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Address
Pjazza Kastilja
Valletta VLT 1060
Malta

Telephone
(+356) 2550 0000

Fax
(+356) 2550 2500

Website
www.centralbankmalta.org

Contact
https://www.centralbankmalta.org/contact-us

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MAIN FINDINGS FROM THE 2024Q3 ROUND OF CONTACTS WITH NON-FINANCIAL CORPORATIONS[1]

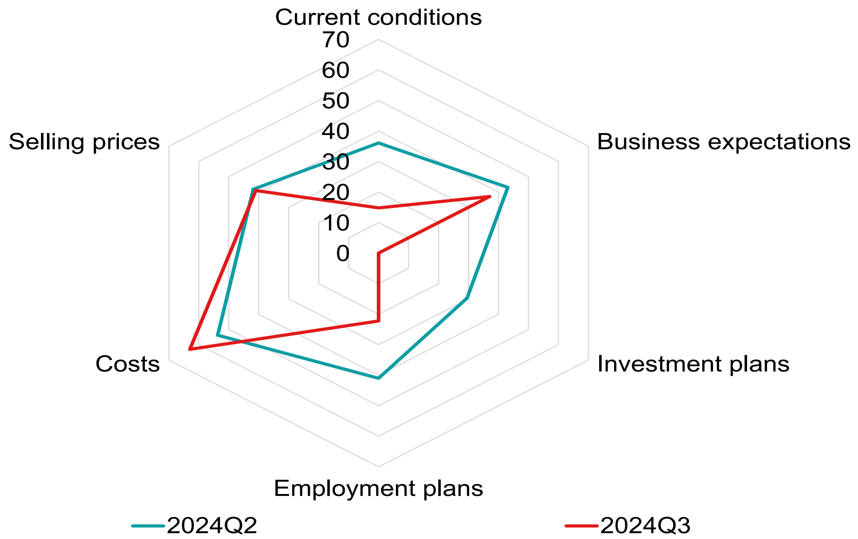
Summary

Information gathered by the Central Bank of Malta during contacts with non-financial corporations (NFCs) and other institutions between July and September 2024 shows that while the overall net balance of recent activity remained positive at 15%, it weakened compared to previous quarters. Furthermore, the assessment differed across sectors. Construction, real estate, and services firms mostly reported an expansion in activity. On balance, activity was also assessed to have continued to expand in the manufacturing sector, though the prevalence of positive replies has decreased. Meanwhile those in retail and wholesale, faced pressure due to rising costs and subdued consumer demand. Looking ahead, companies in Malta expressed cautious optimism regarding future business activity as the net share of businesses anticipating improvements in conditions over the next few months declined to 37%.

Rising input and operating costs were reported as a primary concern across many sectors, particularly for firms dealing with imported goods. The net balance of firms reporting cost increases remained high at 63%. Approximately 41% of firms reported negative impacts on their mark-ups due to elevated costs, with consumer durables, food, and clothing sectors being hit hardest. In response to these cost pressures, firms adopted varied pricing strategies. A net 41% of firms increased prices and while 35% of companies maintained stable mark-ups, around 24% of firms succeeded in increasing their mark-ups. The largest share of these was found in sectors like construction, real estate, and certain services, including catering and maritime freight.

On the investment front, the net balance dropped to 0% from 30% previously. Expectations turned negative in the construction, real estate and wholesale and retail sectors, and were less positive

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



Source: Central Bank of Malta Business Dialogue.

[1] This publication reports a summary of insights gathered during interviews 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.

than before in the services and manufacturing sectors. Firms planning to increase investment generally cited investment in energy efficiency, automation and digitalisation as supporting factors. A non-negligible portion of firms indicated that they have recently finalised major projects and thus do not require further investments.

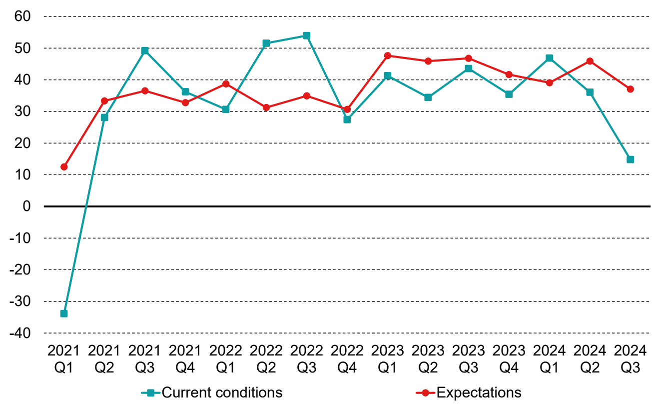
Financing strategies varied widely among firms, with 43% of companies relying on self-financing to fund their investments, while only 9% turned to banks for financial support. This reflects an overall restrained investment climate, although some firms did engage in capital expenditure to maintain competitiveness. The employment outlook remains positive but continues to show signs of easing hiring intentions, with the net balance of firms expecting to recruit broadly halving to 22%. Certain sectors continued to experience tight labour markets, leading to strong upward wage pressures in 2024. However, responses collected this round indicate that wage growth should moderate in 2025.

This report summarizes the key insights gathered from Maltese companies through 54 interviews conducted between July and September 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 recent developments within the tourism industry in Malta.

Activity

While general sentiment remained positive, businesses' replies on recent activity indicate a slowdown during the third quarter of 2024, with a mixed performance across sectors. The net share of businesses reporting improvements in conditions dropped from 36% in the previous quarter to 15% during the third quarter (see Chart 1). While firms in construction and real estate and those in services maintained a relatively strong positive assessment, this was significantly less prevalent among manufacturing firms. Meanwhile retail businesses struggled with weakened consumer demand and lower sales volumes. This possibly reflects a need for households to rebuild the purchasing power of their savings after the impact of high inflation experienced in the past two years.

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?"

On balance, construction and real estate companies contacted in this round noted an improvement in business conditions, partly driven by high demand and project continuity, despite labour shortages. On the other hand, manufacturing sub-sectors showed divergent trends. For example, while the pharmaceuticals sector saw improvements due to seasonality, electronics manufacturers experienced declining sales mainly due to significant inventory correction by automotive companies along with lower-than-expected electric vehicle sales globally. Manufacturers of food and beverage items and consumer durables reported stable activity.

Meanwhile, the services sectors, particularly maritime and freight, reported higher activity. This mainly reflected increased activity during the summer months, the benefits of previous years' investments and population growth.

This varied performance is consistent with global economic trends observed in 2024. In the euro area, the services sector has remained resilient, though slowing, while manufacturing activity appears to have entered contractionary territory according to business surveys. As such, manufacturers based in Malta are facing uneven performance due to a less favourable and more uncertain external environment.

Looking ahead, companies in Malta expressed cautious optimism regarding future business activity. The net share of businesses anticipating improvements in conditions over the next few months amounted to 37% during the third quarter, down from 46% in the previous round (see Chart 1).

A significant majority of construction and Real Estate firms expected a further improvement in activity over the next three months, bolstered by sustained demand. This despite challenges related to costs, labour availability, bureaucracy and increased scrutiny by regulators. The services sector anticipated steady growth, particularly in maritime, freight, and logistics, which benefited from stable demand both domestically and internationally. Overall, manufacturing companies also showed some optimism going forward, with around half of firms in this sector anticipating an expansion in near term activity. Nevertheless, electronics manufacturers do not expect any pick-up in the short term. However, the sentiment expressed by retail companies is that of stable activity, as many contacts in this sector anticipate that demand would remain subdued due to inflationary pressures.

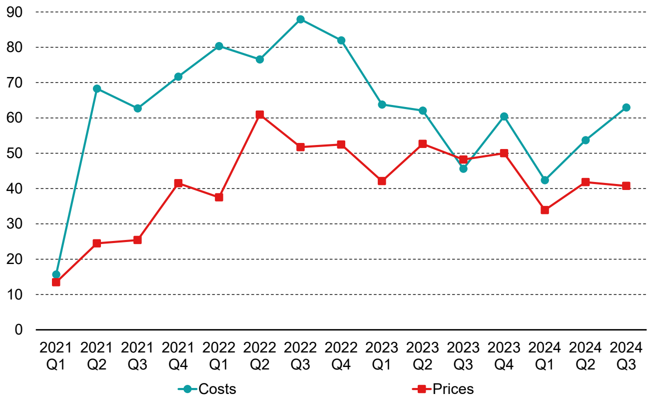
In the broader European context, companies also displayed cautious optimism about future activity. There is a shared sentiment that services are still supporting economic growth, though slowing, while manufacturing remains fragile, echoing the concerns in Malta regarding rising costs, and market volatility. This reflects broader global patterns, where economic recovery is uneven across sectors, reflecting political uncertainty in some key advanced economies, escalating geopolitical tensions as well as lingering effects from the past monetary tightening cycle.

Costs and prices

Cost pressures were a dominant theme across all sectors, although the share of firms reporting price increases remained below recent peaks. Rising input costs, particularly in raw materials, fuel and transport, affected companies' ability to maintain profitability. The rerouting of ships away from the Red Sea area was fuelling an increase in freight rates as companies brought forward their orders to compensate for longer delivery times (which also increased inventory costs). The net share of businesses reporting increasing input costs rose from 54% in the second quarter to 63% during the third quarter (see Chart 2).

Construction firms reported higher material costs including those of cement, apertures, tiles and bitumen. Similarly, manufacturers and retailers contacted this round reported rising material, transport and energy costs, which directly impacted their production expenses. Increasing costs of food, spare parts and maintenance were the main factors cited by services firms. 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.

Chart 2
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?"

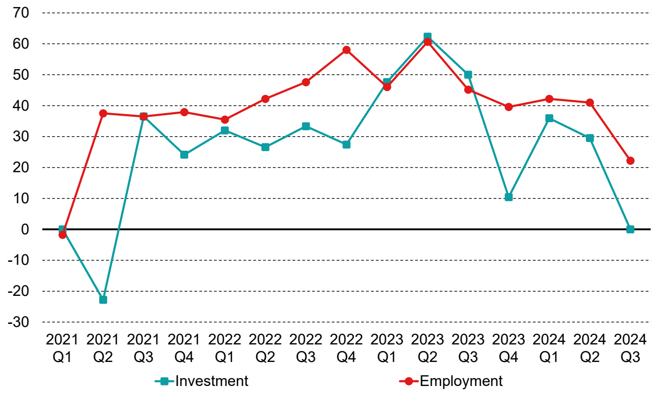
In terms of pricing, while some were able to pass on part of the higher costs to consumers, others faced limitations due to increased price sensitivity, particularly in consumer-facing industries. This pressure limited their ability to raise prices, squeezing profit margins. Several companies also cited fierce domestic competition as a barrier to raise prices. This sentiment was most prominent within retail and service sectors. As such, the net share of businesses claiming to have increased selling prices remained broadly stable, only dropping by one percentage point to 41% during the third quarter (see Chart 2).

In terms of profitability, 41% of the companies interviewed indicated that their mark-ups have recently been negatively impacted due to elevated input and operational costs. This trend was particularly pronounced among businesses in the consumer durables, food, and clothing wholesale and retail sectors. Conversely, approximately 35% of companies were able to maintain their mark-ups by implementing higher selling prices, which enabled them to sustain healthy profit margins. Despite the ongoing reports of rising costs, the proportion of firms that have successfully increased their mark-ups has grown in recent quarters. In this latest round, 24% of the interviewed companies reported an increase in their mark-ups. The highest concentrations of firms experiencing higher mark-ups were observed in the construction and real estate sectors (40%) and the services sector (32%), particularly among catering businesses and maritime and freight service providers. The companies that succeeded in retaining or increasing their mark-ups did so through various strategies, including achieving higher sales volumes, adopting efficiency-enhancing measures, or securing more favourable pricing by placing larger orders.

Investment and employment outlook

The net share of businesses planning to increase investments next year dropped significantly to 0% in the third quarter, from 30% in the previous quarter (see Chart 3). **Although the deterioration in expectations relative to the previous round was broad-based, investment intentions varied significantly across sectors.**

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?"

Expectations among manufacturing companies were mildly positive on balance, as selected firms plan major expansions or investments in energy efficiency and automation to enhance productivity. Most companies in construction have recently completed significant investments and thus anticipated a decrease in investment. In contrast, some service firms, especially in the maritime and logistics sectors, were more confident, planning to maintain or increase their investment. Such investments include expansionary measures and digitalisation. Retail companies, facing a difficult consumer environment, mostly indicated that at best they would keep their investments at the same level, with many hesitant to commit to new projects. Nonetheless, a few claimed that significant investments were recently finalised.

A significant 43% of the firms interviewed prefer to self-finance their investments. These companies seem to have sufficient internal funds, enabling them to maintain control over their financial decisions and avoid the risks associated with external debt. Only 9% of companies interviewed in the third quarter sought bank loans, suggesting limited reliance on traditional lending. A small percentage (7%) rely on their parent companies for capital, showing the role of corporate backing in investment decisions. Companies that use a mixture of financing sources (15%) likely do so to diversify risk and avoid over-dependence on one method. Bonds are notably absent as a financing option.

Investment trends in Malta are somewhat similar to those seen in the euro area, where businesses remain cautious. In the euro area, capital goods sectors have seen restrained investment, particularly in light of uncertainty surrounding the green transition and rising input costs.

Employment plans across sectors remained stable, with some variations although a continued easing of hiring intentions was noted. In fact, the net share of businesses planning to increase employment levels dropped from 41% to 22% in the quarter under review (see Chart 3).

Responses indicate that while employment in the wholesale and retail sector is expected to stabilise in the coming months, by contrast hiring is set to continue in the construction and services sector and to a lesser extent in manufacturing. A few firms intend to increase hiring in specific new areas as part of the firms' diversification processes. Service sectors, particularly tourism related sectors, reported steady or increasing demand for labour, while retail firms noted no significant changes, as hiring remained dependent on consumer demand. Companies in general are also investing in automation and digitalization where possible to enhance productivity.

Wage growth expectations

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?"

Most businesses reported higher wages in 2024. The extent of these increases is quite diverse, but with a noticeable concentration of firms claiming either moderate or high wage growth. Of the firms interviewed, 40%, are evenly split between the 4-5% increase and the 8-10% increase (see Chart 4). Around 80% of the firms plan to raise wages by more than 4%. This shows that while firms are mindful of cost pressures, many are willing to raise wages substantially to either attract new employees or cope with retention challenges. Meanwhile, there is only a small group of firms that have opted for minimal wage rises, with very few reporting increases of less than 1%. Significant pay increases – above 10% – were reported by selected firms. Thus, while aggressive wage growth is not the norm, some companies are taking bold steps in compensation. Companies in construction and services sectors anticipated the highest wage increases due to labour shortages. Retail and manufacturing sectors also expect moderate wage growth, with firms increasingly focusing on retaining talent amid the rising costs of living over the past few years.

Wage increases are expected to moderate in 2025 but still remain significant. Firms' expectations are more concentrated around providing moderate raises when compared to the previous year. The most expected raise is the 5% to 6% range, where a larger share of companies anticipates giving such raises compared to the current year. Interestingly, the share of firms expecting to offer raises exceeding 8% was low, with a significant decline from the corresponding share in 2024. On the other end, the proportion of firms expecting to give minimal raises – between 0% and 2% – increased somewhat, indicating that more companies expect to limit wage growth in 2025.

Overall, while 2024 shows a balanced distribution of wage increases across moderate to high ranges, expectations for 2025 point towards a moderation in wage pressures. Firms appear to be counting on the current increases to be sufficient in meeting employee expectations as inflation has declined significantly.

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 43% of businesses identifying it as the main issue hindering their success. Additionally, 28% 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 are viewed as minor issues.

In the manufacturing sector, half of businesses identify skilled labour shortages as a key issue, with another 28% citing finding customers as a major challenge. For the services sector, the availability of skilled staff is the most pressing issue, reported by half of such companies. Additionally, almost a third of services firms pointed to “Other” difficulties, such as location-related challenges and an emphasis on quantity over quality in tourism. Many expressed concerns about bureaucratic inefficiencies which hinder business success. Similarly, in the wholesale and retail sector, most firms cited “Other” factors, including market saturation and bureaucratic inefficiencies in government departments. In the construction and real estate sector, 40% of respondents highlighted the availability of skilled labour as a significant challenge, while another 40% pointed to finding customer as a major difficulty.

BOX 1: DEVELOPMENTS IN MALTA'S TOURISM INDUSTRY AND HOTEL SECTOR[1]

The tourism industry in Malta has witnessed strong growth over recent years, with 2024 shaping up as a record-breaking year. NSO data indicate inbound tourists increased by 8.1% between 2019 and 2023 to stand at around 3 million (see Table 1). Furthermore, inbound tourists between January and August of 2024 amounted to 2.4 million, 21.1% more than the corresponding period of last year. Tourist expenditure also continues to rise, driven by both the increased volume of visitors and higher spending patterns, particularly among certain tourist demographics. NSO data shows that total expenditure by tourists in Malta increased by 20.3% between 2019 and 2023. In the first eights months of this year, this figure increased by 23.3% over the same period a year earlier, to stand at €2,176 million. The increase was broad-based across all expenditure categories. Over the same period, expenditure per capita increased to €904, from €888 a year earlier while expenditure per night increased to €141 from €130. These figures had also exhibited steady growth in the period 2019-2023. Despite these positive trends, challenges persist, especially in managing seasonal fluctuations, rising operational costs, and shifts in tourist preferences.

Tourism in Malta has evolved, with noticeable shifts in the tourist age profile and spending habits. The youth segment, drawn by Malta's growing reputation as an entertainment destination, has grown significantly. This group tends to have lower expenditure levels compared to more affluent tourists, affecting the profitability of the hospitality sector, especially luxury hotels.

According to contacts in the five-star hotels segment, despite the rise in tourist numbers, there has been a decline in the average spending power of tourists. Contacts in the five-star segment argued that this trend has prompted many tourists to opt for more budget-friendly accommodation, resulting in a shift in occupancy patterns across different hotel classes. For instance, tourists who would traditionally choose five-star hotels are now opting for four-star accommodations. This competitive pressure is also spilling on three-star establishments.

Table 1
TOURISM DEVELOPMENTS

	2019	2023	% change	2023 (Jan.-Aug.)	2024 (Jan.-Aug.)	% change
Inbound tourists	2,753,239	2,975,670	8.1	1,986,260	2,405,568	21.1
Nights	19,338,860	20,241,803	4.7	13,579,112	15,393,206	13.4
Average length of stay (nights)	7.0	6.8	-3.2	6.8	6.4	-5.9
Total expenditure *(€ 000)*	2,220,627	2,671,431	20.3	1,764,704	2,175,592	23.3
Expenditure per capita *(€)*	807	898	11.3	888	904	1.8
Expenditure per night *(€)*	115	132	14.9	130	141	8.8

Source: NSO.

[1] Prepared by Warren Deguara, Martina Cassar and Demi Mock – Principal Economist and Economists, respectively within the Economic Projections and Conjunctural Analysis Office.

Performance of hotels in different classes

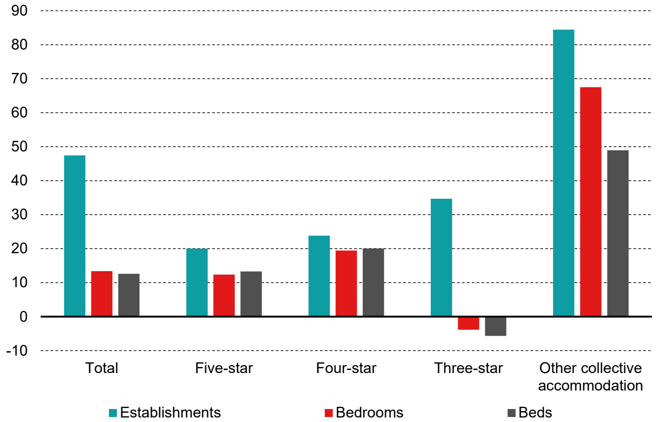
Contacts in the five-star hotel segment have outlined various challenges in the sector, most notably a decline in demand as tourists downgrade to lower-tier hotels. This is partly due to reduced disposable income among travellers because of the high inflation rates observed over the past couple of years, as well as increased competition from new hotels. Occupancy rates in this sector have been stable, increasing steadily throughout the summer, but profits are under pressure due downward pricing adjustments and rising operational costs, including labour and input costs such as food and maintenance. Moreover, five-star hoteliers lament that the winter months are even more challenging as occupancy rates drop significantly, and thus argue that efforts need to be made to promote Malta as a winter destination as well. Staff retention remains a challenge, with many hotels having to offer significant wage increases to attract and retain talent, despite stagnant productivity levels.

Additionally, contacts in five-star hotels have said that they are facing stiffer competition. Indeed, NSO statistics show that the number of total accommodation establishments increased from 215 in January of 2020, to 317 in June of this year, that is a 47.4% increase (see Chart 1). The strongest increase was observed in the 'Other Collective Accommodation' category (84.4%) followed by the three-star tier (34.7%). Moreover, bedrooms and bed capacity over the same period increased by 13.4% to 21,237 and 12.6% to 48,687, respectively. The strongest increase in these cases were again observed in the 'Other Collective Accommodation' followed by the four-star tier. The number of five-star establishments, bedrooms and beds increased more moderately over the same period.

Company contacts in the five-star hotel segment also highlighted that the overall ambiance and conditions in some tourist hotspots, such as St Julian's, have deteriorated, with sanitation and traffic issues negatively impacting the appeal of five-star accommodations in these areas.

The four-star hotel segment has seen relatively stable performance, with steady occupancy rates during the peak season. However, similar to the five-star category, these hotels face increasing pressure during the off-peak months. Contacts mention rising input costs and labour shortages that are also affecting profitability. In response to these challenges, many four-star hotels have increased room

Chart 1
GROWTH IN CAPACITY JANUARY 2020 – JUNE 2024
(percentage)



Source: NSO.

rates and focused on maintaining profitability through cost management. This is substantiated by accommodation HICP figures which show that accommodation prices increased substantially during peak months, when compared to a year earlier.

One of the key issues reported by contacts within the four-star hotel segment is that negative price pressures in five-star hotels is spilling over into the four-star segment. This has led to heightened competition, forcing many mid-tier hotels to reposition themselves in order to maintain their market share. Despite these challenges, the segment remains resilient, particularly during the summer months when tourist numbers peak. Investments in infrastructure, such as room refurbishments and new facilities, have helped maintain competitiveness, though concerns about over-supply in the market remain.

Three-star hotels have been one of the more resilient segments in the Maltese hotel industry. As more tourists prioritize budget accommodation, this segment has seen increased occupancy rates and stable revenue streams. The key drivers of success for three-star hotels have been competitive pricing and the ability to attract younger, more cost-conscious tourists. However, like other segments, three-star hotels face challenges related to rising operational costs, including wage increases which continue to add pressure on profit margins. Yet, three-star hotels have managed to maintain profitability by leveraging high occupancy rates during peak seasons.

Opportunities facing the hotel industry

Hoteliers argue that there is a significant opportunity to expand Malta's tourism appeal during the winter months by promoting the island as a destination for business conferences and large-scale events. This would help mitigate the seasonal fluctuations that currently affect hotel occupancy rates and profitability. Nevertheless, significant investments need to be carried out for Malta to be able to accommodate events that attract a large mass of visitors. Hoteliers argue that this needs to be a public-private initiative.

With increasing awareness of environmental issues, there is an opportunity for hotels to invest in sustainability initiatives, such as solar panels and energy-efficient infrastructure. This can not only reduce operational costs but also attract environmentally conscious tourists. Moreover, many hotels are planning significant investments in refurbishment and new facilities, which can enhance their appeal to tourists and improve profitability. Continued investment in high-quality infrastructure will be essential for maintaining competitiveness in a saturated market.

Challenges outlined by contacts within the hotel industry

Across all hotel segments, rising operational costs, including wages and input materials, have continued to create significant challenges. Many hotels have had to continuously adjust prices and strive to strike a sustainable balance between competitiveness and profit making. Higher room rates especially during peak months are vital to offset elevated costs, but competitive pressures and reduced tourist spending power make it difficult to maintain profitability.

Recruitment and retention of skilled workers also remain persistent challenges. Hotels are facing high employee turnover, particularly in specialized roles.

Annex 1

Table A1
SECTORAL REPLIES
(percentage of companies contacted)

	Construction and Real Estate		Wholesale and Retail		Services		Manufacturing		Total	
	2024 Q2	2024 Q3	2024 Q2	2024 Q3	2024 Q2	2024 Q3	2024 Q2	2024 Q3	2024 Q2	2024 Q3
How have business conditions developed over the past three months?										
Improved	50	60	10	0	68	55	69	33	56	39
Worsened	30	0	30	89	11	5	23	22	20	24
Remained the same	20	40	60	11	21	41	8	44	25	37
Net balance	*20*	*60*	*-20*	*-89*	*57*	*50*	*46*	*11*	*36*	*15*
How do you expect business activity to develop in the next few months?										
Improve	40	80	20	22	64	59	30	39	49	48
Worsen	0	0	0	22	4	9	10	11	3	11
Remain the same	50	20	70	56	25	32	50	50	39	41
Uncertain	10	0	10	0	7	0	10	0	8	0
Net balance	*40*	*80*	*20*	*0*	*61*	*50*	*20*	*28*	*46*	*37*
What are your investment plans for the rest of this / next year?										
Invest more	50	20	50	22	39	32	54	39	46	31
Invest less	20	60	20	44	18	23	8	28	16	31
Invest the same	30	20	30	33	43	45	38	33	38	37
Net balance	*30*	*-40*	*30*	*-22*	*21*	*9*	*46*	*11*	*30*	*0*
How have you changed your employment plans?										
Increased	60	40	50	11	54	45	46	28	52	33
Decreased	0	0	0	11	14	14	23	11	11	11
Unchanged	40	60	50	78	32	41	31	61	36	56
Net balance	*60*	*40*	*50*	*0*	*39*	*32*	*23*	*17*	*41*	*22*
Did you experience any changes in input prices?										
Increased	80	40	60	100	69	73	38	67	61	72
Decreased	0	40	0	0	8	0	15	17	7	9
Unchanged	20	20	40	0	23	27	46	17	31	19
Net balance	*80*	*0*	*60*	*100*	*62*	*73*	*23*	*50*	*54*	*63*
Did you change your selling prices?										
Increased	50	100	40	56	46	50	54	50	47	56
Decreased	0	0	20	11	4	23	0	11	5	15
Unchanged	50	0	40	33	50	27	46	39	47	30
Net balance	*50*	*100*	*20*	*45*	*42*	*27*	*54*	*39*	*42*	*41*

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