



BANK ĊENTRALI TA' MALTA  
EUROSISTEMA  
CENTRAL BANK OF MALTA



# CENTRAL BANK OF MALTA QUARTERLY REVIEW

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## ABBREVIATIONS

APP	asset purchase programme
BCI	Business Conditions Index
BLS	Bank Lending Survey
CBM	Central Bank of Malta
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
EEL	Employment Expectations Indicator
EER	effective exchange rate
EONIA	Euro OverNight Index Average
ERPT	exchange rate pass-through
ESA	European System of Accounts
ESI	economic sentiment indicator
EU	European Union
EURIBOR	Euro Interbank Offered Rate
€STR	euro short-term rate
FCI	Financial Conditions Index
FOMC	Federal Open Market Committee
GDP	gross domestic product
GFCF	gross fixed capital formation
GVA	gross value added
HCI	harmonised competitiveness indicator
HICP	Harmonised Index of Consumer Prices
ICT	information and communications technology
ISCED	International Standard Classification of Education
LFS	Labour Force Survey
LP	local projections
MDB	Malta Development Bank
MFI	monetary financial institution
MGS	Malta Government Stocks
MIA	Malta International Airport
MPC	monetary policy committee
MQF	Malta Qualifications Framework
MRO	main refinancing operation
MSE	Malta Stock Exchange
NEIG	non-energy industrial goods
NEER	nominal effective exchange rate
NFC	non-financial corporation
NPISH	non-profit institutions serving households
NSO	National Statistics Office
OECD	Organisation for Economic Co-operation and Development
PEPP	Pandemic Emergency Purchase Programme
PPI	Property Price Index
RPI	Retail Price Index
TLTRO	targeted longer-term refinancing operation
ULC	unit labour cost
UK	United Kingdom
US	United States
VAT	value added tax
WHO	World Health Organisation

## FOREWORD

During the third quarter of 2021, economic activity continued to be affected by the COVID-19 pandemic and associated containment measures. Even though third quarter year-on-year growth in real gross domestic product (GDP) was robust – at 9.7% – the GDP level remained slightly below the level which prevailed in the third quarter of 2019. In particular, exports and private consumption have not yet returned to pre-pandemic levels.

Potential output growth is estimated to have stood at 2.7% in the third quarter of 2021, up from 2.5% in the previous quarter. The output gap is estimated to have narrowed to -2.2% when measured as a 4-quarter moving average, from -3.8% in the second quarter. This implies that while there is still some degree of underutilisation of the economy's productive capacity, especially in tourism and in entertainment-related sectors, the economy is gradually returning to more normal levels of activity.

Meanwhile, the Bank's Business Conditions Index (BCI) stood strongly above its historical level in the third quarter of 2021. It continued to be affected by strong annual increases in several sub-components, particularly in tourist arrivals, economic sentiment and GDP, as well as significant falls in unemployment. This reflects the fact that the third quarter of 2020 marked a low point for most economic variables due to the COVID-19 pandemic.

Developments in the labour market have remained positive, and indeed, employment stood above pre-pandemic levels. At the same time, activity rates continued to increase in the third quarter. The unemployment rate remained low from a historical perspective and well below that in the euro area.

Inflation as measured by the Harmonised Index of Consumer Prices (HICP) stood at 0.7% in September, above that of 0.2% recorded in June, mainly driven by faster growth in the prices of non-energy industrial goods (NEIG) and unprocessed food. Inflation based on the Retail Price Index (RPI), which only takes into account purchases made by Maltese households, rose from 1.5% in June to 2.2% in September. Meanwhile, annual inflation based on the industrial producer price index also increased sharply.

Growth in Malta's unit labour cost (ULC) index, measured on a 4-quarter moving average basis, moderated to 2.1% in the third quarter, due to an increase in labour productivity per person. Malta's harmonised competitiveness indicators (HCIs) improved between June and September.

In the third quarter of 2021, the current account deficit widened over a year earlier. The larger deficit was due to an increase in the merchandise trade deficit. By contrast, net services receipts increased and net outflows on both the primary and secondary income accounts decreased. When measured over four quarters, the current account balance showed a deficit equivalent to 4.4% of GDP.

During the period under review, the general government balance remained in deficit. On a 4-quarter moving sum basis, the general government balance registered a deficit of 8.5% of GDP in the third quarter of 2021, slightly above the level of 8.4% registered in the preceding quarter. The general government debt-to-GDP ratio, however, decreased to 57.2% from 59.1% at the end of the previous quarter.

In September, Maltese residents' deposits with monetary financial institutions (MFIs) in Malta expanded at a faster rate when compared to June. The shift to overnight deposits persisted in an environment of low interest rates and a continued preference for liquidity. Credit to Maltese residents decelerated, reflecting slower growth in credit to general government and credit to other residents. According to the Bank's Financial Conditions Index (FCI), in the third quarter of 2021, financial conditions remained loose from a historical perspective but were less favourable compared to the previous quarter.

In September, the weighted average deposit rate offered to households and non-financial corporations (NFCs) in Malta was down by five basis points on a year earlier. The weighted average lending rate paid by households and NFCs to resident MFIs fell by 14 basis points over this same time. Thus, the spread between the two narrowed.

Meanwhile, the primary market yield on Treasury bills rose from that prevailing at the end of June. The secondary market yields on 5-year and 10-year Malta Government Stocks (MGS) also increased between June and September while domestic share prices fell over this period.

During the third quarter, loans subject to a moratorium continued to decline and reached very low levels, as the moratoria period is gradually expiring for many borrowers and economic activity continues to normalise in most sectors. As at end-September, there were 56 loans subject to a moratorium on loan repayments with a value of €37.4 million. This amounts to a mere 0.3% of total loans outstanding to Maltese residents.

By end-September, 652 facilities were approved under the Malta Development Bank (MDB) COVID-19 Guarantee Scheme (CGS), covering total sanctioned lending of €508.8 million. As the scheme provides guarantees on loans for working capital and loan repayment purposes, the amounts disbursed may fall short of those sanctioned. In fact, €414.5 million were disbursed by the end of the third quarter of 2021. Hence, by end-September, 65.4% of the scheme's target size was sanctioned while 53.3% 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. However, in both the United Kingdom and the United States the monetary authorities signalled that they could shortly begin to withdraw monetary stimulus amid rising inflation.

On its part, the Governing Council of the European Central Bank (ECB) maintained its accommodative monetary policy stance in the third quarter of 2021. Key policy rates were held unchanged.

In July, the Council approved its new monetary policy strategy. The new strategy adopts a symmetric 2% inflation target over the medium term. The Governing Council confirmed that HICP remains the most appropriate price measure and recommended the inclusion of owner-occupied housing in the HICP over time.

The Governing Council also revised its forward guidance on interest rates. It now expects the key ECB interest rates to remain at their present or lower levels until it has seen inflation reaching two per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and it judges that realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at two per cent over the medium term. This may also imply a transitory period in which inflation is moderately above target.

The Governing Council also confirmed that the Eurosystem will continue to conduct net asset purchases under the pandemic emergency purchase programme (PEPP) until at least the end of March 2022, while reinvestments of principal payments from maturing securities purchased under the PEPP would continue until at least the end of 2023.

During the third quarter, the Governing Council also confirmed earlier decisions on asset purchases under the asset purchase programme (APP). Finally, the Eurosystem will continue to provide ample liquidity through refinancing operations. When it met in December, the Council updated its decisions on asset purchases, noting that progress on economic recovery and towards the medium-term inflation target permitted a step-by-step reduction in the pace of asset purchases over the coming quarters. However, monetary accommodation was still needed for inflation to stabilise at 2% over the medium term. It also decided to discontinue net asset purchases under the PEPP at the end of March 2022 while extending the reinvestment horizon under this programme until at least the end of 2024.

## ECONOMIC SURVEY

### 1. THE EXTERNAL ENVIRONMENT AND THE EURO AREA

*In the third quarter of 2021 real GDP grew at a slower pace in the United States and the United Kingdom, while growth in the euro area was unchanged from the second quarter. While in the United States real GDP has already returned to the level recorded in the last quarter of 2019, it remains below pre-pandemic levels in the United Kingdom and in the euro area. During the quarter employment continued to recover and the three-month average unemployment rate fell in the three economies but nonetheless remained above pre-pandemic levels.*

*Inflationary pressures rose further in the euro area and the United Kingdom but remained unchanged, at more elevated levels, in the United States. Annual consumer price inflation in the United States stood at 5.4% in September, unchanged compared with June. Meanwhile, in the United Kingdom, inflation stood at 3.1%, up from 2.5% in June. In the euro area, inflation rose to 3.4% from 1.9% in June. During the quarter under review, the Federal Reserve, the Bank of England and the ECB all kept their key interest rates unchanged. All three central banks continued to make available liquidity support measures to support the smooth functioning of financial markets and the flow of credit to the economy. However, in both the United Kingdom and the United States, the monetary authorities signalled that they could shortly begin to withdraw monetary stimulus.*

*Brent oil prices remained above USD 70 per barrel throughout July but declined in August amid a resurgence in COVID-19 cases and expectations that this would hinder the recovery in global demand. In September, oil prices regained some ground but still ended the quarter 0.7% below the level prevailing at end-June. Meanwhile, non-energy commodity prices also declined during the quarter under review.*

#### Key advanced economies

##### *US economy grows at a slower pace*

In the third quarter of 2021, economic activity in the United States slowed down amid a resurgence in COVID-19 cases. Real GDP increased by 0.6% in quarter-on-quarter terms, following a rise of 1.6% in the second quarter (see Table 1.1). Personal consumption expenditure grew at a slower pace compared with the previous quarter, and the trade deficit widened further in volume terms as imports increased while exports declined. On the other hand, both gross private domestic investment and government expenditure increased after having declined in the preceding quarter. Notwithstanding the slowdown in activity, the GDP level stood almost 1.5% above its level in the last quarter of 2019.

**Table 1.1**  
**REAL GDP GROWTH IN SELECTED ADVANCED ECONOMIES**

*Quarter-on-quarter percentage changes; seasonally and working day adjusted*

	2019		2020				2021		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
United States	0.7	0.5	-1.3	-8.9	7.5	1.1	1.5	1.6	0.6
Euro area	0.3	0.0	-3.5	-11.7	12.6	-0.4	-0.2	2.2	2.2
United Kingdom	0.5	0.0	-2.6	-19.4	17.6	1.5	-1.3	5.4	1.1

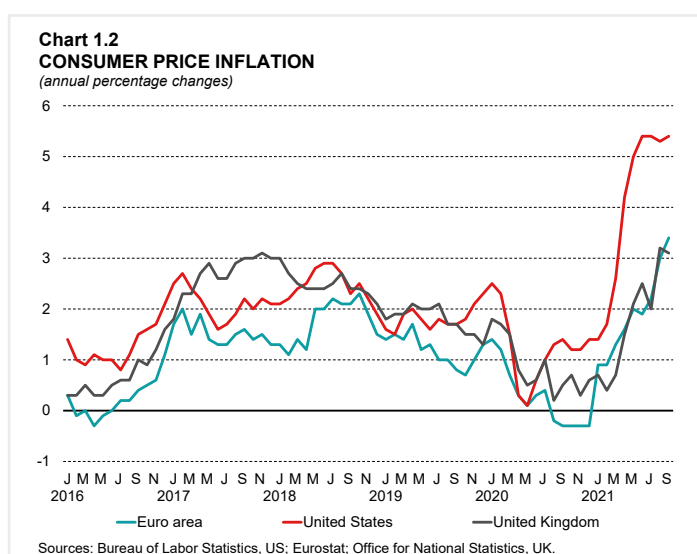
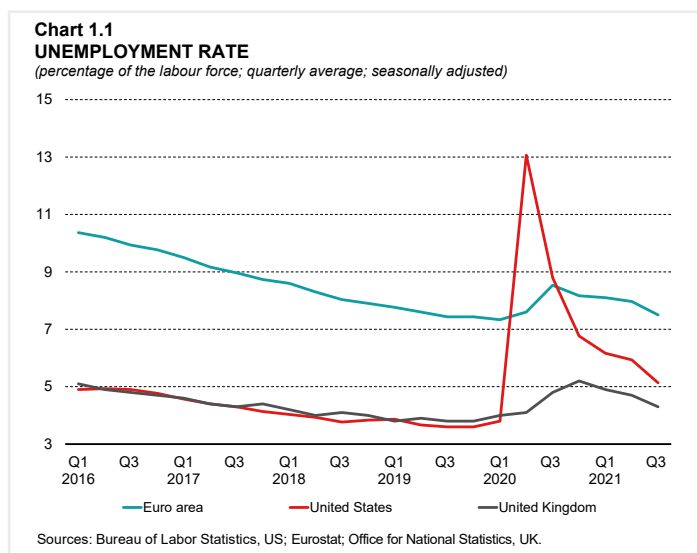
Sources: Bureau of Economic Analysis, US; Eurostat; Office for National Statistics, UK.

In the labour market, the participation rate increased marginally to 61.7% in the third quarter, from 61.6% recorded in the previous quarter, but remained below its pre-pandemic level of around 63.0%. Employment increased further as it rose by 1.2% in quarter-on-quarter terms, after having risen by 0.7% in the second quarter. Compared to the third quarter of 2019, there were around 3.0% fewer persons in employment.

Non-farm payroll data show that compared with the previous quarter, the rate of job creation increased in most sectors. However, slower growth was recorded in the mining and logging and the leisure and hospitality sectors. The average unemployment rate declined to 5.1%, from 5.9% in the preceding quarter but remained high compared with pre-pandemic rates (see Chart 1.1).

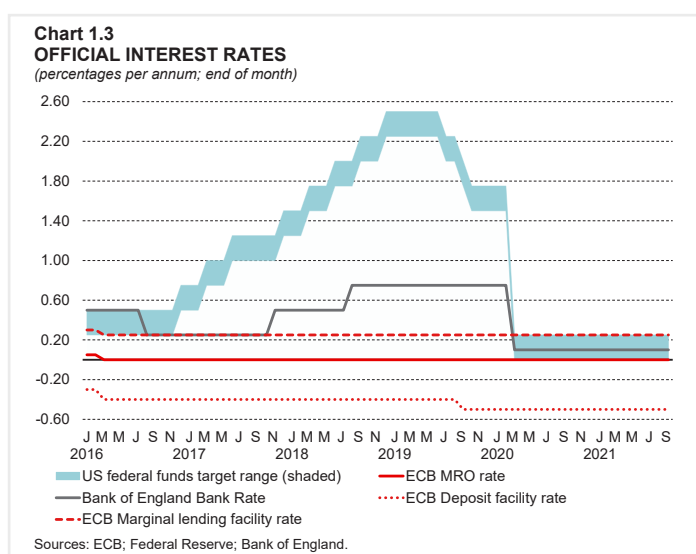
The annual rate of change of the US consumer price index (CPI) remained elevated and stood at 5.4% in September, as in June (see Chart 1.2). Energy inflation increased marginally from 24.5% in June to 24.8% in September. However, food price inflation nearly doubled, rising from 2.4% in June to 4.6%, three months later. Meanwhile, prices of commodities excluding food and energy grew at a slower pace. Services prices also increased at a less rapid pace. Reflecting developments in services prices and commodities other than food and energy, inflation excluding food and energy declined to 4.0% in September, from 4.5% three months earlier.

During the third quarter of 2021, the Federal Open Market Committee (FOMC) reiterated its commitment to use its full range of tools to support the 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 FOMC said that this target range is expected to remain



appropriate until labour market conditions have reached levels consistent with the FOMC's assessment of maximum employment, and inflation has risen to 2.0% and is on track to moderately exceed that rate for some time.

However, as progress had been made towards these goals and conditional on further progress being made broadly as expected, a moderation in the pace of asset purchases may soon be warranted.



In July the FOMC also announced the establishment of two standing repurchase agreement (repo) facilities: a domestic standing repo facility and a repo facility for foreign and international monetary authorities. These overnight facilities will serve as backstops in money markets to support the effective implementation of monetary policy and smooth market functioning.<sup>1</sup>

### UK economic activity slows down

Real GDP in the United Kingdom grew at a slower pace in the third quarter of 2021 as supply chain disruptions and weak consumer spending weighed heavily on activity. Real GDP rose at a quarterly rate of 1.1% after rising by 5.4% in the second quarter (see Table 1.1). Household consumption rose at a slower pace, following the rebound in the second quarter, while growth in gross fixed capital formation (GFCF) and government consumption turned negative, partly reflecting lower health expenditure. Meanwhile, the contribution of net trade also turned negative. The GDP level stood 1.5% below its level at the end of 2019.

Employment rose at a faster quarterly rate of 0.8%, following a 0.3% increase in the second quarter, while the annual rate stood at 0.5%, up from -1.0% in the second quarter. The employment level was still around 1.2% below its pre-pandemic level. Meanwhile, the unemployment rate averaged 4.3% in the quarter under review, down from 4.7% in the previous quarter. Notwithstanding this recent decline, the unemployment rate was still 0.5 percentage point above that prevailing in the last quarter of 2019 (see Chart 1.1).

Consumer price inflation in the United Kingdom edged up to 3.1% in September, from 2.5% in June (see Chart 1.2). Food prices, prices of non-energy industrial goods (NEIG) and those of services all grew at a faster pace whereas energy price inflation decelerated. The annual rate of inflation based on the CPI excluding energy, food, alcohol and tobacco increased to 2.9% in September, from 2.3% in June.

<sup>1</sup> In the fourth quarter of 2021, the FOMC kept the target range for the federal funds rate unchanged and said that with inflation having exceeded 2.0% for some time, the FOMC expects that it will be appropriate to maintain the target range unchanged until labour market conditions have reached levels consistent with the FOMC's assessments of maximum employment. Furthermore, in light of the recent inflation developments and the further improvement in the labour market, the FOMC decided to reduce the monthly pace of its net asset purchases.

In the third 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 MPC 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 judged that, should the economy evolve broadly in line with the central projections, some modest tightening of monetary policy over the forecast period was likely to be necessary to be consistent with meeting the inflation target sustainably in the medium term. Although incoming information, notably positive inflation surprises supported a tightening, considerable uncertainties remained, for example, as regards labour market prospects and its implications for underlying inflation.<sup>2</sup>

## The euro area

### *GDP in the euro area expands steadily*

After having rebounded in the second quarter of 2021, GDP in the euro area continued to expand steadily in the third quarter of 2021. In real terms, GDP grew by 2.2% on a quarter-on-quarter basis, the same rate as in the previous quarter (see Table 1.2). Nevertheless, the level of GDP remained slightly below pre-pandemic levels. During the review period, the services sector extended its recovery whereas manufacturing continued to be affected by supply-side bottlenecks stemming from shortages of imported intermediate inputs and equipment and strong increases in energy prices.

The expansion in economic activity during the third quarter was mostly driven by domestic demand which contributed 1.9 percentage points to GDP growth. In turn, this stemmed from

**Table 1.2**

**CONTRIBUTIONS TO QUARTERLY REAL GDP GROWTH IN THE EURO AREA<sup>(1)</sup>**

*Percentage points; quarter on quarter percentage change*

	2019		2020				2021		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Private consumption	0.2	0.1	-2.3	-6.7	7.3	-1.6	-1.2	1.9	2.1
Government consumption	0.1	0.1	0.0	-0.6	1.3	0.2	-0.1	0.5	0.1
GFCF	-1.2	2.1	-1.0	-4.6	3.0	0.6	0.0	0.3	-0.2
Changes in inventories <sup>(2)</sup>	-0.2	-0.1	0.3	-0.2	-1.5	0.5	1.0	-0.4	-0.1
Exports	0.3	-0.1	-1.7	-9.0	7.3	2.0	0.5	1.1	0.6
Imports	1.0	-2.0	1.3	9.4	-4.9	-2.0	-0.4	-1.3	-0.3
<b>GDP</b>	<b>0.3</b>	<b>0.0</b>	<b>-3.5</b>	<b>-11.7</b>	<b>12.6</b>	<b>-0.4</b>	<b>-0.2</b>	<b>2.2</b>	<b>2.2</b>

Source: Eurostat.

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

<sup>(2)</sup> Including acquisitions less disposals of valuables.

<sup>2</sup> In its meeting held in November, the Bank of England kept the Bank Rate unchanged, but in December the MPC increased this rate by 0.15 percentage point to 0.25%, amid signs of greater persistence in domestic cost and price pressures and further tightening in the labour market. The MPC maintained the stock of sterling non-financial investment-grade corporate bond purchases and the stock of UK government bond purchases, financed by the issuance of central bank reserves, unchanged.

strong increases in household spending where private consumption rose sharply and contributed 2.1 percentage points to GDP growth as restrictions related to the pandemic continued to ease. This was followed by government consumption which pushed GDP growth up by just 0.1 percentage point. On the other hand, GFCF and changes in inventories lowered GDP growth by 0.2 and 0.1 percentage points respectively. Meanwhile, net exports raised GDP growth by 0.3 percentage point as exports rose more rapidly than imports.

### Labour market conditions improve

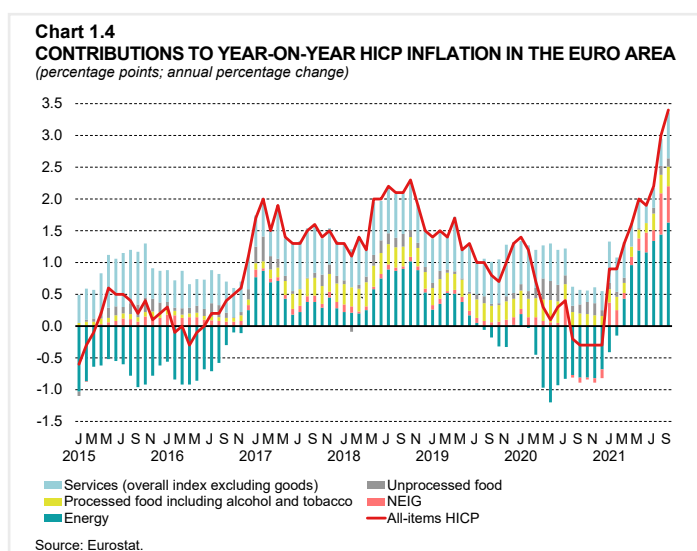
Labour market conditions in the euro area improved further during the quarter under review. The seasonally-adjusted unemployment rate fell by 0.4 percentage point between June and September 2021, to 7.4%. Similarly, the 3-month average rate declined by 0.5 percentage point to 7.5% (see Chart 1.1). The unemployment rate in September 2021 stood at its lowest rate since May 2020.

Turning to employment, this rose during third quarter of 2021 with the annual growth rate standing at 2.0%, the same rate as in the previous quarter.<sup>3</sup> As a result, the number of people in employment is approaching pre-pandemic levels. Employment is still being supported, albeit to a lesser extent than before, by job retention schemes aimed at preventing redundancies.

### Inflation rises significantly

The upward trend in inflation in the euro area that had started in the first quarter of 2021 continued into the third quarter, although inflation rose to a much greater extent during the quarter under review. The annual rate of inflation based on the HICP stood at 3.4% in September, compared to 1.9% in June 2021 (see Chart 1.4). These are rates not seen since 2008.

All major HICP components pushed inflation up during the third quarter. Nevertheless, the increase in HICP inflation largely stemmed from energy inflation which rose from 12.6% in June to 17.6% in September. This reflected a sharp increase in prices of fuels, gas and electricity. In terms of contributions to overall inflation, this was followed by services inflation, which rose from 0.7% to 1.7% over the same period, as the services sector recuperated. Similarly, albeit to a lower extent, the contribution of NEIG prices also increased with the annual rate of change rising from 1.2% in June to 2.1% in September. Lastly, food prices



<sup>3</sup> Employment data refer to the national accounts, total employment domestic concept. Data are seasonally and calendar adjusted.

also contributed positively to inflation with the annual growth rate of processed food rising to 1.9% while that of unprocessed food turning positive and standing at 2.6% in September.

Apart from those aspects related to energy inflation mentioned earlier, the upswing in headline inflation was influenced by two other factors. Firstly, recovering demand stemming from the reopening of the economy outpaced supply which remained constrained by various bottlenecks. This is mostly visible in the prices of services as well as the prices of goods, which were affected most significantly by supply shortages. Secondly, base effects related to the end of the VAT reduction in Germany also contributed. The dynamics of these factors are expected to ease in the course of 2022 or they are set to fall out of the year-on-year inflation calculation altogether.

Consequently the annual rate of HICP inflation excluding energy and food rose to 1.9% in September 2021 compared with 0.9% three months earlier.

### *Macroeconomic projections signal strong economic growth*

According to the Eurosystem staff macroeconomic projections published in December 2021, economic growth in the euro area is expected to remain strong despite some adverse factors in the near term, notably a resurgence of the pandemic and supply bottlenecks. Real GDP is set to expand by 5.1% in 2021 and 4.2% in 2022 as the economy recovers from the effects of the pandemic. Growth is then set to moderate to 2.9% in 2023 and 1.6% in 2024 (see Table 1.3).

Private consumption will remain the key driver of economic growth, benefiting from a rebound in real disposable income and a robust labour market. In addition, households are expected to spend some of the savings accumulated during the pandemic. Investment is projected to substantially recover and account for an increasing share of real GDP over the projection horizon, as supply constraints gradually diminish, demand picks up, financing conditions remain favourable, and the NextGenerationEU programme has a positive impact. Similarly, with the unwinding of bottlenecks and an easing of travel restrictions by mid-2022, the pace of the recovery in exports is expected to gain traction. Meanwhile, the pace of import growth should increase again in 2022 and 2023 as domestic demand recovers but should normalise towards the end of the projection horizon as pent-up demand fades away. These projections imply that real GDP would exceed its pre-crisis level in the first quarter of 2022, one quarter later than foreseen in the September 2021 projections.

Compared with the September 2021 projections, real GDP growth has been revised upwards by 0.1 percentage point in 2021, downwards by 0.4 percentage point for 2022, and upwards by 0.8

**Table 1.3**

#### **MACROECONOMIC PROJECTIONS FOR THE EURO AREA<sup>(1)</sup>**

*Annual percentage changes*

	2021	2022	2023	2024
<b>GDP</b>	<b>5.1</b>	<b>4.2</b>	<b>2.9</b>	<b>1.6</b>
Private consumption	3.3	5.9	2.8	1.0
Government consumption	3.9	0.2	0.5	1.3
GFCF	3.7	3.9	4.3	2.4
Exports	9.3	6.4	6.4	3.1
Imports	7.0	6.1	6.4	2.9
<b>HICP</b>	<b>2.6</b>	<b>3.2</b>	<b>1.8</b>	<b>1.8</b>

<sup>(1)</sup> Eurosystem staff macroeconomic projections (Dec 2021).

Source: ECB.

percentage point for 2023. The revision for 2022 reflects some further tightening of supply constraints, higher energy prices and stricter pandemic-related restrictions in the near term. As the pandemic is expected to moderate, and as supply bottlenecks are expected to unwind, quarterly growth has been revised up from the second quarter of 2022, resulting in an upward revision to annual real GDP growth in 2023. In addition, a smaller fiscal tightening and an effective depreciation of the euro since the September 2021 projections also contributed to the upward revision to GDP growth in that year, although these factors were partly offset by the negative impact of higher oil prices, weaker foreign demand and higher long-term interest rates.

According to the December 2021 projections, HICP inflation is envisaged to rise significantly to 2.6% in 2021 and 3.2% in 2022, before moderating to 1.8% in both 2023 and 2024. The high inflation expected in 2022 is related to developments in energy prices, stronger demand resulting from the reopening of the economy, and increasing producer prices as a result of global supply bottlenecks and higher transport costs. On the other hand, HICP inflation is expected to decline during the course of 2022 from rates registered towards the end of 2021, due to base effects, an assumed decline in energy prices and the reversal of the temporary cut in the German VAT rate in January 2021.

Compared with the September 2021 projections, HICP inflation has been revised upward by 0.4 percentage point in 2021, by 1.5 percentage points in 2022 and by 0.3 percentage point in 2023. These upward revisions reflect recent inflation outcomes, which were higher than previously expected, the impact of the recent surge in energy commodity prices, upward price pressures from supply disruptions, stronger wage growth and a weaker euro.

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 envisages a faster resolution of the pandemic in the course of 2022. In particular, vaccination rates in emerging market economies are expected to be higher than envisaged in the baseline. In this scenario, real GDP growth would rebound to 6.4% in 2022 before slowing down to 2.6% and 1.3% in 2023 and 2024 respectively. Inflation would reach 2.0% in 2024. Alternatively, a severe scenario assumes a prolonged health crisis characterised by recurrent waves of the pandemic. In this case, real GDP growth would fall to 1.5% in 2022, before recuperating to 2.2% and 2.5% in the following two years. Inflation would stand at just 1.3% in 2024.

### *ECB maintains its accommodative monetary policy stance<sup>4</sup>*

The ECB's Governing Council maintained its accommodative monetary policy stance during the third quarter of 2021. The interest rates on the main refinancing operations, on the marginal lending facility and on the deposit facility were held unchanged at 0.00%, 0.25%, and -0.50% respectively during the period under review (see Chart 1.3).

On 8 July 2021, the Governing Council approved its new monetary policy strategy following the conclusion of its strategy review that had been launched in January 2020. The ECB's strategy review aimed at making sure that the monetary policy strategy is fit for purpose, both currently and in the future. The strategy review covered all aspects of monetary policy within the framework

<sup>4</sup> On 16 December 2021, the Governing Council stated that the progress on economic recovery and towards its medium-term inflation target permitted a step-by-step reduction in the pace of its asset purchases over the coming quarters. However, monetary accommodation was still needed for inflation to stabilise at the 2% inflation target over the medium term. In addition, the Governing Council said that it needs to maintain flexibility and optionality in the conduct of monetary policy.

of the ECB's mandate, which is to maintain price stability. The new strategy adopts a symmetric 2% inflation target over the medium term. The Governing Council confirmed that HICP remains the most appropriate price measure and recommended inclusion of owner-occupied housing in the HICP over time. It also approved an ambitious climate change action plan. The Governing Council intends to assess periodically the appropriateness of its monetary policy strategy with the next assessment expected in 2025.

The first monetary policy meeting of the Governing Council following the adoption of the new strategy was held on 22 July 2021. During this meeting, the Governing Council stated that the key ECB interest rates have been close to their lower bound for some time and the medium-term outlook for inflation was still well below the Governing Council's target. In these conditions, the Governing Council revised its forward guidance on interest rates. More specifically, the Governing Council stated that it expects the key ECB interest rates to remain at their present or lower levels until it has seen inflation reaching two per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and it judges that realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at two per cent over the medium term. This may also imply a transitory period in which inflation is moderately above target. It did so to underline its commitment to maintain a persistently accommodative monetary policy stance to meet its inflation target.

The Governing Council confirmed that net purchases under the APP will continue at a monthly pace of €20 billion.<sup>5</sup> Asset purchases under the APP are expected 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 also intended to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

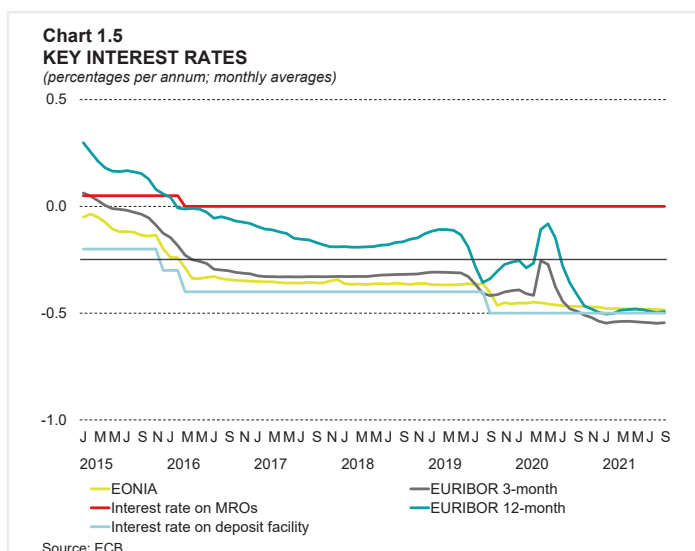
The Governing Council also confirmed that the Eurosystem will continue to conduct net asset purchases under the PEPP with a total envelope of €1,850 billion until at least the end of March 2022 and, in any case, until it judges that the coronavirus crisis phase is over. On 9 September 2021, the Governing Council stated that it judged that favourable financing conditions could be maintained with a moderately lower pace of net asset purchases under the PEPP than in the previous two quarters.

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 could 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 could be recalibrated if required

<sup>5</sup> On 16 December 2021, the Governing Council decided on a monthly net purchase pace under the APP of €40 billion in the second quarter of 2022, €30 billion in the third quarter of 2022, and at a monthly pace of €20 billion from October 2022 onwards.

to maintain favourable financing conditions to help counter the negative pandemic shock to the path of inflation.

The Governing Council reaffirmed that 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.<sup>6</sup>



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 quarter under review, as the market remained conditioned by the ECB's accommodative monetary policy stance and ample excess liquidity. The Euro OverNight Index Average (EONIA) rate fell slightly from -0.48% to -0.49% during the third quarter, remaining slightly above the interest rate on the ECB's deposit facility (see Chart 1.5).<sup>7</sup> Similarly, the 3-month euro interbank offered rate (EURIBOR) edged down to -0.55% from -0.54%, while the 12-month EURIBOR rate decreased to -0.49% in September from -0.48% in June.<sup>8</sup>

### Euro area bond yields decrease

Ten-year benchmark government bond yields in the euro area decreased during the third quarter of 2021 amid expectations of continued monetary policy support, falling from 0.30% in June to 0.20% three months later. Individual sovereign bond yields generally decreased during the period under review, dropping by more than 10 basis points in most cases. The most notable fall was registered in Portuguese bond yields which fell by 17 basis points to 0.26%. German bond yields declined by 7 basis points to -0.36%. On the other hand, the only euro country which saw bond yields increase was Malta.

Consequently, spreads between yields on 10-year German bonds and those on bonds issued by other euro area governments generally narrowed during the review period (see Chart 1.6). In particular, spreads on Portuguese bonds narrowed by 10 basis points while those on Spanish and

<sup>6</sup> On 16 December the Governing Council decided to discontinue net asset purchases under the PEPP at the end of March 2022, but extended the reinvestment horizon under this programme until at least the end of 2024.

<sup>7</sup> 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 €STR plus a fixed spread of 8.5 basis points. The [euro short-term rate \(€STR\)](#) 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.

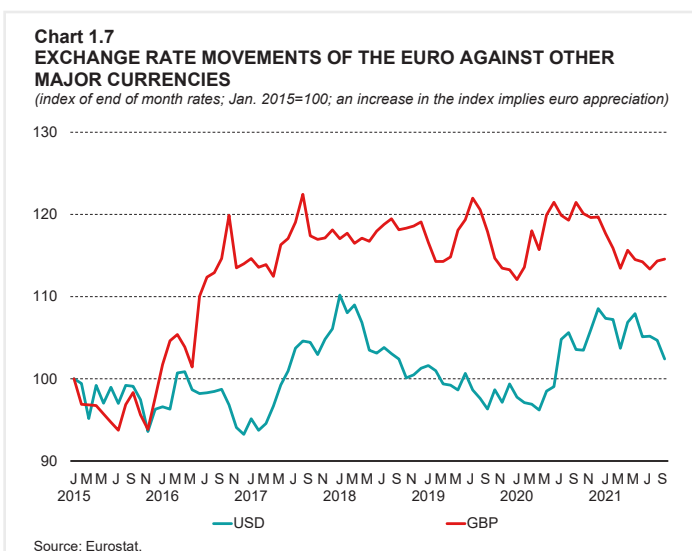
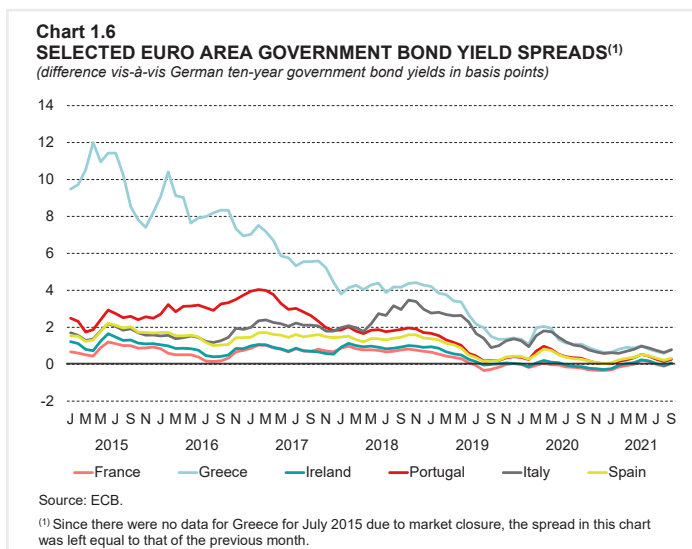
<sup>8</sup> The EURIBOR is an interest rate benchmark indicating the average rate at which principal European banks lend unsecured funds on the interbank market in euro for a given period.

Italian bonds also decreased, though to a lesser extent. On the other hand, spreads on Maltese and Greek sovereign bonds widened by 14 basis points and by six basis points, respectively.

### *Euro exchange rate slightly depreciates in effective terms*

At the end of September, the nominal effective exchange rate (NEER) of the euro against the EER-19 group of countries depreciated by 0.8% compared with the end of June.<sup>9</sup> Divergence between the monetary policy stance of the ECB and that of other major central banks was the main driver of movements in the euro during the period under review. Heightened risks from the faster spread of the Delta variant of COVID-19 in Europe compared to other regions also weakened the euro by supporting safe haven currencies.

Over this period, the euro lost ground by 2.6% against the US dollar, continuing its recent downward trend and reflecting market expectations of a faster normalisation of US monetary policy relative to the euro area (see Chart 1.7). The euro also lost ground against the Hong Kong dollar, Chinese yuan renminbi, the Japanese yen, the Singapore dollar and the Swiss franc. Conversely, it gained 0.3% against the British pound. During the third quarter, the euro also appreciated against the Australian dollar, Korean won, Canadian dollar and Polish zloty.



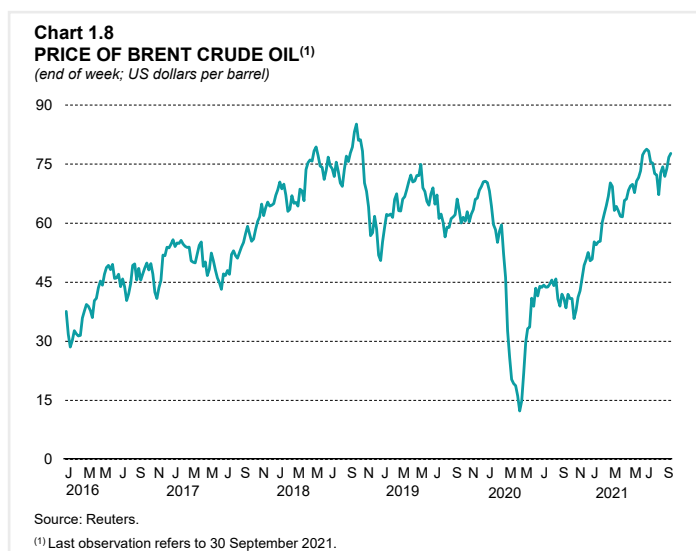
## Commodities

### *Oil price ends the quarter at a slightly lower level*

The price of oil remained above USD 70.0 per barrel in July amid improved expectations for global oil demand and declining oil inventories. In August, however, the price of oil declined

<sup>9</sup> 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.

reflecting rising COVID-19 cases and expectations that these would undermine the recovery in demand. It fell to the lowest level in nearly three months. Thereafter, the price of oil regained some ground supported by a slow restart of US oil production, a drop in inventories, and an easing in COVID-19 containment measures in some Asian countries. The price of Brent crude oil ended the quarter at USD 77.7 per barrel, 0.7% below the level prevailing at end-June (see Chart 1.8).



World Bank data show that non-energy commodity prices fell during the third quarter of 2021. Between June and September, they declined by 2.3%.

## 2. OUTPUT AND EMPLOYMENT

Domestic economic activity in the third quarter of 2021 continued to be affected by the COVID-19 pandemic and associated containment measures. Although, third quarter year-on-year growth in real GDP remained robust, standing at 9.7%, the GDP level was still 2.2% below that which prevailed in the third quarter of 2019. In particular, exports and private consumption have not yet returned to pre-pandemic levels.

On an annual basis, the driver behind growth in the quarter under review was domestic demand, as net exports declined. Sector data show that the expansion was primarily driven by the services sector, especially the sector comprising wholesale and retail trade, transportation, accommodation and related activities. Nevertheless, this sector continues to be relatively affected by the pandemic, with its gross value added (GVA) standing almost 15% lower than its level in the corresponding quarter of 2019. GVA in the manufacturing and construction sector also rose when compared with the third quarter of 2020, although their contribution to economic growth was much more limited than that of the services sector.

During the third quarter of 2021, the developments in the labour market remained positive, and indeed, employment stood above pre-pandemic levels. At the same time, activity rates continued to increase. The unemployment rate remained low from a historical perspective and well below that in the euro area.

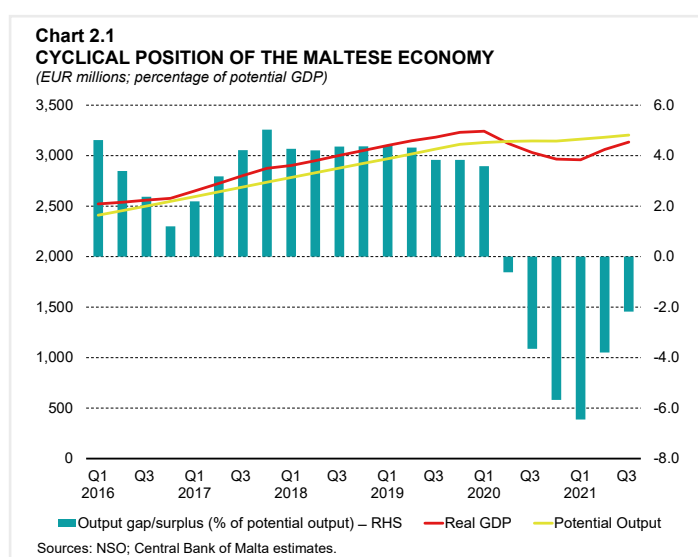
Employment continued to benefit from the ongoing normalisation of economic activity in the context of a tight labour market, although Government measures – such as the Wage Supplement Scheme – also provided some support to employment.

### Potential output and BCI

#### Potential output grows at a slightly faster pace

Potential output growth is estimated to have stood at 2.7% in the third quarter of 2021, up from 2.5% in the previous quarter (see Chart 2.1). At the same time, GDP grew by 9.7% in annual terms following an increase of 14.9% in the second quarter of 2021.

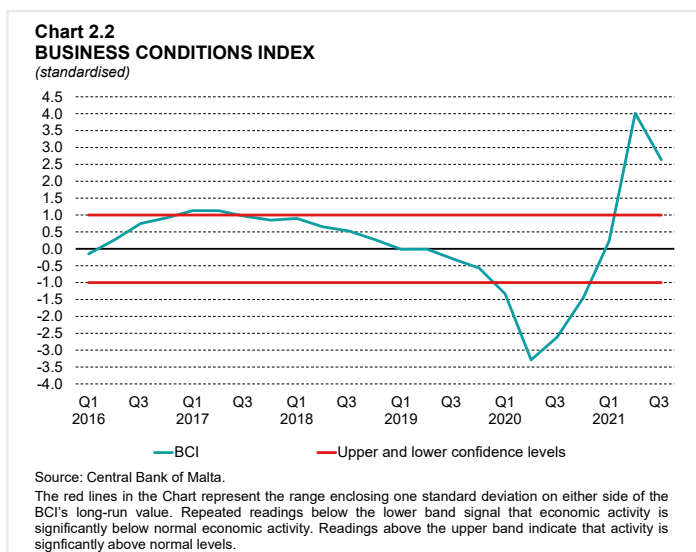
As a result, the output gap narrowed to -2.2% when measured as a 4-quarter moving average, from the -3.8% registered in the previous quarter. This implies that while there is still some degree of underutilisation of the economy's productive capacity, especially in tourism and entertainment-related sectors, the



economy is gradually returning to more normal levels of activity.

### BCI improves on a year earlier

The Bank's BCI stood strongly above its historical level in the third quarter of 2021 (see Chart 2.2).<sup>1</sup> During the quarter under review, the BCI continued to be affected by strong annual increases in several sub-components, particularly in tourist arrivals, economic sentiment and GDP, as well as significant falls in unemployment.<sup>2</sup> This reflects the fact that the third quarter of 2020 marked a low point for most economic variables due to the COVID-19 pandemic.

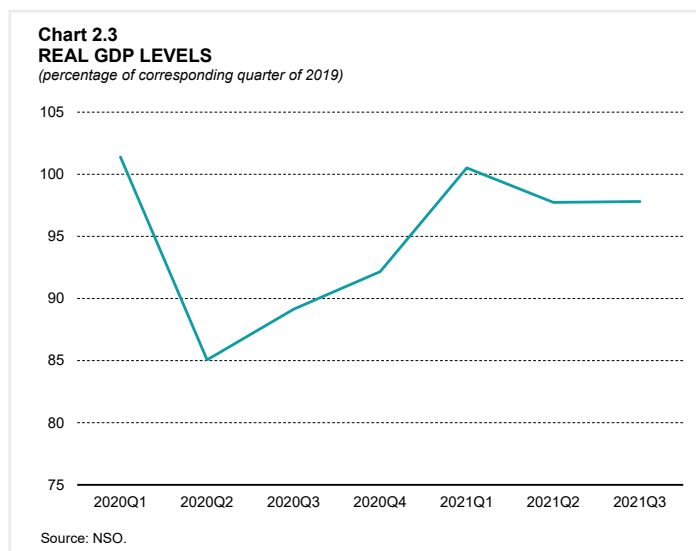


## GDP and industrial production

### Real GDP grows strongly but remains slightly below 2019 levels

In the third quarter of 2021, real GDP rose by 9.7% over the same period of 2020, following an increase of 14.9% in the second quarter.<sup>3</sup> One should note that this strong increase on an annual basis is due to the relatively low activity levels recorded in the third quarter of 2020 – partly reflecting the containment measures imposed at the time. Its level during the quarter under review was 2.2% below its level in the third quarter of 2019 (see Chart 2.3).

During the quarter under review, private consumption was 4.5% below its level two years earlier (see Chart 2.4). This is mostly

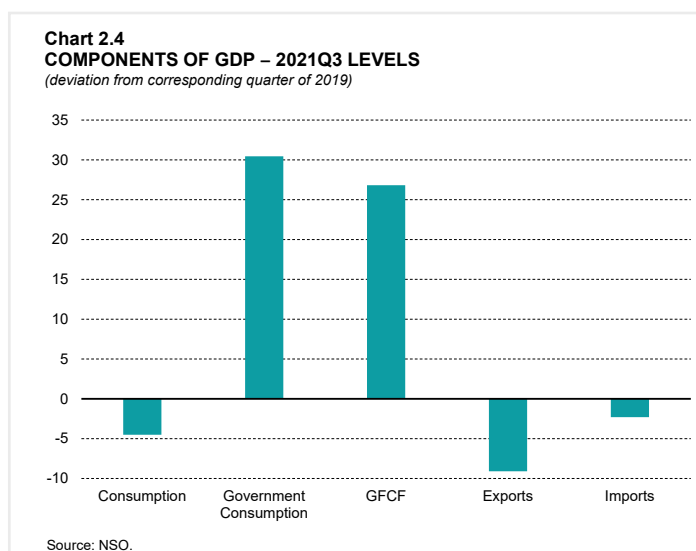


<sup>1</sup> The BCI is a synthetic indicator, which includes information from a number of economic variables such as the term structure of interest rates, industrial production, an indicator for the services sector, economic sentiment, tax revenues and private sector credit. By construction, it has an average value of zero over the estimation period since 2000. A full time series can be found [here](#). For further details on the methodology underlying the BCI, see Ellul, R., (2016), "A real-time measure of business conditions in Malta," [Working Paper 04/2016](#), Central Bank of Malta.

<sup>2</sup> Additional information on the interpretation of the BCI is available in the [January 2020](#) edition of the Bank's *Economic Update*.

<sup>3</sup> The analysis of GDP in this chapter of the *Quarterly Review* is based on data published in NSO [News Release 217/2021](#), which was published on 29 November 2021.

due to the still low level of consumption abroad by Maltese residents compared to 2019. By contrast, their consumption in Malta stood only marginally below that in the third quarter of 2019. In addition, exports remained well below the levels prevailing in that quarter, which reflects weak goods exports as well as low travel exports. On the other hand, the level of government consumption stood around 30.0% above the level that prevailed in the third quarter of 2019, partly as a result of strong COVID-19 support to the economy, which though decreasing when compared to 2020, remained sizable.



GFCF also attained pre-pandemic levels as it stood almost 27.0% above the level that prevailed in the corresponding quarter of 2019. The relatively high level of GFCF this year was driven by a recovery in investment following the postponement of investment plans that were suspended in 2020 as well as extraordinary investment in machinery and transport equipment in the aviation sector.

### *Domestic demand remains the main driver of economic growth*

In the third quarter of 2021 GDP growth was largely underpinned by a strong increase in domestic demand, mostly reflecting strong positive contributions from private consumption and GFCF. As a result, domestic demand added 11.1 percentage points to GDP growth following a contribution of 10.7 percentage points in the previous quarter. Meanwhile, the contribution of net exports turned negative, as imports outpaced exports (see Table 2.1).

Private consumption expenditure increased by an annual 7.5% in the third quarter of 2021, compared to the 14.6% in the second quarter of the year – adding 3.4 percentage points to real GDP growth.

Data on the Classification of Individual Consumption by Purpose (COICOP) show increases across almost all expenditure categories. The strongest increase in absolute terms was recorded in spending on restaurants and accommodation services. This was followed by higher spending on recreation and culture, as well as transport. These developments offset lower spending on clothing and footwear, and to a lesser extent, on communication services. In the national accounts however, COICOP data measure domestic consumption and thus include the expenditure of non-residents in Malta while excluding the expenditure of Maltese residents abroad. Given that tourist arrivals exceeded last year's levels, certain COICOP categories of expenditure were affected by a statistical base effect, reflecting a significant increase in non-residents' expenditure in Malta. At the same time, the remaining part of domestic consumption – the expenditure of Maltese residents in Malta – rose on a year earlier. Moreover, the expenditure of Maltese residents

**Table 2.1**  
**GROSS DOMESTIC PRODUCT<sup>(1)</sup>**

	2020		2021		
	Q3	Q4	Q1	Q2	Q3
<i>Annual percentage changes</i>					
Private final consumption expenditure	-11.2	-7.6	-4.8	14.6	7.5
Government final consumption expenditure	20.6	17.3	21.2	0.3	8.1
GFCF	-4.3	-13.6	-6.4	25.2	32.5
<b>Domestic demand</b>	<b>-2.6</b>	<b>-4.2</b>	<b>0.6</b>	<b>11.8</b>	<b>12.5</b>
Exports of goods and services	-10.6	-6.5	-3.8	13.4	1.6
Imports of goods and services	-5.0	-3.9	-3.2	11.2	2.9
<b>GDP</b>	<b>-10.9</b>	<b>-7.8</b>	<b>-0.9</b>	<b>14.9</b>	<b>9.7</b>
<i>Percentage point contributions</i>					
Private final consumption expenditure	-5.2	-3.4	-2.1	6.1	3.4
Government final consumption expenditure	3.1	3.0	3.8	0.1	1.7
GFCF	-0.8	-3.0	-1.4	5.9	6.8
Changes in inventories	0.7	-0.2	0.3	-1.4	-0.8
<b>Domestic demand</b>	<b>-2.1</b>	<b>-3.5</b>	<b>0.5</b>	<b>10.7</b>	<b>11.1</b>
Exports of goods and services	-14.9	-9.0	-5.5	19.5	2.3
Imports of goods and services	6.1	4.7	4.2	-15.3	-3.7
<b>Net exports</b>	<b>-8.7</b>	<b>-4.3</b>	<b>-1.4</b>	<b>4.2</b>	<b>-1.4</b>
<b>GDP</b>	<b>-10.9</b>	<b>-7.8</b>	<b>-0.9</b>	<b>14.9</b>	<b>9.7</b>
Sources: NSO; Central Bank of Malta calculations.					
<sup>(1)</sup> Chain-linked volumes, reference year 2015.					

abroad also rose on its year-ago level as trips abroad continued to normalise, even though it was only half of its level in the third quarter of 2019.

Government consumption expenditure rose by 8.1% in annual terms, primarily due to higher outlays in intermediate consumption and compensation of employees, particularly in the public administration and the health and elderly care sectors. Overall, government consumption added 1.7 percentage point to annual GDP growth.

Following an increase of 25.2% in the second quarter, real GFCF rose by almost a third in the quarter under review. The recent rise in GFCF was in large part driven by a significant increase in expenditure on transport equipment and machinery. This was followed by higher investment in residential and non-residential construction. Investment in intellectual property products also increased on a year earlier, albeit at a slower pace relative to the second quarter of the year.

Changes in inventories shed 0.8 percentage point from real GDP growth in the third quarter.

Meanwhile, exports rose by an annual 1.6%, following a 13.4% increase in the preceding quarter. The deceleration in export growth reflected both a contraction in goods exports and slower growth in services exports. Imports also rose at a slower pace compared to the second quarter. In the third quarter, they increased by 2.9% after increasing by 11.2% in the previous quarter. As imports rose more strongly than exports, net exports decreased, lowering GDP growth by 1.4 percentage points. This decrease was driven by a larger deficit from trade in goods, which offset a higher surplus from trade in services.

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.<sup>4</sup> In the quarter under review, the majority of the import-adjusted contributions were smaller than those based on the traditional approach, reflecting the increase in imports. This is particularly the case for GFCF and private consumption and, to a smaller degree, government expenditure. On the other hand, the import-adjusted contribution of exports was larger than that reported in Table 2.1.

After accounting for the effect of imports, the largest contributor to growth in real GDP in the third quarter was exports, with its contribution being one percentage point higher than that in the traditional approach. On the other hand, when adjusting for imports, the positive contributions of private investment and private consumption are respectively, 3.9 and 0.9 percentage points lower than those based on the traditional approach.

The import-adjusted contribution of government expenditure was marginally lower while the negative contribution of changes in inventories was smaller compared to the ones derived from the traditional approach.

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 third quarter of 2021, real GVA rose by 9.6% in annual terms following a 13.9% increase in the preceding quarter (see Table 2.3). It added 8.8 percentage points to GDP growth.<sup>5</sup>

**Table 2.2**  
**IMPORT-ADJUSTED CONTRIBUTIONS TO GDP GROWTH<sup>(1)</sup>**

	2020		2021		
	Q3	Q4	Q1	Q2	Q3
	<i>Percentage point contributions</i>				
Private final consumption expenditure	-3.8	-2.6	-1.3	4.0	2.6
Government final consumption expenditure	2.5	2.4	3.1	0.2	1.5
GFCF	-0.8	-1.6	-0.6	2.5	2.9
Changes in inventories	0.4	0.1	0.1	-0.6	-0.5
<b>Domestic demand</b>	<b>-1.8</b>	<b>-1.7</b>	<b>1.4</b>	<b>5.9</b>	<b>6.4</b>
<b>Exports of goods and services</b>	<b>-9.1</b>	<b>-6.2</b>	<b>-2.3</b>	<b>9.0</b>	<b>3.3</b>
<b>GDP</b>	<b>-10.9</b>	<b>-7.8</b>	<b>-0.9</b>	<b>14.9</b>	<b>9.7</b>

Source: Central Bank of Malta estimates.

<sup>(1)</sup> Chain-linked volumes, reference year 2015.

<sup>4</sup> The import intensities utilised for this exercise are based on internal estimates using the 2015 input-output tables, which were published by NSO in [News Release 005/2021](#). 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 [here](#).

<sup>5</sup> The difference between GDP and GVA is made up of taxes on products, net of subsidies. In the third quarter of 2021, taxes on products net of subsidies increased in annual terms.

**Table 2.3**  
**CONTRIBUTION OF SECTORAL GVA TO REAL GDP GROWTH**

*Percentage points*

	2020		2021		
	Q3	Q4	Q1	Q2	Q3
Agriculture, forestry and fishing	-0.2	0.0	0.0	0.0	0.0
Mining and quarrying; utilities	-0.1	-0.1	0.1	0.3	-0.3
Manufacturing	0.0	-0.1	-0.1	1.1	0.5
Construction	0.0	-0.2	0.1	0.2	0.2
Services	-8.0	-6.8	-0.8	11.0	8.4
<i>of which:</i>					
Wholesale and retail trade; repair of motor vehicles; transportation; accommodation and related activities	-8.1	-6.7	-3.3	3.3	5.6
Information and communication	0.7	0.3	0.6	1.4	1.2
Financial and insurance activities	0.5	0.8	0.2	1.1	0.4
Real estate activities	-0.1	-0.3	0.2	0.8	0.4
Professional, scientific, Administrative and related activities	-1.8	-1.2	-0.8	0.9	0.1
Public administration and defence; education; health and related activities	0.2	-0.1	1.6	1.9	0.7
Arts, entertainment; household repair and related services	0.6	0.4	0.8	1.5	-0.1
<b>GVA</b>	<b>-8.3</b>	<b>-7.3</b>	<b>-0.7</b>	<b>12.6</b>	<b>8.8</b>
<b>Taxes less subsidies on products</b>	<b>-2.6</b>	<b>-0.6</b>	<b>-0.1</b>	<b>2.3</b>	<b>0.9</b>
<b>Annual real GDP growth (%)</b>	<b>-10.9</b>	<b>-7.8</b>	<b>-0.9</b>	<b>14.9</b>	<b>9.7</b>

Source: NSO.

Services were the main driver behind the rise in economic activity, adding 8.4 percentage points to real GDP growth. The growth in services in annual terms (primarily) reflects the fact that tourism has been more upbeat in the summer of 2021 when compared to that last year. In fact, most of the increase in GVA stemmed from the sector comprising wholesale and retail trade, transportation, accommodation and related activities. Nevertheless, the recovery in the tourism sector is still partial and thus the GVA of the sector stood almost 15.0% lower than its levels in 2019Q3. This indicates that this sector, while recovering, is still operating below capacity. At the same time, information and communication sector and the sector comprising public administration and defence activities collectively added a further 1.9 percentage points to real GDP growth.

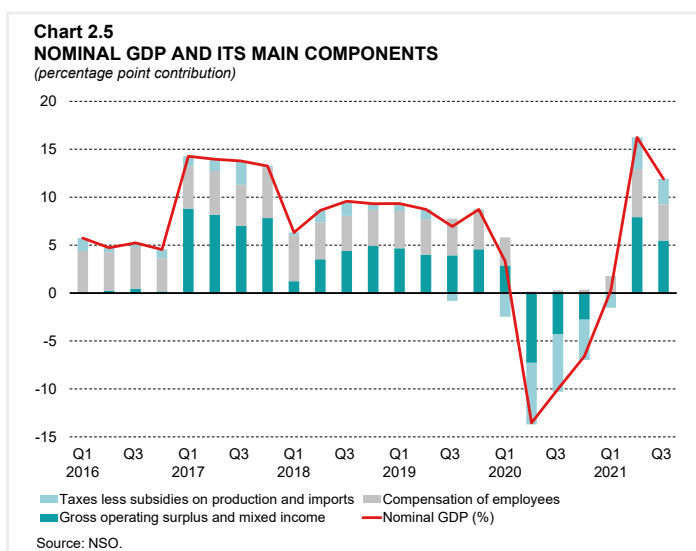
Meanwhile, the contribution of the manufacturing sector almost halved in the quarter under review. Growth in the manufacturing sector is affected by severe supply-chain disruptions.

### *Nominal GDP growth remains robust*

Nominal GDP rose by 11.9% in annual terms in the third quarter of 2021 compared with 16.2% in the previous quarter. This deceleration was underpinned by slower growth in gross operations surplus and, to a lesser extent, in compensation per employee, although both components recorded strong increases over the low levels recorded a year earlier (see Chart 2.5).

The contribution of compensation of employees reached 3.8 percentage points. This component grew by 8.3% in the third quarter of 2021, compared with 10.3% in the previous quarter.

Compensation of employees increased in both the private and the general government sector. All sectors registered increases in their compensation of employees with the largest increase registered in the sector comprising public administration, health and education. Other increases were recorded in the sectors comprising professional, scientific and technical activities and administrative and support service activities, followed by the wholesale and retail trade, together with repair of motor vehicles and motorcycles and the sector incorporating financial and insurance activities.



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. During the quarter under review subsidies on production and imports declined sharply compared to the same quarter last year, as payments in terms of the Wage Supplement Scheme declined. On the other hand, due to the recovery in economic activity, taxes on production and imports rose. As a result, 'net taxes on production and imports' increased when compared to the same quarter last year.

Gross operating surplus grew at annual rate of 11.0%, after rising by 16.9% in the preceding quarter – adding 5.5 percentage points to nominal GDP growth.

When compared with the same quarter a year earlier, the increase in gross operating surplus was broad-based across most sectors. This primarily reflected a rise in the operating surplus of the accommodation and food service activities as well as the transportation and storage sector. It was followed by an increase in the operating surplus of the information and communication sector, the sector comprising wholesale and retail trade, and manufacturing.

### *Industrial production broadly unchanged from its level a year earlier*

Industrial production fell marginally in the third quarter after the strong growth recorded in the previous quarter. Output fell by 0.1% on an annual basis, following a 13.4% increase in the previous three-month period (see Table 2.4). The index stood around 3.0% below its corresponding level in the third quarter of 2019 (the latest comparable period before the pandemic).

The small decline in industrial production reflected mixed developments across sectors. In particular, production rose in the energy and quarrying sectors. On the other hand, the manufacturing sector recorded a contraction of 1.3% after a 13.8% increase in the second quarter of 2021.

**Table 2.4**  
**INDUSTRIAL PRODUCTION<sup>(1)</sup>**  
*Percentages; annual percentage changes*

	Shares	2020			2021	
		Q3	Q4	Q1	Q2	Q3
<b>Industrial production</b>	<b>100.0</b>	<b>-3.0</b>	<b>-0.9</b>	<b>-8.2</b>	<b>13.4</b>	<b>-0.1</b>
<b>Manufacturing</b>	<b>87.1</b>	<b>-4.1</b>	<b>1.6</b>	<b>-5.3</b>	<b>13.8</b>	<b>-1.3</b>
<i>of which:</i>						
Food products	15.4	8.9	-4.8	-7.5	-5.5	-17.5
"Other" manufacturing	10.3	-13.9	12.3	7.5	50.2	-2.0
Repair and installation of machinery and equipment	7.9	-26.0	-26.0	-32.2	5.4	13.9
Basic pharmaceutical products and pharmaceutical preparations	7.3	25.8	69.0	46.2	25.5	-3.4
Printing and reproduction of recorded media	7.3	4.0	-5.5	-9.3	-10.0	-12.7
Beverages	5.6	-17.1	-32.0	-22.4	31.5	8.2
Rubber and plastic products	5.4	-12.9	20.2	-7.5	10.7	22.3
Computer, electronic and optical products	5.0	1.2	8.2	-2.8	8.3	1.7
<b>Energy</b>	<b>12.5</b>	<b>-0.2</b>	<b>-13.5</b>	<b>-21.7</b>	<b>10.8</b>	<b>5.2</b>
<b>Mining and quarrying</b>	<b>0.5</b>	<b>-27.7</b>	<b>-29.0</b>	<b>-24.3</b>	<b>25.2</b>	<b>17.8</b>

Sources: NSO; Eurostat.

<sup>(1)</sup> 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.

A few large sub-sectors in the manufacturing industry contributed to this decline, in particular those producing food products, those that print and reproduce recorded media, and those that specialise in pharmaceutical products and "other manufacturing" products – which includes medical and dental instruments, toys and related products. Production also fell in a number of smaller sectors such as those involved in the manufacture of other non-metallic mineral products, wearing apparel and electrical equipment.

On the other hand, higher output was registered among firms that produce textiles, rubber and plastic products, wood and wood products and among those that repair and install machinery and equipment. Smaller increases were registered in the production of beverages as well as computer, electronic and optical products.

Production continued to recover in the energy and in the quarrying sector, with both registering positive year-on-year changes for the second consecutive quarter. Production in these two sectors stood approximately 5% and 18% higher respectively than their year-ago levels.

### Business and consumer surveys

During the third quarter of 2021, the European Commission's Economic Sentiment Indicator (ESI) retreated slightly from the level recorded in the second quarter but remained elevated from a historical perspective. In the third quarter of 2021, it eased to 112.4, from 115.3 in the preceding quarter. Notwithstanding this decrease, the overall indicator stood above its long-term average of around 100.0 and also exceeded the level recorded just before the pandemic (see Chart 2.6). This may reflect the easing of the COVID-19 restrictions and related improvement in activity as well as a further increase in vaccination rates achieved during the quarter.<sup>6,7</sup> However, the overall ESI indicator stood below that in the euro area which averaged 118.1.

<sup>6</sup> The ESI summarises developments in confidence in five surveyed sectors: industry; services; construction; retail; and consumers. Quarterly data are three-month averages.

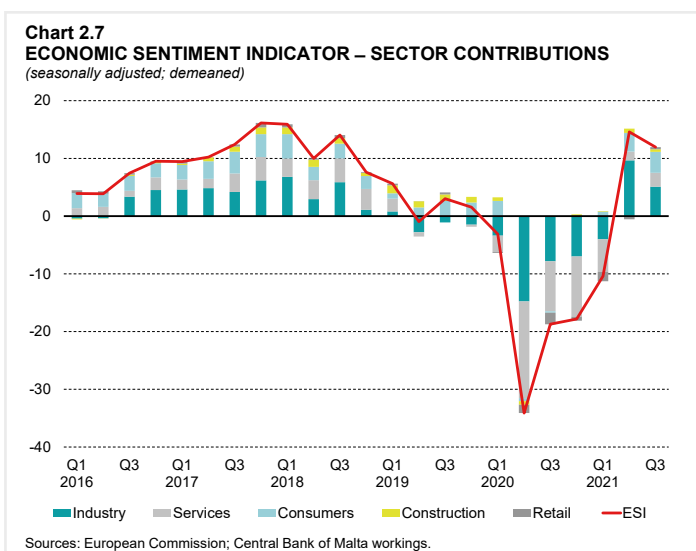
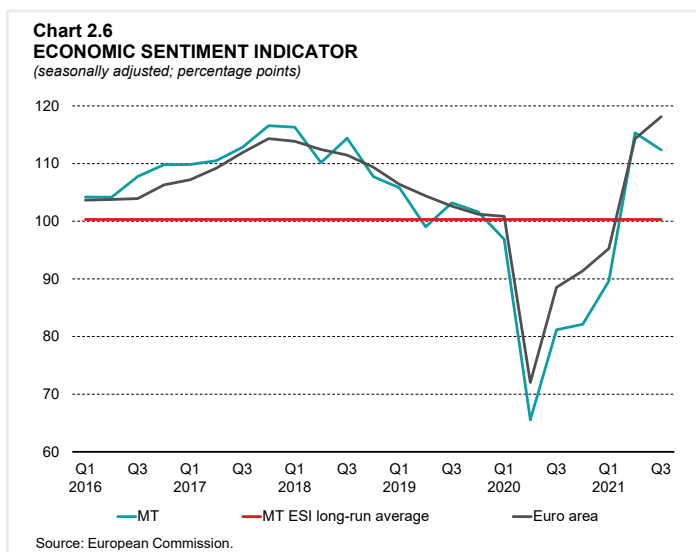
<sup>7</sup> Long-term averages are calculated over the entire period for which data are available. For the consumer and industrial confidence indicators, data for Malta became available in November 2002, while for services and construction data became available in May 2007 and May 2008, respectively. 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.

The latest decrease in sentiment in Malta reflected weaker confidence in industry and in the construction sector. By contrast, confidence improved considerably among retailers, and to a lesser extent, in the services sector. Meanwhile, sentiment among consumers edged up marginally. On average, sentiment was positive in all sectors and strongest in services.

When accounting for the variation in the weights assigned to each sector in the overall index, the fall in the ESI relative to the second quarter of the year was largely driven by industry.<sup>8,9</sup> The construction sector also contributed to the decrease in sentiment, though marginally. The positive assessment of firms in industry and services and that of consumers largely explain why the overall ESI stood well above the long-term average (see Chart 2.7).

### Industrial confidence decreases<sup>10</sup>

Confidence in industry declined during the third quarter of the year. It decreased to 8.6 from 18.0 in the previous 3-month period but remained well above its long-term average of -4.0 (see Chart 2.8). The recent fall in sentiment was largely driven by weaker production expectations. At the same time, while firms reported stocks of finished goods to be below normal in the preceding quarter, in the third quarter they assessed stock levels to be above normal.<sup>11</sup> On the other hand, the assessment of order-book levels stood less negative compared to the second quarter.



<sup>8</sup> Weights are assigned as follows: industry 40%; services 30%; consumers 20%; construction 5%; and retail trade 5%.

<sup>9</sup> 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.

<sup>10</sup> 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.

<sup>11</sup> 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 2.8.

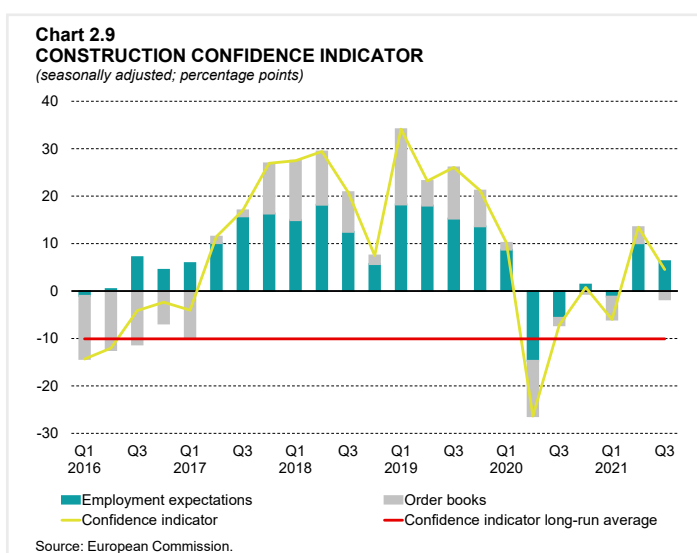
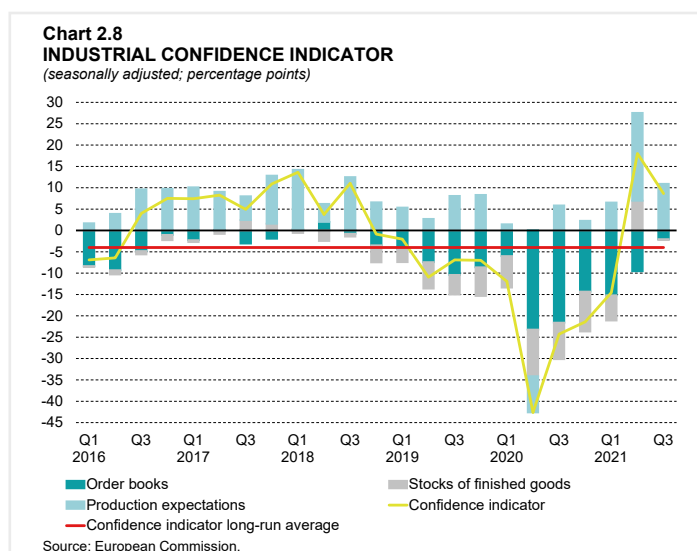
Additional survey data reveal that the share of firms foreseeing an increase in selling prices in the months ahead edged down slightly when compared with the second quarter.

### Confidence in construction declines<sup>12</sup>

In the third quarter of 2021, confidence in the construction sector fell to 4.5 from 13.5 in the previous 3-month period. Notwithstanding this decline, sentiment stood above its long-term average of -10.1 (see Chart 2.9).

By contrast to the second quarter, respondents assessed order books to be below normal levels. At the same time, employment expectations stood less positive in the third quarter of 2021.

Supplementary survey data indicate that, when compared to the second quarter, a higher share of respondents anticipated selling prices to increase in the next three months.



### Consumer confidence broadly stabilises around pre-pandemic level<sup>13</sup>

Consumer confidence averaged 6.7, marginally up from 6.5 in the previous quarter and thus stood further above its long-run average of -10.4 (see Chart 2.10).

The latest amelioration in consumer confidence largely reflected an improved assessment of their financial situation over the last 12 months. At the same time, expectations of major purchases over the next 12 months turned positive for the first time in over seven years. By contrast, consumers' expectations about the general economic situation and, to a lesser extent, of their financial situation in the next 12 months, deteriorated in the quarter under review.

<sup>12</sup> 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.

<sup>13</sup> 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.

Supplementary survey data show a marginal decrease in the share of consumers expecting unemployment to decline over the next 12 months. Meanwhile, price expectations turned positive.

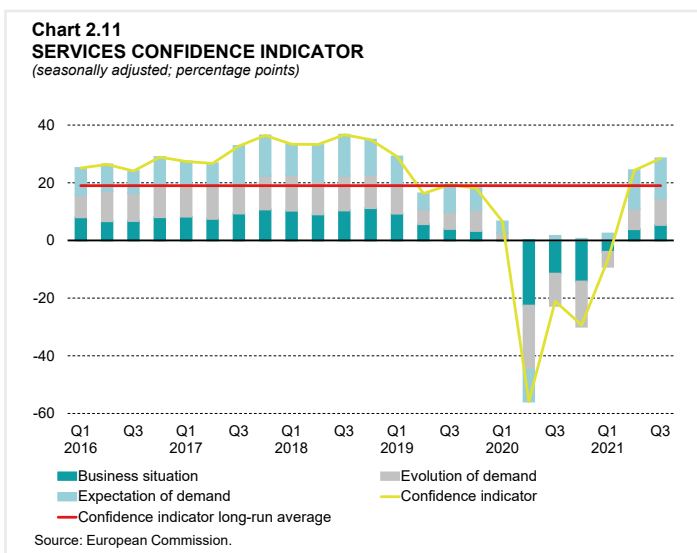
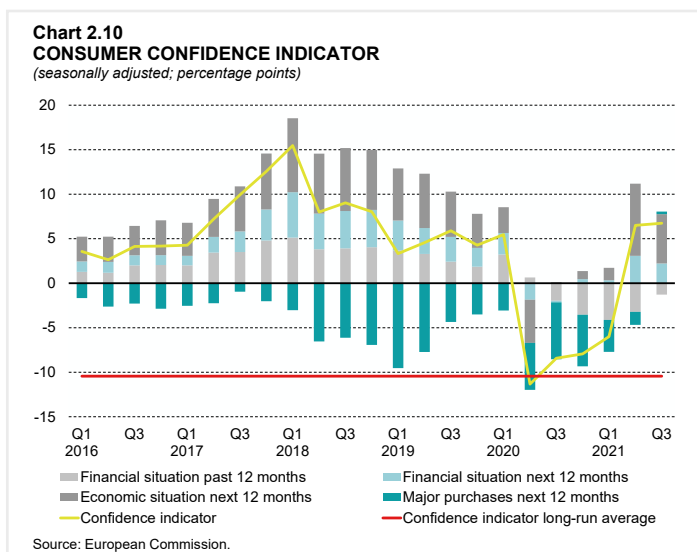
### Confidence in the services sector rises<sup>14</sup>

Confidence in the services sector stood at 28.4, above the 24.3 recorded in the second quarter of 2021 and its long-term average of 19.0. Higher sentiment was driven by developments across all components of the indicator (see Chart 2.11). However, it mostly reflected an improvement in the assessment of demand over the previous three-month period and, to a lesser extent, in demand expectations for the coming months. Respondents' assessment of the business situation over the past three months also improved.

Supplementary survey data indicate that respondents' price expectations also edged up in the third quarter of 2021.

### Confidence in the retail sector turns positive<sup>15</sup>

Sentiment in the retail sector stood at 8.1, up from -20.3 recorded in the previous quarter, thus standing well above its long-term average of -1.7. This improvement was largely driven by firms' assessment of business activity over the past three months, which turned positive. At the same time, fewer participants reported stocks of finished goods to be above normal. These developments offset a slight deterioration in retailers' expectations of business activity over the next three months (see Chart 2.12).



<sup>14</sup> 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.

<sup>15</sup> 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.

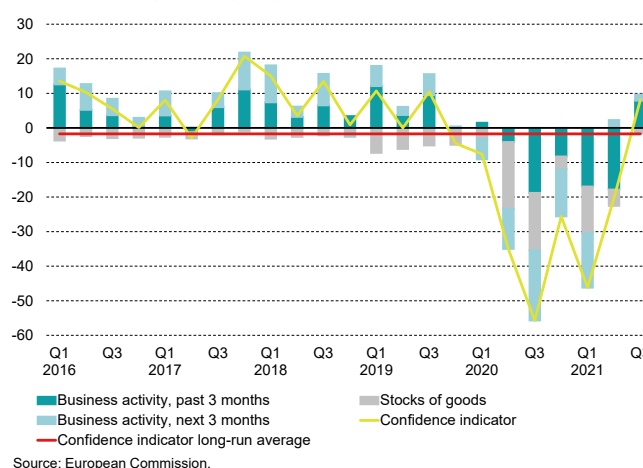
Supplementary survey data indicate that, on balance, orders expectations were significantly less negative compared to the second quarter of the year. Meanwhile, the share of retailers anticipating a rise in prices in the coming months reached a record high.

### Employment Expectations Indicator (EEI) increases

The EEI – which is a composite indicator of employment expectations in industry, services, retail trade and construction – stood above its long-term average of around 100.0 in the third quarter of the year.<sup>16</sup> It stood at 114.9 compared with 105.3 in the preceding quarter. Following this increase, the index exceeded the euro area average of 112.6.

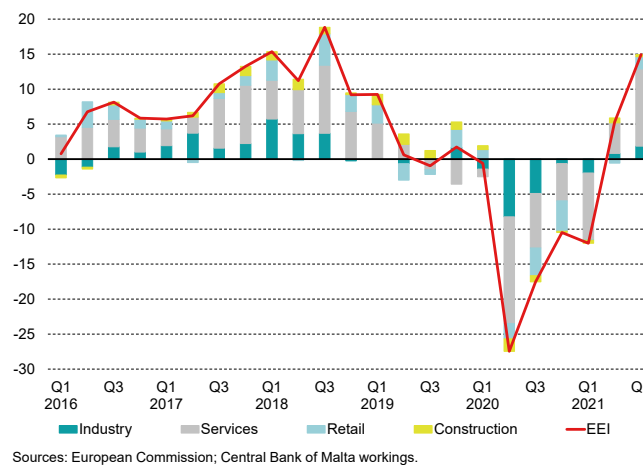
During the quarter under review, employment expectations were positive and stood above their long-term average across all sectors (see Chart 2.13). When accounting for the variation in the weights assigned to each sector in the overall index, the increase relative to the second quarter of 2021 largely reflected developments in the services sector. Improved employment expectations among retailers and in industry also contributed to the rise in the EEI, although by a smaller magnitude. By contrast, the contribution of the construction sector eased slightly compared to the preceding 3-month period.

**Chart 2.12**  
**RETAIL CONFIDENCE INDICATOR**  
(seasonally adjusted; percentage points)



Source: European Commission.

**Chart 2.13**  
**EMPLOYMENT EXPECTATIONS INDICATOR**  
(seasonally adjusted; demeaned)



Sources: European Commission; Central Bank of Malta workings.

<sup>16</sup> 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*.

## BOX 1: MITIGATION MEASURES, PREVALENCE RESPONSE AND PUBLIC MOBILITY DURING THE COVID-19 EMERGENCY<sup>1</sup>

In response to the rapid spread of the COVID-19 outbreak, national governments have implemented a range of mitigation measures designed to limit the transmission of the coronavirus. These policies range from outright strict lockdowns implemented in parts of Asia and in some European states, to less stringent but focused approaches in other regions. As infection rates started to slow down, national authorities began to ease these emergency policies before re-instating them once again through the last two months of 2020 and more recently in late 2021.

Existing literature shows that these so-called “non-pharmaceutical” interventions are usually very effective at limiting societal mobility and the spread of pandemics (Litvinova, 2019).<sup>2</sup> However, to properly estimate the effectiveness of government mitigation measures, it is also important to properly capture self-imposed reductions in mobility. Gersovitz and Hammer (2003) and Farboodi et al. (2020) argue that when deciding on the level of social interaction to maintain during a pandemic, individuals will choose to trade off the utility benefit of social interactions against the risks that come with such interactions.<sup>3</sup> This gives rise to possible self-imposed restrictions which are part of a behavioural trait normally referred to as “prevalence response”. This study explores the effects restrictive policies have had on mobility across the European Union (EU) during the initial phases of the COVID-19 pandemic, while controlling for the prevalence response of individuals.

### Data

This study mainly makes use of two sets of data: indices measuring the extent of government mitigation measures and data on individual mobility across the EU. Data on government mitigation measures are sourced from the Oxford COVID-19 Government Response Tracker. This tracker collects information on several different common policy responses that governments have taken in response to the pandemic. In this case, the analysis is focused on a subset of these indicators, more precisely those that record containment measures and which are collectively known as the stringency indicators. These include data on the closure of schools, workplaces, the cancellation of public events, restrictions on public gatherings, closure of public transport, internal and international travel restrictions and stay-at-home orders.

Chart 1 looks at the evolution of the stringency indices for the EU.<sup>4</sup> All indicators capturing the containment measures enacted by the governments of the EU bloc, show an almost instantaneous increase in their stringency levels between March and April 2020. The strongest increases in stringency levels were registered in the cancelling of public events,

<sup>1</sup> Prepared by Noel Rapa, Manager Modelling Office in the Research Department at the Bank. The views expressed are the author's own and do not necessarily represent the views of the Central Bank of Malta.

<sup>2</sup> See Litvinova, M., Quan-Hui L., Evgeny S. K. and Ajelli, M. (2019), Reactive school closure weakens the network of social interactions and reduces the spread of influenza. *Proceedings of the National Academy of Sciences*, 116, pp. 13174-13181.

<sup>3</sup> See Gersovitz, M. and Hammer, J. (2003), Infectious diseases, public policy, and the marriage of economics and epidemiology. *World Bank Research Observer*, 18, pp. 129-157 and Farboodi, M., Jarosch, G. and Shimer, R. (2020), Internal and External Effects of Social Distancing in a Pandemic. National Bureau of Economic Research, *NBER Working Papers* 27059.

<sup>4</sup> Data for the EU is estimated as a simple average across the 28 countries which made up the EU block up till the end of 2020. For 2021, the EU average is made up by the EU-27 bloc and the UK.

in restrictions to public gatherings and the closing down of schools. On the other hand, the closing down of public transport and stay-at-home orders show a lower level of stringency at an EU level, reflecting the relatively small number of countries that have enacted a full and strict lockdown. All containment measures were partially lifted during the summer of 2020, as the number of new COVID-

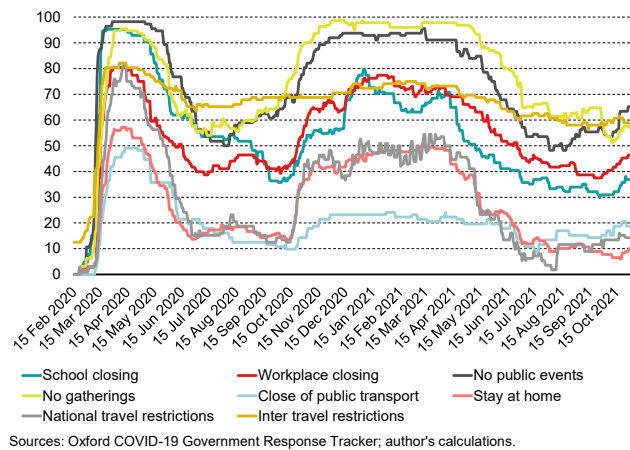
19 cases across the EU slowed down substantially. Fuelled by renewed increases in COVID-19 infections, most containment measures have been imposed again in the last part of 2020 before being relaxed again in the summer of 2021.

With regards to data on mobility, the study utilises Google's COVID-19 Community Mobility data which measure changes in mobility by geography and categories. This database includes data on mobility to retail and recreation establishments, groceries and pharmacies, parks, transit stations, workplaces and residences. All mobility data are compared to a baseline, estimated as the median value of visits over a five-week period between 3 January and 6 February 2020 prior to the start of the pandemic.

Chart 2 shows that while the absolute drops in mobility differ from one country to another, they do exhibit a very similar profile, with considerable drops during the first wave of the pandemic and a rebound during the summer months, followed by renewed drops in autumn of 2020.<sup>5</sup> At the height of the first wave, the most prominent decrease in mobility was registered in the Retail and Recreation category, reaching a maximum drop of almost 70% when compared to baseline levels. This is considerably more pronounced than the average falls registered in less discretionary types of mobility, such as workplace mobility (which has dropped by around 45%) and mobility to groceries and pharmacies (24% drop over baseline levels).

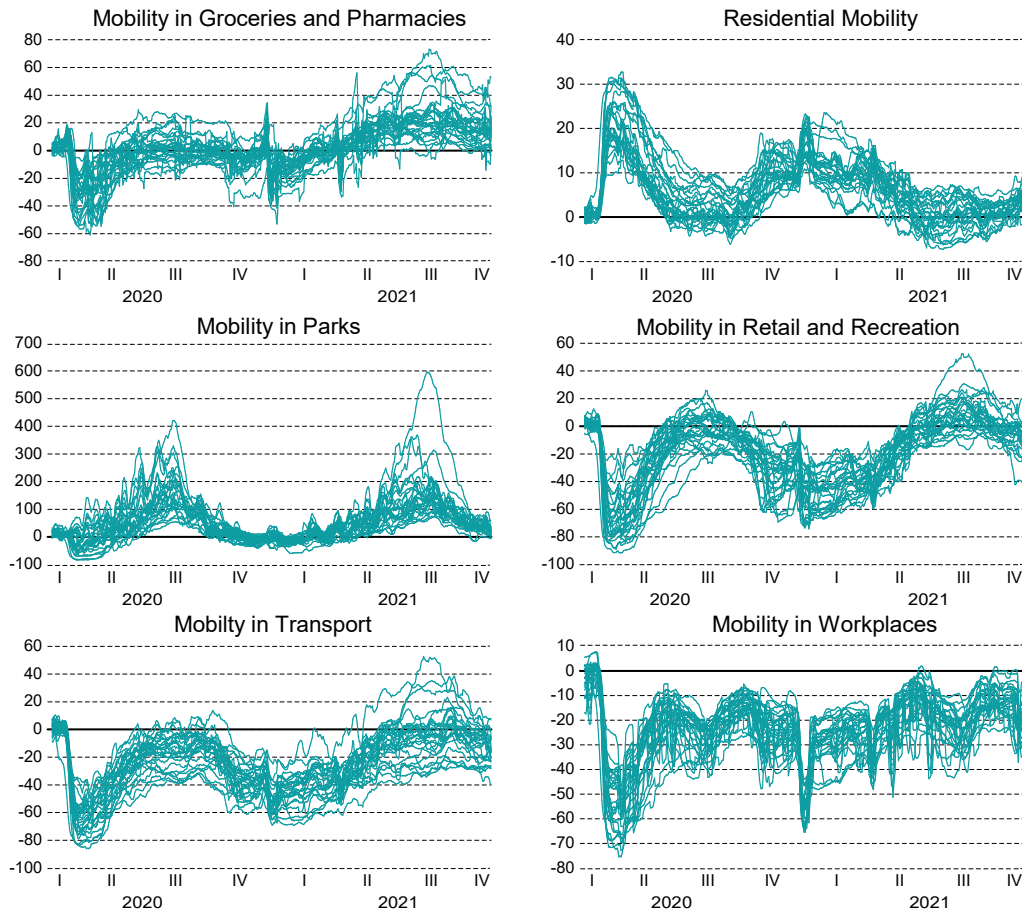
All mobility measures (with the exception of mobility to parks) have slowly returned to baseline levels by mid-summer of 2020 as the situation across all EU countries slowly returned to their pre-pandemic state. Mobility levels then started to drop again in autumn 2020 as more waves of the pandemic hit the continent. Most mobility measures, (especially those of a discretionary nature) exhibit a similar pattern in 2021 with falls in mobility in the winter and

**Chart 1**  
**STRINGENCY INDICATOR – EU-28 AVERAGE**  
(change in price index relative to exchange rate adjustment; forecast horizon in quarters)



<sup>5</sup> The only exception to this is mobility in Parks. The extreme heterogeneity in the results concerning mobility to parks could stem from the definition of what constitutes a park. Google Mobility Data defines a park as a National Park and therefore countries that do not have a large number of National Parks, but instead have other open spaces would not be correctly represented in this data.

**Chart 2**  
**MOBILITY DATA IN EU COUNTRIES**  
*(per cent deviation from baseline (7-day moving average))*



Sources: Google's COVID-19 Community Mobility; author's calculations.

spring months followed by a rebound in summer months, mirroring the patterns exhibited by government mitigation measures. The only two evident exceptions are mobility to work-places, which has remained roughly 20-30% lower than pre-pandemic levels throughout 2020 and 2021, and mobility to groceries and pharmacies which has remained at or above pre-pandemic levels since the third quarter of 2020.

### Econometric estimates

Empirically, it is very challenging to separate the effects that policies have had on individual mobility from those relating to self-imposed restrictions especially since there is considerable correlation between heightened risk factors that trigger prevalence responses and policy induced restrictions.<sup>6</sup> In order to better separate these two effects, this study relies on a panel dataset and a staggered Difference-in-Differences (DiD) econometric specification. This strategy relies on the timing differences between changes in national stringency

<sup>6</sup> See Manski, C. F. (2000), Economic analysis of social interactions. *Journal of Economic Perspectives*, 14, pp. 115-136.

levels and the number of COVID-19 cases and deaths across countries to help isolate the effects of mitigation measures from those due to prevalence responses.

This study makes use of the following econometric specification:

$$y_{\{i,t\}} = \gamma_i + \sum_{\{c=1\}}^7 \beta_{\{i,c\}} cases_{\{i,c,t\}} + \sum_{\{h=1\}}^6 \gamma_{\{i,h\}} deaths_{\{i,h,t\}} + \sum_{\{p=1\}}^8 \xi_{\{i,p\}} P_{\{i,p,t\}} + \sum_{\{j=1\}}^3 \delta_{\{i,j\}} t^j + \sum_{\{d=1\}}^6 \theta_{\{i,d\}} DOW_{\{i,d,t\}} + \phi_{\{i\}} temp_{\{i,t\}} + \sigma_{\{i,t\}} \quad (1)$$

Where  $y_{\{i,t\}}$  measures the change in the mobility measure under analysis across countries  $i$  and time  $t$ ,  $\gamma_i$ , are country fixed effects.  $Cases_{\{i,c,t\}}$  and  $deaths_{\{i,h,t\}}$  are dummy variables that record the number of COVID-19 cases and deaths per million. In particular, seven dummy variables are specified for COVID-19 cases, which take the value of 1 if new reported cases per million in a given country are between 0 and 5, 5 and 10, 10 and 20, 20 and 40, 40 and 80, 80 and 160 or greater than 160. For COVID-19 related deaths, six dummy variables take the value of 1 if new daily deaths per million in a given country are between 0 and 1, 1 and 2, 2 and 5, 5 and 10, 10 and 20 or larger than 20 are specified.  $P_{\{i,p,t\}}$  record the intensity of eight different government mitigation measures as reported in the Oxford COVID-19 Government Response Tracker.<sup>7</sup> All specifications control for day-of-the-week effects, a third-degree polynomial in time and seasonality effects through the introduction of temperature data for each capital city of the countries included in the sample.

Results show that largely, all mitigation measures are found to affect all types of mobility measures in a statistically significant way. In particular, the introduction of new or more stringent measures is estimated to reduce mobility to parks, retail and recreation establishments, transport, groceries and workplaces while increasing residential mobility. Moreover, most stringency sub-indices were found to affect to a larger extent, mobility in discretionary types of mobility, namely retail and recreation. In fact, mobility related to transport, place of residence, work and groceries were found to be less affected by changes in the government mitigation measures.

Policies relating to the closure of schools seem to exert the largest effects on all types of mobility (with the exception of mobility to parks). In this respect, the result pertaining to mobility to retail and recreation establishments and to workplaces are especially striking. Estimates in fact show that these two types of mobility have been significantly more affected by school closures than by workplace closures (with the latter including the forced shutdown of non-essential retail outlets and recreation establishments) and stay at home orders (which capture outright lockdowns). This suggests that individuals across the EU did not simply reduce their mobility as a direct consequence of the restrictions implemented by national authorities but have also reacted to a heightened sense of risk brought about by the implementation of school closures. The role of prevalence response in reducing individual mobility across the EU is also confirmed by the statistical significance of the two sets of dummy variables capturing the number of per million COVID-19 cases and COVID-19 related deaths.<sup>8</sup>

<sup>7</sup> The estimation period runs between 15 February 2020 and the end of November 2020.

<sup>8</sup> Results pertaining to mobility to parks do not paint a clear picture and should be treated with caution. Google Mobility data defines a park specifically as a National Park and does not necessarily including open rural spaces.

Results also indicate that as the number of reported cases and deaths per million increases, the negative effect on mobility is expected to increase considerably. For instance, results show that when the number of daily COVID-19 cases stood between 1 and 5, there was a drop of 2.4% in mobility to retail and recreation outlets that occurred independently of any government measures. This drop climbs gradually to more than 10% when daily cases stood between 81 and 160. The increase in the prevalence response of individuals is slightly more pronounced for news relating to COVID-19 deaths, ranging from no significant effect at the lowest levels of reported deaths to a drop of almost 14% when COVID-19 related per million deaths exceed 20.

Finally, results indicate that the precautionary effects following news relating to COVID-19 cases peak before the number of cases reported in each country reach their maximum. This could suggest that as the number of COVID-19 cases started to stabilise at very high levels, the general public started to acclimatise to this new normal thereby reducing the degree of prevalence response. The re-assessment of one's risk profile and the subsequent demotivation to engage in protective behaviours during a prolonged period of

**Table 1**  
**REGRESSION ANALYSIS**

(dependent variable: % change in mobility)

	Home	Park	Retail and Recreation	Transport	Groceries and Pharmacies	Work
0 ≤ Cases < 5	0.32	-4.08 *	-2.4 ***	-1.07	1.17	0.41
5 ≤ Deaths < 10	1.27 ***	-1.66	-5.45 ***	-3.29 ***	-0.77	-2.3 ***
10 ≤ Deaths < 20	1.84 ***	-1.79	-6 ***	-4.46 ***	-1.34 *	-3.26 ***
20 ≤ Deaths < 40	2.14 ***	-2.25	-7.39 ***	-5.38 ***	-2.81 ***	-4.05 ***
40 ≤ Deaths < 80	2.65 ***	-14.98 ***	-8.86 ***	-7.56 ***	-4.39 ***	-5.2 ***
80 ≤ Deaths < 160	3.25 ***	-13.21 ***	-10.66 ***	-7.67 ***	-5.25 ***	-5.61 ***
160 ≤ Deaths	2.13 ***	12.73 ***	-4.81 ***	-4.14 ***	-1.74	-4.56 ***
0 ≤ Deaths < 1	-0.2 *	-4.82 ***	-0.09	-0.03	0.13	0.35
1 ≤ Deaths < 2	0.56 **	-8.88 ***	-3.53 ***	-0.95	-0.44	-1.67 ***
2 ≤ Deaths < 5	1.05 ***	-7.13 *	-3.98 ***	-0.74	-0.31	-3.24 ***
5 ≤ Deaths < 10	1.87 ***	1.36	-5.1 ***	-1.32	-1.77 *	-6.43 ***
10 ≤ Deaths < 20	4.26 ***	-3.24	-12.35 ***	-7.63 ***	-8.49 ***	-13.42 ***
20 ≤ Deaths	4.59 ***	-13.71	-13.88 ***	-7.44 ***	-1.58	-11.34 ***
School closing	0.06 ***	-0.01	-0.19 ***	-0.17 ***	-0.07 ***	-0.16 ***
Workplace closing	0.03 ***	0.22 ***	-0.1 ***	-0.05 ***	-0.05 ***	-0.09 ***
No public events	0 *	-0.21 ***	-0.03 ***	-0.04 ***	-0.02 ***	0
No gatherings	0.03 ***	-0.09 ***	-0.08 ***	-0.07 ***	-0.05 ***	-0.06 ***
Close of public transport	0.03 ***	-0.19 ***	-0.09 ***	-0.07 ***	-0.09 ***	-0.06 ***
Stay at home	0.02 ***	0.15 ***	-0.07 ***	-0.05 ***	-0.02	-0.06 ***
National travel restr	0.03 ***	-0.2 ***	-0.09 ***	-0.08 ***	-0.05 ***	-0.04 ***
Inter travel restriction	0.01 ***	0.07	-0.05 ***	-0.08 ***	-0.06 ***	-0.05 ***
Temperature	-0.22 ***	5.11 ***	0.45 ***	0.41 ***	0.24 ***	-0.07
Fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Cubic trend	Yes	Yes	Yes	Yes	Yes	Yes
Day of the week dummies	Yes	Yes	Yes	Yes	Yes	Yes
R-squared	0.84	0.69	0.83	0.82	0.47	0.7

Source: Author's calculations.

crisis is a very well documented phenomenon, known as pandemic fatigue (World Health Organisation, 2020).<sup>9</sup>

In conclusion, this study finds that the vast majority of mobility breaks across the EU occurred after the intensification of national mitigation measures implying that containment policies enacted at national levels have been instrumental in reducing the levels of mobility in individual states. Second, mitigation measures directed at school closures have affected all types of mobility including mobility towards retail and recreation establishments, indicating that such policies could have led to an overall re-assessment of the risk situation by the general public, leading to widespread drops in mobility. Finally, self-imposed restraints which occurred independently of government measures, have been responsible for a significant part of the fall in mobility, with communities reacting to news relating to both COVID-19 cases and deaths.

These conclusions show that policies which are targeted at controlling a specific type of activity (such as school closures and cancellation of public events) might have strong and unintended effects on mobility types which are not specifically being targeted. Moreover, the introduction or lifting of containment measures needs to internalise the effects emanating from the prevalence response of the public, which occurs independently of government measures and which depends on the prevailing state of the pandemic.

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<sup>9</sup> WHO (2020), *Pandemic fatigue: Reinvigorating the public to prevent COVID-19*. World Health Organisation, *Policy framework for supporting pandemic prevention and management*, 112, pp. 1-8.

## The labour market<sup>17</sup>

### Labour force increases further

LFS data show that in the third quarter of 2021, the labour force grew by 2.1% over the same quarter of the previous year, the same rate of increase registered in the previous quarter (see Table 2.5).<sup>18</sup> Following this rise, the labour force stood 2.4% higher than its level in the corresponding quarter of 2019.

The activity rate stood at 78.0% in the quarter under review, higher than the 77.1% registered a year earlier.<sup>19</sup> The rise in the overall participation rate was driven entirely by an increase in the male participation rate. The latter reached 86.3% and thus remained higher than the euro area average of 79.2%. On the other hand, the activity rate of females fell by 0.2 percentage point to 68.5% and remained below the euro area average of 69.7.

On a quarter-on-quarter basis, the number of active persons (the labour force) increased by 2,655 after rising by 2,313 in the second quarter. In particular, the number of employed people rose by 2,434 on a quarterly basis, which follows an increase of 3,153 during the previous quarter.

On the other hand, after three consecutive quarterly declines, the number of unemployed increased by 221 people compared to the second quarter, to 9,897 persons – marginally above the level recorded in the third quarter of 2019.

**Table 2.5**  
**LABOUR MARKET INDICATORS BASED ON THE LFS**

*Persons; annual percentage changes*

	2020	2021	Annual change
	Q3	Q3	%
<b>Labour force</b>	<b>273,070</b>	<b>278,884</b>	<b>2.1</b>
Employed	259,666	268,987	3.6
<i>By type of employment:</i>			
Full-time	229,274	239,362	4.4
Part-time	30,392	29,625	-2.5
Unemployed	13,404	9,897	-26.2
<b>Activity rate (%)</b>	<b>77.1</b>	<b>78.0</b>	
Male	84.5	86.3	
Female	68.7	68.5	
<b>Employment rate (%)</b>	<b>73.3</b>	<b>75.1</b>	
Male	80.4	83.0	
Female	65.1	66.2	
<b>Unemployment rate (%)</b>	<b>4.9</b>	<b>3.6</b>	
<b>Actual hours worked (per week)</b>	<b>34.0</b>	<b>33.5</b>	

Source: NSO.

<sup>17</sup> 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.

<sup>18</sup> 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.

<sup>19</sup> 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.

On the other hand, the number of inactive persons fell by 1,593 compared to the second quarter, after rising by 206 persons in the previous quarter.

### Employment grows at a faster pace

In the third quarter of 2021, employment rose by 3.6% in annual terms, following a rise of 3.2% in the previous quarter.

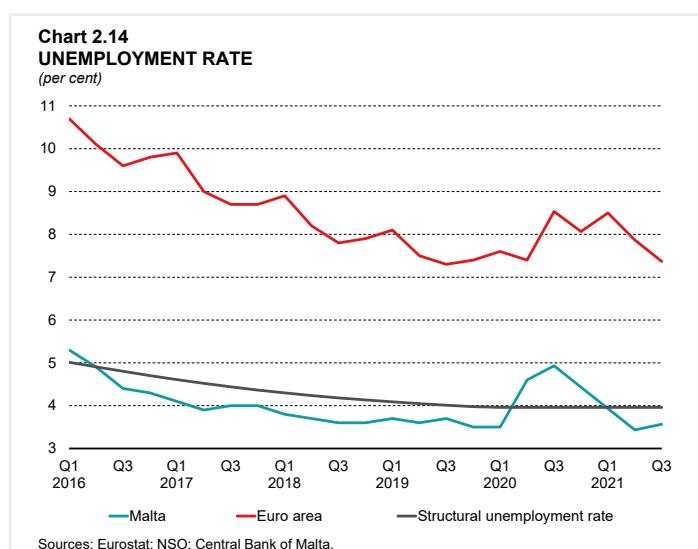
The latest increase in employment reflects a steep rise in full-time employment, which offset a fall in part-time jobs. The former rose by 10,088, or 4.4% in annual terms (see Table 2.5). On the other hand, the number of part-time employees – which also includes those employed full-time on reduced hours – fell by 767 persons, or 2.5% on a year earlier. Eurostat data show that this decrease was largely driven by the sector comprising arts, entertainment and recreation, followed by the sector of professional, scientific, technical and administrative activities as well as the one that specialises in human health and social work.

The overall employment rate rose by 1.9 percentage points on the same period of 2020, to 75.1%.<sup>20</sup> This reflected a rise in both the male and female employment rates. The male employment rate rose by 2.5 percentage point to 83.0%, with the increase broad-based across age brackets but more significant in the 55-64 years cohort. The female employment rate rose by 1.1 percentage points to 66.2%, driven primarily by increases in the 15-24 and 25-54 age brackets.

In the third quarter of 2021, average weekly hours fell marginally to 33.5 compared to 34.0 a year earlier (see Table 2.5).<sup>21</sup> In addition, they are still short of the average hours worked in the corresponding period of 2019.

### The unemployment rate remains low

During the quarter under review, the unemployment rate based on the LFS stood at 3.6%, slightly higher than the 3.4% registered in the previous quarter. It stood well below the 4.9% recorded a year earlier (see Table 2.5).<sup>22</sup> The historically low jobless rate in Malta reflects the ongoing recovery in demand, in the context of a tight labour market, although Government COVID-19 support also contributed. Labour market conditions



<sup>20</sup> 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.

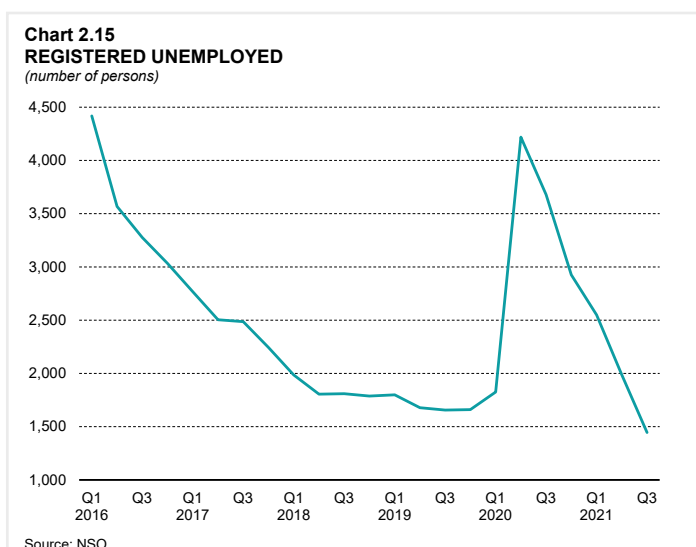
<sup>21</sup> Actual hours refer to the number of hours actually spent at the place of work during the reference week for the main job. However, owing to increased flexibility at workplaces coupled with technology, the place of work may also include one's home. In this regard, actual hours worked also include the hours of work carried out by persons who telework.

<sup>22</sup> 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.

also remain more favourable by euro area standards. Malta's unemployment rate is well below the average rate for the euro area which stood at 7.4% in the third quarter of this year (see Chart 2.14).

The unemployment rate also stood below the Bank's structural measure of 3.9% during the September quarter.<sup>23</sup> This indicates a high degree of labour market tightness.

Jobsplus data show that the number of persons on the unemployment register continued to decline on a quarterly basis. It also fell in annual terms. During the third quarter, the average number of unemployed persons stood at 1,445 – less than half that registered a year earlier (see Chart 2.15).



<sup>23</sup> 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: TRENDS IN EDUCATIONAL ATTAINMENT IN MALTA<sup>1</sup>

Data obtained from the LFS show that the educational attainment of the Maltese workforce has improved significantly in the last decade though still falls short of the EU benchmarks in some respects. This Box follows the study by Gauci (2021) which analyses the long-term trends in educational attainment in Malta but takes into consideration the revised educational attainment statistics published by the National Statistics Office in September 2021.<sup>2</sup> The revisions were deemed necessary to ensure better compliance with European Regulations governing education statistics and improve the comparability of the results at a European level. The revisions resulted from a realignment of the International Standard Classification of Education (ISCED) with the Malta Qualifications Framework (MQF) but the sources and methodology used to compile the indicators remain unchanged.

### Trends in educational attainment

Human capital refers to “the knowledge, skills, competencies and other attributes embodied in individuals that are employed in the creation of individual, social and economic well-being” (OECD, 2001, p. 18).<sup>3</sup> The most common approach used for measuring skills is the indirect approach, where qualifications are used to measure skills supply. However, official qualifications only certify skills developed in formal education programmes and thus do not cover soft skills acquired by individuals outside of the formal education system. Such skills are increasingly becoming more valuable, and hence, it is important to complement information on formal educational attainment with information on participation in non-formal educational activities and in lifelong learning.

The analysis is based on the ISCED 2011 classification which is the standard framework used to categorise and report comparable education statistics internationally. This framework enables comparisons across countries and allows authorities to monitor progress towards national and international targets. Table 1 shows the ISCED 2011 classification

**Table 1**  
**ISCED 2011 CODING OF LEVELS**

Levels	Description	Levels of Education
0	Early childhood education	
1	Primary education	Basic level of education
2	Lower secondary education	
3	Upper secondary education	Intermediate level of education
4	Post-secondary non-tertiary education	
5	Short-cycle tertiary education	High level of education
6	Bachelor's or equivalent level	
7	Master's or equivalent level	
8	Doctoral or equivalent level	

Sources: United Nations Educational, Scientific and Cultural Organization; European Commission.

<sup>1</sup> Written by Tiziana M. Gauci, a senior Research Economist at the Economic Research Office 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. Any remaining errors are the author's own.

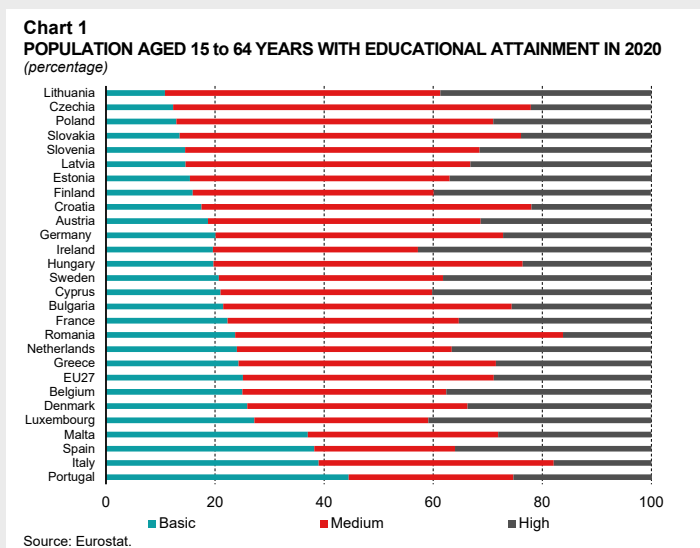
<sup>2</sup> For a full version of this study, see Gauci, T.M., (2021), “An analysis of educational attainment in Malta”, Central Bank of Malta *Policy Note* June 2021.

<sup>3</sup> See OECD, (2001), “The Well-being of Nations: The role of human and social capital”, Paris: OECD Publishing.

which consists of nine separate levels from level 0 to level 8. The nine levels of ISCED are often combined into three categories as follows: levels 0 to 2 refer to a basic level of education, levels 3 and 4 refer to an intermediate level of education and levels 5 to 8 refer to a high level of education.<sup>4</sup> Educational attainment is measured with respect to the highest education programme successfully completed with the data source being the LFS.

Figures on the educational attainment of the population in Malta show that Malta's educational attainment has improved substantially over the years though some challenges remain. The share of persons between 15 and 64 years having a basic level of education decreased from 59.6% in 2010 to 37.0% in 2020. This was the fourth highest share of low-skilled persons within the EU, with the EU average standing at 25.1% (see Chart 1). In the national context, persons having finished a secondary level of education and having obtained at least two O Levels or equivalent are now classified as ISCED 3, whereas prior to the revisions, only persons with five O Levels or more were included in this category. This resulted in a reclassification between low and medium levels of education. Meanwhile, 34.9% of the working-age population had a medium level of education while 28.1% had a tertiary level of education (ISCED 5-8).<sup>5</sup>

Between 2010 and 2020, the share of population aged between 25 and 64 years having a tertiary level of education has doubled with the gap between the EU average and Malta amounting to 2.2 percentage points in 2020, down from 9.7 percentage points in 2010 (see Chart 2). The improvement in educational attainment, in part, reflects the rising role of women in the labour market which led a greater number of females to further their studies.<sup>6</sup> The percentage of females with a tertiary level of education has generally exceeded the male counterpart over the last decade, with the gender gap widening in recent years. In 2020, 32.5% of women aged between 25



<sup>4</sup> A low level of education comprises persons with no schooling, those who attended primary education and special schools for disabled and those who attained a secondary level of education and have less than two O levels or equivalent. Medium level of education comprises persons with a secondary level education and having two O levels, or equivalent qualifications, or more and persons with a post-secondary level attainment who have at least obtained one Intermediate or A level or equivalent qualification. High level of education comprises those with a tertiary level education and with qualifications ranging from university diploma to doctorate level.

<sup>5</sup> Before the revisions, the share of persons aged between 15 and 64 years having a low level of education stood at 40.3% in 2020, meaning a downward revision of 3.3 percentage points. On the other hand, the share of those with a medium level of education rose from 31.7% to 34.9%. Figures for those with a tertiary level of education were not affected by the revisions.

<sup>6</sup> See Micallef, B., (2018), "Estimating the impact of structural reforms to increase the female participation in Malta", *International Journal of Social Science Studies*, 6(8), pp. 73-84.

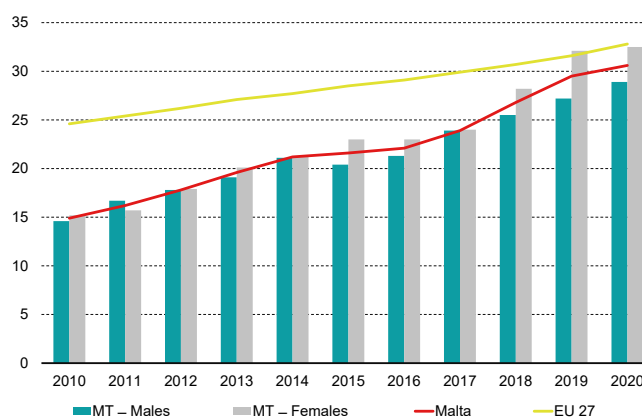
and 64 years had a tertiary level of education, compared to 28.9% for men. An increasing share of foreign population, which has a relatively higher share of people with tertiary qualifications, has also contributed to the improvement in Malta's overall education level (European Commission, 2016).<sup>7</sup>

Table 2 shows that persons aged between 25 and 34 years are the

most highly educated, mirroring the situation in the EU. Among this cohort, 40.1% had a tertiary level of education in 2020. On the other hand, the older generations have a lower level of educational attainment, with over 65% of those between 55 and 64 having a basic level of education. Amongst the younger generation, that is, those between 20 and 24 years, around 15% have only achieved a basic level of education. A cross-country comparability study finds that low levels of education are persistent in Malta, which indicate that children belonging to parents with low education face bigger obstacles to transition to a higher level of education.<sup>8</sup>

Following rapid improvements in technology, the skill requirements in advanced economies, including Malta, are rapidly changing. Lifelong learning can continue to support professional development and skill upgrading. Furthermore, this process can be an important alternative to formal education, helping individuals to progress further up in their careers or find alternative employment.<sup>9</sup> Participation in lifelong learning in Malta, as measured by the LFS, has improved over the last decade, increasing from around 6% in 2010 to 11%

**Chart 2**  
SHARE OF POPULATION AGED 25 TO 64 YEARS WITH TERTIARY LEVEL OF EDUCATION  
(percentage)



Source: Eurostat.

**Table 2**  
EDUCATIONAL ATTAINMENT IN MALTA BY AGE COHORTS AS OF 2020

(Percentage)

ISCED level	20-24	25-34	35-44	45-54	55-64
Levels 0-2	14.9	24.0	38.0	44.9	65.2
Levels 3-4	61.3	35.8	26.5	30.9	18.7
Levels 5-8	23.8	40.1	35.5	24.2	16.0

Source: Eurostat.

<sup>7</sup> See European Commission, (2016), [Country report Malta 2016: staff working document](#).

<sup>8</sup> See Eurostat, (2013), "[Educational attainment: persistence or movement through the generations?](#)", News release 188/2013.

<sup>9</sup> Lifelong learning encompasses all learning activities undertaken throughout life with the aim of improving knowledge, skills and competences within personal, civic, social or employment-related perspectives.

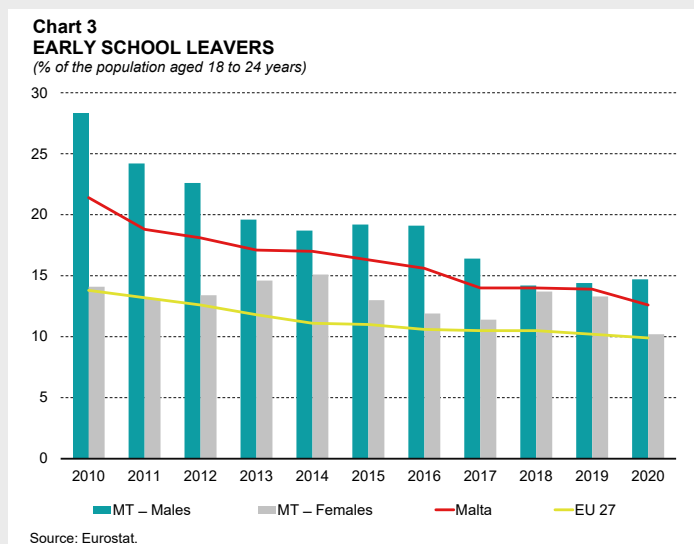
in 2020.<sup>10</sup> While the figure for Malta exceeds the EU average, its participation in lifelong learning still remains low compared, for example, to Scandinavian countries, which top the list at an average of 25%.

### EU2020 objectives

In 2010, the EU established two education-related targets to be reached by 2020 as part of Europe 2020 strategy – (i) a reduction in the share of early school leavers to 10% and (ii) at least 40% of people aged 30 to 34 to have completed tertiary or equivalent education. These targets were then translated into national targets, reflecting different situations and circumstances. Malta adopted the same target in respect of early school leavers but set out the target in respect of tertiary educational attainment for 30 to 34-year-olds to 33%.

Early school leaving can lead to several problems in the labour market – the most important of which are related to unemployment and the risk of poverty or social exclusion. Eurostat defines early school leaving as the percentage of the population aged between 18 and 24 years having completed at most, a lower secondary education or less (ISCED 0-2) and not pursuing further education or training in the previous four weeks.

The share of early school leavers in Malta has almost halved in the last decade, dropping from 21.4% in 2010 to 12.6% in 2020 (see Chart 3).<sup>11</sup> The decline in early school leaving follows the reduction in secondary school absenteeism which has declined from 30% in 2012/2013 to around 22% in 2016/2017.<sup>12</sup> Also, in a bid to respond to different educational needs, from 2019 secondary school students have the option to choose between general, vocational or applied subjects. While reductions in early school leaving can be observed for both males and females, the former tend to leave education and training earlier than the latter, a trend that is also observed in other EU countries. Despite the improvement in the rate of early school leavers, Malta still falls short



<sup>10</sup> In 2017, there is a break-in series due to a modification in the national LFS question related to lifelong learning to capture better any lifelong learning being undertaken by respondents.

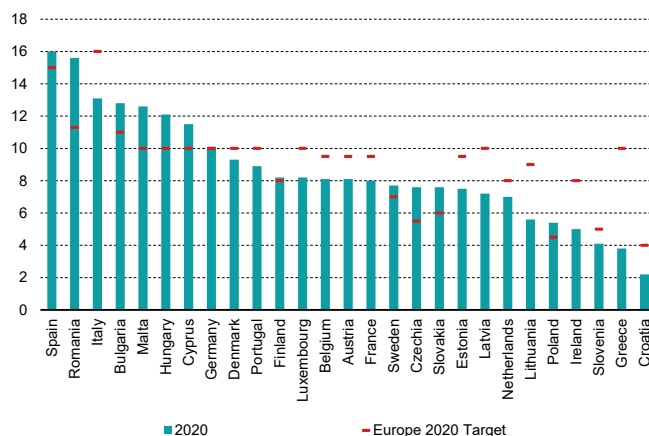
<sup>11</sup> Figures for early school leavers were also affected by the revisions mentioned earlier. The early school leaver rate was revised downwards by an average of 3.6 percentage points over the period 2010-2020. Before the revisions, Malta's early school leaver rate stood at 16.7% in 2020, the highest rate within the EU.

<sup>12</sup> See Directorate-General for Education, Youth, Sport and Culture, (2019), Education and Training Monitor 2019: Malta, Luxembourg: Publications Office of the European Union.

of the target. At the EU level, 15 countries had reached their national target in 2020 (see Chart 4).

In addition to socio-economic status, labour market trends could have an impact on early school leaving decisions. For instance, studies have found that the unemployment rate has a positive impact on enrolment in post-secondary education.<sup>13</sup> This is in line with the opportunity cost argument whereby high rates of unemployment reduce the cost of remaining in education and so increase post-compulsory enrolment.<sup>14</sup> In Malta, the strong growth experienced prior to the pandemic led to a sharp decrease in the unemployment rate, which fell to historical lows. In such circumstances, the incentive to invest in one's education may have declined in the short run, in part explaining why the rate of early school leavers has remained high in Malta. Even though leaving school with a basic level of education, data shows that most early school leavers in Malta were still employed. In fact, almost 70% of early school leavers in Malta were employed in 2020, the highest employment rate of early school leavers across the EU. In the EU, less than half of early school leavers were employed. This suggests that despite the lack of official qualifications, early school leavers in Malta may still possess skills that are relevant for the labour market. Nonetheless, lacking basic qualifications could compromise employability later in life and has social

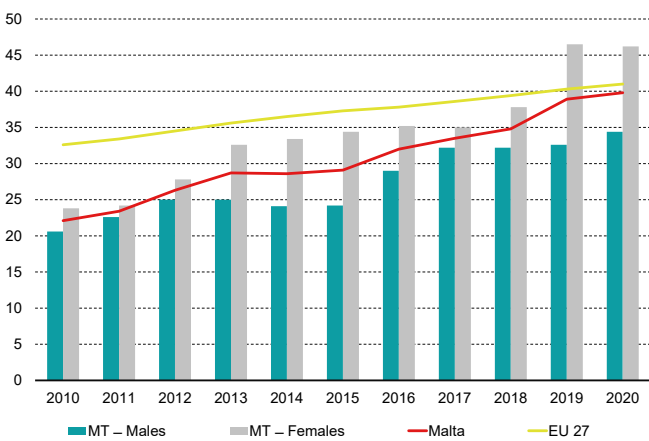
**Chart 4**  
EARLY SCHOOL LEAVERS IN 2020 COMPARED WITH 2020 TARGETS  
(percentage)



Source: Eurostat.

Chart 5 shows the percentage of the population aged 30-34 years with tertiary education from 2010 to 2020. The y-axis ranges from 0 to 50%. The x-axis shows years from 2010 to 2020. The chart compares Malta (red line) and the EU 27 (yellow line) for both males (teal bars) and females (grey bars). Both Malta and the EU 27 show an upward trend, with Malta reaching approximately 40% and the EU 27 reaching approximately 42% by 2020.

**Chart 5**  
POPULATION AGED 30-34 YEARS WITH TERTIARY EDUCATION  
(percentage)



Source: Eurostat.

<sup>13</sup> See Pissarides, C. A., (1981), "Staying-on at School in England and Wales", *Economica*, 48, pp. 345-363 and Clark, D., (2011), "Do Recessions Keep Students in School? The impact of Youth Unemployment on Enrolment in Post-compulsory Education in England", *Economica*, 78, pp. 523-545.

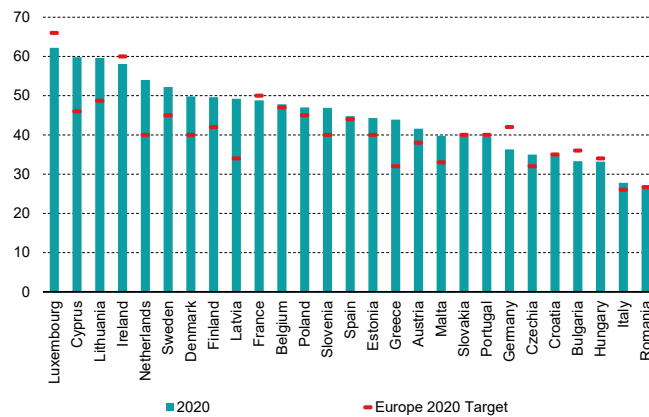
<sup>14</sup> See Tumino, A. and Taylor, M., (2013), "The impact of local labour market conditions on school leaving decisions" presented during IZA Workshop on the future of Labor: The Effects of the Economic Crisis on the Labour Market, Unemployment and Income Distribution, 21 February 2013.

and economic costs with the latter often being reflected in wage differentials between those with different levels of education.<sup>15</sup>

With regards to the second target, Malta managed to reach its target of having 33% of its population aged between 30 and 34 with a tertiary level of education by 2017. In terms of gender, 46.2% of women aged between 30 and 34 years

had a tertiary level of education in 2020, while the share of men stood at 34.4% (see Chart 5). In 2020, the share of the population aged 30 to 34 years with a tertiary level of education stood at 39.8%, close to the EU average of 41.0%. Seventeen countries had reached their national target in 2020 (see Chart 6).

**Chart 6**  
POPULATION AGED 30-34 YEARS WITH TERTIARY EDUCATIONAL ATTAINMENT IN 2020  
(percentage)



Source: Eurostat.

<sup>15</sup> See Cedefop, (2017), "Vocational education and training in Malta: short description", Luxembourg: Publications Office.

### 3. PRICES, COSTS AND COMPETITIVENESS

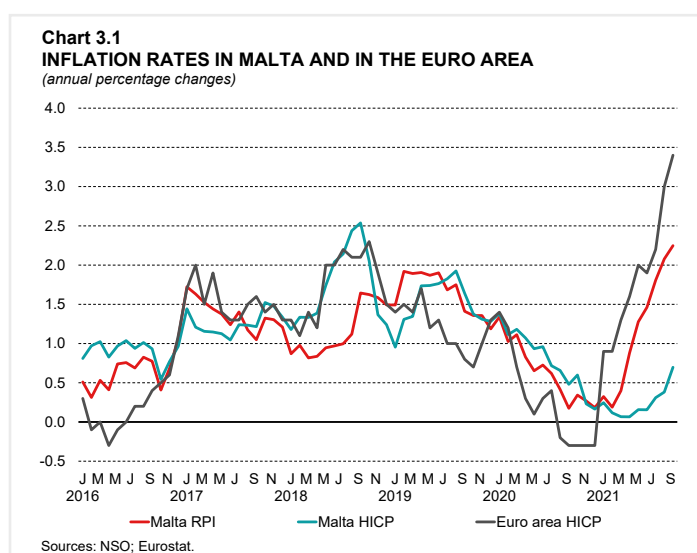
Annual inflation as measured by the HICP stood at 0.7% in September, above that of 0.2% recorded in June, mainly driven by faster growth in NEIG and unprocessed food prices. At the same time, energy prices were unchanged in September following a year-on-year decrease in June.

Annual inflation based on the RPI – which only takes into account expenditure by Maltese residents – rose from 1.5% in June to 2.2% in September. Producer price inflation also increased sharply, reaching 5.4% in September from 2.2% in three months earlier. Meanwhile, growth in Malta's unit labour cost (ULC) index, measured on a 4-quarter moving average basis, moderated to 2.1% in the third quarter, due to an increase in labour productivity per person. Malta's HCIs point to an improvement in international competitiveness between June and September 2021.

#### Inflation

##### HICP inflation increases

Annual HICP inflation increased to 0.7% in September, from 0.2% in June (see Table 3.1).<sup>1</sup> Headline HICP inflation in Malta was below that recorded in the euro area, where inflation ended the third quarter at 3.4% (see Chart 3.1). This divergence largely stems from energy prices which were unchanged in Malta but rose by 17.6% in the euro area. In addition, other transitory factors such as the reversal of the German VAT rate cut in January 2021 also contributed



**Table 3.1**  
HICP INFLATION

Annual percentage change

	2021								
	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.
Unprocessed food	-2.5	-2.0	1.1	2.5	4.1	6.2	8.8	9.4	10.6
Processed food including alcohol and tobacco	1.0	0.7	0.6	0.3	0.6	0.5	0.6	0.6	0.7
Energy	-3.5	-3.5	-3.5	-3.2	-3.2	-1.5	0.0	0.0	0.0
NEIG	0.4	0.3	0.4	0.8	1.0	0.9	1.4	2.2	2.2
Services (overall index excluding goods)	0.7	0.6	0.3	0.4	0.5	0.5	0.3	0.1	0.3
<b>All Items HICP</b>	<b>0.2</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>	<b>0.2</b>	<b>0.2</b>	<b>0.3</b>	<b>0.4</b>	<b>0.7</b>

Source: Eurostat.

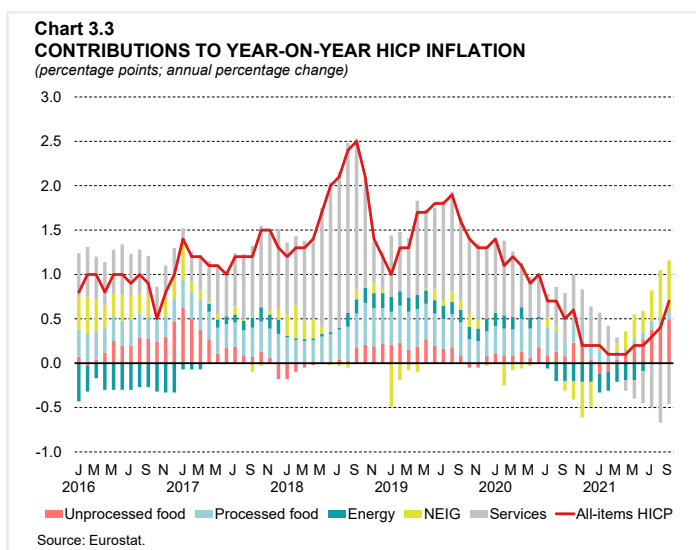
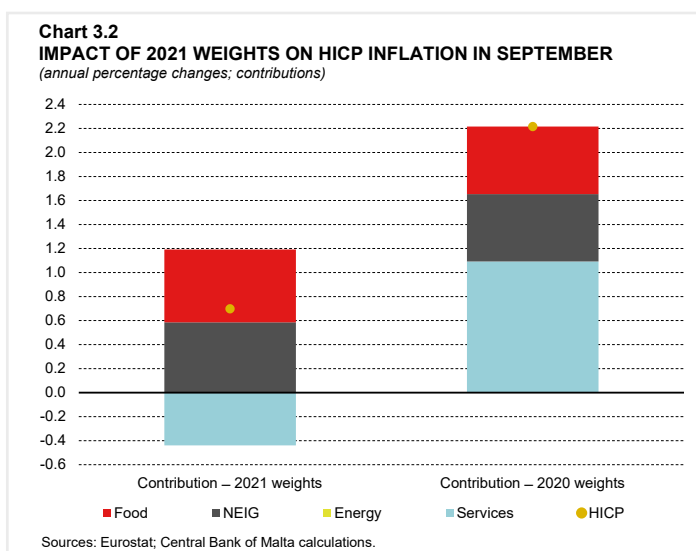
<sup>1</sup> The HICP weights are revised on an annual basis to reflect changes in overall consumption patterns. In 2021, the weight allocated to services stand at 42.6%, while that of NEIG is 28.6%. Food accounts for 22.1% of the index, while the share allocated to energy stands at 6.7%. These were revised from 47.2% for services, 27.1% for NEIG, 19.7% for food, and 6.0% for energy in 2020.

to the wedge between euro area and domestic inflation. Technical factors also contributed to this divergence. In particular, the 2021 change in HICP weights due to the pandemic's impact on households' consumption basket had a large negative impact on overall HICP inflation in Malta (see Chart 3.2). The largest impact is on the services contribution to HICP inflation. Indeed, when using the 2020 weights, the services component would have contributed positively to overall HICP inflation and the latter would have reached 2.2%. In contrast, only a small negative effect has been detected for overall inflation in the euro area in September.<sup>2</sup>

The rise in HICP inflation relative to June mostly reflected faster growth in NEIG and unprocessed food prices (see Chart 3.3). Also, energy prices were unchanged in annual terms, following a negative contribution in June. The contribution from processed food was unchanged compared to June. These movements offset a slightly more negative contribution from services inflation.

Food inflation increased during the quarter under review, as unprocessed food inflation rose to 10.6% from 6.2% in June. Furthermore, processed food inflation rose marginally to 0.7%, from 0.5% over the same period. As a result, the overall contribution of food to HICP inflation stood at 0.6 percentage point in September, up from 0.4 percentage point in June.

NEIG inflation increased to 2.2% in September from 0.9% in June. This follows a prolonged period of weak or negative readings that mainly reflected downward international price pressures on traded, manufactured goods. The pick-up in 2021 may reflect a correction from previous negative readings as well as some pass-through to consumer prices from the recent rise in input costs in the context of pandemic-related disruptions to global value chains.



<sup>2</sup> An assessment of the effect of the changes in HICP weights on euro area inflation is available in the ECB *Economic Bulletin*, [Issue 7/2021](#).

Energy inflation stood at 0.0% in September, up from -1.5% three months earlier, as the negative base effect related to the cut in prices for fuel transport in mid-2020 dropped out of the inflation rate.

Services inflation declined from 0.5% in June to 0.3% in September. Almost all sub-components contributed to this decline, except for housing services, where the contribution increased compared to June (see Chart 3.4). However, the decline mainly reflected a more negative contribution from services related to transport as inflation in this component turned more negative.

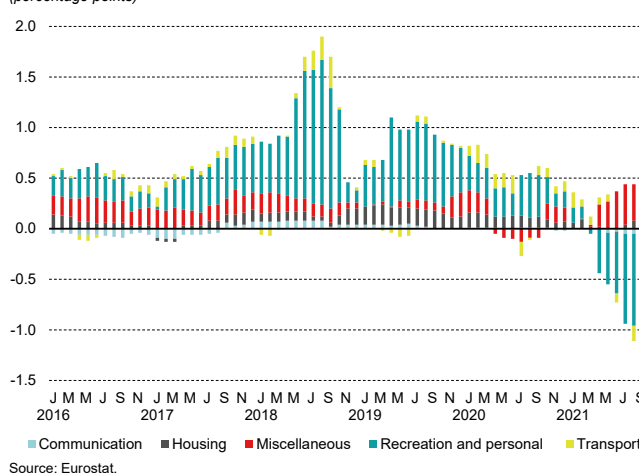
### Core HICP inflation increases further

Core inflation rose to 1.6% in September, from 1.0% three months earlier (see Chart 3.5).<sup>3</sup> 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.

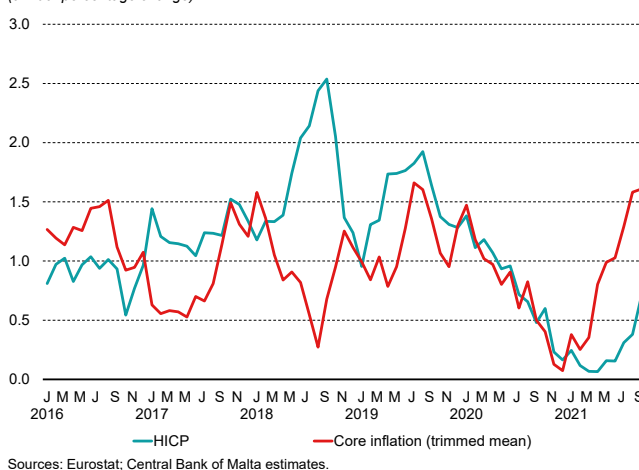
### RPI inflation increases

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 2.2% in September from 1.5% in June (see Table 3.2).<sup>4</sup> The increase in RPI inflation was primarily driven by a higher contribution from food prices as well as prices of transport and communications

**Chart 3.4**  
**CONTRIBUTIONS FROM SERVICES TO HICP INFLATION**  
(percentage points)



**Chart 3.5**  
**HICP IN MALTA: OVERALL AND CORE MEASURE**  
(annual percentage change)



<sup>3</sup> The Bank uses a 'trimmed mean' approach to measure core inflation, whereby the more volatile subcomponents of the index are removed from the basket of consumer goods so as to exclude extreme movements from the headline inflation rate. See Gatt, W. (2014), "An Evaluation of Core Inflation Measures for Malta", *Quarterly Review* 2014(3), pp. 39-45, Central Bank of Malta.

<sup>4</sup> 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 diverge significantly as weights in the HICP have changed significantly while those of the RPI have not been adjusted.

**Table 3.2**  
**CONTRIBUTIONS TO YEAR-ON-YEAR RPI INFLATION**

Percentage points

	2021								
	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.
Food	0.1	0.0	0.1	0.1	0.5	0.5	0.6	0.7	0.8
Beverages and tobacco	0.1	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Clothing and footwear	0.1	0.0	0.1	0.2	0.2	0.1	0.0	0.2	0.2
Housing	0.1	0.1	0.1	0.0	0.0	0.1	0.2	0.2	0.2
Water, electricity, gas and fuels	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Household equipment and house maintenance costs	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.2
Transport and communications	-0.3	-0.3	-0.2	-0.2	-0.3	-0.1	0.1	0.2	0.2
Personal care and health	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Recreation and culture	0.0	0.1	0.1	0.4	0.4	0.4	0.5	0.5	0.5
Other goods and services	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
<b>RPI (annual percentage change)</b>	<b>0.3</b>	<b>0.2</b>	<b>0.4</b>	<b>0.9</b>	<b>1.3</b>	<b>1.5</b>	<b>1.8</b>	<b>2.1</b>	<b>2.2</b>

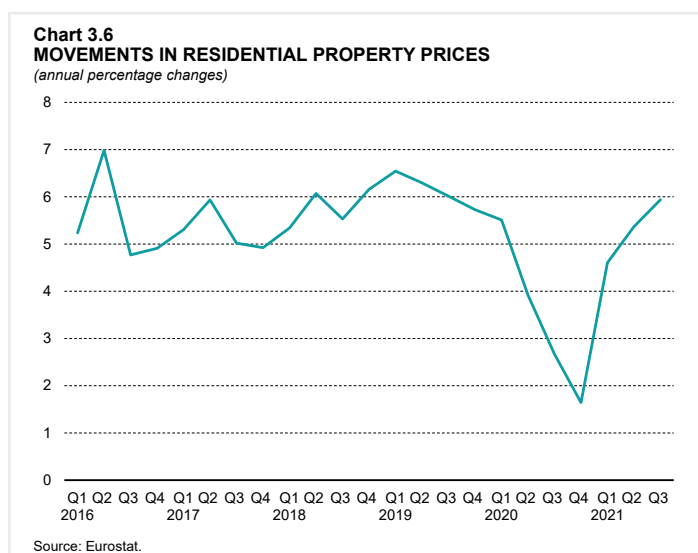
Source: NSO.

services. Indeed, the contribution from the latter turned positive during the period under review, following a sequence of negative contribution. The contribution of prices for clothing and footwear, housing, household equipment and house maintenance as well as recreation and culture services also increased. On the other hand, the contribution of prices related to personal health and care edged down in the period under review.

## 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 reached 5.9% in the third quarter of 2021, up from 5.4% in the previous quarter (see Chart 3.6).<sup>5</sup> Nevertheless, house price inflation in Malta remained below that in the euro area where prices increased at an annual rate of 8.8%. Notwithstanding the acceleration in the third quarter of 2021, house price inflation remains close to that recorded in the years before the pandemic.



<sup>5</sup> 'Apartments' are defined as dwellings with self-contained rooms or a suite of rooms that have a separate entrance accessible from a common passageway, landing or stairway. 'Maisonettes' have a separate entrance that is accessible from the street and are either at ground-floor level with overlying habitation, or at first-floor level with underlying habitation. 'Terraced houses' are dwellings with at least two floors, own access at street level and airspace, and with no underlying structures that are not part of the house itself. They are attached to other structures on both sides.

From a shorter-term perspective, residential property prices seem to have returned to a dynamic path following the sharp slowdown during the initial stages of the pandemic. Residential property prices continue to be supported by numerous factors including the low-interest rate environment that makes property more attractive as an investment as well as the Government's schemes related to the property market. Property prices were also supported by the enhancement of government support in response to the pandemic such as lower property tax rate and stamp duty to 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.<sup>6</sup> These measures were initially intended for final transfers made before 1 April 2021 but were later extended.<sup>7</sup> Moreover, Budget 2021 extended or introduced more favourable terms on several schemes supporting the property market that were in place before the pandemic.<sup>8</sup>

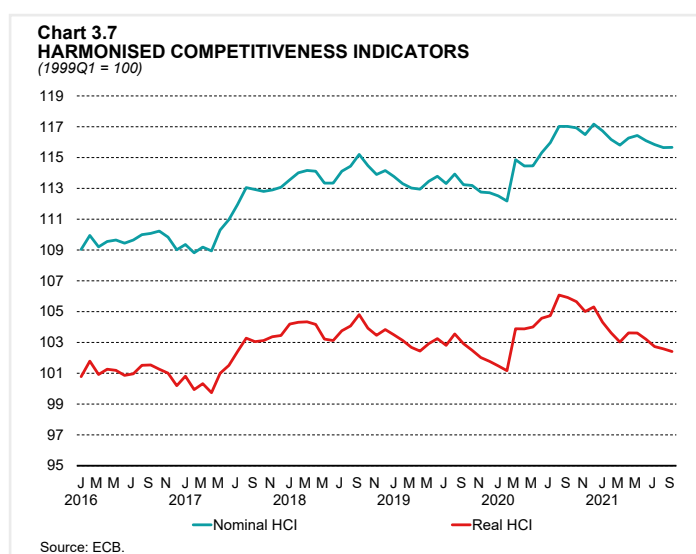
## Costs and competitiveness

### Producer price inflation increases further

Annual inflation based on the industrial producer price index, which measures domestic factory output prices, rose sharply from 2.2% in June to 5.4% in September.<sup>9</sup> This largely reflected developments in the prices of intermediate goods which rose by an annual rate of 9.6% in September following a 3.4% increase in June. Prices of consumer goods and capital goods also contributed positively to the increase in prices, although to a lesser extent. Energy inflation remained zero. The strong increase in producer prices during September might reflect the impact of the rising cost pressures due to ongoing global supply bottlenecks.

### HICIs point to an improvement in competitiveness compared to June

Annual growth in Malta's nominal HCI turned negative in July and remained in negative territory thereafter, which suggests an improvement in international competitiveness over the year.<sup>10</sup> In September the nominal HCI declined by an annual rate of 1.2%, reflecting the euro's depreciation against currencies of trading partners (see Chart 3.7). At the same time, the real HCI fell by 3.3%, suggesting



<sup>6</sup> These reductions in taxes on property transfers and stamp duty were introduced in terms of Legal Notices [240](#) and [241](#) of 2020.

<sup>7</sup> Legal Notice 240 was followed by Legal Notice [427](#) of 2020, Legal Notice [130](#) of 2021 and Legal Notice [324](#) of 2021. Legal Notice 241 was followed by Legal Notices [459](#) of 2020, [129](#) of 2021 and [325](#) of 2021.

<sup>8</sup> 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.

<sup>9</sup> 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.

<sup>10</sup> HICIs act as an EER 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.

that the gain in international competitiveness arising from a weaker euro was amplified by favourable developments in relative prices vis-à-vis trading partners.

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

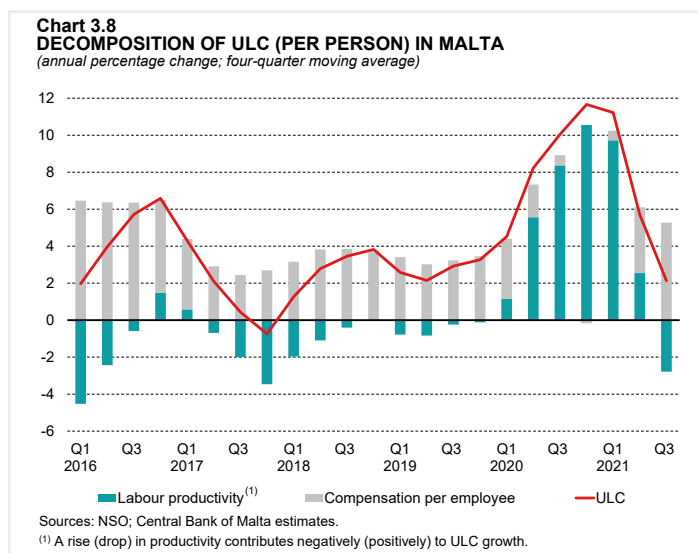
### ULC growth moderates

Malta's ULC index – measured as the ratio of compensation per employee to labour productivity – moderated during the third quarter of 2021 when compared with the previous quarter, but remained relatively elevated compared to 2005 levels.<sup>11</sup> When measured on a 4-quarter moving average basis in headcount terms, ULC in Malta grew at an annual rate of 2.1%. This followed a 5.7% increase in the previous quarter (see Chart 3.8).

The moderation in ULC growth was driven by an increase in labour productivity. Meanwhile, growth in compensation per employee increased at a stronger rate of 5.3% in the year to September.

Labour productivity based on 4-quarter moving averages increased by an annual 2.8% over the year to September, following a 2.6% decrease in the previous quarter, marking the first increase since the outbreak of the COVID-19 pandemic. This improvement in labour productivity reflects the recovery in economic activity which was stronger than that in employment. This is due to the resilience of employment displayed last year, which reflected 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 even during the initial phase of the pandemic, notwithstanding the sharp contraction in economic activity at the time.

During the third quarter of 2021, total hours worked declined when compared with the previous quarter but were still higher than those worked in the third quarter of 2020.<sup>12</sup> When measured on a 4-quarter moving average basis, they fell by an annual 1.3% which is a smaller drop than the 2.8% decline recorded in the previous quarter. This implies that

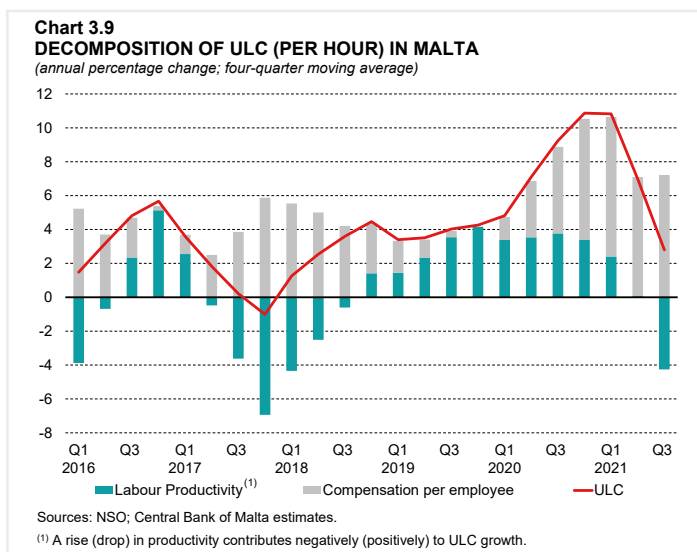


<sup>11</sup> Annual growth in ULC, compensation per employee and labour productivity is measured on a 4-quarter moving average basis. A degree of caution is required in the interpretation of ULC in view of contemporaneous structural shifts in the composition and factor-intensity of production, notably the shift to labour-intensive services. See Micallef, B. (2015), "Unit labour costs, wages and productivity in Malta: a sectoral and cross-country analysis", Policy Note August 2015, Central Bank of Malta, and Rapa, N. (2016), "Measuring international competitiveness", Quarterly Review 2016(1), pp. 53-63, Central Bank of Malta.

<sup>12</sup> Hours worked refer to employee hours.

average hours worked, are gradually normalising, even though they remain below pre-pandemic levels.

Productivity per hour increased by 4.3%, following a contraction of 0.1% in the second quarter, while compensation per hour rose by 7.2% in annual terms, marginally up from 7.0% in the previous quarter. Thus, growth in ULC per hour moderated to 2.8% following a 7.0% increase in the second quarter of 2021 (see Chart 3.9).



### BOX 3: EXCHANGE RATE PASS-THROUGH TO CONSUMER PRICES IN MALTA<sup>1</sup>

Exchange rate pass-through (ERPT) refers to the extent to which exchange rate changes are reflected in the price levels of goods and services in an economy. This relationship is important from both theoretical and policy perspectives. Theoretically, incomplete ERPT estimates might indicate deviations in relative purchasing power parity (PPP) with implications on firm market power and on the efficiency of allocation of commodities across economies. ERPT may also play an important policy role through interactions with monetary policy. Strong exchange rate fluctuations that are substantially reflected in prices may require counteracting policy interventions to maintain price stability. On the contrary, monetary policy responses to inflationary shocks which are unrelated to exchange rate movements may result in adjustments to the NEER, which in turn further acts to drive price levels towards policy targets.

Exchange rate movements are transmitted to consumer prices through three main channels (Colavecchio and Rubene, 2020).<sup>2</sup> Changes in exchange rates directly impact prices of imported final consumer goods. They also impact the prices of any imported intermediate products used as inputs in domestic production processes, thus indirectly affecting final consumer prices. Similarly, exchange rates also affect the price competitiveness of domestic commodities in international markets, which in turn impacts domestic output levels and consequently domestic prices.

The extent to which exchange rates move consumer prices – the magnitude of ERPT – depends on a number of factors. Greater openness to imports, a higher proportion of imports priced in foreign currencies and lower integration in global value chains are associated with higher pass-through (Ortega and Osbat, 2020).<sup>3</sup> Market power of both importers and exporters tends to be negatively related to the extent of ERPT (Özyurt, 2016).<sup>4</sup> Moreover, ERPT is commonly observed to be non-linear, with appreciations commonly leading to weaker transmission to prices than depreciations, whilst sizeable exchange rate shocks typically found to impact prices to a greater degree than smaller changes.<sup>5</sup>

In this respect, one could *a priori* expect ERPT in the Maltese economy to be considerable. Malta's economy is highly trade-intensive and mostly characterised by firms which are small by international standards. As of 2019, Malta's total imports of goods and services as a share of GDP was one of the highest in the euro area whilst its share of extra-euro area

<sup>1</sup> Prepared by Glenn Abela and Noel Rapa. Glenn Abela is a Research Economist in the Modelling Office of the Research Department at the Central Bank of Malta, whilst Noel Rapa is the Manager of the Modelling Office. The views expressed in this paper are the authors' own and do not necessarily reflect the views of the Central Bank of Malta.

<sup>2</sup> Colavecchio, R. and Rubene, I. (2020). Non-linear exchange rate pass-through to euro area inflation: a local projection approach. Working Paper Series 2362, European Central Bank.

<sup>3</sup> Ortega, E. and Osbat, C. (2020). Exchange rate pass-through in the euro area and EU countries. Occasional Paper Series 241, European Central Bank.

<sup>4</sup> Özyurt, S. (2016). Has the exchange rate pass through recently declined in the euro area? Working Paper Series 1955, European Central Bank.

<sup>5</sup> See, amongst others, Bussière, M. (2007). Exchange rate pass-through to trade prices: The role of non-linearities and asymmetries. Working Paper Series 822, European Central Bank; and Delatte, A. L. and López-Villavicencio, A. (2012). Asymmetric exchange rate pass-through: Evidence from major countries. *Journal of Macroeconomics*, 34(3):833–844.

imports as a proportion of GDP was the second-highest in the currency area. Nevertheless, these could be mitigated by the fact that approximately half of all extra-euro-area imports of goods in the Maltese economy are invoiced in euro, again one of the highest proportions in the euro area.

ERPT estimates for the Maltese economy appear only in two studies; in their cross-country comparisons, Colavecchio and Rubene (2020) and Ortega and Osbat (2020) find that estimates of ERPT to consumer prices in Malta are in line with euro area economies, peaking at around 0.1 after 1 year.<sup>6</sup> However, it is important to note that both these papers make use of data spanning from 1999 to 2017, a period which encompasses the adoption of the euro.<sup>7</sup> We estimate ERPT to consumer prices in the Maltese economy, employing a robust methodology which allows for the presence of non-linearities in transmission and using data from 2008 onwards, thus avoiding breaks in Malta's effective exchange rate relating to the adoption of the single currency.<sup>8</sup>

### Model and data

We employ a local projections (LP) model largely based on that of Colavecchio and Rubene (2020). Local projections (Jordà, 2005) can be used to estimate impulse response functions of variables of interest over chosen forecast horizons.<sup>9</sup> In the present case, we estimate the proportional impact of a change in Malta's NEER on several consumer price indices and sub-indices at successively longer forecast intervals.<sup>10</sup> After estimating the ERPT to all price indices, we augment our model with a state-dependent variable to test for size and sign non-linearities in ERPT to overall consumer prices.

We estimate our model using quarterly data from 2008Q1 to 2021Q2. Our reference exchange rate variable is the NEER on the import side as sourced from the Eurosystem Macroeconomic Projection Database.<sup>11</sup> This is rebased in terms of foreign currency per euro; hence, an increase in the NEER represents an appreciation of the euro, such that *a priori* our ERPT coefficients are expected to be negative. The foreign prices variable is an index of extra-euro area competitors' prices on the import side defined in 'national currency', that is, excluding exchange rate movements, obtained from the same Eurosystem database. As our baseline consumer price level, we use the HICP for all goods and services, but also compute estimates of ERPT to several other HICP indices and sub-indices. All consumer price indices are sourced from Eurostat. We use an internal estimate of the

<sup>6</sup> A coefficient of 0.1 after one year signifies that a 1% adjustment in exchange rates would be estimated to result in a 0.1% change in prices a year after the shock, or else that the change in prices at the chosen forecast horizon is equal to 10% of the exchange rate adjustment that triggered it.

<sup>7</sup> The adoption of the euro and consequently of a floating exchange rate regime led to a clear break in the variability of the exchange rate series. Encompassing such volatility within a longer sample would be expected to impact the reliability of results.

<sup>8</sup> This article builds upon work published in a recent working paper; see Abela, G. and Rapa, N. (2021). A study on the exchange rate pass-through to consumer prices in Malta. Working Paper 05/2021, Central Bank of Malta. Estimates presented in the paper are based on data up to Q4 of 2019. For the purposes of this article, we re-estimate identical models with data series extended until Q2 of 2021.

<sup>9</sup> Jordà, Ó. (2005). Estimation and inference of impulse responses by local projections. *American Economic Review*, 95(1):161-182.

<sup>10</sup> For a given change in the NEER between time periods  $t - 1$  and  $t$ , we estimate the proportional impact of the change on price levels at successive forecast horizons ranging from 0 to 7 quarters. Thus in total we provide ERPT results for a maximum of two years after the initial shock.

<sup>11</sup> This NEER index is an arithmetic single-weighted EER with weights reflecting the importance each country of the 36 countries taken in consideration in the Maltese import basket.

output gap (measured as the percentage difference between actual and potential output) as our baseline measure of slack in the domestic economy. For our sensitivity analysis we also use the share of migrants in Malta's labour force and the unemployment gap, both of which are estimated internally, as well as the price of Brent crude oil, sourced from the Eurosystem Macroeconomic Projection Database.<sup>12</sup>

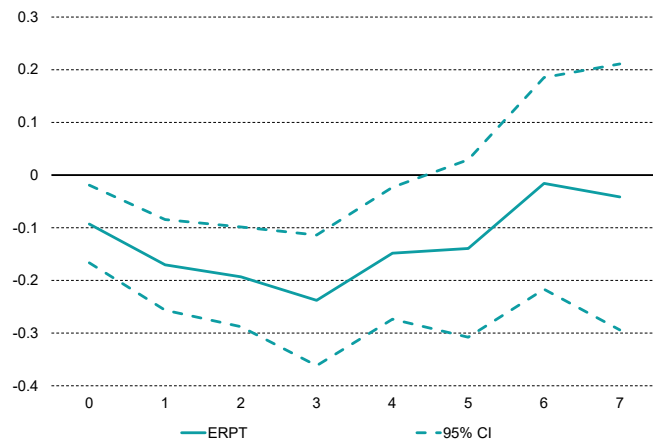
## Results

We first estimate linear ERPT to overall or headline HICP prices. The estimates are statistically significant on impact and increase progressively up to an absolute value of 0.24, or 24%, one year after the shock. This implies that a 1% fluctuation in the NEER will approximately lead to a 0.24% change in the headline HICP index at its maximum. However, the estimated coefficient diminishes slightly thereafter and is no longer statistically significant at the conventional 5% level after five quarters, as seen in Chart 1.

Separately analysing the impact of exchange rate changes on goods and services prices, our results show that pass-through to goods prices is significantly larger than that to services prices (see Chart 2). With one exception, ERPT to goods prices is statistically significant at all forecast horizons except on impact. The pass-through a year after the shock surpasses 40% and remains significant after eight quarters, though the uncertainty associated with the estimates tends to increase notably at longer horizons. ERPT to services prices is, to the contrary, insignificant throughout. These results are in line

**Chart 1**  
**ERPT TO HEADLINE HICP**

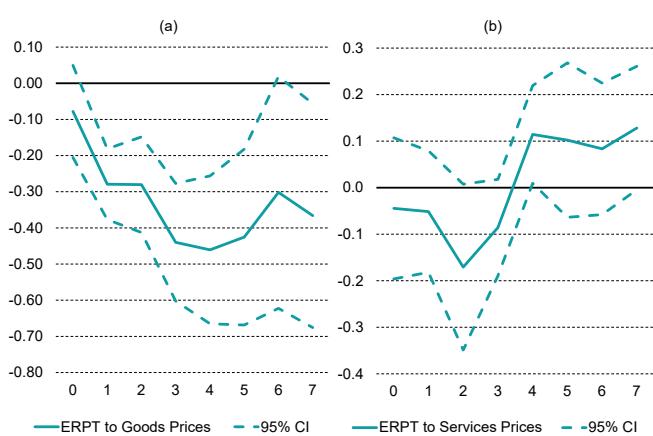
(change in price index relative to exchange rate adjustment; forecast horizon in quarters)



Source: Authors' calculations.

**Chart 2**  
**ERPT TO GOODS AND SERVICES PRICES**

(change in price index relative to exchange rate adjustment; forecast horizon in quarters)



Source: Authors' calculations.

<sup>12</sup> HICP indices as well as the index of foreign prices and oil prices are seasonally adjusted using the Census X12 procedure.

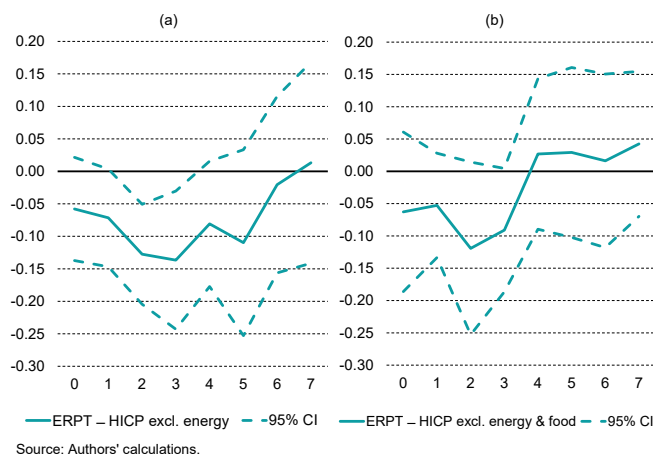
with expectations given that the import content of services consumption is much lower than that for goods.

We also estimate pass-through to core inflation (i.e., HICP excluding energy and HICP excluding energy and food), finding markedly weaker results when compared to the specification using overall or headline HICP, as shown in Chart 3. This could suggest that our initial finding is somewhat driven by the behaviour of pass-through to energy and food prices. To investigate this, we decompose the goods sub-index into industrial goods and food. ERPT to food prices is statistically significant and considerably high from the one-quarter forecast horizon onwards.<sup>13</sup> Results for industrial goods prices are statistically insignificant on impact before

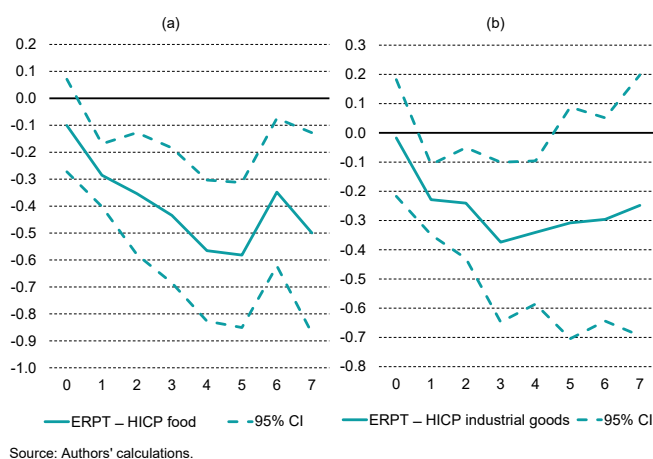
turning significantly negative between the first and fourth quarter after the shock (see Chart 4). In turn, this is wholly driven by developments in the energy subcomponent, with no significant ERPT being found for non-energy industrial goods prices at any forecast horizon.<sup>14</sup>

Results in Chart 5 show that higher pass-through is observed in episodes of exchange rate depreciation relative to appreciations and that large exchange rate changes are passed through to a greater extent than relatively small changes. Both these results are in line with much of the literature. The ERPT coefficient for appreciations is statistically insignificant at all horizons, while that for depreciation episodes is statistically significant one quarter after impact, one year after the shock, and again beyond six quarters after impact. Similarly, no significant ERPT is found for small changes at all projected horizons, while large changes

**Chart 3**  
**ERPT TO CORE INFLATION**  
(change in price index relative to exchange rate adjustment; forecast horizon in quarters)



**Chart 4**  
**ERPT TO HICP GOODS INDEX SUBCOMPONENTS**  
(change in price index relative to exchange rate adjustment; forecast horizon in quarters)



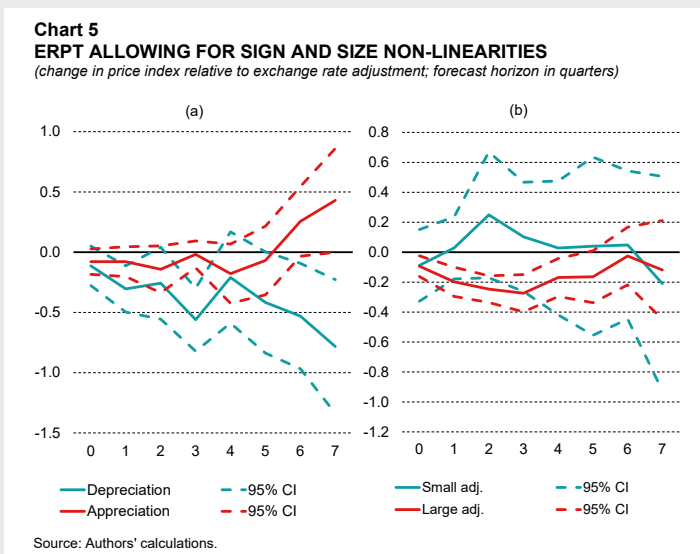
<sup>13</sup> This result is not sensitive to controlling for international food prices.

<sup>14</sup> The reader is kindly referred to Abela and Rapa (2021) for HICP energy and NEIG ERPT estimates.

show a relatively stable pass-through which is significant up to the five-quarter forecast horizon.

Our results are robust to a series of sensitivity tests which modify and augment, using separate regressions, the controls for domestic and foreign price pressures. We also test for the robustness in our estimation of the LP models by employing an alternative lag-selection algorithm. This exercise

yields a result which is very close to the baseline estimates, including in the case of ERPT to goods and services prices. Results are also robust to different definitions of what constitutes a 'large' change in the exchange rate index.



## Conclusion

ERPT is a key metric which has several uses, including in forecasting inflation and as an input to monetary policy decisions. In this study, we use LP methods to estimate linear and non-linear ERPT to consumer prices in Malta post-euro adoption. We find that ERPT to overall consumer prices exceeds 20% in the short term, subsequently tapering off after a year. This result is driven by pass-through to goods prices, which in turn results from the considerable responsiveness of energy and food prices to exchange rate fluctuations. Allowing for non-linearities demonstrates that it is mainly episodes of depreciation and changes of a relatively larger magnitude that are transmitted into consumer price inflation. Sensitivity tests show that our results are fairly robust to changes in the model, particularly at shorter horizons. Our results are also mostly consistent with theory and with the empirical literature for euro area countries. This work therefore provides an initial set of reduced-form ERPT estimates for the Maltese economy using a robust methodology and accounting for changes in the monetary regime, potentially serving as a benchmark for the calibration and estimation of macroeconomic models of the Maltese economy.

## 4. THE BALANCE OF PAYMENTS

During the third quarter of 2021, the current account deficit widened over a year earlier. The larger deficit was due to an increase in the merchandise trade deficit. By contrast net services receipts increased and net outflows on both the primary and secondary income accounts decreased.

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

When measured as a 4-quarter moving sum, the current account balance registered a deficit equivalent to 4.4% of GDP. This contrasts with a current account surplus of 2.8% of GDP in the euro area.<sup>1</sup>

The cyclically-adjusted current account balance is estimated to have recorded a deficit of 6.8% during the third quarter of 2021 – below the unadjusted measure.

### The current account

#### The current account deficit widens

Between July and September 2021 the current account deficit stood at €151.1 million, up from €94.6 million in the same quarter of 2020 (see Table 4.1). The increase in the deficit was driven by a larger merchandise trade deficit which offset an increase in net services receipts as well as lower net outflows on the primary and secondary income accounts.

When measured as a 4-quarter moving sum, the balance on the current account showed a deficit of €612.3 million in the third quarter of 2021, more than three times as much the deficit of €178.4 million recorded a year earlier. This significant increase was spurred by a wider merchandise trade deficit. This offset an increase in net receipts from trade in services and lower net outflows on the primary and secondary income accounts. As a result, the current account-to-GDP ratio

**Table 4.1**  
**BALANCE OF PAYMENTS**

EUR millions

	Four-quarter moving sums					2020 Q3	2021 Q3
	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3		
<b>Current account</b>	<b>-178.4</b>	<b>-400.8</b>	<b>-491.8</b>	<b>-555.9</b>	<b>-612.3</b>	<b>-94.6</b>	<b>-151.1</b>
Goods	-1,477.0	-1,421.6	-1,436.6	-1,724.9	-2,013.2	-447.2	-735.5
Services	2,711.5	2,444.6	2,334.4	2,548.5	2,750.9	701.1	903.5
Primary income	-1,244.1	-1,260.8	-1,235.6	-1,231.4	-1,208.3	-306.2	-283.0
Secondary income	-168.9	-163.0	-154.0	-148.1	-141.8	-42.3	-36.1
<b>Capital account</b>	<b>91.4</b>	<b>81.7</b>	<b>65.4</b>	<b>57.9</b>	<b>86.1</b>	<b>31.5</b>	<b>59.7</b>
<b>Financial account<sup>(1)</sup></b>	<b>-377.0</b>	<b>-317.4</b>	<b>74.4</b>	<b>218.0</b>	<b>328.7</b>	<b>-2.0</b>	<b>108.7</b>
<b>Errors and omissions</b>	<b>-289.9</b>	<b>1.7</b>	<b>500.8</b>	<b>716.0</b>	<b>854.9</b>	<b>61.2</b>	<b>200.1</b>

Source: NSO.

<sup>(1)</sup> Net lending (+) / net borrowing (-).

<sup>1</sup> Balance of payments data for 2020 and 2021 should be interpreted in the context of the unprecedented developments related to COVID-19.

stood at -4.4%, from -1.3% a year earlier (see Chart 4.1).

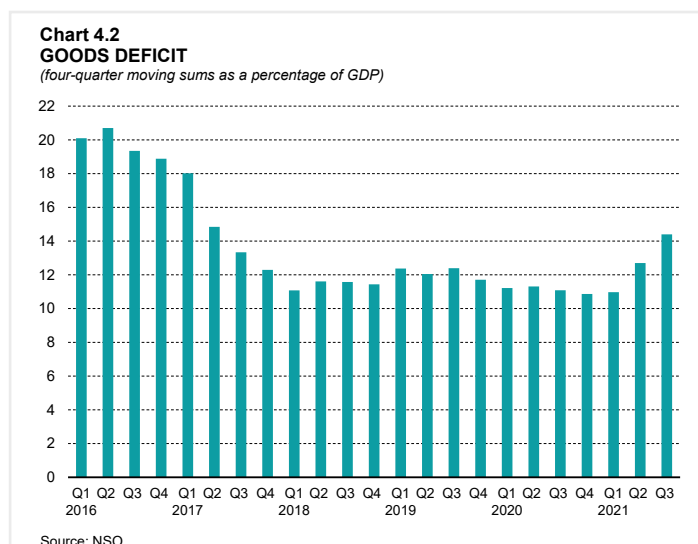
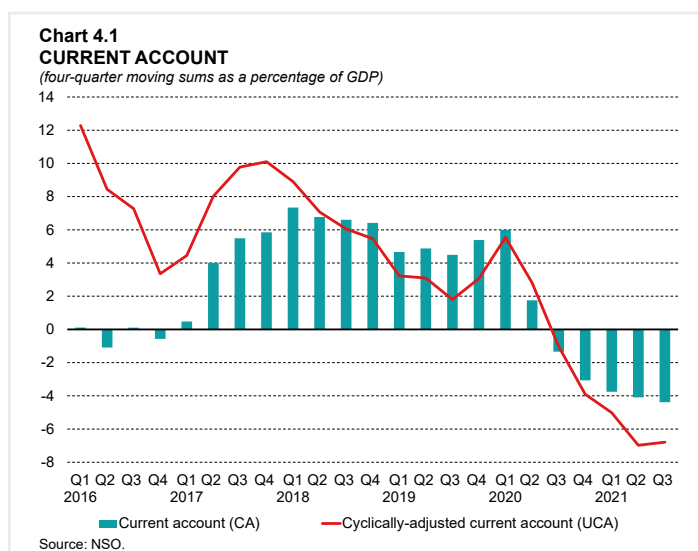
Malta's cyclically-adjusted current account balance is estimated to have stood at -6.8% of GDP in the third quarter of 2021.<sup>2</sup> The cyclically-adjusted measure recorded a deficit for the fifth consecutive period, thus exhibiting similar developments to the unadjusted measure. However, once again, it stood below the headline measure, as Malta's economic cycle was slightly 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 output gap measure for the whole economy that is used to derive the cyclically-adjusted balance, likely does not fully take into account the significant degree of underutilisation in sectors hit hardest by the pandemic and related social distancing measures. This factor is likely inflating the deterioration in the cyclically-adjusted balance from its level estimated before the pandemic.

### The merchandise trade deficit widens significantly

In the third quarter of 2021, the merchandise trade deficit stood at €735.5 million, €288.3 million more than in the corresponding period of 2020. This was driven by a large increase in imports and a small decrease in exports. The strong increase in goods imports partly reflects extraordinary investment in the aviation sector.

When measured on a 4-quarter cumulative basis, the visible trade gap widened to €2,013.2 million – €536.2 million more than the deficit recorded a year earlier. This stemmed from a €374.0 million rise in goods imports as well as a €162.2 million drop in exports. As a result, the share of the goods deficit in GDP rose to 14.4% in the year to September 2021, from 11.1% a year earlier (see Chart 4.2).



<sup>2</sup> For more information on Malta's cyclically-adjusted current account see Grech, A. G., & Rapa, N., "An evaluation of recent shifts in Malta's current account position", in Grech, A.G., & Zerafa, S. (eds.), *Challenges and Opportunities of Sustainable Economic Growth: the Case of Malta*, Central Bank of Malta, 2017.

### The surplus on services widens

In the quarter under review, net receipts on the services account amounted to €903.5 million, €202.5 million more than in the corresponding period of 2020. Both services receipts and payments increased on a year earlier but the rise in the former was substantially larger.

The main contributor to the surplus in services during the quarter under review was the travel component. Tourism activity continued on its gradual recovery, whereby the increase in tourism exports outweighed a rise in expenditure by Maltese residents on travel abroad. This led net travel receipts to increase by €156.0 million. Additionally, net receipts on the transport account rose by €76.9 million when compared to the corresponding quarter of last year.

Net receipts on 'other services' declined by €30.4 million, to €497.3 million. A fall in net receipts related to financial services as well as personal, cultural and recreational services – which include betting activities – outweighed lower net payments related to 'other business services'

On a 4-quarter cumulative basis, the overall surplus from services stood at €2,750.9 million, a €39.4 million increase over the surplus recorded in the corresponding period of 2020. This was mainly due to higher net receipts from personal, cultural and recreational services and transport services. Together these offset lower net receipts from the travel component as well as financial and certain other business services. The share of net services receipts in GDP dropped to 19.7% in the 12 months to September 2021, from 20.4% in the corresponding period of 2020 (see Chart 4.3).

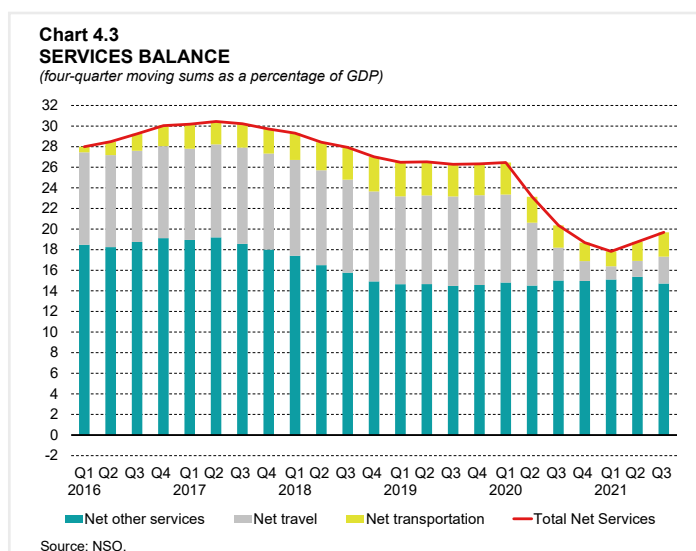
### Net outflows on the primary income account decline<sup>3</sup>

Between July and September 2021, net outflows on the primary income account stood at €283.0 million, €23.2 million lower than in the third quarter of 2020.

During the four quarters to September, such outflows reached €1,208.3 million, €35.8 million less than in the same period a year earlier. This was due to lower net outflows on investment income, as higher net outflows on direct investment were outweighed by higher net inflows on portfolio income and 'other investment' income. Flows relating to primary income continued to be strongly influenced by internationally-oriented firms which transact predominantly with non-residents.

### Outflows on the secondary income account decrease<sup>4</sup>

In the third quarter of the year, net outflows on the secondary income account decreased by €6.3 million on a year earlier, to stand at €36.1 million.



<sup>3</sup> The primary income account shows income flows related mainly to cross-border investment and compensation of employees.

<sup>4</sup> The secondary income account shows current transfers between residents and non-residents.

Net outflows on this account also decreased when measured on a four-quarter moving sum basis. These stood at €141.8 million – €27.1 million less than the amount recorded a year earlier.

## Tourism activity

### Activity in the tourism sector

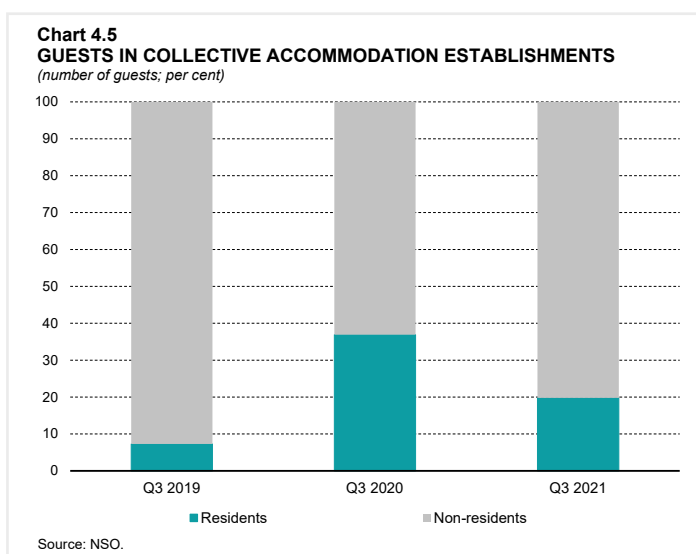
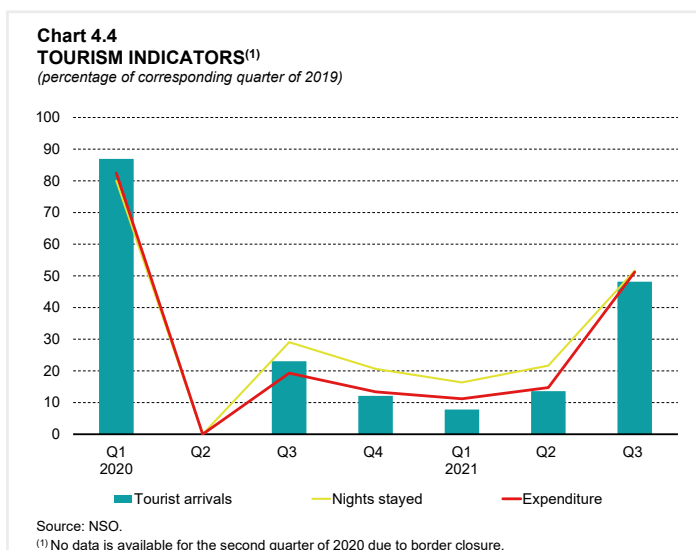
Although COVID-19 related travel restrictions remained in place, the third quarter of 2021 registered a marked improvement in the number of inbound tourists, nights stayed and tourist expenditure in Malta relative to those recorded in the corresponding period of 2020. Nonetheless, activity indicators for the sector generally remain below 2019 levels.

In the quarter under review, the number of inbound tourists more than doubled compared to the third quarter of 2020, reaching 446,547 (see Chart 4.4). In absolute terms, tourists visiting Malta for leisure purposes accounted for most of the year-on-year increase in arrivals although the number of visitors with business and other motives also increased.

Meanwhile, the total number of guest nights that tourists spent in Malta during the third quarter of 2021 increased to around 3.8 million, from over 2.1 million a year earlier. This increase was attributed to rented accommodation – in particular, collective accommodation – which offset a decline in non-rented accommodation.

As the epidemiological situation in several countries improved over the summer and the willingness to travel increased, the share of non-residents in collective accommodation establishments in the third quarter of 2021 increased relative to the same period a year earlier, exceeding 80.0%, though it remained below that of 92.7% recorded in the third quarter of 2019 (see Chart 4.5).

The total occupancy rate in collective accommodation establishments in the third quarter of 2021 soared to 54.8% from



30.0% in the corresponding quarter of 2020, although remaining short of that recorded in 2019 (see Chart 4.6). The 5-star category reported the largest increase – of 27.5 percentage points – followed by a rise of 27.0 percentage points in the 4-star category. Meanwhile, the smallest increase – of 14.0 percentage points – was recorded in the 2-star category.

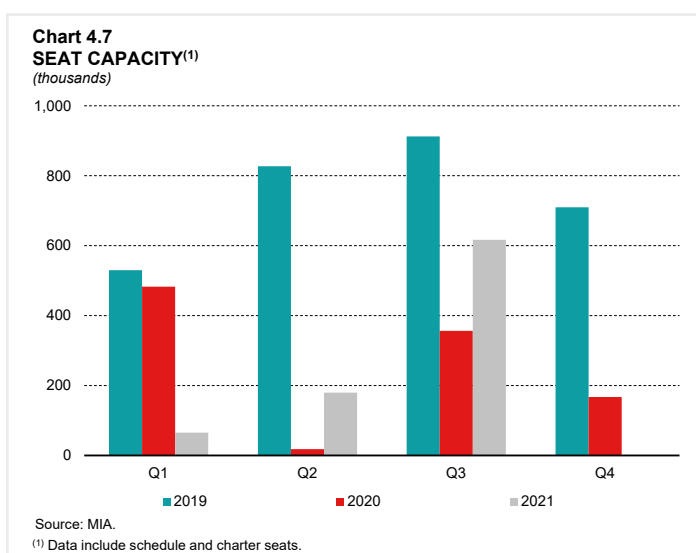
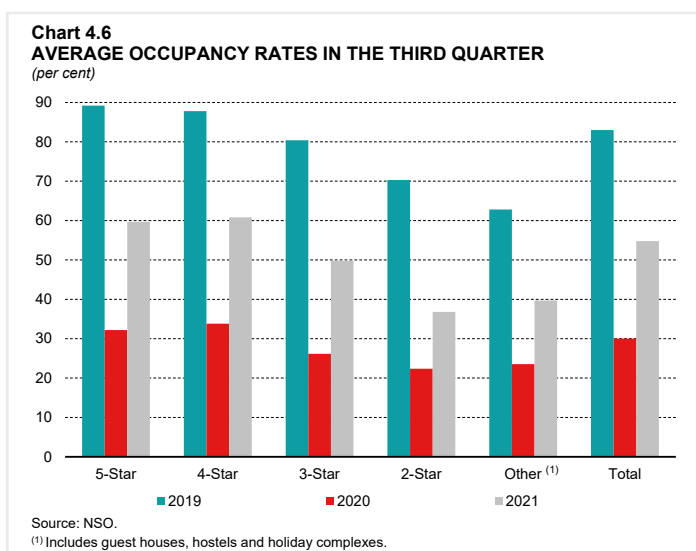
Tourist expenditure in Malta more than doubled relative to year ago levels, standing at €446.3 million during the third quarter of the year. The increase relative to 2020 was driven by higher ‘other’ and non-package expenditure, although spending on package holidays also increased significantly. Following this increase, tourist expenditure in Malta stood 48.8% below its level two years earlier.

Expenditure per capita increased to €999.4 from €787.8 in the third quarter of 2020, as expenditure per night increased, offsetting a decrease in the average length of stay, which stood at 8.5 nights from 10.0 a year earlier.

According to Malta International Airport data, in the third quarter of 2021, average seat capacity increased by 73.0% relative to the corresponding period of 2020 and was more than half of its level in the third quarter of 2019 (see Chart 4.7).

### The capital account

Net inflows on the capital account stood at €59.7 million in the third quarter of 2021, up from €31.5 million in the corresponding period of 2020 (see Table 4.1). Nonetheless, capital inflows decreased when measured on a 4-quarter moving sum basis, standing at €86.1 million, compared to €91.4 million in 2020.



## 5. GOVERNMENT FINANCE

The general government deficit widened when compared to 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 8.5% of GDP, marginally above the 8.4% recorded in the second quarter. Nonetheless, the general government debt-to-GDP ratio decreased to 57.2% from 59.1% at end-June 2021. The net financial worth as a share of GDP improved in the quarter under review, as the share of financial liabilities held by the government in GDP declined at a faster pace than the share of financial assets in GDP.

### Quarterly developments

#### General government balance deteriorates

In level terms, the general government registered a deficit of €267.6 million in the third quarter of 2021, a deterioration of €56.9 million when compared with the corresponding quarter of 2020. This was due to an increase in expenditure which outweighed an increase in revenue. As a result, the primary deficit widened from €169.4 million in the third quarter of 2020 to €227.6 million in this quarter.

#### Higher indirect tax receipts and inflows from 'other' revenue underpin revenue growth

In the period under review, general government revenue increased by €65.6 million, or 5.3% when compared with the same quarter of 2020 (see Table 5.1). This is largely due to higher non-

**Table 5.1**  
**REVENUE, EXPENDITURE AND DEBT**  
EUR millions

	2020		2021			Change 2021Q3-2020Q3	
	Q3	Q4	Q1	Q2	Q3	Amount	%
<b>Revenue</b>	<b>1,247.9</b>	<b>1,350.9</b>	<b>1,091.1</b>	<b>1,380.3</b>	<b>1,313.6</b>	<b>65.6</b>	<b>5.3</b>
Taxes on production and imports	354.0	389.7	335.9	391.0	394.0	40.0	11.3
Current taxes on income and wealth	483.1	472.9	385.6	577.6	476.7	-6.4	-1.3
Social contributions	226.7	217.2	203.3	207.0	210.1	-16.7	-7.4
Capital and current transfers receivable	48.3	110.2	33.9	47.3	55.3	7.0	14.5
Other <sup>(1)</sup>	135.9	160.9	132.4	157.4	177.6	41.7	30.7
<b>Expenditure</b>	<b>1,458.6</b>	<b>1,658.9</b>	<b>1,501.9</b>	<b>1,588.4</b>	<b>1,581.1</b>	<b>122.5</b>	<b>8.4</b>
Compensation of employees	403.8	396.1	442.3	438.9	433.0	29.2	7.2
Intermediate consumption	296.1	373.1	295.4	299.1	358.1	62.1	21.0
Social benefits	309.1	335.8	342.8	386.1	319.0	9.9	3.2
Subsidies	203.8	182.1	135.7	155.8	155.2	-48.6	-23.8
Interest	41.3	41.9	41.0	43.5	39.9	-1.4	-3.3
Other current transfers payable	47.7	82.6	90.2	101.1	120.3	72.6	152.0
GFCF	122.0	180.4	120.5	135.3	105.7	-16.2	-13.3
Capital transfers payable	26.3	57.5	21.4	26.0	33.5	7.2	27.4
Other <sup>(2)</sup>	8.5	9.4	12.7	2.4	16.2	7.7	
<b>Primary balance</b>	<b>-169.4</b>	<b>-266.1</b>	<b>-369.8</b>	<b>-164.5</b>	<b>-227.6</b>	<b>-58.2</b>	
<b>General government balance</b>	<b>-210.7</b>	<b>-308.0</b>	<b>-410.8</b>	<b>-208.1</b>	<b>-267.6</b>	<b>-56.9</b>	
<b>General government debt</b>	<b>6,851.5</b>	<b>6,977.5</b>	<b>7,496.2</b>	<b>8,025.9</b>	<b>7,989.3</b>		

Source: NSO.

<sup>(1)</sup> "Other" revenue includes market output as well as income derived from property and investments.

<sup>(2)</sup> "Other" expenditure principally reflects changes in the value of inventories and in the net acquisition of valuables and other assets.

tax revenue, which increased by €41.7 million, as a result of higher income from dividends and from sales. Meanwhile, capital and current transfers increased by €7.0 million, mainly due to higher grants from the EU.

Overall, tax receipts rose on the back of a €40.0 million increase in inflows from taxes on production and imports. The latter is mainly due to higher receipts from VAT, reflecting the partial recovery in tourist activity from the low levels registered a year earlier. On the other hand, inflows from social contributions and current taxes on income and wealth declined by €16.7 million and €6.4 million, respectively. These declines come after a strong performance in the first half of the year.

### *Current expenditure underpins expenditure growth*

Total government expenditure increased by €122.5 million or 8.4% when compared with the third quarter of 2020. This increase reflects higher current expenditure, mostly caused by higher outlays on current transfers and intermediate consumption. The latter increased by €62.1 million, largely on the back of higher outlays in public administration. Meanwhile, current transfers rose by €72.6 million, partly reflecting higher transfers to the EU budget. Outlays on compensation of employees rose by €29.2 million, on the back of higher spending in public administration and, to a lower extent, in the education, social work and health care sectors. Spending on social benefits increased by €9.9 million, partly on account of higher outlays on retirement pensions. Meanwhile, outlays on subsidies declined by €48.6 million, mainly due to a drop in pandemic-related assistance schemes.

The substantial increase in current expenditure was partly offset by a fall in capital expenditure, in particular lower government investment. The latter declined by €16.2 million, reflecting a decrease in EU-funded expenditure as well as lower outlays on locally-financed projects.

### *Debt decreases*

In September 2021, the stock of general government debt amounted to €7,989.3 million, €36.6 million lower than the level registered at end-June 2021. The fall in debt mainly reflects a decline in the stock of outstanding short-term securities (composed of Treasury bills). These fell by €91.8 million, with their share in total debt declining by 1.1 percentage points to 8.6%. Meanwhile, the stock of long-term securities outstanding increased by €52.6 million, and consequently, their share in total debt increased by 1.0 percentage point to 74.6%.

Loans outstanding increased slightly – by €2.2 million – due to an increase in the amount of long-term loans outstanding. The latter rose significantly since the start of the pandemic, reflecting funds received from the EU's Support to mitigate Unemployment Risks in an Emergency (SURE) instrument.

## **Headline and cyclically-adjusted developments**

### *Headline balance ratio rose marginally, while the debt ratio decreases*

When measured on a four-quarter moving sum basis, the general government deficit widened slightly, from 8.4% of GDP in the second quarter of 2021 to 8.5% in the quarter under review (see Chart 5.1).

This marginal increase was mainly driven by a fall in the revenue-to-GDP ratio which outweighed the fall in the expenditure-to-GDP ratio. The former declined to 36.7% from 37.3% in the previous

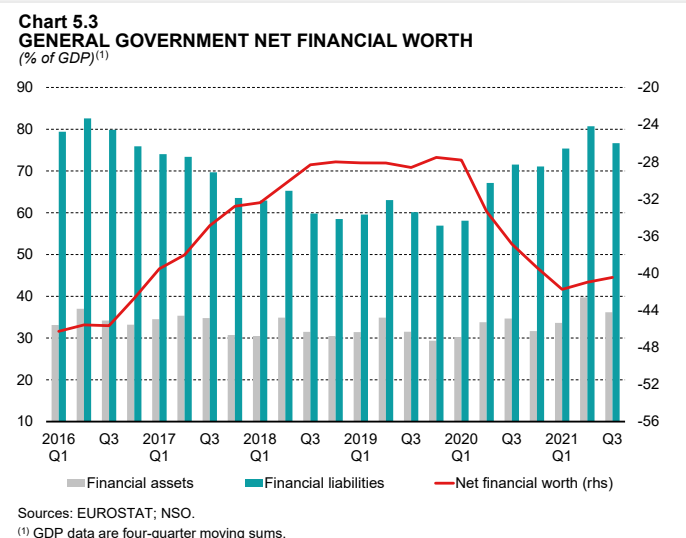
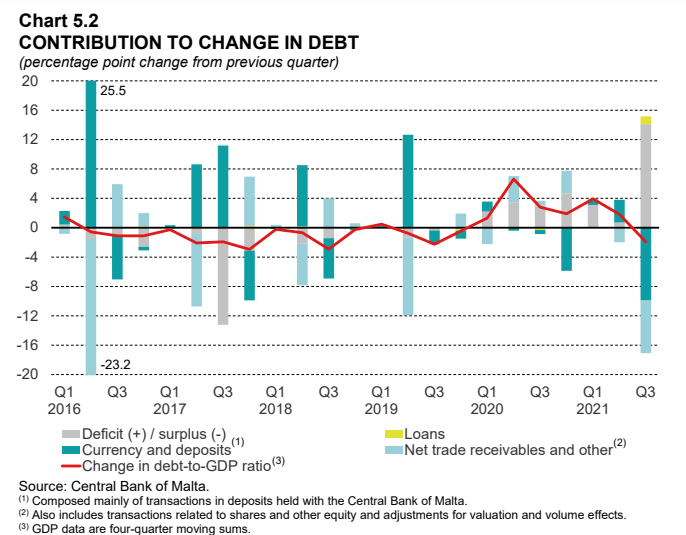
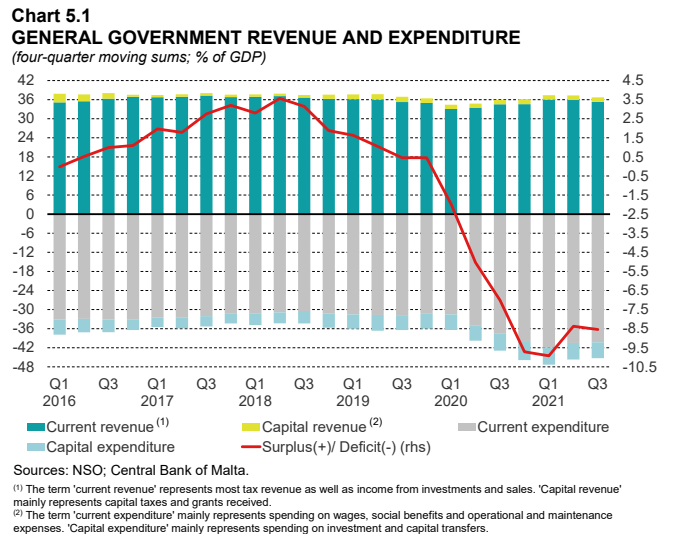
quarter, due to a 0.6 percentage point fall in the share of current revenue in GDP. Meanwhile, the government expenditure-to-GDP ratio declined by 0.4 points, which is attributable to lower shares of both current and capital expenditure in GDP.

Between June and September 2021, the debt-to-GDP ratio declined by 1.9 percentage points to 57.2%. The fall in general government debt despite the posting of a deficit, was due to a negative deficit-debt adjustment stemming from the drawdown of deposits and a decline in net trade receivables (see Chart 5.2).

### Net financial worth improves slightly

The market value of financial assets declined to €5,059.1 million by September 2021, €339.2 million less than the level as at end June 2021. This was mainly due to a strong fall in the value of bank deposits, coupled with a drop in other accounts receivable, owing to the timing of tax receipts. As a result, the share of financial assets in GDP declined by 3.5 percentage points to 36.2% (see Chart 5.3).

The stock of financial liabilities declined at a slower pace relative to financial assets. The former decreased by €249.7 million, to stand at €10,716.1 million. This is due to lower accounts payable, reflecting the timing of processing of income tax refunds to firms, as well as the above-mentioned



fall in outstanding debt securities. As a result, the share of financial liabilities in GDP fell by 4.1 percentage points to reach 76.7%.

The resulting net financial worth of general government stood at -€5,657.0 million, which is €89.5 million below that registered in the previous quarter. However, when calculated as a share of GDP, the net financial worth of general government slightly improved in the period under review, as it increased from -41.0% at end-June to -40.5% at end-September.

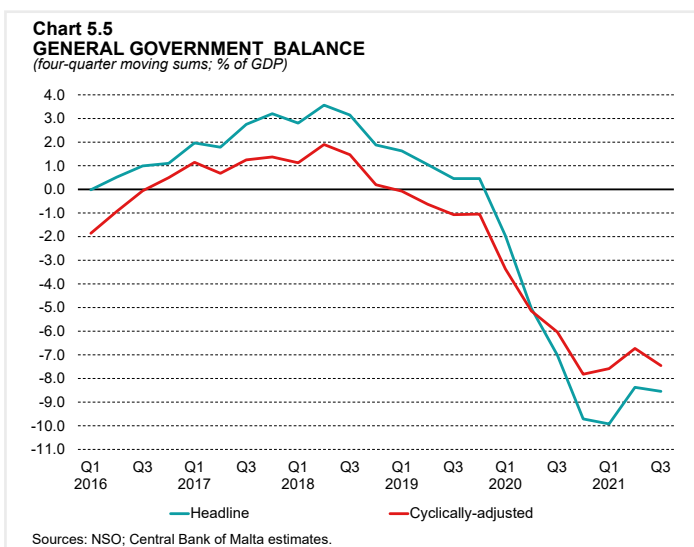
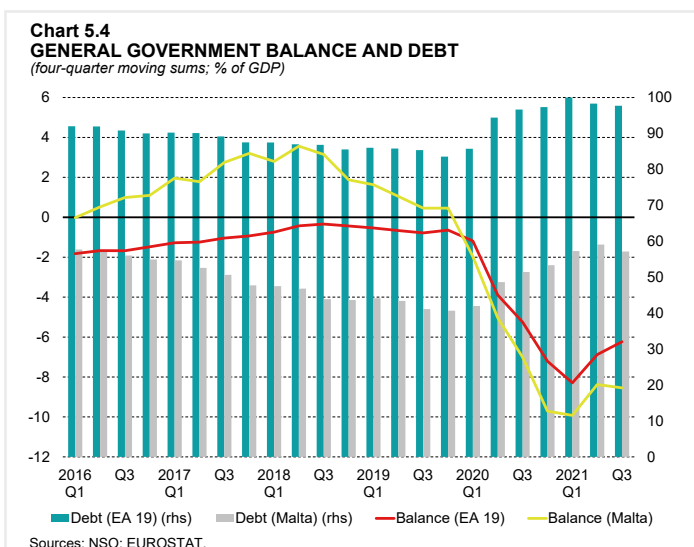
As a share in GDP, the net financial worth of the euro area also improved by 0.5 percentage point in the quarter under review. However, since the latter now stands at -72.8% of GDP, the Maltese general government net financial outlook is more favourable.

### Debt ratio continues to compare favourably with the euro area's

During the quarter under review, the euro area general government deficit stood at 6.2% of GDP on a four-quarter moving sum basis, down from 6.9% of GDP at end-June (see Chart 5.4). Over the same period, the euro area debt ratio declined to 97.7% of GDP from 98.3% of GDP previously. The Maltese government debt-to-GDP ratio remains well below the corresponding ratio for the euro area, despite having a higher deficit.

### Cyclically-adjusted deficit declines marginally<sup>1</sup>

On a four-quarter moving sum basis, the cyclically-adjusted deficit stood at 7.5% of GDP in the quarter under review, 0.7 percentage point higher than the deficit posted three months earlier (see Chart 5.5). This deterioration was more pronounced than the increase in



<sup>1</sup> 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.

the headline deficit over the same period which reflects the estimated narrowing of the negative output gap.

Overall, the share of cyclically-adjusted revenue in GDP declined by 0.4 percentage point (see Table 5.2), reflecting the above-mentioned fall in current taxes on income and wealth and social contributions. On the other hand, the share of 'other revenues' in GDP increased, reflecting an increase in capital and current transfers received. However, the decline in tax revenue offset this rise.

The share of cyclically-adjusted expenditure rose by 0.3 percentage point, mainly due to an increase in intermediate consumption, and in current transfers, which are captured under 'other' expenditure. At the same time, the share of capital expenditure declined, driven by lower government investment.

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

*Percentage points of GDP*

	2020		2021		
	Q3	Q4	Q1	Q2	Q3
<b>Revenue</b>	<b>0.9</b>	<b>0.3</b>	<b>1.3</b>	<b>0.4</b>	<b>-0.4</b>
Current taxes on income and wealth	1.2	0.3	1.0	0.0	-0.6
Taxes on production and imports	-0.1	0.0	0.0	0.2	0.0
Social contributions	0.3	0.1	0.4	-0.2	-0.2
Other <sup>(1)</sup>	-0.5	-0.2	-0.1	0.4	0.5
<b>Expenditure</b>	<b>1.8</b>	<b>2.1</b>	<b>1.1</b>	<b>-0.5</b>	<b>0.3</b>
Compensation of employees	0.2	0.1	0.3	0.2	0.0
Intermediate consumption	0.5	0.5	0.7	-0.3	0.3
Social benefits	0.0	0.0	0.0	0.0	0.0
Interest payments	0.0	0.0	0.0	0.0	0.0
GFCF	0.2	0.0	-0.2	-0.1	-0.2
Other <sup>(2)</sup>	1.0	1.4	0.2	-0.2	0.2
<b>Primary balance</b>	<b>-0.9</b>	<b>-1.8</b>	<b>0.2</b>	<b>0.8</b>	<b>-0.8</b>
<b>General government balance</b>	<b>-0.9</b>	<b>-1.8</b>	<b>0.2</b>	<b>0.9</b>	<b>-0.7</b>

Sources: NSO; Central Bank of Malta estimates.

<sup>(1)</sup> Includes market output, income derived from property and investments and current and capital transfers received.

<sup>(2)</sup> Mainly includes subsidies, current and capital transfers.

## 6. MONETARY AND FINANCIAL DEVELOPMENTS

According to the Bank's FCI, in the third quarter of 2021, financing conditions were loose from a historical perspective.

In September, Maltese residents' deposits with MFIs in Malta expanded at a faster rate when compared to June.<sup>1</sup> The shift to overnight deposits persisted in an environment of low interest rates and a continued preference for liquidity. Credit to Maltese residents decelerated, reflecting slower growth in both credit to general government and credit to other residents. The latter, in turn, reflected slower growth in loans to NFCs. By contrast, loans to households rose at a faster 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 September, the primary market yield on Treasury bills rose from that prevailing at the end of June. Secondary market yields on 5-year and 10-year MGS increased, while in the euro area, the benchmark yields on both the 5-year bonds and the 10-year bonds declined. Domestic share prices fell, ending September at a lower level compared with end-June, but were higher compared with a year earlier.

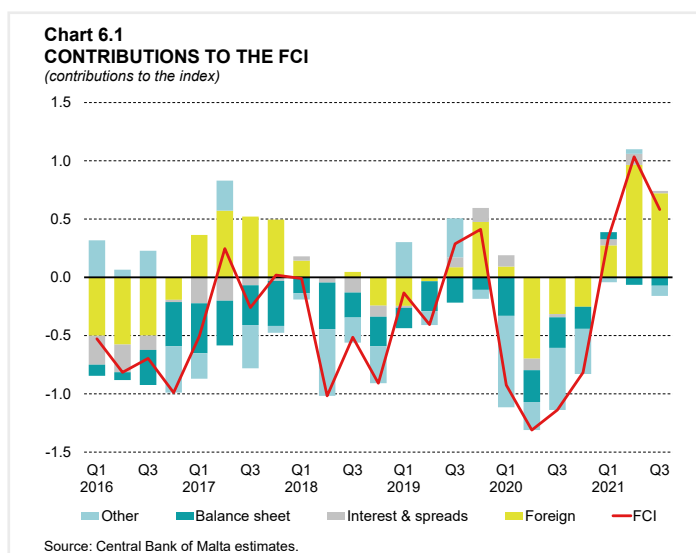
The number and value of loan facilities covered by loan moratoria issued in terms of CBM Directive No. 18 or earlier continued to decrease from already low levels, signalling a recovery in income flows, though this may also reflect the expiration of the moratoria period. However, firms' recourse to guarantees in terms of the MDB CGS increased, with sanctioned amounts for capital and loan repayment purposes granted to businesses under this scheme reaching €508.8 million at the end of September, or 65.4% of the scheme's target size.

### Monetary and financial conditions

#### Financial conditions remain loose from a historical perspective

According to the Bank's FCI, in the third quarter of 2021, financial conditions remained loose from a historical perspective, but were less favourable compared to the previous quarter (see Chart 6.1).

The recent decrease in the index partly reflects developments in foreign influences, in particular, a decline in euro area stock prices and marginally higher uncertainty levels.



<sup>1</sup> 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.

However, domestic influences also contributed to the decrease in the FCI, largely reflecting a decline in securities issued by NFCs which are included in the 'other' component. The 'interest rate' component also had a smaller loosening effect compared to the second quarter of the year, reflecting an increase in sovereign spread. Meanwhile, the 'balance sheet' component continued to have a small tightening effect on the FCI as more favourable dynamics in real deposits were offset by slower growth in real credit.

Financial conditions improved sharply when compared to the third quarter of 2020. This was mostly driven by foreign influences, as euro area equity prices increased and uncertainty decreased over this period.

However, domestic influences also contributed to the loosening in financial conditions compared to a year earlier, partly as a result of an increase in equity prices and in net issues of NFC securities – included in the 'other' component. Improved dynamics in balance sheet items – notably in core banks' return-on-equity and, to a lesser extent, in real credit and real deposit conditions – also contributed to the loosening in annual terms. The contribution of the 'interest rates' component turned mildly positive relative to the third quarter of 2020, reflecting a decline in the sovereign spread and lending-to-policy rate spread.

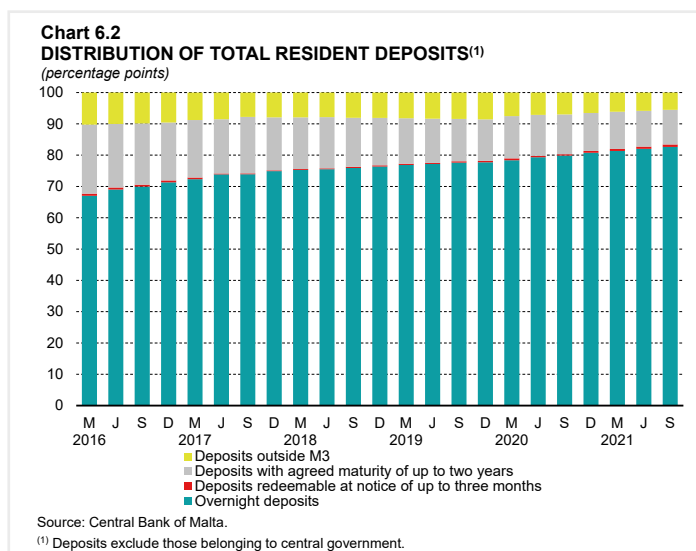
### *Maltese residents' deposits continue to expand*

Total deposits held by Maltese residents with MFIs in Malta expanded at a faster pace relative to the second quarter of 2021. The annual rate of change stood at 8.3% in September, above the 5.1% recorded in June (see Table 6.1).

	EUR millions 2021 Sep.	Annual percentage changes				
		2020		2021		
		Sep.	Dec.	Mar.	June	Sep.
<b>Overnight deposits</b>	<b>18,260</b>	<b>7.3</b>	<b>9.8</b>	<b>9.4</b>	<b>8.6</b>	<b>12.0</b>
<i>of which</i>						
Households	12,158	15.0	14.4	14.1	13.2	14.3
NFCs	4,148	13.7	16.8	17.8	12.3	11.7
<b>Deposits redeemable at notice of up to three months</b>	<b>178</b>	<b>1.9</b>	<b>40.1</b>	<b>12.1</b>	<b>70.6</b>	<b>104.5</b>
<i>of which</i>						
Households	39	2.4	4.7	9.4	8.0	15.2
NFCs	105	79.5	150.1	-3.6	89.4	200.0
<b>Deposits with an agreed maturity of up to two years</b>	<b>2,442</b>	<b>-2.0</b>	<b>-3.3</b>	<b>-7.2</b>	<b>-8.2</b>	<b>-5.9</b>
<i>of which</i>						
Households	1,927	-3.3	-2.3	-4.7	-4.9	-4.2
NFCs	202	-10.5	-10.9	-14.1	-33.9	-20.2
<b>Deposits with an agreed maturity above two years</b>	<b>1,222</b>	<b>-13.8</b>	<b>-19.6</b>	<b>-14.3</b>	<b>-13.9</b>	<b>-14.2</b>
<i>of which</i>						
Households	1,081	-10.7	-15.6	-11.5	-13.0	-13.2
NFCs	63	-34.1	-35.9	-34.2	29.6	39.6
<b>Total residents' deposits<sup>(1)</sup></b>	<b>22,102</b>	<b>4.2</b>	<b>5.7</b>	<b>5.4</b>	<b>5.1</b>	<b>8.3</b>

Source: Central Bank of Malta.  
<sup>(1)</sup> 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 reached 12.0% in September, from 8.6% three months earlier. Meanwhile, the share of this category in total deposits edged up marginally to 82.6% from 82.0% three months 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 rose at a faster pace, with their share in total deposits rising marginally to 0.8%.

Deposits with an agreed maturity of up to two years contracted by 5.9% in September, following a decline of 8.2% in the year to June. Meanwhile, deposits with an agreed maturity of over two years fell by 14.2%, after contracting by 13.9% three months earlier. As a result, the share of these two categories of deposits edged down compared to June, closing the third quarter at 11.1% and 5.5% respectively.

### *Credit to residents increases at a slower pace*

Credit to Maltese residents expanded by 7.1% in the year to September, below the 8.9% registered in June, reflecting slower growth in credit to general government, and to a lesser extent, in credit to other residents (see Table 6.2).

	EUR millions 2021 Sep.	Annual percentage changes				
		2020		2021		
		Sep.	Dec.	Mar.	June	Sep.
<b>Credit to general government</b>	<b>4,353</b>	<b>37.5</b>	<b>32.3</b>	<b>33.9</b>	<b>13.5</b>	<b>9.3</b>
<b>Credit to residents outside general government</b>	<b>12,443</b>	<b>4.2</b>	<b>5.3</b>	<b>5.5</b>	<b>7.4</b>	<b>6.4</b>
Securities and Equity	332	-27.7	-25.9	-16.4	-6.2	-2.1
Loans	12,110	5.6	6.5	6.3	7.8	6.6
<i>of which:</i>						
Loans to Households	6,867	5.7	5.4	5.9	8.8	9.4
Mortgages	6,314	7.0	6.7	7.3	10.1	10.6
Consumer Credit and Other Lending	552	-5.6	-6.4	-7.4	-3.7	-2.8
Loans to NFCs <sup>(1)</sup>	4,346	5.0	8.6	7.1	6.5	4.2
<b>Total credit to residents</b>	<b>16,796</b>	<b>11.0</b>	<b>10.9</b>	<b>11.6</b>	<b>8.9</b>	<b>7.1</b>

Source: Central Bank of Malta.  
<sup>(1)</sup> NFCs include sole proprietors and non-profit institutions serving households (NPISH).

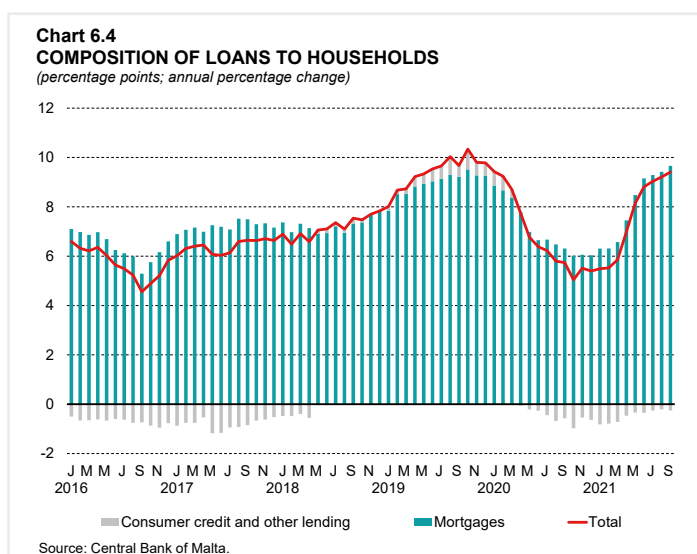
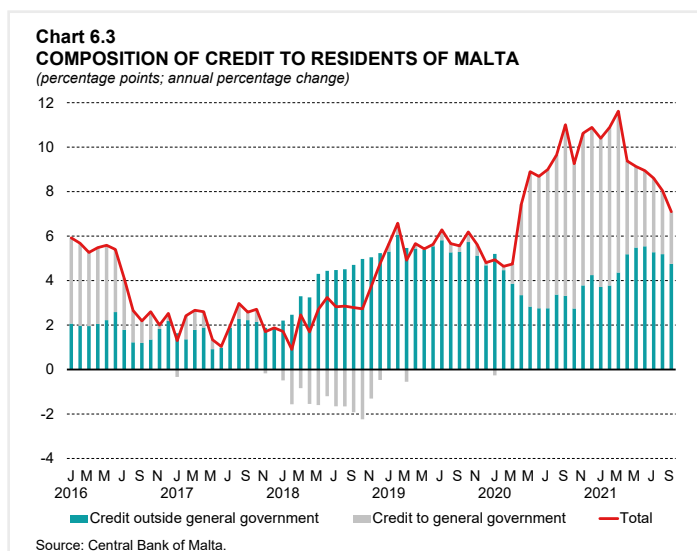
Credit to general government rose by 9.3% in the year to September, following an increase of 13.5% three months earlier. The deceleration in this credit component mainly reflects a smaller increase in MFI holdings of government stocks and a larger decrease in their holdings of Treasury bills.

The annual rate of change of credit to residents outside general government stood at 6.4%, below the 7.4% recorded three months earlier (see Chart 6.3). This reflects slower growth in loans to the private sector, which offset a smaller contraction in security holdings.

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

Loans to households grew by 9.4% on an annual basis, following an 8.8% increase in June. This partly reflected faster growth in mortgage lending, which increased by 10.6% in September, up from 10.1% three months earlier. At the same time, consumer credit and other lending contracted at a slower rate of 2.8% over the same period, following a decrease of 3.7% in the year to June (see Chart 6.4).

Meanwhile, annual growth in loans to NFCs stood at 4.2% in September, below the 6.5% increase recorded in June. This slowdown was largely driven by a decrease in lending to the construction and real estate sector. This was followed by slower growth in credit to the sector comprising accommodation and food service activities, and to a lesser extent, in the transportation and storage sector and in administrative and support service activities. Loans to 'other' sectors also increased at a more moderate pace, mostly reflecting developments in loans to the information and communication sector and the sector comprising professional, scientific and technical activities. On the other hand, lending to the

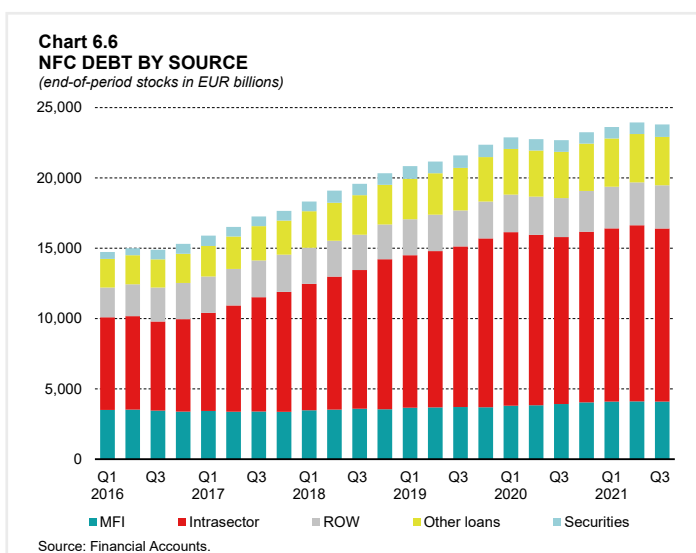
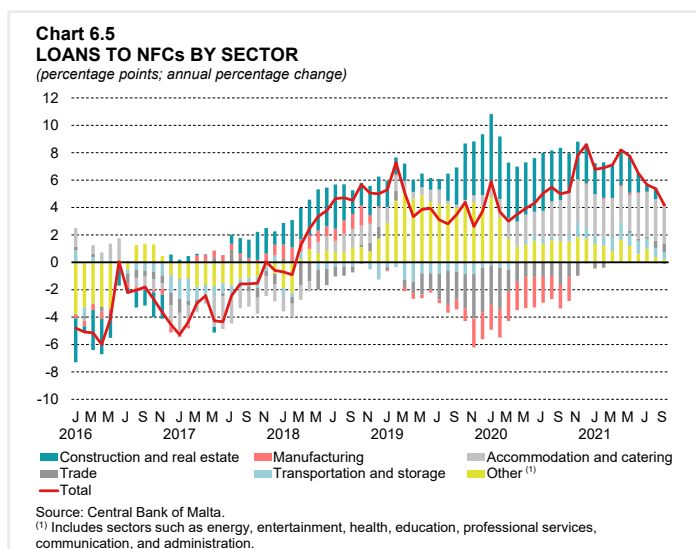


wholesale and retail trade, and to a smaller degree, loans to the manufacturing sector, rose at a faster pace compared to June (see Chart 6.5).

Financial accounts data show that the share of bank lending in total NFC debt was comparable to June's and only marginally below the share recorded 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 16.5% at the end of 2019. However, this pattern was reversed 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 2020, the share of bank loans in total NFC debt had reached 17.4%, before easing to 17.2% more recently.<sup>2</sup>

The increase in the share of bank lending in total NFC debt and the rise in the level of loans issued to NFCs during 2020 suggest 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 during the pandemic since 2019. During the third quarter of 2021, the latter stood at 51.7%, down from 52.3% in June and from 52.9% in the third quarter of 2019. Meanwhile, the share of loans from non-residents reached 12.9%, from 12.2% a year earlier and from 12.7% in June.

MSE data show that as at September 2021, around €1.5 billion in corporate debt was listed on the Exchange, 1.4% less than the outstanding stock 12 months earlier (see Chart 6.7).<sup>3</sup> By contrast,



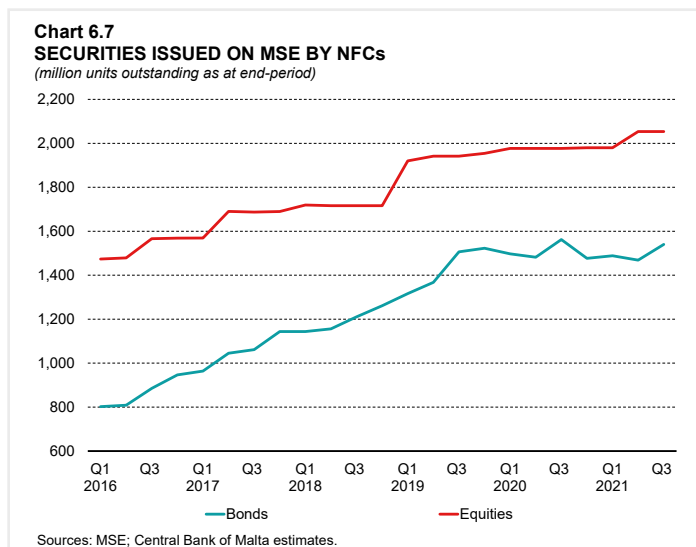
<sup>2</sup> See Darmanin, J. (2017), "The financing of companies in Malta", *Policy Note* July 2017, Central Bank of Malta.

<sup>3</sup> MSE data may differ from financial accounts data due to differences in valuation methodology and coverage. In particular, financial accounts data are at market value and include both listed and privately-placed securities.

the outstanding amount of equity listed on the MSE increased by 3.9% in annual terms, to €2.1 billion.

### Spread between deposit and lending rate declines

In September, the weighted average deposit rate offered to households and NFCs in Malta was down by 5 basis points on a year earlier, standing at 0.18% (see Table 6.3).<sup>4</sup> This was largely driven by a further decrease in rates on time deposits held by NFCs, although rates on households' time deposits also declined.



Meanwhile, the weighted average lending rate paid by households and NFCs to resident MFIs fell by 14 basis points, to 3.25%. This decrease was largely due to lower rates paid by

**Table 6.3**  
**INTEREST RATES ON DEPOSITS AND LOANS**

Percentages per annum to residents of Malta; weighted average rates as at end of period

	2018	2019	2020	2020		2021	
	Sep.	Sep.	Sep.	Dec.	Mar.	June	Sep.
<b>Total deposits<sup>(1)</sup></b>	<b>0.35</b>	<b>0.31</b>	<b>0.23</b>	<b>0.21</b>	<b>0.20</b>	<b>0.18</b>	<b>0.18</b>
<i>of which</i>							
<b>Overnight deposits</b>							
Households	0.06	0.05	0.02	0.02	0.02	0.02	0.02
NFCs	0.04	0.03	0.02	0.01	0.01	0.01	0.02
<b>Time deposits (less than 2 years)</b>							
Households	0.77	0.75	0.59	0.57	0.57	0.54	0.53
NFCs	0.74	0.73	0.68	0.58	0.62	0.53	0.48
<b>Time deposits (more than 2 years)</b>							
Households	2.20	1.98	1.89	1.87	1.80	1.79	1.77
NFCs	2.12	1.53	1.59	1.39	1.41	1.15	1.05
<b>Total loans<sup>(1)</sup></b>	<b>3.58</b>	<b>3.48</b>	<b>3.39</b>	<b>3.36</b>	<b>3.32</b>	<b>3.30</b>	<b>3.25</b>
<i>of which</i>							
Households and NPISH	3.41	3.32	3.25	3.21	3.15	3.12	3.05
NFCs	3.85	3.74	3.62	3.61	3.60	3.62	3.60
<b>Spread<sup>(2)</sup></b>	<b>3.23</b>	<b>3.17</b>	<b>3.16</b>	<b>3.15</b>	<b>3.12</b>	<b>3.12</b>	<b>3.07</b>
ECB MROs rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Source: Central Bank of Malta.

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

<sup>(2)</sup> Difference between composite lending rate and composite deposit rate.

<sup>4</sup> Basis points are rounded to the nearest whole number and hence may not exactly match the figures given in Table 6.3.

both households. The weighted average lending rate paid by NFCs declined marginally and 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 307 basis points, below the 316 basis points recorded 12 months earlier.

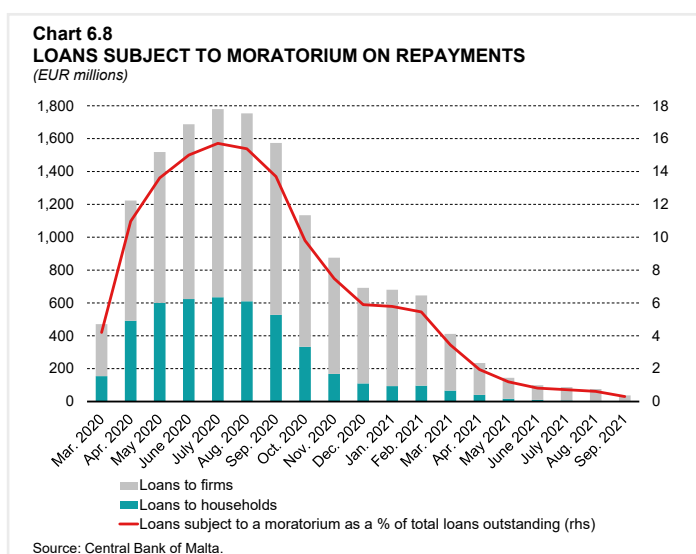
### Liquidity support measures related to COVID-19

In response to the COVID-19 pandemic and subsequent containment measures, in 2020 the Bank issued Directive No. 18 to regulate the temporary suspension of debt repayments on credit facilities advanced by credit institutions to borrowers.<sup>5</sup> A number of businesses and households that were faced with liquidity challenges applied with MFIs in Malta for a moratorium on loan repayments. The value of loans benefiting from such moratoria peaked in July 2020 and has since declined progressively (see Chart 6.8).<sup>6,7</sup>

By September 2021, loans subject to a moratorium reached very low levels, as the moratoria period is gradually expiring for many borrowers and economic activity continued to normalise in most sectors. As at end-September, there were 56 loans subject to a moratorium on loan repayments, with a value of €37.4 million. This is equivalent to 0.3% of total loans outstanding to Maltese residents. The number of loans that were subject to a moratorium on repayments was around a fourth of that in June when there were 207 loans benefitting from these moratoria, or 0.8% of total outstanding loans at the time.

The outstanding value of loans subject to a moratorium of Maltese households fell from €10.3 million as at end-June to €1.2 million at the end of September – equivalent to 3.2% of the total value of loans subject to a moratorium. Meanwhile, firms held €36.2 million in loans subject to a moratorium as at the end of September, thus accounting for most of outstanding loans still covered by moratoria.

Over a fourth of these loans were held by the accommodation



<sup>5</sup> 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.

<sup>6</sup> 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&itemid=30087&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.

<sup>7</sup> As at end-November 2021, there were 19 loans subject to a moratorium on repayments, amounting to €27.3 million, or 0.2% of total outstanding loans to Maltese residents.

and food services activities sector. However, the share of this sector's loans that was subject to a moratorium edged down to 1.8%, from 4.1% three months earlier. The real estate and construction sectors jointly held a similar amount, equivalent to 0.7% of their outstanding loans.

Meanwhile, the 'other category' sector – which includes loans subject to a moratorium in agriculture and fishing, education, health, financial and insurance activities among others – held €14.4 million in loans subject to a moratorium, or 0.7% 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.<sup>8</sup>

By end-September, 652 facilities were approved under the CGS, covering total sanctioned lending of €508.8 million, up from €451.5 million in June (see Table 6.4). 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, €414.5 million were disbursed by the end of September 2021. Hence, by then, 65.4% of the scheme's target size was sanctioned, while 53.3% 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-September, 173 facilities were approved for this sector with a total value of sanctioned loans of €99.6 million.<sup>9</sup> This was followed by accommodation and food services activities, with 157 facilities and a sanctioned amount of €123.1 million.

**Table 6.4**  
**MALTA DEVELOPMENT BANK COVID-19 GUARANTEE SCHEME – AS AT SEPTEMBER 2021**  
(number of facilities; EUR millions)

	As at June 2021		As at September 2021	
	Total number of facilities <sup>(1)</sup>	Sanctioned Amount <sup>(2)</sup>	Total number of facilities <sup>(1)</sup>	Sanctioned Amount <sup>(2)</sup>
Manufacturing	52	23.6	57	26.1
Construction	36	41.4	38	49.9
Wholesale and retail trade; repair of motor vehicles and motor cycles	165	95.2	173	99.6
Transportation and storage and information and communication	41	50.3	40	50.2
Accommodation and food service activities	142	107.4	157	123.1
Professional, scientific and technical activities	37	21.7	40	22.2
Administrative and support service activities	36	13.5	41	14.2
Real estate activities	17	6.4	19	7.4
Other <sup>(3)</sup>	80	92.1	87	116.1
<b>Total</b>	<b>606</b>	<b>451.5</b>	<b>652</b>	<b>508.8</b>

Source: Malta Development Bank.

<sup>(1)</sup> The number of facilities taken by various sectors.

<sup>(2)</sup> The total number of loans sanctioned under the scheme as at end month, in EUR millions.

<sup>(3)</sup> Includes loans to education, health and social work, financial and insurance activities, arts, entertainment and recreation, other services activities and extra-territorial bodies & organisations, and the electricity, gas & water supply sector.

<sup>8</sup> The MDB CGS was approved by the European Commission on 2 April 2020. For further details see [here](#).

<sup>9</sup> As at end-November 2021, 653 facilities were approved under the CGS, covering total sanctioned lending of €507.3 million.

The manufacturing sector also had a significant number of facilities approved, followed by the administrative and support service activities sector and the sectors comprising transport, storage and ICT, and the professional, scientific and technical activities.<sup>10</sup> The real estate sector had the least number of facilities approved under the scheme. The 'other' sector which includes loans to education, health, financial and insurance activities as well as arts, entertainment and recreation among others, had 87 approved facilities with a sanctioned amount of €116.1 million.

### *Bank Lending Survey (BLS) indicates broadly unchanged credit standards, terms and conditions*

In the BLS conducted in October 2021, respondent banks reported unchanged credit standards and terms and conditions for NFCs in Malta during the third quarter of 2021. All participating banks also expected credit standards on such loans to remain unchanged in the fourth quarter. As regards the demand for credit by NFCs, half of respondent banks considered demand not to have changed while the remaining half assessed demand to have increased somewhat. Looking ahead, the majority of banks expected demand to remain stable in the fourth quarter.

As regards credit standards on loans for house purchases, these too were assessed to have remained unchanged for the majority of surveyed banks while all banks reported unchanged terms and conditions. Looking forward to the fourth quarter of 2021, most banks expected credit standards to remain unchanged. Most of the banks reported no change in demand for house loans in the third quarter of 2021. While half of the respondent banks expected demand to remain stable, one bank foresaw some decline and the other bank expected demand to increase somewhat.

All participating banks reported unchanged credit standards and terms and conditions for consumer credit and other lending in the third quarter. Generally, no changes in credit standards were expected during the fourth quarter. Most of the participating banks reported unchanged demand for consumer credit. Demand was largely expected to remain unchanged also in the fourth quarter.

The October BLS posed ad hoc questions on changes in banks' access to wholesale and retail funding and on their risk transfer capability as a result of the prevailing situation in financial markets. In this regard, half of the banks reported some easing in market access to short-term retail deposits while the other half did not report an impact. Results were more mixed with regards to access to long-term retail funding. For the fourth quarter, half of the banks expected no changes in access to short-term retail deposits while the other banks gave mixed replies. In the case of access to long-term retail funding, half of the banks expected no change while the other half foresaw some easing.

Most of the surveyed banks reported no impact in terms of their ability to access the unsecured segment of the interbank money market or said that this market segment was not relevant for their business. No changes were anticipated in the quarter ahead.

Banks also 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 or not relevant. This also applies for the following quarter.

<sup>10</sup> The sector comprising transport and storage and information and communication registered a decline in the amounts sanctioned between June and September 2021. This may reflect the repayment of loans in between quarters, or the reduction of the facility value.

Banks were also asked to assess the impact of the ECB's APP on their financial situation, assets and lending behaviour. Most of the surveyed banks said that the APP had no impact on their assets in the preceding six months and that no changes were expected in the six months ahead. None of the participating banks reported that the APP affected their credit standards, lending volumes, and terms and conditions and no changes were expected in the six months ahead.

With regard to the impact of the ECB's negative deposit facility rate, all participating banks reported a fall in their overall profitability as a result of lower net interest income, which was expected to persist in the fourth quarter. All respondent banks reported no changes in their lending rates, loan margins, non-interest rate charges and lending and deposits volumes. Most banks also claimed that there were no changes to their deposit rates as a result of the deposit facility rate. In general, the majority of banks 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. Most of the 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 interest rates on loans and deposits and all banks foresaw no impact in the next six months.

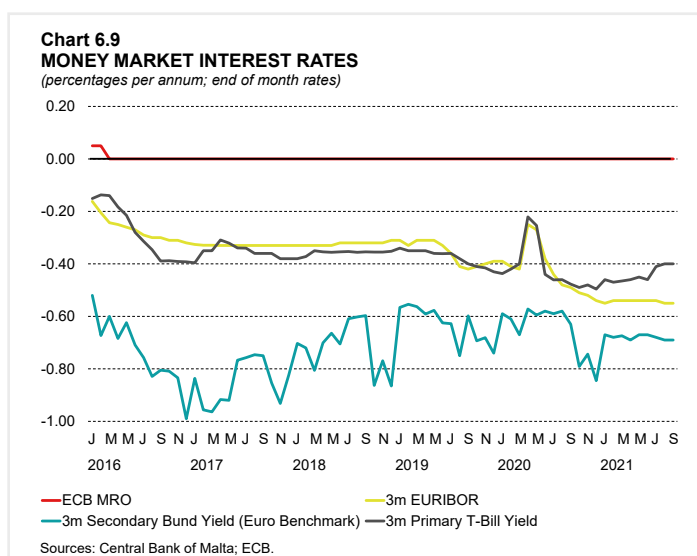
Finally, respondent banks were asked to gauge the impact of the Eurosystems's targeted longer-term refinancing operations (TLTRO) III. None of the respondents participated in the TLTRO III that took place in September 2021. Half of the respondent banks did not plan to participate in future TLTRO III operations while the other half were undecided.

## The money market

### Domestic money market interest rates fall

During the second 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 declined marginally to -0.55% in September, from -0.54% in June. Likewise, secondary market yields on 3-month German government securities, which act as a benchmark for euro area yields, fell to -0.69% from -0.67% previously (see Chart 6.9).

In the domestic primary market, the yield on 3-month Treasury bills increased to -0.40%, from -0.46% at end-June. On the other hand, the 3-month yield in the secondary market fell to -0.65% in September, from -0.48% three months earlier.



As the yield on the euro area benchmark fell less sharply, the spread between the yield on domestic 3-month Treasury bills and the former narrowed. It stood at 4 basis points at the end of September, down from 19 basis points three months earlier.

During the third quarter of 2021, the Government issued €541.0 million in Treasury bills, €28.5 million less than the amount issued during the second quarter of 2021.

### The capital market

During the third quarter of 2021, the Government issued 11 new MGS with a total value of €581.9 million. Two institutions launched new bond issues on the Malta Stock Exchange (MSE): Go plc issued €60.0 million in unsecured bonds and Browns Pharma Holdings issued €13.0 million in unsecured callable bonds.

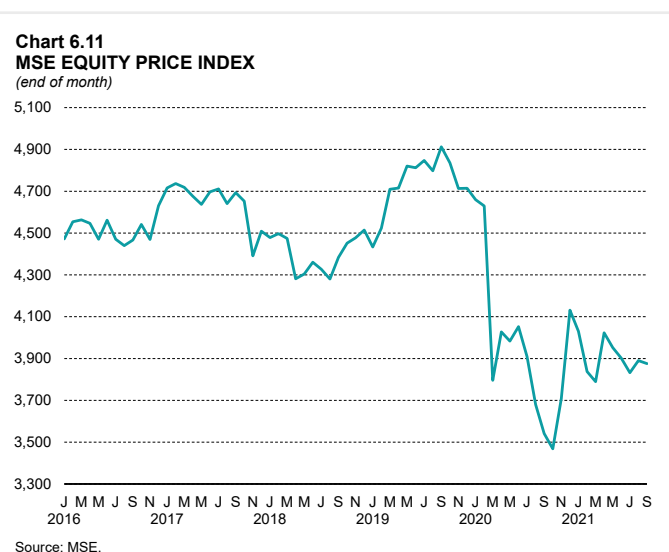
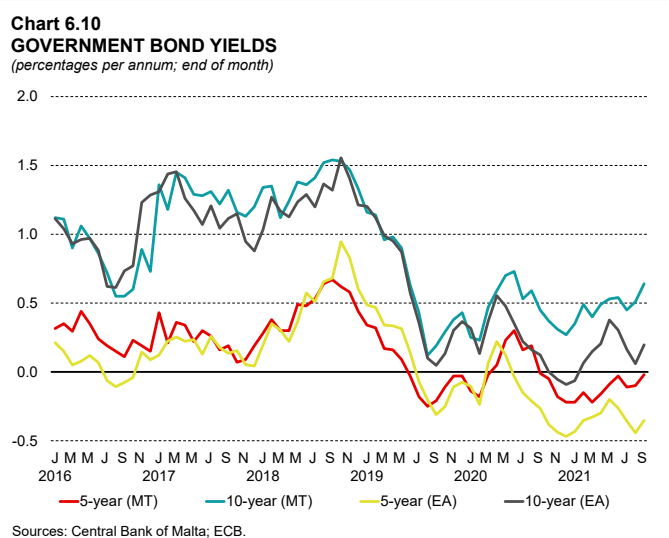
By the end of September, 21 firms had bonds that were listed on the MSE through Prospects, an unchanged number from that at the end of June.

In the secondary market, turnover in government bonds declined, falling to €21.4 million from €33.3 million in the second quarter of 2021, while turnover in corporate bonds increased to €24.4 million from €21.8 million previously.

The yield on 5-year bonds rose marginally to -0.02% at the end of September, from -0.03% three months earlier (see Chart 6.10). The yield on 10-year bonds increased to 0.64% from 0.54%. Meanwhile, the euro area benchmark yield on 5-year bonds fell to -0.35% from -0.26%, while the benchmark yield on 10-year bonds decreased to 0.20% from 0.30%. As the euro area benchmark yield declined and the domestic 10-year yield rose, the spread between them widened to 44 basis points, from 24 basis points in June.

### MSE Share Index declines

During the third quarter of 2021, share prices in Malta fell. At end-September, the MSE



Equity Price Index stood 0.7% below its level at end-June but was 9.5% above the reading a year earlier (see Chart 6.11). The MSE Equity Total Return Index, which accounts for changes in equity prices and dividends, declined by 0.3% between end-June and end-September.

Equity turnover increased to €7.7 million during the third quarter of 2021, from €7.3 million in the second.