4. THE BALANCE OF PAYMENTS[1]

During the third quarter of 2023, the current account balance turned into a surplus from a deficit during the same quarter in the previous year. This was due to a narrowing of the merchandise trade deficit, higher net receipts from services, and lower net outflows on the secondary income account. These offset higher net outflows on the primary income account.

In the quarter under review, net inflows on the capital account increased when compared to the corresponding quarter of 2022, while net lending on the financial account increased.

The current account balance registered a surplus equivalent to 1.2% of GDP in the third quarter of 2023. This compares with a current account surplus of 1.3% of GDP in the euro area.

The cyclically-adjusted current account balance is estimated to have recorded a surplus of 2.4% during the quarter under review.

As balance of payments data are undergoing substantial revisions, readers are advised to exercise caution in interpreting changes over time.

During the third quarter of 2023, the tourism sector reported further gains. The number of inbound tourists, nights stayed, and tourist expenditure in Malta all increased when compared with a year earlier, and surpassed 2019 levels.

The current account

The current account turns into a surplus

Between July and September 2023, the current account of the balance of payments registered a surplus of €366.5 million, a €479.5 million improvement from the deficit recorded in the same quarter of 2022 (see Table 4.1). This was driven by a decrease in the merchandise trade deficit,

Table 4.1
BALANCE OF PAYMENTS
EUR millions

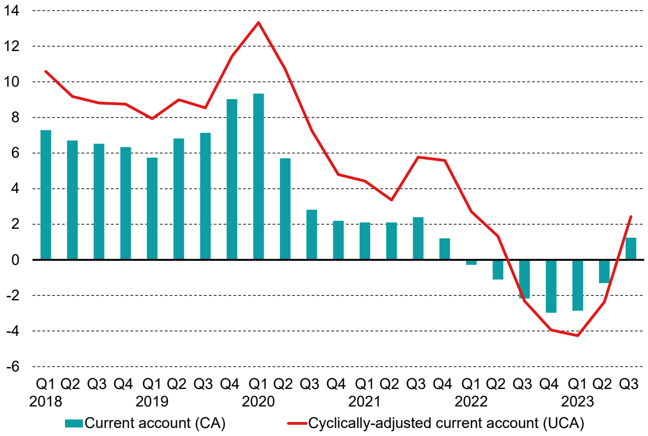
	Four-quarter moving sums						
	2022 Q3	2022 Q4	2023 Q1	2023 Q2	2023 Q3	2022 Q3	2023 Q3
Current account	**-367.3**	**-518.7**	**-513.0**	**-241.6**	**237.9**	**-113.0**	**366.5**
Goods	-3,009.8	-3,184.6	-3,192.3	-3,017.6	-2,552.7	-1,096.0	-631.1
Services	4,964.3	5,102.1	5,173.9	5,253.7	5,354.4	1,530.9	1,631.6
Primary income	-1,894.2	-1,974.0	-2,028.5	-2,181.9	-2,320.1	-457.7	-595.9
Secondary income	-427.5	-462.1	-466.2	-295.9	-243.8	-90.2	-38.1
Capital account	**235.6**	**266.7**	**357.9**	**345.3**	**365.7**	**56.9**	**77.3**
Financial account(1)	**-1,185.4**	**-71.0**	**1,981.8**	**3,483.6**	**4,333.9**	**409.7**	**1,260.0**
Errors and omissions	**-1,053.5**	**181.2**	**2,137.0**	**3,380.0**	**3,730.3**	**465.9**	**816.2**

Sources: Eurostat; Central Bank of Malta.
(1) Net lending (+) / net borrowing (-).

[1] Data in this chapter are sourced from the Central Bank of Malta and Eurostat and may differ from data published in *NSO News Release* 231/2023.

higher net receipts from services, and lower net outflows on the secondary income account, which offset higher net outflows on the primary income account.

Chart 4.1
CURRENT ACCOUNT
(four-quarter moving sums as a percentage of GDP)



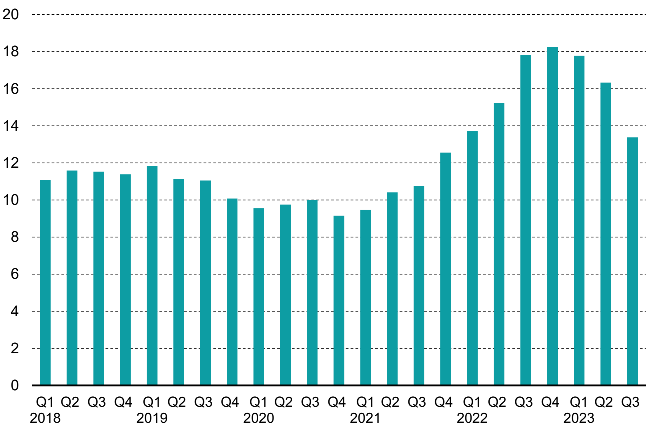
Sources: Eurostat; Central Bank of Malta.

In the four quarters up to September 2023, the current account turned to a surplus of €237.9 million, from a deficit of €367.3 million a year earlier. The change in the current account balance from a deficit to a surplus was mainly spurred by the abovementioned developments in the third quarter. As a result, the current account balance-to-GDP ratio reached 1.2%, from -2.2% a year earlier (see Chart 4.1). Malta's cyclically-adjusted current account surplus is estimated to have stood at 2.4% of GDP in the third quarter of 2023, and thus more positive than the headline measure (see Chart 4.1).[2]

The merchandise trade deficit narrows

In the third quarter of 2023, the merchandise trade deficit stood at €631.1 million, down from €1,096.0 million in the corresponding period of 2022. This was driven by a decrease in imports together with an increase in exports. The former mostly reflected lower imports of machinery and transport equipment as well as fuel and chemicals.

Chart 4.2
GOODS DEFICIT
(four-quarter moving sums as a percentage of GDP)



Sources: Eurostat; Central Bank of Malta.

The visible trade gap decreased when measured on a four-quarter cumulative basis, reaching €2,552.7 million, from €3,009.8 million in the same period a year earlier. This reflected a €359.9 million decline in goods imports, reflecting a decrease in imports of fuel and chemicals, and a €97.4 million increase in exports. As a result, the share of the goods deficit in GDP declined to 13.4% in the year to September 2023, from 17.8% a year earlier (see Chart 4.2).

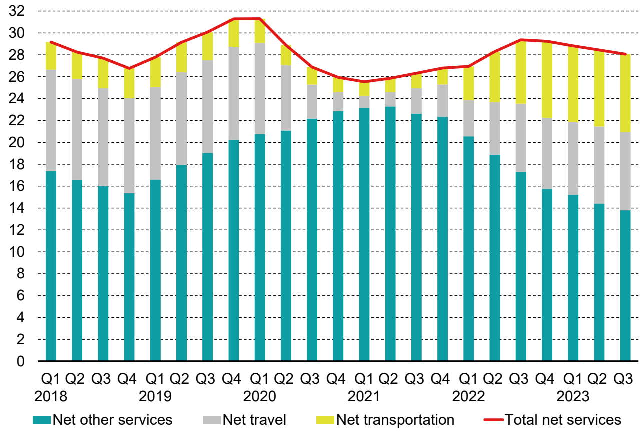
[2] For more information on Malta's cyclically-adjusted current account see Grech, A. G., & Rapa, N., "An evaluation of recent shifts in Malta's current account position", in Grech, A.G., & Zerafa, S. (eds.), *Challenges and Opportunities of Sustainable Economic Growth: the Case of Malta*, Central Bank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

The surplus on services widens

In the quarter under review, net receipts on the services account amounted to €1,631.6 million, €100.7 million more than in the corresponding period of 2022. Both services exports and imports increased on a year earlier. However, the increase in the former was stronger.

The transport and travel components drove the increase in the surplus from services. By contrast, net receipts on 'other services' decreased.

Chart 4.3
SERVICES BALANCE
(four-quarter moving sums as a percentage of GDP)



Sources: Eurostat; Central Bank of Malta.

On a four-quarter cumulative basis, the overall surplus from services stood at €5,354.4 million, an increase of €390.1 million over the surplus recorded in the year to September 2022. The main contributors to this increase were the transport and travel components. The share of net services receipts in GDP stood at 28.1%, from 29.4% over the same period last year (see Chart 4.3).

Net outflows on the primary income account increase[3]

Between July and September 2023, net outflows on the primary income account stood at €595.9 million, €138.2 million more than in the third quarter of 2022. This was mainly due to higher net payments related to reinvestment earnings and lower receipts on 'other investment income'.

In the four-quarter period to September 2023, net outflows on the primary income account increased by €425.9 million, to stand at €2,320.1 million. Transactions relating to primary income continued to be strongly influenced by internationally-oriented firms, which transact predominantly with non-residents. Over the year to September 2023, net outflows on the primary income account amounted to 12.2% of GDP.

Outflows on the secondary income account decline[4]

In the third quarter of the year, net outflows on the secondary income account declined by €52.1 million on a year earlier, to stand at €38.1 million.

Net outflows on this account also declined when measured on a four-quarter moving sum basis. These stood at €243.8 million, equivalent to 1.3% of GDP, and €183.7 million less than the amount recorded in the same quarter of 2022.

Tourism activity

In the quarter under review, the number of inbound tourists amounted to 996,158, up from 839,968 a year earlier (see Chart 4.4). This represents an increase of almost 19%, with visitors from Italy and the UK accounting for a significant part of the increase. In absolute terms,

[3] The primary income account shows income flows related mainly to cross-border investment and compensation of employees.
[4] The secondary income account shows current transfers between residents and non-residents.

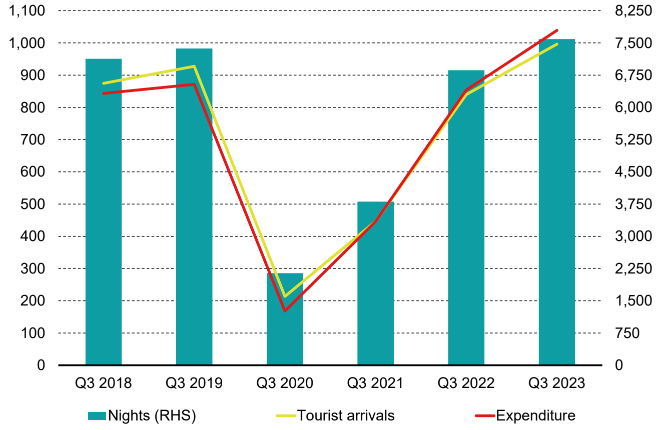
tourists visiting for holiday purposes accounted for most of the annual rise in arrivals. Visitors coming for 'other' motives also reported some gains. On the other hand, the number of those visiting for business purposes declined.

Meanwhile, the total number of guest nights that tourists spent in Malta during the third quarter of 2023 amounted to 7.6 million, up from 6.9 million a year earlier. Stays in collective rented accommodation accounted for most of this increase.

In this quarter, the share of non-residents in collective accommodation establishments stood at 90.7%, up from 89.0% in the third quarter of 2022, though still below the share of 92.7% recorded in the third quarter of 2019 (see Chart 4.5).

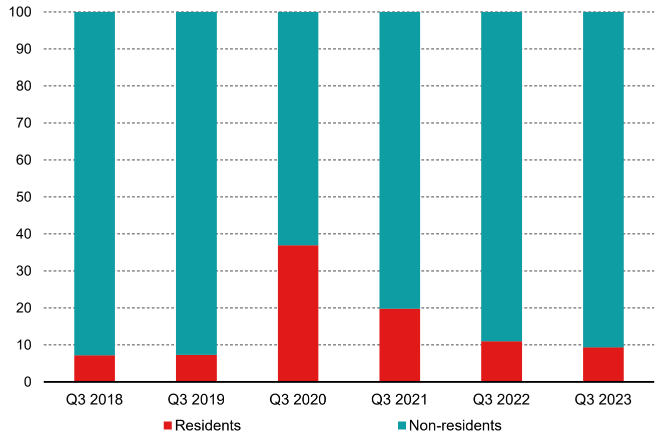
The total occupancy rate in collective accommodation establishments in the third quarter of 2023 rose to 77.9%, from 72.5% a year earlier (see Chart 4.6). All categories reported increases in their occupancy rates over 2022, with the five-star and three-star categories registering the largest increases – of 9.4 and 7.6 percentage points, respectively. Meanwhile, the smallest increase – of just 0.8 percentage point – was registered in the two-star category. Occupancy rates in collective accommodation remained below those recorded in the third quarter of 2019 in all

Chart 4.4
TOURISM INDICATORS
(tourist arrivals and nights stayed in thousands; expenditure in EUR millions)



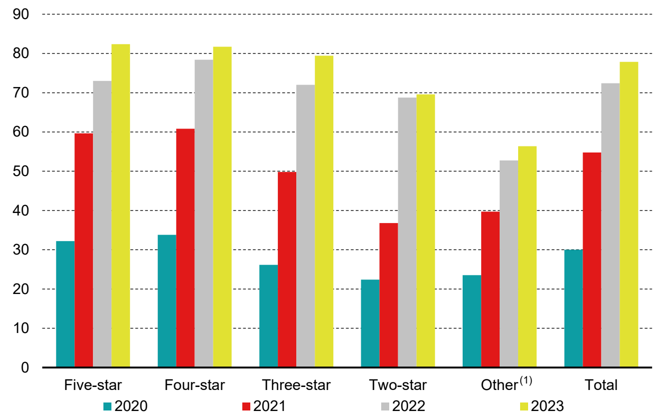
Source: NSO.

Chart 4.5
GUESTS IN COLLECTIVE ACCOMMODATION ESTABLISHMENTS
(number of guests; per cent)



Source: NSO.

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



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

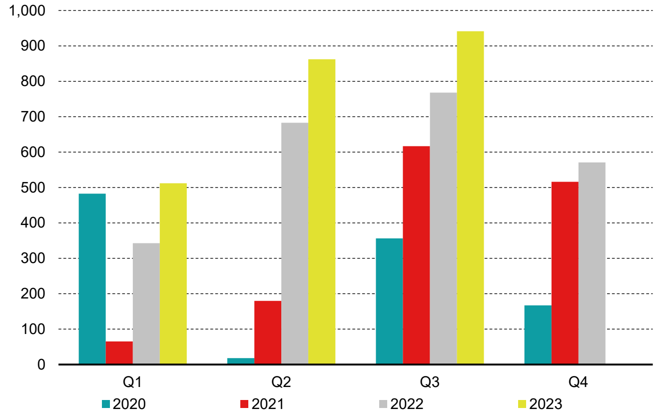
categories, and especially for five-star, four-star and "other" accommodation. This is mainly due to an increase in the availability of bed-places since 2019.

Tourist expenditure in Malta totalled €1,038.9 million in the third quarter of 2023, up from €853.7 million a year earlier. All expenditure categories registered gains over this period.

Expenditure per capita increased to €1,042.9, from €1,016.4 in the third quarter of 2022, as expenditure per night increased. This offsets a decline in the average length of stay, which stood at 7.6 nights from 8.2 nights a year earlier.

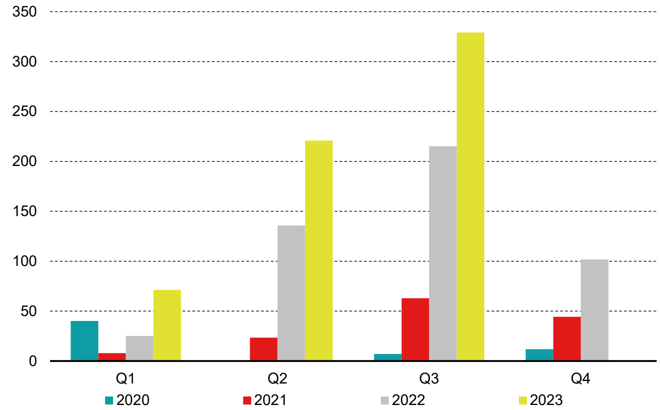
According to Malta International Airport (MIA) data, in the third quarter of 2023, average seat capacity stood at 941,518 seats per month, up from 768,060 a year earlier (see Chart 4.7). Seat capacity was 3.2% above the level recorded in the third quarter of 2019.

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.

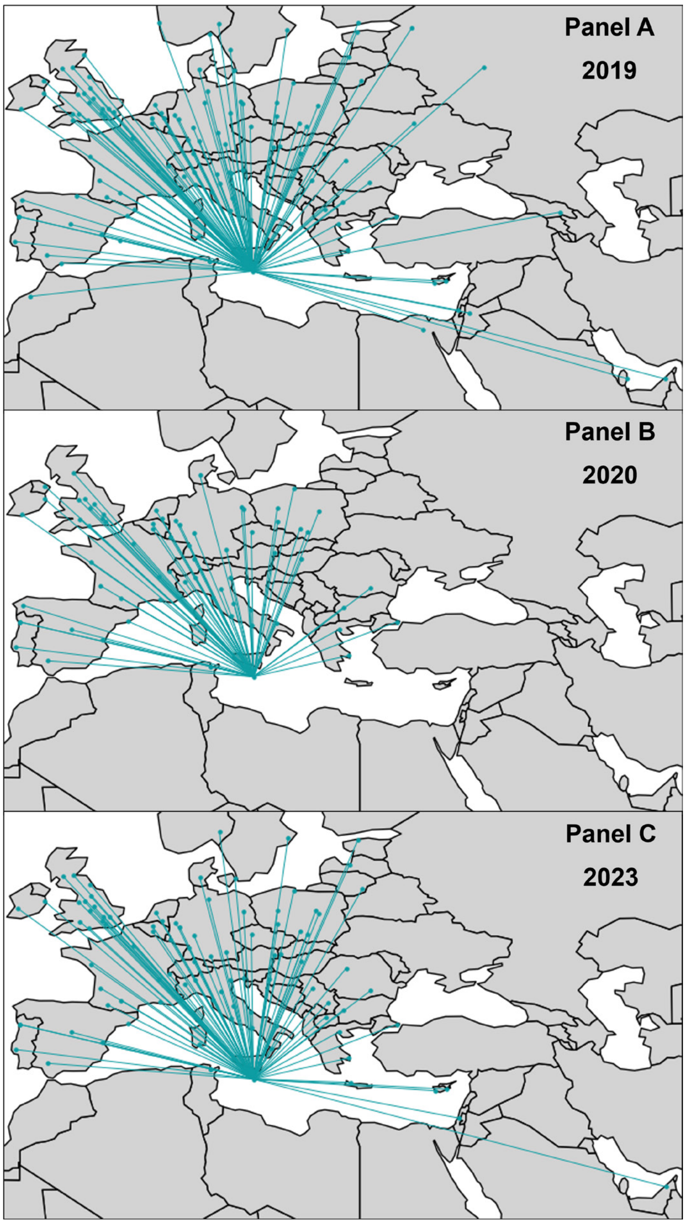
A total of 108 cruise liners visited Malta in the third quarter of 2023, 11 more than a year earlier. Foreign passengers reached 329,108 persons, up from 215,244 visitors in the third quarter of 2022 (see Chart 4.8). The number of passengers exceeded the levels recorded in the third quarter of 2019.

Visitors from Italy comprised the largest share of total cruise passengers in the quarter under review, followed by visitors from the United Kingdom, Germany and the United States.

BOX 2: ANALYSING POST COVID-19 AIR CONNECTIVITY AND THE IMPLICATIONS OF A NEW NATIONAL AIRLINE[1]

This box analyses the rebound in Malta's air connectivity in a post-pandemic environment. It is an update of a 2020 Central Bank of Malta Policy Note, which assessed flight connections and airline competition before and immediately following the outbreak of COVID-19.[2] The study showed that air connectivity in 2020 declined significantly due to a combination of demand and supply factors, while various airlines downsized their operations from Malta. This box assesses developments in connectivity since then, and changes in the country's connections due to the closure of Air Malta and the setup of a new national airline.

Figure 1
AIR CONNECTIVITY IN MALTA (2019 vs 2020 vs 2023)



Sources: MIA; Author's calculations.

Post COVID-19 air connectivity in Malta

In 2019, Malta was directly connected to 125 airports (see Figure 1, Panel A) of which 118 were connections to mainland Europe, four to the Middle East (Tel Aviv, Amman, Doha and Dubai) and three to Africa (Casablanca, Tunis and Cairo). By 2020, direct route connectivity fell by over 50 connections to

[1] Prepared by Kurt Sant, Senior Economist within 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] Sant, K (2020), "An Analysis of Recent Developments in Malta's Air Connectivity", *Policy Note*, Central Bank of Malta.

70 direct flights (see Figure 1, Panel B). Moreover, connections available at the time suffered from a decline in flight frequency and airline competition, hence compounding the negative effects of COVID-19 on air connectivity. Crucially, connections to important European hubs were still maintained. However, other links to large hubs such as Doha and Dubai were not retained, severely hindering indirect connectivity offered by these hubs, particularly to Asia and Australia.

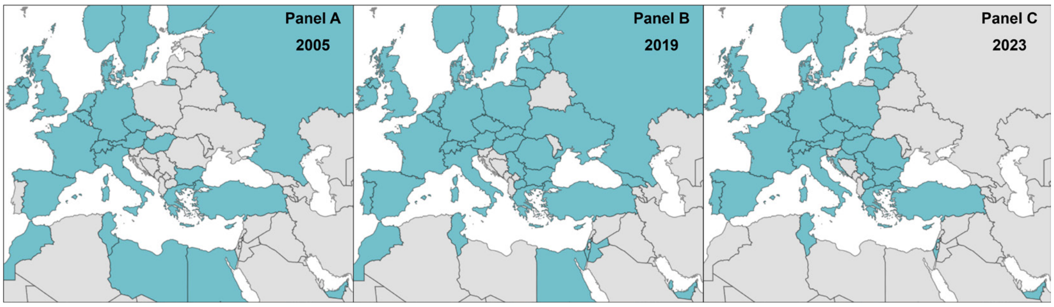
By 2023, direct air connectivity increased to 100 direct connections (see Figure 1, Panel C). Thus, it is still lagging 2019 levels by 25 connections. An increase in seven new direct connections in 2023 (see Figure 2, green) is more than offset by the loss of 32 direct connections (see Figure 2, red) which were present in 2019. Most notably, the United Kingdom accounts for five of these losses, followed by Germany and Spain with four lost connections each.

By 2019, country connectivity from the Maltese Islands had increased to 40 countries (see Figure 3, Panel B), from 27 in 2005 (see Figure 3, Panel A). Improvements were especially noticeable in Eastern Europe and the Balkans. These include the Baltic states, Poland,

Figure 2
NEW AND LOST AIR CONNECTIONS IN MALTA (2019 vs 2023)[1,2]

Source: Author's calculations.
(1) Green indicates a new connection when compared to 2019.
(2) Red indicates a lost connection when compared to 2019.

Figure 3
COUNTRY CONNECTIONS FROM MALTA (2005 vs 2019 vs 2023)



Source: Author's calculations.

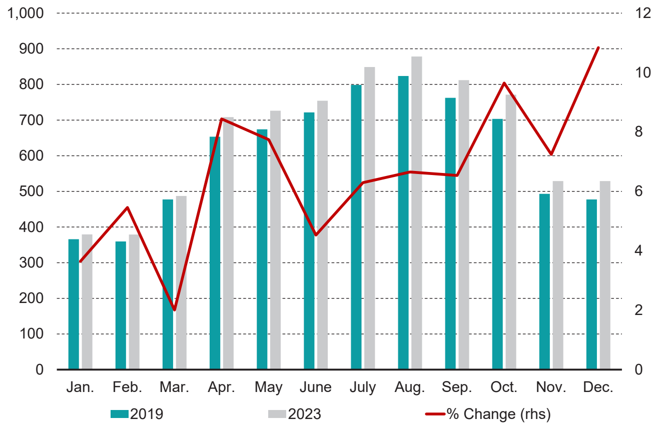
Ukraine, Slovakia, Romania, Serbia and Northern Macedonia. The Middle East also experienced important connectivity improvements, with Israel, Jordan and Qatar directly connected to Malta in 2019.

Following the COVID-19 shock, direct flights from the United Kingdom, Germany and Spain declined significantly. However, these countries still have ample connections to Malta. On the other hand, the loss of other flights means that direct connectivity from Malta to certain countries is completely lost.

By 2023, country connectivity stands at 34 (see Figure 3, Panel C). Although one new country – Croatia – is now connected to Malta, seven countries which were connected directly in 2019 are no longer directly connected. These countries are Egypt, Finland, Jordan, Morocco, Qatar, Russia and Ukraine. Whilst some may have been wiped out temporarily due to extraordinary reasons, such as the Russia-Ukraine war wiping out direct connections to Kyiv, Moscow and St. Petersburg, others might have been lost indefinitely. Crucially, when compared to 2019 – and to a lesser extent even to 2005 – direct connectivity from Malta to North Africa and the Middle East has notably deteriorated by 2023.

Notwithstanding this reduction in airport and country connectivity in 2023, when compared to 2019, passenger movements through MIA increased significantly (see Chart 1). In fact, 7.8 million passenger

Chart 1
PASSENGER MOVEMENTS AT MIA
(thousands of persons)



Source: MIA.

movements were registered in 2023, an increase of 0.5 million passengers when compared to 2019. Moreover, each month during 2023 outperformed the corresponding one of 2019, with the largest percentage increase experienced in December. Significantly, this means that passenger traffic exceeded the 500,000 mark in November and December for the first time in the airport's history.

Such increases in passenger movements occurred despite the loss in airport connectivity. This signals that movements to and from long-standing connections intensified. This intensification, together with further route recovery and new connectivity developments will likely lead to significant increases in passenger movements in the near future. In fact, MIA expects a further increase this year, with passenger movements expected to exceed the eight million mark in 2024. In this view, in November 2023 MIA announced a six-year €250 million investment to upgrade airport facilities, such as the airport terminal, main runway, and aprons amongst others. This will be crucial to be able to sustain such increases in passenger movements in the future and accommodate further connectivity growth from Malta.

The implications of a new national airline on air connectivity in Malta

On 2 October 2023, Government announced that the current national airline is to be replaced by a new flag carrier on 31 March 2024. This follows an agreement reached with the European Commission, following discussions on restructuring assistance for the existing national airline. The new company – officially named KM Malta Airlines – will operate flights as Air Malta, the same name as the existing carrier.

The new airline will retain Air Malta's current fleet of eight Airbus A320 aircraft, but will aim to significantly contain costs.[3] It aims to increase its average aircraft utilisation and boost the seat load factor, while limiting outlays on wages. With these steps, amongst others, the airline is aiming for profitability by 2025. The new airline aims to offer 284 weekly flights (see Figure 4). 82 of these weekly flights will service Italy, 48 to France, 44 to the UK and 40 to Germany.

The strategy of the new national airline will be a drastic departure from Air Malta's strategy in the pre COVID-19 period. Back then, Air Malta expanded to new countries and airports. It was also exploring the possibility of long-haul flights and the opening of hubs in different airports in the Mediterranean. The new airline will instead build upon Air Malta post-COVID strategy of mostly servicing profitable routes.

Figure 4
NEW NATIONAL AIRLINE WEEKLY FLIGHTS (2024)

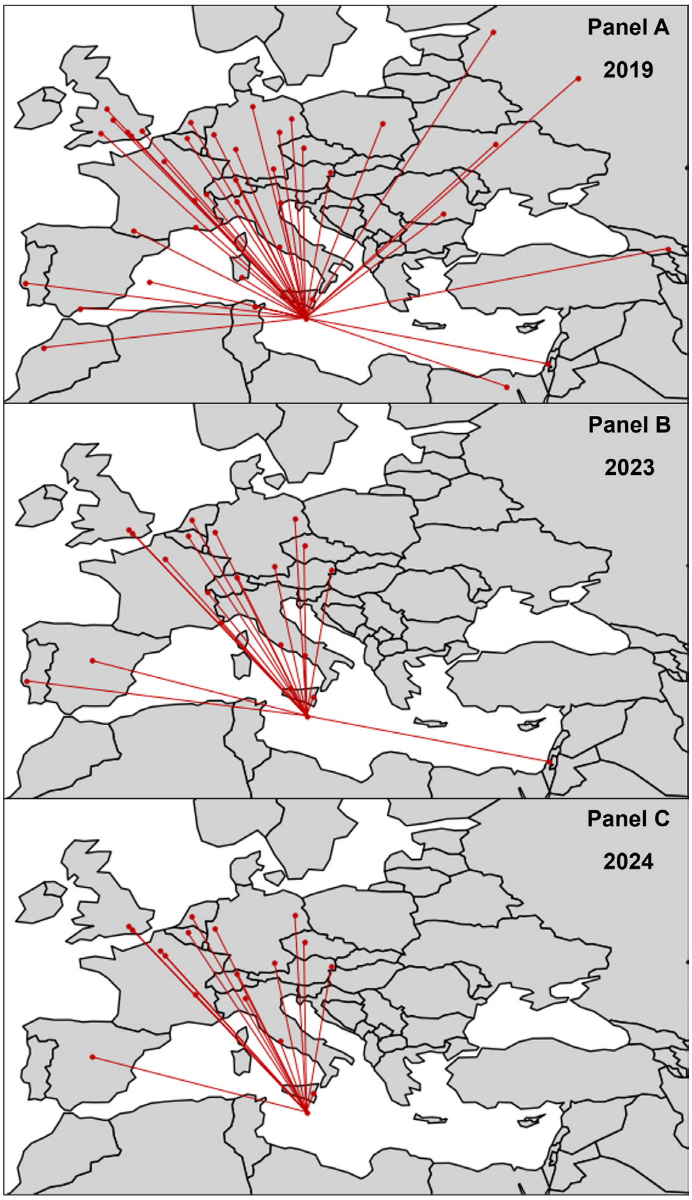
Sources: KM Malta Airlines; Author's calculations.

In fact, from up to 43 direct connections offered to passengers in 2019

[3] https://www.kmmaltairlines.com/en/about-km-malta-airlines.

(see Figure 5, Panel A), Air Malta halved its connectivity to 22 airports in 2023 (see Figure 5, Panel B). In addition to this downsizing, the new national airline will reduce six further connections in 2024, concentrating its operations on 17 of the profitable routes currently operated by Air Malta (see Figure 5, Panel C). However, five routes – Rome Fiumicino, Munich, Paris Charles-de-Gaulle, Zurich and Vienna – will experience increased flight frequencies.

Figure 5
NATIONAL AIRLINE CONNECTIVITY (2019 vs 2023 vs 2024)

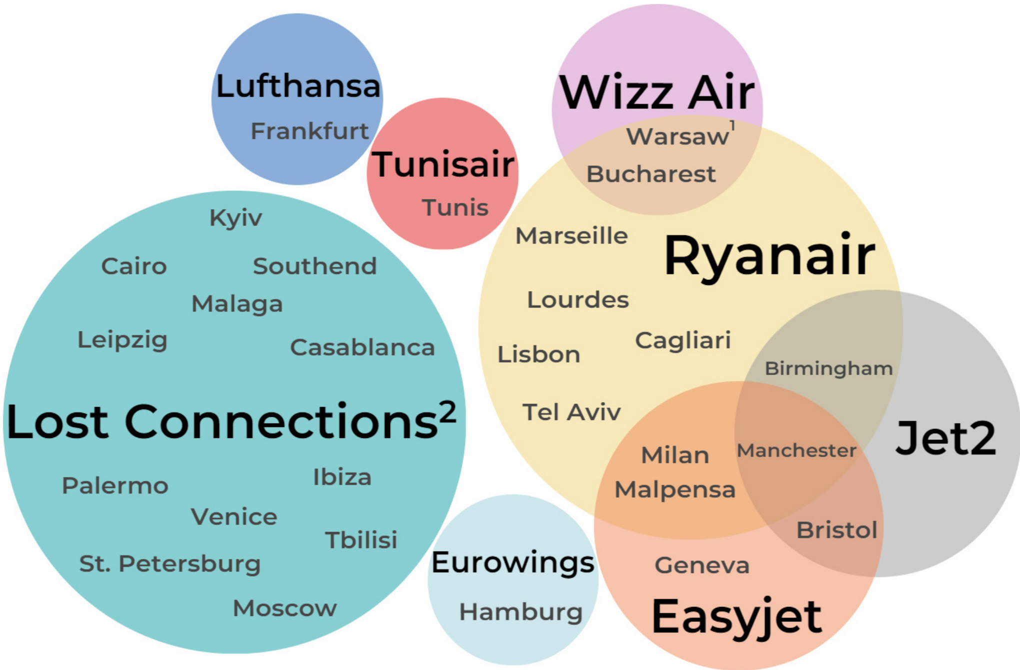


Sources: Air Malta; KM Malta Airlines.

Thus, compared to 2019, the national carrier in 2024 will be offering up to 26 less connections to passengers. However, not all of these twenty-six connections will be entirely wiped out from Malta's air connectivity (see Figure 6). Seven alternative airlines – both low-cost and flag carriers – offer flights to 15 of such destinations. Some of these connections are also served by multiple airlines. However, a reduction in competition may still lead to a negative impact on connectivity, since fewer seats are available. In addition, since certain airlines end up having a monopoly on some routes, travellers may face adverse price effects.

Figure 6 also highlights Air Malta connections which are set to be lost permanently. Whilst some are lost due to extraordinary events (such as flights to Moscow and St. Petersburg), other connections such as Venice and London Southend – although lost – are still served by multiple airports close by. Thus, the overall impact on connectivity from the downscaling of Air Malta routes appears to be minimal.

Figure 6
ANALYSIS OF LOST AIR MALTA CONNECTIONS (2019 vs 2024)



Source: Author's calculations.
(1) Different airports (Wizz Air flies to Warsaw Chopin Airport (WAW); Ryanair flies to Warsaw Modlin Airport (WMI).
(2) Incomparable with Figure 2 since these only refer to lost Air Malta connections.

Crucially, the 17 routes serviced by the new national airline connect Malta to Europe's largest airports. These are important hubs, providing excellent connectivity across the globe. With Malta's size and population making long-haul routes unprofitable and unsustainable in the long run, it is crucial to rely on indirect connectivity from such airports as a gateway to the rest of the world. In fact, Figure 7 shows which airports are just two flights away, based

Figure 7
NEW NATIONAL AIRLINE INDIRECT CONNECTIVITY (2024)

Source: Author's calculations.

on connections offered from the seventeen airports which the new national airline will fly to. This clearly illustrates that whilst the new airline will in fact restrict its route offering, by retaining connections to the largest airports in Europe, the airline is still offering strong secondary connectivity to all continents.

In conclusion, although passenger numbers in 2023 have surpassed those in 2019, Malta's air connectivity remain below its pre-pandemic levels. As a result, Malta's connection to seven countries has been severed. This is especially evident in North Africa and the Middle East. In 2024, the new national airline replacing Air Malta will cut back further on its destination offering. However, due to the availability of indirect connections and the presence of alternative airlines, Malta's overall connectivity is not expected to be severely impacted. However, this does result in a less competitive environment on certain routes and countries, which may hurt consumers.

The capital account

Net inflows on the capital account stood at €77.3 million in the third quarter of 2023, up from €56.9 million a year earlier (see Table 4.1). When measured on a four-quarter cumulative basis, capital inflows increased to €365.7 million, compared to €235.6 million during the 12 months to September 2022.