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MAIN FINDINGS FROM THE 2023Q1 ROUND OF CONTACTS WITH NON-FINANCIAL CORPORATIONS

Summary

Information gathered by the Central Bank of Malta during contacts with non-financial corporations (NFCs) and other institutions made between January and March 2023 indicates that overall business conditions improved. A net 41% of respondents reported an increase in activity over the three months preceding the interview, up from a net share of 27% in the previous quarter. On balance, conditions were positive across all sectors.

Short-term expectations about improved business activity also increased. Around 54% of firms contacted during the first quarter of 2023 reported that they expect business activity to expand over the next three months, while 6% anticipated a decline. The net share of respondents expecting an amelioration thus stood at 48%, up from 31% in the preceding quarter. Meanwhile, the share of contacts reporting that the outlook was uncertain broadly halved – to 5%.

Cost pressures have eased but remain broad-based. Indeed, a net 64% of contacts reported that input prices have increased, down from 82% in the previous quarter. In the period under review the share of companies that experienced a decrease in input costs (10%) doubled when compared to the previous quarter.

The net share of firms reporting higher selling prices also decreased, and now stands at 42%, 10 percentage points below the previous quarter's share. Increases in selling prices were classified as significant by only 7% of all companies surveyed, and less prominent by 44%.

In the quarter under review, a net 48% of respondents reported that they plan to invest more, up from 27% in the previous quarter. At the same time, a net 46% of firms planned to hire more staff, below the 58% share observed in the previous quarter.

In the first quarter of 2023, a total of 64 telephone/virtual meetings were held with 15 manufacturing companies, 28 services-oriented companies, ten wholesale and retail companies, ten construction and real estate companies and one institution.[1]

Business conditions improve

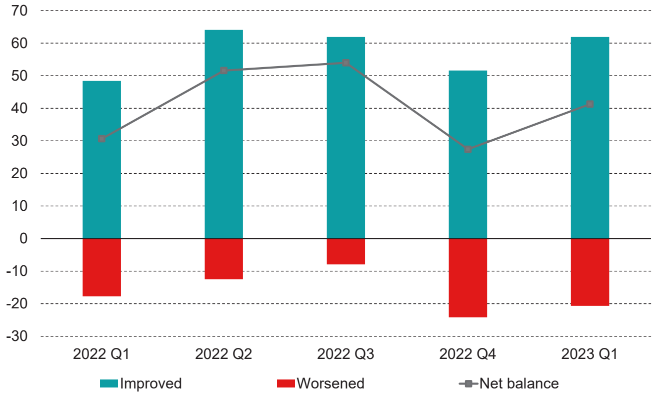
Information gathered between January and March 2023 indicates that – on balance – business conditions improved when compared to the previous quarter.

During the quarter under review, 62% of firms stated that business conditions had improved over the past three months, up from 52% in the fourth quarter of 2022 (see Chart 1). At the same time, the share of firms stating that business activity worsened declined to 21%, from 24% in the previous quarter. Consequently, the net share of respondents reporting an amelioration in business conditions increased to 41%, from 27% in the previous quarter.

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

The share of firms stating that business conditions remained unchanged fell to 17%, from 24% 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?"

While all sectors reported positive conditions on balance, the manufacturing sector had the least positive score. The assessment of recent business conditions improved most in the construction and real estate sector, where the net balance turned positive, from -25% in the fourth quarter of last year, to 60% in the first quarter of 2023. However, the significant improvement in this round partly reflects the higher share of real estate firms who were more likely to express a positive sentiment.

The net balance of manufacturing companies reporting improved business conditions continued to fall, reaching 13% from 18% in the previous quarter. The percentage of firms reporting an improvement in activity declined from 50% to 47% over this period. Meanwhile, the share of firms reporting worsened conditions increased marginally, from 32% to 33%, while the share of manufacturing firms reporting unchanged conditions also rose marginally from 18% to 20%. Positive conditions were reported in the pharmaceuticals, consumer durables and food and beverage sub-sectors.

In the wholesale and retail trade sector, a net 50% of respondents assessed conditions to have improved in recent months, down from 55% in the previous quarter. Although highly positive, this marks a second consecutive decline in conditions in this sector (a similar pattern observed in manufacturing). The share of wholesale and retail firms reporting improvements fell from 73% to 70% in the first quarter of the year, while those reporting worsening conditions increased from 18% to 20%. The share of firms reporting unchanged conditions remained broadly unchanged at around 10%. Positive conditions were mostly reported in the electronics and automotive retail sub-sectors.

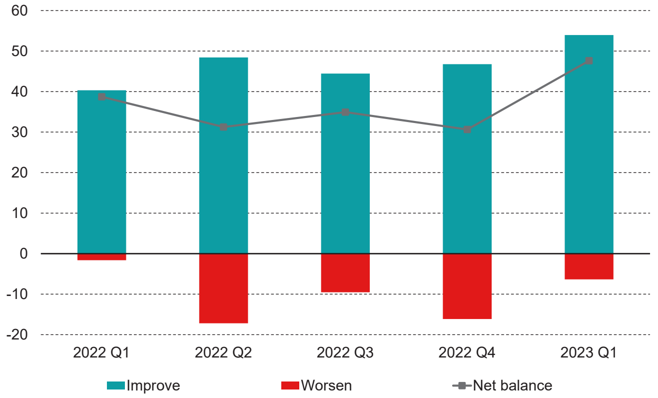
The net balance in the services sector increased, from 43% in the fourth quarter of 2022 to 46% in the first quarter of 2023. While the share of services firms stating that conditions improved rose to 64% from 57%, the percentage of firms reporting worse conditions also increased from 14% to 18%. The positive assessment was especially observed in the accommodation, hospitality and food and beverage sub-sectors, as well as in travel and transport. Meanwhile, the share of services-oriented businesses reporting unchanged conditions fell from 29% to 18%.

Expectations for short term business conditions are more optimistic

Business expectations for the next three months are more positive than those expressed in the fourth quarter of 2022. Indeed, 54% of the firms contacted during the first quarter of this year anticipated their business activity to improve further over the next three months, up from 47%

in the previous quarter (see Chart 2). At the same time, the share of firms which expected conditions to worsen over the next three months decreased from 16% in the fourth quarter of 2022, to just 6% in the quarter under review. Consequently, the net share of firms reporting an improvement in the near-term outlook rose from 31% to 48%.

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?"

The share of respondents expecting similar conditions in the coming three months, increased to 35% in the first quarter of 2023, from 26% in the previous quarter. Meanwhile, the share of respondents reporting an uncertain outlook declined to 5%, from 11% previously.

In terms of net balance, the strongest improvement in the near-term business outlook is recorded for firms in the wholesale and retail sector. Indeed, the net balance rose from 27% to 60% in the quarter under review. The share of such firms expecting an improvement in their business activity over the next three months increased to 60%, while firms expecting conditions to worsen dropped to nil. Moreover, the share of firms which are uncertain of short-term business conditions has fallen from 18% to 10%.

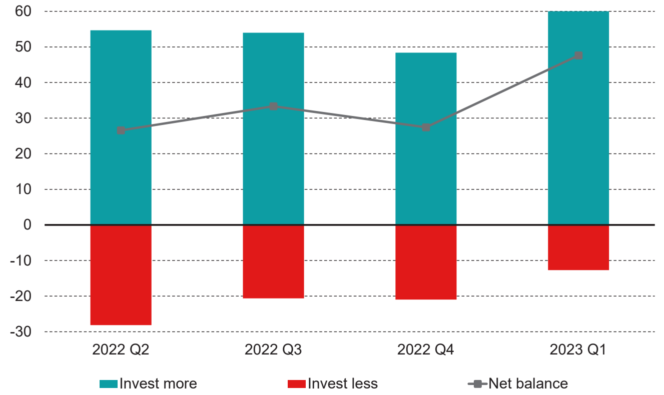
The short-term outlook for activity in the manufacturing sector also improved significantly. Although the proportion of manufacturing firms anticipating business conditions to improve fell by just 1 percentage point to stand at 40% in the quarter under review, the share of manufacturing firms expecting conditions to worsen dropped significantly, from 23% to nil. Consequently, the net balance of firms reporting improved business expectations within this sector increased to 40%, from 18% in the preceding quarter. Nevertheless, uncertainty in this sector edged up to 13% from 9%.

No changes in the net balance of the services sector was observed. However, this sector retained the most positive expectations after the wholesale and retail sector. A net 57% of firms contacted between January and March 2023 expected conditions over the next three months to improve, the same as in the previous quarter. This reflected an equal movement in the share of firms expecting improved (62% to 64%) and worse (5% to 7%) conditions. The share of those expecting unchanged conditions also increased from 24% to 29%, while uncertainty in this sector has receded completely.

With regards to the construction and real estate sector, 40% of firms expect business conditions to improve in the next three months, up from 13%. A fifth of companies interviewed in the first quarter of 2023 expected worse conditions over the next three months, up from 13% in the previous quarter. As a result, the net balance in this sector rose sharply from nil to 20%. The share of firms expecting unchanged conditions dropped by 23 percentage points to stand at 40%. Uncertainty in this sector has also receded completely.

Firms’ investment plans remain strong

Chart 3
INVESTMENT PLANS
(contributions to net balance; percentage of companies contacted)



Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "What are your investment plans for this/next year (in comparison to last year)?"

During the quarter under review, on balance, 48% of the companies interviewed said that they planned to invest more, compared to 27% in the previous quarter.[2] This was mostly on account of more firms planning to increase investment. Several companies (60%) contacted planned to invest more, compared to 48% in the previous quarter (see Chart 3). Moreover, 27% of the companies interviewed in the first quarter said that they planned to keep the same level of investment, down from 31% recorded in the previous quarter. This reflects the overall optimistic long-term expectations, as well as the need to continue investing in order to remain competitive. Still, 13% of the companies contacted said that they will be investing less, partly because they had finished the projects planned in the last few years and thus do not require significant investments in the short term. This compares with 21% in the last quarter of 2022.

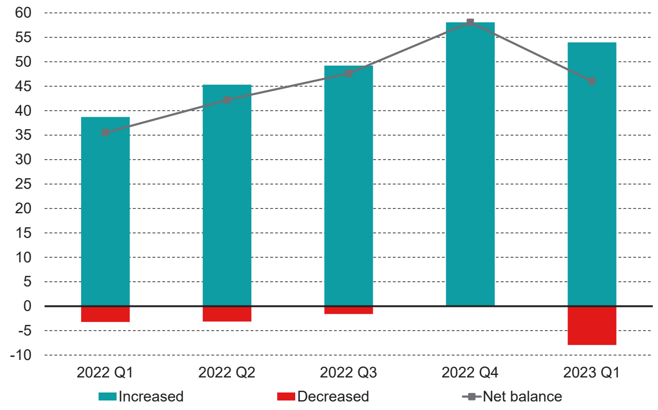
Looking at investment plans by sector, on balance, around 40% of the manufacturing companies planned to invest more, up from 36% in the previous quarter. Moreover, the net balance for the services sector almost doubled, reaching 46% from 24% in the previous quarter. This was because more firms reported an increase in investment levels, and fewer firms reported a decrease in investment levels. In the wholesale and retail sector, on balance, 20% of the companies planned to invest more, down from 27% in the previous quarter. This was mostly because more firms in this sector plan to invest less. A notable improvement can be observed in the net balance of the real estate and construction sector, as 90% of firms reported that they plan to invest more with no firm planning fewer investments.

During this round of contacts, the firms interviewed were also asked to comment on their sources of financing investment. 57% of the companies interviewed noted that they plan to self-finance their investments, while 13% said that they will utilising bank facilities. Moreover, 30% of the companies said that their investments are financed through a mix of sources of finance, including self-financing, bank facilities and through the mother company. Few firms also mentioned equity, shareholder financing, leasing, and monthly payments as one of their sources of finance. Additionally, one company said that they were eligible to benefit from the European Regional Development Fund (ERDF) grants.

[2] In previous editions of the business dialogue, this section focused on whether firms continued with their scheduled investments, or whether they have cancelled their investments. As from reference period 2022Q2, the question posed to firms was changed to ask whether firms plan to invest more or less when compared to last year. Hence, Chart 3 starts from the second quarter of 2022, in contrast to the other charts that start from 2022Q1.

Firms' plan to continue to hire

Chart 4
EMPLOYMENT PLANS
(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 you changed your employment plans?"

When asked about employment plans, the responses collected reveal that the demand for labour remains robust. However, for the first time since the second quarter of 2022, the expected pace of hiring has declined when compared to the previous quarter. In fact, in the latest round of contacts, a net 46% of respondents anticipated higher employment, 12 percentage points lower than in the previous quarter. This reflects a drop in the share of companies reporting increased employment plans and a rise in the share of firms planning to shed labour (see Chart 4). In fact, 8% of the companies interviewed reported that they plan to decrease their staff levels. This was the highest share recorded since the first quarter of 2021. These companies noted that they will not be renewing the employment contract of workers that are still on probation and not replacing anyone who resigns. This was attributed to a combination of factors including softening demand and operational restructuring.

The share of respondents that did not alter their employment plans declined to 38%, from 42% in the final quarter of 2022. This mainly relates to companies that are only recruiting for replacement purposes.

On balance, hiring intentions were strongest in the construction and real estate sector, with a net share of 60%. This is followed by the wholesale and retail and services sectors, which both recorded a net balance of 50%. The net balance was significantly lower in the manufacturing sector at 27%.

BOX 1: LABOUR SHORTAGES – AN EVER-GROWING CONCERN[3]

The economic recovery from the COVID-19 pandemic was faster than what most had anticipated. Although faced with new challenges, mostly related to supply chain disruptions, and increasing costs, most local firms have been operating at positive levels and thus, continued to grow their businesses in 2022. For some, this entailed resuming investments which were on hold between 2020 and 2021, while others started new significant investments including ones which expand the company's product portfolio, or which allow them to penetrate new markets. A fast-recovering business environment coupled with an optimistic outlook, has raised firms' demand for labour. However, most company representatives remarked that the current labour market tightness is higher than that which prevailed prior to the pandemic.

[3] Prepared by Warren Deguara, Erica Maria Brincat and Aleandra Muscat, Principal Economist, Senior Economist and Economist, respectively.

During 2022, 43% of interviewed firms claimed that they are finding it very difficult to recruit new workers. This figure rises to 56% when considering replies in the first quarter of 2023 only. Whether recruitment is for replacement purposes or to enlarge the workforce, difficulties were still reported.

In addition, skills shortages were also mentioned as a significant challenge. This was particularly the case in roles related to information technology, compliance, and finance. Company insights show that skill shortages were most prevalent in the services sector, followed by the manufacturing sector. Some companies noted:

> "Labour is a major limiting factor in satisfying demand." – Services company

> "We had to relocate part of our operations to another country to meet the lack of labour supply." – Services company

> "Every resignation we get in Malta, is replaced in one of our foreign offices." – Services company

> "Vacancies are not being filled. Maltese workers do not want to work under certain conditions such as night shifts and overtime." – Manufacturing company

Moreover, some companies expressed their concern with regards to retaining their current workforce, consequently leading to high staff turnover rates. This sentiment was expressed by firms across all sectors.

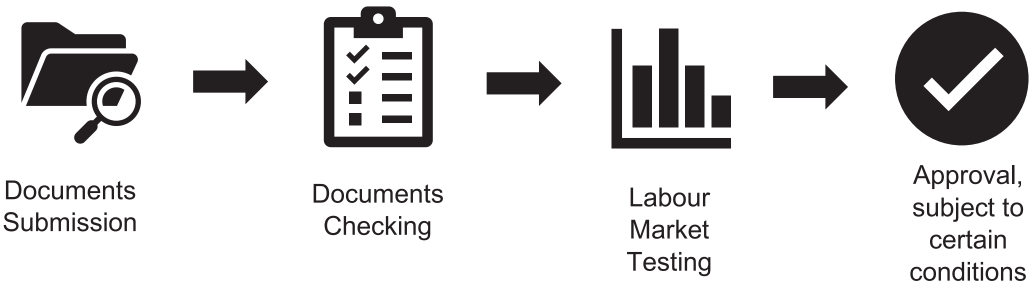
Due to the severe lack of local labour supply, most firms turn to foreign labour markets, mostly, third-country nationals. However, several companies are concerned about the lengthy process to obtain work permits for third-country nationals. As a result, those affected are forced to over utilise overtime work or engage sub-contracted workers, which is more costly. One firm noted:

> "Labour shortages have continued to dampen business success such that not all opportunities are tapped into. The plan is to engage additional workers however, recruitment is very challenging and the process to employ third-country nationals is way too long." – Services company

The application process for third-country nationals, including UK citizens, to work in Malta can be summarised in four main steps (see Figure 1). Firstly, applicants are to submit all required valid documentation to Identity Malta, Malta's authority responsible for the vetting and approval of work permits. These documents then undergo a set of due diligence checks. This is followed by specific labour market testing mainly analysing whether there is the need for the specific job requested. If the application passes through this set of checks, a work permit is issued, subject to certain conditions such as a working visa.

FIGURE 1

Work permit application process



The application process takes between three to six months depending on various factors such as the validity of the applicant's documents, the applicant's criminal record, the country's need for the applicant's profession and whether this could be filled by a Maltese or a European citizen first, and most importantly, the need of a working visa.

In view of the increase in labour market tightness as well as inflation, companies have recently reported an intensification in wage pressures. Wage demands by potential recruits have been rising since early 2022 and so have labour costs covering current employees. The record high cost of living adjustment (COLA) increment awarded for 2023 has increased firms' labour costs and several companies emphasised that in many cases, they had to give additional significant increments above the COLA in view of the labour market tightness.

Wage pressures have also been recently increasing among the foreign labour force. In particular, the rising cost of living has affected markedly both persons coming from other EU member states, but also those from third countries. Two companies claimed:

> "While before foreign workers would accept a relatively lower salary, they are now dictating the salary during the interview." – Services company

> "Wage demands by third-country nationals have increased." – Manufacturing company

Moreover, many company representatives have expressed concern regarding the relatively short length of stay of foreign workers, as well as Malta's attractiveness as an employer of choice. Destinations such as Ireland, Cyprus, Spain, and Portugal are reportedly becoming more attractive.

Manufacturing firms have intensified their investments in automating their production process. However, this is more challenging for service-oriented firms, as well as those in construction and wholesale and retail.

Cost pressures soften slightly, while supply chain disruptions have eased

In the first quarter of 2023, companies noted that supply chain disruptions have eased. Many companies claimed that although they are still facing relatively longer lead times than normal, supply conditions have improved in comparison to previous quarters. Also, companies have now become accustomed to such delays and are therefore frontloading orders to limit the risk of input shortages and related operational disruptions. However, in certain cases this is impacting the companies' cashflow levels. Additionally, chip shortages remain a persistent issue for many companies, affecting several manufacturing sub-sectors globally, although these have recently eased. The war in Ukraine and Russia has also had significant impact on the availability of glass.

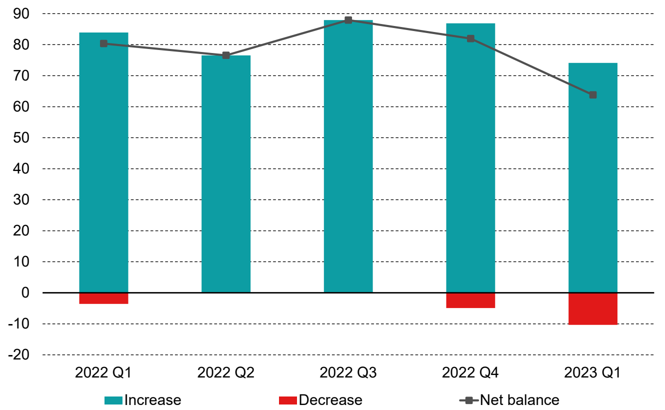
Many firms confirmed that transportation costs have stabilised at high levels, reflecting high demand and low competition in the global shipping market. Hence, prices of containers especially from mainland Europe remain elevated.

In the first quarter of 2023, around 74% of companies contacted reported an increase in their input costs (see Chart 5). Of the remaining firms, 16% indicated that their input costs remained unchanged, while 10% of firms reported a decrease in input costs. In net terms, the share of companies reporting an increase in input costs decreased from 82% in the last quarter of 2022 to 64% in the first quarter of 2023.

Although cost pressures eased slightly, they remained widespread in all sectors, reflecting lingering effects from earlier increases in import prices and higher wage demands. However, the net share of firms reporting an increase in input costs has decreased for all sectors, except in the construction and real estate. In fact, all construction and real estate companies noted that input costs have increased. This sector was followed then by the services sector as a net 64% of companies reported increases in input costs. The latter mostly reflects rising wage pressures due to the tightness of the labour market. In the wholesale and retail sector, the net share of respondents reporting higher input costs was slightly lower at 60%. The lowest net share of increases in input costs was reported by the manufacturing sector, at 53%.

Companies were also asked about their unit cost expectations for the coming 12 months. Overall, companies expressed a more positive sentiment in comparison to the previous quarter. In fact, 11% of companies are expecting unit costs to decrease in the coming months, while none of the companies interviewed in the previous quarter had anticipated declines. Additionally, the share of companies which are anticipating an increase in unit costs fell from 52% in the last quarter of 2022 to 39% in the quarter

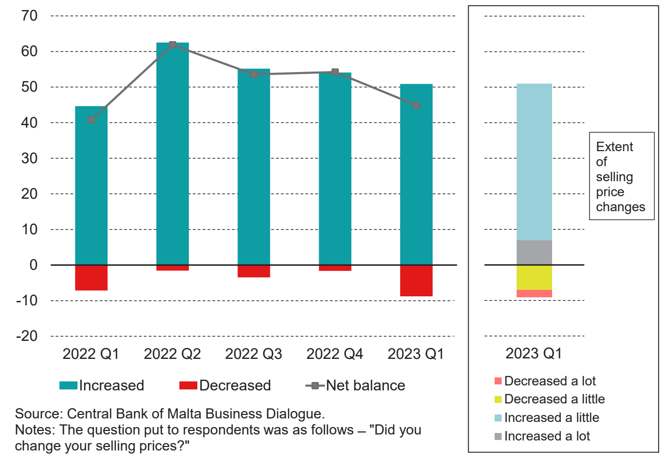
Chart 5
CHANGES IN INPUT PRICES
(contributions to net balance; percentage of companies contacted)



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

under review. In fact, 27% are expecting an increase between 1% and 3%, while another 9% expect the increase to be between 3% and 5%. Additionally, only 4% of companies are anticipating unit cost increases larger than 5%. As expected, given the recent global economic uncertainty, 11% were reluctant to share their expectations as they believe that markets have become very difficult to predict.

Chart 6
CHANGES IN SELLING PRICES
(contributions to net balance; 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?"

During the quarter under review, the percentage of firms that have reported an increase in selling prices decreased slightly from 54% in the previous quarter to 51% (see Chart 6). In this round, 7% said that prices increased by ‘a lot’ while the other 44% noted that they increased selling prices by ‘a little’. Only 9% of firms were able to decrease selling prices, and in most cases the decrease was minimal. The remaining 40% kept prices unchanged. This is because typically selling prices are determined through long term contracts, thus forcing the firm to absorb cost increases. As the share of firms that cut selling prices increased (from 2% to 9%), the net share of companies that increased selling prices declined from 52% to 42% in the first quarter of 2023.

The net share of increases in selling prices has decreased across all sectors in comparison to the previous quarter, except for the services sector. Increases in selling prices were most prominent in the wholesale and retail sector, with a net share of 60%. This was followed by the construction and real estate sector where the net balance of companies reporting an increase in selling prices stood at 50%, and the services sector at 39%. A lower net share of 33% is recorded for the manufacturing sector.

Companies were also asked whether they have specific rules that guide changes in selling prices. However, most companies noted that they have been adjusting selling prices at their own discretion, mostly to reflect the changes in input costs and safeguard their mark-up levels as much as possible. Some companies even reported that they have to change their selling prices on a daily basis, while others are bound by long-term contracts or government agreements which allow for revisions at longer intervals.

Profitability impacted by higher costs

While some companies argued that consumers are becoming more accepting of price increases, some are either unable to alter selling prices due to contractual obligations or are still absorbing part of the cost increases to remain competitive. Because of this, profitability is said to have been negatively impacted. Although there is no clear indication as to which sectors have been impacted the most, company insights suggest that services and manufacturing firms may have found it more difficult to retain profits. The wholesale and retail sector on the other hand has managed to secure profitability levels since costs are easier to pass to consumers. Overall, however, firms managed to work their way around such cost increases and found ways to retain high and healthy profit levels, although in a few cases, at levels which are lower than pre-pandemic ones. Some managed to increase sales levels, while others found measures to be more efficient or secure better pricing through bulk buying.

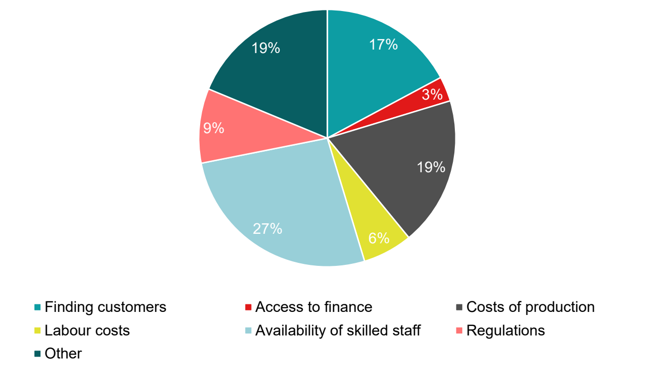
BOX 2: MAIN CHALLENGES RESTRICTING FIRMS' SUCCESS[4]

During the first quarter of 2023, companies were asked to rank the main problems or challenges that are or may be restricting the success of their business. Chart 7 identifies the main challenges mentioned by the companies. The main challenge reported by the companies in the first quarter of 2023 related to the availability of skilled workers (27%), followed by costs of production (19%). Additionally, another 19% of companies noted that they faced other challenges, such as those related to macroeconomic conditions, competition, and supply issues. Finding customers is also of concern for some companies (17%), particularly those operating in the wholesale and retail sector. Regulation and the additional bureaucratic processes were mentioned by 9% of the companies interviewed, mostly operating in the services and real estate sectors. Even though labour cost was a challenge mentioned by most firms, only 6% said that higher labour costs and wage pressures is the main challenge restricting their success. Moreover, access to finance does not seem to be a major concern for the companies contacted in the first quarter of 2023 as it was only mentioned by 3% of the companies, all operating in the services sector.

Looking at the responses by sector, the main challenge reported by service-oriented firms as expected is availability of skilled staff (32%), followed by finding customers (18%) (see Chart 8). Service-oriented firms are also concerned about costs of production (14%) and regulation (11%).

In the manufacturing sector, the main challenges mentioned by companies are the availability of skilled staff and costs of production which were both mentioned by 27% of the firms in this sector. These challenges were followed by the challenge of finding customers (20%). Access to finance and regulation does not seem to be a concern for firms operating in the manufacturing sector as

Chart 7
MAIN CHALLENGES
(percentage of companies)

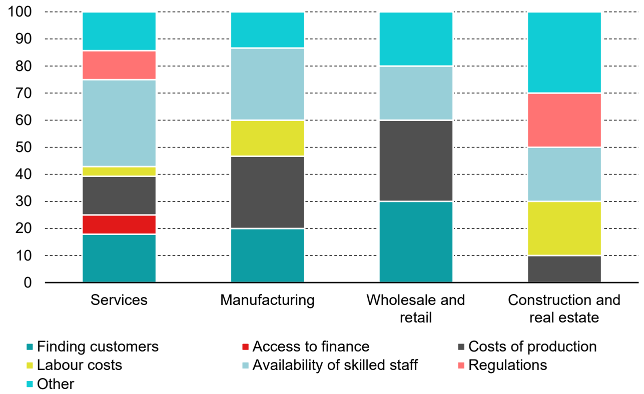


Source: CBM Business Dialogue.
Notes: The question put to respondents was as follows – "What is the main problem/challenge which is/may be restricting business success."

[4] Prepared by Warren Deguara, Erica Maria Brincat and Aleandra Muscat, Principal Economist, Senior Economist and Economist, respectively.

this was not mentioned by any firm in the quarter under review.

Chart 8
MAIN CHALLENGES – BY SECTOR
(percentage of companies)



Source: CBM Business Dialogue.
Notes: The question put to respondents was as follows – "What is the main problem/challenge which is/may be restricting business success."

In the wholesale and retail sector, 30% of the companies mentioned that the main challenge is finding customers and another 30% mentioned costs of production. This was followed by availability of skilled staff and other challenges.

Challenges in the construction and real estate sector seem to be different, as most companies (30%) mentioned competition and cash-flow problems. Availability of skilled staff, regulation and labour costs are also a challenge for these firms.

Annex 1

Table 1
SECTORAL REPLIES
(percentage of companies contacted)

	Construction and Real Estate		Wholesale and Retail		Services		Manufacturing		Total	
	2022 Q4	2023 Q1	2022 Q4	2023 Q1	2022 Q4	2023 Q1	2022 Q4	2023 Q1	2022 Q4	2023 Q1
How have business conditions developed over the past three months?										
Improved	*13*	70	73	70	57	64	50	47	52	62
Worsened	*38*	10	18	20	14	18	32	33	24	21
Remained the same	*50*	20	9	10	29	18	18	20	24	17
Net balance	*-25*	*60*	*55*	*50*	*43*	*46*	*18*	*13*	*27*	*41*
How do you expect business activity to develop in the next few months?										
Improve	*13*	40	55	60	62	64	41	40	47	54
Worsen	*13*	20	27	0	5	7	23	0	16	6
Remain the same	*63*	40	0	30	24	29	27	47	26	35
Uncertain	*13*	0	18	10	10	0	9	13	11	5
Net balance	*0*	*20*	*27*	*60*	*57*	*57*	*18*	*40*	*31*	*48*
How have you changed your investment plans for this year?										
Invest more	38	90	45	50	48	57	55	53	48	60
Invest less	25	0	18	30	24	11	18	13	21	13
Invest the same	38	10	36	20	29	32	27	33	31	27
Net balance	*13*	*90*	*27*	*20*	*24*	*46*	*36*	*40*	*27*	*48*
How have you changed your employment plans?										
Increased	50	60	45	60	71	57	55	40	58	54
Decreased	0	0	0	10	0	7	0	13	0	8
Unchanged	50	40	55	30	29	36	45	47	42	38
Net balance	*50*	*60*	*45*	*50*	*71*	*50*	*55*	*27*	*58*	*46*
Did you experience any changes in input prices?										
Increased	86	100	82	70	90	75	86	67	87	74
Decreased	0	0	9	10	5	11	5	13	5	10
Unchanged	14	0	9	20	5	14	9	20	8	16
Net balance	*86*	*100*	*73*	*60*	*85*	*64*	*82*	*53*	*82*	*64*
Did you change your selling prices?										
Increased	86	50	82	70	33	50	50	40	54	51
Decreased	0	0	0	10	5	11	0	7	2	9
Unchanged	14	50	18	20	62	39	50	53	44	40
Net balance	*86*	*50*	*82*	*60*	*29*	*39*	*50*	*33*	*52*	*42*

Source: Central Bank of Malta Business Dialogue.