The cut-off date for statistical information published in the Economic Survey of this Review is 24 June 2021. However, for residential property prices and labour market statistics the cut-off date is extended to 8 July and 14 July 2021 respectively, while for government finance statistics it is extended to 22 July 2021. Figures in tables may not add up due to rounding.
# CONTENTS

## FOREWORD

## ECONOMIC SURVEY

1. **The External Environment and the Euro Area**
   - Key advanced economies
   - The euro area
   - Commodities

2. **Output and Employment**
   - Potential output and BCI
   - GDP and industrial production
   - Box 1: Saving behaviour in Malta: Insights from the Household Budgetary Survey
   - Business and consumer surveys
   - The labour market
   - Box 2: Renewable electricity in Malta: A question of sources

3. **Prices, Costs and Competitiveness**
   - Inflation
   - Box 3: The inflation experience of low-income households
   - Residential property prices
   - Costs and competitiveness

4. **The Balance of Payments**
   - The current account
   - Tourism activity
   - The capital account

5. **Government Finance**
   - Quarterly developments
   - Headline and cyclically-adjusted developments

6. **Monetary and Financial Developments**
   - Monetary and financial conditions
   - Liquidity support measures related to COVID-19
   - The money market
   - The capital market
ABBREVIATIONS

APP asset purchase programme
BCI Business Conditions Index
BLS Bank Lending Survey
CBM Central Bank of Malta
COLA cost-of-living adjustment
CLBO cost-of-living bonus
COICOP Classification of Individual Consumption by Purpose
COVID-19 coronavirus disease 2019
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
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
GME Gestore del Mercato Elettrico
GVA gross value added
HBS Household Budgetary Survey
HCI harmonised competitiveness indicator
HFCS Household Finance and Consumption Survey
HICP Harmonised Index of Consumer Prices
LFS Labour Force Survey
LIH low income households
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
NEIG non-energy industrial goods
NFC non-financial corporation
NPISH non-profit institutions serving households
NSO National Statistics Office
PEPP pandemic emergency purchase programme
PPI Property Price Index
RPI Retail Price Index
TLTRO targeted long-term refinancing operation
ULC unit labour cost
UK United Kingdom
US United States
VAT value added tax
FOREWORD

During the first quarter of 2021, economic activity continued to be affected by the COVID-19 pandemic and the associated containment measures. Real gross domestic product (GDP) fell by 1.8% in annual terms, following a larger 7.8% fall in the fourth quarter of 2020. The economic contraction in the quarter under review was underpinned by a sharp fall in net exports, as the contribution of domestic demand was positive.

Potential output growth is estimated to have picked up during the first quarter of 2021, standing at 1.9%, from -0.3% in the previous quarter, mainly due to an improvement in the contribution of total factor productivity. When measured as a 4-quarter moving average, the output gap was estimated at -8.7%. The Central Bank of Malta's (Bank) estimate of the output gap was the lowest on record. The large degree of underutilisation of the economy's productive capacity mainly reflected the Bank's assessment that the temporary nature of containment measures relating to the COVID-19 pandemic had a stronger impact on the demand side than the supply side of the economy.

The Bank’s Business Conditions Index (BCI) indicates the start of a turnaround in macroeconomic variables but economic activity levels were still below pre-pandemic levels.

During the first quarter of 2021, the labour market continued to recover, as employment increased on a quarterly basis, while unemployment decreased. Employment and activity rates, however, remained below those recorded in the corresponding quarter of the previous year, reflecting the impact of COVID-19 measures.

Inflation as measured by the Harmonised Index of Consumer Prices (HICP), eased to 0.1% in March, from 0.2% three months earlier, as a result of slower growth in the prices of services and processed food. Inflation based on the Retail Price Index (RPI), which only takes into account purchases made by Maltese households, stood at 0.4% in March, up from 0.2% in December 2020. Meanwhile, annual inflation based on the industrial producer price index recovered from recent declines.

The annual rate of growth of Malta’s unit labour costs (ULC) moderated during the first quarter but remained elevated. The moderation in ULC growth was driven by a smaller decline in labour productivity, as growth in compensation per employee turned positive. Meanwhile, Malta’s harmonised competitiveness indicators (HCIs) pointed to a slight deterioration in international competitiveness over the year to March.

In the first quarter of 2021, the balance on the current account showed a deficit, from a surplus in the first quarter of 2020. This shift to a deficit was mostly due to a decline in net services receipts, although a larger deficit on merchandise trade also contributed. By contrast, net primary and secondary income outflows decreased. When measured over four quarters, the current account balance showed a deficit equivalent to 4.2% of GDP.

Public finances continued to be negatively impacted by the COVID-19 pandemic, with the general government balance deteriorating significantly. On a 4-quarter moving sum basis, the general government balance registered a deficit of 10.6% of GDP in the first quarter of 2021, following
a deficit of 10.2% of GDP in the preceding quarter. Meanwhile, the general government debt-to-GDP ratio rose to 59.0%, from 54.8% at end-December 2020.

During the quarter under review, Maltese residents’ deposits with monetary financial institutions (MFIs) in Malta expanded at a slower pace when compared with the previous quarter. The shift to overnight deposits continued in an environment of low interest rates and a continued preference for liquidity. Credit to Maltese residents grew at a faster pace, reflecting faster growth in credit to general government and, to lesser extent, in credit to residents outside general government. The latter largely reflected faster growth in loans to households. According to the Bank’s Financial Conditions Index (FCI), in the first quarter of 2021, financial conditions became loose from a historical perspective and were considerably more favourable than in the fourth quarter of 2020.

In March, the weighted average interest rate on deposits held by Maltese residents with domestic banks was 7 basis points lower than a year earlier. The weighted average lending rate paid to resident MFIs by households and non-financial corporations (NFCs) fell by 12 basis points over this same period. Thus, the spread between the two narrowed, although it remained wide.

Meanwhile, the primary market yield on Treasury bills rose marginally from that prevailing at the end of December 2020. The secondary market yield on 5-year Malta Government Stocks (MGS) was unchanged while that on 10-year MGS increased. Domestic share prices fell between December and March.

As at end-March, there were 1,206 loans subject to a moratorium on loan repayments either offered in terms of Central Bank of Malta Directive No. 18 or before this Directive, with a value of €421.4 million. This is lower than the level prevailing at the end of 2020, primarily reflecting the expiration of the moratorias period for some beneficiaries.

By end-March, 576 facilities were approved under the Malta Development Bank (MDB) COVID-19 Guarantee Scheme (CGS), covering total sanctioned lending of €439.6 million. As the scheme provides guarantees on loans for new working capital and loan repayment purposes, the amounts disbursed may fall short of those sanctioned. In fact, €340.5 million were disbursed by the end of the first quarter of 2021. Hence, by the end of the first quarter, 56.5% of the scheme’s target size was sanctioned, while 43.7% was disbursed.

All major central banks continued to make available liquidity support measures to support the smooth functioning of financial markets and the flow of credit to the economy. On its part, the Governing Council of the European Central Bank (ECB) reinforced its accommodative monetary policy stance in the first quarter of 2021. The interest rates on the main refinancing operations (MROs), on the marginal lending facility and on the deposit facility were held unchanged. 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.

In March, the Governing Council confirmed that the Eurosystem will continue to conduct net asset purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1,850.0 billion until at least the end of March 2022 and, in any case, until it judges that the
coronavirus crisis phase is over. However, during the second quarter of 2021, PEPP purchases were expected to be conducted at a significantly higher pace than during the first months of the year. As previously announced, reinvestments of the principal payments from maturing securities purchased under the PEPP were expected to continue until at least the end of 2023.

The Governing Council also confirmed earlier forward guidance on the asset purchase programme (APP).
1. THE EXTERNAL ENVIRONMENT AND THE EURO AREA

In the first quarter of 2021, real GDP grew at a faster pace in the United States, with the GDP level broadly returning to pre-pandemic levels. On the other hand, real GDP fell in the United Kingdom after having expanded in the previous two quarters, with activity remaining well below pre-pandemic levels. GDP in the euro area also fell compared with the last quarter of 2020, though at a slower pace. Meanwhile, the three-month average unemployment rate fell in all the three economies.

In March, annual consumer price inflation in the United States increased markedly to 2.6% from 1.4% in December, mainly reflecting developments in energy prices. In the euro area, prices also picked up, with HICP inflation standing at 1.3% in March, up from -0.3% in December. In the United Kingdom, inflation rose by only 0.1 percentage point to 0.7%. During the first quarter of 2021, the Federal Reserve, the Bank of England and the ECB all kept their key interest rates unchanged. All three central banks continued to make available liquidity support measures to support the smooth functioning of financial markets and the flow of credit to the economy.

The price of Brent crude oil rose during the first quarter, reflecting improving vaccination rates and global demand prospects as well as supply cuts in major oil producers. Thus, the price of Brent crude oil ended the quarter nearly a fourth higher than the level prevailing at end-2020. Non-energy commodity prices also rose during the quarter under review.

Key advanced economies

US economy expands at a faster pace

In the first quarter of 2021, real GDP in the United States increased by 1.6% in quarter-on-quarter terms, after having risen by 1.1% in the preceding quarter (see Table 1.1). Widespread vaccination coupled with fiscal and monetary stimulus supported economic activity. Personal consumption expenditure grew at a faster pace compared with the fourth quarter of 2020, while government expenditure recovered from the decline recorded in the previous quarter. On the other hand, gross private domestic investment contracted. The trade deficit widened in volume terms, as imports increased and exports fell.

In the labour market, the participation rate continued to decline. It averaged 61.4% in the first quarter of 2021, marginally below the 61.5% recorded in the preceding quarter and still well below the rate of 63.1% recorded in the first quarter of 2020.

<table>
<thead>
<tr>
<th>Table 1.1</th>
<th>REAL GDP GROWTH IN SELECTED ADVANCED ECONOMIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarter-on-quarter percentage changes; seasonally and working day adjusted</td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td>2020</td>
</tr>
<tr>
<td></td>
<td>Q1</td>
</tr>
<tr>
<td>United States</td>
<td>0.7</td>
</tr>
<tr>
<td>Euro area</td>
<td>0.4</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0.6</td>
</tr>
</tbody>
</table>

Sources: Bureau of Economic Analysis, US; Eurostat; Office for National Statistics, UK.
Employment continued to show signs of recovery, as it rose by 0.4% in quarter-on-quarter terms, while the annual rate of change was less negative compared with the fourth quarter. The number of job holders fell by 4.6% in annual terms, after having fallen by 5.5% in the fourth quarter of 2020.

Non-farm payroll data show that the number of persons in employment remained below year ago levels in all major sectors, with the largest gaps evident in the leisure and hospitality, and the mining and quarrying sectors. At the same time, the rate of job losses dissipated in the vast majority of sectors when compared to the last quarter of 2020, barring the construction and government sectors. The average unemployment rate eased further, falling to 6.2% from 6.7% in the preceding quarter, but was still well above the rate of 3.8% recorded a year earlier (see Chart 1.1).

The annual rate of change of the US consumer price index (CPI) rose to 2.6% in March, from 1.4% in December (see Chart 1.2). This reflected developments in energy inflation which stood at 13.2% in March, up from -7.0% in December. Food inflation edged down. The annual rate of change of prices of commodities excluding food and energy, and services was unchanged. Reflecting developments in services prices and commodities other than food and energy, inflation excluding food and energy remained stable at 1.6%.

During the first quarter of 2021, 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, thereby promoting its maximum employment and price stability goals. The target range for the federal funds rate was kept unchanged in a range between 0.00% and 0.25% (see Chart 1.3). The Committee said that it expects to maintain this target range until labour market conditions have reached levels consistent with its assessments of maximum...
employment, and inflation has risen to 2.0% and is on track to moderately exceed 2.0% for some time.

In addition, the Federal Reserve will continue to increase its holdings of Treasury securities by at least USD 80 billion per month and its holdings of agency mortgage-backed securities by at least USD 40 billion per month until substantial further progress has been made toward its policy goals. These asset purchases help foster smooth market functioning and accommodative financial conditions, thereby supporting the flow of credit to households and businesses.

During the quarter being reviewed, the Federal Reserve also extended its Paycheck Protection Program Liquidity Facility by three months, which supports the flow of credit to small businesses, until the end of June 2021. Usage of other facilities – the Commercial Paper Funding Facility, the Money Market Mutual Fund Liquidity Facility and the Primary Dealer Credit Facility – was not significant recently. These facilities thus expired as scheduled at the end of March.¹

**UK economy contracts**

Following two quarters of expansion, real GDP in the United Kingdom fell at a quarterly rate of 1.5% in the first quarter of 2021, as a number of restrictions were activated or extended to combat the spread of COVID-19. This contraction followed an increase of 1.3% in the final quarter of 2020 (see Table 1.1). Government consumption increased at a slower pace, while growth in gross fixed capital formation (GFCF) turned negative. In addition, private consumption contracted at a faster pace. In contrast, the contribution of net exports turned positive, as imports fell faster than exports.

Employment fell at the same pace recorded in the preceding quarter, declining at an annual rate of 1.6%. Meanwhile the unemployment rate averaged 4.8%, down from 5.1% in the previous 3-month period (see Chart 1.1).

Consumer price inflation in the United Kingdom edged up marginally to 0.7% in March from 0.6% in December (see Chart 1.2). This was attributable to energy prices, which declined at a much slower pace. On the other hand, prices of non-energy industrial goods grew at a slower pace while food price inflation turned negative. Meanwhile, service price inflation was unchanged. The annual rate of inflation excluding energy, food, alcohol and tobacco declined from 1.4% in December to 1.1% in March.

¹ In the second quarter of 2021, the FOMC confirmed its March decisions on interest rates and asset purchases, and reiterated its commitment to using its full range of tools to support the economy in this challenging time, thereby promoting its maximum employment and price stability goals. The Federal Reserve announced plans to begin winding down the portfolio of the Secondary Market Corporate Credit Facility, a temporary emergency lending facility that closed at the end of 2020. It also announced the extension of its temporary US dollar liquidity swap lines with nine central banks through end-2021.
In the first quarter of 2021, the Bank of England’s Monetary Policy Committee (MPC) maintained the Bank Rate unchanged at 0.1% (see Chart 1.3). The Committee decided to keep the stock of sterling non-financial, investment-grade, corporate bond purchases, financed by the issuance of central bank reserves, at GBP 20 billion. It also agreed to continue with its existing programme of UK government bond purchases, financed by the issuance of central bank reserves, maintaining the target for the stock of these government bond purchases at GBP 875 billion and the target for the total stock of asset purchases at GBP 895 billion.

The MPC reiterated that if the outlook for inflation weakens, it stood ready to take whatever additional action was necessary to achieve its remit. The Committee did not intend to tighten monetary policy – at least until there was clear evidence that significant progress was being made in eliminating spare capacity and achieving the 2.0% inflation target sustainably.2

**The euro area**

**GDP in the euro area contracts at a slower place**

In the first quarter of 2021, GDP in the euro area contracted for the second consecutive quarter. In real terms, GDP shrank by 0.3% on a quarter-on-quarter basis, a slower pace than the reduction of 0.6% registered in the previous quarter (see Table 1.2). This decline in GDP reflects the intensification of containment measures following the renewed rise in infection rates related to the COVID-19 pandemic early in the year. As a result, real GDP remained below pre-pandemic levels.

This contraction in economic activity was driven by domestic demand, which lowered GDP growth by 0.4 percentage point. In turn, this was entirely driven by private consumption, which dragged GDP growth down by 1.2 percentage points. Elevated uncertainty and restrictions limiting mobility and social interaction as a response to the COVID-19 pandemic dampened consumer demand, especially in the services sector. On the other hand, changes in inventories added 0.7 percentage point to GDP growth, while gross fixed capital formation pushed GDP growth up by 0.1 percentage point. Meanwhile, government consumption had a neutral impact on GDP growth. Unlike

<table>
<thead>
<tr>
<th>Table 1.2</th>
<th>CONTRIBUTIONS TO QUARTERLY REAL GDP GROWTH IN THE EURO AREA(1)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percentage points; annual percentage change</td>
</tr>
<tr>
<td></td>
<td>2019</td>
</tr>
<tr>
<td>Private consumption</td>
<td>0.3</td>
</tr>
<tr>
<td>Government consumption</td>
<td>0.2</td>
</tr>
<tr>
<td>GFCF</td>
<td>-0.5</td>
</tr>
<tr>
<td>Changes in inventories(2)</td>
<td>-0.5</td>
</tr>
<tr>
<td>Exports</td>
<td>0.6</td>
</tr>
<tr>
<td>Imports</td>
<td>0.4</td>
</tr>
<tr>
<td>GDP</td>
<td>0.4</td>
</tr>
</tbody>
</table>

Source: Eurostat.

(1) Data are seasonally and working day adjusted. Figures may not add up due to rounding.

(2) Including acquisitions less disposals of valuables.

2 In its meetings held in May and June 2021, the Bank of England kept the Bank Rate unchanged at 0.1%. The Committee also confirmed its previous decision on the target stock of asset purchases.
domestic demand, net exports contributed a negligible 0.1 percentage point to GDP growth, as exports rose at a marginally faster pace than imports.

**Labour market conditions remain broadly stable**
Labour market conditions in the euro area remained broadly stable during the quarter under review. The seasonally-adjusted unemployment rate fell slightly by 0.1 percentage point between December 2020 and March 2021, to 8.1% (see Chart 1.1). Similarly, the 3-month average rate also declined by 0.1 percentage point to 8.2%. Nevertheless, the unemployment rate in March 2021 stood 1.0 percentage point higher than a year earlier. In addition, policy measures and job retention schemes aimed at preventing redundancies and supporting jobs continue to dampen the rise in unemployment.

Turning to employment, the annual growth rate was slightly more negative in the first quarter of 2021, standing at -1.9%, compared with -1.8% registered in the previous quarter.³ This implies that around 3.0 million fewer people were employed in the quarter under review compared to a year earlier.

**Inflation increases significantly**
After falling below zero for the first time in more than four years in the second half of 2020, inflation in the euro area returned to positive territory and increased significantly during the quarter under review. The annual rate of inflation in the euro area, based on the HICP, shot up from -0.3% in December 2020 to 0.9% in the first two months of the year and increased further to 1.3% in March 2021 (see Chart 1.4).

All five main HICP components contributed positively to annual inflation in March 2021. The increase observed during the first quarter largely stemmed from energy inflation, which rose from -6.9% in December 2020 to 4.3% in March 2021. This development reflected both a sizeable upward base effect and relatively large month-on-month increases in energy prices, mirroring developments in the global oil market. Prices of services and non-energy industrial goods (NEIG) also contributed, albeit to a much lower extent. In particular, the annual inflation rate of services rose from 0.7% in December to 1.3% in March, while that of NEIG increased from -0.5% to 0.3% over the same period. On the other hand, prices of processed and unprocessed food increased at a slower annual rate. The annual rate of change of processed food prices edged down to 1.0% in March, while that of unprocessed food prices dropped to 1.6%.

The upswing in headline inflation reflected several factors that can be considered as temporary and partly of a statistical

³ Employment data refer to the national accounts, total employment domestic concept. Data are seasonally- and calendar-adjusted.
nature. These include: the reversal in January of the temporary reduction in German value added tax (VAT) rates during the second half of 2020 which will continue to have an impact on inflation rates throughout 2021; changes in the timing and magnitude of seasonal sales in some euro area countries, which led to a substantial rise in NEIG inflation; and the impact of stronger than usual changes in HICP weights for 2021 due to changes in household consumption patterns during the pandemic, particularly related to services inflation.

Consequently, the annual rate of HICP inflation excluding energy and food surged to 0.9% in March 2021 from the historical low of 0.2% three months earlier.

**Macroeconomic projections signal a recovery in economic activity**

According to the Eurosystem staff macroeconomic projections published in June 2021, following a contraction of 6.8% in 2020, real GDP in the euro area is expected to rebound strongly. Real GDP is set to expand by 4.6% in 2021 and 4.7% in 2022, before moderating to 2.1% in 2023 (see Table 1.3). This rebound is expected as vaccinations proceed and the number of COVID-19 infections falls, allowing the authorities to ease lockdown and containment measures. These projections also imply that real GDP would exceed its pre-crisis level from the first quarter of 2022 onwards, one quarter earlier than previously foreseen. The projections also assume that the health crisis will be resolved by early 2022.

Private consumption is expected to be the key driver of the recovery, as uncertainty relating to the pandemic is expected to gradually decline and as disposable incomes rise. Nonetheless, the projections do not envisage a strong contribution from pent-up demand as the large stock of accumulated excess savings is assumed to remain largely unspent. Turning to investment, housing investment is expected to return to its pre-pandemic level in the second quarter of 2021 while business investment is expected to recover substantially this year, reaching its pre-crisis level by the end of the year. Finally, net trade is expected to have a positive impact on GDP growth in 2021 due to strong export growth, itself reflecting robust foreign demand, while the acceleration of imports will imply a broadly neutral contribution of net trade to growth afterwards.

Compared with the March 2021 projections, real GDP growth has been revised upwards by 0.6 percentage point in both 2021 and 2022, while it has remained unchanged in 2023. The upward revisions in real GDP for 2021 and 2022 reflect a number of factors. First, the assumption that the pandemic will have a smaller economic impact given the progress of the vaccination campaign.

<table>
<thead>
<tr>
<th>Table 1.3</th>
<th>MACROECONOMIC PROJECTIONS FOR THE EURO AREA(1)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual percentage changes</strong></td>
<td>2020</td>
</tr>
<tr>
<td>GDP</td>
<td>-6.8</td>
</tr>
<tr>
<td>Private consumption</td>
<td>-8.0</td>
</tr>
<tr>
<td>Government consumption</td>
<td>1.4</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>-8.2</td>
</tr>
<tr>
<td>Exports</td>
<td>-9.8</td>
</tr>
<tr>
<td>Imports</td>
<td>-9.3</td>
</tr>
<tr>
<td>HICP</td>
<td>0.3</td>
</tr>
</tbody>
</table>

(1) Eurosystem staff macroeconomic projections (June 2021).
Source: ECB.
Second, substantial additional fiscal policy measures partly funded by the Next Generation EU programme imply an additional boost to economic activity. Third, an upgrade to the outlook for foreign demand supported by the recent fiscal policy packages in the United States. Finally, monetary, fiscal and macroprudential policy measures have succeeded in averting large financial amplification effects and limiting the economic scars caused by the crisis.

According to the June 2021 projections, HICP inflation is envisaged to significantly rise to 1.9% in 2021, before moderating to 1.5% in 2022 and 1.4% in 2023 as demand pressures remain muted and oil prices decline. Notably, inflation is projected to peak at 2.6% in the fourth quarter of this year due to temporary factors as mentioned earlier relating to the reversal of the German VAT rate cut, the rebound in the energy inflation rate amid strong base effects, and an increase in input costs related to supply disruptions. Changes in weights imply some volatility in the inflation profile but on average they are expected to have only a small downward impact on HICP inflation in 2021. These temporary factors are expected to fade at the beginning of 2022. Upward price pressures from rising demand are expected to remain subdued overall. At the same time, upward pressures from adverse supply effects related to the pandemic are expected to diminish over the projection horizon. On balance, therefore, the profile of inflation is largely flat in 2022 and 2023.

Compared with the March 2021 projections, HICP inflation has been revised upward by 0.4 percentage point in 2021 and by 0.3 percentage point in 2022, while it is unchanged for 2023. Upward revisions relate to a more positive outlook for economic activity and upward effects from commodity prices.

In view of the continued uncertainty related to the pandemic and its impact on the economy, ECB staff prepared two alternative scenarios for the euro area. A mild scenario assumes a resolution of the health crisis by late 2021 and only temporary economic losses. In this scenario, real GDP growth would rebound to 6.2% and 5.5% in 2021 and 2022 respectively before moderating to 2.2% in 2023. Inflation would reach 1.7% in 2023. Alternatively, a severe scenario assumes a protracted health crisis and permanent losses in potential output. In this case, real GDP growth would remain moderate at 2.9%, 2.3% and 2.2% over the same horizon. Inflation would fall to just 1.1% in 2023.

**ECB reinforces its accommodative monetary policy stance**

The ECB’s Governing Council reinforced its accommodative monetary policy stance during the first quarter of 2021. The interest rates on the MROs, 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.

On 11 March, the Governing Council announced that the Eurosystem will continue to conduct net asset purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1,850.0 billion until at least the end of March 2022 and, in any case, until it judges that the coronavirus crisis phase is over. The Governing Council expected purchases under the PEPP over the next quarter to be conducted at a significantly higher pace than during the first months of this year.
The Governing Council reiterated that the Eurosystem will purchase flexibly according to market conditions to prevent a tightening of financing conditions that is inconsistent with countering the downward impact of the pandemic on the projected path of inflation. In addition, the flexibility of purchases over time, across asset classes and among jurisdictions will continue to support the smooth transmission of monetary policy. If favourable financing conditions can be maintained with asset purchase flows that do not exhaust the envelope over the net purchase horizon of the PEPP, the envelope need not be used in full. Equally, the envelope can be recalibrated if required to maintain favourable financing conditions to help counter the negative pandemic shock to the path of inflation.

The Eurosystem will continue to reinvest the principal payments from maturing securities purchased under the PEPP until at least the end of 2023. In any case, the future roll off of the PEPP portfolio will be managed to avoid interference with the appropriate monetary policy stance.

Net purchases under the APP will continue at a monthly pace of €20.0 billion. The Governing Council continues to expect monthly net asset purchases under the APP to run for as long as necessary to reinforce the accommodative impact of the ECB’s policy rates, and to end shortly before it starts raising the key ECB interest rates. The Governing Council’s intentions regarding the reinvestment of maturing securities purchased under the APP remained unchanged. Finally, the Eurosystem will continue to provide ample liquidity through refinancing operations.

**Money market rates broadly unchanged**

Money market interest rates in the euro area remained broadly unchanged during the first quarter of 2021, as the market remained conditioned by the accommodative monetary policy stance and ample excess liquidity. The Euro OverNight Index Average (EONIA) rate was stable during the quarter under review, remaining slightly above the interest rate on the ECB’s deposit facility. It fell to -0.48% in January 2021 and remained at that level until the end of the quarter (see Chart 1.5). Meanwhile, the 3-month euro interbank offered rate (EURIBOR) dropped further as excess liquidity rose, reaching a new historical low of -0.55% in January 2021, before returning to its December 2020 level of -0.54%.

---

4 In the second quarter of 2021, the monetary policy stance remained unchanged, with the Governing Council reaffirming its previous commitments on interest rates and asset purchases.

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. See: [https://www.ecb.europa.eu/stats/financial_markets_and_interest_rates/euro_short-term_rate/html/index.en.html](https://www.ecb.europa.eu/stats/financial_markets_and_interest_rates/euro_short-term_rate/html/index.en.html)
in the following two months.\(^6\) Meanwhile, the 12-month EURIBOR rate remained at -0.50% in the first two months of the year, subsequently rising slightly to -0.49% in March 2021.

**Euro area bond yields increase**

Ten-year benchmark government bond yield in the euro area increased and turned positive during the first quarter of 2021, rising to 0.15% in March from -0.09% three months earlier. Similarly, individual sovereign bond yields went up significantly during the period under review. The most notable increases were registered in Slovak, Belgian and Austrian bond yields, which rose by 47, 35 and 33 basis points to -0.05%, -0.04% and -0.09% respectively. German bond yields rose by 26 basis points, while Irish, Greek, French, Spanish and Portuguese bond yields rose by between 20 and 32 basis points. Italian bond yields also rose overall during the quarter, though they declined in February in the run up to the formation of a new government by former ECB President Mario Draghi. The general rise in yields was driven by an increase in risk-free rates, reflecting improved economic prospects and robust risk sentiment.

Spreads between yields on 10-year German bond yields – often considered as a benchmark for the euro area – and those on bonds issued by other euro area governments diverged during the quarter under review. On the one hand, spreads on Slovak, Belgian and Austrian bonds widened by 21, 9 and 7 basis points respectively. To a lesser degree, those on bonds issued by Ireland, Greece, France and Spain also increased, widening by 6, 2, 1 and 1 basis points respectively (see Chart 1.6). On the other hand, those of Italy and Portugal narrowed by 14 and 6 basis points respectively.

**The euro exchange rate depreciates in effective terms**

During the first quarter of 2021, the nominal effective exchange rate of the euro against the EER-19 group of countries depreciated by 2.3%, reflecting diverging bilateral exchange rate developments in a market environment characterised by increasing risk appetite.\(^7\)

The euro depreciated significantly by 5.2% against the British pound during the review period, mainly reflecting the pound’s appreciation following the conclusion of the Brexit process, which ended in December 2020 with the announcement of the EU-UK Trade and Cooperation Agreement (see Chart 1.7). It also lost 4.4% against the US dollar on the back of the broad-based strength of the dollar. The strength of the US dollar reflected positive macroeconomic developments in the United States, as well as market expectations of an earlier and less gradual monetary policy tightening.

---

\(^6\) 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.

\(^7\) 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.
by the Federal Reserve. These factors offset downward pressure from improving global risk sentiment.

The euro also depreciated against the Australian dollar, the Norwegian krone, the Canadian dollar and the Chinese renminbi. On the other hand, the euro strengthened against safe-haven currencies, such as the Japanese yen and the Swiss franc, as well as against the Polish zloty and other currencies of Central and Eastern European countries.

Commodities

Oil prices rise further

The price of Brent crude oil generally increased during the first quarter of 2021, with oil prices rising briefly above USD 70 per barrel, for the first time since the beginning of 2020 (see Chart 1.8). Improved global demand prospects amid progress with vaccination programmes pushed up oil prices. Moreover, from the supply side, supply cuts by Saudi Arabia also put upward pressure on prices.

By the end of March, the price of Brent crude oil stood at USD 63.1 per barrel, 24.0% higher than the price prevailing at the end of 2020.

World Bank data show that non-energy commodity prices also rose during the first quarter of 2021. Between December 2020 and March 2021, they increased by 8.1%.
2. OUTPUT AND EMPLOYMENT

Economic activity in the first quarter of 2021 continued to be affected by the COVID-19 pandemic and the associated containment measures. As active cases rose sharply during the first quarter, some containment measures were re-introduced in March. This included the shutdown of most shops and catering establishments, as well as school closures. As a result, real GDP fell by 1.8% in annual terms in the first quarter of 2021, although this is a more muted decline than that experienced in the previous quarter – when GDP had contracted by an annual 7.8%. The economic contraction was underpinned by a sharp fall in net exports, as the contribution of domestic demand was positive. Sector data show that the contraction was primarily driven by the services sector, especially the sector comprising wholesale and retail trade, transportation, accommodation and related activities. This reflects the fact that tourism-related activities remained relatively depressed, as well as the shutdown of non-essential services in March 2021. Activity also decreased in the manufacturing and construction sectors, although the dampening effect on overall GDP was relatively minimal.

The Bank’s BCI shows the first signs of a turnaround in macroeconomic variables – although from very low levels. In the first quarter of 2021, the output gap remained firmly in negative territory, as demand remains short of the economy’s potential.

During the first quarter of 2021, the labour market continued to recover, as employment increased in quarter-on-quarter terms, while unemployment decreased. However, employment and activity rates remained below those recorded in the corresponding quarter of 2020, reflecting the impact of COVID-19 measures.

Government measures – such as the Wage Supplement Scheme – as well as firms’ reliance on shorter working-time arrangements were successful in protecting employment. Indeed, the unemployment rate remained low from a historical perspective – though it stood slightly above pre-pandemic rates – and well below that in the euro area.

Potential output and BCI

Potential output growth picks up
Potential output growth is estimated to have picked up in the first quarter of 2021, standing at 1.9%, from -0.3% in the previous quarter (see Chart 2.1). This acceleration is mainly due to an improvement in the contribution of total factor productivity, which had turned negative in 2020 owing to the containment measures that were introduced to stem the pandemic. At the
same time, GDP contracted by 1.8% in annual terms, following a decline of 7.8% in the final quarter of 2020.

The output gap, when measured as a 4-quarter moving average, is estimated at -8.7% in the first quarter of 2021, below the -7.9% registered in the previous quarter. The Bank’s estimate of the output gap is the lowest on record. The large degree of underutilisation of the economy’s productive capacity mainly reflects the Bank’s assessment that the temporary nature of containment measures relating to the COVID-19 pandemic had a stronger impact on the demand side than the supply side of the economy.

**BCI improves from low levels**

The Bank’s BCI shows that business activity started to improve on a year-on-year basis in the first quarter of 2021 (see Chart 2.2). However, economic activity levels are still below those prevailing before the pandemic. The level of the BCI should not be interpreted as implying that economic activity has necessarily returned to pre-pandemic levels. Rather, at the current juncture, the BCI reading for the first quarter of this year should be interpreted as indicating the start of a turnaround in macroeconomic variables.

During the first quarter of 2021, the BCI continued to be adversely affected by strong annual declines in tourist arrivals and industrial production – as the first containment measures related to the pandemic were introduced late in the first quarter of 2020, the level of tourist arrivals and industrial production prior to their introduction was still relatively high. However, these factors began to be offset by significant improvements in economic sentiment and unemployment. As a result, while still signalling weak activity levels, the BCI recently moved closer to zero.

**GDP and industrial production**

**Real GDP contracts at a slower pace**

Real GDP fell by an annual 1.8% in the first quarter of the year, following a contraction of 7.8% in the preceding quarter. The fall in GDP was largely underpinned by a sharp contraction in net exports. By contrast, the contribution of domestic demand was slightly positive, as falls in private consumption and GFCF were largely offset by an increase in government consumption

---

1. 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 at [https://www.centralbankmalta.org/business-conditions-index](https://www.centralbankmalta.org/business-conditions-index). 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, Central Bank of Malta.

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

3. The analysis of GDP in this chapter of the Quarterly Review is based on data published in NSO News Release 097/2021, which was released on 28 May 2021.
and a positive contribution from changes in inventories. Reflecting these developments, domestic demand added 0.7 percentage point to GDP growth, following a negative contribution of 2.2 percentage points in the previous quarter (see Table 2.1).

In the quarter under review, exports fell by 4.3%, mainly reflecting lower foreign demand for goods and the impact of the pandemic on tourism-related services. Meanwhile, imports decreased by 2.9% on a year earlier, mirroring the drop in demand. As exports fell more strongly than imports, net exports declined, shedding 2.5 percentage points from real GDP growth. This decline was driven by a lower surplus from trade in services and a slightly larger deficit from trade in goods.

Private consumption expenditure contracted by 4.8% in the first quarter of 2021, following a decline of 5.4% in the fourth quarter of 2020 – shedding 2.2 percentage points from real GDP growth.

Data on the Classification of Individual Consumption by Purpose (COICOP) show falls in most expenditure categories. However, the strongest decline in absolute terms was recorded in spending on restaurants and accommodation services. This was followed by lower spending on transport, clothing and footwear, as well as food and beverages. These developments offset higher expenditure on housing and energy, and on ‘furnishings, household equipment and routine household maintenance’. In the national accounts, however, COICOP data measure domestic consumption and thus include the expenditure of non-residents in Malta while they exclude the expenditure of Maltese residents abroad. Given that tourist arrivals were very low compared to last year’s levels, certain COICOP categories of expenditure continued to be severely affected by the decrease in non-residents’ expenditure in Malta. The remaining part of

### Table 2.1

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Q1</td>
<td>Q2</td>
</tr>
<tr>
<td><strong>Annual percentage changes</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private final consumption expenditure</td>
<td>-2.1</td>
<td>-16.8</td>
</tr>
<tr>
<td>Government final consumption expenditure</td>
<td>2.9</td>
<td>19.9</td>
</tr>
<tr>
<td>GFCF</td>
<td>-7.4</td>
<td>-2.6</td>
</tr>
<tr>
<td><strong>Domestic demand</strong></td>
<td>-2.1</td>
<td>-3.9</td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>4.0</td>
<td>-11.4</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>1.5</td>
<td>-3.7</td>
</tr>
<tr>
<td><strong>GDP</strong></td>
<td>1.9</td>
<td>-14.7</td>
</tr>
</tbody>
</table>

| **Percentage point contributions** | 2020          | 2021          |
|                                    | Q1  | Q2  | Q3  | Q4  | Q1  |           |
| Private final consumption expenditure | -1.0 | -7.4 | -3.6 | -2.4 | -2.2 |           |
| Government final consumption expenditure | 0.5  | 3.4  | 3.3  | 3.1  | 4.6  |           |
| GFCF                   | -1.8 | -0.5 | -0.9 | -2.8 | -2.6 |           |
| Changes in inventories     | 0.3  | 1.4  | 0.8  | -0.2 | 0.9  |           |
| **Domestic demand**        | -2.0 | -3.2 | -0.5 | -2.2 | 0.7  |           |
| Exports of goods and services | 5.9  | -16.2 | -17.9 | -10.9 | -6.5 |           |
| Imports of goods and services | -2.0 | 4.6  | 8.5  | 5.3  | 4.0  |           |
| **Net exports**            | 3.9  | -11.6 | -9.4 | -5.6 | -2.5 |           |
| **GDP**                   | 1.9  | -14.7 | -9.9 | -7.8 | -1.8 |           |

Sources: NSO; Central Bank of Malta calculations.

(1) Chain-linked volumes, reference year 2015.
domestic consumption – the expenditure of Maltese residents in Malta – declined by less and explains only around a third of the fall in private consumption based on the national concept – which is the measure reported in Table 2.1. This reflects a sharp decrease in the expenditure of Maltese residents abroad.

Government consumption expenditure rose by 24.6% in annual terms, mainly due to expenditure on COVID-19-related measures. Expenditure on such measures started in the second quarter of 2020, and hence, government consumption was still relatively low in the first quarter of 2020. This is reflected by a positive statistical base effect on the annual growth rate of government consumption in the first quarter of 2021. The latest increase in government consumption is primarily due to higher spending on intermediate consumption and, to a lesser extent, in compensation of employees. Increases in outlays mainly featured within the health and public administration sectors. Revenue from sales increased in this period, dampening somewhat the aforementioned increases in spending. Overall, government consumption added 4.6 percentage points to annual GDP growth.

Following a contraction of 12.8% in the previous quarter, real GFCF contracted by 11.8% in the first quarter of the year, lowering GDP growth by 2.6 percentage points. The fall in GFCF was primarily driven by lower investment in residential and non-residential buildings. This was followed by lower investment in machinery. By contrast, investment in products of agriculture, forestry, fisheries and aquaculture, as well as intellectual property increased on a year earlier.

Changes in inventories added 0.9 percentage point to real GDP growth in the first quarter of 2021.

The contributions shown in Table 2.1 are consistent with the approach normally followed in official databases and economic publications. However, they do not account for the variation in import content across different expenditure components and thus 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 the quarter under review, the majority of import-adjusted contributions were larger than those based on the traditional approach and reported in Table 2.1, reflecting the fall in imports. This is particularly the case for exports and, to a lesser degree, GFCF and private consumption.

Even after accounting for the effect of imports, though, exports remained the main driver behind the contraction of real GDP in the first quarter of 2021. However, the import-adjusted contribution of exports to the GDP contraction is almost half that in the traditional approach. When adjusting for imports, the negative contribution of private consumption is slightly larger than that for private investment, in contrast to the results of the traditional approach.

Positive contributions to economic growth stemmed from government expenditure and changes in inventories in both approaches.

---

4 From this edition, the import intensities have been updated with the 2015 input-output tables, which where published by NSO in News Release 005/2021, and can be accessed from https://nso.gov.mt/en/News_Releases/Documents/2021/01/News2021_005.pdf. These new weights differ slightly from those published by Dr Aaron G. Grech and Mr Noel Rapa in the 2016 Annual Report, which can be accessed from https://www.centralbankmalta.org/file.aspx?f=51553. The revised import intensities for private consumption are marginally higher at 45.1%, while that for investment was revised down strongly, by around 10 percentage points to 69.3%. On the other hand, the weight of government consumption was revised marginally down to 18.5%, while that of imports declined to 70.6%.
It should be noted, however, that import-adjusted contributions should be interpreted with caution in episodes of high volatility, such as those prevailing since the onset of the pandemic, as import intensities can change significantly.

GDP data based on the output approach show that in the first quarter of 2021, real gross value added (GVA) fell by 1.5% in annual terms, after contracting by 7.3% in the preceding quarter (see Table 2.3). In the quarter under review, GVA shed 1.4 percentage points from GDP growth.\(^5\)

| Table 2.2 | IMPORT-ADJUSTED CONTRIBUTIONS TO GDP GROWTH\(^{(1)}\) |
|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                | 2020            | 2021            |                  |                  |                  |
| Q1              | Q2              | Q3              | Q4              | Q1              |                  |
| Private final consumption expenditure | -0.5 | -5.4 | -2.8 | -2.0 | -1.5 |
| Government final consumption expenditure | 0.5 | 2.6 | 2.6 | 2.5 | 3.7 |
| Gross fixed capital formation | -0.6 | -1.1 | -0.8 | -1.5 | -1.1 |
| Changes in inventories | 0.2 | 0.6 | 0.3 | 0.1 | 0.4 |
| Domestic demand | -0.4 | -3.3 | -0.5 | -0.9 | 1.6 |
| Exports of goods and services | 2.3 | -11.5 | -9.3 | -6.9 | -3.4 |
| GDP | 1.9 | -14.7 | -9.9 | -7.8 | -1.8 |

Source: Central Bank of Malta estimates.

\(^{(1)}\) Chain-linked volumes, reference year 2015.

| Table 2.3 | CONTRIBUTION OF SECTORAL GVA TO REAL GDP GROWTH |
|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                | 2020            | 2021            |                  |                  |                  |
| Q1              | Q2              | Q3              | Q4              | Q1              |                  |
| Agriculture, forestry and fishing | 0.0 | 0.0 | -0.1 | 0.0 | 0.0 |
| Mining and quarrying; utilities | -0.1 | -0.4 | -0.2 | 0.0 | 0.1 |
| Manufacturing | 0.9 | -0.8 | 0.1 | 0.0 | -0.2 |
| Construction | 0.3 | 0.0 | -0.1 | -0.3 | 0.0 |
| Services | 2.1 | -11.2 | -7.7 | -6.2 | -1.2 |
| of which: |                  |                  |                  |                  |                  |
| Wholesale and retail trade; repair of motor vehicles; transportation; accommodation and related activities | -1.0 | -8.8 | -8.0 | -6.5 | -3.7 |
| Information and communication | 0.8 | 0.3 | 0.7 | 0.4 | 1.0 |
| Financial and insurance activities | 0.4 | 0.1 | 0.5 | 0.7 | 0.6 |
| Real estate activities | -0.1 | -0.6 | -0.2 | -0.2 | 0.0 |
| Professional, scientific, administrative and related activities | 0.3 | -1.7 | -1.6 | -1.0 | -1.0 |
| Public administration and defence; education; health and related activities | 0.4 | -0.4 | 0.3 | 0.0 | 1.4 |
| Arts, entertainment; household repair and related services | 1.1 | -0.2 | 0.6 | 0.4 | 0.6 |
| GVA | 3.1 | -12.3 | -7.9 | -6.5 | -1.4 |
| Taxes less subsidies on products | -1.2 | -2.4 | -1.9 | -1.4 | -0.4 |
| Annual real GDP growth (%) | 1.9 | -14.7 | -9.9 | -7.8 | -1.8 |

Source: NSO.

\(^5\) The difference between GDP and GVA is made up of taxes on products, net of subsidies. In the first quarter of 2021, taxes on products net of subsidies decreased in annual terms.
Services remained the main driver behind the fall in activity, shedding 1.2 percentage points from real GDP growth, which is the smallest negative contribution since the start of the pandemic. Most of the decline stemmed from the sector comprising wholesale and retail trade, transportation, accommodation and related activities. This reflects the fact that tourism-related activities remained relatively depressed, due to ongoing travel restrictions, social distancing measures and elevated uncertainty. It also reflects the shutdown of non-essential shops, which commenced in March 2021. At the same time, the sector comprising professional and scientific activities shed a further 1.0 percentage point from real GDP growth. By contrast, public administration sectors, information and communication, arts and entertainment, as well as financial and insurance activities, collectively added 3.5 percentage points to real growth.

Although GVA also fell in the manufacturing sector and in construction, the impact on GDP was minimal.

Nominal GDP contracts at a slower pace
Nominal GDP fell by 0.5% in annual terms in the first quarter of 2021, following a contraction of 6.6% in the previous quarter, with the improvement largely underpinned by a recovery in gross operating surplus and a smaller negative contribution from net taxes on production and imports (see Chart 2.3).

The contribution of compensation of employees reached 0.4 percentage point. The latter component grew by 0.9% in the first quarter of 2021, compared with 0.4% in the previous quarter.

Compensation of employees continued to grow despite the contraction in activity, reflecting the employment protection measures that were undertaken during the year, together with an element of labour hoarding by firms.

Compensation of employees increased in both the private and the general government sector. However, developments in the private sector were mixed. The majority of sectors registered increases in their compensation of employees, with the largest increase registered in the sector comprising financial and insurance activities. Other increases were recorded in the arts and entertainment sector, construction and manufacturing. By contrast, compensation of employees declined markedly in the sector comprising wholesale and retail trade, repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities, as well as in the sector incorporating professional, scientific and technical
activities, and administrative and support services. It also declined in the information and communication sector, and real estate activities, though to a much lesser extent.

Data on compensation of employees include the Wage Supplement Scheme. The Government provided eligible employees with a basic wage to address the disruption caused by the COVID-19 pandemic. To simplify the administration of the scheme, funds were forwarded to the employer, who in turn would forward such funds to employees. These funds were simultaneously recorded as compensation of employees and subsidies. Reflecting this statistical treatment, subsidies on production increased in the first quarter of 2021, albeit at a slower pace relative to the previous quarter, in turn lowering ‘net taxes on production and imports’.

Meanwhile, the annual growth rate of gross operating surplus turned positive in the quarter under review. This component grew at an annual rate of 1.8% – the first positive increase in a year – adding 0.8 percentage point to nominal GDP growth.

When compared with the same quarter a year earlier, the increase in gross operating surplus was driven primarily by the information and communication sector and, to a lesser extent, by the sector comprising arts, entertainment and recreation activities as well as that including financial insurance activities. These developments were partly offset by a decrease in profits in the transportation and storage sector, as well as the wholesale and retail trade sector, and accommodation and food service activities.

*Industrial production declines at a faster pace*

During the first quarter of 2021, industrial production declined for the fourth consecutive time. Production fell at a faster pace of 8.1% on an annual basis, following a 1.2% decrease in the December quarter (see Table 2.4).6

The faster rate of decline primarily reflected developments in the manufacturing sector, where growth turned negative. Production in the energy sector fell at a stronger pace during the quarter under review.7 Meanwhile, the quarrying sector registered a smaller decline compared to the last quarter of 2020.

In the manufacturing sector, production fell at an annual rate of 5.2%, after it had increased by 1.2% in the fourth quarter of 2020. Several sub-sectors in the manufacturing industry contributed to this deterioration. In particular, stronger contractions were recorded among firms that repair and install machinery and equipment, and ‘other non-metallic mineral products’ as well as food. Growth turned negative among firms producing computer, electronic and optical products as well as firms producing rubber and plastic products. At the same time, production slowed down among firms producing pharmaceuticals, firms involved in the manufacture of motor vehicles, trailers and semi-trailers and those producing ‘other manufacturing’ goods – which include medical and dental instruments, toys and related products.

---

6 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.

7 Industrial production in the energy sector excludes energy generated abroad and imported through the interconnector.
Table 2.4

INDUSTRIAL PRODUCTION\(^{(1)}\)

Percentages; annual percentage changes

<table>
<thead>
<tr>
<th>Shares</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Q1</td>
<td>Q2</td>
</tr>
<tr>
<td>Industrial production</td>
<td>100.0</td>
<td>11.1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>87.1</td>
<td>7.9</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food products</td>
<td>15.4</td>
<td>-9.5</td>
</tr>
<tr>
<td>&quot;Other&quot; manufacturing</td>
<td>10.3</td>
<td>18.7</td>
</tr>
<tr>
<td>Repair and installation of machinery and equipment</td>
<td>7.9</td>
<td>4.9</td>
</tr>
<tr>
<td>Basic pharmaceutical products and pharmaceutical preparations</td>
<td>7.3</td>
<td>3.5</td>
</tr>
<tr>
<td>Printing and reproduction of recorded media</td>
<td>7.3</td>
<td>36.4</td>
</tr>
<tr>
<td>Beverages</td>
<td>5.6</td>
<td>22.0</td>
</tr>
<tr>
<td>Rubber and plastic products</td>
<td>5.4</td>
<td>0.5</td>
</tr>
<tr>
<td>Computer, electronic and optical products</td>
<td>5.0</td>
<td>5.1</td>
</tr>
<tr>
<td>Energy</td>
<td>12.5</td>
<td>21.3</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>0.5</td>
<td>20.6</td>
</tr>
</tbody>
</table>

Sources: NSO; Eurostat.

\(^{(1)}\) The annual growth rates of the industrial production index are averages for the quarter based on working-day adjusted data. The annual growth rates of the components are based on unadjusted data.

By contrast, when compared to the last quarter of 2020, smaller declines in output were registered among firms that produce beverages and firms that specialise in printing and reproduction of recorded media, while growth turned positive among firms producing wearing apparel.
Household saving and consumption behaviour play a key role in macroeconomic analysis – explaining wealth accumulation in the wake of economic shocks – and have been the subject of extensive theoretical and empirical research. The theoretical starting point that underpins most empirical research on consumption and saving behaviour is the Life Cycle hypothesis, which postulates that rational, forward-looking agents attempt to avoid excessive swings in consumption expenditure over time. To do this, households borrow in advance of future income when they are young, save in middle age and dissave in retirement, implying that the main saving motive under the Life Cycle hypothesis is retirement saving. Other saving motives have since been incorporated in theoretical models, primarily the precautionary saving and bequest motives, as well as saving due to liquidity constraints, down payment requirements and medical expenses among others.

Despite its importance, few studies have explored saving behaviour in Malta. In turn, available studies have either analysed aggregate saving rates or, in the case of studies looking at household behaviour, have been limited to simple analysis of mean and median saving rates conditional on one household characteristic at a time. This box summarises the results of a study conducted with the aim of bridging this gap. The study uses granular information from the Household Budgetary Survey (HBS) to explore the full saving rate distribution of Maltese households and map the probability of saving over a range of household characteristics.

The HBS, carried out by the National Statistics Office (NSO), tracks patterns and trends in household expenditure in Malta for the purpose of calibrating expenditure weights in official statistics. Nevertheless, the rich dataset collected by the survey can serve several other purposes and is particularly suitable for economic research relating to consumption and saving. The analysis is based on household-level saving rates, which are calculated by using the difference between income and expenditure as a proxy for saving. Although it is a good proxy, there are some limitations with this measure of saving, primarily concerning the issue of potential under-reporting of income. Although recent HBS data are available for 2008 and 2015, in this box the main analysis is conducted using the 2015 HBS wave.
The data

Table 1 shows summary statistics relating to the income, expenditure, saving level and saving rates of households in each wave. Income rises faster than expenditure between the two waves, which is reflected in higher saving levels and saving rates in 2015. In both instances, the mean saving rate is lower than the median, indicating that the saving rate distribution is negatively skewed. This characteristic appears to be a general feature of the data.

Chart 1 shows the unconditional saving rate distributions across the two waves. The distribution of saving rates has shifted upwards between the two waves, with a greater mass of households having positive saving rates in 2015. However, both distributions also exhibit fat left tails, reflecting the

---

Table 1
SUMMARY STATISTICS

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>€20,853</td>
<td>€28,158</td>
</tr>
<tr>
<td>Expenditure</td>
<td>€19,784</td>
<td>€23,006</td>
</tr>
<tr>
<td>Saving</td>
<td>€1,069</td>
<td>€5,152</td>
</tr>
<tr>
<td>Saving rate</td>
<td>-4.5%</td>
<td>8.2%</td>
</tr>
</tbody>
</table>

Sources: HBS (2008, 2015) and authors’ calculations.

---

5 In the paper, we also present summary statistics pertaining to each household characteristic in the dataset.
strongly negative saving rates exhibited by some households in both waves, despite the removal of outliers.

The conditional saving rate distributions yield a number of interesting preliminary observations. Firstly, saving rate distributions by income quintiles suggest that, as expected, higher income households are progressively more likely to have positive saving (see Chart 2). Another key observation relates to age, where the saving rate densities by age group indicate that those in the 55-64 year age bracket and retired households are somewhat more likely to save than relatively younger households (see Chart 3).

Similar conditional saving rate distributions over other characteristics – such as educational attainment and residential tenure status – also reveal that a small share of households have high negative saving rates. The fat left tail in saving rates appears to be a general feature of the data, rather than being limited to a specific sub-group.

Probability of positive saving across household characteristics
An econometric model was developed to estimate the probability of a household having positive saving while controlling for all key household characteristics captured in the data-set simultaneously. A Logit model was fitted to each wave. The model estimates the probability of saving \( p_i \) for a household conditional on its set of characteristics as follows:

\[
p_i = Pr(s_i = 1|x_i) = \Lambda(x_i\beta)
\]

where \( s_i \) takes a value of 1 if a household’s income is larger than its expenditure and 0 otherwise, \( x_i \) is a vector of household characteristics and a constant, \( \beta \) is a vector of coefficients and \( \Lambda(\cdot) \) is the logistic function. The covariates included in the vector \( x_i \) are based on both theoretical and empirical considerations. Apart from income, the model controls for key predictors such as age, employment status, education, marital status, housing tenure status and household size. In the absence of wealth data in the HBS, the type of residential property occupied, the ownership of a second house and the rental of other property are included as proxies for wealth.
The estimation results are presented as average marginal effects relative to a baseline household. The baseline household belongs to the middle-income quintile and has a representative person aged 40-54 who is married, is employed or self-employed, holds a secondary or post-secondary level of education, owns and lives in a terraced house without an outstanding mortgage, does not rent other property and does not own a second house. Table 2 shows a subset of the estimation results, focusing on the 2015 HBS wave.

Higher levels of income and older age are strongly associated with a higher probability of positive saving. Further analysis reveals that these two characteristics are associated with a higher probability of households being strong savers. The positive correlation between income levels and the probability of saving is in line with economic theory. On the contrary, the association between older age and higher saving probability runs counter to the basic Life Cycle model, although it is a common empirical finding in similar studies in the

<table>
<thead>
<tr>
<th>Table 2</th>
<th>REGRESSION RESULTS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income</strong></td>
<td><strong>Marital Status</strong></td>
</tr>
<tr>
<td>Bottom quintile</td>
<td>-0.321 ***</td>
</tr>
<tr>
<td>Fourth quintile</td>
<td>-0.116 ***</td>
</tr>
<tr>
<td>Third quintile (benchmark)</td>
<td>-</td>
</tr>
<tr>
<td>Second quintile</td>
<td>0.147 ***</td>
</tr>
<tr>
<td>First quintile</td>
<td>0.254 ***</td>
</tr>
<tr>
<td><strong>Life Cycle</strong></td>
<td></td>
</tr>
<tr>
<td>Age 25-39</td>
<td>-0.032</td>
</tr>
<tr>
<td>Age 40-54 (benchmark)</td>
<td>-</td>
</tr>
<tr>
<td>Age 55-64</td>
<td>0.048 *</td>
</tr>
<tr>
<td>Age 65+</td>
<td>0.129 ***</td>
</tr>
<tr>
<td>Yes</td>
<td>-</td>
</tr>
<tr>
<td>No</td>
<td>-</td>
</tr>
<tr>
<td><strong>Employment status</strong></td>
<td></td>
</tr>
<tr>
<td>Employed/self-emp. (benchmark)</td>
<td>-</td>
</tr>
<tr>
<td>Unemployed</td>
<td>0.099 **</td>
</tr>
<tr>
<td>Retired</td>
<td>0.005</td>
</tr>
<tr>
<td>Inactive</td>
<td>0.034</td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td></td>
</tr>
<tr>
<td>Low education</td>
<td>0.112 ***</td>
</tr>
<tr>
<td>Medium education (benchmark)</td>
<td>-</td>
</tr>
<tr>
<td>High education</td>
<td>0.019</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations.

6 Average marginal effects measure the average change in the probability of saving for a change in any household characteristic relative to the characteristics of the baseline household.

literature. This finding likely reflects precautionary and bequest motives as well as saving brought on by credit constraints that old-age households are likely to face. An unemployed household is about 10 percentage points more likely to save. Conversely, having medium or higher educational attainment is negatively associated with higher saving when compared to households with lower-educated representative persons. Neither of these results are common in the literature, although they have been replicated in another unrelated study. Households with unemployed reference persons could be more likely to save by cutting back on expenditure, driven by precautionary motives. Similarly, precautionary motives might be behind the higher probability of saving by lower-educated households, who might face higher income and unemployment risks, all else being equal. Under-reporting of income could also be behind some of these results. Unmarried households are more likely to be savers relative to the benchmark group, while larger households are also less likely to be savers, all else being constant.

Turning to indicators of housing tenure, the probability of saving rises if the representative person either owns their property with an outstanding mortgage, rents the property or uses it without cost. Owning a second property is associated with a drop of 6.2 percentage points in the probability of saving. The latter result suggests that, controlling for other factors, wealthier households are less likely to save, possibly because they have a bigger stock of wealth to fall back on in the event of a negative economic shock. This result should nevertheless be interpreted with caution since ownership of other property is an imperfect wealth proxy. Further research is needed to assess whether this result holds if one uses actual data on wealth, which is available from other surveys like the Household Finance and Consumption Survey (HFCS).

Conclusion
This box summarises the results of a study aimed at understanding the cross-sectional saving behaviour of Maltese households. The key findings are generally in line with theory and empirical literature, showing how rising income and age are associated with a higher likelihood of saving. The study is also important as it sheds light on the heterogeneity in saving patterns across different household characteristics. It therefore can serve as a useful input to model development as well as policy formation. Future work will investigate these patterns further using alternate data sources, like the HFCS, as well as focusing on and addressing relevant policy questions.

10 Higher employment risk may also be associated with a higher propensity for a household to be credit-constrained. This can be another channel that raises the saving rate of such households. This hypothesis also extends to the behaviour of households with high educational attainment. If the latter face fewer employment risks, then they are likely to be less credit-constrained, and therefore have a less pressing need to save.
11 The HBS dataset only includes the interest component of mortgage repayments in household expenditure. Therefore, intuitively, the increased saving by mortgagors likely corresponds to an allocation for debt financing. Meanwhile, as argued in Abela, G. and Gatt, W. (2021). “Saving behaviour in Malta: Insights from the Household Budgetary Survey”, Central Bank of Malta Working Paper WP/02/2021, most renters in the sample pay social rents. These, together with dwellers who reside in a property without cost, are likely to save more due to lower housing costs.
Business and consumer surveys
The European Commission’s ESI continued to recover from the trough recorded in 2020 as a result of the pandemic. In the first quarter of 2021, it rose to 89.6, from 82.1 in the preceding quarter. Notwithstanding this increase, the overall indicator remained below its long-term average of around 100.0 as the COVID-19 pandemic continued to weigh on consumer and business confidence throughout the quarter (see Chart 2.4).\(^8\)\(^9\) The overall ESI indicator also stood below that in the euro area, which averaged 95.3.

Confidence improved in services and, to a lesser extent, in industry and among consumers. By contrast, it fell in the construction sector and among retailers. On average, sentiment was negative in all sectors, with the most negative reading recorded in the retail sector.

When accounting for the variation in the weights assigned to each sector in the overall index, the increase in the ESI relative to the fourth quarter of 2020 was largely driven by the services sector and, to a smaller extent, by industry.\(^10\)\(^11\) Meanwhile, the contribution of consumers also edged up. By contrast, the construction sector contributed less positively, while the retail sector registered a more negative contribution compared to the previous quarter. The overall ESI remained below its long-term average, driven especially by negative sentiment in services and industry (see Chart 2.5).

\(^8\) The ESI summarises developments in confidence in five surveyed sectors: industry; services; construction; retail; and consumers. Quarterly data are 3-month averages.

\(^9\) 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.

\(^10\) Weights are assigned as follows: industry 40%; services 30%; consumers 20%; construction 5%; and retail trade 5%.

\(^11\) In January 2021, data were revised for previous periods following the annual updating of country weights and the inclusion of 2020 in the standardisation sample.
Confidence in the services sector turns less negative

Confidence in the services sector stood at -6.7, well above the -29.3 recorded in the fourth quarter of 2020. Notwithstanding this increase, sentiment remained below its long-term average of 18.9. The rise in sentiment was driven by developments across all sub-components of the indicator (see Chart 2.6). However, it mostly reflected an improvement in the backward-looking components, though these remained negative. Although the improvement in demand expectations was of a smaller magnitude, the balance of responses remained positive.

Supplementary survey data indicate that respondents’ price expectations were slightly less negative compared to the fourth quarter of 2020.

Industrial confidence increases from low levels

Confidence in the industrial sector edged up to -14.6, from -21.4 in the previous 3-month period, but remained well below its long-term average of -4.3 (see Chart 2.7). The recent rise in sentiment was largely driven by more optimistic production expectations and a decline in the number of firms reporting above normal stocks of finished goods. However, the assessment of order-book levels stood slightly more negative.

Additional survey data reveal a decrease in the share of firms foreseeing a fall in selling prices in the months ahead.

---

12 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.

13 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.

14 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.
Consumer confidence improves slightly\(^{15}\)

Consumer confidence averaged -6.0, marginally up from -7.9 in the previous quarter, and above its long-run average of -10.9 (see Chart 2.8).

The amelioration in consumer confidence reflected improved expectations about major purchases and, to a lesser extent, the general economic situation in the next 12 months. By contrast, consumers’ assessment of the financial situation and, to a smaller degree, their expectations of the financial situation in the 12 months ahead worsened in the quarter under review.

Supplementary survey data show a decrease in the share of respondents expecting unemployment to rise. The share of consumers anticipating prices to decline over the next 12 months remained broadly unchanged.

Confidence in construction turns negative\(^{16}\)

In the first quarter of 2021, confidence in the construction sector fell to -6.0, from 0.8 in the previous 3-month period. Notwithstanding this decline, sentiment remained above its long-term average of -11.0 (see Chart 2.9).

Weaker sentiment in the first quarter of 2021 was largely driven by an increase in the share of respondents assessing order books to be below normal levels. Moreover, employment expectations turned negative.

Supplementary survey data indicate that the assessment of building activity over the past three months deteriorated significantly in the quarter under review. Nonetheless, respondents anticipate selling prices to increase in the next three months.

---

\(^{15}\) 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.

\(^{16}\) 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 to employment expectations over the subsequent three months.
Confidence in the retail sector deteriorates significantly

Sentiment in the retail sector declined to -46.2, from -25.6 in the previous quarter, thus standing well below its long-term average of -2.3. The recent fall in sentiment was spread across all sub-components of the indicator, with firms’ assessment of their stocks of finished goods and of business activity in the past three months recording the largest deterioration (see Chart 2.10).

Supplementary survey data indicate that, on balance, orders expectations were significantly more negative compared to the fourth quarter of 2020. Meanwhile, the share of retailers anticipating a rise in prices in the coming months increased, while employment expectations turned mildly positive.

Employment Expectations Indicator (EEI) decreases

The EEI – which is a composite indicator of employment expectations in industry, services, retail trade and construction – edged down in the first quarter of the year. It averaged 88.1, compared with 89.3 in the preceding quarter. Following this decline, the index remained well below its long-term average of around 100.0 and also stood below the euro area average of 92.6.

During the quarter under review, employment expectations were negative in all sectors bar in the retail sector. Furthermore, they stood below their long-term average in all sectors (see Chart 2.11). When accounting for the variation in the weights assigned to each sector in the overall index, the marginal decline relative to the fourth quarter of 2020 largely reflected developments in the services sector and in industry. Employment expectations in the construction sector also contributed to the decline in the EEI, but to a much lesser extent. By contrast, the contribution of the retail sector was less negative compared to the preceding 3-month period.

17 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.

18 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.
The labour market

Labour force declines in annual terms but recovers in quarter-on-quarter terms

Labour Force Survey (LFS) data show that in the first quarter of 2021, the labour force declined by 0.8% over the same quarter of the previous year, following an annual growth of 0.1% in the previous quarter (see Table 2.5). The activity rate stood at 77.2% in the quarter under review, down from 77.6% a year earlier. The decrease in the overall participation rate reflects lower activity among males, as their activity rate fell by 1.2 percentage points to 85.0% but still remained above the euro area average of 77.5%. On the other hand, the participation of females rose by 0.6 percentage point to 68.3% – above the euro average of 67.7%.

On a quarter-on-quarter basis, however, the labour market continued to recover as the number of active persons (the labour force) increased by 1,921, fully reversing the decline of 325 persons seen during the last quarter of 2020. The number of employed people increased strongly, with the increase being almost double the decline in unemployment. Meanwhile, the number of inactive persons rose by 317 compared to the previous quarter.

Employment continues to recover, but remains below year ago levels

In the first quarter of 2021, employment fell by 1.1% in annual terms, following a decline of 0.8% in the previous quarter.

The decline in employment over the corresponding period of 2020 reflects a steep decline in part-time employment, which offset a rise in full-time jobs. The latter rose by 607 persons, or 0.3% in annual terms (see Table 2.5). On the other hand, the number of part-time employees – which also includes those employed full-time on reduced hours – declined by 3,456 persons, or 10.0% on a year earlier. Eurostat data show that this decrease was largely driven by the sector comprising wholesale and retail trade, transport, and accommodation and food services activities, followed by the education sector.

The overall employment rate fell by 0.5 percentage point on the same period of the previous year, to 74.2%. This reflected a decline in the male employment rate, which fell by 1.2 percentage points to 81.7%. This drop was evident in the 55-64 and the 15-24 age brackets. Conversely, the female employment rate rose by 0.3 percentage point to 65.7%, with the strongest increase recorded in the 15-24 age bracket.

On a quarterly basis, employment levels continued to recover from the losses that occurred in the second quarter of 2020, despite the escalation of COVID-19 measures during the first quarter of 2021 when compared to the last quarter of 2020. Indeed, the number of employed persons in the first quarter of 2021 rose by 3,291 persons, which follows an increase of around 378 persons

---

19 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.

20 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 were actively seeking a job during the previous four weeks and available for work within two weeks of the reference period.

21 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.

22 The employment rate measures the number of persons aged between 15 and 64 employed on a full-time or part-time basis as a proportion of the working-age population.
during the previous quarter. Despite the gradual improvement on a quarterly basis since the third quarter of 2020, employment levels in the first quarter of 2021 were almost 2,850 fewer than those that prevailed in the first quarter of 2020 (pre-pandemic).

Meanwhile, the number of unemployed persons declined by 1,370 compared to the fourth quarter of 2020, but was still 525 persons more compared to the first quarter of that year.

Another response to the pandemic was a decline in actual weekly hours, which fell to 33.7 in the first quarter of the year from 34.9 in the first quarter of the previous year (see Table 2.5). These also remained below those registered in the previous quarter, when they had stood at 34.6, likely reflecting the restrictions related to the pandemic introduced in March 2021.

**The unemployment rate remains low**

During the quarter under review, the unemployment rate based on the LFS stood at 3.9%, lower than the 4.4% registered in the previous quarter. Nevertheless, this rate was still higher than the 3.6% recorded a year earlier (see Table 2.5).

The jobless rate in Malta remained relatively low given the extent of the decline in economic activity – reflecting the highly supportive government measures. The Bank’s feedback from firms indicates that the Wage Supplement Scheme limited the extent of redundancies. In addition, labour

---

23 Actual hours refer to the number of hours actually spent at the place of work during the reference week for the main job. However, owing to increased flexibility at workplaces coupled with technology, the place of work may also include one’s home. In this regard, actual hours worked also include the hours of work carried out by persons who telework.

24 According to the LFS, the unemployed comprise persons aged between 15 and 74 years who are without work, available for work and who have actively sought work during the four weeks preceding the Survey. In contrast, the number of unemployed on the basis of the Jobsplus definition includes only those persons registering for work under Part 1 and Part 2 of the unemployment register.
market conditions 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 8.5% (see Chart 2.12).

The unemployment rate also stood marginally below the Bank’s structural measure of 4.0% during the first quarter of 2021. Estimates of structural measures are, however, highly uncertain in the current environment and should thus be treated with caution.

Jobsplus data show that the number of unemployed persons continued to decline on a monthly basis, following the peak in June 2020. However, it remained above that prevailing the year before. During the quarter under review, the average number of unemployed persons stood at 2,549 – 724 persons more than a year earlier, but 377 persons fewer than in the last quarter of 2020 (see Chart 2.13).

---

25 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”, Central Bank of Malta Working Paper 05/2014.
BOX 2: RENEWABLE ELECTRICITY IN MALTA: A QUESTION OF SOURCES

Malta had committed to reach a target share of energy from renewable sources of 10.0% by 2020 and 11.5% by 2030 in gross final consumption of energy.\(^2,3\) Focusing on the electricity component of energy consumption, renewable electricity production in Malta reached around 8.0% of the total by 2019, falling short of Malta’s renewable energy targets. In 2020, Malta had to purchase €2.0 million in renewable energy credits from Estonia to reach its EU targets for 2020, and it had previously also entered a €1.4 million 7-year deal with Bulgaria to cover the years 2013 to 2020.\(^4\)

This box looks at electricity supply in Malta and adjusts the total amount of electricity supplied in Malta with an imputation of the true underlying sources of production for electricity imported via the interconnector through the Italian electricity grid.

The production of renewable energy in Malta, as a share of electricity supply, has been increasing strongly over recent years (see Table 1).\(^5\) While it stood at 4.4% in 2015, it rose to 8.2% by 2019 – almost doubling. This was supported by the adoption of solar energy, which accounted for more than 97.0% of total renewable energy production in Malta in 2019. This push probably benefitted from policy initiatives to subsidise and promote the installation of solar panels in residential, commercial and public spaces. While commendable, this effort still fell short of achieving Malta’s renewable energy targets.

When looking at gross local electricity production alone, the renewable element exceeded the 10.0% threshold since 2016, although this share decreased from 15.9% in 2016 to 10.5% in

<table>
<thead>
<tr>
<th>Table 1</th>
<th>ELECTRICITY SUPPLY BY YEAR (Megawatt-hours)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>2016</td>
</tr>
<tr>
<td>Power Plants</td>
<td>1,203,236</td>
</tr>
<tr>
<td>Renewable sources</td>
<td>101,693</td>
</tr>
<tr>
<td>Gross production</td>
<td>1,304,929</td>
</tr>
<tr>
<td>Own use (Power Plants)</td>
<td>63,901</td>
</tr>
<tr>
<td>Net production</td>
<td>1,241,028</td>
</tr>
<tr>
<td>Imports (balance)</td>
<td>1,053,981</td>
</tr>
<tr>
<td>Exports (balance)</td>
<td>0</td>
</tr>
<tr>
<td>Electricity supply</td>
<td>2,295,009</td>
</tr>
</tbody>
</table>


\(^1\) Prepared by Reuben Ellul, Principal Economist at the Economic Analysis Department at the Bank. The views expressed in this article represent those of the author and should not be interpreted to reflect those of the Bank. The author would like to thank Mr Alexander F. Demarco and Dr Aaron G. Grech for their comments and suggestions. Any remaining errors are the author’s own.


\(^4\) Times of Malta (2020-01-25): “Malta must pay Estonia €2 million to reach renewable energy targets”.

2019. This suggests that in local production terms, no progress has been made in increasing the renewable element share.

**Transmitted electricity sources**

However, the picture described above changes once one accounts for the different sources of electrical energy supplied to Malta via the interconnector. The Italian Power Exchange managed by the Gestore del Mercato Elettrico (GME) publishes high frequency data for power supplied in its network, detailing times, loads and – crucially for this analysis – the estimated sources of the electricity being transmitted over the network towards a virtual zone for any given moment. For example, 14.8% of all electricity transmitted to Malta in 2019 derived from renewable sources. By summing up the proportion of electrical energy from renewable sources being transmitted to Malta via the interconnector, one can see the true environmental footprint of Malta’s electricity demand.

As Chart 1a shows, Malta appears to be making steady progress towards the 10.0% target, even if by 2019 this was not reached on the basis of renewable electricity sources produced in Malta alone. In Chart 1b, the net electricity import components are disaggregated into renewables and non-renewables. Using this simple accounting procedure – which matches the electricity source with the electricity imported by Malta – it appears that in almost all the five years to 2019, Malta would have

---

5 This refers to the Sicily-Malta electricity interconnector which was put in service in March 2015.

7 For the purposes of this analysis, renewable sources of electricity follow the GME classifications of Fer - Other renewable energetic sources, I.Modulazione - Basin hydro power plant and I.Fluente - Run of the river. The category I.Pompaggio - Pumped storage is excluded in line with Article 5, Par. 3 of Directive 2009/28/EC of the European Parliament and of the Council.
exceeded the 10.0% threshold for electricity being supplied from renewable sources (see Chart 2).

Some caveats must be made regarding the data. The sources are estimates arrived at by GME analysts, and the amount of electricity being transmitted from Italy may not always match readings recorded in Malta, due to electricity losses in transmission. Other caveats relate to measurement errors and assumptions regarding the netting of electricity exports from Malta, and the electricity use being consumed by the Maltese power plants for own use.

Policy implications and recommendations

While this approach sheds light on the interconnectedness of countries sharing an international grid and allows for a clearer picture regarding Malta’s environmental footprint, it should not be taken as a vindication of Malta’s energy policy. Further efforts are encouraged to even exceed Malta’s set targets, and to use the existing natural resources – whether solar, wind, other natural endowments or a combination of these – to shift Malta strongly into renewable energy production. Moreover, this simple analysis focuses on electricity generation and supply, which is only part of gross final energy consumption. It is the latter, rather than the former, which has a 10.0% renewable energy threshold requirement.

In terms of policy recommendations, provisions exist for EU Member States to set up shared projects in this field, with the positive impacts from renewable electricity projects being shared between participating countries. Transfers between participating countries are allowed under EU law. Similar arrangements may also be entered into with countries outside the EU for investment. Moreover, the EU recently introduced a new renewable energy financing mechanism, which considers closer cooperation between States on renewable projects, focusing on a more collective approach recognising the benefits in terms of lower emissions in both the countries contributing to projects, and to those hosting them.⁸

Finally, the data show that Malta has made bolder steps in shifting its supply towards renewable energy than would be indicated by a cursory reading of statistics. With further investment, Malta may soon achieve its set targets outright, at least in respect of electricity generation.

3. PRICES, COSTS AND COMPETITIVENESS

Annual inflation as measured by the HICP eased to 0.1% in March, from 0.2% in December, driven by slower growth in the prices of services and processed food. This offset an increase in NEIG inflation and unprocessed food inflation. Energy inflation was unchanged over this period.

Annual inflation based on the RPI – which only takes into account expenditure by Maltese residents – stood at 0.4%, up from 0.2% in December. At the same time, producer output price inflation turned positive, standing at 1.0% in March. Meanwhile, growth in Malta’s ULC index moderated to 10.5% in the first quarter of 2021. Malta’s harmonised competitiveness indicators (HCIs) point to a slight deterioration in international competitiveness over the year to March.

**Inflation**

**HICP inflation moderates**

Annual HICP inflation edged down to 0.1% in March, from 0.2% in December (see Table 3.1). Headline HICP inflation in Malta was below that recorded in the euro area (see Chart 3.1). This divergence largely stems from transitory factors, such as the reversal of the German VAT rate cut in January 2021 and base effects related to the recent increase in oil prices, which are exerting an upward impact on euro area inflation in 2021. Technical factors also contributed to this divergence. In particular, the 2021 change

<table>
<thead>
<tr>
<th>Table 3.1</th>
<th>HICP INFLATION</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual percentage change</strong></td>
<td>2020</td>
</tr>
<tr>
<td>Unprocessed food</td>
<td>2.1</td>
</tr>
<tr>
<td>Processed food including alcohol and tobacco</td>
<td>2.1</td>
</tr>
<tr>
<td>Energy</td>
<td>-1.2</td>
</tr>
<tr>
<td>NEIG</td>
<td>0.5</td>
</tr>
<tr>
<td>Services (overall index excluding goods)</td>
<td>0.4</td>
</tr>
<tr>
<td>All Items HICP</td>
<td>0.7</td>
</tr>
</tbody>
</table>

Sources: NSO, Eurostat.

1 The HICP weights are revised on an annual basis to reflect changes in overall consumption patterns. In 2021, the weight allocated to services stood at 42.6%, while that of NEIG was 28.6%. Food accounted for 22.1% of the index, while the share allocated to energy stood at 6.7%.
in HICP weights due to the pandemic’s impact on households’ consumption basket had a small negative impact on overall HICP inflation in Malta, but a broadly neutral effect has been detected for the euro area.2

The fall in HICP inflation relative to December reflected slower growth in services prices, and, to a lesser extent, slower growth in processed food prices. These developments offset an increase in NEIG and unprocessed food inflation. Services inflation, NEIG inflation and food inflation all contributed positively to HICP inflation, with energy inflation being the only negative contributor (see Chart 3.2).

Services inflation decelerated from 0.9% in December, to 0.3% in March. The drop in services inflation mainly reflected a negative contribution from recreation and personal care services which include accommodation services (see Chart 3.3). The latter was driven by a decrease in the weight attributed to this component.

Moreover, food inflation moderated from the rates recorded three months earlier, as processed food inflation fell to 0.6% in March from 1.1% in December. On the other hand, unprocessed food inflation rose marginally to 1.1%, from 0.9% over the same period. As a result, the overall contribution of food to HICP inflation stood at 0.1 percentage point in March, slightly down from 0.2 percentage point in December.

NEIG inflation increased to 0.4% in March, from -1.0% in December. This component has been weak for a prolonged period, mainly as a result of downward international price pressures on traded manufactured goods. The pick up in March may reflect the recent rise in transport prices and disruptions to global value chains caused by the pandemic.

Energy inflation stood at -3.5% in March, unchanged from the rate recorded three months earlier.

earlier. Negative inflation in this component was partly driven by the cut in prices of fuel for transport in June 2020, which began to be felt fully as from July. It also reflects a cut in gas prices in April 2020.

**Core HICP inflation exceeds headline inflation**

Core inflation, which excludes the more volatile components of the HICP index, rose to 0.4% in March, from 0.1% three months earlier (see Chart 3.4). Hence, it was higher than overall HICP inflation. The divergence between the two measures of inflation reflects the exclusion of volatile items from the core measure and the different impact of the 2021 update of weights on the two measures.

**RPI inflation increases**

Annual inflation based on the RPI index, which is based on a different basket of goods and services from the HICP index, and a different frequency of weight updates, increased to 0.4% in March, from 0.2% in December (see Table 3.2). The increase in RPI inflation was primarily driven by a higher contribution from clothing and footwear prices as well as prices of household equipment and house maintenance costs. Furthermore, prices of transport and communications services decreased at a slower pace compared to December.

### Table 3.2

**CONTRIBUTIONS TO YEAR-ON-YEAR RPI INFLATION**

<table>
<thead>
<tr>
<th>Item</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>0.4</td>
<td>0.3</td>
</tr>
<tr>
<td>Beverages and tobacco</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Clothing and footwear</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Housing</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Water, electricity, gas and fuels</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Household equipment and house maintenance costs</td>
<td>-0.1</td>
<td>-0.1</td>
</tr>
<tr>
<td>Transport and communications</td>
<td>-0.2</td>
<td>-0.4</td>
</tr>
<tr>
<td>Personal care and health</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Recreation and culture</td>
<td>-0.2</td>
<td>-0.2</td>
</tr>
<tr>
<td>Other goods and services</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td><strong>RPI (annual percentage change)</strong></td>
<td><strong>0.6</strong></td>
<td><strong>0.4</strong></td>
</tr>
</tbody>
</table>

Source: NSO.

---


4 The RPI index differs from the HICP index in that RPI weights are based on expenditure by Maltese households, while HICP weights also reflect expenditure patterns by tourists in Malta, such as accommodation services. See Darmanin, J. (2018), “Household Expenditure in Malta and the RPI Inflation Basket”, Quarterly Review 2018(3), pp. 33-40, Central Bank of Malta. Due to the strong impact of the pandemic on tourist expenditure, the two measures are expected to deviate significantly as weights in the HICP have changed significantly while those of the RPI have not been adjusted.
BOX 3: THE INFLATION EXPERIENCE OF LOW-INCOME HOUSEHOLDS

There are two main measures of consumer price inflation in Malta: the RPI and the HICP. Both indices measure changes in the cost of purchasing a representative basket of consumer goods and services. In the case of the RPI, this basket is mainly derived using expenditure shares for residents of Malta obtained from the Household Budgetary Survey (HBS). On the other hand, the HICP basket is derived from expenditure shares in national accounts consumption data, a methodology that is harmonised across the EU. Due to these basket differences, the RPI measures cost-of-living increases for resident households, while the HICP also takes into account the expenditure of non-residents.

This box focuses on the RPI, in view of the relevance of this index for adjusting wages and rents in Malta.

The use of average expenditure patterns to derive the weights for different categories of expenditure can mask significant differences in consumption across different household types, and hence differences in the rate of inflation faced by them. Therefore, the overall average inflation rate may not always accurately reflect the cost-of-living increases experienced by certain subsets of households, such as those in the bottom income quartile.

This box estimates the inflation rate faced by low-income households in Malta from 2010 to 2020 and assesses the implications on the real value of social benefits distributed to these households. This estimation is derived by re-weighting the official RPI inflation rate using expenditure shares for low-income households from the HBS, and is referred to in the text as the low-income household (LIH) rate. For the purposes of this study, a low-income household is defined as a household within the bottom income quartile, earning less than €12,491 per annum in disposable income in 2015.

The expenditure patterns of different household types

The products and quantities consumed can vary considerably across different kinds of households and over time within the same household. Chart 1 provides an example from the most recent HBS edition, which carries data for the reference year 2015. It shows how household budget shares vary across the income spectrum. In particular, compared to other groups, low-income households exhibit larger shares of expenditure on basic necessities such as food, housing, energy and health. On the other hand, high-income households tend to spend a larger percentage of their incomes on restaurants and hotels, recreation and culture, as well as transport services.

---

1 Written by Jude Darmanin, a Senior Economist working in the Economic Analysis Department at the Central Bank of Malta.
Due to such differences in expenditure patterns, overall measures of inflation may deviate from changes in the cost of living of certain household types. Indeed, Table 1 shows that current RPI weights are generally quite different from the expenditure shares defined in the latest HBS for low-income households. This discrepancy between official RPI weights and expenditure shares for low-income households mainly occurs because the composition of the basket of goods and services used to determine overall inflation depends on all households’ consumer spending on each good and service divided by the economy-wide spending. Hence, RPI weights tend to be skewed by the spending patterns of higher-income households, which account for a disproportionately larger share of total spending.

Did low-income households experience a higher inflation rate between 2010 and 2020?
In order to estimate the inflation rate faced by low-income households, this study re-weights the official RPI inflation rate between 2010 and 2020, using the consumption basket for households in the bottom income quartile. These expenditure shares are obtained from
disaggregated expenditure data provided by the NSO from the HBS 2008 and HBS 2015.

Chart 2 shows the estimated inflation rate calculated for low-income households (the LIH rate), compared with the official RPI inflation rate. Both the estimated LIH rate and the official rate generally followed the same trend since 2010. However, due to the difference in consumption baskets reported in Table 1, there have been periods where the inflation rate for low-income households has diverged from the official RPI. In particular, the inflation rate faced by households in the bottom income quartile was significantly higher during periods when food inflation was high, such as in the first half of 2010 and in 2013. The difference between the two rates peaked at over 1 percentage point during these two periods.

After 2013, the gap was generally smaller, following a sharp drop and subsequent stabilisation in energy prices. Between 2016 and 2019, inflation for low-income households on average stood 0.1% above the official RPI. However, the gap re-widened somewhat during 2020, to over 0.7 percentage point at one instance. This was mainly due to the sharp reduction in education tuition fees during the COVID-19 pandemic, which carries a much higher weight in the official RPI than in the LIH rate. This is primarily because low-income households tend to make more use of state-funded education (which is a benefit-in-kind) rather than private tuition.

The real value of social benefits

The next step in this study was to establish whether social benefits granted to low-income households maintained their real value during the intervening period. In Malta, the main mechanism used to compensate households for cost-of-living increases is the cost-of-living adjustment (COLA). The COLA is a partial indexation mechanism, whereby incomes and social benefits in Malta are adjusted for consumer price increases in the previous 12-month period. It is calculated on the basis of the percentage increase in the RPI applied to the social wage, established by agreement between the Government and social partners.

Chart 3 depicts the evolution of the actual minimum wage in Malta since 2010. It also shows the minimum wage as at 2010, incremented annually by both the RPI inflation rate and the estimated LIH rate. This shows by how much the minimum wage would have increased had
annual increments been based on pure inflation indexation – i.e. just enough to maintain its 2010 purchasing power.

The results suggest that the actual minimum wage as of 2020 stood above the minimum wage indexed only by RPI inflation, meaning that it exceeded its 2010 real value. There are two reasons for this. Firstly, as the minimum wage is lower than the social wage, the annual increments to the minimum wage as a result of the COLA are higher in percentage terms than the official inflation rate. Secondly, the minimum wage may also be supplemented by ad hoc government allowances unrelated to the COLA. For example, in 2017, the Government and social partners signed the National Agreement on the Minimum Wage. As part of this agreement, the weekly COLA for 2018 and 2019 was to be supplemented by an additional €1 per week for persons earning the minimum wage.

Chart 3 also suggests that the actual minimum wage as of 2020 stood at broadly the same level as the wage indexed by the estimated LIH inflation rate. Hence, even when accounting for the estimated inflation faced by low-income households, the minimum wage still maintained its 2010 real value in 2020. The closeness of the two series – particularly since 2014 – highlights the importance of the additional weekly supplement granted by Government during this period. In the absence of this supplement, the actual minimum wage in 2020 would have dropped below the LIH-indexed wage.

Apart from the minimum wage, a source of income received by a large number of households within the bottom income bracket is the national minimum pension. This is shown in Chart 4, along with a similar analysis of its real value as that done for Chart 3. Unlike the minimum wage, the minimum pension is only incremented by two-thirds of the COLA. However, the minimum pension has been subject to non-COLA increments to a much larger extent than the minimum wage in recent years. Examples include the Cost-of-Living-Bonus (CLBO), which was introduced in 2008 and is equivalent to the one-third COLA, and a number of increments introduced from 2016 onward.

---

7 Minimum pension calculations are based on a person retiring in 2010.
8 Budget measures affecting the national minimum pension can be found at https://finance.gov.mt/en/The-Budget/Pages/default.aspx
When accounting for all increments, the national minimum pension has significantly exceeded the inflation-indexed pension since 2013. This is the case when accounting for official RPI inflation as well as for the estimated LIH rate and suggests that the purchasing power of the national minimum pension as of 2020 was higher than in 2010.

**Conclusion and limitations**

These results suggest that during the period between 2010 and 2020, households in the bottom income quartile did experience some periods of higher inflation compared with the official rate, particularly when food prices were rising. However, the differential between inflation faced by low-income households and the official RPI rate has narrowed significantly in recent years, mainly reflecting lower inflation for essential commodities such as energy.

When accounting for official RPI inflation, the minimum wage and the minimum pension in 2020 both recorded increases in their real value. When accounting for the estimated LIH inflation rate, the real value of the minimum wage was maintained, while that of the minimum pension increased. This is mainly due to additional government pension allowances beyond the COLA. Here it must be noted that the aim of this analysis was to assess the real value of social benefits over time, not to evaluate the adequacy of these benefits.

It is necessary to highlight some caveats with the above analysis. The calculation of consumption baskets based on the RPI classification requires the re-classification of the individual expenditure items found in the HBS, which depends heavily on the author’s assumptions and calculations. Furthermore, the sample population surveyed by the HBS is taken from the latest Census, which was held in 2011. During the intervening period, the population of Malta grew rapidly due to migrant inflows, which may have significantly altered the household distribution away from that used in the HBS. The HBS is published very infrequently, and hence its ability to capture changes in consumption patterns over time is limited. A case in point is the change in consumption patterns during 2020 caused by the COVID-19 pandemic and subsequent containment measures.

Moreover, this study does not take into account the impact of social benefits in kind, such as public health and education. Since these benefits tend to be provided at zero cost or below market price by the Government, this might ultimately lead to an overestimation of the inflation rate faced by low-income households.
This study takes price changes as given by the official RPI index. The products included in the RPI basket are representative products, and hence the inflation rate does not take into account the wide range of substitutable products available for consumption, to which consumers can turn in response to price changes.

Further research in this area should include a more detailed, micro-level study on the specific products purchased by low-income households, as well as changes in the prices of these products. This research could be used to calculate an inflation index for low-income households, separate from the official RPI. Such an index could serve as a guide in measuring by how much social benefits could be increased over and above the COLA to ensure that the purchasing power of low-income households is maintained. This would make the granting of supplementary allowances more transparent and effective, as current benefit adjustments tend to depend on the prevailing cyclical fiscal position.⁹

⁹ A similar suggestion was made by Caritas, with the proposal of a Minimum Essential Budget for a Decent Living in Malta for a number of different household types. See Caritas (2020) "A Minimum Essential Budget for a Decent Living".
Residential property prices

Residential property prices grow at a faster pace

The NSO’s Property Price Index (PPI) – which is based on actual transactions involving apartments, maisonettes and terraced houses – continued to increase in annual terms. The annual rate of change edged up to 4.7% in the first quarter of 2021, from 1.6% in the previous quarter (see Chart 3.5). However, house price inflation in Malta stood below that in the euro area, where prices increased at an annual rate of 5.8%.

Notwithstanding the acceleration in the first quarter of 2021, house price inflation still remains below that recorded in the four years before the pandemic. This reflects a degree of stabilisation in the housing market, following a period of above-average growth.

At the same time, when assessed from a shorter perspective, house prices appear to have returned to a dynamic path, following the lull during the first phase of the pandemic, likely supported by the relaxation of containment measures and enhanced government support to the property sector from mid-2020. For example, in June 2020, the Government lowered the property tax rate and stamp duty on eligible transfers of immovable property. 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. These measures, initially intended for final transfers made before 1 April 2021, were later extended to final transfers made before 1 February 2022, on condition that the notice of promise of transfer or sale is submitted to the Commissioner of Inland Revenue before 1 August 2021 and notice of the final deed is received by not later than 28 February 2022. Also, Budget 2021 extended or introduced more favourable terms on a number of schemes supporting the property market that were in place before the pandemic.

6 These reductions in taxes on property transfers and stamp duty were introduced in terms of Legal Notices 240 and 241 of 2020.
7 Legal Notice 240 was followed by Legal Notice 427 of 2020 and Legal Notice 130 of 2021. Legal Notice 241 was followed by Legal Notices 459 of 2020 and 129 of 2021.
8 These include the first-time and second-time buyers’ schemes, the purchase of vacant property located in Urban Conservation Areas (UCA), purchases of property in Gozo as well as the refund schemes for restoration expenses. Furthermore, the threshold for the duty exemption for first time buyers was increased from €175,000 to €200,000, while that applicable on immovable property donated by parents to their descendants was increased from €200,000 to €250,000.
Costs and competitiveness

Producer price inflation turns positive
Annual inflation based on the industrial producer price index, which measures domestic factory output prices, recovered from recent declines. Annual producer price inflation stood at 1.1% in March, up from -0.1% three months earlier. This reflected a return to positive growth in intermediate goods prices, which offset slower growth in capital goods and consumer goods prices. Energy inflation remained zero.

HCIs point to a slight improvement in competitiveness compared to December
Annual growth in Malta’s nominal HCI remained positive in March, which suggests a deterioration in international competitiveness over the year. In March, the nominal HCI grew by an annual rate of 0.8%, reflecting an appreciation in the euro exchange rate against currencies of trading partners (see Chart 3.6). At the same time, the real HCI fell by -0.8%, suggesting that the loss in international competitiveness arising from a stronger euro was offset by favourable developments in relative prices vis-à-vis trading partners.

When compared with December, both the nominal and real HCI fell, suggesting an improvement in competitiveness on a quarter-on-quarter basis.

ULC growth moderates
Malta’s ULC index – measured as the ratio of compensation per employee to labour productivity – moderated during the first quarter of 2021, but remained elevated. When measured on a 4-quarter moving average basis in headcount terms, ULC in Malta grew at an annual rate of 10.5%. This followed an 11.4% increase in the previous quarter (see Chart 3.7).

The moderation in ULC growth was driven by a smaller decline in labour productivity. Conversely growth in compensation

---

9 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.
10 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.
Labour productivity was down by an annual 9.5% over the year to March, following a 10.4% decrease in the previous quarter. The decline in productivity reflects the sharp drop in economic growth, which coincided with an increase in employment. The resilience of employment over the year to March reflects 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, notwithstanding the sharp contraction in economic activity caused by the pandemic.

Hours worked fell by 7.0% on a 4-quarter moving average basis, compared to a decrease of 7.4% in the previous quarter. Productivity per hour fell by 1.6%, following a rise of 0.2% in the fourth quarter. On the other hand, compensation per hour rose by 8.3% in annual terms, down from 10.6% in the previous quarter. Thus, growth in ULC per hour moderated to 10.0%, following a 10.3% increase in the fourth quarter of 2020 (see Chart 3.8).

---

12 Hours worked refer to employee hours.
4. THE BALANCE OF PAYMENTS

During the first quarter of 2021, the current account showed a deficit when compared to a surplus in the first quarter of 2020. This shift to a deficit was mostly due to a decline in net services receipts, although a larger deficit on merchandise trade also contributed. By contrast, net primary and secondary income outflows decreased.

In the quarter under review, net inflows on the capital account decreased when compared to the corresponding quarter of last year, while net lending on the financial account was registered as opposed to net borrowing in the first quarter of 2020.

When measured as a 4-quarter moving sum, the current account balance registered a deficit equivalent to 4.2% of GDP. This contrasts with a current account surplus of 2.5% of GDP in the euro area.¹

The cyclically-adjusted current account balance is estimated to have recorded a deficit of 5.7% during the first quarter of 2021 and thus it is below the unadjusted measure.

The current account

The current account registers a deficit

Between January and March 2021, the current account registered a deficit of €42.6 million, when compared to a surplus of €29.8 million in the same quarter of 2020 (see Table 4.1). The shift to a deficit was mostly driven by a fall in net services receipts. In addition, a small widening in the merchandise trade deficit also contributed. These movements offset lower net outflows on the primary income and secondary income accounts.

When measured as a 4-quarter moving sum, the balance on the current account showed a deficit of €529.7 million in the first quarter of 2021, as opposed to a surplus of €854.5 million a year earlier. This shift was largely spurred by lower net receipts from trade in services, mostly reflecting the sharp decline in net travel receipts following the global spread of COVID-19 and, to a lesser extent, higher net outflows on the primary income. By contrast, the merchandise trade deficit narrowed and net outflows on the secondary income decreased. The current account-to-GDP ratio

<p>| Table 4.1 | BALANCE OF PAYMENTS |</p>
<table>
<thead>
<tr>
<th>EUR millions</th>
<th>2019</th>
<th>2020</th>
<th>2020 Q1</th>
<th>2021 Q1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current account</td>
<td>778.6</td>
<td>-457.3</td>
<td>29.8</td>
<td>-42.6</td>
</tr>
<tr>
<td>Goods</td>
<td>-1,583.8</td>
<td>-1,356.4</td>
<td>-352.1</td>
<td>-369.0</td>
</tr>
<tr>
<td>Services</td>
<td>3,649.3</td>
<td>2,316.7</td>
<td>720.7</td>
<td>608.7</td>
</tr>
<tr>
<td>Primary income</td>
<td>-1,121.6</td>
<td>-1,254.0</td>
<td>-294.5</td>
<td>-245.3</td>
</tr>
<tr>
<td>Secondary income</td>
<td>-165.3</td>
<td>-163.6</td>
<td>-44.2</td>
<td>-37.0</td>
</tr>
<tr>
<td>Capital account</td>
<td>107.2</td>
<td>81.0</td>
<td>23.3</td>
<td>7.2</td>
</tr>
<tr>
<td>Financial account(¹)</td>
<td>162.6</td>
<td>-314.7</td>
<td>-101.7</td>
<td>57.6</td>
</tr>
<tr>
<td>Errors and omissions</td>
<td>-723.2</td>
<td>61.6</td>
<td>-154.8</td>
<td>93.0</td>
</tr>
</tbody>
</table>

Source: NSO.

¹ Net lending (+) / net borrowing (-).

¹ Balance of payments data for 2020 and 2021 should be interpreted in the context of the unprecedented developments related to COVID-19.
edged down to -4.2%, from 6.2% a year earlier (see Chart 4.1).

Malta’s cyclically-adjusted current account balance is estimated to have stood at -5.7% of GDP in the first quarter of 2021. The cyclically-adjusted measure recorded a deficit for the third consecutive period, thus exhibiting similar developments to the unadjusted measure. Furthermore, the cyclically-adjusted measure stands below the headline measure, which suggests that Malta’s economic cycle was weaker than that estimated for its trading partners (see Chart 4.1). However, given the high uncertainty and the volatility in trade related to COVID-19, cyclically-adjusted estimates are likely to be affected by several one-off factors that are difficult to quantify and interpret. For example, the degree of underutilisation in sectors hit hardest by the pandemic is likely more significant than the output gap measure for the whole economy used to derive the cyclically-adjusted balance. This factor is likely contributing to the deterioration in the cyclically-adjusted balance since the onset of the pandemic in the first quarter of 2020.

The merchandise trade deficit widens compared to the first quarter of 2020

In the first quarter of 2021, the merchandise trade deficit stood at €369.0 million, €16.9 million more than in the corresponding period of 2020. This was driven by a decrease in exports which outweighed a contraction in imports.

By contrast, when measured on a 4-quarter cumulative basis, the visible trade gap narrowed to €1,373.3 million – €154.9 million less than the deficit recorded a year earlier. This stemmed from a €698.7 million fall in merchandise imports, which offset a €543.8 million drop in exports. As a result, the share of the goods deficit in GDP fell to 10.8%, from 11.1% in the year to March 2020 (see Chart 4.2).

---

The surplus on services narrows

In the quarter under review, net receipts on the services account amounted to €608.8 million, €111.9 million less than in the corresponding period of 2020. Both services receipts and payments decreased on a year earlier, but the fall in the former was substantially larger.

The decrease in the surplus was mainly driven by a sharp decline in net travel receipts. These declined by €85.3 million to stand at just €10.3 million. Both receipts and payments within the travel account dropped sharply, but the decrease in the former was almost three times the latter. This reflects continued disruptions to both inbound and outbound travel, as some travel restrictions – as well as fear of travel – remained elevated in the first quarter of the year. These factors also contributed to a decrease in net receipts on the transport account, which fell to €65.1 million, from €96.5 million last year.

On the other hand, the surplus on ‘other services’ increased marginally to €533.4 million, from €528.7 million a year earlier. A rise in net receipts related to personal, cultural and recreational services – which include remote gaming - completely offset a fall in net financial services receipts and higher net payments related to ‘telecommunications, computer and information services’ as well as ‘other business services’.

On a 4-quarter cumulative basis, the overall surplus from services stood at €2,204.7 million, a decrease of €1,484.5 million when compared with the corresponding period of 2020. The main contributor to this decline was the significant drop in net travel receipts. As a result, the share of net services receipts in GDP dropped to 17.4% in the 12 months to March 2021 from 26.9% in the corresponding period of 2020 (Chart 4.3).

Primary income account continues to show net outflows3

Between January and March 2021, net outflows on the primary income account stood at €245.3 million, €49.2 million lower than in the first quarter of 2020.

Conversely, during the four quarters to March, such outflows reached €1,204.8 million, €67.1 million more than in the same period a year earlier. Higher net outflows were driven by higher net payments of investment income, although lower net interest receipts on portfolio investment also contributed. By contrast net receipts from other investment increased. Flows relating to primary income continued to be strongly influenced by internationally-oriented firms which transact predominantly with non-residents.

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 first quarter of the year, net outflows on the secondary income account decreased by €7.2 million on a year earlier, to €37.0 million.

During the year to March 2021, net outflows on this account stood at €156.4 million – €12.5 million less than the amount recorded a year earlier.

Tourism activity

Activity in the tourism sector

In the first quarter of 2021, COVID-19 related restrictions and hesitation to travel continued to severely affect the tourism sector. The number of inbound tourists, nights stayed and tourist expenditure in Malta remained significantly below those recorded in the corresponding period of 2020. The number of inbound tourists amounted to 33,249 in the first quarter of 2021, less than a tenth of the number registered in the first quarter of 2020 (see Chart 4.4). In absolute terms, tourists visiting Malta for leisure purposes accounted for most of the year-on-year decline in arrivals, although the number of visitors with business and other motives also decreased.

Meanwhile, the total number of guest nights that tourists spent in Malta during the first quarter of 2021 fell to 0.5 million, from over 2.2 million a year earlier, with rented accommodation accounting for most of this decline.

The total occupancy rate in collective accommodation establishments in the first quarter of 2021 edged down to 10.2%, from 37.4% in the corresponding quarter of 2020 (see Chart 4.5). The 4-star category reported the largest decline – of 38.6 percentage points – followed by a drop of 29.4 percentage points in the 2-star category. In contrast to a year earlier, when 4-star establishments recorded the...
highest accommodation rate, this category registered the lowest occupancy rate of 7.8% in the first quarter of 2021. The highest occupancy rates were registered in the 3-star and 2-star categories.

Tourist expenditure in Malta also remained significantly below its year-ago level (and pre-pandemic levels), standing at €30.5 million during the first quarter of the year. The decrease relative to 2020 was driven by lower non-package and ‘other’ expenditure, although spending on package holidays also decreased significantly.

Expenditure per capita increased to €916.1 from €606.6 a year earlier, as the average length of stay increased to 13.8 nights, from 6.0 nights a year earlier.

According to Malta International Airport (MIA) data, in the first quarter of 2021, average seat capacity decreased by 86.5% relative to the corresponding period a year earlier and was broadly equivalent to an eighth of its level in the first quarter of 2019 (see Chart 4.6).

A total of nine cruise liners visited Malta in the first quarter of 2021, as in the previous year. Foreign passengers were down to 7,961 persons, from 40,173 persons in the first quarter of 2020 (see Chart 4.7). This reflected primarily a decrease in the number of visitors coming from France, Italy, the United Kingdom and the United States. Visitors from Germany and Spain, however, were also significantly short of the number registered in the first quarter of 2020.

The capital account
Net inflows on the capital account stood at €7.2 million in the first quarter of 2021, down from €23.3 million in the corresponding period of 2020 (see Table 4.1). Capital inflows also decreased when measured on a 4-quarter moving sum basis, standing at €64.9 million, compared to €98.9 million in 2020.
5. GOVERNMENT FINANCE

COVID-19 continued to have a negative impact on general government finances during the first quarter of 2021, with the general government deficit significantly wider than that recorded in the corresponding period a year earlier. When measured on a 4-quarter moving sum basis, the general government balance registered a deficit of 10.6% of GDP. Meanwhile, the general government debt-to-GDP ratio increased to 59.0% from 54.8% at end-December 2020. Although the stock of financial assets held by the Government increased during the period under review, this was offset by a larger increase in financial liabilities. Consequently, the net financial worth as a share of GDP worsened.

Quarterly developments

General government deficit widens
In level terms, the general government registered a deficit of €425.3 million in the first quarter of 2021, a deterioration of €42.6 million when compared with the corresponding quarter of 2020. This was largely due to an increase in expenditure, which outweighed that in revenue. As a result, the primary deficit widened from €341.3 million in the first quarter of 2020 to €384.6 million a year later.

Higher tax receipts from income and wealth underpin revenue growth
In the first quarter of 2021, general government revenue increased by €167.0 million, or 18.2%, when compared with the same quarter of 2020 (see Table 5.1). This was largely due to an increase

<table>
<thead>
<tr>
<th>Table 5.1</th>
<th>REVENUE, EXPENDITURE AND DEBT</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR millions</td>
<td>2020</td>
</tr>
<tr>
<td>Q1</td>
<td>Q2</td>
</tr>
<tr>
<td>Revenue</td>
<td>916.3</td>
</tr>
<tr>
<td>Taxes on production and imports</td>
<td>335.0</td>
</tr>
<tr>
<td>Current taxes on income and wealth</td>
<td>273.1</td>
</tr>
<tr>
<td>Social contributions</td>
<td>162.3</td>
</tr>
<tr>
<td>Capital and current transfers receivable</td>
<td>44.7</td>
</tr>
<tr>
<td>Other(1)</td>
<td>101.2</td>
</tr>
<tr>
<td>Expenditure</td>
<td>1,299.0</td>
</tr>
<tr>
<td>Compensation of employees</td>
<td>385.9</td>
</tr>
<tr>
<td>Intermediate consumption</td>
<td>195.2</td>
</tr>
<tr>
<td>Social benefits</td>
<td>322.5</td>
</tr>
<tr>
<td>Subsidies</td>
<td>82.9</td>
</tr>
<tr>
<td>Interest</td>
<td>41.4</td>
</tr>
<tr>
<td>Other current transfers payable</td>
<td>87.0</td>
</tr>
<tr>
<td>GFCF</td>
<td>133.6</td>
</tr>
<tr>
<td>Capital transfers payable</td>
<td>49.0</td>
</tr>
<tr>
<td>Other(2)</td>
<td>1.4</td>
</tr>
<tr>
<td>Primary balance</td>
<td>-341.3</td>
</tr>
<tr>
<td>General government balance</td>
<td>-382.7</td>
</tr>
<tr>
<td>General government debt</td>
<td>5,933.4</td>
</tr>
</tbody>
</table>

Source: NSO.
(1) "Other" revenue includes market output as well as income derived from property and investments.
(2) "Other" expenditure principally reflects changes in the value of inventories and in the net acquisition of valuables and other assets.
in tax revenue, which was adversely hit in the first quarter of 2020 when non-essential businesses were first obliged to close and travel restrictions started being implemented.

Revenue from current taxes on income and wealth, and from social contributions jointly increased by over €150.0 million in the period under review. This reflects a recovery in the labour market as well as higher inflows from income taxes paid by firms. Moreover, other revenue increased by €14.2 million, on the back of revenue from sales. Capital and current transfers receivable increased by €8.4 million.

Meanwhile, taxes on production and imports recorded a drop of €9.0 million. Although receipts from VAT increased, this was offset by lower inflows from import duties and stamp duty on property. The latter reflects the temporary reduction in tax rates on property transfers and property purchases.

**Current expenditure underpins expenditure growth**

Total government expenditure surged by €209.6 million or 16.1% when compared with the first quarter of 2020. This mostly reflects an increase in recurrent expenditure items, reflecting spending on treatment for COVID and related economic support measures. Such outlays were comparatively lower in the first quarter of 2020, as implementation of most measures started late in the quarter.

Intermediate consumption grew by €118.7 million, mainly due to higher outlays within the public administration and increased spending on health. These remained elevated due to ongoing COVID-19 testing and vaccination. Subsidies increased by €53.6 million on the back of continued COVID-related support measures, notably the Wage Supplement Scheme. Compensation of employees rose by €46.8 million, partly due to higher outlays in the health care sector. Spending on social benefits increased by €20.2 million, partly reflecting higher expenditure on pensions. Furthermore, other current transfers payable rose by €2.3 million.

Meanwhile, interest payments declined by €0.7 million, as interest payments on new debt issues were lower than foregone interest on maturing debt.

The substantial increase in current expenditure was partly dampened by a fall in capital expenditure – largely on account of lower government investment. This reflects the timing of payments on infrastructural projects part financed by the EU, as well as lower outlays on other, locally-financed projects. Moreover, outlays on capital transfers declined by €8.1 million.

**Debt increases**

In March 2021, the stock of general government debt amounted to €7,478.2 million, €519.6 million more than the level registered at the end of December 2020. The increase in debt mainly reflects the issue of new long-term debt securities to fund the shortfall in public finances caused by the pandemic as well as an increase in long-term loans outstanding.

The stock of long-term securities outstanding (composed of MGS) increased by €270.6 million. However, their share in total debt declined by 1.7 percentage points to 75.3%. At the same time, the stock of short-term securities (composed of Treasury bills) increased by €123.8 million, with their share in total debt increasing by 1.1 percentage points to 9.5%.
Loans outstanding increased by €126.9 million, mainly attributable to an increase in long-term loans. This reflects the second tranche of funds from the EU’s Support to mitigate Unemployment Risks in an Emergency (SURE) instrument. The share of total loans in debt rose by 1.2 percentage points to 8.5%.

Headline and cyclically-adjusted developments

Headline deficit and debt ratios increase

When measured on a 4-quarter moving sum basis, the general government deficit widened from 10.2% of GDP in the fourth quarter of 2020 to 10.6% in the quarter under review (see Chart 5.1).

The deterioration in public finances was mainly driven by a rise in the expenditure-to-GDP ratio, which rose to 48.7% from 47.0% at end December 2020 – mainly due to a 2.0 percentage points increase in the share of current expenditure in GDP, largely reflecting higher expenditure related to the COVID-19 pandemic. This was slightly offset by a decrease of 0.3 percentage point in the share of capital expenditure in GDP. Meanwhile, the government revenue-to-GDP ratio increased by 1.4 percentage points, almost entirely on the back of higher current revenue.

Between December 2020 and March 2021, the debt-to-GDP ratio increased by 4.2 percentage points to 59.0%. The rise in general government debt was higher than the fiscal deficit recorded in this period, due to a positive deficit-debt adjustment stemming from the accumulation of government deposits (see Chart 5.2).

Net financial worth deteriorates further

The market value of financial assets increased to €4,320.5 million by March 2021, €256.8 million more than the level as at end December 2020. This was mainly due to a rise in
other accounts receivable and, to a lesser extent, in the value of currency and deposits. As a result, the share of financial assets in GDP increased by 2.1 percentage points to 34.1% (see Chart 5.3). Meanwhile, the stock of financial liabilities increased more strongly than financial assets. The former rose by €539.1 million, to stand at €9,797.3 million, largely reflecting a strong increase in debt securities and loans, but also reflecting higher accounts payable. As a result, the share of financial liabilities in GDP rose by 4.4 percentage points to reach 77.2%.

The resulting net financial worth of general government as a share of GDP stood at -43.2%, which is less favourable than the -40.9% 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’s. The latter stood at -75.5% as a share of GDP, compared with -75.6% at end-2020.

**Debt ratio continues to compare favourably with the euro area’s despite a higher deficit**

During the quarter under review, the euro area general government deficit stood at 8.4% of GDP on a 4-quarter moving sum basis, following a deficit of 7.3% of GDP at end-2020 (see Chart 5.4). Over the same period, the euro area debt ratio rose to 100.5% of GDP from 97.8%. Malta’s deficit ratio increased by less than the euro area average. Although the Maltese government debt-to-GDP ratio rose at a stronger pace, it remains well below the corresponding ratio for the euro area.
Cyclically-adjusted deficit improves marginally

The pandemic has introduced 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.

On a 4-quarter moving sum basis, the cyclically-adjusted deficit stood at 7.3% of GDP in the quarter under review, 0.1 percentage point below the deficit posted in the final quarter of 2020 (see Chart 5.5). This contrasts with the deterioration in the headline deficit over the same period, and reflects the estimated widening of the negative output gap.

Overall, the share of cyclically-adjusted revenue in GDP increased by 1.4 percentage points (see Table 5.2). This was driven by higher shares of tax items, in particular those of direct taxes and

---

**Table 5.2**

<table>
<thead>
<tr>
<th>QUARTER-ON-QUARTER CHANGES IN CYCLICALLY-ADJUSTED FISCAL COMPONENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage points of GDP</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>2020              2021</td>
</tr>
<tr>
<td>Q1   Q2   Q3   Q4   Q1</td>
</tr>
<tr>
<td>Revenue   -2.0   -0.1   0.9   0.2   1.4</td>
</tr>
<tr>
<td>Current taxes on income and wealth   -1.1   0.7   1.1   0.3   1.0</td>
</tr>
<tr>
<td>Taxes on production and imports   -0.4   -0.3   -0.2   -0.2   0.0</td>
</tr>
<tr>
<td>Social contributions   -0.3   0.2   0.4   0.1   0.4</td>
</tr>
<tr>
<td>Other(1)   -0.3   -0.7   -0.4   -0.1   0.0</td>
</tr>
<tr>
<td>Expenditure   0.4   1.8   1.9   2.3   1.3</td>
</tr>
<tr>
<td>Compensation of employees   0.0   0.1   0.2   0.2   0.3</td>
</tr>
<tr>
<td>Intermediate consumption   -0.2   0.6   0.6   0.7   0.8</td>
</tr>
<tr>
<td>Social benefits   0.0   0.3   0.0   0.1   0.1</td>
</tr>
<tr>
<td>Interest payments   0.0   0.0   0.0   0.0   0.0</td>
</tr>
<tr>
<td>GFCF   0.1   -0.1   0.2   0.1   -0.3</td>
</tr>
<tr>
<td>Other(2)   0.4   0.9   0.9   1.3   0.4</td>
</tr>
<tr>
<td>Primary balance   -2.4   -2.0   -1.1   -2.1   0.1</td>
</tr>
<tr>
<td>General government balance   -2.4   -2.0   -1.0   -2.1   0.1</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.

---

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.
social contributions. Meanwhile, the share of non-tax revenue in GDP remained unchanged as a small increase in the share of sales was offset by lower inflows from current transfers.

The share of cyclically-adjusted expenditure rose by 1.3 percentage points, due to a higher share of current outlays. In large part, this reflects an increase in intermediate consumption, although higher compensation of employees and subsidies, which is included under ‘other’ expenditure, also contributed. At the same time, the share of capital expenditure declined, mainly driven by lower GFCF.
6. MONETARY AND FINANCIAL DEVELOPMENTS

The Bank’s FCI suggests that in the first quarter of 2021, financing conditions were loose from a historical perspective.

In March, Maltese residents’ deposits with MFIs in Malta expanded at a slower rate when compared to December. The shift to overnight deposits persisted in an environment of low interest rates and a continued preference for liquidity. Credit to Maltese residents accelerated, reflecting faster growth in credit to general government and, to lesser extent, in credit to residents outside general government. The latter largely reflected faster growth in loans to households. By contrast, loans to NFCs rose at a slower pace. Interest rates on loans and deposits fell further when compared with a year earlier, thus resulting in a lower spread between the two rates, though it remained at elevated levels.

In March, the primary market yield on Treasury bills rose marginally from the level prevailing at the end of December 2020. The secondary market yield on 5-year MGS was unchanged while that on 10-year MGS increased. Meanwhile, in the euro area, both yields increased. Domestic share prices fell, ending the quarter at a lower level compared with end-2020.

The number and value of loan facilities covered by loan moratoria issued in terms of CBM Directive No. 18 or earlier fell between December and March, signalling a recovery in income flows and, for some, the expiration of the moratoria period. Meanwhile, firms’ recourse to guarantees in terms of the MDB CGS increased, with sanctioned amounts for capital and loan repayment purposes granted to businesses under this scheme reaching €439.6 million at the end of March, or 56.5% of the scheme’s target size at the end of March 2021.

Financial conditions improve considerably

According to the Bank’s FCI, in the first quarter of 2021, financial conditions became loose from a historical perspective, and were considerably more favourable than in the fourth quarter of 2020 (see Chart 6.1).

The recent improvement in financial conditions is driven by developments in both domestic and foreign influences. The former mainly improved due to an increase in securities issued by NFCs, which is subsumed in the ‘other’ component. The balance sheet component also had

---

1 Monetary data analysed in this chapter are compiled on the basis of the statistical standards found in the Statistics section of the Bank’s website.
a smaller tightening effect on the FCI, when compared to that estimated in the previous quarter, as marginally weaker real credit conditions were offset by an improved return on equity and more favourable dynamics in real deposits. At the same time, the ‘interest rate’ component had a slightly more positive contribution than before, reflecting a decrease in sovereign spreads and higher deposit interest rates.

With regards to foreign influences, their contribution turned positive in the quarter under review, reflecting lower levels of uncertainty and an increase in euro area stock prices.

Financial conditions also improved sharply when compared to the first quarter of 2020. This was mostly driven by domestic influences as a result of an increase in net issues of NFC securities – subsumed in the ‘other’ component. Improved dynamics in balance sheet items – notably in real credit, deposits and in core banks’ return-on-equity – also contributed to the loosening in annual terms. Meanwhile, the contribution of the ‘interest rates’ component stood less positive relative to the first quarter of 2020, due to a decline in the deposit interest rate as well as an increase in lending rates and in the sovereign spread.

Foreign influences also contributed to the loosening effect of financial conditions compared to a year earlier, primarily due to lower uncertainty.

Maltese residents’ deposits continue to expand

Total deposits held by Maltese residents with MFIs in Malta expanded, albeit at a slower pace, in the first quarter of 2021. The annual rate of change stood at 5.4% in March, below the 5.7% recorded in December 2020 (see Table 6.1).

<table>
<thead>
<tr>
<th>Table 6.1</th>
<th>DEPOSITS OF MALTESE RESIDENTS</th>
<th>EUR millions</th>
<th>Annual percentage changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overnight deposits</td>
<td>17,337</td>
<td>7.9 9.1 7.3 9.8 9.4</td>
<td></td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>11,476</td>
<td>14.4 15.8 15.0 14.4 14.1</td>
<td></td>
</tr>
<tr>
<td>NFCs</td>
<td>3,989</td>
<td>0.4 13.0 13.7 16.8 17.8</td>
<td></td>
</tr>
<tr>
<td>Deposits redeemable at notice of up to three months</td>
<td>133</td>
<td>59.2 33.1 1.9 40.1 12.1</td>
<td></td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>36</td>
<td>-6.9 3.1 2.4 4.7 9.4</td>
<td></td>
</tr>
<tr>
<td>NFCs</td>
<td>71</td>
<td>270.8 213.3 79.5 150.1 -3.6</td>
<td></td>
</tr>
<tr>
<td>Deposits with an agreed maturity of up to two years</td>
<td>2,537</td>
<td>-1.6 -1.5 -2.0 -3.3 -7.2</td>
<td></td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>1,983</td>
<td>-4.7 -3.1 -3.3 -2.3 -4.7</td>
<td></td>
</tr>
<tr>
<td>NFCs</td>
<td>246</td>
<td>11.7 2.2 -10.5 -10.9 -14.1</td>
<td></td>
</tr>
<tr>
<td>Deposits with an agreed maturity above two years</td>
<td>1,303</td>
<td>-3.0 -9.5 -13.8 -19.6 -14.3</td>
<td></td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households</td>
<td>1,155</td>
<td>-4.2 -6.9 -10.7 -15.6 -11.5</td>
<td></td>
</tr>
<tr>
<td>NFCs</td>
<td>45</td>
<td>33.9 -33.8 -34.1 -35.9 -34.2</td>
<td></td>
</tr>
<tr>
<td>Total residents’ deposits(^1)</td>
<td>21,310</td>
<td>5.8 6.2 4.2 5.7 5.4</td>
<td></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 eased slightly to 9.4% in March, from 9.8% three months earlier. Following the latest increase, the share of this category in total deposits increased to 81.4% from 78.4% a year earlier, thereby extending the established upward pattern observed in recent years (see Chart 6.2).

Deposits with an agreed maturity of up to three months also rose at a slower pace, with their share in total deposits remaining broadly unchanged – at 0.6%.

Meanwhile, deposits with an agreed maturity of up to two years contracted by 7.2% in March, following a decline of 3.3% in the year to December 2020. At the same time, deposits with an agreed maturity of over two years fell by 14.3%, after contracting by 19.6% three months earlier. As a result, the share of these two categories of deposits edged down to 11.9% and 6.1%, respectively.

**Credit to residents increases at a faster pace**

Credit to Maltese residents expanded by 11.8% in the year to March, above the 11.1% registered in December 2020, reflecting faster growth in both credit to general government and credit to other residents (see Table 6.2). Credit to general government continued to expand at a brisk pace, growing by more than a third over the year to March. This followed a somewhat smaller increase

<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>Credit to general government</td>
<td>4,185</td>
</tr>
<tr>
<td>Credit to residents outside general government</td>
<td>12,115</td>
</tr>
<tr>
<td>Securities and Equity</td>
<td>328</td>
</tr>
<tr>
<td>Loans</td>
<td>11,787</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
</tr>
<tr>
<td>Loans to Households</td>
<td>6,524</td>
</tr>
<tr>
<td>Mortgages</td>
<td>5,969</td>
</tr>
<tr>
<td>Consumer Credit and Other Lending</td>
<td>555</td>
</tr>
<tr>
<td>Loans to NFCs(1)</td>
<td>4,344</td>
</tr>
<tr>
<td>Total credit to residents</td>
<td>16,299</td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.

(1) NFCs include sole proprietors and non-profit institutions serving households (NPISH).
of 32.3% three months earlier. The slight acceleration in growth in this credit component mainly reflects a larger increase in government stocks following strong issuances of MGSs since the onset of the pandemic, and further new issues that took place during the first quarter of 2021.

The annual rate of change of credit to residents outside general government reached 5.8%, up from 5.6% in December (see Chart 6.3). This reflects a smaller contraction in security holdings, as loans to the private sector grew at a slower pace.

Data by sector show that slower growth in loans outside the general government sector was largely driven by movements in loans to NFCs. By contrast, loans to households increased at a faster pace.

These grew by 5.9% on an annual basis, following a 5.4% increase in December. This reflected faster growth in mortgage lending, which increased by 7.3% in March, up from 6.7% three months earlier. By contrast, consumer credit and other lending contracted by 7.4% over the same period, following a decrease of 6.2% in the year-end to December (see Chart 6.4).

Annual growth in loans to NFCs stood at 7.1% in March, below the 8.4% increase recorded in December. This was largely driven by a contraction in credit to the energy sector and, to a smaller extent, to the education, health and social sector. Additionally, slower growth in credit was recorded in accommodation and food services activities, the construction and real estate sector, as well as the sector comprising information and communication activities. On the other hand, loans to the transportation and storage sectors, as well as the sector comprising professional, scientific and technical activities, and the arts and entertainment sector, rose at a faster pace while loans to the trade sector increased after declining in the year to December (see Chart 6.5).

Financial accounts data show that the share of bank lending in total NFC debt edged up marginally on a year earlier (see Chart 6.6). NFCs had been consistently reducing their reliance on
bank loans in recent years in favour of alternative sources, mainly intra-sectoral lending, and loans from the rest of the world, with the share of bank loans in total NFC debt reaching a low of 20.1% at the end of 2019. However, this pattern began to reverse in 2020, likely as a result of firms’ recourse to loan moratoria and guaranteed loans from banks during the pandemic. In fact, by the end of March 2021, it had reached 21.2%, up from 20.4% a year earlier. The increase in the share of bank lending in total NFC debt 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 at a time when alternative sources of financing may have become less attractive to firms. Furthermore, the pandemic has likely negatively affected corporate profitability and firms’ cash flow. This may have contributed to the observed fall in the share of intra-sectoral lending in total NFC debt, which edged down to 44.5% from 46.1% in the first quarter of 2020. Meanwhile, the share of loans from non-residents reached 15.3%, from 14.7% a year earlier.

Malta Stock Exchange (MSE) data show that as at March 2021, €1.5 billion in corporate debt was listed on the Exchange, 0.6% less than the

---

outstanding stock 12 months earlier (see Chart 6.7). By contrast, the outstanding amount of equity listed on the MSE remained broadly unchanged in annual terms.

**Interest rate spread between deposit and lending rate declines**

In March, the weighted average deposit rate offered to households and NFCs in Malta was down by 7 basis points on a year earlier, standing at 0.20% (see Table 6.3). This was driven by a further decrease in rates on time deposits.

Meanwhile, the weighted average lending rate paid by households and NFCs to resident MFIs fell by 12 basis points, to 3.32%. This decrease was due to lower 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 312 basis points, below the 317 basis points recorded 12 months earlier.

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

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 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).

As at end-March, there were 1,206 loans subject to a moratorium on loan repayments. These amounted to €421.4 million, or 3.5% of total loans outstanding to Maltese residents. The number of loans that were subject to a moratorium on repayments was around 60% of that in December when there were 1,984 loans benefitting from these moratoria, or 6.0% of total outstanding loans at the time.

The decline in the number of beneficiaries as well as the amount of loans subject to a moratorium primarily reflects the expiration of the moratoria period for some beneficiaries.

Table 6.4
LOANS SUBJECT TO MORATORIUM
(Number of loans; EUR millions; percentage)

<table>
<thead>
<tr>
<th></th>
<th>As at December 2020</th>
<th>As at March 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Volume of loans(1)</td>
<td>Outstanding amounts(2)</td>
</tr>
<tr>
<td>Households</td>
<td>1,176</td>
<td>110.5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>45</td>
<td>8.2</td>
</tr>
<tr>
<td>Construction</td>
<td>30</td>
<td>18.2</td>
</tr>
<tr>
<td>Wholesale &amp; retail</td>
<td>125</td>
<td>28.0</td>
</tr>
<tr>
<td>Transportation &amp;</td>
<td>50</td>
<td>18.4</td>
</tr>
<tr>
<td>Accommodation &amp;</td>
<td>220</td>
<td>204.9</td>
</tr>
<tr>
<td>Food service activities</td>
<td>129</td>
<td>181.3</td>
</tr>
<tr>
<td>Other(4)</td>
<td>210</td>
<td>131.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,984</strong></td>
<td><strong>700.8</strong></td>
</tr>
</tbody>
</table>

Source: Central Bank of Malta.

(1) The number of loans subject to moratorium.

(2) Outstanding amounts of loans subject to moratorium as at end of month, in EUR millions.

(3) The percentage of loans subject to moratorium in total outstanding loans held by the sector as at end of month.

(4) Includes loans to agriculture and fishing, mining and quarrying, public administration, education, health and social work, financial and insurance activities (including interbank loans), 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.

---

5 This Directive was issued in consultation with the Malta Financial Services Authority and the Malta Bankers’ Association and entered into force on 13 April 2020. A number of banks had already started to provide moratorium facilities voluntarily in March 2020. In view of the protracted impact of the COVID-19 pandemic, on 14 January 2021, the Minister for Health, in consultation with the Ministry for Finance, issued Legal Notice (LN) 15 of 2021 on ‘Moratorium on Credit Facilities in Exceptional Circumstances’, which relates to the reactivation of moratoria in Malta. This reactivation allowed borrowers to submit their applications for new moratoria or to extend their existing moratoria subject to a number of conditions, before 31 March 2021.

6 Data on moratoria include arrangements approved both pre and post the Legal Notice 142 of 2020 on the Moratorium on Credit Facilities Regulations in Exceptional Circumstances (see http://www.justiceservices.gov.mt/downloadDocument.aspx?app=lp&termid=306877&l=1) and Directive No. 18. Data on moratoria refer to loans that were issued before the onset of the pandemic and which became subject to a moratorium as a result of COVID-19 before Directive No. 18 of 2020, or in terms of the same Directive.

7 As at end-April 2021, there were 750 loans subject to a moratorium on repayments, amounting to €281.8 million, or 2.3% of related outstanding loans to Maltese residents.
The largest number of loans covered by moratoria was held by households, with the sector accounting for 62.1% of the total volume of loans subject to a moratorium as at end-March. Nevertheless, the number of households benefitting from these moratoria fell significantly during the quarter. Maltese households held €65.9 million of such loans, equivalent to 15.6% of all of loans subject to a moratorium and to 1.0% of outstanding household loans.

In value terms, though, the accommodation and food services activities sector remained the largest beneficiary. In March 2021, it held €126.5 million in loans subject to a moratorium, or 30.0% of the value of such loans. This sector was the one most affected by the containment measures introduced in response to COVID-19. The share of loans held by this sector that was subject to a moratorium edged down to 23.9% of the sector’s outstanding loans as at end-March, compared with 40.4% three months earlier. This was followed by the real estate sector, which held €66.5 million in loans subject to a moratorium, or 13.4% of such loans – equivalent to 5.6% of this sector’s outstanding loans.

As at end-March, the wholesale and retail trade sector held €18.9 million in loans subject to a moratorium, making up 4.5% of all loans subject to a moratorium, or 2.8% of loans held by the sector, a smaller share from 4.3% as at end-December.

Moreover, the ‘other category’ sector – which includes loans subject to a moratorium in agriculture and fishing, education, health, and financial and insurance activities among others – held €119.6 million in loans subject to a moratorium, or 5.9% of this sector’s outstanding loans.

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.8

By end-March, 576 facilities were approved under the CGS, covering total sanctioned lending of €439.6 million (see Table 6.5). As the scheme provides guarantees on loans for working capital and loan repayment purposes, the amounts actually disbursed may fall short of those sanctioned. In fact, €340.5 million were disbursed by the end of the first quarter of 2021. Hence, by then, 56.5% of the scheme’s target size was sanctioned, while 43.7% was disbursed.

In terms of the number of facilities, the sector comprising wholesale and retail activities applied for the largest number of facilities. By end-March, 161 facilities were approved for this sector with a total value of sanctioned loans at €94.2 million.9 This was followed by accommodation and food services activities, with 131 facilities and a sanctioned amount of €105.1 million. The manufacturing sector also had a significant number of facilities approved, followed by the sectors comprising administrative and support services, professional, scientific and technical activities as well as the sector covering transport, storage and ICT.10

---

9 As at end-April 2021, 587 facilities were approved under the CGS, covering total sanctioned lending of €444.4 million.
10 The wholesale and retail trade sector and the repair of motor vehicles and motorcycles sector registered a decline in the amounts sanctioned between December 2020 and March 2021. This reflects the repayment of loans in between quarters, as well as loan cancellations.
Bank Lending Survey (BLS) indicates unchanged credit standards, terms and conditions
According to the BLS which was conducted in April 2021, respondent banks reported unchanged credit standards, and terms and conditions for NFCs in Malta during the first quarter of 2021. All participating banks also expected credit standards on such loans to remain unchanged in the second quarter. As regards the demand for credit by NFCs, half of the respondent banks considered demand not to have changed while the remaining half assessed demand to have decreased somewhat. Looking ahead, the majority of banks expected demand to remain stable in the second quarter, with only one bank foreseeing an increase.

As regards credit for house purchases, credit standards, and terms and conditions for the first quarter, these were unchanged for all surveyed banks. Looking forward to the second quarter of 2021, the majority of banks foresaw no changes in credit standards, with only one bank anticipating some easing. All participating banks assessed demand for house loans to have remained unchanged in the first quarter and expected demand to remain stable in the second quarter.

All participating banks reported unchanged credit standards, and terms and conditions for consumer credit and other lending in the first quarter, with the majority anticipating unchanged credit standards also in the second quarter. One bank, however, expected some easing in credit standards in the near term. All participating banks reported unchanged demand for consumer credit, and demand was expected also to remain unchanged in the second quarter.

In response to a series of ad hoc question on banks’ access to wholesale and retail funding and on their risk transfer capability as a result of the prevailing situation in financial markets, half of the banks reported some easing in market access to short-term retail deposits while results were more mixed with regards to access to long-term retail funding. Looking at the second quarter, one
bank anticipated that there will be further easing in access to short- and long-term retail funding while another bank foresaw a deterioration.

Most of the surveyed banks reported that the unsecured segment of their interbank money market experienced no impact or was not relevant for their business. No changes were anticipated in the quarter ahead. Moreover, banks reported that access to wholesale debt securities was either not relevant for their business or that there was no change in access conditions. The ability to transfer credit risk off balance sheet was also assessed to have remained unchanged and was expected to remain unaffected in the following three months.

Banks were also asked to assess the impact of the ECB’s APP and PEPP on their balance sheet position, total assets, profits and lending behaviour. All surveyed banks said that the programmes had had no impact on their assets in the preceding six months and that no changes were expected in the six months ahead.

Only one of the surveyed banks experienced an improvement in its liquidity position and its overall market financing position, with the rest of the banks reporting no impact. The situation remained similar when looking at the following six months. This same bank also said that the ECB’s APPs led to an increase in its profits, via the capital gains channel, with a similar positive effect expected also in the six months ahead. Another bank, however, experienced a drop in profitability owing to a decline in net interest income, and expected lower profits in the six months ahead. None of the participating banks reported that the programmes affected their credit standards, lending volumes, and terms and conditions and no changes were expected in the six months ahead.

Regarding the impact of the ECB’s negative deposit facility rate, all respondent banks reported some fall in their overall profitability as a result of lower interest income, which was expected to persist in the six months ahead. One of the surveyed banks reported some decline in lending rates and loan margins, across all sectors, which was expected to persist in the following six months. Another bank reported lower deposit rates for NFCs and households in the preceding six months, though no changes were expected in the six months ahead. The rest of the participating banks reported no changes in their lending and deposit rates, and loan margins. Moreover, the majority of banks reported no changes in non-interest rate charges, and lending and deposit volumes, and – in general – expected no changes in the six months ahead.

Respondent banks were also asked about the impact of the ECB’s two-tier system for remunerating excess liquidity holdings on their financial situation, lending and deposit rates. All banks reported an improvement in their overall profitability on account of higher net interest income. This amelioration was expected to persist in the six months ahead. All participating banks reported no impact on their interest rates on loans and deposits, and all banks foresaw no impact in the subsequent six months.

Finally, respondent banks were asked to gauge the impact of the Eurosystem’s TLTRO III. All participating banks stated that they did not participate in the TLTRO III operation of December 2020, and only one bank participated in the March 2021 operation. Half of the respondent banks did not plan to participate in future TLTRO III operations while the other half were still undecided, with the attractive conditions on TLTROs cited as a factor for considering participation.
One bank said that the funding could be used to purchase financial assets other than loans to the non-financial private sector, domestic sovereign bonds and Eurosystem liquidity. This bank also said that the TLTRO III operations had some positive impact on its overall liquidity position and its market financing conditions, and these positive effects were expected to persist in the six months ahead.

Another bank did not report any impact on its liquidity and market funding conditions in the preceding six months but expected some positive impact on these and on its overall profitability in the next six months. Some positive effects were also expected on its credit standards and lending volumes for loans to enterprises and non-mortgage lending to households. The remaining banks did not report any such effects from TLTRO III operations, and none were expected over the next six months.

The money market

Domestic money market interest rates rise
During the first quarter of 2021, the ECB kept the interest rate on the 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 3-month EURIBOR remained unchanged at -0.54% compared with end-2020. Meanwhile, secondary market yields on 3-month German government securities, which act as a benchmark for euro area yields, rose to -0.67% from -0.85% (see Chart 6.8).

In the domestic primary market, the yield on 3-month Treasury bills increased to -0.47%, from -0.50% at end-December. On the other hand, the 3-month yield in the secondary market declined, standing at -0.58% in March from -0.49% three months earlier.

As the yield on the euro area benchmark rose and the yield on the domestic 3-month Treasury bills fell, the spread between them narrowed. It stood at 10 basis points at the end of March, down from 36 basis points three months earlier.

During the first quarter of 2021, the Government issued €408.8 million in Treasury bills, €64.3 million less than the amount of €473.0 million issued during the fourth quarter of 2020.

The capital market
During the first quarter of 2021, the Government issued four new MGS with a total value of €300.2 million. One institution announced a new bond issue: Smartcare Finance plc issued €13.0 million in secured bonds.
By the end of March, 21 firms had bonds that were listed on the MSE through Prospects, one less compared with the end of December.

In the secondary market, turnover in government bonds increased to €66.9 million, compared with €38.4 million in the final quarter of 2020, while turnover in corporate bonds fell to €24.6 million, from €31.6 million previously.

The yield on 5-year bonds was unchanged at -0.22% at the end of March compared with three months earlier (see Chart 6.9). The yield on 10-year bonds increased to 0.40% from 0.27%. Meanwhile, the euro area yield on 5-year bonds rose to -0.64% from -0.74%, and the yield on 10-year bonds rose by 28 basis points to -0.30%. As the domestic 10-year yield rose at a slower pace compared with the euro area benchmark yield, the spread against the latter narrowed to 70 basis points, from 85 basis points in December.

**MSE Share Index ends March at lower levels**

After regaining some ground in the fourth quarter of 2020, share prices in Malta fell during the quarter being reviewed. At end-March, the MSE Equity Price Index stood 8.3% below its level at the end of 2020 (see Chart 6.10). The index was only 0.2% lower than the level prevailing a year earlier. Similarly, the MSE Equity Total Return Index, which accounts for changes in equity prices and dividends, declined by 8.3% between end-December 2020 and end-March 2021.

Equity turnover edged down to €11.9 million during the first quarter of 2021, from €14.1 million in the fourth quarter of 2020.