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MAIN FINDINGS FROM THE 2024Q2 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 April and June 2024, indicates that on balance, the net share of firms reporting better business conditions weakened when compared to the previous quarter, but remained within the range estimated over the last few years. In the second quarter of 2024, this share stood at 36%, down from 47% in the first quarter of 2024. The services sector remains buoyant especially due to very strong tourism performance. Conversely, business conditions in the construction and real estate sector have continuned to weaken. Moreover, conditions in the wholesale and retail sector have turned negative. which partly reflects relatively weaker profitability in this sector.

Regarding short-term expectations, the net share of respondents expecting an amelioration in activity increased from 39% in the first quarter of 2024 to 46% in the quarter under review. This share is comparable to that of the last few years. The services sector retained the most positive expectations, likely reflecting the strong performance of tourism-related activities, while the wholesale and retail sector and the manufacturing sector had the least optimistic outlook among the four sectors assessed.

The net share of companies reporting higher input costs increased. Indeed, a net 54% of contacts reported that input prices have increased, up from 42% in the previous quarter. This share increased in all sectors, bar the manufacturing sector.

The net share of firms reporting higher selling prices also increased but remain well below that reported during the last two years. It rose to 42%, from 34% in the first quarter of 2024. Increases in selling prices were classified as significant by 9% of all companies surveyed, and less prominent by 38%.

In the quarter under review, a net 30% of respondents reported that they plan to invest more, down from 36% in the previous quarter. This drop is largely driven by less favourable responses collected from the services sector.

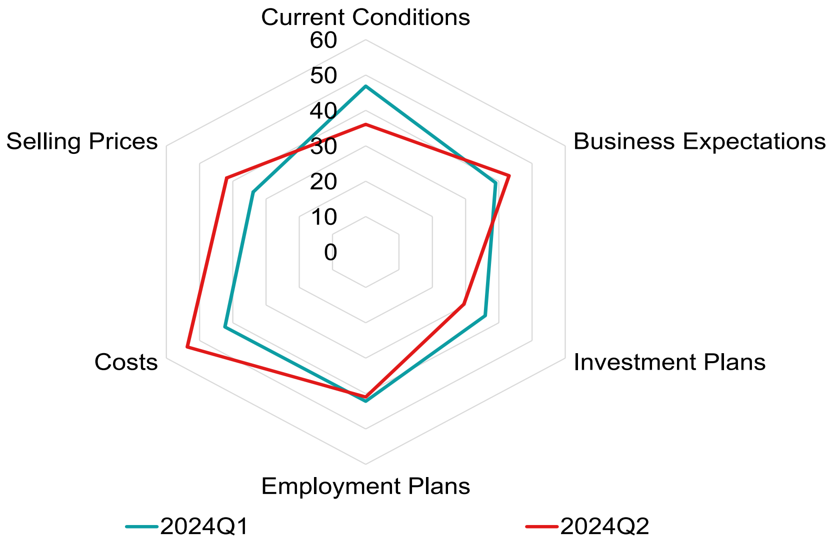
At the same time, a net 41% of firms planned to hire more staff, marginally lower than the 42% share observed in the previous quarter. Labour and skills shortages remained a pressing concern. Hiring intentions are however lower than those reported last year, which is indicative of some incipient cooling in the labour market.

In the second quarter of 2024, a total of 62 telephone/virtual meetings were held with 13 manufacturing companies, 28 services-oriented companies, ten wholesale and retail companies, and ten construction and real estate companies. In this round of contacts, one institution was also interviewed.[1,2]

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.

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



Source: Central Bank of Malta Business Dialogue.

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

Business conditions similar to recent quarters

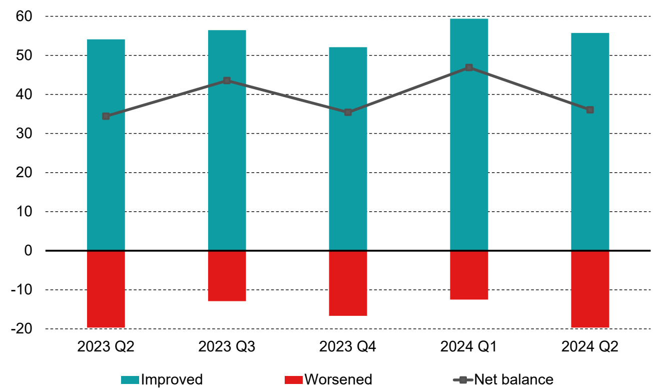
Information gathered between April and June 2024 indicates that – on balance – business conditions remained positive, although the net share of firms reporting an amelioration decreased compared with the previous quarter. However, this is in line with the average business conditions reported since 2021.

During the quarter under review, 56% of firms stated that business conditions had improved over the past three months, down from 59% in the first quarter of 2024 (see Chart 1). At the same time, the share of firms stating that business activity worsened rose to 20%, from 13% in the previous quarter. Consequently, the net share of respondents reporting an amelioration in business conditions fell to 36%, from 47% in the previous survey round.

The share of firms stating that they experienced no changes in business conditions fell to 25% from 28% previously.

Similar to previous quarters, firms within the services sector

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?"

had the most positive assessment across sectors. A net 57% of respondents in this sector reported higher activity in the second quarter of 2024, up from 54% in the first quarter of 2024. The share of services firms stating that conditions improved rose to 68%, from 63% previously, while the percentage of firms reporting worse conditions increased to 11%, from 8%. Meanwhile, the share of businesses reporting unchanged conditions dropped from 29% to 21%. A particularly positive assessment was reported by contacts in the accommodation and hospitality, and travel and transport sectors.

The net balance of manufacturing companies assessing conditions to have improved also grew from 39% in the first quarter of 2024, to 46% in the second quarter of this year. The percentage of firms reporting an improvement in activity rose from 56% to 69%, and this outweighed an increase in the share of firms reporting worse conditions from 17% to 23%. The share of those reporting unchanged conditions dropped significantly from 28% to just 8%. The positive sentiment was mostly reported within the food and beverage, and printing and packaging sub-sectors.

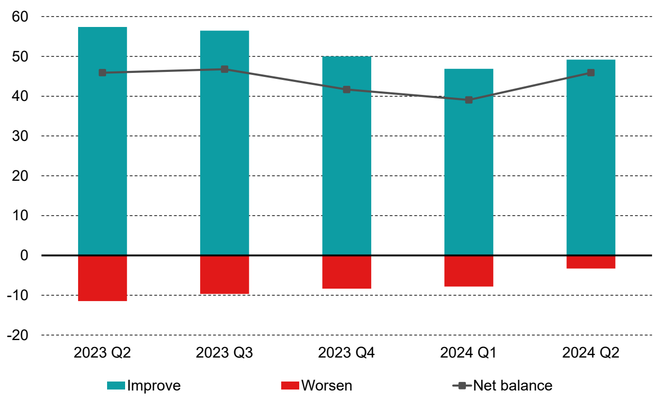
Firms in the construction and real estate sector were less likely than before to report improving conditions. Indeed, the net share of firms in this sector reporting an improvement in activity fell from 33% in the first quarter of the year to 20% in the quarter under review, reflecting a stronger rise in the share of firms reporting worse conditions in comparison to the rise in the share of firms reporting improved conditions. Real estate agents largely reported positive conditions in the property sales and rental markets while the sentiment reported by construction firms is relatively weaker.

The net balance in the wholesale and retail segment turned negative for the first time in over three years. The reason for this shift was mainly due to a significant drop in the share of wholesale and retailers reporting improved conditions, which alternatively reported unchanged conditions. In part this reflects weaker profitability in this sector. As such, the share of firms reporting an improvement in conditions decreased from 69% to 10%, while the share of firms reporting worsening conditions increased from 15% to 30%. At the same time, the share of firms reporting unchanged conditions rose sharply from 15% to 60%.

Expectations for short term business conditions broadly stable

In the quarter under review, 49% of the firms anticipated their business activity to improve over the next three months, up slightly from 47% in the previous quarter (see Chart 2). Meanwhile, the share of firms which expect conditions to worsen over the next three months fell to just 3% from 8% in the previous quarter. Consequently, the net share of firms expecting an improvement in the near-term increased from 39% to 46%. This is in line with the average expectations reported since 2021.

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 unchanged conditions in the coming three months decreased to 39%, from 44% in the previous quarter. At the same time, the share of respondents reporting an uncertain outlook rose to 8%, from 2% in the previous quarter.

The services sector experienced a rise in expectations and registered the highest net balance across sectors. As such, the net balance in the services sector increased from 46% in the first quarter of 2024 to 61% in the quarter under review. This was due to more firms expecting improvements and fewer firms expecting poorer conditions. Positive conditions were mainly expected by firms operating in accommodation and hospitality in view of increased tourism throughout the summer.

The short-term outlook for activity in the manufacturing sector remained positive, but less so than in the previous quarter. The proportion of such firms anticipating business conditions to improve fell from 50% to 30%, while the share of manufacturing firms expecting conditions to worsen declined marginally from 11% to 10% in the second quarter of this year. Consequently, the net balance of firms reporting improved business expectations within this sector dropped to 20%, from 39% in the preceding quarter. Meanwhile, the share of firms signalling uncertainty rose to 10%.

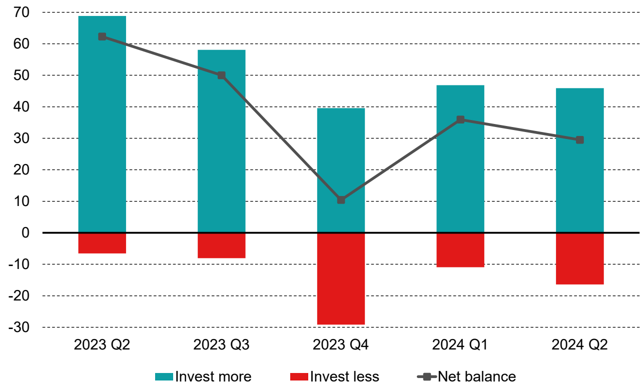
Movements in expected conditions in the wholesale and retail sector mirrored those of the manufacturing sector. A net 20% of wholesale and retail firms contacted between April and June 2024 expected conditions to improve over the next three months, down from 38% in the previous quarter. This reflected a lower share of firms expecting an improvement (38% to 20%), as the share of firms expecting worse conditions remained at 0%. The share of those expecting unchanged conditions rose again from 62% to 70%. In this round, uncertainty in this sector affected more firms, with a share of 10%.

With regards to the construction and real estate sector, the share of firms expecting conditions to improve increased from 22% to 40%, while the share of firms expecting worse conditions remained 0%. The net balance in this sector increased.

Fewer firms expect to increase investment

During the quarter under review, on balance, 30% of the companies interviewed said that they plan to invest more, compared to a net balance of 36% in the previous quarter. However, this drop of 6% in the net balance largely reflects the fact that 16% of the companies contacted – compared to 11% previously – 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. There were also fewer firms planning to invest more throughout the rest of 2024. The majority of the companies contacted (46%) plan to invest more, marginally lower than the 47% recorded in the previous quarter (see Chart 3).

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)?"

Moreover, 38% of the companies interviewed in the second quarter of 2024 said that they plan to keep the same level of investment, down from 42% in the previous quarter.

Looking at investment plans by sector, on balance, a net 46% of the manufacturing companies plan to invest more, down from 50% in the previous quarter. Positive responses were received mainly from firms active in printing and packaging. The net balance for the services sector decreased significantly, to 21% from 42% in the previous quarter. Most accommodation and hospitality providers will be investing the same as they did last year, while investment appetite within the maritime and freight sub-sector seems to be very positive. In the wholesale and retail sector, the net balance decreased slightly to 30%, from 31% in the previous quarter. In the real estate and construction sector, the net balance increased significantly to 30% from 0%.

Firms' hiring intentions are broadly stable but lower than last year

The net share of firms anticipating further recruitment decreased marginally to 41%, from 42% in the previous quarter. This reflects a marginal rise in the share of companies planning to increase their staff complement, which was offset by a larger increase in the share of firms planning to shed labour (see Chart 4). More than half (52%) of the companies interviewed reported that they plan to increase their staff levels, compared to 50% in the previous quarter. The share of those planning to reduce staff level rose to 11% from 8% previously.

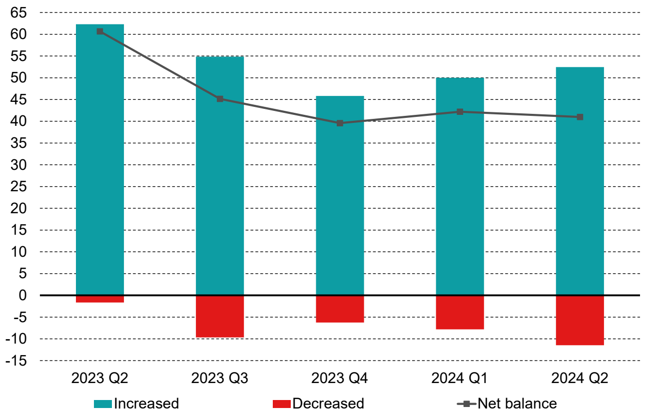
Meanwhile, 36% of companies said that they plan to keep the same staff levels. This mainly relates to companies that are only recruiting for replacement purposes or have reached their desired level of staff headcount.

The responses collected on hiring plans reveal that the demand for labour this year has declined when compared to the same period last year, which suggests that while employment growth remains robust, this is softening.

On balance, hiring intentions were strongest in the construction and real estate sectors, with a net share of 60%. This is followed by the wholesale and retail sector (50%). Hiring intentions were less prevalent in services (39%), and in the manufacturing sector (23%).

Firms across all sectors continued to find recruitment very challenging, reporting shortages of various skills. Indeed, 36% 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. Furthermore, skill shortages prevail across sectors and roles.

Chart 4
EMPLOYMENT PLANS
(contributions to net balance; percentage of companies contacted)

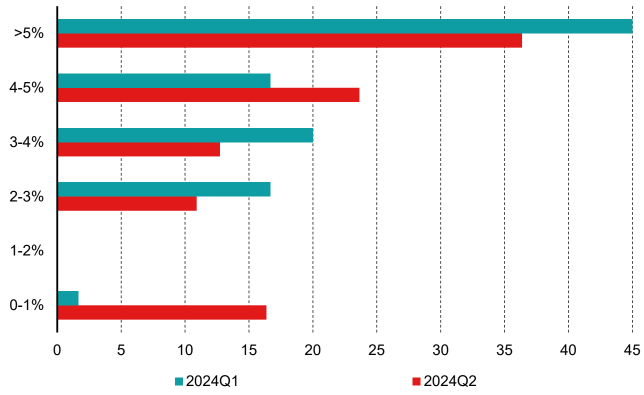


Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows - "How have you changed your employment plans?"

Changes in average wages and expected increases

Firms were also asked about their expectations for wage growth in 2024. The distribution of replies continues to suggest that wage increases of above 5% dominate (see Chart 5). However, the share of firms expecting such increases were slightly lower than those collected in the previous quarter, which might suggest that while wage pressures are still assessed to be high, they are diminishing. The reported figures below are inclusive of the 2024 COLA.

Chart 5
EXPECTED WAGE INCREASES IN 2024
(percentage of firms)

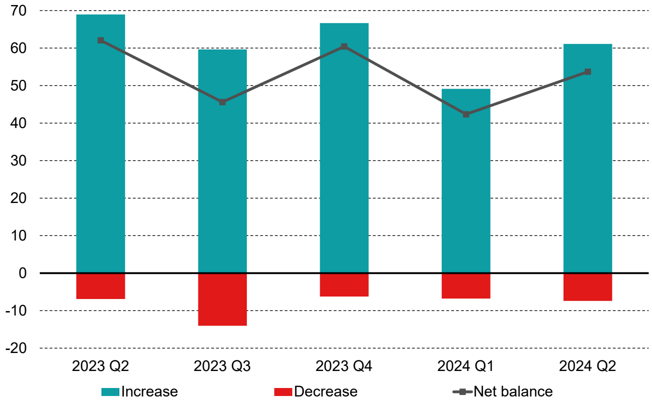


Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "By how much do you expect your company's wages to increase on average in 2024?"

Input and selling price pressures increase but remain below recent peaks

In the second quarter of 2024, 61% of companies contacted reported an increase in their input costs, up from 49% in the first quarter of 2024 (see Chart 6). However, the distribution of replies has shifted away from significant price increases to moderate increases, which continues to point to a normalisation of cost pressures. Meanwhile, 31% indicated that their input costs remained unchanged, down from 44% in the previous quarter. At the same time, only 7% of firms reported a decrease in input costs, unchanged from the last quarter. In net terms, the share of companies reporting an increase in input costs increased from 42% in the previous quarter, to 54% in the quarter under review.

Chart 6
CHANGES IN INPUT PRICES
(contributions to net balance; percentage of companies contacted)

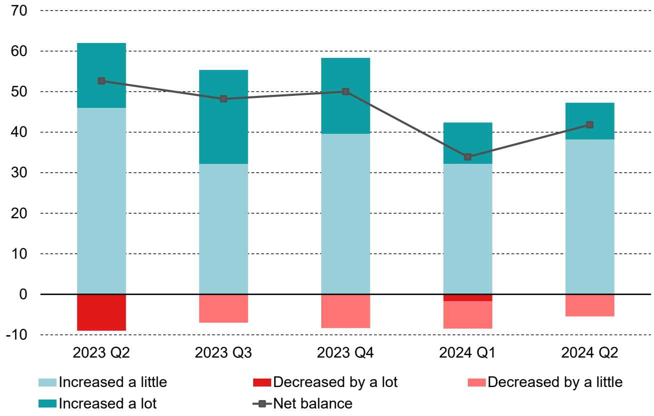


Source: Central Bank of Malta Business Dialogue.
Notes: The question put to respondents was as follows – "Did you experience any changes in input prices?"

The highest net share of companies reporting non-labour input cost increases is reported for the construction and real estate sector, at 80%, up from 60% in the previous quarter. This is followed by the services sector, with a net balance of 62%, up from 30% in the previous quarter. In the wholesale and retail sector, a net 60% of firms reported input price increases, up from 46% in the previous quarter. The manufacturing sector reported a net balance of 23%, down from 50%.

Expectations about unit cost increases have moderated considerably when compared to replies received in the previous round of contacts. Indeed, a decline has been observed in the share of firms expecting an increase (to 51% from 65%). Moreover, the distribution of replies from those firms expecting further price increases has shifted towards smaller increases than those reported in the previous round of contacts.

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?"

The higher incidence of input cost increases is reflected in the assessment of selling prices. The share of firms that have reported an increase in selling prices rose from 42% in the previous quarter to 47% in the quarter under review (see Chart 7). However, such expectations are lower than those reported for the past two years, which suggests that the inflation continues to gradually normalise. In this round, 9% said that prices increased by 'a lot', compared to 10% in the previous quarter. The other 38% noted that they increased selling prices by 'a little', up from the 32% in the previous quarter.

Only 5% of firms decreased selling prices in the quarter under review, and in almost all cases, the decrease was minimal as no firm reported significant decreases. In this round, 47% kept prices unchanged, down from 49% 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 rose to 42%, from 34% in the previous survey round.

The net share of firms reporting increases in selling prices went up in all sectors except for the services sector, which experienced a decline. The highest net balance (54%) was recorded in the manufacturing sector. This was followed by the construction and real estate sector at 50%. The balance in the wholesale and retail sector stood at 20%. The net balance in the services sector declined to 42% from 52% in the previous quarter.

With regards to profitability, 53% of the companies contacted have reported that mark-ups have recently suffered due to the high input and operating costs, and this was evident across sectors. Almost 40% retained mark-ups through higher selling prices, allowing them to also retain healthy profit levels. Only 9% of interviewed firms reported to have increased their mark-ups. The largest share of firms reporting higher mark-ups (11%) was found to be in the services sector. Half of the construction firms interviewed managed to retain mark-ups as did 42% of manufacturing firms, particularly those operating in the electronics sub-sectors. A smaller share of services firms (39%), managed to retain mark-ups, and this was much more prevalent amongst accommodation and hospitality providers, while 30% of wholesale and retail firms also managed to retain mark-ups.

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: TELEWORKING ARRANGEMENTS AND ITS IMPACT ON FIRMS' DEMAND FOR OFFICE SPACE[1]

The shift towards teleworking has been a significant global trend in recent years, accelerated by the COVID-19 pandemic. Eurostat LFS data show that the share of persons working from home as a percentage of the total employment in Malta, reached a peak of 14.8% in 2020 and 2021 when containment measures were in full force. Although this figure declined to 11.5% in 2023, it remains well above pre pandemic levels (6.1% in 2019).

This round of contacts obtained insights from company representatives on the teleworking arrangements at their firm and its impact on the companies' demand for office space. It seems that this trend has had a varied impact on the demand for office space across different sectors, reflecting both the opportunities and constraints associated with remote working, as well as companies' perception of teleworking.

Most companies in the services sector reported limited impact on their office space needs due to teleworking. While some firms allowed hybrid systems or occasional remote work, the majority noted that employees preferred working on-site or that their roles did not allow for teleworking. This was particularly the case in contact intensive sectors or operations.

Nonetheless, a few firms, such as those in audit and consultancy and gaming, successfully reduced their use of office space through hybrid work arrangements. For instance, companies mentioned using telework as a cost-cutting measure, allowing employees to work from home two days a week, which lessened their office space requirements. Conversely, sub-sectors like accommodation and hospitality saw minimal potential for teleworking.

Teleworking had minimal to no impact on office space needs within the wholesale and retail sector, due to the nature of business in this sector. Companies in this sector typically found that teleworking was not feasible for most of their operations. In the manufacturing sector, teleworking was generally limited to administrative activities. However, telework did not translate into a reduced demand for office space, especially since manufacturing companies operate from their own plants. Once again, the nature of manufacturing work, which often requires physical presence, meant that the impact of teleworking on office space was negligible. This was consistent across sub-sectors such as consumer durables and electronics. Despite the high scope for automation in this sector, it seems that Maltese manufacturing firms still rely on traditional methods of production. Nevertheless, recent company insights point at a slow shift towards more automation to rely less on human capital.

For construction firms, teleworking was largely impractical. However, the real estate sector has been significantly impacted by a shift in demand. Real estate agents and developers highlighted that the supply of commercial office space has exceeded demand, partly due to changing work habits post-pandemic and potentially less foreign direct investment. The views of the former thus appear to contrast the replies obtained from companies

[1] Prepared by Warren Deguara, Martina Cassar and Demi Mock – Principal Economist and Economists, respectively, within the Economic Projections and Conjunctural Analysis Office.

themselves. Yet, many companies that had invested in office spaces for leasing purposes found it challenging to rent out these spaces. The challenges with the oversupply of office space, seem to highlight the misalignment between pre-pandemic investment strategies and current market demands. Real estate agents confirmed that this caused rent prices for such spaces to fall, in order to close the gap between demand and supply. Moreover, some agents highlighted that new commercial spaces will soon enter the market and thus could have more severe repercussions on commercial rent prices. Landlords, however, typically insert annual price increase clauses in commercial leases.

In general, company contacts indicate that while teleworking has been adopted to some extent, it has not led to a substantial reduction in office space demand for most firms. This is primarily due to the specific nature of many roles that require on-site presence as well as companies' reluctance to offer such work arrangements, fearing disruptions to the workflow. However, the real estate market has felt the impact more severely, with indications of a non-negligible oversupply of commercial office spaces. Real estate professionals have stressed that the commercial segment has slowed down, attributing this to both an oversupply and the pandemic-induced shift in working patterns. Contacts in this sector highlighted that investments made by developers in recent years have led to a significant surplus in office space, which has not been matched by demand, despite continued strong growth in employment, which could indicate that job creation in sectors that usually demand office space may contain a higher element of telework.

Company replies also hint that teleworking has allowed some firms to tap into a larger pool of labour supply by hiring workers that offer services from overseas. Should this practice become more widespread, it could have more significant consequences on the demand for office space.

Annex 1

Table 1
SECTORAL REPLIES
(percentage of companies contacted)

	Construction and Real Estate		Wholesale and Retail		Services		Manufacturing		Total	
	2024 Q1	2024 Q2	2024 Q1	2024 Q2	2024 Q1	2024 Q2	2024 Q1	2024 Q2	2024 Q1	2024 Q2
How have business conditions developed over the past three months?										
Improved	44	50	69	10	63	68	56	69	59	56
Worsened	11	30	15	30	8	11	17	23	13	20
Remained the same	44	20	15	60	29	21	28	8	28	25
Net balance	*33*	*20*	*54*	*-20*	*54*	*57*	*39*	*46*	*47*	*36*
How do you expect business activity to develop in the next few months?										
Improve	22	40	38	20	58	64	50	30	47	49
Worsen	0	0	0	0	13	4	11	10	8	3
Remain the same	78	50	62	70	25	25	39	50	44	39
Uncertain	0	10	0	10	4	7	0	10	2	8
Net balance	*22*	*40*	*38*	*20*	*46*	*61*	*39*	*20*	*39*	*46*
What are your investment plans for the rest of this / next year?										
Invest more	22	50	31	50	58	39	56	54	47	46
Invest less	22	20	0	20	17	18	6	8	11	16
Invest the same	56	30	69	30	25	43	39	38	42	38
Net balance	*0*	*30*	*31*	*30*	*42*	*21*	*50*	*46*	*36*	*30*
How have you changed your employment plans?										
Increased	22	60	62	50	58	54	44	46	50	52
Decreased	11	0	8	0	0	14	17	23	8	11
Unchanged	67	40	31	50	42	32	39	31	42	36
Net balance	*11*	*60*	*54*	*50*	*58*	*39*	*28*	*23*	*42*	*41*
Did you experience any changes in input prices?										
Increased	60	80	46	60	43	69	56	38	49	61
Decreased	0	0	0	0	13	8	6	15	7	7
Unchanged	40	20	54	40	43	23	39	46	44	31
Net balance	*60*	*80*	*46*	*60*	*30*	*62*	*50*	*23*	*42*	*54*
Did you change your selling prices?										
Increased	20	50	23	40	57	46	44	54	42	47
Decreased	20	0	23	20	4	4	0	0	8	5
Unchanged	60	50	54	40	39	50	56	46	49	47
Net balance	*0*	*50*	*0*	*20*	*52*	*42*	*44*	*54*	*34*	*42*

Source: Central Bank of Malta Business Dialogue.
Note: Figures may not add up due to rounding.