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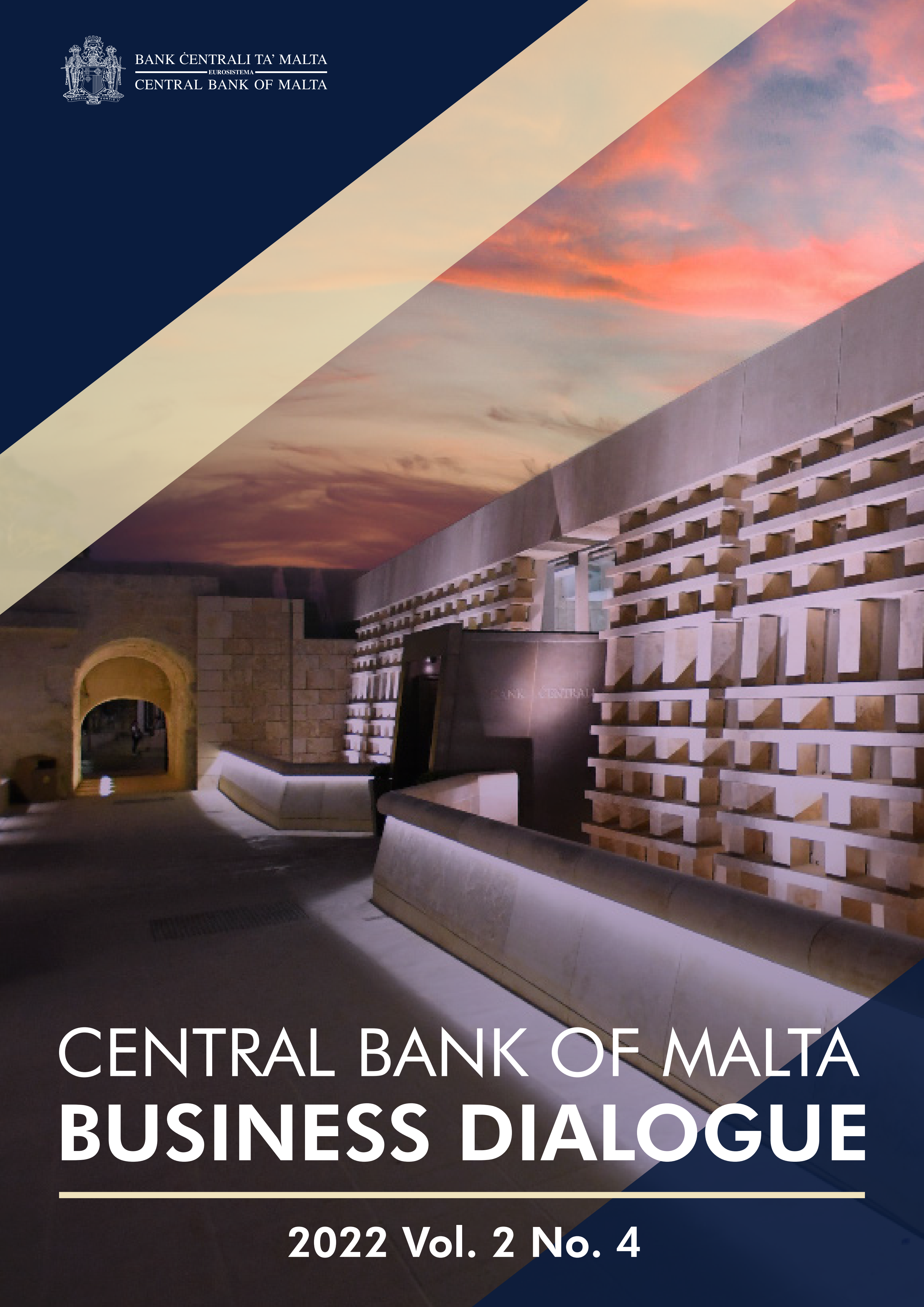

CENTRAL BANK OF MALTA
BUSINESS DIALOGUE

2022 Vol. 2 No. 4

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

ISSN 2788-7758 (online)

MAIN FINDINGS FROM THE 2022 Q3 ROUND OF CONTACTS WITH NON-FINANCIAL CORPORATIONS

Summary

Information gathered during contacts with non-financial corporations made by the Central Bank of Malta between July and September 2022 indicates that overall business conditions remain positive. A net 54% of respondents reported an increase in activity over the three months preceding the interview, up from a net share of 52% in the previous quarter. The strongest positive assessment was recorded in the services and in the wholesale and retail sectors.

Short-term expectations about business activity improved slightly. Around 44% of the contacts reported that they expect business activity to expand over the next three months, while 10% anticipated a decline. When compared to the preceding quarter, the net share of respondents expecting an amelioration in business activity rose to 35% from 31%. Nonetheless, the share of contacts reporting that the outlook was uncertain has risen to 11%, from 8% in the second quarter, with the increase in uncertainty strongest among wholesale and retail firms.

Cost pressures have remained elevated. Indeed, a record high net 88% of contacts reported that input prices have increased, up from 77% in the previous quarter.

The net share of firms reporting selling price increases fell to 52% from the 61% reported in previous quarter. Such increases in selling prices were classified as significant by 24% of all companies surveyed, and less prominent by 31%. In the quarter under review, 83% of respondents reported that investment plans continued as scheduled, down from 92% in the previous quarter. At the same time, a net 48% of firms planned to hire staff, higher than the 42% observed in the previous quarter.

In the third quarter of 2022, a total of 63 telephone/virtual meetings with leading non-financial corporations were conducted. These include 17 manufacturing companies, 31 services-oriented companies, 10 wholesale and retail companies, and five construction and real estate companies.[1]

Insights gathered during the third quarter continue to suggest that the Russia-Ukraine war remains a concern, particularly in terms of higher import prices and the availability of supplies.

Business conditions continue to improve

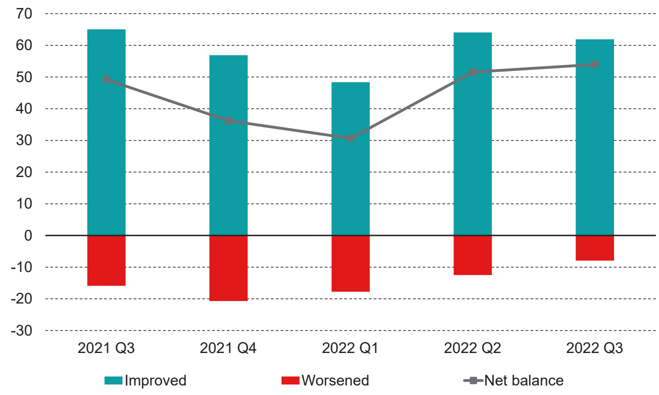
Information gathered between July and September 2022 indicates that – on balance – business conditions continued to improve during the three months preceding the survey. The net share of respondents reporting an amelioration in business conditions increased marginally to 54%, from 52% in the previous quarter.

During the quarter under review, 62% of firms stated that business conditions had improved over the past three months, down marginally from 64% in the second quarter of the year (see Chart 1). At the same time, the share of firms stating that business activity worsened declined

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

to 8% from 13% in the previous quarter. The number of firms stating that business conditions remained unchanged increased to 30%, from 23% in the previous quarter.

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 manufacturing sector, where the net balance of manufacturing companies reporting improved business conditions increased sharply to 53%, from 35% in the previous quarter. The percentage of firms reporting an improvement in activity increased from 53% in the second quarter of 2022 to 59% in the third quarter. A positive assessment was common across multiple manufacturing sub-sectors but particularly in the injection moulding, printing, and packaging and pharmaceutical sub-sectors. Firms reporting worsened conditions declined from 18% to just 6%. Meanwhile, the share of manufacturing firms stating that conditions have remained unchanged has risen from 29% to 35% in the third quarter.

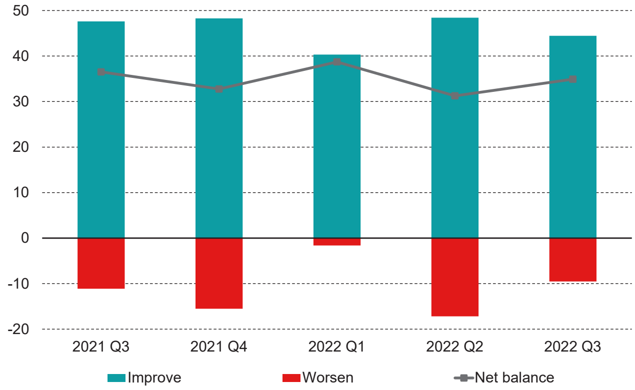
Business conditions also improved significantly in the services sector, though by less than in manufacturing. The net balance rose from 50% in the second quarter to 61% in the third quarter. Business conditions were particularly positive within the accommodation, travel and transport related segments reflecting a strong pickup in tourism. Indeed, the share of services firms stating that conditions improved has risen to 68%, up from 59% in the preceding quarter. The share of services firms reporting worse conditions declined slightly from 9% to 6%. Meanwhile, the share of services-oriented businesses reporting unchanged conditions decreased from 32% to 26%.

Conversely, business conditions in the trade sector have softened. A net 60% of respondents in this sector assessed conditions to have improved in recent months, down from 86% in the previous quarter. The share of firms reporting improvements declined from 93% to 60% in the third quarter. At the same time, those reporting worsening conditions also declined from 7% in the second quarter to nil in the third quarter. The share of firms stating conditions remained the same has risen sharply from nil to 40% in the quarter under review. Despite the recent softening in business conditions, demand remained robust across various retail segments but most particularly within the food and beverage, and electronics and appliances segments.

Conditions in the construction and real estate sector were somewhat mixed as 40% of firms reported higher activity during the period under review, while another 40% stated that conditions worsened. The remaining 20% share said that conditions remained the same. Therefore, the net balance of firms reporting an improvement stood at 0% – down from 36% in the second quarter of the year. Lengthy vetting processes by banks for loan applications by foreigners were among the factors mentioned by contacts that were impacting the operations of surveyed real estate companies.

Expectations for short term business conditions remain optimistic

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?"

Looking ahead, 44% of the firms contacted during the third quarter of this year anticipated their business activity to improve further over the next three months, slightly down from 48% in the previous quarter (see Chart 2). Nonetheless, the share of firms which expected conditions to worsen over the next three months decreased even more significantly, from 17% in the second quarter to 10% in the quarter under review. Consequently, the net share of firms reporting an improvement in the near-term outlook increased from 31% to 35%. The share of respondents expecting similar conditions in the coming three months, has risen from 27% in the second quarter of 2022 to 35% in the third.

Meanwhile, uncertainty amongst respondents has risen somewhat, driven by heightened inflationary pressures. Indeed, the share of respondents reporting an uncertain outlook rose from 8% to 11% in the third quarter of the year.

The strongest improvement in the near-term business outlook was reported by firms in the construction and real estate sector. Indeed, 75% of such companies interviewed in the third quarter of 2022 expected an improvement in their business activity over the next three months, up from 45% in the previous quarter. At the same time, the share of these firms expecting conditions to worsen declined from 9% to nil. As a result, the net balance in this sector increased sharply from 36% to 75%. Meanwhile, the share of construction and real estate firms expecting conditions to remain the same fell by 2 percentage points to stand at 25%.

In the services sector, the net balance of firms reporting a better outlook rose from 9% to 35%. Although the share of firms expecting an improvement in their business activity over the next three months remained unchanged at 45%, the share of services firms expecting conditions to worsen decreased from 36% in the second quarter to 10% in the quarter under review. Compared to the previous quarter, the share of firms in the services sector that were uncertain about the immediate future declined marginally from 5% to 3%.

Moreover, the proportion of manufacturing firms that expect business conditions to improve rose from 47% in the previous quarter to 50% in the quarter under review. Yet, the share of manufacturing firms expecting conditions to worsen increased from 6% to 11%. Therefore, the net balance of firms reporting improved business expectations within this sector declined marginally to 39%, from 41% in the preceding quarter. However, uncertainty doubled in this sector to stand at 11% of respondents.

Less favourable conditions are expected within the wholesale and retail sector. A net 10% of firms contacted between July and September 2022 expected sales activity over the next three months to improve, significantly down from 50% in the previous quarter. This reflected a strong decline in the share of respondents expecting an improvement in sales (from 57% to 20%), while those expecting worse conditions also increased but at a much lesser extent (from 7% to 10%). Furthermore, uncertainty in this sector increased sharply from 7% to 40%, driven by high inflation and its potential to negatively affect demand.

Firms' investment and hiring plans continue to be strong

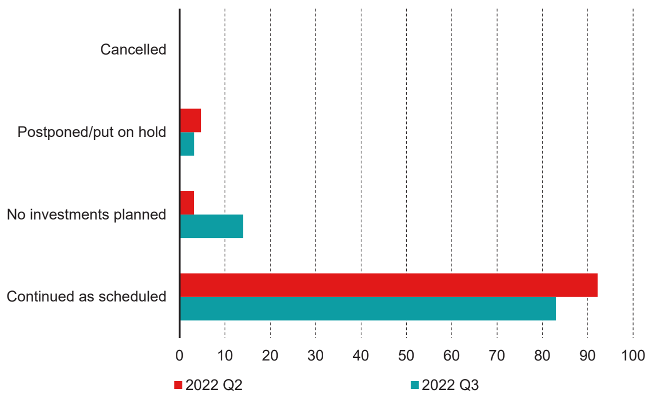
During the quarter under review, most companies (83%) contacted reported that their investment plans continued as scheduled, compared to 92% in the previous quarter (see Chart 3). Most firms noted that they were maintaining their investment plans as they are optimistic of future business conditions. Moreover, certain companies have initiated additional investments or resumed the projects that were halted in the past two years due to the pandemic. Additionally, most companies plan to invest more or the same level next year. This reflects the overall improvement in business activity and positive long-term expectations beyond the impact of the Russia-Ukraine war.

The share of companies that postponed their investment plans continued to decline from the previous quarter to only 3%. As in the previous quarter, none of the companies contacted cancelled their investment plans. Nevertheless, 14% of the companies contacted in the third quarter of 2022 claimed that they did not have any investments planned, compared to 3% in the previous quarter. However, some of these companies – which operate in the retail and services sectors – said that they had significant investments in the past few years and hence no further investment was required for the time being.

Looking at investment plans by sector, 94% of the manufacturing companies contacted in the third quarter reported that they had continued with their planned investments. The rest of the companies decided to put their investment plans on hold for the near future. Similarly, in the real estate and construction sector, all the firms interviewed said that investments continued as planned. Most firms contacted in the services sector (81%) also noted that they continued with their planned expenditure, but almost a fifth of firms in this sector said that they do not have any investment planned. Wholesale and retail companies were the least likely to say that they continued with their investment plans (60%). This sector also had the highest incidence of firms with no planned investments (40%).

When asked about employment plans, the responses collected reveal continued increase in the demand for labour. During the third quarter of 2022, a net 48% of respondents anticipated

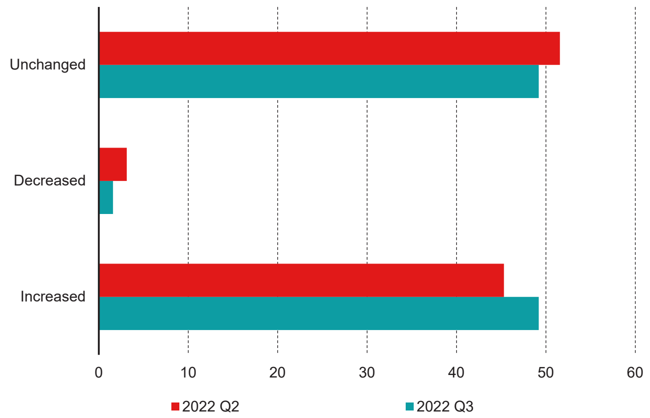
Chart 3
INVESTMENT PLANS
(percentage of companies contacted)



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?"

higher employment, 6 percentage points higher than the net 42% recorded in the previous quarter. 49% of all firms interviewed were planning to increase the number of workers. This was marginally higher than 45% reported in the second 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 remains low, at 2% (see Chart 4). These include companies that are not replacing workers who voluntarily resign. The share of respondents that did not alter their employment plans declined to 49%, from 52% in the second quarter of the year. 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 balance, hiring intentions were more prevalent in the construction and real estate sector (with a net share of 60%), followed by industry and services (around 48%). In the wholesale and retail sector this share was smaller (40%).

Labour shortages and wage pressures remain a major concern

The companies interviewed remain highly concerned about shortages of labour and skills. Most of the companies contacted claim that they are finding it very difficult to find new workers. Company representatives said that it is also challenging to retain their current workforce, and consequently, most companies reported high staff turnover rates. This sentiment was expressed by firms across all sectors.

Also, some companies expressed concerns regarding the lengthy process to obtain work permits for third-country nationals. Consequently, those affected are resorting to sub-contracting workers, which is more costly.

In view of the parallel increase in labour market tightness and inflation, a rising number of companies claimed that they are being forced to offer very significant wage increases to avoid excessive staff turnover. Wage increases were mentioned by firms operating in all sectors, with increases ranging from 3% to even 20% in some instances.

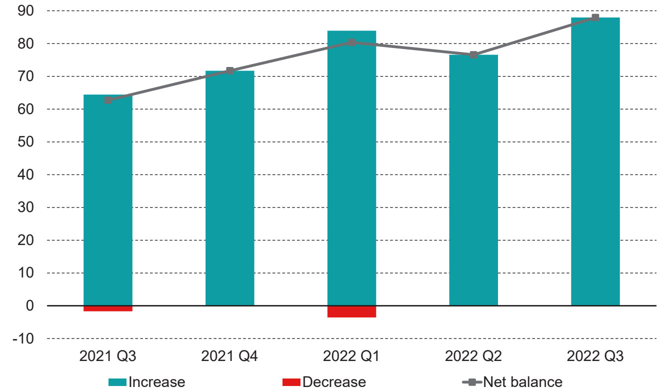
Supply chain disruptions and cost pressures remain elevated

The majority of firms across all sectors outlined that supply chain disruptions remain a concern. As expected, the war between Russia and Ukraine has led to increasingly significant delays in the delivery of raw materials and amplified shortages of certain vital inputs such as glass, electronic chips, cereal, flour, sunflower oil, meat products and plastic. This is forcing companies to change suppliers and to increase their ordering levels and frequency, as lead times are continuously increasing. Strikes and delays in airports overseas also had an impact on the operations of local firms while transportation costs have remained elevated. As a result, some businesses are faced with increased storage costs and cashflow shortages as they seek to stock up on raw materials to ensure availability of inputs and secure more favourable prices.

In the third quarter of 2022, around 88% of companies contacted reported an increase in their input costs (see Chart 5). This implies that cost pressures have remained dominant across all sectors. The remaining 12% indicated that their input prices remained unchanged, with no firms reporting a decrease in input costs. In net terms, the share of companies reporting an increase in input costs increased from 77% in the second quarter of the year to 88% in the third quarter, reaching the highest net share of companies reporting an increase in input costs since the start of the exercise.

The rise in input costs was broad-based across all sectors. All contacted companies in the construction sector reported higher input costs, followed by the services sector (90%), the manufacturing sector (88%) and the wholesale and retail companies (78%).

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

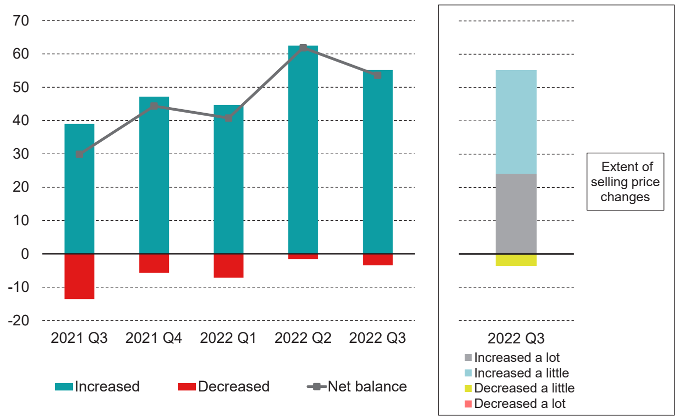


Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "Did you experience any changes in input prices?"

The significant rise in input costs reported by firms reflects global price hikes for several commodities, including fuel, food (particularly meat, oil, and flour), cement, and electronics, as well as materials such as glass, iron, and copper. Higher costs and wage demands have brought a lot of uncertainty in terms of budgeting, production planning and guaranteeing delivery to customers.

During the quarter under review, the percentage of firms that have reported an increase in selling prices decreased from 63% in the previous quarter to 55% (see Chart 6). Of those which reported higher selling prices, 24% said that prices increased by 'a lot' while the other 31% noted that they

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?"

increased selling prices by ‘a little’. Only 3% of firms were able to decrease selling prices slightly, while the remaining 41% 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 decreased from 61% in the previous quarter to 52%.

This increase in selling prices was most prominent in the construction sector as all of these companies reported increases. This was followed by the trade sector where the net balance of companies reporting an increase in selling prices stood at 60%, and the manufacturing sector at 59%. A lower net share of 43% was observed in the services sector.

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.

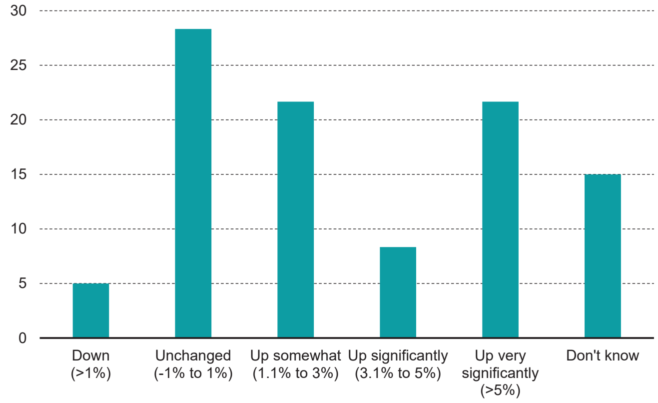
BOX 1: EXPECTATIONS OF UNIT COSTS[2]

In view of the exceptional increase in costs, during this round of contacts, respondents were asked about their projected unit costs for the next 12 months.

The largest share of respondents (28%) noted that they expect the unit costs to remain broadly unchanged, that is, an increase of up to 1% or a decrease of not more than 1% (see Chart 7). Around 22% of the respondents said that they expect the unit costs to increase by up to 3%, while 8% expect increases of between 3% and 5%.

At the same time, 22% of the companies responded that they project unit cost increases of over 5%. Most of these firms operate in the services sector. Around 15% of firms are uncertain about changes in unit costs in the next 12 months. On the other hand, some companies (5%) anticipate lower unit costs next year, partly because they experienced abnormal increases this year.

Chart 7
UNIT COST EXPECTATIONS
(percentage of companies contacted)



Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "What changes in unit costs are you expecting this time next year?"

[2] 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.

Firms express concerns regarding the war between Ukraine and Russia

Insights gathered from the contacts during the third quarter suggest that most companies experienced direct or indirect impacts of the war. The main impact mentioned relates to higher import prices and supply chain disruptions. A few companies were also impacted directly by sanctions imposed by the European Union on Russia. These companies operate in the real estate, shipping, and education sectors. Additionally, firms are concerned about the uncertainty associated with the war. Conversely, a few firms were impacted positively. One service-oriented firm noted that demand increased due to the shutdown of some firms in Ukraine, while a retail company said that as a result of the war, some countries in mainland Europe were impacted very negatively and lowered their order levels, leading to a larger availability of supply.

Annex 1

Table 1
SECTORAL REPLIES
(percentage of companies contacted)

	Construction and Real Estate		Wholesale and Retail		Services		Manufacturing		Total	
	2022 Q2	2022 Q3	2022 Q2	2022 Q3	2022 Q2	2022 Q3	2022 Q2	2022 Q3	2022 Q2	2022 Q3
How have business conditions developed over the past three months?										
Improved	55	40	93	60	59	68	53	59	64	62
Worsened	18	40	7	0	9	6	18	6	13	8
Remained the same	27	20	0	40	32	26	29	35	23	30
Net balance	36	0	86	60	50	61	35	53	52	54
How do you expect business activity to develop in the next few months?										
Improve	45	75	57	20	45	45	47	50	48	44
Worsen	9	0	7	10	36	10	6	11	17	10
Remain the same	27	25	29	30	14	42	41	28	27	35
Uncertain	18	0	7	40	5	3	6	11	8	11
Net balance	36	75	50	10	9	35	41	39	31	35
How have you changed your investment plans for this year?										
Continued as scheduled	91	100	100	60	86	81	94	94	92	83
No investments planned	0	0	0	40	9	16	0	0	3	14
Postponed/put on hold	9	0	0	0	5	3	6	6	5	3
Cancelled	0	0	0	0	0	0	0	0	0	0
How have you changed your employment plans?										
Increased	27	60	36	40	73	52	29	47	45	49
Decreased	9	0	0	0	0	3	6	0	3	2
Unchanged	64	40	64	60	27	45	65	53	52	49
Net balance	18	60	36	40	73	48	24	47	42	48
Did you experience any changes in input prices?										
Increased	91	100	93	78	45	90	94	88	77	88
Decreased	0	0	0	0	0	0	0	0	0	0
Unchanged	9	0	7	22	55	10	6	12	23	12
Net balance	91	100	93	78	45	90	94	88	77	88
Did you change your selling prices?										
Increased	64	100	64	60	50	50	76	59	63	55
Decreased	0	0	0	0	0	7	6	0	2	3
Unchanged	36	0	36	40	50	43	18	41	36	41
Net balance	64	100	64	60	50	43	71	59	61	52

Source: Central Bank of Malta Business Dialogue.