FOREWORD

During the fourth quarter of 2023, annual real gross domestic product (GDP) growth rose by 4.3%, following a 7.0% increase in the previous quarter. Growth was driven by net exports, as domestic demand contracted following, in part, very high levels of investment in the aviation sector a year earlier. 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 5.7% in the final quarter of 2023, below the annual rate of 7.0% estimated for the preceding quarter. On a four-quarter moving average basis, the level increase in potential output relative to the previous quarter was stronger than that in GDP, resulting in a smaller positive output gap. This implies a slight easing in the degree of over-utilisation of the economy's productive capacity.

Although the Bank's Business Conditions Index (BCI) edged down further in the fourth quarter, it remained slightly above its historical average. The index was affected by an above-average performance in several sub-components, particularly in the Economic Sentiment Indicator (ESI) and in industrial production. The historically low unemployment rate also contributed to a positive BCI level.

Developments in the labour market remained positive, although there were signs of a moderation in the pace of job creation. The unemployment rate remained low from a historical perspective and stood well below that in the euro area. Meanwhile, the job vacancy rate and the labour tightness indicator remained at an elevated level.

Consumer price pressures eased further during the quarter under review, but inflation remained above the European Central Bank's (ECB) inflation aim of 2%. Annual inflation, as measured by the Harmonised Index of Consumer Prices (HICP), stood at 3.7% in December, down from 4.9% in September. This was driven by slower growth in the prices of services, processed food, and non-energy industrial goods (NEIG). Meanwhile, annual inflation based on the Retail Price Index (RPI), which only considers expenditure by Maltese residents, edged down to 3.6% in December, from 4.1% in September.

Annual inflation, based on the industrial producer price index, fell to 1.4% in the fourth quarter, down from 3.5% in the third. Other indicators such as the domestic producer price index, Eurostat's construction cost index (CCI), and the goods imports deflator also suggest easing cost pressures. Meanwhile, Malta's unit labour cost (ULC) index, measured on a four-quarter moving average basis, increased at a slower rate of 2.4% in the fourth quarter, from 3.0% in the previous quarter.

In the fourth 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, and higher net receipts from services, which offset higher net outflows on the primary and secondary income accounts. The current account balance registered a surplus equivalent to 0.9% of GDP in the fourth quarter of 2023.

When measured on a four-quarter moving sum basis, the general government balance registered a deficit of 4.9% of GDP, higher than in the third quarter, but below the 5.5% registered a year earlier. Similarly, the general government debt-to-GDP ratio increased on the previous quarter but was lower when compared to the preceding year.

In December, Maltese residents' deposits with monetary financial institutions (MFIs) in Malta increased on the previous year, reflecting mainly higher balances belonging to households. Credit to Maltese residents grew at a faster pace, reflecting a smaller decline in credit to general government. According to the Bank's Financial Conditions Index (FCI), in the fourth quarter of 2023, financial conditions turned loose from a historical perspective. This follows seven quarters of tight conditions. The improvement was driven by a loosening effect from domestic factors.

During the year to December, the weighted average interest rate offered to households and non-financial corporations (NFCs) on their outstanding deposits in Malta increased by 15 basis points on a year earlier, standing at 0.31%. This was largely driven by higher rates on time deposits belonging to NFCs, although remuneration of households' balances also increased. Meanwhile, over the same period, the weighted average lending rate paid by households and NFCs to resident MFIs increased by 27 basis points, to 3.58%. As a result, the spread between the two rates widened.

Data on new business, which may be more indicative of the transmission of monetary policy impulses, show a 111 basis points increase in the weighted average deposit rate, while the lending rate declined by 54 basis points, with a particularly steep decline in the rate applied on consumer credit.

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

Following ten consecutive hikes, the ECB's Governing Council kept the three key ECB interest rates unchanged in the fourth quarter of 2023. The Council observed that past interest rate increases continued to be transmitted forcefully to financing conditions. This was increasingly dampening credit demand and thereby helping to push down inflation. Underlying inflation had also eased further. Nonetheless, domestic price pressures remained elevated. Thus, the Council reiterated that it would continue to follow a data-dependent approach in determining the appropriate level and duration of a restrictive monetary policy.

In December, the Governing Council announced further steps in the normalisation of the Eurosystem balance sheet. The Council stated that it intended to continue to reinvest, in full, the principal payments from maturing securities purchased under the pandemic emergency purchase programme (PEPP) during the first half of 2024. Over the second half of this year, the Governing Council intended to reduce the PEPP portfolio, before discontinuing reinvestments under the PEPP at the end of 2024.

ECB policy rates remained unchanged during the first quarter of 2024, with the Governing Council confirming that it will continue to follow a data dependent approach in setting these rates. In March, the Governing Council also announced the key parameters and features that will guide the implementation of its monetary policy in the future.