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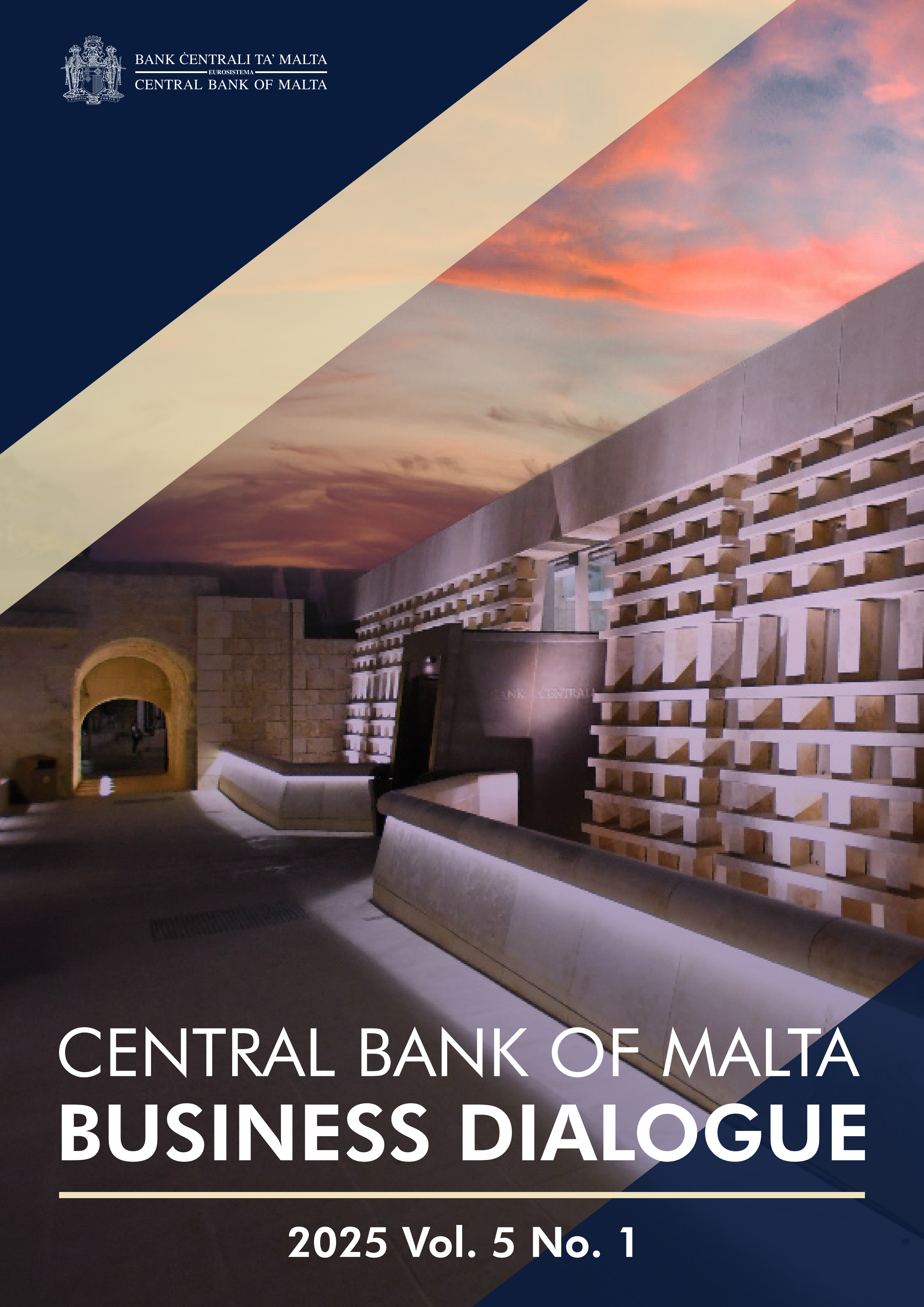

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MAIN FINDINGS FROM THE 2024Q4 ROUND OF CONTACTS WITH NON-FINANCIAL CORPORATIONS[1]

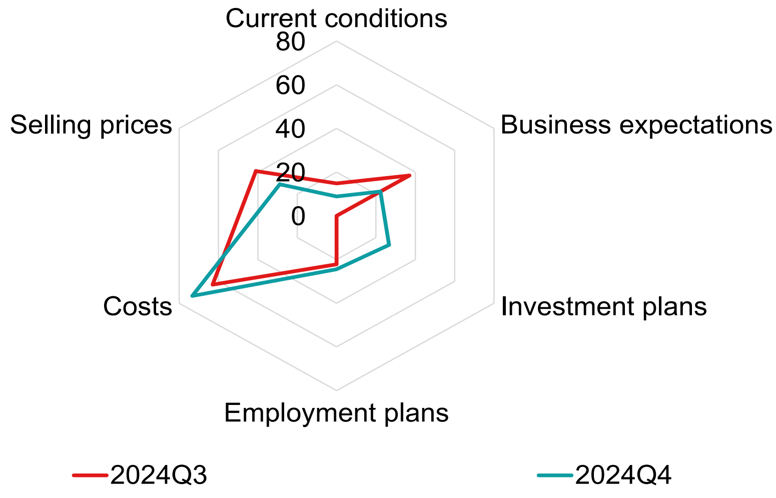
Summary

Information gathered by the Central Bank of Malta during contacts with non-financial corporations (NFCs) and other institutions between October and December 2024 shows that while the overall net balance of recent activity remained positive at 9%, it weakened compared to previous quarters indicating a slowdown. Sectoral responses diverged. Service-oriented firms had the highest incidence of firms reporting an expansion in activity, followed by manufacturing firms. On the other hand, conditions were more or less stagnant in the wholesale and retail trade sector where demand is uneven across sectors. Despite reporting resilient demand in property sales and letting, the construction sector continued to report relatively low demand for new projects and stronger regulations.

Looking ahead, the net balance of businesses expecting an improvement in business activity fell to 20% from 37% in the previous quarter, with the construction and real estate sector once again exhibiting the least favourable outlook. Retailers foresee seasonal demand increases, while a similar proportion of manufacturing firms as in the previous quarter continue to expect growth. In services, meanwhile, the net share of firms expecting an improvement in activity more than halved. In several sub-sectors, optimism is tempered by external risks such as more stringent EU regulations and global economic uncertainties.

Rising input costs remain a concern, with a net 69% of all interviewed firms reporting increases, up six percentage points from the previous quarter. However, the pace of cost increases has moderated compared to prior years. Labour costs are the most significant pressure point. Despite higher costs, the net share of businesses raising selling prices dropped to 29% from 41%, as firms found it more challenging to pass on cost increases to selling prices.

SUMMARY OF COMPANIES' OVERALL RESPONSES
(net balance; percentage)



Source: Central Bank of Malta Business Dialogue.

[1] This publication reports the main outcome of interviews held with local NFCs. The views expressed are solely those of the companies interviewed and do not necessarily reflect the views of the Central Bank of Malta.

The net balance of firms planning to increase investment rose to 27% from 0%, driven by a focus on sustainability and digitalization. Self-financing remains the dominant funding method as reported by 43% of firms.

Replies about employment plans point to a similar pace of job creation as in the third quarter, with a net balance of 24% compared to 22% previously. Labour shortages persist, leading to innovative recruitment strategies. Most firms reported wage increases of 5-6% in 2024, with some exceeding 8% to attract and retain talent. For 2025, expectations are for more moderate wage growth, primarily in the 3-6% range. Labour-intensive sectors anticipate continued pressures.

Skilled labour shortages remain the most pressing issue, affecting 36% of respondents, particularly in manufacturing and construction. Other notable challenges include bureaucratic inefficiencies and increased competition.

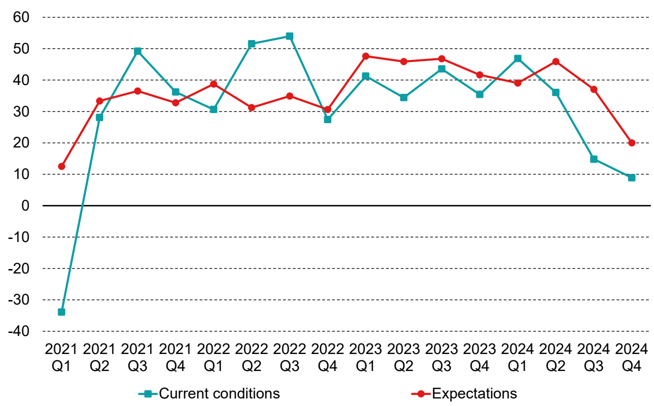
This report summarizes the key insights gathered from Maltese companies through 45 interviews conducted between October and December of 2024 as part of the Central Bank of Malta's ongoing Business Dialogue exercise. The exercise aims to gather information on current business conditions, short-term activity expectations, cost and price changes, investment and employment plans, and wage growth expectations. Additional topics such as mark-ups, profits, and challenges faced by companies are also discussed. This round's report also includes a Box on cost changes and company profitability over the past two years.

Activity

While overall sentiment remained positive, businesses' replies on recent activity indicate a continued slowdown during the fourth quarter of 2024. Moreover, the assessment of the current business environment differs across sectors. The net share of businesses reporting improvements in conditions dropped from 15% in the previous quarter to 9% during the final quarter of 2024 (see Chart 1). This indicator remained positive in services and manufacturing, while it turned neutral in the wholesale and retail sector. By contrast, sentiment in construction turned negative.

In parts of the manufacturing sector, particularly in subsectors producing food and beverages, firms reported stable or improving sales, revenues and profits. Service-oriented industries, such as accommodation and hospitality, travel and transport and audit and consultancy also largely reported improving or stable conditions, although contacts in the latter sub-sector stated that while activity is positive, market conditions are tough due to competition, international taxation and political uncertainty in key economies.

Chart 1
ACTIVITY
(net balance)



Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "How have business conditions developed over the past three months and how do you expect these to develop over the next three months?"

Maritime and freight services providers described a stable scenario although operations depend on the number of ships calling at Maltese ports, which have reportedly declined due to issues in the Red Sea and the recent extension of the EU's Emissions Trading Scheme to maritime activities. Considerable efforts were undertaken in this case to ensure companies maintained positive levels.

The retail sector experienced a somewhat uneven performance. Vehicle sales continued to thrive, sustained by demand from higher-income consumers, while mid-range retailers and sellers of daily goods struggled to reach the desired levels as consumers became more price-sensitive.

Despite reporting resilient demand in property sales and letting, the construction sector continued to report relatively low demand for new projects. Moreover, stronger regulations have made the conduct of business more challenging.

Across the board, businesses highlighted a heightened sense of caution. Many firms expressed concerns over the sustainability of current market conditions. Although inflation has significantly eased in recent months, companies continue to cite inflationary pressures along with regulatory challenges and geopolitical uncertainties as key factors that are affecting their operations negatively. Despite these challenges, there remains a sense of resilience, with firms adapting their strategies to maintain competitiveness.

Looking ahead, companies in Malta were more optimistic about future business activity than they were about recent performance, although their expectations have also been marked down compared with the third quarter. The net share of businesses anticipating improvements in business conditions over the next few months fell to 20% during the fourth quarter, from 37% in the previous round (see Chart 1). This deterioration was mostly driven by firms in the construction and services sectors.

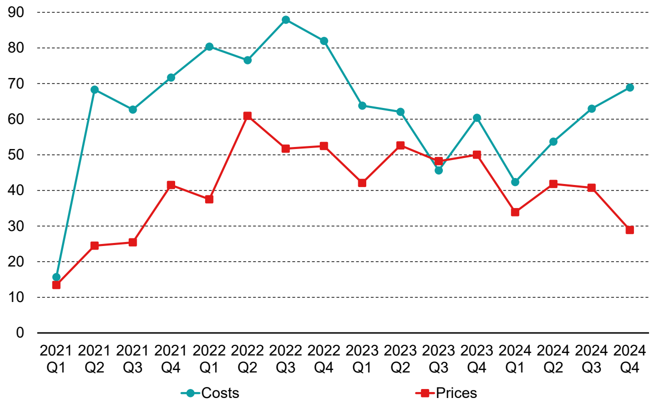
Retailers anticipate a seasonal uptick in sales following the holiday season, partly aided by January sales. Service providers, particularly in consultancy and professional services, foresee incremental growth, while accommodation providers anticipate a slow start to 2025 due to seasonal fluctuations, before a gradual pick expected from February onwards. Meanwhile, manufacturing firms largely expect stability, with a focus on operational efficiency and cost management. Construction and real estate firms expected stable economic conditions over the next three months despite challenges related to costs, labour availability, bureaucracy and increased scrutiny by regulators.

In several cases, optimism is tempered by external risks. The ongoing regulatory evolution within the European Union, trade policy uncertainty and fluctuating global economic conditions, continue to weigh on business sentiment. Nevertheless, many firms remain committed to pursuing growth opportunities, leveraging their adaptability and sector-specific strengths.

Costs and prices

Rising input costs remain a concern for Maltese businesses, although the reported increases are lower than in previous years. Indeed, the net share of companies reporting higher input costs increased by six percentage points to reach 69% in the last quarter of 2024 but remained below peaks observed in 2022 (see Chart 2). Firms cited regulatory compliance costs, mostly in the form of higher transport costs particularly in sectors heavily affected by the European Union's environmental policies.

Chart 2
COSTS AND PRICES
(net balance)



Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "Did you experience any recent changes in input prices and did you change your selling prices?"

According to contacts, the cost of some food and beverage items, and raw materials such as reinforcement materials used in construction, and plastic continued to increase. This was also the case for parts for equipment and certain services such as maintenance and engineering. However, the distribution of replies was centred around moderate increases, in contrast to the significant price increases that had been reported in 2021 and 2022. Labour costs, driven by a tight labour market and increasing wage demands, are the most significant pressure point.

Selling price dynamics varied across sectors. Construction firms, and just over half of manufacturing ones, reported stable prices, with the aim of maintaining market share amidst intense competition. Conversely, almost two-thirds of service providers raised prices, driven by the need to pass on rising labour costs to consumers. Retailers faced a challenging pricing situation. Some adopted promotional strategies to boost sales while others had to push down prices to remain competitive. Only a few adjusted prices upward to offset cost increases. As such, the net share of businesses claiming to have increased selling prices in recent months dropped from 41% to 29% during the fourth quarter of 2024 (see Chart 2). This share ranged from 58% in services to -29% in the wholesale and retail sector (where prices were reduced).

Businesses reported that they are continuously grappling with balancing cost recovery and maintaining affordability for consumers. The ability to manage this trade-off effectively will be crucial for sustaining profitability in the coming quarters.

BOX 1: ANALYSIS OF PROFIT TRENDS IN MALTESE COMPANIES (2023-2024)[1]

The interaction between input costs and profitability is challenging for businesses across various sectors in Malta. As firms continue to deal with the aftereffects of a high inflationary period, managing costs while maintaining profits has become crucial.

This box explores the impact of cost fluctuations on profitability over the past two years from the perspective of firms. To limit double counting only insights from the most recent interview with each company in both 2023 and 2024 were considered. As such, this analysis is based on responses provided by 148 companies in 2023 and 164 companies in 2024.

Data collected from Maltese companies shows distinct patterns between changes in input costs, prices and total company profits over 2023 and 2024. Firstly, the share of companies reporting higher profits in 2024 is more than double that in 2023. In fact, 29% of companies interviewed in 2024 reported higher profits compared to 14% in 2023. Moreover, 37% of companies interviewed in 2024 reported lower profits, which is less than the 43% share in 2023.

Table 1 shows the replies regarding changes in profits conditional on responses about the evolution of costs. It shows that 30% of firms that experienced higher costs in 2024 were able to also raise their profits. Conversely, only 12% of firms that experienced higher costs in 2023 were able to increase their profits that year. This suggests that companies interviewed in 2024 were better able to absorb rising input costs by implementing mitigating strategies or increasing their margin than those who provided information for 2023. It also reflects that increases in costs in 2023 were of higher magnitude than those in 2024. Furthermore, the share of firms reporting lower profits and rising costs was smaller in the 2024 sample than in the 2023 one, though still significant at 40%.

Looking at specific sectors, the services sector, including catering and entertainment, accommodation and hospitality, audit and consultancy, and maritime and freight showed

Table 1
COSTS AND PROFITS
(percentage of companies contacted during the year)

	Costs increased		Unchanged costs		Costs decreased	
	2023	2024	2023	2024	2023	2024
Profit increased	12	30	21	21	0	54
Profit unchanged	40	31	52	44	40	31
Profit decreased	48	40	26	35	60	15
Total	100	100	100	100	100	100

Source: Central Bank of Malta Business Dialogue.

Note: Figures may not add up due to rounding.

[1] Prepared by Warren Deguara, Martina Cassar, Eliza Farrugia and Christine Borg. Principal Economist and Economists, respectively, within the Economic Analysis Department.

different trends in the two years. In 2023, rising costs in the services sector often caused profits to decline, as many companies were unable to adjust their pricing quickly. In 2024, however, some firms managed to stabilise profits despite higher costs, possibly through improved operational efficiencies or selective price adjustments.

In manufacturing, the difference between the two years was notable. In 2023, many companies faced falling profits as costs rose, but in 2024, there was better use of cost-management strategies, such as automation, bulk buying, sourcing alternatives, and other operational efficiencies which helped maintain profitability. These strategies were especially effective in sub-sectors like consumer durables, food and beverage and electronics manufacturing.

Wholesale and retail businesses, particularly in food and beverage, struggled with rising costs in both years. However, the impact was more severe in 2024, when fewer companies were able to adjust their prices to offset increased costs due to competitive pressures and consumer price sensitivity.

In construction and real estate, the effects also differed between the two sectors. Real estate firms broadly reported stable profits in both years as costs did not change significantly. Construction firms were more likely to report profit declines in both years due to rising material and compliance costs causing lower margins.

Another trend of interest is the performance of companies that reported unchanged or reduced costs. Such were more likely to report stable or improved profits in 2024 compared to 2023, which also reflects better cost-management strategies. In 2024, 54% of companies experiencing cost reductions reported profit increases, compared to none in 2023, and only 15% of such firms, compared to 60% of firms in 2023 reported lower profits.

When looking at price changes and profit outcomes, there were also noticeable patterns. Among companies that reported profit increases, around 60% also reported selling price increases. This share increased slightly in 2024 (see Table 2). This indicates a strong willingness or ability among businesses to pass on higher costs to consumers without losing competitiveness. Nonetheless, not all firms that saw an increase in profit raised prices. It

Table 2
PRICES AND PROFITS
(percentage of companies contacted during the year)

	Profit increased		Profit unchanged		Profit decreased	
	2023	2024	2023	2024	2023	2024
Increased prices	60	63	50	48	53	33
Unchanged prices	30	29	47	43	36	53
Decreased prices	10	8	3	9	11	13
Total	100	100	100	100	100	100

Source: Central Bank of Malta Business Dialogue.
Note: Figures may not add up due to rounding.

is notable that in both years, almost a third of firms reported higher profits with unchanged prices, while around a tenth even reduced them.

Meanwhile, around half of firms that reported unchanged profits reported an increase in selling prices. In such cases, price increases were likely just sufficient to counteract cost increases. Most of the remaining firms that reported unchanged profits also reported unchanged prices. This broadly applies to both 2023 and 2024.

In turn, while in 2023 just over a half of firms with decreasing profits also reported higher prices, by 2024 this share fell to one-third. This indicates that selling price increases may have been more effective in countering cost increases in 2024 compared to 2023 or that some of the price hike was a lagged response to earlier cost increases. It is also notable that in 2024, the share of firms with falling profits and unchanged prices increased.

Firms' responses indicated that the manufacturing sector was better able to pass on increases in costs to selling prices in 2024 when compared to 2023. In 2023, many firms hesitated to raise prices, leading to lower margins. By 2024, more manufacturing companies used moderate price adjustments to cover costs while maintaining competitiveness, especially in sub-sectors like food production, electronics and consumer durables.

In wholesale and retail, especially in food and beverages, the two years displayed contrasting trends. In 2023, while many firms faced cost challenges, many adopted selective price increases (especially clothing and footwear, and food and beverage sellers), which helped in maintaining profit outcomes. However, in 2024, most companies avoided price increases due to consumer price sensitivity and increased competition, which often led to declining profits.

The services sector showed little differences across the two years. Since demand remained relatively strong, businesses were more inclined to raise prices to offset rising costs, which helped maintain or improve their profitability.

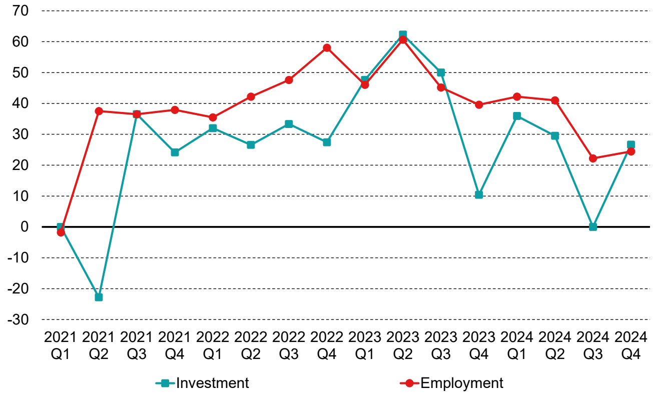
In construction and real estate, real estate firms in both years did not raise prices as costs remained stable. On the other hand, costs in the construction sector increased considerably and hence firms that were unable to raise prices for their services experienced lower profits.

Overall, the replies show that for several firms selling price increases were effective in achieving higher profits or at least maintain stable profit levels. However, more than a third of firms were also able to increase their profits without changing prices, likely by reaping efficiency gains or sourcing cheaper products.

Investment and employment outlook

Investment activities during the fourth quarter of 2024 reflected a focus on resilience and innovation. The net share of businesses planning to increase investments next year increased from 0% in the third quarter, to 27% in the quarter under review (see Chart 3). Firms across sectors prioritised initiatives that enhance operational efficiency and sustainability. Notably, manufacturing companies are planning to invest in automation and energy efficiency, to be able to benefit from the digital and green transition. Some companies are also planning further expansions of their premises. Similarly, service providers emphasized digitalisation and IT upgrades as well as facility refurbishments to improve service delivery and customer experiences. Retail companies are mostly planning additional outlets and some refurbishment of their retail establishments. In contrast, construction firms are planning investments to diversify their revenue streams. Nevertheless, the share of firms expecting to invest more remained highest in services and manufacturing.

Chart 3
INVESTMENT AND EMPLOYMENT OUTLOOK
(net balance)



Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "What are your investment plans for this/next year (in comparison to last year) and what are your employment plans going forward?"

Investment enthusiasm was tempered by regulatory and market uncertainties. Some firms deferred capital expenditures, opting instead for incremental improvements. Financing conditions, though generally favourable due to lower costs of borrowing, were not without challenges, particularly for smaller enterprises with limited access to diversified funding sources. As such, heavy reliance on internal funding persists.

A significant 43% of all firms interviewed prefer to self-finance their investments while only 14% of companies interviewed in the fourth quarter sought only bank loans. Companies that use a mixture of financing sources (32%) aim to diversify risk and avoid over-dependence on one method. Almost a tenth of those interviewed claimed to have made use of other sources of finances, though corporate bonds are notably absent as a financing option.

Employment in the quarter under review continued to grow on balance as companies sought to fill remaining vacancies amid persistent labour shortages. The net share of businesses planning to increase employment levels rose marginally from 22% to 24% in the fourth quarter of 2024 (see Chart 3).

While many firms reported modest expected increases in headcount, challenges in attracting and retaining skilled labour persisted. The services sector, including tourism, audit and consultancy, are expected to continue being a significant driver of employment growth. In contrast, some manufacturing subsectors will adopt a more cautious approach, focusing on optimising existing workforce productivity despite still expressing the need for further recruitment. Responses indicate that employment in the wholesale and retail and construction sectors is expected to stabilise further in the coming months.

Labour market tightness, a common theme across Europe, has intensified competition for talent. As a result, businesses continuously lament of labour shortages despite better wage offers. Some companies, particularly services providers, are adopting innovative recruitment and retention strategies, including offering flexible work arrangements and enhanced benefit packages. These measures aim to address immediate workforce needs while positioning firms as attractive employers in a very competitive market.

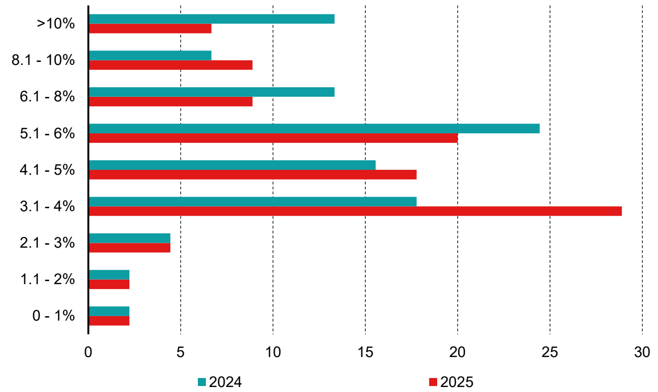
Wage growth expectations

In 2024, the majority of firms implemented higher wages, with the most common increases reported in the 5-6% range (see Chart 4). Over 90% of companies indicated moderate to high wage increases, reflecting significant wage pressures as a key challenge. Many firms acknowledged that these adjustments were necessary to retain and attract workers in a competitive labour market. Notably, 20% of firms reported wage increases exceeding 8%, highlighting a willingness to take bold measures to maintain workforce stability despite cost pressures. The services sector reported the highest wage increases, as it faced the strongest wage pressures.

Looking ahead to 2025, wage expectations have shifted toward more moderate increases, with nearly 70% of respondents projecting wage growth between 3-6%, and the most common expected increases falling within the 3-4% range. This indicates a general expectation of easing wage pressures compared to 2024. The moderation in expectations was reported across all sectors; however, the services sector and the wholesale and retail sector continue to anticipate the highest wage increases. This suggests that labour-intensive industries are likely to face ongoing challenges due to persistent labour shortages and heightened competition for talent well into 2025.

Overall, while 2024 reflects a balanced distribution of wage increases across moderate to high levels, the outlook for 2025 suggests a softening of wage pressures, confirming signals from the previous round. Most firms appear confident that current wage increases will be sufficient to meet employee expectations. However, this optimism is not shared by all, as some firms continue to anticipate workforce challenges in the year ahead.

Chart 4
CURRENT AND EXPECTED WAGE INCREASES
(percentage of firms)



Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "By how much have/do you expect your company's wages increased/to increase on average in 2024/2025?"

Main challenges

The exercise reveals significant challenges faced by companies across various sectors. At an aggregate level, the availability of skilled staff emerges as the primary concern, with 36% of businesses identifying it as the main issue hindering their success. Additionally, 24% of respondents cited 'Other' challenges, reflecting a range of issues not covered by predefined categories. Common among all sectors, these 'Other' challenges include bureaucratic inefficiencies and increased competition. Finding customers is regarded as a moderate concern, while access to finance, production costs, labour costs, and regulation were mentioned less often.

In the manufacturing sector, almost half of businesses identify skilled labour shortages as a key issue, with another 27% citing increased regulations as a major challenge. For the services sector, more than a third of services firms pointed to "Other" difficulties. For example, some tourism operators pointed to the need to improve Malta's direct air connectivity with countries outside Europe. Moreover, others pointed to the small size of the local market. The availability of skilled staff was reported as a challenge by 30% of such companies. Some expressed concerns about bureaucratic inefficiencies which hinder business success. In the wholesale and retail sector, most firms cited market saturation leading to low margins, and the availability of skilled labour. In the construction and real estate sector, 43% of respondents highlighted the availability of skilled labour as a significant challenge, while another 43% pointed to finding customers as a major difficulty.

Annex 1

Table A1
SECTORAL REPLIES
(percentage of companies contacted)

	Construction and Real Estate		Wholesale and Retail		Services		Manufacturing		Total	
	2024 Q3	2024 Q4	2024 Q3	2024 Q4	2024 Q3	2024 Q4	2024 Q3	2024 Q4	2024 Q3	2024 Q4
How have business conditions developed over the past three months?										
Improved	60	0	0	29	55	45	33	36	39	33
Worsened	0	43	89	29	5	15	22	27	24	24
Remained the same	40	57	11	43	41	40	44	36	37	42
Net balance	*60*	*-43*	*-89*	*0*	*50*	*30*	*11*	*9*	*15*	*9*
How do you expect business activity to develop in the next few months?										
Improve	80	14	22	43	59	40	39	27	48	33
Worsen	0	14	22	14	9	20	11	0	11	13
Remain the same	20	71	56	29	32	35	50	64	41	47
Uncertain	0	0	0	14	0	5	0	9	0	7
Net balance	*80*	*0*	*0*	*29*	*50*	*20*	*28*	*27*	*37*	*20*
What are your investment plans for the rest of this / next year?										
Invest more	20	29	22	29	32	55	39	55	31	47
Invest less	60	14	44	29	23	20	28	18	31	20
Invest the same	20	57	33	43	45	25	33	27	37	33
Net balance	*-40*	*14*	*-22*	*0*	*9*	*35*	*11*	*36*	*0*	*27*
How have you changed your employment plans?										
Increased	40	29	11	29	45	55	28	45	33	44
Decreased	0	29	11	14	14	10	11	36	11	20
Unchanged	60	43	78	57	41	35	61	18	56	36
Net balance	*40*	*0*	*0*	*14*	*32*	*45*	*17*	*9*	*22*	*24*
Did you experience any changes in input prices?										
Increased	40	43	100	71	73	80	67	91	72	76
Decreased	40	14	0	0	0	5	17	9	9	7
Unchanged	20	43	0	29	27	15	17	0	19	18
Net balance	*0*	*29*	*100*	*71*	*73*	*75*	*50*	*82*	*63*	*69*
Did you change your selling prices?										
Increased	100	0	56	14	50	63	50	36	56	40
Decreased	0	0	11	43	23	5	11	9	15	11
Unchanged	0	100	33	43	27	32	39	55	30	49
Net balance	*100*	*0*	*45*	*-29*	*27*	*58*	*39*	*27*	*41*	*29*

Source: Central Bank of Malta Business Dialogue.
Note: Figures may not add up due to rounding.