3. OUTPUT AND EMPLOYMENT

The Bank's Business Conditions Index (BCI) decreased to 0.7 in 2022, from 2.7 in 2021, indicating that growth in business activity has normalised following the exceptionally strong rebound of 2021. It now stands slightly above its long-term average, estimated since 2000.

Real GDP growth reached 6.9% in 2022, following an increase of 11.8% a year earlier. The expansion in economic activity was driven by domestic demand, as net exports contributed negatively to growth. Real gross value added (GVA) data show that the increase in real GDP was largely driven by the services sector, which recovered from the removal of travel restrictions and mitigation measures that had been introduced in response to the COVID-19 pandemic. The largest gains within the services sector stemmed from the sector comprising wholesale and retail trade, transportation, accommodation and related activities.

The GVA of firms within the sector comprising professional, scientific, administrative and related activities, as well as the information and communication sector, and the arts and entertainment sector, also exhibited notable positive contributions to growth. GVA also rose in the manufacturing sector, although its contribution to economic growth was modest compared to that of services. Conversely, the contribution of the construction sector turned negative in 2022, as GVA in this sector declined.

LFS data for the first three quarters of 2022 show that employment continued to benefit from the ongoing normalisation of economic activity in the context of a tight labour market. The number of foreign workers continued to rise, with inflows rising faster than outflows.

The unemployment rate remained low from a historical perspective, and was less than half of that reported for the euro area. It was also lower than the Bank's estimate of structural unemployment.

Administrative data show that in 2022, the average number of registered unemployed persons fell by 796, to 998 persons, while the job vacancy rate rose to 2.7% for the first three quarters of the year. Another indicator of labour tightness, which is the ratio of the job vacancy rate to the unemployment rate, also increased to levels that can be considered high.

Potential output and Business Conditions Index

Malta's output gap turns positive[1]

The Central Bank of Malta estimates that in 2022, potential output growth stood at 5.6%, up from 4.7% in 2021 (see Chart 3.1). As GDP growth was stronger, the output gap turned positive, standing at 0.9% in 2022 from -0.3% in 2021. This implies that there is some degree of overutilization of the economy's productive capacity.[2]

The acceleration in potential output in 2022 was driven by the contribution of labour. This was due to an influx of foreign workers joining the labour market during the year. The contribution of capital increased, reflecting

[1] Potential output measures the medium-to-long-term level of real output which is sustainable in an economy. The estimates presented here are derived using a production function approach. For further details on the methodology adopted see Micallef, B., and Ellul, R. (2017), "Medium-term Estimates of Potential Output Growth in Malta", in Grech, A. G., and Zerafa, S. (Eds.), *Challenges and Opportunities of Sustainable Economic Growth: the Case of Malta*, Central Bank of Malta.

[2] The output gap may be viewed as a gauge of over- or underutilisation of the productive capacity of the economy over the business cycle. A positive gap signals over-utilisation of resources, whereas a negative one indicates underutilised resources.

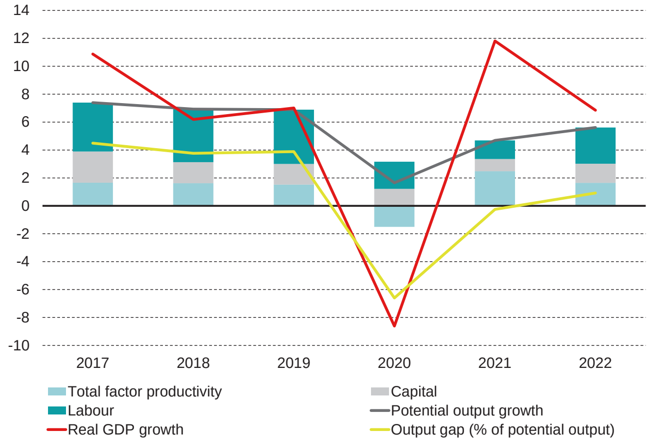
strong investment growth while that of total factor productivity eased from the previous year's high.

BCI normalises[3]

The Bank's BCI normalised from its exceptional highs registered in 2021, when business activity was still recovering from the contraction caused by the pandemic. The index averaged 0.7 during 2022, compared with 2.7 in 2021 (see Chart 3.2). The decrease in the index mainly mirrors slower growth in GDP and tax revenues, although growth in these components remains strong. At the same time, the ESI decreased compared to 2021, though remaining marginally above its long-term average.

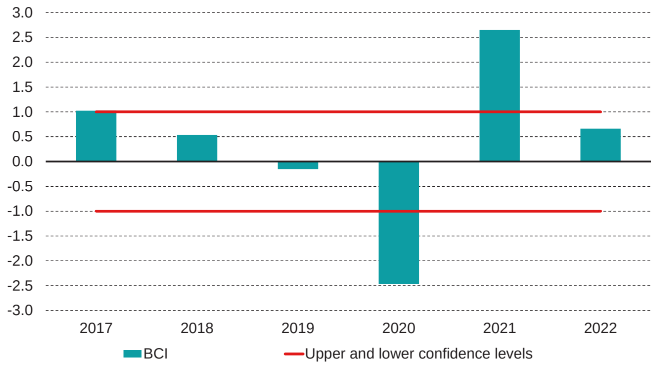
The above average BCI mainly reflected the very strong recovery in tourist arrivals, above average growth in GDP and tax revenues, as well as historical low unemployment rate. Overall, the index marks a normalisation in economic conditions.

Chart 3.1
CYCLICAL POSITION OF THE MALTESE ECONOMY
(annual percentage change; percentage of potential output; percentage points)



Sources: NSO; Central Bank of Malta estimates.

Chart 3.2
BUSINESS CONDITIONS INDEX
(standardised)



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

GDP and industrial production

Real GDP growth increases, driven by domestic demand

Economic activity in Malta moderated in 2022, following a strong increase in 2021. Real GDP rose by 6.9%, after increasing by 11.8% a year earlier.[4] In 2022 as a whole, the level of economic activity exceeded its pre-pandemic level by 9.2% (see Chart 3.3).

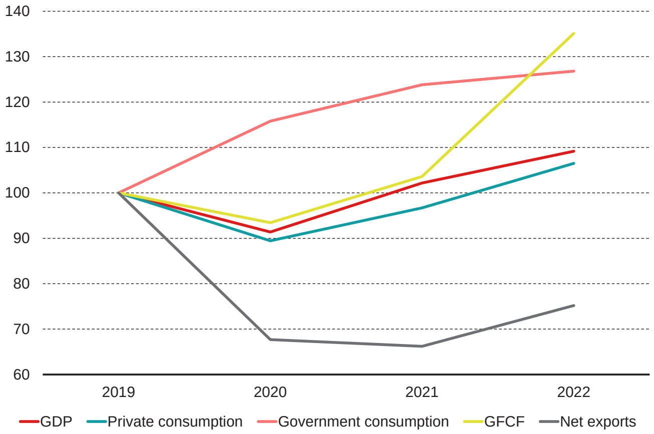
Domestic demand helped push GDP further above 2021 and pre-pandemic levels. The level of GFCF exceeded 2019 levels by over a third. Government consumption stood almost 27% above the corresponding level in 2019. Private consumption exceeded its level reached three years earlier by 6.5%. By contrast, net exports were around a fourth below the level prevailing in 2019, reflecting a surge in import-intensive investment in the aviation sector.

[3] 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.
[4] The analysis of GDP in this Chapter is based on data published in *News Release* 036/2023 published on 28 February 2023.

Domestic demand is the main driver of economic growth

In 2022, the expansion was underpinned by developments in domestic demand, which added 10.9 percentage points to GDP growth (see Table 3.1). All domestic demand components rose on a year earlier, with the exception of changes in inventories. GFCF was the main driver behind this expansion, followed by private consumption.

Chart 3.3
REAL GDP AND SELECTED COMPONENTS
(Index, 2019=100)



Source: NSO.

Private consumption rose by 10.1%, following an 8.1% increase in 2021, and added 4.3 percentage points to GDP growth. Data on the Classification of Individual Consumption by Purpose (COICOP) show that the rise in private consumption was broad-based across all expenditure categories. The strongest increase in absolute terms was recorded in expenditure on restaurants and accommodation services. This was followed by spending on recreation and culture as well as transport. Expenditure on these items benefitted from the removal of all pandemic-related restrictions on travel and mobility during 2022.

In the national accounts, private consumption data by COICOP category are based on the domestic concept, and thus include the expenditure of non-residents in Malta. Given that tourist arrivals by far exceeded the previous year's levels, certain COICOP categories of expenditure were affected by the significant increase in

Table 3.1
GROSS DOMESTIC PRODUCT[1]

	2017	2018	2019	2020	2021	2022
			Annual percentage changes			
Private final consumption expenditure	5.5	10.0	4.0	-10.5	8.1	10.1
Government final consumption expenditure	1.5	12.4	13.2	15.8	6.9	2.4
GFCF	-2.3	5.2	11.8	-6.6	10.9	30.4
Domestic demand	**3.0**	**8.8**	**8.2**	**-3.5**	**0.7**	**2.6**
Exports of goods and services	10.4	9.2	10.1	-1.6	6.3	6.4
Imports of goods and services	5.6	11.1	11.2	2.0	3.8	9.7
GDP	**10.9**	**6.2**	**7.0**	**-8.6**	**11.8**	**6.9**
			Percentage point contributions			
Private final consumption expenditure	2.7	4.5	1.9	-4.7	3.6	4.3
Government final consumption expenditure	0.2	1.8	2.0	2.6	1.4	0.5
GFCF	-0.5	1.0	2.3	-1.3	2.2	6.2
Changes in inventories	0.2	-0.2	0.5	0.5	-0.3	-0.1
Domestic demand	**2.6**	**7.1**	**6.7**	**-2.9**	**6.9**	**10.9**
Exports of goods and services	16.4	14.5	16.5	-2.7	11.2	10.8
Imports of goods and services	-8.1	-15.4	-16.3	-3.0	-6.2	-14.8
Net exports	**8.3**	**-0.9**	**0.3**	**-5.7**	**4.9**	**-4.0**
GDP	**10.9**	**6.2**	**7.0**	**-8.6**	**11.8**	**6.9**

[1] Chain-linked volumes, reference year 2015.
Sources: NSO; Central Bank of Malta calculations.

non-residents' expenditure in Malta. Nevertheless, the remaining part of domestic consumption – the expenditure of residents of Malta – also rose on a year earlier. Meanwhile, the expenditure of Maltese residents abroad increased on its year-ago level, as trips abroad continued to gradually recover, although it was still around a fifth below its 2019 level.

In 2022, government consumption grew by 2.4%, below the 6.9% recorded in 2021. This is due to lower growth in spending on intermediate consumption and compensation of employees. In 2021, both these components were boosted by pandemic-related spending, such as outlays on treatment and additional allowances. These base effects offset a decline in revenue from sales, which is netted against consumption expenditure. Overall, government consumption added 0.5 percentage point to annual GDP growth.

Following an increase of 10.9% in 2021, GFCF rose sharply by 30.4% in 2022, adding 6.2 percentage points to GDP growth. This reflected a significant increase in machinery and transport equipment, notably in the aviation sector, which offset decreases in most remaining investment categories other than investment in intellectual property products.

Meanwhile, changes in inventories shed 0.1 percentage point from GDP growth in 2022.

During 2022, imports grew by 9.7% and exports increased by 6.4% on a year earlier. As imports grew faster than exports, net exports declined, shedding 4.0 percentage points from annual real GDP growth. The negative contribution reflected a strong widening in the goods deficit (in volume terms), compared to 2021. This offset an improvement in the services balance.

The contributions shown in Table 3.1 are consistent with the approach traditionally followed in official databases and economic publications. However, this approach does not account for the fact that the import content varies across the different expenditure components. Consequently, such contributions fail to represent the true underlying relative contribution of domestic and external demand to economic growth.

Table 3.2 presents import-adjusted contributions, which addresses this limitation by apportioning imports to the respective domestic demand components and exports. In line with the strong increase in imports in the year under review, the majority of import-adjusted contributions are smaller than those based on the traditional approach, as reported in Table 3.1. This is particularly the case for exports, and, to a lesser extent, GFCF and private consumption.

According to this method, the main driver behind the growth of real GDP in 2022 was domestic demand. In contrast with the traditional approach, private consumption contributed more to import-adjusted GDP growth than GFCF. Exports also contributed positively to import-adjusted GDP growth.

Table 3.2
IMPORT-ADJUSTED CONTRIBUTIONS TO GDP GROWTH[(1)]

	2017	2018	2019	2020	2021	2022
	Percentage point contributions					
Private final consumption expenditure	2.1	2.2	0.8	-3.5	2.6	2.2
Government final consumption expenditure	0.3	1.4	1.6	2.0	1.3	0.4
GFCF	0.2	0.1	0.6	-1.1	1.1	1.9
Changes in inventories	0.0	0.0	0.2	0.4	-0.3	-0.1
Domestic demand	**2.5**	**3.7**	**3.3**	**-2.2**	**4.7**	**4.4**
Exports of goods and services	**8.3**	**2.5**	**3.8**	**-6.4**	**7.2**	**2.4**
GDP	**10.9**	**6.2**	**7.0**	**-8.6**	**11.8**	**6.9**

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

Table 3.3
CONTRIBUTION OF SECTORAL GVA TO REAL GDP GROWTH
Percentage points

	2017	2018	2019	2020	2021	2022
Agriculture, forestry and fishing	-0.2	0.0	-0.2	0.3	0.3	0.1
Mining and quarrying; utilities	-0.5	0.2	0.1	-0.1	0.3	0.1
Manufacturing	0.4	0.4	0.3	0.0	0.2	0.6
Construction	0.6	0.4	1.0	0.0	0.1	-0.3
Services	9.4	4.2	6.0	-6.9	10.0	7.0
of which:						
Wholesale and retail trade; repair of motor vehicles; transportation; accommodation and related activities	2.6	0.8	0.9	-6.1	4.0	3.3
Information and communication	1.1	0.6	1.5	-0.4	1.4	0.6
Financial and insurance activities	1.0	0.4	0.5	0.2	0.6	0.3
Real estate activities	0.6	0.2	0.3	-0.2	0.5	0.2
Professional, scientific, administrative and related activities	2.8	0.7	1.6	-1.3	1.2	1.4
Public administration and defence; education; health and related activities	0.4	0.8	1.0	0.1	1.1	0.5
Arts, entertainment; household repair and related services	0.8	0.6	0.2	0.8	1.2	0.6
GVA	**9.7**	**5.1**	**7.2**	**-6.7**	**10.9**	**7.4**
Net taxation on products	**1.2**	**1.1**	**-0.2**	**-1.9**	**0.9**	**-0.5**
Annual real GDP growth (%)	**10.9**	**6.2**	**7.0**	**-8.6**	**11.8**	**6.9**

Source: NSO.

GDP data from the output approach show that real GVA grew by 8.1%, following a 12.0% increase in 2021. In 2022, GVA added 7.4 percentage points to real GDP growth (see Table 3.3).

Services were the main driver of economic activity, accounting for 7.0 percentage points of overall real GDP growth. The largest additions within the services sector stemmed from the sector comprising wholesale and retail trade, transportation, accommodation and related activities. This sector added 3.3 percentage points to real GDP growth. The sector comprising professional, scientific, administrative and related activities, as well as the information and communication sector, and the arts and entertainment sector, also contributed positively to growth, jointly adding a further 2.7 percentage points. The sectors comprising public administration, education, health and related activities, financial and insurance activities, and real estate activities lifted GDP growth by 1.0 percentage point. Compared with 2021, the contribution of these sectors more than halved, though in 2021 growth was achieved from a lower base following the pandemic shock of 2020. Meanwhile, the contribution of the manufacturing sector stood at 0.6 percentage point, up from 0.2 point a year earlier. By contrast, the construction sector contracted, shedding 0.3 point from real GDP growth, with GVA in this sector standing below 2019 levels.

Nominal GDP growth remains strong

Nominal GDP rose by 12.5% in annual terms in the year under review, after increasing by 13.9% in the previous year.

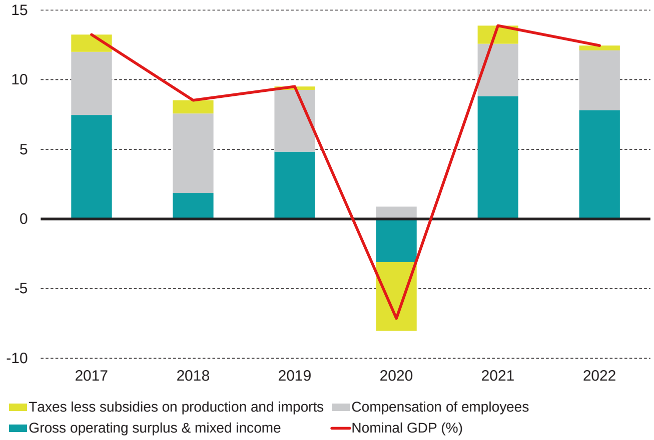
Compensation of employees grew by 9.4% in 2022, compared with 7.8% in the previous year. It added 4.3 percentage points to nominal growth. The increase was spread across both the public and private sectors.

In the private sector, the largest increases in level terms were recorded in the sector comprising wholesale and retail trade activities, the sector comprising professional, scientific and technical activities, and in the financial sector. These were followed by developments in the information and communication sector, and the arts and entertainment sector.

In addition, profitability increased significantly in 2022, albeit at a slower pace relative to 2021. Gross operating surplus rose by 16.2%, compared with 19.1% a year earlier. It added 7.8 percentage points to nominal GDP growth (see Chart 3.4).

Almost all sectors registered an increase in their gross operating surplus when compared with a year earlier. The largest increase in absolute terms was recorded in the transportation and storage sector, and in the sector comprising accommodation and food services activities. This was followed by the wholesale and retail trade sector, and the manufacturing sector.

Chart 3.4
NOMINAL GDP AND ITS MAIN COMPONENTS
(percentage point contribution)



Source: NSO.

In 2022, subsidies on production and imports increased sharply by 21.2% from a year earlier, partly reflecting efforts to mitigate energy price pressures. Meanwhile, due to the recovery in economic activity, growth in taxes on production and imports also grew strongly, at 12.7%. As a result of the surge in subsidies, 'net taxes on production and imports' increased, albeit by less than in 2021.

Industrial production[5]

Industrial production rose by 3.2% in 2022, following a decrease of 0.3% in 2021 (see Table 3.4). After recording year-on-year declines in the first half of the year, industrial production recovered in the second half, registering double digit growth in the last quarter.

The increase in production over the previous year reflected higher output in the manufacturing and energy sector – where the latter excludes energy generated abroad and imported through the interconnector. By contrast, output declined sharply in the quarrying sector.

The volume of production in the manufacturing sector, which has the largest weight in the index of industrial production, rose by 3.6% in 2022, following a decline of 0.8% in 2021.

Production rose strongly in the computer, electronic and optical sector, and in the pharmaceutical industry. Smaller, though still significant increases were reported by firms that repair and install machinery and equipment, as well as those that produce food and beverages. These increases offset falls in the production of wood and wood products, and among firms producing "other manufacturing" products – which include medical and dental instruments, toys and related products. Lower output was also reported, on average, by firms that produce textiles and wearing apparel, and by firms involved in the printing and reproduction of recorded media.

Data on manufacturing sales point to an increase in turnover of 16.1% in 2022, following a 4.6% increase in 2021.[6] This rise in turnover reflects higher sales in both the domestic and non-domestic market.

[5] Industrial production data are based on samples of firms engaged in quarrying, manufacturing and energy production. 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. Industrial production measures the volume of output without considering input costs. The sectorial coverage also differs, as industrial production data include the output of the energy sector, as well as mining and quarrying.

[6] Data on manufacturing sales are sourced from the NSO.

Table 3.4

INDUSTRIAL PRODUCTION[1]

Percentages; annual average percentage changes

	Shares	2020	2021	2022
Industrial production	**100.0**	**-0.3**	**-0.3**	**3.2**
Manufacturing	**87.1**	**-0.9**	**-0.8**	**3.6**
Of which:				
Food products	15.4	-1.3	-11.2	13.6
Repair and installation of machinery and equipment	7.9	-16.9	-0.2	17.9
Basic pharmaceutical products and pharmaceutical preparations	7.3	33.4	5.5	23.4
Printing and reproduction of recorded media	7.3	18.2	-11.7	-8.1
Beverages	5.6	-21.2	12.6	12.6
Rubber and plastic products	5.4	-1.2	1.6	-6.5
Computer, electronic and optical products	5.0	3.4	1.4	31.4
Energy	**12.5**	**1.5**	**1.5**	**2.8**
Mining and quarrying	**0.5**	**-14.2**	**14.1**	**-35.7**

Sources: NSO; Eurostat.

[1] The annual growth rates of the industrial production index are averages for the year based on working-day adjusted data. The annual growth rates of the components are based on unadjusted data.

Construction

The number of permits for residential units issued by the Planning Authority increased significantly in 2022, after declining for three consecutive years. Still, it remained below 2019 levels. Permits issued stood at 9,599, up from 7,578 in the previous year, but lower than the 12,485 issued in 2019 (see Table 3.5). Even though the number of permits in 2022 stood below 2019 levels, they exceeded the historical average of around 7,000 permits per year.

The overall increase in the number of permits issued in 2022 was largely on account of more permits for apartments, followed by an increase in permits for maisonettes, and terraced houses. These were partly offset by a decrease in the number of permits issued for other property categories.

Similarly, the number of development permits for commercial buildings increased by 7.7% in 2022, following a rise of 3.1% in the preceding year. In 2022, 2,984 commercial permits were issued, slightly above the 2,770 permits approved in 2021. This compares with 3,474 permits issued in 2019.

During 2022, construction investment decreased by around 6.7% in real terms, following an increase of around 3.6% in the preceding year. The latest decrease was largely driven by a fall in non-residential investment, which was down by almost a tenth. This after declining by 3.7% in the previous year, with the level standing well below 2019 levels. Residential investment contracted by 3.1% in the year under review, following an increase of 13.3% in 2021, but remained above pre-pandemic levels.

Table 3.5

PERMITS ISSUED FOR THE CONSTRUCTION OF DWELLING UNITS BY TYPE

	2017	2018	2019	2020	2021	2022
Apartments	7,762	11,211	10,726	6,735	6,451	8,280
Maisonettes	852	1,166	1,226	727	738	910
Terraced houses	301	396	402	299	290	333
Other	91	112	131	76	99	76
Total	9,006	12,885	12,485	7,837	7,578	9,599

Source: Planning Authority.

Table 3.6
CONSTRUCTION ACTIVITY INDICATORS[1]

	2019	2020	2021	2022
Real GVA (EUR millions)	**552.8**	**551.9**	**559.8**	**520.3**
Share in total economy GVA (%)	4.7	5.1	4.6	4.0
Total employment	13,316	14,965	15,810	17,253
of which private employment	12,686	14,373	15,258	16,708
Share in total gainfully occupied population (%)	6.0	6.4	6.7	6.9

Source: NSO.

(1) Employment data are averages for the first nine months of the year, and are sourced from administrative records.

GVA in the construction sector decreased by 7.0%, following an increase of 1.4% in the preceding year (see Table 3.6). Its share in GVA for the total economy declined to 4.0%, from 4.6% in 2021.

Nevertheless employment in construction continued to grow, likely reflecting a degree of labour hoarding following a period of shortages. Jobsplus data for the first nine months of 2022 show that the number of persons employed on a full-time basis in this sector rose by 1,443 or 9.1%, compared with the same period a year earlier (see Table 3.6). This followed a 5.6% increase in 2021. Growth in 2022 was also above that registered in the economy as a whole. Private sector employment in construction increased by 9.5%.

The construction sector's share in the total gainfully occupied population increased to 6.9%, from 6.7% in 2021. According to national accounts data for the full year, compensation of employees in the sector increased by 9.4%, following a 9.2% increase in 2021.

The labour market[7]

Labour force grows further

On average, the labour force expanded by 4.3% in the first nine months of 2022, a faster pace than that of 1.6% registered in the same period of 2021 (see Table 3.7).

The activity rate went up by 2.0 percentage points on a year earlier, to 79.7%, exceeding the euro area average of 74.6%.[8] The increase in the activity rate primarily reflects a higher female activity rate, as the latter edged up by 3.8 percentage points to 72.4%. The male activity rate rose by 0.3 percentage point to 86.0%. Both rates stood higher than their respective euro area rate, which stood at 69.9% and 79.3%, respectively.[9]

Employment grows at a faster pace

During the first three quarters of 2022, employment expanded at an average annual rate of 5.0% (see Table 3.7). This compares with 2.4% during the corresponding period of 2021, and also exceeds the average increase of 3.3% estimated since 2003 (see Chart 3.5). This reflects the strong rebound in activity following the pandemic in the context of an already tight labour market. At the same time, growth in employment during the first three quarters of 2022 has been more moderate than that recorded during the three years preceding the pandemic, likely reflecting the recent moderation in GDP growth and binding labour constraints.

In absolute terms, the rise in the number of employed persons during the first three quarters of the year was primarily driven by full-time jobs, which went up by around 11,000. Part-time employment also increased, with the number of such jobs rising by around 2,300. Over the same period, the number of unemployed

7 This section draws mainly on labour market statistics from two sources: the LFS, which is a household survey conducted on a quarterly basis by the NSO based on definitions set by the International Labour Organization (ILO) and Eurostat; and administrative records compiled monthly by Jobsplus, according to definitions established by domestic legislation on employment and social security benefits.

8 The activity rate measures the number of persons in the labour force aged 15-64 years (whether employed or seeking work) as a proportion of the working-age population, which is defined as all those aged 15-64 years.

9 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.

Table 3.7

LABOUR MARKET INDICATORS BASED ON THE LFS [1]

Persons; annual percentage changes

	2021 (revised) Jan.-Sep.	2022 Jan.-Sep.	Annual change %
Labour force	**277,200**	**289,100**	**4.3**
Employed	267,400	280,700	5.0
By type of employment:			
Full-time	235,300	246,300	4.7
Part-time	32,100	34,400	7.1
Unemployed	9,800	8,400	-13.7
Activity rate (%)	**77.7**	**79.7**	
Male	85.7	86.0	
Female	68.6	72.4	
Employment rate (%)	**74.9**	**77.3**	
Male	82.3	83.3	
Female	66.4	70.5	
Unemployment rate (%)	**3.5**	**2.9**	
Male	3.8	3.2	
Female	3.2	2.6	
Actual hours worked (per week)	**34.0**	**34.0**	

(1) Labour force figures are based on averages for the first three quarters published by Eurostat and are rounded to the nearest 100 persons. Growth rates reported in this Table are derived from Eurostat period averages.

Sources: NSO; Eurostat.

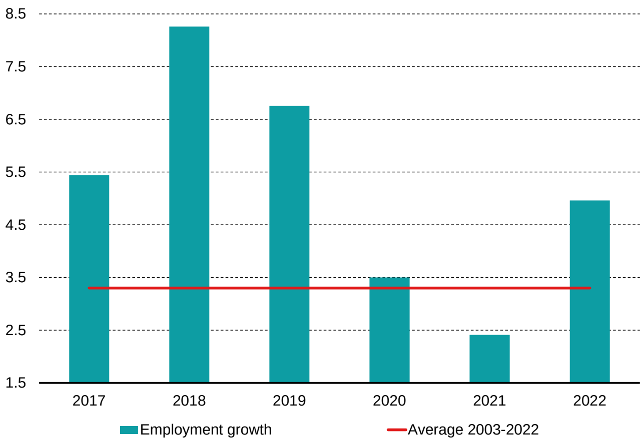
persons fell by around 1,400, to 8,400 persons according to the LFS – a decrease of almost 14%.

The overall employment rate rose by 2.4 percentage points to 77.3% in the first three quarters of 2022, higher than the 69.5% registered in the euro area.[10] The female employment rate registered the strongest increase, gaining 4.1 percentage points, to reach 70.5%, thus remaining above the euro area average of 64.7%. The male employment rate rose by 1.0 percentage point, to 83.3% and remained well above the average rate of 74.2% recorded for the euro area.

Chart 3.5

EMPLOYMENT GROWTH BASED ON THE LFS: JANUARY-SEPTEMBER

(annual percentage changes)



Sources: Eurostat; Central Bank of Malta calculations.

The stock of foreign workers in September 2022 stood at 89,911, up from 76,284 a year earlier. Additional administrative data indicates that the number of foreign workers arriving in Malta increased strongly during 2022, rising by almost 10,800 workers, to exceed 25,900 by September 2022 (see Chart 3.6).[11] Outflows

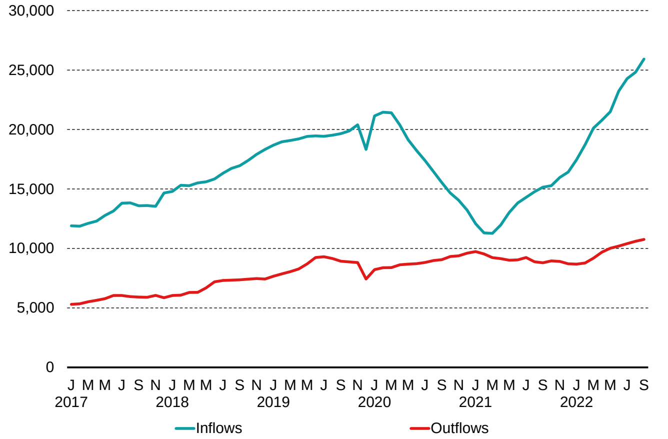
[10] The employment rate measures the number of persons aged 15-64 years, employed on a full-time or part-time basis as a proportion of the working-age population, which is defined as all those aged 15-64 years.

[11] Data on worker flows may not add up to the stock of workers, due to methodological differences in the administrative data.

of foreign workers increased at a milder pace of almost 2,000 persons, to reach almost 10,800 persons by September 2022.

In the first three quarters of 2022, the number of actual weekly hours worked averaged 34.0, the same number of hours reported in the same period of 2021. However, hours worked are still more than 7% below pre-pandemic levels.[12]

Chart 3.6
INFLOWS AND OUTFLOWS OF FOREIGN WORKERS
(number of persons)

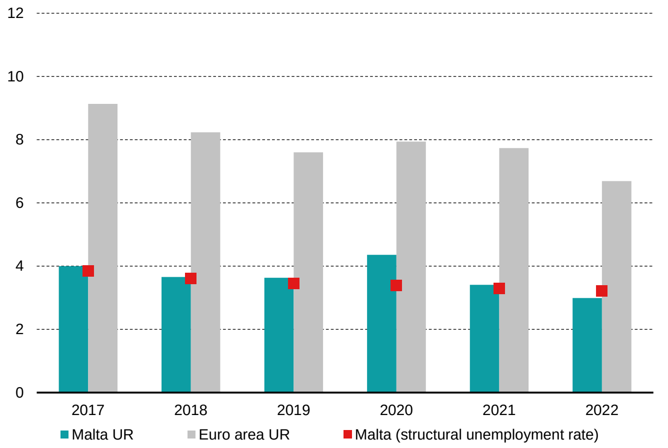


Source: Jobsplus.

Unemployment rate edges down

The LFS unemployment rate averaged 2.9% during the first three quarters of 2022, compared to 3.5% in the same period of 2021 (see Table 3.7).

Chart 3.7
UNEMPLOYMENT RATE
(not seasonally adjusted; per cent)



Sources: Eurostat; Central Bank of Malta calculations.

Monthly data up to December, which take into account LFS data up to the third quarter as well as more recent administrative data – show that the unemployment rate averaged 3.0% in 2022, lower than rate of 3.4% recorded in 2021 (see Chart 3.7). Apart from being one of the lowest rates on record, the unemployment rate also remained well below that of 6.7% registered in the euro area.

The unemployment rate also stood below the Bank's estimate of the structural measure of 3.8% for 2022.[13] This indicates a degree of labour market tightness, which is also confirmed by surveys.

The decline in unemployment is confirmed by administrative sources. According to Jobsplus data, on average, the number of unemployed persons fell by 796 persons over 2021, to 998 (see Chart 3.8).[14]

This decrease was recorded across all age cohorts. However, the largest decrease was observed among those aged 45 years and over, which fell by 358 persons, to 469. This was followed by those aged between 30 and 44, which fell by 272 persons to 281.

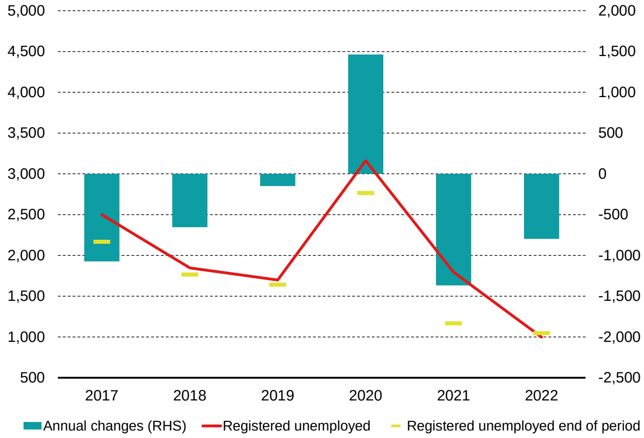
[12] Actual hours refer to the number of hours actually spent at the place of work during the reference week for the main job. Data cited in this report are sourced from the NSO, which may differ from Eurostat data due to differences in the methodology.

[13] 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 as described in Ellul, R., (2019). "An Unobserved Components Model for potential output in Malta", Article published in the *Quarterly Review* 2019:2, pp. 17-21

[14] The annual number of registered unemployed is based on the average of the total registered unemployed published by NSO on a monthly basis.

In terms of duration, the decline in the number of unemployed reflected a fall in both short-term (unemployed for less than a year) and long-term unemployed. The largest decline was among those who were unemployed for more than a year, which fell by around 280 persons. This was followed by those employed between 21 to 52 weeks, which fell by about 250 persons, and by those employed for less than 21 weeks which fell by almost 220 people.

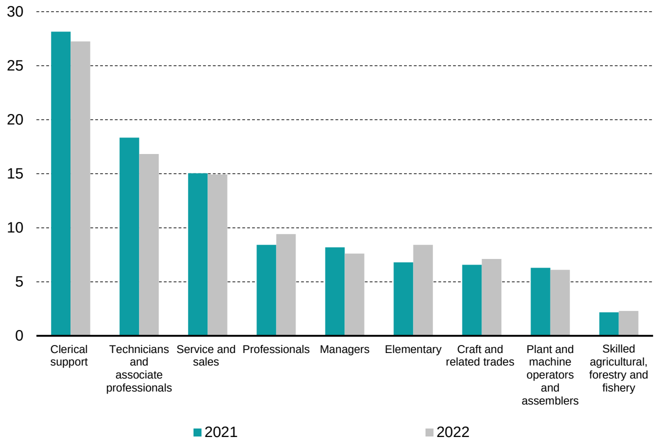
Chart 3.8
REGISTERED UNEMPLOYED
(persons; absolute changes)



Source: NSO.

During the year under review, over a fourth of those on the unemployment register were looking for clerical support work, and around a sixth registered for the post of technician or associate professional (see Chart 3.9). The third most sought-after occupation category was that of service and sales, with this category selected by almost 15% of persons on the unemployment register. Professional occupations accounted for more than 9% of requested jobs, while managerial and elementary jobs each accounted for around 8%. Occupations related to crafts and related trades, the operation and assembly of plant and machinery, and agriculture and fisheries attracted less interest.

Chart 3.9
REGISTERED UNEMPLOYED BY MAIN TYPE OF OCCUPATION
(per cent)



Source: NSO.

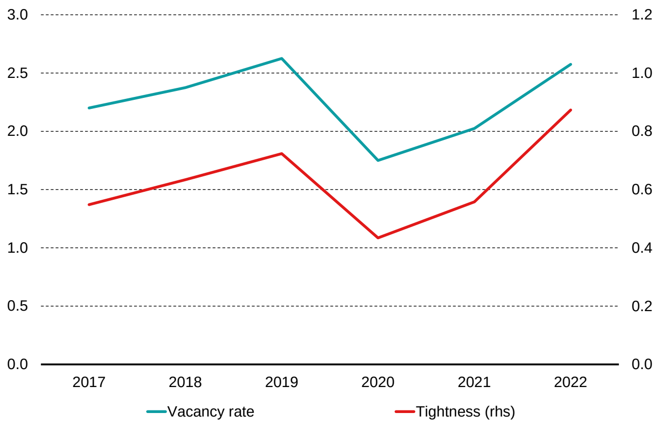
Although unemployment decreased in all occupation categories compared to 2021, the largest declines in absolute terms were recorded among unemployed persons interested in clerical support work, in the role of technician or associate professional, and in services and sales work. Persons expressing a preference for such occupations accounted for almost two-thirds of the overall decrease in registered unemployment during 2022. As a result, the share of these roles in sought after occupations decreased compared to 2021, as did that of managers and machine operators and assemblers.

By contrast, there was a larger share of unemployed persons interested in elementary and professional occupations, due to these roles seeing only a modest loss in interest compared to other occupations. The share of persons registering for jobs in craft and related trades as well as skilled agriculture, and fishing also rose, but to a much smaller degree.

The job vacancy rate for industry, construction and services stood at elevated levels in the first three quarters of 2022, on a par with 2019 rates (see Chart 3.10). It amounted to 2.7%, higher than the 2.1% recorded in the same period a year earlier.[15] The vacancy rate was highest in the arts and entertainment sector (5.8%), followed by the information and communication sector (5.4%).

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 first three quarters of 2022, this ratio stood at 0.9, higher than the ratio registered in the same period a year earlier. This is the result of a higher vacancy rate and a lower unemployment rate compared to last year. This indicator thus stands at elevated levels from a historical perspective.

Chart 3.10
VACANCY RATE AND LABOUR MARKET TIGHTNESS INDICATOR: JANUARY-SEPTEMBER
(per cent)



Sources: Eurostat; Central Bank of Malta calculations.

Business and consumer surveys

Economic sentiment falls but remains in line with its long-term average in 2022

During 2022, the European Commission's Economic Sentiment Indicator (ESI) for Malta averaged 100.9, down from 104.9 in 2021. Following this decline, the index stood below the level of 103.0 recorded in 2019, just before the pandemic (see Table 3.8). The recent decline might in part reflect the soaring cost pressures and supply bottlenecks fuelled by China's zero-COVID policy and the war in Ukraine.[16,17]

Table 3.8
SENTIMENT INDICATOR BY SECTOR
Annual average; absolute change

	2020	2021	2022	Change	2022			
					Mar.	June	Sep.	Dec.
ESI	**82.4**	**104.9**	**100.9**	**-4.0**	**107.3**	**102.7**	**93.6**	**96.7**
Industrial confidence indicator	-24.2	2.1	-9.4	-11.5	1.4	-10.3	-11.4	-23.5
Consumer confidence indicator	-5.6	3.4	-7.3	-10.8	-2.7	-7.1	-9.7	-11.8
Construction confidence indicator	-4.5	7.3	7.0	-0.3	3.4	15.1	5.9	-4.3
Services confidence indicator	-23.1	13.7	20.4	6.8	28.1	28.2	5.4	19.6
Retail trade confidence indicator	-30.3	-8.4	6.0	14.4	8.2	-4.0	5.7	27.3
EEI	**86.7**	**103.5**	**106.4**	**2.9**	**111.4**	**113.3**	**103.7**	**110.8**
Retail	-12.1	4.4	15.8	11.4	19.9	3.6	1.2	26.7
Services	-0.7	25.1	30.2	5.1	46.2	43.5	31.1	56.8
Industry	-10.9	14.8	12.0	-2.8	2.9	34.0	10.1	-37.4
Construction	-4.1	13.2	5.4	-7.9	-1.9	21.0	-1.8	-2.0
ESI demeaned	**-17.6**	**4.9**	**0.9**	**-4.0**	**7.3**	**2.7**	**-6.4**	**-3.4**
EEI demeaned	**-13.5**	**3.4**	**6.2**	**2.8**	**10.7**	**13.4**	**3.4**	**9.1**

Source: European Commission.

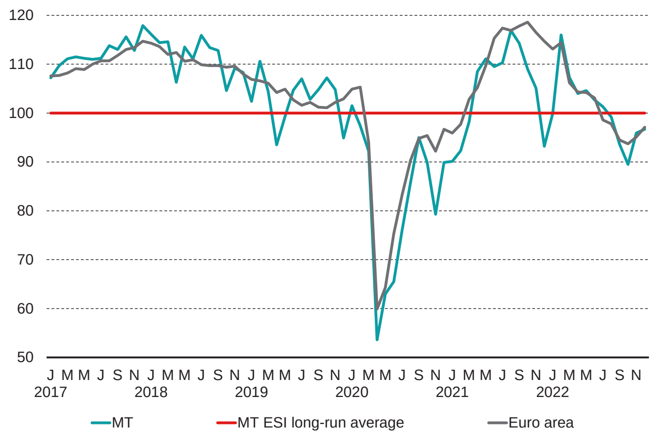
[15] The job vacancy rate measures the number of job vacancies as a percentage of total jobs (occupied and vacant). Data for Malta are available since 2017.

[16] Long-term averages are calculated over the entire period for which data are available. For the consumer and industrial confidence indicators, data became available in November 2002, while the services and construction confidence indicator data became available in May 2007 and May 2008, respectively. The long-term average of the retail confidence indicator is calculated since May 2011, when it was first published. The long-term average of the ESI is computed from November 2002.

[17] The ESI summarises developments in confidence in five surveyed sectors (industry, services, construction, retail and consumers).

The ESI reached a six-month high of 116.0 in February 2022, as COVID-19 restrictions eased further, primarily those related to quarantine and the use of masks. Sentiment remained relatively strong during the first half of the year, reflecting the ongoing recovery in economic activity from the pandemic. Nevertheless, sentiment was dented somewhat by new sources of uncertainty following the war in Ukraine. In fact, the ESI fell to 89.5 by October 2022 and although it recovered in the subsequent two months, it remained below its long-term average of 100, closing the year at 96.7 (see Chart 3.11).

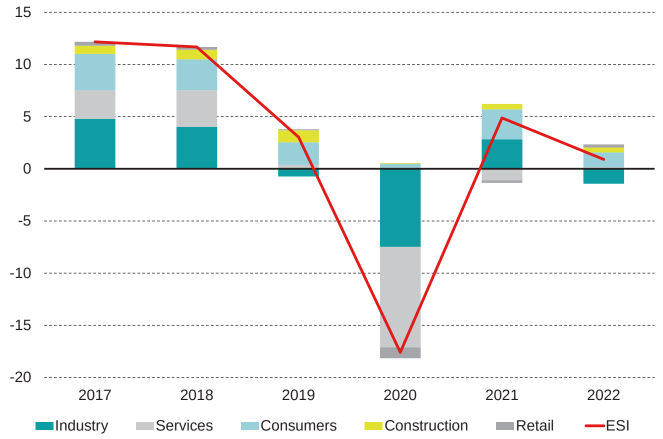
Chart 3.11
ECONOMIC SENTIMENT INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

Malta's ESI stood slightly below that of the euro area, which averaged 101.8. This was entirely due to negative sentiment in the domestic industry, which contrasted the positive sentiment in the euro area.

Chart 3.12
ECONOMIC SENTIMENT INDICATOR
(seasonally adjusted; demeaned)



Sources: European Commission; Central Bank of Malta workings.

Table 3.8 presents the annual average reading for each sector included in the ESI and the absolute change relative to 2021. During 2022, positive sentiment was registered in the services, retail, and construction sectors. By contrast, sentiment was negative in industry and among consumers. The most positive reading was recorded in the services sector.

While the confidence indicator deteriorated across most sectors in 2022, demeaned data show that most of the decline was driven by developments in industry and among consumers. At the same time, sentiment in the construction sector stood marginally less positive compared to 2021 (see Chart 3.12).[18] Furthermore, sentiment among consumers and construction firms explain why the overall ESI stood above its long-term average during the year under review.

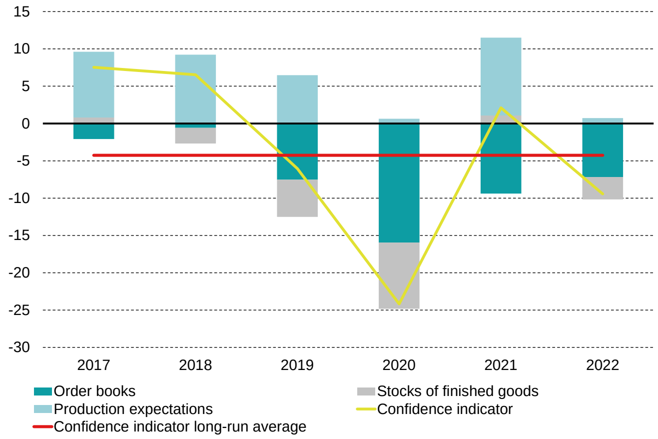
Although the ESI fell below its long-term average in the second half of the year, this reflected developments in industry and services. While the confidence indicators in construction and among consumers also decreased over that period, they remained above their long-term average and thus retained a positive contribution to the ESI. The contribution of the retail sector was also positive on average over this period.

[18] Weights are assigned as follows: industry 40%; services 30%; consumers 20%; construction 5%; and retail trade 5%.

Industrial confidence turns negative, falling below its long-term mean[19]

Sentiment among manufacturing firms decreased to -9.4, from 2.1 in 2021, thus falling below its long-term mean of -4.3 (see Chart 3.13). The deterioration in sentiment largely reflected a decline in production expectations. Furthermore, and by contrast to 2021, firms assessed their stocks of finished goods to be well above normal levels.[20] At the same time, a smaller share of respondents deemed order book levels to be below normal.

Chart 3.13
INDUSTRIAL CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



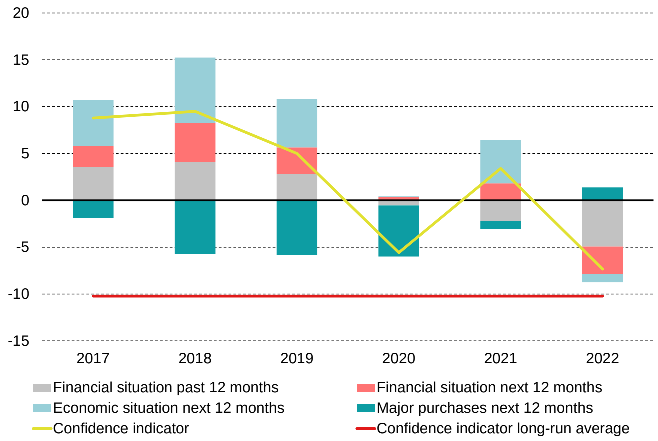
Source: European Commission.

After reaching a six-month high of 25.1 in February 2022, sentiment in industry fell below its long-term average in May, decreasing to -23.5 in December.

Consumer confidence turns negative, but remains above its long-term average[21]

Consumer confidence declined to -7.3, from 3.4 in 2021. Notwithstanding this decrease, sentiment has continued to stand above its long-term average of -10.2 (see Chart 3.14).

Chart 3.14
CONSUMER CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

The fall in sentiment was notably driven by a deterioration in consumers' expectations of the general economic situation and of the financial situation over the next 12 months. Consumers' assessment of their financial situation over the last 12 months stood more negative compared to 2021. On the other hand, households on balance, signalled that they intended to undertake additional major purchases in subsequent months. This contrasts with 2021, when expectations of major purchases stood negative.

Additional survey information suggests that on balance, fewer respondents expected unemployment to decline in the following 12 months. Meanwhile, savings expectations also decreased compared to a year earlier, but remained positive. The survey also reveals that both inflation perceptions and expectations rose significantly, with the former reaching unprecedented levels.

[19] 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, current levels of order books and stocks of finished goods (the last with inverted sign).

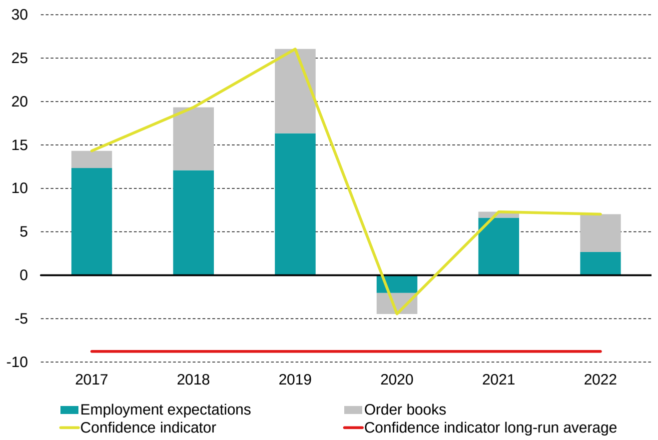
[20] A rise in the stock levels indicates lower turnover and affects the overall indicator in a negative way. Such decreases are thus represented by bars below the 0 mark in Chart 3.14.

[21] 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.

Confidence in construction eases slightly[22]

The sentiment indicator for the construction sector averaged 7.0 during 2022, down from 7.3 in the preceding year. Notwithstanding this decrease, confidence remained firmly above its long-term average of -8.8 (see Chart 3.15). Weaker employment expectations in the coming months contributed to the decline in sentiment during the year. By contrast, respondents' assessment of order book levels stood more positive relative to 2021.

Chart 3.15
CONSTRUCTION CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



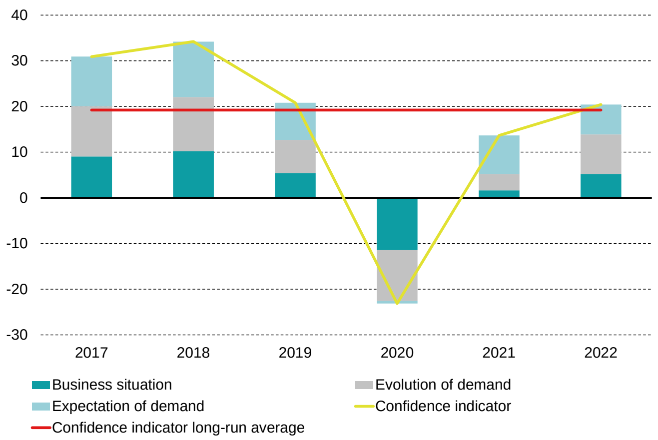
Source: European Commission.

Additional survey data show that financial constraints were the most important impediment to production signalled by respondents during the year under review, followed by labour shortages.

Confidence in the services sector improves further[23]

The confidence indicator within the services sector reached 20.4, up from 13.7 in the preceding year (see Chart 3.16). This increase reflected a more positive assessment of demand and of the business situation over the past three months. By contrast, respondents' demand expectations edged down but remained positive. Following this increase, confidence in the services sector stood somewhat above its long-term average of 19.2.

Chart 3.16
SERVICES CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

Sentiment in services was positive during most of 2022, with the highest readings recorded in May and August.

Confidence in the retail sector turns positive[24]

The retail confidence indicator stood at 6.0 in 2022, up from -8.4 a year earlier. Following this increase, sentiment increased above its long-term average of -0.7 (see Chart 3.17). The amelioration in sentiment was largely driven by assessment of business activity in recent months. At the same time, in contrast to 2021,

[22] 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 employment expectations over the subsequent three months.

[23] 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 for the subsequent three months.

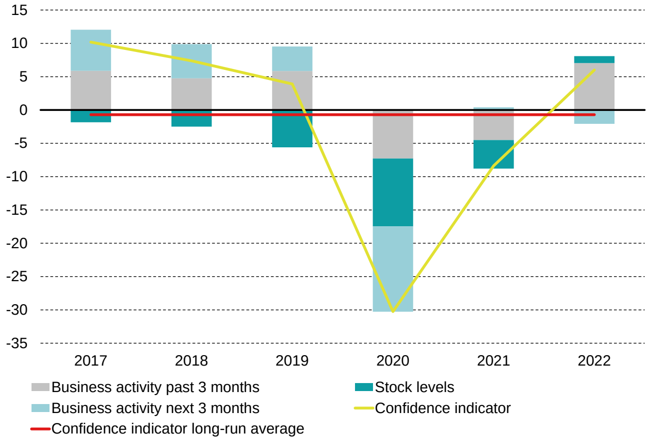
[24] The retail confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to survey questions relating to the present and future business situation and stock levels.

respondents assessed stock levels to be below normal. However, expectations of business activity fell in negative territory.

Sentiment in this sector was positive for most of the year, with the best monthly reading reached in December, when the index stood at 27.3.

Additional survey data indicate that, on balance, retailers anticipated order book levels to stand above normal levels in 2022 – a significant improvement over 2021 when order books were assessed to be below normal.

Chart 3.17
RETAIL CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)

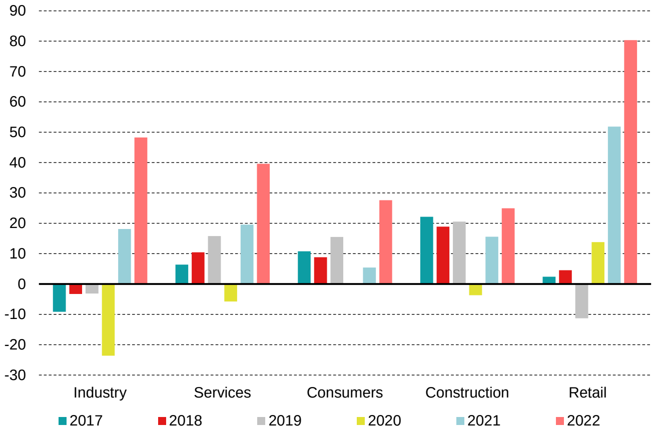


Source: European Commission.

Selling price expectations remain elevated

In 2022, selling price expectations increased significantly in most sectors, with a smaller increase recorded in the construction sector (see Chart 3.18). Differences across sectors remained significant – while the net share of firms signalling price increases exceeded 80% on average in the retail sector, that in other sectors ranged between 25% and 48%.

Chart 3.18
SECTORAL SELLING PRICE EXPECTATIONS
(seasonally adjusted)



Source: European Commission.

When assessed from a longer-term perspective, price expectations attained new highs in all productive sectors other than construction. In this case, as was also the case among consumers, price expectations were within the range of values observed since the start of the respective survey.

Employment Expectations Indicator increased somewhat

The EEI – which is a composite indicator of employment expectations in industry, services, retail trade and construction – increased.[25] It averaged 106.4, compared with 103.5 a year earlier, and stood above its long-term average of around 100.0.

Employment expectations were positive across all sectors, with the most positive reading recorded in the services sector. When accounting for the variation in the weights assigned to each sector in the overall index, it appears that the increase in expectations relative to 2021 was driven by developments in the services and retail sectors (see Chart 3.19). Industry also contributed to the increase in the EEI, but in a more limited

[25] 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.*

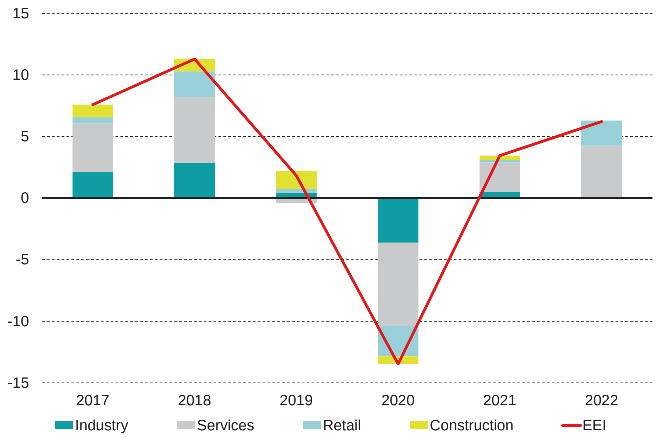
way. At the same time, the contribution of the construction sector was slightly negative.

Economic uncertainty increases

The European Commission's Economic Uncertainty Indicator (EUI) for Malta reached 28.1 in 2022, up from 21.3 in the previous year, and stood above the euro area average of 25.1.[26] During this period, uncertainty was above that in the euro area among consumers and in the retail sector (see Table 3.9).

Malta's EUI stood at 25.1 in January, but reached 38.3 in October. This was the highest reading recorded so far. The index moderated to 24.4 by the end of the year.[27,28]

Chart 3.19
EMPLOYMENT EXPECTATIONS INDICATOR
(seasonally adjusted; demeaned)



Sources: European Commission; Central Bank of Malta workings.

During 2022, on balance, uncertainty increased most in industry and among consumers, but was highest among retailers. By contrast, lower uncertainty was recorded in the services and construction sectors. The lowest uncertainty score was recorded among consumers, despite the significant increase.

Table 3.9
ECONOMIC UNCERTAINTY INDICATOR BY SECTOR
Period average; absolute change

	2021 May-Dec.[(1)]	2022	Change	2022 Mar.	June	Sep.	Dec.
Euro area	**15.7**	**25.1**	**9.5**	**26.8**	**24.8**	**29.3**	**27.5**
Industry	28.1	40.3	12.2	43.3	41.9	46.1	42.3
Services	17.6	21.0	3.5	23.8	17.6	22.9	22.1
Consumers	-15.8	-2.9	12.9	-3.8	-2.4	1.7	2.2
Construction	14.1	24.8	10.7	20.9	25.7	29.7	28.8
Retail	32.6	40.7	8.1	40.6	39.1	43.7	41.6
Malta	**21.3**	**28.1**	**6.8**	**27.8**	**33.0**	**21.3**	**24.4**
Industry	21.0	39.4	18.4	59.1	49.3	33.3	32.0
Services	32.2	20.3	-11.9	-1.3	17.2	1.5	17.2
Consumers	-3.5	13.7	17.2	1.9	19.1	19.7	13.5
Construction	30.1	19.5	-10.7	27.4	37.2	17.1	35.2
Retail	48.8	50.8	1.9	56.4	48.5	54.8	40.4

Source: European Commission.

[(1)] Data for 2021 are estimated for the period May-Dec. 2021, as data for Malta is only available from May 2021.

[26] 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.

[27] Data on consumer uncertainty in Malta became available in October 2020, while data for industry, services, retail and construction became available in May 2021.

[28] In January 2023, the EUI fell to 14.0, largely reflecting lower uncertainty among retailers, followed by industry, and to a lesser extent, the construction sector.

BOX 3: ECONOMIC PROJECTIONS

Economic outlook

The Bank's latest economic projections were finalised on 7 February 2023 and thus pre-date the latest release of the national accounts on 28 February 2023. According to these projections, Malta's GDP growth is projected to moderate from almost 7% 2022, to 3.7% in 2023, and to ease slightly further to 3.6% and 3.5% in 2024 and 2025, respectively (see Table 1).

Private consumption growth is projected to moderate to 4.9% in 2023, as growth normalises following the strong recovery last year. However, inflation is also expected to have an adverse impact on household income, which in turn impacts consumption. Private consumption is set to moderate further in the following years but should still outpace the Bank's estimate of real disposable income growth. The saving ratio is thus envisaged to retreat from recent peaks over the projection horizon, as some households may seek to smoothen consumption during a period of high inflation.

With regards to investment, this is projected to grow by 1.7% in 2023, fall by 0.3% in 2024, and grow by 2.5% in 2025. The growth in 2023 partly reflects the profile of construction activity, which is expected to pick-up gradually from the decline in 2022. Moreover, government investment is also expected to increase this year. The latter is then set to decline strongly in 2024 (by 14.4%), and by a further 1.1% in 2025. This profile is partly driven by the expected take up of EU funds, notably the full

Table 1
PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES FOR MALTA[1]

	2022[2]	2023	2024	2025
Real economic activity (% change)				
GDP	6.9	3.7	3.6	3.5
Private consumption expenditure	10.1	4.9	4.8	4.1
Government consumption expenditure	2.4	4.3	3.8	3.7
GFCF	30.4	1.7	-0.3	2.5
Exports of goods and services	6.4	2.8	3.2	3.0
Imports of goods and services	9.7	2.9	3.1	3.1
Contribution to real GDP growth (in percentage pts)				
Final domestic demand	10.9	3.3	2.8	3.0
Net exports	-4.0	0.4	0.8	0.5
Changes in inventories	-0.1	0.0	0.0	0.0
Labour market (% change)[2]				
Total employment	6.0	3.3	2.0	2.0
Unemployment rate (% of labour supply)	3.0	3.0	3.2	3.2
Prices and costs (% change)				
Overall HICP	6.1	4.4	2.3	2.2
Public Finances(% of GDP)[3]				
General government balance	-5.2	-4.9	-3.8	-2.9
General government debt	54.8	56.8	57.9	57.9

(1) Data on GDP were sourced from NSO *News Release* 036/2023 published on 28 February 2023, while HICP was sourced from *News Release* 008/2023 published on 18 January 2023. Inflation projections presented here differ from those published by the Bank in February 2023, due to new information available after the cut-off date for that exercise.
(2) Data on the number of employed are consistent with national accounts data. The unemployment rate is based on the number of unemployed and employed as reported in the LFS.
(3) Central Bank of Malta projections.

absorption of funds from the 2014-2020 financing framework by 2023, and the take up of Recovery and Resilience Facility grants in 2023 and 2024. It also reflects a shift from domestically-funded projects to EU-funded investment over this period.

Net exports are expected to decelerate in 2023. In view of the envisaged weakness in the international economic environment, export growth is set to moderate to 2.8% in 2023, and expand at around 3.0% in the following two years. With regard to imports, growth is set to moderate to 2.9% in 2023 due to a lower rise in overall demand, and to pick up marginally to 3.1% over the remainder of the forecast horizon.

The labour market is expected to remain robust, but to slow down from 2023. Employment growth is set to moderate to 3.3% in 2023, which partly reflects the envisaged slowdown in economic activity towards potential growth. Over the rest of the projection horizon, employment is set to expand by 2.0%. The unemployment rate is expected to stand at 3.0% in 2023, and to remain at a relatively low level of 3.2% in 2024 and 2025.

Annual HICP inflation is projected to moderate to 4.4% in 2023, as international supply bottlenecks are expected to ease further. However, lingering indirect effects from recent increases in input costs are set to keep inflation high from a historical perspective. The fall in inflation in 2023 reflects a broad-based decrease across all sub-components of HICP, except for energy inflation, which remained unchanged in 2022 as a result of government support measures. Services is envisaged to be the main contributor to HICP inflation, but NEIG and processed food are also projected to contribute somewhat to annual HICP inflation in 2023. Services inflation is expected to ease from 6.0% in 2022, to 4.0% in 2023, and to 2.9% in 2024 and 2025. This moderation is expected to be primarily driven by weaker spillovers from other subcomponents, such as food, where inflation is also expected to moderate over the projection horizon. Food prices are projected to rise by 5.9% in 2023, down from 9.1% in 2022. Indeed, both processed and unprocessed food inflation are expected to decrease in 2023, although the largest decline is expected to be in unprocessed food inflation, which is projected to fall to 4.4%, from 12.1% in 2022. This reflects the indirect impact of lower import prices for most commodities and falling international freight costs. Food inflation is set to moderate to 2.2% by 2025, in line with expected developments in international commodity prices. NEIG inflation is expected to remain rather persistent and decline only slightly from 5.3% in 2022 to 4.6% in 2023. This reflects the lagged pass-through from high import price pressures to goods inflation. As import prices are expected to ease slightly this year, NEIG inflation is projected to moderate over the rest of the projection horizon, standing at 1.4% in 2025.

Despite the decline in international energy commodity prices, these remain elevated. Nevertheless, domestic energy prices are expected to remain unchanged during the whole projection horizon, in line with the Government's commitment of keeping energy prices stable. HICP inflation is set to ease steadily in the following years. Thus, overall HICP is set to stand at 2.3% and 2.2% in 2024 and 2025.

The headline budget balance is expected to remain in deficit throughout the forecast horizon but should narrow over time, driven by resilient economic activity and the profile of price mitigation measures. It is set to decline to 4.9% of GDP in 2023 and to continue declining over the rest of the forecast horizon, reaching 2.9% of GDP by 2025. Meanwhile, the general government debt-to-GDP ratio is projected to rise to 56.8% in 2023, but is set to stabilise at just under 58.0% by the end of the projection horizon.

On balance, risks to economic activity are slightly tilted to the downside for 2023, and more balanced thereafter. The main downside risks relate to the possibility of stronger than envisaged weakness in the international economic environment, which could lead to lower exports. Foreign demand may also be weaker than expected, especially if monetary policy in advanced economies tightens by more than assumed in this projection exercise. Some of these downside risks could be mitigated in the short term by stronger than expected wage growth, which could offer additional support to household consumption.

Risks to inflation are considered as balanced for the entire projection horizon. Indeed, while upward price pressures to salaries in Malta, and an incomplete lagged pass-through of past increases in energy costs in the euro area could increase commodity prices further, the re-opening of China could be seen as a partial reversal of the supply shock. Also, a stronger pass-through of the recent appreciation of the euro, monetary tightening as well as lower international energy and transport costs could result in lower inflationary pressures.

On the fiscal side, risks are on the downside (deficit-increasing) from 2023 onwards. These mainly reflect the likelihood of additional State Aid to the national airline, though possible weaker economic growth in 2023 would also have an impact. These risks may be partly offset by the profile of outlays on price mitigation measures, which could be less than projected should oil and gas prices stabilise at lower levels.