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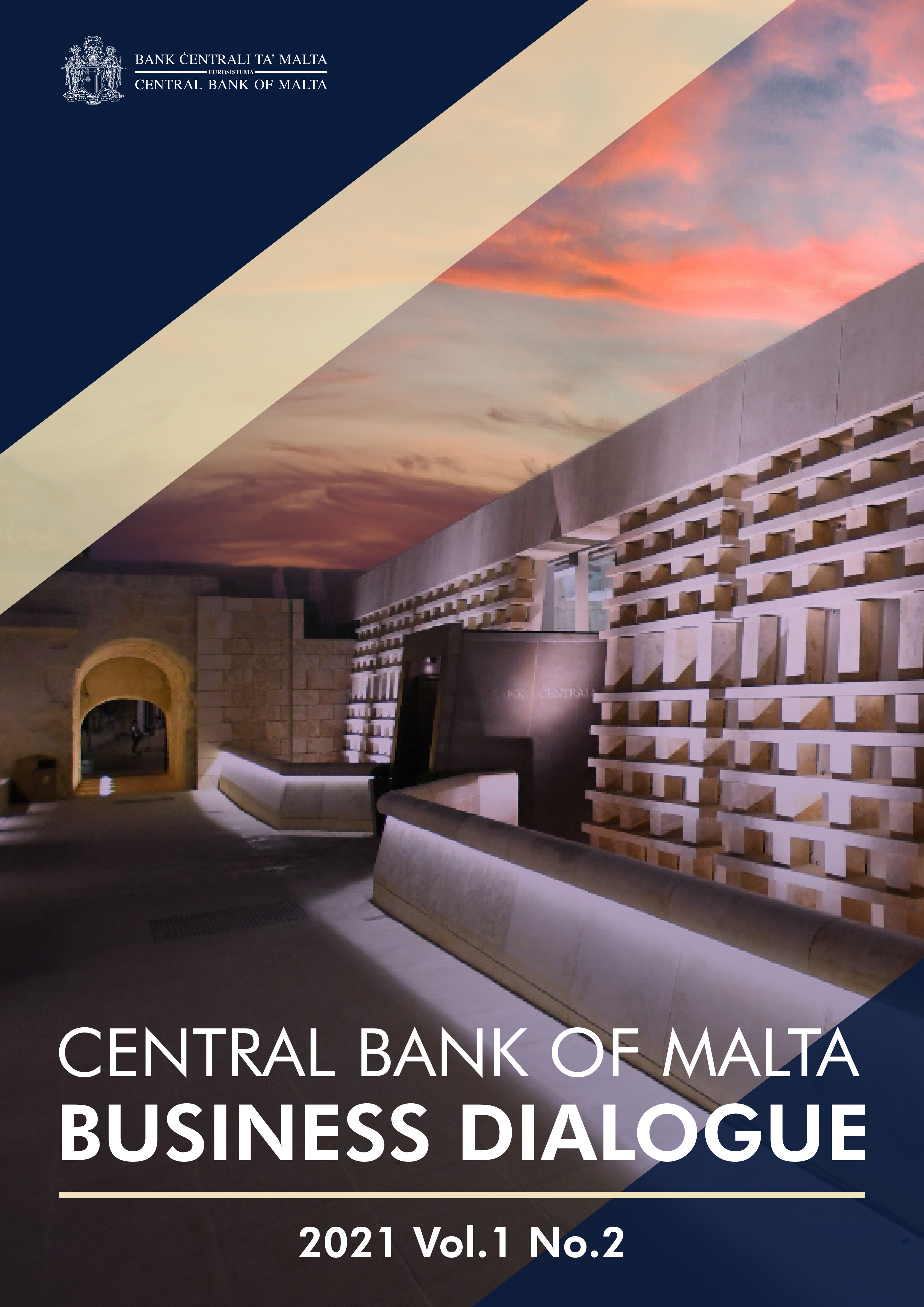

CENTRAL BANK OF MALTA BUSINESS DIALOGUE

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MAIN FINDINGS FROM THE 2021Q2 ROUND OF CONTACTS WITH NON-FINANCIAL CORPORATIONS

Summary

Information gathered during contacts made between April and June 2021 indicates that overall business conditions have improved significantly with almost half of the firms contacted reporting higher activity, significantly above the 21% that reported negative developments. Thus, a net 28% of respondents reported an increase in activity over the three months preceding the interview. This contrasts with the results for the first quarter, when on balance firms had reported a decrease in activity.

Short-term expectations about business activity also improved. Almost 40% of contacts expect business activity to expand over the next three months, while 5% anticipated a decline. As a result, the net share of respondents expecting an amelioration in business activity more than doubled, reaching 33%. Nonetheless, uncertainty remains elevated, especially in certain manufacturing sub-sectors and in tourism- and entertainment-related services.

The vast majority of contacts reported that input prices have increased recently with some of these firms forced to increase selling prices.

As in the previous quarter, almost 70% of respondents reported that investment plans continued as scheduled, with a further 15% reporting postponement. The share of respondents reporting cancellations fell to zero. However, a non-negligible percentage (16%) stated that they have no planned investments – with the highest percentage reported in the wholesale and retail sector, and in 'other services' activities.

The employment situation looks more encouraging as a net 38% of firms plan to increase employment levels. In the first quarter of the year, by contrast, on balance firms had expected a decrease in headcount. Nonetheless, issues with labour shortages have resurfaced.

In the second quarter of 2021, a total of 62 telephone/virtual meetings with leading non-financial corporations were conducted. These include 17 manufacturing companies, 20 services-oriented companies, ten wholesale and retail companies, ten construction or real estate companies and five public/private institutions.[1]

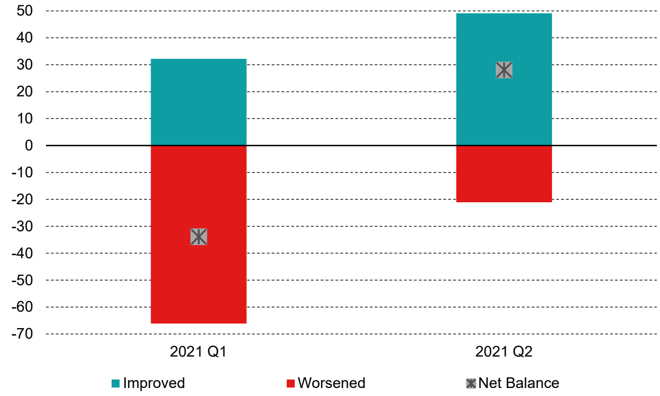
Overall business conditions have improved significantly

Information gathered between April and June 2021 indicates that – on balance – business conditions have improved significantly. Indeed, 49% of the firms interviewed in the second quarter of 2021 stated that their business conditions improved over the past three months, up from 32% in the first quarter (see Chart 1). Meanwhile, the share of firms stating that business activity worsened over the prior three months fell from 66% in the first quarter of the year to 21% in the second quarter. Hence, a net share of 28% reported an amelioration in business conditions, compared to a net 34% that reported a deterioration in the previous quarter. Moreover, the number of firms

[1] More information on the structure, methodology and evolution of the CBM Business Dialogue exercise can be found at: https://www.centralbankmalta.org/site/Publications/CBM-Business-Dialogue-Exercise.pdf?revcount=1846

stating that business conditions have remained unchanged also rose sharply, from 2% in the first quarter to 30% in the second.

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?"

The improvement in overall business conditions was mostly attributed to the services sector, which underwent an impressive upturn in activity. Around 70% of the services-oriented firms contacted in the second quarter of 2021 stated that economic conditions had improved over the past three months, up from 15% in the previous quarter (see Table 1). At the same time, the number of services companies signalling a worsening in activity declined from 85% in the first quarter of 2021 to 15% in the second. In the meantime, 15% of the services firms interviewed confirmed that conditions were unchanged, as opposed to zero in the first quarter. Reflecting these developments, the net balance of replies shifted from -69% to 55%. In particular, business conditions have improved in the gaming, transport, logistics and freight forwarding, travel, financial, catering, and accommodation and hospitality services sub-sectors.

Following the recent lifting of restrictions, a net 30% of respondents within the wholesale and retail sector assessed conditions to have improved, up from 22% in the previous quarter. However, the share of respondents assessing business conditions to have remained unchanged more than doubled, reaching 30% of firms in the sector. A strong pick up in demand was reported by firms that sell durables and electronics, domestic appliances, food and beverage items, and clothing and footwear, in May and June.

Business conditions within the construction and real estate sector seem to have stabilised on balance. This contrasts with the assessment in the first quarter, when a net balance of respondents reported deteriorating conditions. In the reference quarter, most respondents (40%) claimed that activity remained the same over the past three months, whereas the remaining firms were equally divided between those reporting an improvement and those reporting a worsening in business conditions (see Table 1).

Similarly, business conditions improved in the manufacturing sector. Around 41% of firms claimed that business conditions remained the same over the previous three months. The number of firms reporting improvements declined, while the number of firms reporting a deterioration in business conditions more than halved since the first quarter of 2020 (see Table 1). Indeed, a net 12% of respondents reported an improvement in business conditions, in contrast to a net balance of -6% in the first quarter. Firms in the production of electronics and electronic components as well as of pharmaceutical products continued to report positive conditions while conditions in certain food and beverage items generally remained negative.

Supply chain disruptions intensify

Given that firms had indicated their concerns on supply chain disruptions during the initial stages of the pandemic, the Bank has continued to gather intelligence on this aspect. Between April and June 2021, firms contacted indicated considerable disruptions to the supply chain, which have intensified considerably in recent months. In particular, there are increasing concerns regarding delays in deliveries. Lead times have increased drastically, generally by between a couple of weeks to four months.

Supply-chain disruptions have increasingly resulted in an international shortage of microchips as demand for semiconductors is significantly outweighing supply. In particular, the motor vehicle industry's faster-than-anticipated recovery following factory shutdowns – when companies cancelled chip orders after incorrectly forecasting lower demand for the rest of the year – caused significant bottlenecks. Recourse to teleworking during the pandemic may have amplified these shortages. Contacts claim that the shortage was intensified by companies looking to overstock in anticipation of concerns about the security of supplies. Combined with shortages of other inputs (e.g. chemicals, plastic, metals, and wood), and shipping disruptions, the semiconductor chip shortage severely affected suppliers' delivery times. This shortage is expected to persist in the near term and may continue to disrupt delivery times of other materials and components.

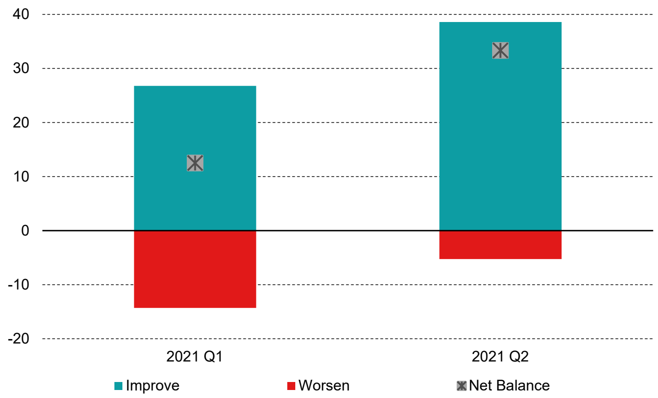
Brexit impact remains limited

During the period under consideration, firms were again asked to provide their assessment of the impact of Brexit on their companies. Most companies interviewed were either not directly impacted by Brexit or only mentioned minor issues. Nonetheless, a relatively small number of firms mentioned a few Brexit-related issues. The main concerns relate to shortages of certain products, delays, cost increases, lengthy customs clearance procedures, extra paperwork, and additional invoicing. The quoted cost increases directly derived from Brexit varied between 5% to 25%. Furthermore, some retailers had to stop importing certain UK brands, whereas others started importing substitute products from other European markets. Most companies which currently interact with UK firms are looking to move away from the UK market by sourcing new suppliers.

Expectations about activity have improved – labour shortages have become pressing

Looking ahead, most firms contacted during the second quarter of 2021 anticipate their business activity to get better over the next three months. In fact, 39% of firms expect conditions to improve (see Chart 2). Moreover, the number of firms which

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?"

expect conditions to worsen over the next three months declined from 14% in the first quarter to just 5% in the quarter under review. Consequently, the net share of firms reporting improved expectations more than doubled, to 33%.

Although the pace of vaccination in Malta has continued to increase strongly, uncertainty among firms remains elevated, especially in specific economic sectors. Indeed, the number of firms who were uncertain about future activity increased slightly from 16% to 18% between April and June 2021. In particular, uncertainty remains elevated among firms in some manufacturing sub-sectors and companies operating within the hospitality and catering and entertainment industries.

The overall more upbeat expectations were mostly driven by an improvement in expectations in the services sector and, to a lesser extent, in the manufacturing sector (see Table 1).

Indeed, 60% of firms categorised as service-oriented companies expected a further improvement in their business activity over the next three months, a substantial increase when compared to the previous quarter. Meanwhile, 10% of services firms expected conditions to worsen, up slightly from 8% in the previous quarter. The increase in the share of respondents with upbeat expectations was mostly mirrored by a decrease in the share of respondents reporting unchanged conditions or uncertainty about their business conditions.

In the manufacturing sector, a net 29% of firms contacted between April and June 2021 expected activity over the next three months to improve. This contrasts with a net share of 6% who anticipated a deterioration in the previous round. This shift in sentiment mostly reflected a sharp fall in the share of firms anticipating a decrease in activity – which fell from 29% to 6% although the share of firms with positive expectations also contributed. Nevertheless, uncertainty in this sector has increased considerably since the first quarter, as now 24% of manufacturing firms – mostly those involved in the production of electronics, food and beverage, and consumer durables – are unsure of short-term business conditions.

By contrast, in the wholesale and retail sector, and in the construction and real estate sector – while still positive on balance – expectations were less upbeat compared with the first quarter.

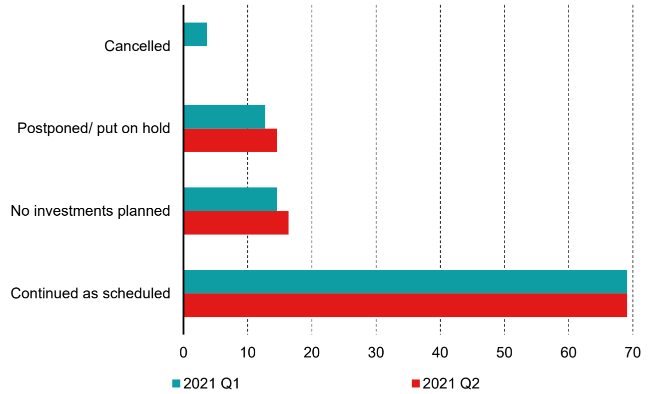
Within the wholesale and retail sector, half of respondents predicted that sales levels will be on the same levels in the next three months, up from 33% in the first quarter. Nevertheless, the share of firms expecting an improvement in sales dropped from 44% to 30%. Once again, none of the firms interviewed are expecting a deterioration in sales. The remaining 20% were still uncertain. Firms expressing this view were mainly retailers of food, clothing and footwear.

On the other hand, 80% of construction and real estate firms stated that activity was expected to remain unchanged from that in previous quarters. Meanwhile, a tenth of respondents in this sector expected an improvement, while none envisaged a deterioration. Thus, a net 10% of respondents anticipated an improvement in business conditions, down from 33% in the first quarter of 2021.

Firms' investment and hiring plans are encouraging

During the initial stages of the pandemic, a substantial number of firms had halted their investment plans, primarily due to the elevated level of uncertainty. However, since the third quarter of 2020, the survey reveals an increase in the percentage of firms who have restarted their investment plans. Indeed, the majority of companies contacted during the first two quarters of 2021 reported that their investment plans remain on track (see Chart 3). Indeed, 69% of the firms contacted in the second quarter of 2021 reported that they persevered with their planned capital expenditure. This was partly because some projects would have been committed far in advance. The share of the contacts claiming that they postponed or paused their investment plans and adopted a 'wait-and-see' approach remained broadly unchanged at 15% in the second quarter of 2021, compared to 13% in the previous quarter. Moreover, none of the firms contacted during the second quarter of 2021 cancelled their projects. Around 16% of the contacts made in the second quarter claimed that they did not have any investments planned, compared to 15% recorded in the previous quarter. This share was highest in the services sector, followed by the wholesale and retail sector.

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?"

Looking at investment plans by sector, 76% of the manufacturing companies continued with their plans, while 18% postponed their investments (see Table 1). A similar scenario was observed in other sectors.

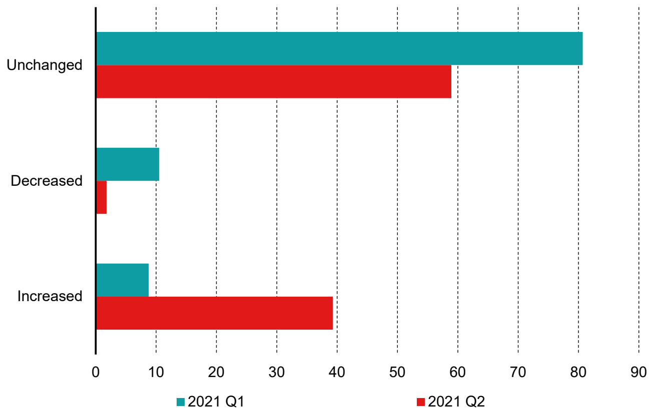
During the second quarter of 2021, the contacts interviewed – particularly those operating in the services industry – said that the shortage of labour is a major concern and that they are finding it difficult to recruit new employees. These firms claimed that the situation is similar or slightly more challenging than the period prior to the pandemic, due to limited access to third-country nationals.

Indeed, the responses collected reveal an increase in the share of firms that plan to recruit more staff. Around 39% of the firms interviewed expected to increase their staff complement, significantly up from 9% in the previous quarter, while the share of firms expecting to shed labour fell to 2%, from 11% in the previous round (see Chart 4). Consequently, a net 38% of respondents anticipated higher employment, in contrast to a net 2% that expected to decrease their staff complement in the previous round. The share of respondents that did not alter their employment plans also decreased, standing at 59%, compared to 81% in the first quarter of 2021.

Nonetheless, while hours worked have increased in most sectors, some firms still report that these have not completely returned to normal levels for their business. At the same time, while the reliance on the Wage Supplement Scheme remains essential, its importance is declining due to the improvement in business conditions.[2]

All sectors reported a strong increase in labour demand and hence plan to increase head-count (see Table 1). In particular, a net 64% of services-oriented firms plan to recruit, sharply up from 0% in the previous quarter. The latter recruitment drive was mostly due to the recent increase in demand, particularly following the lifting of Covid-19 restrictions.

Chart 4
EMPLOYMENT PLANS
(percentage of companies contacted)



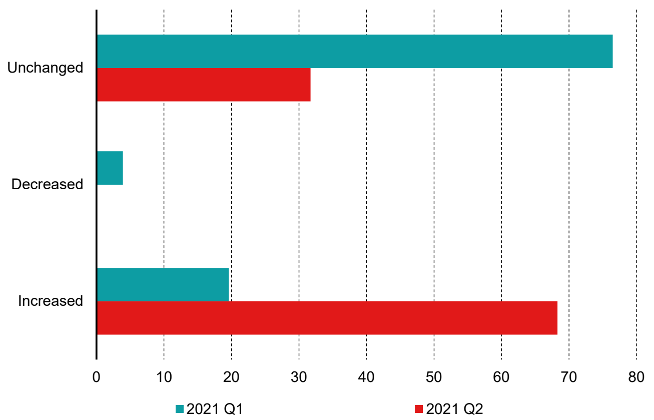
Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "How have you changed your employment plans?"

Contacts report increased input prices

During the first quarter of 2021, 68% of firms interviewed reported an increase in input prices, significantly up from 20% in the first quarter of 2021 (see Chart 5). The rest of the firms (32%) experienced unchanged costs, with none of the firms interviewed reporting falling input costs. As a result, the net share of respondents reporting higher costs reached 68%, from 16% in the previous survey round.

The increase in prices for many raw materials and related inputs accelerated in recent months given the rise in global demand and supply imbalances. Moreover, since the third quarter of 2020, some firms have been lamenting the rise in global transportation costs. This issue has now become a key concern for almost all importing firms, especially those importing from outside Europe. Higher transport prices partly reflect the strong rise in demand for intermediate inputs on the back of stronger manufacturing activity and a consequent rise in the demand for container shipments. At the same time, as containers were grounded as a consequence of measures adopted to contain the spread of COVID-19, shortages of containers at Asian ports further increased shipping costs. Moreover, lack of routes

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



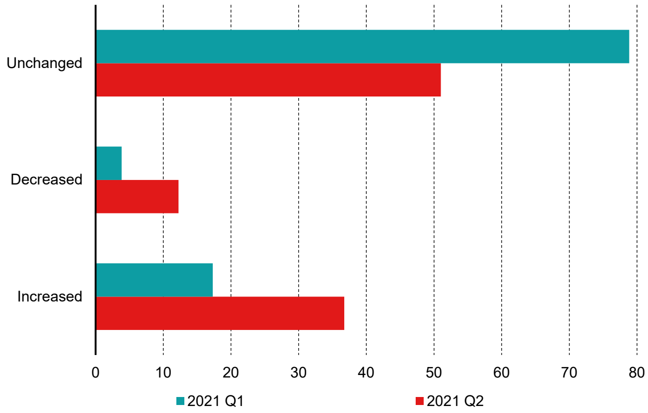
Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "Did you experience any changes in input prices?"

[2] In addition to the Government's wage supplement, many firms were also beneficiaries of other government schemes such as the rent refund scheme and the electricity bill refund scheme. These schemes continued to provide support to businesses during difficult times, although to a much lesser extent than the Wage Supplement Scheme.

by both sea and air towards Malta also contributed.

Apart from higher input and transport costs, some businesses also continued to incur additional costs related to COVID-19 safety measures. These include preventative measures such as hygiene requirements and social distancing, as well as disruptions caused by infections at the workplace and the quarantining of workers.

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?"

As a consequence of the steep increase in input prices, more firms have reported that they are charging higher selling prices. Indeed, around 37% of firms interviewed said that they had to increase their selling prices – up from 17% in the previous quarter (see Chart 6). On the other hand, some firms – particularly those operating in the construction, wholesale and retail, and service-oriented industries – offered discounts or reduced their selling prices to attract demand. The share of firms reporting price cuts thus also increased compared to the first quarter, but this increase was limited in comparison to the increase in the number of firms reporting higher selling prices. Thus, the net balance of firms reporting higher selling prices broadly doubled compared to the first quarter. Around half of the firms contacted in the second quarter of 2021 kept their selling prices unchanged, notably lower than the 79% in the previous quarter.

Annex 1

Table 1
SECTORAL REPLIES
(percentage of companies contacted)

	Construction and Real Estate		Wholesale and Retail		Services		Manufacturing		Total	
	2021 Q1	2021 Q2	2021 Q1	2021 Q2	2021 Q1	2021 Q2	2021 Q1	2021 Q2	2021 Q1	2021 Q2
How have business conditions developed over the past three months?										
Improved	40	30	56	50	15	70	47	35	32	49
Worsened	60	30	33	20	85	15	53	24	66	21
Remained the same	0	40	11	30	0	15	0	41	2	30
Net Balance	-20	0	22	30	-69	55	-6	12	-34	28
How do you expect business activity to develop in the next few months?										
Improve	67	10	44	30	15	60	24	35	27	39
Worsen	33	0	0	0	8	10	29	6	14	5
Remain the same	0	80	33	50	54	15	41	35	43	39
Uncertain	0	10	22	20	23	15	6	24	16	18
Net Balance	33	10	44	30	8	50	-6	29	13	33
How have you changed your investment plans for this year?										
Continued as scheduled	80	70	78	60	58	67	81	76	69	69
No investments planned	20	10	11	20	13	28	13	6	15	16
Postponed/put on hold	0	20	11	20	21	6	6	18	13	15
Cancelled	0	0	0	0	8	0	0	0	4	0
How have you changed your employment plans?										
Increased	0	10	22	30	8	71	6	29	9	39
Decreased	0	0	0	0	8	7	24	0	11	2
Unchanged	100	90	78	70	85	21	71	71	81	59
Net Balance	0	10	22	30	0	64	-18	29	-2	38
Did you experience any changes in input prices?										
Increased	0	100	44	60	13	55	18	76	20	68
Decreased	0	0	0	0	4	0	0	0	4	0
Unchanged	100	0	56	40	83	45	82	24	76	32
Net Balance	0	100	44	60	9	55	18	76	16	68
Did you change your selling prices?										
Increased	0	40	33	50	18	32	12	35	17	37
Decreased	0	60	11	13	5	11	0	0	4	12
Unchanged	100	0	56	38	77	58	88	65	79	51
Net Balance	0	-20	22	38	14	21	12	35	13	24

Source: Central Bank of Malta Business Dialogue.