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MAIN FINDINGS FROM THE 2021 Q4 ROUND OF CONTACTS WITH NON-FINANCIAL CORPORATIONS

Summary

Information gathered during contacts with non-financial corporations that the Central Bank of Malta made between October and December 2021 indicates that overall positive business conditions have softened somewhat. Indeed, a net 36% of respondents reported an increase in activity over the three months preceding the interview, down from a net share of 49% in the third quarter. While 57% of firms contacted reported that activity has improved, 21% reported negative developments.

Short-term expectations about business activity also eased slightly. Almost half of the contacts reported that they expect business activity to expand over the next three months while 16% anticipated a decline. As a result, the net share of respondents expecting an amelioration in business activity decreased to 33% from 37% in the previous round. Moreover, the share of contacts reporting that the outlook was uncertain receded marginally reflecting contrasting developments across sectors.

Cost pressures have remained elevated in the quarter under review, and indeed, almost three quarters of contacts reported that input prices have increased, up from around two-thirds in the third quarter of 2021. In part due to elevated cost pressures, around 47% of firms interviewed reported an increase in their selling prices. However, 6% reported reductions in selling prices while almost a half of firms left selling prices unchanged. As a result, the net share of firms reporting price increases almost doubled to 42%. The share of firms reporting increases in selling prices rose in all sectors barring the wholesale and retail trade sector, although even in the latter, price increases were significantly more prevalent than price decreases.

In the fourth quarter, 78% of respondents reported that investment plans continued as scheduled, slightly up from 73% in the third quarter. A further 14% reported postponement. The share of respondents reporting cancellations fell marginally to 2% while that of firms reporting that they have no investment planned decreased to 7%.

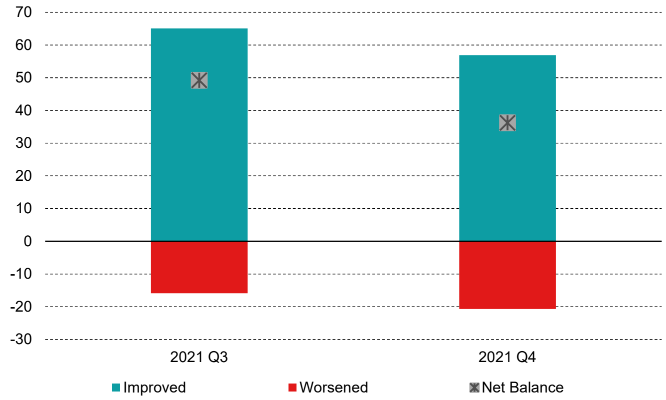
In view of positive activity, a net 38% of firms planned to hire staff, in line with the previous quarter. However, more firms during the quarter under review have expressed concerns about labour shortages.

In the fourth quarter of 2021, a total of 63 telephone/virtual meetings with leading non-financial corporations were conducted. These include 20 manufacturing companies, 17 services-oriented companies, nine wholesale and retail companies, 12 construction and real estate companies and five public/private institutions.[1]

[1] More information on the structure, methodology and evolution of the CBM Business Dialogue exercise can be found here.

Assessment of current business conditions softens but remains positive

Chart 1
CURRENT BUSINESS CONDITIONS
(contributions to 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?"

Information gathered between October and December 2021 indicates that – on balance – positive business conditions softened somewhat. Indeed, a net share of 36% reported an amelioration in business conditions, down from 49% in the previous quarter. During the quarter under review, 57% of firms stated that business conditions had improved over the past three months, down from 65% in the third quarter (see Chart 1). At the same time, the share of firms stating that business activity worsened increased to 21% in the fourth quarter from 16% in the previous quarter. The number of firms stating that business conditions remained unchanged increased to 22% in the quarter under review, from 19% previously.

Business conditions moderated in the services and wholesale and retail sectors, and to a lesser extent in manufacturing. By contrast the assessment of respondents in the construction and real estate sector improved considerably compared to the third quarter. Although a large majority (71%) of services-oriented firms contacted in the fourth quarter of 2021 stated that economic conditions had improved over the past three months, this was lower than the 77% figure reported in the previous quarter (see Table 1). Upbeat conditions were noticed across a broad range of services sub-sectors; in particular, the improvement in hospitality and accommodation services continued and those in the professional services were notable. At the same time, the percentage of firms in the services sector stating that business conditions had worsened increased to 18%. These firms provide services related to logistics, entertainment and hospitality. Reflecting these developments, the net balance of services firms reporting an improvement fell from 68% in the third quarter to 53% in the last three months of the year.

In the wholesale and retail sector, a net 33% of respondents assessed conditions to have improved in recent months, down from 44% in the third quarter. This was a result of a drop in the share of firms stating that business conditions improved, as the share of respondents reporting a deterioration in current business conditions remained the same as in the previous quarter (11%). Strong demand was mainly reported by firms selling food and beverage items, as well as clothing and footwear.

Overall business conditions also eased in the manufacturing sector. The number of firms reporting an improvement in activity fell, from 63% in the third quarter to 55% in the fourth. A quarter of firms continued to report a worsening in business conditions, similar to the previous quarter. Therefore, the net balance of manufacturing companies stood at 30%, down from 38% in the third quarter. Positive conditions were observed particularly among firms involved in the production of electronic components, food and beverages and pharmaceutical products.

Conditions within the construction and real estate sector improved significantly as a net 25% of respondents considered conditions to have improved over the past three months, up from nil in the third quarter. This reflects an increase in the share of firms reporting an improvement and a decrease in the share of negative responses.

Expectations for short term business conditions decline slightly

Looking ahead, almost half (48%) of the firms contacted during the fourth quarter of 2021 anticipated their business activity to improve further over the next three months, the same as in the previous quarter (see Chart 2). However, the number of firms which expected conditions to worsen over the next three months rose from 11% in the third quarter to 16% in the quarter under review. Consequently, the net share of firms reporting an improvement in the near-term outlook fell from 37% to 33%. The decrease in the net balance of firms reporting an expected amelioration in short-term business conditions was mostly driven by the construction and real estate and the services sectors. Meanwhile, the share of respondents reporting an uncertain outlook declined marginally from 11% to 10% in the fourth quarter, mainly reflecting a clearer outlook for short-term business conditions in the two sectors mentioned above.

Survey replies show that half of the manufacturing firms interviewed in this quarter expected an improvement in their business activity over the next three months, the same as in the previous quarter. Meanwhile, 10% of manufacturing firms expected conditions to worsen, down from 13% in the previous quarter. The net balance of firms reporting improved business expectations within this sector therefore stood at 40%, up from 38% in the third quarter. The share of firms reporting uncertain prospects in this sector rose from 6% in the third quarter to 10% in the quarter under review.

In the wholesale and retail sector, a net 33% of firms contacted between October and December 2021 expected sales activity over the next three months to improve, up from 22% in the third quarter. Although the share of firms expecting an improvement remained unchanged at 33%, the share of firms expecting a worsening in sales activity declined from 11% in the third quarter to zero in the fourth. Around a fifth of firms interviewed in this sector remained uncertain about future business conditions. This share is high relative to that in other sectors.

Chart 2
EXPECTATIONS FOR BUSINESS ACTIVITY
(contributions to net balance; percentage of companies contacted)

Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "How do you expect business activity to develop in the next three months?"

Firms expressing this view were mainly wholesalers of food and beverage items with links to the hospitality sector.

Within the construction and real estate sector, a small net share of respondents continues to expect an amelioration in business conditions with the net balance standing at 14%, down from 8% in the third quarter. A rise in the share of respondents expecting an improvement in activity over the next few months was outweighed by a larger increase in the share of respondents expecting a worsening.

Within the services sector, expectations for activity over the next three months also moderated. The number of firms expecting an improvement increased from 55% in the third quarter to 65% in the fourth. However, the share of services firms expecting conditions to worsen also increased significantly – from 10% to 24%. These companies operate in the hospitality and entertainment sectors. As a result, the net balance dropped by 4 percentage points to 41%. Compared to the third quarter, fewer firms in this sector said that they were uncertain about the immediate future.

Firms' investment and hiring plans remain encouraging

During 2020, most firms interviewed had halted their investment plans due to the elevated level of uncertainty. However, the survey shows that in 2021 the companies contacted continued or expected to continue with their investment plans. In fact, 78% of companies contacted during the last quarter of 2021 reported that their investment plans remain on track, compared to 73% in the previous quarter (see Chart 3). Local firms suggested that they continued with their investment plans partly because some projects had been committed far in advance or because work had already started.

The share of companies participating in the CBM Business Dialogue that postponed or paused their investment plans remained unchanged at 14%. Furthermore, only 2% of the firms contacted cancelled their capital expenditure plans. These companies operate in the real estate and construction sector. Finally, 7% of companies contacted in the last quarter of 2021 claimed that they did not have any investments planned, compared to 10% in the previous quarter. All such firms operate outside the manufacturing sector.

Looking at investment plans by sector, 85% of manufacturing companies contacted in the fourth quarter reported that they had continued with their plans while 15% postponed their investments. The share of firms reporting that investment plans have continued as scheduled was also high in the other sectors, with the lowest share, of

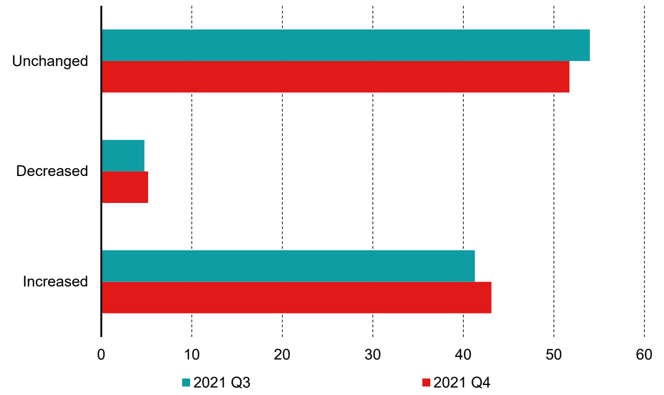
Chart 3
INVESTMENT PLANS
(percentage of companies contacted)

Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "How have you changed your investment plans for this year?"

71%, recorded in the services sector.

When asked about employment plans, the responses collected reveal a small increase in hiring expectations with 43% of all firms interviewed planning to increase staff. This was slightly higher than 41% in the third quarter, but significantly more than what was recorded in previous quarters. The share of firms expecting to shed labour remained unchanged at 5% (see Chart 4). These are mostly companies that are not replacing workers who voluntarily resigned. Accordingly, a net 38% of respondents anticipate higher employment, marginally above the net 37% recorded in the previous quarter. The share of respondents that did not alter their employment plans decreased slightly to 52%, from 54% in the third quarter of 2021. This mainly relates to companies that are only recruiting for replacement purposes.

Chart 4
EMPLOYMENT PLANS
(percentage of companies contacted)



Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "How have you changed your employment plans?"

This overall picture conceals mixed developments across sectors. A higher net share of firms planning to increase employment was recorded in the manufacturing and services sectors. Conversely, the net share of firms that plan to increase employment decreased in the real estate and construction and in the wholesale and retail sectors. In particular, a net share of 8% of real estate and construction firms interviewed plan to increase their staff complement, sharply down from 57% in the previous quarter. Similarly, the net share of firms within the wholesale and retail sector which replied that they plan to recruit stood at 8%, notably down from 33% in the previous quarter.

On the other hand, there was a notable increase in the share of services firms that plan to increase the staff complement. Indeed, a net 65% of services-oriented firms plan to recruit, sharply up from 35% in the previous quarter. This surge in recruitment requirements reflects the recovery and increased optimism in this sector. A higher net share was also recorded in the manufacturing sector.

Labour shortages remain a major concern

While the Wage Supplement Scheme continues to provide some support for businesses, it is no longer a major factor in sustaining employment. Indeed, firms are currently highly concerned about shortages of labour and skills. The majority of the companies contacted continued to claim that such shortages remain a major concern and that they are finding it increasingly difficult to recruit new employees and/or retain current workers. This sentiment was expressed by firms across all sectors but such response was more prevalent among firms operating in the services industry. Contacts in this sector said that the situation is similar and sometimes slightly more challenging than before the pandemic. This is partly because of more limited access to third-country nationals. Consequently, this labour shortage was resulting in upward wage pressures. Firms also reported increased instances of poaching, leading to higher staff turnover.

Remote working facilities are being provided by more than half of firms interviewed

The significant increase in the digitalisation of the workplace was one of the major changes brought about by the COVID-19 pandemic. Between October and December, the firms contacted were asked to comment on the availability of remote working facilities for staff. More than half of the Bank's contacts (59%) claimed that they offer some form of teleworking or remote working facilities to their employees. These firms usually adopt a hybrid system whereby workers can work remotely for some days per week or month. In general, the companies that do not offer remote working facilities are those whose operations are not amenable to teleworking. This is mostly the case for manufacturing companies and firms that offer services which require face-to-face contact with their clients. However, almost all companies that currently do not offer remote working facilities allowed some of their workers to work remotely during the initial phase of the pandemic.

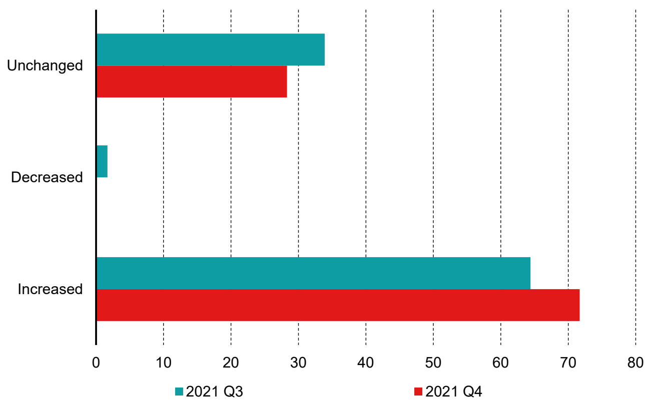
In general, the expectations related to the future availability of remote working facilities from local firms has been mixed, with some firms claiming that teleworking facilities are to become a permanent system whilst other halted these temporary facilities due to a perceived decline in productivity.

Supply chain disruptions and cost pressures remain elevated

A significant number of firms indicated that supply chain disruptions remained elevated during the fourth quarter, particularly firms operating in the manufacturing and trade sectors. These disruptions were reflected in significantly extended lead times for deliveries of raw materials, the unavailability of vital inputs, and increased transportation costs. Supply disruptions are being brought about by a combination of international factors, such as increased demand for shipping, backlogs in ports, a shortage of containers, pandemic-related mobility restrictions, and low competition in the global shipping industry. Some firms attempted to lessen the impact of these disruptions on production by holding onto more inventory, resulting in increased storage costs and reduced cashflow.

In part due to supply chain disruptions, firms are grappling with increases in input costs. A large majority of firms contacted (72%) reported an increase in input prices, higher than the 64% recorded in the previous quarter (see Chart 5). None of

Chart 5
CHANGES IN INPUT PRICES
(percentage of companies contacted)



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

the contacted firms reported a drop in input prices with the remaining 28% reporting unchanged prices.

At a sectoral level, 90% of manufacturing firms and 78% of wholesale and retail firms reported that input costs had risen. Almost 60% of services firms also reported an increase in operating costs. Compared with the previous quarter, the net balance of manufacturing firms reporting higher input costs rose by 15% with the net balance in both the services and trade sectors rising by 11%. On the other hand, firms operating in construction and real estate were more likely (57%) to state that input costs were unchanged.

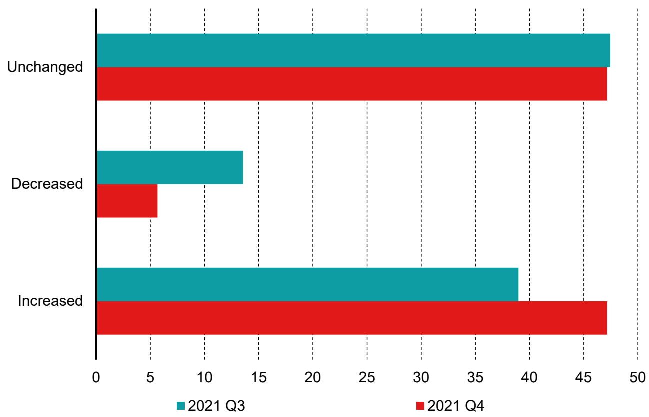
The significant increase in input costs reported by firms reflects sharp increases in freight costs as well as global price increases for several commodities. These include prices for food, paper, packaging, plastic, and electronics, as well as materials such as wood, iron, copper and steel. Some firms reported that suppliers are refusing to enter into long-term supply agreements due to market volatility and are introducing variable price clauses into supply agreements. This has brought a lot of uncertainty in terms of budgeting, production planning, and guaranteeing delivery for clients.

Mainly as a consequence of the steep increase in input prices, 47% of firms reported an increase in selling prices during the fourth quarter of 2021, up from 39% in the previous quarter (see Chart 6). The number of firms reporting higher selling prices has been steadily increasing over the past quarters. Only 6% of respondents reduced prices with the remaining 47% kept prices unchanged, in part due to competitive pressures. As a result, the net balance of firms reporting higher output prices rose to 42% from 25% in the previous quarter.

At a sectoral level, the net balance of firms reporting higher selling prices rose from 38% to 55% in the manufacturing sector, and from 40% to 57% in the construction and real estate sector. The net balance turned positive in the services sector, at 18%, though the large majority of firms in this sector reported unchanged prices.

In the trade sector, 56% of firms contacted reported higher selling prices, down from 78% in the previous quarter. At the same time, the number of firms reporting unchanged or reduced selling prices rose, leading the net balance of firms reporting higher prices to decrease to 44% from 78% in the previous quarter. The small number of firms reducing selling prices did so to encourage demand and support their brands.

Chart 6
CHANGES IN SELLING PRICES
(percentage of companies contacted)



Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "Did you change your selling prices?"

BOX 1: THE IMPACT OF BREXIT ON LOCAL FIRMS

During the month of November 2021, the Central Bank of Malta launched a pilot survey assessing the impact of Brexit on local firms. This survey was distributed among a subset of the Bank's contacts with the aim of obtaining initial insights into the changes brought about by Brexit.

The results are obtained from a pilot of 31 targeted sampled companies, out of which 17 companies replied. Results shown below should be treated with caution due to the non-probabilistic nature of the sampling framework and the small number of replies received.

The questionnaire was split into five sections. The first section was used to collect general information about the responding companies. The second section assessed the overall impact of Brexit. The third section investigated the impact on trade relations while the fourth gathered information about companies' responses and adaptation to Brexit. The final section asked respondents on their expectations regarding Brexit.

Most (65%) of the participating companies have been established for more than 30 years while the remainder have been in operation between six to 20 years. As such, most of these firms are medium to large enterprises in terms of revenue and employment. Indeed, 35% of firms interviewed reported €2 million to €10 million in annual revenue, 29% reported a value of €10 million to €50 million, and a further 24% reported over €50 million in annual turnover. The remaining firms generate less than €2 million in revenue per year.

Moreover, almost half (47%) of participating companies employ over 250 workers. A further 35% employ between 50 and 249 workers, while the remaining 18% employ between 10 and 49 employees. Half of the respondents were split equally between services-oriented firms and firms operating within the construction and real estate sector. Meanwhile, 35% were manufacturing companies, and the remaining 18% were wholesalers and retailers. It is important to note that this distribution diverges from the population composition of the Maltese economy, particularly because of the over-representation of manufacturing companies and under-representation of services firms in the chosen sample.[2]

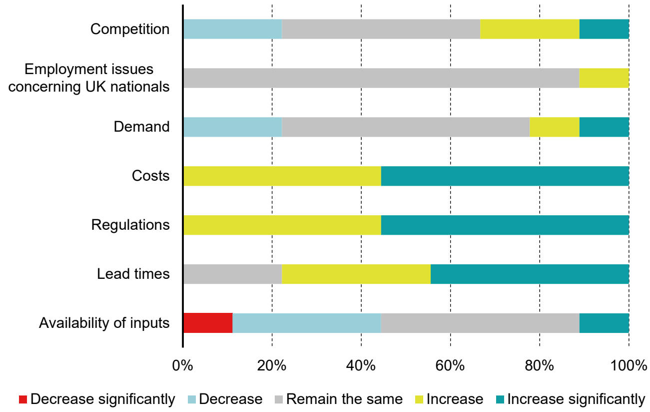
Almost 30% of companies surveyed have no imports which originate from the UK, while 53% import between 1% and 10% of their inputs from the UK, with 12% importing 11% to 25% and 6% importing over 50% of their total inputs from the UK.

On the export side, 53% of participating firms reported that they have no exports to the UK, while 24% of respondents said they sell up to a tenth of their exports to the UK, 18% have 11% to 25% and 6% have 26% to 50% of their exports which end up in the UK.

[2] The latest registered business units data published by the NSO shows that in 2020, services firms represent around 60% of total registered units in Malta (excluding Government/ Non-Profit/ Other organisations), whereas the share of manufacturing firms of total registered business units (excluding Government/ Non-Profit/ Other organisations) only adds up to close to 4%. For more information, see NSO *News Release* 081/2021.

The results of the pilot survey suggest that almost half of these companies were not impacted by Brexit. On the other hand, 41% stated that they were negatively impacted and a further 12% reported a very negative impact.

Chart 7
THE IMPACT OF BREXIT ON LOCAL FIRMS
(share of total companies interviewed; conditional on Brexit impact already felt)



Source: Central Bank of Malta Brexit Pilot Survey.
Notes: The question put to respondents was as follows – "How was your firm impacted by Brexit?"

The three most concerning issues mentioned by firms interviewed were increased costs, higher regulations, and longer lead times. Indeed, all companies which stated that they were impacted by Brexit reported increases in both costs and regulations (see Chart 7). Furthermore, more than three-fourths of Brexit-affected firms stated that lead times had increased. Most of these firms reported lead time increases of one to two months but a few reported even longer delays because of Brexit. The availability of inputs was also affected though not to the same extent as other mentioned issues. Nevertheless, a strong majority of Brexit-impacted firms stated that supply from the UK has been restricted.

According to responses from this survey, imports from the UK have declined for around a third of respondents. On the export side, none of the respondents reported declines, but a small number recorded higher exports to the UK. Another interesting finding from this pilot survey is that 29% of companies that replied increased their selling prices in response to Brexit, while the rest reported either unchanged prices or noted that their prices were not impacted by Brexit.

Annex 1

Table 1
SECTORAL REPLIES
(percentage of companies contacted)

	Construction and Real Estate		Wholesale and Retail		Services		Manufacturing		Total	
	2021 Q3	2021 Q4	2021 Q3	2021 Q4	2021 Q3	2021 Q4	2021 Q3	2021 Q4	2021 Q3	2021 Q4
How have business conditions developed over the past three months?										
Improved	29	50	56	44	77	71	63	55	65	57
Worsened	29	25	11	11	10	18	25	25	16	21
Remained the same	43	25	33	44	13	12	13	20	19	22
Net Balance	0	25	44	33	68	53	38	30	49	36
How do you expect business activity to develop in the next few months?										
Improve	29	33	33	33	55	65	50	50	48	48
Worsen	14	25	11	0	10	24	13	10	11	16
Remain the same	43	33	33	44	26	6	31	30	30	26
Uncertain	14	8	22	22	10	6	6	10	11	10
Net Balance	14	8	22	33	45	41	38	40	37	33
How have you changed your investment plans for this year?										
Continued as scheduled	71	75	78	78	68	71	81	85	73	78
No investments planned	14	8	11	11	10	12	6	0	10	7
Postponed/put on hold	14	8	0	11	19	18	13	15	14	14
Cancelled	0	8	11	0	3	0	0	0	3	2
How have you changed your employment plans?										
Increased	57	17	33	17	39	65	44	50	41	43
Decreased	0	8	0	8	3	0	13	10	5	5
Unchanged	43	75	67	75	58	35	44	40	54	52
Net Balance	57	8	33	8	35	65	31	40	37	38
Did you experience any changes in input prices?										
Increased	100	43	67	78	52	59	75	90	64	72
Decreased	0	0	0	0	3	0	0	0	2	0
Unchanged	0	57	33	22	45	41	25	10	34	28
Net Balance	100	43	67	78	48	59	75	90	63	72
Did you change your selling prices?										
Increased	60	57	78	56	21	24	44	60	39	47
Decreased	20	0	0	11	21	6	6	5	14	6
Unchanged	20	43	22	33	59	71	50	35	47	47
Net Balance	40	57	78	44	0	18	38	55	25	42

Source: Central Bank of Malta Business Dialogue.