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ABBREVIATIONS

APP asset purchase programme
ATM automated teller machine
BCI Business Conditions Index
BLS Bank Lending Survey
COVID-19 coronavirus disease 2019
CCFF Corporate Financing Facility
CGS COVID-19 Guarantee Scheme
CPI consumer price index
ECB European Central Bank
EEI Employment Expectations Indicator
EER effective exchange rate
EONIA Euro OverNight Index Average
ESA European System of Accounts
ESI economic sentiment indicator
EU European Union
EURIBOR Euro Interbank Offered Rate
€STR euro short-term rate
FCI Financial Conditions Index
FOMC Federal Open Market Committee
GDP gross domestic product
GFCF gross fixed capital formation
GVA gross value added
HCI harmonised competitiveness indicator
HICP Harmonised Index of Consumer Prices
IMF International Monetary Fund
LFS Labour Force Survey
LTRO long-term refinancing operation
MDB Malta Development Bank
MFI monetary financial institution
MGS Malta Government Stocks
MIA Malta International Airport
MPC monetary policy committee
MRO main refinancing operation
MSE Malta Stock Exchange
NACE statistical classification of economic activities in the European Community
NAIRU non-accelerating inflation rate of unemployment
NEIG non-energy industrial goods
NFC non-financial corporation
NPISH non-profit institutions serving households
NPL non-performing loans
NSO National Statistics Office
OPEC Organization of the Petroleum Exporting Countries
PELTROs pandemic emergency longer-term refinancing operations
PEPP Pandemic Emergency Purchase Programme
POS point of sale
PPI Property Price Index
RPI Retail Price Index
TCN third country nationals
TFP total factor productivity
TLTRO targeted long-term refinancing operation
ULC unit labour cost
UK United Kingdom
US United States
WAP working-age population
FOREWORD

In the second quarter of 2020, real gross domestic product (GDP) fell by 16.2% in annual terms following a 1.4% increase in the first quarter, amid high levels of uncertainty and the introduction of various containment measures in response to COVID-19. The contraction in the second quarter, which was the strongest on record, was underpinned by a sharp decline in both domestic demand and net exports.

Growth in potential output moderated to its lowest since 2003. When measured as a four-quarter moving average, the output gap was estimated at -4.5% in the second quarter, well below the 0.2% estimated in the first quarter.

The Bank’s Business Conditions Index (BCI) was also negatively affected by the exceptionally difficult economic environment triggered by COVID-19, falling deeper into negative territory. The BCI suggests that economic conditions stood significantly below their long-term average. The index also stood well below estimates during the 2009 recession.

Labour market conditions weakened, reflecting the impact of the COVID-19 pandemic. Employment rose at a much slower pace than in the first quarter. The unemployment rate based on the Labour Force Survey (LFS) increased compared to the preceding quarter and a year earlier. Nevertheless, the impact of COVID-19 on unemployment was mitigated by government measures aimed at protecting employment as well as firms’ reliance on shorter working-time arrangements. At 4.4%, the unemployment rate in Malta remained below that in the euro area, but rose above the Bank’s structural measure.

Annual inflation based on the Harmonised Index of Consumer Prices (HICP) moderated to 1.0% in June from 1.2% in March, driven by slower growth in the prices of services and energy. Inflation based on the Retail Price Index (RPI), which only takes into account purchases made by Maltese households, eased to 0.7% in June, from 1.1% three months earlier. Meanwhile, producer output prices fell in annual terms.

Malta’s unit labour cost (ULC) index accelerated in the second quarter, reflecting a sharp drop in productivity as a result of the contraction in activity triggered by the pandemic. Meanwhile, Malta’s harmonised competitiveness indicators (HCIs) pointed to a deterioration in international competitiveness, largely reflecting unfavourable exchange rate developments.

In the second quarter of 2020, the balance on the current account recorded a deficit, which contrasts with a surplus in the second quarter of 2019. This was mainly attributable to a sharp decline in net services receipts, largely on account of the travel ban imposed to limit the spread of the virus. However, when measured on a four-quarter moving sum basis, the current account showed a surplus equivalent to 1.3% of GDP. The cyclically-adjusted measure was estimated at 4.9% of GDP, indicating that Malta’s current account developments largely reflect structural factors.

Public finances were considerably impacted by the COVID-19 pandemic and the general government balance deteriorated significantly. When measured as a four-quarter moving sum, the general government balance registered a deficit of 5.1% of GDP in the second quarter of 2020, against a deficit of 1.7% in the previous quarter. Meanwhile, the general government debt-to-GDP ratio rose to 51.1%, from 44.0% at end-March.
During the quarter under review, Maltese residents’ deposits with monetary financial institutions (MFIs) in Malta continued to expand. The shift to overnight deposits persisted in an environment of low interest rates and a continued preference for liquidity. Meanwhile, credit to Maltese residents expanded at a faster pace, reflecting stronger growth in credit to general government, partly reflecting banks’ purchases of new Malta Government Stocks (MGSs) issued by the Government to fund economic support to the private sector. By contrast, credit to residents outside general government grew at a more moderate rate. The annual rate of change of loans to non-financial corporations (NFCs) was above that recorded three months earlier. According to the Bank’s Financial Conditions Index (FCI), financing conditions tightened significantly when compared with the first quarter of the year, while remaining more favourable than at the time of the global financial crisis.

In June, the weighted average interest rate on deposits held by Maltese residents with domestic banks was six basis points lower compared with a year earlier. The weighted average lending rate paid to resident MFIs by households and NFCs also decreased by six basis points over this period. Hence, the spread between the two was unchanged compared to a year earlier.

Meanwhile, the primary market yield on Treasury bills fell from that prevailing at the end of March. By contrast, secondary market yields on 5- and 10-year MGS rose. Domestic share prices regained some of their losses and ended the June quarter at a higher level compared with end-March.

In response to the COVID-19 pandemic and subsequent containment measures, the Bank issued Directive No. 18 to regulate the temporary suspension of debt repayments on credit facilities advanced by credit institutions to borrowers prior to April 2020. As at end of June 2020, 9,492 businesses and households were benefiting from a moratorium on repayments on total outstanding loans amounting to around €1.8 billion. Furthermore, in order to alleviate liquidity shortfalls as a result of the pandemic, in April 2020 the Government launched the Malta Development Bank (MDB) COVID-19 Guarantee Scheme (CGS) which provides guarantees to commercial banks with the aim of enhancing access to new working capital for businesses. By end June 2020, 255 facilities were approved under this scheme, covering total sanctioned lending of €161.1 million.

During the quarter under review, central banks continued to provide liquidity support to sustain the smooth functioning of financial markets and the flow of credit to the economy.

The Governing Council of the European Central Bank (ECB) reinforced its accommodative monetary policy stance. The interest rates on the main refinancing operations, on the marginal lending facility and on the deposit facility were held unchanged at 0.00%, 0.25%, and -0.50% respectively. Furthermore, the Governing Council reiterated that it expected the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics. It also reiterated its intention to reinvest in full the principal payments from maturing securities under the asset purchase programme (APP) for an extended period of time past the date when it starts raising the key ECB interest rates and in any case for as long as necessary.

At the end of April, the Governing Council announced a package of monetary policy measures aimed at supporting the euro area economy in the face of economic disruption and heightened
uncertainty. These included a further easing of the conditions on the targeted longer-term refinancing operations (TLTRO III) and the launch of a new series of seven non-targeted pandemic emergency longer-term refinancing operations (PELTROs).

In early June, the Governing Council also decided to increase the envelope for the Pandemic Emergency Purchase Programme (PEPP) by €600 billion to a total of €1,350 billion. In addition, the horizon for net purchases under the PEPP was extended to at least the end of June 2021.
1. THE EXTERNAL ENVIRONMENT AND THE EURO AREA

In the second quarter of 2020, GDP contracted sharply in the United States (US), the United Kingdom (UK) and the euro area as measures implemented to combat the spread of COVID-19 continued to deter economic activity. During the quarter, the unemployment rate was unchanged in the United Kingdom, rose moderately in the euro area but reached an all-time high in the United States.

Annual consumer price inflation, in both the United States and the United Kingdom declined further to 0.6% in June from 1.5% in March. Inflation also eased in the euro area, where it stood at 0.3% in June, from 0.6% in March. During the quarter under review, the Federal Reserve, the Bank of England and the ECB all kept their key interest rates unchanged. All three central banks continued to provide extensive liquidity support packages to support the smooth functioning of financial markets and the flow of credit to the economy.

Brent oil prices continued to decline in April as demand contracted owing to the spread of COVID-19. However, as restrictions related to COVID-19 eventually started to be lifted leading to improved global energy demand expectations, oil prices began to recover. An OPEC+ agreement to lower supply and various supply shut-ins across the United States also put upward pressures on prices. The price of Brent oil ended the quarter twice as high as at end-March, but was still well below levels prevailing at the start of the year. Meanwhile, non-energy commodity prices rose.

Key advanced economies

US economic activity falls sharply

In the second quarter of 2020, GDP growth in the United States contracted further. In quarter-on-quarter terms, GDP decreased by 9.0%, a significantly larger contraction than the 1.3% decline recorded in the first quarter (see Table 1.1).

Personal consumption expenditure and gross private domestic investment, including inventories, fell at a significantly faster pace than in the first quarter of the year. In contrast, government expenditure rose at a marginally stronger pace than before, while the trade deficit narrowed slightly in volume terms, as lower imports offset the fall in exports.

The decline in GDP reflected mainly the response to COVID-19, as lockdown orders were in force for most of the quarter in most of the country. This led to rapid shifts in activity, as businesses and

<table>
<thead>
<tr>
<th>Table 1.1</th>
<th>REAL GDP GROWTH IN SELECTED ADVANCED ECONOMIES</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Quarter-on-quarter percentage changes; seasonally and working day adjusted</td>
</tr>
<tr>
<td></td>
<td>2018</td>
</tr>
<tr>
<td></td>
<td>Q2</td>
</tr>
<tr>
<td>United States</td>
<td>0.7</td>
</tr>
<tr>
<td>Euro area</td>
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</tr>
<tr>
<td>United Kingdom</td>
<td>0.4</td>
</tr>
<tr>
<td>Sources: Bureau of Economic Analysis, US; Eurostat; Office for National Statistics, UK.</td>
<td></td>
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</table>
schools continued to operate remotely and consumers and businesses cancelled, restricted, or redirected their spending.

In the labour market, the participation rate stood at 60.8%, in the second quarter of 2020, down from 63.2% in the preceding quarter and from 62.9% a year earlier. Meanwhile, employment growth turned negative, with the number of job holders falling by 12.3% in annual terms, after increasing by 0.6% in the first quarter. Non-farm payroll data suggest that these job losses were broad-based across all main economic sectors, but were more pronounced in the leisure and hospitality sector and also in the retail sector. The average unemployment rate over the three months to June stood at 13.0%, well above 3.8% in the preceding quarter (see Chart 1.1). The rate reached an all-time high of 14.7% in April.

The annual rate of change of the US consumer price index (CPI) stood at 0.6% in June, down from 1.5% in March (see Chart 1.2). This was mainly a result of developments in energy inflation which fell to -12.6% in June, from -5.7% in March. Service price inflation eased and prices of commodities other than food and energy fell further. On the other hand, food inflation edged up. Reflecting developments in services prices and commodities other than food and energy, inflation excluding food and energy declined to 1.2% in June from 2.1% in March.

During the second quarter of 2020, the Federal Open Market Committee (FOMC) reiterated its commitment to use its full range of tools to support the US economy in this challenging time. The Committee maintained the target range for the federal funds rate unchanged in a range between 0.00% and 0.25% (see Chart 1.3). The Committee said that it expected to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals.
The FOMC also said that to support the flow of credit to households and businesses, it will increase its holdings of Treasury securities and agency residential and commercial mortgage-backed securities at least at the current pace to sustain smooth market functioning, thereby fostering effective transmission of monetary policy to broader financial conditions. In addition, the Open Market Desk would continue to offer large-scale overnight and term repurchase agreement operations.

Moreover, some of the facilities introduced in March were expanded or made available on more favourable terms during the second quarter. The Federal Reserve took additional actions to provide up to USD 2.3 trillion in loans to support the economy. This funding would assist households and employers of all sizes and bolster the ability of state and local governments to deliver critical services during the pandemic. The actions included the establishment of the Paycheck Protection Program Liquidity Facility (PPPLF) which helps small businesses keep their workers by providing term financing to financial institutions that originate loans to small businesses under the Paycheck Protection Program (PPP), taking these loans as collateral.

In order to ensure credit flows to small and medium-sized businesses and non-profit organisations, the Fed also announced a new emergency lending facility, the Main Street Business Lending Program that would purchase up to USD 600 billion in loans from eligible companies. The Municipal Liquidity Facility was also established. This facility helps state and local governments manage cash flow stresses caused by COVID-19. The Fed also expanded the size and scope of the Primary and Secondary Market Corporate Credit Facilities (PMCCF and SMCCF) as well as the Term Asset-Backed Securities Loan Facility (TALF). On various occasions during the second quarter, the Federal Reserve extended the eligibility criteria of some of its facilities or adopted more favourable collateral requirements to make them accessible to a larger number of beneficiaries. It also expanded the size and duration of certain facilities.¹

**UK economy contracts at an unprecedented rate**

After falling at a quarterly rate of 2.5% in the first quarter of 2020, GDP in the United Kingdom declined further by an unprecedented 19.8% in the second quarter of 2020 (see Table 1.1). This contraction reflected the ongoing containment policies that have been put in place, including

¹ During the third quarter of 2020, the FOMC reiterated its commitment to use its full range of tools to support the US economy, committing to keep the target range for the federal funds rate unchanged until labour market conditions have reached levels consistent with maximum employment and inflation has risen to 2.0% and is on track to moderately exceed 2.0% for some time. The Committee also said that the Federal Reserve would increase its holdings of Treasury securities and agency residential and commercial mortgage-backed securities at least at the current pace. Meanwhile, the Federal Reserve extended several lending facilities that were due to expire in September through December 2020. The temporary US dollar liquidity swap lines and the temporary repurchase agreement facility for foreign and international monetary authorities (FIMA repo facility) were extended through end-March 2021. The Main Street Lending Program was modified again to be more accessible to smaller non-profit organisations.
public health restrictions and forms of voluntary social distancing. Private consumption declined at a much faster pace, as did gross fixed capital formation and government consumption. Large falls in gross trade flows were also recorded in the second quarter.

Given the decline in economic activity, employment fell in quarter-on-quarter terms. As a result, the annual rate of change eased to 0.3%, from 1.4% in the first quarter of 2020. Notwithstanding recent job losses, the average unemployment rate was unchanged at 3.9% compared with the preceding three-month period (see Chart 1.1).

Consumer price inflation in the United Kingdom edged down to 0.6% in June from 1.5% in March (see Chart 1.2). This was primarily due to developments in energy price inflation which turned negative. Services price inflation declined. On the other hand, prices of food, alcohol and tobacco and of non-energy industrial goods grew at a faster pace. The annual rate of inflation based on the CPI excluding energy, food, alcohol and tobacco declined to 1.4% in June, from 1.6% in March.

In the second quarter of 2020, the Bank of England’s Monetary Policy Committee maintained the Bank Rate unchanged at 0.1% (see Chart 1.3). The Committee also decided to continue with the existing programme of UK government bond and sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, and increased the target stock of purchased UK government bonds, by an additional GBP 100 billion, to GBP 745 billion. The Committee reiterated that it would continue to monitor the situation closely and, consistent with its remit, stands ready to take further action as necessary to support the economy and ensure a sustained return of inflation to the 2% target. The Committee would also keep the APP under review.

During the second quarter, the Bank of England also announced a change to the Term Funding Scheme with additional incentives for SMEs (TFSME) to support HM Treasury’s Bounce Back Loans Scheme (BBLS). The Bank also said that in light of continued improvements in funding market conditions and recent usage patterns, some of the Contingent Term Repo Facility (CTRF) operations would be discontinued by the end of June 2020, but these could be reintroduced at any stage if justified by market conditions.²

The euro area

GDP in the euro area contracts for the second consecutive quarter
The euro area economy contracted for the second consecutive time in the second quarter of 2020. Real GDP shrank by an extraordinary 11.8% on a quarter-on-quarter basis, following a contraction of 3.7% in the previous quarter (see Table 1.2).

This contraction is unprecedented, as governments in the euro area – as in the rest of the world – implemented measures to contain the spread of COVID-19, with adverse effects on economic activity.

² During the third quarter of 2020, the Bank of England kept the Bank Rate unchanged at 0.1%. The Committee maintained its target stock of UK government bond and sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves at GBP 745 billion. The Committee said that it did not intend to tighten monetary policy until there is clear evidence that significant progress was being made in eliminating spare capacity and achieving the 2% inflation target sustainably. In September, the Bank of England and HM Treasury in line with an earlier notice – which foresaw termination after 12 months – announced that the Corporate Financing Facility (CCFF) will close for new purchases of commercial paper with effect from 23 March 2021. The CCFF will also close to new applications from counterparties and issuers looking to become eligible, at the end of 2020.
Table 1.2
CONTRIBUTIONS TO QUARTERLY REAL GDP GROWTH IN THE EURO AREA\(^{(1)}\)
Seasonally and working day adjusted

<table>
<thead>
<tr>
<th></th>
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<tr>
<td>Private consumption</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.3</td>
<td>0.1</td>
<td>0.2</td>
<td>0.1</td>
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<td>-6.6</td>
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<tr>
<td>Government consumption</td>
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<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>-0.2</td>
<td>-0.6</td>
</tr>
<tr>
<td>GFCF</td>
<td>0.2</td>
<td>0.2</td>
<td>0.9</td>
<td>-0.4</td>
<td>1.4</td>
<td>-1.2</td>
<td>1.2</td>
<td>-1.2</td>
<td>-3.8</td>
</tr>
<tr>
<td>Changes in inventories(^{(2)})</td>
<td>0.1</td>
<td>0.2</td>
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<td>-0.4</td>
<td>0.1</td>
<td>-0.2</td>
<td>-0.3</td>
<td>0.5</td>
<td>0.1</td>
</tr>
<tr>
<td>Exports</td>
<td>0.4</td>
<td>0.1</td>
<td>0.5</td>
<td>0.5</td>
<td>0.1</td>
<td>0.3</td>
<td>0.0</td>
<td>-1.9</td>
<td>-9.1</td>
</tr>
<tr>
<td>Imports</td>
<td>-0.6</td>
<td>-0.4</td>
<td>-1.1</td>
<td>0.4</td>
<td>-1.6</td>
<td>1.1</td>
<td>-1.0</td>
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<td>8.1</td>
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<td>GDP</td>
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<td>0.5</td>
<td>0.1</td>
<td>0.3</td>
<td>0.1</td>
<td>-3.7</td>
<td>-11.8</td>
</tr>
</tbody>
</table>

Source: Eurostat.
\(^{(1)}\) Figures may not add up due to rounding.
\(^{(2)}\) These are changes in inventories and acquisitions less disposals of valuables.

The contraction during the quarter under review was mostly driven by domestic demand, which contributed a negative 10.8 percentage points to GDP growth. Containment measures to curb the spread of COVID-19 and a sharp decline in consumer confidence led to a significant drop in private consumption, which lowered GDP growth by 6.6 percentage points. This was followed by gross fixed capital formation, which also contracted amid disruptions to production, weak demand and high uncertainty, pushing GDP growth down by a further 3.8 percentage points. In the meantime, government consumption also contributed negatively to GDP growth by 0.6 percentage point. On the other hand, changes in inventories added 0.1 percentage point to GDP growth.

At the same time, net exports reduced GDP growth by 0.9 percentage point, as exports fell faster than imports, reflecting the impact containment measures had on foreign demand as well as disruptions to supply.

**Euro area inflation approaches zero**
Inflation in the euro area decreased in the second quarter of 2020, maintaining the declining trend observed since the beginning of the year. The annual rate of inflation in the euro area, based on the HICP, dropped to 0.3% in June from 0.7% three months earlier (see Chart 1.4). This decline largely stemmed from energy prices, which fell at a faster pace and contributed a negative 0.9 percentage point to inflation overall, as oil prices continued to fall. Meanwhile, prices of non-energy industrial goods and services rose at a slower pace than in the previous quarter. In contrast, the prices of unprocessed food grew at a...
faster pace, rising at an annual rate of 6.0% in June, as against 3.6% in March, while processed food prices rose at a slightly faster pace. In particular, prices of unprocessed food surged in the context of the various COVID-19 containment measures. As a result of these developments, the annual rate of HICP inflation excluding energy and food edged down to 0.8% in June from 1.0% in March.

**Labour market conditions deteriorate significantly**
As a result of the COVID-19 pandemic, labour market conditions in the euro area deteriorated significantly during the quarter under review. Consequently, the general downward trend in unemployment observed in recent years came to a halt. Indeed, the seasonally-adjusted unemployment rate edged up by 0.6 percentage point between March and June to 7.8% (see Chart 1.1). The three-month average rate rose by 0.3 percentage point to 7.6% over the same period. Meanwhile, employment fell during the second quarter of 2020, with the annual rate of growth standing at -2.9%, significantly down from 0.4% in the preceding quarter. Seasonally-adjusted data imply that in the June quarter, 4.7 million fewer people were employed than in the March quarter. Labour market conditions would have been much worse were it not for policy measures aimed at preventing redundancies and supporting workers in response to the outbreak of the pandemic.

**ECB staff projections indicate a dramatic fall in growth in the near term**
According to the ECB staff macroeconomic projections published in September 2020, real GDP growth in the euro area is expected to fall significantly to -8.0% in 2020 from 1.3% in 2019, before picking up to 5.0% in 2021 and 3.2% in 2022 (see Table 1.3). The contraction in 2020 is projected to be mainly driven by domestic demand, though net exports are also expected to post a negative contribution.

The pandemic has drastically affected economic activity since early 2020, reflecting the adverse impact of strict lockdown measures implemented in most euro area countries. Indeed, euro area real GDP contracted in the first half of the year. The gradual relaxation of containment measures from May onwards spurred a resumption of economic activity. High-frequency indicators as well as survey results suggest a strong, though incomplete rebound of real GDP, which is projected

<table>
<thead>
<tr>
<th>Table 1.3</th>
<th>MACROECONOMIC PROJECTIONS FOR THE EURO AREA⁽¹⁾</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Annual percentage changes</td>
</tr>
<tr>
<td></td>
<td>2019</td>
</tr>
<tr>
<td>GDP</td>
<td>1.3</td>
</tr>
<tr>
<td>Private consumption</td>
<td>1.3</td>
</tr>
<tr>
<td>Government consumption</td>
<td>1.8</td>
</tr>
<tr>
<td>GFCF</td>
<td>5.0</td>
</tr>
<tr>
<td>Exports</td>
<td>2.5</td>
</tr>
<tr>
<td>Imports</td>
<td>3.9</td>
</tr>
<tr>
<td>HICP</td>
<td>1.2</td>
</tr>
</tbody>
</table>

⁽¹⁾ ECB staff macroeconomic projections (September 2020).
Source: ECB.

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³ National accounts data.
⁴ The cut-off date for oil prices and other technical assumptions was 18 August 2020 and the projections were finalised on 27 August 2020. The projections assume that measures to contain the virus will be only partly successful and some lockdown measures will have to remain in place until a medical solution is found, which is assumed to take place in mid-2021.
to rise by 8.4% in the third quarter. This increase implies a recovery of around half of the loss experienced in the first half of the year. Despite some resurgence of the pandemic and some containment measures remaining in place, the recovery is projected to continue during the next few quarters. Nonetheless, the pandemic is set to have a long-lasting effect on the economy, such that by the end of the projection horizon, real GDP would stand around 3.5% lower than projected in December 2019.

Compared with the June 2020 projections, euro area GDP growth was revised upwards by 0.7 percentage point in 2020 and marginally downwards by 0.2 percentage point in 2021 and 0.1 percentage point in 2022. The upward revision in real GDP growth in 2020 mainly reflects a better than expected outcome in the second quarter. Compared with the June 2020 exercise, several factors are expected to have a downward impact on growth in the following two years, including lower euro area foreign demand from the third quarter of 2020 onwards, a deterioration in the competitiveness of euro area exports stemming from the recent euro appreciation and higher oil prices. These will be broadly offset by the ECB monetary policy measures announced in June 2020, additional fiscal stimulus, and confidence effects related to the new EU recovery fund.

Turning to prices, the September 2020 projections envisage annual HICP inflation to ease significantly to 0.3% in 2020 and then to rise to 1.0% in 2021 and 1.3% in 2022. In particular, weaker inflation in 2020 reflects the impact of the sharp drop in energy prices as oil prices dropped, as well as the appreciation of the euro, which makes foreign goods cheaper. Despite the partial recovery in oil prices in recent months, HICP energy inflation is expected to drag overall inflation down substantially in 2020. Over the remainder of the projection horizon, the assumed increases in oil prices and environmental tax measures imply a rise in HICP energy inflation. Meanwhile, annual food price inflation is expected to decrease in the course of this year before increasing gradually over the remainder of the horizon. HICP inflation excluding energy and food is set to ease to 0.8% in 2020 before picking up gradually to 1.1% in 2022. Compared with the June 2020 projections, HICP inflation projections remained unchanged in both 2020 and 2022, but were revised upwards by 0.2% in 2021.

Given the large uncertainty surrounding these projections, ECB staff prepared two alternative scenarios to the baseline scenario. The mild scenario assumes that, despite the recent upturn in infections, the virus is contained successfully and a medical solution is found relatively quickly. In contrast, the severe scenario envisions a strong resurgence of the pandemic and a return to strong containment measures. Under the mild scenario, real GDP declines by 7.2% in 2020, followed by a strong rebound of 8.9% in 2021, and growth of 3.5% in 2022. Inflation in this scenario would reach 1.8% by 2022, while the unemployment rate would stand at 6.6% – compared to 8.8% in the baseline. By contrast, under the severe scenario real GDP falls by 10.0% in 2020, only to recover slowly by 0.5% in 2021 and 3.4% in 2022. This severe scenario envisions an inflation rate of just 0.7% in 2022 and an unemployment rate of 11.2% in that year.

**ECB reinforces its accommodative monetary policy stance**

The ECB’s Governing Council reinforced its accommodative monetary policy stance during the second quarter of 2020.

The interest rates on the main refinancing operations, on the marginal lending facility and on the deposit facility were held unchanged at 0.00%, 0.25%, and -0.50% respectively during the period under review (see Chart 1.3). Furthermore, the Governing Council reiterated that it expects the
key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics. It also reiterated its intention to reinvest in full the principal payments from maturing securities under the APP for an extended period of time past the date when it starts raising the key ECB interest rates and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

On 30 April, to continue supporting the euro area economy in the face of economic disruption and heightened uncertainty, the Governing Council announced a package of monetary policy measures. These included a further easing of the conditions on the TLTRO III especially by reducing the interest rates on these operations and the launch of a new series of seven non-targeted PELTROs. The interest rate on these operations will be 25 basis points below the average rate on the main refinancing operations prevailing over the life of each PELTRO.

On 4 June, the Governing Council also decided to increase the envelope for the PEPP by €600 billion to a total of €1,350 billion. In addition, the horizon for net purchases under the PEPP will be extended to at least the end of June 2021. It also announced that the maturing principal payments from securities purchased under the PEPP will be reinvested and net purchases under the APP are to continue at a monthly pace of €20 billion together with the APP purchases under the additional €120 billion temporary envelope available until the end of 2020.

**Money market rates edge up**

Money market interest rates in the euro area were mixed during the second quarter of 2020. The euro overnight index average (EONIA) overnight rate was broadly stable during the quarter under review, remaining slightly above the interest rate on the ECB’s deposit facility. It decreased marginally to an average of -0.46% in June from -0.45% three months earlier (see Chart 1.5). On the other hand, the three-month euro interbank offered rate (EURIBOR) increased to -0.38% in June from its average March level of -0.42%, while the 12-month EURIBOR rate rose to -0.15% from -0.27%.

---

5 The EONIA is a measure of the effective interest rate prevailing in the euro overnight market. Until 30 September 2019, it was measured as the weighted average of the interest rates on unsecured interbank overnight lending transactions, in euro, as reported by a panel of contributing banks. As of 2 October 2019, and until its discontinuation on 3 January 2022, the EONIA will be calculated as euro short-term rate (€STR) plus a fixed spread of 8.5 basis points. The €STR is a reference rate based on money market data collected by the Eurosystem, reflecting the wholesale euro unsecured overnight borrowing costs of banks located in the euro area. It was first published by the ECB on 2 October 2019. See [here](#).

6 The EURIBOR is an interest rate benchmark indicating the average rate at which principal European banks lend unsecured funds on the interbank market in euro for a given period.

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Euro area bond yield developments mixed

Developments in the 10-year benchmark government bond yields in the euro area were mixed during the second quarter of 2020. German bond yields, rose by 11 basis points to -0.43%, possibly because flight-to-safety flows that were pronounced at the onset of the pandemic diminished. Yields on Slovenian, Maltese, French and Irish sovereign debt also rose during this period. On the other hand, Greek bond yields dropped considerably by 65 basis points to 1.32%. Smaller declines were reported in Cypriot, Portuguese, Italian, and Spanish bond yields. Despite the still high uncertainty relating to the pandemic, the most likely factor behind the stabilisation in government bond yields is the accommodative monetary policy stance taken by the ECB and, in particular, the purchases of sovereign bonds under the PEPP.

Spreads over 10-year German bond yields generally narrowed during the second quarter of 2020 (see Chart 1.6). Greece recorded the most significant decrease in spreads, followed by Cyprus, Portugal and Italy.

The euro exchange rate appreciates slightly in effective terms

During the second quarter of 2020, the nominal effective exchange rate of the euro against the EER-19 group of countries strengthened by 0.7%.

The euro appreciated by 2.9% against the British pound, followed by 2.2% against the US dollar and by 1.5% against the Japanese yen (see Chart 1.7). The euro has also appreciated against the Chinese yuan, the Hong Kong dollar, the Swiss franc, the Czech koruna and the Hungarian forint. On the other hand, the euro depreciated against the Australian dollar, the Canadian dollar, the Norwegian krone and the Swedish krona.

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7 The EER-19 is based on the weighted averages of the euro exchange rate against the currencies of Australia, Bulgaria, Canada, China, Croatia, Czech Republic, Denmark, Hong Kong, Hungary, Japan, Norway, Poland, Romania, Singapore, South Korea, Sweden, Switzerland, the United Kingdom and the United States.
Economic and institutional convergence is a prerequisite for increasing cohesion within the European Union. This process of convergence is facilitated through access to the single market, with its competition in product markets and a common set of rules, combined with limited transfers from the EU regional policy, targeted primarily on infrastructural projects, and economic development. However, this process, which has been negatively affected by the financial crisis of 2009 and the European sovereign debt crisis of 2012, risks being further derailed by the impact of the COVID-19 pandemic, especially if the recovery in activity is asymmetric across countries.

This box presents a simple growth accounting framework that decomposes GDP growth for all EU countries into a number of supply-side components. The latter includes total factor productivity, capital deepening, demographics and various labour market indicators, such as the unemployment rate, the participation rate and the share of working age population. This decomposition is not intended to identify or estimate potential output since, by definition, the change in these components must add up to GDP growth. However, this framework can be a useful complement to the analysis from the demand side and to identify the nature of the shocks that affected European economies over the past two decades. The identification of these supply-side trends, which tend to be persistent, is helpful to shed light on the underlying factors that could, eventually, assist or hamper the economic recovery after the COVID-19 pandemic.

A supply-side growth accounting framework

The supply-side decomposition of GDP is based on a simple growth accounting framework. According to this framework, an increase in GDP can be due to three factors: higher productivity (defined as GDP per employed person), higher labour utilisation (defined as the ratio of employment to the total population), or an increase in population.

\[
GDP = \frac{GDP}{Employment} \times \frac{Employment}{Population} \times Population
\]  

(1)

Alternatively, GDP per capita can be expressed as the product of labour productivity and labour utilisation.²

Labour utilisation can be further decomposed into three factors:

\[
\frac{Employment}{Population} = \frac{Employment}{Labour\ Supply} \times \frac{Labour\ Supply}{Working\ Age\ Population} \times \frac{Working\ Age\ Population}{Population}
\]  

(2)

---

1 Prepared by Brian Micallef, the Manager of the Research Department at the Bank. The analysis presented in this box is based on the author’s study: Micallef, B. (2020), “Real convergence in Malta and the EU countries after the financial crisis”, Journal of Economic Integration 35(2), pp. 215-239. Helpful comments by Dr Aaron G. Grech are gratefully acknowledged. The views expressed in this article represent those of the author and should not be interpreted to reflect those of the Bank. Any remaining errors are the author’s own.

The first term in (2) represents the share of employment in the labour force or, alternatively, one minus the unemployment rate, since an increase in the unemployment rate will reduce this ratio. The second term represents the labour participation rate, while the third term reflects the age structure of the population. The latter is defined as the ratio of working-age population (WAP) aged between 15 and 64 years to the total population.

Labour productivity can also be decomposed into two separate components. Assuming a constant return to scale Cobb Douglas production function with two factor inputs, capital and labour:

\[ GDP = TFP \times Capital^\alpha \times Employment^{1-\alpha} \]  

(3)

where TFP represents total factor productivity, and \( \alpha \) and \( 1-\alpha \) are the share of capital and labour, respectively, in the production function. For advanced economies, the share of capital is usually assumed to be 1/3, with the remaining 2/3 going to labour. Dividing both sides of (3) by employment gives the two main components of labour productivity:

\[ Labour\ productivity = \frac{GDP}{Employment} = TFP \times \left( \frac{Capital}{Employment} \right)^\alpha \]  

(4)

Hence, in this framework, productivity is a function of total factor productivity and the capital-to-employment ratio, also known as capital deepening.

The growth accounting framework is derived by substituting equations (2) and (4) into (1):

\[ GDP = \left\{ TFP \times \left( \frac{Capital}{Employment} \right)^\alpha \right\} \times \left\{ \frac{Emp}{Lab.Supply} \times \frac{Lab.Supply}{WAP} \times \frac{WAP}{Population} \right\} \times Population \]  

(5)

The growth rate of GDP is equal to the sum of the growth rate of the individual components, whereas the level of GDP is the product of these terms.

All data were sourced from Eurostat. The only exception is capital stock, which was obtained from the AMECO database. Missing data – mostly for the mid-1990s for some Member States – were in turn sourced from the respective IMF Article IV country reports. Data are in annual frequency, covering the period 1995-2018.

**Results**

Table 1 lists the decomposition of GDP growth for all EU countries, as well as the overall European Union and euro area averages, post-financial crisis. For comparison purposes, Table 2 displays the decomposition for the decade prior to the financial crisis (1997-2007).

At 5.7%, Malta had one of the highest growth rates post-crisis. All three main components – labour productivity, labour utilisation and population growth – contributed to GDP growth, although not to the same extent. The largest contributor was labour utilisation, mostly due to a higher participation rate. Malta’s female participation rate increased from 40% in 2008 to 64% in 2018 because of measures to attract more females to the labour market such
as free childcare, longer schooling hours, longer maternity leave and tax incentives. The decline in the unemployment rate also contributed to higher labour utilisation, whereas the age structure of the population – reflecting an aging domestic population – contributed negatively. The contribution of population growth, which averaged 1.8% during this period, is the second highest among EU countries. This reflects the influx of foreign workers, which increased from less than 3% of the workforce in 2004 to 22.5% in 2018. This inflow was concentrated on both ends of the skill spectrum and was crucial to overcome Malta’s labour and skill shortages. Finally, since 2010, labour productivity increased on average by 1.3% per annum. Productivity was entirely driven by an increase in total factor productivity, which

Table 1
SUPPLY-SIDE DECOMPOSITION OF GDP GROWTH (2010-2018)

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Sources: Eurostat; author’s calculations.

3 Micallef, B. (2018), "Estimating the impact of structural reforms to increase the female participation rate in Malta", International Journal of Social Science Studies 6(8), pp. 73-84.
had recovered strongly after the crisis following a trend decline from the 1990s. In contrast, capital deepening contributed negatively to growth as the increase in investment lagged strong employment growth. This finding is in line with a recently published study that documented a significant infrastructure gap in Malta. However, it also reflects the structural shift in economic activity towards the services sector at the expense of manufacturing, which usually requires more physical investment in plant and equipment than services. In fact, Malta registered the largest shift in the share of services among EU countries between 2007 and 2018, both in terms of gross value added and in employment. Furthermore, some high value added services tend to be more reliant on human – rather than physical –

Table 2
SUPPLY-SIDE DECOMPOSITION OF GDP GROWTH (1997-2007)

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<th>Capital deepening</th>
<th>TFP utilisation</th>
<th>1-Unr Rate</th>
<th>Particip. Share of working age pop.</th>
<th>Pop.</th>
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<td>1.1</td>
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<td>0.0</td>
</tr>
<tr>
<td>Finland</td>
<td>4.0</td>
<td>2.3</td>
<td>0.1</td>
<td>2.2</td>
<td>1.4</td>
<td>0.8</td>
</tr>
<tr>
<td>Sweden</td>
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<td>0.2</td>
<td>2.0</td>
<td>0.9</td>
<td>0.5</td>
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<tr>
<td>United Kingdom</td>
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<td>1.9</td>
<td>0.3</td>
<td>1.7</td>
<td>0.6</td>
<td>0.3</td>
</tr>
</tbody>
</table>

Sources: Eurostat; author's calculations.


capital, which explains why the economy continued to grow rapidly despite a decline in the investment ratio compared to the 1990s.\(^8\)

Notable differences emerge when comparing Malta’s post- and pre-crisis performance. In fact, Malta and Germany are the only two EU countries with a post-crisis growth higher than that registered before the crisis. All three components have contributed to this difference. In the case of Malta, the major difference comes from labour utilisation, which did not contribute anything to average GDP growth between 1997 and 2007. The components of labour utilisation have also inverted compared with the 2010-2018 period. Both the unemployment rate and the participation rate contributed negatively, whereas the age structure was still contributing positively as the aging effects had not yet kicked in. Second, the contribution of population growth was only a third of that post-crisis. The contribution from population pre-crisis was mostly due to the natural increase in the local population, whereas after 2010, immigration became population’s main driver. Finally, the contribution of capital deepening was much stronger in the pre-crisis period, owing to both a higher investment rate and a slower rate of employment growth.

Almost all EU countries registered slower average growth post-crisis. GDP growth in the European Union and euro area averaged 1.6% and 1.4%, respectively, post-crisis, significantly lower than the 2.6% and 2.4% pre-crisis. Labour utilisation was the most severely affected, mostly because of an aging population, which resulted in a declining share of the working age population. Similarly, the contribution of population growth almost halved, from 0.3% to 0.4% pre-crisis to 0.2% post-crisis. Most of the labour productivity decline is driven by capital deepening, reflecting reduced investment post-crisis. The latter could be explained by a combination of subdued demand, heightened uncertainty and tighter financing conditions.\(^9\)

The degree of growth slowdown differs considerably across the European Union and country-specific factors play an important role. Countries heavily affected by the financial crisis or the European sovereign debt crisis – such as Greece, Spain, Cyprus, and Slovenia – recorded the largest slowdown. This led to the so-called ‘unbearable divergence’ in the European Union, referring to persistent unemployment in a number of EU countries, along with economic, social, and political implications.\(^10\) In some of these countries, the pre-crisis growth masked the build-up of unsustainable imbalances and vulnerabilities, with the boom-bust dynamics in the aftermath of the crisis eventually unravelling years of convergence. The Baltic countries also experienced a marked slowdown between the two periods. In the Baltics, the pre-crisis boom was associated with fast credit growth, whereas the onset of the financial crisis limited the availability of foreign capital, pushing these countries into a severe recession.\(^11\) Despite this slowdown, the average growth rate registered by the Baltic countries post-crisis still surpassed that of the European Union, reflecting their flexible labour market and thus helped to resume their convergence process. However, some

euro area countries have exhibited a “non-convergence trap” that started well before the introduction of the euro currency.\textsuperscript{12} This non-convergence trap occurs when “an economy does not progress from growth driven by accumulation of capital to growth led by innovation, then it stops converging towards the technology frontier”.\textsuperscript{13} This process is evidenced by the decline in the growth rate of TFP in some countries, most notably in Italy. In other countries, sector-specific developments are crucial to understand the growth performance. For instance, in Finland, developments in the semi-conductor and paper industries are partly behind its sharp growth slowdown. On the contrary, Germany’s increase in average GDP growth is mostly due to population growth (reflecting significant immigration), as the contributions from productivity and utilisation are broadly similar between the two periods.

Conclusion
The growth accounting framework presented in this article can be used to shed light on the sources of convergence or divergence in EU countries from a supply-side perspective. The experience of some euro area countries during the financial crisis and the European sovereign debt crisis highlights the importance of achieving sustainable economic growth without the accumulation of underlying imbalances. The analysis also identifies other important lessons for a country’s real convergence process, such as the need for a flexible adjustment process following an economic shock and the importance of having the right institutions conducive to innovation, technological adoption and productivity growth. Going forward, the importance of these lessons becomes more compelling as EU economies deal with structural challenges such as aging populations in conjunction with tackling the severe disruptions to economic activity during and after COVID-19.


Commodities

Oil prices fall sharply in April, before rebounding

In April, the price of Brent crude oil continued to follow a downward path, as demand contracted owing to the spread of COVID-19 (see Chart 1.8). In May and June, oil prices started to rise again, as many countries began to ease various lockdown measures, which led to improving global energy demand expectations. An OPEC+ agreement to lower supply, which became effective in May, together with various supply shut-ins across the United States also helped oil prices recover from their recent trough.

By the end of June, the price of Brent crude oil stood at USD 42.51 per barrel, broadly double the price prevailing at the end of March. Notwithstanding this recovery, the price of Brent crude oil still remains around 40.0% below its level at the start of the year.

World Bank data show that non-energy commodity prices increased during the second quarter of 2020. Between March and June, they rose by 2.0%.
2. OUTPUT AND EMPLOYMENT

In the context of the containment measures introduced by governments worldwide to stem the spread of COVID-19 and to mitigate elevated uncertainty, real GDP fell by 16.2% in annual terms in the second quarter of 2020, following a 1.4% increase in the first quarter of the year. The economic contraction in the second quarter of this year is the strongest on record. It was underpinned by a sharp fall in both domestic demand and net exports. Nominal data on gross value added (GVA) show that although activity declined across most sectors, the contraction was largely driven by the services sector. This reflects the fact that the COVID-19 containment measures mostly hit the sector comprising wholesale and retail trade, transportation, and accommodation and food service activities. The sector was impacted strongly by the imposed travel ban during the entire second quarter, and the temporary shut-down of non-essential services during the quarter. The construction and manufacturing sectors, as well as the sector comprising quarrying and utilities, also contracted on a year earlier, but to a much lesser extent.

The Bank’s BCI indicated significantly below-average conditions. The index fell to -4.6 in the second quarter of 2020, from -2.5 in the previous quarter. It is worth noting that the index fell to -2.2 at the peak of the global financial crisis.

During the June quarter, labour market conditions weakened, reflecting the impact of the COVID-19 pandemic. On an annual basis, employment rose but at a much slower rate than in the first quarter, reflecting some job losses during the second quarter of this year. In addition, on a year-on-year basis, the labour force increased more slowly when compared with the previous quarter, as the pandemic triggered an increase in the number of inactive persons and a decline in the working age population during the second quarter. The unemployment rate based on the LFS increased when compared to the previous quarter as well as when compared to its year-ago level. In fact, it reached levels last seen in the third quarter of 2016. Nevertheless, the impact of COVID-19 containment measures on unemployment was mitigated by government measures aimed at protecting employment, such as the Wage Supplement Scheme, as well as firms’ reliance on shorter working-time arrangements. Indeed, the unemployment rate remained well below that in the euro area. However, it rose above the Bank’s structural measure.

Potential output and BCI

Output gap turns negative\(^1\)\(^2\)

Potential output growth is estimated to have moderated to 2.8% in the second quarter of 2020, from 3.8% in the previous quarter (see Chart 2.1). This is the lowest growth in potential output since 2003. At the same time, GDP contracted strongly, by 16.2%, following a 1.4% year-on-year increase in the first quarter.

When measured as a four-quarter moving average, the output gap is estimated at -4.5% in the second quarter of 2020, well below the 0.2% estimated in the previous quarter.\(^3\) This is

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\(^1\) Potential output measures the medium-to-long-term level of real output which is sustainable in an economy. The estimates presented here are derived using a production function approach. For further details on the methodology adopted, see Micallef, B., and Ellul, R. (2017), “Medium-term Estimates of Potential Output Growth in Malta”, in Grech, A. G., and Zerafa, S. (Eds.), Challenges and Opportunities of Sustainable Economic Growth: the Case of Malta, Central Bank of Malta.

\(^2\) Real GDP and potential output are reported as annual growth rates in the respective quarter. The output gap/surplus is expressed as a percentage of potential output on the basis of four-quarter moving averages.

\(^3\) The output gap may be viewed as a gauge of the degree of over- or underutilisation of the productive capacity of the economy over the business cycle. A positive gap signals overutilisation of resources, whereas a negative one indicates underutilised resources.
also the lowest output gap on record. The large degree of underutilisation of the economy’s productive capacity mainly reflects our assessment that, in the near term, the containment measures related to the pandemic had a stronger impact on the demand-side than on the supply-side of the economy.4

**BCI drops, suggesting below normal economic conditions**

The Central Bank’s BCI declined during the second quarter of 2020 (see Chart 2.2). The index fell to -4.6, reflecting the exceptionally difficult economic environment triggered by COVID-19 and sharp contraction in economic activity during the second quarter of 2020. The latest quarterly BCI estimate was significantly lower than the value of -2.5 for the previous quarter, and well below estimates during the 2009 recession. The BCI suggests economic conditions continued to shift significantly below their long-term average and the lower confidence level. This latter level was only crossed in episodes of very low or negative growth.5

**GDP and industrial production**

**Real GDP contracts**

Real GDP contracted by 16.2%, following an increase of 1.4% in the first quarter of the year.7 This is the strongest ever drop in economic activity on record.

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4 Given the high uncertainty related to COVID-19, it is challenging to assess supply and demand-side impacts, and hence, estimates of the cycle have to be treated with caution.

5 The BCI is a synthetic indicator, which includes information from a number of economic variables such as the term-structure of interest rates, industrial production, an indicator for the services sector, economic sentiment, tax revenues and private sector credit. By construction, it has an average value of zero over the estimation period since 2000. A full time series can be found [here](#). For further details on the methodology underlying the BCI, see Ellul, R., (2016), “A real-time measure of business conditions in Malta,” Working Paper 05/2016.

6 Additional information on the interpretation of the BCI is available in the January 2020 edition of the Bank’s Economic Update.

7 The analysis of GDP in this Chapter of the Quarterly Review is based on data published in NSO News Release 142/2020 and released on 28 August 2020.
The decline in growth was underpinned by a sharp contraction in both domestic demand and net exports.

The contraction in domestic demand was largely driven by a fall in private consumption in the second quarter of 2020. The latter partly reflected the containment measures related to COVID-19, which heavily restricted mobility and the provision of most goods and services. Gross fixed capital formation also declined. Conversely, government consumption rose when compared with the first quarter of 2020, while the contribution of changes in inventories stood positive. Reflecting these developments, domestic demand shed 7.9 percentage points of GDP growth, following a negative contribution of 2.0 percentage points in the previous quarter (see Table 2.1).

In the quarter under review, exports fell by 12.8%, reflecting lower foreign demand for goods and services, supply-chain disruptions, and the imposed travel ban. Moreover imports decreased by 7.9% on a year earlier, mirroring the drop in demand. As exports fell more strongly than imports, net exports declined, shedding 8.4 percentage points from real GDP growth. The drop in the trade surplus (in volume terms) was driven by a narrower surplus on services, as the goods balance registered a lower deficit, compared to the second quarter of 2020.

Private consumption expenditure contracted substantially – by over a fifth in annual terms – shedding 9.3 percentage points from real GDP growth. Nominal data show that the fall in private consumption was broad based across almost all expenditure categories, with the exception of housing, water, electricity, gas and other fuels. The strongest decline in absolute terms was recorded in spending on restaurants and accommodation services. This was followed by spending on recreation, transport, and clothing and footwear. These decreases occurred notwithstanding

<table>
<thead>
<tr>
<th>Table 2.1</th>
<th>GDP(^{(1)})</th>
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<tr>
<td></td>
<td>2019</td>
</tr>
<tr>
<td></td>
<td>Q2</td>
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<tr>
<td>Annual percentage changes</td>
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<tr>
<td>Private final consumption expenditure</td>
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<td>Government final consumption expenditure</td>
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<td>Exports of goods and services</td>
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<tr>
<td>Imports of goods and services</td>
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<td>GDP</td>
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<tr>
<td>Percentage point contributions</td>
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<td>GFCF</td>
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<tr>
<td>Exports of goods and services</td>
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<tr>
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<td>Net exports</td>
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<tr>
<td>GDP</td>
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</tr>
</tbody>
</table>

Sources: NSO; Central Bank of Malta calculations.

\(^{(1)}\) Chain-linked volumes, reference year 2010.
continued growth in compensation of employees, and may reflect the containment measures related to COVID-19, which entailed the closure of several retail and personal services outlets in March.

Government consumption expenditure rose by 11.9% in annual terms, mainly due to higher outlays on intermediate consumption related to public administration and defence. Outlays on compensation of employees also increased, albeit to a lower extent, while revenue from sales increased slightly. Overall, government consumption added 2.0 percentage points to annual GDP growth.

Following a contraction of 14.5% in the previous quarter, real gross fixed capital formation contracted by 11.0% in the second quarter of the year, lowering GDP growth by 2.3 percentage points. The fall in gross fixed capital formation was primarily driven by lower investment in residential and non-residential buildings as well as investment in machinery and equipment. By contrast, investment in intellectual property increased on a year earlier.

Changes in inventories added 1.7 percentage points to GDP growth in the second quarter of 2020.

The contributions shown in Table 2.1 are consistent with the approach normally followed in official databases and economic publications. However, this approach does not account for the fact that the import content varies across the different expenditure components. Consequently, they fail to represent the true underlying relative contribution of domestic and external demand to economic growth.

Table 2.2 presents import-adjusted contributions, which address this limitation by apportioning imports to the respective demand components. In line with the sharp fall in imports in the second quarter of 2020, the majority of import-adjusted contributions are larger than those based on the traditional approach as reported in Table 2.1. This is particularly the case for exports, private consumption and, to a lesser extent, investment. Similar to the analysis that emerges from Table 2.1, the main drivers behind the contraction of real GDP in 2020 Q2 were exports and private final consumption. However, while in the traditional approach exports contributed twice as much as private consumption to the decline in real GDP, the disparity in import-adjusted contributions is far less. Gross fixed capital formation also contributed negatively, but its contribution remained

<table>
<thead>
<tr>
<th>Table 2.2</th>
<th>IMPORT-ADJUSTED CONTRIBUTIONS TO GDP GROWTH(1)</th>
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<tbody>
<tr>
<td></td>
<td>2019 Q2</td>
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<tr>
<td>Private final consumption expenditure</td>
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<tr>
<td>Government final consumption expenditure</td>
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<tr>
<td>Gross fixed capital formation</td>
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<td>Changes in inventories</td>
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<td>Domestic demand</td>
<td>2.9</td>
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<tr>
<td>Exports of goods and services</td>
<td>1.8</td>
</tr>
<tr>
<td>GDP</td>
<td>4.6</td>
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</tbody>
</table>

Source: Central Bank of Malta estimates.

(1) Chain-linked volumes, reference year 2010.
unchanged from the March quarter. On the other hand, government consumption was the largest contributor to growth, followed by changes in inventories.

**Nominal GDP growth falls sharply**

Nominal GDP contracted by 14.9% in annual terms in the second quarter of 2020, following a moderate increase of 3.2% in the previous quarter (see Table 2.3). The fall in nominal GDP largely reflected that in GVA. The latter fell at an annual rate of 13.8%, after growing by 4.0% in the preceding quarter. In the quarter under review, GVA shed 12.3 percentage points from nominal GDP growth.\(^8\)

Services were the main driver behind the fall in activity, shedding 10.8 percentage points to nominal GDP growth. The largest decline stemmed from the sector comprising wholesale and retail trade, transportation and accommodation. This shed 9.5 percentage points to nominal GDP growth, reflecting the impact of the ban on international travel during the quarter, and the temporary closure of several retail and personal services outlets during the quarter. Professional and scientific activities, the arts and entertainment sector as well as financial and insurance activities jointly shed a further 2.0 percentage points. By contrast, information and communication, as well as real estate activities, and public administration collectively added 0.7 percentage point to nominal growth.

Meanwhile, the contribution from manufacturing and construction turned negative. These two sectors shed 0.7 and 0.3 percentage points, respectively, from nominal GDP growth. GVA also

| Table 2.3 | CONTRIBUTION OF SECTORAL GVA TO NOMINAL GDP |
| Percentage points |
| 2019 | 2020 |
| Q2 | Q3 | Q4 | Q1 | Q2 |
| Agriculture, forestry and fishing | 0.1 | 0.0 | 0.1 | 0.0 | -0.2 |
| Mining and quarrying; utilities | 0.2 | 0.1 | 0.1 | 0.0 | -0.4 |
| Manufacturing | 0.0 | 0.2 | 0.7 | 0.5 | -0.7 |
| Construction | 0.3 | 0.4 | 0.6 | 0.1 | -0.3 |
| Services | 5.3 | 5.9 | 6.1 | 3.0 | -10.8 |
| of which: |
| Wholesale and retail trade; repair of motor vehicles; | 0.5 | 1.5 | 1.6 | -0.6 | -9.5 |
| Transportation; accommodation and related activities |
| Information and communication | 0.5 | 0.2 | 0.5 | 0.5 | 0.4 |
| Financial and insurance activities | 0.6 | 0.4 | -0.2 | 0.3 | -0.1 |
| Real estate activities | 0.4 | 0.5 | 0.6 | 0.5 | 0.1 |
| Professional, scientific, | 2.0 | 1.7 | 1.8 | 0.3 | -1.7 |
| Administrative and related activities |
| Public administration and defence; | 1.1 | 1.4 | 1.3 | 0.7 | 0.1 |
| Education; health and related activities |
| Arts, entertainment; household repair and related services | 0.2 | 0.1 | 0.3 | 1.3 | -0.2 |
| GVA | 5.9 | 6.7 | 7.6 | 3.6 | -12.3 |
| Taxes less subsidies on products | 0.9 | -0.7 | -0.2 | -0.4 | -2.6 |
| Annual nominal GDP growth (%) | 6.8 | 5.9 | 7.4 | 3.2 | -14.9 |

\(^8\) The difference between nominal GDP and GVA is made up of taxes on products, net of subsidies. In the second quarter of 2020, taxes on products net of subsidies decreased in annual terms.
contracted slightly in the sector comprising quarrying and utilities.

GDP data from the income approach show that while household income remained robust during the peak of the pandemic, profitability declined sharply. Indeed, gross operating surplus contracted by 20.5% in annual terms, reflecting the substantial decline in turnover across most sectors during the peak of the pandemic. It shed 9.5 percentage points of nominal GDP growth (see Chart 2.3). At the same time, net taxes on production and imports contracted further on a year earlier. This reflects lower taxation revenue due to the drop in economic activity, as well as a rise in subsidies partly related to the COVID-19 government support measures. Meanwhile, compensation of employees continued to grow, despite the steep fall in economic activity, as government support measures – particularly the wage supplement scheme – supported labour income. It rose at an annual rate of 3.9% compared with 7.7% in the previous quarter, and added 1.7 percentage points to nominal growth.

Almost all sectors registered a decline in gross operating surplus when compared with the same quarter a year earlier. Accommodation and food services activities, as well as transportation and storage, accounted for a significant share of the overall decrease. Similar developments were recorded in a number of other sectors, including the sector comprising professional, scientific and technical activities, wholesale and retail trade, construction, human health and social work activities, education, administrative and support services activities, manufacturing and utilities. By contrast, operating surplus increased in the information and communication sector, real estate activities, the sector comprising arts, entertainment and recreation, as well as other mining and quarrying activities.

Compensation of employees continued to grow across most sectors in annual terms, with the largest absolute increase registered in the sector incorporating public administration and defence. This was followed by the sector comprising professional and scientific activities, construction, arts and entertainment. By contrast, compensation of employees fell in the sector comprising wholesale and retail trade, in manufacturing, as well as in the quarrying and utilities sectors.

*Industrial production contracts*

During the June quarter, industrial production contracted following four consecutive quarters of growth. Production fell by 6.5% on an annual basis following a rise of 10.6% in the first quarter of 2020 (see Table 2.4).9

9 Methodological differences may account for divergences between developments in GVA in the manufacturing sector and industrial production. GVA nets input costs from output to arrive at value added, and is expressed in nominal terms. Industrial production is a measure of the volume of output and takes no account of input costs. The sectoral coverage between the two measures also differs, since industrial production data also include the output of the energy and quarrying sectors.
In the quarter under review, output in the manufacturing sector contracted by 6.5% compared to a year earlier. Meanwhile, production in mining and quarrying decreased by 9.9%, and that in the energy sector fell by 0.5%.

Most sub-sectors in the manufacturing sector recorded negative growth. The largest contraction was registered among firms that produce ‘other manufacturing’ goods – which include medical and dental instruments, toys and related products – and beverages. Production also decreased significantly among firms producing motor vehicles, trailers and semi-trailers and among firms that repair and install machinery and equipment. Smaller falls were recorded among firms that produce rubber and plastic products, and computer, electronic and optical products. By contrast, firms that print and reproduce recorded media registered the highest increase in production. Similarly, production rose among firms producing pharmaceutical products. Food production also increased, though to a smaller extent when compared with the aforementioned sectors.

**Business and consumer surveys**

During the second quarter of 2020, the European Commission’s Economic Sentiment Indicator (ESI) fell to 55.1, from 93.8 in the preceding quarter,
as COVID-19 weighed heavily on consumer and business confidence throughout the quarter, pushing the overall indicator significantly below its long-term average of around 100.0 (see Chart 2.4). The overall ESI indicator also stood below that in the euro area, which averaged 69.4.

Confidence weakened across all sectors. The strongest decline was recorded in the services sector. However, sentiment also weakened significantly in the construction sector, in industry and in the retail sector. Sentiment among consumers fell to a lesser extent and in fact remained very close to its long-term average. When accounting for the variation in the weights assigned to each sector in the overall index, the deterioration relative to the first quarter of 2020 was driven almost entirely by the services sector and industry. Furthermore, the evolution of sentiment in these sectors largely explains why the overall ESI has fallen below its long-term average in recent quarters (see Chart 2.5).

Confidence in the services sector falls sharply
Confidence in the services sector plunged to -55.9, from 6.6 in the preceding quarter, standing significantly below the long-term average of 20.3. The deterioration in sentiment in the second quarter of 2020 was spread across all sub-components of the indicator, though the sharpest declines were registered in respondents’ assessment of demand and the business situation over the previous three months.

10 The ESI summarises developments in confidence in five surveyed sectors: industry, services, construction, retail and consumers. Quarterly data are three-month averages.
11 Long-term averages are calculated over the entire period for which data are available. For the consumer and industrial confidence indicators, data for Malta became available in November 2002 while for services and construction data became available in May 2007 and May 2008, respectively. The long-term average of the retail confidence indicator is calculated as from May 2011, when it was first published. However, the long-term average of the ESI is computed from November 2002.
12 Weights are assigned as follows: industry 40%, services 30%, consumers 20%, construction 5% and retail trade 5%.
13 The services confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to survey questions relating to the business climate, the evolution of demand in the previous three months and demand expectations in the subsequent three months.

Sources: European Commission; Central Bank of Malta workings.
Expectations of demand over the next three months also deteriorated, though to a lesser extent (see Chart 2.6).

Supplementary survey data indicate that respondents’ price and employment expectations turned negative.

*Industrial confidence is more negative*

Confidence in the industrial sector decreased to -42.6 from -11.9 in the previous three-month period, thus falling further below its long-term average of -4.1 (see Chart 2.7). The recent fall in sentiment was mainly driven by a higher share of firms reporting falling orders and, to a lesser extent, by a worsening of production expectations. At the same time, the number of firms reporting above normal stocks of finished goods edged up.\(^\text{14}\)

Additional survey data reveal an increase in the share of firms that foresee a decline in selling prices in the months ahead.

*Confidence in construction weakens significantly*

In the second quarter of 2020, confidence in the construction sector edged down to -26.4, significantly below the 10.2 registered in the previous three-month period. Consequently, sentiment fell below its long-term average of -11.6 (see Chart 2.8).

Lower sentiment was driven by both negative employment expectations for the following months and below normal levels of overall order books, though the fall in the former was more pronounced.

\(^{14}\) The industrial confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to a subset of survey questions relating to expectations about production over the subsequent three months, to current levels of order books and to stocks of finished goods.

\(^{15}\) Above-normal stock levels indicate lower turnover and affect the overall indicator in a negative way. Such levels are thus represented by negative bars in Chart 2.7.

\(^{16}\) The construction confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to two survey questions, namely those relating to order books and employment expectations over the subsequent three months.
Supplementary survey data indicate that labour shortages remained a key factor limiting production, although this was not the most pressing problem. At the same time, respondents anticipated a fall in selling prices in the next three months, which contrasts with previous expectations of price increases.

**Consumer confidence turns negative but remains close to its historical average**\(^{17}\)

Consumer confidence averaged -11.3, down from 5.5 in the first quarter of 2020 but was still broadly in line with its long-run average of -11.2 (see Chart 2.9).

The deterioration in sentiment during the quarter under review was driven by consumers’ expectations of the general economic situation and, to a lesser extent, the financial situation in the year ahead. Their assessment of the financial situation over the last 12 months also worsened. Furthermore, expectations of major purchases over the next 12 months were more negative than before.

Supplementary survey data suggest that, on balance, respondents expected unemployment to rise in the months ahead, with such expectations being particularly prevalent in April and May.\(^{18}\) At the same time, a marginally smaller share of consumers expected prices to increase over the next 12 months.

**Confidence in the retail sector declines further**\(^{19}\)

Sentiment in the retail sector fell to -35.0, from -7.6 in the first quarter of the year and remained further below its long-term average of -0.1 (see Chart 2.10).

---

\(^{17}\) The consumer confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to a subset of survey questions relating to households’ assessment and expectations of their financial situation, their expectations about the general economic situation and their intention to make major purchases over the subsequent 12 months. The computation of this indicator was changed as reflected in the January 2019 release of the European Commission.

\(^{18}\) Negative unemployment expectations affect the overall indicator in a positive way. Thus, a fall in the number of respondents expecting unemployment to fall affects the overall indicator in a negative way.

\(^{19}\) The retail confidence indicator is the arithmetic average of the seasonally-adjusted balances (in percentage points) of replies to survey questions relating to the present and future business situation and stock levels.
Weaker sentiment was largely driven by a significant increase in the number of respondents that considered their stock levels to be above normal, partly reflecting the forced closure of several retail outlets during the first part of the quarter. Meanwhile, retailers’ assessment of business activity over the past three months and in the months ahead worsened.¹⁰

Supplementary survey data indicate that, on balance, orders expectations were strongly negative in the quarter under review. On balance, however, retailers anticipated a rise in prices in the coming months.

Employment Expectations Indicator (EEI) decreases

The EEI – which is a composite indicator of employment expectations in industry, services, retail trade and construction – fell further in the second quarter of 2020.¹¹ It averaged 66.3, compared with 97.6 in the preceding quarter and stood well below its long-term average of around 100.0.

During the quarter under review, employment expectations were negative across all sectors, with the most negative readings recorded in industry and, to a lesser extent, in the construction and services sectors. However, when accounting for the variation in the weights assigned to each sector in the overall index, it appears that the deterioration relative to the first quarter of 2020 was largely driven by developments in the services sector and, to a lesser degree, by developments in industry (see Chart 2.11). Weaker employment expectations in retail and construction also contributed to the fall in the EEI, but in a more limited way.

The labour market²²

Labour force growth slows down

LFS data show that in the second quarter of 2020, the labour force grew by 3.7% over the same quarter of 2019 (see Table 2.5).²³ This is a sharp deceleration from the year-on-year increase of 7.7% in the first quarter of 2020.

²⁰ A fall in the balance of above-normal stock levels affects the overall indicator in a positive way.
²¹ The EEI is based on question 7 of the industry survey, question 5 of the services and retail trade surveys and question 4 of the construction survey, which gauge the respondent firms’ expectations as regards changes in their total employment over the next three months. Before being summarised in one composite indicator, each balance series is weighted on the basis of the respective sector’s importance in overall employment. The weights are applied to the four balance series expressed in standardised form. Further information on the compilation of the EEI is available in European Commission (2020), The Joint Harmonised EU Programme of Business and Consumer Surveys User Guide.
²² This section draws mainly on labour market statistics from two sources: the LFS which is a household survey conducted by the NSO on the basis of definitions set by the International Labour Organization (ILO) and Eurostat, and administrative records compiled by Jobsplus according to definitions established by domestic legislation on employment and social security benefits.
²³ The LFS defines the labour force as all persons aged 15 and over who are active in the labour market. This includes those in employment, whether full-time or part-time, and the unemployed, defined as those persons without work but who are actively seeking a job and are available for work.
The activity rate stood at 76.4% in the quarter under review, up from 75.5% a year earlier. The increase in the overall participation rate reflects increased activity among both males and females, as their participation rates rose by 1.2 and 0.5 percentage points to 84.9% and 66.9%, respectively. The activity rate exceeded the euro area average of 71.6% with the female rate exceeding the euro area average of 66.5% for the first time.

The activity rate of males remained well above the euro area average of 76.8%.

Given that the pandemic and the associated containment measures commenced in mid-March and reached their peak in the second quarter, annual changes could mask the impact of COVID-19 on the labour market. Indeed, on a quarter-on-quarter basis, the labour force declined by over 4,600 persons in the second quarter of 2020. Such a decline in the labour force is unusual for this time of the year, according to seasonal regularities. The quarterly decline primarily reflects a relatively strong increase in inactivity – in fact the inactivity rate rose by 1.2 percentage points to 23.6% compared to the first quarter of 2020 though the working age population also declined somewhat.

The quarterly rise in inactivity could reflect two main reasons. Firstly, according to the ILO definition, a person can only be classified as being unemployed if the person is willing and actively looking for a job. Due to the shutdown of a number of businesses during April and May, a number of individuals who were laid off could not actively look for a job, and were thus classified as inactive. Moreover, given the extent of the decline in economic activity, an element of discouraged-worker effect could have also played a role, particularly among older workers, who tend to be disproportionately affected by COVID-19. With regards to the decline in the working age population, this might reflect outward immigration flows of foreign workers.

**Employment growth moderates**

In the second quarter of 2020, employment rose by 2.8% in annual terms, following an increase of 7.7% in the previous quarter. Meanwhile, the number of unemployed persons was up by almost 24

**Table 2.5**

**LABOUR MARKET INDICATORS BASED ON THE LFS**

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2020</th>
<th>Annual change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Q2</td>
<td>Q2</td>
<td>%</td>
</tr>
<tr>
<td>Labour force</td>
<td>261,773</td>
<td>271,554</td>
<td>3.7</td>
</tr>
<tr>
<td>Employed</td>
<td>252,506</td>
<td>259,523</td>
<td>2.8</td>
</tr>
<tr>
<td>Full-time</td>
<td>219,484</td>
<td>228,192</td>
<td>4.0</td>
</tr>
<tr>
<td>Part-time</td>
<td>33,022</td>
<td>31,331</td>
<td>-5.1</td>
</tr>
<tr>
<td>Unemployed</td>
<td>9,267</td>
<td>12,031</td>
<td>29.8</td>
</tr>
<tr>
<td>Activity rate (%)</td>
<td>75.5</td>
<td>76.4</td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td>83.7</td>
<td>84.9</td>
<td></td>
</tr>
<tr>
<td>Female</td>
<td>66.4</td>
<td>66.9</td>
<td></td>
</tr>
<tr>
<td>Employment rate (%)</td>
<td>72.8</td>
<td>73.0</td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td>80.9</td>
<td>81.2</td>
<td></td>
</tr>
<tr>
<td>Female</td>
<td>63.7</td>
<td>63.6</td>
<td></td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>3.6</td>
<td>4.4</td>
<td></td>
</tr>
<tr>
<td>Actual hours worked (per week)</td>
<td>37.0</td>
<td>31.6</td>
<td></td>
</tr>
</tbody>
</table>

Source: NSO.

The activity rate measures the number of persons in the labour force aged between 15 and 64, as a proportion of the working age population, which is defined as all those aged 15 to 64 years.
a third compared to the same period a year earlier and by around a fifth when compared with the first quarter of 2020.

In absolute terms, job creation continued to be driven by full-time jobs, which rose by 8,708, or 4.0% in annual terms (see Table 2.5). On the other hand, the number of part-time employees – which includes those employed full-time on reduced hours – declined by 1,691 persons, or 5.1% on a year earlier.

The overall employment rate rose by 0.2 percentage point on the same period of 2019, to 73.0%. This reflected a rise in the male employment rate, which rose by 0.3 percentage point to 81.2%, driven by an increase across all age brackets except for the 22-54 bracket. On the other hand, the overall employment rate of women decreased marginally to 63.6%, reflecting a decline in the 22-54 bracket, which offset increases in the other groups.

On a quarterly basis, however, the number of employed in the June quarter declined by around 6,700 persons. Over the same period, the number of unemployed persons rose by 2,040, as most of the decrease in employment was reflected the aforementioned rise in inactivity.

LFS data show that while in the first stages of the pandemic employers may have been hesitant to shed labour in response to the economic shock caused by containment measures, job losses increased during the second quarter. Part of the response to the economic shock is also visible in actual weekly hours worked. In fact, these fell to 31.6 from 37.0 in the same period of the previous year (see Table 2.5).

The unemployment rate picked up

During the June quarter, the unemployment rate stood at 4.4%. This rate was higher than the 3.6% recorded a year earlier and in the first quarter of 2020 (see Table 2.5). The unemployment rate registered in the June quarter had been last seen during the September quarter of 2016.

However, the jobless rate in Malta remained relatively muted given the extent of the decline in economic activity. Indeed, government measures have been highly supportive of employment. In particular, the Bank’s feedback from firms indicate that the wage supplement scheme limited the extent of redundancies. In addition,
labour market conditions – though weaker than before – remain more favourable by euro area standards. In fact, Malta’s unemployment rate is well below the average rate for the euro area, which stood at 7.2% (see Chart 2.12).

The unemployment rate stood above the Bank’s structural measure of 4.0%. Estimates of structural measures are, however, highly uncertain in this environment and should thus be treated with caution.

Jobsplus data show a significant increase in the number of registered unemployed persons in the second quarter of 2020. The average number of unemployed persons in this quarter stood at 4,219 – 2,542 persons more than a year earlier (see Chart 2.13). This was the strongest rise ever recorded in any quarter. When compared with the first quarter of 2020, the number of persons on the unemployment register rose by 2,394 persons, with this increase driven in large part by developments in April. The increase in unemployment during May was much smaller while in June unemployment declined when compared to the previous month.

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29 The structural unemployment rate in this chapter refers to the non-accelerating inflation rate of unemployment (NAIRU), that is, the unemployment rate that is consistent with stable inflation. This measure of the unemployment rate is based on a multivariate filter as described in Micallef, B., (2014). “A Multivariate filter to estimate potential output and NAIRU for the Maltese economy”, Working Paper 05/2014.
3. PRICES, COSTS AND COMPETITIVENESS

Annual inflation as measured by the HICP moderated to 1.0% in June, from 1.2% in March, driven by slower growth in the prices of services and energy. Annual inflation based on the RPI – which only takes into account expenditure by Maltese residents – eased to 0.7%, from 1.1% in March. At the same time, producer output prices fell in annual terms. Growth in Malta’s ULC index accelerated to 10.4% in the second quarter, reflecting a sharp drop in productivity as a result of the containment measures triggered by the pandemic. Meanwhile, Malta’s HCIs point to a deterioration in international competitiveness during the period under review.

Inflation

HICP inflation moderates

Annual HICP inflation edged down to 1.0% in June, from 1.2% in March (see Table 3.1). While overall price pressures remained contained, HICP inflation was higher than that recorded in the euro area (see Chart 3.1).

The fall in HICP inflation relative to March reflected slower growth in services inflation and energy inflation. Services inflation stood at 0.8% in June, from 1.6% three months earlier. Notwithstanding this drop, services inflation remained one of the main drivers behind overall inflation, along with food inflation (see Chart 3.2). Services inflation eased mainly due to

![Chart 3.1](image)

**Table 3.1**  
**HICP INFLATION**  
*Annual percentage change*

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Oct Nov Dec Jan Feb Mar Apr May June</td>
<td></td>
</tr>
<tr>
<td>Unprocessed food</td>
<td>-1.1 -1.1 1.9 2.4 2.0 2.0 3.2 1.3 1.3 4.6</td>
<td></td>
</tr>
<tr>
<td>Processed food</td>
<td>1.8 1.6 1.8 2.0 1.9 1.8 2.5 2.2 2.2</td>
<td></td>
</tr>
<tr>
<td>Energy</td>
<td>2.4 2.4 2.4 2.4 2.4 2.4 2.1 2.1 0.4</td>
<td></td>
</tr>
<tr>
<td>NEIG</td>
<td>0.6 0.4 -0.1 0.0 -0.9 -0.3 -0.2 -0.1 0.0</td>
<td></td>
</tr>
<tr>
<td>Services</td>
<td>1.7 1.8 1.7 1.7 1.8 1.6 1.0 0.9 0.8</td>
<td></td>
</tr>
<tr>
<td>All Items HICP</td>
<td>1.4 1.3 1.3 1.4 1.1 1.2 1.1 0.9 1.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: Eurostat.

1 The HICP weights are revised on an annual basis to reflect changes in overall consumption patterns. In 2020, the weight allocated to services stood at 47.2%, while that of non-energy industrial goods (NEIG) was 27.1%. Food accounted for 19.7% of the index, while the share allocated to energy stood at 6.0%.
a decline in prices of administrative, legal, accountancy and funeral services within the miscellaneous services category. Moreover, inflation eased in the recreational and personal services category, such as restaurants and accommodation services. (see Chart 3.3).

Meanwhile, NEIG inflation stood at 0.0% in June, compared with -0.3% at the end of the previous quarter. As a result, the contribution of this subcomponent to overall HICP was nil, following a small negative contribution three months earlier. Inflation in this subcomponent has been weak for a prolonged period. It mainly reflects downward price pressures on traded manufactured goods in the context of a weak international environment.

By contrast, food inflation remained robust at the end of the second quarter of 2020, possibly reflecting the impact of supply-chain disruptions due to the pandemic. Processed food inflation increased to 2.2% in June, from 1.8% three months earlier, while inflation in unprocessed food items rose significantly to 4.6%, from 2.0%. Food inflation was mainly supported by increases in prices of meat, fruit and vegetables and milk, cheese and eggs. As a result, the overall contribution of food to HICP inflation stood at 0.5 percentage point in June, up by 0.1 percentage point when compared with March.

Energy inflation fell to 0.4% in June, from 2.4% three months earlier. The moderation in annual inflation in this subcomponent was primarily driven by a cut in fuel prices in June.

**Core HICP inflation remains below overall inflation**

Core inflation, which excludes the more volatile components of the HICP index, moderated to 0.9% in June, from 1.0% at the end of the first quarter (see Chart 3.4).² Hence, it remained slightly

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lower than overall HICP inflation. This suggests that overall inflation was being partly supported by a small number of volatile subcomponents.

**RPI inflation eases**
Annual inflation based on the RPI index – which is based on a different basket of goods and services from the HICP index – eased to 0.7% in June, from 1.1% three months earlier (see Table 3.2). This inflation measure also suggests that overall price pressures remained contained during the second quarter, with the recent deceleration largely driven by a negative contribution from the recreation and culture subcomponent.

**Residential property prices**

*Residential property prices grow at a significantly slower pace*
The NSO’s Property Price Index (PPI) – which is based on actual transactions involving apartments, maisonettes and terraced houses – increased at a significantly slower pace during the second quarter of 2020 (see Chart 3.5). The annual rate of change slowed to 3.4% from 5.5%
in the first quarter of 2020. During the quarter under review, house price inflation in Malta stood below that in the euro area, where prices increased at an annual rate of 5.0%.

Growth in residential property prices reflects households’ elevated liquidity levels, the low-interest rate scenario and various government schemes supporting the residential property sector, in particular the first-time and second-time buyers’ schemes, which raises the attractiveness of the property market as an investment opportunity. Furthermore, in June, the Government lowered the property tax rate and stamp duty on eligible transfers of immovable property arising from 9 June 2020 until 1 April 2021. In particular, the property tax and stamp duty on the first €400,000 of the value of the transfer were reduced to 5.0% and 1.5%, respectively. Also, some individuals who did not qualify as first-time buyers will now be able to qualify.

The Individual Investor Programme also continues to support growth in residential property prices, but to a lesser extent as property acquisition under this programme accounts for a limited proportion of all property transactions. At the same time, growth is less dynamic than before the pandemic, reflecting less favourable developments in households’ income and lower demand for private rental accommodation in view of the uncertain outlook for the tourism industry.

Costs and competitiveness

Producer price inflation turns negative

The industrial producer price index, which measures price inflation of domestic factory output, posted a small decrease. Producer prices contracted by an annual 0.3% in June, from 0.0% three months earlier. This mainly reflected a contraction in intermediate goods prices, which offset a higher contribution from consumer goods. The contribution from capital goods also eased, albeit marginally, while energy inflation remained zero.

HCIs point to deterioration in competitiveness

Annual growth in Malta’s HCIs remained positive in June, suggesting a further deterioration in Malta’s international competitiveness. In June, the nominal HCI grew at an annual rate of 1.3%.

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5 The Budget 2021 extends or introduces more favourable terms on a number of existing schemes supporting the property market, including the first-time and second-time buyers’ schemes, the purchase of vacant property located in Urban Conservation Areas (UCA), purchases of property in Gozo and the reductions in taxes on property transfers and stamp duty introduced in terms of Legal Notices 240 and 241 of 2020. Furthermore, the threshold for the duty exemption on immovable property donated by parents to their descendants was increased from €200,000 to €250,000.

6 The industrial producer price index measures the prices of goods at the factory gate and is commonly used to monitor inflationary pressures at the production stage.

7 HCIs act as an effective exchange rate measure for countries operating within the euro area monetary union. The nominal HCI tracks movements in the euro exchange rate against the currencies of Malta’s main trading partners, weighted according to the direction of trade in manufactured goods. The real HCI also takes into account the relative inflation rate of Malta vis-à-vis its main trading partners. A higher (or lower) score in the HCI indicates a deterioration (or improvement) in Malta’s international price competitiveness.
reflecting unfavourable developments in trade-weighted exchange rates (see Chart 3.6). The real HCI also rose by 1.3% in June, suggesting that the unfavourable impact of exchange rate movements was not significantly affected by favourable developments in relative prices.

**ULC growth accelerates strongly**
Malta’s ULC index, measured as the ratio of compensation per employee to labour productivity, accelerated sharply during the second quarter of 2020. When measured on a four-quarter moving average basis, ULC in Malta grew at an annual rate of 10.4%, following a 5.0% increase in the previous quarter (see Chart 3.7).

The pick-up in ULC growth was driven by a sharper decline in labour productivity. The latter fell by an annual 6.6% in the first quarter, following a 2.0% decrease in the previous quarter. The decline in productivity reflects the sharp contraction in economic activity caused by the containment measures related to COVID-19, while at the same time, employment growth remained positive on an annual basis. The latter might reflect an element of labour hoarding following an extended period of labour shortages as well as government support measures intended at limiting job losses. In particular, the wage supplement scheme meant that employment levels remained elevated during the quarter, especially when compared with the scale of contraction of economic activity. This contributed to the strong fall in productivity levels per head. In addition, annual growth in compensation per employee decelerated only slightly, to 2.3% when compared with 2.8% in the previous quarter.

---

While the scheme was successful at preserving employment, hours worked contracted by an annual rate of -8.6%, compared to an increase of 1.4% in the previous quarter. This suggests that due to the pandemic, firms cut hours rather than jobs. As a result, productivity per hour fell by 2.3%. This is still greater than the 1.3% reduction recorded in the first quarter, but well below the decrease in productivity per person. While firms responded to negative economic shock by reducing hours worked, they were unable to cut salaries by a similar margin and as a result, compensation per hour rose by 6.2% in the second quarter of 2020, up from a 3.3% increase in the previous quarter. This meant that similar to ULC per employee, ULC per hour also rose sharply, by 8.8% in the second quarter, following a 4.6% increase in the first quarter (see Chart 3.8).
4. THE BALANCE OF PAYMENTS

During the second quarter of 2020, the balance on the current account recorded a deficit when compared to a surplus in the second quarter of 2019. This deficit was mainly on account of a sharp decline in net services receipts, largely on account of the travel ban imposed to limit the spread of COVID-19. This more than offset a lower deficit on merchandise trade. Net inflows on the capital account decreased. On the financial account, net borrowing was reported, as opposed to net lending in the corresponding quarter of last year.

When measured on a four-quarter moving sum, the current account balance showed a surplus, which was equivalent to 1.3% of GDP. This compares with 2.1% of GDP in the euro area.¹

Meanwhile, the cyclically-adjusted current account balance is estimated to have stood at around 4.9%. This indicates that Malta’s current account developments largely reflect structural factors.

The current account

The current account registers a deficit

Between April and June 2020, the current account registered a deficit of €352.3 million, when compared to a surplus of €235.6 million recorded in the same quarter of 2019 (see Table 4.1). The shift to a deficit was mostly driven by a significant fall in net services receipts and, to a lesser extent, higher net outflows on the primary income account. These movements were partly offset by a smaller merchandise trade deficit and lower net outflows related to secondary income.

Mostly reflecting developments in the first two quarters of this year – when measured as a four-quarter moving sum – the surplus on the current account narrowed to €170.3 million, from €529.7 million a year earlier. This drop was largely spurred by lower net receipts from trade in services, mostly reflecting the imposition of a travel ban on 21 March 2020 to curb the spread of COVID-19 and, to a lesser extent, higher net outflows on the primary income. By contrast, a smaller merchandise trade

<table>
<thead>
<tr>
<th>Table 4.1</th>
<th>BALANCE OF PAYMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR millions</td>
<td>Four-quarter moving sums</td>
</tr>
<tr>
<td></td>
<td>2019 Q2</td>
</tr>
<tr>
<td>Current account</td>
<td>529.7</td>
</tr>
<tr>
<td>Goods</td>
<td>-1,616.7</td>
</tr>
<tr>
<td>Services</td>
<td>3,440.1</td>
</tr>
<tr>
<td>Primary income</td>
<td>-1,133.8</td>
</tr>
<tr>
<td>Secondary income</td>
<td>-159.9</td>
</tr>
<tr>
<td>Capital account</td>
<td>172.1</td>
</tr>
<tr>
<td>Financial account(1)</td>
<td>448.7</td>
</tr>
<tr>
<td>Errors and omissions</td>
<td>-253.2</td>
</tr>
</tbody>
</table>

Source: NSO.
(1) Net lending (+) / net borrowing (-).

¹ Statistics related to the BOP in this Quarterly Review should be interpreted in context to the unprecedented developments related to COVID-19.
deficit and lower net outflows on the secondary income were recorded. The current account-to-GDP ratio edged down to 1.3%, from 4.1% a year earlier (see Chart 4.1).

Malta’s cyclically-adjusted current account balance is estimated to have stood at 4.9% of GDP in the second quarter of 2020, up by 1.1 percentage points on a year earlier. The cyclically-adjusted and the unadjusted current account balances for the Maltese economy tracked each other very closely in 2018 and 2019. However, the gap between these two measures widened in the past two quarters, with the cyclically-adjusted measure exceeding the headline measure (see Chart 4.1). This partly reflects a weaker economic cycle in Malta’s trading partners relative to the domestic output gap, which is negatively impacting the cyclical component of Malta’s current account surplus. Given the high uncertainty related to COVID-19, cyclically-adjusted estimates are likely to be affected by several one-off factors that are difficult to quantify and interpret.

The merchandise trade deficit narrows
In the second quarter of 2020, the merchandise trade deficit stood at €322.0 million, €102.7 million less than in the corresponding period of 2019. This was driven by a contraction in imports which outweighed a decrease in exports.

Partly reflecting developments in the first and second quarters, the visible trade gap narrowed to €1,455.6 million when measured on a four-quarter cumulative basis, €161.1 million less than the deficit recorded a year earlier. This stemmed from a €298.7 million fall in merchandise imports, which offset a €137.5 million drop in exports. As a result, the share of the goods deficit in GDP fell to 11.2%, from 12.5% in the year to June 2019 (see Chart 4.2).

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The surplus on services falls considerably

In the quarter under review, net receipts generated by the services industry amounted to €334.1 million, €634.0 million less than in the corresponding period of 2019. Both services receipts and payments decreased on a year earlier, but the fall in the former was much more significant.

The drop in the surplus was mainly driven by the travel ban imposed towards the end of the first quarter in light of the COVID-19 pandemic. Indeed, both travel receipts and payments were nil in the second quarter of 2020, as both inbound and outbound travel were banned. Since the travel account is historically always in surplus, the drop in receipts was significantly larger than the decline in payments. The transport account, meanwhile, swung to a deficit of €12.9 million, from a surplus of €103.7 million a year earlier, as both receipts and payments fell considerably but the fall in the former was more than double that in the latter.

A €144.4 million drop in the net surplus of the ‘other services’ component also contributed to the decline in the overall surplus on services. This was largely on account of higher net payments related to ‘other business services’, in particular professional and management consulting services. This offset a rise in net receipts related to personal, cultural and recreational services, which include remote gaming.

On a four-quarter cumulative basis, the overall surplus from services stood at €2,968.7 million, a decrease of €471.4 million when compared with the corresponding period of 2019, with this decrease entirely underpinned by higher imports – in particular imports of telecommunications, computer, and information services as well as technical services related to ‘technical, trade-related and other business services’. As a result, the share of net services receipts in GDP dropped to 22.8% over the 12 months to June 2020, from 26.5% a year earlier (see Chart 4.3).

Primary income account records higher net outflows

Between April and June 2020, net outflows on the primary income account stood at €328.5 million, €64.7 million higher than in the second quarter of 2019.

During the four quarters to June, net outflows on this account reached €1,201.3 million, €67.5 million more than in the same period a year earlier. Higher net outflows were driven by lower net receipts on portfolio investment, which offset higher net interest earned on ‘other investment’ income. Flows relating to primary income continued to be strongly influenced by internationally-oriented firms which transact predominantly with non-residents.

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3 The primary income account shows income flows related mainly to cross-border investment and compensation of employees.
Outflows on the secondary income account decrease

In the second quarter of the year, net outflows on the secondary income account fell by €8.1 million on a year earlier, to stand at €35.9 million.

In the four quarters to June 2020, net outflows on this account were €18.4 million less than the amount recorded a year earlier, reaching €141.5 million.

The capital account

Net inflows on the capital account stood at €23.4 million in the second quarter of 2020, down from €34.9 million in the corresponding period of 2019 (see Table 4.1). When measured on a four-quarter moving sum basis, capital inflows broadly halved on a year earlier, standing at €86.9 million.

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4 The secondary income account shows current transfers between residents and non-residents.

Introduction

The global economy has experienced substantial disruptions due to the COVID-19 pandemic. The tourism industry was hit particularly hard by this unprecedented shock as international travel was brought to a halt mainly during the second quarter of 2020, in an effort to contain the spread of the virus.

Tourist arrivals data for April, May and June were not been published by the NSO as the airport and seaport were closed in those months. This box seeks to analyse the local tourism sector during the second quarter of 2020 by using alternative data sources, outlines government measures directed at tourism-related sectors and briefly looks at data for July and August.

Containment measures affecting the tourism sector during the second quarter of 2020

To limit the spread of COVID-19, the Maltese Government implemented a number of containment measures, which severely restricted international travel. One of the initial travel restrictions required passengers arriving in Malta from 26 February onwards, from Italy, China (including Hong Kong), Singapore, Japan, Iran and South Korea, to remain in quarantine for 14 days. Throughout the second and third week of March, a number of legal notices were issued suspending air travel from other areas of high transmission, such as France, Switzerland and Germany. Subsequently, with effect from 13 March, passengers arriving from any destination were to quarantine for a period of 14 days. Fines were also imposed to ensure compliance with the obligatory quarantine. On 21 March, all flights to/from all destinations were suspended. Similarly, during March a ban on the entry of cruise liners into Maltese ports was imposed.

Aside from these travel-related containment measures, there were other measures which impacted tourism-reliant enterprises. For instance, in mid-March restaurants, bars, museums were closed to the public. These enterprises gradually reopened in the last week of May, but with reduced capacity due to COVID-19 safety measures.

Malta International Airport (MIA) reopened on 1 July to a small group of countries considered to be part of a ‘safe corridor’. In addition, travel by sea between Sicily and Malta also restarted on 1 July.

Inbound tourism data for March 2020

The NSO released tourist data for March 2020, before halting the publication for April, May, and June. In the context of the aforementioned containment measures, unprecedented declines in tourism activity can be observed as early as March. During that month, 75,157

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1 Prepared by Roberta Montebello. The author is an economist in the Economic Analysis Department of the Central Bank of Malta.
2 Legal Notice 63 of 2020.
4 In terms of Legal Notice 92 of 2020, the restriction applied to all flights other than repatriation flights, cargo flights, ferry flights and humanitarian flights as well as travel deemed as essential by the Superintendent of Public Health.
5 Legal Notice 76 of 2020.
Tourists visited Malta, 56.5% fewer than the corresponding period in the previous year. The major contributor to this decline was the leisure category, though all other categories registered a sharp drop. Moreover, in March, total nights spent declined by 60.2%, while tourism expenditure declined by 62.6% compared with March 2019. Given that inbound tourism expenditure experienced a sharper decline relative to the number of tourist arrivals, expenditure per capita fell to €580.0 in March 2020, from €673.7 a year earlier.

**MIA data on passenger traffic**

Following the suspension of all commercial inbound flights from the end of March, the total number of departures and arrivals of international terminal passengers at the MIA registered a year-on-year decline of 99.6% in the second quarter of 2020 (see Chart 1). During this period, only 8,747 passengers made use of the airport, compared with 2.1 million passengers in 2019. Departures accounted for around three-quarters of passenger movements.

During the second quarter, the number of passengers arriving through MIA was very low from a historical perspective, standing at 1,984. This contrasts with 6,763 departures. Passenger movements during the quarter mainly reflect repatriation flights of foreign nationals, and residents returning to Malta.

Around 70.0% of all passenger arrivals in the second quarter departed from the UK and Germany. Italy followed with another 5% (see Chart 2). With respect to departures, around a fifth of departures went to Italy, while around a third were directed to the UK and Germany.6

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6 Data reported in Chart 2 is based on geographic location rather than nationality.
Collective accommodation in the Maltese islands during the second quarter of 2020

The drop in tourist arrivals, as well as the associated containment measures, had a deep negative impact on the collective accommodation sector in Malta. Indeed, during the second quarter of 2020, the total number of guests in collective accommodation establishments dropped by 97.0% compared to the corresponding quarter in 2019. The decrease in guest nights was of a similar magnitude, as these fell from 2.8 million in the second quarter of 2019, to just 64,161 in the second quarter of 2020. Moreover, the average length of stay in collective accommodation establishments, at 3.7 nights, stood lower than the average 4.8 nights recorded during the same quarter last year.

The second quarter of 2020 was also characterised by a shift in the composition – by residency – making use of collective accommodation establishments. With flights suspended, the majority of guests staying in collective accommodations were Maltese residents. Chart 3 shows that the latter accounted for 81.8% of total guests in collective accommodation establishments, substantially higher than the 7.1% share recorded a year earlier. A similar pattern is observed in guest nights, with Maltese residents accounting for 47.1% of all guest nights during the quarter, substantially higher than the 3.6% recorded in the second quarter of 2019 (see Chart 4).

The average net use of bed-places during the second quarter stood

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7 This section focuses solely on collective accommodation since data on other rented accommodation and non-rented accommodation was unavailable.

8 Note that, as per NSO News Release 138/2020, guests accommodated in collective accommodation establishments for health and safety reasons were excluded from the survey.
at 6.5%, a substantial decline compared to the 73.5% recorded in 2019. The largest decline in occupancy rates was seen in the 4-star hotel category (70.5 percentage points), followed by the 3-star (69.7 percentage points) and 5-star categories (67.9 percentage points). In contrast, other collective accommodation declined by relatively less (48.7 points), as did the 2-star hotel category (46.7 points). Although 4-star and 3-star hotels historically had the largest net use of bed-places, 2-star hotels recorded the largest net use of bed-places all throughout Quarter 2 (see Chart 5).

On a regional level, the drop in occupancy was stronger in Malta than Gozo and Comino (see Chart 6). Indeed, while guests in Malta decreased by 97.5% over the second quarter of 2019, those in Gozo declined by 87.7%. Chart 5 also shows that, while the net occupancy rate in Malta fell to 5.9% from 74.9% in the same quarter last year, that for Gozo and Comino stood at 17.8%, down from 48.5% in 2019 Q2. Nevertheless, throughout the quarter, occupancy rates remained historically low across both regions.

Gozo’s superior performance in terms of occupancy rates is mostly driven by developments in the month of June. This may reflect a lagged response to the lifting of the ban on non-essential travel between Malta and Gozo. This ban came into effect on 3 April and was revoked on 4 May. NSO data show that the number of passenger crossings between Malta and Gozo stood at 581,311 during the second quarter of 2020, representing a 63.1% decline over the second quarter of 2019 (see Chart 7). Similarly, the number of vehicles crossing between the

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9 In terms of the Legal Notice 116 of 2020, travel between the two islands was limited to work purposes, family visits, and medical purposes or to visit family members who are hospitalised. This mandatory non-essential travel ban did not apply to commercial vehicles and merchandise, as well as to individuals travelling to return to their ordinary residence.
two islands declined to 282,446, albeit by a lesser extent to 37.9%.

Although traffic between Malta and Gozo is an indicator of internal tourism, it is also influenced by non-leisure related movements and should thus be interpreted with caution. For example, increased teleworking arrangements may have also played a role in the decrease in passengers travelling between the two islands. Indeed, the largest year-on-year fall in the number of passengers and vehicles was observed in April. More specifically, an 84.9% drop in the number of passengers and a 67.3% decline in vehicles were recorded in that month. This compares with year-on-year falls of 40.3% and 10.2%, respectively in June. The recovery in crossings between the two islands in May and June mainly reflects the aforementioned lifting of the ban on non-essential travel as well as the suspension of telework arrangements by some employers.

Sentiment indicators of tourism-related sectors

The European Commission’s Economic Sentiment Indicator (ESI) fell sharply in the second quarter of 2020. As containment measures eased, sentiment began to improve, though it remained well below 2019 levels. In general, the sub-categories of the ESI that refer to tourism-dependent sectors – air transport, accommodation, food and beverage service activities, and travel agency-related activities – show an even sharper drop than the overall ESI (see Chart 8).

According to the NSO News Release 107/2020 on the effect of COVID-19 on the labour market, 33% of employed persons worked from home during April, substantially higher than the 12% recorded in 2019.

The focus of this section is placed on the accommodation, air transport, travel agency, tour operator reservation service and related activities, and food and beverage service activities sub-sectors given that they have a high tourist ratio to total supply as shown in the Tourism Satellite Accounts available here.
Economic sentiment for enterprises operating within the accommodation sub-sector deteriorated sharply as early as March 2020 (see Chart 9). It declined sharply again in April and only began to show signs of improvement in July. Sentiment increased substantially in August. It remained negative, however, broadly around the March 2020 level. Since the outbreak of the pandemic in Malta, all components contributed to the decline in sentiment. In July, as the airport and seaport were re-opened, demand expectations turned slightly positive. This contributed to a slight uptick in sentiment. Nevertheless, demand expectations fell again in August, despite improvements (less negative scores) in the other sub-components.

Similar developments were observed in the sentiment indicators of enterprises offering tourism operator and related services and the sector comprising food and beverages and travel activities (see Charts 10 and 11).

By contrast, the air transport sub-sector registered a sharp improvement in confidence in March (see
However, similar to the other indicators, sentiment deteriorated sharply in the second quarter of 2020. In contrast to the other sectors, recovery between the second and third quarters was rather limited. However, it is also the case that the sector was already showing very negative readings for a good part of 2019.

Government support measures

In response to the COVID-19 pandemic and the economic consequences of the related containment measures, the Maltese Government implemented a number of economic support measures aimed primarily to support affected businesses and preserve employment. Enterprises and employees linked with the tourism sector have benefitted from economy-wide stimulus measures, but also from specific measures intended to directly support the tourism sector.

In particular, businesses benefitted from a wage supplement scheme whereby the Government financed part of the salary of full-time employees to businesses which were hardest hit by COVID-19.12 This wage supplement scheme was extended until the end of March 2021. LFS data show that in the second quarter of 2020, the number of people employed within the land, water and air transport sub-sector, the accommodation sector and the food service activities sector rose by 9.7% on a year earlier, but were down by around a tenth over the previous quarter. This decline was driven by employees, as the number of self-employed increased. The average monthly salary during this quarter — even after taking into account the wage supplement scheme — also decreased substantially, by 29.5% when compared with the first quarter of 2020.

In addition, firms benefitted from measures to support liquidity shortages. Firstly, a tax deferral scheme was announced as early as March, whereby dues related to provisional tax, VAT, and social security payments were deferred. This scheme was extended in August. In addition, enterprises facing liquidity shortages benefitted from a temporary moratorium on loan repayments, as well as a MDB COVID-19 Guarantee Scheme, whereby working capital loans were extended to businesses facing liquidity shortfalls. Other liquidity measures include a one-time grant of up to €2,500 to help in rent costs, as well as a 50% refund of their electricity bills for the third quarter of 2020, up till a maximum amount of €1,500.

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12 This includes businesses operating within the accommodation, food and beverage service activities, tour operators, travel agencies and other related enterprises and transport companies.
To stimulate domestic tourism, the Government also issued a €100 voucher to each person aged 16 years and over, whereby €20 could be spent at outlets which were forced to close temporarily at the beginning of the public health emergency, while €80 could be spent at restaurants, accommodation establishments and bars. These vouchers were initially set to be valid until the end of September, but were eventually extended until the end of October. The Government announced that it had spent €44.6 million on this scheme by the end of August. These vouchers were mainly spent in 4-star hotels, restaurants, and large retail groups. As outlined in the 2021 Budget, a further round of government vouchers will be issued in the beginning of 2021.

**Passenger and inbound tourism data in July and August**

Following the easing of travel restrictions in July, activity in the tourism sector started to recover. However, as the infection rate in Malta and worldwide rose again, restrictions by several countries were imposed again. In particular, an amber list was added to the red and green travel lists with effect from August 22, which meant that tourists travelling from the countries on the list must present a negative COVID-19 test result before boarding.

MIA data show that in July, passenger movements picked up sharply compared to June. There were 152,818 passenger movements, a substantial increase from just 3,345 movements in the previous month. Passenger movements continued to increase in August on a month-on-month basis, whereby 252,022 passenger movements were recorded. On an annual basis, however, this still represents a 69.4% decline on August 2019. Furthermore, the announcement of several quarantine restrictions on travellers from Malta and the introduction of the amber list locally put a brake on the recovery in the second half of August.

NSO data show that the number of inbound tourists in July decreased by 84.0% relative to the corresponding period a year earlier. Nights spent and expenditure show similar movements, standing at 75.3% and 88.1%, below their respective year-ago level. Meanwhile, expenditure per capita stood at around €693.6, down from €936.4 in July 2019.

The rate of contraction eased further in August, with inbound visitors still down by 66.0% in annual terms. A similar pattern is observed in nights spent and tourism expenditure. In August, these decreased by 62.6% and 71.3%, respectively. Expenditure per capita stood at €826.8, relative to the €979.3 observed in August 2019. This implies the gap relative to pre-pandemic levels – while still sizeable – continued to narrow over the summer months.

**Conclusion**

Overall, the lifting of containment measures and financial support offered by the authorities appears to have provided some relief to the sector but there is still some way to go for a meaningful recovery which will probably not materialise until an effective vaccine becomes available. Travel remains severely limited as the world is experiencing a resurgence in infections. In addition, social distancing measures remain in place, which tends

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13 Press release by the Ministry for the economy, investment and small businesses.
to increase operational costs as well as to limit the recovery in demand. In fact, some hotels have already announced that they plan to temporarily close down during winter, and available data for August show that tourist traffic is still very weak.

The global nature of travel restrictions – which are likely to persist for some time – and Malta’s dependence on air travel, with reduced flight capacity, and limited scope for domestic tourism suggest that the sector will return only very gradually to the levels of activity seen in 2019.
5. GOVERNMENT FINANCE

COVID-19 has had a considerable impact on general government finances. During the second quarter of 2020, the general government balance deteriorated significantly when compared with the corresponding period a year earlier. When measured on a four-quarter moving sum basis, the general government balance registered a deficit of 5.1% of GDP. Meanwhile, the general government debt-to-GDP ratio increased to 51.1% from 44.0% at end-March. Although the stock of financial assets held by government increased, this was offset by a larger increase in financial liabilities, partly reflecting the issue of stocks to fund the provision of financial support to the private sector in light of the pandemic. Consequently, the net financial worth as a share of GDP worsened.

Quarterly developments

General government balance swings into deficit
In level terms, the general government registered a deficit of €392.2 million in the second quarter of 2020, a deterioration of €436.8 million when compared with the same quarter last year. This was due to a significant drop in revenue and an increase in expenditure. As a result, the primary balance shifted from a surplus of €91.9 million in the second quarter of 2019 to a deficit of €347.2 million in the second quarter of 2020.

Decline in tax receipts
In the second quarter of 2020, general government revenue decreased by €220.0 million or 16.8% when compared with the second quarter of 2019 (see Table 5.1). This was largely on the back of lower tax receipts, which were negatively affected by the slowdown in economic activity. The former fell by €113.1 million, mainly on the back of lower VAT receipts. This drop also reflected lower income from duty on documents, gaming taxes and motor vehicle registration taxes. Revenue from current taxes on income and wealth declined by €75.0 million, mainly reflecting lower tax receipts from companies. Moreover, capital and current transfers receivable declined by €41.7 million, mostly due to lower grants from the European Union.

On the other hand, social contributions increased by €9.2 million when compared to the corresponding quarter in 2019, while other revenue increased marginally, by €0.6 million.

Current expenditure underpins expenditure growth
Total government expenditure rose by €216.7 million or 17.2% when compared with the second quarter of 2019. This rise was underpinned by higher recurrent expenditure, largely due to an increase in subsidies, social benefits and intermediate consumption. Subsidies grew by €121.1 million reflecting the economic support measures with respect to the COVID-19 pandemic, notably the wage supplement scheme. Spending on social benefits increased by €66.9 million, mainly due to higher outlays on retirement pensions and COVID-related benefits to parents and vulnerable persons. Meanwhile, intermediate consumption increased by €37.4 million on the back of higher expenditure related to health as well as operational and maintenance-related outlays. Compensation of employees rose by €18.8 million, mainly due to higher outlays in the health, education and residential care sectors. Meanwhile, other current transfers payable rose by €34.2 million – partly due to the timing of contributions to Church schools. On the other hand, interest payments declined by €2.3 million.
The upsurge in current spending was somewhat offset by lower capital expenditure. This partly reflects lower outlays on EU-funded investment and capital transfers.

Debt increases
In June, the stock of general government debt amounted to €6,646.0 million, €711.4 million more than the level registered at the end of March.

The increase in debt reflects the issue of debt securities to fund the shortfall in public finances caused by the pandemic. Short-term securities (composed of Treasury bills) rose by €370.5 million. Consequently, their share in total debt rose by 4.8 percentage points to 12.0%. At the same time, the stock of long-term securities outstanding (composed of MGS) increased by €333.7 million. Notwithstanding this increase, their share in total debt declined by 3.5 percentage points to 75.9%, from 79.3% in the previous quarter.

Loans outstanding rose by €7.9 million. Their share in total debt fell by 0.6 percentage point to 6.5%, from 7.1% in the previous quarter.

The value of currency and deposits outstanding decreased marginally by €0.6 million, while its share in total debt also declined, going to 5.7% from 6.4% in the first quarter of the year.
Headline and cyclically-adjusted developments

Headline balance ratio deteriorates, while the debt ratio increases

COVID-19 has had a considerable impact on the general government finances. On a four-quarter moving sum basis, the general government balance registered a substantial deficit for two successive quarters. When compared to the first quarter of 2020, the deficit-to-GDP ratio widened from 1.7% to 5.1% (see Chart 5.1).

The deterioration in public finances was mainly driven by a rise in the expenditure-to-GDP ratio, which rose to 40.8% from 37.7% at end-March 2020. This was due to a 3.4 percentage points increase in the share of current expenditure in GDP, mainly due to higher expenditure related to the COVID-19 pandemic. At the same time, the government revenue-to-GDP ratio fell to 35.7%, from 36.0% in the first quarter of 2020, mainly reflecting a 0.2 percentage point decline in the share of capital revenue in GDP.

In the period under review, the debt-to-GDP ratio increased by 7.1 percentage points to 51.1%, from 44.0% in the previous quarter. The rise in general government debt is higher than the fiscal deficit recorded in this period, due to a positive deficit-debt adjustment stemming from higher net trade receivables (see Chart 5.2).

Net financial worth deteriorates

The market value of financial assets increased to €4,509.4 million by June 2020, €251.9 million more than the level as at end March 2020. This was primarily due to a rise in accounts receivable, due to the statistical treatment of deferred taxes following the pandemic. Consequently, the share of financial assets in GDP increased by 3.1 percentage points to 34.7% (see Chart 5.3). However, the stock of financial liabilities increased at a faster pace than financial assets. The former...
rose by €842.7 million to stand at €9,087.3 million. This largely reflects a rise in debt securities and account payables. As a result, the share of financial liabilities rose by 8.8 percentage points to 69.9%.

The resulting net financial worth of general government as a share of GDP stood at -35.2%, which is less favourable than the -29.6% registered in the previous quarter. Notwithstanding recent developments, the net financial worth of the Maltese general government continued to compare favourably with the euro area average. The latter stood at -69.9% as a share of GDP, down from -64.9% at end-March.

Public finances continue to compare favourably with the euro area’s

During the quarter under review, the euro area general government deficit stood at 3.7% of GDP on a four-quarter moving sum basis, following a deficit of 1.1% of GDP at end-March (see Chart 5.4). Over the same period, the euro area debt ratio rose to 95.1% of GDP from 86.3%. Thus, in Malta’s case the increase in the debt ratio was more limited than that in the euro area, notwithstanding a more significant deterioration in the Maltese fiscal balance. The Maltese government debt-to-GDP ratio remains well below the corresponding ratio for the euro area, indicating that Malta still retains considerable fiscal space for manoeuvre.

Cyclically-adjusted deficit widens

The COVID-19 pandemic has disrupted economic activity worldwide and contributed to a significant deterioration in government finances. At this juncture, there exists considerable uncertainty about estimates of the economic cycle and the degree to which government revenue reacts to changes in economic activity. Consequently, the following estimates need to be interpreted with caution.

1 The cyclically-adjusted balance is corrected for the impact of the economic cycle on government tax revenue and unemployment assistance. This methodology is in line with the approach used by the European Commission but is based on own estimates for fiscal items’ elasticities and the output gap. For an overview of the method used by the Commission, see Mourre, G., Astarita C., and Princen S. (2014): “Adjusting the budget balance for the business cycle: the EU methodology,” European Economy – Economic Papers 536, (DG ECFIN), European Commission.
On a four-quarter moving sum basis, the cyclically-adjusted deficit ended the quarter under review at 3.8% of GDP (see Chart 5.5), a drop of 2 percentage points when compared with the deficit posted three months earlier. This is less than the deterioration in the headline general government balance posted at end June 2020, which declined by 3.4 percentage points.

The quarter under review saw a significant decline in the share of cyclically-adjusted revenue in GDP, equivalent to 0.9 percentage point (see Table 5.2). This drop was mainly due to a decrease in ‘other revenues’, especially due to the drop in current and capital transfers received. Overall, the share of tax revenue items in GDP remained unchanged.

The share of cyclically-adjusted expenditure rose significantly by 1.1 percentage points, mainly due to a higher share of current spending. This is mostly the result of the above-mentioned increases in subsidies, current social benefits and intermediate consumption, reflecting COVID-19 related measures. On the other hand, the share of government investment in GDP declined in the quarter under review.

Table 5.2
QUARTER-ON-QUARTER CHANGES IN CYCLICALLY-ADJUSTED FISCAL COMPONENTS

<table>
<thead>
<tr>
<th></th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Q1</th>
<th>Q2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td>0.2</td>
<td>-0.8</td>
<td>-0.4</td>
<td>-1.8</td>
<td>-0.9</td>
</tr>
<tr>
<td>Current taxes on income and wealth</td>
<td>0.2</td>
<td>-0.4</td>
<td>0.3</td>
<td>-1.0</td>
<td>0.6</td>
</tr>
<tr>
<td>Taxes on production and imports</td>
<td>0.1</td>
<td>-0.4</td>
<td>-0.2</td>
<td>-0.1</td>
<td>-0.5</td>
</tr>
<tr>
<td>Social contributions</td>
<td>-0.2</td>
<td>0.1</td>
<td>0.0</td>
<td>-0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Other(1)</td>
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<td>-0.1</td>
<td>-0.4</td>
<td>-0.4</td>
<td>-0.9</td>
</tr>
<tr>
<td><strong>Expenditure</strong></td>
<td>0.7</td>
<td>-0.4</td>
<td>-0.4</td>
<td>0.2</td>
<td>1.1</td>
</tr>
<tr>
<td>Compensation of employees</td>
<td>0.0</td>
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<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Intermediate consumption</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Social benefits</td>
<td>-0.1</td>
<td>-0.1</td>
<td>-0.1</td>
<td>0.0</td>
<td>0.3</td>
</tr>
<tr>
<td>Interest payments</td>
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<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>GFCF</td>
<td>0.4</td>
<td>-0.2</td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.3</td>
</tr>
<tr>
<td>Other(2)</td>
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<td>-0.1</td>
<td>-0.5</td>
<td>0.2</td>
<td>1.0</td>
</tr>
<tr>
<td><strong>Primary balance</strong></td>
<td>-0.5</td>
<td>-0.5</td>
<td>0.0</td>
<td>-2.0</td>
<td>-2.0</td>
</tr>
<tr>
<td><strong>General government balance</strong></td>
<td>-0.5</td>
<td>-0.4</td>
<td>0.1</td>
<td>-2.0</td>
<td>-2.0</td>
</tr>
</tbody>
</table>

Sources: NSO; Central Bank of Malta estimates.

(1) Includes market output, income derived from property and investments and current and capital transfers received.
(2) Mainly includes subsidies, current and capital transfers.
6. MONETARY AND FINANCIAL DEVELOPMENTS

The Bank’s FCI suggests that in the second quarter of 2020, financing conditions tightened significantly when compared with the first quarter of the year, while remaining more favourable than at the time of the global financial crisis.

In June, the annual rate of change of Maltese residents’ deposits with MFIs in Malta rose when compared to March. The shift to overnight deposits persisted in an environment of low interest rates and a continued preference for liquidity. Credit to Maltese residents expanded at a faster pace, reflecting stronger growth in credit to general government. By contrast, credit to residents outside general government grew at a more moderate rate, mainly reflecting a larger contraction in security holdings and slower growth in loans to the private sector. The annual rate of change of loans to NFCs was above that recorded three months earlier. Interest rates on loans and deposits fell further when compared with a year earlier, though the spread between the two rates remained unchanged at elevated levels.

In June, the primary market yield on Treasury bills fell from that prevailing at the end of March. By contrast, secondary market yields on 5-year and 10-year MGS rose, contrasting with falls in the euro area benchmark rates. Domestic share prices regained some of their losses and ended the June quarter at a higher level compared with end-March.

The number and value of loan facilities covered by loan moratoria increased significantly compared with March. Firms also made increased use of guarantees in terms of the MDB CGS, with sanctioned amounts under this scheme reaching €161.1 million at the end of June.

Monetary and financial conditions

According to the Bank’s FCI, in the second quarter of 2020, financial conditions were tight from a historical perspective. The tightening, compared with the first quarter of 2020, reflects the negative impact of the pandemic on funding conditions and risk appetite in domestic financial markets as well as globally (see Chart 6.1). Additional factors – such as the significant increase in number and value of loan facilities subject to moratoria, as well as the increased use of guarantees by firms covered by the CGS – are not reflected in the index. In this regard, the FCI reading for the second quarter

\[ \text{Chart 6.1} \]

\[ \text{CONTRIBUTIONS TO THE FCI} \]

\[ \text{(contributions to the index)} \]

Source: Central Bank of Malta estimates.

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1 Monetary data analysed in this chapter are compiled on the basis of the statistical standards found in the Statistics section of the Central Bank of Malta website.
of 2020 should be treated with caution, as financing conditions may not be as tight as the index suggests.

The deterioration in domestic influences was broad-based across almost all domestic components, with the largest decline being recorded in equity prices (part of the ‘other’ component) and in the core banks’ return on equity (part of the ‘balance sheet’ component). At the same time, real credit rose at a slower pace when compared to the previous quarter. Foreign influences also contributed negatively to domestic financial conditions, largely reflecting lower euro area equity prices and a rise in uncertainty.

Financial conditions also worsened considerably when compared with the second quarter of 2019. This was driven by a deterioration in domestic influences, notably a decline in core banks’ profitability and a fall in equity prices, followed by a deceleration in real credit. Meanwhile, foreign influences also tightened when compared to the same quarter in 2019 – although to a more limited extent – due to losses in equity prices, pushing the average reading in the second quarter below its level a year ago.

Although still more favourable than those prevailing in the global financial crisis, financial conditions tightened to a level similar to that recorded in the first quarter of 2014.

**Maltese residents’ deposits continue to expand**

Total deposits held by Maltese residents with MFIs in Malta continued to expand during the second quarter of 2020. The annual rate of change stood at 6.2% in June, above the 5.8% recorded in March (see Table 6.1). Growth in deposits remained robust among both households and NFCs, despite the contraction in economic activity.

<table>
<thead>
<tr>
<th>Table 6.1</th>
<th>DEPOSITS OF MALTESE RESIDENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR millions</td>
<td>Annual percentage changes</td>
</tr>
<tr>
<td></td>
<td>2020</td>
</tr>
<tr>
<td>Overnight deposits</td>
<td>16,286</td>
</tr>
<tr>
<td>of which</td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>10,494</td>
</tr>
<tr>
<td>NFCs</td>
<td>3,690</td>
</tr>
<tr>
<td>Deposits redeemable at notice of up to three months</td>
<td>88</td>
</tr>
<tr>
<td>of which</td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>35</td>
</tr>
<tr>
<td>NFCs</td>
<td>41</td>
</tr>
<tr>
<td>Deposits with an agreed maturity of up to two years</td>
<td>2,688</td>
</tr>
<tr>
<td>of which</td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>2,066</td>
</tr>
<tr>
<td>NFCs</td>
<td>290</td>
</tr>
<tr>
<td>Deposits with an agreed maturity above two years</td>
<td>1,463</td>
</tr>
<tr>
<td>of which</td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>1,276</td>
</tr>
<tr>
<td>NFCs</td>
<td>45</td>
</tr>
<tr>
<td>Total residents’ deposits(1)</td>
<td>20,525</td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.

(1) Total residents’ deposits exclude deposits belonging to central government.
During the quarter under review, deposit growth remained driven by overnight deposits, the most liquid component. Annual growth in this category of deposits rose to 9.2% in June from 7.9% three months earlier. The share of this category in total deposits thus increased to 79.3% from 77.2% a year earlier, thereby extending the established upward pattern observed in recent years (see Chart 6.2).

Meanwhile, demand for time deposits declined. In particular, deposits with an agreed maturity of up to two years contracted by 2.1% in the year to June, following a 1.6% decrease three months earlier. At the same time, deposits with an agreed maturity of over two years contracted by 8.7% over the same period, following a decline of 3.0% in March. As a result, the share of deposits with an agreed maturity of up to two years eased to 13.1%, from 14.1% a year earlier, while that of deposits with an agreed maturity of over two years edged down to 7.1%, from 8.3% over the same period. The share of deposits redeemable at notice of up to three months edged up, but remained small.

Credit to residents grows at a faster pace
Credit to Maltese residents expanded by 8.8% in the year to June 2020, significantly higher than the 4.8% increase recorded in March (see Table 6.2). The acceleration in growth was largely driven by credit to general government, which rose by 27.5% in June, following an increase of 4.1% in March (see Chart 6.3). This reflects the issue of large amounts of MGS issued to fund the shortfall in the public finances caused by the pandemic.

<table>
<thead>
<tr>
<th>Table 6.2</th>
<th>MFI CREDIT TO MALTESE RESIDENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR millions</td>
<td>Annual percentage changes</td>
</tr>
<tr>
<td>2020 June</td>
<td>2019 June</td>
</tr>
<tr>
<td>Credit to general government</td>
<td>3,883</td>
</tr>
<tr>
<td>Credit to residents outside general government</td>
<td>11,468</td>
</tr>
<tr>
<td>Securities and Equity</td>
<td>350</td>
</tr>
<tr>
<td>Loans</td>
<td>11,118</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
</tr>
<tr>
<td>Loans to Households</td>
<td>6,165</td>
</tr>
<tr>
<td>Mortgages</td>
<td>5,580</td>
</tr>
<tr>
<td>Consumer Credit and Other Lending</td>
<td>586</td>
</tr>
<tr>
<td>Loans to NFCs&lt;sup&gt;(1)&lt;/sup&gt;</td>
<td>4,102</td>
</tr>
<tr>
<td>Total credit to residents</td>
<td>15,351</td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.

<sup>(1)</sup> NFCs include sole proprietors and non-profit institutions serving households (NPISH).
By contrast, credit to residents outside general government rose by 3.6% in year-on-year terms, below the 4.9% increase registered three months earlier.

The slower rate of growth in credit to residents outside general government was primarily driven by loans, although a larger contraction in holdings of securities also contributed.

Data by sector show that the weaker growth in loans was driven by households, as the annual rate of loans to NFCs was above that recorded in March.

Loans to households grew by 6.4% on an annual basis, following an 8.7% increase in March. Mortgage lending eased to 7.3%, from 9.3% three months earlier, while consumer credit and other lending contracted by 1.6% over the same period, following an increase of 3.4% in the year-end to March (see Chart 6.4).

Annual growth in loans to NFCs stood at 4.3% in June, from 3.0% in March. A sectoral breakdown shows that the faster rate of expansion mainly reflected developments in loans to the transportation and storage sector as well as the trade sector. Loans to the accommodation and food services sector also rose at a slightly faster pace. By contrast, loans to the construction and real estate sector grew at a slower pace, while loans to the manufacturing sector contracted at a marginally stronger pace (see Chart 6.5).
Financial accounts data show that the share of bank lending in total NFC debt eased marginally, going to 20.6% in June, from 20.7% a year earlier (see Chart 6.6). This suggests that NFCs reduced slightly their reliance on bank loans in favour of alternative sources, mainly loans from the rest of the world and, to a lesser extent, intra-sectoral lending.\(^2\) The relative stability in this share and the fact that the level of loans to NFCs continued to increase in absolute terms, show that the liquidity support measures introduced since the outbreak of the pandemic helped preserve the flow of credit to the corporate sector. The share of intra-sectoral lending in total NFC debt edged down to 45.5% from 45.7% in the second quarter of 2019. Meanwhile, the share of loans from non-residents reached 15.1% from 14.3% a year earlier.

MSE data show that as at June 2020, €1.5 billion in corporate debt was listed on the Exchange, 8.4% higher than the outstanding stock 12 months earlier but almost 3.0% less than the recent peak recorded at the end of 2019 (see Chart 6.7).\(^3,4\) The amount of equity listed on the MSE increased by 1.8% over this period.

**Interest rate spread between deposit and lending rate remains elevated**

In June, the weighted average deposit rate offered to households and NFCs in Malta was down by six basis points on a year earlier, standing at 0.25% (see Table 6.3).\(^5\) This was mainly driven by a further decrease in rates on longer term deposits, for both households and NFCs.

---


\(^3\) Additionally, a number of companies obtained capital from the MSE platform, Prospects, which is mainly geared towards small and medium-sized enterprises (SME).

\(^4\) MSE data may differ from financial accounts data due to differences in valuation methodology and coverage. In particular, financial accounts data are at market value and include both listed and privately-placed securities.

\(^5\) Basis points are rounded to the nearest whole number and hence may not exactly match the figures given in Table 6.3.
Meanwhile, the weighted average lending rate paid to resident MFIs by households and NFCs also fell by six basis points, to 3.43%. This decrease was reflected in rates paid by both households and NFCs, although the weighted average lending rate paid by NFCs remained above that charged to households, reflecting different assessments of credit risk in these two institutional sectors.

The spread between the weighted average lending rate and the deposit rate closed the quarter under review at 318 basis points, unchanged from 12 months earlier. The elevated level of the spread suggests that the transmission of the ECB’s monetary policy easing measures to retail lending rates remained weaker than that to deposit rates.

**Liquidity support measures related to COVID-19**

In response to the COVID-19 pandemic and subsequent containment measures, the Central Bank of Malta issued Directive No. 18 to regulate the temporary suspension of debt repayments on credit facilities advanced by credit institutions to borrowers prior to 14 April 2020. A number of businesses and households that were faced with liquidity challenges applied with MFIs in Malta for a moratorium on loan repayments (see Table 6.4).  

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### Table 6.3

**INTEREST RATES ON DEPOSITS AND LOANS**

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total deposits (1)</strong></td>
<td>0.42</td>
<td>0.36</td>
<td>0.32</td>
<td>0.31</td>
<td>0.30</td>
<td>0.27</td>
<td>0.25</td>
</tr>
<tr>
<td><strong>Overnight deposits</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>0.07</td>
<td>0.07</td>
<td>0.05</td>
<td>0.05</td>
<td>0.05</td>
<td>0.03</td>
<td>0.03</td>
</tr>
<tr>
<td>NFCs</td>
<td>0.02</td>
<td>0.05</td>
<td>0.03</td>
<td>0.03</td>
<td>0.03</td>
<td>0.02</td>
<td>0.02</td>
</tr>
<tr>
<td><strong>Time deposits (less than 2 years)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>0.79</td>
<td>0.76</td>
<td>0.76</td>
<td>0.75</td>
<td>0.71</td>
<td>0.71</td>
<td>0.67</td>
</tr>
<tr>
<td>NFCs</td>
<td>0.60</td>
<td>0.63</td>
<td>0.62</td>
<td>0.73</td>
<td>0.72</td>
<td>0.70</td>
<td>0.73</td>
</tr>
<tr>
<td><strong>Time deposits (more than 2 years)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>2.45</td>
<td>2.24</td>
<td>2.03</td>
<td>1.98</td>
<td>1.97</td>
<td>1.95</td>
<td>1.92</td>
</tr>
<tr>
<td>NFCs</td>
<td>1.89</td>
<td>2.11</td>
<td>1.55</td>
<td>1.53</td>
<td>1.53</td>
<td>1.37</td>
<td>1.47</td>
</tr>
<tr>
<td><strong>Total loans (1)</strong></td>
<td>3.66</td>
<td>3.61</td>
<td>3.50</td>
<td>3.48</td>
<td>3.46</td>
<td>3.44</td>
<td>3.43</td>
</tr>
<tr>
<td><strong>Households and NPISH</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>3.52</td>
<td>3.44</td>
<td>3.35</td>
<td>3.32</td>
<td>3.29</td>
<td>3.26</td>
<td>3.26</td>
</tr>
<tr>
<td>NFCs</td>
<td>3.87</td>
<td>3.89</td>
<td>3.75</td>
<td>3.74</td>
<td>3.76</td>
<td>3.75</td>
<td>3.73</td>
</tr>
<tr>
<td><strong>Spread (2)</strong></td>
<td>3.24</td>
<td>3.25</td>
<td>3.18</td>
<td>3.17</td>
<td>3.16</td>
<td>3.17</td>
<td>3.18</td>
</tr>
<tr>
<td>ECB MROs rate</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.

(1) Annualised agreed rates on outstanding euro-denominated amounts belonging to households (incl. NPISH) and NFCs.

(2) Difference between composite lending rate and composite deposit rate.
As at end June, there were 9,492 loans subject to a moratorium on loan repayments. These amounted to around €1.8 billion, or 15.7% of total loans outstanding to Maltese residents. The outstanding amount of loans that were subject to a moratorium on repayments rose significantly compared to March, when there were 2,726 loans benefiting from these moratoria, amounting to €489.0 million of loans. At that time, the share of loans covered by moratoria in total outstanding loans was also lower, standing at 4.4%.

The largest number of loans covered by moratoria was held by households, with the sector accounting for 75.6% of the total volume of loans subject to a moratorium as at end of month. Maltese households held €622.2 million of such loans, equivalent to 35.2% of all of loans subject to a moratorium and to 10.1% of outstanding household loans.

Meanwhile, the real estate sector held €307.0 million in loans subject to a moratorium, or 17.4% of such loans – equivalent to a third of this sector’s outstanding loans. This was followed by the accommodation and food services activities, which held €228.7 million in loans subject to a moratorium. The latter was the sector most affected by the containment measures introduced in response to COVID-19. The share of loans held by this sector that were subject to a moratorium rose from around a quarter of the sector’s outstanding loans as at end March, to more than half as at end June. Moreover, as at end June, the wholesale and retail trade sector held €92.0 million in loans subject to a moratorium, making up 5.2% of such loans subject to a moratorium, or 13.7% of loans held by the sector. In March, loans subject to a moratorium made up only 4.4% of total loans held by this sector.

In order to further alleviate liquidity shortfalls as a result of the pandemic, the Government launched the MDB’s CGS. This scheme provides guarantees to commercial banks with the aim
of enhancing access to new working capital loans for businesses. It enables credit institutions to leverage government guarantees up to a total portfolio volume of €777.8 million.\(^9\)

By end June 2020, 255 facilities were approved under the CGS, covering total sanctioned lending of €161.1 million (see Table 6.5). As the scheme provides loans for working capital, the amounts actually disbursed may fall short of those sanctioned. In fact, only €64.9 million were disbursed by the end of the second quarter.

In terms of the number of facilities, the sector comprising wholesale and retail activities applied for the largest number of facilities. By end June, 73 facilities were approved for this sector with a total value of sanctioned loans at €36.5 million.\(^10\) This was followed by accommodation and food services activities, with 61 facilities and a sanctioned amount of €40.4 million. The manufacturing sector, the sector comprising professional, scientific and technical activities, the administrative and support services sector, as well as the sector covering transport, storage and ICT, also had a significant number of facilities approved. By contrast, the number of approved facilities in construction and real estate was low.

**Bank Lending Survey (BLS) indicates increasing or stable demand for credit**

Results from the BLS, conducted in July 2020, show that all respondent banks except one reported unchanged credit standards and terms and conditions on loans to enterprises during the second quarter of 2020. Most participating banks also reported that credit standards on these loans were expected to remain unchanged in the third quarter of 2020. As regards the demand for credit by NFCs, banks generally considered demand to have increased somewhat, with one

\[\text{Table 6.5}\
\text{MDB COVID-19 GUARANTEE SCHEME – AS AT JUNE 2020}\
\text{(Number of facilities; EUR millions)}\
\begin{tabular}{l|rr}
\hline
\textbf{Total number of} & \textbf{Sanctioned} \\
\textbf{facilities}\(^1\) & \textbf{Amount}\(^2\) \\
\hline
Manufacturing & 22 & 11.1 \\
Construction & 7 & 20.0 \\
Wholesale and retail trade; repair of motor vehicles and motor cycles & 73 & 36.5 \\
Transportation and storage and information and communication & 18 & 25.7 \\
Accommodation and food service activities & 61 & 40.4 \\
Professional, scientific and technical activities & 18 & 2.8 \\
Administrative and support service activities & 19 & 5.1 \\
Real estate activities & 9 & 1.3 \\
Other\(^3\) & 28 & 18.1 \\
\hline
\textbf{Total} & \textbf{255} & \textbf{161.1} \\
\hline
\end{tabular}
\]

Source:MDB.

\(^1\) The number of facilities taken by various sectors.

\(^2\) The total number of loans sanctioned under the scheme as at end month, in EUR millions.

\(^3\) Includes loans to education, health and social work, financial and insurance activities, professional, scientific and technical activities, administrative and support service activities, arts, entertainment and recreation, other services activities and extra-territorial bodies & organisations, and the electricity, gas & water supply sector.

\(^9\) The MDB CGS was approved by the European Commission on 2 April 2020. See [here](https://example.com) for further details.

\(^10\) As at end August, 412 facilities were approved under the CGS, covering total sanctioned lending of €285.1 million.
bank reporting stable demand. Looking forward, all four banks expected no change in demand, save for one bank which anticipated an increase.

As regards credit for house purchases, credit standards and terms and conditions for the second quarter were assessed to have remained unchanged for the majority of respondent banks. One bank, however, reported some tightening in credit standards. While the majority of banks expected no changes in credit standards in the third quarter, one bank expected these to ease somewhat. The majority of participating banks reported a decline in the demand for house loans in the second quarter, in some cases by a significant margin. However, one bank reported that demand had not changed. Expectations for the third quarter were mixed. Two of the participating banks expected demand to remain unchanged while another two foresaw an increase in demand.

Half of the surveyed banks reported unchanged credit standards and terms and conditions for consumer credit and other lending in the second quarter of 2020. One bank, however, reported some easing, while another reported a considerable tightening. One surveyed bank also reported some easing in terms and conditions. Looking forward to the third quarter of 2020, while half of the banks anticipated no changes in credit standards, the rest expected these to ease somewhat. The assessment of demand for consumer credit was mixed: one bank claimed a stable demand for credit and other lending in the second quarter; while another two felt that demand had decreased considerably. Another bank saw a slight increase. For the third quarter, three banks saw no change in demand, while another bank expected demand to somewhat increase.

The July BLS posed ad hoc questions on banks’ access to wholesale and retail funding and on their risk transfer capability as a result of the prevailing situation in financial markets. In this regard, the majority of respondent banks generally reported unchanged market access to retail funding. One bank, however, reported some improvement in its access to retail deposits. Looking forward, all four banks expected no change.

Half of the participating banks claimed that access to the interbank unsecured money market was unchanged or not relevant for their bank. The other half said that access to the short-term money market had tightened, although one of these banks only reported a tightening at the short-end of the market, and said that access had eased somewhat in the case of very-short term interbank unsecured funding. The majority expected no change in access to the interbank unsecured money market in the third quarter. Furthermore, all four banks reported that access to debt securities was not relevant for their business, as was their ability to transfer credit risk off the balance sheet.

Participating banks claimed that their non-performing loan (NPL) ratio had not affected their lending policies in the previous 6-month period and no impact was expected in the six months ahead.

Finally, respondent banks were asked to state how their credit standards, terms and conditions on new loans, and demand for loans changed across the main sectors of economic activity – namely manufacturing, construction, services, wholesale and retail trade, and real estate – have changed. All banks reported no change in credit standards in the past six months and were foreseeing no changes in the next six months for all the five sectors. With regards to terms and conditions, one bank claimed that these have eased somewhat for all sectors in the past six months, while another bank expected some easing in the following six months in manufacturing, services and wholesale and retail. One bank reported unchanged demand for loans across all sectors, another bank saw higher demand for loans coming from the construction and real estate sectors.
and another bank said that demand from the manufacturing sector increased but the services sector requested considerably fewer loans. The remaining bank stated that demand for loans was lower only in the construction sector. Looking into the next six months, half of the banks expected no changes, while one bank anticipated higher demand for loans from the construction and real estate sectors and another bank expected an increase in demand from the manufacturing, services, and wholesale and retail trade sectors.

The money market

**Domestic money market interest rates fall**

During the second quarter of 2020, the ECB kept the interest rate on MROs and the interest rates on the marginal lending facility and the deposit facility unchanged at 0.00%, 0.25% and -0.50% respectively. In the euro area money markets, the three-month EURIBOR rose to -0.38% at the end of June from -0.42% at the end of March. Secondary market yields on 3-month German government securities, which act as a benchmark for euro area yields, rose to -0.58%, from -0.67% (see Chart 6.8).

In the domestic primary market, the yield on 3-month Treasury bills fell to -0.44% from -0.40% at the end of March. In the secondary market, the 3-month yield rose from -0.39% to -0.05% during the same period.

As the yield on the euro area benchmark rose less sharply, the spread between the yield on domestic 3-month Treasury bills and the former widened. It stood at 53 basis points at the end of June, up from 28 basis points at end-March.

During the second quarter of 2020, the Government issued €762.0 million in Treasury bills, more than double the amount of €359.0 million issued between January and March.

The capital market

In the second quarter of the year, the Government issued five new MGS with a total value of €600.0 million. However, no public limited companies announced new bond issues.

By the end of June, 22 firms had bonds that were listed on the MSE through Prospects, an unchanged number from that at the end of March. In the secondary market, government bonds turnover fell to €30.3 million, from €51.2 million during the first quarter of 2020, and turnover in corporate bonds was down to €23.1 million from €32.5 million in the previous quarter.
Secondary market yields on Maltese government bonds rose (see Chart 6.9). The yield on 5-year bonds increased to 0.30% at the end of June from -0.02% at the end of March. Similarly, the yield on 10-year bonds rose to 0.73% at end-June from 0.47% three months earlier. In contrast, euro area yields on 5-year bonds fell by six basis points to -0.70% while the yield on 10-year bonds was unchanged at -0.46%. As the euro area benchmark yield was stable while the domestic 10-year yield rose, the spread against the former widened to 119 basis points, from 93 basis points in the first quarter of the year.

**MSE share index ends June at a higher level compared with end-March**

After falling sharply in the first quarter of 2020, share prices in Malta regained some of their losses during the second quarter. At end-June, the index stood 6.8% above its level at end-March (see Chart 6.10). Nonetheless, the index was still 15.8% lower than the level prevailing a year earlier. The MSE Equity Total Return Index, which accounts for changes in equity prices and dividends, rose by 7.6% between March and June.

Equity turnover edged down to €12.6 million during the second quarter, from €25.3 million in the first quarter.
**BOX 3: ATM CASH WITHDRAWALS IN MALTA – 2019**

**Introduction**
Cash services in Malta are available across the island through an extensive network of bank branches as well as Automated Teller Machines (ATMs) which serve well the local population. ATMs are offered by five main local credit institutions, namely Bank of Valletta plc, HSBC Bank Malta plc, APS Bank Ltd, BNF (Malta) plc and Lombard Bank Malta plc. Additionally, a foreign-licensed financial institution – Euronet – also provides its ATM services in Malta through the exercise of passporting rights. As a result, it is not difficult to find an ATM in the densely-populated country, since these are located strategically near bank branches, shopping centres, food outlets and touristic areas. There were 405 ATM terminals in Malta as at December 2019, although the number rises to 434 at certain times of the year. This results in an average of 1.28 ATM terminals per square kilometre, which tend to be concentrated in specific areas of the island. Furthermore, according to IMF data published for 2019, the number of ATMs per 100,000 adults stood at 49.0 in 2019, which is below the euro area average of 65.1. However, these data only cover ATMs operated by local institutions and do not include ATMs operated by foreign providers. In Malta’s case, the inclusion of ATMs operated by Euronet increases the ratio to 96.0. Although ATMs in Malta offer a variety of services, these are mainly used for the withdrawal of cash, with the maximum withdrawal limit set by the issuing institution currently ranging between €500 and €1,000 on a daily basis.

**Number of ATMs**
The number of ATMs in operation at the end of 2019 reached 405, a slight increase of nine terminals over 2018 (see Chart 1). According to data reported by financial intermediaries in Malta, Euronet had the highest number of ATMs, followed by Bank of Valletta and HSBC Malta.

Although there were 405 ATM terminals as at end 2019, the maximum number of those active at any

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1 This box was prepared by Charles Saliba, Manager Regulation and Oversight Office and Victoria Briffa, Officer II in the same office. The views expressed in this box represent those of the authors and should not be interpreted to reflect those of the Bank.

Any remaining errors are the authors’ own.

2 The term institutions refers to credit, payment and electronic money institutions.

3 Euronet commenced its operations in Malta in 2017 and its ATM data is included as from that year.

4 Limits were raised to these levels following the spread of COVID-19, to discourage over-the-counter withdrawals.

5 Other ATM services include mobile phone top-up, checking account balance, cash and/or cheque deposits, fund transfers between own accounts or to third parties, and statement requests.
point during the year rises to 434 terminals. This reflects the fact that a few ATMs are operated on a seasonal basis (for example, during summer only) while some were installed temporarily at events and other sites where, for a variety of reasons, the ATM was not present for the whole year.

Data on the distribution of ATMs by locality show that 44% of all ATM terminals are located in the northern harbour area, with Euronet having the strongest presence in this region, mostly in Sliema, Paceville and St Julian’s. The northern area of the island boasts 23% of the total number of ATM terminals located in Malta, with Euronet again accounting for most of these terminals. The majority of these are strategically installed in touristic areas such as Qawra, Buġibba and Mellieha – close to hotels, restaurants and shops. A further 13% of the overall number of ATM terminals are located in the southern harbour area, with Bank of Valletta having the strongest presence in this region. These are dispersed in various parts of this region, with the majority installed in the capital city Valletta. The south eastern and western regions each account for 7% of all ATMs.

In 2019, there were 25 ATM terminals located in Gozo and Comino. This represents 6% of the total number of ATMs, with the majority found at Rabat (Gozo). Euronet also has the largest share of the ATM terminals in Gozo.

Although having a greater number of ATMs increases the accessibility to customers, both local and foreign, to withdraw cash, it may encourage them to use more cash for their daily purchases rather than availing themselves of point-of-sales (POS) terminals.

**ATM cash withdrawals analysis (volume and value)**

Traditionally, ATMs are considered to be an electronic banking outlet allowing basic transactions without the need for bank employee input. However, in Malta, ATMs have always been considered primarily as a source for cash withdrawals. Table 1 shows the volume and value of ATM cash withdrawals at resident terminals, including Euronet, with Maltese-issued cards and foreign-issued cards between 2010 and 2019. There is an evident increasing trend in the number of ATMs as well as the use of such terminals for cash withdrawal over the last 10 years. Indeed, the number of ATMs more than doubled over a decade. Such data show that there was an increase in recourse to ATM cash withdrawals.

The available data distinguish between cash withdrawals using Maltese issued cards and those using foreign issued cards.

Table 1 shows that the number of withdrawals using Maltese cards remains larger than those with foreign cards, reflecting demographic conditions. However, the share of withdrawals with foreign cards out of all ATM withdrawals has increased over time. While in 2010, foreign cards accounted for 8.6% of all ATM withdrawals, in 2019 their share stood at 18.3%. A similar pattern is observed when looking at transaction values. These trends reflect the buoyant tourism industry during this period and the rapid growth of foreign workers in Malta.
### Table 1
**CASH WITHDRAWALS AT MALTESE ATM TERMINALS**

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of ATMs</th>
<th>Maltese Cards</th>
<th>Foreign Cards</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>No. of ATMs</td>
<td>Volume</td>
<td>Value</td>
</tr>
<tr>
<td>2010</td>
<td>185</td>
<td>10.8</td>
<td>1,188.4</td>
</tr>
<tr>
<td>2011</td>
<td>195</td>
<td>10.9</td>
<td>1,080.4</td>
</tr>
<tr>
<td>2012</td>
<td>216</td>
<td>11.8</td>
<td>1,321.2</td>
</tr>
<tr>
<td>2013</td>
<td>216</td>
<td>11.8</td>
<td>1,379.4</td>
</tr>
<tr>
<td>2014</td>
<td>207</td>
<td>12.4</td>
<td>1,452.4</td>
</tr>
<tr>
<td>2015</td>
<td>213</td>
<td>12.8</td>
<td>1,550.4</td>
</tr>
<tr>
<td>2016</td>
<td>215</td>
<td>12.5</td>
<td>1,566.5</td>
</tr>
<tr>
<td>2017</td>
<td>345</td>
<td>13.5</td>
<td>1,751.3</td>
</tr>
<tr>
<td>2018</td>
<td>396</td>
<td>14.0</td>
<td>1,941.1</td>
</tr>
<tr>
<td>2019</td>
<td>405</td>
<td>13.2</td>
<td>1,919.6</td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.

**ATM cash withdrawals at Maltese terminals with Maltese cards**

When analysing the years 2010-2019, both the volume and value of ATM cash withdrawals with Maltese cards followed a steady upward pattern. However, the volume of cash withdrawals decreased by 5.5%, from 14.0 million in 2018 to 13.2 million in 2019, whilst the value fell by €21.5 million from the previous year, or 1.1% (see Chart 2). In 2019, the value of ATM withdrawals with Maltese cards as a percentage of private consumption of Maltese households locally stood at 33.2%, compared to 28.1% in 2010 (see Chart 3). However, the increase in withdrawals of cash from ATMs is likely to have displaced withdrawals over the counter for payment transactions purposes.

**ATM cash withdrawals at Maltese terminals with foreign cards**

During the period 2010-2019, an upward pattern was also seen in

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6 Maltese cards refer to those cards which are issued by locally-licensed institutions.

7 Foreign cards refer to those cards issued by foreign-licensed institutions.
the volume and value of transactions at Maltese terminals with foreign cards. In 2019, there were 3.0 million, up from 2.7 million a year earlier (see Chart 4). This pattern is also visible in values, with an increase of €5.3 million or 1.3% in 2019. It is also worth noting that there was a sharp increase in cash withdrawals carried out by foreign cards, both in terms of volume and value. The value of ATM cash withdrawals with foreign cards as a share of expenditure by non-residents in Malta increased from 18.9% in 2010 to 23.7% in 2019. This suggests a higher incidence of expenditure that is settled by means of cash sourced from ATMs (see Chart 3).

**Average value per ATM cash withdrawal**

The average value per ATM cash withdrawal – carried out by both resident and foreign cards – increased by €7 per transaction, from €139 per transaction registered in 2018 to €146 per transaction in 2019 (see Chart 5). This is the highest recorded along the years under review. The evolution of the average value of withdrawals by Maltese cards, however, differs from that by foreign cards. While the former shows a steady upward trend, the
average value of withdrawals with foreign cards does not show a clear pattern. In the latter case, the average value stood at €152 in 2010, while those for 2018 and 2019 stood at €146 and €136, respectively.

**Conclusion**

The analysis presented in this box shows that the number of ATM terminals in Malta increased markedly after 2017, when Euronet began to offer its services on the island. The volume and value of ATM withdrawals using Maltese cards also followed an upward trend since 2010, though the data suggest that this trend was interrupted in 2019. Notwithstanding the increase in the value of ATM withdrawals with Maltese cards in recent years, their share in the consumption of Maltese households has risen only moderately over this period. This increase in ATM withdrawals may reflect the reduced reliance on over-the-counter cash withdrawals amid increased availability and usage of cards. Indeed, it is estimated that around one half of the value of consumption by Maltese households in 2019 was transacted by means of Maltese cards at POS or by means of online transactions – a significant increase over around 30% estimated for 2015.

The shift from cash transactions to online card payments was amplified by the COVID-19 pandemic in 2020 as well as the increased take up of contactless cards. Although there is a trend towards more card usage by the public, there is evidently scope for increased use of electronic means of payments.
This article looks at developments in the transportation and storage sector, which includes land transport, water transport, air transport, warehousing and support activities for land, water and air transportation as well as postal and courier activities, by using various measures of activity. The article also looks into developments in the sentiment indicator published by the European Commission for the warehousing and land transport sub-sectors, which are the key contributors to GVA and employment in the sector as a whole.

Business structure
Business demographics data published by the National Statistics Office (NSO) show that the number of business units registered within the transportation and storage sector (NACE division H) in 2019 stood at 5,977 – equivalent to 4.8% of total registered business units in Malta. Almost half of these business units (around 2,800) were classified under the sub-sector of land transport and transport via pipelines (H49), which includes taxi and chauffeur services (see Chart 1). This is also the fastest-growing sector since 2012. The sub-sectors of warehousing and support activities for transportation (H52) and water transport (H50) accounted for around 27.0% and 23.0% of all units within the transportation and storage sector. Less than 3.0% of registered units in NACE Section H were classified either within air transport (H51) or within the sub-sector comprising postal and courier activities (H53), although both NACE categories include a number of entities that render important public services and are important for employment.

In 2019, the transportation and storage sector overall...
experienced a 13.0% increase in the number of registered business units, compared to a 5.8% increase in the whole economy. Nevertheless, the land transportation sub-sector accounted for around 73.0% of the overall increase in the transportation and storage sector. Although increases were also recorded in each of the other sub-sectors within NACE division H, these were mostly concentrated in NACE sectors 50 and 52.

Data on the number of births and deaths within the transportation and storage sector show that the number of newly-registered businesses exceeded the number of deregistered businesses in most years, especially in 2018 and 2019. In 2019, there were 862 new units in this sector – mainly due to a surge in new units in land transport – while 303 units were deregistered, giving a net increase of 559 units (see Chart 2).

In 2019, 53.4% of all entities in transportation and storage operated as sole proprietors or were in a partnership agreement, whereas 45.5% were limited liability companies or public limited companies (see Chart 3a). A further 1% of units operated under a different legal structure, such as corporation, cooperative or joint venture.

These averages mask significant heterogeneity across sub-sectors, with limited liability companies or public limited companies being a more...
dominant model among firms providing water transport services or warehousing services. In contrast, sole proprietorships and partnership agreements prevail in land transport.

This contrasts with the situation in 2015, when just under 58.0% of all units in NACE Division H operated as limited liability companies or public limited companies (see Chart 3b). This partly reflects the fact that the aforementioned surge in the number of entities registered in the sub-sector of land transport in the last two years mostly reflected an increase in sole traders or partnerships. This organisational setup also increased in the sectors of air transport and postal and courier services.

A large majority (97.4%) of enterprises within the transportation and storage sector are classified as microenterprises with fewer than ten employees. The large share of micro enterprises is not only a feature of the transportation and storage sector overall, but also characterises its sub-sectors (see Chart 4a). A further 2.2% were classified as small enterprises in 2019, with only 0.45% classified as medium or large enterprises. The vast majority of medium and large enterprises registered in the sector in turn operate in the land transport sub-sector and in warehousing and related activities.

Microenterprises generated around a quarter of employment in the transportation and storage sector, with small enterprises accounting for a further 17.8% of jobs. This implies that a relatively small number of firms generated the remaining 56.8% of jobs in the sector. As is the case with the legal structure, the distribution of employment by firm size also exhibits significant variation across sub-sectors. For example, microfirms account for a very small share of employment among firms providing air transport and postal and courier services (see Chart 4b). On the other hand, in the subsector comprising land transport, microfirms generate almost 43.0% of employment.

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According to the NSO News Release 072/2020 on registered business units, microenterprises are ones which employ up to nine employees. Small enterprises employ between ten and 49 employees, while medium enterprises engage between 50 and 249 employees. Units employing 250 or more employees are considered as large businesses.

In Charts 4a and 4b, data for small firms have been merged with data for medium and large enterprises to preserve the confidentiality of data for some of the sub-sectors assessed in this article.
employment, with medium and large firms accounting for only 40.4% of jobs in this sub-sector. On balance, the land and water sub-sectors show a greater dependence on microfirms than the other sub-sectors.

Activity indicators
According to national accounts data, nominal GVA in the transportation and storage sector in 2019 amounted to approximately €688.7 million – which is more than double that recorded in 2010, when the sector’s GVA stood at €342.3 million – and more than triple the amount recorded in 1995 (€216.6 million). Growth has picked up significantly since 2012 (see Chart 5). This increase was mostly driven by the expansion of warehousing and support services and, to a lesser extent, by the expansion of air transport services. Notwithstanding the rapid expansion in recent years, the sector’s share in the economy has diminished over time. In 2019, the transportation and storage sector accounted for 5.8% of the GVA of the whole economy, lower than the 6.9% recorded in 2007 and the 7.9% registered in 1995.

Disaggregated national accounts data show that the sub-sector comprising warehousing and support activities is the largest in terms of GVA, accounting for more than half of the sector’s GVA. Firms operating in the sub-sectors of air transport and land transport also play a significant role, whereas water transport and postal and courier services are relatively small.

Taking a longer-term perspective, warehousing and support activities and, to a lesser extent, water transport and postal and courier activities assumed greater importance over time. By contrast, the share of land transport almost halved over this period.

Despite its modest share in the overall economy GVA, the transportation and storage sector has important linkages with other sectors of the economy as can be seen from the latest input-output tables, which refer to 2010 (see Table 1). To generate output worth €981 million, the transportation and storage sector imported intermediate inputs of €220 million, but utilised €399 million in domestic production, suggesting that around 60% of its inputs were sourced locally. The latter consisted mainly of services, particularly those services related to transport itself and also financial and insurance services. In 2010, services accounted for almost 90% of domestically-sourced inputs. The construction sector supplied €19 million (4.9%), with a further €17 million of domestic inputs (4.2%) sourced from the quarrying and utility sectors. A further €14 million (representing 3.5% of locally-sourced inputs) were supplied by the manufacturing sector. The import content of the transportation and storage sector was 35% of intermediate consumption in 2010.

Table 2 shows that over 53% of the output generated by the transportation and storage sector was used as final demand. Almost 80% of this was in the form of exports, with final consumption...
accounting for most of the remaining part and a very small element of gross capital formation. However, in 2010, 47% of the transportation and storage output was utilised as intermediate demand in the economy, the largest share of which went to the transportation and storage sector itself.

### Table 1
**INTERMEDIATE CONSUMPTION FOR THE TRANSPORTATION AND STORAGE SECTOR (H49-H53), 2010**

<table>
<thead>
<tr>
<th>EUR millions</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output at basic prices</td>
<td>981</td>
</tr>
<tr>
<td>Total Intermediate Consumption</td>
<td>634</td>
</tr>
<tr>
<td>of which: Domestic Production</td>
<td>399</td>
</tr>
<tr>
<td>Agriculture, forestry and fishing</td>
<td>0.3</td>
</tr>
<tr>
<td>Mining and quarrying; utilities</td>
<td>17</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>14</td>
</tr>
<tr>
<td>Construction</td>
<td>19</td>
</tr>
<tr>
<td>Services</td>
<td>349</td>
</tr>
<tr>
<td>some of which: Wholesale and retail trade; repair of motor vehicles</td>
<td>14</td>
</tr>
<tr>
<td>Transportation and Storage</td>
<td>214</td>
</tr>
<tr>
<td>Financial and insurance activities</td>
<td>58</td>
</tr>
<tr>
<td>Professional services</td>
<td>14</td>
</tr>
<tr>
<td>Imported Products</td>
<td>220</td>
</tr>
<tr>
<td>Taxes less subsidies on products</td>
<td>15</td>
</tr>
<tr>
<td>GVA at basic prices</td>
<td>346</td>
</tr>
</tbody>
</table>

Source: NSO.

### Table 2
**OUTPUT IN THE TRANSPORTATION AND STORAGE SECTOR (H49-H53), 2010**

<table>
<thead>
<tr>
<th>EUR millions</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intermediate demand</td>
<td>458</td>
</tr>
<tr>
<td>Final demand</td>
<td>523</td>
</tr>
<tr>
<td>of which: Final consumption</td>
<td>112</td>
</tr>
<tr>
<td>Gross capital formation</td>
<td>4</td>
</tr>
<tr>
<td>Exports</td>
<td>407</td>
</tr>
<tr>
<td>Output at basic prices</td>
<td>981</td>
</tr>
</tbody>
</table>

Source: NSO.
A study by the Central Bank of Malta, using the 2010 input-output framework, puts forward industry-specific accounting multipliers (see Table 3).\textsuperscript{7,8} The transportation and storage sector generated low output and income multipliers relative to other economic sectors. The accounting multipliers for this sector, though, exceeded those generated in the information and communication sector and real estate. The sector also had one of the lowest value added and employment multipliers. However, there are indications that the sector is evolving towards higher value added activities.

### Employment and wages in the transportation and storage sector

Administrative data show that in December 2019, there were 15,336 persons employed within the transportation and storage sector, 12,134 of which held full-time jobs and 3,202 held part-time jobs (see Chart 6). The sector accounted for 5.4% and 4.9% of full-time and part-time employment in the economy, respectively. While the sector’s share in full-time

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\textsuperscript{7} This study was published in Rapa, N. (2017), “Estimates of industry specific multipliers”, Quarterly Review 2017(2), pp. 19-23, Central Bank of Malta.

\textsuperscript{8} Firstly, the study derives Type I and Type II multipliers for the Maltese economy by solving the Leontief demand model. Type I multipliers capture the direct and indirect effects on output, income, value added and employment of an increase in final demand of a particular industry on all the sectors of the economy. The direct effect refers to the increase in output of the particular product following a rise in its final demand. The demand for intermediate inputs will increase for each sector to increase its supply, which in turn would lead to subsequent increased rounds of production of these intermediate inputs. This is referred to as the indirect effect. Type II multipliers capture the direct and indirect effects but also include induced effects which refer to the effect on household’s consumption due to a rise in output. Secondly, the study derives a set of accounting multipliers which go one step further than modelling multipliers since they account for the size of the sector generating the final demand.

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<table>
<thead>
<tr>
<th>Table 3</th>
<th>ACCOUNTING MULTIPLIERS FOR SPECIFIC SECTORS OF THE ECONOMY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Output</td>
</tr>
<tr>
<td>---------</td>
<td>--------</td>
</tr>
<tr>
<td>Transportation and storage</td>
<td>4.8</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>14.9</td>
</tr>
<tr>
<td>Wholesale and retail trade, repair of motor vehicles and motorcycles</td>
<td>6.0</td>
</tr>
<tr>
<td>Financial services, except insurance and pension funds</td>
<td>24.4</td>
</tr>
<tr>
<td>Arts, entertainment and recreation</td>
<td>10.4</td>
</tr>
<tr>
<td>Accommodation and food service activities</td>
<td>6.1</td>
</tr>
<tr>
<td>Real estate activities</td>
<td>2.6</td>
</tr>
<tr>
<td>Public administration and defence</td>
<td>4.2</td>
</tr>
<tr>
<td>Education</td>
<td>2.4</td>
</tr>
<tr>
<td>Information and communication</td>
<td>3.9</td>
</tr>
</tbody>
</table>

employment has generally diminished over time, its importance in terms of part-time jobs has increased in the last decade.

The sub-sectors comprising warehousing and land transport account for almost three fourths of full-time employment in the transportation and storage sector. The land transportation sector also has the highest concentration of part-time workers. The number of part-timers in the other sub-sectors is small by comparison (see Table 4).

From 2015 to 2019, part-time and full-time employment increased by approximately 31.3% and 25.5% respectively within the sector overall. The land transport sub-sector generated the majority of new full and part-time positions over this period – 1157 and 626 new positions, respectively. On balance, jobs increased in all other sub-sectors. However, the number of part-time job holders in postal and courier activities decreased since 2015.

The private sector accounts for the larger part of full-time employment overall in the sector (82%). This pattern can be observed for all the sub-sectors apart from the air-transport sub-sector where the majority of full-time employment is within the public sector.

Foreign workers
In line with other sectors in the economy, the transportation and storage sector has become increasingly reliant on foreign workers. In 2019, the number of foreigners employed within the sector more than quadrupled compared with 2014 levels (see Chart 7).

Jobplus data shows that by December 2019, the number of foreign workers in full-time and part-time jobs in the sector stood at 2,699, equivalent to almost 4% of all the foreigners employed in the economy. Slightly more than half (around 55.0%) of foreign workers employed in this sector

Table 4
FULL-TIME AND PART-TIME GAINFULLY OCCUPIED POPULATION

<table>
<thead>
<tr>
<th></th>
<th>Number of persons at the end of the year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Full-time</strong></td>
<td></td>
</tr>
<tr>
<td>Land transport</td>
<td>3,397</td>
</tr>
<tr>
<td>Water transport</td>
<td>442</td>
</tr>
<tr>
<td>Air transport</td>
<td>1,392</td>
</tr>
<tr>
<td>Warehousing and support activities</td>
<td>3,770</td>
</tr>
<tr>
<td>Postal and courier activities</td>
<td>665</td>
</tr>
<tr>
<td><strong>Transportation and storage</strong></td>
<td>9,666</td>
</tr>
<tr>
<td><strong>Part-time</strong></td>
<td></td>
</tr>
<tr>
<td>Land transport</td>
<td>1,394</td>
</tr>
<tr>
<td>Water transport</td>
<td>128</td>
</tr>
<tr>
<td>Air transport</td>
<td>334</td>
</tr>
<tr>
<td>Warehousing and support activities</td>
<td>359</td>
</tr>
<tr>
<td>Postal and courier activities</td>
<td>223</td>
</tr>
<tr>
<td><strong>Transportation and storage</strong></td>
<td>2,438</td>
</tr>
</tbody>
</table>

Source: NSO.
were hired by companies operating in the land transport sub-sector, which also accounted for almost three-fourths of all third country nationals (TCNs) within NACE Division H.

Around 58.0% of foreign workers within the transportation and storage sector were EU nationals, lower than the 75.6% in 2014. While the share of the EU nationals in total foreign employment was on an upward path through 2017 – when it reached 82.4% – this share decreased in 2018 and declined further in 2019, reflecting increased recourse to TCNs. In fact, the share of TCNs rose from slightly less than 25.0% in 2014 to 41.7% by the end of 2019, marginally below the share of TCNs in total foreign employment, which stood at around 46.0%.

A study by the Central Bank of Malta shows that there are sectoral heterogeneities concerning the exit rates of foreign workers. The exit rates for the transportation and storage sector within the first year of engagement stands at 21.5% (see Chart 8). This contrasts with the wholesale & retail sector which has the lowest exit rate at 17.5% within the first year and the accommodation sector – which has the highest exit rate at 32.3% for the shortest duration. However, for longer durations, the transportation and storage sector has the third highest exit rate compared with other sectors, with almost 70% of new foreign workers exiting after five years.

**Labour costs**

According to the Labour Cost Survey, labour cost per hour in the transportation and storage sector stood at €14.5 in 2019, below comparable costs in sectors such as financial and insurance activities, arts, entertainment and recreation, and professional, scientific and technical activities (see Chart 9). However, the transportation and storage sector had a higher labour cost per hour

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9 This study was published in Borg, I. (2019), “The Length of Stay of Foreign Workers in Malta”, Policy Note January 2019, Central Bank of Malta.
than manufacturing, wholesale and retail, construction as well as accommodation and food service activities.

Labour costs of firms operating within the transportation and storage sector locally were on the lower end of the spectrum for the euro area. In 2019, the average labour cost per hour in the euro area stood at €27.7 which was 91% higher than the labour cost in Malta (see Chart 10).

### Confidence indicator and factors limiting businesses

Given that the largest sub-sector in terms of GVA in the transportation and storage sector is warehousing and support activities for transportation, this section takes a closer look at sentiment in this sub-sector. Furthermore, since the sub-sector of land transport accounts for 38% of full-time employment in NACE Division H and it has the highest share of part-time workers, attention is also given to the confidence indicator in this sub-sector.10

The business confidence survey carried out by the European Commission shows that, since May 2007, when the first observation for Malta was recorded, confidence in the warehousing sub-sector was positive in most years and also exceeded the euro area average.11 Nevertheless, in light of the COVID-19 pandemic, the confidence indicator turned negative in March 2020 and only turned positive again in August. The decrease in sentiment in March and in the second quarter of the year pushed the average for the first eight months of the year below its long-term average. The index also stood slightly below the euro area average. All sub-components have supported the index in recent years. At the same time, all sub-components contributed to the negative sentiment in 2020, although the largest negative contribution came from firms’ assessment of past demand (see Chart 11).12 Additional survey information reveals that both employment and price

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10 Data is not available for the transportation and storage sector overall, hence the need to focus on particular sub-sectors.
11 A monthly qualitative survey is administered by the European Commission to get information about managers’ assessment of their recent business situation, of the past and future changes in their company’s demand and employment and of their expected selling prices. Further information about this survey is available on ‘The joint harmonised EU programme of business and consumer surveys – User Guide’, March 2016, European Commission.
12 The confidence indicator is the arithmetic average of the balances (in percentage points) of the answers to the questions on business climate and on recent and expected evolution of demand.
expectations became negative, on average, during the first eight months of 2020.

Confidence in the land transport sector was negative initially but turned positive in 2015 and peaked in 2017 (see Chart 12). Although confidence decreased slightly in 2018 and 2019, it remained high from a historic perspective and, in line with developments in the last few years, exceeded that in the euro area. Developments in 2020 broadly mirrored those in the warehousing sub-sector: the overall confidence indicator turned negative in the second quarter of 2020 due to a fall in all of the sub-components. However, the deterioration in the land transport sector was more significant than that in warehousing.

In 2019, the main limiting factors for firms active locally in the sub-sector of warehousing and supporting activities were labour shortages and shortages of equipment and space. In 2020, however, these factors were mentioned by very few firms. Labour shortages were gaining importance until 2019, but in 2020 these were only mentioned by 2.5% of respondents (see Chart 13a). This share was also below the 8.7% of the euro area (see Chart 13b).

Firms, however, highlighted insufficient demand and other factors as their main concerns. These were mentioned by 27.1% and 46.5% of respondents respectively, significantly higher than 10.8% and 9.9% of respondents in 2019. Locally,
financial constraints in the warehousing sub-sector were less of a limiting factor relative to the euro area before 2020. Nevertheless, in the first three quarters of 2020, the share of respondents citing financial constraints locally stood at 7.2%, roughly equating the euro area average.

In the first three quarters of 2020, the main factor limiting activity in firms that provide land transport services was insufficient demand. This was cited by 39.7% of respondents, significantly above the previous year’s 6.9% and close to the share of respondents that mentioned this factor in the euro area. Another limiting factor for this sub-sector relates to labour shortages, mentioned by 37.0% of respondents. Although this share was lower than in 2019, it was still one of the highest values recorded in recent years and well above the corresponding figure of around 20.3% in the euro area. This may reflect the increased demand for delivery services since the onset of COVID-19. The concern about labour shortages observed in both sub-sectors may also explain the surge in the number of foreign workers in past years, especially the greater recourse to TCNs. Furthermore, the share of respondents that mentioned financial constraints and other factors also rose significantly compared with 2019, though it remained within the range of values recorded in recent years. While the share of respondents citing financial concerns was close to that in the euro area, other factors were mentioned much less frequently by Maltese respondents (see Charts 14a and 14b).
Loans to the transportation and storage sector

Data shown in Chart 15 can provide some insight into the access to finance of the transportation and storage sector. Lending to both public and private entities within this sector has declined over recent years. This decline may represent the repayment of outstanding loans but it may also reflect the use of alternative sources of finance given that the survey administered by the European Commission showed that financial constraints were not a main limiting factor for Maltese firms until 2019. Data for July 2020, though, show that credit to this sector rose by 5.7% in annual terms, reflecting developments in private sector corporations.

Conclusion

The transportation and storage sector has grown considerably over the past few years, with the sub-sector of warehousing emerging as the largest sub-sector in terms of GVA. The increased activity has been reflected in employment growth in all sub-sectors in NACE Division H, although a significant proportion of new jobs created in recent years is attributable to firms offering land transport services.

Labour costs remain competitive when compared to other euro area countries. However, labour shortages have been a key factor hindering the land transport and warehousing sub-sector. This could explain the surge in foreign workers in recent years, particularly the sharp increase in TCNs in the sub-sector of land transport after 2017. COVID-19 appears to have reduced the importance of labour shortages in warehousing, but this remains a prevalent issue in land transport. The pandemic has also brought new challenges to the fore. While labour shortages and shortages of equipment appear to have diminished (though to varying extents across sub-sectors), insufficient demand and financial constraints have gained in importance this year. This may reflect the fact that several operators in this sector were hit directly by the containment measures introduced to fight the spread of the virus as well as the sector’s dependence on international trade and tourism.