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ABBREVIATIONS

APP	asset purchase programme
ATM	Automated Teller Machine
BCI	Business Conditions Index
BLS	Bank Lending Survey
CCI	construction cost index
COICOP	Classification of Individual Consumption by Purpose
COVID-19	coronavirus disease 2019
CGS	COVID-19 Guarantee Scheme
CPE	compensation per employee
CPI	Consumer Price Index
CVM	chain volume measure
ECB	European Central Bank
EEI	Employment Expectations Indicator
EER	Effective Exchange Rate
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
HICP	Harmonised Index of Consumer Prices
ILO	International Labour Organisation
IMF	International Monetary Fund
LFS	Labour Force Survey
LSGS	Liquidity Support Guarantee Scheme
MDB	Malta Development Bank
MFI	monetary financial institution
MGS	Malta Government Stocks
MIA	Malta International Airport
MPC	monetary policy committee
MRO	main refinancing operation
MSE	Malta Stock Exchange
MT	Malta
NACE	nomenclature of economic activities
NEIG	non-energy industrial goods
NFC	non-financial corporation
NPISH	non-profit institutions serving households
NSO	National Statistics Office
NTB	non-tariff barrier
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
PEPP	pandemic emergency purchase programme
POS	Point of Sale
PPI	Property Price Index

RPI	Retail Price Index
SLS	Subsidised Loans Scheme
TCA	Trade and Cooperation Agreement
TCN	third country national
TLTRO	targeted longer-term refinancing operation
UCA	Urban Conservation Areas
ULC	unit labour cost
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
US	United States
VAT	value added tax
WTO	World Trade Organisation

FOREWORD

During the second quarter of 2023, annual real gross domestic product (GDP) decelerated to 3.9%, after having increased by 5.0% in the preceding quarter. This slowdown was driven by a larger negative contribution from domestic demand, which reflected a correction in import-intensive investment in the aviation sector from exceptionally high levels a year earlier. On the other hand, the contribution of net exports increased. After adjusting for imports, domestic demand had a neutral impact on GDP growth, while exports had a smaller positive effect than indicated by unadjusted figures.

Potential output growth is estimated to have stood at 6.7% in the second quarter of 2023, below the annual rate of 7.4% estimated for the previous quarter. On a four-quarter moving average basis, the level increase in potential output relative to the first quarter was somewhat stronger than that in GDP. This resulted in a narrower but still positive output gap. This implies that the degree of over-utilisation of the economy's productive capacity has eased further.

Meanwhile, the Bank's Business Conditions Index (BCI) edged up in the second quarter and stood slightly above its historical average. The index was affected by strong annual increases in several sub-components, particularly in tourist arrivals and in industrial production. Low unemployment and above average Economic Sentiment Indicator (ESI), also contributed to the above-average BCI level.

Developments in the labour market remained favourable, with employment levels and employment rates both rising in annual terms. The unemployment rate reached a new low and stood well below that in the euro area. The job vacancy rate and other indicators of labour market remained 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 6.2% in June, below the 7.1% recorded in March. The slowdown in inflation reflected slower growth in the prices of non-energy industrial goods (NEIG) and food. Meanwhile, annual inflation based on the Retail Price Index (RPI), which only considers expenditure by Maltese residents, edged down from 7.0% in March, to 5.4% in June.

Industrial producer price inflation increased to 4.2% in the second quarter, from 4.0% in the preceding quarter. However, other indicators show moderating cost pressures. The domestic producer price index rose at a slower annual rate of 1.7%, down from 4.1% in the first quarter. The imports of goods deflator also shows weaker growth, while Eurostat's construction cost index (CCI) declined further in the second quarter. 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 4.4% in the second quarter, from 3.6% in the previous quarter.

In the second quarter of 2023, the current account deficit decreased significantly when compared with a year earlier. This was a result of a narrowing of the merchandise trade deficit, higher net receipts from services, and 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 1.3% of GDP in the second quarter of 2023.

When measured on a four-quarter moving sum basis, the general government balance registered a deficit of 4.3% of GDP, lower than the 4.9% recorded in the first quarter. The general government debt-to-GDP ratio declined to 50.7% at end-June, from 52.4% at end-March.

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, reflecting a larger decline in credit to general government and slower growth in credit to other residents. According to the Bank's Financial Conditions Index (FCI), in the second quarter of 2023, financial conditions were tight from a historical perspective, but the degree of tightness diminished when compared to the first quarter. This improvement was driven by a smaller tightening impact from both domestic and foreign influences – in equal measure.

In June, the weighted average interest rate offered to households and non-financial corporations (NFCs) on their outstanding deposits in Malta increased by nine basis points on a year earlier, standing at 0.24%. 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 41 basis points, to 3.59%, over the same period. Hence, the spread between the two widened.

Data on new loans, which may be more indicative of the transmission of monetary policy impulses, show a 98 basis points increase in the weighted average deposit rate, and a 39 basis points increase in the lending rate.

The primary market yield on Treasury bills rose between March and June. Secondary market yields on five-year and ten-year Malta Government Stocks (MGS) also increased over this period. Meanwhile, domestic share prices rose.

The European Central Bank's (ECB) Governing Council raised its key interest rates by 25 basis points in May and again in June. Thus, by the end of the second quarter, the interest rates on the deposit facility, the main refinancing operations (MROs), and the marginal lending facility, had risen to 3.50%, 4.00% and 4.25%, respectively. The Council reiterated that it would continue to follow a data-dependent approach to determining the appropriate level and duration of restriction of the policy interest rates. In particular, future policy rate decisions would continue to be based on an assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary transmission.

Further rate hikes of 25 basis points each were announced in July and September. In July, the Governing Council also decided to set the remuneration of minimum reserves at 0%.

The Governing Council confirmed its decision to discontinue reinvestments under the asset purchase programme (APP) as of July 2023. 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, while redemptions coming due in the PEPP portfolio continue to be reinvested flexibly.

ECONOMIC SURVEY

1. THE EXTERNAL ENVIRONMENT AND THE EURO AREA

In the second quarter of 2023, real GDP grew at practically the same pace as in the preceding quarter in the United States, while in the United Kingdom it continued to rise moderately. In the euro area, real GDP expanded by 0.1% on a quarter-on-quarter basis, same as in the first quarter of 2023. During the quarter under review, the unemployment rate was stable in the United States, edged up in the United Kingdom but fell slightly further in the euro area.

While still high from a historical perspective, consumer price inflation continued to slow down. In the United States inflation fell to 3.0% in June, from 5.0% three months before, while in the United Kingdom, inflation fell to 7.9% in June, from 10.1% in March. Meanwhile, in the euro area, annual consumer price inflation declined to 5.5% in June, from 6.9% in March. 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 dropped in the review period, mainly reflecting lacklustre demand, which offset the effects of supply cuts. Also, the price of European natural gas fell, largely as inventory levels continued to gradually increase following last year's crisis.

Key advanced economies

US economic growth remains practically unchanged

In the United States, real GDP grew at a quarterly rate of 0.5% in the second quarter of 2023, only slightly below the rate recorded in the preceding quarter (see Table 1.1). This growth was largely driven by gross private domestic investment, which began to recover from the drop in the previous quarter, mainly reflecting an increase in transport equipment. Personal consumption and government consumption expenditures also had a positive contribution to growth, although both grew at a slower pace than in the previous quarter. Net exports provided only a marginal positive contribution to growth as the drop in exports was smaller than the drop in imports.

Meanwhile, in the labour market, employment increased by 0.3% in quarter-on-quarter terms, after having risen by 1.0% in the previous quarter. Non-farm payroll data indicate that the increase in employment was driven by services and was most pronounced in the education and health services sectors. The participation rate edged up by 0.1 percentage point, to 62.6% during the review period.

Table 1.1
REAL GDP GROWTH IN SELECTED ADVANCED ECONOMIES

Quarter-on-quarter percentage changes; seasonally and working day adjusted

	2021			2022				2023	
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
United States	1.5	0.8	1.7	-0.5	-0.1	0.7	0.6	0.6	0.5
Euro area	2.0	2.1	0.5	0.7	0.8	0.3	-0.1	0.1	0.1
United Kingdom	7.3	1.7	1.5	0.5	0.1	-0.1	0.1	0.3	0.2

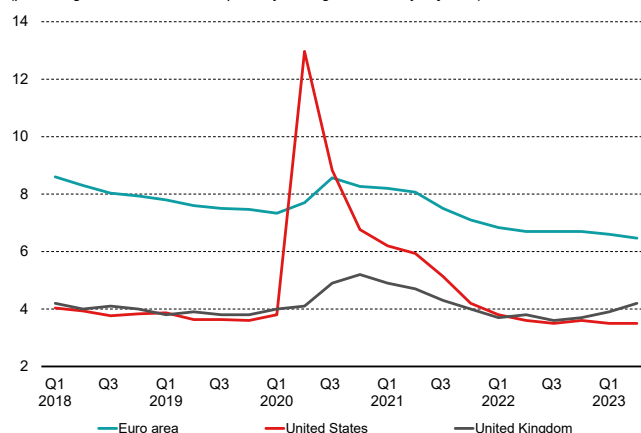
Sources: Bureau of Economic Analysis, US; Eurostat; Office for National Statistics, UK.

On average, the unemployment rate was unchanged from the first quarter, at 3.5% (see Chart 1.1).

Inflation showed further signs of moderation in the review period. In fact, the annual inflation rate based on the consumer price index (CPI) stood at 3.0% in June, down from 5.0% three months earlier (see Chart 1.2). This decline was mainly driven by energy inflation, which fell to -16.7% in June as against -6.4% in March. Meanwhile, food inflation (including beverages) eased to 5.7% from 8.3% in March, while services inflation also moderated. Inflation excluding food and energy eased to 4.8% in June, from 5.6% in March.

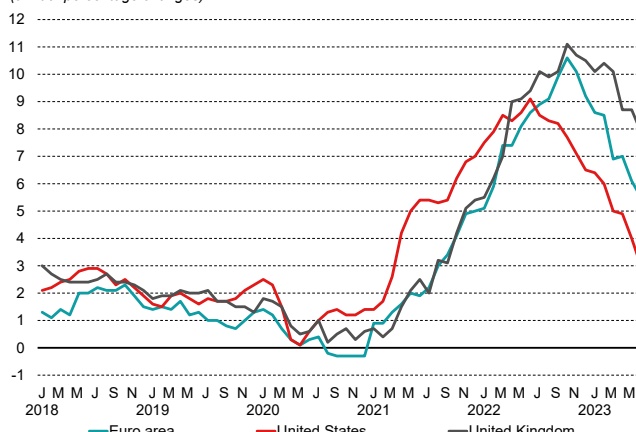
During the second quarter of 2023, the Federal Open Market Committee (FOMC) increased the target range for the federal funds rate once. On 3 May, the target range was raised by 25 basis points to between 5.00% and 5.25%. In June, the FOMC kept the target range unchanged in order to assess additional information and its implications for monetary policy.

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



Sources: 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.

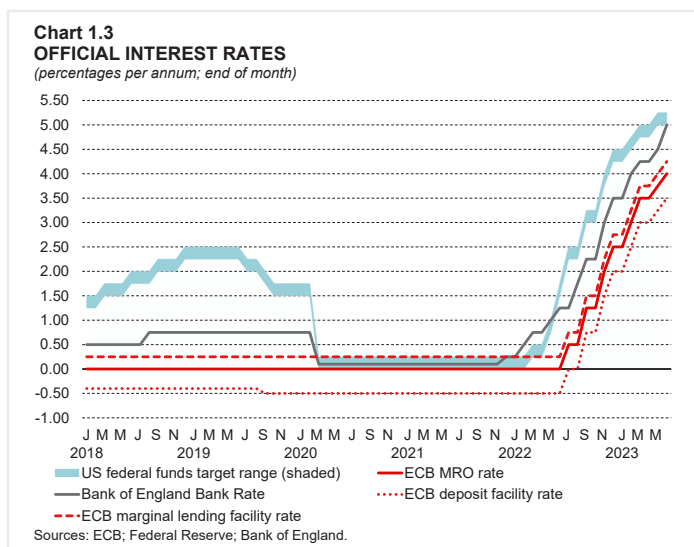
The Committee expressed its preparedness to adjust the stance of monetary policy as appropriate if risks emerged that could impede the attainment of its goals. In determining the extent of additional policy firming that might be appropriate to return inflation to 2% over time, the Committee would consider 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 commitment to returning inflation to its 2% objective.¹

¹ In July 2023, the Committee decided to raise the target range for the federal funds rate to between 5.25% and 5.50% and in September it kept the target range unchanged.

UK economy continues to grow moderately

Real GDP in the United Kingdom increased at a quarterly rate of 0.2% in the quarter under review, slightly less than the pace recorded in the previous quarter (see Table 1.1). Growth was mainly driven by a rise in government consumption and, to a lesser extent, by increases in household expenditure, changes in inventories and investment. These outweighed a decline in net exports, as exports fell and imports rose.



The labour market showed some signs of weakening. After having expanded in the previous quarter, employment fell by 0.2% on a quarterly basis. Meanwhile, the unemployment rate averaged 4.2% in the quarter under review, up from 3.9% in the previous quarter (see Chart 1.1).

Consumer price inflation in the United Kingdom eased further during the review period, although inflationary pressures remained elevated. The inflation rate decreased to 7.9% in June, compared to 10.1% in March (see Chart 1.2). This decrease largely reflected a significant decline in energy inflation and a marginal drop in food inflation. By contrast, services and NEIG inflation rose when compared to March. The annual rate of inflation based on the CPI excluding energy, food, alcohol and tobacco rose to 6.9% in June, from 6.2% in March.

Against the background of a tight labour market and continued resilience in demand as well as the second-round effects in domestic price and wage developments, the Bank of England's Monetary Policy Committee (MPC) increased the Bank Rate by 25 basis points, to 4.50%, on 10 May and by a further 50 basis points, to 5.0%, on 21 June (see Chart 1.3). The Committee stated that, if there were to be evidence of more persistent pressures, it would tighten the Bank Rate further as required.

The MPC reiterated that monetary policy would ensure that, as the adjustment to economic shocks continued, CPI inflation would return to the 2% target sustainably in the medium term.²

The euro area

GDP in the euro area grows marginally

Economic activity in the euro area expanded modestly in the second quarter of 2023. In real terms, GDP growth stood at 0.1% on a quarter-on-quarter basis, the same as in the previous quarter (see Table 1.2). Economic activity during the quarter under review was mainly characterised by subdued domestic consumption as weakness in consumer and business confidence

² In its meeting held in August 2023, the MPC increased the Bank Rate to 5.25% and in September 2023 it kept the Bank Rate unchanged. At its September meeting, the MPC agreed that the Bank of England should reduce the stock of UK government bond purchases held for monetary policy purposes, and financed by the issuance of central bank reserves, by £100 billion over the 12-month period from October 2023 to September 2024.

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

	2021			Q1	2022			Q1	Q2
	Q2	Q3	Q4		Q2	Q3	Q4		
Private consumption	1.8	2.1	0.1	0.0	0.6	0.5	-0.4	0.0	0.0
Government consumption	0.3	0.2	0.1	0.1	-0.1	0.0	0.1	-0.1	0.1
GFCF	0.4	-0.2	0.7	-0.1	0.2	0.2	0.0	0.1	0.1
Changes in inventories ⁽²⁾	-0.4	-0.2	0.6	0.0	0.2	0.3	-0.3	-0.6	0.4
Exports	1.1	0.8	1.4	0.8	0.8	0.6	-0.2	0.1	-0.4
Imports	-1.3	-0.6	-2.4	-0.1	-0.9	-1.2	0.7	0.7	0.0
GDP	2.0	2.1	0.5	0.7	0.8	0.3	-0.1	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

intensified, a drop in exports amid slowing global demand and an increase in inventories. These developments occurred in the context of still elevated, albeit easing, inflationary pressures and tighter financing and credit supply conditions.

In the second quarter of 2023, domestic demand added 0.6 percentage point to GDP growth. Private consumption remained stagnant amid high inflationary pressures. Gross fixed capital formation (GFCF) contributed 0.1 percentage point to economic growth, mainly reflecting increases in business and government investment. Government consumption partly recovered from the previous quarter's contraction, adding 0.1 percentage point to GDP. Changes in inventories, which had contributed negatively to growth in the previous quarter, added a further 0.4 percentage point. In contrast, net exports deducted 0.4 percentage point to GDP growth. This mainly reflected a decrease in exports, as imports rose marginally.

Labour market remains strong

The labour market in the euro area remained resilient during the second quarter despite the sluggish economic growth. The seasonally adjusted unemployment rate fell marginally to 6.4% in June, compared to 6.5% in March. Meanwhile, the three-month average rate went down to 6.5% in the quarter under review from 6.6% in the first quarter (see Chart 1.1).

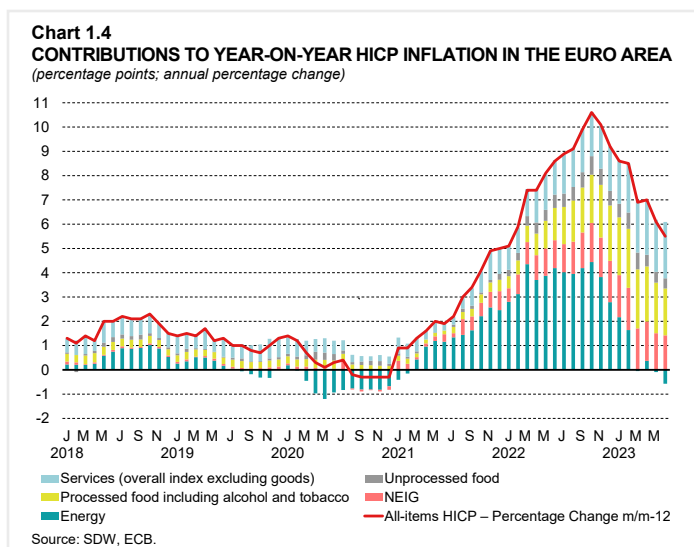
Employment continued to expand albeit at a slower pace, growing at a quarterly rate of 0.2% during the second quarter, compared to 0.5% in the preceding quarter.³

Headline inflation decelerates further and underlying inflation starts to ease

Although inflationary pressures in the euro area remained high, they abated further in the second quarter. The annual rate of inflation based on the HICP stood at 5.5% in June, compared to 6.9% three months before (see Chart 1.4). This deceleration mainly reflected a sustained drop in energy inflation coupled with slower growth in food prices and in NEIG prices, which outweighed faster growth in the prices of services. Inflation continued to be fuelled by the gradual pass-through of past cost increases and second-round effects generated by strong growth in labour costs.

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, as energy prices fell at an annual rate of 5.6% in June, compared to a drop of 0.9% in March. Unprocessed food inflation eased to 9.0% in June, compared to 14.7% in March, while processed food inflation eased to 12.4%, from 15.7%, over this period. Also, the annual rate of NEIG inflation eased to 5.5% in June, compared to 6.6% three months earlier. On the other hand, the annual rate of change of services prices rose to 5.4% in June from 5.1% in March.



Underlying inflationary pressures exhibited incipient signs of easing during the review period, as the effects of past energy price shocks and other pipeline price pressures started to fade. Thus, the annual rate of HICP inflation excluding energy and food prices decelerated to 5.5% in June, following a historical peak of 5.7% in March.

ECB projects an eventual rebound in economic activity, abating inflationary pressures

According to the ECB staff macroeconomic projections published in September 2023, real GDP growth in the euro area is estimated to slow down to 0.7% in 2023, from 3.4% in 2022. Real GDP is then expected to expand by 1.0% in 2024 and 1.5% in 2025 (see Table 1.3). Economic activity is set to remain subdued in the second half of 2023 as manufacturing activity remains weak while the services sector is set to slow down – in part owing to tightening financing conditions and intensifying adverse credit supply conditions. Over the medium term, GDP growth is projected to strengthen moderately on the back of rising household real incomes and an improvement in

Table 1.3
MACROECONOMIC PROJECTIONS FOR THE EURO AREA⁽¹⁾

Annual percentage changes

	2022	2023	2024	2025
GDP	3.4	0.7	1.0	1.5
Private consumption	4.1	0.3	1.6	1.6
Government consumption	1.5	-0.1	1.1	1.4
GFCF	2.9	1.7	-0.4	1.4
Exports	7.3	1.3	2.5	3.1
Imports	8.1	0.3	2.5	3.1
HICP	8.4	5.6	3.2	2.1
HICP excluding energy and food	3.9	5.1	2.9	2.2

Source: ECB.

⁽¹⁾ ECB staff macroeconomic projections (September 2023).

foreign demand. These factors are expected to outweigh the negative impact on GDP stemming from tighter financing conditions and declining fiscal support.

Compared to the June 2023 projections, the baseline projections are built on assumptions that include higher oil and gas prices, lower electricity prices, tighter financial conditions and a stronger euro exchange rate, as well as weaker foreign demand.

Compared to the previous projection exercise, real GDP growth is revised downwards by 0.2 percentage point for 2023, 0.5 percentage point for 2024 and 0.1 percentage point for 2025. The revision in 2023 reflects downward revisions to domestic demand in the second half of the year, as seen in survey indicators, tighter financial conditions, a stronger euro and weaker external demand. The downward revision to the 2023 forecast also extends to 2024, and is compounded by further downward revisions to private investment. The latter is expected to result in lower domestic demand in 2025. The tightening of credit supply is assessed to have a more forceful impact on real GDP than expected in the June projections.

Turning to the outlook for prices, according to the September 2023 projections, HICP inflation is foreseen to moderate to an average of 5.6% in 2023 and ease further to 3.2% and 2.1% in 2024 and 2025, respectively. HICP inflation is expected to reach the ECB's 2% target in the third quarter of 2025. The decline in headline inflation reflects decreases in the annual rates of change of all the main components. Overall, the profile of inflation is affected by strong base effects related to energy and food, as well as fiscal policy measures and an expected drop in commodity prices. By contrast, nominal wage growth is expected to remain rather high, though it should decline gradually over the projection horizon. HICP inflation excluding energy and food is expected to continue to moderate from an average of 5.1% in 2023 to 2.9% in 2024 and further to 2.2% in 2025. Underlying inflation is expected to decrease as supply bottlenecks unwind, as demand grows at more normal rates following the re-opening after the pandemic and as a result of monetary policy tightening.

Compared to the June 2023 projections, HICP inflation has been revised upwards by 0.2 percentage point for both 2023 and 2024. By contrast, HICP inflation is revised downwards by 0.1 percentage point for 2025. Upward revisions in the energy component for 2023 and 2024 outweigh downward revisions to the non-energy components. Whereas food inflation is revised upwards for 2023, it is revised downwards for 2024 and 2025. Underlying inflation is kept unchanged for 2023 but it is revised marginally downwards for 2024 and 2025 in view of the stronger euro and the downward revision to the outlook for demand.

ECB raises interest rates further

In May 2023, the Governing Council raised the three key ECB interest rates by 25 basis points. Regarding the APP portfolio, the Governing Council reiterated that bond holdings would decline at an average monthly pace of EUR15 billion until the end of June. The Council announced that it expected to discontinue the reinvestments under the APP as of July 2023.

In June, the Governing Council hiked the three policy interest rates by an additional 25 basis points so that the interest rates on the deposit facility, the MROs and the marginal lending facility reached 3.50%, 4.00% and 4.25%, respectively (see Chart 1.3). The Council reiterated that it would continue to follow a data-dependent approach to determining the appropriate level and duration of restriction of the policy interest rates. In particular, future policy rate decisions would

continue to be based on an assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary transmission.

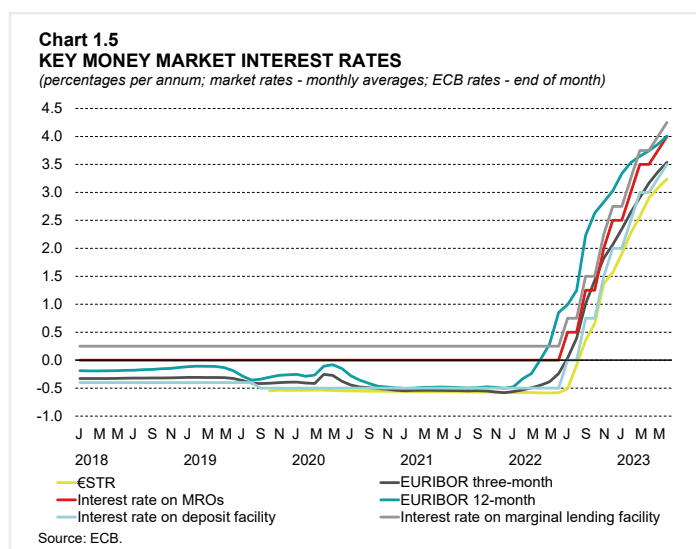
The Governing Council confirmed its decision to discontinue reinvestments under the APP as of July 2023. Regarding the PEPP portfolio, the Governing Council reiterated its intention to continue reinvesting the principal payments from maturing securities purchased under the programme until at least the 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 would continue to be reinvested flexibly, to counter risks to the monetary policy transmission mechanism related to the pandemic.

As to refinancing operations, the Governing Council reiterated that since banks were repaying the amounts borrowed under TLTRO III, it would regularly assess how targeted lending operations were contributing to its monetary policy stance.⁴

Money market rates continue to increase

Money market interest rates in the euro area rose further 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 notably further though it remained below the interest rate on the ECB's deposit facility (see Chart 1.5).⁵ It averaged 3.24% in June, compared to 2.57% in March. The three-month Euro Interbank Offered Rate (EURIBOR) averaged 3.54% in June, as against 2.91% three months earlier.

Meanwhile, the 12-month EURIBOR also continued to increase, with its average reaching 4.01% in June from 3.65% in March.⁶



Euro area government bond yields generally fell

The euro area ten-year benchmark government bond yield fell during the second quarter, interrupting a rising (quarterly) trend established since the fourth quarter of 2021. It averaged 3.16% in June, compared to 3.23% three months earlier. The decrease could reflect an element of re-evaluation in investors' expectations regarding further tightening of monetary policy in the euro area and in other major economies.

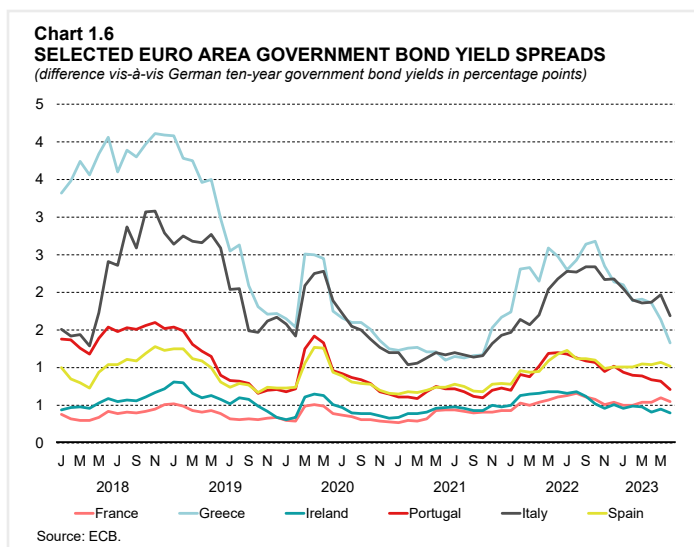
⁴ The Governing Council raised the three key ECB interest rates by 25 basis points in July and again in September, bringing the interest rates on the deposit facility, MROs and the marginal lending facility to 4.00%, 4.50% and 4.75%, respectively. In July, the Council decided to set the remuneration of minimum reserves at 0% with effect from 20 September 2023.

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 the €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.

Individual sovereign bond yields changed tack and fell in most euro area countries. Whereas in Germany and France ten-year sovereign bond yields remained broadly unchanged, yields decreased by 58 basis points in Greece and by 18 and 17 basis points in Portugal and Italy, respectively. In Ireland and Spain, the corresponding bond yields fell slightly.

Accordingly, spreads between yields on the ten-year German bonds and those on the bonds issued by other euro area sovereigns tended to narrow (see Chart 1.6). This trend was more pronounced in case of the spreads on Greek, Cypriot, Portuguese and Italian bonds. By contrast, the spreads on the bonds issued by a few of the smaller jurisdictions, including Malta, widened somewhat, while that of France was broadly unchanged.

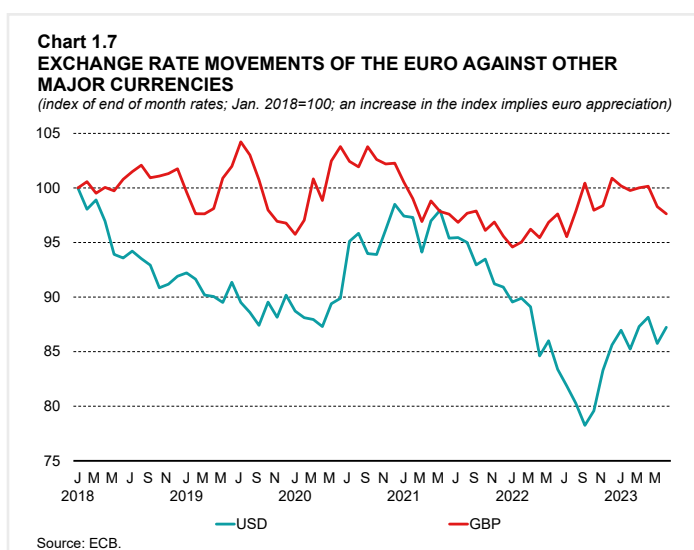


The euro eases slightly versus the US dollar, but strengthens further in effective terms

In the three months to June, the euro depreciated by 0.1% versus the US dollar, marking a pause in the euro's recovery that had started in the last quarter of 2022 (see Chart 1.7). Narrowing interest-rate differentials between the euro area and the United States probably continued to support the euro against the US currency. However, this development could have been undermined by indications of a global economic downturn, which tends to dent investor risk appetite, prompting safe-haven flows into the US unit. This was probably reinforced by resilient economic activity in the US and signs of economic weakness in the euro area.

Besides the US dollar, the euro also fell against other currencies including the British pound, the Swiss franc, the Canadian dollar, the Polish zloty and the Hungarian forint.

By contrast, the euro recorded strong gains with respect to the Japanese yen, where monetary policy remained accommodative, and the Chinese renminbi, possibly reflecting investors' concerns about the strength of the Chinese economy mainly because of problems in



the residential real estate sector. The euro also strengthened against the Swedish krona and the Norwegian krone as well as, to a lesser degree, the Australian, Singapore and Hong Kong dollars.

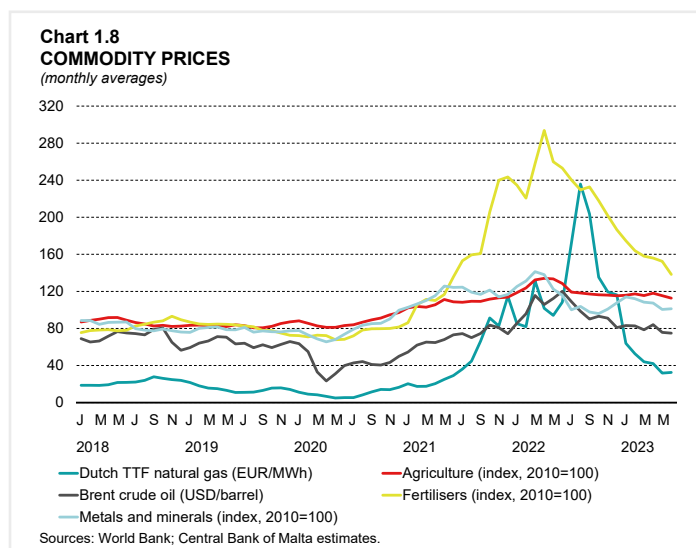
Therefore, the nominal effective exchange rate (EER) of the euro against the EER-18 group of countries appreciated by 0.8% in the quarter under review.⁷

Commodities

Commodity prices end the quarter lower

Oil prices fell further in the review period, as bearish macroeconomic indicators and a generally subdued economic climate likely influenced market dynamics. Indeed, lacklustre demand particularly in OECD countries outpaced supply cuts from some OPEC+ countries. The price of Brent crude oil averaged USD74.89 per barrel in June, 4.6% below the level prevailing in March. Also, the price of European natural gas fell further as inventory levels at storage sites in key Asian and European markets continued to gradually increase following last year's crisis. Thus, the average price of Dutch TTF natural gas in June 2023 was 26.0% lower than three months before (see Chart 1.8).

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



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.

2. OUTPUT AND EMPLOYMENT

Annual real GDP growth decelerated to 3.9% in the second quarter of 2023, following a 5.0% increase in the previous quarter, as domestic demand had a larger negative contribution compared to the first quarter. This in turn reflected a correction in private investment, which had benefited from exceptional outlays in the aviation sector a year earlier. After adjusting for imports, domestic demand had a neutral impact on GDP growth, while exports had a positive effect.

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 second quarter of 2023, developments in the labour market remained positive, with employment levels and employment rates both rising in annual terms. The unemployment rate reached a new low from a historical perspective, and stood well below that in the euro area.

The job vacancy rate remained at elevated levels, but edged down slightly from the level of the previous year. Another indicator of labour tightness, which is the ratio of the job vacancy rate to the unemployment rate, reached its highest level from a historical perspective.

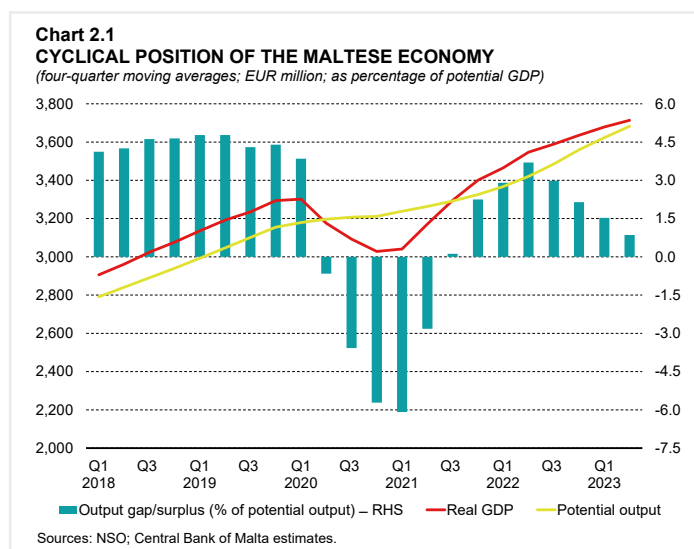
Potential output and Business Conditions Index

Potential output grows at a slower rate

The Bank estimates that potential output growth stood at 6.7% in the second quarter of 2023, below that of 7.4% estimated for the previous quarter.

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 0.9%, down from 1.5% in the first quarter of 2023 (see Chart 2.1).

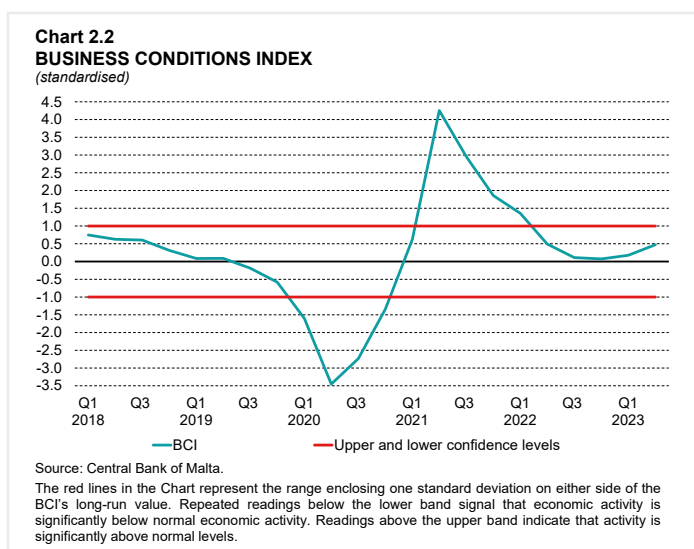
This implies that the degree of over-utilisation of the economy's productive capacity has continued to ease.



BCI increases marginally but remains close to its historic average growth.

The Bank's BCI edged up in the second quarter, standing slightly above its historical average (see Chart 2.2).¹

During the quarter under review, the BCI was affected by strong annual increases in several sub-components, particularly in tourist arrivals and in industrial production. Low unemployment and above average ESI, also contributed to a positive BCI level. By contrast, while building permits rose strongly on a year earlier, growth was lower than its historical average. Similarly, annual GDP growth was marginally below its long-term average.



GDP and industrial production

Real GDP increases at a slower pace

The pace of economic expansion moderated in the second quarter of 2023. Real GDP rose by 3.9% on an annual basis, following a 5.0% increase in the previous quarter.² The slowdown in growth reflects a larger negative contribution from domestic demand offsetting a higher positive contribution from net exports (see Table 2.1).

Domestic demand contracted by 3.1%, following a 0.2% decrease in the previous quarter. It shed 2.7 percentage points from GDP growth in the quarter under review. Movements in this component were largely underpinned by a decline in government consumption and in GFCF. The latter, in turn, mostly reflected a correction in import-intensive investment in the aviation sector from the extraordinary level recorded in 2022. At the same time, private consumption recorded slower growth compared with the previous quarter.

Private consumption expenditure increased by an annual 5.9% in the second quarter of 2023, following an 8.1% increase in the previous quarter, adding 2.5 percentage points to real GDP growth.

Data on the Classification of Individual Consumption by Purpose (COICOP) show that the strongest increase in absolute terms was recorded in spending on miscellaneous goods and services, which includes expenditure on personal care, insurance and financial services among others. This was followed by higher spending on restaurants and hotels, transport and recreation and

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. A full time series can be found at <https://www.centralbankmalta.org/business-conditions-index>. 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.

² 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	
	Q2	Q3	Q4	Q1	Q2
<i>Annual percentage changes</i>					
Private final consumption expenditure	13.3	7.3	7.0	8.1	5.9
Government final consumption expenditure	10.9	1.4	-1.7	2.0	-3.8
GFCF	21.0	34.6	42.2	-16.7	-18.3
Domestic demand	14.6	12.5	13.5	-0.2	-3.1
Exports of goods and services	7.1	9.4	1.0	-1.5	2.5
Imports of goods and services	9.4	14.4	5.2	-5.0	-1.6
GDP	9.9	4.7	5.3	5.0	3.9
<i>Percentage point contributions</i>					
Private final consumption expenditure	5.4	3.1	2.9	3.3	2.5
Government final consumption expenditure	2.1	0.3	-0.3	0.4	-0.7
GFCF	4.6	6.7	8.7	-3.9	-4.5
Changes in inventories	0.0	0.1	0.1	0.1	0.1
Domestic demand	12.1	10.1	11.3	-0.1	-2.7
Exports of goods and services	12.0	15.5	1.6	-2.7	4.1
Imports of goods and services	-14.2	-20.9	-7.7	7.8	2.4
Net exports	-2.2	-5.4	-6.1	5.1	6.6
GDP	9.9	4.7	5.3	5.0	3.9

Sources: NSO; Central Bank of Malta calculations.

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

culture. Expenditure on these items benefitted from the continued growth in tourism activity. On the other hand, households reduced spending on housing, water, electricity, gas, and other fuels. Smaller declines were also reported for spending on food and non-alcoholic beverages, as well as furnishings, household equipment and routine household maintenance.

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 when compared to the same period a year earlier. Meanwhile, the expenditure of Maltese residents abroad increased significantly on its year-ago level, reflecting an increase in trips over the same period.

Government consumption expenditure fell by 3.8% in annual terms, following an increase of 2.0% in first quarter of 2023. This decline mostly reflects an increase in revenue from sales, which is netted out of consumption expenditure. Overall, government consumption shed 0.7 percentage point from annual GDP growth.

Real GFCF declined by an annual 18.3% in the second quarter of the year, following a contraction of 16.7% in the previous quarter. All components declined on a year earlier, except for investment in intellectual properties, while investment on cultivated biological resources remained broadly stable. 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 4.5 percentage points from real GDP growth.

The contribution of changes in inventories was marginal in the second quarter of 2023, and unchanged from the previous period.

Exports increased by 2.5%, while imports decreased by 1.6% on a year earlier. As a result, net exports increased, adding 6.6 percentage points to annual real GDP growth. This mainly reflected a smaller deficit from trade in goods, which in part reflected the aforementioned correction in aircraft imports.

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. GFCF was most affected by this adjustment, and recorded a much smaller negative contribution to GDP growth compared with the traditional approach. Furthermore, after adjusting for imports, domestic demand had a neutral contribution to growth in the second quarter of 2023. The main driver behind the growth in domestic demand remains private consumption. At the same time, the contribution of exports remained similar to the traditional method.

GDP data based on the output approach show that in the second quarter of 2023, real GVA rose by 5.2% in annual terms, following a 5.6% increase in the previous three-month period. It added 4.8 percentage points to GDP growth (see Table 2.3).³

Services remained the main driver behind the rise in economic activity, adding 3.6 percentage points to real GDP growth. Most of the increase stemmed from the sector comprising

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

	2022			2023	
	Q2	Q3	Q4	Q1	Q2
<i>Percentage point contributions</i>					
Private final consumption expenditure	3.0	1.2	1.7	2.5	1.8
Government final consumption expenditure	1.7	0.1	-0.3	0.4	-0.5
GFCF	1.5	1.8	3.0	-0.8	-1.2
Changes in inventories	0.0	0.1	-0.1	-0.2	-0.1
Domestic demand	6.2	3.2	4.3	1.9	0.0
Exports of goods and services	3.7	1.6	1.0	3.1	3.9
GDP	9.9	4.7	5.3	5.0	3.9

Source: Central Bank of Malta estimates.

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

³ 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	
	Q2	Q3	Q4	Q1	Q2
Agriculture, forestry and fishing	0.3	-0.2	0.0	0.0	-0.1
Mining and quarrying; utilities	-0.2	0.1	0.1	0.4	0.7
Manufacturing	0.3	0.8	1.4	0.7	0.9
Construction	-0.2	-0.3	-0.4	-0.6	-0.5
Services	9.9	6.4	5.3	4.7	3.6
<i>of which:</i>					
Wholesale and retail trade; repair of motor vehicles; transportation; accommodation and related activities	5.6	3.3	2.5	0.9	1.0
Information and communication	1.1	1.0	0.8	0.5	0.0
Financial and insurance activities	-0.3	-0.2	-0.1	0.9	1.1
Real estate activities	0.0	0.1	0.0	0.2	0.0
Professional, scientific, administrative and related activities	1.8	1.4	1.0	1.3	1.8
Public administration and defence; education; health and related activities	0.8	0.4	0.8	0.6	-0.4
Arts, entertainment; household repair and related services	0.9	0.4	0.3	0.3	0.1
GVA	10.1	6.8	6.4	5.1	4.8
Taxes less subsidies on products	-0.2	-2.1	-1.1	-0.1	-0.9
Annual real GDP growth (%)	9.9	4.7	5.3	5.0	3.9

Source: NSO.

professional, scientific, administrative, and related activities, which contributed 1.8 percentage points to GDP growth. The sector comprising financial and insurance activities added a further 1.1 percentage points to GDP growth. At the same time, the sector comprising wholesale and retail trade, transportation, accommodation, and related activities, added another percentage point to growth. Meanwhile, the remaining services sectors together shed 0.3 percentage point from growth, reflecting a negative contribution from the sector comprising public administration and defence, education, health, and related activities. The manufacturing sector added 0.9 percentage point to growth, while construction lowered growth by 0.5 percentage point. Construction has contributed negatively to growth since the final quarter of 2021.

The contribution of services to GDP growth moderated compared to the first quarter of 2023, mostly reflecting a contraction in the sector comprising public administration and defence, education, health, and related activities. At the same time, growth slowed in the real estate and in the information and communication sectors. Meanwhile, the contribution of manufacturing increased, while the contribution of construction stood slightly less negative relative to the previous quarter.

Net taxes on products decreased strongly in annual terms.

Nominal GDP growth moderates but remains strong

Nominal GDP rose by 9.7% in annual terms in the second quarter of 2023, after increasing by 11.0% in the previous quarter. Growth remained strong, reflecting robust contributions from both compensation of employees and operating surplus. The latter contributed more than two thirds of growth in nominal GDP.

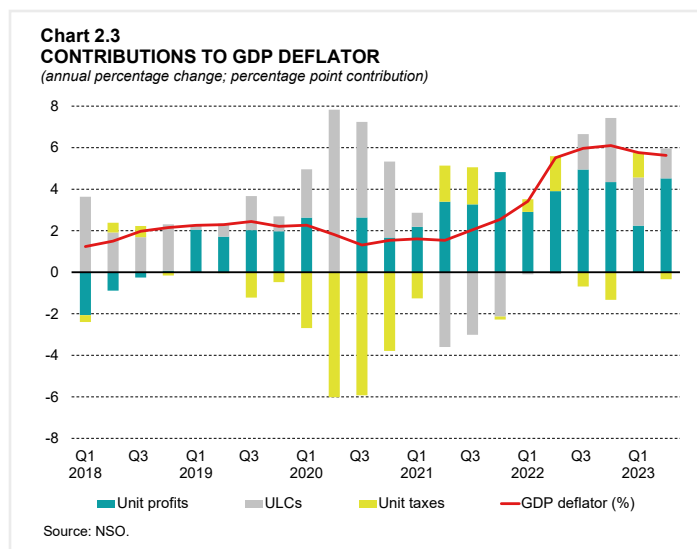


Chart 2.3 shows the main contributors to growth in the GDP deflator. Annual growth in the latter eased slightly in the second quarter of 2023 but remained elevated from a historical perspective. It stood at 5.6% in annual terms, compared with 5.8% in the previous three-month period.

This primarily reflected developments in unit taxes on production and imports, whose contribution to the GDP deflator turned slightly negative. This partly reflects slower growth in indirect taxes. At the same time, the contribution of ULCs edged down compared to the first quarter of the year, as productivity declined at a slower pace.⁴ By contrast, the unit profit component exhibited a higher positive contribution, compared with the previous quarter.

Industrial production increases at a slower rate

Industrial production increased at an annual rate of 7.5% in the second quarter of 2023, after a rise of 13.7% in the previous quarter.⁵

Production in the manufacturing sector rose at a slower pace. Production in the mining and quarrying sector grew at a faster rate on a year-on-year basis while that in the energy sector also accelerated when compared with the first quarter of 2023.⁶

In the manufacturing sector, production rose by 5.5%, after rising by 14.9% in the first quarter. Firms involved in printing, the manufacture of computer, electronic and optical products, wood and wood products, as well as machinery and equipment recorded the strongest year-on-year increases. Production also rose strongly among firms that produce motor vehicles and furniture. In all these sectors, production increased at double-digit rates. Smaller increases were recorded among firms that manufacture wearing apparel, certain non-metallic minerals, and basic pharmaceuticals.

⁴ The analysis of ULCs in this section is not comparable to that in the prices and competitiveness section, as the latter is based on four-quarter moving averages.

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.

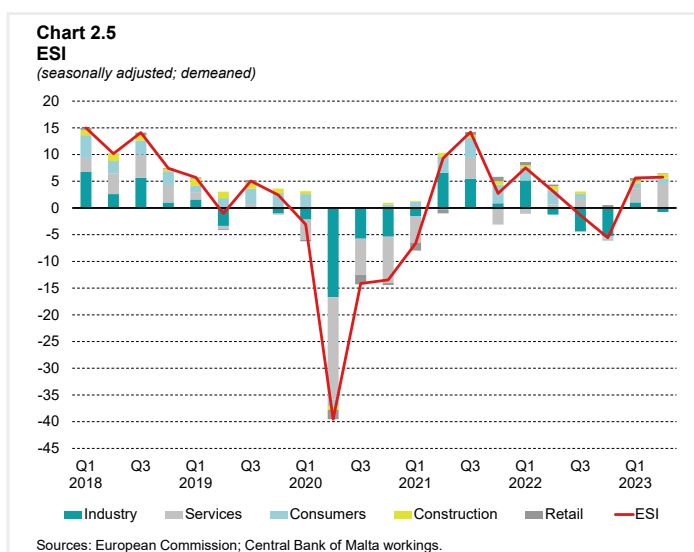
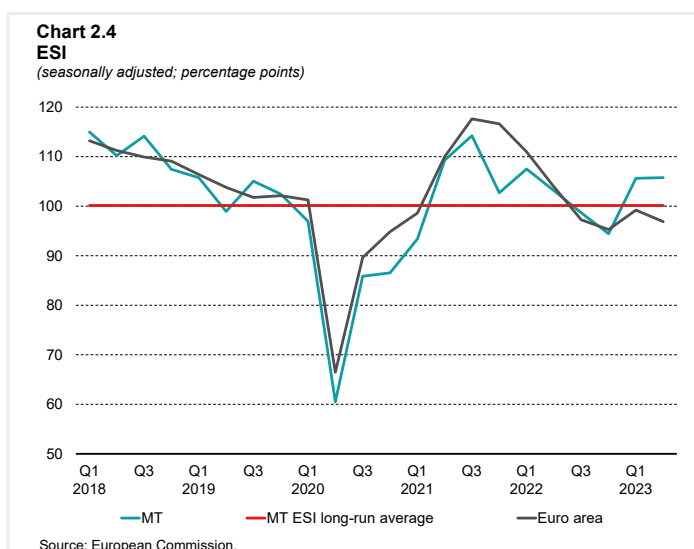
By contrast, output contracted among firms that produce textiles, chemicals and chemical products, and those involved in ‘other manufacturing’ – which includes medical and dental instruments. Smaller reductions were recorded in the food and paper production sectors.

Business and consumer surveys

During the second quarter of 2023, the European Commission’s ESI for Malta remained above its long-term average of around 100.0. It edged up to 105.8, from 105.6 in the preceding quarter. The overall indicator also remained above that in the euro area, which averaged 96.9 (see Chart 2.4).^{7,8}

When compared with the first quarter of the year, confidence increased in the construction sector, and among services firms, while sentiment among consumers remained broadly stable. By contrast, confidence in the retail sector and in industry, deteriorated. In the quarter under review, sentiment remained negative in industry and among consumers.

When accounting for the weights assigned to each sector, and the time variation of each sector, the increase in the ESI relative to the first quarter of 2023 was mostly driven by developments in the services sector.⁹ This sector also largely explains why the overall ESI stood above the long-term average in the quarter under review (see Chart 2.5).



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%.

Confidence in construction increases¹⁰

In the second quarter of 2023, the indicator measuring confidence in the construction sector rose further above its long-term average of -8.1. It reached 18.5, from 6.7 in the previous three-month period (see Chart 2.6).

The improvement was largely driven by employment expectations. Furthermore, and contrary to the first quarter of 2023, respondents assessed order book levels to be above normal levels.

Meanwhile, the net share of respondents expecting price increases over the next three months increased further, setting a new record high in April.

Confidence in the services sector rises¹¹

The confidence indicator in the services sector increased to 38.2 in the second quarter of 2023, from 30.6 in the previous quarter, and stood well above its long-term average of 19.7 (see Chart 2.7). The recent increase for this sector reflected improvements in all its components.

Supplementary survey data indicate that participants' price expectations eased slightly compared to the first quarter of 2023, but remained elevated from a historical perspective, standing at around 39%.

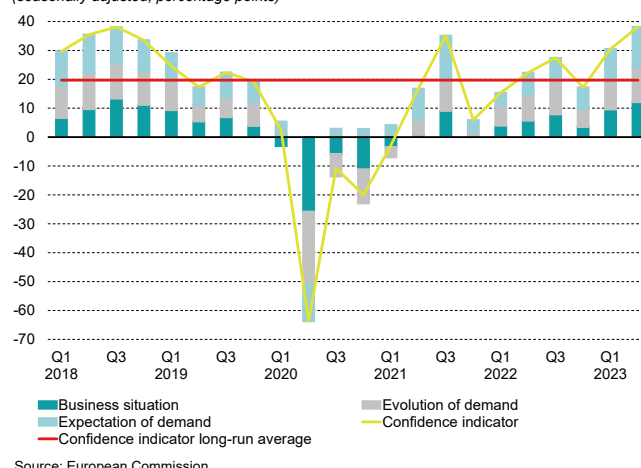
Consumer confidence remains negative¹²

The consumer confidence indicator averaged -9.1 during the second quarter of 2023, marginally above -9.3 recorded in the previous quarter, and stood above its long-run average of -10.2 (see Chart 2.8).

Chart 2.6
CONSTRUCTION CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



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



¹⁰ 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.

¹¹ 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.

¹² 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.

Although consumers' expectations about their finances in the coming months improved, they remained negative. At the same time, their expectations of major purchases over the next 12 months stood slightly more positive compared to the first quarter of 2023. By contrast, respondents reported a more negative outlook of the general economic situation in the 12 months ahead, and a more negative assessment of their financial situation over the last 12 months.

Supplementary survey data show that a smaller share of respondents expected unemployment to increase in the next twelve months, compared with the previous quarter. While the net share of respondents expecting price increases eased somewhat, it remained elevated at around 23%.

Industrial confidence falls below its long-term average¹³

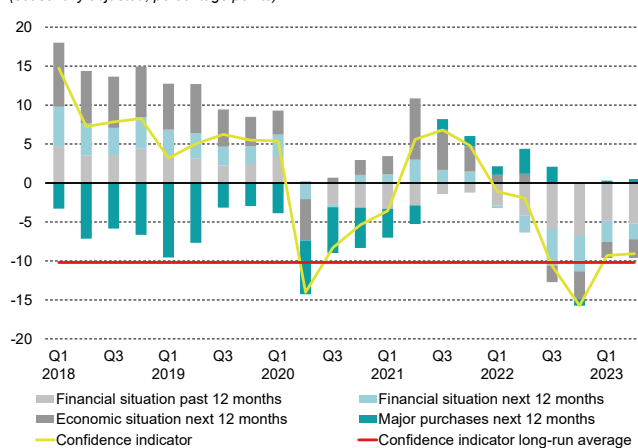
The industrial confidence indicator stood at -7.6, down from -1.7 in the previous three-month period, and below its long-term average of -4.3 (see Chart 2.9). The share of participants assessing order book levels to be below normal doubled. At the same time, production expectations for the months ahead decreased slightly (though remaining positive). These developments offset a decline in the share of respondents assessing stocks of finished goods to exceed normal levels.

Additional survey data reveal that price expectations in industry decreased significantly.

Sentiment among retailers decreases¹⁴

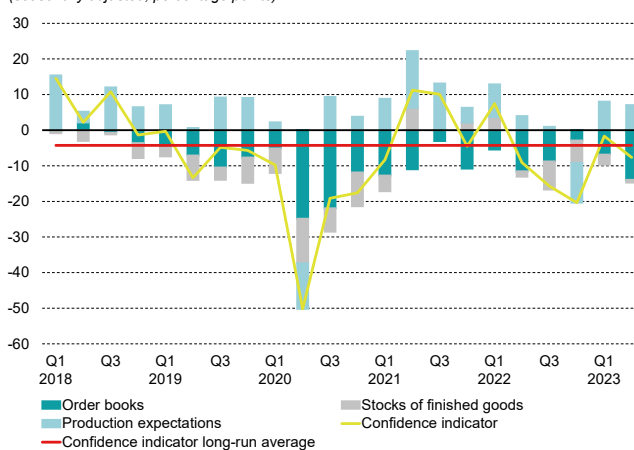
The indicator representing sentiment in the retail sector decreased to 3.6 in the second quarter of 2023, from 16.3 in the previous quarter. Notwithstanding this decline, sentiment remained above its long-term average of -0.3. The recent fall in sentiment was largely driven by a strong deterioration

Chart 2.8
CONSUMER CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

Chart 2.9
INDUSTRIAL CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



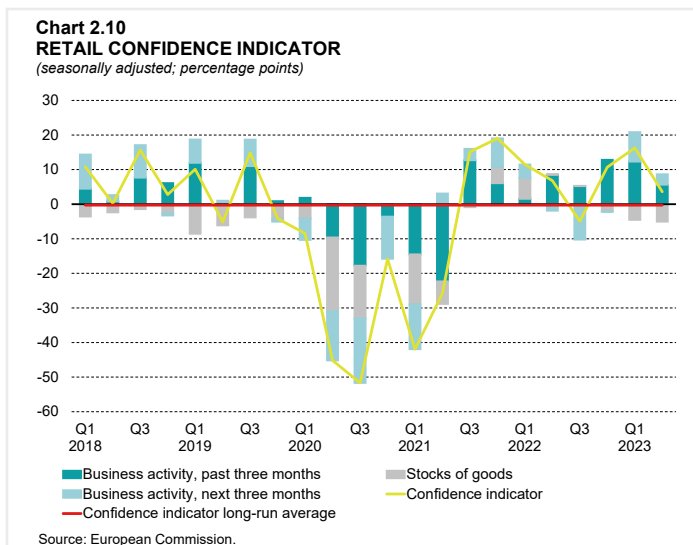
Source: European Commission.

¹³ 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.

¹⁴ 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.

in retailers' assessment of sales over the past three months, and lower expectations of business activity over the next three months. At the same time, the net share of participants reporting stocks of finished goods to be above normal, edged up compared with the previous three-month period (see Chart 2.10).¹⁵

Supplementary survey data indicate that, in contrast to the previous quarter, short-term orders expectations turned negative. Meanwhile, price expectations decreased significantly, broadly in line with the pattern observed in industry.

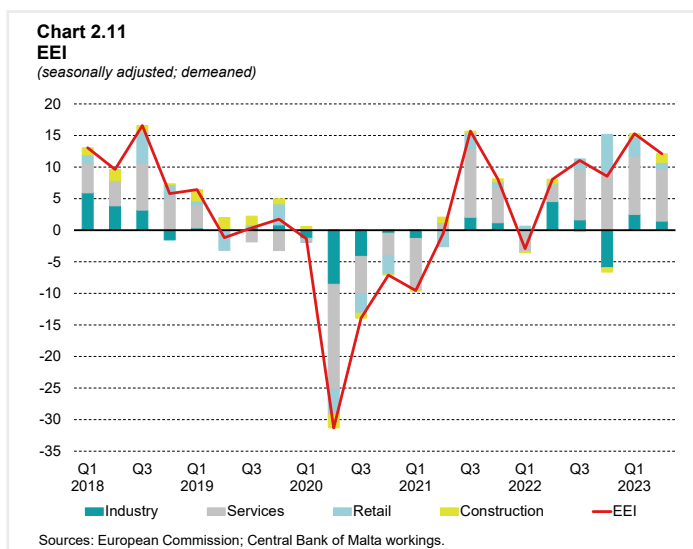


Employment Expectations Indicator (EEI) falls but remains above long-run average

The EEI – which is a composite indicator of employment expectations in industry, services, retail trade and construction – edged down in the second quarter of 2023. It averaged 112.3, compared with 115.4 in the preceding quarter, but remained well above its long-term average of around 100.0. The index continued to exceed the euro area average of 105.7.¹⁶

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

Demeaned data suggest that the decrease relative to the preceding quarter largely reflected developments in the retail sector (see Chart 2.11). The services sector largely explains why the overall EEI stood above its long-term average in the quarter under review.

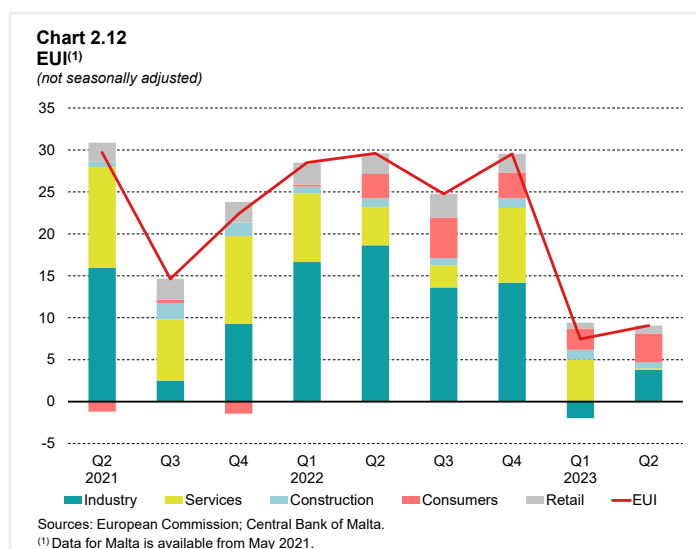


¹⁵ Above-normal stock levels indicate lower turnover and affect the overall indicator in a negative way.

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 (EUI) increases

The European Commission's 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 increased to 9.1 in the second quarter of the year, from 7.5 in the preceding quarter (see Chart 2.12). However, the indicator stood well below that in the euro area, which averaged 21.4.^{17,18}



The strongest rise in uncertainty in Malta was recorded in industry. This was followed by higher uncertainty in the retail sector and among consumers. By contrast, uncertainty in the services and construction sectors declined when compared with the previous three-month period.

The highest uncertainty scores were recorded in retail and among consumers, followed by construction. Developments in industry contributed the most to the increase in Malta's EUI, when considering each sector's weight and past volatility.

The labour market¹⁹

Labour force and activity rate continue to increase

Labour Force Survey (LFS) data show that in the second quarter of 2023, the labour force grew by 12,977 persons, or 4.5% on an annual basis, slightly slower than the 5.2% increase registered in the previous quarter (see Table 2.4).²⁰

The activity rate stood at 80.9% in the quarter under review, higher than the 79.9% registered a year earlier.²¹ This was due to increases in the female and male participation rates, with the former increasing slightly more than that of males. The female participation rate reached 73.5%, while that of males increased to 87.3%. 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 Q2	2023 Q2	Annual change %
Labour force	288,915	301,892	4.5
Employed	280,469	294,313	4.9
<i>By type of employment:</i>			
Full-time	245,293	258,909	5.6
Part-time	35,176	35,404	0.6
Unemployed	8,446	7,579	-10.3
Activity rate (%)	79.9	80.9	
Male	86.5	87.3	
Female	72.3	73.5	
Employment rate (%)	77.5	78.8	
Male	83.8	85.0	
Female	70.4	71.7	
Unemployment rate (%)	2.9	2.5	
Actual hours worked (per week)	34.4	35.2	

Source: NSO.

Employment increases further

In the quarter under review, employment rose by 4.9% in annual terms, following a rise of 5.3% in the previous quarter.

Most of the increase in employment in the quarter under review was driven by full-time jobs, as part-time employment increased moderately. The number of persons in full-time jobs rose by 13,616, or 5.6% in annual terms (see Table 2.4). This increase was mainly coming from the accommodation and food service activities, the human health and social work activities sector, and the sector comprising wholesale and retail trade, repair of motor vehicles and motorcycles.

The number of part-time employees – which also includes those employed full-time on reduced hours – rose by 228 persons, or 0.6% on a year earlier. This increase was mostly driven by the sector comprising professional, scientific and technical activities, and the information and communication sector.

The overall employment rate rose by 1.3 percentage points on the same period of 2022, to reach 78.8%.²² The male employment rate rose by 1.2 percentage points to 85.0%, mainly due to higher rates in the 55 to 64, and to a lower extent, those in the 25 to 54 age brackets. Meanwhile, the male employment rate in the 15 to 24 age bracket continued to decline. The female employment rate rose by 1.3 percentage points to 71.7%, 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.

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.

During the quarter under review, average weekly hours worked derived from the LFS rose to 35.2, from 34.4 a year earlier (see Table 2.4).²³ This reflected an increase in average hours worked by full-time employees. By contrast, average hours worked by those in part-time jobs decreased.

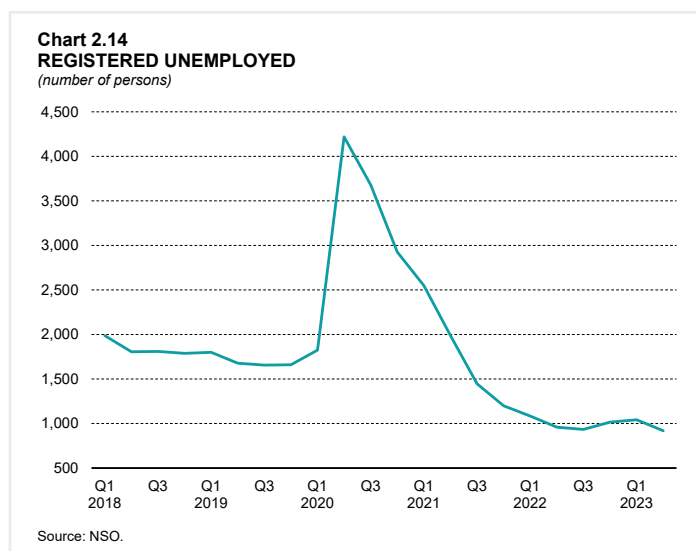
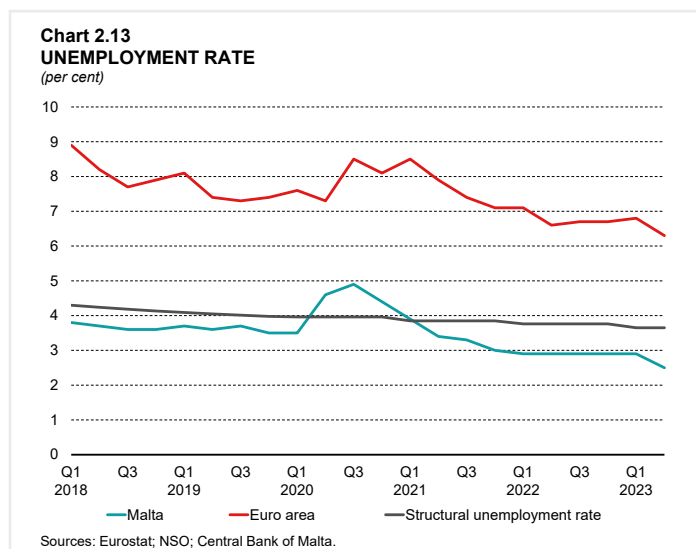
The unemployment rate reaches a new low

The unemployment rate based on the LFS reached a new historic low of 2.5% in the second quarter of 2023, reflecting resilient demand for labour (see Table 2.4).²⁴ Labour market conditions remain more favourable than those in the euro area, where the unemployment rate, on average stood at 6.3% (see Chart 2.13).

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.

Jobsplus data show that the number of persons on the unemployment register fell slightly both on a quarterly basis, and in annual terms. During the second quarter of 2023, the average number of persons on the unemployment register stood at 919, staying lower than the 959 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 2.7% (see Chart 2.15). At this level, the vacancy rate was slightly below



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.

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.

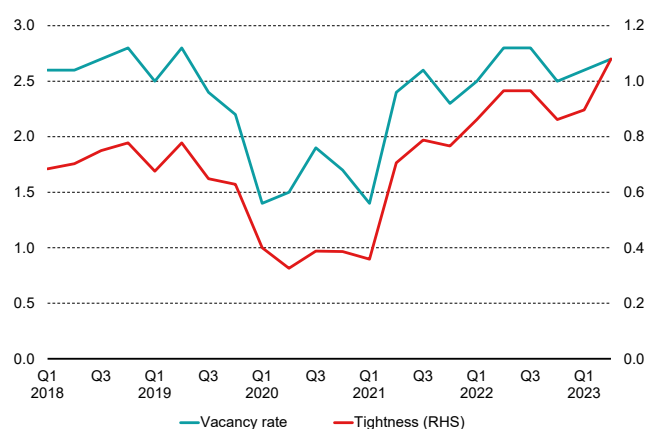
that recorded in the same quarter of 2022.²⁶ The vacancy rate was high in certain manufacturing and services sectors. The highest rates were recorded in the water supply sector (5.9%), the accommodation and food services sector (4.5%), and the arts, entertainment, and recreation sector (3.8%).

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 1.1, marginally higher than the ratio registered a year earlier. This indicator has reached its highest level in recent years.

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 4.3% of the extended labour force in the first quarter of the year (see Chart 2.16).²⁷ This is 0.7 percentage point lower than the 5.0% registered a year earlier, and is well below this measure's average of around 8.2% estimated since 2010. It is also significantly lower than the 12.0% recorded for the euro area.

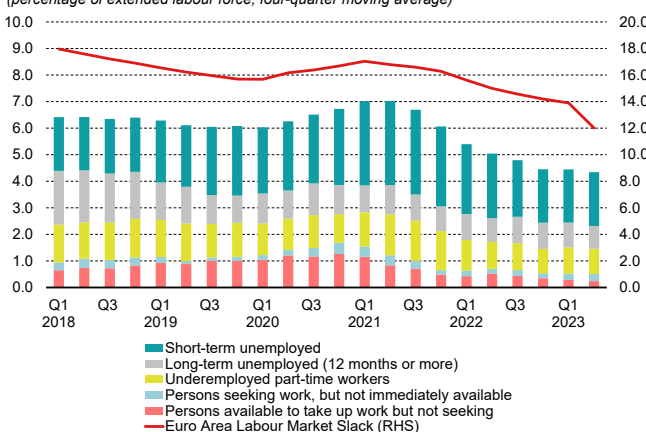
The gap between the broader measure of labour market slack and the unemployment rate has been declining since the last quarter of 2021, indicating a reduction in the share of underutilised labour. However, the gap has broadly stabilised in the quarter under review.

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



Sources: Eurostat; NSO; Central Bank of Malta.

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.

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.

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.

In the second quarter of 2023, around two-thirds of the labour market slack stemmed from unemployment (primarily from short-term unemployment). 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.

BOX 1: ESTIMATING LABOUR TURNOVER IN THE MALTESE ECONOMY USING ADMINISTRATIVE DATA¹

Despite labour supply rising sharply in recent decades, Maltese firms have consistently indicated that labour is a major constraining factor for their operations.

Discussions on labour availability issues in Malta have tended to be limited by the fact that they have focused on net changes in labour aggregates.² The Organisation for Economic Co-operation and Development (OECD) (1996)³ suggests that focusing on changes in the employment stock rather than the flows misconstrues the challenge faced by employers, and to demonstrate this, it distinguishes between two indicators: job turnover and labour turnover. Job turnover is “the net change in employment between two points in time – the total number of jobs created less the number of jobs which have disappeared” expressed as a percentage of total employment. On the other hand, labour turnover “is concerned with the movements of individuals into jobs and out of jobs over a particular period”, again expressed as a percentage of the initial amount of employment.

Consider an economy with 100,000 jobs. Assume that 20,000 persons moved into jobs and 10,000 moved out of jobs. As the net increase in jobs was 10,000, the job turnover rate would be 10%. By contrast the labour turnover rate would be 30%, or three times more, as the net increase of 10,000 involved 30,000 moves (20,000 persons into jobs and 10,000 out). If job tenure, or the length of time people work in a particular job, is declining, one could have a rising labour turnover rate even in the context of a declining job turnover rate. If one has a high job turnover rate combined with declining job tenure, finding employees becomes an even bigger issue for employers.

In Malta it is possible to estimate the labour turnover rate using administrative data compiled by the national employment agency, Jobsplus. National legislation stipulates that in every new employment, an engagement form needs to be submitted to Jobsplus. When a contract of employment is terminated, a self-employed person ceases to be self-employed or the status of an employee is changed (e.g., from part-time to full-time, or from definite to indefinite) a termination form needs to be filled in. The sum of these forms therefore may overstate labour movements as an employee may still be working for the same employer but still need a termination and an engagement form due to change in employment status. Moreover, the timing of termination forms may be less accurate than that of engagement forms, as employers face less incentives to send these immediately.

¹ Prepared by Aaron G. Grech, Chief Officer of the Economics Division at the Bank. The analysis presented in this box is based on the author's study: Grech (2023), “The extent of labour turnover in Malta”, Central Bank of Malta *Policy Note* Series, July 2023. Helpful comments by Dorianna Bezzina, Ian Borg and Alexander F. Demarco are gratefully acknowledged. The views expressed are the author's own and do not necessarily reflect those of the Central Bank of Malta.

² Notable exceptions are Ellul (2018), “Forecasting unemployment rates in Malta: A labour market flows approach”, Central Bank of Malta *Working Paper* WP/03/2018, and Borg, I. (2019), “The length of stay of foreign workers in Malta”, Central Bank of Malta *Policy Note*.

³ OECD (1996), “Employment adjustment, workers and unemployment”, *Employment Outlook*, Chapter 5 pp.161-184.

Labour market turn-over: absolute versus relative trends

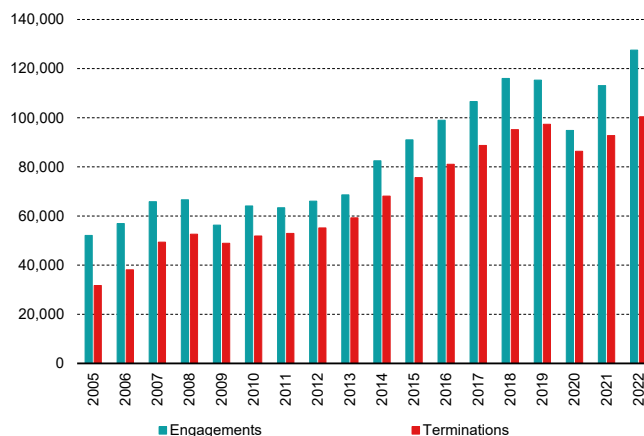
Chart 1 shows the overall amount of engagement and terminations forms that have been submitted between 2005 and 2022. In absolute terms, engagements and terminations have soared over time. In 2005, the total number of engagement and termination forms stood at 83,808. By 2008, it had risen to 119,206, an increase of 42%. After

falling in 2009, the total of forms remained below the 2008 level till 2012. In subsequent years, both engagements and terminations embarked on very rapid upward paths, such that by 2019, their total stood at 212,681. The pandemic brought the total back to its 2016 level, but by 2022 the sum of engagement and termination forms had reached a new record level of 227,955, or 7% higher than the pre-pandemic record, and nearly double the amount observed a decade earlier.

To understand better the implications of these trends, Chart 2 represents the absolute number of engagement and termination forms as a percentage of the overall number of employed. This indicates that the amount of engagement forms was equivalent to 33.1% of the total number of employed in 2005, while the amount of termination forms represented 20.1% of the total employed. By 2018, engagements had risen to 50.0% of the total number of employed, while terminations were up to 41.0%. Using the OECD definition of labour turnover, this would imply that turnover had risen from 53.3% in 2005 to 91.0% in 2018, or by some 71%.

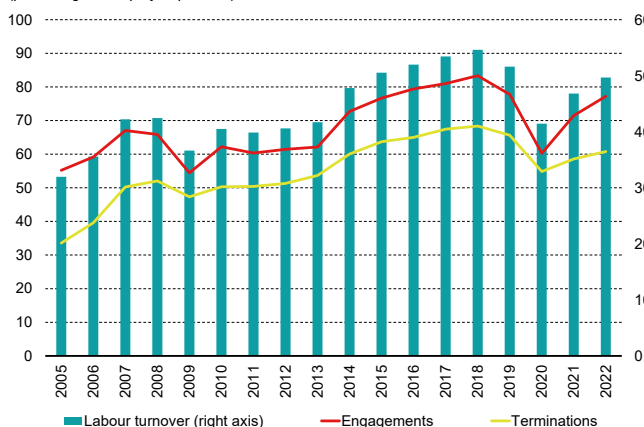
In 2019, relative to the size of the overall workforce, turnover decreased to 86.0%, and then in 2020 to 69.1%, a ratio

Chart 1
ENGAGEMENTS AND TERMINATIONS
(number of engagements and terminations)



Source: Jobsplus.

Chart 2
LABOUR TURNOVER
(percentage of employed persons)



Source: Author's calculations using Jobsplus data.

Table 1**TERMINATIONS DUE TO CHANGES WITHIN THE SAME ORGANISATION OR TRANSFER OF BUSINESS***Number of terminations; percentages*

	2010	2015	2019	2022
Total terminations	51,849	75,630	97,346	100,406
Of which due to:				
Changes within organisation or transfer of business	3,961	8,549	13,523	12,366
% of total terminations	7.6	11.3	13.9	12.3

Source: Author's estimates using Jobsplus data.

previously seen in 2013. By 2022 the labour turnover ratio was back to 82.8%, or close to the levels observed between 2014 and 2015.

So one can have two different readings of the situation. On the one hand, in absolute numbers, 2022 was a record year in terms of overall engagements and terminations, while on the other hand, when seen in relation to the size of the overall workforce, turnover in 2022 was still below the record seen in pre-pandemic years. Also, while in absolute terms there was a drop in turnover in two years (2009 and 2020), in relative terms there was a drop in four years (2009, 2011, 2019 and 2020).

Given that a lot of the engagement and termination forms reflect changes in employment status rather than actual movements of persons between employers, one needs to interpret these numbers with care. Active employment numbers are based on single individuals, while engagement/termination forms may involve the same individual more than once. Table 1 presents data on terminations that were due to changes within the same organisation or transfer of business. This includes changes from definite to indefinite employment, or from part-time to full-time contracts and viceversa. These changes have more than tripled since 2010, and accounted for one-eighth of all terminations in 2022. If one excludes these terminations, the labour turnover rate was 61.7% in 2010, rising to 72.0% in 2015, before falling to 70.8% in 2019, and to 68.7% in 2022.

Using this more restricted definition of terminations, the labour turnover rate remains high, but is much smaller. The trend in the labour turnover rate is somewhat different, though when using either definition, in recent years they both show a decline. If one looks at labour turnover in absolute terms, using either definition, the number of overall engagements and terminations in 2022 was higher than in 2019. Taking a different perspective, using this definition of terminations, the proportion of employees who stayed with the same employer they had a year earlier, moved from 72.4% in 2010 to 69.2% by 2022, as shown in Table 2.

Another way to try to arrive at a better understanding of labour turnover, is to focus on engagement and termination forms submitted just for those in full-time employment, as many part-time contracts tend to be limited in duration. The labour turnover rate for those in full-time employment are consistently smaller than the rate shown for all employment, though it is gradually converging. From 31.8% in 2005, it rose to 49.4% in 2008, falling in

Table 2
EMPLOYEES STAYING WITH THE SAME EMPLOYER THEY HAD A YEAR EARLIER

Percentages

	2010	2015	2019	2022
% staying with same employer	72.4	66.9	67.1	69.2

Source: Author's estimates using Jobsplus data.

2009, and remaining below the 2008-level till 2014, when it reached 54.3%. By 2018 the labour turnover rate among full-time workers had risen to 67.2%, but then it fell to 56.2% by 2020 and stood at 64.2% in 2022, just below the 2017 level. Similar to overall engagements, the data for full-time engagements and terminations suggests that in absolute numbers 2022 was a record, but in relation to the overall amount of employed, it was below the peak year.

Drivers of labour turnover

The development in labour turnover over recent decades of course reflects the large underlying changes experienced in the Maltese labour market during this period. These are, in turn, the larger presence of foreign workers, higher female participation, the age structure of the workforce and the increased share of service activities.

The number of foreign workers has risen from 5,231 in 2005 to 96,970 in 2022. The bulk of the increase was among third-country nationals (TCNs).⁴ Table 3 shows that labour turnover among foreign workers is much more pronounced than amongst Maltese ones. In 2022, the sum of engagements and terminations of TCNs was one and a half times the amount of TCNs employed the previous year, more than double the rate seen for Maltese nationals.

Jobsplus data suggest that about 70% of termination forms submitted for TCNs are for persons who have been employed for less than 12 months. In fact, 29% of all terminations are for TCNs who have been in that employment for less than three months. Back in 2015 this proportion stood at just 15%, with the bulk of terminations clustering near the 12-month period.

Table 3
LABOUR TURNOVER RATE BY NATIONALITY

Percentages

Nationality	2005	2010	2015	2019	2022
Maltese	52	62	71	67	63
EU citizens	135	196	190	132	114
TCNs	85	84	108	167	149

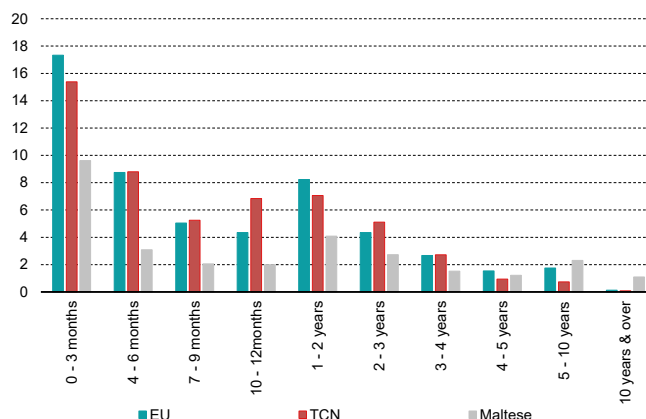
Source: Author's estimates using Jobsplus data.

⁴ As from 2020 UK citizens started to be classified as TCNs. In 2022 there were 5,167 such individuals.

As a result of this trend, by 2022, the length of time by when TCNs' employment is terminated has broadly converged to that of EU citizens, as can be seen in Chart 3. Among Maltese workers, terminations are much less prevalent, though interestingly, the equivalent of 10% of all Maltese workers are subject to a termination notice within three months of them being first engaged. The proportion then drops

much strongly, and in relative terms TCNs are twice as likely as a Maltese worker to face a termination notice within a year of being employed. While in 2022 the equivalent of about 30% of all employed Maltese either changed their jobs or experienced a change in their employment status, the proportion for foreign workers was above 50%.

Chart 3
TERMINATIONS IN 2022 BY DURATION OF EMPLOYMENT
(percentage of employment by nationality)



Source: Author's calculations using Jobsplus data.

Maltese workers accounted for about a third of the rise in labour turnover in absolute terms between 2005 and 2022. That said, the total of engagements and terminations of Maltese workers in 2022 stood at its 2015 level and was 6% lower than its 2016 peak. Maltese persons accounted for 55% of all terminations and engagements in 2022, down from 94% in 2005. By contrast TCNs now account for 25.8% of all labour turnover, up from 2.2% in 2005. Increased dependence on foreign workers appears to have been the main driver behind the rise in labour turnover. Initially this reflected very high dependence on flows of very transient EU citizens, with nearly half of them being subject to a termination notice within six months of being engaged. In recent years EU citizens working in Malta appear to be lengthening somewhat their stays.⁵ While EU nationals in Malta are still increasing in absolute numbers, in recent years their increase is being surpassed greatly by that observed in TCNs, who in turn, appear to be more transient than they used to be. As a result of the fact that both TCNs and EU nationals are much less likely than Maltese citizens to stay with the same employer for more than a year, the greater reliance on foreign workers is leading to higher labour turnover.

Another major change in the Maltese labour market was the rise in female participation. The number of women working in 2022 was 223% that in 2005, while that of men was 165%. Women still constitute less than half of total employment, but their share has grown from less than 34% of total employment in 2005, to close to 41% in 2022. Before the sharp acceleration in foreign labour flows from 2015 onwards, in absolute terms, the increase in employment was mostly of women. This had an impact on labour turnover

⁵ In 2015 the equivalent of 83% of all EU citizens working in Malta were subject of a termination notice, while in 2022 this has fallen to 54%.

Table 4
LABOUR TURNOVER RATE BY GENDER

Percentages

Gender	2005	2010	2015	2019	2022
Men	45	59	77	82	82
Women	69	79	95	92	84

Source: Author's estimates using Jobsplus data.

rates, as administrative data indicate that women tend to be more subject to engagement and termination forms than men. Table 4 shows that over time the gender difference in turnover has narrowed very rapidly.

Before the introduction of free childcare in 2014, many women tended to drop out from the labour force to take care of their children, which explains the large gender gap in the decade to 2015. Initially most women joining the labour force tended to be from younger cohorts, and younger individuals tend to be more prone to move jobs. Women also tended to mostly work part-time, and contracts in this type of employment tend to be of shorter duration. Furthermore, the introduction of make work pay labour policies meant that many relatively unskilled women joined the labour market, many for the first time or after long career breaks. This was also bound to raise labour turnover rates. However, after the peak in 2015, labour turnover rates for women declined to those observed for men, reflecting the fact that most of the growth in female employment was in full-time employment, which tends to be more stable.

The age structure is another important determinant of labour turnover. Older workers tend to stay longer in jobs and are less likely to be fired. This emerges very clearly in Table 5, which shows that while engagements and terminations of those aged 25 to 34 in 2022 were equivalent to the entire workforce of that age, those for those aged 65 and over were less than 22% of that cohort of workers. An ageing workforce should therefore lead to a more stable workforce. In the case of Malta, this may have been the case between 2005 and 2010, but subsequently, thanks to the combination of foreign worker inflows and the

Table 5
LABOUR TURNOVER RATE BY AGE

Percentages

Age bracket	2005	2010	2015	2019	2022
20-24	107	142	180	176	181
25-34	45	67	95	102	101
35-44	32	46	60	67	66
45-54	22	36	45	49	48
55-59	14	24	33	35	33
60-64	29	39	44	41	39
65 & over	23	22	24	24	22

Source: Author's estimates using Jobsplus data.

surge in female participation, the workforce became younger. Considering the much larger labour turnover rates observed among younger workers, this inevitably led to higher overall labour turnover. Moreover, in many age brackets, there appears to have been an increase in labour turnover rates, especially between 2005 and 2015. In more recent years, apart from the 25 to 54 cohorts (possibly due to higher shares of foreign workers), there have been some declines in labour turnover.

Changes in economic sector shares also lead to changes in labour turnover. Certain services sectors, as discussed previously, are well known to be characterised by more labour churn. Table 6, in fact, shows that the accommodation and food services sector in Malta faces labour turnover rates that are nearly three times those of the public sector dominated sectors of administration, health and education. That said, accommodation and food services do not explain the trend in labour turnover observed in Malta. The rise in the total of engagements and terminations in this sector between 2005 and 2022 accounted for less than 6% of the overall increase in labour turnover. The largest contributor was the administrative support sector, which accounted for a fifth of the entire increase in turnover. Wholesale and retail, transport and construction together accounted for another quarter of the increase, while on the other end of the value-added spectrum, arts & recreation and professional services contributed another quarter of the rise.

Labour turnover rates appear to have risen in all sectors compared to 2005, but they fell after the pandemic, except for transport and administrative support. The latter two sectors are, in turn, increasingly dominated by TNCs with a much shorter length of stay than in previous years.

The declining relative importance of manufacturing and public services also explains the rise in turnover, as employees in these sectors tend to have longer job tenure.

Table 6
LABOUR TURNOVER RATE BY ECONOMIC SECTOR (SELECTED)

Percentages

Sector	2005	2010	2015	2019	2022
Agriculture & fisheries	21	25	27	38	34
Manufacturing	41	58	60	62	57
Construction	43	48	60	82	69
Wholesale & retail	49	57	77	83	79
Transport & storage	26	37	90	78	89
Accommodation & food	151	142	159	145	144
Financial services	23	51	64	69	66
Professional services	124	105	125	109	86
Administrative support	123	149	149	134	141
Arts & recreation	95	139	141	121	116
Public administration/health/education	29	42	52	53	52

Source: Author's estimates using Jobsplus data.

Conclusions

Administrative data suggest that while there has been a very significant increase in the labour turnover rate over time, it is still not at its pre-pandemic peak. In terms of absolute numbers, the situation is different in that the churn in employment is now at an all-time high. That said, the effectiveness of the labour market to match employment demand and supply appears to be improving. While in 2015 the number of engagement and termination forms per net increase in employment stood at 17, this had fallen to 14 by 2019, and to 11 by 2022. The job turnover and labour turnover rate are, in fact, getting closer to each other.

While the labour turnover rate for TCNs has increased, that for EU workers has fallen, but job tenure among foreign workers remains much shorter than that among Maltese ones. At the same time, the gender gap in turnover appears to have disappeared, while job tenure among all age categories, apart from the very young cohorts, is above pre-pandemic levels. Increased reliance on high value-added services is also likely to reduce turnover, as employees in these sectors appear to lengthening their tenure.

3. PRICES, COSTS AND COMPETITIVENESS

Consumer price pressures eased somewhat during the quarter under review, but inflation remained high from a historical perspective.

Annual inflation, as measured by the HICP, stood at 6.2% in June, down from 7.1% in March. The slowdown in overall inflation was driven by slower growth in the prices of NEIG and food. Annual inflation based on the RPI – which only considers expenditure by Maltese residents – fell to 5.4% in June, from 7.0% in March.

ULCs increased at a faster pace in the second quarter of 2023, while most other input cost indicators moderated. The former, measured on a four-quarter moving average basis, increased by 4.4% in the first quarter, from 3.6% in the previous quarter.

Inflation

HICP inflation eases

Annual HICP inflation eased to 6.2% in June 2023, from 7.1% in March 2023 (see Table 3.1).¹ Chart 3.1 shows that HICP inflation in Malta exceeded that recorded in the euro area, which ended the quarter at 5.5%. The lower outturn in the euro area inflation partly reflects the decrease in energy prices experienced in 2023 following the record highs reached in 2022. Indeed, energy inflation dragged down overall inflation, as the contribution of energy inflation to euro area HICP inflation turned

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

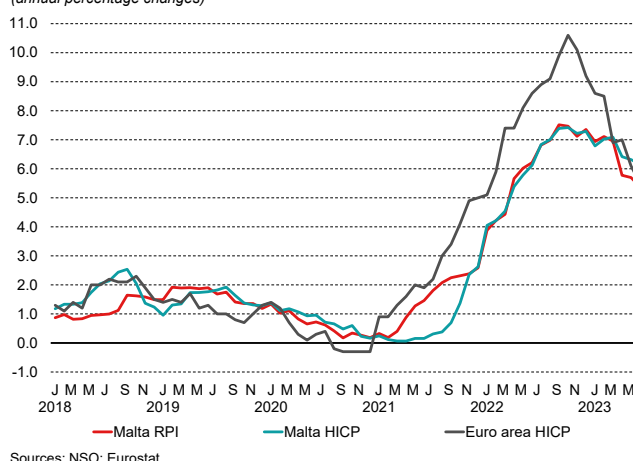


Table 3.1
HICP INFLATION

Annual percentage change

	2022						2023					
	July	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
Unprocessed food	13.0	9.6	8.7	14.4	10.0	10.3	8.5	13.0	12.3	8.3	7.0	8.4
Processed food including alcohol and tobacco	8.9	9.4	10.4	11.3	12.0	11.8	10.6	11.0	11.0	10.6	10.4	10.9
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	5.5	5.4	6.6	6.5	6.7	6.7	7.3	6.7	6.6	5.4	5.1	4.0
Services (overall index excluding goods)	6.9	7.5	7.4	6.7	6.5	6.7	5.8	6.1	6.4	6.0	6.1	6.1
All Items HICP	6.8	7.0	7.4	7.4	7.2	7.3	6.8	7.0	7.1	6.4	6.3	6.2

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.

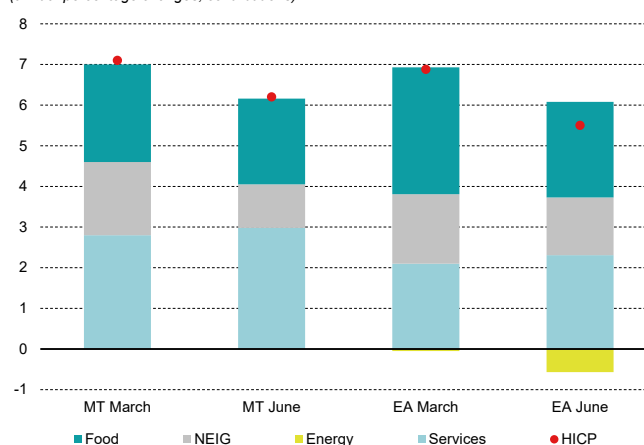
more negative in June (see Chart 3.2). In the case of Malta, energy prices have remained unchanged since mid-2020. At the same time, services inflation in Malta is higher than that of the euro area. On the other hand, the contribution of food and NEIG to HICP inflation in June was lower in Malta than in the euro area.

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.

The share of subcomponents registering inflation rates in the lowest inflation band has declined in both Malta and the euro area since late 2021, which was mirrored in a substantial rise in the share of subcomponents with year-on-year price increases of more than 5%. The share of the latter stood at 55.0% in June, marginally below the euro area figure.

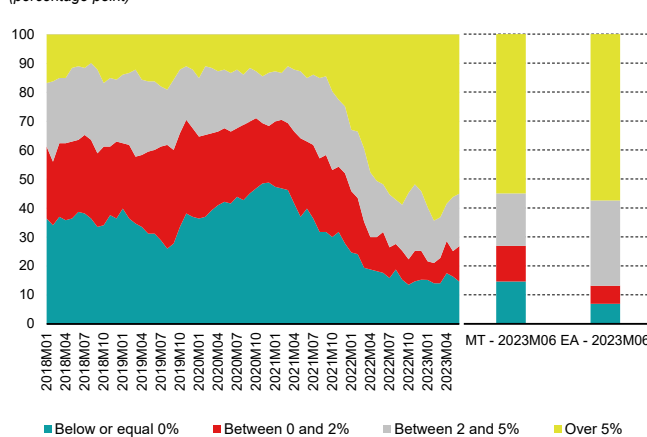
When compared to three months earlier, the share of the Maltese basket falling in this band decreased by 8.2 percentage points from the peak of 63.2% reached in the first quarter of 2023, though it remained high by historical standards. On the other hand, there was an increase in the shares of subcomponents with yearly price increases of less than 5%. The bracket holding items with inflation between 2% and 5% expanded by 4.1 percentage points to stand at 18.1% in June, though still lower than that of the euro area which stood at 29.4%.

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



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

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



Source: Central Bank of Malta calculations.

² The calculation of the shares in this chart do not consider 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 17.6% 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 40.7% and 32.3% respectively in the euro area. While 19.4% of the Maltese basket fell in the over 5% interval, only 9.4% of the euro area basket falls in this interval.

The two intervals holding items with inflation rates of 2% or below also rose since March, standing higher than those of the euro area. The bracket holding items with inflation between 0% and 2% grew by 3.5 percentage points, while that holding items with negative growth rates grew marginally by 0.6 percentage point, standing at 12.3% and 14.6%, respectively.

Overall, the latest data indicate that inflationary pressures in Malta remain persistent and broad-based across consumer items, but with some moderation in the extent of inflationary pressures. In part, subcomponents that are of an administrative nature, including energy, education, and passenger transport by bus, have contributed somewhat to curb inflationary pressures.³ There has also been a slowdown in other components, in line with the easing of cost pressures and supply bottlenecks. In particular, a number of components that until recently recorded inflation rates above 5% showed increases below this threshold in June. These included clothing and footwear, certain household tools and equipment, and some food products. Indeed, the drop in HICP inflation relative to March was driven by slower growth in the prices of food and NEIG (see Chart 3.4).

Food inflation eased during the quarter under review, though still growing at double-digit growth rates. It stood at 10.3% in June, down from 11.3% in March. Consequently, the overall contribution of food to HICP inflation eased to 2.1 percentage points in June, from 2.4 percentage points in March. The decline was driven by unprocessed and, to a lesser extent, processed food inflation. These eased to 8.4% and 10.9%, respectively. A decline in the contribution from meat was the main driver of the moderation in food inflation (see Chart 3.5). On the other hand, the contribution from fruit, dairy products, and bread and cereals, increased slightly.

NEIG inflation declined from 6.6% in March to 4.0% in June. The drop reflects slower growth in all subcomponents, but especially in prices of semi-durables.

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

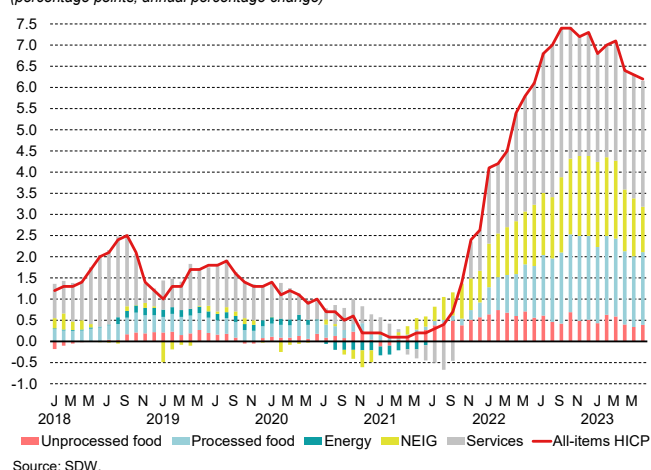
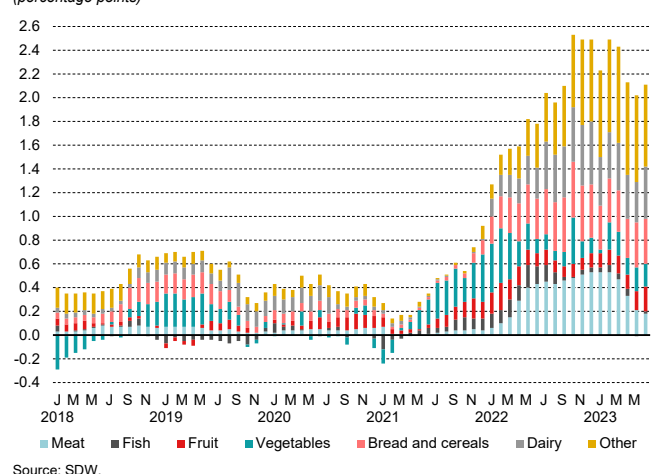


Chart 3.5
CONTRIBUTIONS FROM FOOD TO HICP INFLATION
(percentage points)



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

These rose by an annual 2.3%, down from 6.8% in March. At the same time, prices of durables rose by 3.5%, down from 5.4%, while price of non-durables increased by 6.1% down from 7.9%.

Services inflation decreased from 6.4% in March to 6.1% in June, contributing 3.0 percentage points to overall HICP inflation (see Chart 3.6). Despite easing, services inflation still stands relatively high from a historical perspective. All services components had a positive contribution to overall HICP inflation in June, with the largest contribution stemming from the recreation and personal care subcomponent. The latter's contribution rose further during the period under consideration. 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. An increase in the contribution from transport services was also recorded between March and June, reflecting higher growth in the prices of passenger transport services by air.

While the contribution from housing services remained strong, it declined somewhat from March, reflecting slower growth in fees for the maintenance and repair of buildings, though the latter continued to grow at double-digit rates.

Energy inflation was unchanged at 0.0% in June, 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.

Core HICP inflation declines

The Bank's measure of core inflation, which excludes the more volatile items in each month, fell to 5.0% in June 2023, from 6.9% three months earlier (see Chart 3.7).⁴ Hence,

Chart 3.6
CONTRIBUTIONS FROM SERVICES TO HICP INFLATION
(percentage points)

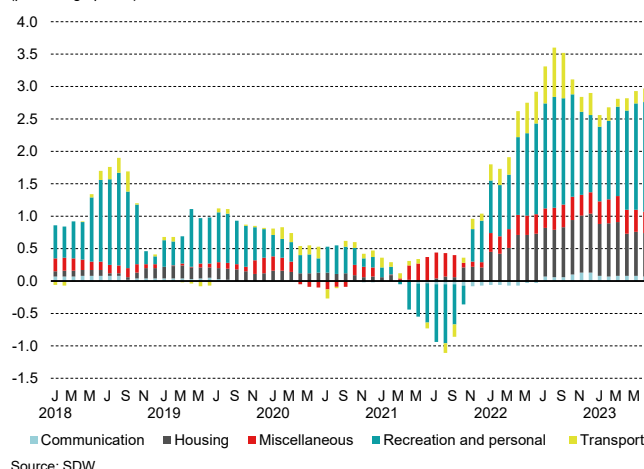
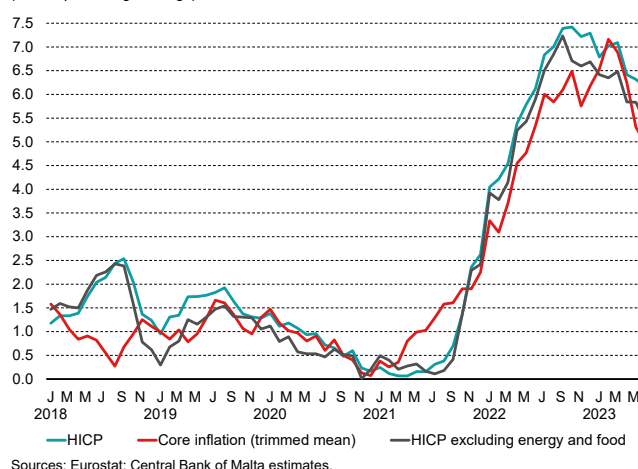


Chart 3.7
HICP IN MALTA: OVERALL AND CORE MEASURE
(annual percentage change)



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.

it was 1.2 percentage points lower than overall HICP inflation. An alternative measure of underlying inflationary pressures – HICP excluding food and energy – also eased in June, reaching 5.4% from 6.5% in March.

RPI inflation drops

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 5.4% in June, from 7.0% in March, following a decline in the contribution of most subcomponents (see Table 3.2).⁵ Food, clothing and footwear and housing inflation were the main contributors towards the easing in RPI inflation. The contribution of prices for recreation and cultural activities, and household equipment and maintenance, also fell, though to a lesser extent. Meanwhile, energy tariffs continued to have a neutral impact on overall RPI inflation in the period under review.

The difference between HICP and RPI inflation in part reflects the different structure of weights applied to the two indices, as mentioned earlier. Different weight levels are allocated to each subcomponent in the respective indices, such that RPI includes only domestic consumption, whilst HICP also includes tourism related consumption. Moreover, the 2023 set

Chart 3.8
IMPACT OF 2023 WEIGHTS ON HICP INFLATION IN JUNE
(annual percentage changes; contributions)

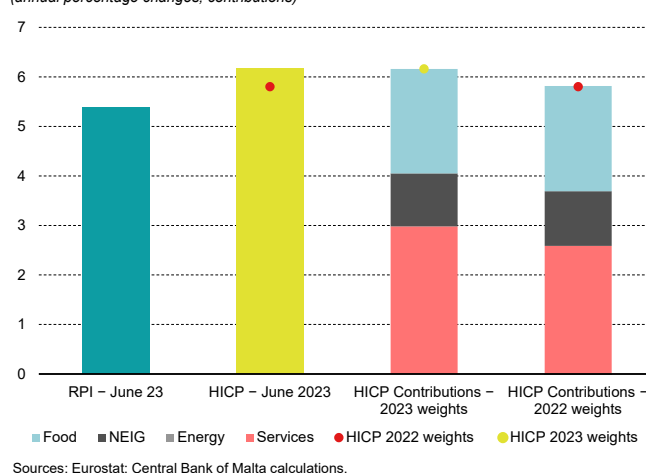


Table 3.2
CONTRIBUTIONS TO YEAR-ON-YEAR RPI INFLATION

Percentage points

	2022							2023					
	July	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	
Food	2.5	2.4	2.5	2.9	2.7	2.7	2.3	2.6	2.5	2.2	2.2	2.2	
Beverages and tobacco	0.2	0.3	0.3	0.3	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	
Clothing and footwear	0.0	-0.1	0.2	0.2	0.1	0.0	0.5	0.4	0.3	-0.1	-0.1	-0.1	
Housing	1.2	1.2	1.3	1.5	1.5	1.5	1.3	1.1	1.2	0.8	0.8	0.7	
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	0.4	0.5	0.6	0.5	0.6	0.6	0.5	0.4	0.4	0.5	0.5	0.4	
Transport and communications	1.1	1.4	1.2	0.6	0.5	0.6	0.4	0.4	0.4	0.6	0.6	0.4	
Personal care and health	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.6	0.6	0.5	0.5	0.4	
Recreation and culture	0.5	0.3	0.4	0.3	0.2	0.3	0.3	0.3	0.4	0.1	0.1	0.2	
Other goods and services	0.4	0.5	0.5	0.5	0.5	0.5	0.6	0.7	0.6	0.5	0.5	0.6	
RPI (annual percentage change)	6.8	7.0	7.5	7.5	7.1	7.4	6.9	7.1	7.0	5.8	5.7	5.4	

Source: NSO.

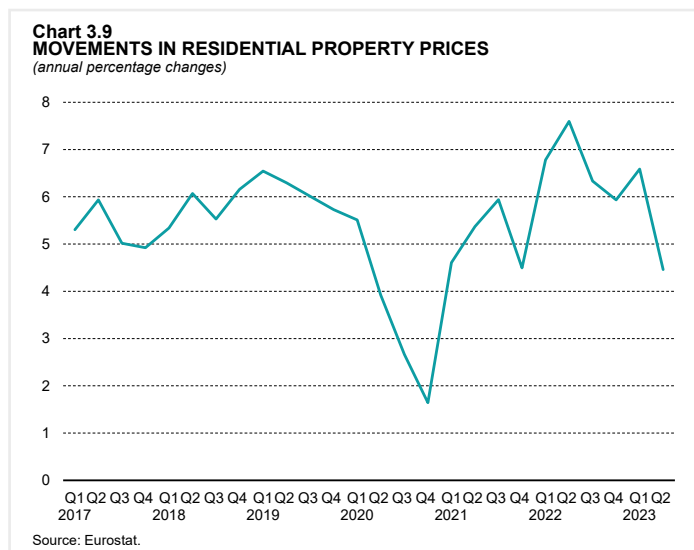
⁵ The RPI index differs from the HICP index in that RPI weights are based on expenditure by Maltese households, while HICP weights also reflect expenditure patterns by tourists in Malta, such as accommodation services. See Darmanin, J. (2018), "Household Expenditure in Malta and the RPI Inflation Basket", *Quarterly Review* 2018(3), pp. 33-40, Central Bank of Malta.

of weights applied to the HICP index have been revised compared with the 2022 weights. The weights of the RPI are not updated annually and hence are not affected by such changes. A hypothetical estimate of HICP inflation using 2022 weights leads to an inflation rate of 5.8% in June, indicating that around half of the discrepancy between HICP and RPI is due to the latest update of HICP weights. Looking at the subcomponents, the main difference stems from services inflation (see Chart 3.8).

The housing market

Residential property prices grow at a slower 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 4.5% in the second quarter of 2023, down from 6.6% in the previous quarter (see Chart 3.9).⁶ This contrasts with developments in the euro area, where prices on average decreased at an annual rate of 1.7%.



Residential property prices in Malta continue to be supported by a number of Government schemes supporting demand for property, including 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. Moreover, a dynamic tourism sector, and an increase in migrant workers flows continue to support demand for accommodation and hence, property prices.

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.

According to the misalignment indicator, house prices, as measured by the NSO's PPI, were slightly below the level consistent with fundamentals in the second quarter of 2023, with the gap

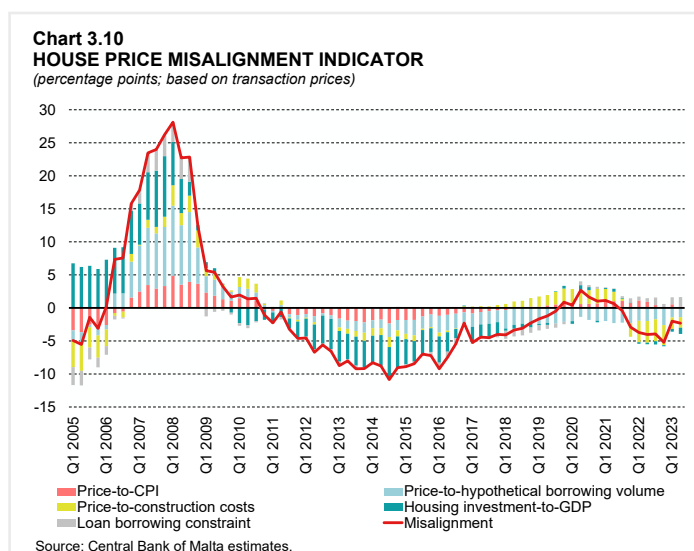
⁶ 'Apartments' are defined as dwellings with self-contained rooms or a suite of rooms that have a separate entrance accessible from a common passageway, landing or stairway. 'Maisonettes' have a separate entrance that is accessible from the street and are either at ground-floor level with overlying habitation, 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.

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.

marginally wider than that estimated for the first quarter of the year (see Chart 3.10).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. While construction costs declined in the quarter under review, they are still high from a historical perspective, thereby pushing down the price-to-construction cost ratio below its long-run average. Although to a lesser extent, the housing investment-to-GDP ratio, which is an indicator of overheating, also contributed negatively to the index. By contrast, the loan borrowing constraint, and the price-to-CPI ratio contributed positively to the misalignment indicator.



Property transactions decrease in quarterly and annual terms

NSO data on residential property transactions show that 3,007 final deeds of sale were registered in the quarter under review, a decrease of 3.0% compared to the number of sales concluded in the first quarter of 2023, and 15.7% 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 second quarter of 2023, the largest year-on-year decrease in absolute terms was recorded in Gozo, followed by the Northern Harbour region. Over 90% of transactions concluded in the second quarter of 2023 involved purchases by individuals. A quarter-on-quarter decline of 4.0% was recorded in the total value of final deeds.

At 3,503, the number of promise-of-sale agreements was 12.1% higher than those notified in the previous quarter, and 8.6% higher than those registered in the same quarter of 2022. Most of the

Table 3.3
TRANSACTIONS

Levels

	2022			2023	
	Q2	Q3	Q4	Q1	Q2
Residential transactions					
Promise of sale	3,227	2,848	3,354	3,125	3,503
Final deeds of sale	3,567	3,593	3,764	3,101	3,007

Source: National Statistics Office.

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

increase in year-on-year terms was reported for the Northern Harbour, and the Southern Harbour regions, with the other regions recording more moderate increases, and, in the case of Gozo, a marginal decline.

Mortgage transactions declined but remain above pre-pandemic average¹⁰

The number of new mortgage contracts declined in the second quarter of 2023 in annual terms, standing at 1,078. When compared with the second quarter of 2022, they stood lower by around 7% (see Chart 3.11). This decrease was observed for apartments and maisonnettes, as the number of mortgage contracts for terraced houses and the 'other' category increased. Notwithstanding this decline, the total number of mortgage contracts in the second quarter of 2023 exceeded the average of 827 transactions per quarter recorded between 2017 and 2019.

Advertised rent prices continue to increase

The annual rate of change of advertised rents collected from internet sources increased in the second 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 9.7% and 11.4% in the quarter under review (see Chart 3.12). Compared with the previous quarter, the range of estimates has widened. Furthermore, the level of advertised rents remained around 14% above the pre-pandemic level, as estimated in the final quarter of 2019.

Chart 3.11
MORTGAGE CONTRACTS
(number of contracts)

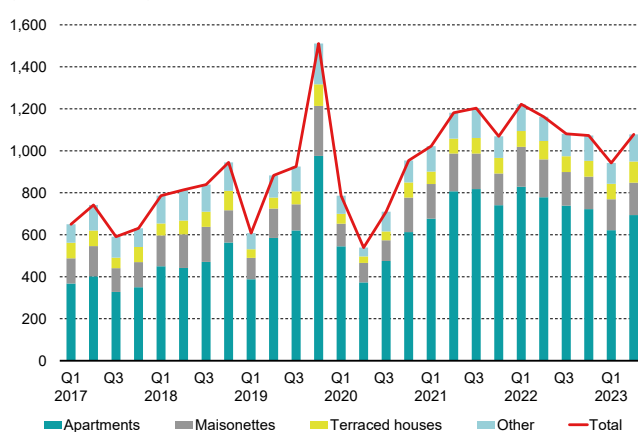
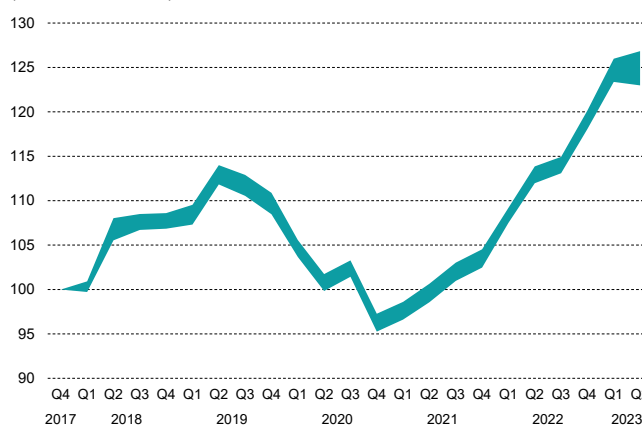


Chart 3.12
ADVERTISED RENTAL PRICES
(Index 2017Q4 = 100)



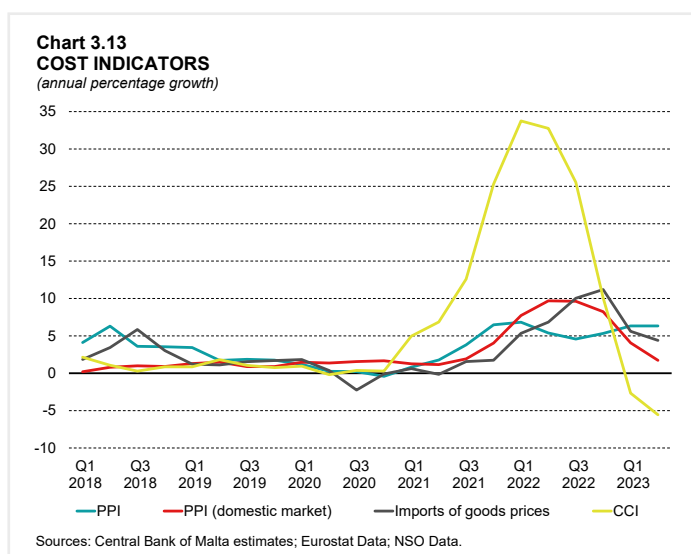
¹⁰ The data used in the section are collected by the Central Bank of Malta from four commercial banks and relate only to properties which have been purchased with a mortgage. The dataset excludes properties that have either been transacted using other means of financing, as well as mortgages that have been refinanced. The property types included are flats, penthouses, maisonnettes, 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.

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, maisonnettes, and penthouses.

Cost indices

Producer costs grew at a faster pace

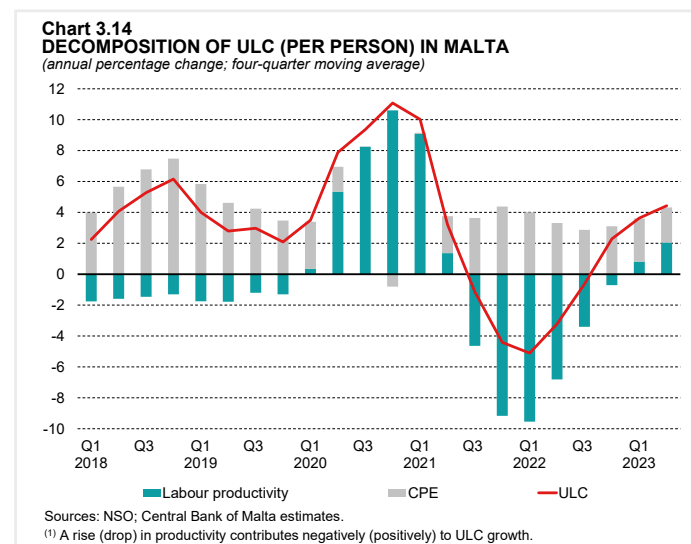
Annual inflation, based on the industrial producer price index, which is a measure of the change in the prices of goods sold by producers in the industrial sector, reached 4.2% in this quarter, from 4.0% in the previous quarter.¹² This was mainly driven by developments in producer prices for intermediate goods, which rose by 2.7% in this quarter, up from 0.1% previously, offsetting slower growth in the other non-energy components. Meanwhile, energy producer price inflation remained zero in the period under review.



Other indicators affecting the domestic market show a downward trend (see Chart 3.13). The domestic producer price index rose at a slower annual rate of 1.7%, down from 4.1% in the first quarter, mainly driven by prices of intermediate goods.¹³ The imports of goods deflator also shows weaker growth of 4.4% during the quarter under review, from 5.6% in the first quarter of 2023.¹⁴ The CCI for new residential buildings published by Eurostat declined further in the second quarter, falling by an annual 5.6%, after it had declined by 2.7% in the last quarter. 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 second quarter of 2023 in annual terms but was broadly stable in quarter-on-quarter terms.¹⁵ When measured on a four-quarter moving average basis in headcount terms, ULCs in Malta rose at an annual rate of 4.4%. This followed an increase of 3.6% in the previous quarter (see Chart 3.14). The



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.

¹³ The domestic PPI refers to the producer prices relating to the domestic market only, whilst the PPI 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.

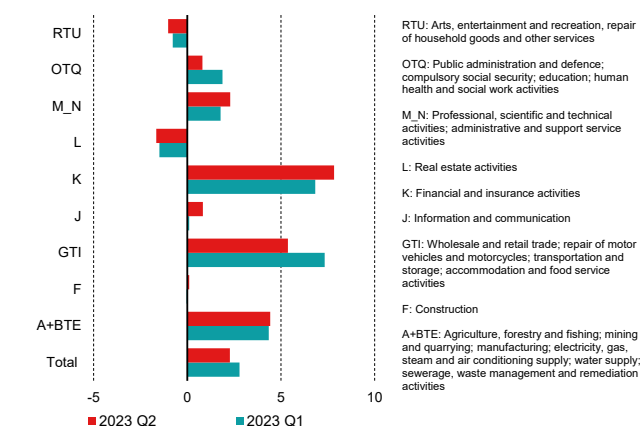
¹⁵ Annual growth in ULC, CPE and labour productivity is measured on a four-quarter moving average basis. A degree of caution is required in the interpretation of ULC in view of contemporaneous structural shifts in the composition and factor-intensity of production, notably the shift to labour-intensive 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), pp. 53-63, Central Bank of Malta.

recent rise in ULCs occurred as productivity declined, while CPE continued to grow. Indeed, labour productivity declined by 2.1% after declining by 0.8% in the previous quarter and was the main driver behind the pick-up in ULC growth. By contrast, growth in CPE moderated to 2.3%, from 2.8% in the first quarter.

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 7.8% (see Chart 3.15). This was followed by the wholesale and retail sector, where compensation per person grew by 5.4%. Most of the other sectors also show an increase in CPE. However, average compensation in the real estate activities, and in the arts and entertainment sectors, declined by 1.7% and 1.0%, respectively. Overall, most of the sectors experienced weaker dynamics in growth when compared to the first quarter of the year, except for financial and insurance activities and the information and technology sector.

Chart 3.15
CPE BY SECTOR

(annual percentage growth; four-quarter moving average)



4. THE BALANCE OF PAYMENTS¹

During the second 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 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 decreased 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 1.3% of GDP for the second quarter of 2023. This compares with a current account surplus of 0.2% of GDP in the euro area.

The cyclically-adjusted current account balance is estimated to have recorded a deficit of 2.3% during the quarter under review.

During the second quarter of 2023, the tourism sector continued to perform well. The number of inbound tourists, nights stayed, and tourist expenditure in Malta all increased when compared with a year earlier, and surpassed 2019 levels.

The current account

The current account deficit narrows considerably

Between April and June 2023, the current account of the balance of payments registered a deficit of €3.8 million, €271.5 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.

Table 4.1
BALANCE OF PAYMENTS

EUR millions

	Four-quarter moving sums					2022 Q2	2023 Q2
	2022 Q2	2022 Q3	2022 Q4	2023 Q1	2023 Q2		
Current account	-180.9	-367.3	-518.8	-513.1	-241.7	-275.3	-3.8
Goods	-2,496.4	-3,009.8	-3,184.7	-3,192.3	-3,017.6	-881.9	-707.2
Services	4,636.3	4,964.2	5,102.1	5,174.0	5,253.8	1,316.1	1,395.9
Primary income	-1,879.6	-1,894.2	-1,974.0	-2,028.5	-2,181.9	-516.2	-669.6
Secondary income	-441.2	-427.6	-462.2	-466.3	-296.0	-193.2	-22.9
Capital account	242.0	235.5	266.6	357.8	345.2	60.7	48.1
Financial account⁽¹⁾	-1,592.3	-1,185.4	-71.0	1,981.8	3,483.7	-408.3	1,093.6
Errors and omissions	-1,653.4	-1,053.6	181.2	2,137.1	3,380.1	-193.8	1,049.3

Sources: Eurostat; Central Bank of Malta

⁽¹⁾ Net lending (+) / net borrowing (-).

¹ Data in this chapter are sourced from the Central Bank of Malta and Eurostat and may differ from data published in NSO News Release 169/2023, which has an earlier cut-off date.

In the four quarters up to June 2023, the current account deficit increased to €241.7 million, from €180.9 million a year earlier. The increase in the current account deficit was spurred by a significant widening in the merchandise trade deficit and, to a lesser extent, higher net outflows on the primary account. Together, these offset an increase in net receipts from trade in services, and lower net outflows on the secondary income account. As a result, the current account deficit-to-GDP ratio reached 1.3%, from 1.1% a year earlier (see Chart 4.1). Malta's cyclically-adjusted current account deficit is estimated to have stood at 2.3% of GDP in the second quarter of 2023, and thus more negative than the headline measure (see Chart 4.1).²

The merchandise trade deficit narrows

In the second quarter of 2023, the merchandise trade deficit stood at €707.2 million, down from €881.9 million in the corresponding period of 2022. This was driven by a decrease in imports, which offset a smaller fall in exports.

The visible trade gap increased when measured on a four-quarter cumulative basis, reaching €3,017.6 million, from €2,496.4 million in the same period a year earlier. This reflected a €849.9 million rise in goods imports, in large part reflecting an extraordinary increase in imports of aircraft in the second half of 2022. These outweighed a €328.8 million increase in exports. As a result, the share of the goods deficit in GDP rose to 16.7% in the year to June 2023, from 15.3% a year earlier (see Chart 4.2).

The surplus on services widens

In the quarter under review, net receipts on the services account amounted to €1,395.9 million, €79.9 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.

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

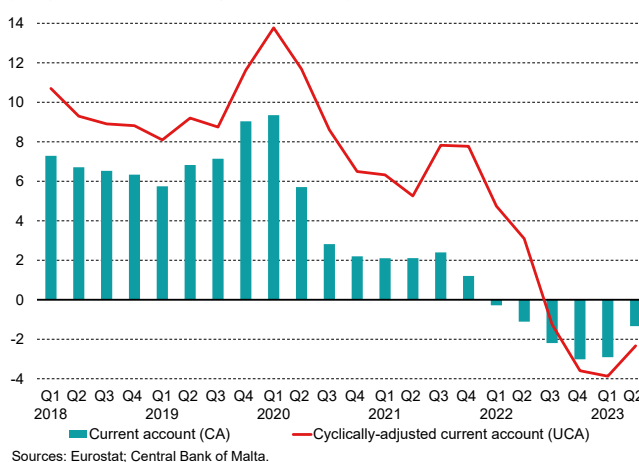
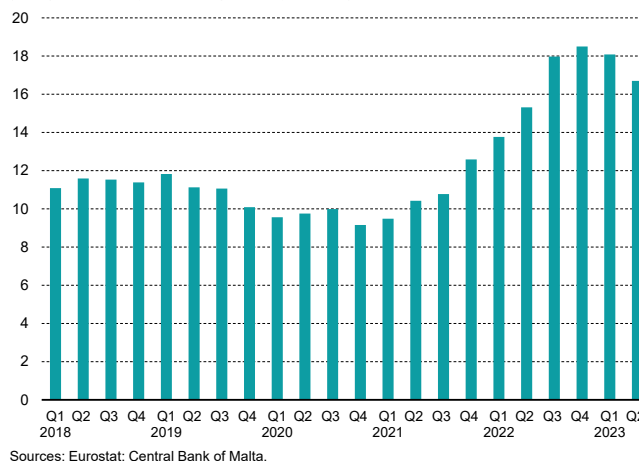
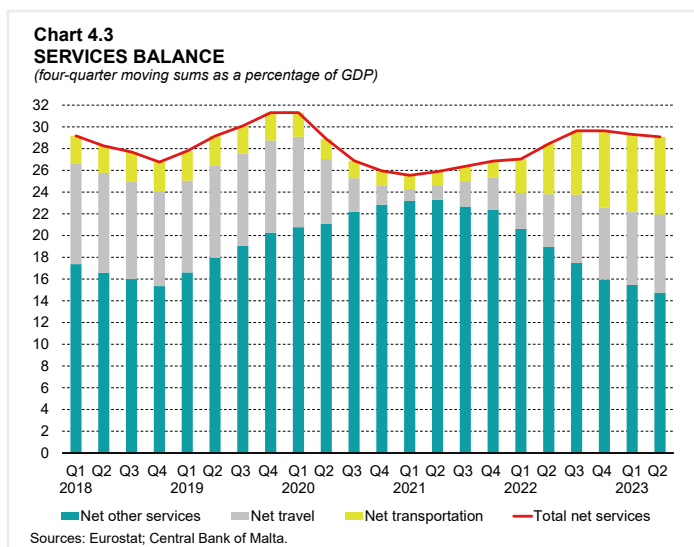


Chart 4.2
GOODS DEFICIT
(four-quarter moving sums as a percentage of GDP)



The transport and travel components drove the increase in the surplus from services. Net transport receipts increased by €37.6 million. Meanwhile, net receipts on the travel component rose by €108.2 million compared with the corresponding quarter of last year.

By contrast, net receipts on 'other services' decreased by €65.9 million, mainly due to higher net payments related to telecommunications, computer, and information services, charges for the use of intellectual property, and 'other business services'. Lower net receipts from financial services also contributed. These more than offset higher net receipts from personal, cultural, and recreational services, which includes gaming and betting activities.



On a four-quarter cumulative basis, the overall surplus from services stood at €5,253.8 million, an increase of €617.5 million over the surplus recorded in the year to June 2022. The main contributors to this increase were the transport and travel components. The share of net services receipts in GDP rose to 29.1%, from 28.4% over the same period last year (see Chart 4.3).

Net outflows on the primary income account increase³

Between April and June 2023, net outflows on the primary income account stood at €669.6 million, €153.5 million more than in the second quarter of 2022. This was mainly due to higher net payments from investment income, reflecting lower net interest receipts from 'other investment income'.

In the four-quarter period to June 2023, net outflows on the primary income account increased by €302.3 million, to stand at €2,181.9 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 June 2023, net outflows on the primary income account amounted to 12.1% of GDP.

Outflows on the secondary income account decline significantly⁴

In the second quarter of the year, net outflows on the secondary income account declined by €170.4 million on a year earlier, to stand at €22.9 million.

Similarly, net outflows on this account declined substantially when measured on a four-quarter moving sum basis. These stood at €296.0 million, equivalent to 1.6% of GDP, and €145.2 million less 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 846,230, up from 661,142 a year earlier (see Chart 4.4). In absolute terms, tourists visiting for holiday purposes accounted for the vast majority of the annual rise in arrivals, even though visitors coming for ‘other’ motives also increased. On the other hand, the number of those visiting for business purposes declined.

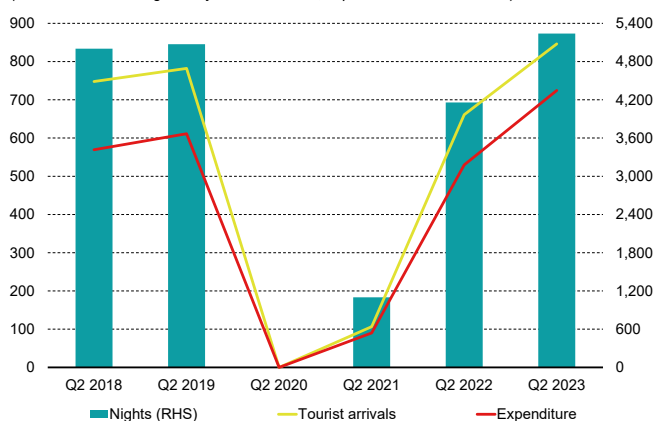
Meanwhile, the total number of guest nights that tourists spent in Malta during the second quarter of 2023 amounted to 5.2 million, up from 4.2 million a year earlier. Stays in rented accommodation accounted for most of this increase. When compared with the same quarter of 2019, guest nights increased moderately. A strong increase in “other rented” accommodation was partly offset by a decrease in non-rented accommodation. Nights stayed in collective accommodation rose modestly.

The share of non-residents in collective accommodation establishments in the second quarter of 2023 rose. It stood at 90.8%, up from 88.4% in the second quarter of 2022, and slightly below the share of 92.9% recorded in the second quarter of 2019 (see Chart 4.5).

The total occupancy rate in collective accommodation establishments in the second quarter of 2023 rose to 68.4%, from 58.7% a year earlier (see Chart 4.6).

Chart 4.4
TOURISM INDICATORS⁽¹⁾

(tourist arrivals and nights stayed in thousands; expenditure in EUR millions)

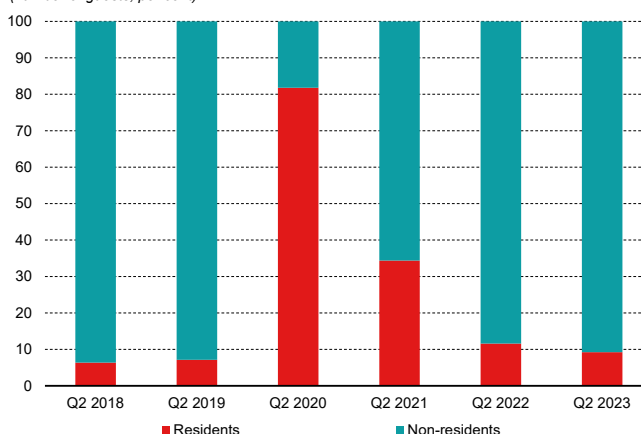


Source: NSO.

⁽¹⁾ No data is available for the second quarter of 2020 due to border closure.

Chart 4.5
GUESTS IN COLLECTIVE ACCOMMODATION ESTABLISHMENTS

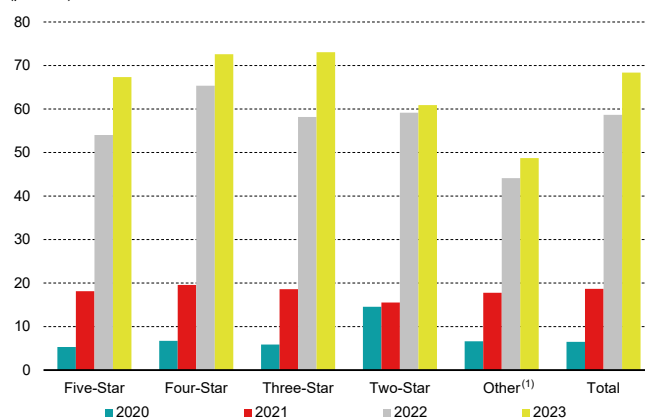
(number of guests; per cent)



Source: NSO.

Chart 4.6
AVERAGE OCCUPANCY RATES IN THE SECOND QUARTER

(per cent)



Source: NSO.

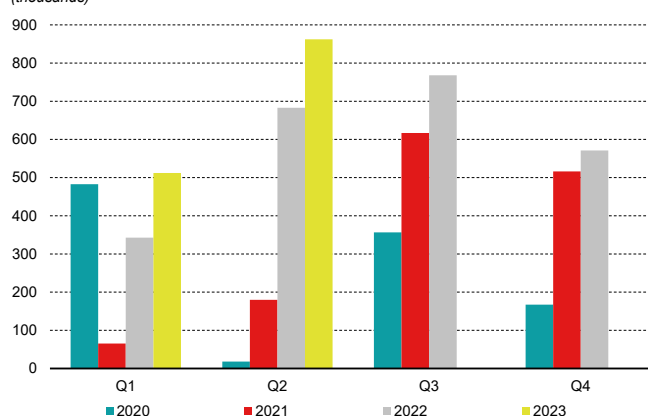
⁽¹⁾ Includes guest houses, hostels and holiday complexes.

However, it remained below that recorded in the second quarter of 2019, when it had stood at 73.6%. All categories reported increases in their occupancy rates over 2022, with the three-star and five-star categories registering the largest increases – of 14.9 and 13.3 percentage points, respectively. Meanwhile, the smallest increase – of just 1.8 percentage points – was registered in the two-star category. Occupancy rates remained below those prevailing before the pandemic across all category levels.

Tourist expenditure in Malta totalled €724.4 million in the second quarter of 2023, up from €529.6 million a year earlier. When compared to 2022, all expenditure categories registered gains.

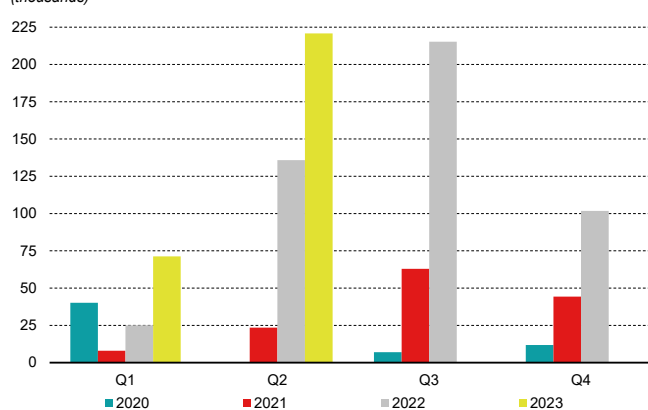
Expenditure per capita increased to €856.0, from €801.1 in the second quarter of 2022, as expenditure per night increased, offsetting a marginal decline in the average length of stay, which stood at 6.2 nights from 6.3 nights a year earlier.

Chart 4.7
AVERAGE MONTHLY SEAT CAPACITY⁽¹⁾
(thousands)



Source: MIA.
(¹) Data include schedule and charter seats.

Chart 4.8
CRUISE LINER PASSENGERS⁽¹⁾
(thousands)



Source: NSO.
(¹) Ports were closed during the second quarter of 2020.

According to Malta International Airport (MIA) data, in the second quarter of 2023, average seat capacity stood at 862,128 seats per month, up from 682,849 a year earlier (see Chart 4.7). Seat capacity was 4.2% above the level recorded in the second quarter of 2019.

A total of 98 cruise liners visited Malta in the second quarter of 2023, four less than a year earlier. Nonetheless, foreign passengers reached 220,805 persons, from 135,811 visitors in the second quarter of 2022 (see Chart 4.8).

Visitors from the United Kingdom comprised the largest share of total cruise passengers in the quarter under review, followed by visitors from Italy, Germany and the United States.

The capital account

Net inflows on the capital account stood at €48.1 million in the second quarter of 2023, down from €60.7 million a year earlier (see Table 4.1). However, when measured on a four-quarter cumulative basis, capital inflows increased. They stood at €345.2 million, compared to €242.0 million during the 12 months to June 2022.

BOX 2: RECENT DEVELOPMENTS IN UK TRADE WITH THE EU AND MALTA¹

According to the International Monetary Fund (IMF), the UK is the world's sixth largest economy, and the second largest in Europe after Germany. With an estimated GDP of USD 3.2 trillion (approximately GBP 2.6 trillion) in 2023, and a population of more than 68 million, the UK is an important player in global trade, especially with regard to its European partners.²

The UK joined the European Union (EU) in 1973 and became an important member of the bloc. However, following a referendum in 2016, the UK left the Union following a protracted negotiation process. The UK formally triggered its withdrawal procedure in March 2017. Nonetheless, it effectively left the EU in January 2020, while a withdrawal agreement that included a transition period of one year allowed it to remain in the EU single market until January 2021.

Right after Brexit, The UK signed a trade and cooperation agreement (TCA) with the EU, setting out a framework for its relationship with the Union, and allowing it to benefit from a free trade agreement and more. The TCA was applied provisionally as of 1 January 2021, and entered into force on 1 May 2021. While the TCA cannot match the level of integration the UK had with the EU member states, it provides for free trade in goods and a mutual market access in services.³

This box reviews international trade developments in the UK in recent years amid the various disruptions to trade stemming from Brexit and the COVID-19 pandemic.^{4,5}

The first section of the box looks at trade relations between the UK and the rest of the world. The second section explores the UK's trade relations with the EU, while the third section looks more specifically at UK trade with Malta. A final section concludes the box.⁶

Global trade partners of the UK

This section deals with UK trade with the rest of the world over the period extending from 2012 to 2022, and the shares each partner holds of the UK's total imports and exports.⁷ Although as shown in the next sections of this box, most of the UK trade disruptions occurred in the transition year of 2020, it must be noted that during the same year, the global economy contracted by 2.4% due to the COVID-19 pandemic and recorded an annual drop of 5.1% in the world merchandise trade volume, as reported by the World Trade Organisation (WTO).^{8,9}

¹ This Box was prepared by Ahmed Hnesh, Expert in the Eurosystem and International Relations Office, Monetary Policy, Eurosystem and International Relations Department of the Central Bank of Malta. The Box was reviewed by Kalina Koleva and John Caruana. The views expressed in the Box are the author's own and do not necessarily reflect the views of the Bank.

² The IMF DataMapper.

³ TCA between the European Union and the European Atomic Energy Community, of the one part, and the United Kingdom of Great Britain and Northern Ireland, of the other part; Official Journal L 149, 30.4.2021.

⁴ Unless otherwise stated, all the data used in this box are retrieved from the UK's Office for National Statistics (ONS) and views trade from the UK's perspective. Data need to be interpreted with caution because of changes in data collection methods.

⁵ COVID restrictions in the UK were introduced in March 2020.

⁶ All data are in current prices, in GBP million and are seasonally adjusted unless stated otherwise.

⁷ Total exports and total imports refer to trade in both goods and services.

⁸ [IMF World Economic Outlook, April 2023](#).

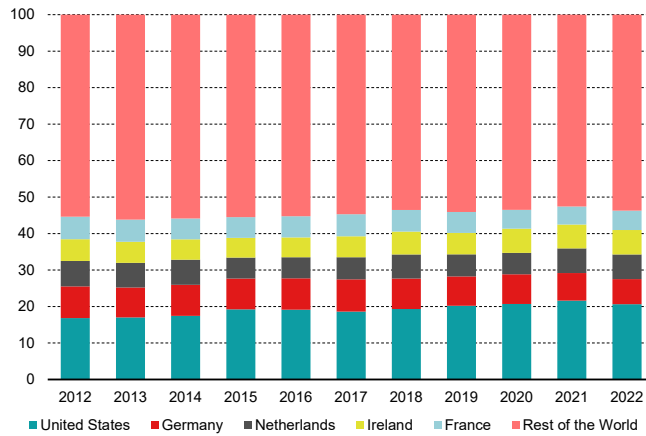
⁹ [Global Trade Outlook, April 2023](#).

Exports

The US remained the largest export partner of the UK throughout the period under review, with export shares of 16.8% and 20.6% in 2012 and 2022 respectively (see Chart 1).¹⁰ Germany kept its second place between 2012 and 2022, although its share shrank from 8.7% of the UK's total exports in 2012 to 6.9% in 2022. The Netherlands was the UK's third largest

total export partner with a share of 6.8% in 2022, compared to 7.0% in 2012. Ireland was the fourth largest total exports partner and experienced an increase in its share of total UK exports from 2020 onwards, whereby it reached 6.7% in 2022, compared to average levels below 6.0% in the years before 2020. France is the fifth largest export partner for the UK accounting for around 5.3% of the UK's total exports in 2022. France lost some of its share of UK exports, compared to its share of 6.2% in 2012.

Chart 1
UK EXPORT PARTNERS
(percentage)

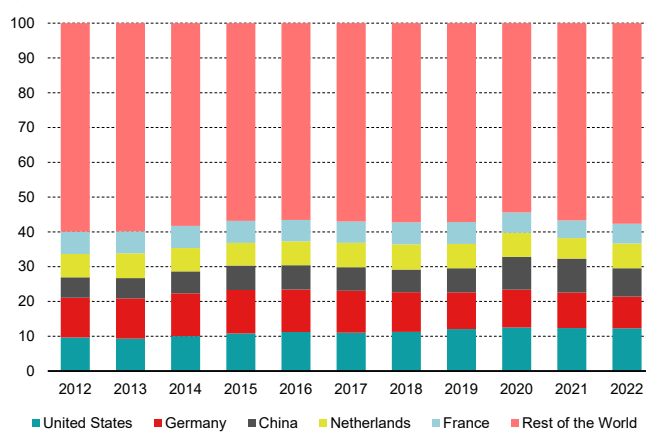


Source: ONS.

Imports

As for imports, Chart 2 shows that the biggest UK import partners are Germany, the US, China, the Netherlands, and France. Prior to 2019, Germany was the largest exporter to the UK. However, from 2019 onwards, the US overtook Germany in this respect. UK imports from China as a share also increased significantly over the observed period. In 2012 only 5.8% of the UK's total imports originated from China. This share increased to 9.7% in 2021, though it dropped back to 8.1% in 2022. France lost some of its share of the UK imports in 2020 and beyond, while the Netherlands sustained its levels around the average of 6.8%.

Chart 2
UK IMPORT PARTNERS
(percentage)



Source: ONS.

¹⁰ The United States include Puerto Rico.

The EU as a trade partner of the UK¹¹

To better understand whether the UK trade patterns shifted following Brexit, Chart 3 views the UK total trade (imports plus exports) with the rest of the world and treats the EU as a single trading bloc. The EU is the largest single trade partner for the UK, accounting for more than two-fifths of the UK total trade throughout the period reviewed. This is mainly related to the

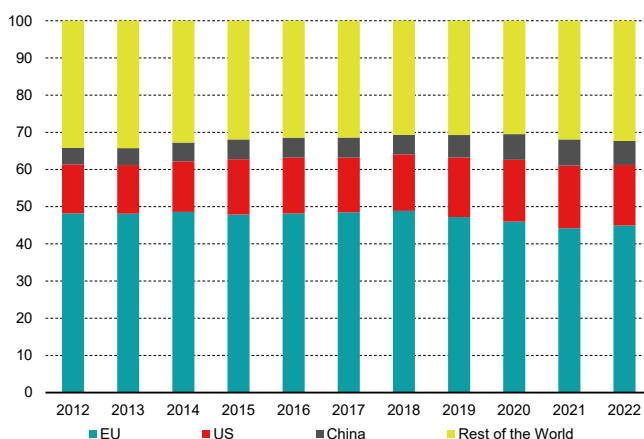
close geographical proximity of the UK and the EU and the fact that, for much of the period, the UK formed part of the EU single market and thus, enjoyed smooth, barrierless trade with the other EU member states.

The UK's exit from the EU was expected to affect the UK trade patterns and, more specifically, have a negative impact on its trade with EU member states due to the tariffs and non-tariff barriers (NTBs) that would stem from leaving the single market and the customs union. A paper published by the ECB in 2020 on the potential impact of Brexit indicated *“robust negative effects both on trade and migration flows for the United Kingdom due to Brexit”*. Furthermore, the paper also stated that *“it is clear that Brexit will give rise to trade barriers – both tariffs and NTBs – between the EU and the United Kingdom”*.¹²

Annual developments in UK trade flows depend on a variety of factors, including shifts in demand, supply constraints and exchange rate movements. Bearing these caveats in mind, some effect of the UK's exit from the EU can be observed when total trade with the EU is translated into a percentage of total UK trade with the world. Although the EU remained the largest trading partner of the UK, it has lost some of its share of the UK total trade to other partners. The EU share in total UK trade peaked at 48.9% in 2018, dropping to 44.2% in 2021 when the UK effectively left the EU single market, before picking up slightly in the following year.

The loss in the share of UK trade with the EU translated into increased shares for the US and China. Both countries were reported to have a greater share of UK total trade from 2020 and beyond. To illustrate, as seen in Chart 3, 16.3% of the UK total trade in 2022 was with the US, compared to 13.2% in 2012. Similarly, 6.5% of the UK's total trade was with China in 2022, compared to 4.5% in 2012.

Chart 3
UK TOTAL TRADE PARTNERS
(percentage)



Source: ONS.

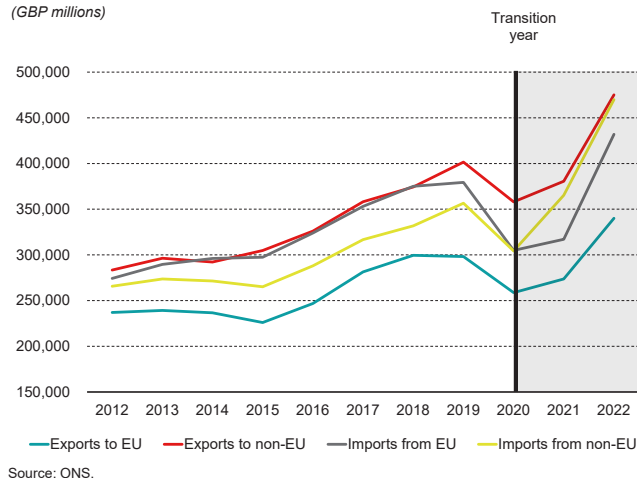
¹¹ In this analysis the EU refers to the 27 EU countries, implying that the UK is excluded from the EU data even in the years prior to Brexit.

¹² [Occasional Paper Series - A review of economic analyses on the potential impact of Brexit](#), ECB 2020.

Total UK trade with the EU and non-EU countries

Chart 4 shows UK trade with EU and non-EU countries encompassing both imports and exports of goods and services. Drops in both UK imports and exports are visible in 2020. However, it is also noticeable that the drop in imports is more pronounced than the one in exports.

Chart 4
UK TOTAL TRADE WITH THE EU AND NON-EU
(GBP millions)



UK imports from the EU

In the transition year dropped by 19.6% compared to a 14.6% drop in imports from non-EU countries. Furthermore, non-EU imports were quicker to recover in the following year, while imports from the EU had a slower recovery. In fact, imports from non-EU countries exceeded those from the EU in 2021 for the first time throughout the observed period and continued to do so in the following year. The substitution which may have taken place could have resulted from changes in prices as well as supply bottlenecks in certain regions arising during the COVID period which may have diverted trade.

On the export side, in 2020, UK exports to the EU and non-EU dropped by 13.2% and 10.8% respectively. Nevertheless, they recovered at a similar rate in the following years, maintaining the EU's position as the largest export partner for the UK.

To strip away the effects of price changes, an analysis of monthly chain volume measure (CVM) estimates of trade in goods was conducted. This confirms that UK imports of goods from non-EU countries overtook UK imports of goods from EU countries in 2021.¹³ However, imports of goods from the EU recovered in 2022 and exceeded the non-EU imports, suggesting only a short-term disruption of UK imports from the EU. In addition, CVM data shows that UK goods exports to non-EU countries remained higher than those to the EU in 2020 and the years following.

Trade in goods

In nominal terms, UK trade in goods with the EU increased between 2012 and 2022. During the period under review, exports to the EU rose from GBP 150,505.0 million in 2012 to GBP 193,698.0 million in 2022, while imports went up from GBP 209,554.0 million to GBP 310,953.0 million over the same period (see Chart 5). Although in 2020 both exports and imports of goods dropped from the previous year, the fall was reversed in the

¹³ CVM estimates are volume measure estimates obtained by chain-linking. They are the result of joining together two indices that overlap in one period by rescaling one of them to make its value equal to that of the other in the same period, thus combining them into single consistent cvm time series.

following years. Between 2012 through 2022, the UK registered on average an annual goods trade deficit of GBP 87,759.0 million with the EU.

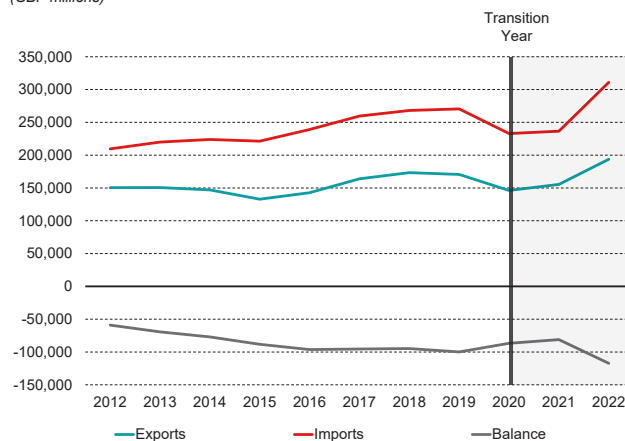
Trade in services

As can be seen in Chart 6, UK services exports to the EU also followed a general upward trend in nominal terms. However, a drop of 11.7% to GBP 112,549.0 million occurred in 2020. UK services exports to the EU resumed growth in the following years, increasing to GBP 146,372.0 million in 2022. UK services imports from the EU followed a similar pattern, although they dropped even more strongly in 2020, contracting by 33.8% to GBP 71,996.0 million, which in turn increased the services trade surplus for the same year. Notwithstanding the drop, UK services imports

from the EU recovered in the following two years, to reach GBP 120,975.0 million in 2022. Throughout the observed period, the UK recorded on average an annual services trade surplus of around GBP 23,620.4 million with the EU. Given that financial services account for a significant share of trade in services with the EU, the UK's trade surplus could decrease if financial services firms increasingly shift business away from London because of Brexit.¹⁴

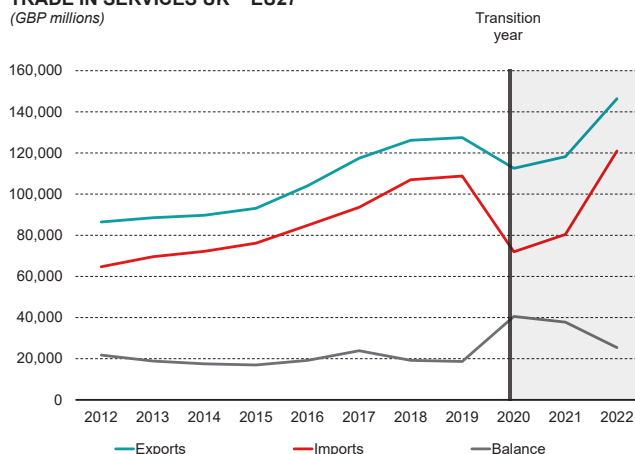
Chart 7 shows the shares of UK exports of services to the EU and to non-EU countries during the observed period. More than a third of the UK's services exports were directed to the EU during the observed period. In 2020, the EU's share in UK services exports dropped by two percentage points compared to 2019 and amounted to 36%. The fact that in the following two years, it did not regain its 2019 level might signify that Brexit could have contributed

Chart 5
TRADE IN GOODS UK – EU27
(GBP millions)



Source: ONS.

Chart 6
TRADE IN SERVICES UK – EU27
(GBP millions)



Source: ONS.

¹⁴ There is no evidence so far of major shifts in the importance of the City of London for euro-denominated financial market segments, with some exceptions. See: [Impact of Brexit on the international role of the euro](#).

to this decrease. In contrast, shorter term effects could be more clearly attributable to restrictions related to COVID-19, which disrupted travel.

As for imports, around half of the UK's services imports originated from the EU (see Chart 8). An observable shift of shares occurred in 2020, whereby the EU's share of the UK's services imports decreased to 43% from 49% in 2019. The EU share dropped further in the following year to 42%, before recovering in 2022 to reach 47%. Although the EU regained a significant part of the share lost in the transition year, it is yet to return to pre-2020 levels.

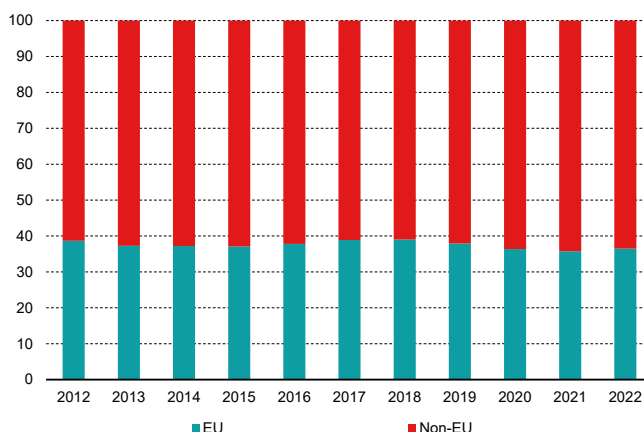
Malta as a trade partner to the UK

The UK is a relevant trade partner for Malta.

In the period extending from 2012 to 2022, the UK's total trade with Malta averaged GBP 1,794.5 million annually. To put in context, according to the United Nations Conference on Trade and Development (UNCTAD), Malta's total trade annually averaged USD 37,414.5 million (around GBP 26,887.45 million)¹⁵ between 2012 and 2022. Hence, Malta's trade with the UK would represent around 6.7% of Malta's total trade.

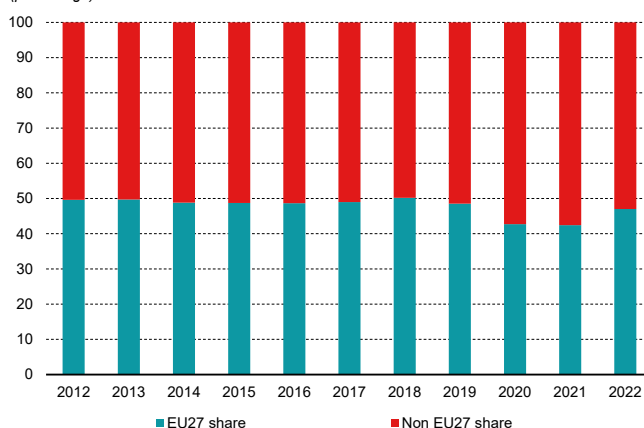
In value terms, figures are likely to rise over time, especially when inflation is relatively high. To minimize the effect of price fluctuation on trade values, Chart 9 shows the UK's trade with Malta as a percentage of Malta's total trade. The UK's share of Malta's trade remained relatively stable over the years under review. Although the share did drop in 2020, the Brexit transition year, it recovered in the following years, reaching 6.7% in 2022. This could

Chart 7
UK EXPORTS OF SERVICES
(percentage)



Source: ONS.

Chart 8
UK IMPORTS OF SERVICES
(percentage)



Source: ONS.

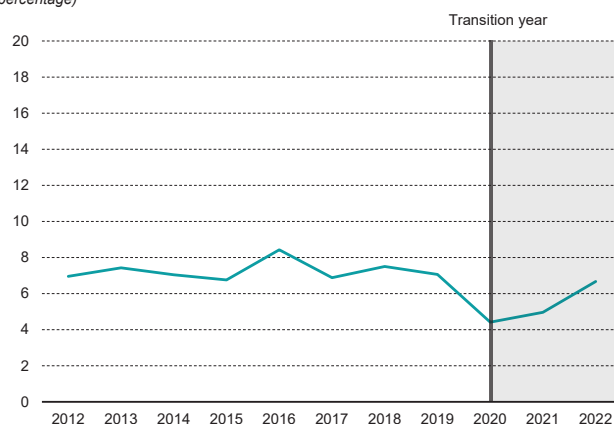
¹⁵ Based on estimated average exchange rate for the period between 2012 and 2022 of USD 1 = GBP 0.7186

indicate that the short-lived drop was primarily caused by COVID-19 restrictions, which would have affected tourism, rather than Brexit.

In nominal terms, the UK's total exports to Malta increased significantly over time as seen in Chart 10. The increase was mainly driven by services exports. In 2012, the value of total exports from the UK to Malta stood at GBP 750.0 million, rising to GBP 1,280.0 million in 2022. This indicates a 70.7% increase over the period covered. The UK's exports to Malta peaked in 2019, when the value of total exports reached GBP 1,376.0 million, before dropping to GBP 1,126.0 million in 2020. This drop occurred in the transition year when also various restrictions related to COVID-19 pandemic were introduced, and the global economy contracted sharply. Throughout the years in review, service exports dominated, and accounted for 70.7% of the total UK exports to Malta in 2022.

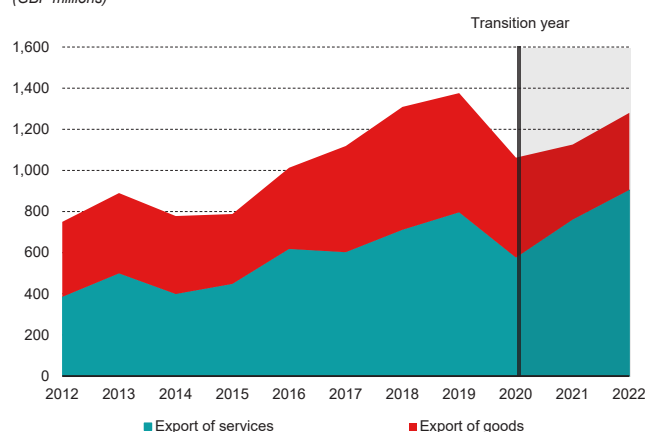
As for imports, services clearly dominated the UK imports from Malta as shown in Chart 11. Between 2012 and 2015,

Chart 9
UK SHARE OF MALTA TOTAL TRADE
(percentage)



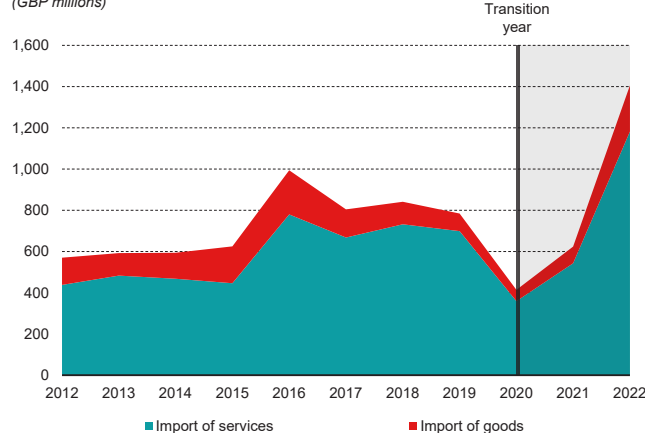
Source: Author's calculations based on data from ONS and UNCTAD.

Chart 10
UK EXPORTS TO MALTA
(GBP millions)



Source: ONS.

Chart 11
UK IMPORTS FROM MALTA
(GBP millions)



Source: ONS.

UK total imports from Malta remained at a stable level of around GBP 600.0 million, before increasing sharply in 2016 to GBP 994.0 million driven by an increase in service imports. The value of UK imports from Malta then dropped to GBP 804.0 million, in 2017 and remained around the same level in the following two years. In 2020, UK total imports from Malta dropped sharply to GBP 414.0 million. Travel contributes the largest share to UK's imports from Malta, and this was one of the sectors most impacted by the pandemic. In fact, UK imports of travel services from Malta dropped by 71.9% in 2020. In 2021, imports began to recover, reaching levels similar to the ones prior to 2016, before rising to GBP 1,406.0 million in 2022, which is the highest value for the observed period. Over the period extending from 2012 to 2022, services accounted for more than four-fifths on average to the UK's total imports from Malta.

Top goods traded with Malta (exports and imports)

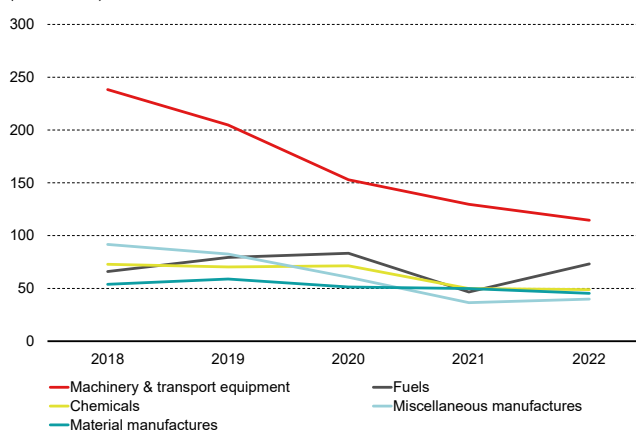
According to Eurostat, from 2012 to 2022, on average, Malta imported 8.1% of its total goods from the UK, while it exported 3.6% of its total goods exports to the UK.

In order to analyse goods trade between the UK and Malta, this section breaks down imports and exports of goods by category using ONS data. This shows the top five most traded goods between Malta and the UK, and how trade in each of these five goods evolved over the last five years, which is when this breakdown is available.

Exports

Chart 12 shows that the UK's top five exported goods to Malta in the last five years were machinery & transport equipment,¹⁶ fuels, chemicals, miscellaneous manufactures, and material manufactures.¹⁷ Over the five years observed, UK exports of machinery and transport equipment to Malta followed a downward trend, whereby in 2018 their value stood at GBP 238.3 million compared to GBP 114.6 million in 2022. The sharpest drop in exports of machinery and transport equipment was experienced in 2020, when they fell by 25% compared to the previous year. Nevertheless, this category remains the most important category in UK goods exports to Malta. Moreover, UK exports of miscellaneous manufactures also dropped significantly over the period, from GBP 91.7 million in 2018 to GBP 39.9 million in 2022. The reported value of UK's fuel exports to Malta (mainly made up of refined oil) stood at GBP 66.0 million in 2018

Chart 12
UK TOP FIVE GOODS EXPORTED TO MALTA
(GBP millions)



Source: ONS.

¹⁶ This category includes ships, aircrafts, road vehicles, electrical machinery and mechanical machinery.

¹⁷ Material manufactures include items made of leather, rubber, cork, wood, paper, textile yarn, fabrics, non-metallic mineral manufactures, iron and steel.

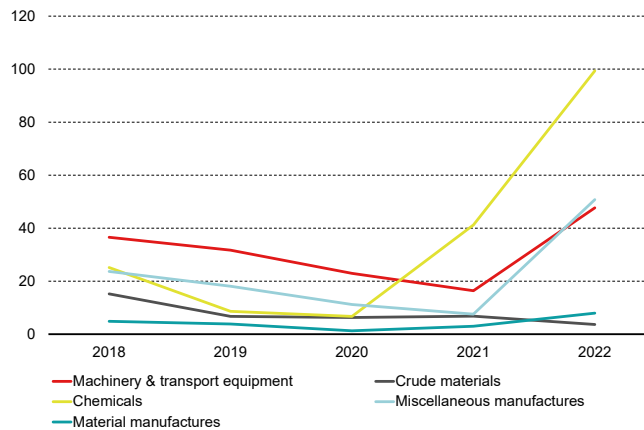
and increased in the following two years reaching GBP 83.3 million in 2020. It almost halved in 2021, but later picked up to GBP 73.3 million in 2022.

Imports

The top five goods imported into the UK from Malta between 2018 to 2022 were chemicals, machinery & transport equipment, miscellaneous manufactures, crude materials, and material manufactures.

As Chart 13 shows, imports of chemicals increased significantly in 2021 and 2022, with values of GBP 41.2 million and GBP 99.4 million respectively, compared to just GBP 6.7 million in 2020. This increase was driven by an increase in UK imports of medicinal and pharmaceutical products from Malta.

Chart 13
UK TOP FIVE GOODS IMPORTED FROM MALTA
(GBP millions)



Source: ONS.

Conclusion

Although the referendum for Brexit took place in 2016, the UK effectively left the EU in 2021. Furthermore, the UK signed the TCA with the EU right after it left the EU. An observable drop in UK trade occurred in 2020 (the transition year). However, this was the same year when the global economy and world trade contracted due to the impact of COVID-19. This makes it difficult to disentangle the impact of Brexit on UK trade from the impact of the pandemic.

Nevertheless, while the UK's total trade did in fact drop in 2020, we can also observe a loss in the EU's share of the UK's total trade in the same year. Given that the pandemic probably affected the UK trade with all its trade partners, this loss of share the EU has experienced may be linked to Brexit. Moreover, the loss of share continued in 2021, but came to a halt in 2022. In part, the loss in trade share may have been temporary and due to uncertainty that clouded businesses over the consequences of Brexit and the new costs that would arise from leaving the EU single market and customs union. This could also justify the increase in value of trade between the EU and the UK in 2022, as business may have become more accustomed to the TCA, and the uncertainty over the trade barriers caused by Brexit may have started to fade away. A report published in 2019 by the Bank of England indicated that uncertainty levels based on various indicators were close to post-crisis highs in Q3 2019,¹⁸ which would support the hypothesis that the drop was caused by uncertainty as well as trade barriers originating from Brexit.

¹⁸ [In focus – uncertainty over Brexit](#), Bank of England 2019.

As for UK trade with Malta, a drop in trade between the two countries is observable in 2020. The drop was most likely caused by a combined effect of both the COVID-19 pandemic and Brexit. However, given that trade levels returned to pre-Brexit levels in the following years, it is probable that the pandemic was the larger contributor to the drop in that year, and Brexit had relatively minor effects. The short-term nature of the drop in trade between Malta and the UK might also indicate a relatively short-lived Brexit effect on bilateral trade.

Nonetheless, a longer timeframe after Brexit must be observed to evaluate whether UK trade shares with the EU and Malta would stabilise at around the same levels prior to Brexit or deviate from them. At the current stage, it is too early to determine such finding, particularly since global supply chains were disrupted first by the pandemic and continue to be so by the Russian invasion of Ukraine.

5. GOVERNMENT FINANCE

In the second quarter of 2023, the general government deficit narrowed significantly 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 4.3% of GDP, lower than the 4.9% registered in the first quarter of 2023. The general government debt-to-GDP ratio declined to 50.7% at end-June 2023, from 52.4% in March 2023. The net financial worth as a share of GDP improved in the quarter under review. Meanwhile, the cyclically-adjusted deficit ratio narrowed.

Quarterly developments

General government deficit narrows significantly

In level terms, the general government registered a deficit of €4.4 million in the second quarter of 2023, a drop of €84.5 million when compared to the deficit registered in the corresponding period of 2022. This was due to an increase in government revenue, outweighing a rise in expenditure. The primary balance shifted to a surplus of €48.1 million, from a deficit of €47.2 million a year earlier.

Higher tax receipts support revenue growth

In the second quarter of 2023, general government revenue increased by €235.3 million, or 15.7% 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 2023Q2-2022Q2	
	Q2	Q3	Q4	Q1	Q2	Amount	%
Revenue	1,494.6	1,465.2	1,618.6	1,400.8	1,729.9	235.3	15.7
Taxes on production and imports	440.5	482.9	468.4	446.0	459.2	18.7	4.2
Current taxes on income and wealth	597.0	551.3	622.6	498.7	747.0	149.9	25.1
Social contributions	240.5	255.8	265.2	241.0	263.3	22.8	9.5
Capital and current transfers receivable	66.9	57.5	90.2	58.3	52.7	-14.2	-21.2
Other ⁽¹⁾	149.6	117.7	172.2	156.7	207.7	58.0	38.8
Expenditure	1,583.5	1,648.6	1,964.5	1,642.5	1,734.3	150.8	9.5
Compensation of employees	466.4	457.4	459.2	476.7	475.9	9.5	2.0
Intermediate consumption	344.8	300.6	381.4	335.1	388.7	43.9	12.7
Social benefits	352.8	326.4	386.1	442.1	399.5	46.7	13.2
Subsidies	152.9	263.1	267.2	140.2	182.6	29.7	19.4
Interest	41.6	41.7	43.5	44.0	52.5	10.9	26.2
Other current transfers payable	52.2	88.7	186.8	74.5	37.5	-14.7	-28.2
GFCF	143.6	135.0	175.2	96.9	156.3	12.7	8.8
Capital transfers payable	26.9	29.6	61.4	30.1	36.9	10.0	37.1
Other ⁽²⁾	2.2	6.2	3.5	3.0	4.4	2.2	
Primary balance	-47.2	-141.7	-302.4	-197.7	48.1	95.4	
General government balance	-88.9	-183.4	-345.9	-241.7	-4.4	84.5	
General government debt	8,595.4	8,695.0	9,000.5	9,250.8	9,161.1		

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, especially from current taxes on income and wealth. Inflows from the latter increased by €149.9 million, mostly due to income taxes paid by companies. Moreover, inflows from taxes on production and imports rose by €18.7 million, reflecting higher receipts from gaming taxes and from stamp duty. Inflows from social contributions rose by €22.8 million, reflecting favourable labour market conditions.

Non-tax revenue also increased when compared to a year earlier. This was due to a rise in intakes from sales of services provided by general government entities. This item is part of the 'other' component of government revenue shown in Table 5.1.

Current expenditure underpins the rise in expenditure

Total government expenditure increased by €150.8 million, or 9.5% when compared with the second quarter of 2022. This increase primarily reflects higher current expenditure, which in turn was mostly driven by higher outlays on intermediate consumption and social benefits. The latter increased by €46.7 million, largely on the back of higher outlays on retirement pensions and contributory bonuses. Meanwhile, intermediate consumption rose by €43.9 million, as a result of higher outlays in the public administration, education and residential care service sectors. Outlays on subsidies rose by €29.7 million, due to support measures to mitigate energy price pressures. On the other hand, outlays on current transfers declined by €14.7 million, reflecting a one-time refund from the EU.

Capital spending rose during the period under review. Outlays on government investment rose by €12.7 million, mainly attributable to various projects, including investments in ICT. Meanwhile, capital transfers increased by €10.0 million in annual terms.

Debt decreases

In June 2023, the stock of general government debt amounted to €9,161.1 million, €89.7 million lower than the level registered at end-March. This mostly reflects a decline in long-term debt securities outstanding (composed of MGS), which outweighed a rise in short-term debt securities outstanding (composed of Treasury bills). The former declined by €111.2 million, and as a result, their share in total debt declined by 0.5 percentage point to 77.4%. Meanwhile, holdings of short-term debt securities rose by €37.1 million, and their share in total debt increased by 0.5 percentage point to 8.2%.

The value of loans outstanding increased by €1.7 million. Their share in total debt stood at 9.4%, up slightly from 9.3% in March.

Headline and cyclically-adjusted developments

Headline deficit ratio declines while debt ratio declines slightly

When measured on a four-quarter moving sum basis, the general government deficit-to-GDP ratio narrowed by 0.6 percentage point, from 4.9% in the first quarter of 2023 to 4.3% in the quarter under review (see Chart 5.1). This was mainly driven by a 0.5 percentage point rise in the revenue-to-GDP ratio, which stood at 34.4%, due to an increase in the share of current revenue in GDP. This was coupled with a marginal decline of 0.1 percentage point in the expenditure-to-GDP ratio, which reached 38.7%.

Between March 2023 and June 2023, the debt-to-GDP ratio declined by 1.7 percentage points, from 52.4% to 50.7%. The ratio declined despite there being a small fiscal deficit recorded in this period. This is due to a negative deficit-debt adjustment stemming from net trade receivables, which offset a build-up in government deposits (see Chart 5.2).

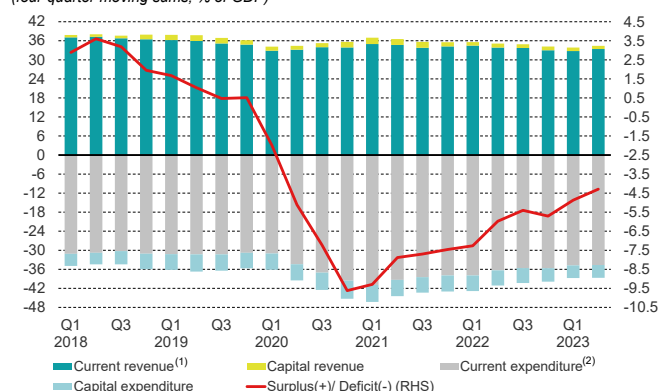
Net financial worth improves

The market value of financial liabilities held by the general government increased by €659.8 million during the second quarter of 2023, to stand at €11,352.5 million. This is mainly due to a strong rise in 'other accounts payable'. Consequently, the share of financial liabilities in GDP rose by 2.3 percentage points, to reach 62.8% (see Chart 5.3).

The market value of financial assets rose to €5,634.2 million, €806.2 million higher than the level as at end-March 2023. This was mainly due to an increase in the value of deposits, and to a lesser extent, a rise in the value of other accounts receivable. Consequently, the share of financial assets in GDP rose to 31.2%, from 27.4% in the previous quarter.

The resulting net financial worth of general government stood at -€5,718.3 million, an improvement of €146.4 million compared to the previous quarter. As a share of GDP, the net financial worth improved by 1.6 percentage points, standing at -31.6% by end-June.

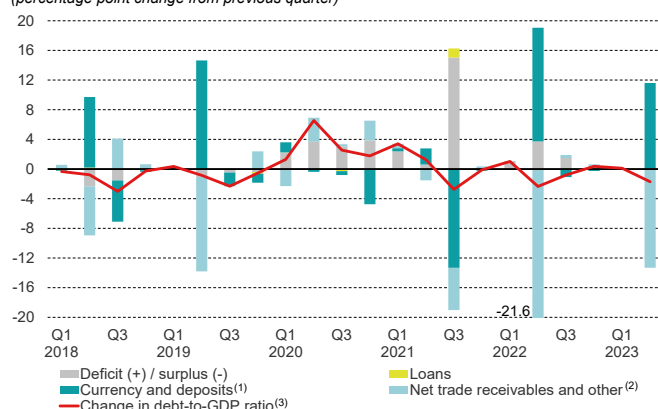
Chart 5.1
GENERAL GOVERNMENT REVENUE AND EXPENDITURE
(four-quarter moving sums, % of GDP)



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.

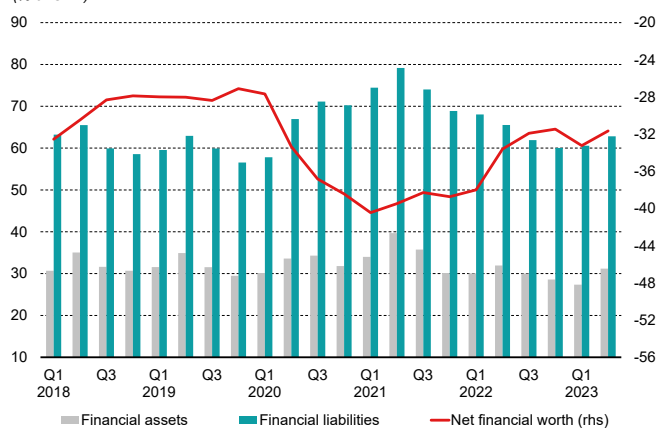
Chart 5.2
CONTRIBUTION TO CHANGE IN DEBT
(percentage point change from previous quarter)



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.

As a share in GDP, the net financial worth in the euro area deteriorated by 0.4 percentage point compared to March, to -56.4% of GDP. Thus, the net worth position of the Maltese general government remained more favourable than the euro area average.

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

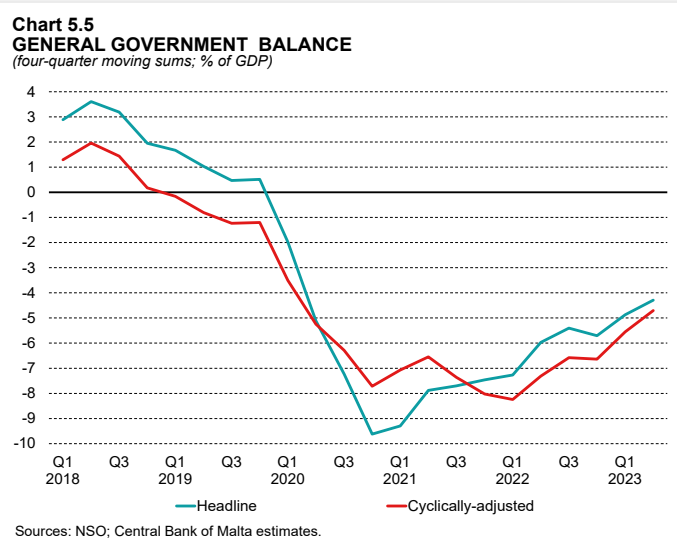
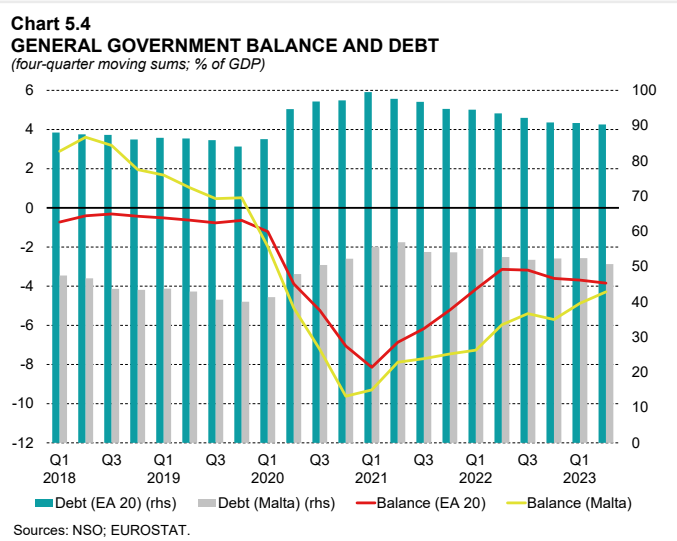
During the quarter under review, the euro area general government deficit stood at 3.8% of GDP on a four-quarter moving sum basis, slightly wider than the deficit registered in March 2023 (see Chart 5.4). Over the same period, the euro area debt ratio declined slightly to 90.3% of GDP, from 90.7% of GDP in the previous quarter.

While the Maltese government continues to post a higher deficit compared with the euro area average, its debt-to-GDP ratio remains well below the corresponding ratio for the euro area.

Cyclically-adjusted deficit narrows¹

On a four-quarter moving sum basis, the cyclically-adjusted deficit stood at 4.7% of GDP in the quarter under review, 0.8 percentage point 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.

The share of cyclically-adjusted revenue in GDP rose by 0.5 percentage point (see Table 5.2). This was driven by a 0.6 percentage point increase in the share of current taxes on income and wealth. This development was partly offset by a 0.1 percentage point decrease in the share of taxes on production and imports.



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.

At the same time, the share of cyclically-adjusted expenditure fell by 0.4 percentage point. This was mainly due to a fall in the share of outlays on compensation of employees, which declined by 0.3 percentage point. The share of 'other' expenditure also contributed to this decline, as it decreased by 0.1 percentage point. This mainly reflected the abovementioned decline in current transfers. Meanwhile, the share of other forms of expenditure remained broadly stable in the period under review.

Table 5.2
QUARTER-ON-QUARTER CHANGES IN CYCLICALLY-ADJUSTED FISCAL COMPONENTS

Percentage points of GDP

	2022			2023	
	Q2	Q3	Q4	Q1	Q2
Revenue	-0.5	-0.4	-0.8	-0.3	0.5
Current taxes on income and wealth	-0.6	0.2	-0.1	-0.1	0.6
Taxes on production and imports	0.0	0.0	0.0	0.0	-0.1
Social contributions	-0.1	0.0	-0.4	-0.1	0.0
Other ⁽¹⁾	0.1	-0.6	-0.4	-0.1	0.0
Expenditure	-1.4	-1.1	-0.8	-1.4	-0.4
Compensation of employees	-0.2	-0.3	-0.3	-0.2	-0.3
Intermediate consumption	0.1	-0.3	-0.6	-0.1	0.0
Social benefits	-0.5	-0.3	0.1	-0.2	0.0
Interest payments	0.0	0.0	0.0	0.0	0.0
GFCF	-0.1	0.0	-0.2	-0.3	0.0
Other ⁽²⁾	-0.7	-0.1	0.3	-0.7	-0.1
Primary balance	0.9	0.7	-0.1	1.1	0.9
General government balance	0.9	0.7	-0.1	1.1	0.8

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.

BOX 3: THE HOUSEHOLD-LEVEL IMPACTS OF THE COVID-19 WAGE SUPPLEMENT SCHEME¹

The macroeconomic effects stemming from the COVID-19 pandemic have been well documented. However, until recently, analysis of its impacts at the household and/or the individual level was limited by the lack of availability of household-level survey data collected after the outbreak of the pandemic.

In such instances, microsimulation modelling offers one way to obtain timely estimates of the effects of interest. ‘Microsimulation’ encompasses a variety of techniques which apply policy rules at the level of individual units and enable analysis of related outcomes at a granular level, making them ideal for analysing the welfare impact of policy changes or economic shocks (Figari, Paulus, and Sutherland, 2015).²

Microsimulation models have been widely applied in the literature dealing with the welfare impact of COVID-19 and the related income protection policies adopted by national governments. Several such studies focused on European countries have utilised EUROMOD, a static and non-behavioural tax-benefit microsimulation model for the European Union.^{3,4}

This box seeks to evaluate the microeconomic impact of the wage supplement scheme introduced in Malta in response to the pandemic, for the year 2020.⁵ Simulations are carried out using the Maltese economy module in EUROMOD (Vella, Said, and Apap, 2021), re-calibrated in line with the most recent data available at the time of writing.⁶

Simulation Design

The study involves constructing three scenarios: a baseline scenario, calibrated to model a ‘no-Covid’ outcome for the year 2020, as well as a counterfactual and an actual scenario which are then contrasted to this baseline. The baseline scenario simulates microeconomic conditions in 2020 as forecasted to be in the absence of the pandemic, using the Central Bank of Malta’s latest-available pre-COVID-19 forecasts for 2020 to calibrate the levels of incomes, prices and other monetary variables in the model.

The counterfactual, or ‘no support’ scenario simulates the income and employment effects of COVID-19 in a situation where the wage supplement scheme is not enacted. Adversely affected individuals in this scenario are therefore only protected by the automatic stabilisers

¹ Prepared by Glenn Abela, a Research Economist in the Modelling Office within the Research Department of the Central Bank of Malta. The author would like to thank Dr Aaron G. Grech and Noel Rapa for comments and suggestions. The views expressed are those of the author and do not necessarily reflect the views of the Central Bank of Malta. Any errors are the sole responsibility of the author.

² Figari, F., Paulus, A., & Sutherland, H. (2015). Microsimulation and policy analysis. In *Handbook of income distribution* (Vol. 2, pp. 2141-2221). Elsevier.

³ The model is “static and non-behavioural” in that it only simulates first-round effects of policy changes and does not endogenously account for changes in the behaviour and/or the structure of the population over time.

⁴ See for example Almeida, V., Barrios, S., Christl, M., De Poli, S., Tumino, A., & van der Wielen, W. (2021). The impact of COVID-19 on households’ income in the European Union. *The Journal of Economic Inequality*, 19(3), 413-431, and Christl, M., De Poli, S., Figari, F., Hufkens, T., Papini, A., & Tumino, A. (2021). The cushioning effect of fiscal policy in the European Union during the COVID-19 pandemic. JRC Working Papers on *Taxation and Structural Reforms*, No. 02/2021.

⁵ This box summarises work published in Abela, G. (2022). Assessing the impacts of the COVID-19 wage supplement scheme: A microsimulation study. *Central Bank of Malta Working Paper*, WP/06/2022.

⁶ Vella, S., Said, R., & Apap, W. (2021). *EUROMOD Country Report Malta (MT) 2018-2021*.

built into the Maltese social security system prior to the pandemic. This scenario sees a share of workers (both employees and self-employed) in each economic sector in the model being simulated to become unemployed for a determined proportion of the year, losing a corresponding share of earned income and benefiting from statutory unemployment support according to their eligibility. The employment shocks fed into the model are based on the observed sector-specific shortfalls in GVA in 2020, adjusted for labour intensity in each sector and are shown in Table 1.⁷

The actual, or 'wage supplement' scenario intends to simulate the microeconomic effects of COVID-19 in the presence of the wage compensation scheme enacted by the Maltese government in response to the pandemic. It is important to note that no other COVID-19-related aid, apart from the wage supplement scheme, is studied in this exercise.

The extent of the support offered by Government was sector-dependent, with businesses categorised under three lists or "Annexes" depending on the extent to which their operations were impacted by the restrictions set up in response to the pandemic. All three annexes are simulated in the model, using monthly data from Malta Enterprise indicating the number of workers receiving the wage supplement by nomenclature of economic activities (NACE) category

Table 1
SIMULATED SHARE OF WORKERS MADE UNEMPLOYED (IN 'NO SUPPORT' SCENARIO) AND TRANSFERRED TO WAGE SUPPLEMENT (IN 'WAGE SUPPLEMENT' SCENARIO)

			'No support'	'Wage supplement'		
EUROMOD sector			Employment shock (%)	% of workers in Annex A/C	% of workers in Annex B	% of workers on wage supplement
1	Agriculture and Fishing	A	-24.1%	0.0%	0.0%	0.0%
2	Manufacturing, Mining & Quarrying, Utilities	B, C, D, E	-9.7%	0.0%	27.2%	27.2%
3	Construction	F	-4.2%	0.0%	0.0%	0.0%
4	Wholesale and Retail	G	-61.6%	26.7%	13.4%	40.1%
5	Hotels and Restaurants	I	-86.1%	95.1%	0.0%	95.1%
6	Transport and Communication	H, J	-23.9%	15.2%	11.6%	26.9%
7	Financial intermediation	K	0.0%	0.0%	0.0%	0.0%
8	Real estate and Business	L, M, N	-15.3%	33.0%	1.6%	34.6%
9	Public administration and defence	O	-8.8%	0.0%	0.0%	0.0%
10	Education	P	-8.8%	8.1%	0.0%	8.1%
11	Health and Social Work	Q	-8.8%	0.0%	0.0%	0.0%
12	Other	R, S, T, U	0.0%	20.8%	5.9%	26.7%

Source: Author's calculations.

⁷ For a detailed explanation of the calculation of the employment shocks simulated see Abela (2022).

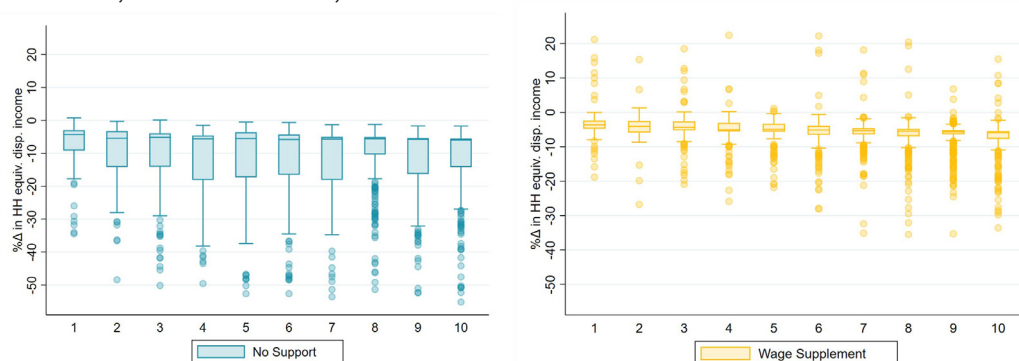
between April and December 2020 to calibrate the shares of workers being transferred onto the wage supplement in the model.⁸ In line with the actual implementation of the scheme, the simulation also allows employees under the wage supplement scheme to receive part of their salary from their employers in addition to government support, provided that their total income does not exceed their normal monthly salary. The share of workers simulated to receive the wage supplement in each sector as defined within EUROMOD is shown in Table 1.

Income changes across the household income distribution

The first set of results quantifies the impacts of the scheme across the distribution of equivalised household incomes present in the baseline scenario. Considering only households which in the baseline have at least one employed member ('working households'), estimates suggest that households are invariably better off under the 'wage supplement' scenario compared to the 'no support' case. Households in the top half of the distribution lose between 10.3% and 12.7% of their pre-shock (equivalised) income under the 'no support' scenario, down to between 5.9% and 7.8% under the 'wage supplement' scenario. The wage supplement seems to have had a slightly larger impact on households in the bottom half of the distribution; these lose 7.3% to 12.4% of their income in the absence of the wage supplement scheme, but between 3.3% and 5.3% in a scenario where it is enacted.

Chart 1 delves deeper into these results by looking at the whole distribution of losses suffered by households in each decile. These results suggest two important points. First, it is immediately clear that in the absence of the wage supplement, some households suffer income losses which are markedly greater than those indicated by average losses cited above. In fact, the simulation data shows that 5% of working households suffer losses exceeding 47% under the 'no support' scenario, with some households losing more than half of their pre-shock equivalised income.⁹ Second, the dispersion of losses within deciles tends to fall

Chart 1
DISTRIBUTION OF % CHANGES IN HOUSEHOLD EQUIVALISED DISPOSABLE INCOME VIS-À-VIS BASELINE, BY INCOME DECILE, ALL WORKING HOUSEHOLDS



Source: Author's calculations.

⁸ A detailed explanation of the calibration process is given in Abela (2022).

⁹ Values lying outside the whiskers fall beyond a threshold of 1.5 times the interquartile range away from the nearest quartile value.

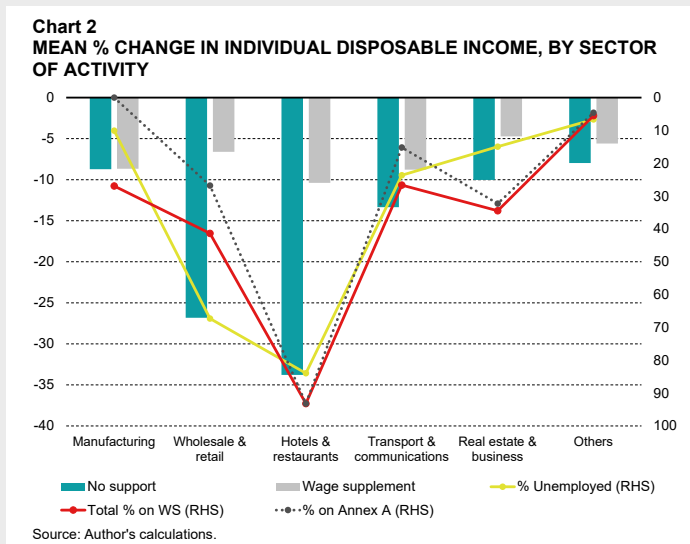
significantly under the ‘wage supplement’ scenario, shown by the considerable narrowing of the box plots. In other words, apart from dampening losses in general, the wage supplement scheme limits considerably the magnitude of losses suffered by the worst-hit households. This observation remains valid if the sample is further limited to households which are directly affected by the shock, i.e., where at least one member was simulated to lose their job.

The variability of the income losses suffered within and across income deciles reflects the heterogeneous impacts of the simulated shocks across economic sectors. Sector-specific circumstances determine not only the probability of a particular worker being hit by the economic shock, but also the duration of unemployment (in the ‘no support’ case), the duration of receipt of the wage supplement, and the share of pre-shock earned income received whilst also receiving the wage supplement. In turn, the relative concentration in different segments of the income distribution of workers active in particular sectors will affect how sectoral impacts play out across the income spectrum.¹⁰ Given these observations, the next section reframes the results obtained from a sectoral perspective, focusing on five key sectors.¹¹

Income changes by sector of employment

Chart 2 plots the average shares of income lost by individuals working in each of the five chosen sectors, and the ‘Others’ category, for both the ‘no support’ and the ‘wage supplement’ scenarios vis-à-vis the baseline. In addition, it shows the share of workers by sector that become unemployed in the ‘no support’ scenario, and both the total share of workers in each sector transferred onto the wage supplement, and the share transferred onto Annex A (the highest benefit category) in the ‘wage supplement’ scenario.

As expected, in the ‘no support’ case, the proportional losses correlate well with the size of the unemployment shock. The highest average income losses are registered in the wholesale & retail, and the hotels & restaurants sectors, which also see the highest employment reductions. Meanwhile, the proportion of workers on Annex A in the ‘wage supplement’ case helps explain what could initially seem to be



¹⁰ For instance, data shows that individuals active in sectors 6 (transportation and communications) and 7 (financial intermediation) are noticeably more likely to be in the top half of the earnings distribution than those active in, say, agriculture and fishing (sector 1) or wholesale and retail (sector 4).

¹¹ When looking at results disaggregated by sector, it is significantly easier to interpret results by looking at the distribution of individuals, rather than households.

inconsistencies in the pattern between the proportion of workers receiving the wage supplement and the share of income lost in each sector.

For instance, Chart 2 shows that a greater proportion of workers in wholesale & retail are transferred onto the wage supplement scheme when compared to manufacturing; however, most of those in the former group are transferred to Annex A, whilst in manufacturing, all shocked workers are transferred onto Annex B. This explains why on average, individuals working in wholesale and retail lose about 6.6% of their pre-shock incomes in the ‘wage supplement’ scenario, as opposed to 8.7% for those who are active in the manufacturing sector. This also explains why, for example, the overall share of income lost by individuals active in the ‘hotels and restaurants’ sector is relatively low under the ‘wage supplement’ scenario despite the very high share of workers affected by the shock.

Looking at affected individuals only, the median share of income lost in the ‘no support’ scenario is around 30% in four of the five key sectors, being slightly less than 40% in manufacturing. Median losses are reduced to around 10% in the wholesale & retail, hotels & restaurants, and real estate & business sectors in the ‘wage supplement’ case, remaining close to 20% in both manufacturing and transport & communications. Comparing the distribution of losses in each sector across scenarios again shows that the wage supplement scheme seems to have successfully dampened the losses incurred by individuals and narrowed the discrepancy between the losses suffered by the worst-hit sectors and the rest.

Impact on poverty

To understand the impact the wage supplement scheme has had on poverty rates, the box estimates the at-risk-of-poverty (AROP) rates for each scenario.¹²

Table 2 shows that under a no support scenario, there would have been a widespread increase in the risk of poverty for all household categories. The wage supplement scheme reduced the

Table 2
AROP RATES ACROSS SCENARIOS BY INDIVIDUAL CHARACTERISTICS
(per cent)

	Baseline	No support	Supplement
Overall	17.1	21.9	18.5
Children	16.2	23.1	18.5
Working age	11.5	16.7	12.8
Working age & active	5.3	10.4	6.4
Elderly	35.1	37.2	36.0
Elderly living alone	40.9	41.5	41.5
Single parent	11.7	16.7	13.1
HH with 3+ children	43.1	51.4	45.9

Source: Author's calculations.

¹² The AROP is defined as the proportion of individuals in a population living in households whose equivalised disposable income is below the poverty line. For the purpose of this study, the poverty line is conventionally defined as 60% of the median equivalised disposable household income and maintained at the level of the baseline scenario (€850.47) throughout to ensure comparability.

risk of poverty for almost all categories, with the exception of households composed of elderly persons living alone, who by construction did not receive direct aid through this particular scheme. The most significant improvements in the AROP rates due to the wage supplement scheme are found in households with three children or more, in the single parents and the working age cohorts. On average, the wage supplement scheme is estimated to have reduced poverty rates by more than 3 percentage points.

Conclusion

The results presented suggest that the introduction of a wage compensation scheme in response to the predicted economic fallout of the COVID-19 pandemic and restrictions enacted to curb its spread had several positive effects. First, the scheme meets the primary aim of dampening average income losses, both across the income distribution and within economic sectors irrespective of the extent to which these were impacted. In particular, the results suggest that the scheme's impact across the income spectrum was progressive, in the sense that it shielded the lowest earners relatively more, an outcome which is important from an equity and financial security perspective. Whilst poverty rates measured against a pre-shock standard generally remain higher than in the baseline, they are invariably lower under the wage supplement scenario, suggesting that the scheme was at least partially effective in shielding people from poverty. It could also be argued that the scheme served to limit the dispersion of losses suffered by different households.

These results are not generally sensitive to key assumptions made in the modelling process, such as assumptions on the time taken by the employment shock to be fully realised, affecting the average *length* of unemployment in the no support case. However, changing the assumption on the share of normal salaries that Annex B benefit recipients received on top of the wage supplement has noticeable effects on results for sectors where most or all beneficiaries were receiving Annex B benefits, such as manufacturing. Hence, without additional data on the share of normal hours worked by these beneficiaries, solid conclusions on the effectiveness of this lower tier of benefits may be difficult to draw.

6. MONETARY AND FINANCIAL DEVELOPMENTS

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

In June, annual growth in Maltese residents' deposits with MFIs in Malta, moderated compared to March, partly reflecting slower growth in those held by households and NFCs. Meanwhile, deposits held by other sectors continued to record a significant contraction.¹ Growth in credit to Maltese residents also slowed down. This reflected a larger decline in credit to general government. Furthermore, credit to residents outside general government decelerated, largely reflecting slower growth in both loans to NFCs and loans to households.

The weighted average interest rate on outstanding deposits stood 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.

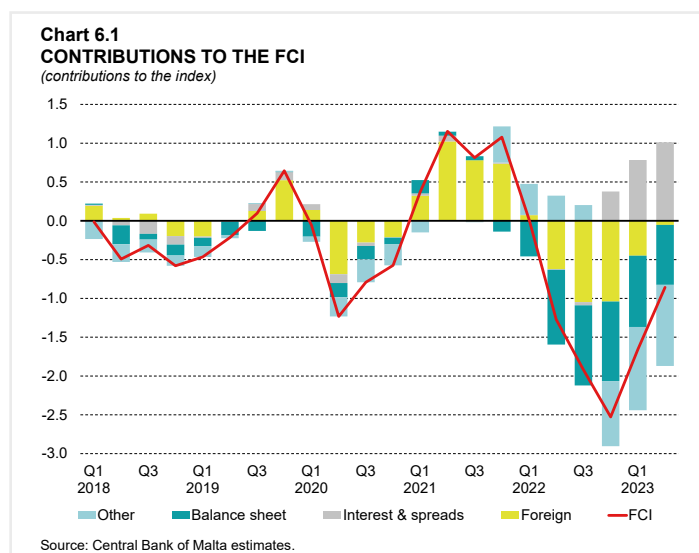
In June, the primary market yield on Treasury bills increased further from that prevailing three months earlier. Meanwhile, secondary market yields on five and ten-year MGS rose. As the domestic ten-year yield increased while the euro area benchmark yield fell, the spread against the latter widened. Domestic share prices rose between March and June, and were also higher 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 tight²

According to the Bank's FCI, in the second quarter of 2023, financial conditions were tight from a historical perspective, but the extent of tightness decreased compared to the first quarter (see Chart 6.1). The recent improvement in financial conditions was driven by a smaller tightening impact from both domestic and foreign influences – in equal measure.



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.

The smaller tightening effect of domestic factors largely reflected movements in the ‘interest and spreads’, and the ‘balance sheet’ components. The former was affected by a steeper year-on-year decline in the spread between MFI lending rates and the policy rate. While lending rates began to respond to the monetary tightening, the increase in the lending rate has been modest when compared to that recorded in the policy rate during the current monetary policy tightening phase. Furthermore, the ‘balance sheet’ component had a smaller tightening effect, notably reflecting a smaller negative contribution from the return on equity, and real deposits. At the same time, the tightening effect of the ‘other’ component eased marginally compared with the previous quarter, driven by a smaller negative contribution from equity prices.

The smaller tightening effect in foreign influences in turn reflected an increase in euro area stock prices during the quarter, and lower uncertainty.

Financial conditions were also less tight when compared to the second quarter of 2022. When measured on this basis, the lower tightening in financing conditions was partly driven by foreign influences, reflecting an increase in euro area stock prices and lower uncertainty.

Overall, domestic factors had a stronger tightening impact compared to the corresponding quarter of 2022, reflecting a stronger decline in net issues of NFC securities (part of the ‘other’ component), and in real deposits (part of the ‘balance sheet’ component). This was amplified by a fall in equity prices (part of the ‘other’ component).

Maltese residents’ deposits expand at a moderate pace

Total deposits held by Maltese residents with MFIs in Malta continued to expand, albeit at a slower pace than before. The annual rate of change stood at 0.6% in June, down from 0.9% in March (see Table 6.1). While deposits belonging to households and NFCs increased in annual terms, those belonging to other sectors recorded a significant contraction.

During the 12 months to June, deposit growth remained driven by overnight deposits, which is the most liquid component. Annual growth in this category stood at 1.2% in June, below the 3.2% recorded three months earlier. The latest increase in this component was mainly driven by an increase in households’ balances. The share of overnight deposits in total deposits eased to 86.5% in June, compared with 86.8% in March (see Chart 6.2).

Deposits with an agreed maturity of up to two years – the second largest component – also increased, though marginally. In the year to June these rose by

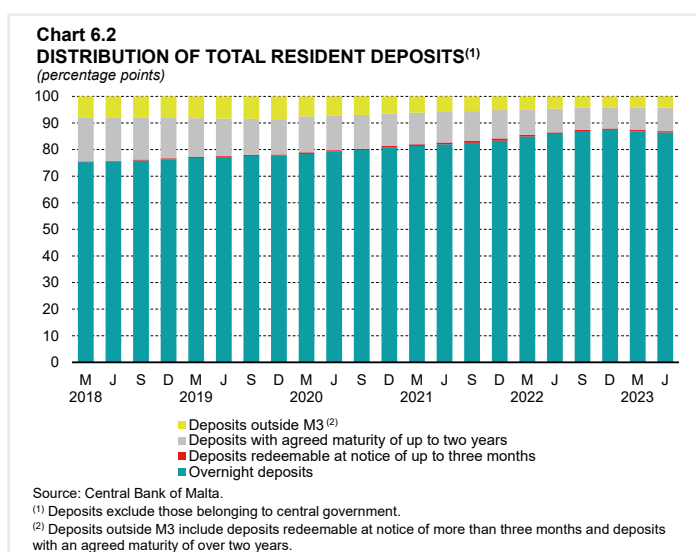


Table 6.1
DEPOSITS OF MALTESE RESIDENTS

	EUR millions 2023 June	Annual percentage changes				
		2022		2023		
		June	Sep.	Dec.	Mar.	June
Overnight deposits	20,330	13.5	12.7	8.1	3.2	1.2
<i>of which</i>						
Households	14,138	13.4	14.8	12.4	7.8	5.0
NFCs	4,624	10.8	11.0	8.1	4.0	0.8
Deposits redeemable at notice of up to three months	113	-11.9	-36.6	-38.7	-21.0	-15.0
<i>of which</i>						
Households	40	6.2	3.5	5.4	-1.4	-0.2
NFCs	50	-27.4	-59.0	-59.5	-35.9	-12.0
Deposits with an agreed maturity of up to two years	2,083	-16.2	-20.4	-24.7	-11.4	0.3
<i>of which</i>						
Households	1,625	-20.4	-26.7	-27.6	-15.4	3.9
NFCs	219	3.0	18.0	-3.4	19.0	10.6
Deposits outside M3⁽¹⁾	989	-14.1	-17.1	-14.4	-12.4	-8.7
<i>of which</i>						
Households	931	-11.3	-12.2	-9.6	-7.3	-5.4
NFCs	32	-31.2	-43.7	-34.5	-34.9	-20.3
Total residents deposits⁽²⁾	23,515	8.3	6.9	3.0	0.9	0.6
<i>of which</i>						
Households	16,734	7.1	7.6	6.0	4.3	4.2
NFCs	4,925	9.2	9.0	5.5	3.5	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.

0.3%, after contracting by 11.4% in the year to March, with their share in overall deposits reaching 8.9%.

Deposits with an agreed maturity of up to three months fell by 15.0% since June 2022, after contracting by 21.0% in the year to March. This may reflect a shift towards term deposits, as the remuneration on the latter began to respond to the recent policy rate hikes. The share of deposits with an agreed maturity of up to three months in total deposits remained broadly unchanged from three months earlier, at 0.5%.

Meanwhile, deposits classified outside M3 – which are mainly composed of deposits with an agreed maturity of over two years – fell by 8.7%, following a year-on-year decrease of 12.4% in March. Their share in overall resident deposits remained at 4.2% at the end of June.

Credit to residents grows at a slower pace

Credit to Maltese residents expanded by 3.9% in the year to June, below the 5.4% registered in March, as growth in credit to general government stood more negative, while credit to other residents expanded at a slower pace (see Table 6.2 and Chart 6.3).

Credit to general government fell by 5.8% in the year to June, following a contraction of 1.7% three months earlier. This was driven by a sharper decline in MFI holdings of Treasury bills over the

Table 6.2**MFI CREDIT TO MALTESE RESIDENTS**

	EUR millions 2023 June	Annual percentage changes				
		2022		2023		
		June	Sep.	Dec.	Mar.	June
Credit to general government	4,512	8.7	12.4	7.0	-1.7	-5.8
Credit to residents outside general government	14,081	6.3	7.4	7.8	8.1	7.5
Securities and equity	319	0.0	-0.3	-5.7	-2.2	-2.6
Loans	13,761	6.4	7.6	8.1	8.4	7.7
<i>of which:</i>						
Loans to households	7,942	9.7	9.8	9.5	8.5	7.9
Mortgages	7,364	10.9	10.5	9.8	8.6	8.0
Consumer credit and other lending	578	-3.3	1.1	4.9	7.4	6.9
Loans to NFCs ⁽¹⁾	4,850	2.8	5.4	7.8	10.1	8.1
Total credit to residents	18,593	6.9	8.7	7.5	5.4	3.9

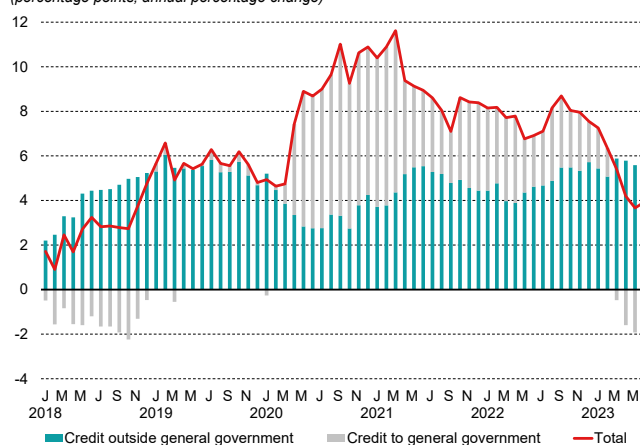
Source: Central Bank of Malta.

⁽¹⁾ NFCs include sole proprietors and non-profit institutions serving households (NPISH).

12 months to June. At the same time, growth in MFI holdings of Government stocks stood at 4.8% in June, below the 6.2% recorded in March, in line with the issuance profile of MGS.

The annual rate of change of credit to residents outside general government edged down to 7.5%, from 8.1% three months earlier. This deceleration largely reflected slower growth in loans to the private sector. Furthermore, MFI holdings of securities issued by the private sector decreased at a faster annual rate of 2.6%, following a decline of 2.2% in March.

Chart 6.3
CONTRIBUTIONS TO GROWTH IN CREDIT TO MALTESE RESIDENTS
(percentage points; annual percentage change)



Source: Central Bank of Malta.

Growth in loans to households moderated to 7.9% on an annual basis, from 8.5% three months earlier, notably driven by slower growth in mortgage lending. This component rose at an annual rate of 8.0% in June, down from 8.6% in March. At the same time, consumer credit and other lending grew at a slower rate of 6.9% after increasing by 7.4% in March. Meanwhile, loans to NFCs rose at an annual rate of 8.1%, below the 10.1% recorded three months earlier (see Chart 6.4).

The increase in loans to NFCs over the year to June 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 growth in loans to NFCs in June was largely driven by credit to the construction and real estate sectors (see Chart 6.5).

The year-on-year growth in loans declined when compared to March. On the one hand, loans to the sector comprising transport, storage, information and communication increased at a faster pace, as did credit to the construction sector. Meanwhile, loans to the sector comprising accommodation and food service activities increased, following a decline in the year to March. By contrast, loans to the real estate sector, as well as the manufacturing sector, increased at a slower pace compared to March. At the same time, loans to the wholesale and retail trade sector decreased, while loans to the sector comprising electricity, gas, and water supply declined at a faster pace.

Financial accounts data show that the share of bank lending in total NFC debt was slightly above that recorded in March, and also exceeded the share recorded a year earlier (see Chart 6.6). By June 2023, the share of bank loans in total NFC debt had reached 21.0%, up from 18.9% in the second quarter of 2022. Bank lending has been on an upward trend ever since, after reaching a low of 15.4% at the end of 2019.

The share of intra-sectoral lending in total NFC debt continued to decline. It decreased to

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

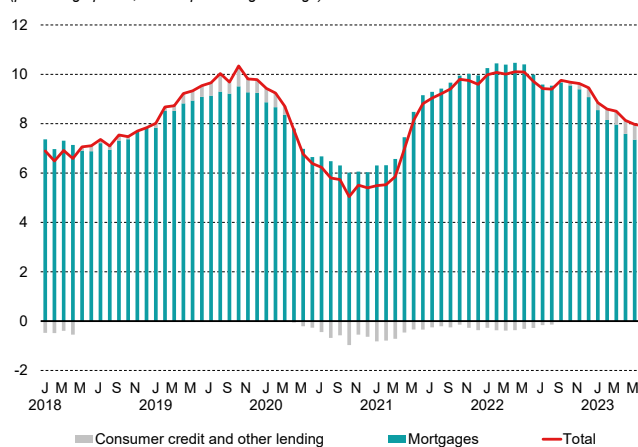


Chart 6.5
LOANS TO NFCs BY SECTOR
(percentage points; annual percentage change)

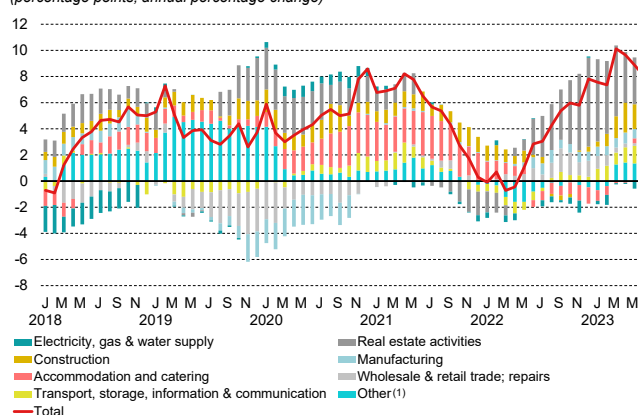
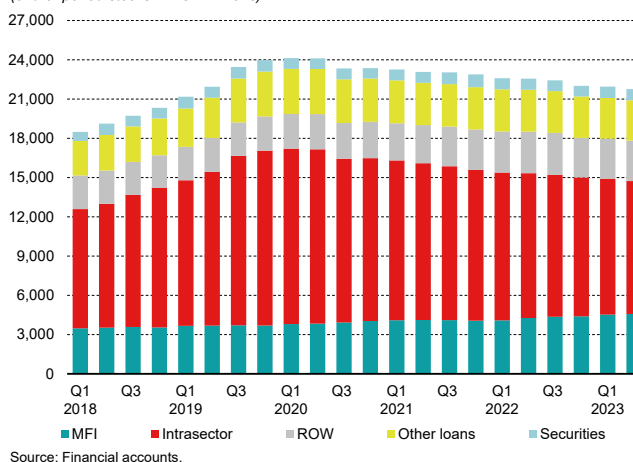


Chart 6.6
NFC DEBT BY SOURCE
(end-of-period stocks in EUR millions)



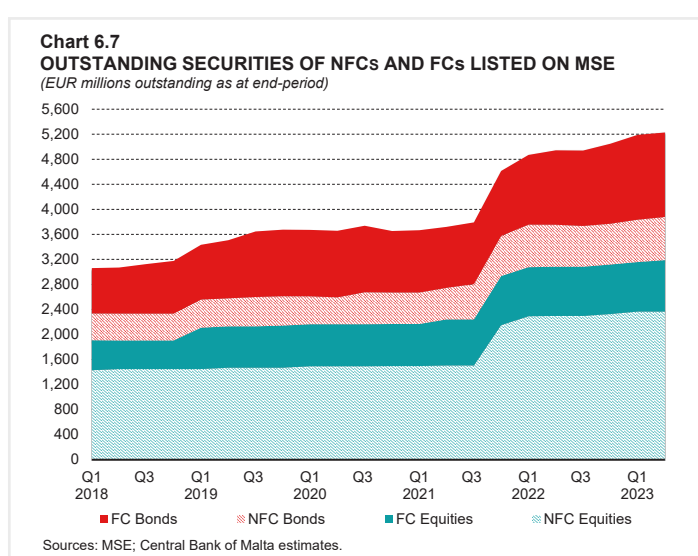
46.7% in June, from 47.3% three months earlier. It also stood below the 49.1% registered a year earlier. Despite this decrease, this component continued to account for the bulk of NFCs external financing.

The share of loans from non-residents edged up to 14.2% in June, up from 13.9% in March, and was broadly in line with that recorded a year earlier. Furthermore, the share of ‘other loans’ was unchanged from March, and from that recorded a year earlier, standing at 14.2% in June. This component largely reflects loans from households and ‘other financial institutions’.

Furthermore, the share of securities stood at 4.0%, remained unchanged from that recorded three months earlier. This was slightly above the share recorded in June 2022.

Stock of securities of NFCs and financial corporations listed on Malta Stock Exchange (MSE) increases

MSE data show that by June 2023, around €2,039.6 million in outstanding corporate debt securities were listed on the Exchange, 9.6% higher than the amount listed a year earlier (see Chart 6.7).³ Around two-thirds of this amount was issued by financial entities other than credit institutions. These also accounted for most of the increase since June 2022. The rest was issued by NFCs.



Meanwhile, the outstanding amount of equity listed on the MSE increased by 3.5% in annual terms, to reach €3,188.3 million. Around three-fourths of this volume was issued by NFCs, with financial corporations (FCs) playing a secondary role. The increase over the year to June was mostly driven by NFCs that operate within the real estate and construction sectors. The total amount of outstanding listed equity as at June 2023 exceeded that of bonds by over 56.3%.⁴

Spread between deposit and lending rate widens

During the year to June, the weighted average deposit rate offered on outstanding balances held by households and NFCs in Malta increased by 9 basis points, to 0.24% (see Table 6.3).⁵ This was largely driven by a further increase in the rates paid on households' and NFCs' outstanding fixed deposits with a maturity of up to two years. These increased by 83 and 68 basis points, respectively. The rate on NFCs' savings deposits redeemable at notice also increased compared

³ 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 other than MFIs.

⁴ Apart from the official MSE platform, small and medium-sized enterprises can also obtain finance through the specifically-geared platform – Prospects.

⁵ Basis points are rounded to the nearest whole number and hence may not exactly match the figures given in Table 6.3.

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 June	2021 June	2022 June	2022		2023	
				Sep.	Dec.	Mar.	June
Total deposits⁽¹⁾	0.25	0.18	0.15	0.14	0.15	0.19	0.24
<i>of which</i>							
Overnight deposits							
Households	0.03	0.02	0.02	0.02	0.02	0.03	0.04
NFCs	0.02	0.01	0.03	0.02	0.03	0.07	0.07
Savings deposits redeemable at notice							
Households	0.84	0.44	0.38	0.17	0.16	0.16	0.15
NFCs	0.22	0.11	0.08	0.05	0.12	0.06	0.72
Time deposits (less than 2 years)							
Households	0.67	0.54	0.50	0.54	0.72	0.95	1.32
NFCs	0.73	0.53	0.47	0.59	0.74	0.95	1.15
Time deposits (more than 2 years)							
Households	1.92	1.79	1.78	1.77	1.73	1.73	1.76
NFCs	1.47	1.15	1.36	1.60	1.60	1.49	1.26
Total loans⁽¹⁾	3.43	3.30	3.18	3.25	3.32	3.41	3.59
<i>of which</i>							
Households and NPISH	3.26	3.12	2.96	2.94	2.87	2.84	2.91
NFCs	3.73	3.62	3.60	3.82	4.15	4.45	4.87
Spread⁽²⁾	3.18	3.12	3.03	3.11	3.16	3.21	3.35
ECB MROs rate	0.00	0.00	0.00	1.25	2.50	3.50	4.00

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.

with 12 months earlier, rising by 64 basis points. By contrast, the corresponding rates paid to households decreased by 22 basis points. The rates paid on households' and NFC's time deposits with a maturity of over two years also decreased in the year to June by 2 and 11 basis points, respectively.

Meanwhile, the weighted average lending rate paid by households and NFCs to resident MFIs increased by 41 basis points, to 3.59%, over the year to June 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 335 basis points, above the 303 basis points recorded 12 months earlier.

During the year to June, the weighted average deposit rate offered on new balances held by households and NFCs in Malta increased by 98 basis points, to 1.91%. Meanwhile, the weighted average lending rate paid by households and NFCs to resident MFIs increased by 39 basis points, to 3.18%, over the year to June 2023. As a result, the spread between the weighted average lending rate and

the deposit rate closed the quarter under review at 127 basis points, below the 186 basis points recorded 12 months earlier.

Liquidity support measures

By the end of June 2023, 622 facilities were approved and still outstanding under the MDB's COVID-19 Guarantee Scheme (CGS), covering total sanctioned lending of €482.6 million, largely unchanged from the total amount of sanctioned lending in March (see Table 6.4).⁶ By end-June, the outstanding value of loans stood at €281.4 million, down from €307.6 at end-March 2023. Around half of these loans will mature in the next four years.

The sector comprising wholesale and retail activities had the largest outstanding number of facilities benefitting from the scheme. By end-June 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 Loans Scheme (SLS). By end-June 2023, three SLS facilities were approved, covering total sanctioned lending of €14.2 million.⁷ The outstanding level of disbursements from this scheme stood at €7.4 million. These facilities will be fully repaid in 2024. In June 2022, the MDB launched the Liquidity Support Guarantee Scheme (LSGS). By the

Table 6.4

MDB COVID-19 GUARANTEE SCHEME – AS AT JUNE 2023

Number of facilities approved and still outstanding; EUR millions

	As at March 2023		As at June 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	40	45.4
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	85	115.8
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.

⁶ The MDB CGS provided guarantees to commercial banks with the aim of enhancing access to new working capital loans for businesses. The scheme received applications until 30 June 2022. For further details see [MDB CGS](#).

⁷ The SLS 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. The total portfolio allocated for this scheme is €30.0 million.

end of June 2023, a total of €24.5 million was approved under the LSGS, and €21.8 million was disbursed.⁸

Bank Lending Survey (BLS) indicates broadly unchanged credit standards, terms and conditions

According to the July BLS, in the second quarter of 2023, all participating banks reported unchanged credit standards and terms and conditions for lending to NFCs in Malta. Banks also expected credit standards on such loans to remain unchanged in the third quarter.

As regards the demand for credit by NFCs, half of the respondent banks claimed that it had remained unchanged during the quarter under review, while the remaining banks had more mixed views. The majority of surveyed banks did not anticipate changes in demand in the third quarter.

Credit standards on loans for house purchases, consumer credit and other lending were assessed to have remained unchanged by the majority of banks in the second quarter of 2023. All participating banks expected no changes in credit standards for consumer credit and other lending in the third quarter. In the case of loans for house purchases, credit standards were mostly expected to remain unchanged.

Meanwhile, all participating banks reported unchanged terms and conditions for house purchases, consumer credit and other lending in the second quarter.

Demand for loans for house purchases, was assessed to have remained unchanged by half of the banks, with the remaining half having more mixed responses. In the case of consumer credit and other lending, demand for such lending was unchanged for all banks. For the third quarter, all banks were expecting stable demand for mortgage loans, consumer credit and other lending.

The July 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 isolated tightening effect was reported in terms of access to retail deposit funding. This assessment was also reflected in expectations for the third quarter.

Participating banks claimed that their non-performing loan (NPL) ratio had not affected their lending policies in the preceding six-month period, and expect no effects in the six months ahead.

Respondent banks were also asked to state how their credit standards, terms and conditions on new loans, and demand for loans have changed across the main sectors of economic activity – namely manufacturing, construction, services, wholesale and retail trade, and real estate. Respondent banks reported no change in credit standards and the terms and conditions in the past six months and were foreseeing no changes in the next six months for all the five sectors. With regards to demand for loans, half of the surveyed banks experienced no changes over the past six months and foresaw no changes in the upcoming six-month period. The other half witnessed some changes. These include an increase in demand for loans from firms that operate in the manufacturing and the

⁸ The LSGS 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 working capital loan under LSGS-A, and 80% under LSGS-B.

wholesale and retail trade sectors, and somewhat lower demand from firms active in commercial real estate. Their assessment for the third quarter was generally of unchanged demand compared with the second quarter.

Finally, participating banks were asked whether climate-related risks and measures to cope with it led to changes in the bank's credit standards, terms and conditions and demand for loans to enterprises. All banks said that there were no changes to their credit standards in the past 12 months, but half of the respondent banks expected some tightening in the coming 12-month period, more commonly for firms in transition and for brown firms.⁹

As regards credit terms and conditions, half of the banks reported no changes while the other half experienced some easing for non-brown sectors.

Turning to demand for loans, half of the banks said that due to climate change, the demand for loans by green firms, brown firms, and also by firms in transition had increased. The remaining half said that they experienced no such changes. Half of the banks said that fixed investment and corporate restructuring related to climate change had brought about an increase in demand for loans, as did fiscal support. Looking at demand in the coming 12 months, most of the banks expected climate change to be reflected in an increase in demand for loans in the case of green firms, while responses were more mixed for firms in transition and brown firms.

The money market

During the second quarter of 2023, the Government issued €726.7 million in Treasury bills (before redemptions), €76.9 million more than the amount issued in the first quarter of 2023.

In the domestic primary market, the yield on three-month Treasury bills rose further to 3.42% by the end of June, from 2.89% at end-March.

The capital market

During the second quarter of 2023, the Government did not issue any new MGSs. Two private sector institutions launched new bond issues on the MSE. Bonnici Brothers Properties plc issued unsecured bonds worth €12.0 million, while AST Group plc issued €8.5 million in secured bonds.

By the end of June, 20 firms had bonds that were listed on the MSE through Prospects, one less compared with end-March.¹⁰

In the secondary market, turnover in government bonds increased to €26.5 million, from €16.6 million in the first quarter of 2023. Meanwhile, turnover in corporate bonds was broadly unchanged at €27.6 million.

After falling in the previous quarter, the yield on five-year bonds rose to 3.67% at the end of June, from 3.14% three months earlier (see Chart 6.8). The yield on ten-year bonds also rose, reaching 3.76% from 3.45% in March. On the other hand, the euro area benchmark yield on

⁹ The BLS uses the following terms: "Green firms" – Firms that do not contribute or contribute little to climate change; "Firms in transition" – Firms that contribute to climate change, which are making considerable progress in the transition; "Brown firms" – Firms that highly contribute to climate change, which have not yet started or have so far made only little progress in the transition.

¹⁰ Prospects is a multi-lateral trading facility operated by the MSE with the aim of facilitating access to capital markets for SMEs.

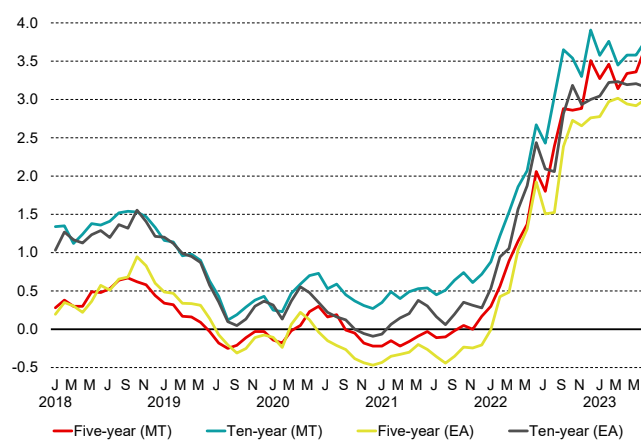
five-year bonds fell marginally to 3.00% from 3.02%, while the benchmark yield on ten-year bonds declined to 3.16% from 3.23%. As the domestic ten-year yield rose while the euro area benchmark fell, the spread against the latter widened to 60 basis points, from 22 basis points in March.

MSE Share Index rises during the quarter

During the second quarter of 2023, share prices in Malta rose. The MSE Equity Price Index ended the quarter 5.9% above its level at end-March, and was 2.4% higher than 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 7.1% higher than its level at end-March.

Equity turnover rose to €12.4 million during the second quarter of 2023, from €11.1 million in the previous quarter.

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



Sources: Central Bank of Malta; ECB.

Chart 6.9
MSE EQUITY PRICE INDEX
(end of month)



Source: MSE.

BOX 4: ATM CASH WITHDRAWALS IN 2022¹

Malta is considered to have a developed and extensive financial services industry. It has a number of retail institutions which serve the local population. It is also considered an international finance hub, with several foreign institutions operating locally.² Malta also has an extensive network of Automated Teller Machines (ATMs) offered by the five main local credit institutions, as well as a foreign licenced independent ATM provider which has been providing its ATM acquiring services in Malta since 2017. ATMs are strategically located near bank branches, shopping centres, food outlets and touristic areas, thus providing consumers with easy access to cash services. The scope of this exercise is to assess the penetration rate of ATMs in Malta and Gozo, the usage of such ATMs, and the volumes and values withdrawn from such ATMs.

Number of ATMs

As at December 2022, Malta had 391 terminals, resulting in approximately one ATM terminal per square kilometre (316 km²).³ When compared with 2021, the number of ATMs decreased slightly by 11 terminals. However, it is important to highlight that ATM availability is more limited in the rural areas and less populated villages. Although ATMs in Malta offer a variety of services, they are mainly used for the withdrawal of cash.⁴ Maximum withdrawal limits are set up on the card by the issuing institution. There are limits per transaction, and also per day. Currently this ranges between €250 and €1,000 daily depending on the card issuer, card type, and the account holder's profile.

It is worth pointing out that, although the number of ATM terminals as at end 2022 amounted to 391, the number of those active at any point during the year under review have been 414 as a number of ATMs were operated on a seasonal basis (i.e. are active only during summer), whereas others were installed at temporary locations during specific events. Having a greater number of ATMs located strategically increases the ease of accessibility to consumers, both local and foreign, to withdraw cash.

The data depicts a balanced number of acquired terminals between all local and foreign institutions, with the local institutions altogether providing 199 terminals located in Malta and Gozo. On the other hand, 215 terminals were provided by the sole foreign institution. As depicted in Chart 1, analysing the geographical breakdown of these ATM localities by region, the highest number of ATMs were located in the Northern Harbour regions with 173 terminals or 41.8% of the total. 57 terminals were located in the Southern Harbour regions representing a share of 13.8%.⁵ Gozo and the Western region both had 31 terminals each, equivalent to 7.5% of the total terminals located around the island.

¹ This box was prepared by Kirsten Ellul, Manager Regulation and Oversight Office, and Victoria Briffa, Officer II in the same Office. This box was reviewed by Sylvana Gatt, Head of Payments and Banking Department. The views expressed in this box represent those of the authors and should not be interpreted to reflect those of the Bank. Any remaining errors are the authors' own.

² The term 'institutions' refers to credit, payment and electronic money institutions.

³ Data for 2022 was extracted in May 2023. Data could be subject to revision.

⁴ ATM services other than cash withdrawals include mobile phone top-up, checking account balance, cash and/or cheque deposits, fund transfers between own accounts or to third parties and statement request.

⁵ List of regions as provided by National Statistics Office (NSO).

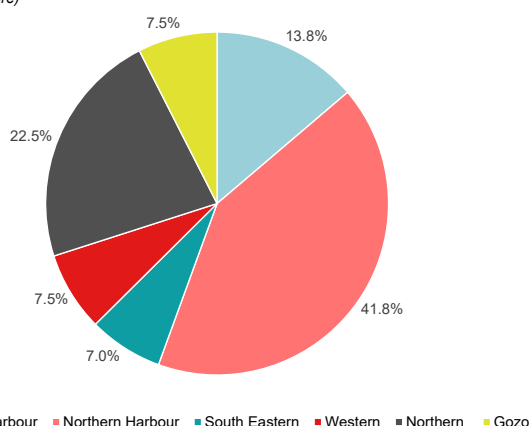
Table 1**POPULATION AND AREA BY REGION AS AT 2022**

Region	Population	Square km	Number of ATM terminals during 2022	ATM terminals per 1,000 persons	ATM terminals per square km
Gozo	40,191	69	31	0.77	0.45
Northern	99,295	74	93	0.94	1.26
Northern Harbour	168,636	24	173	1.03	7.20
South Eastern	79,498	50	29	0.36	0.58
Southern Harbour	87,438	26	57	0.65	2.18
Western	66,993	72	31	0.46	0.43

Sources: NSO; Central Bank of Malta.

Table 1 outlines ATM presence based on the population and area (in km²) per region as at the end of 2022. The Northern Harbour region appears to be the best well-served region recording both the highest number of ATM terminals per resident, as well as per km². Meanwhile, the least served region in terms of ATMs per resident was the South Eastern region, though in terms of ATM terminals per km², the Western region and Gozo had the lowest number of ATM terminals.

Chart 1
ATM LOCALITIES BY REGION
(percentage share)



Source: Central Bank of Malta.

ATM cash withdrawals analysis (volume and value)

ATMs are considered as electronic outlets that allow customers to complete basic transactions, mainly cash withdrawals, together with cash and cheque deposits. This without the need of going to a branch representative or teller. Table 2 shows the volume and value of cash withdrawals at ATMs located in Malta, including those reported by the foreign institution, with Maltese issued cards and foreign issued cards between 2012 and 2022. The increasing trend in the number of ATMs is evident especially as from 2015 onwards, with 2017 presenting the strongest increase. The volume of ATM cash withdrawals with Maltese issued cards has dropped slightly over the last four years. On the other hand, the volume of ATM cash withdrawals with foreign issued cards registered a more significant drop over the same time period, mainly due to the restrictions arising from the COVID-19 pandemic.

Table 2
CASH WITHDRAWALS AT MALTESE ATM TERMINALS⁽¹⁾

	No. of ATMs	ATM cash withdrawals at Maltese terminals with Maltese cards			ATM cash withdrawals at Maltese terminals with foreign cards		
		Volume	Value	Average value per transaction	Volume	Value	Average value per transaction
		Millions	EUR millions	EUR	Millions	EUR millions	EUR
	Actual						
2012	216	11.761	1,321	112	1.192	178.791	150
2013	216	11.817	1,379	117	1.372	203.554	148
2014	207	12.402	1,452	117	1.467	233.524	159
2015	213	12.836	1,550	121	1.696	256.382	151
2016	215	12.451	1,566	126	1.960	285.838	146
2017	345	13.463	1,751	130	2.849	392.287	138
2018	395	14.000	1,938	138	2.482	366.789	148
2019	405	13.068	1,894	145	2.770	378.281	137
2020	410	11.079	1,867	169	1.327	185.349	140
2021	402	11.446	2,075	181	1.467	201.707	138
2022	391	10.917	2,144	196	1.641	231.346	141

Source: Central Bank of Malta.

⁽¹⁾ Figures include ATMs provided by the foreign institution as from 2017.

It should be noted however, that the volume of ATM withdrawals by foreign cards has not yet reached pre-pandemic levels.

By contrast, the value of ATM cash withdrawals with Maltese issued cards in 2022 has exceeded pre-pandemic levels, while ATM cash withdrawals with foreign cards, despite registering weak increases, are still below pre-pandemic levels. This increase in the value of ATM cash withdrawals may not necessarily indicate an increased preference in the usage of cash in payment channels but could partly reflect a diversion in the way from withdrawing cash from branches due to imposed limitations. The effect of higher inflation in 2022 could also be another factor. Comparing the average value per ATM cash withdrawal for Maltese cards with foreign issued cards, it can be noted that while the latter has remained relatively stable over the last four years, the former has registered a strong increase. A likely contributing factor to this is the increase in the daily withdrawal limits at ATMs by the local banks. Nevertheless, the volume of transactions at ATMs did not increase.

ATM cash withdrawals at Maltese terminals with Maltese cards

Analysing the data for the years 2012-22, it can be noted that the volume and value of ATM cash withdrawals with Maltese cards followed a constant upward pattern for both volume and value up to 2018. The subsequent years depict a more volatile trend, largely reflecting the disruptions that the pandemic brought about in both activity levels and use of payment channels. In 2019, the volumes declined by 7% to 13.1 million transactions, while the value fell by 2% to €1.89 billion, (with the average value per withdrawal increasing). This trend continued during 2020, recording a reduction of 15.2% in the volume of cash

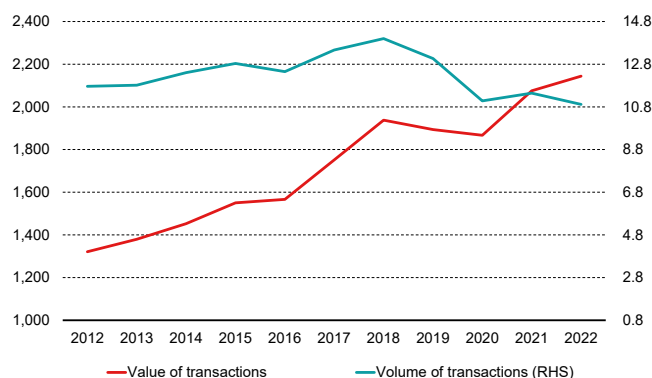
withdrawal transactions and a drop of 1.4% in the value of such transactions. The pandemic could be attributed to these developments, as many shops and outlets had to close because of restrictions imposed by health authorities. Consumers needed less cash for transaction purposes as they switched to online shopping. During 2021, trends recovered slightly, registering a yearly increase of

3.3% in volumes (11.4 million transactions) and 11.2% in values (€2.08 billion). However, data reported for 2022 shows yet another decrease of 4.6% in the volume of cash withdrawals and an increase of 3.3% in the corresponding value of transactions, closing the year under review with a total volume of 10.9 million transactions for a value of €2.14 billion. This means that customers made less use of ATMs but withdrew a higher value (see Chart 2). This was due to the increased limits allowed for daily withdrawals and also due to the higher inflation.

ATM cash withdrawals at Maltese terminals with foreign cards

The volume and value of transactions at Maltese terminals with foreign cards followed a similar pattern throughout the period 2012-22, registering a constant upward trend up to 2017. This however declined in 2018, registering decreases of 12.9% and 6.5% respectively in terms of both volume and value (see Chart 3). Another sharp decline can also be noted when comparing 2020 to 2019, with the volume of these transactions broadly halving to 1.3 million transactions for a value of €185.35 million during 2020. This result is the lowest yearly value of transactions registered

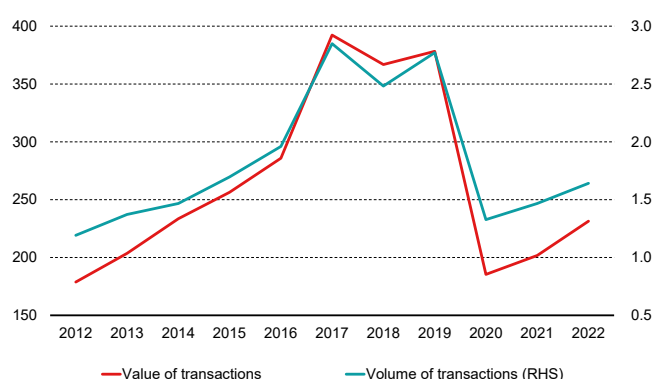
Chart 2
VALUE AND VOLUME OF CASH WITHDRAWALS AT MALTESE ATM TERMINALS WITH MALTESE CARDS⁽¹⁾
(EUR millions; millions)



Source: Central Bank of Malta.

⁽¹⁾ Figures include terminals provided by the foreign institution as from 2017.

Chart 3
VALUE AND VOLUME OF CASH WITHDRAWALS AT MALTESE ATM TERMINALS WITH FOREIGN CARDS⁽¹⁾
(EUR millions; millions)



Source: Central Bank of Malta.

⁽¹⁾ Figures include terminals provided by the foreign institution as from 2017.

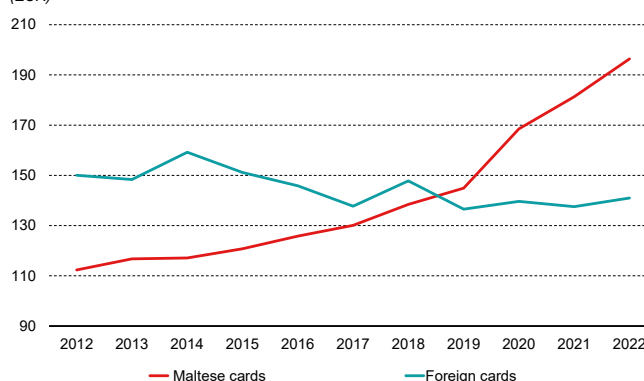
during the previous seven years, largely reflecting the restrictions in global international travel following the outbreak of the pandemic.

However, a recovery was registered during the last two years with the gradual re-opening of high-contact services sectors such as tourism. With a total of 1.6 million transactions, the 2022 results register an increase of 11.9%. The value of cash withdrawals effected with foreign cards reached €231.3 million, representing an increase of 14.7%. Additionally, data shows that foreigners use more the foreign provided ATM terminals as they might be more familiar with such terminals given that the same foreign institution provides such services to other EU countries.

Average value per ATM cash withdrawal

Analysing the average value per ATM cash withdrawal carried out by Maltese cards, a yearly consistent upward trend can be noted, from an average value of €112 in 2012 to €196 in 2022 registering an increase of €84 per transaction in the ten-year period under consideration. The increases in the daily limits of ATM cash withdrawals by the local banks contributed to this result. The introduction of contactless cards might also have contributed to an increase in the usage of non-cash payments for low value transactions due to their efficiency with 'tap to pay' functionality. On the other hand, the result for the average value per ATM cash withdrawal with foreign cards does not show a clear pattern. This is because an average value of €150 was registered in 2012, whilst that for 2022 decreased to €141. However, a minimal increase of €3 per transaction was recorded when comparing to €138 registered in 2021 (see Chart 4). This suggests that foreigners may be relying less on the use of cash in payments.

Chart 4
AVERAGE VALUE OF CASH WITHDRAWALS AT MALTESE ATM
TERMINALS WITH MALTESE AND FOREIGN CARDS⁽¹⁾
(EUR)



Source: Central Bank of Malta.

⁽¹⁾ Figures include terminals provided by the foreign institution as from 2017.

Conclusion

In conclusion, during 2022 the number of ATM terminals located in Malta decreased slightly when compared to 2021. The decrease in the volume of transactions could be attributed to the increase in the daily withdrawal limits, thus limiting the frequency for cash withdrawals from ATMs. The value of cash withdrawals with resident cards have increased and now exceeded 2019 levels. The volumes and values of cash withdrawals with foreign cards on ATM terminals located locally also increased in 2022. Although the banking industry is seeking to encourage greater use of electronic payments through the extensive Point of

Sale (POS) network, including the contactless technology introduced in 2019, the use of cash still remains significant.

From an international perspective, it is worth noting that according to a report published by RBR London, as at January 2023, despite the impact of COVID-19 on cash usage, investment by retailers in devices that count, verify and store banknotes has increased worldwide, and retailers' demand for cash automation solutions is surging.⁶

According to a report issued by the ECB, Malta's national share of the population covered by cash services within a 5 km radius is 100%.⁷ This can be supported by the results of this analysis which confirms that despite a slight decrease of 2.8% in the number of ATMs during 2022, the presence of ATMs in Malta is still very strong, with over one ATM per square kilometre.

Over a period of ten years, the number of ATMs located in Malta more than doubled, mainly due to the introduction of the ATMs supplied by the foreign institution in 2017. While the volume of withdrawals with domestic cards remains unchanged, the corresponding values nearly doubled from 2012 to 2022. As for withdrawals with foreign cards, both the volume and value of transactions depict increasing trends up to 2019, followed by a substantial slide in 2020 due to the COVID-19 pandemic.

From this analysis, it can be concluded that cash is easily accessible in Malta to both the local and foreign population. However, this might have negative implications to both the local credit institutions and to the Central Bank of Malta due to the costs and inefficiencies attributed to such a payment instrument. The drive to promote further penetration in the use of electronic means of payment should persist without compromising accessibility to cash.

⁶ RBR London is widely recognised as the leading provider of strategic research and consulting services to organisations active in the area of retail banking, banking automation, cards and payments and retail technology. RBR Press Release (rbrlondon.com)

⁷ European Central Bank – Report on access to cash in the euro area in 2021.