FOREWORD

During the third quarter of 2023, annual real gross domestic product (GDP) rose by 7.1%, following a 5.9% increase in the previous quarter. In the quarter under review, growth was driven by net exports, which offset a negative contribution from domestic demand. When adjusting for imports, exports remained the main driver of GDP growth, while domestic demand had a marginally positive impact.

Potential output growth is estimated to have stood at 6.7% in the third quarter of 2023, below the annual rate of 8.1% estimated for the previous quarter. On a four-quarter moving average basis, the level increase in GDP relative to the previous quarter was stronger than that in potential output, resulting in a slightly wider output gap. This implies a marginal increase in the degree of over-utilisation of the economy's productive capacity.

Meanwhile, the Bank's Business Conditions Index (BCI) edged down marginally in the third quarter but remained above its historical average. The index was affected by strong annual increases in several sub-components, particularly in tourist arrivals, in the Economic Sentiment Indicator (ESI), and a moderate expansion in industrial production. The strong rate of annual GDP growth and the historically low unemployment rate also contributed to a positive BCI level.

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. The job vacancy rate and other indicators continued to signal a tight labour market.

Consumer price pressures eased further during the quarter under review, but inflation remained above the policy target. Annual inflation, as measured by the Harmonised Index of Consumer Prices (HICP), stood at 4.9% in September, down from 6.2% in June. The slowdown in inflation was spread across all non-energy components, while energy prices remained stable. Meanwhile, annual inflation based on the Retail Price Index (RPI), which only considers expenditure by Maltese residents, edged down from 5.4% in June, to 4.1% in September.

Annual inflation, based on the industrial producer price index, fell to 3.9% in the third quarter of 2023, from 4.7% in the previous quarter. Other indicators such as the domestic producer price index and the goods imports deflator also suggest easing cost pressures. Meanwhile, Eurostat's construction cost index (CCI) declined further in the third quarter. On the other hand, Malta's unit labour cost (ULC) index, measured on a four-quarter moving average basis, increased at a marginally faster rate of 3.1% in the third quarter, from 3.0% in the previous quarter.

In the third quarter of 2023, the current account balance turned into a surplus from a deficit a year earlier. 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. The current account balance registered a surplus equivalent to 1.2% of GDP in the third quarter of 2023.

When measured on a four-quarter moving sum basis, the general government balance registered a deficit of 3.4% of GDP, lower than the 4.2% recorded in the second quarter. The general government debt-to-GDP ratio declined slightly, despite increasing in level terms.

In September, Maltese residents' deposits with monetary financial institutions (MFIs) in Malta declined for the first time in over a decade, reflecting lower balances belonging to financial intermediaries and non-financial corporations (NFCs). Credit to Maltese residents grew at a more moderate pace, reflecting a larger decline in credit to general government. According to the Banks' Financial Conditions Index (FCI), in the third quarter of 2023, financial conditions were tight from a historical perspective, but the extent of tightness decreased considerably compared with the second quarter. The improvement was driven by a loosening effect from foreign influences, and a smaller tightening impact from domestic factors – in almost equal measure.

During the year to September, the weighted average interest rate offered to households and NFCs on their outstanding deposits in Malta increased by 11 basis points on a year earlier, standing at 0.27%. This was largely driven by a further increase in rates paid on households' and NFCs' outstanding fixed deposits with a maturity of up to two years. Meanwhile, over the same period the weighted average lending rate paid by households and NFCs to resident MFIs increased by 36 basis points, to 3.61%. Hence, the spread between the two widened.

Data on new business, which may be more indicative of the transmission of monetary policy impulses, show a 120 basis points increase in the weighted average deposit rate, and a 14 basis points increase in the lending rate.

The primary market yield on Treasury bills rose further between June and September. Secondary market yields on five-year and ten-year Malta Government Stocks (MGS) also increased over this period, while domestic share prices fell.

The European Central Bank's (ECB) Governing Council raised its three key interest rates by 25 basis points in July, and also decided to set the remuneration of minimum reserves at 0%. The key rates were raised by a futher 25 basis points in September. Thus, by the end of the third quarter, the interest rates on the deposit facility, the main refinancing operations (MROs), and the marginal lending facility, had risen to 4.00%, 4.50%, and 4.75%, respectively. The Council considered that the key ECB interest rates had reached levels that, if maintained for a sufficiently long duration, would make a substantial contribution to the timely return of inflation to the target. The Council reiterated its commitment to a data-dependent approach to determining the appropriate level and duration of restriction of the policy interest rates.

The Governing Council reiterated that bond holdings under the asset purchase programme (APP) were declining at a measured pace, as the Eurosystem no longer reinvested the principal payments from maturing securities. Regarding the pandemic emergency purchase programme (PEPP) portfolio, the Council restated its intention to reinvest the principal payments from maturing securities purchased under the programme until at least the end of 2024, while redemptions coming due in the PEPP portfolio would continue to be reinvested flexibly. In December, the Council approved a reduction in the PEPP portfolio in the second half of 2024, and an end to PEPP reinvestments at the end of the year.