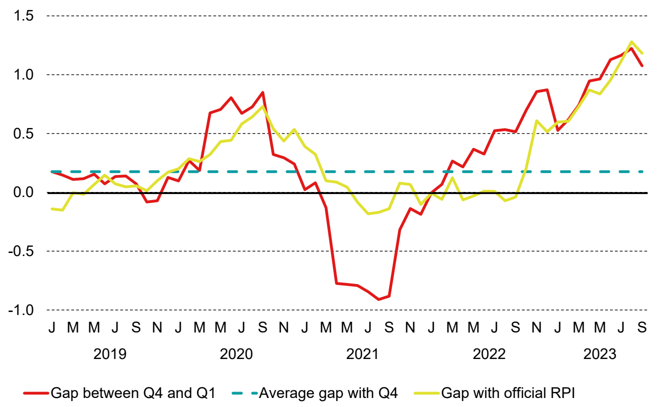
BOX 3: THE IMPACT OF THE RECENT RISE IN INFLATION ON THE PURCHASING POWER OF LOWER INCOME HOUSEHOLDS IN MALTA[1]

Inflation typically has a stronger impact on lower income households. This was demonstrated for Malta by Darmanin (2021),[2] who utilized disaggregated expenditure shares from the Household Budgetary Survey to estimate inflation faced by different household groups for the period 2010 to 2020. The author had shown that low-income and retired households had experienced generally higher inflation than the overall population during this period, as the price of necessities such as food, energy and health had grown at a sharper rate than prices of other goods and services. This box extends this work to cover the period to 2024, in particular assessing whether the minimum wage and pensions have managed to retain their purchasing power over this high-inflation period.

The gap between inflation experienced by the top 25% and the lowest 25% earners has increased sharply since the beginning of 2022 and has exceeded the historical gap of around 0.2 percentage point (see Chart 1). Moreover, the gap with the official RPI has also risen sharply, which implies that lower-income households have experienced higher inflation also when compared to the average household. Despite some easing in overall inflation during the first nine months of 2023, the gap between the lowest and highest income groups continued to gather pace, and peaked in August 2023 at 1.2 percentage points. Similarly, when compared with the official RPI, the gap stood at 1.3 percentage points in August 2023. These gaps are the second highest gaps experienced since 2013. The very high inflation gap implies that the recent surge in inflation impacts mostly low-income households, which have experienced a peak inflation rate of 7.9% in December 2022.

Chart 1
INFLATION DIFFERENCE BETWEEN THE LOWEST AND HIGHEST INCOME QUINTILE AND THE OFFICIAL RPI
(percentages)



Source: Own workings based on Darmanin (2021).

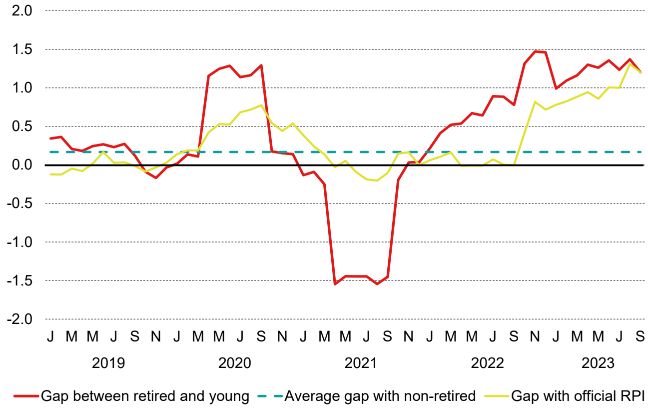
The rise in the gap between the lowest and highest income group since 2022 has been primarily driven by food

[1] Prepared by Dr Valentina Antonaroli, Ian Borg and Dr Aaron G. Grech, respectively principal economist, Manager of the Economic Projections and Conjunctural Analysis Office and Chief Officer of the Economics Division at the Central Bank of Malta. This box summarises Grech, A.G., Borg, I. and Antanaroli, V., (2024), "The cost of inflation: How has the recent surge in inflation impacted lower-income households in Malta", Central Bank of Malta *Policy Note*. The authors would like to thank Mr Mark Musu, Permanent Secretary of the Ministry for Social Policy and Children's Rights for providing the authors with data assistance and Mr Alexander F. Demarco for his comments and suggestions. The views expressed are those of the authors and do not necessarily reflect the views of the Central Bank of Malta or any other institutions. Any remaining errors are the sole responsibility of the authors.

[2] Darmanin, J. (2021), "The inflation experience of low-income households", Central Bank of Malta *Policy Note*.

inflation. Given that the latter has a higher share in the lowest income group consumption basket, it has been more burdensome for the lower income households. Moreover, rent inflation has been very dynamic throughout 2022 and 2023, which has also contributed positively to the gap between the two groups. Indeed, since July 2023, this has overtaken food inflation as the main driver that explains the gap between lowest and highest income group inflation rate. Meanwhile, relatively strong inflation in transport and communication has somewhat muted the positive gap.

Chart 2
INFLATION DIFFERENCE BETWEEN THE RETIRED AND NON-RETIRED HOUSEHOLDS AND THE OFFICIAL RPI
(percentages)



Source: Own workings based on Darmanin (2021).

Developments for retired households are very similar, with a sharp increase in the gap in the inflation of retired when compared to non-retired households (see Chart 2). The positive inflation difference peaked at 1.5 percentage points in November and December 2022, which was the highest recorded gap since 2010. Meanwhile, the retired household inflation rate peaked at 8.1% in December 2022. Moreover, the gap between the retired household inflation rate and the official inflation rate has also tuned positive since October 2022. The gap has been rising sharply and has peaked in August 2023 at 1.3 percentage points.

The impact of inflation on selected retirement pensions

The Maltese state pension is indexed to prices through the COLA. All pensions in Malta are incremented by two-thirds of the COLA and a further one-third is given as a cost-of-living bonus (CLBO).[3] In addition, Maltese pensioners receive other statutory bonuses in the form of a 6-Monthly Bonus (6MBO), and a Special Weekly Bonus (SPBO). Those on minimum pensions also benefit from a Supplementary Allowance (SPA). In addition, a Deficiency Contributions Benefit (DCB) is awarded to non-pensioners who have reached state pension age but have less than ten years of social security contributions. A Senior Citizen's Grant (SCG) is given to persons above the age of 75.

Table 1 documents the growth in the various combinations of weekly pension rates over the period 2013 to 2023. It shows that nominal pensions have increased markedly over these past 11 years. However, the growth experienced by those on the minimum pension has generally been larger than that for those on the maximum pension. Pension increases have been set equally in nominal terms for all, meaning higher percentage rises for those

[3] COLA is a partial indexation mechanism whereby incomes and pensions are adjusted for inflation that occurred over the previous 12-month period. COLA is thus backward-looking. COLA is calculated on the basis of a social wage, a wage typically higher than the minimum wage but lower than the average wage. An absolute amount is then given to all pensioners and wage earners irrespective of their income levels. See Darmanin (2021) for further details.

Table 1
EVOLUTION OF NOMINAL PENSIONS BETWEEN 2013 AND 2023[1]
Percentage changes

	Weekly rate inclusive of bonuses	Inclusive of DCB	Inclusive of SPA and DCB	Inclusive of SPA, DCB, and SCG
Single minimum pension	42.2	NA	45.9	45.4
Married minimum pension	38.4	45.6	51.6	50.3
Maximum married pension	18.6	22.9	NA	27.6

Sources: Social Security Department; own workings.

[1] These results refer to an individual born in 1946 and retired in 2007.

on lower pensions. Moreover the benefits awarded to those on low pensions have tended to be increased more frequently than those awarded to all pensioners.

To assess the evolution of these pensions in real terms, Table 2 deflates nominal pensions with the retired household inflation rate. During the period prior to the surge in inflation in 2022 pensions generally kept up with inflation. On the other hand, weekly rates lost some value in 2022, as COLA is a backward-looking mechanism which compensates for inflation in the previous 12-month period and therefore in periods of rising inflation it lags.

Nevertheless, when considering all benefits, minimum pensions experienced an increase in their real value in 2022 despite the historically high inflation. This stems from increases given in the SPA and the DCB. With regards to maximum pensions, their real value deteriorated slightly in 2022 despite the additional top-ups over and above COLA.

It should be noted that in the Budget for 2023, Government introduced an additional COLA mechanism, which was intended to pay an additional benefit to those on low incomes, depending on family size. However the way the mechanism was initially determined excluded most pensioners, as the mechanism did not pay any additional benefit to those in receipt of COLA increases.

Looking forward, thanks to the latest increments announced in Budget 2024 for pensions, which includes the extension and amendment of the additional COLA mechanism, and also because inflation is projected to decline significantly over 2024, any losses in purchasing

Table 2
EVOLUTION OF THE REAL VALUE OF PENSIONS[1]
Percentage changes

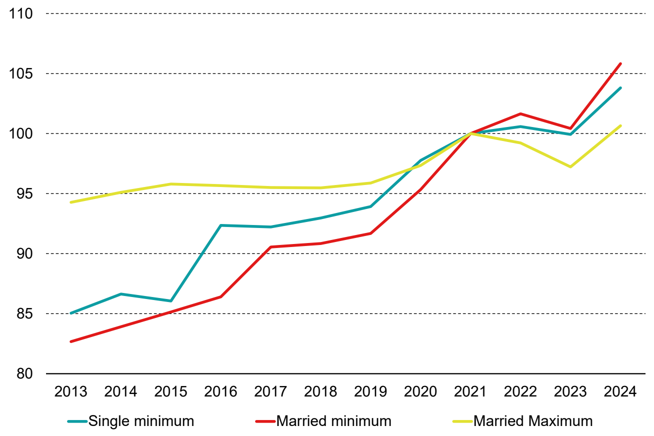
	Growth between 2013 and 2021				Growth between 2021 and 2022			
	Weekly rate inclusive of bonuses	Inclusive of DCB	Inclusive of SPA and DCB	Inclusive of SPA, DCB, and SCG	Weekly rate inclusive of bonuses	Inclusive of DCB	Inclusive of SPA and DCB	Inclusive of SPA, DCB, and SCG
Single minimum pension	17.4	NA	18.1	17.6	-3.2	NA	1.2	1.5
Married minimum pension	15.2	19.4	22.0	21.0	-3.4	-2.1	0.4	0.8
Maximum married pension	1.4	3.9	NA	6.1	-4.2	-3.3	NA	-1.4

Sources: Social Security Department; own workings.

[1] Real value is obtained by deflating nominal pensions with the retired household inflation rate.

power will be recouped. Chart 3 shows how after the negative impact of the 2022 and 2023 high inflation rates, the real value of minimum pensions is projected to improve in 2024. Thanks to the changes effected in the Budget for 2024, when the additional COLA benefit started to be based as a top-up to the COLA for all those earning less than the median equivalised household income, the mechanism will now support greatly the real value of minimum pensions, boosting real purchasing power by close to 5% for pensioners on the married rate. Even for those on the maximum pension, the real value of their benefits should exceed 2021 levels slightly in 2024.

Chart 3
PROJECTED REAL VALUE OF PENSIONS
(index of pensions inclusive of bonuses, SPA, DCB, SCG, deflated with retired inflation rate)



Source: Own workings.

The impact of inflation on minimum wages

Like pensions, minimum wages are indexed to prices through COLA. Similar to pensions, minimum wage earners also receive statutory bonuses such as the SPBO and 6MBO. Additionally, parents receive child benefits in the form of children's allowance and the children's allowance supplement (CAS) for each child. Since 2015, an in-work benefit (IWB) is awarded to working parents. Given their level of income, these individuals also benefit from the additional COLA mechanism.

Table 3 documents the growth in nominal minimum wages over the decade to 2023. Those in receipt only of the national minimum wage and other statutory bonuses experienced a growth of around 15.4% over the whole period. This growth generally reflects the increments

Table 3
EVOLUTION OF NOMINAL WAGES BETWEEN 2014 AND 2023
Percentage changes

	Weekly rate exclusive of bonuses	Weekly rate inclusive of bonuses	Weekly rate inclusive of child benefits[(1)]	Weekly rate inclusive of benefits & ADCL[(2)]
Single minimum wage	9.3	15.4	43.3	46.1
Married minimum wage	9.3	15.4	30.8	NA

Sources: Social Security Department; own workings.

(1) These child benefits are assumed to accrue to a single or married household with two children.

(2) The additional COLA mechanism only affects single minimum wage earners.

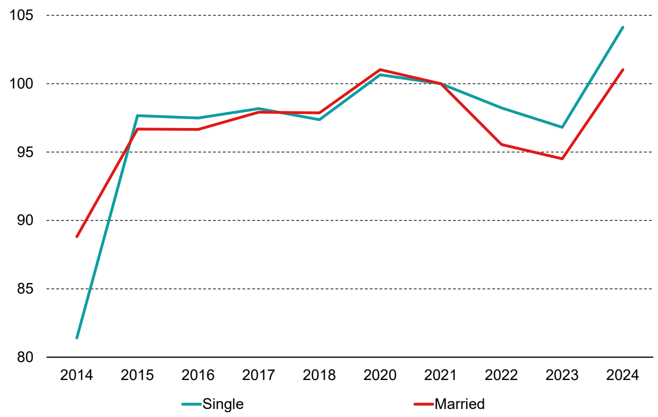
given due to COLA. However, minimum wages were also increased above COLA in 2018 and 2019, following the signing of the National Agreement on the Minimum Wage in 2019. However, other statutory bonuses in terms of the SPBO and 6MBO were left unchanged.

Those in receipt of child benefits experienced a much larger increase in their income over the period under consideration, with growth of between 30% to 50%. This reflects an increase in the children's allowance in 2019, the introduction of the CAS in 2021 (the latter was increased again in 2023), and the introduction of IWB in 2015.

To assess the evolution of minimum wages in real terms, Table 4 deflates nominal minimum wages with the low-income household inflation rate. Minimum wages kept up with inflation during the period prior to the surge in inflation in 2022, even when accounting for the higher inflation experienced by lower-income households. Moreover, parents in receipt of child benefits have experienced a sharp increase in their income, mainly because of the introduction of the IWB. On the other hand, those on the minimum wage experienced a loss in their purchasing power in 2022, even though they benefitted from the additional COLA.

Following the conclusion of the work by the Low-Wage Commission, the national minimum wage rate will increase over the period 2024-2027, by a cumulative amount of €11 over and above the COLA. Budget 2024 also incremented the children's allowance by €250 in annual terms per child, and €50 per child as IWB. As can be seen from Chart 4, these changes will mean that minimum wage earners will see their benefits in real terms exceed 2021 levels by end-2024.

Chart 4
PROJECTED REAL VALUE OF MINIMUM WAGE INCOME INCLUSIVE OF BENEFITS
(index of minimum wages inclusive of bonuses, child benefits, and ADCL; 2021=100)



Source: Own workings.

Table 4
EVOLUTION OF THE REAL VALUE OF WAGES[(1)]
Percentage changes

	Growth between 2014 and 2021			Growth between 2021 and 2022			
	Weekly rate exclusive of bonuses	Weekly rate inclusive of bonuses	Weekly rate inclusive of child benefits[(1)]	Weekly rate exclusive of bonuses	Weekly rate inclusive of bonuses	Weekly rate inclusive of child benefits[(1)]	Weekly rate inclusive of benefits & ADCL[(2)]
Single minimum wage	0.0	-0.4	22.8	-5.0	-5.0	-3.8	-1.8
Married minimum wage	0.4	-0.4	12.6	-4.9	-5.0	-4.4	NA

Sources: Social Security Department; own workings.

[(1)] These child benefits are assumed to accrue to a single or married household with two children.

[(2)] The additional COLA mechanism only affects single minimum wage earners.

Conclusion

Minimum wages and pensions suffered some loss in their effective purchasing power between 2021 and 2023, with the exception of those on minimum pensions. The main reason is that COLA is one-year backward looking mechanism. Moreover, these households faced higher inflation than that indicated by the official RPI. Also, some benefits that typically accrue to lower-income households and pensioners are not adjusted automatically to inflation.

However, in 2024 both pensioners and those on minimum wages are expected to recoup their purchasing power. This partly reflects the fact that the COLA announced for 2024 was the highest in history and will be given during a year in which inflation should ease somewhat. Furthermore, several increments have been given in terms of a higher national minimum wage, an increase in children's allowance and IWB, an extra addition to the pension rate that exceeds COLA, as well as the modification of the additional COLA mechanism.

In particular, the latter benefit is now computed as a top-up to the COLA for all those earning less than the median equivalised income, and is based on an estimate of the inflation rate computed on the basis of the consumption basket of retired or low income households. This should ensure that the effective purchasing power of retired and low-income households is better protected.