BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

CENTRAL BANK OF MALTA
BUSINESS DIALOGUE

2022 Vol. 2 No. 3

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

The cut-off date for information in this publication is 30 June 2022. Figures in tables may not add up due to rounding.

ISSN 2788-7758 (online)

MAIN FINDINGS FROM THE 2022 Q2 ROUND OF CONTACTS WITH NON-FINANCIAL CORPORATIONS

Summary

Information gathered during contacts with non-financial corporations made by the Central Bank of Malta between April and June 2022 indicates that overall business conditions have improved. Indeed, a net 52% of respondents reported an increase in activity over the three months preceding the interview, up from a net share of 31% in the previous quarter. Assessments of more favourable conditions were broad-based across sectors. This was the first improvement after two quarters when conditions had softened.

By contrast, short-term expectations about business activity declined even though uncertainty has receded. Around 48% of the contacts reported that they expect business activity to expand over the next three months while 17% anticipated a decline. When compared to the first quarter of the year, the net share of respondents expecting an amelioration in business activity fell to 31% from 39%. Nonetheless, the share of contacts reporting that the outlook was uncertain has declined to 8%, from 16% in the first quarter of 2022.

Cost pressures have remained elevated – though these seem to have stabilised at historically high levels. Indeed, a net 77% of contacts reported that input prices have increased, down from 80% in the previous quarter. Input cost increases were mentioned more often by manufacturing as well as wholesale and retail trade firms than those in other sectors.

The net share of firms reporting price increases increased significantly to 61% from the 38% reported in previous quarter. The net share of firms reporting increases in selling prices rose in all sectors except for the construction and real estate.

In the second quarter, 92% of respondents reported that investment plans continued as scheduled, up from 74% in the previous quarter. At the same time, a net 42% of firms planned to hire staff, higher than 35% in the previous quarter.

In the second quarter of 2022, a total of 64 telephone/virtual meetings with leading non-financial corporations were conducted. These include 17 manufacturing companies, 22 services-oriented companies, 14 wholesale and retail companies, and 11 construction and real estate companies.[1]

Insights gathered during this round of contacts signal a number of concerns arising from the Russia-Ukraine war, particularly related to higher import prices and lower availability of supplies.

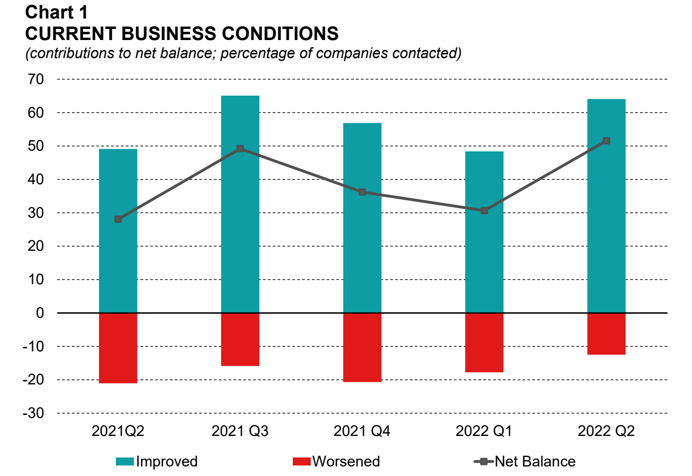
Business conditions improve

Information gathered between April and June 2022 indicates that – on balance – business conditions improved, after a couple of quarters when conditions had softened. The net share of respondents reporting an amelioration in business conditions increased to 52%, from 31% in the previous quarter, exceeding the highest recorded balance of 49% in the third quarter of last year.

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

During the quarter under review, 64% of firms stated that business conditions had improved over the past three months, up from 48% in the first quarter of the year (see Chart 1). At the same time, the share of firms stating that business activity worsened declined to 13% from 18% in the previous quarter. The number of firms stating that business conditions remained unchanged also fell, standing at 23% in the quarter under review, from 34% previously. This improvement in business sentiment was broad-based across sectors.

Chart 1
CURRENT BUSINESS CONDITIONS
(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 have business conditions developed over the past three months?"

On balance, the strongest amelioration was observed in the construction and real estate sector, whereby a net 36% of respondents noted an improvement in business activity, up from nil in the previous quarter. 55% of firms reported higher activity during the period under review, while 18% stated that conditions worsened and the remaining 27% said that conditions remained the same.

Very positive developments were also experienced within the wholesale and retail sector. A net 86% of respondents in this sector assessed conditions to have improved in recent months, up from 54% in the previous quarter. This was entirely due to a rise in the share of firms stating that business conditions improved, which offset a small rise in the share of firms stating that conditions had recently worsened. The former increased from 54% to 93%, while the latter increased from nil to 7%. Strong demand was reported across various retail segments but most particularly within the food and beverage segment, which indicates that this sector is being positively affected by the gradual easing of containment measures and the ongoing recovery in tourism demand.

Business conditions also improved in the manufacturing sector. The percentage of firms reporting an improvement in activity increased from 37% in the first quarter of 2022 to 53% in the second quarter. Firms reporting worsened conditions declined from 21% to 18%, while the share of manufacturing firms stating that conditions have remained unchanged fell from 42% to 29% in the second quarter. Therefore, the net balance of manufacturing companies reporting improved business conditions more than doubled to 35%, from 16% in the previous quarter. This positive assessment was mainly reported by firms in the production of durables and electronics. Despite a substantial increase in input costs, these firms stated that their business conditions were particularly positive due to strong demand.

Although in the second quarter of 2022, broadly the same share of services firms (59%) stated that conditions improved when compared to the previous quarter (57%), the share of services firms reporting worse conditions declined significantly from 25% to 9%. Meanwhile, the share of services-oriented businesses reporting unchanged conditions increased from 18% to 32%. Reflecting these developments, the net balance of services firms reporting an improvement rose from 32% in the first quarter of 2022 to 50% in the second quarter of 2022. Business conditions were particularly positive within travel and freight related segments.

Expectations for short term business conditions are less optimistic amid a clearer outlook

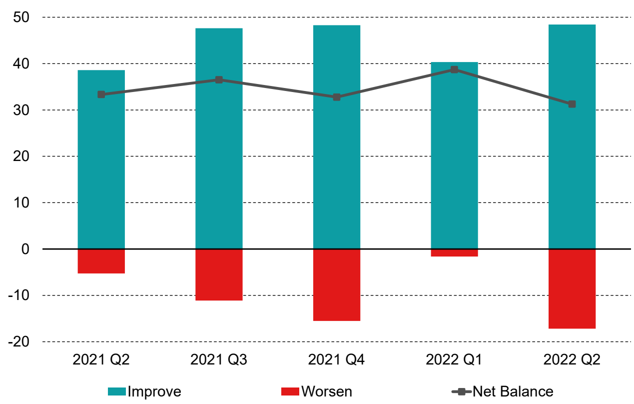
Looking ahead, 48% of the firms contacted during the second quarter of this year anticipated their business activity to improve further over the next three months, up from 40% in the previous quarter (see Chart 2). However, the share of firms which expected conditions to worsen over the next three months increased from 2% in the first quarter of 2022 to 17% in the quarter under review. Consequently, the net share of firms reporting an improvement in the near-term outlook fell from 39% to 31%. The share of respondents expecting similar conditions in the coming three months, fell from 42% in the first quarter of 2022 to 27% in the second.

Meanwhile, uncertainty has receded, possibly reflecting a clearer outlook about the impact of the Russia-Ukraine war on global supply chains and inflation. Indeed, the share of respondents reporting an uncertain outlook fell from 16% to 8% in the second quarter of the year, reflecting clearer (more pessimistic) prospects in the manufacturing, services and wholesale and retail sectors.

The strongest deterioration in the near-term business outlook was reported by firms in the services sector. 45% of the services-oriented companies interviewed in the second quarter of 2022 expected an improvement in their business activity over the next three months, almost the same as in the previous quarter. An amelioration was mostly expected by firms which operate in the transport and audit and consultancy segments. Nonetheless, the share of services firms expecting conditions to worsen increased significantly from 4% in the first quarter to 36% in the quarter under review. This outlook was reported by firms operating within the hospitality and accommodation and food and beverage services sub-sectors. The net balance of services firms reporting a better outlook thus fell from 43% to only 9%. Compared to the previous quarter, the share of firms in the services sector that were uncertain about the immediate future declined from 14% to 5%.

Less favourable expectations were also noted within the manufacturing sector. The proportion of firms expecting an improvement fell from 53% in the previous quarter to 47% in the quarter under review, while the share of manufacturing firms expecting conditions to worsen increased from nil to 6%. Therefore, the net balance of firms reporting improved business expectations within this sector declined to 41%, from 53% in the preceding quarter. Uncertainty almost halved in this sector.

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?"

On the other hand, expectations in the wholesale and retail sector improved sharply. A net 50% of firms contacted between April and June 2022 expected sales activity over the next three months to improve, significantly up from 15% in the previous quarter. This reflected a strong rise in the share of respondents expecting an improvement in sales (from 15% to 57%) while those expecting worse conditions also increased but at a much lesser extent (from 0% to 7%). Uncertainty in this sector declined drastically.

Moreover, conditions within the construction and real estate sector are expected to be better than those experienced over the past three months as the net balance in this sector increased from nil to 36%.

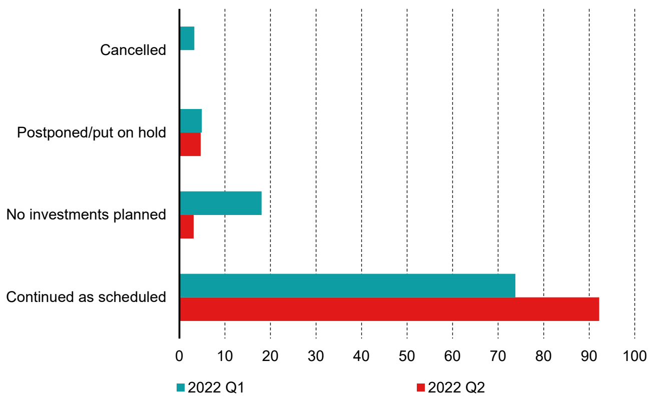
Firms' investment and hiring plans remain strong

During the quarter under review, almost all the companies (92%) contacted reported that their investment plans continued as planned, compared to 74% in the previous quarter (see Chart 3). Most firms noted that they continued with their investment plans as they had already committed to them. However, more companies have initiated additional investments or resumed their projects that were paused during the peak of the pandemic. Also, most companies said that they plan to invest more or the same level next year. This reflects the overall improvement in business activity and suggests positive long-term expectations beyond the impact of the Russia-Ukraine war.

The share of companies that postponed their investment plans remained unchanged from the previous quarter at 5%. Furthermore, none of the companies contacted cancelled their investment plans, compared to 3% in the previous quarter. Finally, 3% of the companies contacted in the second quarter of 2022 claimed that they did not have any investments planned, compared to 18% in the previous quarter. However, some of these companies – which operate in the services sector – said that they had major projects which were recently finalised and hence no further investments were envisaged for 2022.

Looking at investment plans by sector, 94% of the manufacturing companies contacted in the second quarter reported that they had continued with their planned investments. The rest of the companies (6%) postponed their investment plans. Similarly, in the real estate and construction sector, 91% of the firms said that investments continued as planned, while the remaining 9% reported postponed investments. Most companies interviewed in the services sector also said that they continued with their planned expenditure, however, the share was lower than other sectors at 86%. All wholesale and retail

Chart 3
INVESTMENT PLANS
(percentage of companies contacted)

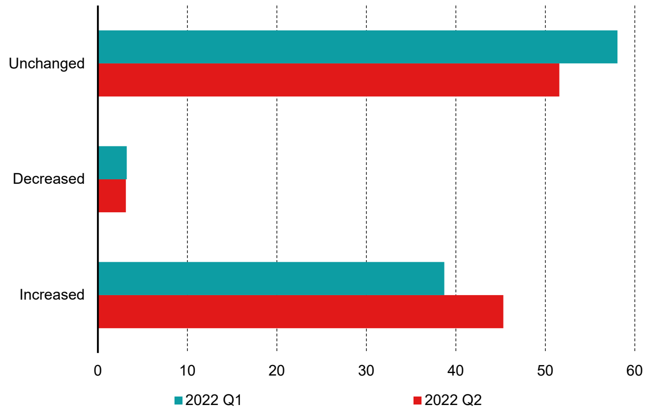


Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "How have you changed your investment plans for this year?"

companies contacted said that they continued with their investment plans.

When asked about employment plans, the responses collected reveal continued increase in hiring expectations. During the second quarter of 2022, 45% of all firms interviewed were planning to increase the number of workers. This was higher than 39% reported in the first quarter of 2022 and significantly more than what was recorded in previous quarters. At the same time, the share of firms expecting to shed labour remained unchanged at 3% (see Chart 4). These include some companies that are not replacing workers who voluntarily resign. However, one construction firm noted that it decreased its workforce by 10% due to lower demand and a negative outlook. Still, a net 42% of respondents anticipated higher employment, 7 percentage points higher than the net 35% recorded in the first quarter of 2022. The share of respondents that did not alter their employment plans declined to 52%, from 58% in the previous quarter. 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?"

On a sectoral level, the responses were somewhat mixed. Expected job increases were significantly more often recorded in the services sector, where a net 73% of respondents anticipated recruitment. The net share of firms that plan to increase employment increased to 18% in the real estate and construction sector, compared to 0% in the previous quarter. The recruitment drive can also be observed in the wholesale and retail sector, where on balance, 36% of the companies reported increased employment plans. This is higher than what was recorded in the previous quarter. Conversely, the net share of firms that plan to increase employment fell significantly in the manufacturing sector from 58% to 24%, as more companies are recruiting only for replacement purposes. Moreover, 6% of the manufacturing companies interviewed claimed that they plan to decrease their staff complement as they will not be replacing outgoing workers.

Labour shortages and wage pressures are a major concern

Firms are still highly concerned about shortages of labour and skills and increased wage pressures. Most companies contacted claim that they are finding it very difficult to find new workers and/or retain their current workforce. This sentiment was expressed by firms across all sectors. Also, some companies noted that labour shortages have exceeded pre-pandemic levels. This is partly because of limited access to third-country nationals and a lengthy process in obtaining work permits. As a result of labour shortages and inflationary pressures, more companies claimed that they increased or plan to increase their wages. Wage increases were mentioned by firms operating in all sectors, with increases ranging from 3% to even 20% in some instances.

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 war between Russia and Ukraine has led to increasingly significant delays in the delivery of raw materials and the shortage of certain vital inputs. This is forcing companies to change suppliers and to increase their ordering levels, as lead times are continuously increasing. Businesses have also continued to experience significant increases in transport costs particularly due to the surge in the price of fuel, higher freight costs and lower availability of flights. The latter was also mentioned by firms operating in the accommodation and hospitality industry, leading to lower-than-expected demand. Such geopolitical issues together with the impact of Brexit and the COVID-19 pandemic are causing significant price increases. As a result, some businesses are faced with increased storage costs and cashflow problems as they seek to stock up on raw materials to ensure availability of inputs and secure more favourable prices.

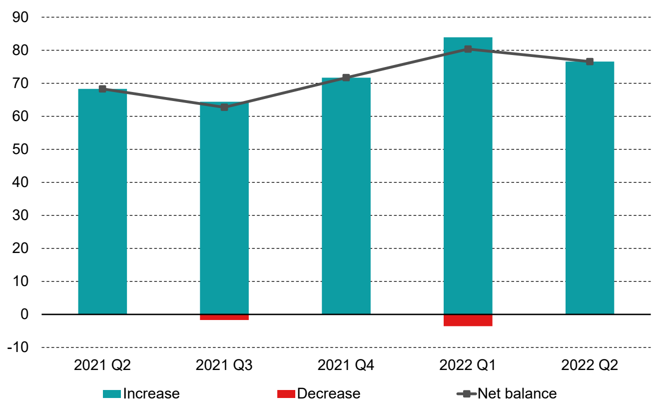
In the second quarter of 2022, 77% of firms contacted stated that they have experienced increases in input costs, slightly down from 84% in the previous quarter (see Chart 5). This implies that cost pressures have stabilised at very high levels. The remaining 23% indicated that their input prices remained unchanged while no company reported a decrease in input costs. In net terms the share of companies reporting an increase in input costs fell from 80% in the first quarter to 77% in the second quarter.

At a sectoral level, higher prices were more often observed in the manufacturing sector (94%), up from 89% in the previous quarter. This was followed closely by the trade (93%) and construction and real estate sectors (91%). The net balance for the services sector has decreased to 45% from 73% in the previous quarter as the majority of the companies had no changes in their input costs.

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 chicken, meat, oil and flour) cement, fuel and electronics, as well as materials such as glass, iron, copper and steel. Given that consumer prices have also increased in response, some companies are now experiencing higher wage demands. This has brought a lot of uncertainty in terms of budgeting, production planning and guaranteeing delivery for clients.

During the quarter under review, the percentage of firms that have reported an increase in selling prices rose sharply to 63%, from 45% in the previous quarter (see Chart 6).[2] Only 2% of firms were able to decrease

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

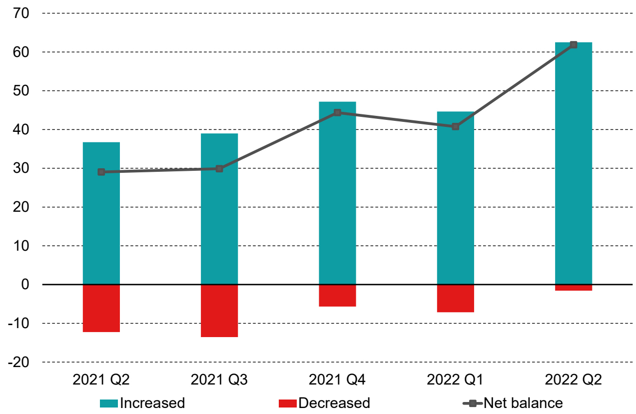


Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "Did you experience any changes in input prices?"

[2] See Box 1 for more details about the determinants of selling prices during the quarter.

selling prices while the remaining 36% kept prices unchanged. This is because most of these firms either have selling prices determined through long term contracts or through sealed bid auctions and are therefore forced to absorb cost increases. The net share of companies that increased selling prices increased significantly to 61% from 38% in the previous quarter. This was the highest net balance since the survey began.

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?"

This increase in selling prices was most prominent in the manufacturing sector, where the net balance of companies reporting an increase in selling prices increased from 68% to 71%. This was followed by the trade and construction and real estate sectors at 64%. A lower net share was observed in the services sector as half the companies increased selling prices while the remaining half kept prices unchanged. Still, there was a significant increase in the net share of companies reporting increased selling prices in the services sector compared to the previous quarter.

While some companies argued that consumers are becoming more accepting of the price increases, some are still absorbing part of the costs in an effort to remain competitive.

BOX 1: HIGH COST PRESSURES ARE LEADING TO INCREASES IN SELLING PRICES[3]

A net 77% of firms contacted during the second quarter of 2022 stated that they have experienced increases in input costs, which is close to historical highs. This issue is more prevalent in the manufacturing, wholesale and retail, and construction and real estate sectors due to their higher need of inputs when compared to services firms. At the same time, a net 61% of companies interviewed in the second quarter of this year increased their selling prices, which is the highest since the survey began to be conducted.

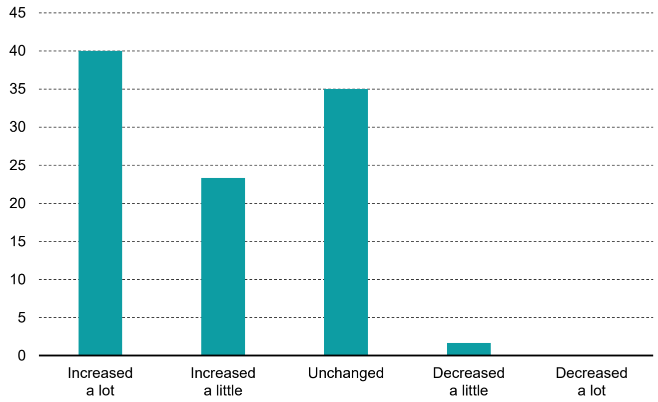
In view of these exceptional developments, in this survey round respondents were asked for more details regarding these issues. Ad-hoc questions were set to seek to get an indication of the extent of price changes, and secondly the reasons behind such changes.

The Bank asked company representatives by how much prices have changed. 40% of interviewed firms stated they had to increase their prices by ‘a lot’, while a further 23% said that

[3] Prepared by Warren Deguara, Erica Maria Brincat and Aleandra Muscat, Senior Economists and Economist respectively, within the Economic Projections and Conjectural Analysis Office of the Central Bank of Malta.

they have increased price a 'little' (see Chart 7).[4] Around 35% of contacted firms have kept their selling prices unchanged, while a small portion (2%) managed to lower their prices by 'a little'. No firm was able to significantly decrease its prices.

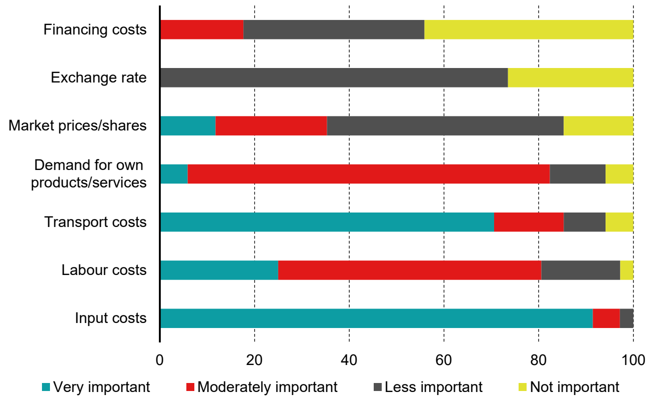
Chart 7
EXTENT OF CHANGES IN SELLING PRICES
(percentage of companies contacted)



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

Furthermore, the ad-hoc questions tried to identify the key factors causing selling price increases. As expected, the most important determinant was found to be input costs (mainly the cost of raw materials) as reported by 91% of contacted firms which increased selling prices (see Chart 8). A further 6% stated that these were moderately important. Higher transport cost was also found to be a very important factor causing increases in selling prices. Indeed, 71% of contacts which increased selling prices identified transport costs as a key factor, while a further 15% claimed that these were moderately important.

Chart 8
KEY FACTORS INFLUENCING SELLING PRICE INCREASES
(percentage of companies contacted)



Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "What were the key factors influencing your selling price increases, ranked in order of importance?"

Labour costs were found to be mostly moderately important in price setting. Indeed, 56% of interviewed firms which increased selling prices said so, while 25% suggested that labour costs are a very important consideration when increasing prices. Similarly, just over three quarters of the contacted companies which increased selling prices claimed that demand was moderately important and 6% said that this was a very important factor.

Market prices/shares were less important in influencing price increases, while exchange rates and financing costs were found to be the least determining factors.

[4] These replies have to be interpreted with caution since these categories are subjective and do not give ranges in terms of percentages.

Firms express concerns regarding the war between Ukraine and Russia

Insights gathered from the contacts during the second quarter suggest that most companies were impacted by the war, either directly or indirectly. The main impact relates to higher import prices. This sentiment was felt even though most firms contacted do not import directly from either Ukraine or Russia. Others mentioned supply disruptions, mainly in the form of shortages, as a key concern. Higher prices and supply disruptions were mentioned for a number of products, particularly cereal, flour, sunflower oil, meat products, textiles, neon gas and electronic components. Some companies also argued that the conflict may lead to lower demand, either due to its impact on demand of trading partners or even as a result of the sanctions and restrictions imposed. Conversely few services companies noted that they were able to attract Ukrainian workers that left their country.

Annex 1

Table 1
SECTORAL REPLIES
(percentage of companies contacted)

	Construction and Real Estate		Wholesale and Retail		Services		Manufacturing		Total	
	2022 Q1	2022 Q2	2022 Q1	2022 Q2	2022 Q1	2022 Q2	2022 Q1	2022 Q2	2022 Q1	2022 Q2
How have business conditions developed over the past three months?										
Improved	0	55	54	93	57	59	37	53	48	64
Worsened	0	18	0	7	25	9	21	18	18	13
Remained the same	100	27	46	0	18	32	42	29	34	23
Net Balance	0	36	54	86	32	50	16	35	31	52
How do you expect business activity to develop in the next few months?										
Improve	0	45	15	57	46	45	53	47	40	48
Worsen	0	9	0	7	4	36	0	6	2	17
Remain the same	100	27	54	29	36	14	37	41	42	27
Uncertain	0	18	31	7	14	5	11	6	16	8
Net Balance	0	36	15	50	43	9	53	41	39	31
How have you changed your investment plans for this year?										
Continued as scheduled	100	91	62	100	64	86	95	94	74	92
No investments planned	0	0	38	0	21	9	0	0	18	3
Postponed/put on hold	0	9	0	0	11	5	0	6	5	5
Cancelled	0	0	0	0	4	0	5	0	3	0
How have you changed your employment plans?										
Increased	0	27	23	36	36	73	58	29	39	45
Decreased	0	9	0	0	7	0	0	6	3	3
Unchanged	100	64	77	64	57	27	42	65	58	52
Net Balance	0	18	23	36	29	73	58	24	35	42
Did you experience any changes in input prices?										
Increased	100	91	77	93	82	45	89	94	84	77
Decreased	0	0	0	0	9	0	0	0	4	0
Unchanged	0	9	23	7	9	55	11	6	13	23
Net Balance	100	91	77	93	73	45	89	94	80	77
Did you change your selling prices?										
Increased	100	64	38	64	26	50	68	76	45	63
Decreased	0	0	8	0	13	0	0	6	7	2
Unchanged	0	36	54	36	61	50	32	18	48	36
Net Balance	100	64	31	64	13	50	68	71	38	61

Source: Central Bank of Malta Business Dialogue.