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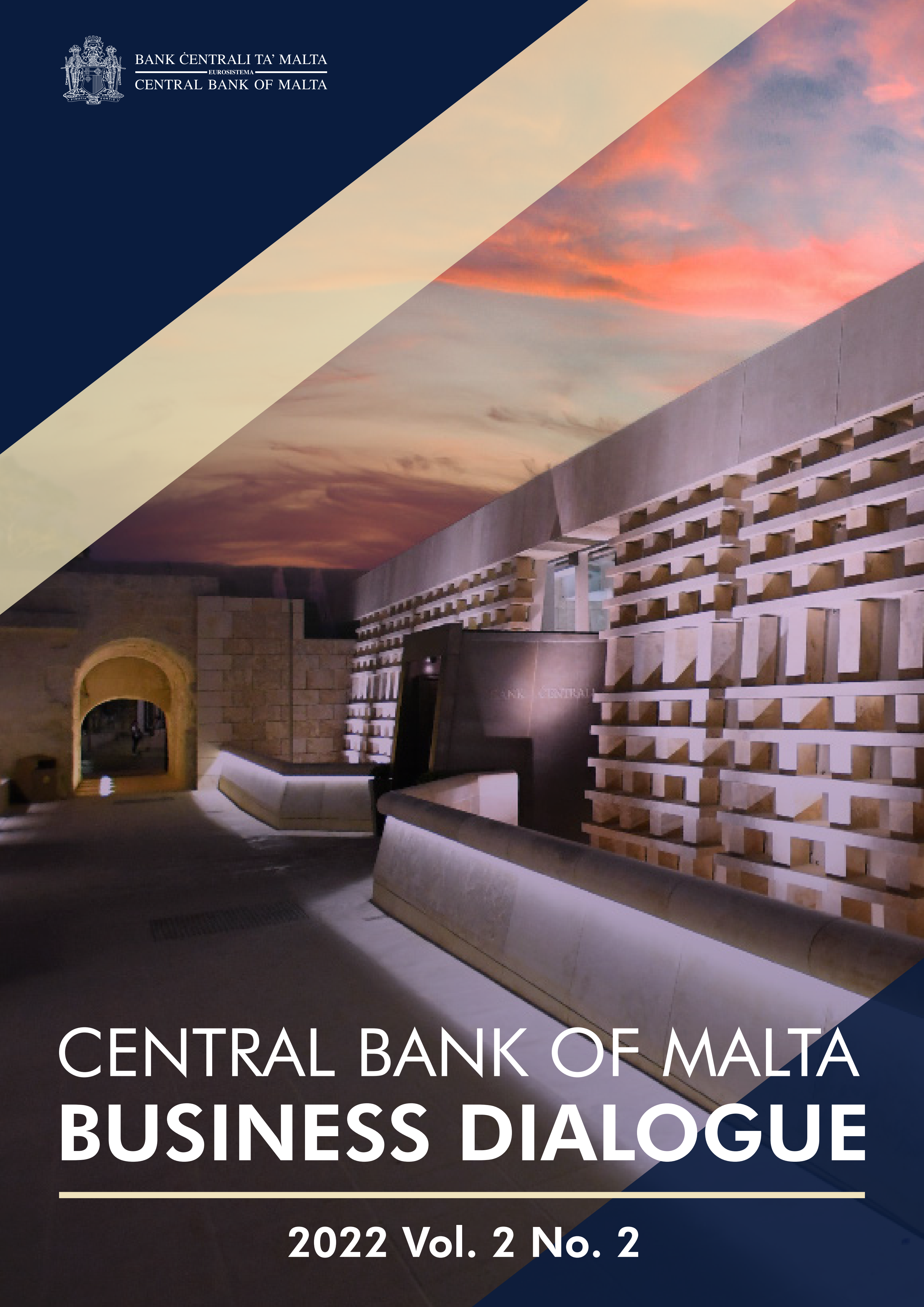

CENTRAL BANK OF MALTA BUSINESS DIALOGUE

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Address
Pjazza Kastilja
Valletta VLT 1060
Malta

Telephone
(+356) 2550 0000

Fax
(+356) 2550 2500

Website
www.centralbankmalta.org

E-mail
info@centralbankmalta.org

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MAIN FINDINGS FROM THE 2022 Q1 ROUND OF CONTACTS WITH NON-FINANCIAL CORPORATIONS

Summary

Information gathered during contacts with non-financial corporations made by the Central Bank of Malta between January and March 2022 indicates that overall business conditions have softened somewhat but continue to remain positive. Indeed, a net 31% of respondents reported an increase in activity over the three months preceding the interview, down from a net share of 36% in the previous quarter. Less favourable conditions were reported by all sectors, barring the wholesale and retail sector.

By contrast to the assessment of recent business conditions, short-term expectations about business activity improved slightly but uncertainty has increased. Around 40% of the contacts reported that they expect business activity to expand over the next three months while only 2% anticipated a decline. As a result, the net share of respondents expecting an amelioration in business activity increased to 39% from 33% in the previous round. Nonetheless, the share of contacts reporting that the outlook was uncertain has risen to 16%, from 10% in the last quarter of 2021.

Cost pressures have remained elevated in the quarter under review, mostly reflecting the ongoing disruptions to supply chains. Indeed, 84% of contacts reported that input prices have increased, up from 72% in the fourth quarter of 2021. Input costs were mentioned more often by manufacturing as well as construction firms than those in the other sectors.

In part due to elevated cost pressures, around 45% of firms interviewed reported an increase in their selling prices. However, 7% reported reductions in selling prices while almost half left selling prices unchanged. As a result, the net share of firms reporting price increases fell slightly to 38% from the 42% reported in previous quarter. The net share of firms reporting increases in selling prices rose in the manufacturing sector and in the construction and real estate sector but decreased in wholesale and retail and in services.

In the first quarter, 74% of respondents reported that investment plans continued as scheduled, slightly down from 78% in the previous quarter. A further 5% reported postponement, lower than before. The share of respondents reporting cancellations rose marginally to 3% while that of firms reporting that they have no investment planned increased to 18%.

In view of positive activity, a net 35% of firms planned to hire staff, 3 percentage points lower than the previous quarter. This may reflect concerns about labour shortages and wage pressures rather than weak demand.

In the first quarter of 2022, a total of 62 telephone/virtual meetings with leading non-financial corporations were conducted. These include 19 manufacturing companies, 28 services-oriented companies, 13 wholesale and retail companies, and two construction and real estate companies.[1]

Preliminary information collected during this round of contacts signals a number of concerns arising from the Russia-Ukraine conflict. Nonetheless, as only a subset of firms was contacted

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

after the conflict started, the impact of the war may be better captured in the forthcoming round of contacts.

Assessment of current business conditions softens but remains positive

Information gathered between January and March 2022 indicates that – on balance – business conditions continued to be seen as positive by the Bank's contacts. However, the net share of respondents reporting an amelioration in business conditions decreased to 31%, from 36% in the previous quarter and from the high rate of 49% in the third quarter of last year.

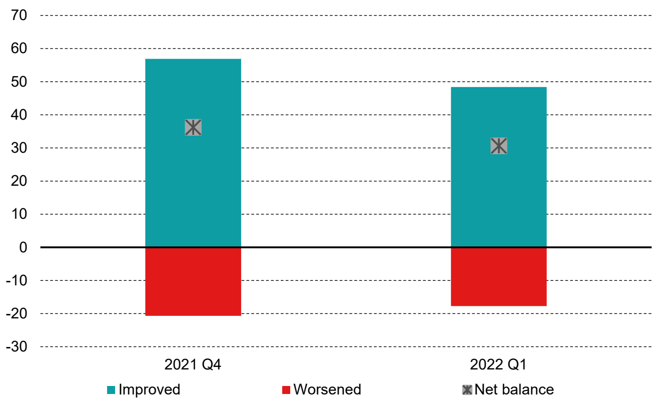
During the quarter under review, 48% of firms stated that business conditions had improved over the past three months, down from 57% in the fourth quarter of last year (see Chart 1). Meanwhile, the share of firms stating that business activity worsened declined slightly to 18% from 21% in the previous quarter. The number of firms stating that business conditions remained unchanged increased to 34% in the quarter under review, from 22% previously.

This overall benign picture, however, masks diverse developments across sectors. Business conditions, while still positive, moderated significantly in the services and the manufacturing sectors and were assessed to be broadly neutral in the construction and real estate sector. By contrast, a higher share of respondents in the wholesale and retail trade sector reported an improvement in their business conditions when compared to the last quarter of 2021.

Although more than half of services-oriented firms contacted in the first quarter of 2022 stated that economic conditions had improved over the past three months, this share declined from the 71% figure reported in the previous quarter (see Table 1 in the Annex). Business conditions were particularly positive within the maritime and freight as well as in the hospitality and accommodation services sub-sectors. The latter, which were negatively impacted by the spread of the Omicron variant during the first weeks of the year, recovered strongly by the end of the first quarter. At the same time, the percentage of firms in the services sector stating that business conditions had worsened increased to 25% from 18% in the previous quarter. Reflecting these developments, the net balance of services firms reporting an improvement fell from 53% in the fourth quarter of 2021 to 32% in the first three months of 2022.

Business conditions also softened in the manufacturing sector. The percentage of firms reporting an improvement in activity fell from 55% in the fourth quarter of 2021 to 37% in the first quarter of 2022. Around 21% of firms continued to report a worsening in business conditions, just 4 percentage points less than in the previous quarter. Therefore, the net balance of manufacturing companies reporting improving business conditions broadly halved to

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?"

16%, from 30% in the previous quarter. A positive assessment was mainly reported by firms in the production of food and beverages. Despite a substantial increase in input costs, these firms stated that their business conditions were particularly positive due to strong demand.

In the wholesale and retail sector, a net 54% of respondents assessed conditions to have improved in recent months, up from 33% in the last quarter of 2021. This was due to a drop in the share of firms stating that business conditions worsened as well as a rise in the share of firms stating that conditions had recently improved. The former dropped from 11% to nil, while the latter increased from 44% to 54%. Strong demand was mainly reported by firms selling clothing and footwear and food and beverage items. Furthermore, conditions within the construction and real estate sector remained stable.

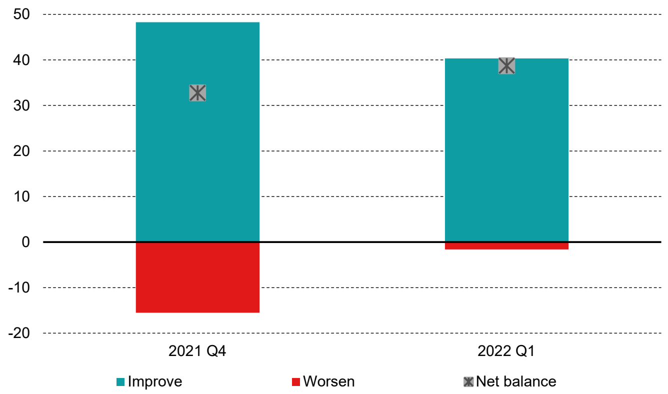
Expectations for short term business conditions improve slightly but uncertainty increases

Looking ahead, 40% of the firms contacted during the first quarter of this year anticipated their business activity to improve further over the next three months, down from 48% in the previous quarter (see Chart 2). However, the number of firms which expected conditions to worsen over the next three months fell from 16% in the fourth quarter of 2021 to just 2% in the quarter under review. Consequently, the net share of firms reporting an improvement in the near-term outlook rose from 33% to 39%. The largest share of respondents (42%) expects no change in business conditions.

Meanwhile, uncertainty has increased, which could reflect the initial impact of the Russia-Ukraine conflict on firms' outlook. Indeed, the share of respondents reporting an uncertain outlook increased from 10% to 16% in the first quarter of the year, reflecting an ambiguous outlook for short-term business conditions in the trade sector and, to a lesser extent, in the manufacturing and services sectors.

The strongest improvement in the near-term business outlook was reported by firms in the manufacturing sector. Slightly more than half of the manufacturing firms interviewed in the first quarter of 2022 expected an improvement in their business activity over the next three months, slightly up from half in the previous quarter. In particular, manufacturing firms within the food and beverage, injection moulding, and electronics sub-sectors expected demand for their products to improve. Meanwhile, no manufacturing firm expected conditions to worsen, compared to 10% in the previous quarter. Therefore, the net balance of firms reporting improved business expectations within this sector increased to 53%, from

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?"

40% in the preceding quarter. Around a tenth of firms reported uncertain prospects in this sector, broadly similar to the share estimated for the previous quarter.

Within the services sector, expectations for activity over the next three months also improved, but marginally. Although the number of firms expecting an improvement fell from 65% in the previous quarter to 46% in the quarter under review, the share of services firms expecting conditions to worsen also declined significantly – from 24% to 4%. The net balance thus rose by 2 percentage points – to 43%. An amelioration was mostly expected by firms which operate in the maritime and freight as well as in the hospitality and accommodation services sub-sectors. Nonetheless, compared to the previous quarter, the share of firms in the services sector that were uncertain about the immediate future more than doubled (from 6% to 14%).

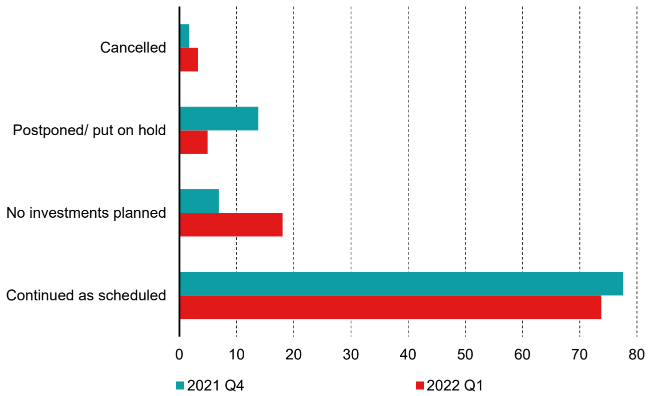
In the wholesale and retail sector, a net 15% of firms contacted between January and March 2022 expected sales activity over the next three months to improve, significantly down from 33% in the previous quarter. This reflected a fall in the share of respondents expecting an improvement in sales while those expecting worse conditions remained at zero. Around a third of firms interviewed in this sector remained uncertain about future business conditions. This share is high relative to that in other sectors. Firms expressing this view operate in various sub sectors. Moreover, conditions within the construction and real estate sector are expected to be similar to those experienced over the past three months.

Firms' investment and hiring plans remain encouraging

During the quarter under review, 74% of companies contacted during the first quarter reported that their investment plans remain on track, compared to 78% in the previous quarter (see Chart 3). Most local firms suggested that they continued with their investment plans partly because some projects had already commenced. However, more companies have initiated further investments or resumed their investment plans following improved business conditions and an optimistic outlook.

The share of companies participating in the CBM Business Dialogue that postponed or paused their investment plans decreased to 5% in the first quarter of 2022, compared to 14% in the final quarter of 2021. This is substantially lower than what was reported in 2020. Furthermore, only 3% of the firms contacted cancelled their investment plans, marginally up from 2% in the previous quarter. These companies operate in the services sector, particularly in the travel and transport segment. Finally, 18% of companies contacted in the first quarter of 2022 claimed that they did not have any investments planned, compared to 7% in the previous quarter. However, some of these companies said that they

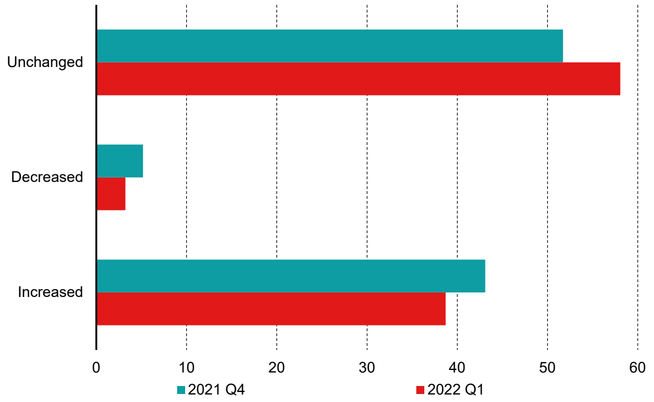
Chart 3
INVESTMENT PLANS
(percentage of companies contacted)



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?"

had major projects which were recently finalised and hence no further investments were envisaged for 2022. All these firms operate in the wholesale and retail, and services sectors.

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?"

Looking at investment plans by sector, 95% of manufacturing companies contacted in the first quarter reported that they had continued with their planned investments, while 5% cancelled their investments. In the real estate and construction sector, investments also continued as planned. Most companies interviewed in the wholesale and retail and services sector also reported that they continued with their planned capital expenditure. However, the share was lower at 62% and 64%, respectively.

When asked about employment plans, the responses collected reveal a moderate decrease in hiring expectations. During the first quarter of 2022, 39% of all firms interviewed were planning to increase staff. This was slightly lower than 43% in the last quarter of 2021 but still significantly more than what was recorded in previous quarters. At the same time, the share of firms expecting to shed labour declined to 3%, from 5% in the last quarter of the year (see Chart 4). These are mostly companies that are not replacing workers who voluntarily resigned. Accordingly, a net 35% of respondents anticipated higher employment, 3 percentage points lower than the net 38% recorded in the final quarter of 2021. The share of respondents that did not alter their employment plans increased to 58%, from 52% in the fourth quarter of 2021. This mainly relates to companies that are only recruiting for replacement purpose.

On a sectoral level, there were mixed developments. Expected job increases were more often recorded in the manufacturing and wholesale and retail sectors. The rise in recruitment requirements reflects the recovery in both sectors.

Conversely, the net share of firms that plan to increase employment fell significantly in the services sector from 65% to 29%. This was mostly due to lower employment expectations in the services sector, where firms continue to report difficulties in finding suitable recruits. In the real estate and construction sector, firms contacted during the quarter on balance planned to keep their staff headcount unchanged.

Labour shortages and wage pressure are a major concern

Firms remain highly concerned about shortages of labour and skills, which have contributed to rising wage pressures. Most companies contacted continued to claim that labour shortages remain their main concern and that they are finding it very challenging to recruit new workers and/or retain current employees. This sentiment was expressed by firms across all sectors, but such response was more prevalent among firms operating in the services industry, which indicate that shortages of labour have exceeded pre-pandemic levels. This is partly because of limited access to third-country nationals.

As a result of labour shortages, as well as the acceleration in inflation, several companies said that they increased or expect to increase their wages. Wage increases were mentioned by firms operating in all sectors, with increases ranging from 3% to even 15% in some instances. Firms also reported increased instances of poaching, leading to higher staff turnover.

Company efforts to a greener economy

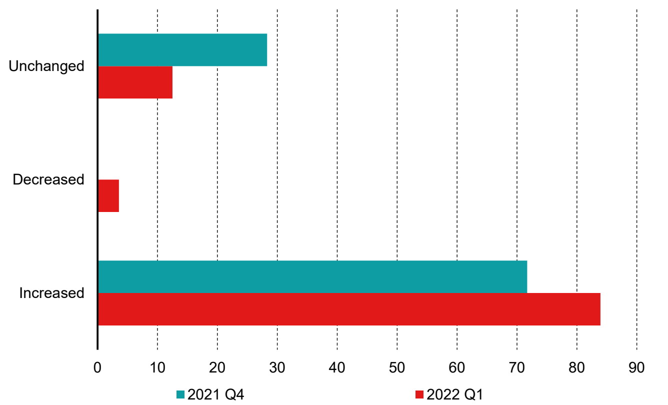
During the first quarter of 2022, companies were also asked to comment on their efforts in transitioning to a green economy. Overall, most companies interviewed said that throughout the past few years they have made some efforts to adopt cleaner practices. Some undertook significant investments while others implemented minor measures. These changes range from investments in energy efficient machinery and renewable energy sources, to everyday practices such as recycling, waste management and lowering the use of paper and plastics. The most common measure adopted by firms was the installation of Photovoltaic panels. Other firms opted for reverse osmosis, a rainwater collection systems, intelligent electrical systems, hybrid or electric vehicles, and systems to clean and reuse water.

Supply chain disruptions and cost pressures remain elevated

The majority of firms across all sectors outlined that supply chain disruptions remain one of their biggest concerns. As expected, the conflict between Russia and Ukraine, as well as the reinforced COVID-19 mitigation lockdowns in China have led to significant delays in the delivery of raw materials and the shortage of certain vital inputs. Businesses have also continued to experience significant increases in transport costs particularly due to the surge in the price of fuel and the increase in the price of airspace as a result of the war. Some businesses also mentioned that freight is taking longer to arrive due to the longer journeys required to avoid the war zone. Such geopolitical issues together with the impact of Brexit and the COVID-19 pandemic are causing significant price increases such that businesses are faced with increased storage costs and cashflow challenges as they seek to stock up on raw materials to try and secure lower prices, as prices are constantly changing.

In fact, 84% of firms contacted in the first quarter of 2022 outlined that they have experienced input cost increases, up from 72% in the previous period (see Chart 5). Only 4% of firms

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?"

reported a decrease in their input costs. However, these companies operate in the services sector and were able to benefit from reduced costs due to the shift to remote working. The remaining 13% indicated that their input prices remained relatively unchanged. Reflecting these developments, the share of firms reporting higher input costs reached 80%, from 72% previously.

At a sectoral level, a net 89% of manufacturing firms reported that input costs increased. This share was slightly lower in the wholesale and retail sector and in services, at 77% and 73%, respectively. The net percentage of firms reporting increases in prices of input costs in the manufacturing and trade sectors remained relatively unchanged from the last quarter of 2021. By contrast, firms operating in the construction and real estate sector were more likely to report increases in input costs when compared with the last quarter of 2021.

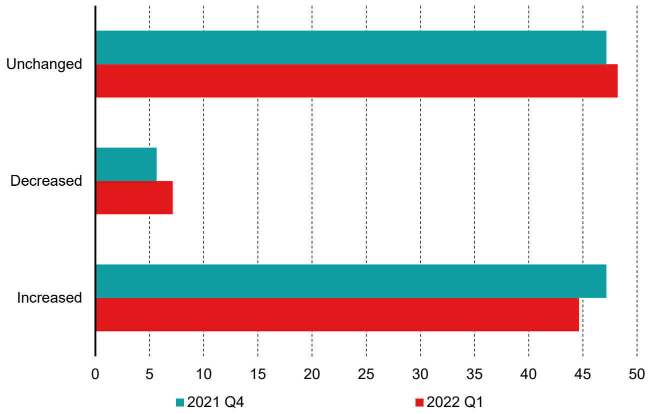
The significant rise in input costs reported by firms reflects sharp increases in freight costs as well as global price hikes for several commodities. These include prices for food (particularly meat, oil and flour), paper, packaging, plastic, cement, fuel and electronics, as well as materials such as wood, iron, copper and steel. Some companies in the services sector also mentioned higher operating costs related to the mitigation of the COVID-19 pandemic such as increased staff, face masks, sanitizers etc. A number of contacts also mentioned that they were refusing or encountering business partners that 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. Scarcity of supply is also forcing local businesses to diversify their suppliers across the globe to secure stock levels, sometimes even at higher costs.

Notwithstanding further significant increases in input prices, the share of firms reporting that they raised their selling prices during the first quarter of 2022 decreased by 2 percentage points from the previous quarter (see Chart 6). Only 7% of firms were able to decrease prices to remain competitive, while the remaining 48% kept their prices unchanged. As a result, the net share of firms raising selling prices decreased to 38% during the quarter reviewed, from 42% in the previous three months.

This mostly reflected developments in the wholesale and retail sector, where the net balance fell from 44% to 31% as less firms in this sector increased prices. The net balance also declined in the services sector, although the decrease was modest. By contrast, in the manufacturing sector, the net balance of firms reporting higher selling prices increased from 55% to 68%.

A number of companies have kept their prices unchanged, either by absorbing some of the

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?"

cost increases or due to having fixed price contracts. In addition, government support for food producers has lowered the need to pass on additional increases in the cost of locally-produced food products to consumers. Some companies have also managed to keep selling prices unchanged as they were able to build up their inventory level in anticipation of costlier supplies. However, as inventories are drawn down, these companies said that increases in their selling prices will be inevitable.

Firms express concerns regarding the conflict between Ukraine and Russia

Initial insights from the contacts made since the start of the war in Ukraine suggest that a few firms have already incurred an intensification in input price increases while most other firms are either expecting or are concerned that input costs will increase. This sentiment is felt even though none of the firms contacted directly import from either Ukraine or Russia. Others mentioned supply disruptions, mainly in the form of shortages, as key concerns. Some companies also argued that the conflict may lead to lower demand. In particular, firms operating within the tourism industry are concerned that the war may lead to hesitance to travel due to security reasons.

Annex 1

Table 1
SECTORAL REPLIES
(percentage of companies contacted)

	Construction and Real Estate		Wholesale and Retail		Services		Manufacturing		Total	
	2021 Q4	2022 Q1	2021 Q4	2022 Q1	2021 Q4	2022 Q1	2021 Q4	2022 Q1	2021 Q4	2022 Q1
How have business conditions developed over the past three months?										
Improved	50	0	44	54	71	57	55	37	57	48
Worsened	25	0	11	0	18	25	25	21	21	18
Remained the same	25	100	44	46	12	18	20	42	22	34
Net Balance	25	0	33	54	53	32	30	16	36	31
How do you expect business activity to develop in the next few months?										
Improve	33	0	33	15	65	46	50	53	48	40
Worsen	25	0	0	0	24	4	10	0	16	2
Remain the same	33	100	44	54	6	36	30	37	26	42
Uncertain	8	0	22	31	6	14	10	11	10	16
Net Balance	8	0	33	15	41	43	40	53	33	39
How have you changed your investment plans for this year?										
Continued as scheduled	75	100	78	62	71	64	85	95	78	74
No investments planned	8	0	11	38	12	21	0	0	7	18
Postponed/put on hold	8	0	11	0	18	11	15	0	14	5
Cancelled	8	0	0	0	0	4	0	5	2	3
How have you changed your employment plans?										
Increased	17	0	17	23	65	36	50	58	43	39
Decreased	8	0	8	0	0	7	10	0	5	3
Unchanged	75	100	75	77	35	57	40	42	52	58
Net Balance	8	0	8	23	65	29	40	58	38	35
Did you experience any changes in input prices?										
Increased	43	100	78	77	59	82	90	89	72	84
Decreased	0	0	0	0	0	9	0	0	0	4
Unchanged	57	0	22	23	41	9	10	11	28	13
Net Balance	43	100	78	77	59	73	90	89	72	80
Did you change your selling prices?										
Increased	57	100	56	38	24	26	60	68	47	45
Decreased	0	0	11	8	6	13	5	0	6	7
Unchanged	43	0	33	54	71	61	35	32	47	48
Net Balance	57	100	44	31	18	13	55	68	42	38

Source: Central Bank of Malta Business Dialogue.