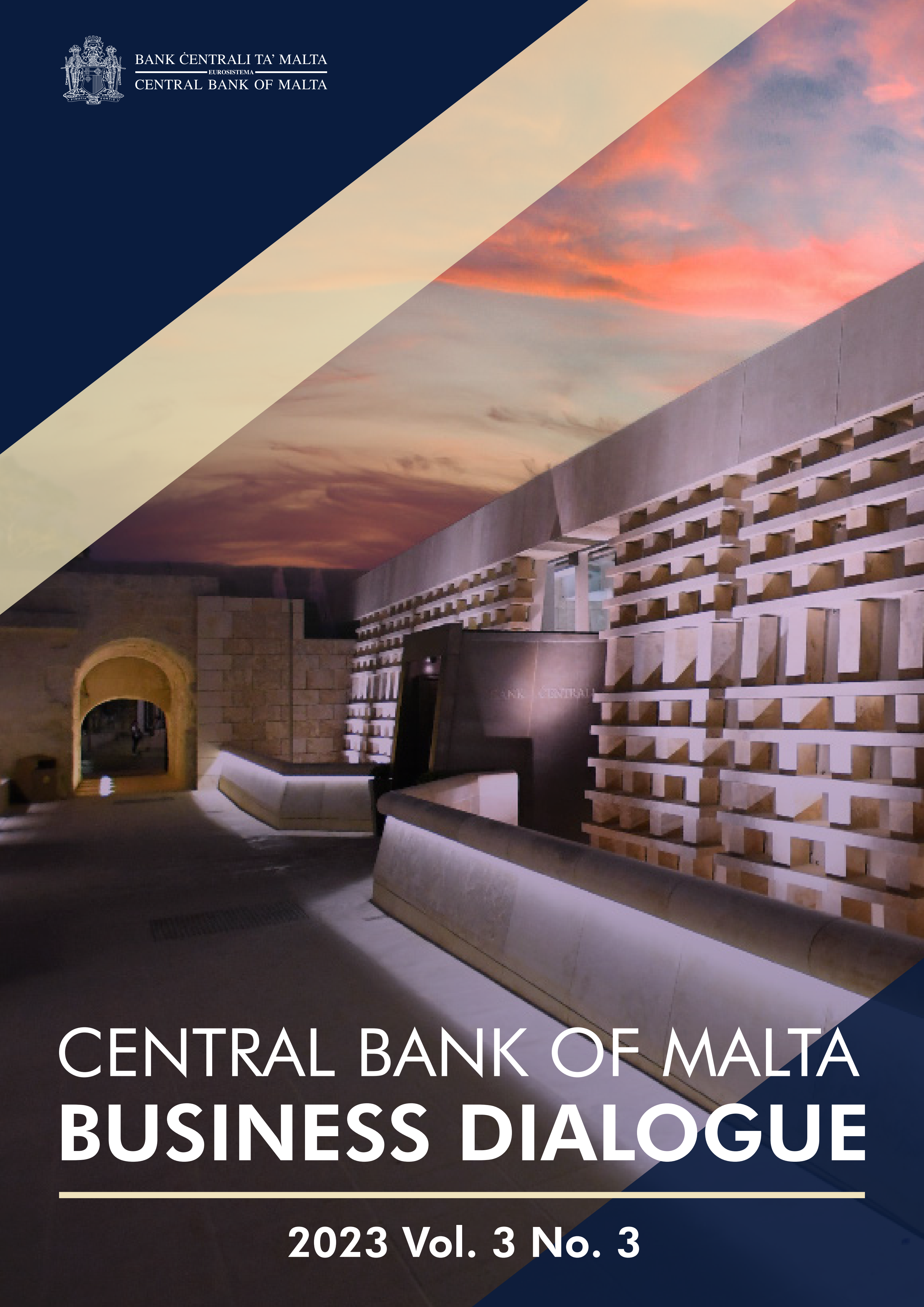

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MAIN FINDINGS FROM THE 2023Q2 ROUND OF CONTACTS WITH NON-FINANCIAL CORPORATIONS

Summary

Information gathered by the Central Bank of Malta during contacts with non-financial corporations and other institutions made between April and June 2023 indicates that on balance, overall business conditions were less positive compared with the first quarter. A net 34% of respondents reported an increase in activity over the three months preceding the interview, down from a net share of 41% in the previous quarter. On balance, conditions were positive across all sectors except the construction and real estate sector, which largely also explains why overall sentiment in the Maltese economy weakened relative to the first quarter.

Short-term expectations decreased marginally but remained positive on balance. Around 57% of firms contacted during the second quarter of 2023 reported that they expect business activity to expand over the next three months, while 11% anticipated a decline. The net share of respondents expecting an amelioration thus stood at 46%, slightly lower than 48% in the preceding quarter. Meanwhile, the share of contacts reporting that the outlook was uncertain increased to 7%, from 5% previously.

Cost pressures have eased but remain broad-based. Indeed, a net 62% of contacts reported that input prices have increased, down from 64% in the previous quarter. This share was highest in the wholesale and retail sector (73%), and lowest in manufacturing (52%).

The net share of firms reporting higher selling prices on the other hand increased, and now stands at 53%, 11 percentage points higher than in the previous quarter. Increases in selling prices were classified as significant by 16% of all companies surveyed, and less prominent by 46%.

In the quarter under review, a net 69% of respondents reported that they plan to invest more, up from 48% in the previous quarter. At the same time, a net 61% of firms planned to hire more staff, higher than the 46% share observed in the previous quarter, with skills shortages remaining a pressing concern.

In the second quarter of 2023, a total of 61 telephone/virtual meetings were held with 23 manufacturing companies, 22 services-oriented companies, 11 wholesale and retail companies, and five construction and real estate companies.[1]

Business conditions weakened slightly

Information gathered between April and June 2023 indicates that – on balance – business conditions weakened when compared to the previous quarter.

During the quarter under review, 54% of firms stated that business conditions had improved over the past three months, down from 62% in the first quarter of 2023 (see Chart 1). At the same time, the share of firms stating that business activity worsened declined slightly to 20%, from 21% in the previous quarter. Consequently, the net share of respondents reporting an amelioration in

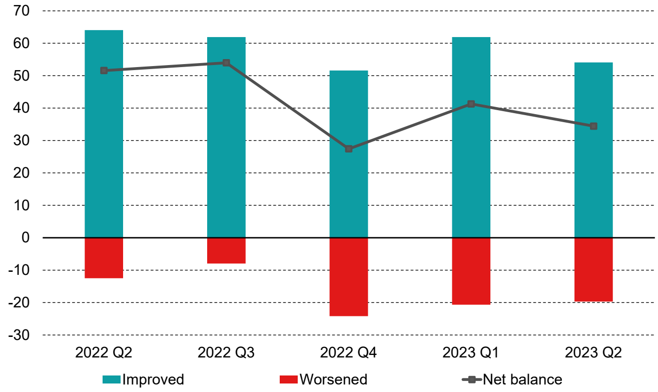
[1] More information on the structure, methodology and evolution of the CBM Business Dialogue exercise.

business conditions decreased to 34%, from 41% in the previous survey round.

The share of firms stating that business conditions remained unchanged increased to 26%, from 17% in the previous quarter.

All sectors reported positive conditions on balance in the second quarter, except the construction and real estate sector, where a net 20% of respondents reported lower activity. This contrasts with a net positive balance of 60% in the previous quarter. Reported sentiment in construction and real estate is quite volatile from one round of contacts to the other due to the low number of contacts. In addition, sentiment expressed by those firms engaged exclusively in construction might differ to those in real estate. In this round, construction firms outnumbered respondents from real estate. Recently, construction firms have tended to express more negative sentiment compared to those in real estate.

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?"

The net balance of manufacturing companies reporting improved business conditions picked up again, reaching 26% from 13% in the previous quarter. The percentage of firms reporting an improvement in activity increased marginally from 47% to 48% over this period. However, the share of firms reporting worsened conditions decreased significantly, from 33% to 22%, while the share of manufacturing firms reporting unchanged conditions rose from 20% to 30%. Positive conditions were reported in the injection moulding, consumer durables, clothing, and food and beverage sub-sectors.

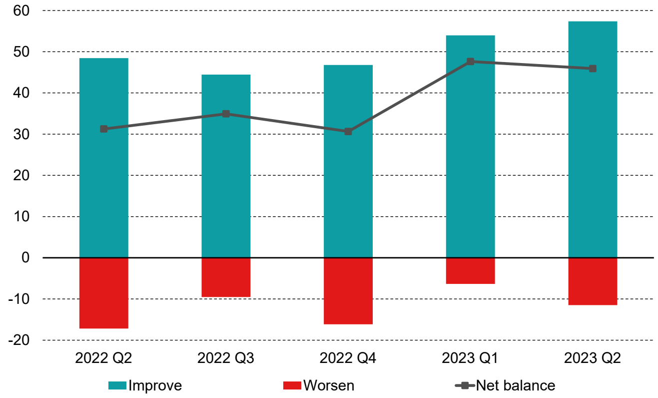
In the wholesale and retail trade sector, a net 64% of respondents assessed conditions to have improved in recent months, up from 50% in the previous quarter. The share of wholesale and retail firms reporting an improvement increased again to 73% from 70% in the previous quarter, while those reporting worsening conditions decreased significantly from 20% to 9%. The share of firms reporting unchanged conditions increased by 8 percentage points to a total of 18%. Positive conditions were mostly reported among supermarkets and retailers selling clothing and footwear.

In the services sector, a net 41% of respondents reported higher activity in the second quarter of 2023, down from 46% in the first quarter. While the share of services firms stating that conditions improved declined to 59% from 64% previously, the percentage of firms reporting worse conditions remained unchanged at 18%. Meanwhile, the share of services-oriented businesses reporting unchanged conditions increased from 18% to 23%. A positive assessment was especially observed in the accommodation, hospitality, and maritime and freight sub-sectors.

Expectations for short term business conditions are slightly less optimistic

Business expectations for the next three months were marginally less positive, on balance, than those expressed in the first quarter of 2023. In the quarter under review, 57% of the firms anticipated their business activity to improve further over the next three months, up from 54% in the previous quarter (see Chart 2). Nevertheless, the share of firms which expected conditions to worsen over the next three months increased from 6% to 11% in the quarter under review. Consequently, the net share of firms reporting an improvement in the near-term outlook fell from 48% to 46%.

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, decreased to 25% in the second quarter of 2023, from 35% in the previous quarter. Meanwhile, the share of respondents reporting an uncertain outlook increased marginally to 7%, from 5% in the previous quarter.

The strongest improvement in the near-term business outlook is recorded for firms in the services sector. Indeed, the net balance rose from 57% in the first quarter of the year to 73% in the quarter under review. The share of such firms expecting an improvement in their business activity over the next three months increased to 73%, while that of firms expecting conditions to worsen dropped to nil. Moreover, the share of firms which are expecting conditions to remain unchanged decreased by 2 percentage points to 27%.

The short-term outlook for activity in the manufacturing sector also improved. In fact, the proportion of manufacturing firms anticipating business conditions to improve increased significantly from 40% to 61%. However, the share of manufacturing firms expecting conditions to worsen increased to 13% from 0% in the previous quarter. Consequently, the net balance of firms reporting improved business expectations within this sector increased to 48%, from 40% in the preceding quarter. Meanwhile, uncertainty in this sector decreased from 13% to 9%.

On the other hand, expectations in both the wholesale and retail and construction and real estate sectors dropped significantly. A net 27% of wholesale and retail firms contacted between April and June 2023 expected conditions to improve over the next three months, down from 60% in previous quarter. This reflected a lower share of firms expecting an improvement (60% to 45%), and more firms expecting worse conditions (0% to 18%). The share of those expecting unchanged conditions decreased from 30% to 18%, while uncertainty in this sector increased to 18% from 10% previously.

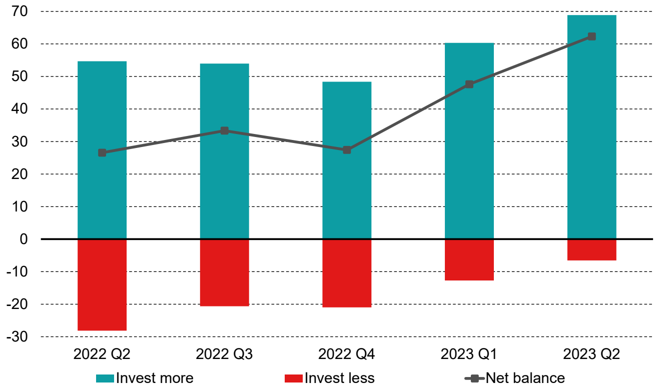
With regards to the construction and real estate sector, none of the firms contacted in the second quarter expected business conditions to improve in the next three months, thus leading to negative conditions of -40% on balance. In fact, 40% of companies interviewed in the first quarter of 2023 expected worse conditions over the next three months, up from 20% in the previous quarter. The share of firms expecting unchanged conditions increased by 20 percentage points to stand at

60%. Uncertainty in this sector has also receded completely. One must however be cautious in interpreting these results due to the small number of firms sampled.

Firms' investment plans remain strong

During the quarter under review, on balance, 62% of the companies interviewed said that they plan to invest more, compared to 48% in the previous quarter. This was mostly on account of more firms planning to increase investment. The majority of the companies (69%) contacted plan to invest more, compared to 60% in the previous quarter (see Chart 3). This mainly reflects the need to continue investing to remain competitive. In some cases, this also reflects the need to remain accessible to their customers at a time when competitors are increasing their outlets. Furthermore, this might reflect the relatively high number of manufacturing firms contacted in comparison to previous quarters. Moreover, 25% of the companies interviewed in the second quarter said that they plan to keep the same level of investment, down from 27% recorded in the previous quarter. Still, 7% 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 13% of firms in the first quarter of 2023.

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)?"

Looking at investment plans by sector, on balance, around 70% of the manufacturing companies plan to invest more, up from 40% in the previous quarter. Moreover, the net balance for the services sector continued to improve, reaching 55% from 46% in the previous quarter. In the wholesale and retail sector, on balance, 82% of the companies plan to invest more, significantly up from 20% in the previous quarter. This was because more firms in this sector plan to invest more, while no firm plans to invest less. A deterioration can be observed in the net balance of the real estate and construction sector.

BOX 1: FIRMS' FINANCING SOURCES AND COSTS OF FINANCE[2]

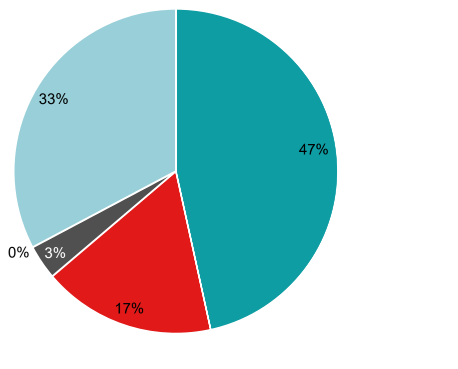
During the quarter under review, the firms interviewed were asked to comment on the main source of financing investment and on their costs of finance.

Almost half (47%) of the companies interviewed in the second quarter of 2023 noted that they plan to self-finance their investments, while 17% said that they plan to utilise only bank facilities (see Chart 4). Moreover, 33% of the companies said that their investments

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

will be financed through a mix of sources of finance, including self-financing, bank facilities and through the mother company, among others. Additionally, some firms said that they will be partly financing their investments by using Government schemes or grants.

Chart 4
SOURCES OF FINANCE
(percentage of companies)



Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "What is the main source of finance?"

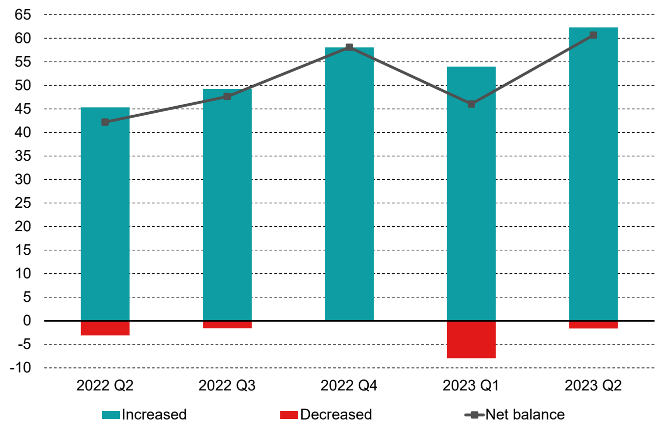
Few of the companies that reported using bank facilities to finance their investments mentioned that the cost of financing rose, mostly in the form of higher bank charges. A few companies also noted higher interest rates as their loan facilities are pegged to the Euribor.[3] Some companies however noted that due to their positive relationship with local banks, they have successfully managed to negotiate advantageous financing terms.

In general, thus, replies as yet, do not indicate a very strong negative impact from higher costs of financing on investment. This is so because firstly, almost half of firms contacted generally utilise their own funds to finance their investment. And secondly, while bank-related financing costs were reported by some firms, these were generally muted in the context of the current tightening of monetary policy.

Firms' plan to continue to hire

When asked about employment plans, the responses collected reveal that the demand for labour remains robust. Following a decline in the net balance in the previous quarter, the net share of firms expecting to hire staff in the second quarter of 2023 improved, reaching 61% (see Chart 5). This compares to 46% in the previous quarter, reflecting a drop in the share of companies planning to reduce their staff complement, and a rise in the share of firms

Chart 5
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?"

[3] Euribor is short for Euro Interbank Offered Rate.

planning to recruit. In fact, 62% of the companies interviewed reported that they plan to increase their staff levels, compared to 54% in the previous quarter. At the same time, reports of layoffs were very limited in number, as only 2% of the companies said that they plan to decrease their staff levels, all of which operate in the manufacturing sector.

The share of respondents that did not alter their employment plans declined slightly to 36%, from 38% in the first quarter of 2023. This mainly relates to companies that are only recruiting for replacement purposes or have reached their desired level of staff headcount.

On balance, hiring intentions were strongest in the trade and services sectors, with a net share of 82% and 77%, respectively. The net balance was significantly lower in the manufacturing and construction sectors at or just below 40%.

Firms from all sectors continued to find recruitment challenging given shortages of various skills. Some companies noted that they have started using the services of recruitment agencies to facilitate recruitment. In fact, some companies said that with significant efforts, they managed to find suitable workers. Still, there were some reports of activity being hindered due to lack of workers or skills. Some companies also noted that they are trying to automate certain processes to limit their dependency on workers. Other firms are resorting to sub-contracted workers. Companies also mentioned that wage pressures have increased significantly.

During the quarter under review, companies were asked to rank the main problems or challenges that are or may be restricting the success of their business. The main challenge reported by the companies in the quarter under review related to the availability of skilled workers (47%). In the real estate and construction, 60% of the firms interviewed mentioned the availability of skilled staff as their main challenge. Half of the service-oriented firms and trade companies said that this was the main challenge, while 38% of the manufacturing companies mentioned shortages of skilled workers as their main challenge.

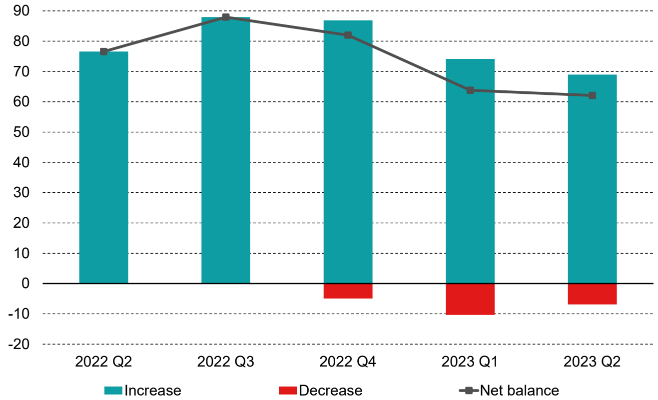
Cost pressures soften slightly, while supply chain disruptions have eased

During the second quarter of 2023, companies noted that supply chain disruptions have eased further. While many companies claimed that they are still facing relatively longer lead times than normal, supply conditions have improved in comparison to previous quarters. Also, supply chain issues are no longer impacting firms' operations as most companies said that they have become accustomed to supply chain disruptions and have contingency plans in place. Many firms confirmed that transportation costs have stabilised but remained at high levels. This reflects the high demand and low competition in the global shipping market. Hence, prices of containers from mainland Europe remain elevated while those from East Asia have started to decrease.

In the second quarter of 2023, around 69% of companies contacted reported an increase in their input costs, compared to 74% in the first quarter of 2023 (see Chart 6). Meanwhile, 24% indicated that their input costs remained unchanged, while 7% of firms reported a decrease in input costs. In net terms, the share of companies reporting an increase in input costs decreased slightly, from 64% in the previous quarter to 62% in the quarter under review.

Although cost pressures eased slightly, they remained widespread in all sectors, reflecting lingering effects from earlier increases in import prices and higher wage demands. The lowest net share of companies reporting input price increases was in the manufacturing sector, at 52%, though this is only marginally lower than the net 53% reported in the first quarter. A decrease was noticeable in the construction sector, as the net share of companies reporting increases fell from 100% to 67% in the quarter under review. Conversely, the net share of companies reporting higher input costs in the services sector rose by 3 percentage points to 67%, while a more significant increase was noted in the wholesale and retail sector, which reported the highest net balance of 73%.

Chart 6
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?"

Companies were also asked about their unit cost expectations for the coming 12 months. The share of companies which are anticipating an increase in unit costs increased slightly from 39% in the first quarter of 2023 to 44% in the quarter under review. 22% are expecting an increase between 1% and 3%, while another 15% expect the increase to be between 3% and 5%. Additionally, only 7% of companies are anticipating unit cost increases larger than 5%.

Only 4% of companies are anticipating a decline in unit costs, while 27% of companies expect prices to remain unchanged. This implies that companies are overall less optimistic that prices will stabilise in the coming months.

However, given the still elevated global economic uncertainty, a quarter of companies contacted were reluctant to share their expectations as they believe that markets have become very difficult to predict.

The percentage of firms that have reported an increase in selling prices increased from 51% in the previous quarter to 61% (see Chart 7). In this round, 16% said that prices increased by "a lot", compared to 7% in the previous quarter. The other 46% noted that they increased selling prices by "a little", slightly above the 44% in the previous quarter. During the first half of

Chart 7
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?"

2023, firms replying to have increased prices have done so by “a little”, which contrasts with a tendency to increase prices by “a lot” last year.

Only 9% of firms were able to decrease selling prices in the quarter under review, and in most cases the decrease was minimal. The remaining 30% 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 increased selling prices increased, the net share of companies that increased selling prices went up from 42% to 52% in the second quarter of 2023.

The net share of firms reporting increases in selling prices went up across all sectors in comparison to the previous quarter. Increases in selling prices were most prominent in the wholesale and retail sector, with a net share of 73%. This was followed by the construction and real estate sector, where the net balance of companies reporting an increase in selling prices stood at 67%, and the manufacturing sector at 52%. A lower net share of 40% is recorded for the services sector.

Despite the ability of firms to increase selling prices, many argue that mark-ups have recently suffered due to the persistently high increase in costs. Some firms managed to work their way around and found ways to retain healthy profit levels, although in a few cases, at levels which are lower than pre-pandemic ones. Very few companies noted stronger profitability levels, normally reflecting increased sales volumes, while others found measures to be more efficient or secure better pricing through larger orders.

Annex 1

Table 1
SECTORAL REPLIES
(percentage of companies contacted)

	Construction and Real Estate		Wholesale and Retail		Services		Manufacturing		Total	
	2023 Q1	2023 Q2	2023 Q1	2023 Q2	2023 Q1	2023 Q2	2023 Q1	2023 Q2	2023 Q1	2023 Q2
How have business conditions developed over the past three months?										
Improved	70	20	70	73	64	59	47	48	62	54
Worsened	10	40	20	9	18	18	33	22	21	20
Remained the same	20	40	10	18	18	23	20	30	17	26
Net balance	*60*	*-20*	*50*	*64*	*46*	*41*	*13*	*26*	*41*	*34*
How do you expect business activity to develop in the next few months?										
Improve	*40*	0	60	45	64	73	40	61	54	57
Worsen	*20*	40	0	18	7	0	0	13	6	11
Remain the same	*40*	60	30	18	29	27	47	17	35	25
Uncertain	*0*	0	10	18	0	0	13	9	5	7
Net balance	*20*	*-40*	*60*	*27*	*57*	*73*	*40*	*48*	*48*	*46*
How have you changed your investment plans for this year?										
Invest more	90	20	50	82	57	68	53	74	60	69
Invest less	0	0	30	0	11	14	13	4	13	7
Invest the same	10	80	20	18	32	18	33	22	27	25
Net balance	*90*	*20*	*20*	*82*	*46*	*55*	*40*	*70*	*48*	*62*
How have you changed your employment plans?										
Increased	60	40	60	82	57	77	40	43	54	62
Decreased	0	0	10	0	7	0	13	4	8	2
Unchanged	40	60	30	18	36	23	47	52	38	36
Net balance	*60*	*40*	*50*	*82*	*50*	*77*	*27*	*39*	*46*	*61*
Did you experience any changes in input prices?										
Increased	100	67	70	82	75	67	67	65	74	69
Decreased	0	0	10	9	11	0	13	13	10	7
Unchanged	0	33	20	9	14	33	20	22	16	24
Net balance	*100*	*67*	*60*	*73*	*64*	*67*	*53*	*52*	*64*	*62*
Did you change your selling prices?										
Increased	50	67	70	82	50	50	40	61	51	61
Decreased	0	0	10	9	11	10	7	9	9	9
Unchanged	50	33	20	9	39	40	53	30	40	30
Net balance	*50*	*67*	*60*	*73*	*39*	*40*	*33*	*52*	*42*	*53*

Source: Central Bank of Malta Business Dialogue.