FOREWORD

During the fourth quarter of 2022, the pace of economic expansion decelerated, with annual real gross domestic product (GDP) increasing by 4.7%, from 5.3% in the previous quarter. Slower growth was driven by a more negative contribution from net exports, in part reflecting a significant increase in imports by the aviation sector, which offset an increase in the contribution of domestic demand. When adjusting for imports, domestic demand remained the main driver of growth, but external trade had a positive contribution as well.

Potential output growth is estimated to have stood at 6.3% in the fourth quarter of 2022, above the rate of 5.8% estimated for the third quarter. On a four-quarter moving average basis, the level increase in potential output relative to the third quarter was somewhat stronger than that in GDP, resulting in a smaller positive output gap. This implies that the degree of over-utilisation of the economy's productive capacity has eased somewhat.

Meanwhile, the Bank's Business Conditions Index (BCI) indicates that annual growth in business activity has normalised from its record highs registered in the first half of 2021, and now stands close to its historical average. The index was affected by strong annual increases in several sub-components, particularly in tourist arrivals.

Developments in the labour market remained positive, with employment levels and employment rates both rising in annual terms. The unemployment rate remained low from a historical perspective and stood well below that in the euro area.

Consumer price pressures eased somewhat during the quarter under review, but inflation remained high from a historical perspective. Annual inflation, as measured by the Harmonised Index of Consumer Prices (HICP), stood at 7.3% in December, marginally below that of 7.4% recorded in September. Services price growth was the driver behind the marginal decrease in inflation since September, as food and non-energy industrial goods (NEIG) inflation increased. Energy prices remained unchanged, reflecting Government subsidies. Meanwhile, annual inflation based on the Retail Price Index (RPI), which only considers expenditure by Maltese residents, edged down from 7.5% in September to 7.4% in December.

Industrial producer price inflation moderated to 4.3% in December, from 4.6% three months earlier. After declining in the third quarter, Malta's unit labour cost (ULC) index, measured on a four-quarter moving average basis, increased by 1.9% in the fourth quarter. The harmonised competitiveness indicators (HCIs), a gauge of external price competitiveness, point to a deterioration in international competitiveness between September and December 2022, reflecting an appreciation of the euro.

In the fourth quarter of 2022, the current account balance turned into a deficit from a surplus a year earlier. This was mostly due to a widening of the merchandise trade deficit, and higher net outflows on the primary income account. These offset higher net receipts from services and lower net outflows on the secondary income account. The current account balance registered a deficit equivalent to -5.8% of GDP for the year 2022.

When measured on a four-quarter moving sum basis, the general government balance registered a deficit of 5.8% of GDP, marginally higher than in the third quarter of 2022. The general government debt-to-GDP ratio increased to 53.4% at end-December, from 52.9% at end-September. Compared with the fiscal position at end-2021, the general government deficit-to-GDP ratio declined by 2.0 percentage points, while the debt-to-GDP ratio decreased by 1.7 percentage points.

In the period under review, Maltese residents' deposits with monetary financial institutions (MFIs) in Malta continued to expand, albeit at a slower pace, compared to the previous quarter. The shift to overnight deposits persisted amid a preference for liquidity. Credit to Maltese residents continued to expand at a strong pace, but showed signs of moderation, reflecting a slower increase in credit to general government. Credit to residents outside general government accelerated, reflecting faster growth in loans to non-financial corporations (NFCs). Meanwhile, growth in loans to households eased slightly in the year to December.

According to the Bank's Financial Conditions Index (FCI), in the final quarter of 2022, financial conditions were tight from a historical perspective, and indeed were among the tightest in the last ten years. The tightening since September reflected a deterioration in domestic influences, as the contribution of foreign factors stood slightly less negative.

In December, the weighted average interest rate offered to households and NFCs on their outstanding deposits in Malta was down by 1 basis point on a year earlier, standing at 0.15%. Although deposit rates for NFCs generally increased, those offered to households showed mixed developments. Meanwhile, the weighted average lending rate paid by households and NFCs to resident MFIs increased by 9 basis points, to 3.32% over the same period. Hence, the spread between the two widened.

The primary market yield on Treasury bills in December was higher than that prevailing at the end of September. Secondary market yields on five-year and ten-year Malta Government Stocks (MGS) also increased between September and December, as recent ECB rates hikes were smoothly transmitted to euro area government bond yields. Meanwhile, domestic share prices declined.

By end-December 2022, 622 facilities were approved and still outstanding under the Malta Development Bank (MDB) COVID-19 Guarantee Scheme (CGS), covering total sanctioned lending of €482.6 million, unchanged from the total amount of sanctioned lending in September. 62.0% of the scheme's target size was sanctioned while 60.5% was disbursed. Meanwhile, four facilities were approved as part of the support measures launched in response to the war in Ukraine and high inflation. By end-December, these covered total sanctioned lending of €38.7 million, €24.5 million more from end-September.

The European Central Bank's (ECB) Governing Council raised its key interest rates further in October, and increased them again in December. Thus, by the end of the fourth quarter, the interest rates on on the deposit facility, the main refinancing operations (MROs) and the marginal lending facility had risen to 2.00%, 2.50% and 2.75%, respectively. The Governing Council stated that it anticipated further significant increases in interest rates given still very high inflation, and in fact two further increases were announced in the first quarter of 2023.

Interest rate hikes are being complemented with measures targeting credit operations and asset purchases. In December, the ECB also announced that from March 2023, the Eurosystem will not reinvest all of the principal payments from maturing securities under the asset purchase programme (APP). Accordingly, the APP portfolio has since started to decline at a measured and predictable pace.

During the quarter, the ECB adjusted the interest rates applicable to the targeted longer-term refinancing operations (TLTRO) III to ensure consistency with the monetary policy stance and offered banks additional voluntary early repayment dates. It also set the remuneration of minimum reserves at the ECB's deposit facility rate, thus aligning it more closely to money market conditions.

Meanwhile, the Governing Council reiterated its intention to continue reinvesting the principal payments from maturing securities purchased under the pandemic emergency purchase programme (PEPP), until at least the end of 2024. The future roll-off of the PEPP portfolio would be managed to avoid interference with the appropriate monetary policy stance.