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The cut-off date for statistical information published in the Economic Survey of this Review is 20 June 2022. However, the cut-off date for monetary and government finance statistics as well as balance of payments data is extended to 21 July 2022. Figures in tables may not add up due to rounding.

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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
ESA	European System of Accounts
ESI	economic sentiment indicator
EU	European Union
EUI	Economic Uncertainty Indicator
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
GHG	greenhouse gas
GVA	gross value added
HCI	harmonised competitiveness indicator
HICP	Harmonised Index of Consumer Prices
LFS	Labour Force Survey
MDB	Malta Development Bank
MENA	Middle East and North Africa
MFI	monetary financial institution
MGS	Malta Government Stocks
MIA	Malta International Airport
MP	maintenance period
MPC	monetary policy committee
MRO	main refinancing operation
MSE	Malta Stock Exchange
NEIG	non-energy industrial goods
NFC	non-financial corporation
NPISH	non-profit institutions serving households
NSO	National Statistics Office
PELTRO	pandemic emergency longer-term refinancing operation
PEPP	pandemic emergency purchase programme
PPI	Property Price Index
PSPP	public sector purchase programme
RPI	Retail Price Index
RRF	Recovery and Resilience Facility
RRP	Recovery and Resilience Plan
SMP	Securities Markets Programme
SURE	Support to mitigate Unemployment Risks in an Emergency
TLTRO	targeted longer-term refinancing operation
TSA	tourism satellite accounts
UCA	Urban Conservation Areas
ULC	unit labour cost
UK	United Kingdom
US	United States
VAT	value added tax

FOREWORD

During the first quarter of 2022, real gross domestic product (GDP) continued to grow at a steady pace, although the annual rate of change moderated to 7.6% from 11.8% in the previous quarter. This reflected a normalisation of growth rates, following the sharp decline and subsequent recovery in GDP growth between 2020 and 2021, due to COVID-19. While domestic demand remained the largest contributor to growth, its contribution more than halved when compared with the last quarter of 2021. Meanwhile, the contribution of net exports doubled, as exports grew at a faster pace than imports. However, when data are adjusted for the import content of the various GDP components, the largest contributor to growth in real GDP was exports rather than domestic demand components.

Potential output growth is estimated to have stood at 4.5% in the first quarter of 2022, up from 4.3% in the previous quarter. The output gap is estimated to be positive, and to have widened to 1.3% when measured as a 4-quarter moving average, from the 0.6% estimated by the Bank for the fourth quarter of 2021. This indicates that the degree of over-utilisation of the economy's productive capacity has increased. This may reflect a strong recovery in demand within sectors that were previously subject to pandemic-related restrictions in the context of persistent supply bottlenecks.

Meanwhile, the Bank's Business Conditions Index (BCI) stood above its average historical level in the first quarter of 2022, but continued to recede from the high level estimated in the first half of 2021. It was affected by strong annual increases in several sub-components, particularly the strong growth in tourist arrivals. Growth in the number of permits issued, economic sentiment and GDP as well as significant falls in unemployment also contributed to the above average BCI level.

Developments in the labour market remained positive with rising employment rates and employment levels in annual terms. At the same time, activity rates rose further in the first quarter. The unemployment rate remained low from a historical perspective and stood well below that in the euro area.

Price pressures continued to build during the first quarter. Annual inflation as measured by the Harmonised Index of Consumer Prices (HICP) stood at 4.5% in March, above that of 2.6% recorded in December. All components except energy prices registered faster growth, although services inflation was the main driver behind the increase in inflation. Annual inflation based on the Retail Price Index (RPI), which only takes into account expenditure by Maltese households, rose to 4.4% in March from 2.6% in December. Meanwhile, annual inflation based on the industrial producer price index remained high although it edged down to 7.1% in March from 7.5% three months earlier. Malta's unit labour cost (ULC) index, measured on a 4-quarter moving average basis, declined by 4.0% in the first quarter as productivity rebounded more strongly than average compensation. However, the index still stood above its pre-pandemic level, both in headcount and hourly terms. Malta's harmonised competitiveness indicators (HCIs) improved further between December 2021 and March 2022.

In the first quarter of 2022, the current account turned into a deficit from a surplus a year earlier. This was mainly due to an increase in the merchandise trade deficit. An increase in net outflows on the secondary income account also contributed but to a much lesser extent. By contrast

net services receipts increased and net outflows on the secondary income account decreased. When measured over four quarters, the current account balance showed a deficit equivalent to 4.9% of GDP.

During the quarter under review, the general government deficit widened when compared to that recorded in the corresponding period of 2021. On a 4-quarter moving sum basis, the general government balance registered a deficit of 8.0% of GDP in the first quarter of 2022, broadly unchanged from the 7.9% registered in the preceding quarter. The general government debt-to-GDP ratio, increased to 57.6% from 56.4% at the end of 2021.

In March, Maltese residents' deposits with monetary financial institutions (MFIs) in Malta continued to expand at a strong pace, broadly comparable with that recorded in December 2021. The shift to overnight deposits persisted in an environment of low interest rates and a continued preference for liquidity. Growth in credit to Maltese residents decelerated, reflecting slower increases in both credit to general government and credit to other residents. According to the Bank's Financial Conditions Index (FCI), in the first quarter of 2022, financial conditions were tight from a historical perspective, although still more favourable than those prevailing during the pandemic.

In March, the weighted average deposit rate offered to households and non-financial corporations (NFCs) in Malta was down by four basis points on a year earlier, standing at 0.16%. The weighted average lending rate paid by households and NFCs to resident MFIs fell by 13 basis points, to 3.19% over the same period. Thus, the spread between the two narrowed.

Meanwhile, the primary market yield on Treasury bills rose from that prevailing at the end of December 2021. The secondary market yields on 5-year and 10-year Malta Government Stocks (MGS) increased between December 2021 and March 2022 while domestic share prices fell over this period.

By end-March 2022, 640 facilities were approved and still outstanding under the Malta Development Bank COVID-19 Guarantee Scheme (CGS), covering total sanctioned lending of €489.3 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, €465.5 million were disbursed by end-March. Hence, by then, 62.9% of the scheme's target size was sanctioned while 59.8% was disbursed.

The Governing Council of the European Central Bank (ECB) maintained its key interest rates constant during the first quarter of 2022, adding that any adjustments would take place some time after the end of the net purchases under the APP and would be gradual. The Governing Council reiterated that it expected the key ECB interest rates to remain at their present levels until it saw inflation reaching 2% well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and when it judged that realised progress in underlying inflation was sufficiently advanced to be consistent with inflation stabilising at 2% over the medium term.

In March, the Governing Council revised the purchase schedule for its asset purchase programme (APP) for the coming months, reducing the amounts to be purchased and bringing forward the expected end date of the net purchase phase. At the same time, reinvestments of maturing securities purchased under the programme will continue for an extended period of time past the first rate hike.

As had been previously communicated, the pandemic emergency purchase programme (PEPP) ended in March. However, the Council said that the reinvestments of principal payments from maturing securities purchased under this programme would continue until at least the end of 2024, and in any case, the future roll-off of the PEPP portfolio would be managed to avoid interference with the appropriate monetary policy stance. Finally, net purchases under the PEPP could also be resumed, if necessary, to counter negative shocks related to the pandemic.

On the third series of targeted longer-term refinancing operations (TLTRO III), the Governing Council stated that it will continue to monitor bank funding conditions and ensure that maturing TLTRO III operations do not hamper the smooth transmission of monetary policy. As announced earlier, the special conditions applicable under TLTRO III ended in June 2022.

In June 2022, the Governing Council decided to take further steps in normalising its monetary policy amid high inflation rates, namely, to end net asset purchases under the APP as of 1 July 2022. It also said that it intended to raise key ECB interest rates by 25 basis points in July and expected to raise rates again in September, with the calibration of the latter increase depending on the updated medium-term inflation outlook.

Subsequently within the same month, the Council decided that it will apply flexibility in reinvesting redemptions coming due in the PEPP portfolio, with a view to preserving the functioning of the monetary policy transmission mechanism. In addition, it agreed to accelerate the completion of the design of a new anti-fragmentation instrument.

ECONOMIC SURVEY

1. THE EXTERNAL ENVIRONMENT AND THE EURO AREA

In the first quarter of 2022, real GDP contracted in the United States while growth slowed down in the United Kingdom. On the other hand, the euro area economy grew at a faster pace. During the quarter, unemployment fell in all three economies, but remained marginally above pre-pandemic levels in the United States.

Inflationary pressures rose sharply in all the three economies. Annual consumer price inflation in the United States reached 8.5% in March, up from 7.0% in December. Meanwhile, in the United Kingdom inflation stood at 7.0%, up from 5.4% in December. In the euro area, inflation rose to 7.4% from 5.0% in December. During the quarter under review, the ECB kept its key interest rates unchanged. The Federal Reserve raised its federal funds rate in March, while the Bank of England raised its Bank Rate on two occasions, in February and March. All three central banks announced reductions in the pace of net asset purchases. The Federal Reserve and the Bank of England also announced plans to unwind the stock of assets held on their balance sheet.

Brent oil prices rose markedly throughout the first quarter amid market optimism that the impact of the Omicron variant on global oil demand would be more limited than previously thought. In addition, oil supply continued to fall short of the planned production targets. Moreover, the Russian invasion of Ukraine raised fears about oil supplies pushing up oil prices further upwards in the second half of the quarter. Supply disruptions related to the war also contributed to a sharp increase in non-energy commodity prices during the quarter under review.

Key advanced economies

US economy contracts

In the first quarter of 2022, economic activity in the United States contracted, amid rising COVID-19 cases and a surge in inflation. In quarter-on-quarter terms, GDP decreased by 0.4% after having increased by 1.7% in the preceding quarter (see Table 1.1).

Government expenditure fell further while gross private domestic investment grew only marginally after having increased significantly in the preceding quarter. On the other hand, personal consumption increased at a marginally faster pace. The trade deficit widened further as imports rose while exports decreased. Even though in the first quarter of 2022 GDP contracted, it still stood nearly 3.0% above its level in the last quarter of 2019, just before the start of the pandemic.

Table 1.1
REAL GDP GROWTH IN SELECTED ADVANCED ECONOMIES

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

	2020				2021				2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
United States	-1.3	-8.9	7.5	1.1	1.5	1.6	0.6	1.7	-0.4
Euro area	-3.5	-11.7	12.8	-0.4	-0.1	2.2	2.3	0.2	0.6
United Kingdom	-2.5	-19.4	17.6	1.5	-1.2	5.6	0.9	1.3	0.8

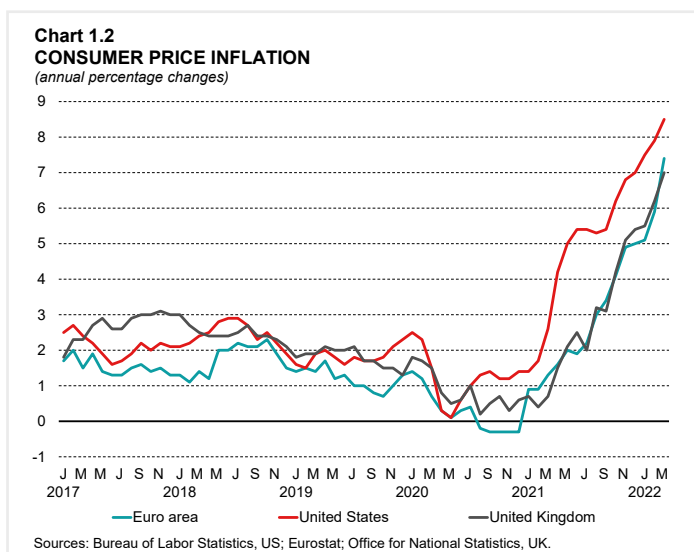
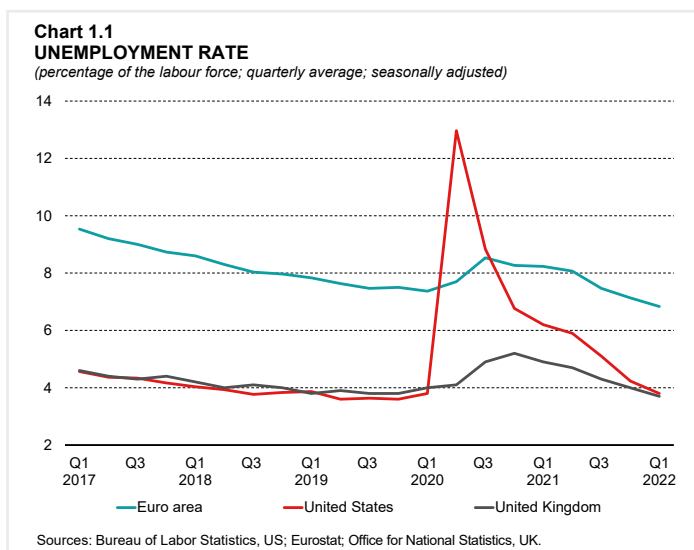
Sources: Bureau of Economic Analysis, US; Eurostat; Office for National Statistics, UK.

In the labour market, the participation rate averaged 62.3% in the first quarter, above the rate of 61.8% registered in the previous quarter. Meanwhile, employment increased by 1.7% in quarter-on-quarter terms, following a 1.3% rise during the fourth quarter of 2021. Notwithstanding recent favourable developments, both the number of persons in employment and the participation rate remained below those prevailing in the last quarter of 2019.

Non-farm payroll data suggest that compared with the preceding quarter, the rate of job creation increased most in the mining and logging sector and in the trade and transportation sector. Slower growth in employment was however recorded in a number of sectors, including the professional and business services sector, the leisure and hospitality sector and the information sector. The average unemployment rate declined further to 3.8%, from 4.2% in the preceding quarter, standing only marginally above pre-pandemic rates (see Chart 1.1).

Inflationary pressures continued to increase, with the annual rate of inflation based on the consumer price index (CPI) reaching 8.5% in March, up from 7.0% in December (see Chart 1.2). This was the highest rate in over 40 years. The increase in inflation was broad-based across categories. In particular, energy inflation increased to 32.0% in March from 29.3% in December. Food price inflation also increased – from 6.0% to 8.5%. Prices of commodities excluding food and energy as well as those of services also increased at a faster rate. As a result, inflation excluding food and energy reached 6.5% in March, from 5.5% three months earlier.

In January, the Federal Open Market Committee (FOMC) decided to keep the target range for the federal funds rate at 0.00% to 0.25%. However, it acknowledged that with inflation well above 2.00% and a strong labour market, an increase would soon be appropriate. The Committee also decided to continue to reduce the monthly pace of its net asset purchases, bringing them to an end in early March, and issued a set of principles regarding its planned



approach for significantly reducing the size of the Federal Reserve's balance sheet. According to these principles, the federal funds rate remains the primary means of adjusting the stance of monetary policy and the process of balance sheet reduction will start after the first policy rate hike.

In March, in response to persistent inflationary pressures and a tight labour market, the FOMC continued to make further adjustments to its policies. After holding the federal funds

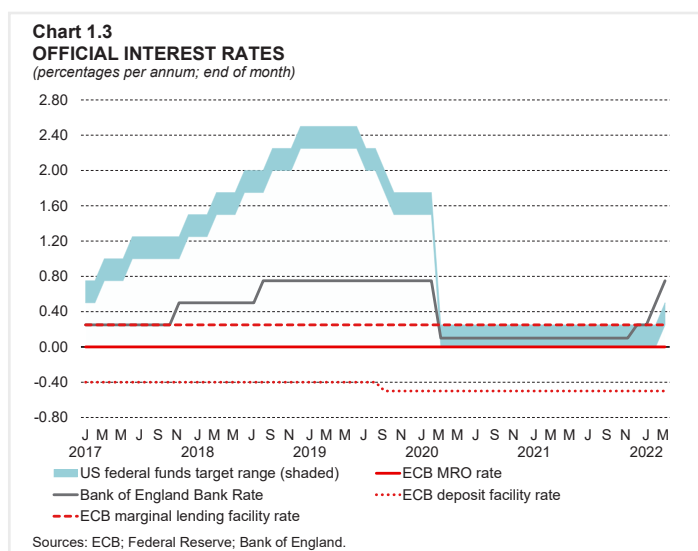
rate near zero since the onset of the pandemic, the FOMC raised the target range for that rate to between 0.25% and 0.50% (see Chart 1.3). The Committee noted that while the implications for the US economy of Russia's invasion of Ukraine were highly uncertain, in the near term the invasion and related events would likely create additional upward pressure on inflation and weigh on economic activity. The Committee anticipated that ongoing increases in the target range would be appropriate. In addition, it expected to begin reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities at a coming meeting.

The Committee reiterated that in assessing the appropriate stance of monetary policy, it will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals.¹

UK economy grows at a slower pace

Real GDP in the United Kingdom grew at a slower pace in the first quarter of 2022, rising at a quarterly rate of 0.8% after rising by 1.3% in the previous quarter (see Table 1.1). Growth in government consumption turned negative. On the other hand, gross fixed capital formation (GFCF) rose at a faster pace while household consumption growth decreased marginally. Meanwhile, the contribution of net exports turned again negative. The GDP level stood slightly above its level at the end of 2019.

After having fallen in the preceding quarter, in the first quarter of 2022 employment rose by 0.2% on a quarterly basis. The annual rate of change increased to 1.5% from 1.3% in the fourth quarter. The employment level was still around 0.9% below its pre-pandemic level. Meanwhile, the unemployment rate stood at 3.7% in the quarter under review, down from 4.0% in the previous quarter. The unemployment rate was 0.1 percentage point below that prevailing in the last quarter of 2019 (see Chart 1.1).



¹ The Committee raised the target range for the federal funds rate again in May and June, bringing it to between 1.50% to 1.75%, and signalled that further increases will be appropriate. In May, it released further details concerning plans for significantly reducing its securities holdings, noting that these reductions would begin on 1 June 2022.

Consumer price inflation in the United Kingdom reached the highest level ever recorded, rising to 7.0% in March from 5.4% in December (see Chart 1.2). Energy price inflation rose to 27.6% in March from 24.5% in December and thus continued to be the main contributor behind the CPI inflation. Meanwhile, food prices, prices of non-energy industrial goods (NEIG) and those of services all grew at a faster pace compared to December. The annual rate of inflation based on the CPI excluding energy, food, alcohol and tobacco increased to 5.7% in March, from 4.2% in December.

In its meeting held in February, the Bank of England increased the Bank Rate by 0.25 percentage point to 0.50%. The Monetary Policy Committee (MPC) also decided to begin reducing the stock of UK government bond purchases and the stock of sterling non-financial investment-grade corporate bond purchases financed by the issuance of central bank reserves, by stopping reinvestments. Furthermore, in the case of corporate bonds, a sales programme is expected to be completed no earlier than towards the end of 2023, with a view to fully unwind the stock of these purchases. In March, the Bank Rate was increased by an additional 0.25 percentage point to 0.75% amid continuing signs of rising domestic cost and price pressures.²

The euro area

GDP growth in the euro area slightly recuperates

After having slowed down sharply during the final quarter of 2021, GDP in the euro area recuperated slightly in the first quarter of 2022. In real terms, GDP grew by 0.6% on a quarter-on-quarter basis, up from 0.2% in the fourth quarter (see Table 1.2). Economic growth during the first quarter of 2022 was hindered by the Omicron variant of COVID-19, further increases in energy costs and, towards the end of the period, by the impact of Russia's invasion of Ukraine.

The expansion in economic activity during the quarter under review was mainly driven by net exports, although domestic demand also contributed. As for domestic demand, it contributed 0.2 percentage point to GDP growth. This was entirely driven by changes in inventories, which

Table 1.2
CONTRIBUTIONS TO QUARTERLY REAL GDP GROWTH IN THE EURO AREA⁽¹⁾
Percentage points; quarter-on-quarter percentage change

	2020				2021				2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Private consumption	-2.3	-6.7	7.4	-1.6	-1.1	1.9	2.3	-0.1	-0.3
Government consumption	0.0	-0.6	1.3	0.1	0.0	0.4	0.1	0.1	-0.1
GFCF	-1.0	-4.5	2.9	0.5	0.0	0.3	-0.2	0.7	0.0
Changes in inventories ⁽²⁾	0.4	-0.2	-1.3	0.5	1.1	-0.6	-0.2	0.4	0.6
Exports	-1.9	-9.0	7.5	2.0	0.4	1.5	0.9	1.3	0.2
Imports	1.3	9.4	-5.0	-1.9	-0.4	-1.4	-0.6	-2.0	0.2
GDP	-3.5	-11.7	12.8	-0.4	-0.1	2.2	2.3	0.2	0.6

Source: Eurostat.

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

⁽²⁾ Including acquisitions less disposals of valuables.

² In its meeting held in May, the MPC increased the Bank Rate by 0.25 percentage point to 1.00% amid tightness in the labour market, continuing signs of robust domestic cost and price pressures, and the risk that these pressures will persist. The Bank Rate was raised by an additional 0.25 percentage point to 1.25% in June.

contributed 0.6 percentage point to GDP growth. On the other hand, private consumption and government consumption pushed GDP down by 0.3 and 0.1 percentage point, respectively. Private consumption was heavily affected by high inflation, which reduced households' purchasing power, as well as by restrictions imposed to counter the pandemic. At the same time, GFCF had a negligible effect on GDP growth, with capital spending being affected by the increased uncertainty following Russia's invasion of Ukraine. While supply chain disruptions caused by the pandemic seemed to start easing before Russia's invasion of Ukraine, there have been signs that they increased again since then and were amplified by a new set of pandemic-related lockdown measures in Asia. Meanwhile, net exports pushed GDP up by 0.4 percentage point, as exports rose, and imports fell.

Labour market conditions continue to improve

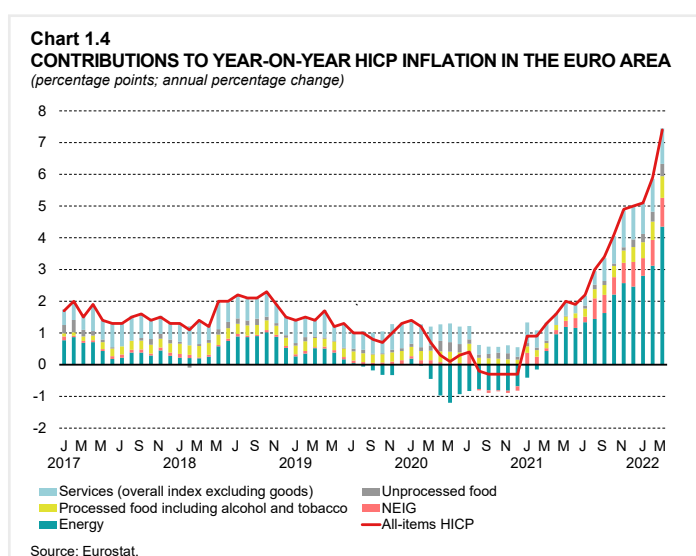
Labour market conditions in the euro area improved further during the quarter under review. The seasonally adjusted unemployment rate fell by 0.2 percentage point between December 2021 and March 2022, to 6.8%. Similarly, the 3-month average rate declined by 0.3 percentage point to 6.8% (see Chart 1.1).

Employment expanded further. As a result, the annual growth rate rose to 2.9% during the first quarter of 2022, from 2.1% in the previous quarter.³ Though to a lesser extent than before, employment was still supported by job retention schemes aimed at preventing redundancies in response to the outbreak of the pandemic.

Inflation surges

The significant increases in inflation in the euro area that had started in the third quarter of 2021 intensified in the first quarter of 2022. Inflation reached levels that had not been seen since June 1984. The annual rate of inflation based on the HICP stood at 7.4% in March 2022, compared to 5.0% in December 2021 and 3.4% in September (see Chart 1.4). This high inflation primarily resulted from higher energy costs, reflecting the impact of the war in Ukraine. Other factors driving up prices in the euro area include higher global commodity prices, supply disruptions and the strong rebound in demand for certain services that re-opened as the pandemic situation in the euro area improved.

All major HICP components pushed the annual inflation rate up during the first quarter. However, more than three-fourths of the increase in inflation stemmed from energy inflation, which rose from 25.9% in December to 44.3% in March. This reflected a sharp increase in prices of fuels, gas and electricity. Similarly, the contribution of NEIG prices also increased, with the annual rate of change rising from 2.9% in December to 3.4% in March. Food prices



³ 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 4.1% in March, while that of unprocessed food increased to 7.8%. Lastly, the annual rate of change of services prices rose from 2.4% to 2.7% over the same period, contributing marginally to the increase in inflation.

Consequently, the annual rate of HICP inflation excluding energy and food rose to 3.0% in March 2022 compared with 2.6% three months earlier.

ECB lowers outlook for economic activity and raises projections for inflation

According to the Eurosystem staff macroeconomic projections published in June 2022, real GDP in the euro area is expected to expand by 2.8% in 2022, with growth then moderating to 2.1% in both 2023 and 2024 (see Table 1.3). Russia's war against Ukraine has had a severe adverse impact on confidence, caused energy and food prices to soar and, together with disruptions in China related to the pandemic, has made existing supply chain pressures worse. These factors are expected to act as a drag on the economic recovery in the euro area. At the same time, however, the relaxation of pandemic-related restrictions is providing a strong boost to the services sector. The baseline projections are built on the assumptions that the current sanctions against Russia will remain in place over the full projection horizon; the intense phase of the war will continue until the end of this year without a further escalation; disruptions to energy supplies will not lead to rationing in euro area countries; and supply bottlenecks will unwind by the end of 2023. In the near term, euro area growth is expected to weaken considerably, while remaining positive. Over the medium term, the economy is expected to gradually recover from the effects of the pandemic, while the negative impacts of the war are set to fade away.

Compared with the March 2022 projections, real GDP growth has been revised downwards by 0.9 percentage point for 2022 and by 0.7 percentage point for 2023. These revisions are mainly due to the economic impacts of the war in Ukraine. On the other hand, real GDP growth has been revised up by 0.5 percentage point for 2024, reflecting a rebound in activity as the adverse effects of the war and the pandemic fade.

Turning to the outlook for prices, according to the June 2022 projections, HICP inflation is envisaged to rise significantly to average 6.8% in 2022, before easing to 3.5% in 2023, and moderating further to 2.1% in 2024. The ECB foresees very high price pressures in the near term owing to

Table 1.3
MACROECONOMIC PROJECTIONS FOR THE EURO AREA⁽¹⁾
Annual percentage changes

	2021	2022	2023	2024
GDP	5.4	2.8	2.1	2.1
Private consumption	3.5	3.1	2.0	1.5
Government consumption	3.9	0.6	-0.5	1.1
GFCF	4.1	2.8	3.1	3.4
Exports	11.3	3.9	4.2	3.7
Imports	8.8	4.1	3.5	3.4
HICP	2.6	6.8	3.5	2.1

⁽¹⁾ Eurosystem staff macroeconomic projections (June 2022).

Source: ECB.

elevated oil and gas prices and increases in food commodity prices. The lower inflation in 2024 mainly reflects an assumed moderation in energy and food commodity prices, as shown in futures markets, in the absence of additional shocks. Furthermore, as the monetary policy tightens and to the extent that it is reflected in higher interest rate assumptions, this will contribute to the moderation in inflation.

Compared with the March 2022 projections, HICP inflation has been revised significantly upwards by 1.7 percentage points for 2022, by 1.4 percentage points for 2023 and by 0.2 percentage point for 2024. These upward revisions reflect recent outcomes, which have been higher than previously foreseen. They also take into account higher energy and food commodity prices, more persistent supply disruptions; stronger wage growth and the weakening of the euro in foreign exchange markets. These factors outweigh the downward impact on inflation of the increase in the interest rate assumptions and the weaker growth outlook.

High uncertainty surrounds this economic outlook. To cater for this, the projections are complemented by a downside scenario that incorporates a severe disruption to European energy supplies and less favourable external and financial conditions than assumed in the baseline. In this scenario, energy prices rise further, and production cuts occur. As a result, real GDP grows by only 1.3% in 2022, contracts by 1.7% in 2023 and recovers in 2024 when it grows by 3%. At the same time, higher commodity prices push up inflation, which averages 8.0% in 2022 and 6.4% in 2023, before dropping below the baseline projection to 1.9% in 2024.

ECB announces changes to its monetary policy stance

The ECB's Governing Council maintained the key ECB interest rates constant during the first quarter of 2022. The interest rates on the main refinancing operations (MROs), on the marginal lending facility and on the deposit facility were held unchanged at 0.00%, 0.25%, and -0.50% respectively during the period under review (see Chart 1.3).

However, during its March meeting, the Governing Council revised the purchase schedule for its APP for the coming months, reducing the amounts to be purchased and bringing forward the expected end date of the net purchase phase. It announced that monthly net purchases under the APP will amount to €40 billion in April, €30 billion in May and €20 billion in June. The Council also stated that if incoming data supported the expectation that the medium-term inflation outlook would not weaken even after the end of its net asset purchases, the Governing Council would conclude net purchases under the APP in the third quarter of 2022. The Governing Council restated its intention 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 started raising the key ECB interest rates and, in any case, for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

As for the key ECB interest rates, the Governing Council said that any adjustments would take place some time after the end of the net purchases under the APP and would be gradual. The Governing Council reiterated that it expected the key ECB interest rates to remain at their present levels until it saw inflation reaching 2% well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and it judged that realised progress in underlying inflation was sufficiently advanced to be consistent with inflation stabilising at 2% over the medium term.

On the PEPP, the Governing Council confirmed that net purchases would cease at the end of March 2022. It said that the reinvestment period for the principal payments from maturing securities purchased under the PEPP would be until at least the end of 2024, and in any case, the future roll-off of the PEPP portfolio would be managed to avoid interference with the appropriate monetary policy stance. Finally, net purchases under the PEPP could also be resumed, if necessary, to counter negative shocks related to the pandemic.

On the third series of TLTRO III, the Governing Council stated that it will continue to monitor bank funding conditions and ensure that the maturing of operations under the TLTRO III does not hamper the smooth transmission of its monetary policy. As announced earlier, it expected the special conditions applicable under TLTRO III to end in June 2022.⁴

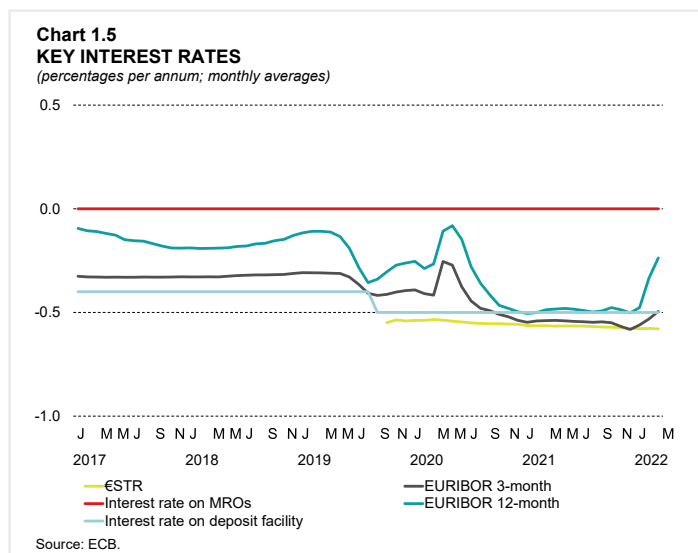
Money market rates increase

Money market interest rates in the euro area increased during the quarter under review, as market participants adjusted upwards their expectations of future interest rate changes. The euro short-term rate (€STR) rate remained unchanged at -0.58% during the first quarter, remaining slightly below the interest rate on the ECB's deposit facility (see Chart 1.5).⁵ On the other hand, the 3-month euro interbank offered rate (EURIBOR) rose to -0.50% from -0.58%, while the 12-month EURIBOR rate increased significantly from -0.50% in December to -0.24% in March.⁶

Euro area bond yields rise significantly

Ten-year benchmark government bond yields in the euro area increased significantly during the first quarter of 2022, rising from 0.28% in December to 1.05% three months later. This was in line with higher inflation compensation and increasing expectations in respect of monetary policy normalisation in the euro area and in other major economies. Uncertainty created by Russia's invasion of Ukraine and the Omicron variant of COVID-19 dampened upward pressure on yields.

Individual sovereign bond yields rose in almost all euro area countries. Most notably, Greek 10-year bond yields gained 132 basis points and more than doubled to 2.61%. Similarly, Cypriot bond yields went up by 128 basis points to 1.92% while Slovak bond



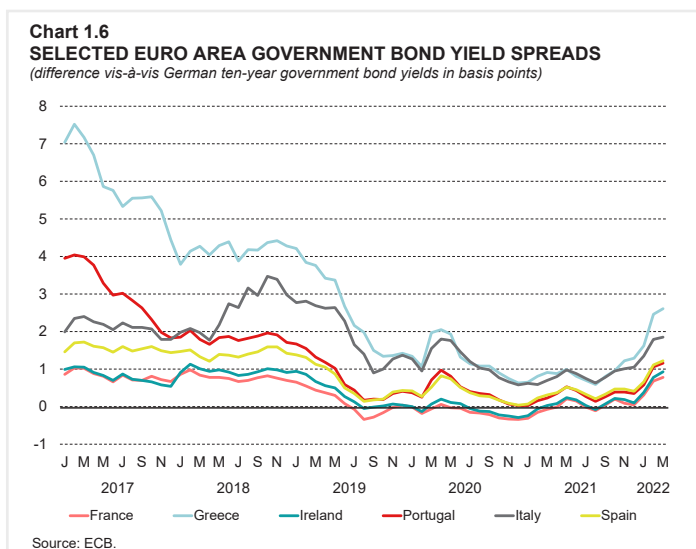
⁴ In June 2022, the Governing Council decided to take further steps in normalising its monetary policy amid high inflation rates, namely, to end net asset purchases under the APP as of 1 July 2022 and to raise key ECB interest rates by 25 basis points in July and to raise rates again in September. The calibration of the latter rate increase would depend on the updated medium-term inflation outlook. If the medium-term inflation outlook were to persist or to deteriorate, a larger increment would be appropriate in September.

⁵ The €STR reflects the wholesale euro unsecured overnight borrowing costs of banks located in the euro area. The €STR is published on each TARGET2 business day based on transactions conducted and settled on the previous TARGET2 business day. The ECB first published €STR on 2 October 2019. The publication of Euro OverNight Index Average was discontinued as of 3 January 2022.

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

yields gained 101 basis points going from negative territory to 0.99%. German bond yields increased by 66 basis points from December to March, going to 0.28% and ending a period of almost three years where yields were negative.

Consequently, almost all spreads between yields on 10-year German bonds and those on bonds issued by other euro area governments widened during the review period (see Chart 1.6). In particular, the spreads on Greek bonds widened by 66 basis points, followed by those on Cypriot and Slovak bonds, which increased by 62 basis points and 35 basis points, respectively.

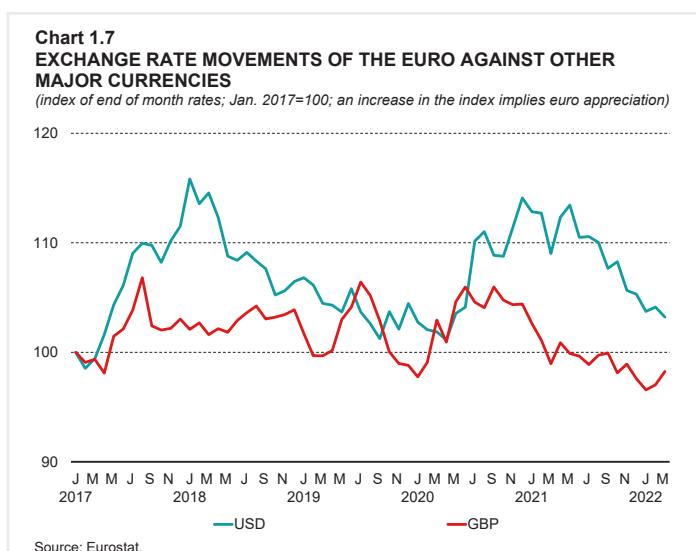


Euro exchange rate depreciates in effective terms

By the end of March, the nominal effective exchange rate (EER) of the euro against the EER-19 group of countries depreciated by 0.7% compared with the end of December.⁷

Over this period, the euro lost ground by 2.0% against the US dollar, continuing its recent downward trend (see Chart 1.7). This resulted from the further widening of the short-term interest rate differential between the euro area and the United States. The latter was driven by expectations of a stronger tightening of US monetary policy. Indeed, in March, the Federal Reserve increased its target range for the federal funds rate for the first time in more than three years. In contrast, the euro gained 0.7% against the British pound.

During the review period, the euro also lost significant ground against currencies of commodity exporting countries, including the Australian dollar, Norwegian krone, and Canadian



⁷ The EER-19 is based on the weighted averages of the euro exchange rate against the currencies of Australia, Bulgaria, Canada, China, Croatia, Czech Republic, Denmark, Hong Kong, Hungary, Japan, Norway, Poland, Romania, Singapore, South Korea, Sweden, Switzerland, the United Kingdom and the United States.

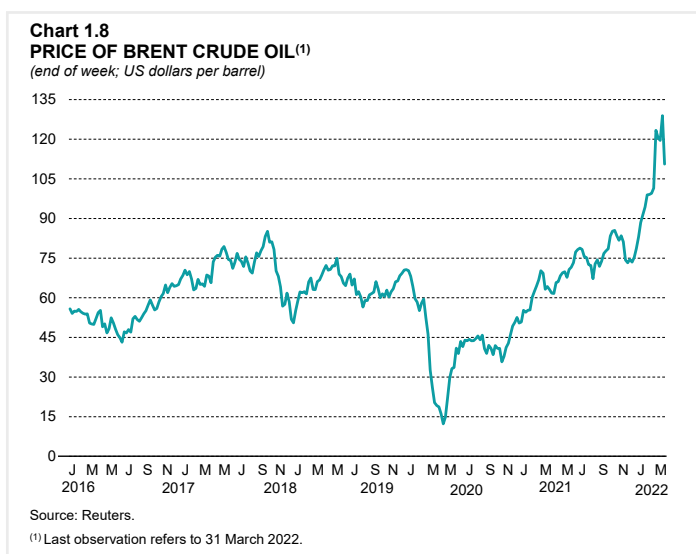
dollar. In contrast, the euro appreciated against some currencies of non-euro area EU member states, particularly the Polish zloty, the Swedish krona, and the Hungarian forint.

Commodities

Commodity prices increase sharply

Oil prices started 2022 on a high note and continued to increase during the quarter under review. By early February, it crossed the threshold of USD 100 per barrel, as markets were optimistic that the Omicron variant would not have a negative impact on global oil demand to the extent previously feared. At the same time, supply from Organization of the Petroleum Exporting Countries continued to fall short of the planned oil production targets. Later in February, oil prices rose further as the Russian invasion of Ukraine raised fears about oil supplies. During March, the price of oil remained elevated and nearly reached USD 140 per barrel, before retreating to USD 110.6 per barrel by the end of the month. It thus closed the quarter 40.7% above the level prevailing at the end of 2021 (see Chart 1.8).

World Bank data show that non-energy commodity prices also rose markedly during the first quarter of 2022, gaining 17.7%. The increase was broad-based across all main components of the index.



2. OUTPUT AND EMPLOYMENT

Annual real GDP growth moderated to 7.6% in the first quarter of 2022, following an 11.8% increase in the previous quarter. Slower growth was underpinned by weaker growth in domestic demand. Meanwhile, the contribution of net exports doubled in the quarter under review as exports outpaced imports.

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. The contribution of the manufacturing sector stood slightly negative in the quarter under review while the combined contribution of the quarrying and construction sectors was broadly neutral.

During the first quarter of 2022, the developments in the labour market remained positive with rising employment rates and employment levels in annual terms. The unemployment rate remained low from a historical perspective and also stood well below that in the euro area.

Potential output and Business Conditions Index

Potential output grows at a slightly faster pace

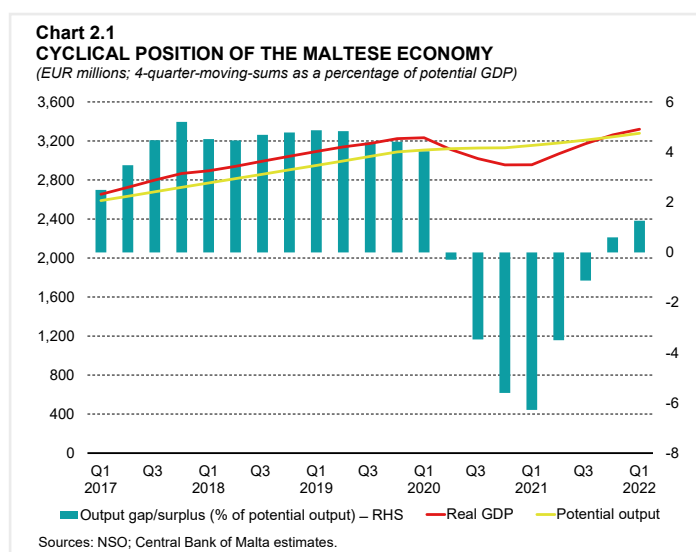
The Bank estimates that potential output growth stood at 4.5% in the first quarter of 2022, up from 4.3% in the previous quarter.

On a 4-quarter moving average basis, both GDP and potential output growth stood higher compared with the fourth quarter of 2021, with a stronger acceleration in the former. As a result, the output gap widened to 1.3% when measured as a 4-quarter moving average, up from 0.6% estimated for the previous quarter (see Chart 2.1).

This implies that the degree of over-utilisation of the economy's productive capacity has increased, reflecting a strong recovery in activity within sectors that were previously subject to pandemic-related restrictions.

BCI signals normalisation in the pace of economic expansion

The Bank's BCI indicates that annual growth in business activity continues to recede from the high level registered in the first half of 2021 but remains above



its historical average (see Chart 2.2).¹

During the quarter under review, the BCI was affected by strong annual increases in several sub-components, particularly the strong growth in tourist arrivals. Growth in the number of permits issued, economic sentiment and GDP as well as significant falls in unemployment also contributed to the above average BCI level.²

GDP and industrial production

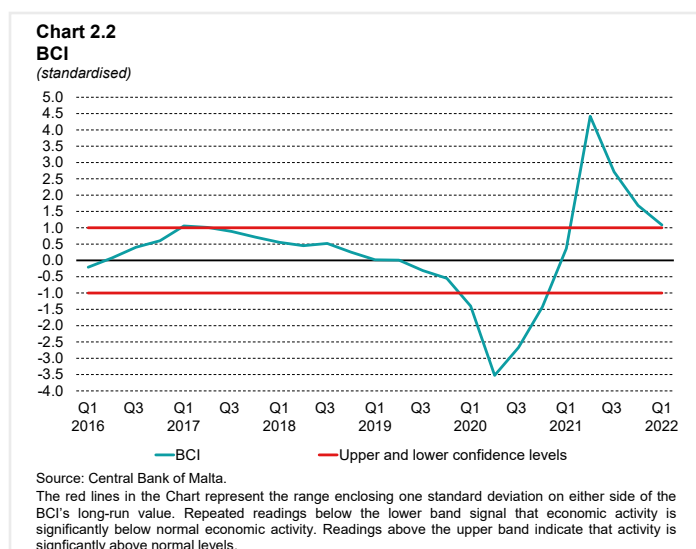
Real GDP grows strongly, but at a slower pace

The pace of economic activity decelerated in the first quarter of 2022. Real GDP rose by 7.6% on an annual basis, following an 11.8% increase in the previous quarter.³ This reflects a normalisation of growth rates following the sharp decline and subsequent recovery in GDP growth between 2020 and 2021 due to COVID-19. Slower growth was underpinned by domestic demand. This added 4.4 percentage points to GDP growth in the quarter under review, following a contribution of 10.2 percentage points in the fourth quarter of 2021 (see Table 2.1). All domestic demand components contributed to the slowdown except for private consumption expenditure, which rose at a faster rate.

In contrast to domestic demand, the positive contribution of net exports doubled, as exports grew at a faster pace than imports.

Private consumption expenditure increased by an annual 9.6% in the first quarter of 2022, following an 8.5% increase in the last quarter of 2021, adding 4.0 percentage points to real GDP growth.

Data on the Classification of Individual Consumption by Purpose (COICOP) show that the increase in consumption was broad based across expenditure categories. The strongest increase in absolute terms was recorded in spending on restaurants and accommodation services. This was followed by higher spending on transport as well as recreation and culture. Expenditure on these items benefitted from the easing in restrictions on travel and mobility compared to the first quarter of 2021. These developments offset a slight decline in spending on communication services.



¹ The BCI is a synthetic indicator, which includes information from a number of economic variables such as the term structure of interest rates, industrial production, an indicator for the services sector, economic sentiment, tax revenues and private sector credit. By construction, it has an average value of zero over the estimation period since 2000. A full time series can be found at <https://www.centralbankmalta.org/business-conditions-index>. For further details on the methodology underlying the BCI, see Ellul, R., (2016), "A real-time measure of business conditions in Malta," *Working Paper 05/2016*, Central Bank of Malta.

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

³ The analysis of GDP in this chapter of the *Quarterly Review* is based on data published in NSO *News Release 095/2022*, which was published on 30 May 2022.

Table 2.1
GDP⁽¹⁾

	2021				2022
	Q1	Q2	Q3	Q4	Q1
<i>Annual percentage changes</i>					
Private final consumption expenditure	-4.9	16.9	7.7	8.5	9.6
Government final consumption expenditure	22.2	-0.6	6.0	5.3	-3.0
GFCF	-7.7	23.5	29.0	25.3	6.3
Domestic demand	0.6	12.0	11.1	11.6	5.2
Exports of goods and services	-0.3	15.0	8.6	9.3	9.2
Imports of goods and services	-0.1	12.2	6.3	8.9	7.9
GDP	0.1	16.4	14.1	11.8	7.6
<i>Percentage point contributions</i>					
Private final consumption expenditure	-2.2	7.1	3.5	3.8	4.0
Government final consumption expenditure	4.0	-0.3	1.3	-0.1	-0.1
GFCF	-1.6	5.2	5.7	4.9	1.2
Changes in inventories	0.3	-1.3	-0.8	1.6	-0.7
Domestic demand	0.5	10.7	9.8	10.2	4.4
Exports of goods and services	-0.5	23.4	13.1	13.7	14.1
Imports of goods and services	0.1	-17.7	-8.8	-12.2	-10.8
Net exports	-0.4	5.7	4.3	1.6	3.2
GDP	0.1	16.4	14.1	11.8	7.6

Sources: NSO; Central Bank of Malta calculations.

⁽¹⁾ Chain-linked volumes, reference year 2015.

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 significant increase in non-residents' expenditure in Malta. The remaining part of domestic consumption – the expenditure of Maltese residents in Malta – also rose compared to the same period a year earlier. Similarly, the expenditure of Maltese residents abroad was around four times its year-ago level as trips abroad continued to normalise, although it was still almost a third below its level in the first quarter of 2019 (the last corresponding quarter before the pandemic).

Government consumption expenditure contracted by 3.0% in annual terms after growing by 5.1% in the previous quarter, partly reflecting a sharper decline in social benefits in kind as well as weaker growth in compensation of employees and intermediate consumption. Overall, government consumption shed 0.1 percentage point from annual GDP growth, unchanged from the previous quarter.

Following a strong increase of 25.3% in the previous quarter, real GFCF rose by a more modest 6.3% in the first quarter of the year. Most of this increase reflected higher expenditure on machinery and equipment, though non-residential investment and investment in intellectual property products also increased. These offset lower investment in non-residential construction. GFCF added 1.2 percentage point to real GDP growth.

Changes in inventories shed 0.7 percentage point from real GDP growth in the first quarter of 2022.

Meanwhile, exports rose by 9.2% and imports increased by 7.9% on a year earlier. As a result, net exports contributed 3.2 percentage points to annual real GDP growth, following a contribution of 1.6 percentage points in the previous quarter. The widening in this contribution reflected a narrowing in the goods deficit and an increase in the services balance (in volume terms).

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.⁴ In the quarter under review, the majority of the import-adjusted contributions were smaller than those based on the traditional approach, reflecting the strong increase in imports (see Table 2.1). This is particularly the case for exports and private consumption.

After accounting for the effect of imports, the largest contributor to growth in real GDP in the first quarter of 2022 was exports rather than domestic demand components.

GDP data based on the output approach show that in the first quarter of 2022, real gross value added (GVA) rose by 6.9% in annual terms, following a 13.2% increase in the preceding quarter. It added 6.3 percentage points to GDP growth (see Table 2.3).⁵

Services remained the main driver behind the rise in economic activity, adding 6.4 percentage points to real GDP growth. Most of the increase stemmed from the sector comprising wholesale and retail trade, transportation, accommodation and related activities, which contributed 3.1 percentage points to GDP growth. At the same time, the information and communication sector and the sector comprising arts, entertainment, household repair and related activities collectively added a further 2.2 percentage points to real GDP growth in the first quarter of 2022. The remaining services sector also supported growth, though with smaller contributions.

Table 2.2
IMPORT-ADJUSTED CONTRIBUTIONS TO GDP GROWTH⁽¹⁾

	2021				2022
	Q1	Q2	Q3	Q4	Q1
	<i>Percentage point contributions</i>				
Private final consumption expenditure	-1.4	4.5	2.8	2.5	2.4
Government final consumption expenditure	3.3	0.0	1.2	1.1	-0.5
GFCF	-0.7	2.2	2.5	2.0	0.5
Changes in inventories	0.2	-0.7	-0.6	-0.1	-0.1
Domestic demand	1.3	6.0	5.9	5.5	2.3
Exports of goods and services	-1.2	10.4	8.2	6.3	5.3
GDP	0.1	16.4	14.1	11.8	7.6

Source: Central Bank of Malta estimates.

⁽¹⁾ Chain-linked volumes, reference year 2015.

⁴ 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*, and can be accessed from https://nso.gov.mt/en/News_Releases/Documents/2021/01/News2021_005.pdf.

⁵ The difference between GDP and GVA is made up of taxes on products, net of subsidies.

Table 2.3
CONTRIBUTION OF SECTORAL GVA TO REAL GDP GROWTH

Percentage points

	2021				2022
	Q1	Q2	Q3	Q4	Q1
Agriculture, forestry and fishing	0.0	0.0	-0.1	0.1	0.0
Mining and quarrying; utilities	0.2	0.5	0.0	0.1	0.3
Manufacturing	-0.2	1.2	0.4	-0.4	-0.1
Construction	0.1	0.1	0.2	0.0	-0.2
Services	-0.5	12.5	11.0	12.0	6.4
<i>of which:</i>					
Wholesale and retail trade; repair of motor vehicles; transportation; accommodation and related activities	-3.3	3.8	5.9	6.2	3.1
Information and communication	0.8	1.6	1.3	2.0	1.3
Financial and insurance activities	0.3	1.1	0.4	0.4	0.3
Real estate activities	0.2	0.9	0.5	0.4	0.0
Professional, scientific, administrative and related activities	-0.3	1.8	1.2	1.1	0.6
Public administration and defence; education; health and related activities	1.2	1.8	0.7	0.6	0.1
Arts, entertainment; household repair and related services	0.6	1.5	1.1	1.3	0.9
GVA	-0.4	14.4	11.6	11.7	6.3
Taxes less subsidies on products	0.5	2.1	2.5	0.1	1.3
Annual real GDP growth (%)	0.1	16.4	14.1	11.8	7.6

Source: NSO.

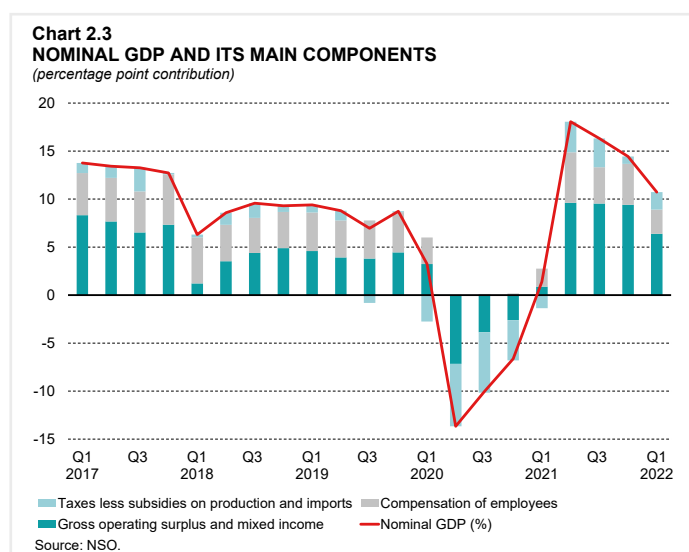
Meanwhile, the contribution of the manufacturing sector remained slightly negative in the quarter under review, partly reflecting the impact of global supply chain disruptions on this sector. At the same time, the combined contribution of the construction and quarrying sectors was broadly neutral.

Nominal GDP growth decelerates but remains robust

Nominal GDP rose by 10.7% in annual terms in the first quarter of 2022, after increasing by 14.4% in the previous quarter. This deceleration was mostly underpinned by slower growth in operating surplus, although compensation of employees also increased at a slower pace (see Chart 2.3). By contrast, the contribution of net taxes on production and imports increased when compared with a year earlier.

Compensation of employees grew by 5.3% in the first quarter of the year, compared with 9.3% in the previous quarter. Its contribution to GDP growth eased to 2.5 percentage points.

Compensation of employees increased in all sectors, with the



sector comprising wholesale and retail trade together with repair of motor vehicles and motorcycles registering the highest increase in absolute terms. Other significant increases were recorded in professional, scientific and technical activities and administrative and support service activities, followed by the information and communication sector.

The slower rate of growth compared to the last quarter of 2021 was mainly underpinned by developments in the sectors comprising public administration as well as professional, scientific and technical activities.

Gross operating surplus grew at annual rate of 13.6%, after rising by 19.6% in the preceding quarter – adding 6.4 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 all sectors. This primarily reflected a rise in the operating surplus of the information and communication sector. It was followed by an increase in the operating surplus of the sector comprising accommodation and food service activities, as well as the arts, entertainment and recreation sector.

During the quarter under review, subsidies on production and imports increased moderately compared to the same quarter last year. On the other hand, taxes on production and imports rose by almost a fifth. As a result, 'net taxes on production and imports' were almost a third higher compared with the first quarter of 2021.

Industrial production declines

Industrial production contracted by 1.8% in the first quarter of 2022, after a fall of 5.3% in the last quarter of 2021 (see Table 2.4).⁶

	Shares	2021				2022
		Q1	Q2	Q3	Q4	Q1
Industrial production	100.0	-8.3	13.5	-0.1	-5.3	-1.8
Manufacturing	87.1	-5.4	13.9	-1.4	-9.3	-2.8
<i>of which:</i>						
Food products	15.4	-7.5	-5.5	-17.5	-13.1	5.6
"Other" manufacturing	10.3	7.5	50.2	-2.0	-22.8	-27.1
Repair and installation of machinery and equipment	7.9	-32.2	5.4	13.8	24.6	23.0
Basic pharmaceutical products and pharmaceutical preparations	7.3	46.2	25.5	-3.4	-22.2	3.1
Printing and reproduction of recorded media	7.3	-9.3	-10.0	-12.7	-15.2	-14.9
Beverages	5.6	-22.4	31.5	8.2	43.4	29.6
Rubber and plastic products	5.4	-7.5	10.7	22.3	-13.5	-1.5
Computer, electronic and optical products	5.0	-2.8	8.3	1.7	-0.7	13.4
Energy	12.5	-21.7	10.8	5.2	16.8	11.2
Mining and quarrying	0.5	-24.3	25.2	17.8	61.5	-22.3

Sources: NSO; Eurostat.

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

⁶ Methodological differences may account for divergences between developments in GVA in the manufacturing sector and industrial production. GVA nets input costs from output to arrive at value added and is expressed in nominal terms. Industrial production is a measure of the volume of output and takes no account of input costs. The sectoral coverage between the two measures also differs, since industrial production data also include the output of the energy and quarrying sectors.

The decline in industrial production in the quarter under review reflected a 2.8% contraction in the manufacturing sector as well as a sharp decline in the quarrying sector. These offset higher production in the energy sector.⁷

A few sub-sectors recorded significant declines in manufacturing production. These include wearing apparel and ‘other manufacturing’ – which includes the medical and dental instruments, the toys and related products. Production also fell, though to a lesser extent, among firms that print and reproduce recorded media as well as firms that manufacture motor vehicles, trailers and semi-trailers.

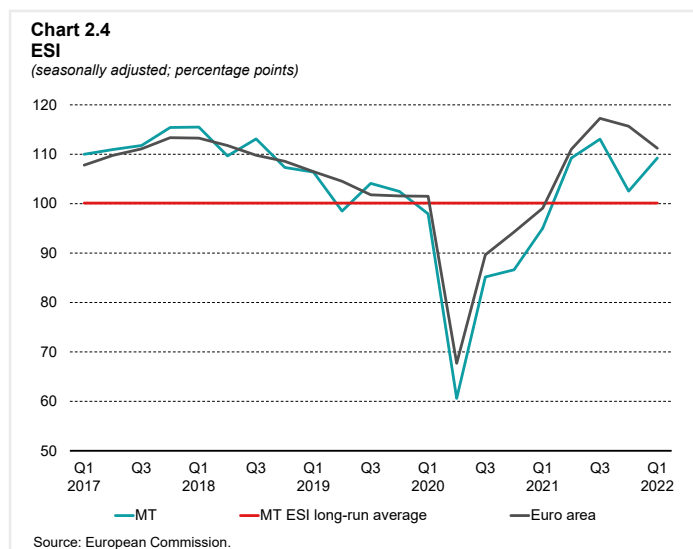
On the other hand, higher output was registered among firms that produce beverages, those that repair and install machinery and equipment as well as those that produce non-metallic mineral products and paper products. Production also rose among firms producing computer, electronic and optical products, pharmaceuticals and food. These increases, however, were moderate by comparison.

Business and consumer surveys

During the first quarter of 2022, the European Commission’s Economic Sentiment Indicator (ESI) for Malta edged up from the level recorded in the fourth quarter of 2021. It stood at 109.2, up from 102.5 in the preceding quarter. Following this increase, the overall indicator remained above its long-term average of around 100.0 and also exceeded the level recorded just before the pandemic (see Chart 2.4).^{8,9} This may reflect the continued easing of COVID-19 restrictions, primarily those related to quarantine and the use of masks. However, the overall ESI indicator stood slightly below that in the euro area which averaged 111.2.

When compared with December, confidence increased sharply in the services sector and turned positive in industry. By contrast, confidence weakened in the other sectors. Sentiment was positive across all sectors except among consumers.

When accounting for the variation in the weights assigned to each sector in the overall index, the increase in the ESI relative to the last quarter of 2021 was driven by industry and by the



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

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

⁹ Long-term averages are calculated over the entire period for which data are available. For the consumer and industrial confidence indicators, data for Malta became available in November 2002, while for services and construction data became available in May 2007 and May 2008, respectively. The long-term average of the retail confidence indicator is calculated as from May 2011, when it was first published. The long-term average of the ESI is computed from November 2002.

services sector.^{10,11} The confidence indicators for industry and consumers largely explain why the overall ESI stood above the long-term average in the quarter under review (see Chart 2.5).

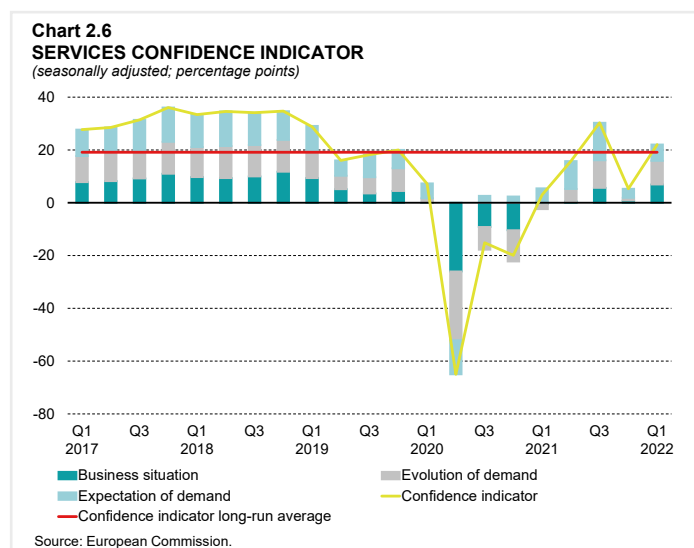
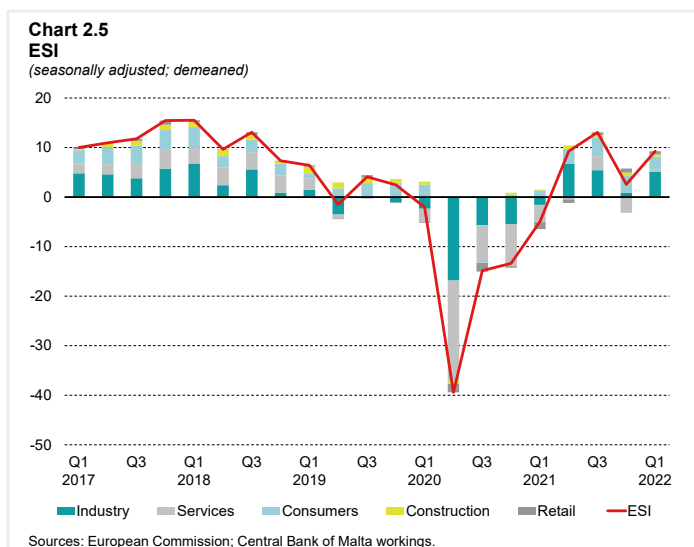
Confidence in the services sector rises sharply¹²

The confidence indicator in the services sector increased to 22.0 in the first quarter of the year, from 5.3 in the previous quarter, and stood above its long-term average of 19.1. The recent rise in sentiment reflected developments across all components of the indicator (see Chart 2.6). However, it was mostly driven by an improved assessment of demand and, to a lesser extent, by the business situation in the previous three months.

Supplementary survey data indicate that respondents' price expectations edged down slightly in the first quarter of 2022 but remained very high from a historical perspective.

Industrial confidence turns positive¹³

The industrial confidence indicator stood in positive territory in the first quarter of 2022. It increased to 7.4, from -4.5 in the previous 3-month period and rose above its long-term average of -3.8 (see Chart 2.7). A significantly smaller share of respondents deemed order-book levels to be below normal compared to the fourth quarter of 2021. At the same time, production expectations more than doubled, while a larger share of firms reported stocks of finished goods to be below normal.¹⁴



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

¹¹ In January 2021, data were revised for previous periods following the annual updating of country weights and the inclusion of 2020 in the standardisation sample.

¹² The services confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to survey questions relating to the business climate, the evolution of demand in the previous three months, and demand expectations in the subsequent three months.

¹³ The industrial confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to a subset of survey questions relating to expectations about production over the subsequent three months, to current levels of order books and to stocks of finished goods.

¹⁴ Above-normal stock levels indicate lower turnover and affect the overall indicator in a negative way. Such levels are thus represented by negative bars in Chart 2.9.

Additional survey data reveal that the share of respondents foreseeing an increase in selling prices in the months ahead fell in the first quarter of the year.

Consumers less upbeat compared to fourth quarter of 2021¹⁵

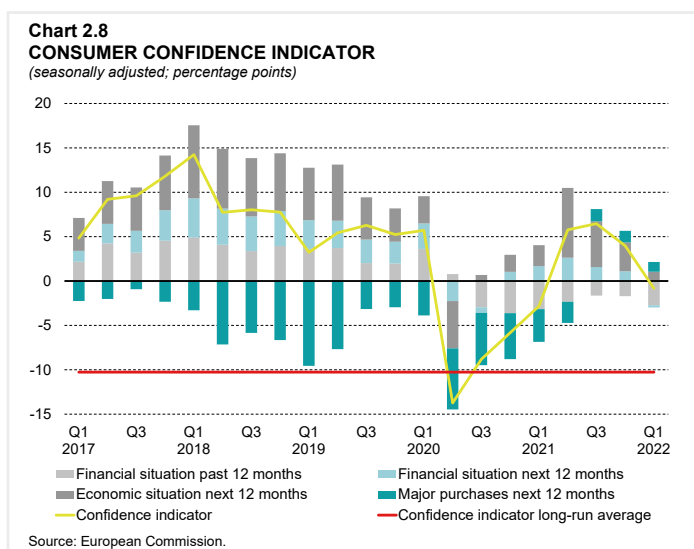
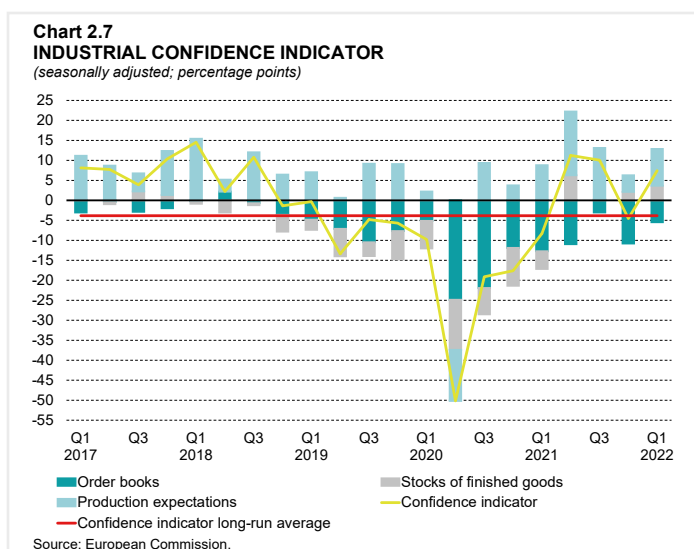
The consumer confidence indicator averaged -0.8 during the first quarter of 2021, down from 4.0 in the previous quarter but remained well above its long-run average of -10.3 (see Chart 2.8).

The latest decline in consumer confidence largely reflected weaker expectations of the general economic situation and the financial situation over the next 12 months. Consumers' assessment of their financial situation over the last 12 months also deteriorated. At the same time, expectations of major purchases over the next 12 months edged down slightly but remained positive.

Supplementary survey data show a decrease in the share of consumers expecting unemployment to fall over the next 12 months. Meanwhile, price expectations eased marginally over the same period, but remained at their highest since 2012.

Confidence in construction halves¹⁶

In the first quarter of 2021, the indicator measuring confidence in the construction sector decreased to 6.1 from 12.7 in the previous 3-month period. Notwithstanding this decline, sentiment remained well above its long-term average of -9.6 (see Chart 2.9).



¹⁵ The consumer confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to a subset of survey questions relating to households' assessment and expectations of their financial situation, their expectations about the general economic situation, and their intention to make major purchases over the subsequent 12 months. The computation of this indicator was changed as reflected in the [January 2019 release](#) of the European Commission.

¹⁶ The construction confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to two survey questions, namely those relating to order books and to employment expectations over the subsequent three months.

Employment expectations more than halved in the first quarter of the year. At the same time, a smaller share of respondents assessed order books to be above normal levels compared with the final quarter of 2021.

Supplementary survey data indicate that when compared to the fourth quarter of 2021, price expectations eased but remained elevated.

Confidence in the retail sector weakens¹⁷

The indicator representing sentiment in the retail sector fell to 12.0 in the first quarter of 2022, from 19.3 in the previous quarter, but remained well above its long-term average of -1.0. The recent deterioration in sentiment was largely driven by retailers' assessment of sales over the past three months and their expectations for business activity over the next three-month period. These developments offset an increase in the share of participants reporting stocks of finished goods to be below normal levels (see Chart 2.10).

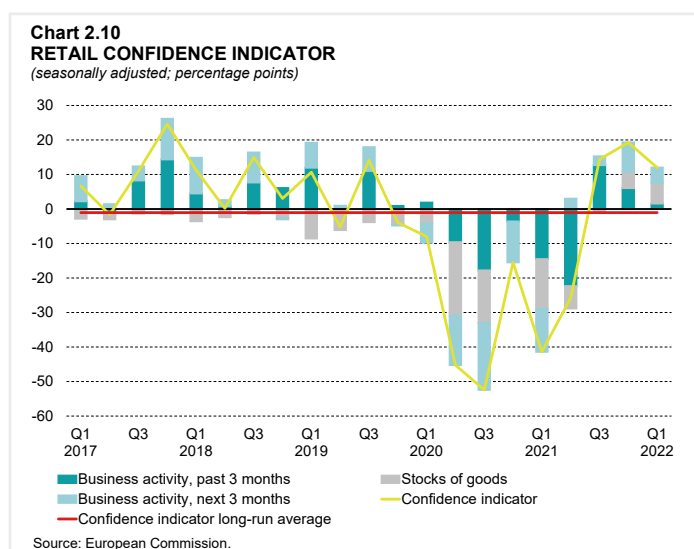
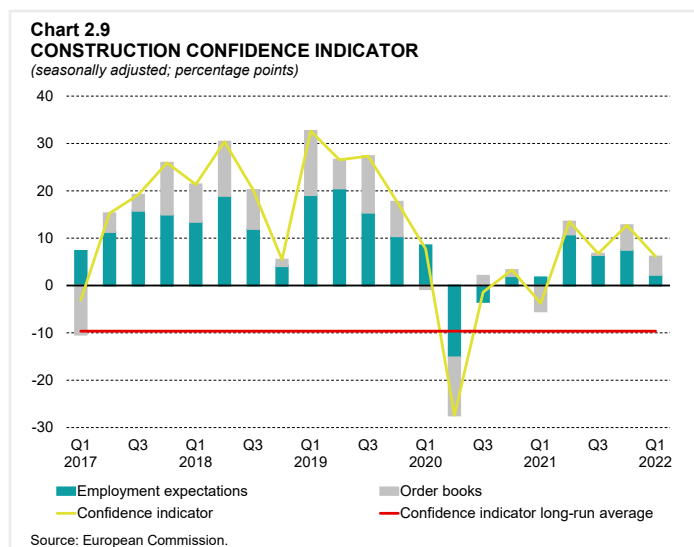
Supplementary survey data indicate that, on balance, orders expectations edged down compared to the fourth quarter of 2021, yet remaining positive. Meanwhile, the share of retailers anticipating a rise in prices in the coming months remained unchanged at historic highs.

Employment Expectations Indicator decreases

The Employment Expectations Indicator (EEI) – which is a composite indicator of employment expectations in industry, services, retail trade and construction – decreased in the first quarter of the year. It stood at 98.9 compared with 105.1 in the preceding quarter. Follow this decline, the index stood below its long-term average of around 100.0 and fell below the euro area average of 114.6.¹⁸

¹⁷ The retail confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to survey questions relating to the present and future business situation and stock levels.

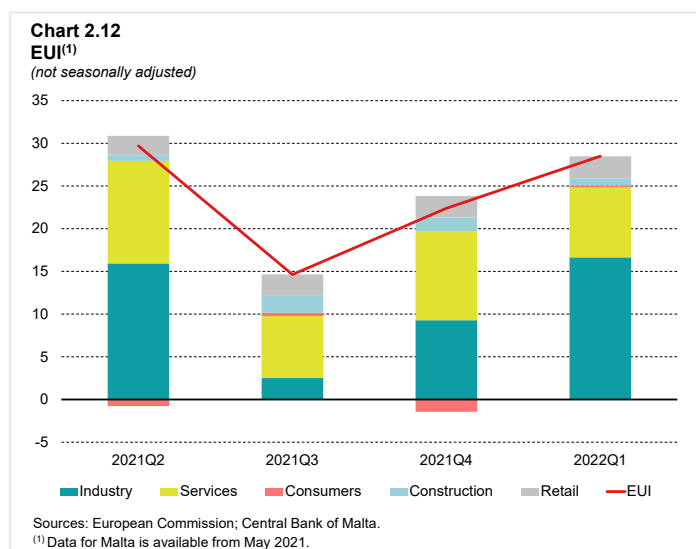
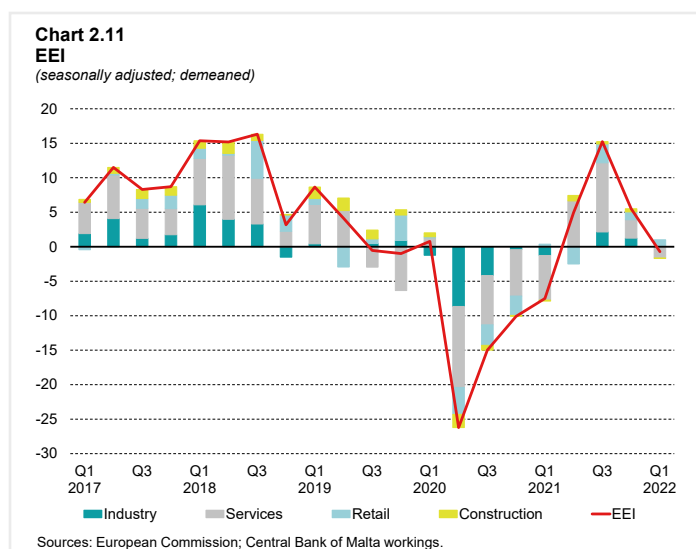
¹⁸ The EEI is based on question 7 of the industry survey, question 5 of the services and retail trade surveys and question 4 of the construction survey, which gauge the respondent firms' expectations as regards changes in their total employment over the next three months. Before being summarised in one composite indicator, each balance series is weighted on the basis of the respective sector's importance in overall employment. The weights are applied to the four-balance series expressed in standardised form. Further information on the compilation of the EEI is available in European Commission (2020). *The Joint Harmonised EU Programme of Business and Consumer Surveys User Guide*.



During the quarter under review, employment expectations were, on average, positive across all sectors, but weaker compared to the last quarter of 2021. When accounting for the variation in the weights assigned to each sector in the overall index, the decrease relative to the fourth quarter of 2021 largely reflected developments in the services sector and in industry (see Chart 2.11). Weaker employment expectations in construction and among retailers also contributed to the fall in the EEI although by a smaller magnitude.

Economic Uncertainty Indicator increases

The European Commission's Economic Uncertainty Indicator (EUI) is a composite indicator of how difficult it is for sectors to make predictions about their future financial or business situation. In Malta, this indicator reached 28.5 in the first quarter of 2022, up from 22.4 in the previous quarter (see Chart 2.12). Following the latest increase, the indicator remained above that in the euro area where the index averaged 20.1.^{19,20}



The recent rise in uncertainty in Malta was largely driven by developments in industry and consumers. The latter reported slight difficulty in predicting their financial situation over the coming months, which contrasts with the response in the last quarter of 2021, when consumers on balance could still predict their future financial situation with ease. At the same time, uncertainty among retailers edged up slightly. These developments offset lower uncertainty in the services sector and, to a smaller degree, in the construction sector.

¹⁹ The EUI is made up of five balances (in percentage points) which summarise managers'/consumers' answers to a question asking them to indicate how difficult it is to make predictions about their future business/financial situation. The series are not seasonally adjusted. The five balance series are summarised in one composite indicator using the same weights used to construct the ESI. The questions asked correspond to Q51 of the industry survey, Q31 of the services survey, Q41 of the retail trade and construction surveys and Q21 of the consumer survey.

²⁰ Data on consumer uncertainty became available in October 2020, while data for industry, services, retail and construction became available in May 2021.

The labour market²¹

Labour force increases

Labour Force Survey (LFS) data show that in the first quarter of 2022, the labour force grew by 9,726 persons, or 3.6% on an annual basis (see Table 2.5). This is the same rate registered in the last quarter of 2021.²²

The activity rate stood at 78.7% in the quarter under review, higher than the 77.0% registered a year earlier.²³ This was mostly driven by an increase in the female participation rate, which rose by 3.5 percentage points to 71.4%. The male activity rate rose by 0.1 percentage points to 85.0%. Both rates exceeded the corresponding rates for the euro area.

Employment rose further

In the first quarter, employment rose by 4.3% in annual terms, following a rise of 5.0% in the previous quarter.

The latest increase in employment primarily reflects a steep rise in full-time employment, but also a small increase in part time jobs. The former rose by 10,959, or 4.8% in annual terms (see Table 2.5). The number of part-time employees – which also includes those employed full-time on reduced hours – increased for the second consecutive time since the onset of the COVID-19 pandemic in 2020. This rose by 483 persons, or 1.5% on a year earlier. Eurostat data show that this increase was largely driven by the wholesale and retail trade sector and manufacturing. Other smaller increases were recorded in human health and social work activities as well as in financial and insurance activities, and real estate activities. These increases offset declines in a number of sectors, including construction, professional, scientific and technical activities as well as in arts, entertainment and recreation.

The overall employment rate rose by 2.2 percentage points on the same period of 2021, to 76.1%.²⁴ This primarily reflected a rise in the female employment rate, which rose by 4.4 percentage points to 69.6%. This increase was spread across all age brackets but was particularly evident in the 55-64 cohort. The male employment rate rose by 0.3 percentage points to 81.8%, solely driven by the 15-24 age bracket.

During the period under review, average weekly hours worked derived from the LFS rose to 35.1 from 33.7 a year earlier (See Table 2.5).²⁵ This reflected a strong rise in part time hours worked, although full-time working hours also increased.

²¹ 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 and Eurostat; and administrative records compiled by Jobsplus according to definitions established by domestic legislation on employment and social security benefits.

²² 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.

²³ 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.

²⁴ 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.

²⁵ 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.

Table 2.5
LABOUR MARKET INDICATORS BASED ON THE LFS

Persons; annual percentage changes

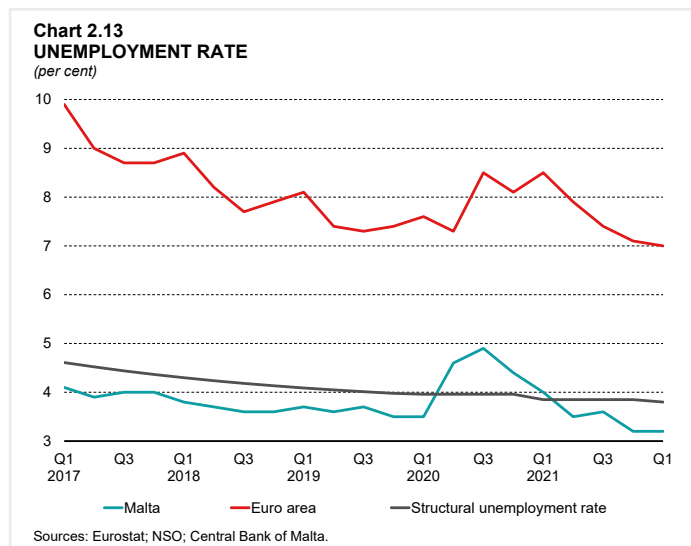
	2021 Q1	2022 Q1	Annual change %
Labour force	273,857	283,583	3.6
Employed	263,051	274,493	4.3
<i>By type of employment:</i>			
Full-time	230,390	241,349	4.8
Part-time	32,661	33,144	1.5
Unemployed	10,806	9,090	-15.9
Activity rate (%)	77.0	78.7	
Male	84.9	85.0	
Female	67.9	71.4	
Employment rate (%)	73.9	76.1	
Male	81.5	81.8	
Female	65.2	69.6	
Unemployment rate (%)	4.0	3.2	
Actual hours worked (per week)	33.7	35.1	

Source: NSO.

The unemployment rate remains low

The unemployment rate based on the LFS stood at 3.2% in the first quarter of 2022, the same rate registered in the previous quarter. However, it stood well below the 4.0% recorded a year earlier (see Table 2.5).²⁶ The historically low jobless rate in Malta continues to reflect the recovery in demand in the context of a tight labour market. Labour market conditions 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 7.0% in the first quarter of this year (see Chart 2.13).

During the quarter under review, the unemployment rate also stood below the Bank's structural measure of 3.8%.²⁷ This

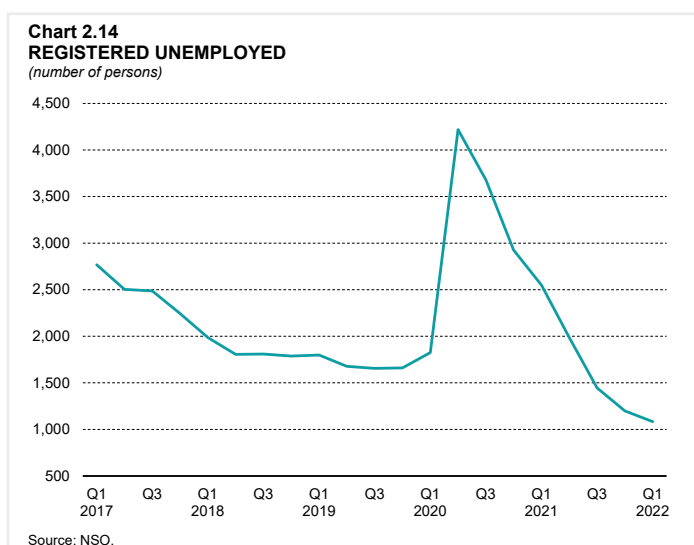


²⁶ According to the LFS, the unemployed comprise persons aged between 15 and 74 years who are without work, available for work and who have actively sought work during the four weeks preceding the Survey. In contrast, the number of unemployed on the basis of the Jobsplus definition includes only those persons registering for work under Part 1 and Part 2 of the unemployment register.

²⁷ 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.

indicates a degree of labour market tightness, which is also confirmed by surveys.

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 first quarter of 2022, the average number of persons on the unemployment register stood at 1,083 – less than half that registered a year earlier (see Chart 2.14).



3. PRICES, COSTS AND COMPETITIVENESS

Price pressures continued to build during the first quarter. Annual inflation as measured by the HICP stood at 4.5% in March, above that of 2.6% recorded in December. All components except energy prices registered faster growth, although services inflation was the main driver behind the increase in inflation since December.

Annual inflation based on the RPI – which only takes into account expenditure by Maltese residents – rose from 2.6% in December to 4.4% in March. Producer price inflation remained high although it edged down to 7.1% in March from 7.5% three months earlier. Meanwhile, Malta's ULC index, measured on a 4-quarter moving average basis, declined by 4.0% in the first quarter as productivity rebounded more strongly than average compensation. However, the index still stood above its pre-pandemic level, both in headcount and hourly terms. Meanwhile, Malta's HICIs point to a further improvement in international competitiveness between December 2021 and March 2022.

Inflation

HICP inflation increases

Annual HICP inflation increased to 4.5% in March 2022 from 2.6% in December (see Table 3.1).¹ This marks the highest inflation rate since 2012. However, HICP inflation in Malta was still below that recorded in the euro area where inflation ended the first quarter of 2022 at 7.4% (see Chart 3.1). This divergence stems from energy prices which were unchanged in Malta but rose by an annual rate of 44.3% in the euro area

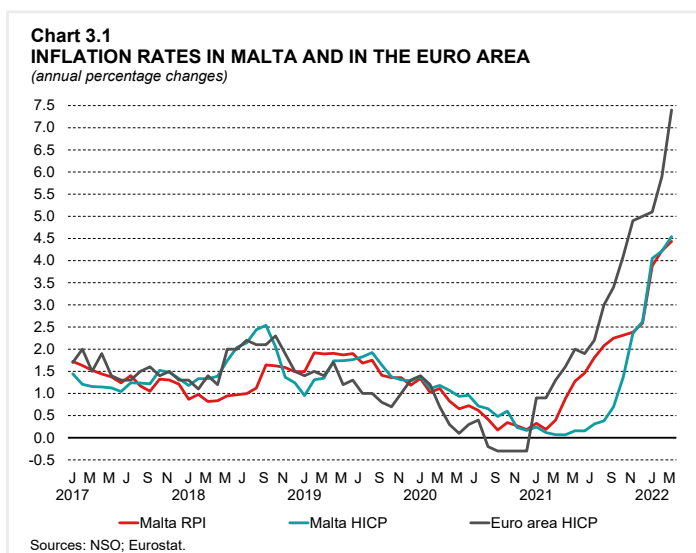


Table 3.1
HICP INFLATION
Annual percentage change

	2021												2022		
	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Jan.	Feb.	Mar.
Unprocessed food	2.5	4.1	6.2	8.8	9.4	10.6	7.5	9.7	11.3	12.7	15.1	13.8			
Processed food including alcohol and tobacco	0.3	0.6	0.5	0.6	0.6	0.7	1.0	1.3	2.0	3.7	4.6	5.3			
Energy	-3.2	-3.2	-1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
NEIG	0.8	1.0	0.9	1.4	2.2	2.2	3.1	2.7	2.6	3.7	3.7	4.0			
Services (overall index excluding goods)	0.4	0.5	0.5	0.3	0.1	0.3	0.9	2.1	2.3	4.1	3.8	4.2			
All Items HICP	0.1	0.2	0.2	0.3	0.4	0.7	1.4	2.4	2.6	4.1	4.2	4.5			

Source: Eurostat.

¹ The HICP weights are revised on an annual basis to reflect changes in overall consumption patterns. In 2021, the weight allocated to services 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.

and contributed 4.4 percentage points to euro area HICP inflation in March (see Chart 3.2). On the other hand, the contribution of the other subcomponents was higher in Malta than in the euro area.

The rise in HICP inflation relative to December reflected faster growth in all components except energy prices, which remained unchanged in annual terms (see Chart 3.3). Furthermore, almost half of the rise in inflation between December and March was driven by higher services inflation.

The latter increased from 2.3% in December to 4.2% in March, contributing 1.8 percentage points to overall HICP inflation (see Chart 3.4). This was driven by all subcomponents except for communication services whose contribution was broadly unchanged. Furthermore, almost half of the services contribution to overall HICP inflation was driven by services related to recreation and personal care. Also, inflation in services related to recreation and personal care was largely driven by restaurants and cafes as these registered an average inflation of 6.7% in the month under review. Housing services also contributed strongly to inflation in March, largely driven by fees for maintenance and repair of dwellings.

Food inflation also increased during the quarter under review, reaching 7.2% in March (see

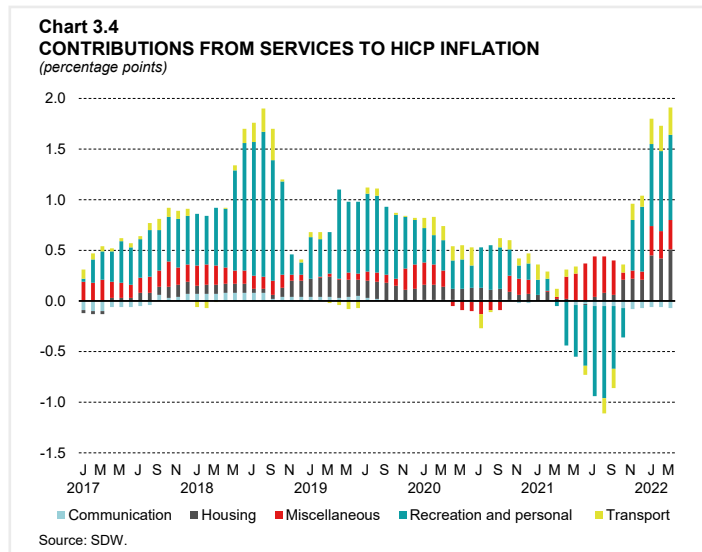
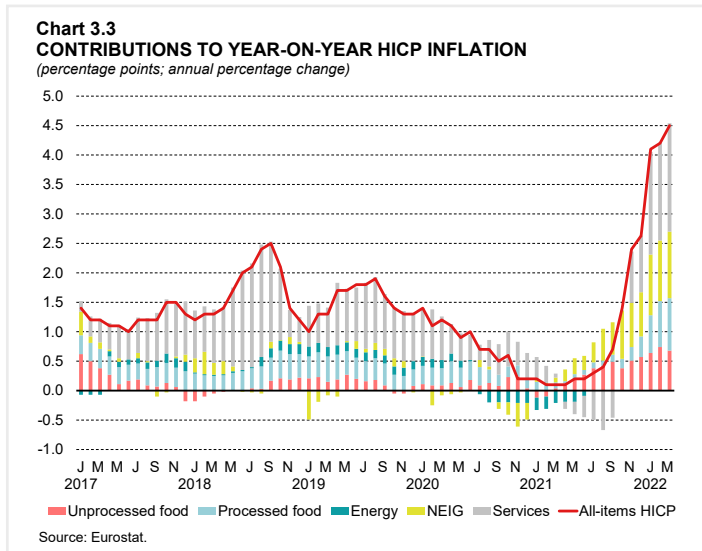
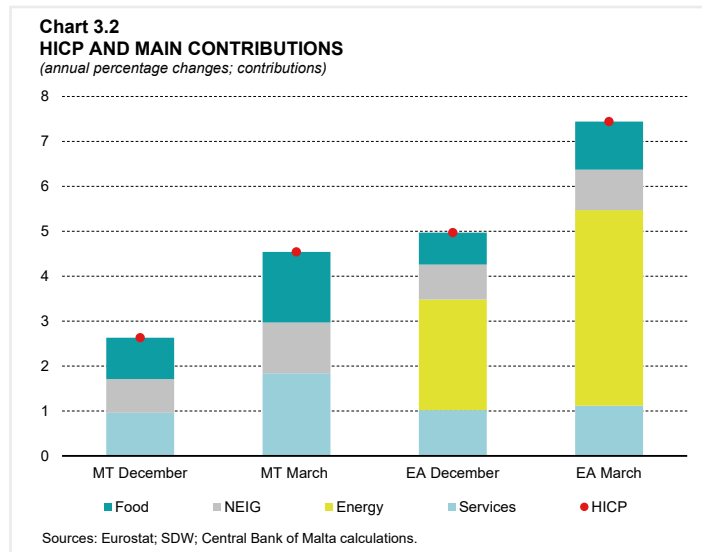
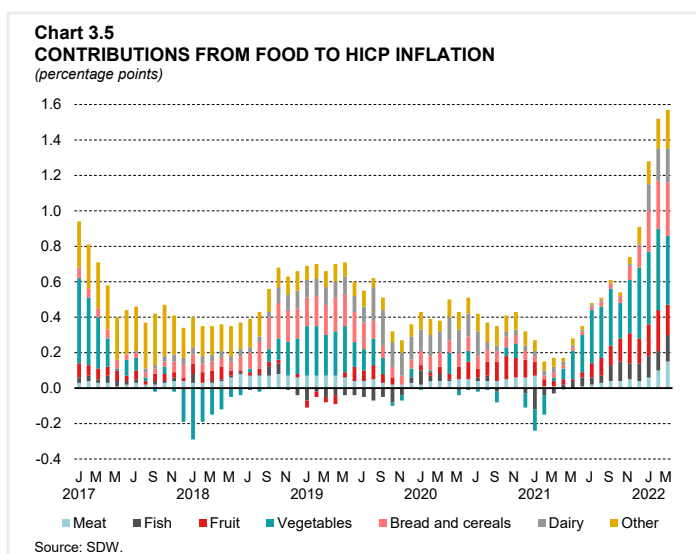


Chart 3.5). Bread and cereals as well as dairy were the main drivers behind the rise in food inflation as the contribution from these subcomponents increased by 0.2 percentage point each. These were followed by the meat subcomponent. As a result, the overall contribution of food to HICP inflation stood at 1.6 percentage points in March, up from 0.9 percentage point in December. Indeed, unprocessed food inflation rose to 13.8% from 11.3% in December, while processed food inflation reached 5.3% from 2.0% previously.

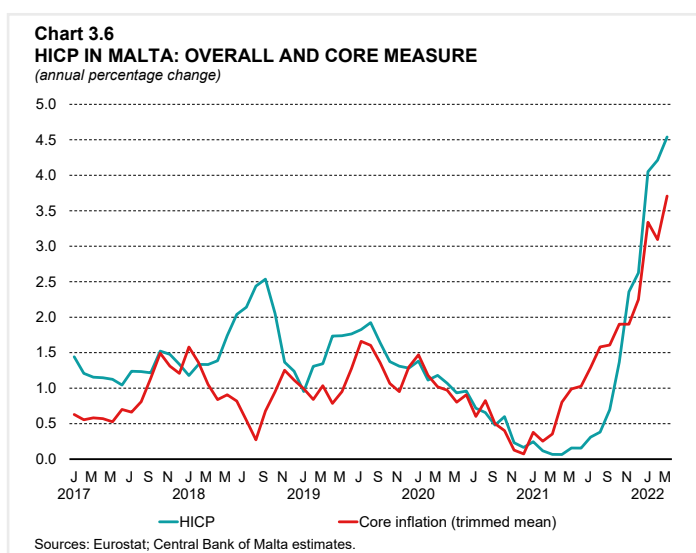


NEIG inflation increased to 4.0% in March from 2.6% in December. All sub-components increased strongly, with the largest increase registered in the non-durables subcomponent. The latter's prices rose by an annual 4.4%, from 2.6% in December. The pick-up in NEIG inflation may reflect some pass-through to consumer prices from the recent rise in input costs in the context of disruptions to global value chains.

Energy inflation was unchanged at 0.0% in March, as electricity, gas and transport fuel prices were kept unchanged from their level a year earlier, through government support measures shielding the economy from rising international energy prices.

Core HICP inflation increases further

The Bank's measure of core inflation rose to 3.7% in March 2022 from 2.2% three months earlier (see Chart 3.6).² Hence, it was 0.8 percentage point lower than overall HICP inflation. The divergence between the two measures of inflation largely reflects the exclusion of volatile items from the core measure.



² 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.

Table 3.2
CONTRIBUTIONS TO YEAR-ON-YEAR RPI INFLATION

Percentage points

	2021												2022		
	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.			
Food	0.1	0.5	0.5	0.6	0.7	0.8	0.7	1.0	1.1	1.5	1.7	1.7			
Beverages and tobacco	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1			
Clothing and footwear	0.2	0.2	0.1	0.0	0.2	0.2	0.3	0.1	0.0	0.1	0.1	0.0			
Housing	0.0	0.0	0.1	0.2	0.2	0.2	0.2	0.2	0.3	0.6	0.7	0.8			
Water, electricity, gas and fuels	0.0	0.0	0.0	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	0.1	0.1	0.1	0.1	0.2	0.3	0.2	0.2	0.3	0.3	0.4			
Transport and communications	-0.2	-0.3	-0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.5	0.5	0.4			
Personal care and health	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2			
Recreation and culture	0.4	0.4	0.4	0.5	0.5	0.5	0.3	0.3	0.3	0.3	0.2	0.3			
Other goods and services	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.4			
RPI (annual percentage change)	0.9	1.3	1.5	1.8	2.1	2.2	2.3	2.4	2.6	3.9	4.2	4.4			

Source: NSO.

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 as well as a different frequency of weight updates – increased to 4.4% in March from 2.6% in December (see Table 3.2).³ The increase in RPI inflation was primarily driven by a higher contribution from prices of food and housing. These two components alone explain around two-thirds of the increase in RPI inflation between December and March. The contribution of prices for household equipment and house maintenance costs, beverages and tobacco, transport and communications services, personal health and care as well as that of ‘other goods and services’ also edged up, but marginally. The contribution of recreation and culture services and clothing and footwear was unchanged while energy tariffs continued to have a neutral impact on overall RPI inflation 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 increased to 6.7% in the first quarter of 2022, from 4.5% in the last quarter of 2021 (see Chart 3.7).⁴ Despite this increase, house price inflation in Malta remained significantly below that in the euro area where prices increased at an annual rate of 9.8%.

Residential property prices seem to have returned to a dynamic path following the slowdown in growth during the initial stages of the pandemic. Indeed, house price inflation exceeded the

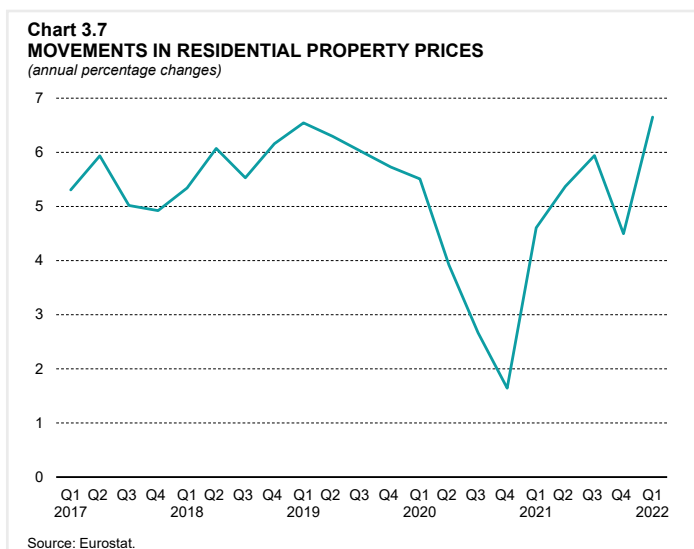
³ The RPI index differs from the HICP index in that RPI weights are based on expenditure by Maltese households, while HICP weights also reflect expenditure patterns by tourists in Malta, such as accommodation services. See Darmanin, J. (2018), “Household Expenditure in Malta and the RPI Inflation Basket”, *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.

⁴ ‘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.

levels recorded in the last five years and reached the highest level since the second quarter of 2016, where the PPI-based inflation rate had stood at 7.0%.

Residential property prices continue to be supported by numerous factors including the low-interest rate environment and a number of Government schemes. 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. Additional tax exemptions on property within UCA, and properties that are vacant or built in a traditional style were announced in the Budget for 2022.



Costs and competitiveness

Producer price inflation edges down but remains elevated

Annual inflation based on the industrial producer price index, which is a measure of the change in the prices of goods sold by producers in the industrial sector, edged down to 7.1% in March from 7.5% in December.⁵ This reflected slower growth in the prices of capital and intermediate goods. Prices of capital goods rose by 3.1% in March, down from 5.8% in December, while inflation in intermediate goods edged down by 0.7 percentage point to 11.2%. On the other hand, consumer goods inflation rose from 5.9% in December to 6.8% in March. Energy producer price inflation remained zero in the period under review.

HCIs point to a further improvement in competitiveness

Annual growth in Malta's nominal HCI continued its negative trend evident since July 2021.⁶ In March 2022, the nominal HCI was down by 1.1% on its level a year earlier, reflecting the euro's depreciation against currencies of trading partners (see Chart 3.8). At the same time, the real HCI fell by 3.7%, suggesting that the gain in international competitiveness arising from a weaker euro was amplified by favourable developments in relative prices vis-à-vis trading partners.

⁵ 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.

⁶ HCIs 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.

When compared with December 2021, both the nominal and real HCI declined, suggesting that price competitiveness also improved on a quarter-on-quarter basis.

ULCs decline but remain above pre-pandemic levels

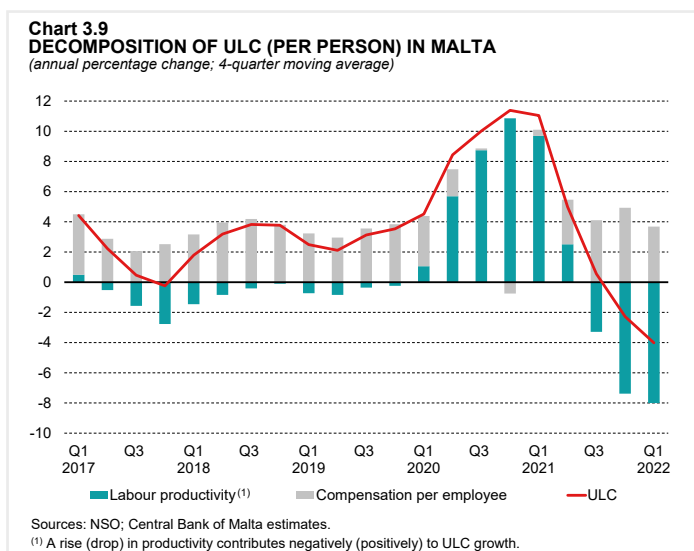
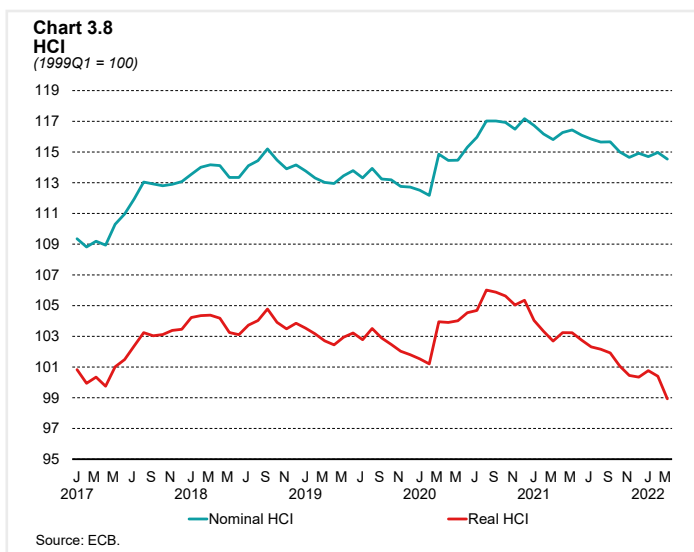
Malta's ULC index – measured as the ratio of compensation per employee to labour productivity – declined during the first quarter of 2022 when compared with the previous quarter.⁷ When measured on a 4-quarter moving average basis in headcount terms, ULCs in Malta fell at an annual rate of 4.0%. This followed a decline of 2.3% in the previous quarter (see Chart 3.9).

The recent fall in ULCs occurred as productivity per person rose almost twice as fast as compensation per employee. Compensation per employee rose by 3.7% in the year to March following a 4.9% increase in the year to December.

Labour productivity based on 4-quarter moving averages increased by an annual 8.0%

following a 7.4% increase in the fourth quarter of 2021. This reflects the stronger increase in economic activity compared to that in employment. The latter remained resilient even when output was hit by the COVID-19 pandemic, in part due to government support measures intended at limiting job losses.

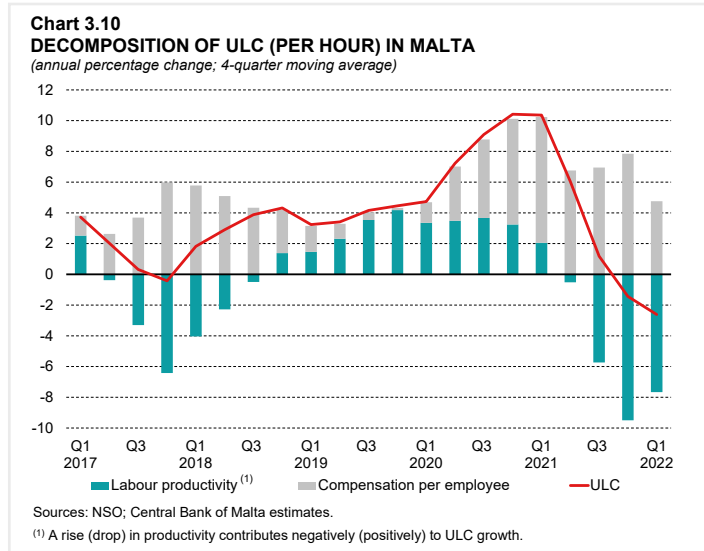
It is notable that although annual growth in ULCs per person was negative in the first quarter of 2022, when measured on a 4-quarter moving average basis they remained above pre-pandemic levels.



⁷ 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), 53-63, Central Bank of Malta.

National accounts data show that, when measured on a 4-quarter moving average basis, total hours worked rose by 3.5% in annual terms in the first quarter of 2022.⁸ Meanwhile, compensation per hour increased by 4.8%. This followed a 7.8% increase in the previous quarter.

Meanwhile, productivity per hour increased by 7.7% after rising by 9.5% in the fourth quarter of 2021. As productivity grew at a higher rate than compensation, ULCs per hour decreased by 2.6% in the first quarter of 2022 following a 1.4% decrease in the previous quarter (see Chart 3.10).



Although productivity per hour stood above its 2019 level, the increase in the hourly wage rate was more significant. As a result, similar to ULCs in headcount terms, ULCs per hour stood above their pre-pandemic level.

⁸ Hours worked refer to employee hours.

4. THE BALANCE OF PAYMENTS

During the first quarter of 2022, the current account turned to a deficit from a surplus a year earlier. This shift was mostly due to an increase in the merchandise trade deficit. An increase in net outflows on the secondary income account also contributed, but to a much lesser extent. By contrast net services receipts increased and net outflows on the primary income account decreased.

In the quarter under review, net inflows on the capital account increased significantly when compared to the corresponding quarter of last year. Net lending on the financial account also increased over the first quarter of 2021.

When measured as a 4-quarter moving sum, the current account balance registered a deficit equivalent to 4.9% of GDP. This contrasts with a current account surplus of 1.7% of GDP in the euro area.

The cyclically-adjusted current account balance is estimated to have recorded a deficit of 4.3% during the first quarter of 2022.

The current account

The current account shifts to a deficit

Between January and March 2022, the current account of the balance of payment registered a deficit of €17.0 million compared to a surplus of €8.9 million in the same quarter of 2021 (see Table 4.1). This shift to a deficit was largely driven by an increase in the merchandise trade deficit. Higher net outflows on the secondary income account also contributed albeit to a much lesser extent. These offset an increase in net services receipts and lower net outflows on the primary income account.

When measured over the year to March, the balance on the current account showed a deficit of €741.7 million, almost double the deficit of €390.5 million recorded a year earlier. This significant increase was completely spurred by a much wider merchandise trade deficit, which 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 stood at -4.9%, from -3.0% a year earlier (see Chart 4.1).

Table 4.1
BALANCE OF PAYMENTS

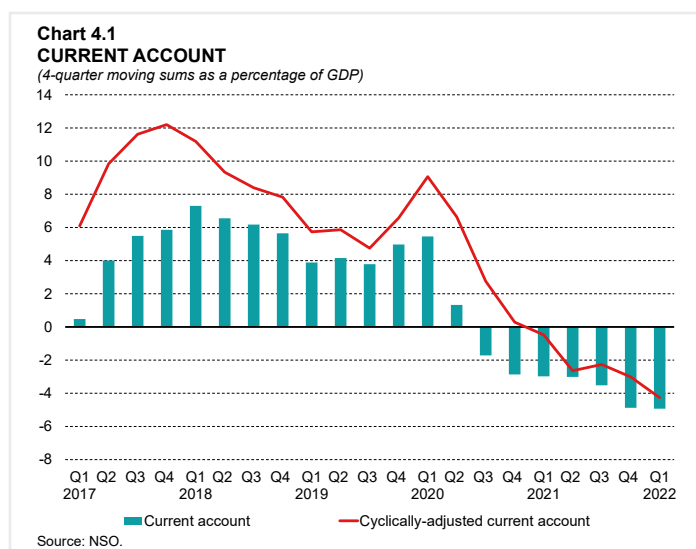
EUR millions

	4-quarter moving sums					2021 Q1	2022 Q1
	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2022 Q1		
Current account	-390.5	-411.3	-499.3	-715.8	-741.7	8.9	-17.0
Goods	-1,370.0	-1,662.3	-1,950.5	-2,428.7	-2,522.4	-375.9	-469.5
Services	2,322.7	2,562.7	2,781.6	3,022.1	3,082.9	650.2	711.0
Primary income	-1,168.0	-1,143.9	-1,169.8	-1,155.8	-1,147.4	-227.1	-218.7
Secondary income	-175.3	-167.8	-160.7	-153.4	-154.8	-38.3	-39.8
Capital account	65.4	57.9	89.5	150.9	177.9	7.2	34.2
Financial account⁽¹⁾	54.8	366.0	402.3	772.7	822.0	259.5	308.7
Errors and omissions	379.8	719.3	812.1	1,337.6	1,385.8	243.3	291.5

Source: NSO.

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

Malta's cyclically-adjusted current account balance is estimated to have stood at -4.3% of GDP in the year to March 2022. The cyclically-adjusted measure recorded a deficit for the fifth consecutive period, thus exhibiting similar developments to the unadjusted measure. However, it stood above the headline measure as Malta's economic cycle was slightly stronger than that estimated for its trading partners (see Chart 4.1).¹ Nevertheless, given the volatility in trade related to COVID-19 and supply bottlenecks, cyclically-adjusted estimates are likely to be affected by several one-off factors that are difficult to quantify and interpret.



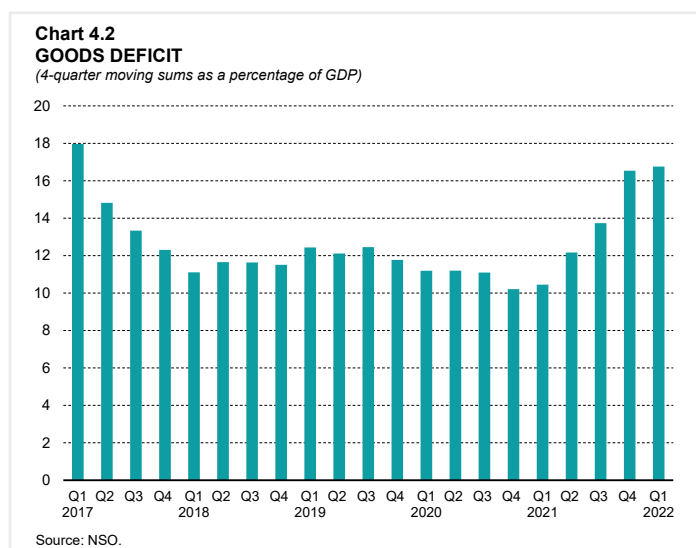
The merchandise trade deficit widens

In the first quarter of 2022, the merchandise trade deficit stood at €469.5 million, up from €375.9 million in the corresponding period of 2021. This was driven by an increase in imports which was larger than the increase in exports. Imports of machinery and transport equipment were the main driver of the increase in imports.

When measured on a 4-quarter cumulative basis, the visible trade gap almost doubled when compared with a year earlier, reaching €2,522.4 million. This was entirely due to a €1,414.3 million rise in goods imports which outweighed a €261.9 million rise in exports. As a result, the share of the goods deficit in GDP rose to 16.8% in the year to March 2022, from 10.4% a year earlier (see Chart 4.2).

The surplus on services widens

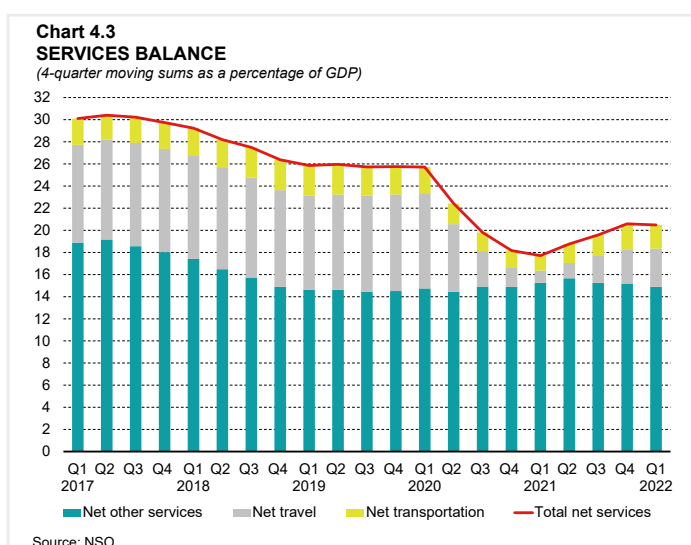
In the quarter under review, net receipts on the services account amounted to €711.0 million, €60.7 million more than in the corresponding period of 2021. Both services receipts and payments increased on a



¹ 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., & Zerfa, S. (eds.), *Challenges and Opportunities of Sustainable Economic Growth: the Case of Malta*, Central Bank of Malta, 2017.

year earlier but the rise in the former was larger.

The main contributor to the increase in the surplus from services during the quarter under review was the travel component, where tourism exports outweighed a rise in expenditure by Maltese residents on travel abroad. This led net travel receipts to increase by €65.4 million. Conversely, net receipts on the transport account fell by €15.8 million when compared to the corresponding quarter of last year, partly reflecting higher freight costs.



Net receipts on 'other services' increased by €11.1 million, mostly due to higher net receipts related to personal, cultural and recreational services – which also include betting activities. These offset higher net payments related to 'other business services' and charges for the use of intellectual property.

On a 4-quarter cumulative basis, the overall surplus from services stood at €3,082.9 million, a €760.1 million increase over the surplus recorded in the corresponding period of 2021. The share of net services receipts in GDP rose to 20.5% in the year to March 2022, from 17.7% in the corresponding period of 2021 (see Chart 4.3).

Net outflows on the primary income account decrease²

Between January and March 2022, net outflows on the primary income account stood at €218.7 million, €8.5 million less than in the first quarter of 2021. This was mainly due to lower cross-border flows of taxes on products net of subsidies classified as 'other primary income'. This was partly offset by higher net payments related to compensation of employees and investment income.

When measured over the four quarters to March 2022, net outflows on the primary income account also decreased. They fell by €20.6 million over the same period a year earlier to stand at €1,147.4 million. This was due to higher net inflows on 'other investment', which outweighed an increase in net outflows on direct investment as well as lower net inflows on portfolio investment.

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 increase marginally³

In the first quarter of the year, net outflows on the secondary income account increased by €1.5 million on a year earlier, to stand at €39.8 million.

Net outflows on this account decreased when measured on a 4-quarter moving sum basis. These stood at €154.9 million – €20.4 million less than the amount recorded a year earlier.

² The primary income account shows income flows related mainly to cross-border investment and compensation of employees.

³ The secondary income account shows current transfers between residents and non-residents.

BOX 1: MERCHANDISE TRADE BETWEEN MALTA AND SELECTED MENA COUNTRIES (2011-2021)^{1,2}

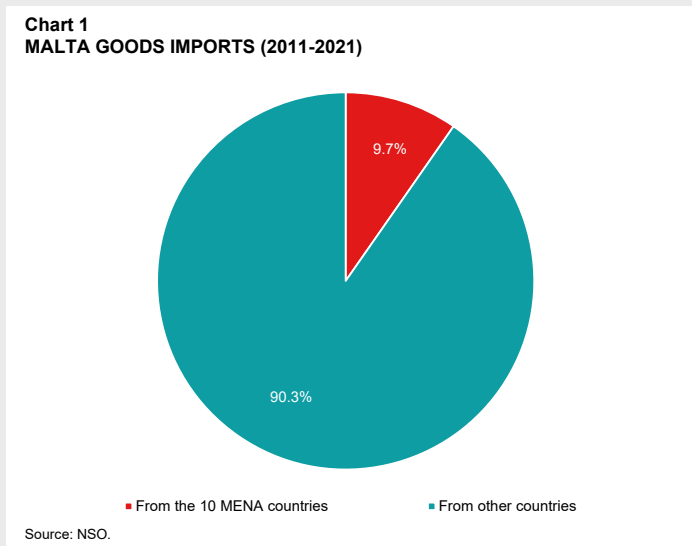
As a member state of the European Union (EU), Malta trades heavily with other EU member states. However, Malta's merchandise trade with countries in the Middle East and North Africa (MENA) is also significant. This study presents an analysis of merchandise trade flows between selected MENA countries and Malta. Furthermore, it presents Malta's goods trade with the MENA countries as a proportion of total Maltese trade with the rest of the world.

For comprehensibility, and since Malta had little to no trade volume with several countries of the MENA region, the MENA countries considered in this box were limited to the ten countries in the region having the highest trade with Malta. These are Algeria, Egypt, Israel, Libya, Morocco, Qatar, Saudi Arabia, Tunisia, Turkey and the United Arab Emirates.

Imports

During the period from 2011 to 2021, Malta imported an average of €6,206.7 million worth of goods a year, of which 9.7% originated from the ten selected MENA countries, with an annual average worth of €602.1 million (see Chart 1). The share of imports from the ten MENA countries increased significantly from 5.0% in 2011 to 13.1% of the total in 2014. The share then dropped to 8.8% in 2016, before increasing to 9.9% in 2017. It has then remained around that level in the following years.

Merchandise imports from the ten MENA countries increased significantly from 2011 to 2012. In fact, in nominal terms, imports more than doubled from around €264.4 million in 2011 to around €597.5 million in 2012. This increase was mainly driven by the increase in oil imports.³ The value of goods imported from the ten MENA countries continued to increase until 2014, when it reached a high of €838.9 million, of



¹ Data in this Box uses the Harmonised System (HS) classification (2 digits) retrieved from the National Statistics Office (NSO) on 23 May 2022.

² Prepared by Ahmed Hnesh, Research Officer within the Monetary Policy, Eurosystem and International Relations Department of the Central Bank of Malta. Reviewed by Kalina Koleva and John Caruana. The views expressed in the Box are the author's own and do not necessarily reflect the views of the Bank.

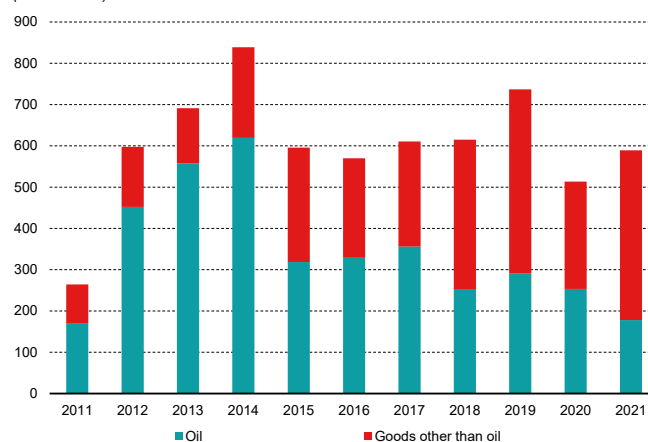
³ Oil consists of mineral fuels, mineral oils and products of their distillation, bituminous substances, and mineral waxes. Oil trade figures include oil bunkering.

which €619.3 million were imports of oil. Moreover, imports of goods other than oil have also substantially increased from 2011, when such imports stood at around €93.8 million, to around €411.2 million in 2021. From 2011 to 2017, oil was the dominant imported good. However, since 2018 Maltese imports mostly reflected trade in goods other than oil, although the latter remained the single most important traded category (see Chart 2 and Chart 5).

Between 2011 and 2021, Maltese imports of goods excluding oil averaged €4,298.2 million a year, of which 6.0% originated from the ten MENA countries with an average value of €258.6 million annually (see Chart 3).

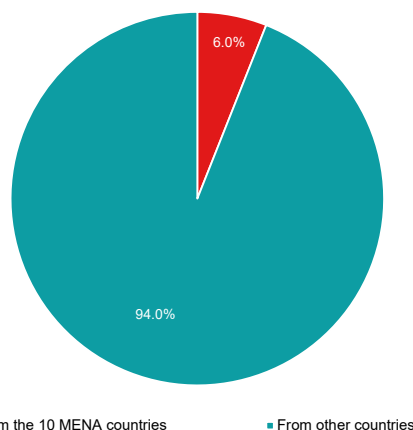
Looking at trade in oil in 2011, Malta imported €1,943.9 million worth of oil, of which 8.8% came from the ten MENA countries with a value of €170.6 million. Oil imports from the MENA countries continued to increase, reaching a peak of €619.3 million in 2014, representing 24.2% of Malta's total oil imports in that year. However, by 2018, the percentage went down to 13%. The

Chart 2
MALTA GOODS IMPORTS FROM THE 10 MENA COUNTRIES
(EUR millions)



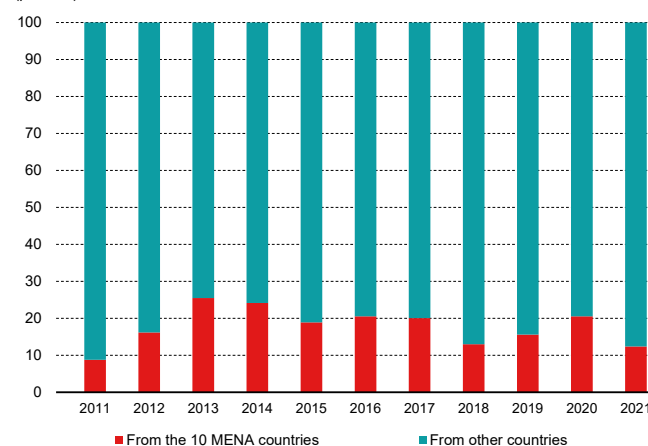
Source: NSO.

Chart 3
MALTA GOODS IMPORTS EXCLUDING OIL (2011-2021)



Source: NSO.

Chart 4
MALTA OIL IMPORTS
(per cent)

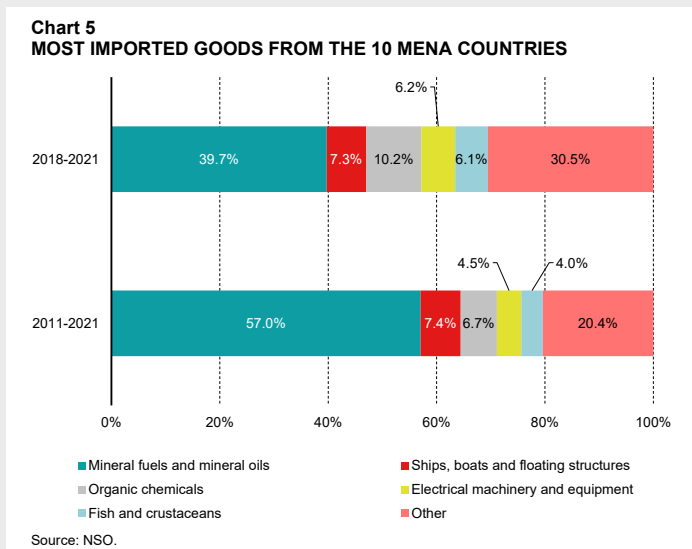


Source: NSO.

share of imports from these selected countries reached 15.6% in 2019, and 20.6% 2020.⁴ In 2021, Malta imported €1,435.9 million of oil, with the selected MENA countries accounting for 12.4% (see Chart 4).

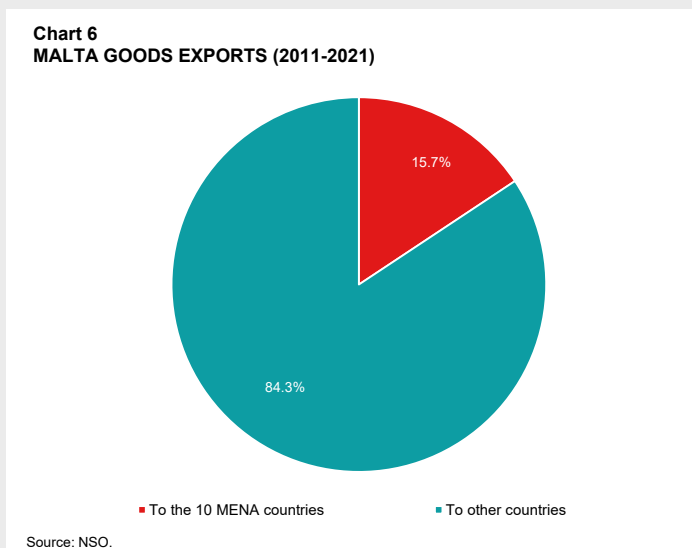
Looking at imports by product category in more detail, in the 2011 to 2021 period, oil made up the biggest share of goods imported. It accounted for 57.0% of total goods

imported. Other imports included ships, boats and floating structures, which accounted for 7.4% of the total, while organic chemicals accounted for 6.7%. Electrical machinery and equipment accounted for 4.5% and fish and crustaceans made up 4.0% of imports over the reviewed period. When grouped together, other goods imported in small values made up the remaining 20.4% (see Chart 5).



Exports

As regards exports of goods, the ten MENA countries accounted for 15.7% of Malta's total exports in the years extending from 2011 to 2021. Malta's goods exports to the ten MENA countries had an average annual value of €592.1 million out of an average of €3,775.6 million worth of total Maltese goods exported annually from 2011 to 2021 (see Chart 6). The share of exports to the ten MENA countries stood at 13.9% of the total in 2011 and reached a high of 25.1% in 2014. Since then, however, it decreased, reaching a low of 7.8% in 2021.



⁴ In 2020, Malta imported its oil from: Italy 20%, Spain 9.9%, Algeria 9.1%, Trinidad and Tobago 8.4%, United Kingdom 7.4%, France 6.4%, Russian Federation 5.1%, Turkey 4.2%, Israel 3.8%, Netherlands 3.6%, Greece 3%, Egypt 2.9%, Belgium 2.1%, Croatia 2%, United States 1.9%, remaining partners 10.3%.

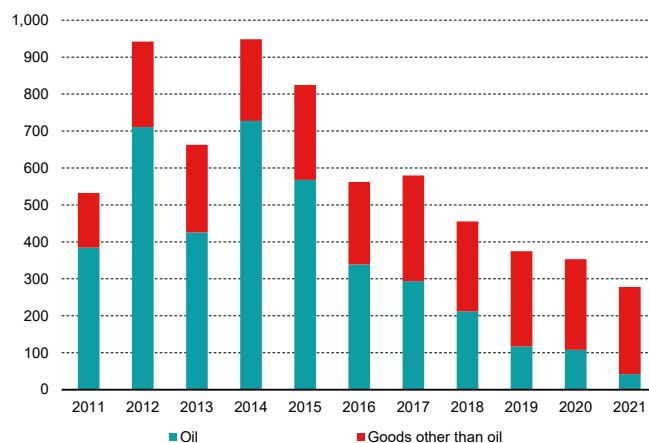
In contrast to imports from the region, exports to the region have fallen over time. This reflects a decrease in the importance of oil-related exports.⁵ By contrast, Malta's exports of goods other than oil to the ten MENA countries remained relatively stable over the period under consideration. However, oil re-exports changed widely, resulting in the fluctuation of overall exports to the selected MENA countries. Exports of goods other than oil were valued at around €147.7 million in 2011 out of total exports worth €532.3 million. The value of exports of goods other than oil peaked at €285.8 million in 2017, while oil stood at €293.9 million, with total goods exported that year amounting to €579.8 million. Exports of goods declined in the following years. In 2020, re-exports of oil were valued at €107.8 million while goods other than oil were valued at €245.2 million resulting in total goods exports of €353.1 million. In 2021, Malta re-exported €42.1 million of oil to the MENA countries, while exporting €235.9 million of goods other than oil resulting in total of goods' exports of €278.0 million (see Chart 7).

When it comes to exports excluding oil, the ten MENA countries imported 9.8% of the Maltese merchandise exports over the period from 2011 to 2021. On average, over this period, Malta exported €235.0 million of goods other than oil to the ten MENA countries annually. This compared with total Maltese exports of goods other than oil averaging €2,392.6 million annually (see Chart 8).

Malta's oil re-exports to the ten MENA countries fluctuated more than imports. In 2011, Malta re-exported a total of €1,620.7 million worth of oil, of which around 23.7%, valued at €384.5 million, went to the ten MENA countries. Oil re-exports to these countries

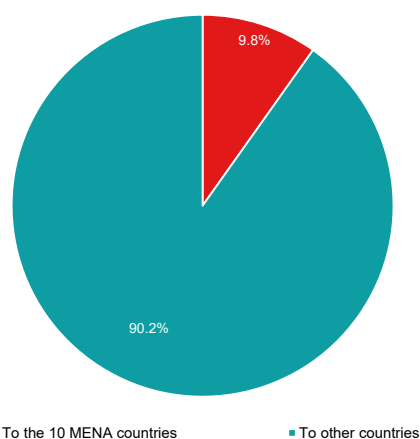
⁵ As Malta produces no oil, all oil exports are re-exports.

Chart 7
MALTA GOODS EXPORTS TO THE 10 MENA COUNTRIES
(EUR millions)



Source: NSO.

Chart 8
MALTA GOODS EXPORTS EXCLUDING OIL (2011-2021)



Source: NSO.

reached a peak of €727.4 million in 2014, equivalent to 45.3% of total Maltese oil re-exports. The share of the ten MENA countries in total oil re-exports then started to decrease from 2015 and reached 20% in 2017. The share then experienced a slight increase to 20.2% in 2018 before halving in 2019 to 10.1%. In 2020, Malta re-exported €107.8 million of oil to the ten MENA countries, which represents 10.0% of total Maltese oil re-exports in that year. Subsequently, in 2021, Malta re-exported a total of €1,014.4 million of oil, of which only 4.2%, or €42.1 million, went to the ten MENA countries (see Chart 9).

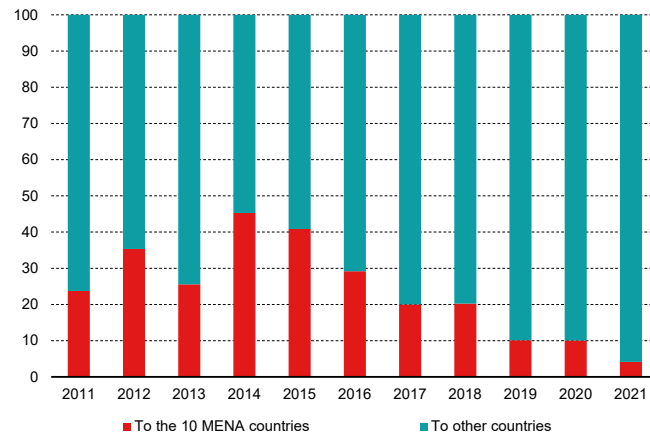
A more detailed breakdown of Maltese goods exports to the ten selected MENA countries shows that during the same period these mainly consisted of oil, which represented 60.3%

of the total goods export value. Other goods contributed to a much lesser extent to exports when compared to mineral fuels, with the categories of electrical machinery and equipment accounting for 5.0% and machinery and mechanical appliances accounting for 4.3% of the total. Miscellaneous edible preparations amounted to 2.9% of Maltese exports of goods, while tobacco and tobacco substitutes accounted for 2.5%. Other goods exported in small values made up the remaining 25.0% of the total value of goods exported by Malta to the ten MENA countries (see Chart 10).

Conclusion

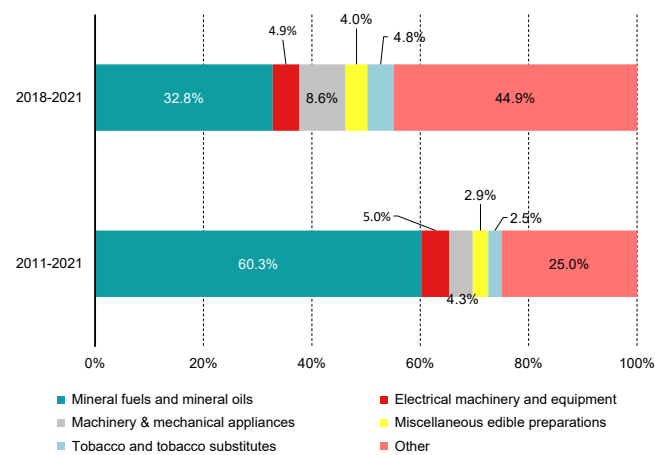
Malta's trade in goods with the ten selected countries of the MENA region held a relatively significant weight between 2011-2021. However, the region's relative share in Malta's

Chart 9
MALTA OIL RE-EXPORTS
(per cent)



Source: NSO.

Chart 10
MOST EXPORTED GOODS TO THE 10 MENA COUNTRIES



Source: NSO.

merchandise trade peaked in 2014 and then decreased over the remainder of the period reviewed.

Although as a trading partner it is less significant than the EU, the share of trade with the selected MENA countries is still relevant. Malta's merchandise trade with the selected MENA countries for the period from 2011 to 2021 was broadly in balance, with average annual net imports of just €10.0 million. Imports from the selected countries of the region represented almost 9.7% of total Maltese goods imports over the reference period, while exports represented 16.2% of total Maltese goods exports. Between 2011 and 2017, trade was dominated by oil. However, from 2018 onwards, goods other than oil accounted for a larger share of overall trade, which indicates a shift in trade patterns with the MENA region.

Tourism activity

In the first quarter of 2022, further gains were registered in the number of inbound tourists, nights stayed and tourist expenditure in Malta, relative to those recorded in the corresponding period a year earlier. Nonetheless, activity indicators for the sector remained below pre-pandemic levels.

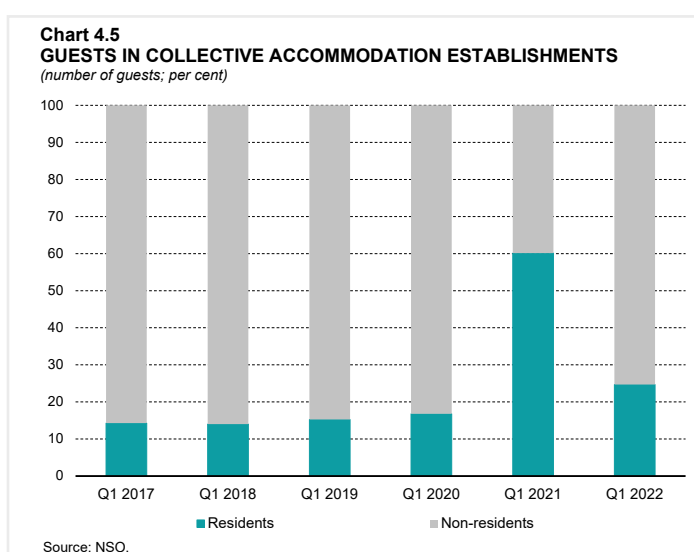
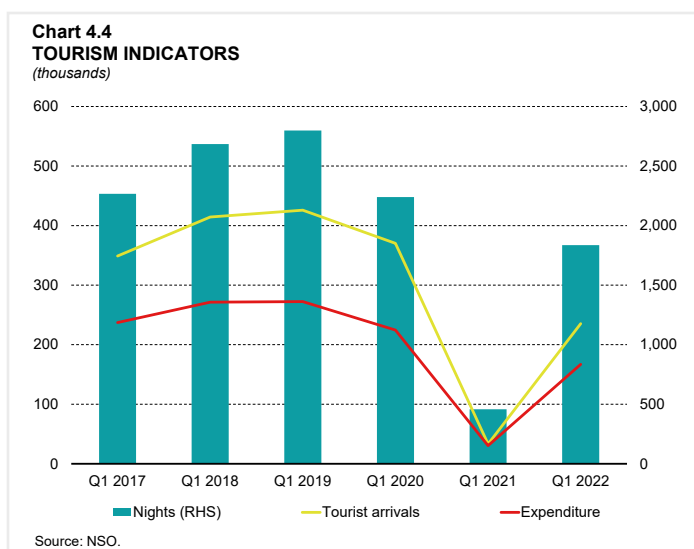
In the quarter under review, the number of inbound tourists totalled 235,295, up from 33,249 a year earlier (see Chart 4.4). In absolute terms, tourists

visiting Malta for holiday purposes accounted for the majority of the annual increase in arrivals even though those visiting for business and other motives also increased. The number of inbound tourists was however still just over half the level recorded in the corresponding period of 2019.

Meanwhile, the total number of guest nights that tourists spent in Malta during the first quarter of 2022 amounted to 1.8 million, up from 0.5 million a year earlier. Rented accommodation, in particular collective accommodation, accounted for most of this increase.

The share of non-residents in collective accommodation establishments in the first quarter of 2022 rose further. It stood at 75.3%, up from 39.9% in the first quarter of 2021, though below the 84.8% ratio recorded in the first quarter of 2019 (see Chart 4.5).

The total occupancy rate in collective accommodation establishments in the first quarter of 2022 rose to 29.4% from just 10.2% a year earlier. However, it remained below that recorded in the first quarter of 2019 when it had reached 47.7% (see Chart 4.6). All categories reported increases in their occupancy rates when compared with 2021, with the 4-star category registering the largest increase, that of 26.3 percentage points. This was followed by a rise of 22.1 percentage points in the 2-star category. Meanwhile, the smallest increase, that of 11.5 percentage points, was registered in the 5-star category.



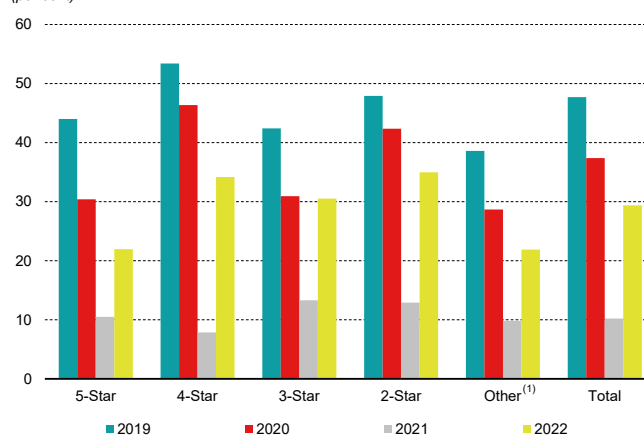
Tourist expenditure in Malta reached €167.1 million in the first quarter of 2022, more than five times the level recorded a year earlier. However, this was still below the level registered in the corresponding period of 2019. When compared to 2021, all expenditure categories registered gains, with the ‘other’ and the non-package expenditure categories recording the largest increases in absolute terms.

Expenditure per capita decreased to €710.0 from €916.1 in the first quarter of 2021, as the average length of stay fell to 7.8 nights from 13.8 nights a year earlier. Both expenditure per capita and nights per capita exceeded those recorded in the first quarter of 2019.

According to Malta International Airport (MIA) data, in the first quarter of 2022, average seat capacity was more than five times that recorded in same quarter of 2021. It reached an average of 342,674 seats per month (see Chart 4.7). This was almost two-thirds of its level in the first quarter of 2019.

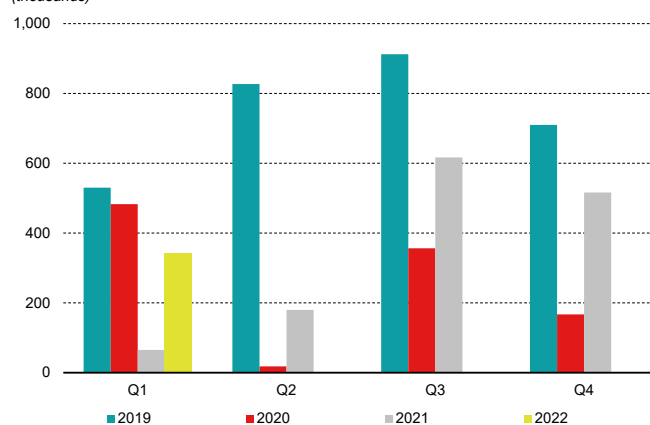
A total of 23 cruise liners visited Malta in the first quarter of 2022. Foreign passengers reached 25,054 persons (see Chart 4.8), amounting to less than a third of the number recorded in the corresponding quarter of 2019. EU nationals continued to comprise the largest share of total cruise passengers during the quarter under review.

Chart 4.6
AVERAGE OCCUPANCY RATES IN THE FIRST QUARTER
(per cent)



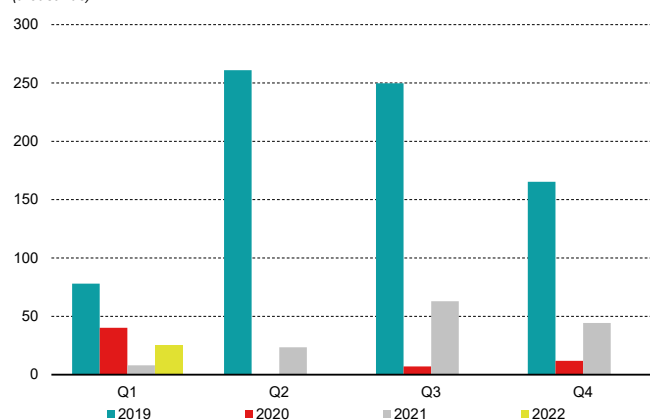
Source: NSO.
⁽¹⁾ Includes guest houses, hostels and holiday complexes.

Chart 4.7
AVERAGE MONTHLY SEAT CAPACITY⁽¹⁾
(thousands)



Source: MIA.
⁽¹⁾ Data include schedule and charter seats.

Chart 4.8
CRUISE LINER PASSENGERS⁽¹⁾
(thousands)



Source: NSO.
⁽¹⁾ Ports were closed during the second quarter of 2020.

The capital account

Net inflows on the capital account stood at €34.2 million in the first quarter of 2022, increasing significantly from €7.2 million in the corresponding period of 2021 (see Table 4.1). Capital inflows also increased considerably when measured on a 4-quarter moving sum basis, standing at €177.9 million compared to €65.4 million in 2021.

BOX 2: THE ECONOMIC EFFECTS OF THE COVID-19 TOURISM DOWNTURN¹

In response to the rapid spread of the COVID-19 outbreak, national governments, including that of Malta, have implemented a range of mitigation measures designed to limit the transmission of the coronavirus. Most of these measures have been focused on limiting social interactions and consequently, have had disproportionately large effects on contact intensive industries such as tourism. Most of the first measures that were introduced globally were directly aimed to restrict international travel, thus having substantial effects on the global tourism industry. Indeed, the tourism industry is considered to be one of the worse hit industries worldwide, with estimates suggesting that in 2020 global tourism arrivals dropped by more than 70%, reducing global GDP by around 2% and putting more than 100 million employees at risk (UNWTO, 2021).²

In line with measures introduced at a global scale, Maltese authorities have started introducing inbound passenger screening by late February 2020, followed by a rapid implementation of further containment measures (Sant, 2021).³ Among others, these included restrictions on gatherings and public events, closures of schools and of the non-essential retail shops and services, and the suspension of all inbound passenger flights, with some exceptions for repatriation flights. As a result of these developments, together with the direct effect of the outbreak of the pandemic, Malta's real GDP in 2020 declined by 8.3% when compared to a year earlier. In line with global estimates, the Maltese tourism industry was the most heavily hit sector in Malta, with tourist arrivals in 2020 falling by around 76% when compared to 2019. Given the unprecedented scale of the crisis that hit global tourism, as well as the considerable intersectoral linkages that characterise the industry, it is likely that the downturn in the tourism industry had far reaching effects in other sectors of the Maltese economy. This study aims to quantify the sectoral and macroeconomic effects that this unprecedented fall in tourism had on the Maltese economy during 2020, while taking in consideration the considerable interlinkages this industry has with the rest of the economy.

Method

This study makes use of a Leontief demand module found within the Input-Output framework put forward in Rapa (2020),⁴ updated with the latest symmetric input-output table (SIOT) available for the year 2015. This simulation framework is exceptionally well-suited to capture the sector-dependent direct and indirect economic effects of the contraction in the tourism industry following the COVID-19 crisis.

The calibration of this scenario analysis requires the estimation of the direct exposures each sector has to the tourism industry. The latest information in this respect is available

¹ 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.

² See World Tourism Organisation, (2021). Tourism Data Dashboard, <https://www.unwto.org/unwto-tourism-dashboard>, viewed 29 October 2021.

³ See Sant, K. (2021). The COVID-19 pandemic and disruption in 2020: Developing a government response tracker for Malta. CBM *Policy Note*, April 2021.

⁴ See Rapa, N. (2020). A sectoral model extension to STREAM. CBM *Working Papers*, WP/08/2020, Central Bank of Malta.

from the Tourism Satellite Accounts (TSA) of 2010. Table 1 shows the proportion of sectoral output that is directly supplied to fulfil tourism related expenditure.

These figures convey two points. First, there is considerable heterogeneity in the sectors' direct exposure to the tourism sector. Second, there is even more heterogeneity when we decompose tourism demand into inbound tourism, domestic tourism for the purposes of domestic trips and domestic tourism for the purposes of outbound trips.^{5,6} Against this backdrop, the calibration of the shocks needs to reflect the heterogeneity in the cross-sectoral exposures to the three different types of tourism expenditure which have been impacted to varying degrees by the pandemic emergency. The calibration of the tourism shocks is further complicated by the fact that the latest TSA for the Maltese economy have been published in 2010. While still relying on TSA 2010 tables, the calibration of the simulation analysis needs to take in consideration the profound structural changes that have significantly changed the relative size of some sectors within the Maltese economy.

To this end the calibration process used in this study proceeds in three steps. First, we estimate the percentage change in inbound, outbound and domestic tourism expenditure that is attributable to the COVID-19 emergency. Based on this definition, the shock to inbound tourism expenditure in 2020 is estimated at -80.6%. On the other hand, the shock to the expenditure of domestic tourists for the purposes of domestic trips is calculated at +43.9%, largely reflecting the substantial increase in the number of Maltese residents visiting Gozo for leisure purposes in 2020. As less Maltese residents travelled abroad during the year, the expenditure of Maltese tourists for the purposes of outbound trips in 2020 was estimated to have fallen by 78.6% vis-à-vis baseline levels as a result of the pandemic.

Table 1
PROPORTION OF SECTORAL OUTPUT DIRECTLY ABSORBED BY THE TOURISM INDUSTRY

Per cent of sectoral output

	Inbound tourism	Domestic tourism (domestic trips)	Domestic tourism (outbound trips)	Total tourism
Travel agencies and other reservation activities	24.0	0.0	28.1	52.1
Land transport and transport via pipelines,...	45.3	1.3	4.2	50.8
Accommodation and food services activities	42.7	1.9	0.1	45.2
Creative, arts and entertainment activities	32.9	0.0	0.0	32.9
Education	23.4	0.1	0.1	23.6
Rental and leasing activities	15.0	0.1	0.1	15.1
Sports activities and amusement and recreation activities	13.1	0.0	0.0	13.1
Other	0.9	0.0	0.0	0.9

Source: Author's calculations based on TSA 2010.

⁵ 'Domestic tourism for the purposes of domestic trips' refers to instances when residents of Malta travel to Gozo for leisure. In the rest of this report, this type of tourism will be referred to as "domestic tourism".

⁶ 'Domestic tourism for the purposes of outbound trips' refers to expenditure in Malta that is solely due, or for the purposes of, undertaking an outbound trip. This includes all expenditure incurred in Malta for the purposes of traveling abroad, including any flights, hotels etc booked with local travel agents. In the rest of this report, this type of tourism will be referred to as "outbound tourism".

Table 2
SHARE OF INTERNAL TOURISM OUTPUT USED IN EACH SECTOR

Per cent of tourism output

	Inbound tourism	Domestic tourism (domestic trips)	Domestic tourism (outbound trips)	Total tourism
Accommodation and food services activities	52.3	64.4	2.5	49.6
Land transport and transport via pipelines,...	25.4	20.1	32.8	25.6
Travel agencies and other reservation activities	3.6	0.1	58.4	7.0
Retail trade, except of motor vehicles and motorcycles	3.8	4.4	3.7	3.8
Manufacture of food products, beverages and tobacco products	3.9	4.7	0.4	3.7
Education	3.0	0.3	0.1	2.7
Rental and leasing activities	2.1	0.3	0.1	1.9
Sports activities and amusement and recreation activities	1.8	0.0	0.0	1.6
Wholesale trade, except of motor vehicles and motor cycles	1.5	3.1	1.1	1.5
Creative, arts and entertainment activities	1.3	0.0	0.0	1.2
Publishing activities, motion picture, video...	0.4	0.8	0.3	0.4
Manufacture of textiles, wearing apparel and leather products	0.2	0.2	0.0	0.2
Real estate activities	0.2	0.4	0.1	0.2
Other professional, scientific and technical activities...	0.2	0.4	0.1	0.2
Crop and animal production, hunting and related services...	0.1	0.2	0.1	0.1
Manufacture of paper and paper products, printing...	0.1	0.2	0.1	0.1
Other personal service activities	0.1	0.1	0.0	0.1
Manufacture of computer, electronic and optical products...	0.1	0.1	0.0	0.1
Legal and accounting activities; activities of head offices...	0.0	0.1	0.0	0.0
Activities auxiliary to financial services and insurance activities	0.0	0.1	0.0	0.0
Total	100	100	100	100

Source: Author's calculations based on TSA 2010.

Second, we normalise the level of final demand changes to all three types of tourism to 2015 EUR million levels, a step necessary to make use of the simulation framework which is based on a set of IO tables covering 2015.⁷

Finally, the shocks to each sector are estimated by decomposing the overall change in aggregate final demand (estimated in 2015 prices) for each tourism type into different sectors in line with the sectoral tourism output decomposition, derived from data contained within the TSA tables. These are illustrated in Table 2 and show the proportion of tourism output by type that is supplied by each sector.⁸

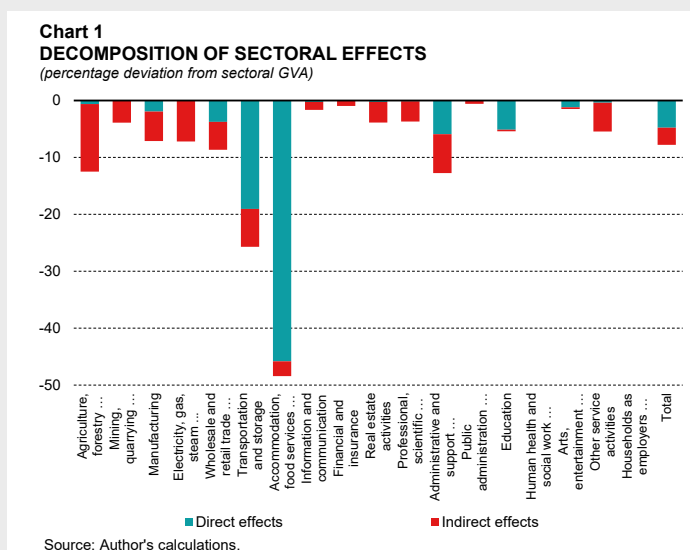
Results

We simulate the model by imposing a series of final demand shocks to all sectors in line with Table 2. Results in Chart 1 show the sectoral effects of the drops in tourism expenditure in terms of GVA. The chart indicates that the contraction in the tourism industry has led

⁷ This is done in two stages. First, we use the proportion of output in the Maltese economy that is directly used by the overall tourism industry as per TSA 2010 and apply this proportion to the total final demand in the Input Output database for 2015. Second, we find the aggregate final demand shock for each tourism type by using information contained within the TSA 2010 tables. In particular, we use information on the proportion of total tourism output supplied for the purposes of inbound tourism, domestic trips and domestic expenditure for outbound trips, to disaggregate the shock to total tourism final demand to different tourism types. The reader is referred to the Appendix of Debono and Rapa (2021), The Economic Effects of the COVID-19 Tourism Downturn, Central Bank of Malta *Policy Note*, December 2021, for a detailed explanation of all steps involved in this part of the calibration.

⁸ Tables 1 and 2 show different concepts. The proportions in Table 1 are useful in identifying which sectors had the highest direct exposure to the tourism industry. On the other hand, the estimates in Table 2 show the extent to which the tourism industry relies on different sectors to produce its output.

to substantial declines in the GVA of Accommodation and food service activities (-48.4%), Transportation and storage (-25.7%), Administrative and support services activities (-12.8%), Agriculture, forestry and fishing (-12.5%) and Wholesale and retail trade sectors (-8.7%). Moreover, the GVA of sectors covering manufacturing activities as well as the production of electricity and water treatment and supply has also been substantially impacted by the drop in tourism expenditure.



As expected, the overall results show the strongest losses in GVA for sectors which have been identified as being exceptionally exposed to the tourism industry. These include sectors such as the Accommodation and food services activities and the Transportation and storage sector, where a significant part of final demand is directly absorbed by inbound or outbound tourism expenditure. This is mirrored by the fact that the main drivers of sectoral results relate to direct effects. However, the sectoral effects of the downturn in the tourism industry are not only limited to direct effects. This is most evident for the Agriculture, forestry and fishing sector whose GVA is estimated to have fallen by almost 13% when compared to the baseline projections for 2021, almost entirely on the basis of indirect effects. This is especially due to the fact that 40% of the interindustry supply of this sector is demanded by Accommodation and food services activities, which on the other hand is the sector which is most directly exposed to the tourism industry. Similar arguments apply for Electricity, gas, steam and air conditioning supply and waste collection services, the Administrative and support services activities and the Manufacturing sectors, all of which are indirectly exposed to the tourism industry, mainly through the supply of intermediate production to the Transportation and storage and Accommodation and food services activities sectors.

Table 3 shows the annual economy-wide percentage losses in GVA, employment and labour income together with the respective percentage drops in aggregate final demand components that are directly and indirectly attributable to the decline in the tourism industry in 2020.

The contraction of the tourism industry caused by the COVID-19 pandemic has led to a drop in aggregate GVA of almost 7.8%, mostly driven by a contraction in inbound tourism expenditure. In view of the small contribution that domestic expenditure for the purposes of

Table 3
AGGREGATE RESULTS

Percentage deviation from baseline forecasts

	Inbound tourism	Domestic tourism (domestic trips)	Domestic tourism (outbound trips)	Total tourism
Total GVA	-7.5	0.1	-0.5	-7.8
Total labour income	-7.4	0.1	-0.5	-7.8
Total employment	-9.1	0.2	-0.6	-9.5
Aggregate Final Demand				
Private Consumption	-2.9	0.4	-3.9	-6.4
Government Cons.	-0.6	0.0	0.0	-0.6
Private Investment	-2.9	0.1	-0.1	-3.0
Exports	-6.1	0.0	-0.1	-6.2
Imports	-2.9	0.1	-1.1	-4.0

Source: Author's calculations.

outbound trips has on the domestic economy, the fall in the outbound tourism industry has led to subdued negative effects on the overall economy estimated at 0.5% of baseline GVA. On the other hand, the rise in expenditure incurred on domestic trips is estimated to have led to a marginal rise in the aggregate economic activity in Malta of around 0.2%. Thus, on aggregate, the negative effects attributable to the drop in outbound tourism expenditure have only been partially outweighed by an increase in domestic tourism expenditure, implying that the combined effects of the COVID emergency on the domestic tourism market – defined as the sum of outbound and domestic trips – on the local economy is estimated to have been slightly negative.

As expected, given the size of the sectors and the extent of the fall in their GVA, the Accommodation and food services activities, the sector comprising Land transport and transport via pipelines and the Wholesale and retail trade, except of motor vehicles are main contributors behind the aggregate falls in GVA. Indeed, together these three sectors explain more than half of the drop in aggregate GVA.

Conclusion

This study reveals that the contraction in the tourism industry has significantly affected sectors that are exceptionally directly exposed to tourism, such as the Accommodation and food services activities and the Transportation and storage activities sector. However, given the substantial cross-sector interlinkages, other sectors such as the Agriculture, forestry and fishing, Manufacturing and the Electricity, gas and steam sectors have also suffered considerable GVA losses from indirect effects. On aggregate, taking in consideration both direct and indirect effects, the fall in the tourism industry has reduced overall GVA by 7.8%, mostly due to a contraction in inbound tourist arrivals. Excluding the effects of government intervention, aimed at mitigating the impact of the pandemic on the labour market, this fall in GVA is likely to have reduced labour income by almost 8% and overall employment by 9.5%.

These results should be interpreted within the context of an ever-transforming tourism industry and a lack of more updated TSA. In the last decade, the Maltese tourism industry has undergone significant transformations characterised by a steep increase in the demand for private accommodation and a considerable rise in the proportion of tourists that choose low-cost airlines to travel to the islands. Indeed, while the calibration process is quite robust to changes in the relative size of sectors due to factors other than tourism, changes in the reliance of the Maltese tourism industry to different sectors could have important implications on the results discussed above.

5. GOVERNMENT FINANCE

In the first quarter of 2022, the general government deficit widened in level terms when compared to that recorded in the corresponding period of 2021. When measured on a 4-quarter moving sum basis, the general government balance registered a deficit of 8.0% of GDP, broadly unchanged from the 7.9% recorded in the fourth quarter of 2021. Meanwhile, the general government debt-to-GDP ratio rose to 57.6% from 56.4% at end-December 2021. The net financial worth as a share of GDP slightly improved in the quarter under review. Meanwhile, the cyclically-adjusted deficit ratio widened.

Quarterly developments

General government deficit widens

In level terms, the general government registered a deficit of €402.1 million in the first quarter of 2022, a deterioration of €36.8 million when compared with the corresponding quarter of 2021. This was mainly due to an increase in expenditure which outweighed an increase in revenue. As a result, the primary deficit widened from €324.3 million in the first quarter of 2021 to €365.2 million in the quarter under review.

Higher tax receipts underpin revenue growth

In the first quarter of 2022, general government revenue increased by €141.4 million, or 12.3% when compared with the same quarter of 2021 (see Table 5.1). Growth was mainly driven by

	2021				2022	Change 2022Q1-2021Q1	
	Q1	Q2	Q3	Q4	Q1	Amount	%
Revenue	1,148.6	1,387.3	1,342.5	1,574.3	1,290.0	141.4	12.3
Taxes on production and imports	343.7	396.2	423.6	412.2	407.5	63.8	18.6
Current taxes on income and wealth	387.3	578.2	477.2	587.0	473.5	86.1	22.2
Social contributions	204.2	211.5	210.8	288.3	224.5	20.3	9.9
Capital and current transfers receivable	94.4	44.9	71.6	92.4	40.3	-54.1	-57.3
Other ⁽¹⁾	119.0	156.5	159.2	194.4	144.2	25.2	21.2
Expenditure	1,513.8	1,611.6	1,639.2	1,852.3	1,692.0	178.2	11.8
Compensation of employees	441.1	444.0	435.6	448.9	446.3	5.2	1.2
Intermediate consumption	295.6	285.2	328.5	427.1	341.5	45.8	15.5
Social benefits	349.6	392.4	327.2	343.2	421.4	71.8	20.5
Subsidies	149.7	167.3	188.1	183.2	151.6	2.0	1.3
Interest	40.9	43.5	39.9	43.2	36.8	-4.1	-9.9
Other current transfers payable	85.8	100.3	159.7	112.5	137.7	51.9	60.5
GFCF	119.7	153.8	122.2	211.1	123.1	3.4	2.9
Capital transfers payable	24.3	23.7	29.2	84.7	32.4	8.1	33.4
Other ⁽²⁾	7.1	1.4	8.8	-1.5	1.1	-5.9	
Primary balance	-324.3	-180.8	-256.9	-234.8	-365.2	-40.9	
General government balance	-365.2	-224.3	-296.7	-277.9	-402.1	-36.8	
General government debt	7,497.2	8,026.9	7,990.3	8,284.4	8,672.2		

Source: NSO.

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

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

higher tax revenue, as inflows from current taxes on income and wealth and from taxes on production and imports both increased by around a fifth in year-on-year terms. The rise in the former reflects higher income tax receipts from both households and firms, whereas the increase in taxes on production and imports largely reflects higher VAT receipts. Moreover, inflows from social contributions rose by €20.3 million, reflecting a buoyant labour market.

Non-tax revenue declined in the quarter under review due to lower capital and current transfers receivable. These declined by €54.1 million on the back of lower grants from the EU. This offset an increase of €25.2 million in 'other' revenue, reflecting higher income from sales.

Current expenditure underpins expenditure growth

Total government expenditure increased by €178.2 million, or 11.8% when compared with the first quarter of 2021. This increase primarily reflects higher current expenditure, notably higher outlays on social benefits, intermediate consumption, and other current transfers. The latter rose by €51.9 million, reflecting the disbursement of tax refunds and a stimulus cheque to compensate for higher prices.

Social benefits rose by €71.8 million, driven by the timing of outlays on retirement pensions. Outlays on intermediate consumption rose by €45.8 million, largely on the back of higher spending related to public administration. Spending on compensation of employees increased by €5.2 million, reflecting higher outlays in various government entities, while expenditure on subsidies increased marginally. Meanwhile, outlays on interest payments declined by €4.1 million.

Capital spending also rose, albeit to a lower extent. Outlays on capital transfers and government investment increased by €8.1 million and €3.4 million respectively, mostly due to higher expenditure on locally-financed initiatives.

Debt increases

In March 2022, the stock of general government debt amounted to €8,672.2 million, €387.8 million higher than the level registered at end-December 2021. The increase in debt mainly reflects the issue of long-term debt securities (composed of MGS) and short-term debt securities (composed of Treasury bills). While the former rose by €227.3 million, their share in total debt declined by 0.8 percentage point to 74.9%. Meanwhile, the stock of short-term securities rose by €160.6 million, with their share in total debt increasing by 1.5 percentage points to 8.5%.

The value of loans outstanding increased by €1.1 million, which was entirely due to an increase in long-term loans. The share of loans outstanding in total debt stood at 9.7%, significantly higher when compared with pre-pandemic times – when they had stood at 7.4%. This was due to the take up of loans from the EU's Support to mitigate Unemployment Risks in an Emergency (SURE) instrument.

Headline and cyclically-adjusted developments

Headline deficit ratio is broadly unchanged, while the debt ratio increases further

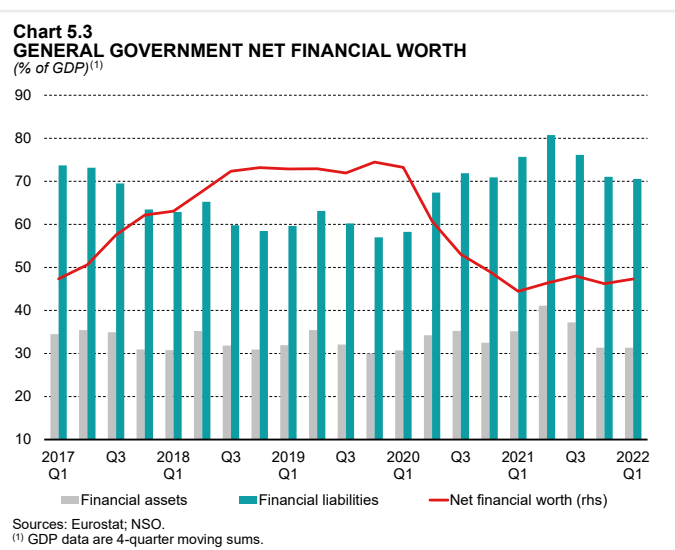
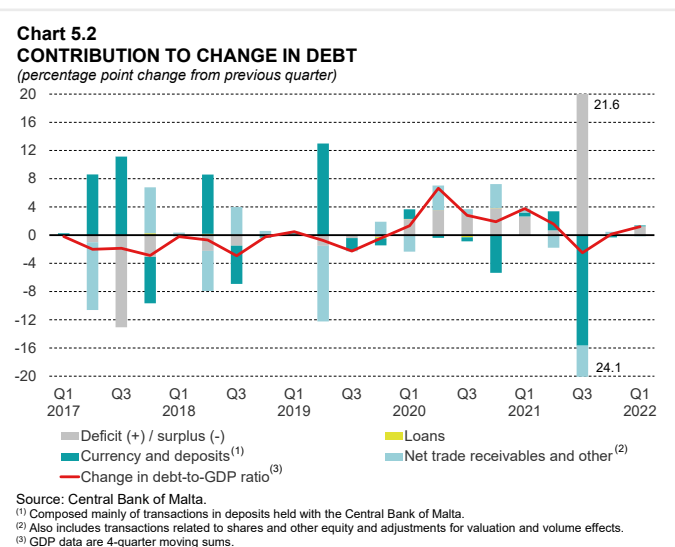
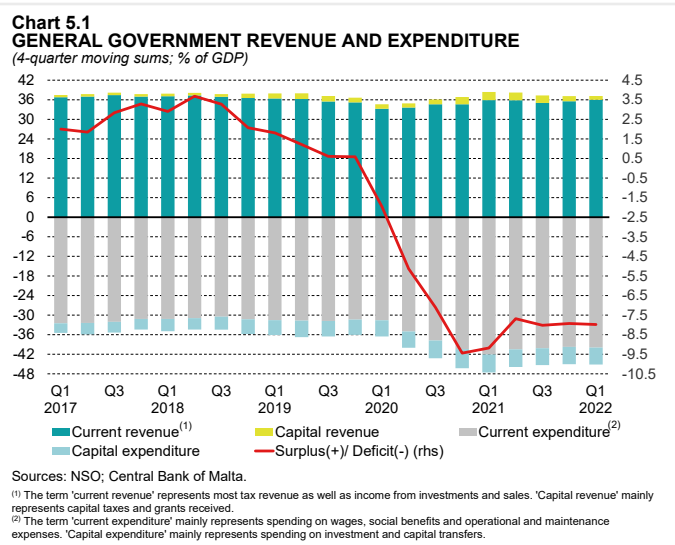
When measured on a 4-quarter moving sum basis, the general government deficit widened slightly, from 7.9% in the fourth quarter of 2021 to 8.0% in the quarter under review (see Chart 5.1).

The slight deterioration in public finances was driven by a small increase in the expenditure-to-GDP ratio. In turn, this reflects a 0.2 percentage point increase in the share of current expenditure in GDP that was partly offset by a lower capital expenditure ratio. In the quarter under review, the revenue-to-GDP ratio remained unchanged. While the share of current revenue in GDP increased by 0.4 percentage point compared to the previous quarter, the share of capital revenue declined by a similar amount.

Between December 2021 and March 2022, the debt-to-GDP ratio rose by 1.2 percentage points from 56.4% to 57.6%. The rise in general government debt was smaller than the fiscal deficit recorded during the first quarter of 2022, due to a negative-debt-adjustment stemming mainly from lower net trade receivables (see Chart 5.2).

Net financial worth improves relative to GDP

The market value of financial assets held by general government rose to €4,720.0 million by March 2022, €116.9 million more than the level as at end December 2021. This was mainly due to a strong increase in the value of other accounts receivable, reflecting accrual adjustments to tax revenue made in line with ESA methodology. Despite this increase, the share of financial assets in GDP remained broadly stable at 31.4% (see Chart 5.3).



The stock of financial liabilities rose at a stronger pace relative to financial assets. The former rose by €187.5 million, to stand at €10,621.3 million. This is due to a strong rise in ‘other accounts payable’, which was mainly driven by adjustments for accrued expenditure. Notwithstanding this increase, the share of financial liabilities in GDP declined by 0.5 percentage point to reach 70.6%.

The resulting net financial worth of general government stood at -€5,901.3 million, which is €70.6 million below that registered in the previous quarter. However, when calculated as a share of GDP, the net financial worth of general government as a share of GDP stood at -39.2%, which is 0.5 percentage point higher than the -39.7% registered in the previous quarter.

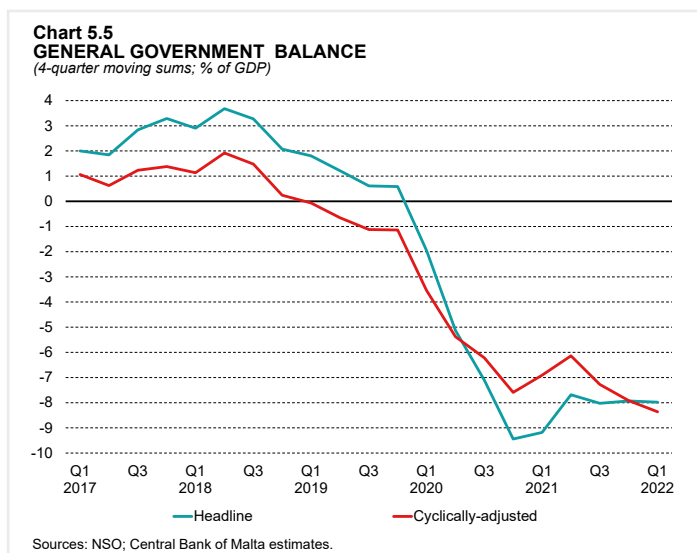
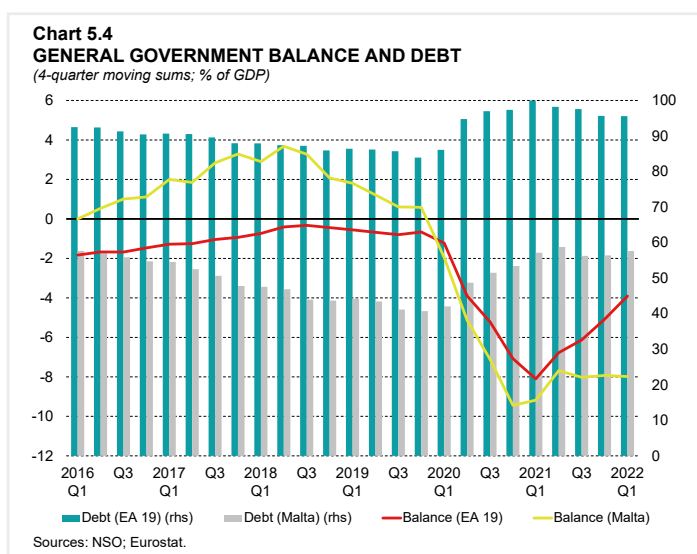
As a share in GDP, the net financial worth of the euro area improved by 4.1 percentage points in the quarter under review. Despite this development, the net worth position of the Maltese general government is still more favourable than that in the euro area, where it stood at -66.5% of GDP in March.

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

During the quarter under review, the euro area general government deficit stood at 3.9% of GDP on a 4-quarter moving sum basis, down from the deficit of 5.1% of GDP at end-December (see Chart 5.4). Over the same period, the euro area debt ratio declined slightly to 95.6% of GDP from 95.7% of GDP in the previous quarter. 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 deteriorates¹

On a 4-quarter moving sum basis, the cyclically-adjusted deficit stood at 8.4% of GDP in the quarter under review, 0.4 percentage point higher than



¹ The cyclically-adjusted balance is corrected for the impact of the economic cycle on government tax revenue and unemployment assistance. This methodology is in line with the approach used by the European Commission but is based on own estimates for fiscal items’ elasticities and the output gap. For an overview of the method used by the Commission, see Mourre, G., Astarita C., and Princen S. (2014): “Adjusting the budget balance for the business cycle: the EU methodology,” European Economy – Economic Papers 536, (DG ECFIN), European Commission.

the deficit posted three months earlier (see Chart 5.5). This deterioration was more pronounced than the small increase in the headline deficit over the same period, and reflects the estimated widening of the positive output gap.

Overall, the share of cyclically-adjusted revenue in GDP declined by a marginal 0.1 percentage point (see Table 5.2). This was mostly due to a fall in the share of 'other revenues', reflecting the above-mentioned decline in EU grants. This was partly offset by an increase in the share of direct and indirect taxes, which jointly rose by 0.2 percentage point.

The share of cyclically-adjusted expenditure rose by 0.4 percentage point, mainly due the above-mentioned increases in social benefits, intermediate consumption and current transfers (which in Table 5.2 form part of 'other' expenditure).

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

Percentage points of GDP

	2021				2022
	Q1	Q2	Q3	Q4	Q1
Revenue	1.7	0.3	-0.7	-0.2	-0.1
Current taxes on income and wealth	0.9	0.0	-0.8	0.1	0.1
Taxes on production and imports	0.1	0.2	0.1	-0.2	0.1
Social contributions	0.4	-0.2	-0.2	0.3	-0.1
Other ⁽¹⁾	0.3	0.3	0.3	-0.2	-0.2
Expenditure	1.0	-0.5	0.5	0.5	0.4
Compensation of employees	0.3	0.2	0.0	0.1	-0.2
Intermediate consumption	0.7	-0.5	0.1	0.2	0.1
Social benefits	0.1	0.0	0.1	0.0	0.3
Interest payments	0.0	0.0	0.0	0.0	0.0
GFCF	-0.2	0.0	-0.1	0.1	-0.1
Other ⁽²⁾	0.1	-0.2	0.5	0.1	0.2
Primary balance	0.7	0.7	-1.2	-0.7	-0.5
General government balance	0.7	0.8	-1.1	-0.6	-0.4

Sources: NSO; Central Bank of Malta estimates.

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

⁽²⁾ Mainly includes subsidies, current and capital transfers.

BOX 3: MALTA'S CLIMATE-RELEVANT FISCAL MEASURES^{1,2}

Climate change has become one of the greatest challenges facing economies in the twenty-first century and has come to the forefront of social and economic debate. Changes in weather patterns and extreme weather events can have a significant impact on economic activity and wellbeing, particularly in climate-sensitive sectors.

The EU has prioritised the response towards climate change by committing itself to an ambitious climate policy. The EU's main priority for the coming decades is to achieve carbon neutrality by 2050, a target that was set into binding legislation with the European Climate Law. To push the EU towards carbon neutrality, the 2030 greenhouse gas (GHG) emission reduction target of 40% was raised in December 2020 to a net domestic reduction of at least 55%.³ This should promote green investments, spur more sustainable economic growth and create considerable health and environmental benefits for citizens. As an EU Member State, Malta is also committed to fulfil its obligation of becoming carbon neutral by 2050. To smoothen the transition towards a carbon-neutral economy, Malta has set a binding target to achieve a 19% reduction in emissions outside the scope of the EU's Emissions Trading Scheme (ETS) by 2030.

Fiscal policy has an important role when it comes to minimise the harmful effects of climate change and facilitate adaptation to it. Through targeted taxation and subsidies, fiscal policy can facilitate the shift to a greener economy and encourage investment in renewable energy or other climate-smart technologies. Government policies also help incentivise energy efficiency and cleaner modes of transport. In turn, these policies will help improve the long-term sustainability of public finances as the economy is less exposed to climate-related shocks. This Box outlines the main climate-relevant measures introduced in Malta and assesses their impact on the fiscal balance from an accounting perspective, through changes in government revenue and current expenditure. This analysis concludes with an overview of already established initiatives that aim to encourage less polluting behaviour and promote higher energy efficiency.

Existing fiscal policy instruments

Environmental taxes

The degree to which fiscal policy is climate friendly can be assessed through the lens of environmental tax data published by Eurostat.

Environmental taxes are one of the most common fiscal instruments used among EU countries to restrict the negative environmental impact of certain forms of production and

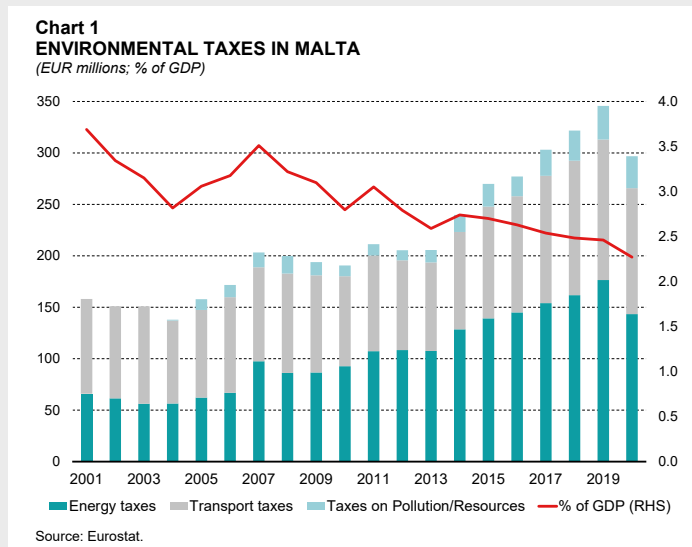
¹ Prepared by Juergen Attard and Larissa Vella, senior economist and economist, respectively in the Economic Analysis Department at the Central Bank of Malta. The authors would like to thank Rita Schembri, John Farrugia and Ian Borg for their helpful comments and suggestions. The views expressed are the authors' own and do not necessarily represent the views of the Central Bank of Malta.

² This box summarises the findings and, where available, updates the information provided in "The role of fiscal policy in climate change mitigation and adaptation in Malta", Central Bank of Malta, [Policy Note](#) (2022).

³ More information on the EU's targets can be found on: https://ec.europa.eu/clima/eu-action/climate-strategies-targets/2030-climate-energy-framework_en.

consumption.⁴ Overall, they can be grouped into three categories: energy, transportation and pollution and resources.⁵ In level terms, revenue from environmental taxes in Malta followed an upward trajectory over the last two decades, reflecting growth in economic activity and the introduction of additional environmental taxes (see Chart 1). Revenue from environmental taxes reached record levels in 2019, before

declining by 14.2% in 2020. The significant drop in 2020 largely reflects the contraction in economic activity caused by the COVID-19 pandemic and – albeit to a lower extent – fuel price cuts as part of the COVID-19 Economic Recovery Plan.



Environmental tax revenue in Malta mostly stems from taxes on energy and transportation. Excise duties on petroleum imports account for a large majority of energy taxes while the rest is composed of excise duties on electricity, tax on bunkering and revenue from auctions of Emission Trading Permits. Meanwhile, motor vehicle registration tax and motor vehicle licenses account for around 90% of transport tax revenue while the remainder is practically derived from the sale of car license plates, driving licenses and administration charges to test motor vehicles. Another source of environmental tax revenue are taxes on pollution and resources, though the share of this component – mainly consisting of excise duties on cement – is very low. Other revenue is derived from various excise duties on plastic bags, construction components, bottled water and non-alcoholic beverages.

Expenditure-based fiscal instruments

Besides revenue-based instruments, the Maltese government allocates a proportion of its yearly budget spending on climate-relevant initiatives, some of which are co-financed by EU funds. These outlays include schemes that support the installation of photovoltaic systems and solar water heaters, favourable tariffs for the electricity produced by solar photovoltaic systems and eco reduction benefits to encourage less electricity consumption from non-renewable sources. Other schemes target firms, including initiatives that assist hoteliers to invest in energy efficiency projects, grants to facilitate investment in technological solutions that provide higher energy efficiency and other schemes for large renewable energy projects. Other climate-relevant spending includes initiatives to boost research and development (R&D) in cleaner and renewable energy technology, educational campaigns,

⁴ Source: https://www.eib.org/attachments/thematic/the_eib_climate_survey_2020_2021_en.pdf

⁵ For a detailed explanation on the statistical concepts and definitions of environmental tax revenues see: https://ec.europa.eu/eurostat/cache/metadata/en/env_ac_tax_esms.htm.

and afforestation initiatives.

The government also allocates additional spending for climate-relevant capital outlays. This includes public spending and investment grants for environmental projects aimed at preventing, reducing and eliminating pollution while also enhancing the country's resilience to climate change. This spending, in the form of govern-

ment investment and investment grants, is gauged from the Classification of the Functions of Government (COFOG). Capital expenditure on environmental protection amounted to €53.5 million or 0.4% of GDP in 2020, with expenditure nearly equally split between public investment and investment grants (see Chart 2). On average these outlays amounted to around 0.4% of GDP between 2001 and 2020. However, year-on-year climate-relevant capital expenditure is highly volatile, as this largely depends on the timing of individual projects. As an example, capital spending on environmental protection rose sharply in 2015, reflecting higher outlays on waste management projects and higher investment grants to waste water management projects. However, once such projects were completed, capital expenditure on environmental protection declined.

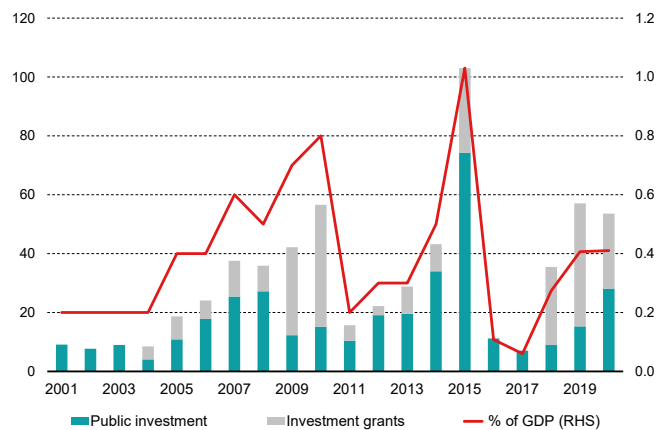
Climate-relevant measures and their fiscal impact

Over the last decade, the Maltese government has stepped up its efforts to address climate change by introducing several measures, with the primary motive of achieving climate change targets. Other measures introduced in this period could however be considered as less climate friendly.

To date, there is no fully defined statistical methodology on the classification of climate-relevant fiscal measures, which could make their identification more subjective. Against this background, this analysis aims to identify the main climate-relevant fiscal initiatives and present an initial assessment of their impact on the fiscal balance. Therefore, this assessment takes an accounting perspective focusing on the incremental impact of climate initiatives on government revenue and expenditure. In this assessment, measures are only considered as climate relevant if they have a direct impact on carbon emissions, energy efficiency or the adaptation to climate change. Therefore, fiscal measures with broader environmental impacts are not considered as climate relevant.

The measures which satisfy the above-mentioned criteria are then either classified as 'green' or 'brown' measures. The measures which help mitigate climate change are labelled

Chart 2
CAPITAL SPENDING ON ENVIRONMENTAL PROTECTION IN MALTA
(EUR millions; % of GDP)



Source: Eurostat.

as 'green', while those which affect the composition of environmental taxes and expenditure but go against climate targets are labelled as 'brown'.

Government announcements, annual reports of public institutions and own calculations are used to gauge the impact of such measures. The assessment does not, however, include measures introduced by public sector entities which are not classified within general government. The cost of the conversion of power plants and the energy interconnector, for example, are not accounted for. Moreover, this assessment excludes the impact of EU-funded initiatives, as they have a budgetary neutral effect. Government investment in green capital projects and capital transfers are also excluded from this assessment. This is due to the difficulty of distinguishing between domestically funded and EU-funded components of such projects, as well as determining actual spending in specific years. This box also excludes the impact of government compensation for damages arising from natural events, which do not qualify as 'green' or 'brown' measures.

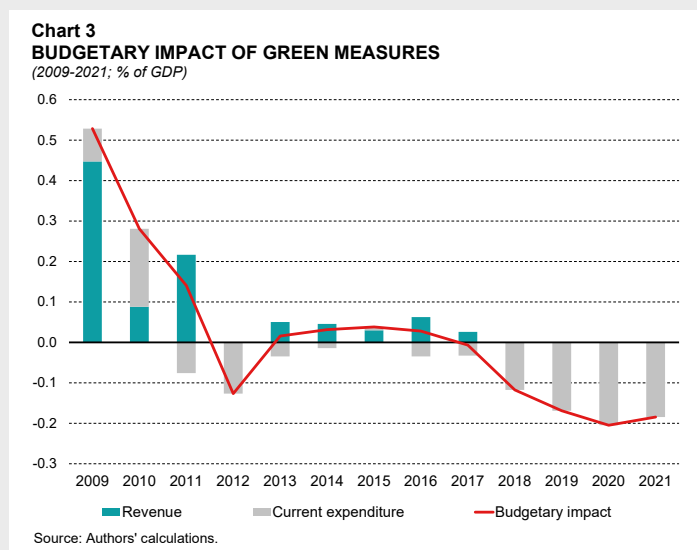
Green measures

Overall, the net impact of green measures on the overall budget balance since 2019 has been positive, as inflows from revenue-related measures outweighed expenditure initiatives. Their impact was mostly positive between 2009 and 2011, due to the revision to vehicle circulation taxes in 2009, the introduction of duties on cement in 2011 and a decline in subsidies on water and electricity production (see Chart 3).

The impact on the budget balance turned negative in 2012 mainly due to higher expenditure related to the Eco reduction scheme. This scheme offers a direct benefit to households to incentivise lower electricity consumption. In the same year, the feed in tariff scheme was introduced to offer subsidised rates on electricity generated from renewable sources of energy.

Over the 2013 and 2017 period, the impact of green measures on the budget balance was broadly neutral.

Revenue-raising measures reflect successive increases in duties on petroleum up until 2016, and the introduction of duties on plastics and environmental contributions levied on tourist accommodation in 2016. Green expenditure measures include the introduction of the car scrap-age scheme in 2014, with the aim of promoting the scrapping of older vehicles and replacing



them with cleaner or electric vehicles. Other climate-relevant initiatives include the frequent issue of schemes to help households and firms replace old energy inefficient electricity and hot water heating systems with newer energy efficient ones, and schemes which promote energy-efficient renovations of private buildings.

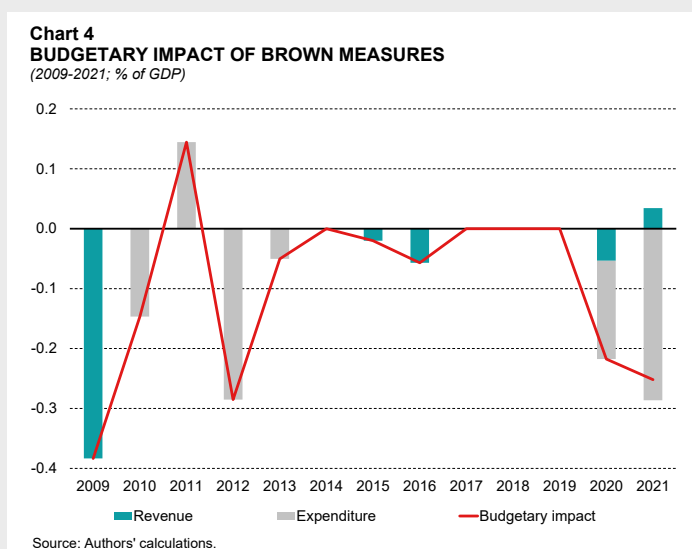
From 2018 onwards, the impact on the budget balance turned negative on the back of an expenditure-driven policy. In fact, spending on climate-related measures increased yearly throughout this period, due to the extension of existing initiatives to promote alternative sources of energy, the shift to greener transport and the introduction of other climate-related measures such the gradual introduction of free public transport from 2017 that will be fully implemented by October of 2022 and the extension of free school transport introduced in 2018. The impact of revenue measures remained unchanged in this period.

The budgetary impact of green revenue measures between 2009 and 2021 amounted to 1.0% of GDP. Meanwhile, new climate-relevant expenditure measures, excluding government investment and capital transfers, had a negative impact on the budget balance of 0.7% of GDP in this period. However, due to their budgetary neutral effect, this estimate does not include the impact of EU-funded initiatives.⁶ Thus, the green measures considered in this exercise overall had a deficit reducing impact of 0.3% of GDP between 2009 and 2021.

Brown measures

Overall, brown measures had a fiscal balance-worsening impact and mainly took the form of expenditure measures (see Chart 4). These measures were originally designed for other purposes, such as competitiveness, and thus the potential climate impact was not factored in.

On the revenue side, measures mainly reflect the implementation of a lower vehicle registration tax in 2009, the elimination of VAT on motor registration and the eco contribution tax in 2009 and 2015 respectively. In June 2020, as part of the COVID-19 recovery plan, fuel prices were cut. Moreover, duties on petrol and diesel were reduced in 2020 and 2021 to keep pump prices unchanged.



⁶ These include schemes to promote the use of renewable energy, capital projects related to water treatment, the Zero Impact Utility Project, the Grand Harbour Clean Air project, flood-prevention infrastructure, the Multi Material Recovery Facility project and the Grand Harbour Clean Air Project. Other smaller EU-funded projects were carried out by ERA, ECO-GOZO and Ambjent Malta.

Meanwhile, on the expenditure side, brown measures consist of support related to electricity prices. This includes one-off transfers to households to offset increases in energy tariffs in 2010 and support to Enemalta to mitigate rising commodity prices in 2012, 2013, 2020 and 2021.

Overall, brown-revenue measures had a negative impact of 0.5% of GDP on the budget balance whilst the impact of brown-expenditure measures stood at around 0.8% of GDP. Thus, overall, brown measures had a negative impact of 1.3% of GDP on the budget balance during the period under consideration.

New initiatives and other major green projects

The government's response to climate change is expected to increase over the coming years. This is exemplified by the green initiatives as announced in the 2022 Budget and under the Recovery and Resilience Facility (RRF).

The 2022 budget includes several measures intended to reduce carbon emissions and to enhance the transition towards a green economy. The budget lists several projects which are set to take place over the medium term. This includes an afforestation project in Inwadar Park, which is expected to cost €20.0 million (0.1% of GDP) over a period of 5 years, and the regeneration of green parks including the transformation of Schreiber's ground. The government also announced the gradual introduction of free public transport for all, which is expected to cost €21.0 million (0.1% of GDP) over the next three years. The extension of electric car charging points, increased grants on electric-powered cars or Plug-In Hybrids, a new scheme for the installation of photovoltaic panels on vehicles, valley rehabilitation, the launch of a carbon farming initiative, the extension of full VAT refund on the purchase of bicycles and electronic bicycles and the introduction of smart bins are examples of other initiatives outlined in the budget. The budget also lists a number of urban green initiatives including green roofing, vertical green walls and the setting up of a Local Council Urban Greening scheme.

Meanwhile, the 2022 Budget Speech also makes an allowance for additional outlays in 2022 to combat rising energy prices. Contrary to the measures mentioned above, these initiatives will have a negative effect on climate targets and are thus regarded as brown measures. According to the Bank's June 2022 projections, these initiatives are set to have a net deficit increasing impact over the 2022 to 2024 period, amounting to around 0.5% of GDP.⁷

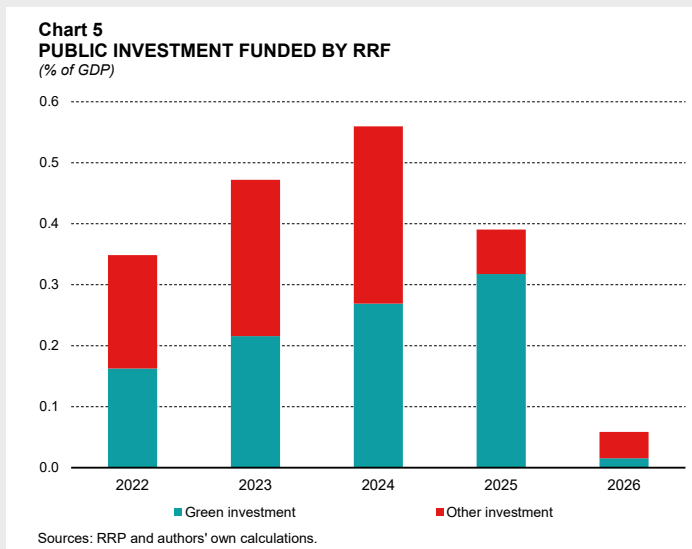
Malta's Recovery and Resilience Plan (RRP), endorsed by the European Commission in September 2021, is the key recovery instrument for mitigating the impacts brought about by the COVID-19 pandemic and for making EU economies more sustainable and resilient. Under this facility, the Maltese government plans to allocate around €170.0 million on climate change initiatives over the 2022-2026 period.⁸ This represents 54% of the allocated funds, exceeding the minimum requirement of 37% set out by the European Commission.

⁷ The Bank's latest projections are available on: <https://www.centralbankmalta.org/economic-projections>.

⁸ Malta's RRP is available on: <https://eufunds.gov.mt/en/Operational%20Programmes/Documents/Malta%27s%20Recovery%20Resilience%20Plan%20-%20July%202021.pdf>.

Malta intends to use such funds on several green transition reforms and investments, including projects related to energy-efficient renovations of private and public buildings, the decarbonization of transport, the renovation and greening of public hospitals and schools, the construction of a carbon-neutral school, enhanced investment in renewable energy in roads and public places, the construction

of a new ferry landing to promote alternative modes of transport as well as other initiatives to enhance the uptake of electric vehicles. According to own estimates, outlays on these green initiatives are set to reach around 0.2% of GDP in 2022 (see Chart 5). Subsequently, outlays are set to increase gradually and peak in 2025 before declining sharply in 2026.



Apart from the above-mentioned climate-relevant investment under the RRF, the Maltese government is expected to complete other two major green projects, these being the Eco-Hive and the shore-to-ship power infrastructure project. The former is a waste management facility, composed of a waste-to-energy plant, a new plant for the management of dry recyclables and a plant to treat organic waste to extract energy and produce compost for agriculture. Overall, this project is expected to cost around €390.0 million (2.7% of GDP), and the plants are expected to start operating by end 2023. The shore-to-ship power infrastructure will cost around €50.0 million (0.3% of GDP) and is expected to be completed by 2023. This project will drastically reduce pollution over the Grand Harbour and the surroundings. Additionally, the Maltese Government is also undertaking a project to construct a gas pipeline that will connect the island with the European Gas network, which will ultimately contribute towards the reduction of GHG emissions by delivering natural gas more efficiently.

The measures outlined above will help towards smoothening Malta's transition to a carbon neutral economy. However, the European Commission's 2022 country report for Malta identifies some areas for improvement in its climate efforts.⁹ The document mentions Malta's traffic congestion issues, which are exacerbated by a lack of soft mobility infrastructure and a relatively low density of public charging stations for electric vehicles. Malta's low use of renewable energy in comparison to other EU countries is also highlighted.

⁹ The Commission Staff Working Document's 2022 Country Report on Malta is available at: https://ec.europa.eu/info/system/files/2022-european-semester-country-report-malta_en.pdf.

Furthermore, in its opinion of the 2022 Stability Programme, the Commission invites Malta to proceed with the implementation of the RRP and reduce overall reliance on fossil fuels by encouraging the use of renewable sources of energy and by promoting investment in wind and solar technology renewable-energy investments that could enhance Malta's solar and wind energy potential.¹⁰ The Commission also invites Malta to reduce energy demand through improved energy efficiency in residential buildings. Finally, the Commission mentions the required improvement in the quality of public transport, the deployment of IT services such as intelligent transport systems and further investment in soft mobility infrastructure.

¹⁰ The Council Recommendation is available at: https://ec.europa.eu/info/system/files/2022-european-semester-csr-malta_en.pdf

BOX 4 : MALTA'S LONG-TERM AGEING EXPENDITURE FORECASTS – THE IMPACT OF MIGRATION ASSUMPTIONS¹

The Maltese economy has experienced high migration flows in recent years. Such kind of flows have made it harder to make reliable population projections especially due to significant revisions of past data every few years. The first set of Eurostat's population projections for Malta made in 2005 suggested a population of 508,000 by 2050 while those made in 2010 indicated 427,000 for the same year. Yet the Maltese population in 2020 was already more than 516,000. This box discusses the main findings in Grech (2021), which assesses existing population projections considering administrative data on the length of stay of migrants.²

Migratory flows in Malta are driven to some extent by the economic cycle, with immigration falling sharply in both the Great Recession and the pandemic. Though emigration of foreigners rises during recessionary periods, it has never actually offset immigration. Rather, emigration flows show a significant degree of correlation with the immigration flows of a year or two earlier. However, the way Eurostat sets its net migration assumption that underpins its population projection does not seem to consider these observations. It instead follows a time series approach with an imposed assumption that migration flows across Europe converge over time, so that gradually net migration to Malta subsides.³ Most migrants are implicitly assumed to stay in Malta till their death. In fact, Eurostat's no migration population projection shows a population aged 65 and over of 168,000 in 2050 as against the baseline projection of 210,000 for the same year. This suggests that the Eurostat baseline projections imply that over 42,000 pensioners in 2060 will be recent migrants to Malta.

However, Borg (2019) using longitudinal administrative data finds that around a quarter of foreigners exit the Maltese labour market within their first year in the country while around half exit between one and two years later.⁴ To qualify for Malta's Two-Thirds pension, a worker must have paid contributions for a minimum period ranging from 10 to 12 years depending on one's date of birth, while to get a full pension the required contributory history is between 35 to 41 years. Workers from EU countries and from nations with whom Malta has signed special agreements may be able to utilise contributory periods in Malta to qualify for a pension when they retire elsewhere, but Malta's share would be pro-rata at most. Administrative data from the Social Security Department indicate that at present the number of foreign citizens who have paid enough contributions to qualify for at least a pro rata minimum pension in Malta amounts to just over 3,500 individuals. This means that less than one in twenty of current foreign workers at present have a direct entitlement to a pension from Malta.

To double check the Social Security Department data, labour market administrative data were investigated to assess if they indicate a similar number of foreign workers having

¹ Prepared by Dr Aaron G. Grech, Chief Officer of the Economics Division of 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 errors are the author's own.

² For a fuller version of this study, see Grech, A.G. (2021), "The impact of migration assumptions on ageing expenditure forecasts", Central Bank of Malta, *Policy Note*.

³ For details see European Commission (2020), "Methodology of the Eurostat population projections 2019-based (EUROPOP2019)", ESTAT/F-2/GL, *Technical Note*.

⁴ Borg, I. (2019), "The length of stay of foreign workers in Malta", Central Bank of Malta, *Policy Note*.

Table 1
ESTIMATE OF FOREIGNERS REMAINING IN THE MALTESE LABOUR MARKET
ENOUGH TO QUALIFY FOR A MINIMUM PRO RATA PENSION

First year in Malta	Amount who entered labour market	Proportion still working in Malta after ten years	Foreign workers qualifying for pension
2002	1,516	24%	361
2003	970	24%	233
2004	1,138	29%	329
2005	2,267	22%	508
2006	3,339	20%	655
2007	4,451	15%	675
2008	5,271	16%	880

Source: Author's calculations using labour market administrative data.

worked for enough years to qualify for a Maltese pension. Table 1 summarises our findings, showing that as the number of foreign workers rose, there was an opposite trend in the proportion of those who were working long enough to get pension entitlement in Malta. Taken together, of all the foreign workers who came to Malta between 2002 and 2008, just over 3,600 may have vested pension rights. This is similar to the amount indicated by Social Security Department data and implies that less than one in five of these workers will get any return on their national insurance contributions.

Based on available data and applying a cohort approach to determine their probability to leave the Maltese labour market, it appears that when one looks at the next decade of arrivals, the proportion who may acquire vested pension rights may be at most 20% of the initial inflow. This would suggest that over 15,500 of the current foreign workforce could eventually have some entitlement to a Maltese pension. Furthermore, while they may have some entitlement to a Maltese pension, their pension is highly likely to be pro rata as they would be unable to reach the required number of contributions for a full pension. Unless a third country national has started to contribute in Malta as from the age of 24, and continues doing so until age 65, such person would not qualify for a full pension. Of all the migrants that have come to Malta in the last decade, only a quarter would have a full contributory period if they were to remain working in Malta till retirement age.

European Commission (2021) identifies Malta as one of the top five EU countries in terms of the projected rise in pension spending.⁵ The rise projected for Malta is nearly four times the EU average. This, however, is expected to occur only after 2040, whereas in the EU the rise in spending will happen by 2040. This is a direct reflection of the population projections, which see Malta's old age dependency ratio take a turn for the worse after 2040, due to the assumed ageing of migrant workers in Malta.

Table 2 presents alternative estimates of ageing costs based on the methodology used in the European Commission study but with different assumptions about how many migrants leave the islands before acquiring pension entitlements. At one extreme, if one assumes all migrants leave Malta before having pension entitlement, ageing costs in 2070 would be

⁵ European Commission (2021), "The 2021 Ageing Report: Economic & budgetary projections for the EU Member States (2019-2070)", Economic and Financial Affairs, Institutional Paper 148.

Table 2
ESTIMATE OF AGEING COSTS USING MODIFIED POPULATION PROJECTIONS

Percentage of GDP

	Baseline projection	Baseline projection with no migrants staying on until 65	Baseline projection with 66% of migrants staying on until 65	Baseline projection with migrant length of stay in line with recent
2019	17.9	17.9	17.9	17.9
2030	17.8	16.9	17.5	17.2
2040	18.5	16.4	17.8	17.2
2050	20.4	17.2	19.3	18.4
2060	23.7	19.0	22.1	20.8
2070	25.9	17.9	23.2	20.9

Source: Author's calculations using European Commission (2021).

the same as in 2019. If instead one assumes two thirds of those migrants which Eurostat assumes will be staying until retirement do so, spending would rise by 5 percentage points compared to 2019. If one were to calibrate this scenario further such that by 2060 there are 15,500 migrants who are retired in Malta, the growth in spending would be of slightly less than 3 percentage points. This would bring Malta's results nearly in line with those of the rest of the euro area, instead of being four times as high.

The extent to which ageing expenditure forecasts are affected by assumptions on migration warrants a degree of caution. For policy formulation purposes, Maltese policymakers need to monitor the length of stay of migrants and take this into consideration when making long-term fiscal plans. Relying on existing population projections, with their strong assumptions about migrants settling permanently in Malta, may make the country's long-term fiscal sustainability appear much worse than it could effectively be. It could also impact the process of pension reform weighing the case against adequacy reforms unnecessarily. Moreover, it is crucial to look at a number of different scenarios with varying assumptions, so as to make pension policy robust to changes in migration patterns.

6. MONETARY AND FINANCIAL DEVELOPMENTS

According to the Bank's FCI, in the first quarter of 2022, financing conditions tightened from a historical perspective, though still favourable compared with the pandemic.

In March, Maltese residents' deposits with MFIs in Malta continued to expand at a strong pace that is comparable to that recorded in December.¹ The shift to overnight deposits persisted in an environment of low interest rates and a continued preference for liquidity. Growth in credit to Maltese residents decelerated, reflecting slower increases in both credit to general government and credit to other residents. The latter, in turn, reflected weaker growth in loans to NFCs. By contrast, loans to households rose at a faster pace, driven by mortgages. Interest rates on loans and deposits fell further when compared with a year earlier, and the spread between the two rates declined. Nevertheless, it remained at elevated levels.

In March, the primary market yield on Treasury bills rose from that prevailing three months earlier. Secondary market yields on 5 and 10-year MGS increased. As the domestic 10-year yield rose at a faster pace compared with the euro area benchmark yield, the spread against the latter widened. Domestic share prices fell between December and March and were also lower compared with a year earlier.

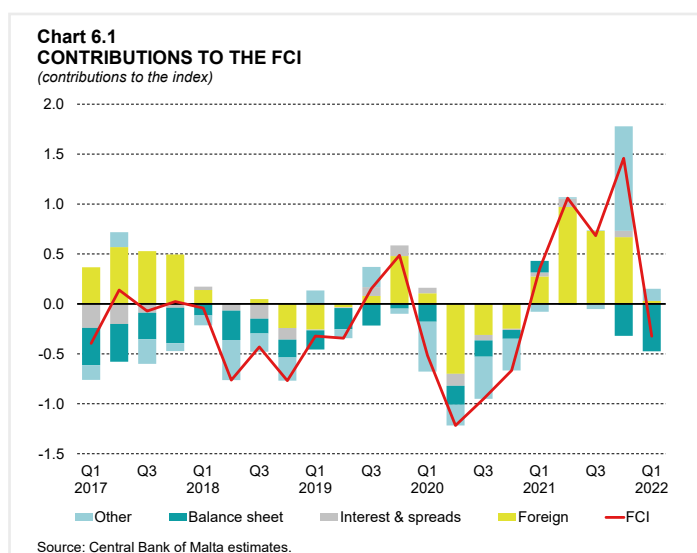
The number of outstanding loans benefitting from guarantees in terms of the MDB CGS fell slightly. Sanctioned amounts associated with these loans stood at €489.3 million at the end of March, or 62.9% of the scheme's target size.

Monetary and financial conditions

Financial conditions tighten²

According to the Bank's FCI, in the first quarter of 2022, financial conditions were tight from a historical perspective, although still more favourable than those prevailing during the pandemic (see Chart 6.1).

The tightening in financial conditions, when compared with the last quarter of 2021, largely reflected developments in domestic influences and, to a lesser extent, a smaller loosening effect from foreign factors. The latter is attributable to a decrease in euro area stock prices and higher uncertainty during the quarter under review.



¹ Monetary data analysed in this chapter are compiled on the basis of the statistical standards found in the Statistics section of the Bank's website.

² This index is composed of various financial indicators, which are available at a high frequency. This section is based on quarterly averages for each indicator.

The decrease in the contribution of domestic influences was mostly driven by developments in the 'other' component, which was affected by a decrease in securities issued by NFCs and, to a lesser extent, a further decline in equity prices. Meanwhile, the 'balance sheet' component had a larger tightening effect compared with the last quarter of 2021, reflecting weaker dynamics in real deposits and less favourable credit conditions. At the same time, the 'interest rate' component also contributed slightly towards tighter financial conditions, mainly driven by some widening in the spread relative to German 10-year sovereign yields.

Financial conditions also worsened when compared to the first quarter of 2021. When measured on this basis, the tightening in financing conditions was mostly driven by domestic influences. This in turn reflects a decrease in real credit and real deposits (part of the 'balance sheet' component), although a wider sovereign spread (part of the 'interest rate' component) also contributed. The tightening effect linked to foreign influences reflected an increase in uncertainty over the year to March 2022.

Maltese residents' deposits continue to expand at a strong pace

Total deposits held by Maltese residents with MFIs in Malta continued to expand at a quick pace. The annual rate of change stood at 8.7% in March, marginally below the 8.8% recorded in December 2021 (see Table 6.1).

During the quarter under review, deposit growth remained driven by overnight deposits, which is the most liquid component. Annual growth in this category of deposits reached 13.4% in March, from 12.3% three months earlier. Growth in this component was mainly driven by an increase in households' balances. The share of overnight deposits in total deposits edged up to 84.9% from

Table 6.1
DEPOSITS OF MALTESE RESIDENTS

	EUR millions	Annual percentage changes				
		2022 Mar.	2021			2022
			Mar.	June	Sep.	Dec.
Overnight deposits	19,667	9.4	8.6	12.0	12.3	13.4
<i>of which</i>						
Households	13,108	14.1	13.2	14.3	12.8	14.2
NFCs	4,523	17.8	12.3	11.7	11.2	13.4
Deposits redeemable at notice of up to three months	142	12.1	70.6	104.5	59.9	6.9
<i>of which</i>						
Households	39	9.4	8.0	15.2	14.7	10.7
NFCs	73	-3.6	89.4	200.0	67.3	1.8
Deposits with an agreed maturity of up to two years	2,229	-7.2	-8.2	-5.9	-4.3	-12.2
<i>of which</i>						
Households	1,713	-4.7	-4.9	-4.2	-6.2	-13.7
NFCs	177	-14.1	-33.9	-20.2	-12.8	-28.1
Deposits with agreed maturity above 2 years⁽¹⁾	1,126	-14.3	-13.9	-14.2	-13.9	-13.6
<i>of which</i>						
Households	1,009	-11.5	-13.0	-13.2	-12.7	-12.6
NFCs	52	-34.2	29.6	39.6	-1.1	13.9
Total residents' deposits⁽²⁾	23,164	5.4	5.1	8.3	8.8	8.7

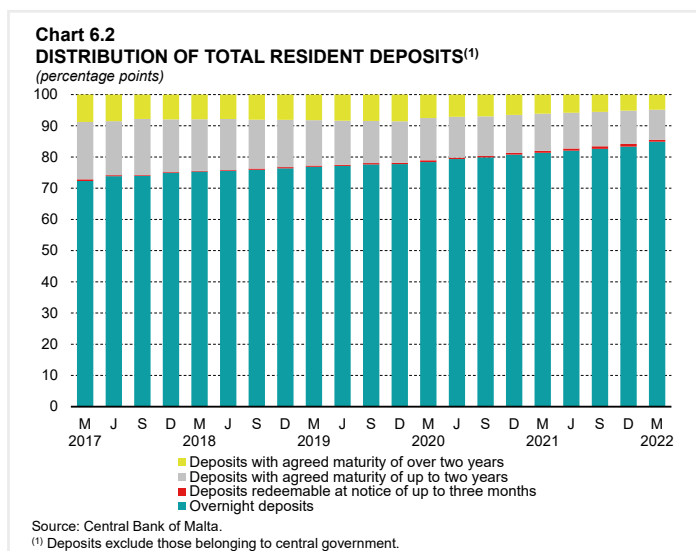
Source: Central Bank of Malta.

⁽¹⁾ Deposits with agreed maturity above 2 years are classified outside M3.

⁽²⁾ Total residents deposits exclude deposits belonging to Central Government.

83.3% in December, 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, albeit at a slower pace when compared to December. Furthermore, in absolute terms, the increase in this component was much smaller than that in overnight deposits. Thus, the former's share eased to 0.6% in total deposits, from 0.8% three months earlier.



Deposits with an agreed maturity of up to two years contracted by 12.2% in March, following a decline of 4.3% in the year to December. Meanwhile, deposits with an agreed maturity of over two years fell by 13.6%, after contracting by 13.9% three months earlier. As a result, the share of these two categories of deposits edged down compared to December, closing the first quarter of the year at 9.6% and 4.9%, respectively.

Credit to residents increases at a slower pace

Credit to Maltese residents expanded by 7.7% in the year to March, below the 8.3% registered in December 2021, mainly reflecting slower growth in credit to residents outside general government, although credit to general government also moderated (see Table 6.2 and Chart 6.3).

Credit to general government rose by 14.6% in the year to March, following an increase of 16.0% three months earlier. The deceleration in this credit component reflects a lower increase in MFI holdings of government stocks. Meanwhile, MFI holdings of Treasury bills declined, albeit at a more moderate pace.

The annual rate of change of credit to residents outside general government stood at 5.3%, below the 5.8% recorded three months earlier. This partly reflects a contraction in MFI holdings of securities issued by other sectors. At the same time, growth in loans to NFCs increased at a slower pace.

By contrast, loans to households increased at a faster pace of 10.0% on an annual basis, following a 9.6% increase in

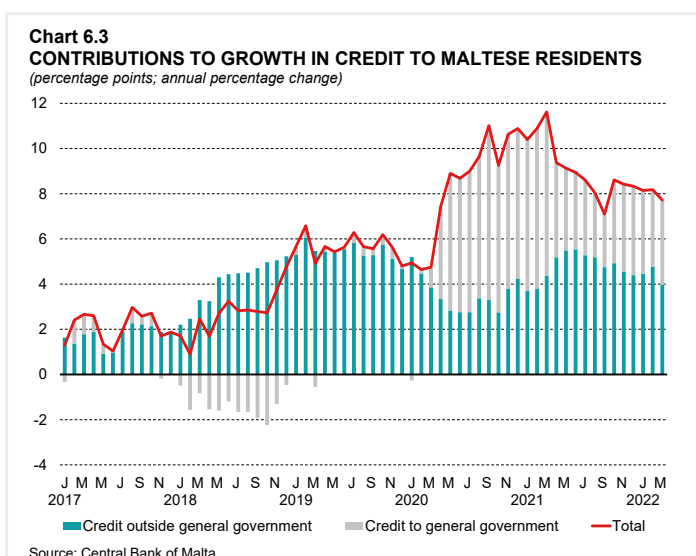


Table 6.2
MFI CREDIT TO MALTESE RESIDENTS

	EUR millions	Annual percentage changes				
		2021				
		2022	Mar.	June	Sep.	Dec.
	Mar.					Mar.
Credit to general government	4,795	33.9	13.5	9.3	16.0	14.6
Credit to residents outside general government	12,762	5.5	7.4	6.4	5.8	5.3
Securities and equity	327	-16.4	-6.2	-2.1	8.7	-0.2
Loans	12,435	6.3	7.8	6.6	5.7	5.5
<i>of which:</i>						
Loans to households	7,177	5.9	8.8	9.4	9.6	10.0
Mortgages	6,647	7.3	10.1	10.6	10.9	11.4
Consumer credit and other lending	530	-7.4	-3.7	-2.8	-4.2	-4.5
Loans to NFCs ⁽¹⁾	4,313	7.1	6.5	4.2	0.2	-0.7
Total credit to residents	17,557	11.6	8.9	7.1	8.3	7.7

Source: Central Bank of Malta.

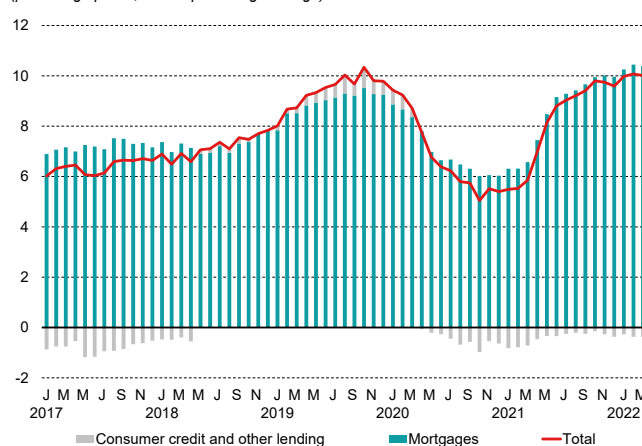
⁽¹⁾ NFCs include sole proprietors and non-profit institutions serving households (NPISH).

December. This reflected faster growth in mortgage lending, which increased by 11.4% in March, up from 10.9% three months earlier. By contrast, consumer credit and other lending contracted at a faster rate of 4.5% over the same period, following a decrease of 4.2% in the year to December (see Chart 6.4).

Meanwhile, annual growth in loans to NFCs contracted by 0.7% in March, following a moderate increase of 0.2% in the year to December. The decrease in lending to firms over the year to March reflects a sharp decline in loans to public NFCs.

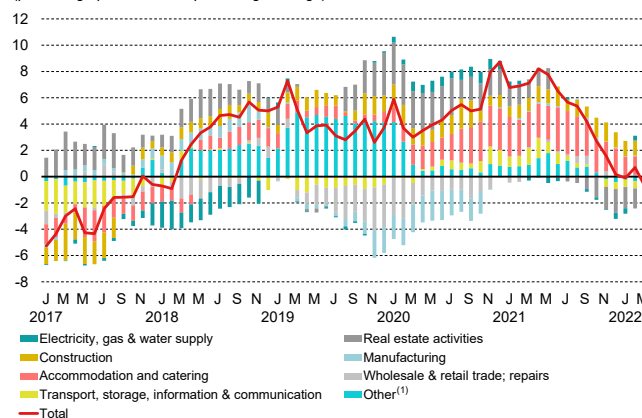
Sectoral data show that weaker dynamics in loans were largely driven by slower growth in credit to firms involved in accommodation and food service activities (see Chart 6.5). This was followed by a sharper contraction in loans to 'other' sectors, mainly reflecting developments in lending to the sector comprising professional, scientific

Chart 6.4
CONTRIBUTIONS TO GROWTH IN LOANS TO HOUSEHOLDS
(percentage points; annual percentage change)



Source: Central Bank of Malta.

Chart 6.5
LOANS TO NFCs BY SECTOR
(percentage points; annual percentage change)



Source: Central Bank of Malta.

⁽¹⁾ Mainly includes entertainment, health, education, professional services, communication, and administration.

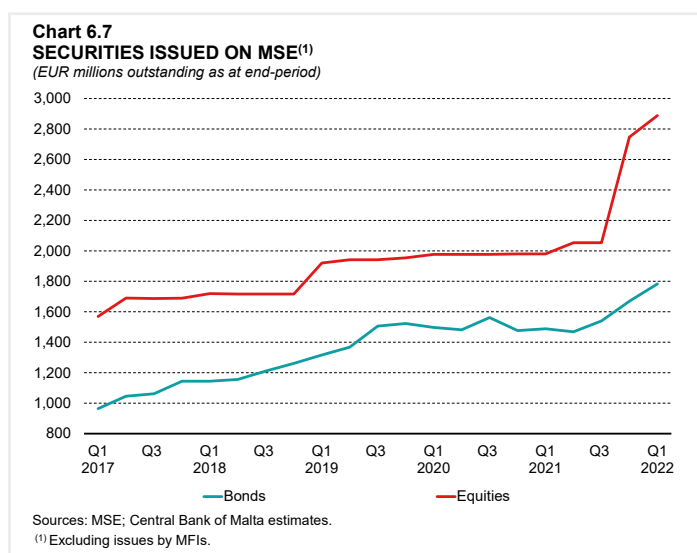
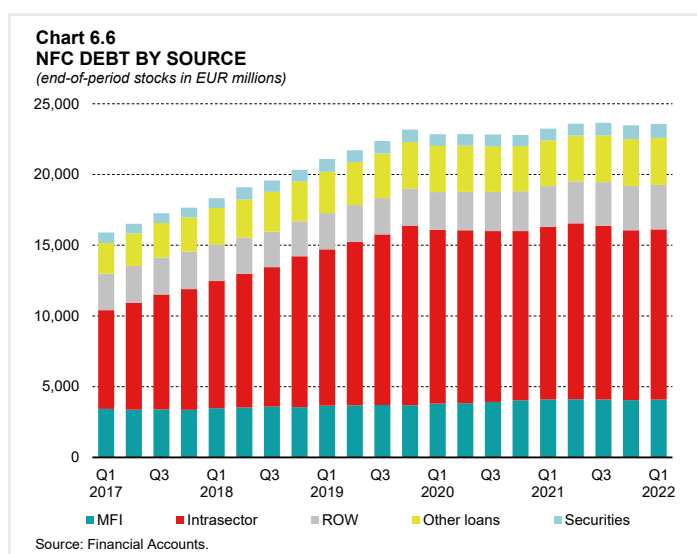
and technical activities. Meanwhile, credit to the information and communication sector recorded a larger decline, while lending to the construction sector increased at a more moderate pace relative to December. These developments were partly offset by a smaller decrease in credit to the sector comprising real estate activities, and faster growth in loans to the wholesale and retail trade sector.

Financial accounts data show that the share of bank lending in total NFC debt was comparable

to December's but slightly 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 15.9% at the end of 2019.³ However, this pattern was reversed in 2020, likely as a result of firms' recourse to loan moratoria and guaranteed loans during the pandemic. In fact, by the end of 2020, the share of bank loans in total NFC debt had reached 17.7%. This share declined to 17.3% by March 2022, unchanged from the previous three months.

During the first quarter of 2022, the share of intra-sectoral lending in total NFC debt stood at 51.0%, broadly as in December, but below the 52.5% recorded a year earlier. This share has been falling since the third quarter of 2021. Meanwhile, the share of loans from non-residents stood unchanged from three months earlier at 13.3%, thus stabilising at a rate that was last observed in the second quarter of 2018. The share of securities remained small and broadly unchanged from December's, at 4.2%.

MSE data show that by March 2022, around €1,783.1 million in corporate debt was listed on the Exchange, almost a fifth more than the stock outstanding a year earlier (see Chart 6.7).⁴



³ See Darmanin, J. (2017). "The financing of companies in Malta", *Policy Note* July 2017, Central Bank of Malta.

⁴ MSE data may differ from financial accounts data due to differences in valuation methodology and coverage. In particular, financial accounts data are at market value and include both listed and privately-placed securities. MSE data on corporates presented in Chart 6.7 is based on the official MSE list and thus excludes securities listed through Prospects. However, it includes financial corporations other than MFIs.

At the same time, the outstanding amount of equity listed on the MSE increased by 45.9% in annual terms, to €2,888.0 million. The real estate sector accounted for most of the new issues in the quarter under review. The amount of outstanding listed equity as at March 2022 exceeded that of bonds by over 60%.⁵

Spread between deposit and lending rate declines

In March, the weighted average deposit rate offered to households and NFCs in Malta was down by four basis points on a year earlier, standing at 0.16% (see Table 6.3).⁶ This was largely driven by a further decrease in rates on time deposits held by NFCs, although rates on households' time deposits also eased slightly.

Meanwhile, the weighted average lending rate paid by households and NFCs to resident MFIs fell by 13 basis points to 3.19%. This decrease was due to lower rates paid by households. The weighted average lending rate paid by NFCs remained above that charged to households, reflecting different assessments of credit risk in these two institutional sectors.

The spread between the weighted average lending rate and the deposit rate closed the quarter under review at 303 basis points, below the 312 basis points recorded 12 months earlier.

Table 6.3

INTEREST RATES ON DEPOSITS AND LOANS

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

	2019	2020	2021		2021	2022	
	Mar.	Mar.	Mar.	June	Sep.	Dec.	Mar.
Total deposits⁽¹⁾	0.32	0.27	0.20	0.18	0.18	0.16	0.16
<i>of which</i>							
Overnight deposits							
Households	0.05	0.03	0.02	0.02	0.02	0.02	0.02
NFCs	0.03	0.02	0.01	0.01	0.02	0.01	0.03
Time deposits (less than 2 years)							
Households	0.74	0.71	0.57	0.54	0.53	0.51	0.53
NFCs	0.71	0.70	0.62	0.53	0.48	0.49	0.44
Time deposits (more than 2 years)							
Households	2.07	1.95	1.80	1.79	1.77	1.78	1.78
NFCs	1.84	1.37	1.41	1.15	1.05	1.12	1.11
Total loans⁽¹⁾	3.52	3.44	3.32	3.30	3.25	3.23	3.19
<i>of which</i>							
Households and NPISH	3.36	3.26	3.15	3.12	3.05	3.01	2.97
NFCs	3.79	3.75	3.60	3.62	3.60	3.63	3.59
Spread⁽²⁾	3.20	3.17	3.12	3.12	3.07	3.06	3.03
ECB MROs rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Source: Central Bank of Malta.

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

⁽²⁾ Difference between composite lending rate and composite deposit rate.

⁵ Apart from the official MSE platform, small and medium-sized enterprises can also obtain finance through the specifically-g geared platform – Prospects.

⁶ Basis points are rounded to the nearest whole number and hence may not exactly match the figures given in Table 6.3.

BOX 5: LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM MAINTENANCE PERIOD 1 TO MAINTENANCE PERIOD 8 OF 2021^{1,2}

Introduction

This box describes the liquidity conditions in the Maltese banking system and the monetary policy operations conducted by the Bank, as part of the Eurosystem's single monetary policy framework during the eight maintenance periods (MPs), starting from 27 January 2021 and ending on 8 February 2022.

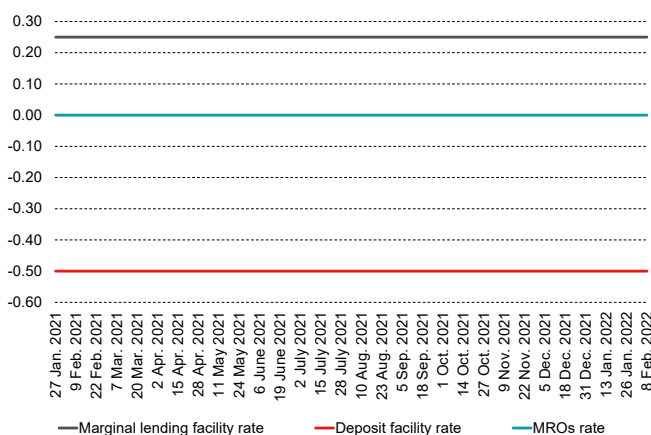
During this period, the Eurosystem continued with the net purchase phase of the APP, resulting in it purchasing public sector debt securities, covered bonds, asset-backed securities as well as corporate sector debt securities. In this regard, the Bank's participation is limited to the Public Sector Purchase Programme (PSPP) component of the APP.

Furthermore, the Eurosystem continued with the net purchase phase of the PEPP that was introduced on 18 March 2020 in response to the COVID-19 pandemic. The PEPP comprises the same purchasing components of the APP, though with greater flexibility across asset classes and jurisdictions. Like the APP, the Bank only purchases public sector debt securities under the PEPP. On 16 December 2021, the Governing Council of the ECB announced that it will discontinue the net asset purchases under the PEPP at the end of March 2022. However, the maturing principal payments from securities purchased under the PEPP will be reinvested until at least the end of 2024.

Furthermore, during the eight MPs reviewed in this box, the ECB continued implementing the quarterly pandemic emergency longer-term refinancing operations (PELTROs) and the third series of the TLTRO-III.

During this period, the key ECB interest rates – that is, the rates on the MROs, the marginal lending facility and the

Chart 1
KEY INTEREST RATE DEVELOPMENTS
(per cent)



Source: ECB.

¹ MP2021 01 (27 January-16 March); MP2021 02 (17 March-27 April); MP2021 03 (28 April-15 June); MP2021 04 (16 June-27 July); MP2021 05 (28 July-14 September); MP2021 06 (15 September-2 November); MP2021 07 (3 November-21 December); MP2021 08 (22 December-8 February 2022).

² Prepared by Ritlen Abela, Officer II, Monetary Operations and Collateral Management Office. The author would like to thank Josette Grech, Head, Monetary Operations and Government Securities Department and André Psaila, Chief Investment Officer, Financial Markets Division for their valuable suggestions. The views expressed in the box are the authors' own and do not necessarily reflect the views of the Bank.

overnight deposit facility – stood unchanged at 0.00%, 0.25% and -0.50%, respectively (see Chart 1).

Excess liquidity

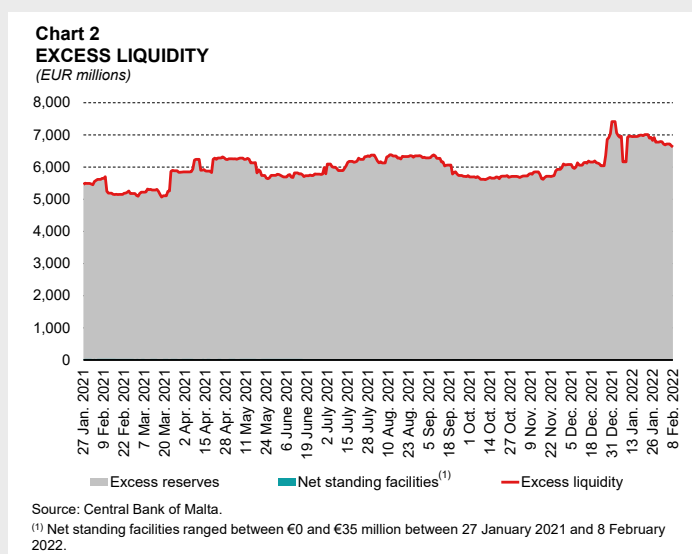
Throughout the period, the Maltese banking system remained characterised by high levels of excess liquidity. Excess liquidity is defined as the amount of deposits placed by banks at the overnight deposit facility of the Bank, net of the recourse to the marginal lending facility, plus the current account holdings in excess of the minimum reserve requirements (excess reserves).

At the beginning of the period, excess liquidity stood at €5,459.3 million and gradually increased reaching €6,622.7 million at the end of MP8. The daily average excess liquidity was €5,980.2 million, reaching a peak of €7,413.0 million on 31 December 2021. The increase in excess liquidity illustrated in Chart 2 was mainly driven by growth in excess reserves while the use of the deposit facility was minimal.

At the beginning of the period, excess reserves stood at €5,434.3 million and grew steadily throughout the period reaching €6,622.7 million on 8 February 2022. Large current account deposits were placed by four credit institutions at the end of the first quarter, mid-year and at year-end. Average excess reserves stood at €5,964.5 million over the entire period reviewed.

During the period under review, credit institutions continued benefiting from the two-tier system for reserve remuneration as introduced by the Governing Council from MP7 2019 starting on 30 October 2019. This system exempts part of the credit institutions' excess reserve holdings from remuneration at the negative rate applicable on the deposit facility. With the two-tier system in place, during the period under review, credit institutions in Malta benefited from an estimated saving of €7.3 million in interest expense compared to a situation where a negative interest rate would have applied to all their excess reserves.

Developments in excess liquidity also reflect the use of standing facilities. Standing facilities are monetary policy instruments that facilitate the provision and absorption of overnight liquidity. The Eurosystem provides two types of standing facilities: the marginal lending facility and the overnight



deposit facility. The marginal lending facility allows counterparties to borrow to meet short-term liquidity needs while the deposit facility allows counterparties to deposit overnight funds with the Eurosystem.

During the period reviewed, there was no utilisation of the marginal lending facility by local credit institutions.

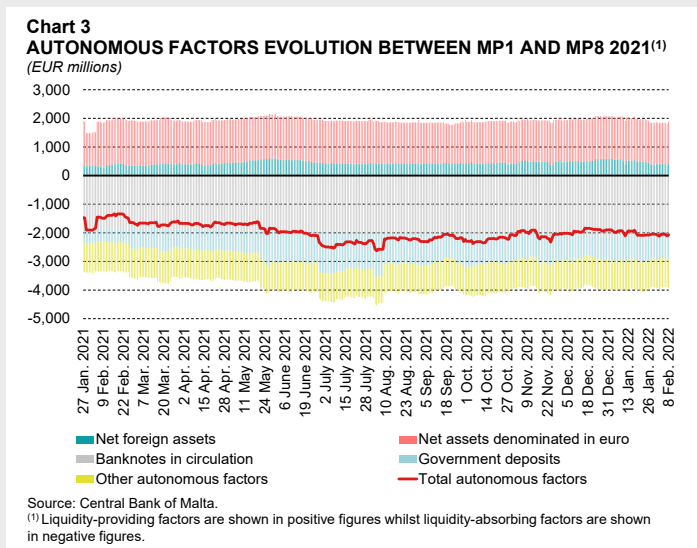
The balance on the overnight deposit facility was generally declining until 27 October 2021, when the facility stopped being used by local credit institutions. The daily average over this period amounted to €21.7 million.³ The low utilisation of the overnight deposit facility is attributable to the fact that the two-tier system does not apply to it.

Autonomous liquidity factors

Autonomous liquidity factors are items in the central bank balance sheet that are neither monetary policy operations nor current account holdings of credit institutions. As the transactions driving autonomous factors involve central bank money, they have a liquidity-providing or liquidity-absorbing effect.^{4,5} Essentially, increases in central bank assets entail the provision of liquidity while increases in central bank liabilities involve the absorption of liquidity, and vice-versa.

Autonomous factors were net liquidity absorbing and stood at an average of €1,982.1 million throughout the eight MPs under review.⁶ It can be noted that combined autonomous factors were relatively stable for the first five months of the year and then started to decline. The lowest point amounting to €2,630.8 million was reached on 4 August 2021 due to an increase in government deposits following the issuance of Malta Government securities (see Chart 3).

The main contributors to the decline in autonomous factors when compared to the previous year were an increase in both banknotes in circulation (which also includes the excess over the allocation based on the capital key) and government deposits. These drivers of change were also observed in most euro area countries during the period under review.



³ The daily average for overnight deposits throughout the eight MPs amounted to €15.7 million.

⁴ Liquidity-providing factors include net foreign assets and net assets denominated in euro.

⁵ Liquidity-absorbing factors consist of government deposits, banknotes in circulation and other autonomous factors.

⁶ Given that total autonomous factors were net liquidity-absorbing, in the Chart these are depicted with a negative sign.

In fact, banknotes in circulation continued to increase in 2021 reaching an average of €1,997.3 million when compared to €1,682.2 million in 2020. The increase was mostly the result of the uncertainty surrounding the COVID-19 pandemic. Government deposits also increased albeit by a small amount from an average of €873.0 million in 2020 to €900.7 million in 2021. The increase in government deposits held with the Bank was mainly due to proceeds from net issuances of Malta Government securities.

Monetary policy instruments

Open market operations

The Eurosystem uses open market operations to provide liquidity in euro to monetary policy eligible counterparties. During the period reviewed, the volume of liquidity injected into the domestic banking system through open market operations increased by €550.4 million.

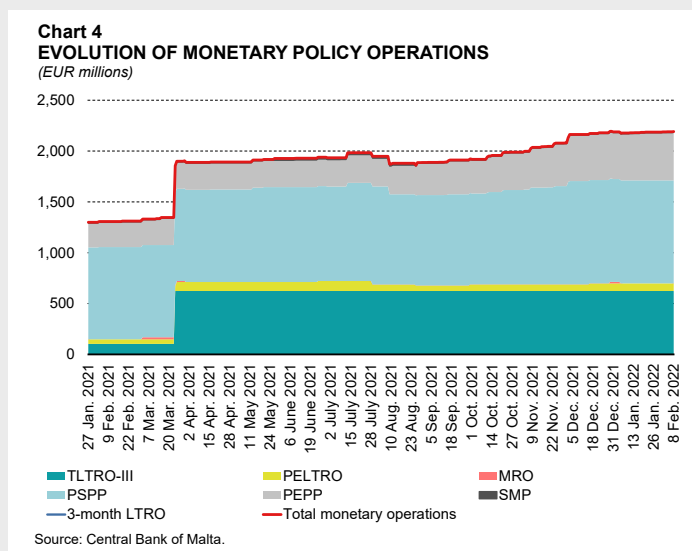
At the beginning of the period, outstanding open market operations stood at €148.5 million, €103.5 million stemming from TLTRO-IIIs and €45.0 million from PELTROs. During the period under review, there was minimal participation in the MROs and in the 3-month longer-term refinancing operations (LTROs) by Maltese counterparties. However, Maltese counterparties participated in the PELTROs and TLTRO-III. At the end of MP8, the outstanding open market operations stood at €698.9 million, consisting of €623.5 million and €75.4 million in terms of the TLTRO-IIIs and PELTROs, respectively (see Chart 4).

Asset purchases

During the eight MPs reviewed, the Bank also influenced liquidity conditions through its participation in the various APPs. The Bank mostly held assets that were purchased through the PEPP and the PSPP.

The Bank's holdings of debt instruments under the Securities Markets Programme (SMP) stood at an average of €9.4 million.⁷

PSPP holdings under the APP stood at an average of €906.6 million in MP1. These holdings grew steadily over the period, standing at an average value of €1,013.1 million in MP8. This increase



⁷ The SMP was announced by the Governing Council of the ECB on 10 May 2010, with the intention of ensuring depth and liquidity in malfunctioning segments of the debt securities markets and to restore an appropriate functioning of the monetary policy transmission mechanism. The SMP was terminated as from 6 September 2012 with the purchased securities held to maturity.

reflects the purchases of securities which were partially offset by a maturing security that occurred in the interim.

PEPP holdings increased substantially from an average of €244.7 million in MP1 to €461.1 million in MP8. These holdings grew significantly due to large purchases of securities which were marginally offset by the redemption of a single security during the period under review.

On balance, the Bank's holdings of securities in terms of the Eurosystem's PSPP and PEPP increased by €341.6 million since the start of MP1, implying a net injection of liquidity during the period reviewed.

Liquidity support measures related to COVID-19

To alleviate liquidity challenges as a result of the pandemic, the Government launched the MDB CGS. This scheme provides guarantees to commercial banks with the aim of enhancing access to new working capital loans for businesses. The scheme was eventually extended to cover the refinancing of loans. It enables credit institutions to leverage government guarantees up to a total portfolio volume of €777.8 million.⁷

By the end of March 2022, 640 facilities were approved and still outstanding under the CGS, covering total sanctioned lending of €489.3 million, down from €505.9 million in December (see Table 6.4).^{8,9} As the scheme provides guarantees on loans for working capital and loan repayment purposes, the amount actually disbursed may fall short of that sanctioned. In fact, €465.5 million were disbursed by the end of March. Hence, by then, 62.9% of the scheme's target size was sanctioned, while 59.8% was disbursed.

In terms of the number of facilities, the sector comprising wholesale and retail activities had the largest outstanding number of facilities benefitting from the scheme. By end-March 2022, 170 facilities were approved and still outstanding with a sanctioned value of €90.1 million. This was followed by accommodation and food service activities, with 154 facilities and a sanctioned amount of €121.3 million. The manufacturing sector also had a number of facilities approved, followed by the sectors comprising of transport, storage and information and communications

Table 6.4
MDB CGS – AS AT MARCH 2022

Number of facilities approved and still outstanding; EUR millions

	As at December 2021		As at March 2022	
	Total number of facilities ⁽¹⁾	Sanctioned amount ⁽²⁾	Total number of facilities ⁽¹⁾	Sanctioned amount ⁽²⁾
Manufacturing	56	24.6	56	24.6
Construction	37	48.4	37	48.4
Wholesale and retail trade; repair of motor vehicles and motor cycles	174	100.8	170	90.1
Transportation and storage and information and communication	42	51.5	41	46.5
Accommodation and food service activities	156	121.7	154	121.3
Professional, scientific and technical activities	41	21.6	40	21.3
Administrative and support service activities	40	14.0	38	13.9
Real estate activities	20	7.3	18	7.3
Other ⁽³⁾	88	116.0	86	116.0
Total	654	505.9	640	489.3

Source: MDB.

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

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

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

⁷ The MDB CGS was approved by the European Commission on 2 April 2020. See <https://mdb.org.mt/en/Schemes-and-Projects/Pages/MDB-Working-Capital-Guarantee-Scheme.aspx> for further details.

⁸ A drop in the number and value of sanctioned facilities may reflect the repayment in full of the facility by the customer, or a reduction in the facility's value and other adjustments.

⁹ As at end-May 2022, 628 facilities were approved and still outstanding under the CGS, covering total sanctioned lending of €486.6 million.

technology, the professional, scientific and technical activities as well as the administrative and support service activities sector. The real estate sector had the least number of facilities approved under the scheme. The 'other' sector which includes loans to firms involved in a range of other eligible sectors, had 86 approved facilities with a sanctioned amount of €116.0 million.

Bank Lending Survey indicates unchanged credit standards, terms and conditions

According to the Bank Lending Survey (BLS) which was conducted in April 2022, respondent banks reported unchanged credit standards and terms and conditions for NFCs in Malta during the first quarter of 2022. All participating banks also expected credit standards on such loans to remain unchanged in the second quarter of 2022. As regards the demand for credit by NFCs, half of the surveyed banks assessed demand to have decreased somewhat, with the remaining banks reporting unchanged demand. Most of the respondent banks expect demand to remain unchanged in the second quarter of this year.

Credit standards on loans for house purchases were assessed to have remained unchanged by the majority of surveyed banks in the first quarter of 2022, while all banks reported no changes on conditions on loans for house purchases. All banks expected credit standards to remain unchanged in the second quarter of 2022. Most of the participating banks reported no change in demand for house loans in the first quarter of 2022 and also expected demand to remain stable in the following quarter.

All surveyed banks reported unchanged credit standards and terms and conditions for consumer credit and other lending for the first quarter. No changes in credit standards were expected during the second quarter of 2022. Demand for this type of credit was unchanged in the first quarter, and was also expected to remain unchanged in the second.

The April 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, the majority of banks reported unchanged market access to retail funding and risk transfer capabilities, with the situation expected to remain stable in the second quarter.

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. There was, however, some impact on net interest income and holdings of euro area sovereign holdings. 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, with half of the banks expecting lower profits to persist in the second quarter. All respondent banks reported no changes in their lending rates, and lending and deposits volumes. Most banks also claimed that there were no changes to their deposit rates and non-interest rate charges as a result of the negative deposit facility rate. All banks expected no changes in the six months ahead.

Respondent banks were also asked about the impact of the ECB's 2-tier system for remunerating excess liquidity holdings on their financial situation, lending and deposit rates. All banks reported

an improvement in their overall profitability. 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 third TLTRO III. None of the respondents participated in the TLTRO III that took place in December 2021.

The money market

During the first quarter of 2022, the Government issued €571.0 million in Treasury bills, €186.1 million more than the amount issued in the fourth quarter of 2021.

In the domestic primary market, the yield on 3-month Treasury bills rose to -0.34% by the end of March, from -0.41% at end-December.

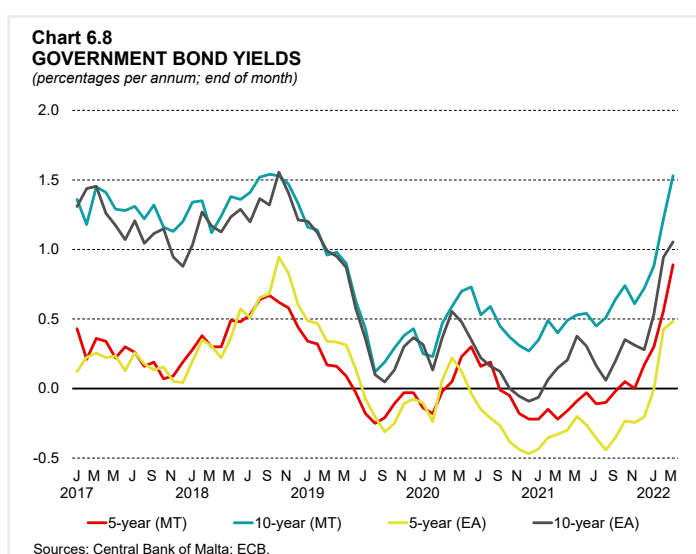
The capital market

During the first quarter of 2022, the Government issued three new MGS with a total value of €237.4 million. Four institutions launched new bond issues on the Malta Stock Exchange (MSE). Gap Group plc and St. Anthony Co. plc issued €21.0 million and €15.5 million respectively in secured bonds. AX Real Estate plc issued €40.0 million in unsecured bonds, while Hili Finance Company plc issued €50.0 million in unsecured bonds.

By the end of March, 22 firms had bonds that were listed on the MSE through Prospects, an unchanged number compared with end-December.¹⁰

In the secondary market, turnover in government bonds increased to €24.8 million from €23.2 million in the fourth quarter of 2021, and turnover in corporate bonds rose to €25.7 million from €18.7 million previously.

The yield on 5-year bonds rose to 0.89% at the end of March, from 0.17% three months earlier (see Chart 6.8). The yield on 10-year bonds also increased, reaching 1.53% from 0.72% in December. Meanwhile, the euro area benchmark yield on 5-year bonds rose to 0.48% from -0.20%, while the benchmark yield on 10-year bonds increased to 1.05% from 0.28%. As the domestic 10-year yield rose at a faster pace compared with the euro area benchmark yield, the spread against the latter widened to 48 basis points, from 44 basis points in December. Maltese sovereign yields have been trending upwards

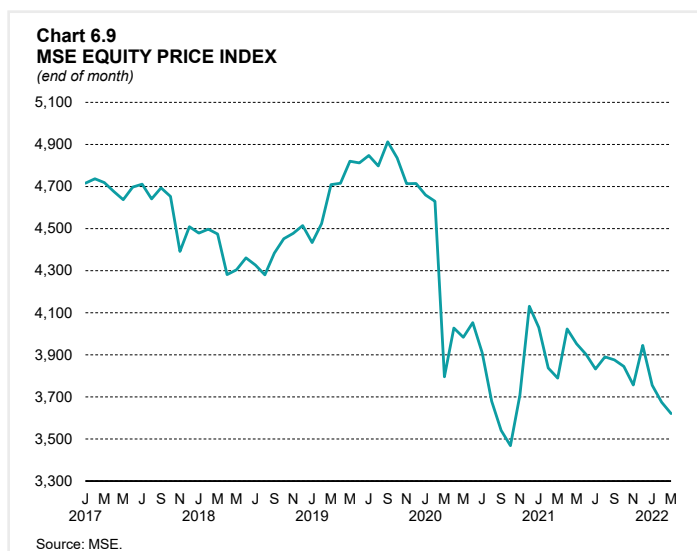


¹⁰ Prospects is a multi-lateral trading facility operated by the MSE with the aim of facilitating access to capital markets for SMEs.

in line with other euro area yields. This reflects the persistent high inflation in major advanced economies, which is resulting in higher interest rate expectations.

MSE Share Index declines

During the first quarter of 2022, share prices in Malta fell. The MSE Equity Price Index ended the quarter 8.2% below its level at end-December, and 4.5% below its reading a year ago (see Chart 6.9). The MSE Equity Total Return Index, which accounts for changes in equity prices and dividends, fell by 7.7% between end-December and end-March.



Equity turnover increased to €8.4 million during the first quarter of 2022, from €5.6 million in the previous quarter.