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MAIN FINDINGS FROM THE 2024Q1 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 2024, indicates that on balance, the net share of firms reporting better business conditions increased when compared to the previous quarter. It stood at 47%, up from 35% in the fourth quarter of 2024. On balance, conditions improved in the manufacturing and wholesale and retail sectors, while they were less positive than before in the services sector.

Regarding short-term expectations, the net share of respondents expecting an amelioration in activity declined marginally from 42% in the fourth quarter of 2024 to 39% in the quarter under review.

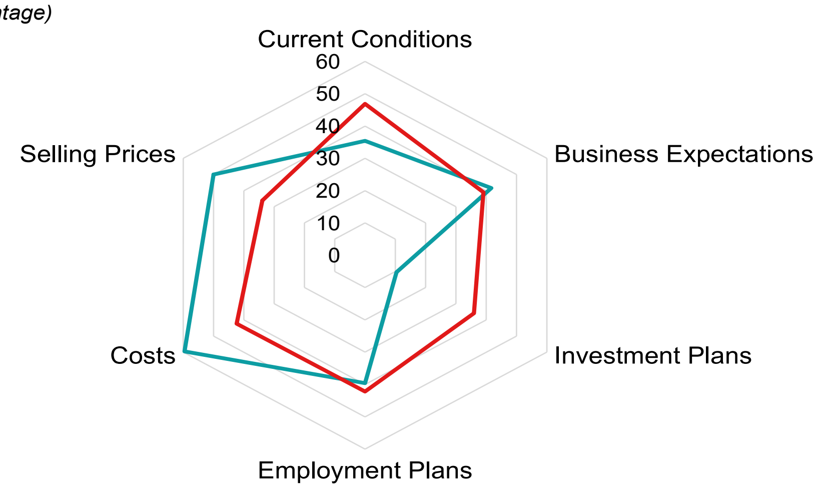
The net share of companies reporting higher input costs declined markedly. Indeed, a net 42% of contacts reported that input prices have increased, down from 60% in the previous quarter. This share decreased in wholesale and retail, and in the other services sectors. However, it increased in the construction and real estate, and manufacturing sectors.

The net share of firms reporting higher selling prices also declined. It fell to 34%, from 50% in the final quarter of 2023. Increases in selling prices were classified as significant by 10% of all companies surveyed, and less prominent by 32%.

In the quarter under review, a net 36% of respondents reported that they plan to invest more, up from 10% in the previous quarter. The stronger investment outlook is largely driven by more favourable responses collected from the services and manufacturing sectors.

At the same time, a net 42% of firms planned to hire more staff, marginally higher than the 40% share observed in the previous quarter, despite labour and skills shortages remaining a pressing concern.

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



Source: Central Bank of Malta Business Dialogue.

In the first quarter of 2024, a total of 64 telephone/virtual meetings were held with 18 manufacturing companies, 24 services-oriented companies, 13 wholesale and retail companies, and nine construction and real estate companies.[1,2]

As in previous rounds, results for the construction and real estate should be interpreted with caution due to the small number of firms covered in this sector.

Business conditions improve

Information gathered between January and March 2024 indicates that – on balance – business conditions were more positive compared to the previous quarter.

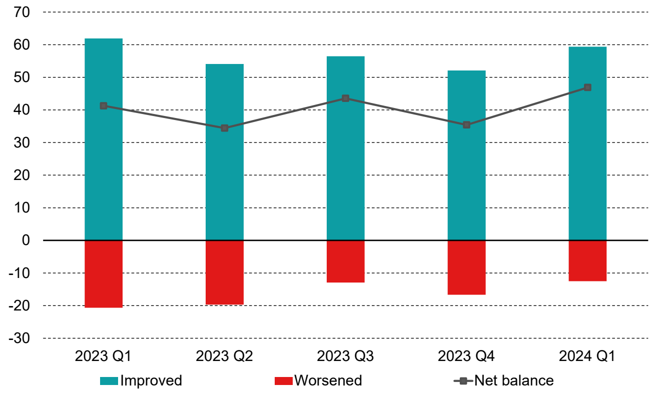
During the quarter under review, 59% of firms stated that business conditions had improved over the past three months, up from 52% in the fourth quarter of 2023 (see Chart 1). At the same time, the share of firms stating that business activity worsened fell to 13%, from 17% in the previous quarter. Consequently, the net share of respondents reporting an amelioration in business conditions rose to 47%, from 35% in the previous survey round.

The share of firms stating that they experienced no changes in business conditions fell marginally to 28%.

Despite dropping significantly, conditions within the services sector had the most positive assessment across sectors. A net 54% of respondents in this sector reported higher activity in the first quarter of 2024, significantly down from the 70% in the fourth quarter of 2023. The share of services firms stating that conditions improved fell to 63%, from 75% previously, while the percentage of firms reporting worse conditions increased to 8%, from 5%. Meanwhile, the share of businesses reporting unchanged conditions increased from 20% to 29%. A particularly positive assessment was reported by contacts in the travel and transport sector, the food and beverages sector, and those providing audit and consultancy services.

The net share of respondents reporting positive sentiment in the wholesale and retail sector also stood at 54%, as it improved sharply following two quarters of decline. The share of wholesale and retail firms reporting an improvement in conditions increased from 30% to 69%, while those reporting worsening conditions decreased from 20% to 15%. The share of firms reporting unchanged conditions dropped from 50% to 15%, as most registered improved sales levels. Within this sector, firms that sell

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?"

[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.

food and beverage items particularly reported positive conditions. The improvement in conditions when compared with the previous quarter partly reflected responses collected from firms selling vehicles and clothing and footwear.

The net balance of manufacturing companies assessing conditions to have improved grew – from 7% in the fourth quarter of 2023, to 39% in the first quarter of this year. The percentage of firms reporting an improvement in activity rose from 40% to 56%, while the share of firms reporting worse conditions dropped from 33% to 17%. The share of those reporting unchanged conditions remained broadly the same (28%). The positive sentiment was mostly reported within the injection moulding, pharmaceuticals, and food and beverage sub-sectors.

Business conditions within the construction and real estate sector remained similar to those observed in the final quarter of 2023, at 33%.

Expectations for short term business conditions moderate slightly

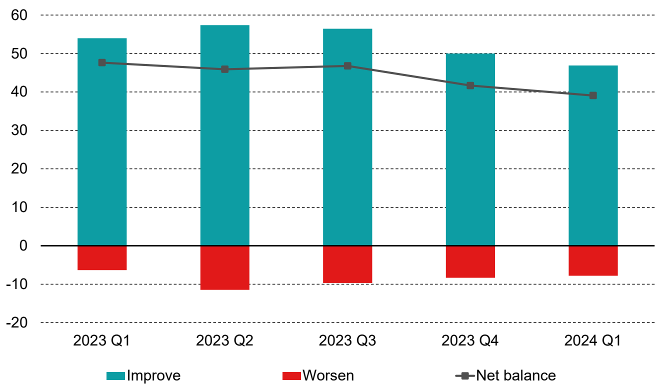
In the quarter under review, 47% of the firms anticipated their business activity to improve further over the next three months, down from 50% in the previous quarter (see Chart 2). Meanwhile, the share of firms which expect conditions to worsen over the next three months stood at 8%, similar to the previous quarter. Consequently, the net share of firms expecting an improvement in the near-term fell slightly from 50% to 47%.

The share of respondents expecting unchanged conditions in the coming three months increased to 44% in the first quarter of 2024, from 35% in the previous quarter. At the same time, the share of respondents reporting an uncertain outlook fell to 2%, from 6% in the previous quarter.

Similar to developments in current business conditions, the services sector experienced a decline in expectations, but registered the highest net balance across sectors. As such, the net balance in the services sector decreased from 70% in the final quarter of 2024 to 46% in the quarter under review. This was due to fewer firms expecting improvements and more firms expecting poorer conditions mainly due to seasonality. Positive conditions were mainly expected by the same firms who reported improving business conditions i.e. those operating in the travel and transport, food and beverage and audit and consultancy sub-sectors.

The short-term outlook for activity in the manufacturing sector improved on balance as the proportion of such firms anticipating business conditions to improve rose from 33% to 50%, while the share of manufacturing firms expecting conditions to worsen declined from 13% to 11% in the first quarter of this year. Consequently, the net balance of firms reporting improved business expectations within this sector rose to

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?"

39%, from 20% in the preceding quarter. Meanwhile, uncertainty in this sector receded completely. Positive expectations are mostly in the same sub-sectors which are currently experiencing positive conditions.

Expectations in the wholesale and retail sector improved somewhat, as a net 38% of wholesale and retail firms contacted between January and March 2024 expected conditions to improve over the next three months, up from 30% in the previous quarter. This reflected a slightly lower share of firms expecting an improvement (40% to 38%), and a lower share of firms expecting worse conditions (10% to 0%). The share of those expecting unchanged conditions rose sharply from 20% to 62%. Uncertainty in this sector receded significantly, following quite a high figure reported in the previous quarter. The reported improvement in this sector was mainly driven by expectations of higher sales of food and beverage items.

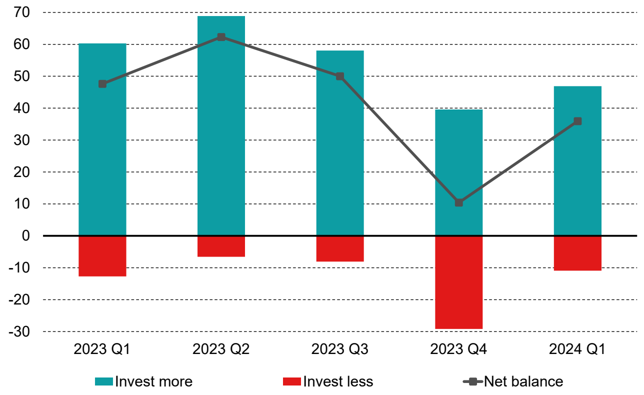
With regards to the construction and real estate sector, the share of firms expecting conditions to improve dropped from a third to a fifth, while the share of firms expecting worse conditions fell to 0%. The net balance in this sector thus turned positive.

Pickup in firms' investment plans

During the quarter under review, on balance, 36% of the companies interviewed said that they plan to invest more, compared to a net balance of 10% in the previous quarter. This was on account of more firms planning to invest more throughout 2024, than they did in 2023, and fewer firms planning to invest less. The majority of the companies contacted (47%) plan to invest more, higher than the 40% recorded in the previous quarter (see Chart 3). Moreover, 42% of the companies interviewed in the first quarter of 2024 said that they plan to keep the same level of investment, up from 31% in the previous quarter. Also, 11% of the companies contacted said that they will be investing less, mostly as a result of the closure of projects planned in the last few years, which reduces the need for additional significant investments in the short term.

Looking at investment plans by sector, on balance, a net 50% of the manufacturing companies plan to invest more, significantly up from 7% in the previous quarter. The net balance for the services sector also increased significantly, reaching 42% from 0% in the previous quarter. Positive responses were received mainly from firms active in the transport, and food and beverages sectors. On the contrary, in the wholesale and retail sector, the net balance declined to 31%, from 40% in the previous quarter. In the real estate and construction sector, the net balance remained 0%, but this result needs to be interpreted with caution in view of the low responses in the sector.

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)?"

Firms' hiring plans slightly higher than previous quarter

The responses collected on hiring plans reveal that the demand for labour remains robust. Indeed, the net share of firms anticipating further recruitment increased marginally to 42%, from 40% in the previous quarter. This mostly reflects a rise in the share of companies planning to increase their staff complement, which offset a smaller increase in the share of firms planning to shed labour (see Chart 4). Half of the companies interviewed reported that they plan to increase their staff levels, compared to 46% in the previous quarter. The share of those planning to reduce staff level rose to 8% from 6% previously.

Meanwhile, 42% of 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.

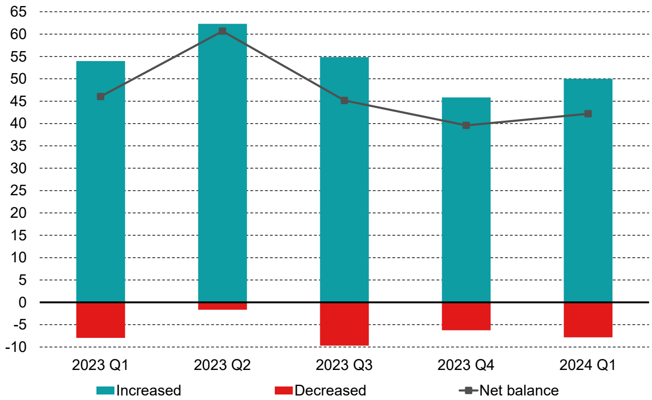
On balance, hiring intentions were strongest in the services sector, with a net share of 58%. This is followed by the wholesale and retail sector (54%). Hiring intentions were less prevalent in manufacturing (28%). The net balance in the construction and real estate sector stood at 11%.

Firms across all sectors continued to find recruitment very challenging, reporting shortages of various skills. Indeed, a third of the firms contacted 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.

Changes in average wages and expected increases

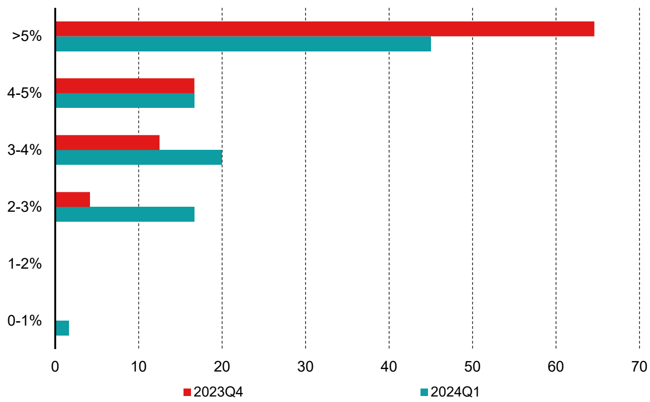
Firms were also asked regarding their expectations for wage growth in 2024. The distribution of replies remained centred on wage increases of more than 5%. Around half of contacted firms expect wage increases of this order of magnitude in 2024, similar to what they reported for 2023. However, this percentage is lower than that reported in the previous round of contacts, whereby 65% of firms had expected wage increases of more than 5% (see Chart 4a). This would suggest that wage

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?"

Chart 4a
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?"

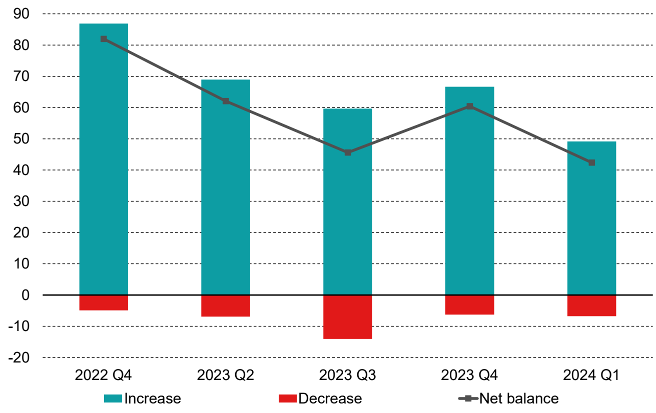
pressures were relatively high in 2023, and firms continue to expect strong wage growth also in 2024. Meanwhile, around a third of firms expect wages in 2024 to increase by less than 5% but more than 3%. The reported figures are inclusive of the 2024 COLA.

Input and selling price pressures decrease

In the first quarter of 2024, 49% of companies contacted reported an increase in their input costs, down from 67% in the last quarter of 2023 (see Chart 5). Moreover, the distribution of replies shifted away from significant price increases to moderate increases, which continues to point to a normalisation of cost pressures. Meanwhile, 44% indicated that their input costs remained unchanged, up from 27% in the previous quarter. At the same time, only 7% of firms reported a decrease in input costs, relatively unchanged from the last quarter. In net terms, the share of companies reporting an increase in input costs decreased from 60% in the previous quarter, to 42% in the quarter under review.

The highest net share of companies reporting non-labour input cost increases is reported for the construction and real estate sector, at 60%, up from 33% in the previous quarter. This is followed by the manufacturing sector, with a net balance of 50%, up from 40% in the previous quarter. In the wholesale and retail sector, a net 46% of firms reported input price increases, down from 70% in the previous quarter. The services sector reported a net balance of 30%, down from 75%.

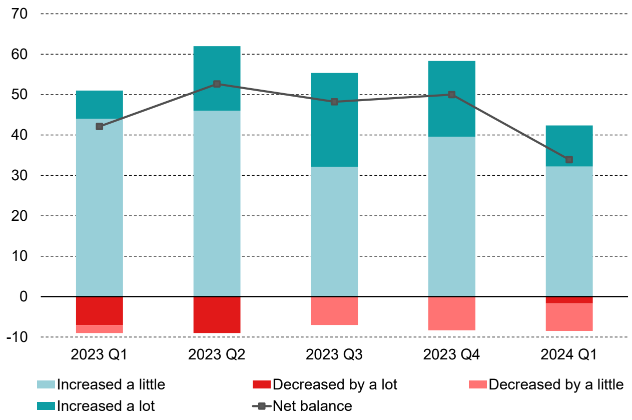
Chart 5
CHANGES IN INPUT PRICES
(contributions to net balance; percentage of companies contacted)



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

Expectations about unit cost increases have also moderated considerably when compared to replies received in the previous round of contacts. Indeed, we can observe a decline in the share of firms expecting an increase (from 80% to 60%). Moreover, the distribution of replies from those firms expecting further price increases has shifted towards lower increases than those reported in the previous round of contacts.

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 lower incidence of input cost increases is also reflected in the assessment of selling prices. Indeed, the percentage of firms that have reported an increase in selling prices fell from 58% in the previous quarter to 42% in the quarter under review (see Chart 6). In this round, 10% said that prices increased by ‘a lot’, compared to 19% in the previous quarter. The other 32% noted that they increased selling prices by ‘a little’, down from the 40% in the previous quarter.

Only 8% of firms decreased selling prices in the quarter under review, and in almost all cases, the decrease was minimal as only 2% reported significant decreases. Around half kept prices unchanged, up from 33% in the previous quarter. As the share of firms raising selling prices exceeded the share of those with price cuts, the net share of companies reporting price increases fell to 34%, from 50% in the previous survey round.

The net share of firms reporting increases in selling prices went up in the manufacturing sector but declined in all other sectors. The highest net balance (52%) was recorded in the services sector. This was followed by the manufacturing sector at 44%. The net balance in the construction and real estate and the wholesale and retail sector stood at 0%.

With regards to profitability, half of the companies contacted have reported 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. Construction firms managed to retain such mark-ups as did 60% of manufacturing firms, particularly those operating in the food and beverage, injection moulding, and pharmaceuticals sub-sectors. A smaller share of services firms (37%), managed to retain mark-ups, and this was slightly more prevalent amongst audit and consultancy services providers. A similar share of wholesale and retail firms also manage retain mark-ups, particularly vehicle sellers.

A minority of companies noted stronger profitability levels due to increases in mark-ups (11%). Those who succeeded to retain or increase mark-ups, managed to retain high profit levels also because they registered higher sales volumes, found efficiency increasing solutions, or secured better pricing through larger orders.

BOX 1: INSIGHTS ON THE POTENTIAL IMPACT OF THE INCLUSION OF MARITIME TRANSPORT INTO THE EUROPEAN UNION'S EMISSION TRADING SCHEME ON FIRMS' OPERATIONS[1]

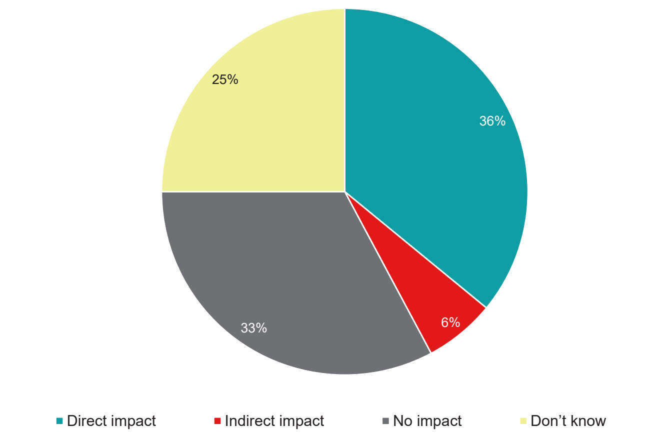
Set up in 2005, the European Union Emission Trading Scheme (EU ETS) is the world's first international emissions trading system, whereby companies must buy or receive allowances corresponding to their CO_2 emissions, making power production from burning coal and other fossil fuels more expensive, and clean power sources comparably more attractive. It covers greenhouse gas emissions from the energy sector and manufacturing industry, as well as aircraft operators flying within the European Union and departing to Switzerland and the United Kingdom.

As from 1 January 2024, the EU ETS also started to cover emissions from maritime transport. It covers 50% of emissions from voyages starting or ending outside of the European Union, and 100% of emissions from voyages between two EU ports and when ships are within EU ports. The inclusion of maritime transport into the scheme has brought with it fears of supply disruptions, particularly route availabilities due to operators potentially shortening voyages to lower their emissions related costs or shipping price increases, as operators can simply pass on the increase in their costs to their clients. Nevertheless, there may be other potential indirect impacts on non-importing firms.

As such, in an effort to analyse the potential impact this may have on local firms, this survey round obtained initial insights on the matter. We asked firm representatives how they expect this change to impact their firm's operations either directly or indirectly.

Around 36% of firms contacted during the first quarter of 2024 expect a direct impact on their operations (see Chart 1). Such firms are not expecting an impact on traffic towards Maltese ports or on activity in general, but rather on shipping costs. Consequently, firms have said that these higher costs will eventually lead to higher selling prices. In fact, some firms are already aware that transport costs will increase but are unsure about the magnitude, while others are still uncertain whether

Chart 1
EXPECTED IMPACT OF THE MARITIME TRANSPORT EU ETS
(percentage of firms)



Source: Central Bank of Malta Business Dialogue.

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

this will indeed result in cost increases. Some firms claimed that they have already started to note increases in transport costs. Out of those expecting a direct impact, only 4% anticipate a positive impact. This is because as import costs increase, the demand for imports will fall and firms will prefer to source goods and services locally.

A 6% share of firms expect an indirect impact on their operations. They expressed concerns that their clients' confidence will fall and that their finances will be negatively impacted. This could possibly have a ripple effect on the demand for other services. Around a third of firms do not expect any impact from the inclusion of maritime transport into the scheme as yet, while a quarter of firms are not yet aware of the potential impact. These mostly include services firms that do not trade actively with other countries.

It is important to note that the shipping industry has recently been hit with many disruptions due to geo-political tensions in the East. Ships are not able to access the Red Sea and are therefore not entering the Mediterranean Sea from the East. This led to the re-routing of many voyages around the African continent causing longer voyages, increased transit time and consequently higher freight charges. However, such increases have started to reverse amid weakening global demand and improving port capacity. Therefore, it could be very challenging for firms to distinguish between the impact of the maritime transport inclusion into the EU ETS from that related to the Israel-Gaza war.

Annex 1

Table 1
SECTORAL REPLIES
Percentage of companies contacted

	Construction and Real Estate		Wholesale and Retail		Services		Manufacturing		Total	
	2023 Q4	2024 Q1	2023 Q4	2024 Q1	2023 Q4	2024 Q1	2023 Q4	2024 Q1	2023 Q4	2024 Q1
How have business conditions developed over the past three months?										
Improved	33	44	30	69	75	63	40	56	52	59
Worsened	0	11	20	15	5	8	33	17	17	13
Remained the same	67	44	50	15	20	29	27	28	31	28
Net balance	*33*	*33*	*10*	*54*	*70*	*54*	*7*	*39*	*35*	*47*
How do you expect business activity to develop in the next few months?										
Improve	33	22	40	38	70	58	33	50	50	47
Worsen	33	0	10	0	0	13	13	11	8	8
Remain the same	33	78	20	62	30	25	53	39	35	44
Uncertain	0	0	30	0	0	4	0	0	6	2
Net balance	*0*	*22*	*30*	*38*	*70*	*46*	*20*	*39*	*42*	*39*
What are your investment plans for the rest of this / next year?										
Invest more	33	22	50	31	35	58	40	56	40	47
Invest less	33	22	10	0	35	17	33	6	29	11
Invest the same	33	56	40	69	30	25	27	39	31	42
Net balance	*0*	*0*	*40*	*31*	*0*	*42*	*7*	*50*	*10*	*36*
How have you changed your employment plans?										
Increased	0	22	70	62	45	58	40	44	46	50
Decreased	0	11	0	8	10	0	7	17	6	8
Unchanged	100	67	30	31	45	42	53	39	48	42
Net balance	*0*	*11*	*70*	*54*	*35*	*58*	*33*	*28*	*40*	*42*
Did you experience any changes in input prices?										
Increased	67	60	70	46	75	43	53	56	67	49
Decreased	33	0	0	0	0	13	13	6	6	7
Unchanged	0	40	30	54	25	43	33	39	27	44
Net balance	*33*	*60*	*70*	*46*	*75*	*30*	*40*	*50*	*60*	*42*
Did you change your selling prices?										
Increased	67	20	70	23	60	57	47	44	58	42
Decreased	33	20	10	23	5	4	7	0	8	8
Unchanged	0	60	20	54	35	39	47	56	33	49
Net balance	*33*	*0*	*60*	*0*	*55*	*52*	*40*	*44*	*50*	*34*

Source: Central Bank of Malta Business Dialogue.