

3. PRICES, COSTS AND COMPETITIVENESS

Consumer price pressures eased further during the quarter under review, but inflation remained high from a historical perspective.

Annual inflation, as measured by the HICP, stood at 4.9% in September, down from 6.2% in June. This was driven by slower growth in the prices of services, food and NEIG. Annual inflation based on the RPI – which only considers expenditure by Maltese residents – fell to 4.1% in September, from 5.4% in June.

When measured over four quarters, ULCs increased at a marginally faster pace in the third quarter of 2023, with its growth rate reaching 3.1%, from 3.0% in the previous quarter. However, most other input cost indicators moderated.

Inflation

HICP inflation eases

Annual HICP inflation eased to 4.9% in September 2023, from 6.2% in June 2023 (see Table 3.1). Chart 3.1 shows that notwithstanding this decline, HICP inflation in Malta exceeded that recorded in the euro area, which ended the quarter at 4.3%. The lower inflation outturn in the euro area mainly reflects the decrease in energy prices experienced in 2023 following the record highs reached in 2022. Indeed, energy inflation pulled down overall HICP inflation in the euro area – by 0.6 percentage point in September (see Chart 3.2). In the case of Malta, energy prices have remained unchanged since mid-2020. At the same time, the contribution of services inflation in Malta is marginally higher than that of the euro area. On the other hand, the contribution of NEIG to HICP inflation in September

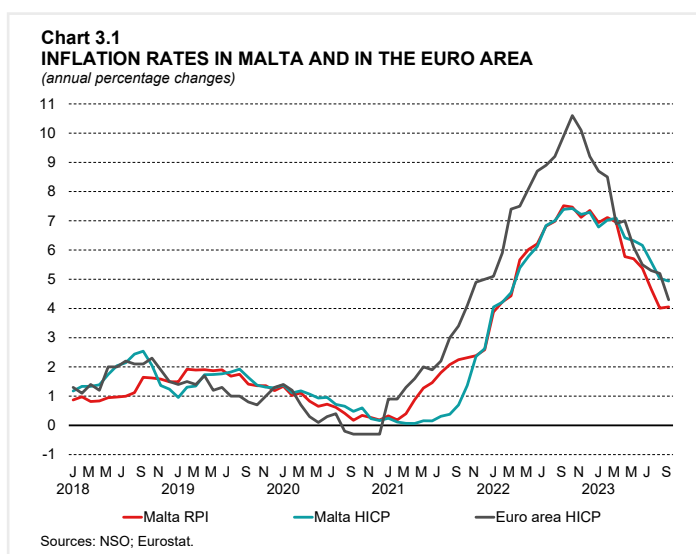


Table 3.1
HICP INFLATION
Annual percentage changes

	2022			2023								
	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.
Unprocessed food	14.4	10.0	10.3	8.5	13.0	12.3	8.3	7.0	8.4	5.4	8.5	8.2
Processed food including alcohol and tobacco	11.3	12.0	11.8	10.6	11.0	11.0	10.6	10.4	10.9	9.9	9.7	9.0
Energy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NEIG	6.5	6.7	6.7	7.3	6.7	6.6	5.4	5.1	4.0	3.8	3.4	3.6
Services (overall index excluding goods)	6.7	6.5	6.7	5.8	6.1	6.4	6.0	6.1	6.1	5.6	4.3	4.3
All items HICP	7.4	7.2	7.3	6.8	7.0	7.1	6.4	6.3	6.2	5.6	5.0	4.9

Source: Eurostat.

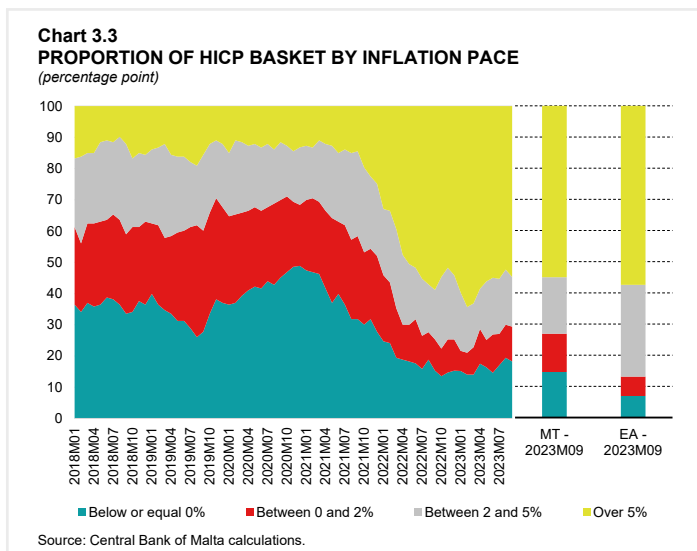
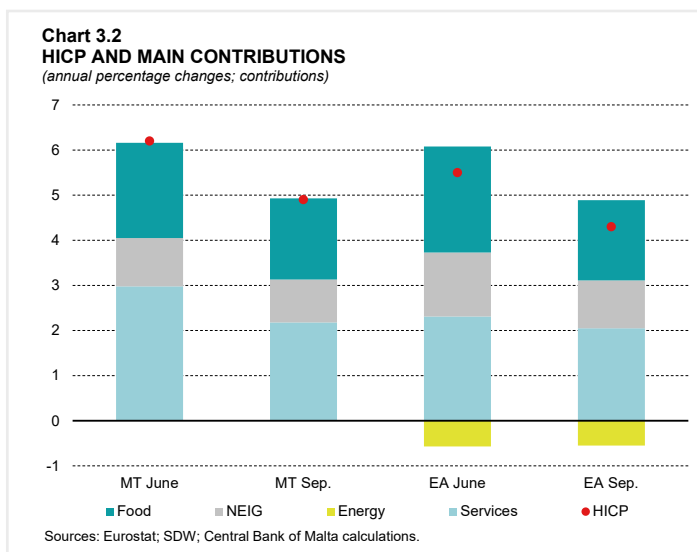
was marginally lower in Malta than in the euro area, while that of food was similar.

Chart 3.3 shows a distribution of price changes whereby subcomponents of HICP are categorised into four classes of inflation rates: i) below or equal to 0%; ii) between 0% and 2%; iii) between 2% and 5%; and iv) over 5%.¹ This indicates whether high inflation is broad-based across HICP items, or if it is being driven only by selected components of the consumption basket.

The share of subcomponents registering inflation rates in the lowest inflation band has declined in both Malta and the euro area since late 2021, which was mirrored in a substantial rise in the share of subcomponents with year-on-year price increases of more than 5%. This trend has started to reverse in recent quarters, although the share of items with price increases over 5% remains high, standing at 54.7% in September, and exceeding the euro area figure which stood at 47.4%.

When compared to three months earlier, the share of the Maltese basket falling in this band has declined marginally by 0.3 percentage point. The two intervals holding items with inflation rates of between 0% and 5% also declined since June. The bracket holding items with inflation between 0% and 2% declined by 1.1 percentage points to stand at 11.2% in September. At the same time, the bracket holding items with inflation between 2% and 5% contracted by 2.2 percentage points to stand at 15.9% in September. By contrast, the share of items with price increase of 5% or less increased in the euro area.

¹ The calculation of the shares in this chart do not consider the weights of individual HICP sub-components. This analysis includes 170 sub-indices of the HICP for Malta and 289 sub-indices for the euro area. On average since 2001, 30.7% of items in Malta's basket fell in the 0% or negative inflation rates interval, while this figure stood at 17.5% for the euro area. Around 47% of the Maltese basket fell in the 0-2% and 2-5% intervals – in almost equal parts. These shares stand at 40.3% and 32.4%, respectively, in the euro area. While 22.0% of the Maltese basket fell in the over 5% interval, only 9.8% of the euro area basket falls in this interval.



On the other hand, the bracket holding items with negative growth rates grew by 3.6 percentage points in Malta, standing at 18.2% and exceeding the euro area figure which stood at 8.3%. The increase in this bracket stemmed mainly from a decline in prices of items classified as NEIG and services. These include footwear, certain household equipment and wireless telephone services.

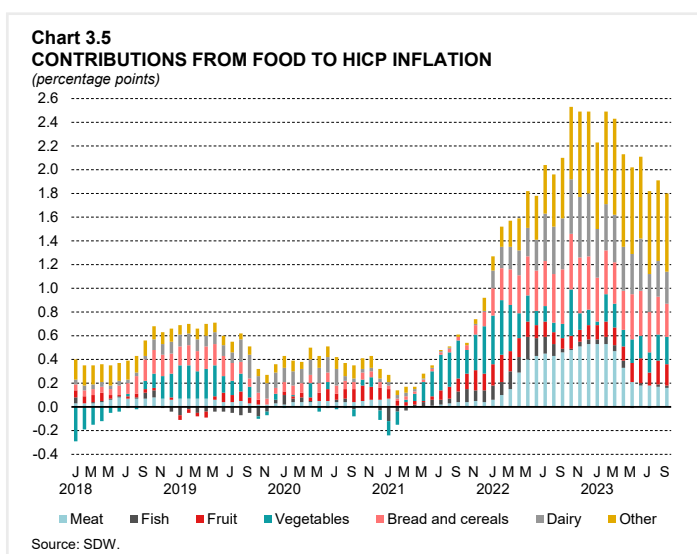
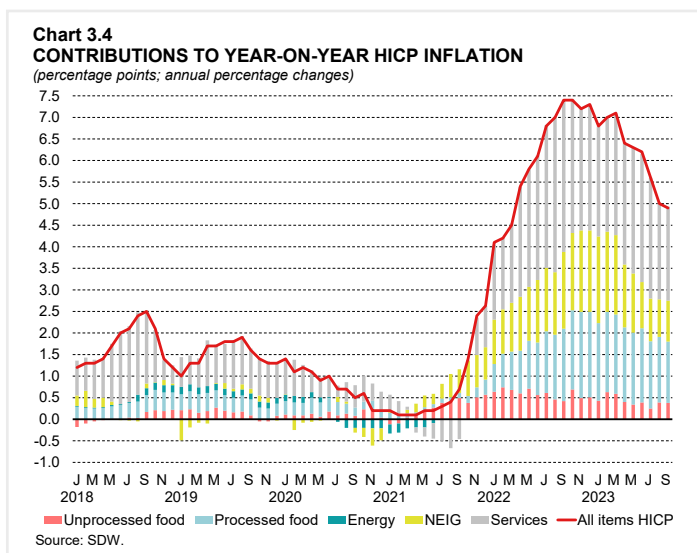
The drop in HICP inflation relative to June was driven by slower growth in the prices of services, processed food and NEIG inflation (see Chart 3.4). The contribution from unprocessed food remained unchanged, as was that of energy.

Food inflation moderated during the quarter under review, though it remained high by historical standards. It stood at 8.8% in September, down from 10.3% in June. Consequently, the overall contribution of food to HICP inflation eased to 1.8 percentage points in September, from 2.1 percentage points in June. The decline was mainly driven by processed food prices which rose at a slower rate of 9.0% from 10.9% in June. Unprocessed food inflation eased more gradually, from 8.4% to 8.2%.

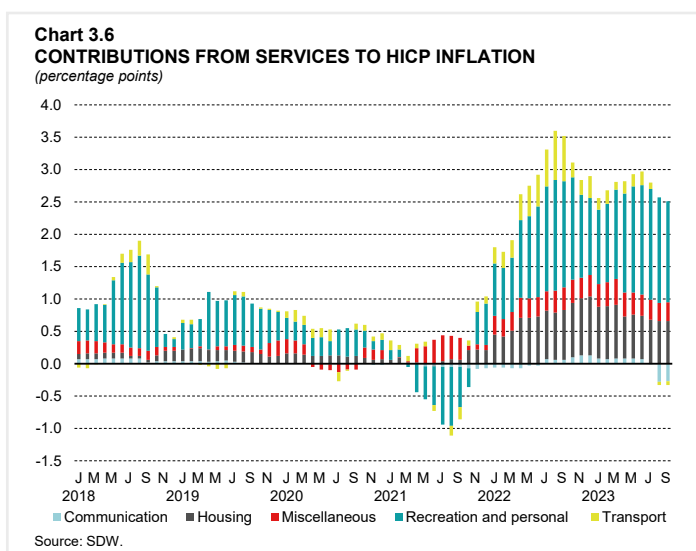
Smaller contributions from dairy products and bread and cereals were the main drivers of the moderation in food inflation, followed by fruit prices (see Chart 3.5). On the other hand, the contribution from vegetables increased slightly.

NEIG inflation declined from 4.0% in June to 3.6% in September. Looking at the sub-components, prices of durables rose at a slower pace of 1.9%, from 3.5% three months earlier, while prices of non-durables rose by an annual 5.6%, down from 6.1% in June. By contrast, prices of semi-durables goods rose by 3.6%, up from 2.3%.

Services inflation decreased from 6.1% in June to 4.3% in September, contributing 2.2 percentage points to overall HICP inflation (see Chart 3.6). Despite easing, services inflation still stands relatively high from a historical perspective.



The largest contribution to services inflation stemmed from the recreation and personal care component. Among other items, this component includes restaurants, cafes, and similar establishments. It also includes hotel accommodation, which also had a strong contribution, although to a lesser extent. The contribution of the recreation and personal care component declined marginally compared with June. On the other hand, the contribution from transport services and communications turned negative. This was a key factor behind the moderation in services inflation since June. Respectively, this reflected falls in the prices of passenger transport by road and air, as well as wireless telephone services.



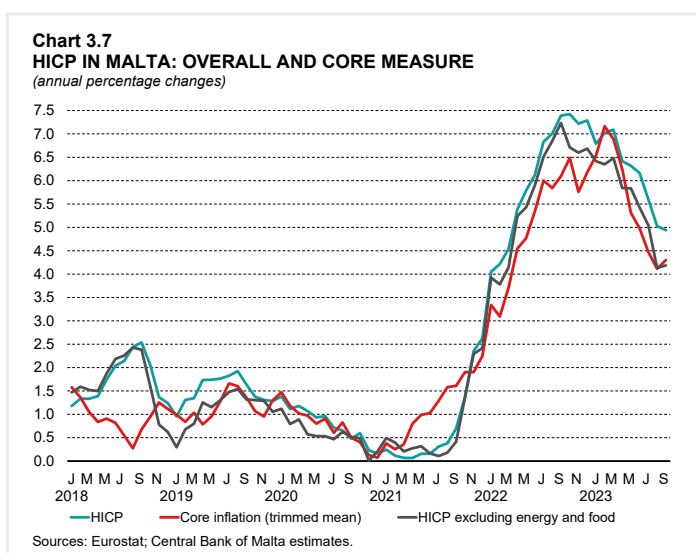
Energy inflation was unchanged at 0.0% in September, as electricity, gas and transport fuel prices were kept unchanged from their level a year earlier, through government support measures shielding the economy from changes in international energy prices.

Core HICP inflation declines

The Bank's measure of core inflation, which excludes the more volatile items in each month, fell to 4.3% in September 2023, from 5.0% three months earlier (see Chart 3.7).² Hence, it was 0.6 percentage point lower than overall HICP inflation. An alternative measure of underlying inflationary pressures – HICP excluding food and energy – also eased in September, reaching 4.2% from 5.4% in June.

RPI inflation drops

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 – fell to 4.1% in September, from 5.4% in June, mainly due to a



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

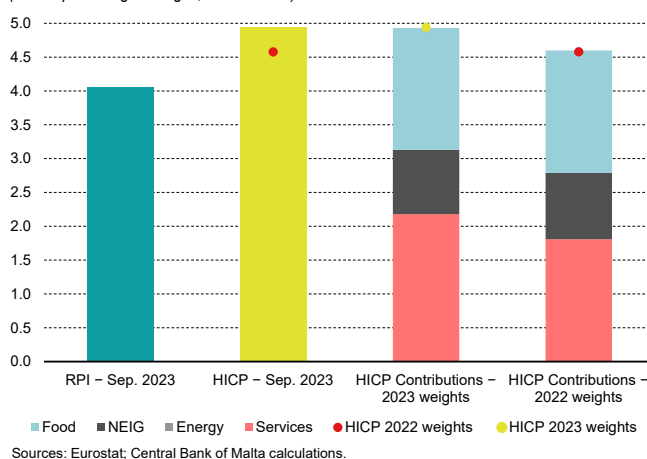
	2022				2023							
	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.
Food	2.9	2.7	2.7	2.3	2.6	2.5	2.2	2.2	2.2	1.9	2.0	1.9
Beverages and tobacco	0.3	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Clothing and footwear	0.2	0.1	0.0	0.5	0.4	0.3	-0.1	-0.1	-0.1	-0.1	-0.1	0.1
Housing	1.5	1.5	1.5	1.3	1.1	1.2	0.8	0.8	0.7	0.7	0.7	0.6
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	0.5	0.6	0.6	0.5	0.4	0.4	0.5	0.5	0.4	0.4	0.2	0.3
Transport and communications	0.6	0.5	0.6	0.4	0.4	0.4	0.6	0.6	0.4	0.0	-0.6	-0.5
Personal care and health	0.5	0.5	0.5	0.5	0.6	0.6	0.5	0.5	0.4	0.4	0.4	0.4
Recreation and culture	0.3	0.2	0.3	0.3	0.3	0.3	0.4	0.1	0.1	0.2	0.1	0.1
Other goods and services	0.5	0.5	0.5	0.6	0.7	0.6	0.5	0.5	0.6	0.5	0.5	0.5
RPI (annual percentage change)	7.5	7.1	7.4	6.9	7.1	7.0	5.8	5.7	5.4	4.7	4.0	4.1

Source: NSO.

drop in the prices of transport and communication services (see Table 3.2). Prices of food, housing and recreation and cultural activities also contributed to reduce inflation, though to a lesser extent. On the other hand, prices of clothing and footwear contributed positively during the quarter under review. Meanwhile, energy tariffs continued to have a neutral impact on overall RPI inflation in the period under review.

The difference between HICP and RPI inflation in part reflects the different structure of weights applied to the two indices.³ Moreover, unlike the RPI, weights applied to the HICP index are updated annually.⁴ A hypothetical estimate of HICP inflation using 2022 weights leads to an inflation rate of 4.6% in September, indicating that almost half of the discrepancy between HICP and RPI is due to the latest update of HICP weights. Looking at the subcomponents, the main difference stems from services inflation (see Chart 3.8).

Chart 3.8
IMPACT OF 2023 WEIGHTS ON HICP INFLATION IN SEPTEMBER
(annual percentage changes; contributions)



Sources: Eurostat; Central Bank of Malta calculations.

The housing market

Residential property price inflation broadly unchanged

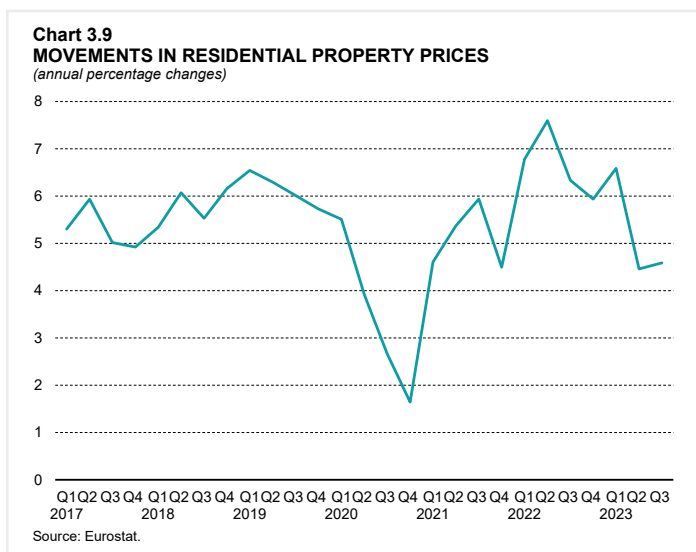
The NSO's Property Price Index (PPI) – which is based on actual transactions involving apartments, maisonettes, and terraced houses – continued to increase in annual terms. The annual rate of change stood at 4.6% in the third quarter of 2023, broadly unchanged from 4.5% in the previous quarter

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.

⁴ In 2023, the weight allocated to services stands at 44.3%, while that of NEIG is 27.9%. Food accounts for 21.4% of the index, while the share allocated to energy stands at 6.5%. These were revised from 43.3% for services, 28.3% for NEIG, 21.8% for food and 6.7% for energy in 2022.

(see Chart 3.9).⁵ This contrasts with developments in the euro area, where prices on average decreased at an annual rate of 2.1%.

Residential property prices in Malta continue to be supported by a number of Government schemes supporting demand for property, including the first-time and second-time buyers' schemes, the purchase of properties located in Urban Conservation Areas (UCA) and in Gozo, as well as refund schemes for restoration expenses. Moreover, a dynamic tourism sector, and an increase in migrant workers flows continue to support demand for accommodation and hence, property prices.

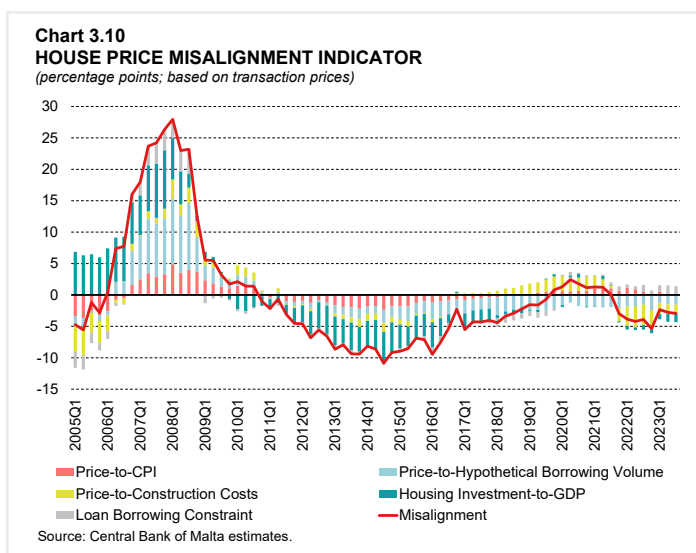


Misalignment indicator partly affected by exceptional inflationary environment

As part of its ongoing macroeconomic analysis, the Bank calculates a house price misalignment index to provide an indication of the evolution of house prices against fundamentals.^{6,7}

This indicator consists of five sub-indices that capture household, investor, and system-wide factors, with the weights being derived using principal component analysis.

According to the misalignment indicator, house prices, as measured by the NSO's PPI, were below the level consistent with fundamentals in the third quarter of 2023, with the gap marginally wider than that estimated for the second quarter of the year (see Chart 3.10).⁸



⁵ '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.

⁶ See Micallef, B. (2018), "Constructing an index to examine house price misalignment with fundamentals in Malta", *International Journal of Housing Markets and Analysis*, 11(2), pp. 315-334.

⁷ The actual numerical results presented in this section should not be overstated given the limitations in the construction of this indicator. For example, relevant variables such as foreign capital inflows are not included, and the unavailability of an official rental index precludes the use of the price-to-rent ratio in the indicator.

⁸ A separate assessment based on advertised house prices can be found in Gatt, W., Micallef, B. and Rapa, N. (2018), "A macro-economic model of the housing market in Malta", *Annual Research Bulletin*, Central Bank of Malta, pp. 11-18.

The undervaluation was driven mainly by the price-to-hypothetical borrowing volume, an affordability indicator, and the price-to-construction costs ratio. The housing investment-to-GDP ratio, which is an indicator of overheating, also contributed negatively to the index. By contrast, the loan borrowing constraint contributed positively to the misalignment index. The price-to-CPI also contributed positively to the index, though marginally.

Number of final deeds decrease in quarterly and annual terms

NSO data on residential property transactions show that 2,870 final deeds of sale were registered in the quarter under review, a decrease of 4.6% compared to the number of sales concluded in the previous quarter, and 20.1% lower than the same level registered in the same quarter a year earlier (see Table 3.3). Over 90% of transactions concluded in the third quarter of 2023 involved purchases by individuals.

In the third quarter of 2023, the largest year-on-year decreases in absolute terms were recorded in the Northern Harbour region, followed by Gozo and Comino, and the Northern region. In value terms, there was a year-on-year decline of 7.6%.

At 3,082, the number of promise-of-sale agreements was 12.0% lower than those notified in the previous quarter, but 8.3% higher than those registered in the same quarter of 2022. Most of the increase in year-on-year terms was reported for the Northern Harbour.

Mortgage transactions increased and remained above pre-pandemic average.⁹

The number of new mortgage contracts increased in the third quarter of 2023 in annual terms, standing at 1,136. When compared with the third quarter of 2022, they increased by around 5.3% (see Chart 3.11). This increase was observed for all

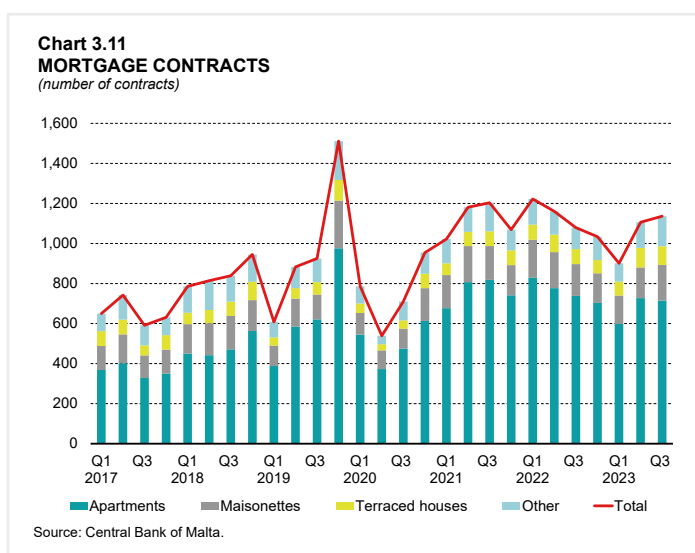


Table 3.3
TRANSACTIONS

Levels

	2022			2023	
	Q3	Q4	Q1	Q2	Q3
Residential transactions					
Promise of sale	2,847	3,353	3,124	3,502	3,082
Final deeds of sale	3,593	3,764	3,101	3,007	2,870

Source: National Statistics Office.

⁹ The data used in the section are collected by the Central Bank of Malta from four commercial banks and relate only to properties which have been purchased with a mortgage. The dataset excludes properties that have either been transacted using other means of financing, as well as mortgages that have been refinanced. The property types included are flats, penthouses, maisonettes, terraced houses, town houses, houses of character, farmhouses, bungalows, and villas. Other property types included in the previous section such as airspace, boathouses, garages, and plots of land are excluded.

categories, except for apartments, as the number of mortgage contracts for apartments declined marginally. Moreover, the total number of mortgage contracts in the third quarter of 2023 exceeded the average of 827 transactions per quarter recorded between 2017 and 2019.

Advertised rent prices continue to increase

The annual rate of change of advertised rents collected from internet sources edged up in the third quarter of 2023.¹⁰ The

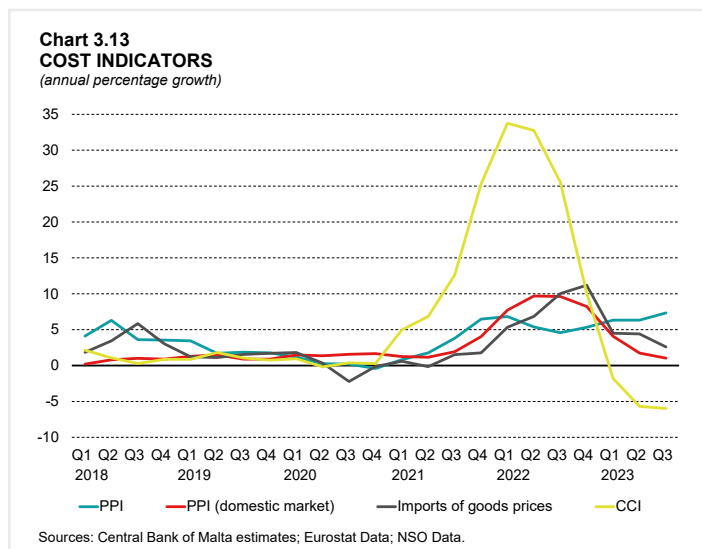
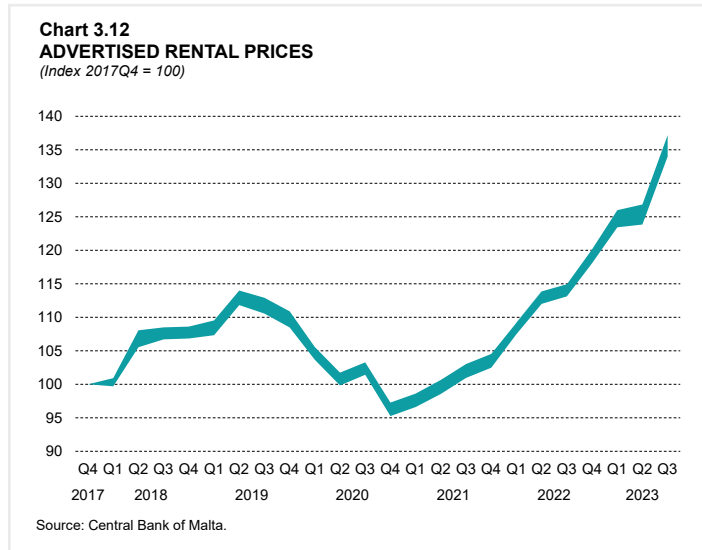
range of estimates from various methods indicate that rents have increased at annual rates of between 18.2% and 19.4% in the quarter under review (see Chart 3.12). Compared with the previous quarter, the range of estimates has widened. Furthermore, the level of advertised rents stood around 24% above the pre-pandemic level, as estimated in the final quarter of 2019.

Cost indices

Producer costs grew at a slower pace

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, reached 3.9% in this quarter, down from 4.7% in the previous quarter.¹¹ This moderation was almost entirely driven by developments in producer prices for consumer goods, which rose by 6.9% in this quarter, down from 9.6% previously. At the same time, producer price inflation for capital goods declined slightly from 5.0% to 4.9%. Meanwhile, energy and intermediate goods producer price inflation remained unchanged.

Other indicators affecting the domestic market also show easing cost pressures (see Chart 3.13). The domestic producer price index rose at a slower annual rate of 1.0%,



¹⁰ The empirical analysis is based on hedonic regression models as described in Debono et al., (2020) and different indices are constructed using alternative methodologies, namely the time dummy method, the rolling time dummy method with a window length of two periods (Q=2) and the average characteristics method chained using the Laspeyres, Paasche and Fisher methods. The properties considered in this analysis include apartments, maisonettes, and penthouses.

¹¹ 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.

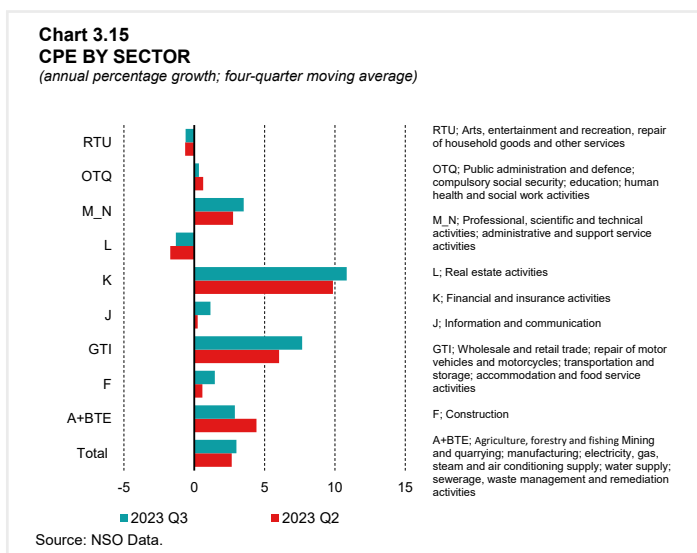
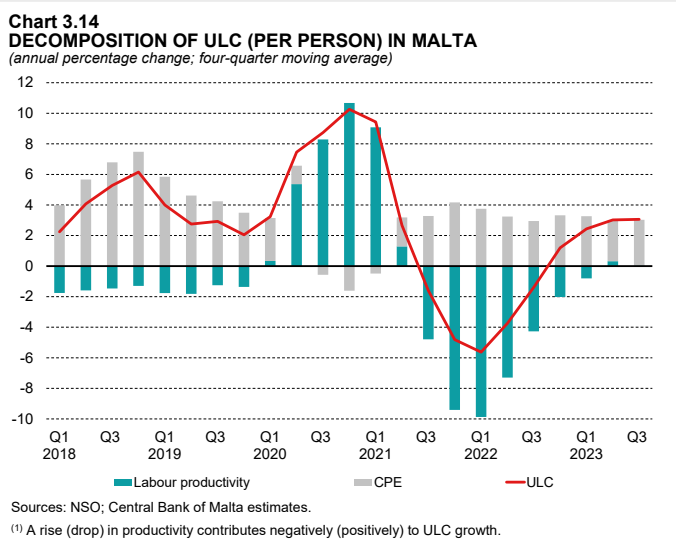
from 1.7% in the second quarter, mainly driven by prices of consumer goods.¹² The imports of goods deflator also shows weaker growth of 2.6% during the quarter under review, from 4.4% in the second quarter of 2023.¹³ The CCI for new residential buildings published by Eurostat continued to decline in the third quarter, falling by an annual 6.0%, after it had declined by 5.7% in the last quarter. Notwithstanding the recent decline, its level remains above that observed before 2020.

ULCs increase at a faster rate

Malta's ULC index – measured as the ratio of compensation per employee (CPE) to labour productivity – increased in the third quarter of 2023 in annual terms but fell in quarter-on-quarter terms.¹⁴

When measured on a four-quarter moving average basis in headcount terms, ULCs in Malta rose at an annual rate of 3.1%. This followed an increase of 3.0% in the previous quarter (see Chart 3.14). The recent growth in ULCs reflected growth in CPE, as productivity per person was stable in annual terms. Indeed, labour productivity showed no growth after marginally declining by 0.3% in the previous quarter. By contrast, CPE rose at a faster pace of 3.0%, from 2.7% in the second quarter.

When measured on a four-quarter moving average basis, growth in CPE was fastest in the financial and insurance activities sector, which had a year-on-year growth rate of 10.8% (see Chart 3.15). This was followed by the wholesale



¹² The domestic PPI refers to the producer prices relating to the domestic market only, whilst the PPI relates to the total market, i.e., including both the domestic and non-domestic markets.

¹³ This index is derived from national accounts data published by the NSO.

¹⁴ Annual growth in ULC, CPE and labour productivity is measured on a four-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.

and retail sector, where compensation per person grew by 7.7%. Most of the other sectors also show an increase in CPE. When compared with the previous quarter, growth in CPE picked up in the construction sector and across various services sectors.