive in the quarter under review. This reflects a decline in outlays on subsidies, compared to a year earlier, due to the unwinding of COVID-19 related support measures.

**Chart 2.3**
**CONTRIBUTIONS TO GDP DEFLATOR**
*(annual percentage change; percentage point contribution)*




Source: NSO.

### *Industrial production increases at a faster rate*

Industrial production increased at an annual rate of 14.2% in the first quarter of 2023, after a rise of 11.6% in the previous quarter.[5]

Production in the manufacturing sector rose at a faster pace. Meanwhile, growth in production in the mining and quarrying sector turned positive after a sequence of year-on-year declines. By contrast, production in the energy sector rose at a slower pace compared with the last quarter of 2022.[6]

In the manufacturing sector, production rose by 15.5%, after rising by 11.6% in the fourth quarter. Several sub-sectors in the manufacturing industry contributed to the latest rise. Firms that manufacture computer, electronic and optical products, wearing apparel, as well as pharmaceutical goods recorded the strongest year-on-year increases in output. Production also rose strongly among firms in the sectors comprising printing and reproduction of recorded media, chemicals and chemical products, and 'other manufacturing' – which includes medical and dental instruments, toys and related products. Smaller increases were recorded among firms that repair and install machinery and equipment, together with those that produce beverages.

By contrast, output contracted among firms that manufacture textiles, paper and paper products, as well as rubber and plastic, while food production was broadly stable.

## Business and consumer surveys

During the first quarter of 2023, the European Commission's ESI for Malta stood above its long-term average of around 100.0. It reached 106.6, from 94.4 in the preceding quarter. Following

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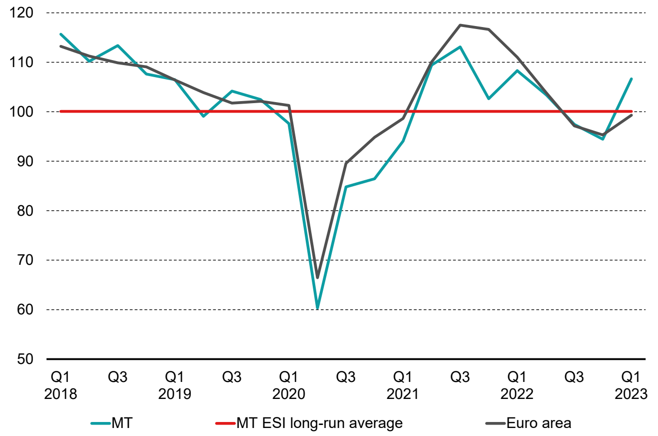
[5] Methodological differences may account for divergences between developments in GVA in the manufacturing sector and industrial production. GVA nets input costs from output to arrive at value added and is expressed in nominal terms. Industrial production is a measure of the volume of output and takes no account of input costs. The sectoral coverage between the two measures also differs since industrial production data also include the output of the energy and quarrying sectors.

[6] Industrial production in the energy sector excludes energy generated abroad and imported through the interconnector.

this increase, the overall indicator was above that in the euro area, which averaged 99.3 (see Chart 2.4).[7,8]

**Chart 2.4**
**ESI**
*(seasonally adjusted; percentage points)*

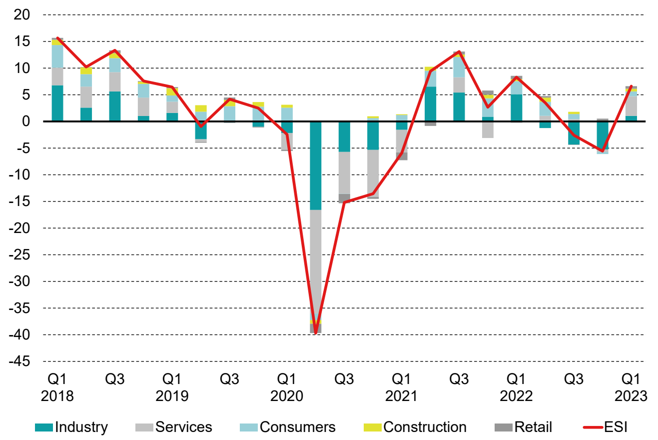



Source: European Commission.

When compared with the fourth quarter of 2022, confidence improved across all sectors, with the most significant improvement recorded in industry, and in the services sector. However, sentiment remained negative in industry, and among consumers.

When accounting for the variation in the weights assigned to each sector in the overall index, the increase in the ESI relative to the fourth quarter of 2022 was notably driven by developments in industry, and in the services sector.[9] The confidence indicator for services largely explains why the overall ESI stood above the long-term average in the quarter under review (see Chart 2.5).

**Chart 2.5**
**ESI**
*(seasonally adjusted; demeaned)*




Sources: European Commission; Central Bank of Malta workings.

## *Industrial confidence improves sharply but remains negative[10]*

The industrial confidence indicator increased to -1.7, up from –20.4 in the previous three-month period, standing above its long-term average of -4.2 (see Chart 2.6). The recent rise in sentiment was largely driven by production expectations, which turned positive during the first quarter of the year. At the same time, the share of respondents assessing stocks of finished goods to exceed normal levels, more than halved.[11] These developments offset an increase in the share of participants assessing order book levels to be below normal.

[7] The ESI summarises developments in confidence in five surveyed sectors: industry; services; construction; retail; and consumers. Quarterly data are three-month averages.
[8] Long-term averages are calculated over the entire period for which data are available. For the consumer and industrial confidence indicators, data for Malta became available in November 2002, while for services and construction data became available in May 2007 and May 2008, respectively. The long-term average of the retail confidence indicator is calculated as from May 2011, when it was first published. The long-term average of the ESI is computed from November 2002.
[9] Weights are assigned as follows: industry 40%; services 30%; consumers 20%; construction 5%; and retail trade 5%.
[10] The industrial confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to a subset of survey questions relating to expectations about production over the subsequent three months, to current levels of order books and to stocks of finished goods.
[11] Above-normal stock levels indicate lower turnover and affect the overall indicator in a negative way. Such levels are thus represented by negative bars in Chart 2.6.

Additional survey data reveal a sharply lower share of respondents foreseeing an increase in selling prices.

*Confidence in the services sector rises significantly*[12]

The confidence indicator in the services sector increased to 34.6 in the first quarter of 2023, from 17.3 in the previous quarter. Following this increase, sentiment stood well above its long-term average of 19.4 (see Chart 2.7). The recent rise in sentiment was spread across all sub-components of the indicator, and notably reflects a more positive assessment of the business situation over the past three months.

Supplementary survey data indicate that participants' price expectations remained elevated from a historical perspective, and edged up compared to the last quarter of 2022, standing at around 43%.

*Confidence in construction turns positive*[13]

In the first quarter of 2023, the indicator measuring confidence in the construction sector rose above its long-term average of -8.5. It stood at 6.7, up from to -0.7 in the previous three-month period (see Chart 2.8).

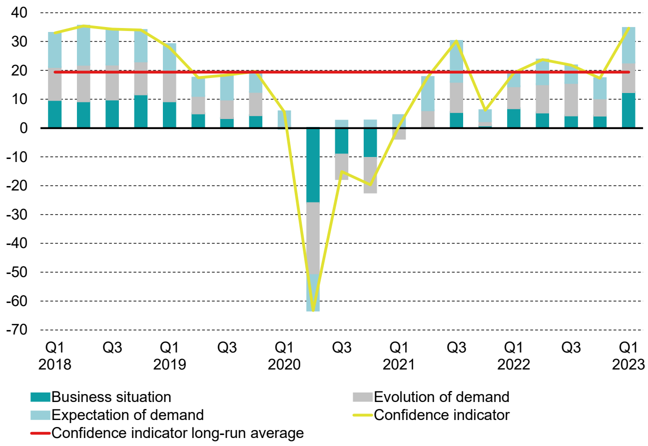
The improvement was driven entirely by employment expectations, which turned positive in the first quarter of the year. Meanwhile, contrary to the fourth quarter of 2022, respondents assessed order book levels to be below normal levels.

Furthermore, the net share of respondents expecting price increases over the next three months increased sharply, exceeding previous record highs.

**Chart 2.6**
**INDUSTRIAL CONFIDENCE INDICATOR**
*(seasonally adjusted; percentage points)*


Source: European Commission.

**Chart 2.7**
**SERVICES CONFIDENCE INDICATOR**
*(seasonally adjusted; percentage points)*




Source: European Commission.

[12] The services confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to survey questions relating to the business climate, the evolution of demand in the previous three months, and demand expectations in the subsequent three months.

[13] The construction confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to two survey questions, namely those relating to order books and to employment expectations over the subsequent three months.

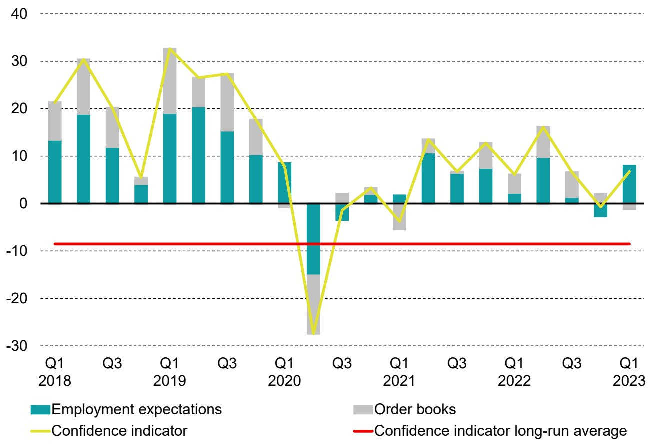
## *Consumer confidence returns above its long-term average*[14]

The consumer confidence indicator averaged -9.3 during the first quarter of 2023, up from -15.7 recorded in the previous quarter. Following this increase, sentiment stood marginally above its long-run average of -10.2 (see Chart 2.9).

Consumers' assessment of their financial situation over the last 12 months, and expectations about their finances in the coming months, were the main drivers behind the latest increase in consumer confidence. Respondents' outlook of the general economic situation in the 12 months ahead also improved compared with the fourth quarter of 2022. At the same time, consumers' expectations of major purchases over the next 12 months turned positive.

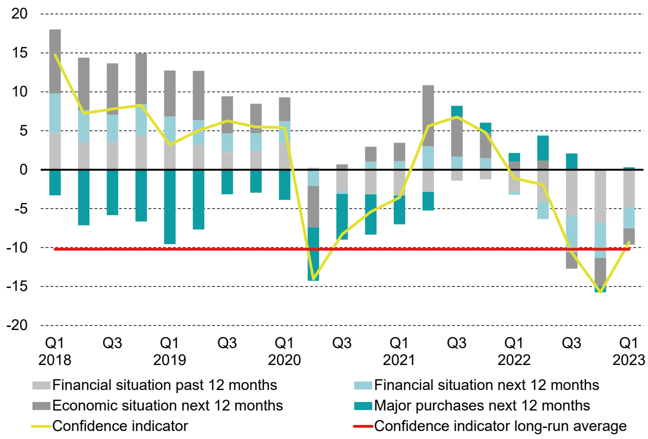
Supplementary survey data show a higher share of respondents expecting unemployment to increase, compared with the fourth quarter of 2022. Furthermore, the net share of respondents expecting price increases fell from around a third in the last quarter of 2022, to around 23%.

**Chart 2.8**
**CONSTRUCTION CONFIDENCE INDICATOR**
*(seasonally adjusted; percentage points)*




Source: European Commission.

**Chart 2.9**
**CONSUMER CONFIDENCE INDICATOR**
*(seasonally adjusted; percentage points)*




Source: European Commission.

## *Sentiment among retailers increases further*[15]

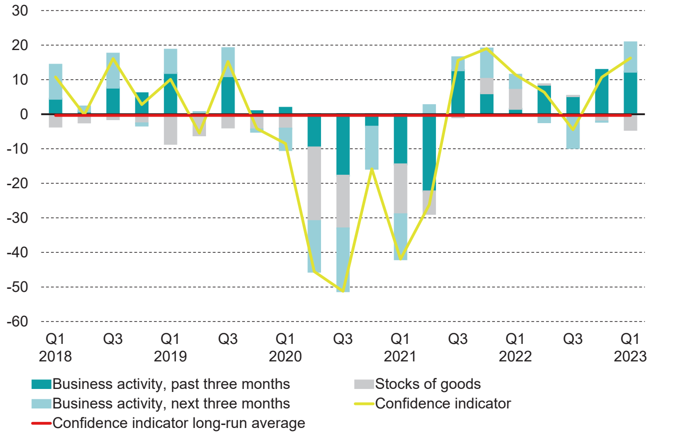
The indicator representing sentiment in the retail sector increased to 16.3 in the first quarter of 2023, from 10.7 in the previous quarter, rising further above its long-term average of -0.3. The recent rise in sentiment was entirely driven by a sharp improvement in retailers' short-term expectations of business activity, from a broadly neutral level in the previous quarter. By contrast, retailers' assessment of sales over the past three months edged down slightly, but remained elevated. Meanwhile, the net share of participants reporting stocks of finished goods to be above normal,

[14] The consumer confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to a subset of survey questions relating to households' assessment and expectations of their financial situation, their expectations about the general economic situation, and their intention to make major purchases over the subsequent 12 months. The computation of this indicator was changed as reflected in the January 2019 release of the European Commission.

[15] The retail confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to survey questions relating to the present and future business situation and stock levels.

more than doubled compared with the previous three-month period (see Chart 2.10).

**Chart 2.10**
**RETAIL CONFIDENCE INDICATOR**
*(seasonally adjusted; percentage points)*




Source: European Commission.

Supplementary survey data indicate that, on balance, orders expectations improved slightly when compared to the last quarter of 2022. Meanwhile, price expectations fell sharply from the elevated levels registered in previous quarters.

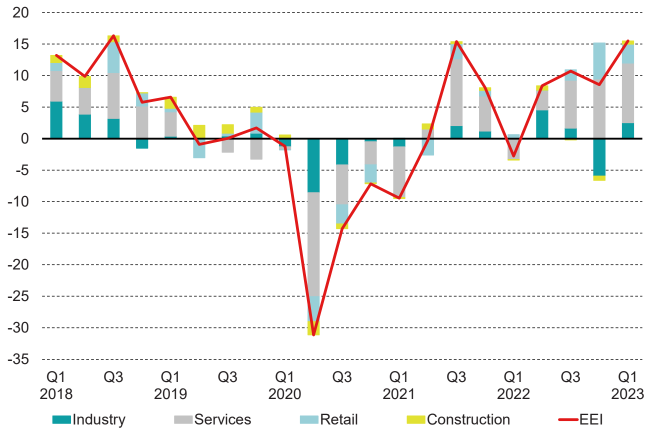
### *Employment Expectations Indicator eases marginally but remains above long-run average*

The Employment Expectations Indicator (EEI) – which is a composite indicator of employment expectations in industry, services, retail trade and construction – edged up in the first quarter of 2023. It averaged 115.6, compared with 109.8 in the preceding quarter, and remained well above its long-term average of around 100.0. Following this increase, the index continued to exceed the euro area average of 109.1.[16]

During the quarter under review, employment expectations were positive across all productive sectors, with the most positive readings recorded in the services sector, and to a lesser extent, in industry and among retailers.

When accounting for the variation in the weights assigned to each sector in the overall index, the increase relative to the preceding quarter largely reflected developments in industry (see Chart 2.11). At the same time, the contribution of the construction sector turned slightly positive in the quarter under review. By contrast, the already positive contributions of retailers edged down, while that of services firms remained unchanged compared with the fourth quarter of 2022.

**Chart 2.11**
**EEI**
*(seasonally adjusted; demeaned)*



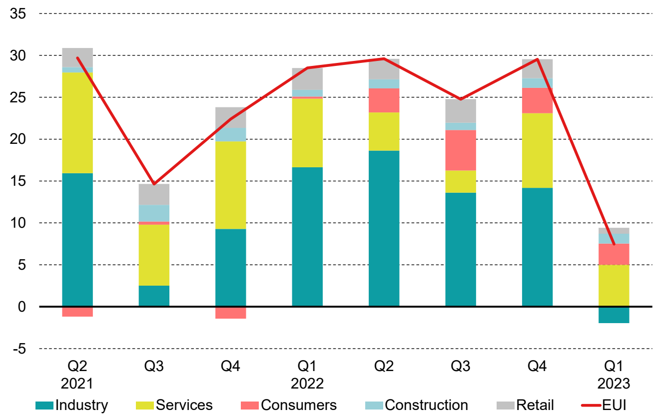

Sources: European Commission; Central Bank of Malta workings.

[16] The EEI is based on question 7 of the industry survey, question 5 of the services and retail trade surveys and question 4 of the construction survey, which gauge the respondent firms' expectations as regards changes in their total employment over the next three months. Before being summarised in one composite indicator, each balance series is weighted on the basis of the respective sector's importance in overall employment. The weights are applied to the four-balance series expressed in standardised form. Further information on the compilation of the EEI is available in European Commission (2020). The *Joint Harmonised EU Programme of Business and Consumer Surveys User Guide.*

*Economic Uncertainty Indicator decreases*

The European Commission's Economic Uncertainty Indicator (EUI) is a composite indicator which measures how difficult it is for sectors to make predictions about their future financial or business situation. In Malta, this indicator fell to 7.5 in the first quarter of the year, from 29.5 in the fourth quarter of 2022 (see Chart 2.12). Following the latest decrease, the indicator stood well below that in the euro area, which averaged 24.0.[17,18]

**Chart 2.12**
**EUI[(1)]**
*(not seasonally adjusted)*




Sources: European Commission; Central Bank of Malta.
[(1)] Data for Malta is available from May 2021.

The strongest falls in uncertainty in Malta were recorded in industry and retail, though uncertainty also declined in the services sector and, to a lower extent, among consumers. These developments offset slightly higher uncertainty in the construction sector.

The highest uncertainty scores were recorded in the construction and services sectors. Developments in industry contributed the most to the decline in Malta's EUI, when considering each sector's weight and past volatility.

## The labour market[19]

*Labour force and activity rate continue to increase*

Labour Force Survey (LFS) data show that in the first quarter of 2023, the labour force grew by 14,975 persons, or 5.2% on an annual basis, slightly slower than the 5.4% increase registered in the previous quarter (see Table 2.4).[20]

The activity rate stood at 80.4% in the quarter under review, higher than the 79.2% registered a year earlier.[21] This was due to a similar increase in both the female and male participation rates, which respectively reached 73.2%, and 86.6%. Both rates exceeded the corresponding rates for the euro area.

[17] The EUI is made up of five balances (in percentage points) which summarise managers'/consumers' answers to a question asking them to indicate how difficult it is to make predictions about their future business/financial situation. The series are not seasonally adjusted. The five-balance series are summarised in one composite indicator using the same weights used to construct the ESI. The questions asked correspond to Q51 of the industry survey, Q31 of the services survey, Q41 of the retail trade and construction surveys and Q21 of the consumer survey.
[18] Data on consumer uncertainty became available in October 2020, while data for industry, services, retail and construction became available in May 2021.
[19] This section draws mainly on labour market statistics from two sources: the LFS, which is a household survey conducted by the NSO based on definitions set by the International Labour Organization (ILO) and Eurostat; and administrative records compiled by Jobsplus according to definitions established by domestic legislation on employment and social security benefits.
[20] The LFS defines the labour force as all persons aged 15 and over who are active in the labour market. This includes those in employment, whether full-time or part-time, and the unemployed, defined as those persons without work but who were actively seeking a job during the previous four weeks and available for work within two weeks of the reference period.
[21] The activity rate measures the number of persons in the labour force aged between 15 and 64 as a proportion of the working age population, which is defined as all those aged 15 to 64 years.

**Table 2.4**
**LABOUR MARKET INDICATORS BASED ON THE LFS**
*Persons; annual percentage changes*

| | 2022 Q1 | 2023 Q1 | Annual change % |
|---|---|---|---|
| **Labour force** | **285,366** | **300,341** | **5.2** |
| Employed | 277,022 | 291,756 | 5.3 |
| *By type of employment:* | | | |
| Full-time | 243,651 | 256,592 | 5.3 |
| Part-time | 33,371 | 35,164 | 5.4 |
| Unemployed | 8,344 | 8,585 | 2.9 |
| **Activity rate (%)** | **79.2** | **80.4** | |
| Male | 85.5 | 86.6 | |
| Female | 72.1 | 73.2 | |
| **Employment rate (%)** | **76.9** | **78.0** | |
| Male | 82.6 | 83.8 | |
| Female | 70.4 | 71.4 | |
| **Unemployment rate (%)** | **2.9** | **2.9** | |
| **Actual hours worked (per week)** | **35.1** | **35.3** | |

Source: NSO.

### *Employment increases further*

In the quarter under review, employment rose by 5.3% in annual terms, following a rise of 5.5% in the previous quarter.

Both full-time employment as well as part-time jobs increased strongly in annual terms. The number of persons in full-time jobs rose by 12,941, or 5.3% in annual terms (see Table 2.4). This increase was mainly coming from the human health and social work activities sector, followed by the wholesale and retail sector, as well as the information and communication sector.

The number of part-time employees – which also includes those employed full-time on reduced hours – rose by 1,793 persons, or 5.4% on a year earlier. This increase was largely driven by the professional, scientific, and technical activities sector.

The overall employment rate rose by 1.1 percentage points on the same period of 2022, to reach 78.0%.[22] The male employment rate rose by 1.2 percentage points to 83.8%, due to higher rates in the 55 to 64, and the 25 to 54 age brackets. Meanwhile, the male employment rate in the 15 to 24 age bracket continued to decline, following steep year-on-year decreases in the previous two quarters. The female employment rate rose by 1.1 percentage points to 71.4%, driven by a higher employment rate in the 25 to 54 age bracket, as the rate for those outside this age bracket (particularly those within the 15 to 24 bracket) declined.

During the quarter under review, average weekly hours worked derived from the LFS rose to 35.3 from 35.1 a year earlier (see Table 2.4).[23] This mostly reflected an increase in part-time working hours.

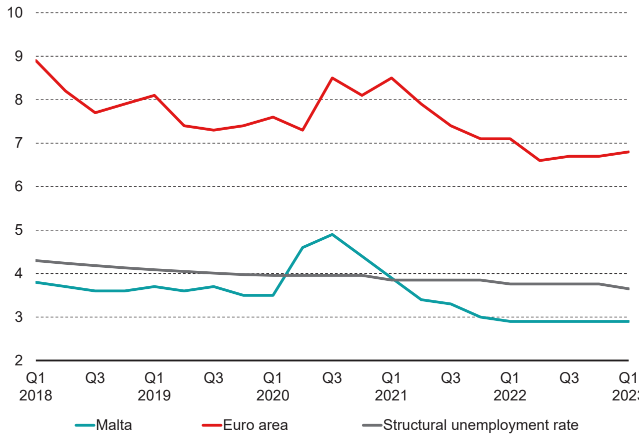
[22] The employment rate measures the number of persons aged between 15 and 64 employed on a full-time or part-time basis as a proportion of the working-age population.

[23] Actual hours refer to the number of hours actually spent at the place of work during the reference week for LFS. However, owing to increased flexibility at workplaces coupled with technology, the place of work may also include one's home. In this regard, actual hours worked also include the hours of work conducted by persons who telework.

*The unemployment rate remains low*

The unemployment rate based on the LFS stood at 2.9% in the first quarter of 2023 (see Table 2.4).[24] This marks the fifth consecutive quarter in which the LFS unemployment rate is at a historic low, and reflects resilient domestic demand. Labour market conditions remain more favourable than those in the euro area, where the unemployment rate stood at 6.8%, on average (see Chart 2.13).

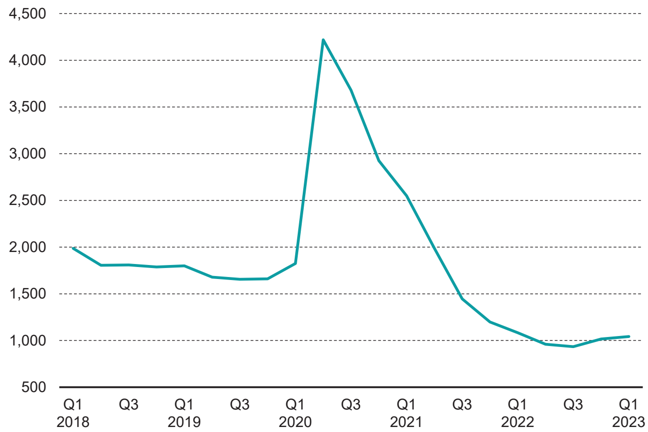
**Chart 2.13**
**UNEMPLOYMENT RATE**
*(per cent)*




Sources: Eurostat; NSO; Central Bank of Malta.

During the quarter under review, the unemployment rate also stood below the Bank's structural measure of 3.7%.[25] This indicates a degree of labour market tightness, which is also confirmed by surveys.

**Chart 2.14**
**REGISTERED UNEMPLOYED**
*(number of persons)*




Source: NSO.

Jobsplus data show that although the number of persons on the unemployment register rose slightly on a quarterly basis, it fell in annual terms. During the first quarter of 2023, the average number of persons on the unemployment register rose by 26 persons to 1,042, although it remained lower than the 1,083 registered a year earlier (see Chart 2.14).

Eurostat's job vacancy rate for industry, construction and services rose slightly compared to the previous quarter, standing at the elevated level of 2.5% (see Chart 2.15). At this level, the vacancy rate was equal to that recorded in the same quarter of 2022.[26] The vacancy rate was highest in services sectors, such as the information and communication sector (5.0%), and the accommodation and food services sector (4.6%).

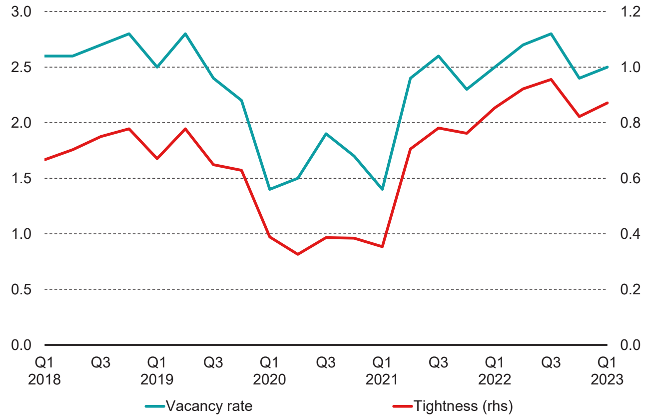
[24] According to the LFS, the unemployed comprise persons aged between 15 and 74 years who are without work, available for work and who have actively sought work during the four weeks preceding the Survey. In contrast, the number of unemployed on the basis of the Jobsplus definition includes only those persons registering for work under Part 1 and Part 2 of the unemployment register.

[25] The structural unemployment rate in this chapter refers to the non-accelerating inflation rate of unemployment (NAIRU), that is, the unemployment rate that is consistent with stable inflation. This measure of the unemployment rate is based on an unobserved components model (UCMPF). For further details, see Borg, I. (2023), "Box 1: Latest Estimates of the NAIRU", *Outlook for the Maltese Economy* 2023:1, pp.7-9 and Ellul, R. (2019), "Box 1: An Unobserved Components Model for potential output in Malta", *Quarterly Review* 2019:2, pp. 17-21.

[26] The job vacancy rate measures the number of job vacancies as a percentage of total jobs (occupied and vacant). Data for Malta are available since 2017.

The ratio of the job vacancy rate to the unemployment rate is an indicator of the imbalance between labour demand and supply and, therefore, of labour tightness. During the quarter under review, this ratio stood at 0.9, in line with the ratio registered in the same quarter a year earlier, and marginally higher than in the previous quarter. The latter was driven by a marginal decline in the unemployment rate. This indicator remains at elevated levels from a historical perspective.

**Chart 2.15**
**VACANCY RATE AND LABOUR MARKET TIGHTNESS INDICATOR**
*(per cent)*



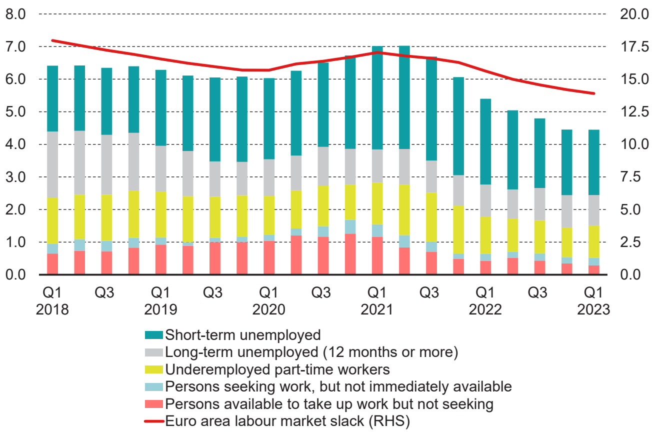

Sources: Eurostat; NSO; Central Bank of Malta.

To measure better labour market slack (unemployed and underutilised labour), one can consider an extended labour force definition, which in addition to the unemployed, also includes persons available to take up work but not seeking it, persons seeking work but not immediately available, and underemployed part-time workers. By this measure labour market slack was equivalent to 4.4% of the extended labour force in the first quarter of the year (see Chart 2.16).[27] This is 1.0 percentage point lower than the 5.4% registered a year earlier and is well below this measure's average of around 8% estimated since 2010. It is also significantly lower than the 13.9% recorded for the euro area.

The gap between the broader measure of labour market slack and the unemployment rate has been declining since the last quarter of 2021, indicating a reduction in the share of underutilised labour.

Around two-thirds of labour market slack in the quarter under review stemmed from unemployment (primarily from short-term unemployed). Underemployed part-time workers, i.e., those working part-time but willing and able to work additional hours, contributed the most to labour underutilisation and accounted for around one fifth of labour market slack.

**Chart 2.16**
**LABOUR MARKET SLACK**
*(percentage of extended labour force; four-quarter moving average)*




Sources: ECB-SDW; Eurostat; Central Bank of Malta's estimates.

[27] For further details on the methodology underlying the measure of labour market slack, see Ellul, R. (2019). "Labour Market Slack," *Quarterly Review* 2019:1, pp. 37-41, Central Bank of Malta. Given that this methodology partly relies on internal estimation, the slack indicator reported in this *Review* may differ slightly from that published by Eurostat.

## BOX 1: HOUSEHOLD WEALTH IN MALTA – EVIDENCE FROM THE LATEST WAVE OF THE HFCS[1]

This box analyses data on wealth for Maltese households as reported in the fourth wave of the Household Finance and Consumption Survey (HFCS) for Malta.

The HFCS is a joint project co-ordinated by the ECB and involves national central banks and national statistical institutes of all euro area countries and selected non-euro area EU member states. The HFCS collects granular information on households' financial position, income and spending.[2] It is the only source of information for wealth and its distribution across socio-economic characteristics at household level for Malta.

The Survey is conducted every three to four years. In Malta, the fieldwork for this wave was conducted between November 2020 and February 2021, with values for assets and liabilities referring to the position at the end of October 2020.[3]

### Wealth by socio-demographic characteristics

Household net wealth is the value of all real and financial assets held by the household, less the value of all their outstanding liabilities. Real assets include all valuables (houses, vehicles, work of art, jewellery) and participation in non-publicly traded business. Financial assets include all financial investments (deposits, savings, retirement savings plans, mutual funds, listed shares). Debt includes loans for home/car purchases, and all other types of debt (credit cards, overdraft).

Table 1 reports the mean and median values of household net wealth for the last HFCS vintage across population structures. In 2020, the median value stood at €273,600 and the mean at around €413,000.

Income is a determining factor of wealth as both the mean and median wealth increase across income quintiles, peaking at a median value of €453,314 for the highest income quintile.

Wealth also varies according to the age of the reference person. Median net wealth in 2020 was highest in the 45-54 age bracket at €343,500. The mean value of wealth is however highest for those households whose reference person is aged between 55 and 64, for which the mean value of net wealth stood at €506,131 in 2020.

The households' net wealth is also positively correlated with the educational attainment of the reference person. Households whose reference person has managed to obtain university level education have a median net wealth of €338,750, which is almost 41% higher

1 Prepared by Aleandra Muscat, Valentina Antonaroli and Warren Deguara, Economist and Principal Economists, respectively within the Economic Projections and Conjunctural Analysis Office. The views in this box are those of the authors only.
2 More detailed information on the HFCS can be retrieved from the ECB's HFCS page.
3 More information, data and studies on the HFCS in Malta are available from the CBM dedicated HFCS page.

**Table 1**
**NET WEALTH: POPULATION STRUCTURES, 2021**
*EUR*

| | Mean | Median |
|---|---|---|
| **Age of the Reference Person** | | |
| Under 35 | 233,931 | 186,775 |
| 35 - 44 | 391,445 | 269,250 |
| 45 - 54 | 451,034 | 343,500 |
| 55 - 64 | 506,131 | 325,900 |
| 65 - 74 | 425,109 | 306,300 |
| Over 75 | 423,944 | 223,400 |
| **Labour Market Situation of Reference Person** | | |
| Employee | 372,241 | 253,700 |
| Self-Employed | 746,020 | 449,000 |
| Retired | 444,226 | 287,800 |
| Other(1) | 335,303 | 266,500 |
| **Level of Education of the Reference Person** | | |
| Below secondary education | 341,971 | 240,550 |
| Secondary Education | 400,630 | 316,000 |
| University Education | 614,071 | 338,750 |
| **Status of the Main Residence** | | |
| Owneship (Full or Part) | 510,430 | 351,800 |
| Other(2) | 46,490 | 10,000 |
| **Number of household members in employment** | | |
| None | 372,990 | 234,100 |
| One | 385,115 | 252,000 |
| Two | 453,509 | 324,250 |
| Three or more | 487,905 | 337,550 |
| **Number of household members** | | |
| One | 276,192 | 184,000 |
| Two | 432,745 | 303,500 |
| Three | 469,091 | 330,250 |
| Four | 786,174 | 463,250 |
| Five or more | 402,948 | 356,500 |
| **Gross Income Quintile** | | |
| 1st quintile (less than 20) | 244,358 | 159,000 |
| 2nd quintile (between 20 and 40) | 356,375 | 253,450 |
| 3rd quintile (between 40 and 60) | 366,792 | 265,100 |
| 4th quintile (between 60 and 80) | 372,316 | 303,500 |
| 5th quintile (between 80 and 100) | 723,717 | 453,314 |
| **All Households** | **412,999** | **273,600** |
| **S.E.** | 0.73 | 0.16 |

Source: Authors' calculations based on MT-HFCS data.

'Reference Person' is taken to be the person that replied to the questionnaire on behalf of the household.

S.E. shows standard erros for the results of all households.

(1) Includes: unemployed, maternity or sick leave, students, unpaid family workers, etc.

(2) Renter/free use.

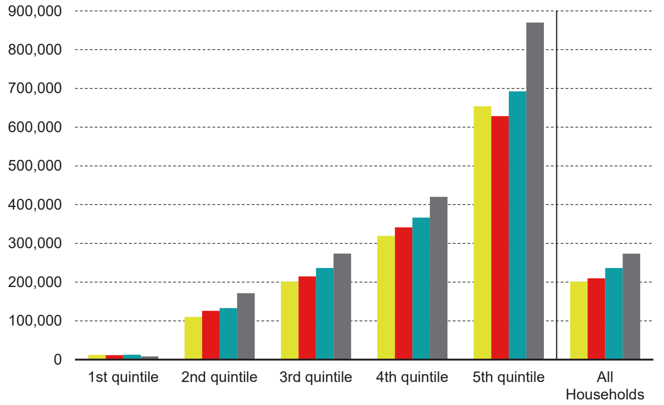
than that of households whose reference person has below secondary level education. The mean shows a larger gap of around 80%.

The median net wealth of those households whose reference person is self-employed stood at €449,000, which is significantly higher than that of those persons which are in employment (€253,700). Households whose reference person is retired also reported higher median net wealth than those in employment. As expected, both the mean and median values of net wealth increase as the number of household members in employment increases.

## Wealth across waves

The median value of net wealth has been increasing consistently across the four waves. In 2020, the median value stood at €273,600, which is 33.5% higher than that reported in 2010. All wealth quintiles experienced an increase in their median wealth over the span of 10 years, except for the first wealth quintile (see Chart 1). However, the most notable increase can be observed in the second wealth quintile, whereby the median value of net wealth increased by 55.6% between 2010 and 2020.

**Chart 1**
**NET WEALTH: MEDIANS BY WEALTH QUINTILE, 2010-2021**
*(EUR)*




Source: Authors' calculations based on MT-HFCS data.

Meanwhile, median net wealth rose by 15.7% between 2017 and 2020, with the second wealth quintile, with 28.9%, showing the most significant increase, followed by the 5th quintile with an increase of 25.6%. For the third quintile the median value increased by 15.7% to reach €273,750, while that for the fourth quintile rose by 14.6% to reach €420,200. Conversely, the bottom quintile reported a decline in net wealth from €12,612 in 2017, to a median net wealth of €8,250 in 2020.

## Panel component

The Survey includes a panel component, which allows to measure the change in wealth for this subset of households across the past two waves.[4] The median net wealth of all households in the panel component has increased by around 40% to €269,250, from €190,969 in 2017. All wealth quintiles within the panel component reported an increase in their median wealth, except for the lowest wealth quintile which, reported a slight decrease of €571.

[4] The panel component for 2021, that is households who also participated in the 2017 wave, made up 33% of interviewed households.

While half of the households in the panel component remained in the same wealth quintile that they formed part of in the 2017 wave, 36% managed to move up the wealth ladder. The change was generally of one quintile, while a small proportion were even able to move up by two or three quintiles. Conversely, 15% of households in the panel component now fall within lower wealth quintiles. The number of households within the panel component belonging to the bottom quintile decreased from 2017 to 2020, while the number of households belonging to the highest quintile increased significantly by almost 60%.

## Wealth composition

The relative importance of the components of assets and liabilities which make up wealth has remained largely the same across the last two waves. In both waves, the main residence was the biggest contributor to net wealth (see Chart 2).[5] The median value of such real asset has in fact increased from €200,000 in 2017, to €300,000 in 2020, when considering all households, and has also increased for all wealth quintiles across the two waves.

The same trend is observed for other real estate assets which have increased in value across waves and across wealth quintiles. In fact, the highest wealth quintile in 2020 held other properties with a median value of €337,500, from €280,000 in 2017, while the other properties owned by the lowest quintile were valued at only €17,500, from €16,000 in 2017.

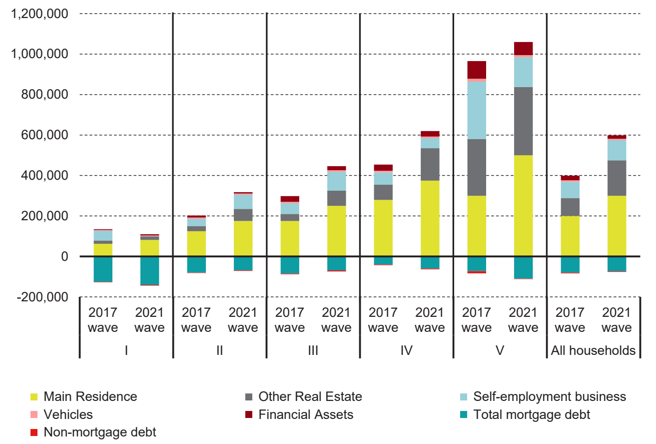
As expected, the highest wealth quintile holds self-employment businesses of much higher median value, and also have more high value financial assets than households in other lower wealth quintiles.

With regards to liabilities, the largest component across all quintiles in both waves is mortgage debt. The median value of mortgage debt is highest for the lowest wealth quintile at €140,000, and lowest for the fourth wealth quintile at €60,000. When compared to 2017, the median value of liabilities in 2020 decreased slightly.

## Wealth distribution

Chart 3 compares the distribution of net wealth across the four waves of the Survey. Across survey rounds, the distribution of wealth remained relatively unchanged below the median (50th percentile). The increase in wealth beyond the 70th percentile is, however, stronger in the 2021

**Chart 2**
**PORTFOLIO ITEMS: MEDIANS BY WEALTH QUINTILE, 2017 & 2021**
*(EUR)*

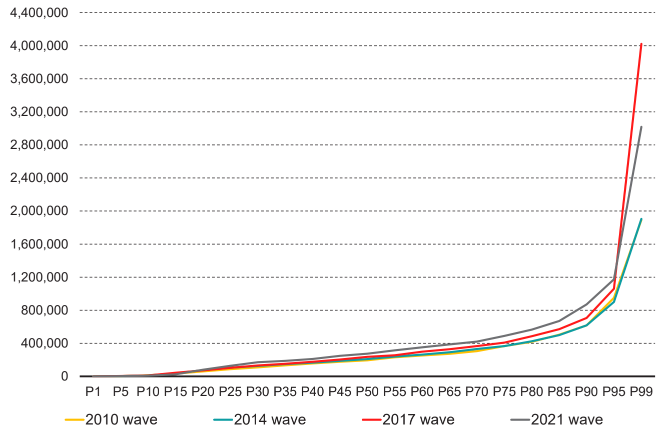



Source: Authors' calculations based on MT-HFCS data.

[5] Net housing wealth (value of primary residence net of the outstanding mortgage on the residence) in 2020 made up around 62% of total wealth, whereas the contribution of net financial wealth (financial assets net of liabilities) was just 5.4%.

wave. This is largely driven by more valuable real assets, as well as a wider portfolio of real asset holdings. However, the rise beyond the 90th percentile in the fourth wave was much slower than that of the 2017 wave. The wealthiest 1% of households saw a drop of around €1.1 million in their wealth between the third and fourth waves.

**Chart 3**
**NET WEALTH – PERCENTILE DISTRIBUTION, 2010-2021**
*(EUR)*



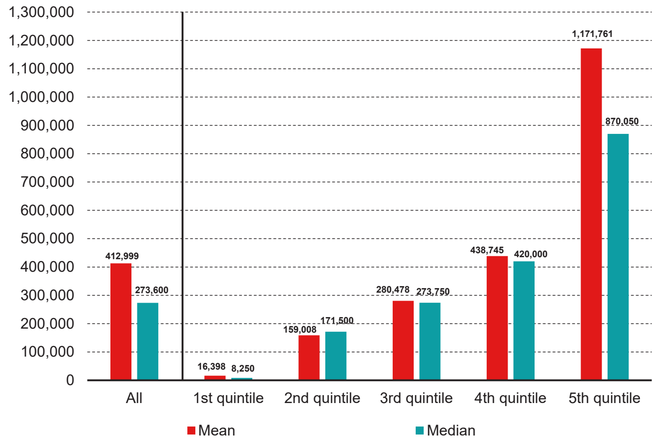

Source: Authors' calculations based on MT-HFCS data.

In Malta, the share of households with negative net wealth – i.e., when the value of assets held is lower than that of their liabilities – stood at 0.3% in 2020, similar to that in 2017.

## Wealth inequality

The mean and median values of household net wealth vary considerably across wealth quintiles in the 2021 wave (see Chart 4). The values for the top quintile are substantially larger than those of the other quintiles, implying that skewness is more pronounced at the far end of the distribution, especially in the case of the mean. Whilst the mean and median net wealth values for the second to the fourth quintiles of households follow each other closely, a notable discrepancy can be noted at the two extremes of the spectrum. The latter may indicate that the degree of inequality is more pronounced amongst the bottom and top parts of the distribution.

**Chart 4**
**NET WEALTH: MEANS AND MEDIANS BY WEALTH QUINTILE, 2021 WAVE**
*(EUR)*




Source: Authors' calculations based on MT-HFCS data.

The HFCS-based Gini coefficient, which measures inequality, shows that in the 2021 wave, inequality in household net wealth dropped to 0.55 from 0.60 in the 2017 wave, indicating a decrease in the overall level of inequality over the last two waves of the Survey (see Table 2). The Gini coefficient stood at 0.57 in 2014 and in 2010.[6]

[6] A more detailed analysis of income and wealth inequality in Malta is provided in this Working Paper.

**Table 2**
**INEQUALITY INDICATORS**
*Percentage*

| | 2010 wave | 2014 wave | 2017 wave | 2021 wave |
|---|---|---|---|---|
| **Quintile ratio indicators** | | | | |
| p90/p10 | 46.8 | 53.4 | 64.2 | 105.5 |
| p90/p50 | 3.2 | 3.0 | 3.0 | 3.2 |
| p50/p10 | 14.7 | 18.0 | 21.5 | 33.2 |
| p75/p25 | 4.2 | 3.5 | 4.0 | 3.8 |
| **Share indicators** | | | | |
| Bottom 50% | 13.6 | 14.3 | 12.6 | 14.4 |
| 50-90% | 43.0 | 42.2 | 39.7 | 45.6 |
| Top 10% | 43.4 | 43.5 | 47.7 | 40.0 |
| Top 5% | 31.8 | 34.6 | 37.0 | 27.5 |
| Top 1% | 16.3 | 19.3 | 17.0 | 9.9 |
| Gini coefficient | 0.57 | 0.57 | 0.60 | 0.55 |

Source: Authors' calculations based on MT-HFCS data.

Table 2 shows some other measures of inequality, namely the p90/p10, p90/p50, p10/p50 and the p75/p25 ratios.[7] The wealthiest 10% of households (p90) are on average three times wealthier than households at the 50th percentile. The p75/p25 ratio declined marginally from 4.0 to 3.8 between the third and fourth wave, while the p90/p10 ratio almost doubled in the 2021 wave.

Analysis of the top end of the spectrum shows that the wealthiest 5% of households had a median net wealth that is more than four times the median net wealth of all households in the 2021 wave (€1.17 million vs €273,600). This ratio is very similar to that obtained in the 2017 round of the Survey. At the same time, the wealthiest 1% of households held more than 10 times the median net wealth held by all households.

The share of total net wealth owned by the wealthiest 10% of households declined from 47.7% in the 2017 wave, to 40.0% in the 2021 wave. Similar movements can be observed in the share of net wealth owned by the wealthiest 5% and 1% of households, although the drop for these two groups was much stronger. At the same time, the share of net wealth held by the bottom 50% of households continued to increase gradually over the four waves reaching 14.4% in the 2021 wave. Moreover, the share of net wealth owned by households between the 50th and 90th percentile, increased to 45.6% in the latest wave, up from 39.7% in the 2017 wave.

Data from the HFCS allows to construct measures of debt burden, which are useful to assess the financial vulnerability of households. By comparing outstanding debt levels with gross household wealth, one can note a gradual increase in the debt burden measured on this basis. The debt to asset ratio stood at 14.9% in the 2021 wave, up from 13.5%

[7] Percentile ratios compare how much wealth households at one level of the wealth distribution have compared to people at some other level of the wealth distribution. For instance, the p90/p10 ratio compares how much wealthier the top 90% of households are compared to the poorest 10%.

in the 2017 wave. This ratio has been constantly increasing wave after wave, implying that households are entering into more debt to fund their acquisition of assets, mostly the purchase of real estate properties. When measured on this basis, debt burden decreased for households in the bottom two quintiles but increased among remaining households between the two waves under consideration.

### Inheritances

Inheritance also plays an important role in the accumulation of wealth by households. In the Survey, respondents are asked whether they have received any form of gifts or inheritance over the household's lifetime. Around a quarter of households reported to have actually received some sort of gifts or inheritance, a decline in comparison to the 33.5% in 2017.[8]

Most gifts or inheritances received were in the forms of cash or properties, while a very small share of households claimed to have received land or valuables which include art, jewellery, and antiques (see Figure 1).

As noted earlier, real estate is a major contributor to net wealth. In part, this form of wealth may be acquired through intergenerational transfers. In the 2021 HFCS, 6.8% of households that owned a property in 2020 have in fact inherited it, and another 5.4% received their main residence as a gift. Another small share of households (2.6%) received half of their main residence through a gift, while 7.7% received financial support to purchase their property. The Survey results also highlight that the probability of receiving gifts increases with wealth. This may suggest the existence of a cultural trait, by which wealth is passed on along families.

### Subjective evaluation of net worth

The Survey also investigates the subjective evaluation of net worth and how this has changed over the two years preceding the survey. Around 44.8% of households in 2020 reported that their net worth had 'increased significantly' over the past two years, while 41.5% claimed that their net worth remained broadly the same. Only 11.8% of households reported a decline in their net worth. The remaining 2.0% share opted not to answer this question.

**Figure 1**
**INTERGENERATIONAL GIFTS AND TRANSFERS, 2021**
*(percentage of households)*


Source: Authors' calculations based on MT-HFCS data.

[8] The positive relationship between household wealth and intergenerational transfers in the EU using HFCS data is analysed in a study by Spiteri and von Brockdorff (2022).

The respondents were overall also optimistic when asked about future net worth as around 30.9% anticipated a substantial increase, and only around 10% are expecting their net worth to decline in the two years following the interview. Another 56% then noted that their net worth will remain the same.

## Conclusions

This box looks at the composition and the evolution of net wealth in Malta along the four available vintages of the HFCS.

The median value of net wealth has been increasing across the four waves and across almost all wealth quintiles, with the most notable increase observed in the highest wealth quintile.

Data from the HFCS show that income is highly correlated with wealth, as both the mean and median wealth increase across income quintiles, with the median peaking for the highest income quintile in 2020. With regards to age, median net wealth peaks in the 45-54 age bracket, before declining again for the older age cohorts.

The composition of assets and liabilities which make up wealth has remained largely the same across the last two waves, with the main residence confirmed as the biggest contributor to net wealth. The median value of this real asset has in fact increased significantly since 2017, when considering all households, and has also increased for all wealth quintiles across the two waves.

Wealth inequality, as measured by the Gini coefficient, dropped between the last two HFCS waves. Nevertheless, P-ratios point to increased dispersion in net wealth in the bottom half of the wealth distribution.

# 3. PRICES, COSTS AND COMPETITIVENESS

*Consumer price pressures eased somewhat during the quarter under review, but inflation remained high from a historical perspective. While broad cost indicators point to moderating cost pressures, ULCs increased at a faster pace in the first quarter of 2023.*

*Annual inflation, as measured by the HICP, stood at 7.1% in March, marginally below that of 7.3% recorded in December. The slowdown in inflation reflects a decrease in all major sub-components, except for energy, where prices remained unchanged. Annual inflation based on the RPI – which only considers expenditure by Maltese residents – edged down from 7.4% in December to 7.0% in March.*

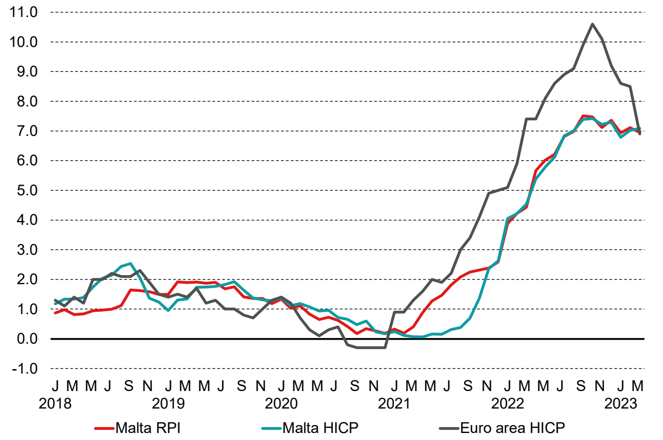
*Producer price inflation declined to 3.9% in the first quarter, from 5.3% in the previous quarter. Malta's ULC index, measured on a four-quarter moving average basis, increased by 3.3% in the first quarter, from 1.8% in the previous quarter. Although wage growth moderated, productivity declined.*

## Inflation

### *HICP inflation eased slightly*

Annual HICP inflation edged down to 7.1% in March 2023, from 7.3% in December 2022 (see Table 3.1).[1] Chart 3.1 shows that in March HICP inflation in Malta exceeded that recorded in the euro area, for the first time since the beginning of 2021, although the average for the quarter as a whole

**Chart 3.1**
**INFLATION RATES IN MALTA AND IN THE EURO AREA**
*(annual percentage changes)*




Sources: NSO; Eurostat.

**Table 3.1**
**HICP INFLATION**
*Annual percentage change*

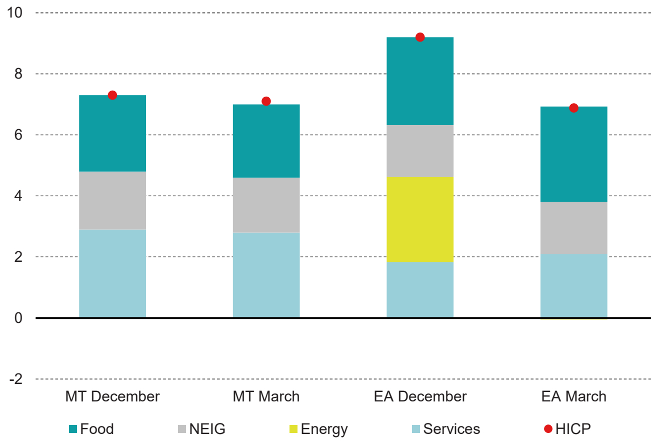
| | 2022 | | | | | | | | | 2023 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Apr. | May | June | July | Aug. | Sep. | Oct. | Nov. | Dec. | Jan. | Feb. | Mar. |
| Unprocessed food | 12.2 | 14.9 | 11.8 | 13.0 | 9.6 | 8.7 | 14.4 | 10.0 | 10.3 | 8.5 | 13.0 | 12.3 |
| Processed food including alcohol and tobacco | 6.0 | 6.8 | 7.6 | 8.9 | 9.4 | 10.4 | 11.3 | 12.0 | 11.8 | 10.6 | 11.0 | 11.0 |
| Energy | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| NEIG | 4.5 | 4.5 | 5.4 | 5.5 | 5.4 | 6.6 | 6.5 | 6.7 | 6.7 | 7.3 | 6.7 | 6.6 |
| Services (overall index excluding goods) | 5.6 | 5.8 | 6.1 | 6.9 | 7.5 | 7.4 | 6.7 | 6.5 | 6.7 | 5.8 | 6.1 | 6.4 |
| **All Items HICP** | **5.4** | **5.8** | **6.1** | **6.8** | **7.0** | **7.4** | **7.4** | **7.2** | **7.3** | **6.8** | **7.0** | **7.1** |

Source: Eurostat.

[1] The HICP weights are revised on an annual basis to reflect changes in overall consumption patterns. In 2023, the weight allocated to services stands at 44.3%, while that of NEIG is 27.9%. Food accounts for 21.4% of the index, while the share allocated to energy stands at 6.5%. These were revised from 43.3% for services, 28.3% for NEIG, 21.8% for food and 6.7% for energy in 2022.

remained below it. Euro area inflation ended the first quarter of 2023 at 6.9%, down from 9.2% in the previous quarter. The sharper decline in euro area inflation stems from a moderation in energy prices, which had reached record highs in 2022. Indeed, the contribution of energy inflation to euro area HICP inflation turned slightly negative in March. In the case of Malta, energy prices have remained unchanged in recent months. While the contribution to inflation of services and NEIG was higher in Malta than in the euro area, the contribution of food was lower in Malta (see Chart 3.2).

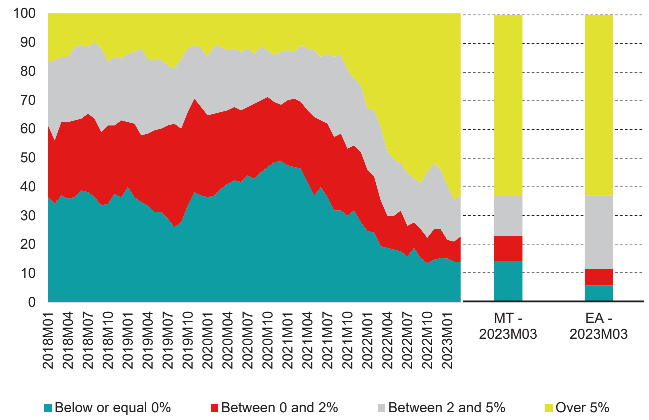
**Chart 3.2**
**HICP AND MAIN CONTRIBUTIONS**
*(annual percentage changes; contributions)*




Sources: Eurostat; SDW; Central Bank of Malta calculations.

Chart 3.3 shows a distribution of price changes whereby subcomponents of HICP are categorised into four classes of inflation rates: i) below or equal to 0%; ii) between 0% and 2%; iii) between 2% and 5% and iv) over 5%.[2] This indicates whether high inflation is broad-based across HICP items, or if it is being driven only by selected components of the consumption basket.

**Chart 3.3**
**PROPORTION OF HICP BASKET BY INFLATION PACE**
*(percentage point)*




Source: Central Bank of Malta calculations.

Since late 2021, the share of subcomponents registering inflation rates in the lowest inflation band has declined in both Malta and the euro area. This was mirrored in a substantial rise in the share of subcomponents, with year-on-year price increases of more than 5%. Indeed, in March, the share of the latter stood at 63.2%, just above the 63.0% estimated for the euro area. This indicates that the relatively high inflation rates registered throughout 2022 and the beginning of 2023 were driven by a majority of items in the respective consumption basket.

The share of the Maltese basket falling in the upper band has increased by 9.0 percentage points when compared to three months earlier. On the contrary, the shares of subcomponent with yearly prices increases of less than 5% have declined. The bracket holding items with inflation between

[2] The calculation of the shares in this chart do not take into account the weights of individual HICP sub-components. This analysis includes 171 sub-indices of the HICP for Malta and 289 sub-indices for the euro area. On average since 2001, 27.4% of items in Malta's basket fell in the 0% or negative inflation rates interval, while this figure stood at 17.7% for the euro area. Around 54% of the Maltese basket fell in the 0-2% and 2-5% intervals – in almost equal parts. These shares stand at 41.1% and 32.4% respectively in the euro area. While 19.0% of the Maltese basket fell in the over 5% interval, only 8.8% of the euro area basket falls in this interval.

2% and 5% shrank by 6.6 percentage points, standing at 14.0% in March, which is lower than that of the euro area which stood at 25.6%. The two intervals holding items with inflation rates of 2% or below also decreased since March but stood higher than in the euro area.

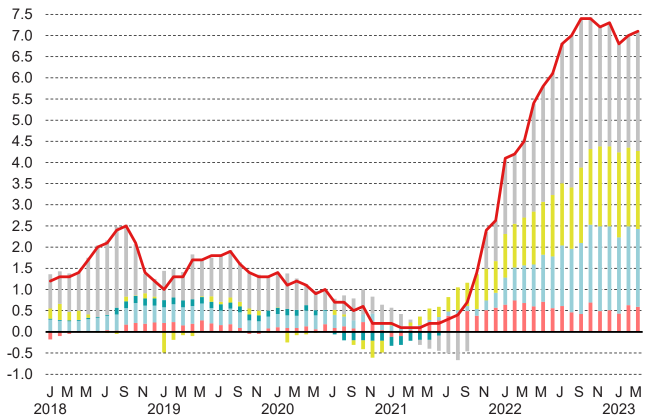
Overall, the latest data indicate that inflationary pressures in Malta remain persistent and broad-based across consumer items. Those subcomponents that are of an administrative nature, including energy, education, and passenger transport by bus, have contributed somewhat to curb inflationary pressures.[3]

The marginal fall in HICP inflation relative to December was driven by slower growth in the prices of processed food, services and NEIG (see Chart 3.4). On the other hand, the contribution from unprocessed food increased slightly, while energy prices remained unchanged in annual terms.

Services inflation decreased from 6.7% in December to 6.4% in March, contributing 2.8 percentage points to overall HICP inflation (see Chart 3.5). Despite easing, services inflation still stands relatively high from a historical perspective. All services components had a positive contribution to overall HICP inflation in March, but the largest contribution stemmed from the recreation and personal care subcomponent. Among other items, this component includes restaurants, cafes and similar establishments, which were the main contributors towards inflation in this subcomponent. It also includes package holidays and hotel accommodation, which also had a strong contribution, although to a lesser extent.

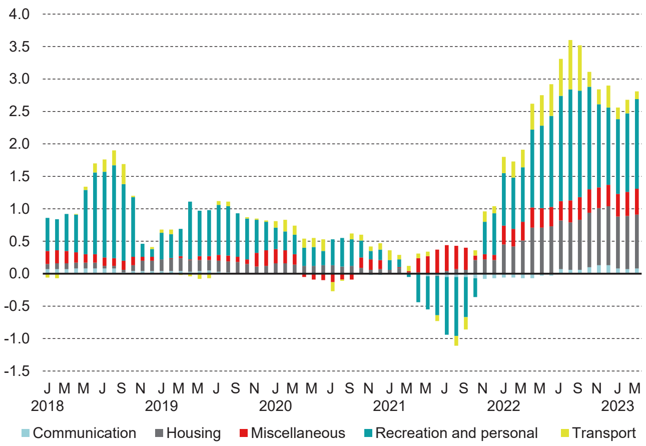
While the contribution from housing services remained strong, it declined somewhat from December. Growth in fees for the maintenance and repair of buildings remained at double-digit levels but declined compared with December. The contribution

**Chart 3.4**
**CONTRIBUTIONS TO YEAR-ON-YEAR HICP INFLATION**
*(percentage points; annual percentage change)*




Source: SDW.

**Chart 3.5**
**CONTRIBUTIONS FROM SERVICES TO HICP INFLATION**
*(percentage points)*




Source: SDW.

[3] Subcomponents that are of an administrative nature refer to those subcomponents where prices are determined by government, either fully or partially.

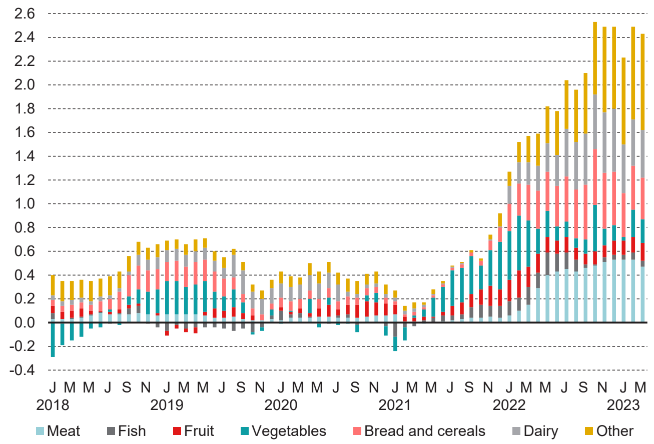
from transport services also declined and was the main driver of the moderation in services inflation since December, reflecting slower growth in the prices of passenger transport services by air and sea as well as in the prices of maintenance and repair of personal transport equipment.

Food inflation decreased slightly during the quarter review, standing at 11.3% in March, down from 11.5% in December. Consequently, the overall contribution of food to HICP inflation stood at 2.4 percentage points in March, from 2.5 percentage points in December. This decline was driven by processed food inflation, which eased to 11.0% from 11.8% in December. Conversely, unprocessed food inflation rose to 12.3% from 10.3% previously.

During the period under review, the contribution of dairy products, bread and cereals and meat declined (see Chart 3.6). On the other hand, the contribution from fruit and vegetables increased slightly.

NEIG inflation edged down by 0.1 percentage point to 6.6% in March. NEIG prices are exhibiting a high degree of inflation persistence and may reflect a lagged pass-through of recent increases in input costs to consumer prices. Looking at the sub-components, prices of durables rose at a slower pace of 5.4%, from 6.4% three months earlier, while prices of non-durables rose by an annual 7.9%, down from 8.5% in December. By contrast, prices of semi-durable goods rose by 6.8%, up from 4.8%.

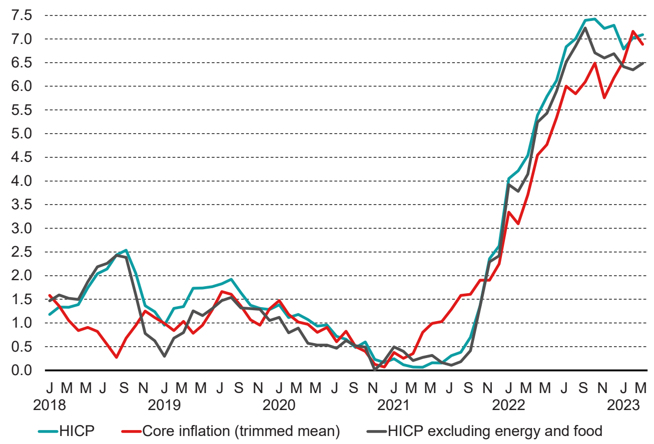
**Chart 3.6**
**CONTRIBUTIONS FROM FOOD TO HICP INFLATION**
*(percentage points)*




Source: SDW.

Energy inflation was unchanged at 0.0% in March, as electricity, gas and transport fuel prices were kept unchanged from their level a year earlier, through government support measures shielding the economy from high international energy prices.

**Chart 3.7**
**HICP IN MALTA: OVERALL AND CORE MEASURE**
*(annual percentage change)*




Sources: Eurostat; Central Bank of Malta estimates.

## *Core HICP inflation edges up*

The Bank's measure of core inflation, which excludes the more volatile items in each month, rose to 6.9% in March 2023, from 6.2% three months earlier (see Chart 3.7).[4] Hence,

[4] The Bank uses a 'trimmed mean' approach to measure core inflation, whereby the more volatile subcomponents of the index are removed from the basket of consumer goods so as to exclude extreme movements from the headline inflation rate. See Gatt, W. (2014), "An Evaluation of Core Inflation Measures for Malta", *Quarterly Review* 2014(3), pp. 39-45, Central Bank of Malta.

**Table 3.2**
**CONTRIBUTIONS TO YEAR-ON-YEAR RPI INFLATION**
*Percentage points*

| | 2022 | | | | | | | | | 2023 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Apr. | May | June | July | Aug. | Sep. | Oct. | Nov. | Dec. | Jan. | Feb. | Mar. |
| Food | 2.0 | 2.1 | 2.1 | 2.5 | 2.4 | 2.5 | 2.9 | 2.7 | 2.7 | 2.3 | 2.6 | 2.5 |
| Beverages and tobacco | 0.2 | 0.2 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.4 | 0.3 | 0.4 | 0.4 | 0.4 |
| Clothing and footwear | 0.1 | 0.0 | 0.0 | 0.0 | -0.1 | 0.2 | 0.2 | 0.1 | 0.0 | 0.5 | 0.4 | 0.3 |
| Housing | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.3 | 1.5 | 1.5 | 1.5 | 1.3 | 1.1 | 1.2 |
| Water, electricity, gas and fuels | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Household equipment and house maintenance costs | 0.3 | 0.3 | 0.4 | 0.4 | 0.5 | 0.6 | 0.5 | 0.6 | 0.6 | 0.5 | 0.4 | 0.4 |
| Transport and communications | 0.6 | 0.8 | 0.9 | 1.1 | 1.4 | 1.2 | 0.6 | 0.5 | 0.6 | 0.4 | 0.4 | 0.4 |
| Personal care and health | 0.3 | 0.3 | 0.3 | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 0.6 | 0.6 |
| Recreation and culture | 0.6 | 0.6 | 0.5 | 0.5 | 0.3 | 0.4 | 0.3 | 0.2 | 0.3 | 0.3 | 0.3 | 0.4 |
| Other goods and services | 0.4 | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.6 | 0.7 | 0.6 |
| **RPI (annual percentage change)** | **5.7** | **6.0** | **6.2** | **6.8** | **7.0** | **7.5** | **7.5** | **7.1** | **7.4** | **6.9** | **7.1** | **7.0** |

Source: NSO.

it was 0.2 percentage point lower than overall HICP inflation. An alternative measure of underlying inflationary pressures – HICP excluding food and energy – eased to 6.5% in March from 6.7% in December.

### *RPI inflation edges down marginally*

Annual inflation based on the RPI index – which is based on a different basket of goods and services from the HICP index, as well as a different frequency of weight updates – fell to 7.0% in March, from 7.4% in December (see Table 3.2).[5] The decline was largely driven by lower contributions from housing and food. The contribution of prices for household equipment and maintenance, and for transport and communications services also declined, although by a lesser extent. On the other hand, the contribution from clothing and footwear edged up from December. Meanwhile, energy tariffs continued to have a neutral impact on overall RPI inflation in the period under review.

## The housing market

### *Residential property prices grow at a faster pace*

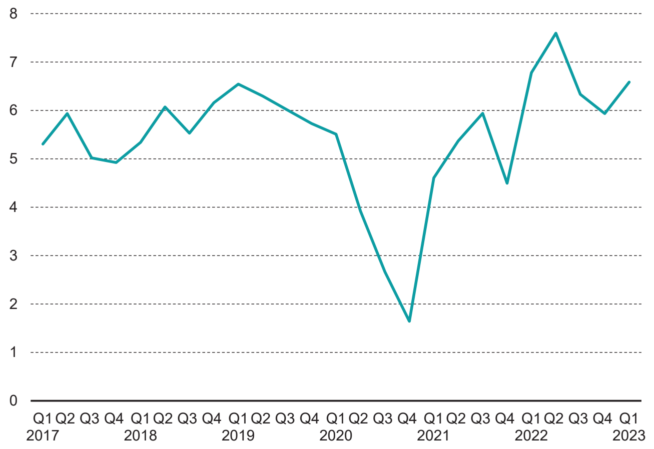
The NSO's Property Price Index (PPI) – which is based on actual transactions involving apartments, maisonettes, and terraced houses – continued to increase in annual terms. The annual rate of change stood at 6.6% in the first quarter of 2023, up from 5.9% in the previous quarter (see Chart 3.8).[6] House price inflation in Malta stood significantly above that in the euro area, where prices increased at an annual rate of 0.4%.

[5] The RPI index differs from the HICP index in that RPI weights are based on expenditure by Maltese households, while HICP weights also reflect expenditure patterns by tourists in Malta, such as accommodation services. See Darmanin, J. (2018), "Household Expenditure in Malta and the RPI Inflation Basket", *Quarterly Review* 2018(3), pp. 33-40, Central Bank of Malta. Due to the strong impact of the pandemic on tourist expenditure, the two measures are expected to diverge significantly as weights in the HICP have changed significantly while those of the RPI have not been adjusted.

[6] 'Apartments' are defined as dwellings with self-contained rooms or a suite of rooms that have a separate entrance accessible from a common passageway, landing or stairway. 'Maisonettes' have a separate entrance that is accessible from the street and are either at ground-floor level with overlying habitation, or at first-floor level with underlying habitation. 'Terraced houses' are dwellings with at least two floors, own access at street level and airspace, and with no underlying structures that are not part of the house itself. They are attached to other structures on both sides.

Residential property prices continue to be supported by numerous factors, including Government schemes supporting demand for property, such as the first-time and second-time buyers' schemes, the purchase of properties located in Urban Conservation Areas (UCA) and in Gozo, as well as refund schemes for restoration expenses. A dynamic tourism sector and an increase in migrant workers flows are also supporting property prices.

**Chart 3.8**
**MOVEMENTS IN RESIDENTIAL PROPERTY PRICES**
*(annual percentage changes)*

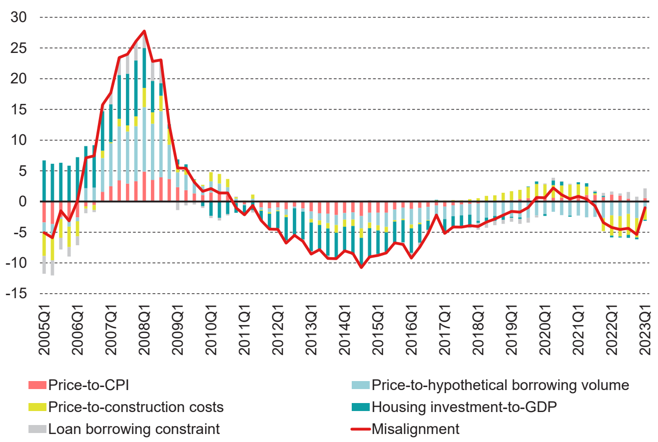



Source: Eurostat.

## *Misalignment indicator affected by exceptional inflationary environment*

As part of its ongoing macroeconomic analysis, the Bank calculates a house price misalignment index to provide an indication of the evolution of house prices against fundamentals.[7,8] This indicator consists of five sub-indices that capture household, investor, and system-wide factors, with the weights being derived using principal component analysis.

**Chart 3.9**
**HOUSE PRICE MISALIGNMENT INDICATOR**
*(percentage points; based on transaction prices)*




Source: Central Bank of Malta estimates.

According to the misalignment indicator, house prices, as measured by the NSO's PPI, were slightly below the level consistent with fundamentals in the first quarter of 2023, with the gap narrower than that estimated for the final quarter of 2022 (see Chart 3.9).[9]

This undervaluation was driven mainly by the price-to-construction cost ratio, and the price-to-hypothetical borrowing volume – that is the affordability indicator. Although construction costs declined in the quarter under review, they remain high from a historical perspective, thereby pushing down the price-to-construction cost ratio. Although marginally, the housing investment-to-GDP ratio, which is an indicator of overheating, also contributed negatively to the index. By contrast,

[7] See Micallef, B. (2018), "Constructing an index to examine house price misalignment with fundamentals in Malta", *International Journal of Housing Markets and Analysis*, 11(2), pp. 315-334.

[8] The actual numerical results presented in this section should not be overstated given the limitations in the construction of this indicator. For example, relevant variables such as foreign capital inflows are not included, and the unavailability of an official rental index precludes the use of the price-to-rent ratio in the indicator.

[9] A separate assessment based on advertised house prices can be found in Gatt, W., Micallef, B. and Rapa, N. (2018), "A macro-econometric model of the housing market in Malta", *Research Bulletin*, Central Bank of Malta, pp. 11-18.

**Table 3.3**
**TRANSACTIONS**
*Levels*

| | 2022 | | | | 2023 |
|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 |
| **Residential transactions** | | | | | |
| Promise of sale | 2,741 | 3,228 | 2,847 | 3,355 | 3,125 |
| Final deeds of sale | 3,407 | 3,567 | 3,593 | 3,764 | 3,101 |

Source: NSO.

the loan borrowing constraint and the price-to-CPI contributed positively to the misalignment indicator.

### *Property transactions decrease in quarterly and annual terms*

NSO data on residential property transactions show that 3,101 final deeds of sale were registered in the quarter under review, a decrease of 17.6% compared to the number of sales concluded in the final quarter of 2022, and 9.0% lower than the same level registered in the same quarter a year earlier (see Table 3.3). Moreover, the number of final deeds registered in the quarter under review stood below the average between 2017 and 2019.

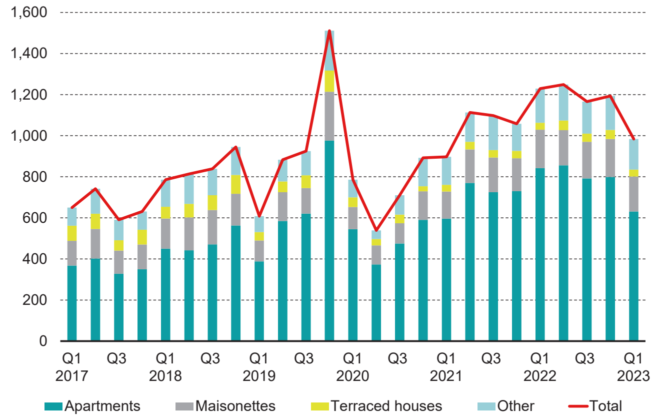
In the first quarter of 2023, the largest year-on-year decrease in absolute terms was recorded in Gozo, followed by the Southern Eastern and Western regions. Over 90% of transactions concluded in the first quarter of 2023 involved purchases by individuals. A quarter-on-quarter decline of 8.5% was recorded in the total value of final deeds.

At 3,125, the number of promise-of-sale agreements was 6.9% lower than those notified in the fourth quarter, but 14.0% higher than those registered in the same quarter of 2022, with the Northern Harbour registering the largest increase on this basis.

### *Mortgage transactions declined but remain above pre-pandemic average[10]*

The number of mortgage contracts declined in the first quarter of 2023, standing at 984. When compared with the first quarter of 2022, they stood lower by almost 20% (see Chart 3.10). This decrease was observed for

**Chart 3.10**
**MORTGAGE CONTRACTS**
*(number of contracts)*

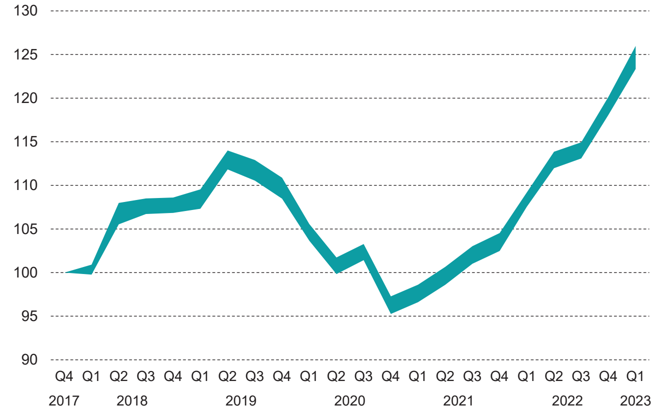



Source: Central Bank of Malta.

[10] The data used in the section are collected by the Central Bank of Malta from four commercial banks and relate only to properties which have been purchased with a mortgage. The dataset excludes properties that have either been transacted using other means of financing, as well as mortgages that have been refinanced. The property types included are flats, penthouses, maisonettes, terraced houses, town houses, houses of character, farmhouses, bungalows, and villas. Other property types included in the previous section such as airspace, boathouses, garages, and plots of land are excluded.

all property types, except for the terraced houses category, which remained unchanged. Notwithstanding this decline, the number of mortgage contracts in the first quarter of 2023 exceeded the average of 827 transactions per quarter recorded between 2017 and 2019.

Chart 3.11
ADVERTISED RENTAL PRICES
*(Index 2017Q4 = 100)*




Source: Central Bank of Malta.

### *Advertised rent prices continue to increase*

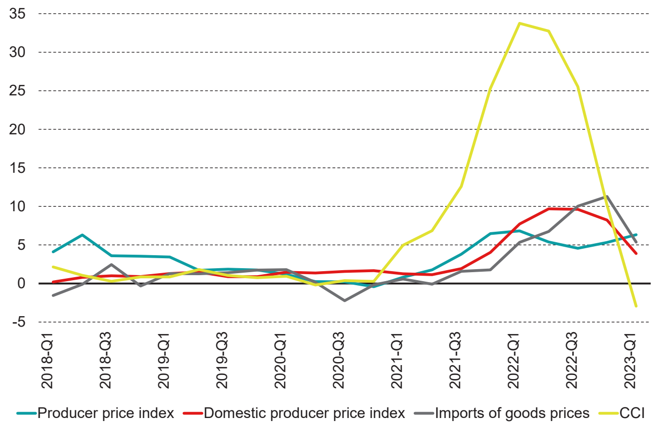
The annual rate of change of advertised rents collected from internet sources increased in the first quarter of 2023 compared with the previous quarter.[11] The range of estimates from various methods indicate that rents have increased at annual rates of between 14.5% and 15.6% in the quarter under review (see Chart 3.11). This is slightly lower than the annual rates registered in the previous quarter. Furthermore, the level of advertised rents remained around 14% above the pre-pandemic level, estimated in the final quarter of 2019.

## Cost indices

### *Producer cost indicators grow at a slower pace*

Annual inflation, based on the industrial producer price index, which is a measure of the change in the prices of goods sold by producers in the industrial sector, eased to 3.9% in the first quarter, from 5.3% in the previous quarter.[12] This was mainly driven by developments in intermediate goods prices, which were broadly unchanged in annual term after having increased by 5.6% in the previous quarter. On the other hand, producer prices for capital goods rose by 8.7% in this quarter, up from 2.2% previously. By contrast, consumer goods prices accelerated marginally to 9.3% from 9.1%. Meanwhile, energy producer price inflation remained zero in the period under review.

Chart 3.12
COST INDICATORS
*(annual percentage growth)*




Sources: Central Bank of Malta estimates: Eurostat data: NSO Data.

Other indicators affecting the domestic market also show a downward trend (see Chart 3.12). The domestic producer

[11] The empirical analysis is based on hedonic regression models as described in Debono et al., (2020) and different indices are constructed using alternative methodologies, namely the time dummy method, the rolling time dummy method with a window length of two periods (Q=2) and the average characteristics method chained using the Laspeyres, Paasche and Fisher methods. The properties considered in this analysis include apartments, maisonettes, and penthouses.

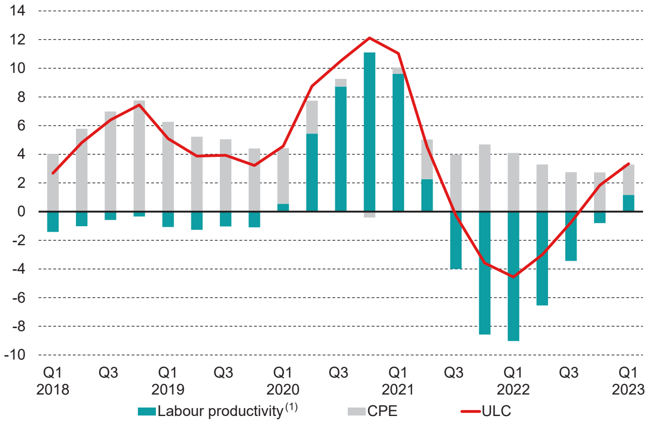
[12] The industrial producer price index measures the prices of goods at the factory gate and is commonly used to monitor inflationary pressures at the production stage.

price index grew at a slower pace of 3.9%, down from 8.2% in the last quarter.[13] The imports of goods deflator also shows weaker growth of 5.4% during the quarter under review, from 11.3% in the last quarter of 2022.[14] The construction cost index (CCI) for new residential buildings published by Eurostat declined by an annual 2.9% in the first quarter, after it had increased by 10.2% in the last quarter of 2022, Notwithstanding the recent decline, its level remains above that observed before 2020.

### *ULCs increase at a faster rate*

Malta's ULC index – measured as the ratio of compensation per employee (CPE) to labour productivity – increased during the first quarter of 2023, both in quarter-on-quarter terms, as well as in annual terms.[15] When measured on a four-quarter moving average basis in head-count terms, ULCs in Malta rose at an annual rate of 3.3%. This followed an increase of 1.8% in the previous quarter (see Chart 3.13). The recent rise in ULCs occurred as productivity declined while CPE continued to grow, albeit at a slower pace. Indeed, while labour productivity declined by 1.2% after growing by 0.8% in the previous quarter, growth in CPE decelerated to 2.1%, from 2.7% previously.

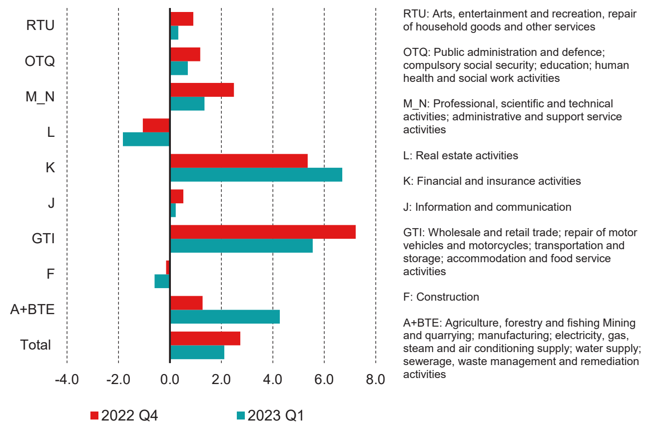
**Chart 3.13**
**DECOMPOSITION OF ULC (PER PERSON) IN MALTA**
*(annual percentage change; four-quarter moving average)*




Sources: NSO; Central Bank of Malta estimates.
(1) A rise (drop) in productivity contributes negatively (positively) to ULC growth.

When measured on a four-quarter moving average basis, growth in CPE was fastest in the financial and insurance activities sector, which had a year-on-year growth rate of 6.7% (see Chart 3.14). This was followed by the wholesale and retail sector, where compensation per person grew by 5.6%. Most of the other

**Chart 3.14**
**CPE BY SECTOR**
*(annual percentage growth; four-quarter moving average)*




Source: NSO data.

[13] The domestic producer price index refers to the producer prices relating to the domestic market only, whilst the producer price index relates to the total market, i.e., including both the domestic and non-domestic markets.
[14] This index is derived from national accounts data published by the NSO.
[15] Annual growth in ULC, CPE and labour productivity is measured on a four-quarter moving average basis. A degree of caution is required in the interpretation of ULC in view of contemporaneous structural shifts in the composition and factor-intensity of production, notably the shift to labour-intensive services. See Micallef, B. (2015), "Unit labour costs, wages and productivity in Malta: a sectoral and cross-country analysis", *Policy Note* August 2015, Central Bank of Malta, and Rapa, N. (2016), "Measuring international competitiveness", *Quarterly Review* 2016(1), 53-63, Central Bank of Malta.

sectors also show an increase in CPE. However, average compensation in the real estate activities and construction sectors declined by 1.8% and 0.6% respectively. Overall, most of the sectors experienced a deceleration in growth when compared to the last quarter, with the exception of financial and insurance activities, primary activities and the quarrying sector.

# 4. THE BALANCE OF PAYMENTS[1]

*During the first quarter of 2023, the current account deficit decreased when compared with the same quarter in the previous year. This was due to a narrowing of the merchandise trade deficit, higher net receipts from services, and marginally lower net outflows on the secondary income account. These offset higher net outflows on the primary income account.*

*In the quarter under review, net inflows on the capital account increased when compared to the corresponding quarter of 2022, while on the financial account, net lending was recorded as opposed to net borrowing previously.*

*The current account balance registered a deficit equivalent to 2.8% of GDP for the first quarter of 2023. This compares with a current account balance of -0.5% of GDP in the euro area.*

*The cyclically-adjusted current account balance is estimated to have recorded a deficit of 4.3% during the quarter under review.*

*During the first quarter of 2023, the tourism sector registered further gains. The number of inbound tourists, nights stayed, and tourist expenditure in Malta all increased when compared with a year earlier, and also exceeded 2019 levels.*

## The current account

### *The current account remains in deficit*

Between January and March 2023, the current account of the balance of payments registered a deficit of €14.7 million, €30.4 million less than the deficit recorded in the same quarter of 2022 (see Table 4.1). This was driven by a decrease in the merchandise trade deficit, higher net receipts from services, and lower net outflows on the secondary income account, which offset higher net outflows on the primary income account.

When measured over the year to March, the current account deficit increased significantly to €479.5 million, from €16.0 million a year earlier. The increase in the current account deficit was

**Table 4.1**
**BALANCE OF PAYMENTS**
*EUR millions*

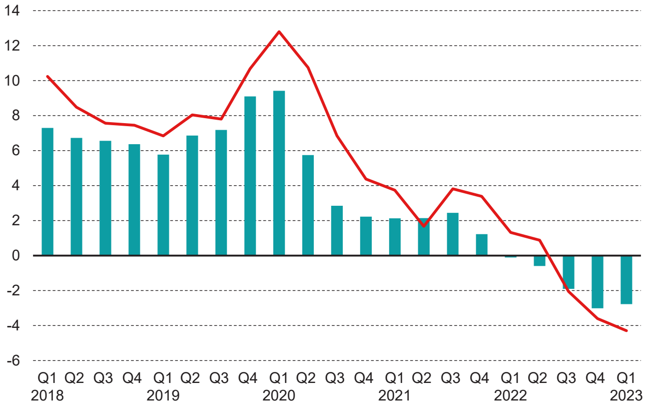
| | Four-quarter moving sums | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2022 Q1 | 2022 Q2 | 2022 Q3 | 2022 Q4 | 2023 Q1 | 2022 Q1 | 2023 Q1 |
| **Current account** | **-16.0** | **-95.2** | **-313.4** | **-509.9** | **-479.5** | **-45.1** | **-14.7** |
| Goods | -2,127.6 | -2,394.1 | -2,922.5 | -3,133.6 | -3,109.1 | -541.2 | -516.7 |
| Services | 4,237.6 | 4,618.4 | 4,933.2 | 5,065.4 | 5,131.4 | 1,038.2 | 1,104.3 |
| Primary income | -1,833.8 | -1,889.0 | -1,909.2 | -1,995.5 | -2,058.0 | -459.0 | -521.6 |
| Secondary income | -292.2 | -430.6 | -414.9 | -446.2 | -443.9 | -83.1 | -80.7 |
| **Capital account** | **197.4** | **242.0** | **235.6** | **265.8** | **357.0** | **53.1** | **144.3** |
| **Financial account(1)** | **-1,007.3** | **-1,660.9** | **-1,347.1** | **-160.9** | **1,676.5** | **-1,418.5** | **419.0** |
| **Errors and omissions** | **-1,188.6** | **-1,807.6** | **-1,269.2** | **83.1** | **1,799.0** | **-1,426.4** | **289.4** |

Source: Central Bank of Malta.
(1) Net lending (+) / net borrowing (-).

[1] Data in this chapter are sourced from the Central Bank of Malta and may differ from data published in NSO *News Release* 113/2023, which has an earlier cut-off date.

spurred by a significant widening in the merchandise trade deficit and, to a lesser extent, higher net outflows on the primary and secondary income accounts. Together, these offset an increase in net receipts from trade in services. As a result, the current account deficit-to-GDP ratio – reached 2.8% from 0.1% a year earlier (see Chart 4.1).

Chart 4.1
CURRENT ACCOUNT
*(four-quarter moving sums as a percentage of GDP)*




Sources: Eurostat; Central Bank of Malta.

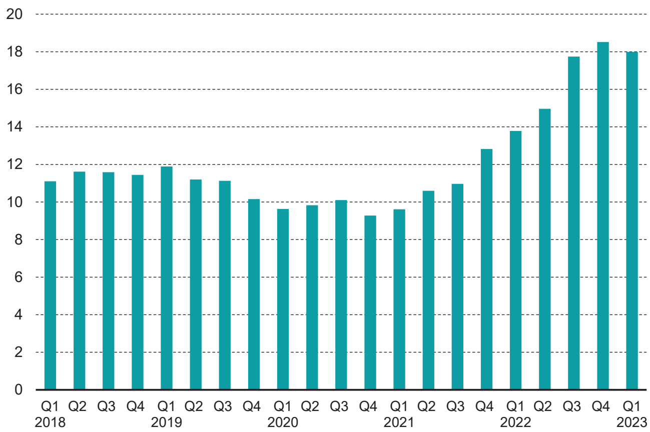
Malta's cyclically-adjusted current account deficit is estimated to have stood at 4.3% of GDP in the first quarter of 2023. The cyclically-adjusted measure broadly exhibits similar developments to the unadjusted measure (see Chart 4.1). However, in the quarter under review, it stood below the headline measure.[2]

### *Extraordinary factors drive the merchandise trade deficit*

In the first quarter of 2023, the merchandise trade deficit stood at €516.7 million, down from €541.2 million in the corresponding period of 2022. This was driven by a decrease in imports, which offset by smaller fall in exports. Imports of fuel, and extraordinary capital investment in the aviation sector were the main drivers behind the decline in imports.

The visible trade gap increased when measured on a four-quarter cumulative basis, reaching €3,109.1 million, from €2,127.6 million in the same period a year earlier. This reflected a €1,445.1 million rise in goods imports, in large part reflecting extraordinary imports of aircraft in the last three quarters of 2022. These outweighed a €463.7 million increase in exports. As a result, the share of the goods deficit in GDP rose to 18.0% in the year to March 2023, from 13.8% a year earlier (see Chart 4.2).

Chart 4.2
GOODS DEFICIT
*(four-quarter moving sums as a percentage of GDP)*



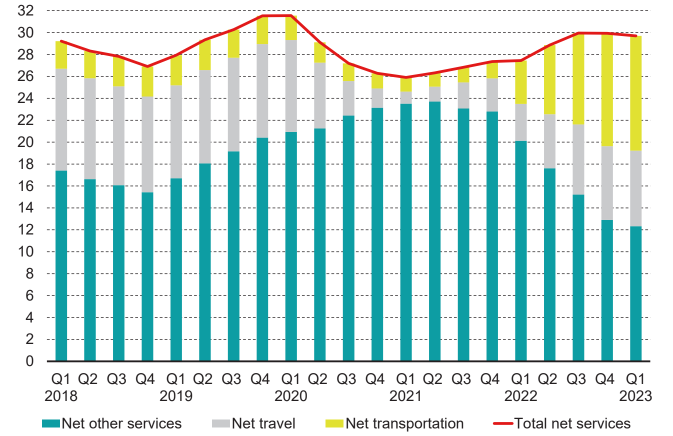

Sources: Eurostat; Central Bank of Malta.

### *The surplus on services widens*

In the quarter under review, net receipts on the services account amounted to €1,104.3 million, €66.1 million more than in the corresponding period of 2022. Both services exports and imports increased on a year earlier. However, the increase in the former was stronger.

[2] For more information on Malta's cyclically-adjusted current account see Grech, A. G., & Rapa, N., "An evaluation of recent shifts in Malta's current account position", in Grech, A.G., & Zerafa, S. (eds.), *Challenges and Opportunities of Sustainable Economic Growth: the Case of Malta*, Central Bank of Malta, 2017.

The transport and travel components drove the increase in the surplus from services. Net transport receipts increased by €65.1 million. Meanwhile, net receipts on the travel component rose by €53.6 million compared with the corresponding quarter of last year.



Sources: Eurostat; Central Bank of Malta.

By contrast, net receipts on 'other services' decreased by €52.6 million, mainly due to lower net receipts from personal, cultural, and recreational services, which includes gaming and betting activities, and higher net payments related to telecommunications, computer and information services. These offset lower net payments from other business services, particularly professional and management consulting services.

On a four-quarter cumulative basis, the overall surplus from services stood at €5,131.4 million, an increase of €893.8 million over the surplus recorded in the year to March 2022. The main contributor to this increase was the transport component. The share of net services receipts in GDP rose to 29.7%, from 27.5% over the same period last year (see Chart 4.3).

### *Net outflows on the primary income account increase*[3]

Between January and March 2023, net outflows on the primary income account stood at €521.6 million, €62.5 million more than in the first quarter of 2022. This was largely due to higher net payments related to direct investment income and lower net interest receipts from 'other 'investment income' which offset a decrease in net inflows related to income on portfolio investment.

When measured over the year to March 2023, net outflows on the primary income account increased by €224.1 million, to stand at €2,058.0 million. Transactions relating to primary income continued to be strongly influenced by internationally-oriented firms, which transact predominantly with non-residents. Over the year to March 2023, net outflows on the primary income account amounted to 11.9% of GDP.

### *Outflows on the secondary income account decline marginally*[4]

In the first quarter of the year, net outflows on the secondary income account declined by €2.4 million on a year earlier, to stand at €80.7 million.

Conversely, net outflows on this account increased substantially when measured on a four-quarter moving sum basis. These stood at €443.9 million, equivalent to 2.6% of GDP, and €151.7 million more than the amount recorded in the same quarter of 2022.

[3] The primary income account shows income flows related mainly to cross-border investment and compensation of employees.
[4] The secondary income account shows current transfers between residents and non-residents.

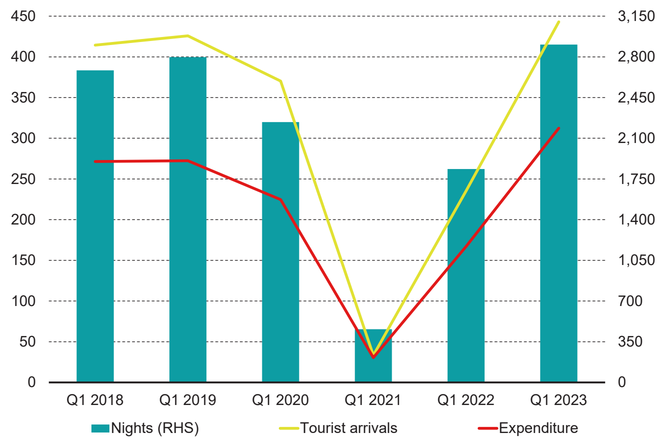
## Tourism activity

In the quarter under review, the number of inbound tourists amounted to 443,062, up from 235,295 a year earlier (see Chart 4.4). In absolute terms, tourists visiting for vacation purposes accounted for most of the annual increase in arrivals, even though those coming over for business and other motives also rose. The number of inbound tourists surpassed the level recorded in the first quarter of 2019 by around 4.0%.

The share of non-residents in collective accommodation establishments in the first quarter of 2023 rose. It stood at 82.3%, up from 75.3% in the first quarter of 2022, though still below the share of 84.8% recorded in the first quarter of 2019 (see Chart 4.5).

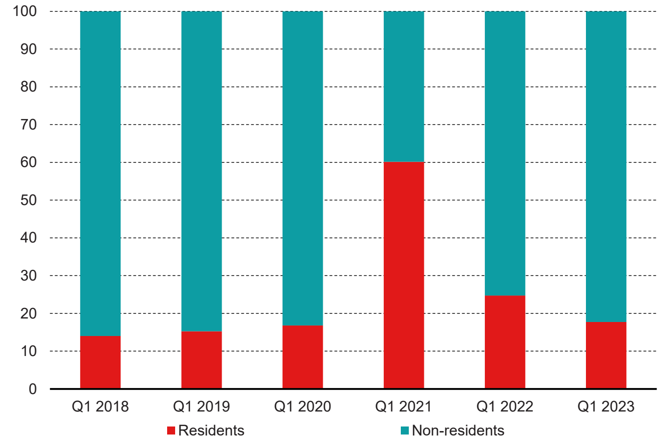
The total occupancy rate in collective accommodation establishments in the first quarter of 2023 rose to 45.3%, from 29.3% a year earlier (see Chart 4.6). However, it remained somewhat below that recorded in the first quarter of 2019, when it had stood at 47.7%. All categories reported increases in their occupancy rates over 2022, with the four-star and three-star categories registering the largest increases – of around 18.0 percentage points. The occupancy rate in the five-star category rose by 15.2 percentage points. Meanwhile, the smallest increase – of 7.5 percentage points – was registered in the two-star category. Occupancy

**Chart 4.4**
**TOURISM INDICATORS**
*(tourist arrivals and nights stayed in thousands; expenditure in EUR millions)*



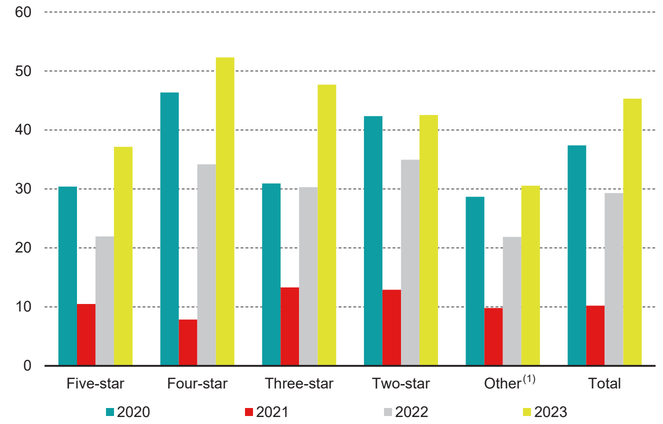

Source: NSO.

**Chart 4.5**
**GUESTS IN COLLECTIVE ACCOMMODATION ESTABLISHMENTS**
*(number of guests; per cent)*




Source: NSO.

**Chart 4.6**
**AVERAGE OCCUPANCY RATES IN THE FIRST QUARTER**
*(per cent)*




Source: NSO.
(1) Includes guest houses, hostels and holiday complexes.

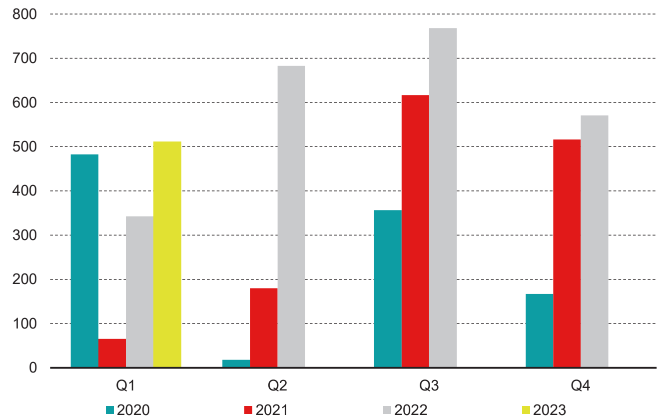
rates remained below those prevailing before the pandemic across all category levels, except for three-star accommodation.

Tourist expenditure in Malta totalled €312.4 million in the first quarter of 2023, up from €167.1 million a year earlier. For the quarter as a whole, total spending was 14.7% higher than the level registered in the corresponding period of 2019. When compared to 2022, all expenditure categories registered significant gains.

Expenditure per capita declined to €705.1, from €710.0 in the first quarter of 2022, as the average length of stay fell to 6.6 nights from 7.8 nights a year earlier. Expenditure per capita exceeded that recorded in the first quarter of 2019, while nights per capita stood at par.

According to Malta International Airport (MIA) data, in the first quarter of 2023, average seat capacity stood at 511,915 seats per month, up from 342,674 a year earlier (see Chart 4.7). Seat capacity was just 3.4% below the level recorded in the fist quarter of 2019.

**Chart 4.7**
**AVERAGE MONTHLY SEAT CAPACITY[1]**
*(thousands)*

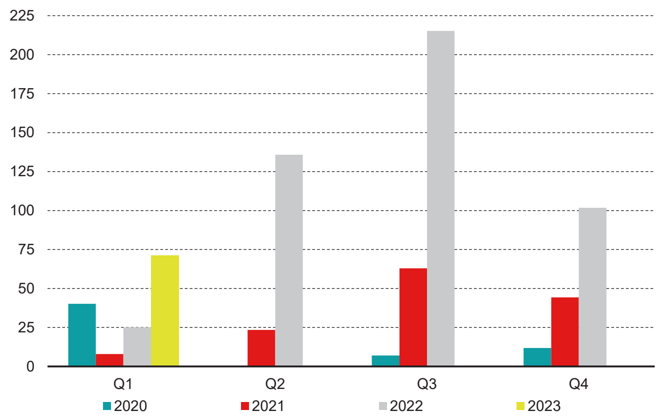



Source: MIA.
[1] Data include schedule and charter seats.

A total of 21 cruise liners visited Malta in the first quarter of 2023, two less than a year earlier. Nonetheless, foreign passengers reached 71,274 persons, almost three times more than the number that visited in the first quarter of 2022, and only 8.6% below the number recorded in the corresponding quarter of 2019 (see Chart 4.8).

Italian visitors comprised the largest share of total cruise passengers during the quarter under review, followed by visitors from Germany and France.

**Chart 4.8**
**CRUISE LINER PASSENGERS[1]**
*(thousands)*




Source: NSO.
[1] Ports were closed during the second quarter of 2020.

## The capital account

Net inflows on the capital account stood at €144.3 million in the first quarter of 2023, increasing from €53.1 million a year earlier (see Table 4.1). Capital inflows also increased when measured on a four-quarter cumulative basis, standing at €357.0 million, compared to €197.4 million during the 12 months to March 2022.

## 5. GOVERNMENT FINANCE

*In the first quarter of 2023, the general government deficit narrowed in level terms when compared to that recorded in the corresponding period of 2022. When measured on a four-quarter moving sum basis, the general government deficit stood at 4.9% of GDP, lower than the 5.8% registered in the fourth quarter of 2022. The general government debt-to-GDP ratio reached 53.6% at end-March 2023, higher than the 53.2% recorded in December 2022. The net financial worth as a share of GDP worsened in the quarter under review. Meanwhile, the cyclically-adjusted deficit ratio narrowed.*

### Quarterly developments

*General government deficit narrows in the first quarter*

In level terms, the general government registered a deficit of €245.5 million in the first quarter of 2023, a drop of €127.8 million when compared to the deficit registered in the corresponding period of 2022. This was mainly due to an increase in government revenue, although a drop in government expenditure also contributed. As a result, the primary deficit decreased to €202.0 million in the quarter under review, down from €335.8 million in the corresponding quarter of 2022.

*Higher tax receipts underpin revenue growth*

In the first quarter of 2023, general government revenue increased by €89.9 million, or 6.9%, when compared with the same quarter of 2022 (see Table 5.1). This was mainly driven by higher

**Table 5.1**
**REVENUE, EXPENDITURE AND DEBT**
*EUR millions*

| | 2022 | | | | 2023 | Change 2023Q1-2022Q1 | |
|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Amount | % |
| **Revenue** | **1,307.6** | **1,506.6** | **1,460.3** | **1,643.9** | **1,397.5** | **89.9** | **6.9** |
| Taxes on production and imports | 394.9 | 455.3 | 471.2 | 456.0 | 438.5 | 43.6 | 11.0 |
| Current taxes on income and wealth | 478.1 | 597.0 | 551.3 | 672.6 | 498.7 | 20.6 | 4.3 |
| Social contributions | 229.2 | 240.5 | 255.8 | 265.2 | 241.0 | 11.9 | 5.2 |
| Capital and current transfers receivable | 56.3 | 56.9 | 55.9 | 83.6 | 62.0 | 5.7 | 10.1 |
| Other(1) | 149.1 | 156.8 | 126.1 | 166.6 | 157.2 | 8.2 | 5.5 |
| **Expenditure** | **1,680.8** | **1,598.4** | **1,652.3** | **1,967.3** | **1,643.0** | **-37.9** | **-2.3** |
| Compensation of employees | 452.5 | 465.8 | 458.8 | 453.2 | 473.6 | 21.1 | 4.7 |
| Intermediate consumption | 321.3 | 350.2 | 304.9 | 391.0 | 329.4 | 8.1 | 2.5 |
| Social benefits | 421.4 | 352.8 | 326.4 | 388.4 | 448.4 | 27.0 | 6.4 |
| Subsidies | 161.1 | 161.1 | 263.1 | 264.9 | 144.0 | -17.1 | -10.6 |
| Interest | 37.4 | 42.1 | 41.7 | 44.7 | 43.5 | 6.1 | 16.3 |
| Other current transfers payable | 133.5 | 54.9 | 85.3 | 190.4 | 84.4 | -49.1 | -36.8 |
| GFCF | 121.1 | 138.8 | 131.1 | 172.8 | 94.7 | -26.5 | -21.8 |
| Capital transfers payable | 28.8 | 29.3 | 31.2 | 64.9 | 22.0 | -6.8 | -23.6 |
| Other(2) | 3.7 | 3.4 | 9.8 | -3.0 | 3.0 | -0.7 | |
| **Primary balance** | **-335.8** | **-49.8** | **-150.3** | **-278.7** | **-202.0** | **133.9** | |
| **General government balance** | **-373.2** | **-91.9** | **-192.0** | **-323.4** | **-245.5** | **127.8** | |
| **General government debt** | **8,651.3** | **8,595.5** | **8,695.0** | **9,003.4** | **9,255.1** | | |

Source: NSO.

(1) "Other" revenue includes market output as well as income derived from property and investments.

(2) "Other" expenditure principally reflects changes in the value of inventories and in the net acquisition of valuables and other assets.

tax revenue. In particular, inflows from taxes on production and imports rose by €43.6 million, mainly reflecting higher VAT receipts. Moreover, receipts from current taxes on income and wealth increased by €20.6 million in year-on-year terms, due to higher inflows from income taxes on households. Inflows from social contributions rose by €11.9 million, reflecting favourable labour market conditions. Meanwhile, non-tax revenue also rose when compared to a year earlier, partly due to higher inflows from sales and dividends.

### *Capital expenditure underpins the drop in expenditure*

Total government expenditure fell by €37.9 million, or 2.3%, when compared with the first quarter of 2022. When assessing developments by type of expenditure, the decline mainly stems from capital spending. This largely reflects a decline of €26.5 million in government investment, mainly attributable to lower outlays on road construction. Furthermore, capital transfers declined by €6.8 million.

Current expenditure also declined during the period under review. Outlays on current transfers payable recorded the largest fall, of €49.1 million, partly due to the timing of tax refunds to households. Moreover, subsidies fell by €17.1 million, mainly driven by a decline in spending on pandemic support, which outweighed a rise in outlays on energy support measures.

Meanwhile, spending on social benefits increased by €27.0 million, due to higher outlays on both transfers in cash as well as benefits in kind, such as the provision of free public transport. Compensation of employees increased by €21.1 million, largely on the back of higher spending related to public administration, education, and human health. Moreover, intermediate consumption and interest payments increased slightly by €8.1 million and €6.1 million, respectively.

### *Debt increases*

In March 2023, the stock of general government debt amounted to €9,255.1 million, €251.8 million higher than the level registered at end-December 2022. This reflects an increase in long-term debt securities outstanding (composed of MGS), which outweighed a decline in short-term debt securities outstanding (composed of Treasury bills). The former rose by €343.1 million, due to new MGS issues. As a result, their share in total debt rose by 1.6 percentage points, to 77.8%. Meanwhile, holdings of short-term debt securities fell by €91.2 million, and their share in total debt decreased by 1.2 percentage points to 7.7%.

The value of loans outstanding increased by €1.4 million. Their share in total debt stood at 9.4%, down from 9.6% in December 2022.

## Headline and cyclically-adjusted developments

### *Headline deficit ratio declines while debt ratio increases slightly*

When measured on a four-quarter moving sum basis, the general government deficit-to-GDP ratio narrowed by 0.9 percentage point, from 5.8% in the fourth quarter of 2022, to 4.9% in the quarter under review (see Chart 5.1). This was driven by a 1.1 percentage points fall in the expenditure-to-GDP ratio, to stand at 39.7%, and mainly reflects a decline in the share of current expenditure in GDP. The drop in the revenue-to-GDP ratio was more limited, at 0.2 percentage point. This share reached 34.8%, due to a decline in the share of current revenue in GDP.

Between December 2022 and March 2023, debt increased in level terms. During this period, the debt-to-GDP ratio increased by 0.4 percentage point, from 53.2% to 53.6%. The impact of transactions in financial assets and other deficit-debt adjustments on the debt ratio during this quarter was marginal (see Chart 5.2).

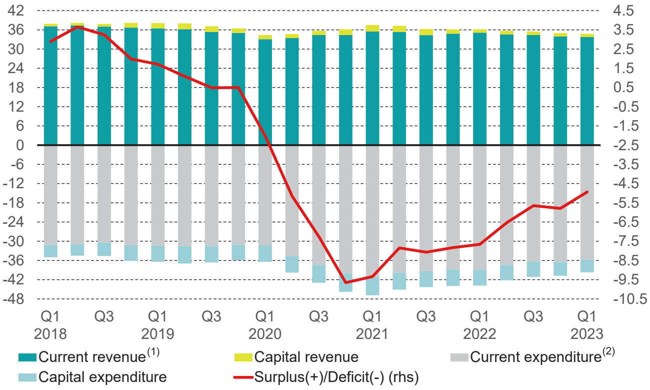
## *Net financial worth deteriorates*

The market value of financial liabilities held by the general government increased by €416.1 million during the first quarter of 2023, to stand at €10,742.8 million. This is mainly due to a strong rise in the value of debt securities, which reflects the abovementioned increase in long-term debt securities outstanding. Consequently, the share of financial liabilities in GDP rose by 1.1 percentage points, to reach 62.2% (see Chart 5.3).

The market value of financial assets fell to €4,794.2 million, €40.3 million less than the level as at end-December 2022. This was mainly due to a decline in the value of other accounts receivables, and loans payable to Government. Consequently, the share of financial assets in GDP dropped to 27.7%, from 28.6% in the previous quarter.

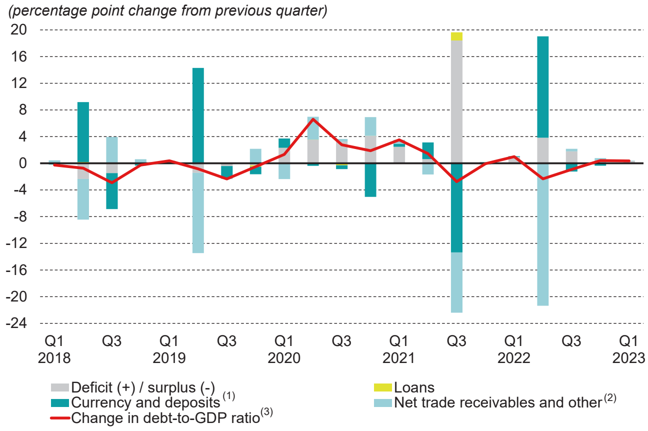
The resulting net financial worth of general government stood at -€5,948.6 million, which is a deterioration of €456.4 million compared to

**Chart 5.1**
**GENERAL GOVERNMENT REVENUE AND EXPENDITURE**
*(four-quarter moving sums; % of GDP)*



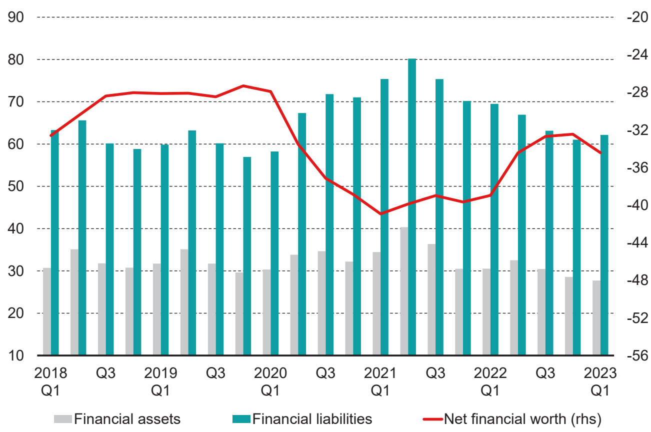

Sources: NSO; Central Bank of Malta.
(1) The term 'current revenue' represents most tax revenue as well as income from investments and sales. 'Capital revenue' mainly represents capital taxes and grants received.
(2) The term 'current expenditure' mainly represents spending on wages, social benefits and operational and maintenance expenses. 'Capital expenditure' mainly represents spending on investment and capital transfers.

**Chart 5.2**
**CONTRIBUTION TO CHANGE IN DEBT**
*(percentage point change from previous quarter)*




Source: Central Bank of Malta.
(1) Composed mainly of transactions in deposits held with the Central Bank of Malta.
(2) Also includes transactions related to shares and other equity and adjustments for valuation and volume effects.
(3) GDP data are four-quarter moving sums.

**Chart 5.3**
**GENERAL GOVERNMENT NET FINANCIAL WORTH**
*(% of GDP)* (1)




Sources: EUROSTAT; NSO.
(1) GDP data are four-quarter moving sums.

the previous quarter. As a share of GDP, the net financial worth deteriorated by 2.0 percentage points, standing at -34.4% by end-March.

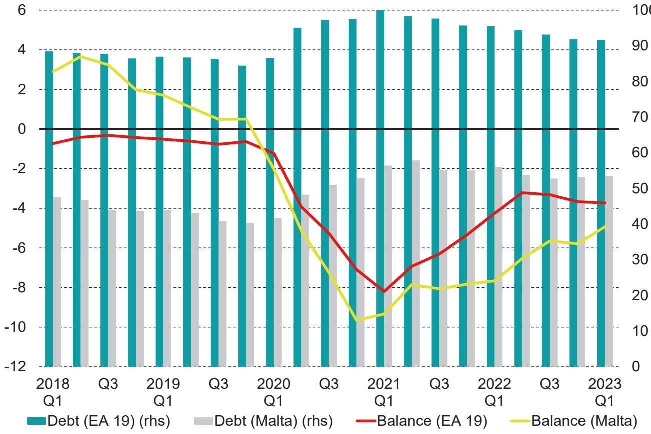
As a share in GDP, the net financial worth of the euro area deteriorated by 0.4 percentage point compared to December, to -57.2% of GDP. Thus the net worth position of the Maltese general government is still more favourable than that in the euro area.

### *Debt ratio continues to compare favourably with the euro area's*

During the quarter under review, the euro area general government deficit stood at 3.7% of GDP on a four-quarter moving sum basis, unchanged from the deficit registered at the end of 2022 (see Chart 5.4). Over the same period, the euro area debt ratio declined slightly to 91.7% of GDP, from 91.8% of GDP in the previous quarter.

The Maltese government debt-to-GDP ratio remains well below the corresponding ratio for the euro area, despite having a higher deficit.

**Chart 5.4**
**GENERAL GOVERNMENT BALANCE AND DEBT**
*(four-quarter moving sums; % of GDP)*

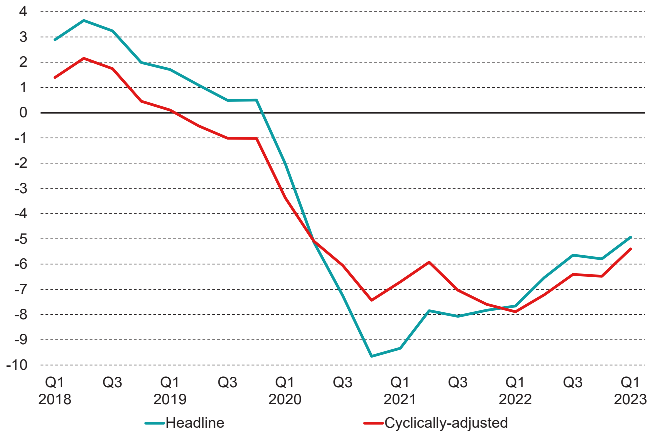



Sources: NSO; EUROSTAT.

### *Cyclically-adjusted deficit narrows*[1]

On a four-quarter moving sum basis, the cyclically-adjusted deficit stood at 5.4% of GDP in the quarter under review, 1.1 percentage points lower than that posted three months earlier (see Chart 5.5). This is broadly in line with the decrease in the headline deficit ratio over the same period.

**Chart 5.5**
**GENERAL GOVERNMENT BALANCE**
*(four-quarter moving sums; % of GDP)*




Sources: NSO; Central Bank of Malta estimates.

The share of cyclically-adjusted expenditure fell by 1.4 percentage points (see Table 5.2). Almost all categories of expenditure contributed to this decline. The ratio of 'other expenditure', declined by 0.7 percentage point, mostly due to

[1] The cyclically-adjusted balance is corrected for the impact of the economic cycle on government tax revenue and unemployment assistance. This methodology is in line with the approach used by the European Commission but is based on own estimates for fiscal items' elasticities and the output gap. For an overview of the method used by the Commission, see Mourre, G., Astarita C., and Princen S. (2014): "Adjusting the budget balance for the business cycle: the EU methodology," *European Economy – Economic Papers* 536, (DG ECFIN), European Commission.

**Table 5.2**
**QUARTER-ON-QUARTER CHANGES IN CYCLICALLY-ADJUSTED FISCAL COMPONENTS**
*Percentage points of GDP*

| | 2022 | | | | 2023 |
|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 |
| **Revenue** | **0.0** | **-0.5** | **-0.3** | **-0.6** | **-0.3** |
| Current taxes on income and wealth | 0.0 | -0.6 | 0.0 | 0.2 | -0.1 |
| Taxes on production and imports | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Social contributions | -0.1 | 0.0 | 0.0 | -0.4 | -0.1 |
| Other[(1)] | 0.0 | 0.1 | -0.3 | -0.3 | -0.2 |
| **Expenditure** | **0.3** | **-1.2** | **-1.1** | **-0.5** | **-1.4** |
| Compensation of employees | -0.2 | -0.2 | -0.2 | -0.3 | -0.2 |
| Intermediate consumption | 0.1 | 0.2 | -0.2 | -0.5 | -0.2 |
| Social benefits | 0.3 | -0.5 | -0.2 | 0.1 | -0.1 |
| Interest payments | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| GFCF | -0.1 | -0.1 | 0.0 | -0.2 | -0.2 |
| Other[(2)] | 0.2 | -0.6 | -0.3 | 0.4 | -0.7 |
| **Primary balance** | **-0.3** | **0.6** | **0.8** | **-0.1** | **1.1** |
| **General government balance** | **-0.3** | **0.7** | **0.8** | **-0.1** | **1.1** |

Sources: NSO; Central Bank of Malta estimates.

[(1)] Includes market output, income derived from property and investments and current and capital transfers received.

[(2)] Mainly includes subsidies, current and capital transfers.

the abovementioned fall in current transfers in the first three months of 2023. Moreover, compensation of employees, intermediate consumption, and government investment each fell by around 0.2 percentage point of GDP.

Overall, the share of cyclically-adjusted revenue in GDP declined by 0.3 percentage point. Tax and non-tax revenue contributed equally to this decline. Both the share of social contributions in GDP and the share of current taxes on income and wealth fell by 0.1 percentage point. The share of 'other revenues', declined by around 0.2 percentage point, mainly due to a fall in the ratio of sales.

## BOX 2: SUPPORT MEASURES AND THEIR IMPACT ON PUBLIC FINANCES[1]

This box assesses the support measures, introduced between 2020 and 2022, to mitigate the impact of COVID-19 and high inflation on the Maltese economy. It updates and builds upon a similar analysis published in 2022.

### Composition of support measures

*Covid-19 support measures*

COVID-19 support measures were introduced in 2020 and were mostly wound down in 2022. Measures affecting the government balance can be classified into four categories, depending on their stated function.[2] This classification is in line with the definitions used by the Maltese Government in its Stability Programme and Draft Budget Plans. The first category consists of economic support measures, which minimised the impact of COVID-19 on industries and employment. The second category refers to social measures providing additional assistance to vulnerable households. A third category of measures includes liquidity support to firms to bolster their working capital. The final set of measures reflects health-related expenditure.

According to the European System of Accounts (ESA) methodology, these measures were mostly classified as subsidies, social benefits, and intermediate consumption. Further details are available in the Box published in 2022.[3]

These measures amounted to 5.3% of GDP in 2020, and 4.6% of GDP in 2021 (see Table 1). The impact declined to 1.6% of GDP in 2022. This profile was mainly driven by economic support measures, which made up around 70% of the total impact in 2020, and around 80% of the impact in both 2021 and 2022. They amounted to 3.8% of GDP in 2020, 3.7% of GDP in 2021, and 1.3% of GDP in 2022.

The Wage Supplement Scheme constituted the largest measure within this category. Outlays on this scheme were highest in 2020, when the level of support for each firm was determined by the industry it operated in. During 2021, support started being determined by the declared loss in turnover compared with pre-pandemic times. From August 2021, the level of support for firms which reported relatively low losses in turnover was tapered down. The scheme was terminated at end-May 2022.

Health-related spending represents the second largest form of COVID-related spending, amounting to 1.3% of GDP in 2020, 0.7% of GDP in 2021, and 0.3% of GDP in 2022. Outlays were higher in 2020, due to one-off expenses related to orders for testing and

[1] Prepared by John Farrugia, Manager Fiscal Affairs and Reports Office. The views expressed are the author's own and do not necessarily reflect the views of the Central Bank of Malta.

[2] The tax deferral scheme and the Covid-19 Guarantee Scheme (CGS) are not covered in this assessment as these measures do not affect the budget balance. The general government accounts are adjusted for accruals and hence consider deferred taxes as part of tax revenue for the year in which they are due. Meanwhile, government guarantees do not affect the general government deficit unless they are called.

[3] See Attard and Farrugia (2022), "The Fiscal Response to the COVID-19 Pandemic", Box published in the *Quarterly Review* 2022:2.

**Table 1**
**COVID-19 FISCAL MEASURES AFFECTING THE BUDGET BALANCE**
*% of GDP* [(1)]

| Classification | Measures impacting budget balance | ESA classification | Budgetary impact | | |
|---|---|---|---|---|---|
| | | | 2020 | 2021 | 2022 |
| Economic support measures | Wage supplement scheme, support to workers in quarantine, distribution of vouchers to households, reduction of stamp duty on property purchases and schemes to facilitate investment in teleworking systems. | Subsidies, indirect taxes | 3.8 | 3.7 | 1.3 |
| Social measures | Additional social benefits to help working parents, the unemployed, persons with disabilities and persons classified as 'vulnerable' by the Superintendent of Public Health, extension of the In-work Benefit and a top-up of rent subsidies for low-income households. | Social benefits other than in kind | 0.1 | 0.0 | - |
| Liquidity support measures | Interest rate subsidy on CGS loans, subsidised commercial electricity bills for firms and a scheme to support business undertakings to provide training and development of their workforce. | Subsidies | 0.1 | 0.1 | 0.1 |
| Health-related measures | Cost associated with containment and treatment of the virus, testing, purchase of additional equipment, cleaning, cargo transportation, purchase and distribution of vaccines, other repatriation costs and the safe re-opening of schools. | Intermediate consumption, social benefits in kind, compensation of employees | 1.3 | 0.7 | 0.3 |
| **Total impact** | | | **5.3** | **4.6** | **1.6** |

Source: Author's calculations.

[(1)] Calculations based on NSO *News Release* 095/2023 (published on 30 May 2023).

Note: Figures may not add up due to rounding. Zero values imply the impact of the measure is less than 0.1% of GDP. A '-' sign indicates the measure was not implemented in that year.

protective equipment, the repatriation of travellers, and the safe reopening of schools once containment measures were eased later on.

Overall, liquidity support and social support measures did not exceed 0.1% of GDP in each year between 2020 and 2022. In level terms, liquidity support measures were highest in 2021, and mainly reflected refunds to commercial rents and electricity bills, and subsidised interest on CGS loans.[4] Meanwhile, social support measures were highest in 2020, due to the introduction of benefits to parents who stopped working while their children were taught from home. Social support measures expired in 2021.

Compared with the 2022 study, the impact of support measures on the budget balance was revised up by around 0.3% of GDP each year in 2020 and 2021. This was due to revisions in the data, new information from parliamentary questions, and revised estimates for the

[4] At end-2022, outstanding government guaranteed CGS loans amounted to 0.9% of GDP.

impact of reductions in tax and stamp duty on the purchase of property, which were repeatedly extended.

### *Inflation mitigation support measures*

Inflation-related support measures started being implemented at end-2021. Their impact on the budget balance amounted to 0.5% of GDP in 2021, and 2.5% of GDP in 2022 (see Table 2). These measures thus partly offset the deficit-reducing impact of the winding down of COVID-related support measures. The size and scope of these measures varies, depending on Government's stated aim.

In November 2021, duties on fuel products were reduced to the lowest permitted level in the EU. Through this measure, the retail price of products such as petrol and diesel remained unchanged. Although this reduction was initially intended to be temporary, it remained in effect as inflation rates remained elevated. This measure's impact on the budget balance is estimated at around 0.2% of GDP in 2022.

However, the largest measures consist of support to mitigate energy and other commodity price increases. These mostly take the form of subsidies, to cover increased operating costs of public sector entities, namely Enemalta, Enemed, and suppliers of liquid petroleum gas (LPG). They served to maintain fixed retail prices of electricity, fuel and LPG cylinders. On a cash basis, Government committed a significant level of support to these entities at end-2021 and made regular top-ups in 2022 as inflation rates continued to climb. However, according to the ESA methodology, the bulk of outlays were mostly due to operations carried out in 2022. These measures amounted to 0.5% of GDP in 2021, and 2.0% of GDP in 2022.

In addition, in March 2022 Government distributed a one-time cheque to all working citizens and pensioners due to the rising cost of living. In ESA terms, this measure is classified as current transfers paid. Its impact amounted to 0.3% of GDP in 2022.

**Table 2**
**INFLATION MITIGATING MEASURES AFFECTING THE BUDGET BALANCE**
*% of GDP* (1)

| Measure | ESA classification | Budgetary impact 2021 | Budgetary impact 2022 |
|---|---|---|---|
| Lower duties on fuel | Indirect taxes | 0.0 | 0.2 |
| Support to mitigate energy and commodity prices | Subsidies, capital transfers | 0.5 | 2.0 |
| Economic stimulus payment to households | Current transfers | - | 0.3 |
| Social measure targeting vulnerable households | Social benefits | - | 0.1 |
| **Total impact** | | **0.5** | **2.5** |

Sources: Author's calculations; 2023 *Stability Programme Update;* 2023 *Draft Budget Plan.*

(1) Calculations based on NSO *News Release* 095/2023 (published on 30 May 2023).

Note: Zero values imply the impact of the measure is less than 0.1% of GDP. A '-' sign indicates the measure was not implemented in that year.

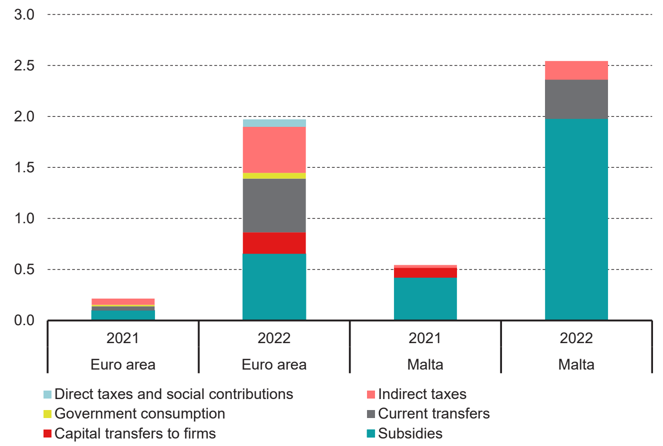
To reduce the impact of inflation on vulnerable households, the 2023 Budget introduced an extended COLA mechanism which acts as an additional social benefit. This benefit is given to low-income households during periods of high inflation.[5] It was first given out at end 2022 and amounted around 0.1% of GDP.

### *Comparisons with the euro area average*

Overall, the impact of COVID-related support measures was higher in Malta compared with the euro area average. For further details, please refer to the 2022 Box.

The impact of inflation mitigation measures implemented by the Maltese government was also higher than the euro area average, which amounted to around 0.2% of GDP in 2021 and around 2.0% of GDP in 2022 (see Chart 1).

**Chart 1**
**INFLATION MITIGATION SUPPORT MEASURES**
*(% of GDP)*




Sources: ESCB; author's calculations.

The majority of inflation mitigation measures in the euro area were expenditure-based, mostly in the form of higher subsidies (through price caps), and current transfers. This is similar to the approach adopted by the Maltese government. At the same time, around a quarter of measures in the euro area during 2021 and 2022 were in the form of cuts in indirect taxes. In contrast, in Malta the impact of lower indirect taxes in these years was around 6% of the total impact. Within the euro area, support measures also took the form of higher government consumption and capital transfers, as well as cuts in direct taxes to mitigate the bracket creep effect.

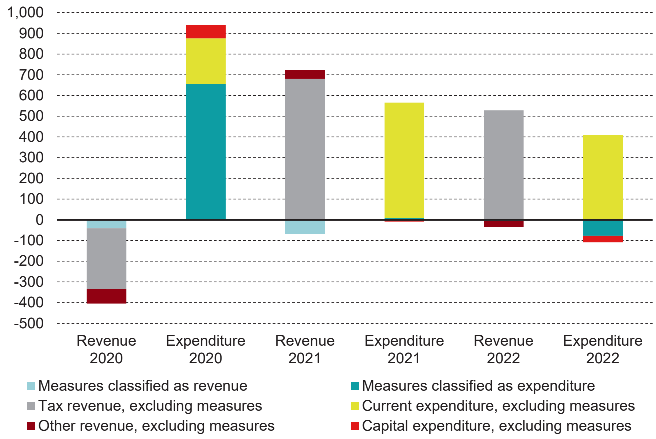
## Impact on the fiscal balance

The general government balance deteriorated from a surplus in 2019 to a sizeable deficit in 2020, and remained in deficit, albeit declining, during 2021 and 2022. The impact of the above-mentioned pandemic and inflation support measures on the fiscal balance can be analysed in a number of ways.

[5] A period of 'high inflation' is defined by two conditions. Firstly, overall inflation exceeds 2%. Secondly, the change in prices among at least three out of five components of the RPI index (food; housing; water, electricity, gas and fuels; household equipment and house maintenance cost; and personal health care) deemed to be essential for vulnerable households, exceeds their five-year rolling average increase. The eligibility of households is based on a formula which takes into account the number of persons in the household and their income relative to the median equivalised income. Further details are available here: https://parlament.mt/media/121288/01459.pdf.

Chart 2 shows year-on-year level changes in revenue and expenditure items, rather than differences in their share in GDP. This excludes the impact of the denominator effect in a period when GDP growth was strongly affected by COVID-related travel and social restrictions.

**Chart 2**
**ANNUAL CHANGE IN FISCAL ITEMS**
*(year-on-year absolute changes in EUR)*

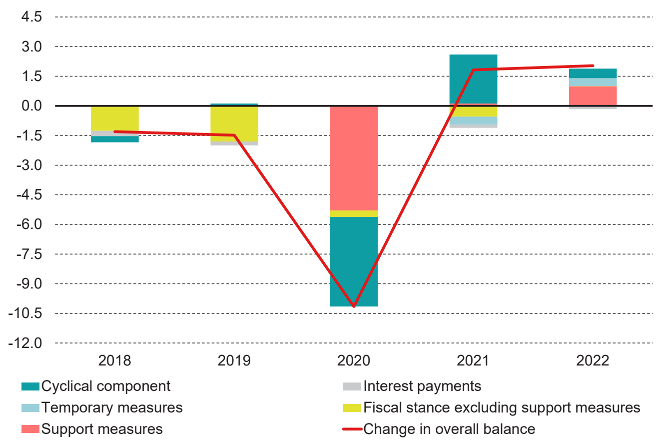



Sources: NSO; Central Bank of Malta.

On the revenue side, support measures did not have a large impact on the balance. The profile of government revenue is mostly determined by tax revenue, which declined sharply in 2020 but grew strongly in 2021 and in 2022. This is in line with developments in domestic economic activity at the time, and the recovery in tourism activity once all travel restrictions were lifted.

Support measures contributed around 70% of the increase in expenditure in 2020. Since outlays remained at elevated levels thereafter – they averaged around €660.0 million each year in 2020 and 2021, and around €590.0 million in 2022 – they do not contribute strongly to expenditure growth in subsequent years. The profile of expenditure is also affected by higher outlays on other current expenditure items. This partly reflects spending on budget measures such as an increase in retirement pensions, health treatment excluding COVID, the extension of school transport, and the introduction of free bus usage. 2021 also saw one-off payments to the EU budget and backdated payments following the signing of collective agreements. One-off subsidies also took place in 2022, due to the restructuring of Air Malta.

**Chart 3**
**CONTRIBUTIONS TO CHANGE IN FISCAL BALANCE**
*(% of GDP; year-on-year changes)*




Source: Author's calculations.

Overall, support measures and cyclical factors largely explain the strong deterioration in the fiscal balance in 2020, and the reduction in the deficit ratio in 2021 and 2022 (see Chart 3). The impact of interest payments and temporary measures in this period was minimal.[6]

[6] The term 'temporary measures' refers to extraordinary measures beyond government control. As a result, from the one-off measures mentioned in the main text, only transfers to the EU budget fall in this category.

Support measures account for the expansionary fiscal stance in 2020, and the contractionary stance in 2022.[7] The stance in 2021 is slightly expansionary, driven by outlays other than support measures.

### Implications for the medium term

According to the 2023 Stability Programme Update, Government expects to retain inflation-related support measures throughout the medium term (the Update includes fiscal forecasts until 2026). Government expenditure – particularly subsidies – is set to remain above pre-pandemic times in the coming years.[8]

In May 2023, the European Commission recommended that Malta winds down energy support measures by the end of the year and retain price support only to vulnerable households and firms.[9] This echoes similar recommendations made by the International Monetary Fund (IMF) in its 2022 Article IV consultation.[10]

In its proposed revamp of its economic surveillance framework, the Commission advocates for multi-year expenditure targets which will determine Member States' fiscal adjustment paths.[11] While these proposals are still being discussed in EU fora, there is broad agreement that adherence to expenditure targets, together with front-loaded consolidation efforts, is necessary to bring finances on a more sustainable footing. According to its latest debt sustainability analysis in the medium term, the Commission assigned a 'medium' risk level for Malta under a no-policy change scenario but considered risks to be 'low' in a scenario when the structural balance reverts to its historical average.[12]

Going forward, therefore, a review of the nature and composition of existing support measures is necessary in order to rebuild the fiscal buffers that can be utilised to stabilise the economy in the event of future shocks.

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[7] The fiscal stance is defined as the annual change in the primary structural balance ratio. The structural balance is in turn defined as the general government balance, adjusted for the impact of the economic cycle and excluding temporary measures.

[8] See also Farrugia (2023), "The Composition of Government Subsidies", Box published in the *Outlook for the Maltese Economy* 2023:2.

[9] See https://commission.europa.eu/system/files/2023-05/COM_2023_618_1_EN.pdf.

[10] See https://www.imf.org/en/Publications/CR/Issues/2023/02/07/Malta-2022-Article-IV-Consultation-Press-Release-and-Staff-Report-529430.

[11] See https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2393.

[12] For further details, refer to the 2022 Debt Sustainability Monitor.

# 6. MONETARY AND FINANCIAL DEVELOPMENTS

*According to the Bank's FCI, in the first quarter of 2023, financing conditions were tight from a historical perspective, but the degree of tightness diminished when compared to the last quarter of 2022.*

*In March, annual growth in Maltese residents' deposits with MFIs in Malta, moderated compared to December while the growth in credit to Maltese residents also slowed down.[1] This reflected a decline in credit to general government. Meanwhile, credit to residents outside general government accelerated, reflecting faster growth in loans to NFCs. Growth in loans to households eased slightly in the year to March, as mortgage credit moderated. The weighted average interest rate on deposits stood marginally above its year-ago level, while that on loans increased more significantly when compared with a year earlier. Thus, the spread between the two rates widened.*

*In March, the primary market yield on Treasury bills increased further from that prevailing three months earlier. Meanwhile, secondary market yields on five and ten-year MGS declined. As the domestic ten-year yield declined and the euro area benchmark yield rose, the spread against the latter narrowed. Domestic share prices declined marginally between December and March and were also lower compared with a year earlier.*

*During the quarter under review, the number of outstanding loans benefitting from guarantees in terms of the Malta Development Bank (MDB) schemes fell.*

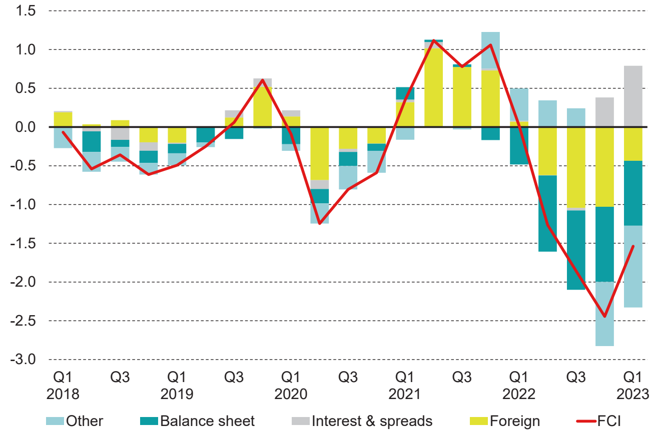
## Monetary and financial conditions

### *Financial conditions remain tight[2]*

According to the Bank's FCI, in the first quarter of 2023, financial conditions were tight from a historical perspective, but the extent of tightness decreased compared to the last quarter of 2022 (see Chart 6.1). The recent improvement in financial conditions was largely driven by a smaller tightening impact from foreign influences, which in turn reflected an increase in euro area stock prices, and lower levels of uncertainty.

Domestic factors also had a smaller tightening effect compared to the last quarter of 2022, driven by movements in the 'interest and spreads', and the 'balance sheet' components. The former was affected by a narrowing in the spread

**Chart 6.1**
**CONTRIBUTIONS TO THE FCI**
*(contributions to the index)*




Source: Central Bank of Malta estimates.

[1] Monetary data analysed in this chapter are compiled on the basis of the statistical standards found in the Statistics section of the Bank's website.

[2] This index is composed of various financial indicators, which are available at a high frequency. This section is based on quarterly averages for each indicator.

relative to the German ten-year sovereign yield as well as a smaller spread between MFI lending rates and the policy rate. Furthermore, the ‘balance sheet’ component had a smaller tightening effect, reflecting a smaller negative contribution from the return on equity. By contrast, the ‘other’ component had a stronger tightening effect on financial conditions compared with the previous quarter, driven by a larger year-on-year decline in net issues of securities issued by NFCs.

Financial conditions worsened considerably when compared to the first quarter of 2022. When measured on this basis, the additional tightening in financing conditions was mostly driven by domestic influences, largely reflecting a decline in net issues of NFC securities (part of the ‘other’ component), and a larger negative contribution from real deposits (part of the ‘balance sheet’ component). This was amplified by a fall in equity prices (part of the ‘other’ component).

Foreign factors also had a stronger tightening impact compared to the corresponding quarter of 2022, reflecting a decline in euro area stock prices and somewhat higher uncertainty.

### *Maltese residents’ deposits expand at a slower pace*

Total deposits held by Maltese residents with MFIs in Malta continued to expand, albeit at a more moderate pace than before. The annual rate of change stood at 0.9% in March, down from 3.0% in December 2022 (see Table 6.1).

During the 12 months to March, deposit growth remained driven by overnight deposits, which is the most liquid component. Annual growth in this category stood at 3.2% in March, below the 8.1% recorded three months earlier. The latest increase in this component was mainly driven by

**Table 6.1**
**DEPOSITS OF MALTESE RESIDENTS**

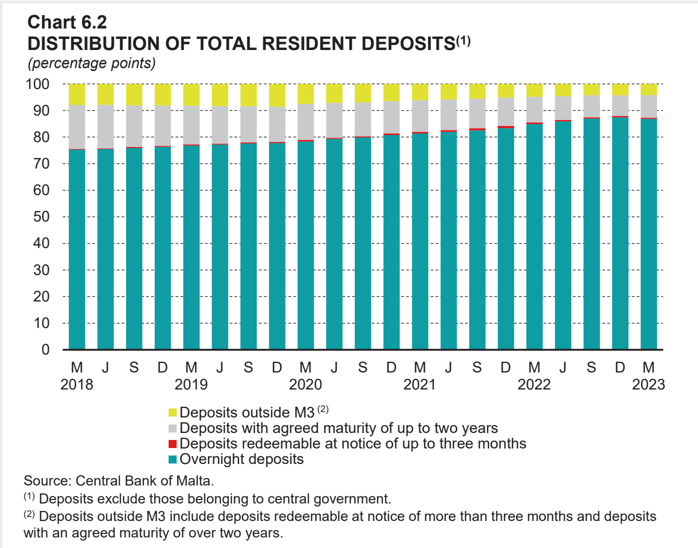
| | EUR millions | Annual percentage changes | | | | |
|---|---|---|---|---|---|---|
| | 2023 | 2022 | | | | 2023 |
| | Mar. | Mar. | June | Sep. | Dec. | Mar. |
| **Overnight deposits** | **20,290** | **13.3** | **13.4** | **12.7** | **8.1** | **3.2** |
| *of which* | | | | | | |
| Households | 14,132 | 14.2 | 13.4 | 14.8 | 12.4 | 7.8 |
| NFCs | 4,703 | 13.4 | 10.8 | 11.0 | 8.1 | 4.0 |
| **Deposits redeemable at notice of up to three months** | **112** | **6.9** | **-11.9** | **-36.6** | **-38.7** | **-21.0** |
| *of which* | | | | | | |
| Households | 39 | 10.7 | 6.2 | 3.5 | 5.4 | -1.4 |
| NFCs | 47 | 1.8 | -27.4 | -59.0 | -59.5 | -35.9 |
| **Deposits with an agreed maturity of up to two years** | **1,975** | **-12.3** | **-16.7** | **-20.4** | **-24.7** | **-11.4** |
| *of which* | | | | | | |
| Households | 1,449 | -13.7 | -20.4 | -26.7 | -27.6 | -15.4 |
| NFCs | 210 | -28.1 | 3.0 | 18.0 | -3.4 | 19.0 |
| **Deposits outside M3**[1] | **986** | **-13.6** | **-14.1** | **-17.1** | **-14.4** | **-12.4** |
| *of which* | | | | | | |
| Households | 936 | -12.6 | -11.3 | -12.2 | -9.6 | -7.3 |
| NFCs | 34 | 13.9 | -31.2 | -43.7 | -34.5 | -34.9 |
| **Total residents' deposits**[2] | **23,363** | **8.5** | **8.1** | **6.9** | **3.0** | **0.9** |

Source: Central Bank of Malta.

[1] Deposits outside M3 include deposits redeemable at notice of more than three months and deposits with an agreed maturity of over two years.

[2] Total residents' deposits exclude deposits belonging to central government.

an increase in households' balances. The share of overnight deposits in total deposits edged down to 86.8%, from 87.4% in December (see Chart 6.2).



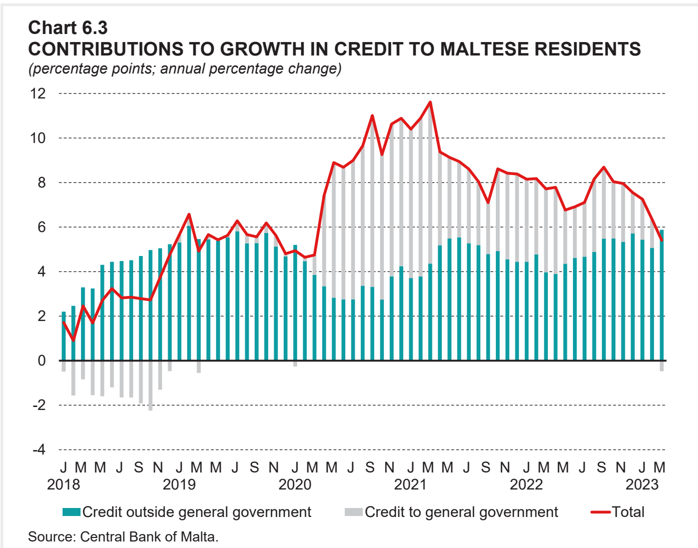

Deposits with an agreed maturity of up to three months fell by 21.0% since March 2022, after contracting by 38.7% in the year to December. Following this decline, their share in total deposits remained broadly unchanged from December's, at 0.5%.

Meanwhile, deposits with an agreed maturity of up to two years declined by 11.4% in March, after contracting by almost a fourth in December. Meanwhile, deposits classified outside M3 – which are mainly composed of deposits with an agreed maturity of over two years – fell by 12.4%, following a year-on-year decrease of 14.4% three months earlier. As a result, the share of these two categories of deposits stood at 8.5% and 4.2%, respectively, at the end of the first quarter.

### *Credit to residents grows at a slower pace*

Credit to Maltese residents expanded by 5.4% in the year to March, below the 7.5% registered in December, as growth in credit to general government turned negative. This contrasts with a faster increase in credit to residents outside general government (see Table 6.2 and Chart 6.3).

Credit to general government fell by 1.7% in the year to March, following an increase of 7.0% three months earlier. This was driven by a sharp decline in MFI holdings of Treasury bills over the 12 months to December. At the same time, growth in MFI holdings of Government stocks edged up to 6.2% in March, in line with the issuance profile of MGS.




The annual rate of change of credit to residents outside general government reached 8.1%, up from 7.8% three months earlier, largely reflecting faster growth in loans to the private sector. Furthermore, MFI holdings of securities issued by the

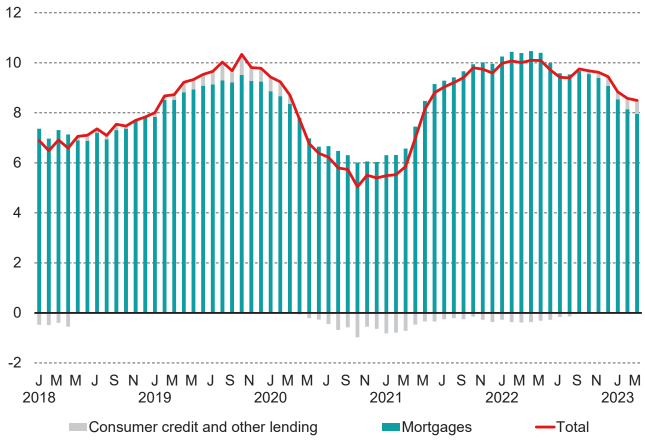
**Table 6.2**
**MFI CREDIT TO MALTESE RESIDENTS**

| | EUR millions | Annual percentage changes | | | | |
|---|---|---|---|---|---|---|
| | 2023 | 2022 | | | | 2023 |
| | Mar. | Mar. | June | Sep. | Dec. | Mar. |
| **Credit to general government** | **4,712** | **14.6** | **8.7** | **12.4** | **7.0** | **-1.7** |
| **Credit to residents outside general government** | **13,794** | **5.3** | **6.3** | **7.4** | **7.8** | **8.1** |
| Securities and equity | 320 | -0.2 | 0.0 | -0.3 | -5.8 | -2.2 |
| Loans | 13,474 | 5.5 | 6.4 | 7.6 | 8.1 | 8.4 |
| *of which:* | | | | | | |
| Loans to households | 7,787 | 10.0 | 9.7 | 9.8 | 9.4 | 8.5 |
| Mortgages | 7,219 | 11.4 | 10.9 | 10.5 | 9.8 | 8.6 |
| Consumer credit and other lending | 569 | -4.5 | -3.3 | 1.1 | 4.8 | 7.3 |
| Loans to NFCs[(1)] | 4,749 | -0.7 | 2.8 | 5.4 | 7.8 | 10.1 |
| **Total credit to residents** | **18,506** | **7.7** | **6.9** | **8.7** | **7.5** | **5.4** |

Source: Central Bank of Malta.
[(1)] NFCs include sole proprietors and non-profit institutions serving households (NPISH).

private sector decreased at a slower annual rate of 2.2%, following a decline of almost 6% in December 2022.

**Chart 6.4**
**CONTRIBUTIONS TO GROWTH IN LOANS TO HOUSEHOLDS**
*(percentage points; annual percentage change)*




Source: Central Bank of Malta.

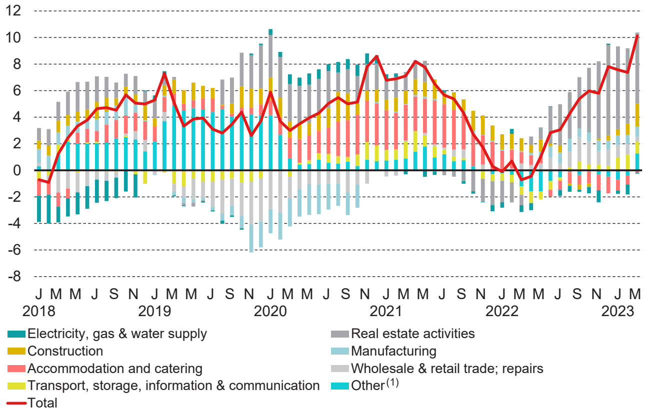
Growth in loans to households moderated to 8.5% on an annual basis, from 9.4% three months earlier, reflecting slower growth in mortgage lending. This component rose at an annual rate of 8.6% in March, down from 9.8% in December. By contrast, consumer credit and other lending grew at a faster rate of 7.3% after increasing by 4.8% in December. Meanwhile, loans to NFCs rose at an annual rate of 10.1%, above the 7.8% recorded three months earlier (see Chart 6.4).

The increase in loans to NFCs over the year to March was mainly driven by an increase in loans to private NFCs. Loans to public NFCs also increased over this period, albeit to a lower extent.

Sectoral data show that improved dynamics in loans were largely driven by a recovery in loans to the sector comprising professional, scientific and technical activities (part of the 'other' sector) (see Chart 6.5). This was followed by a faster increase in loans to the construction sector, and the sector comprising transport, storage, information and communication. At the same time, loans to the accommodation and catering sector decreased at a slower pace. By contrast, loans to the real estate sector, as well as the wholesale and retail trade sector, increased at a slower pace compared to December.

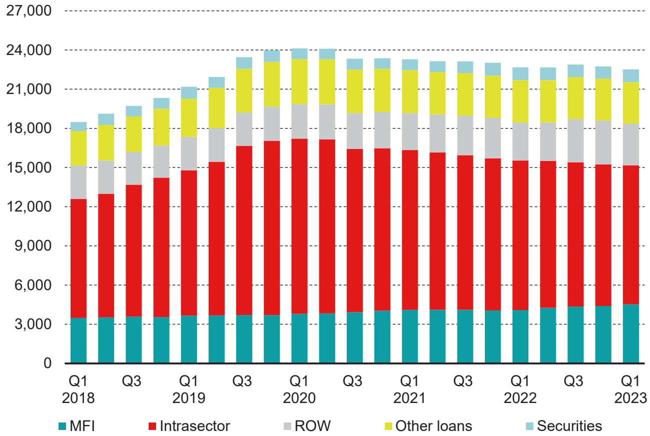
Financial accounts data show that the share of bank lending in total NFC debt was slightly above that recorded in December 2022, and exceeded the share recorded a year earlier (see Chart 6.6). NFCs had been consistently reducing their reliance on bank loans in recent years in favour of alternative sources, mainly intra-sectoral lending. As a result, the share of bank loans in total NFC debt reached a low of 15.4% at the end of 2019.[3] This ratio increased in the following years, in part as a result of firms' recourse to loan moratoria, and guaranteed loans during the pandemic. By March 2023, the share of bank loans in total NFC debt had reached 20.1%, up from 18.0% in the first quarter of 2022.

**Chart 6.5**
**LOANS TO NFCs BY SECTOR**
*(percentage points; annual percentage change)*




Source: Central Bank of Malta.
(1) Mainly includes entertainment, health, education, professional services, communication, and administration.

**Chart 6.6**
**NFC DEBT BY SOURCE**
*(end-of-period stocks in EUR millions)*




Source: Financial accounts.

The share of intra-sectoral lending in total NFC debt decreased to 47.3% in March, from 47.7% three months earlier. It also stood below the 50.5% registered a year earlier. The share of loans from non-residents was broadly unchanged from December, standing at 14.0% in March 2023, but stood slightly below the 14.3% recorded a year earlier. Meanwhile, the share of securities edged up from that recorded three months earlier but remained small, at 4.4%. This was broadly in line with the share recorded in March 2022.

## *Stock of securities of NFCs and financial corporations listed on Malta Stock Exchange increases*

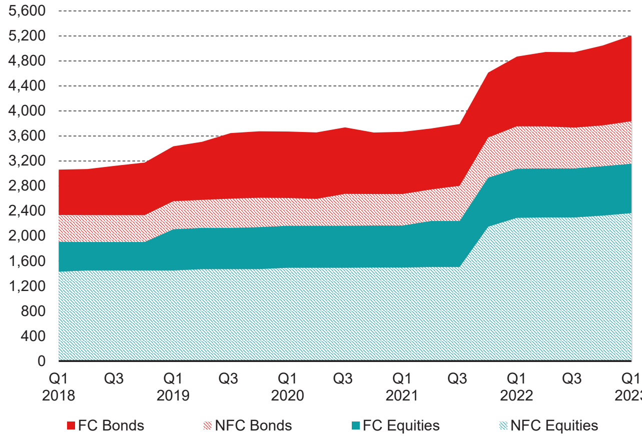
MSE data show that by March 2023, around €2,048.9 million in outstanding corporate debt securities were listed on the Exchange, 14.3% higher than the amount listed a year earlier (see Chart 6.7).[4] Around two thirds of this amount was issued by financial entities other than credit institutions. These also accounted for most of the increase since March 2022. The rest was issued by NFCs.

[3] See Darmanin, J. (2017), "The financing of companies in Malta", *Policy Note* July 2017, Central Bank of Malta.

[4] MSE data may differ from financial accounts data due to differences in valuation methodology and coverage. In particular, financial accounts data are at market value and include both listed and privately-placed securities. MSE data on corporates presented in Chart 6.7 are based on the official MSE list and thus exclude securities listed through Prospects. Chart 6.7 includes data on NFCs and financial corporations (FCs) other than MFIs.

Meanwhile, the outstanding amount of equity listed on the MSE increased by 2.7% in annual terms, to reach €3,157.5 million. Around three-fourths of this volume was issued by NFCs, with FCs playing a secondary role. The increase over the year to March was mostly driven by NFCs that operate within the real estate and construction sectors. The total amount of outstanding listed equity as at March 2023 exceeded that of bonds by over 654.[5]

**Chart 6.7**
**OUTSTANDING SECURITIES OF NFCs AND FCs LISTED ON MSE**
*(EUR millions outstanding as at end-period)*




Sources: MSE; Central Bank of Malta estimates.

## *Spread between deposit and lending rate widens*

During the year to March, the weighted average deposit rate offered on outstanding balances held by households and NFCs in Malta increased by 3 basis points, to 0.19% (see Table 6.3).[6] This was largely driven by a further increase in rates paid on households', and NFCs' outstanding

**Table 6.3**
**INTEREST RATES ON DEPOSITS AND LOANS**
*Percentages per annum to residents of Malta; weighted average rates as at end of period*

| | 2020 Mar. | 2021 Mar. | 2022 Mar. | 2022 June | 2022 Sep. | 2022 Dec. | 2023 Mar. |
|---|---|---|---|---|---|---|---|
| **Total deposits[(1)]** | **0.27** | **0.20** | **0.16** | **0.15** | **0.14** | **0.15** | **0.19** |
| *of which* | | | | | | | |
| **Overnight deposits** | | | | | | | |
| Households | 0.03 | 0.02 | 0.02 | 0.02 | 0.02 | 0.02 | 0.03 |
| NFCs | 0.02 | 0.01 | 0.03 | 0.03 | 0.02 | 0.03 | 0.07 |
| **Savings deposits redeemable at notice** | | | | | | | |
| Households | 0.86 | 0.45 | 0.38 | 0.38 | 0.17 | 0.16 | 0.16 |
| NFCs | 0.19 | 0.14 | 0.08 | 0.08 | 0.05 | 0.12 | 0.06 |
| **Time deposits (less than 2 years)** | | | | | | | |
| Households | 0.71 | 0.57 | 0.53 | 0.50 | 0.54 | 0.72 | 0.95 |
| NFCs | 0.70 | 0.62 | 0.44 | 0.47 | 0.59 | 0.74 | 0.95 |
| **Time deposits (more than 2 years)** | | | | | | | |
| Households | 1.95 | 1.80 | 1.78 | 1.78 | 1.77 | 1.73 | 1.73 |
| NFCs | 1.37 | 1.41 | 1.11 | 1.36 | 1.60 | 1.60 | 1.49 |
| **Total loans[(1)]** | **3.44** | **3.32** | **3.19** | **3.18** | **3.25** | **3.32** | **3.41** |
| *of which* | | | | | | | |
| Households and NPISH | 3.26 | 3.15 | 2.97 | 2.96 | 2.94 | 2.87 | 2.84 |
| NFCs | 3.74 | 3.60 | 3.59 | 3.60 | 3.82 | 4.15 | 4.45 |
| **Spread[(2)]** | **3.17** | **3.12** | **3.03** | **3.03** | **3.11** | **3.16** | **3.21** |
| ECB MROs rate | 0.00 | 0.00 | 0.00 | 0.00 | 1.25 | 2.50 | 3.50 |

Source: Central Bank of Malta.

[(1)] Annualised agreed rates on outstanding euro-denominated amounts belonging to households (incl. NPISH) and NFCs.
[(2)] Difference between composite lending rate and composite deposit rate.

[5] Apart from the official MSE platform, small and medium-sized enterprises (SMEs) can also obtain finance through the specifically-geared platform – Prospects.
[6] Basis points are rounded to the nearest whole number and hence may not exactly match the figures given in Table 6.3.

fixed deposits with a maturity of up to two years. These increased by 51 and 42 basis points, respectively. The rates paid on NFC's time deposits with a maturity of over two years also increased compared with 12 months earlier, rising by 38 basis points. By contrast, the rates paid on households' deposits with similar maturity decreased by 5 basis points. The rate on savings deposits redeemable at notice also decreased, with that on households' balances showing the most marked fall of 22 basis points, to 0.16%.

Meanwhile, the weighted average lending rate paid by households and NFCs to resident MFIs increased by 22 basis points, to 3.41%, over the year to March 2023. This increase was driven by rates paid by NFCs, which also remained above those charged to households, reflecting different assessments of credit risk in the two institutional sectors. This contrasts with a decline in rates on households' outstanding balances.

The spread between the weighted average lending rate and the deposit rate closed the quarter under review at 321 basis points, above the 303 basis points recorded 12 months earlier.

## Liquidity support measures

To alleviate liquidity challenges because of the pandemic, the Government launched the MDB's CGS. This scheme provides guarantees to commercial banks with the aim of enhancing access to new working capital loans for businesses. The scheme was eventually extended to cover the refinancing of loans. It enables credit institutions to leverage government guarantees for up to a total portfolio volume of €777.8 million.[7]

By the end of March 2023, 622 facilities were approved and still outstanding under the CGS, covering total sanctioned lending of €482.6 million, unchanged from the total amount of sanctioned lending in December (see Table 6.4). By end-March, the outstanding value of loans stood at €307.6 million, down from €330.2 million at end-December 2022. Around two thirds of these loans will mature in 2026. Most of the remaining balance is expected to mature in 2027.

The sector comprising wholesale and retail activities had the largest outstanding number of facilities benefitting from the scheme. By end-March 2023, 170 facilities were approved and still outstanding, with a sanctioned value of €89.8 million. This was followed by accommodation and food services activities, with 146 facilities and a sanctioned amount of €119.0 million.

In May 2022, the MDB launched the first of three support measures in response to the war in Ukraine and high inflation. The Subsidised Loan Scheme (SLS) covering grain importers provides temporary urgent liquidity support, backed by government guarantees, to importers and wholesalers of grains and animal feed, thereby ensuring the security of supply of such products. By end-March 2023, three facilities were approved, covering total sanctioned lending of €14.2 million. The outstanding level of disbursements from this scheme stood at €9.5 million.

In June 2022, the MDB launched the Liquidity Support Guarantee Scheme (LSGS), which consists of two measures: LSGS-A provides bank financing support to all undertakings affected by the extraordinary circumstances caused by the war in Ukraine, while LSGS-B is specific to fuel and oil importers. A total portfolio of €100 million and €50 million in working capital loans are available under LSGS-A and LSGS-B, respectively. Government guarantees cover 90% of each

[7] The MDB CGS was approved by the European Commission on 2 April 2020. See https://mdb.org.mt/en/Schemes-and-Projects/Pages/MDB-Working-Capital-Guarantee-Scheme.aspx for further details.

**Table 6.4**
**MDB COVID-19 GUARANTEE SCHEME – AS AT MARCH 2023**
*Number of facilities approved and still outstanding; EUR millions*

| | As at December 2022 | | As at March 2023 | |
|---|---|---|---|---|
| | Total number of facilities[1] | Sanctioned amount[2] | Total number of facilities[1] | Sanctioned amount[2] |
| Manufacturing | 55 | 24.5 | 55 | 24.5 |
| Construction | 34 | 46.8 | 34 | 46.8 |
| Wholesale and retail trade; repair of motor vehicles and motor cycles | 170 | 89.8 | 170 | 89.8 |
| Transportation and storage and information and communication | 39 | 45.2 | 39 | 45.2 |
| Accommodation and food service activities | 146 | 119.0 | 146 | 119.0 |
| Professional, scientific and technical activities | 37 | 20.4 | 37 | 20.4 |
| Administrative and support service activities | 38 | 13.7 | 38 | 13.7 |
| Real estate activities | 17 | 7.3 | 17 | 7.3 |
| Other[3] | 86 | 115.9 | 86 | 115.9 |
| **Total** | **622** | **482.6** | **622** | **482.6** |

Source: MDB.

[1] The number of facilities taken by various sectors.

[2] The total number of loans sanctioned under the scheme as at end month, in EUR millions.

[3] Includes loans to education, health and social work, financial and insurance activities, arts, entertainment and recreation, other services activities and extra-territorial bodies & organisations, and the electricity, gas & water supply sector.

working capital loan under LSGS-A, and 80% under LSGS-B. By the end of March 2023, a total of €24.5 million was approved under one of these schemes.

### *Bank Lending Survey generally indicates broadly unchanged credit standards*

According to the April Bank Lending Survey (BLS), in the first quarter of 2023, all participating banks reported unchanged credit standards and terms and conditions for NFCs in Malta. Banks also expected credit standards on such loans to remain unchanged in the second quarter. As regards the demand for credit by NFCs, this was also deemed to have remained unchanged, and no changes were expected in the second quarter.

Credit standards on loans for house purchases, consumer credit and other lending were assessed to have remained unchanged by the majority of surveyed banks in the first quarter of 2023. All participating banks expected credit standards for consumer credit and other lending to remain unchanged in the second quarter. In the case of loans for house purchases, credit standards were also generally expected to remain unchanged.

Half of the banks reported no changes in terms and conditions for house purchases, with the remaining half saying that conditions were somewhat tighter. Meanwhile, the majority of respondent banks reported no changes in terms and conditions for consumer credit and other lending.

Demand for loans for house purchases, consumer credit and other lending was assessed to have remained unchanged by most of the participating banks in the first quarter, and all banks were expecting stable demand in the following quarter.

The April BLS also posed ad hoc questions on changes in banks' access to wholesale and retail funding, as a result of the prevailing situation in financial markets. No impacts were reported as regards access to interbank unsecured money markets, debt securities, securitisation, or the ability to transfer risks off balance sheet. However, some tightening effect was reported in terms of access to retail funding. This assessment was also reflected in expectations for the second quarter.

Respondent banks were also asked whether the ECB's monetary asset portfolio led to a change in their assets or affected their bank's cost of funds and balance sheet constraints, profitability and capital position. The majority of surveyed banks reported no changes and this scenario was expected to remain unchanged in the six months ahead.

Similarly, most of the participating banks reported no changes in credit standards, terms and conditions, and lending volumes, as a result of the ECB's monetary policy portfolio. For the following six months, the majority of banks also expected no impact.

Respondent banks were asked to gauge the impact of the Eurosystems's third series of TLTROs. All respondents reported no impact on their bank's financial situation, lending policy and lending volumes. This scenario was expected to remain the same in the six months ahead.

Finally, participating banks were asked whether the ECB key interest rates decisions (both those already taken and those expected) led to a change in their profitability. In this regard, the majority of banks reported an increase in their overall profitability owing to higher interest income, while a broadly neutral impact was reported in terms of non-interest income. The majority also felt that the ECB's decisions regarding interest rates will lead to an increase in net interest income in the coming six months.

## The money market

During the first quarter of 2023, the Government issued €649.9 million in Treasury bills (before redemptions), €83.2 million more than the amount issued in the fourth quarter of 2022.

In the domestic primary market, the yield on three-month Treasury bills rose further to 2.89% by the end of March, from 2.23% at end-2022.

## The capital market

During the first quarter of 2023, the Government issued four new MGS with a total value of €349.2 million. Five private sector institutions also launched new bond issues on the MSE. Mariner Finance plc, Pharmacare Finance plc and GPH Malta Finance plc issued unsecured bonds worth €36.9 million, €17.0 million and €18.1 million, respectively. Meanwhile, CF Estates Finance plc issued €30.0 million in secured bonds, as did Qawra Palace plc which issued €25.0 million in secured bonds.

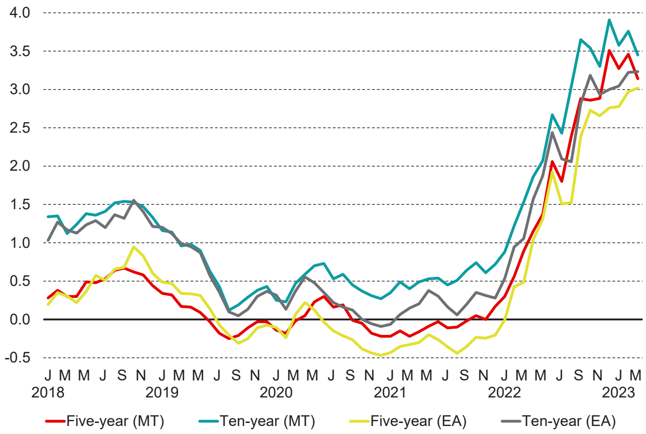
By the end of March, 21 firms had bonds that were listed on the MSE through Prospects, an unchanged number compared with end-December.[8]

In the secondary market, turnover in government bonds more than halved, falling to €16.6 million, from €33.8 million in the last quarter of 2022. Meanwhile, turnover in corporate bonds rose to €27.8 million, from €15.2 million previously.

[8] Prospects is a multi-lateral trading facility operated by the MSE with the aim of facilitating access to capital markets for SMEs.

After rising considerably in previous months, the yield on five-year bonds fell to 3.14% at the end of March, from 3.51% three months earlier (see Chart 6.8). The yield on ten-year bonds also fell, reaching 3.45% from 3.91% at the end of 2022. On the other hand, the euro area benchmark yield on five-year bonds rose to 3.02% from 2.76%, while the benchmark yield on ten-year bonds increased to 3.23% from 3.00%. As the domestic ten-year yield declined while the euro area benchmark yield rose, the spread against the latter narrowed to 22 basis points, from 91 basis points in December.

**Chart 6.8**
**GOVERNMENT BOND YIELDS**
*(percentages per annum; end of month)*




Sources: Central Bank of Malta; ECB.

*MSE Share Index declines marginally during the quarter*

During the first quarter of 2023, share prices in Malta fell marginally. The MSE Equity Price Index ended the quarter 0.4% lower than its level at end-December and was 2.2% below its reading a year earlier (see Chart 6.9). Meanwhile, the MSE Equity Total Return Index, which accounts for changes in equity prices and dividends, was relatively stable declining by just 0.1% between end-December and end-March.

**Chart 6.9**
**MSE EQUITY PRICE INDEX**
*(end of month)*


Source: MSE.

Equity turnover rose to €11.1 million during the first quarter of 2023, from €6.3 million in the previous quarter.

## BOX 3: LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM MAINTENANCE PERIOD 1 TO MAINTENANCE PERIOD 8 OF 2022[1,2]

### Introduction

This box describes the liquidity conditions in the Maltese banking system, and the monetary policy operations conducted by the Bank, as part of the Eurosystem's single monetary policy framework during the eight maintenance periods (MPs), starting from 9 February 2022 and ending on 7 February 2023.

During the period under consideration, the Eurosystem continued with the net purchase phase of the APP until end June 2022, resulting in the Eurosystem purchasing public sector debt securities, covered bonds, asset-backed securities as well as corporate sector debt securities. From 1 July 2022 until the end of February 2023, the Eurosystem continued to reinvest, in full, the principal payments from maturing securities under the APP. The Bank only participates in the Public Sector Purchase Programme (PSPP) component of the APP.

Furthermore, the Eurosystem continued with the net purchase phase of the PEPP that was introduced on 18 March 2020, in response to the COVID-19 pandemic, until end March 2022. The PEPP comprises the same purchasing components of the APP, though with greater flexibility across asset classes and jurisdictions. Like the APP, the Bank only purchases public sector debt securities under the PEPP. As from 1 April 2022, the ECB started the reinvestment phase of the PEPP portfolio and expects to reinvest the maturing principal payments from securities purchased under the PEPP until at least the end of 2024.[3]

During the period under review, the Governing Council recalibrated the conditions of the third series of TLTRO-IIIs, as part of the monetary policy measures adopted to restore price stability over the medium term. From 23 November 2022 until the maturity or early repayment date of each respective outstanding TLTRO-III operation, the interest rate is indexed to the average applicable key ECB interest rates over this period. Furthermore, three additional voluntary early repayment dates were introduced to provide TLTRO-III participants with additional opportunities to partly, or fully, repay their respective TLTRO-III borrowings before their maturity.

Also, the four pandemic emergency longer-term refinancing operations (PELTROs) allotted on a quarterly basis in 2021, matured during the reporting period.

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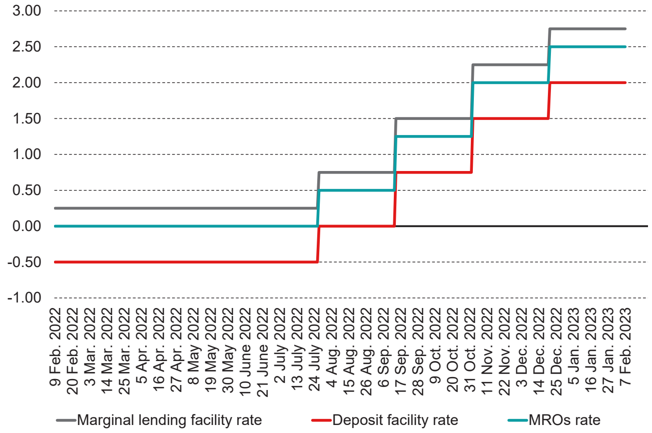
[1] Prepared by Ritlen Abela, Officer II, Monetary Operations and Government Securities Office and reviewed by Josette Grech, Head, Monetary Operations and Government Securities Department and André Psaila, Chief Investment Officer, Financial Markets Division. The views expressed in the Box are the authors' own and do not necessarily reflect the views of the Bank.

[2] MP2022 01 (9 February-15 March); MP2022 02 (16 March-19 April); MP2022 03 (20 April-14 June); MP2022 04 (15 June-26 July); MP2022 05 (27 July-13 September); MP2022 06 (14 September-1 November); MP2022 07 (2 November-20 December); MP2022 08 (21 December-7 February 2023).

[3] In July 2022, the Governing Council approved the Transmission Protection Instrument to support the effective transmission of monetary policy which is an addition to the ECB's toolkit and can be activated to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across the euro area.

In line with the Governing Council's strong commitment to its price stability mandate, the ECB's key interest rates were raised four times during the review period to ensure that inflation returns to its 2% target over the medium term. The increasing interest rates will, over time, reduce inflation by dampening demand, and will also guard against the risk of a persistent upward shift in inflation expectations.

Chart 1
KEY INTEREST RATE DEVELOPMENTS
*(per cent)*




Source: ECB.

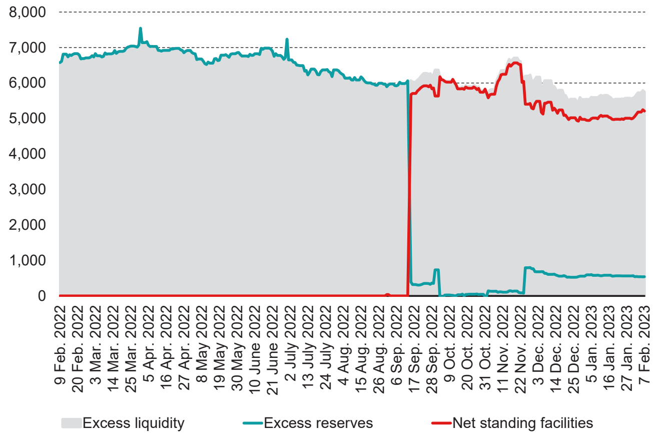
At the beginning of the period, the rates on the MROs, the marginal lending facility, and the overnight deposit facility, stood at 0.00%, 0.25% and -0.50%, respectively. Effective from MP5, the key interest rates were raised by 50 basis points. Two further 75 basis point increases became effective in MP6 and MP7, with another 50 basis points implemented as from MP8. As at MP8, the rates on the MROs, the marginal lending facility and the overnight deposit facility stood at 2.50%, 2.75% and 2.00%, respectively (see Chart 1).

## Excess liquidity

Throughout the period, the Maltese banking system remained characterised by high levels of excess liquidity. Excess liquidity is defined as the amount of deposits placed by banks at the overnight deposit facility of the Bank, net of the recourse to the marginal lending facility, plus current account holdings, in excess of the minimum reserve requirements (excess reserves).

At the beginning of the period, excess liquidity stood at €6,574.0 million, which was fully attributable to excess reserves (see Chart 2). This gradually decreased reaching €5,751.3 million on 7 February 2023, consisting of

Chart 2
EXCESS LIQUIDITY BETWEEN MP1 AND MP8 2022
*(EUR millions)*




Source: Central Bank of Malta.

€541.9 million in excess reserves and €5,209.4 million in overnight deposits. The daily average excess liquidity was €6,335.6 million, reaching a peak of €7,544.4 million on 31 March 2022.

During the period under review, average excess reserves stood at €4,107.3 million. On 9 February 2022, excess reserves stood at €6,574.0 million, and decreased to €3,314.9 million on 14 September 2022, when the deposit facility rate (DFR) was raised above zero. It decreased further in the following days, standing at €304.4 million on 20 September. In fact, following the move of the DFR into positive territory, counterparties shifted their current account holdings to the overnight deposit facility. By then, the two-tier system, which had been activated in October 2019 to exempt part of the credit institutions' excess reserve holdings from remuneration at the negative rate applicable on the deposit facility, was suspended. The suspension of the two-tier system did not materially affect excess liquidity in the Maltese banking system or its composition. However, until the two-tier system was in place, credit institutions in Malta benefitted from an estimated saving of €3.4 million in interest expense, compared to a situation where a negative interest rate would have applied to all their excess reserves. Furthermore, with effect from 21 December 2022, the Governing Council decided to set the remuneration of minimum reserves at the Eurosystem's DFR.

Developments in excess liquidity also reflect the use of standing facilities. Standing facilities are monetary policy instruments that facilitate the provision and absorption of overnight liquidity. The Eurosystem provides two types of standing facilities: the marginal lending facility and the overnight deposit facility. The marginal lending facility allows counterparties to borrow to meet short-term liquidity needs. On the other hand, the deposit facility allows counterparties to deposit overnight funds with the Eurosystem.

During the reporting period, there was no utilisation of the marginal lending facility by local credit institutions. Additionally, along the eight MPs reviewed, the daily average for overnight deposits amounted to €2,228.3 million. There was no daily participation until 14 September 2022, when counterparties shifted most of their excess liquidity holdings to the overnight deposit facility, reaching a peak of €6,567.3 million on 18 November 2022.

By the end of MP8, excess liquidity in Malta was equivalent to a third of GDP. This compares with 30.6% in the euro area. When expressed as a share of GDP, Malta's excess liquidity was the seventh highest in the euro area.

### Autonomous liquidity factors

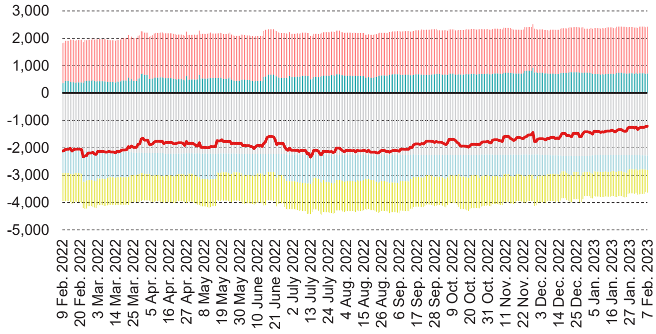
Autonomous liquidity factors are items in the central bank balance sheet that are neither monetary policy operations nor current account holdings of credit institutions. As the transactions driving autonomous factors involve central bank money, they have a liquidity-providing or liquidity-absorbing effect.[4,5] Essentially, increases in central bank assets entail the provision of liquidity, while increases in central bank liabilities involve the absorption of liquidity, and vice-versa.

4 Liquidity-providing factors include net foreign assets and net assets denominated in euro.

5 Liquidity-absorbing factors consist of government deposits, banknotes in circulation and other autonomous factors.

Autonomous factors were net liquidity absorbing and stood at an average of €1,843.6 million throughout the eight MPs under review.[6] It can be noted that combined autonomous factors were relatively stable throughout the period. The lowest point, amounting to €2,341.8 million, was reached on 13 July 2022, due to a decrease in net foreign assets (see Chart 3).

**Chart 3**
**AUTONOMOUS FACTORS EVOLUTION BETWEEN MP1 AND MP8 2022**[(1)]
*(EUR millions)*




Source: Central Bank of Malta.
[(1)] Liquidity providing factors are shown in positive figures whilst liquidity absorbing factors are shown in negative figures.

The drivers behind the increase in autonomous factors when compared to the previous year were a decrease in government deposits and 'other autonomous factors' together with an increase in net foreign assets and net assets denominated in euro. This increase was partially offset by an increase in banknotes in circulation (which also includes the excess over the allocation based on the capital key). Government deposits held with the Central Bank of Malta decreased from an average of €900.7 million in 2021, to €808.9 million in 2022. The main driver behind such a decrease was a lower net issuance when compared to the previous year. Government withdrawals also increased, making it another contributor to the decline, albeit to a lesser extent. The decrease in government deposits indicates that the government deposits are moving towards the pre-pandemic levels.

## Monetary policy instruments

### *Open market operations*

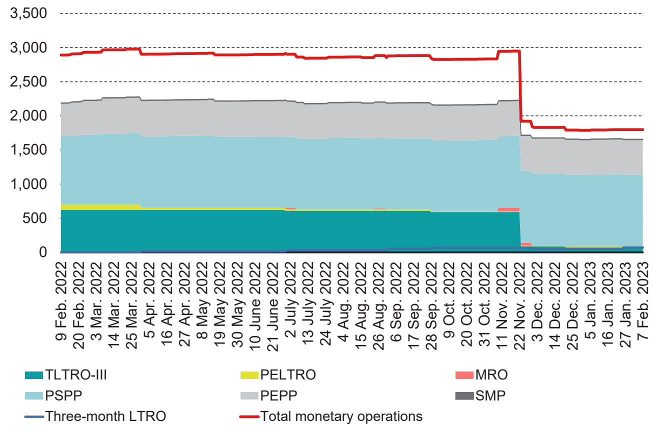
The Eurosystem uses open market operations to provide liquidity in euro to monetary policy eligible counterparties.

At the beginning of the period, outstanding open market operations stood at €698.9 million, €623.5 million stemming from TLTRO-IIIs and €75.4 million from PELTROs. During the period under review, there was limited participation in the MROs by Maltese counterparties. However, Maltese counterparties participated in the three-month longer-term refinancing operations (LTROs). By the end of MP8, these had almost replaced the maturing PELTROs. During the period there were also €40.0 million in maturing TLTRO-IIIs, as well as early repayments from these operations amounting to €513.5 million. Overall, during the reviewed period, the volume of liquidity injected into the domestic banking system through open market

6 Given that total autonomous factors were net liquidity-absorbing, in the Chart these are depicted with a negative sign.

operations decreased by €558.9 million (see Chart 4). Therefore, at the end of MP8, the outstanding open market operations stood at €140.0 million, divided equally between TLTRO-IIIs and three-month LTROs.

**Chart 4**
**EVOLUTION OF MONETARY POLICY OPERATIONS**
*(EUR millions)*




Source: Central Bank of Malta.

## *Asset purchases*

The Bank also influenced liquidity conditions through its participation in the various APPs, during the eight MPs reviewed. As of 7 February 2023, the outstanding assets under the Monetary Policy Outright Purchase programmes amounted to €1,588.9 million, while the average for the whole period stood at €1,568.9 million.

The Bank's holdings of debt instruments under the Securities Markets Programme (SMP) stood at an average of €9.6 million.[7]

PSPP holdings under the APP stood at an average of €1,024.2 million in MP1. These holdings grew steadily over the period, standing at an average value of €1,060.8 million in MP8. This increase reflects the purchases of securities which were partially offset by maturing securities that occurred in the interim.

PEPP holdings increased from an average of €497.0 million in MP1, to €514.2 million in MP8. This increase reflects the purchases of securities, which were marginally offset by the redemption of securities during the period under review.

On balance, the Bank's holdings of securities in terms of the Eurosystem's PSPP and PEPP increased by €95.6 million since the start of MP1, implying a net injection of liquidity during the period reviewed.

[7] The SMP was announced by the Governing Council of the ECB on 10 May 2010, with the intention of ensuring depth and liquidity in malfunctioning segments of the debt securities markets and to restore an appropriate functioning of the monetary policy transmission mechanism. The SMP was terminated as from 6 September 2012 with the purchased securities held to maturity.