BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

CENTRAL BANK OF MALTA BUSINESS DIALOGUE

2024 Vol. 4 No. 1

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The cut-off date for information in this publication is 31 December 2023. Figures in tables may not add up due to rounding.

ISSN 2788-7758 (online)

MAIN FINDINGS FROM THE 2023Q4 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 October and December 2023 indicates that on balance, the net share of firms reporting better business conditions decreased to 35% in the fourth quarter, down from 44% in the third quarter of the year. On balance, conditions were less positive across most economic sectors, except in services where conditions improved.

Regarding short-term expectations about activity the net share of respondents expecting an amelioration declined from 47% in the third quarter to 42% in the last of the quarter of the year.

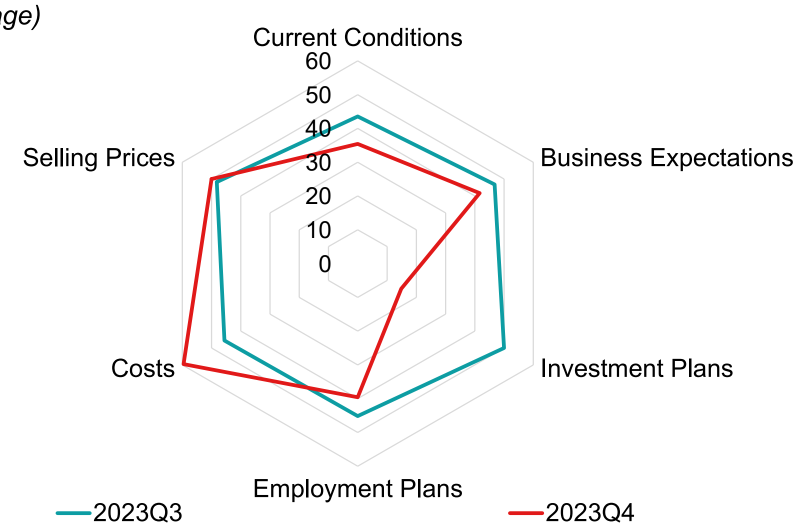
The net share of companies reporting higher input costs have rebounded to the level reported in the second quarter of 2023. Indeed, a net 60% of contacts reported that input prices have increased, up from 46% in the previous quarter. This share was highest in the services sector (75%). Meanwhile, businesses mentioned that wage pressures are a very serious concern.

The net share of firms reporting higher selling prices increased slightly, and now stands at 50%, 2 percentage points higher than in the previous quarter. Increases in selling prices were classified as significant by 19% of all companies surveyed, and less prominent by 40%.

In the quarter under review, a net 15% of respondents reported that they plan to invest more, significantly down from 50% in the previous quarter. The weaker investment outlook is largely driven by less favourable responses collected from the services and manufacturing sectors.

At the same time, a net 40% of firms planned to hire more staff, slightly lower than the 45% share observed in the previous quarter, with skills shortages remaining a pressing concern.

SUMMARY OF COMPANIES' OVERALL RESPONSES
(net balance; percentage)



Source: Central Bank of Malta Business Dialogue.

In the fourth quarter of 2023, a total of 50 telephone/virtual meetings were held with 15 manufacturing companies, 20 services-oriented companies, ten wholesale and retail companies, and three construction and real estate companies.[1][2] Two public institutions were also interviewed.

Business conditions soften

Information gathered between October and December 2023 indicates that – on balance – business conditions were less positive compared to the previous quarter.

During the quarter under review, 52% of firms stated that business conditions had improved over the past three months, down from 56% in the third quarter of 2023 (see Chart 1). At the same time, the share of firms stating that business activity worsened rose to 17%, from 13% in the previous quarter. Consequently, the net share of respondents reporting an amelioration in business conditions fell to 35%, from 44% in the previous survey round.

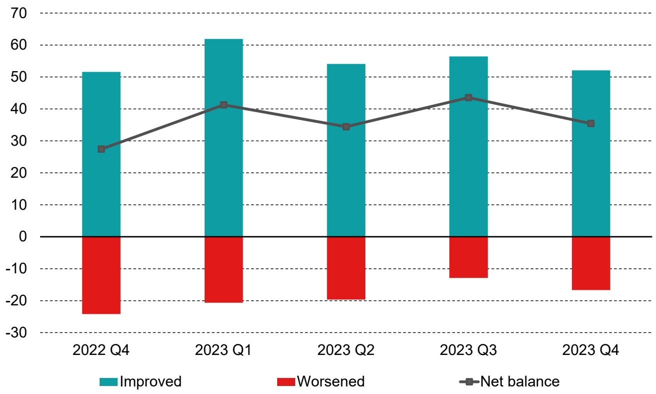
The share of firms stating that they experienced no changes in business conditions remained constant at 31%.

The services sector exhibited an amelioration in its business conditions. A net 70% of respondents in this sector reported higher activity in the final quarter of 2023, up significantly from 47% in the third quarter. While the share of services firms stating that conditions improved increased to 75% from 60% previously, the percentage of firms reporting worse conditions declined to 5%, from 13%. Meanwhile, the share of businesses reporting unchanged conditions fell from 27% to 20%. Once again, a particularly positive assessment was especially observed in the accommodation, hospitality, travel and transport and catering and entertainment activities.

Although declining, the construction and real estate sector registered a second consecutive positive net balance. It should be noted that the reported sentiment in this sector is quite volatile due to the low number of contacts.

Although remaining positive on balance, conditions in the wholesale and retail sector recorded a second consecutive drop. The share of wholesale and retail firms reporting an improvement in conditions decreased from 50% to 30%, while those reporting worsening conditions increased from 17% to 20%. Thus, the net balance in this sector stands at 10%, down from 33% in the previous quarter. This contrasts with retailers' previous predictions. Having said that, the share of firms reporting unchanged conditions stood at 50%, up from 33%.

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 assessing

[1] More information on the structure, methodology and evolution of the CBM Business Dialogue exercise.
[2] The business dialogue survey can also be accessed in a new and interactive way through its dedicated dashboard.

conditions to have improved also declined – from 20% in the third quarter, to 7% in the fourth. The percentage of firms reporting an improvement in activity remained the same at 40%. However, the share of firms reporting worse conditions increased from 20% to 33%, while the share of those reporting unchanged conditions fell from 40% to 27%. The negative sentiment was mostly reported within the electronic components sub-sectors.

Expectations for short term business conditions remain relatively the same

In the quarter under review, 50% of the firms anticipated their business activity to improve further over the next three months, down from 56% in the previous quarter (see Chart 2). Nevertheless, the share of firms which expected conditions to worsen over the next three months decreased from 10% to 8% in the quarter under review. Consequently, the net share of firms reporting an improvement in the near-term outlook fell from 47% to 42%.

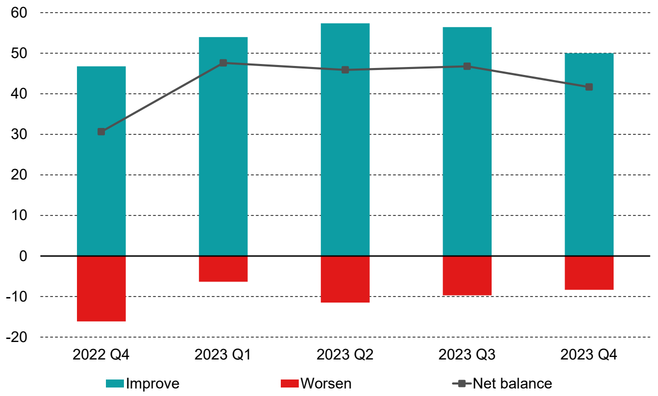
The share of respondents expecting unchanged conditions in the coming three months, increased to 35% in the fourth quarter of 2023, from 29% in the previous quarter. Meanwhile, the share of respondents reporting an uncertain outlook rose marginally to 6%, from 5% in the previous quarter.

Similar to developments in current business conditions, only the services sector saw an improvement in expectations. The net balance in the services sector increased from 50% in the third quarter of 2023 to 70% in the quarter under review. Additionally, uncertainty in this sector receded completely. Positive conditions were mainly expected by the same firms who reported improving business conditions i.e. those operating in the accommodation, hospitality, travel and transport and catering and entertainment activities.

Expectations in the wholesale and retail sector are positive but fell sharply from the previous quarter. A net 30% of wholesale and retail firms contacted between October and December 2023 expected conditions to improve over the next three months, down from 83% in the third quarter. This reflected a lower share of firms expecting an improvement (83% to 40%), and a larger share of firms expecting worse conditions (0% to 10%). The share of those expecting unchanged conditions rose from 17% to 20%. The share of firms who were uncertain of short-term business conditions reached 30% with the most frequently cited factors behind uncertainty being competition and inflation.

The short-term outlook for activity also weakened in the manufacturing sector. In fact, the proportion of manufacturing firms anticipating business conditions to improve fell from 40% to 33%, while the share of manufacturing firms expecting conditions to worsen increased to 13% from 7% in the previous quarter. Consequently, the net balance of firms reporting improved business

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?"

expectations within this sector fell to 20%, from 33% in the preceding quarter. Meanwhile, uncertainty in this sector receded completely.

With regards to the construction and real estate sector, the share of firms expecting conditions to improve is exactly equal to those expecting worse conditions. Thus, the net balance in this sector stands at 0%. One must however be cautious in interpreting quarterly dynamics in this sector due to the abovementioned low number of firms sampled.

BOX 1: EXPECTATIONS VS REALITY. HOW ACCURATE ARE FIRMS IN PREDICTING SHORT TERM BUSINESS CONDITIONS?[1]

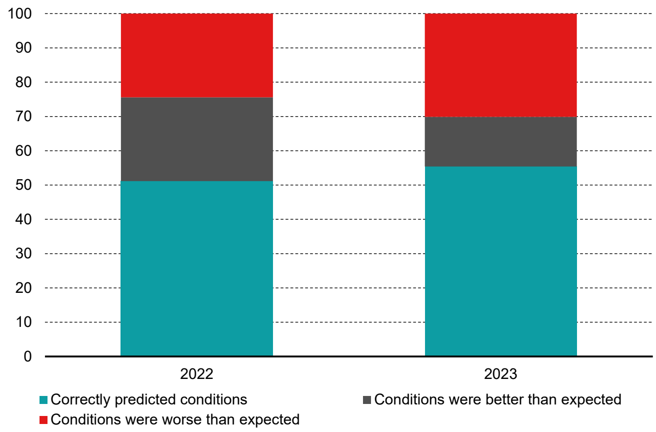
This box replicates the analysis of firm's accuracy of expectations that featured in the fourth quarter of 2022 edition of the Business Dialogue for 2023 and compares the findings to those found a year earlier. To assess firms' ability to accurately predict short-term business conditions, we compare the predictions of firms as reported during the first contact made during 2023 to the outcomes reported during the second interview held with the same companies in 2023. The analysis for 2023 is based on the responses of 90 companies that were interviewed twice during the year.

In the first meeting of 2023, 59% of these firms expected conditions to improve over the following three months, while the share of firms expecting conditions to worsen was 8%. As a result, the net balance exceeded 50%, while 26% expected unchanged conditions. The share of firms that had expected conditions to improve in the first meeting of 2022 was 45%, while the share of firms expecting worse conditions was exactly equal to that in 2023.

In comparison, 50% of firms participating in a second interview in 2023 stated that current business conditions had improved in recent months, while 17% stated that conditions worsened, for a net balance of 33%. The remaining 33% claimed that conditions remained the same. This was broadly similar to the results of 2022 although fewer firms claimed that current business conditions improved in the second meeting of 2023.

When we compare reported outcomes with the predictions made by these same firms in their first meeting for 2023, we find that 55% correctly predicted the direction of change in business conditions for their firm, compared to 51% in 2022 (see Chart 1). The majority of those who have made correct predictions in 2023 (70%) had anticipated an improvement which was later confirmed in the second meeting. Additionally, the share that correctly predicted worsening business conditions stood at 11%, while the remaining 20% successfully predicted unchanged business conditions. Consequently, this

Chart 1
EXPECTATIONS vs CURRENT BUSINESS CONDITIONS
(percentage of companies contacted)



Source: Central Bank of Malta Business Dialogue.

[1] Prepared by Warren Deguara and Erica Maria Brincat. Principal Economist and Senior Economist respectively within the Economic Projections and Conjunctural Analysis Office.

means that almost half of all surveyed firms incorrectly anticipated developments in activity in 2023.

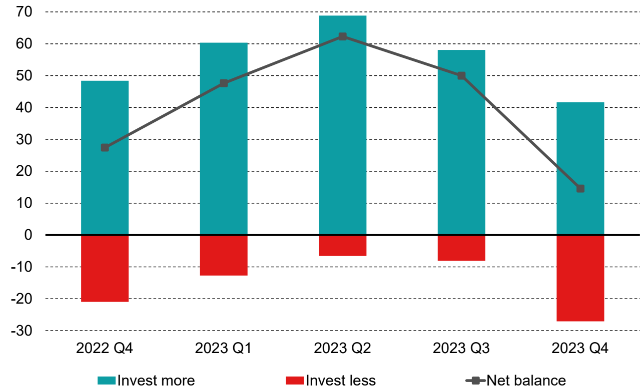
The share of firms that experienced conditions which were worse than what they had predicted in the first meeting was double that which experienced conditions that were surprised on the upside. In 2022, these two were equal.

Even though uncertainty for this group of firms has receded from 11% in 2022 to 8% in 2023, and thus implying that firms may have had more or better information to make a prediction, these findings imply that many firms still find it challenging to forecast activity and budget accordingly. Moreover, it seems that a number of firms might have been too optimistic during the year.

Firms' investment plans slowed down

During the quarter under review, on balance, 15% of the companies interviewed said that they plan to invest more, compared to a net balance of 50% in the previous quarter. This was on account of more firms planning to invest less and fewer firms planning to invest more. The net balance recorded in this quarter was the lowest net balance recorded since the second quarter of 2021. Still, the majority of the companies contacted (42%) plan to invest more, but this declined from 58% in the previous quarter (see Chart 3). Moreover, 31% of the companies interviewed in the last quarter of 2023 said that they plan to keep the same level of investment, down from 34% in the previous quarter. Also, 27% of the companies contacted said that they will be investing less, most of which claiming that they had finished the projects planned in the last few years and thus do not require additional significant investments in the short term. This compares with 8% of firms in the third quarter of 2023.

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



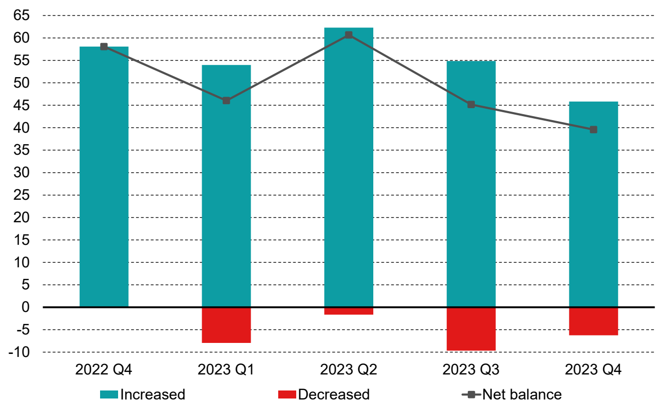
Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows - What are your investment plans for this/next year (in comparison to last year)?"

Looking at investment plans by sector, on balance, a net 7% of the manufacturing companies plan to invest more, significantly down from 40% in the previous quarter. The net balance for the services sector also declined significantly, reaching 0% from 60% in the previous quarter. A more moderate decline was reported in the wholesale and retail sector, reaching 40% from 50% in the previous quarter. An improvement can be observed in the net balance of the real estate and construction sector but this result needs to be interpreted with caution in view of the low responses in the sector.

Firms' hiring plans lower than previous quarter

The responses collected on hiring plans reveal that the demand for labour remains robust but is lower than that reported in the third quarter of 2023. Indeed, the net share of firms anticipating further recruitment declined to 40%, from 45% in the previous quarter. This reflects a drop in the share of companies planning to increase their staff complement, which was partly offset by a decrease in the share of firms planning to shed labour (see Chart 4). In fact, 46% of the

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?"

companies interviewed reported that they plan to increase their staff levels, compared to 55% in the previous quarter. The share of those planning to reduce staff level broadly halved to 6%. These companies operate in the services and manufacturing sectors.

Meanwhile, 48% of the companies said that they plan to keep the same staff levels. 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 wholesale and real estate sector, with a net share of 70%. This is followed by the services sector, with a net balance of 35% and the manufacturing with 33%. All firms operating in the construction and real estate sector said that they plan to keep the same staff levels, resulting in a net balance of 0%.

Firms from all sectors continued to find recruitment very challenging, reporting shortages of various skills. Indeed, 27% of firms reported that their main challenge was the availability of skilled staff.

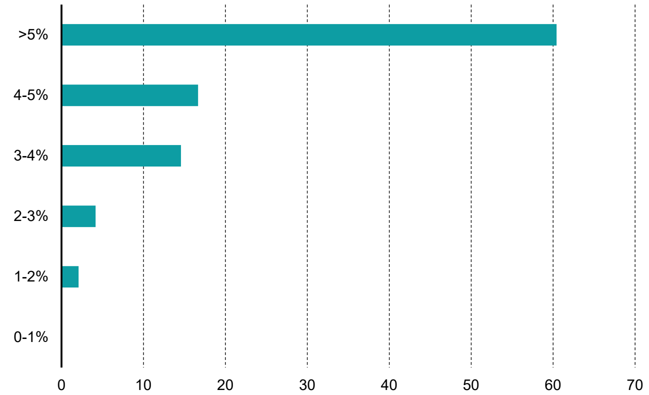
Challenges were noted by firms that are looking to expand their staff complement, as well as those that are only looking to replace outgoing workers. Companies continued to note that they use the services of recruitment agencies to facilitate recruitment.

Changes in average wages and expected increases

Firms were asked to quantify wage changes in 2023. The absolute majority of firms contacted (60%) claimed that labour costs per person have increased by more than 5% in 2023 (see Chart 4a). This figure was found to be significantly higher than the 44% reported in the third quarter. This response was more prevalent in the services sector and reflected developments across many of its sub-sectors. Around a third % of firms claimed that wages rose by between 3% and 5%. The figures reported are inclusive of the 2023 cost of living adjustment (COLA).

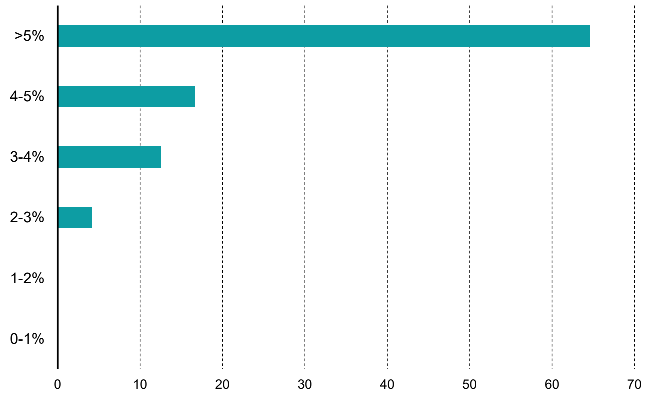
With regards to expected increase in wages to be paid in 2024, 65% of contacted firms expect wages to increase by more than 5% in 2024 (see Chart 4b). This compares to a 35% share reported in the previous quarter. Around a third of

Chart 4a
INCREASE IN AVERAGE WAGES IN 2023
(percentage of companies contacted)



Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "By how much have labour costs increased on average in 2023?"

Chart 4b
EXPECTED WAGE INCREASES IN 2024
(percentage of firms)

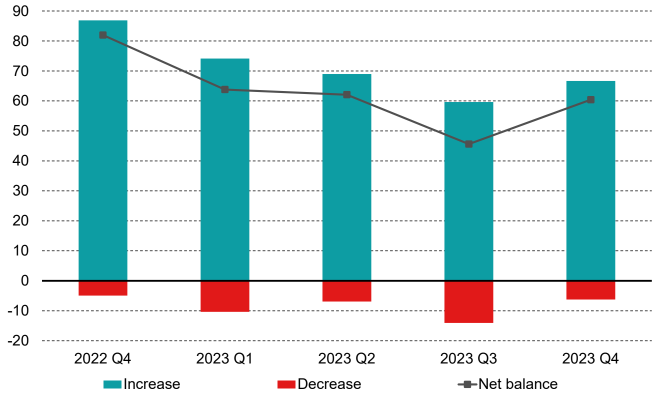


Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "By how much do you expect your company's wages to increase on average in 2024?"

firms expect wages to increase by less than 5% in 2024. The reported figures are inclusive of the 2024 COLA.

Input and selling price pressures increase

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?"

In the fourth quarter of 2023, 67% of companies contacted reported an increase in their input costs, up from 60% in the third quarter of 2023 (see Chart 5). The distribution of replies shifted away from significant price increases to moderate increases. Meanwhile, 27% indicated that their input costs remained unchanged, marginally up from 26% in the previous quarter. At the same time, only 6% of firms reported a decrease in input costs, down from 14%. In net terms, the share of companies reporting an increase in input costs increased from 46% in the previous quarter, to 60% in the quarter under review.

The highest net share of companies reporting input price increases was in the services sector, at 75%, 5 percentage points higher than in the previous quarter. This is followed by the wholesale and retail sector, with a net balance of 70%, significantly up from 33% in the previous quarter. In the manufacturing sector, a net 40% of firms reported input price increases, up from only 7% in the previous quarter. The net balance in the real estate and construction sector was 0%, as half of the firms reported an increase in input costs while the other half reported a decrease in input costs.

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 significantly from 33% in the third quarter of 2023 to around 80% in the quarter under review. This mostly reflects expectation of higher costs related to wages. 17% are expecting an increase between 1% and 3%, while another 44% expect the increase to be between 3% and 5%. Additionally, around 20% of companies are anticipating unit cost increases larger than 5%.

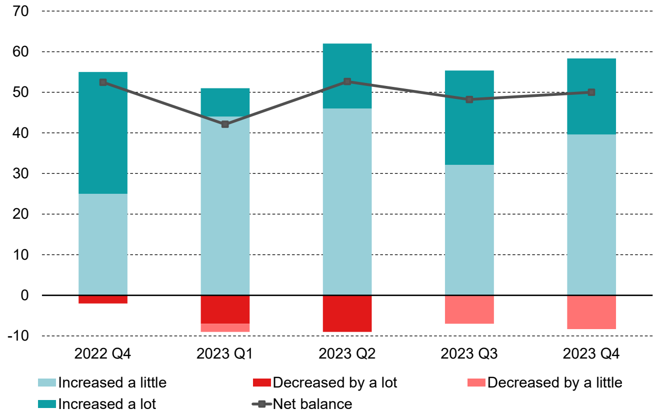
Only 2% of companies are anticipating a decline in unit costs, while 12% of companies expect them to remain unchanged. This implies that companies are overall expecting prices to continue increasing in the coming months.

Only 5% of the companies contacted were reluctant to share their expectations as they believe that markets have become very difficult to predict. This compares to 14% in the previous quarter.

Meanwhile, the percentage of firms that have reported an increase in selling prices rose from 55% in the previous quarter to 58% in the quarter under review (see Chart 6). In this round, 19% said that prices increased by ‘a lot’, compared to 23% in the previous quarter. The other 40% noted that they increased selling prices by ‘a little’, up from the 32% in the previous quarter.

Only 8% of firms decreased selling prices in the quarter under review, and in all cases, the decrease was minimal. Around a third kept prices unchanged, down from 38% in the previous quarter. As a higher share of firms raised selling prices, the net share of companies reported price increases rose to 50%, from 48% in the previous survey round.

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?"

The net share of firms reporting increases in selling prices went up in the wholesale and retail and manufacturing sector but declined in the services and construction and real estate sector. The highest net balance (60%) was recorded in the wholesale and retail sector. This was followed by the services sector at 55% and the manufacturing sector at 40%. The net balance in the construction and real estate sector stood at 33%.

Despite the ability of some firms to increase selling prices, 45% still argue that mark-ups have recently suffered due to the high input and operating costs. Almost 40% retained mark-ups through higher selling prices allowing them to also retain healthy profit levels. Very few companies noted stronger profitability levels due to increases in mark-ups (18%). The latter two groups of firms managed to retain high profit levels also because they registered higher sales volumes, found efficiency increasing solutions or secured 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 Q3	2023 Q4	2023 Q3	2023 Q4	2023 Q3	2023 Q4	2023 Q3	2023 Q4	2023 Q3	2023 Q4
How have business conditions developed over the past three months?										
Improved	73	33	50	30	60	75	40	40	56	52
Worsened	0	0	17	20	13	5	20	33	13	17
Remained the same	27	67	33	50	27	20	40	27	31	31
Net balance	*73*	*33*	*33*	*10*	*47*	*70*	*20*	*7*	*44*	*35*
How do you expect business activity to develop in the next few months?										
Improve	55	33	83	40	60	70	40	33	56	50
Worsen	18	33	0	10	10	0	7	13	10	8
Remain the same	27	33	17	20	23	30	47	53	29	35
Uncertain	0	0	0	30	7	0	7	0	5	6
Net balance	*36*	*0*	*83*	*30*	*50*	*70*	*33*	*20*	*47*	*42*
What are your investment plans for the rest of this / next year?										
Invest more	45	67	67	50	63	35	53	40	58	42
Invest less	9	0	17	10	3	35	13	33	8	27
Invest the same	45	33	17	40	33	30	33	27	34	31
Net balance	*36*	*67*	*50*	*40*	*60*	*0*	*40*	*7*	*50*	*15*
How have you changed your employment plans?										
Increased	82	0	33	70	60	45	33	40	55	46
Decreased	0	0	0	0	7	10	27	7	10	6
Unchanged	18	100	67	30	33	45	40	53	35	48
Net balance	*82*	*0*	*33*	*70*	*53*	*35*	*7*	*33*	*45*	*40*
Did you experience any changes in input prices?										
Increased	50	67	50	70	73	75	40	53	60	67
Decreased	17	33	17	0	3	0	33	13	14	6
Unchanged	33	0	33	30	23	25	27	33	26	27
Net balance	*33*	*33*	*33*	*70*	*70*	*75*	*7*	*40*	*46*	*60*
Did you change your selling prices?										
Increased	50	67	50	70	69	60	33	47	55	58
Decreased	0	33	17	10	7	5	7	7	7	8
Unchanged	50	0	33	20	24	35	60	47	38	33
Net balance	*50*	*33*	*33*	*60*	*62*	*55*	*27*	*40*	*48*	*50*

Source: Central Bank of Malta Business Dialogue.