3. PRICES, COSTS AND COMPETITIVENESS

Consumer price pressures eased further during the quarter under review. Annual inflation, as measured by the HICP, stood at 2.2% in June, down from 2.7% in March. This was driven by a smaller contribution from processed food inflation as all other main components retained the same contribution. Annual inflation based on the RPI – which only considers expenditure by Maltese residents – fell to 1.3% in June, from 1.9% in March.

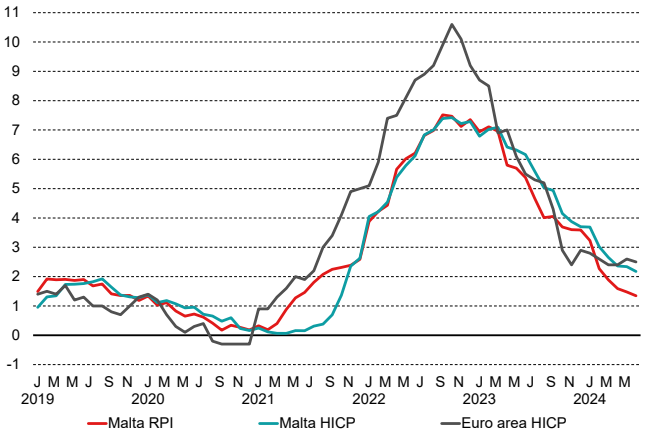
When measured over four quarters, ULC increased at a faster pace in the second quarter of 2024, with its growth rate reaching 1.4%, from 0.6% in the previous quarter. Meanwhile, annual growth in other input cost indicators regularly monitored by the Bank generally continued to moderate, with the exception of the CCI which recorded a small year-on-year increase after contracting in the first quarter.

Inflation

HICP inflation eases

Annual HICP inflation eased to 2.2% in June, from 2.7% in March (see Table 3.1).[1] Chart 3.1 shows that overall HICP inflation in Malta stood lower than that recorded in the euro area, which ended the quarter at 2.5%. Malta's lower inflation rate in June when compared to that of the euro area reflects a lower contribution from services inflation (see Chart 3.2). Furthermore, energy inflation in Malta retained an unchanged

Chart 3.1
INFLATION RATES IN MALTA AND IN THE EURO AREA
(annual percentage changes)



Sources: NSO; Eurostat.

Table 3.1
HICP INFLATION
Annual percentage change

	2023						2024					
	July	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
Unprocessed food	5.4	8.5	8.2	4.0	6.7	12.2	13.4	5.2	3.5	4.3	5.2	3.7
Processed food including alcohol and tobacco	9.9	9.7	9.0	8.2	7.3	7.1	7.4	6.1	5.4	4.7	3.9	3.1
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	3.8	3.4	3.6	2.6	2.2	2.2	1.6	1.7	1.2	1.3	0.9	1.1
Services (overall index excluding goods)	5.6	4.3	4.3	4.0	3.9	3.0	3.1	2.8	2.7	2.1	2.4	2.3
All Items HICP	5.6	5.0	4.9	4.2	3.9	3.7	3.7	3.0	2.7	2.4	2.3	2.2

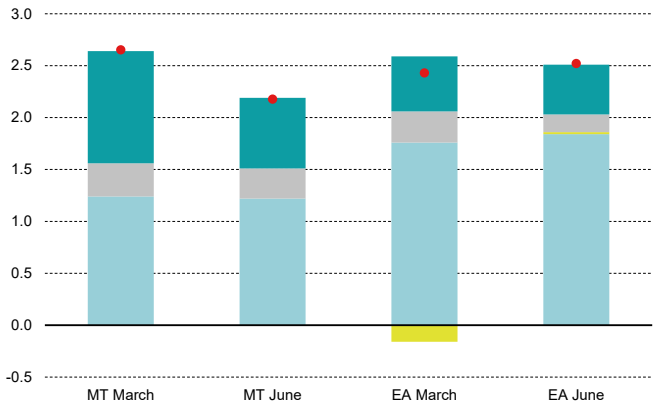
Source: Eurostat.

[1] The HICP weights are revised on an annual basis to reflect changes in overall consumption patterns. In 2024, the weight allocated to services stood at 44.7%, while that of NEIG was 27.5%. Food accounted for 21.5% of the index, while the share allocated to energy stood at 6.2%. These were revised from 44.3% for services, 27.9% for NEIG, 21.4% for food and 6.5% for energy in 2023.

contribution, while it no longer remained negative in the euro area. On the other hand, the contributions of food and NEIG to HICP inflation in June were higher in Malta than in the euro area.

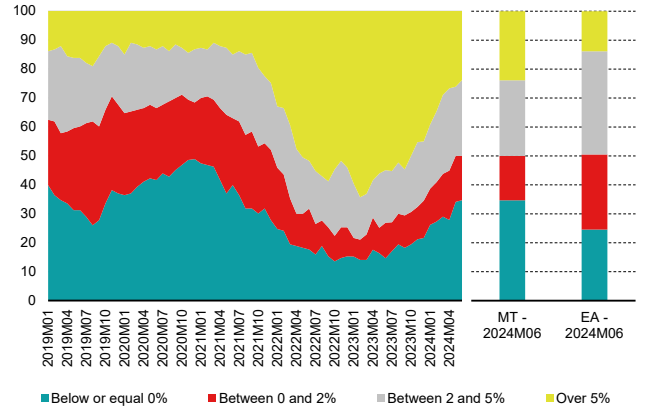
Core inflation, or the annual rate of change of HICP excluding energy and food, stood at 2.0%, and thus also below the 2.9% recorded in the euro area.

Chart 3.2
HICP AND MAIN CONTRIBUTIONS
(annual percentage changes; contributions)



Sources: Eurostat; SDW; Central Bank of Malta calculations.

Chart 3.3
PROPORTION OF HICP BASKET BY INFLATION PACE
(percentage point)



Source: Central Bank of Malta calculations.

Chart 3.3 shows a distribution of price changes whereby subcomponents of the 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%.[2] This analysis indicates whether developments in inflation are broad-based across HICP items or driven only by selected components of the consumption basket.

The share of subcomponents registering inflation rates of more than 5% declined further during the quarter under review as the impact of recent shocks on imported inflation continued to dissipate. Compared to three months earlier, this ratio dropped by 5.1 percentage points to reach 23.9%. Likewise, the bracket holding items with inflation between 2% and 5% decreased by 1.1 percentage points since March, to stand at 26.1% in June.

On the other hand, the bracket holding items with negative inflation rates grew by 5.7 percentage points in Malta, standing at 34.7%. The increase in this bracket mainly reflects a drop in the prices of a number of food products, including dairy products such as eggs and yoghurt, and sugar. Similarly, the bracket holding items with inflation between 0% and 2% increased by 0.6 percentage points, to stand at 15.3% in June.

[2] The calculation of the shares in this chart does not take into account the weights of individual HICP sub-components. This analysis includes 176 sub-indices of the HICP for Malta and 289 sub-indices for the euro area based on the five-digit COICOP classification. On average since 2001, 30.5% 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 stood at 39.7% and 32.6%, respectively, in the euro area. While 22.4% of the Maltese basket fell in the over 5% interval, only 10.3% of the euro area basket fell in this interval.

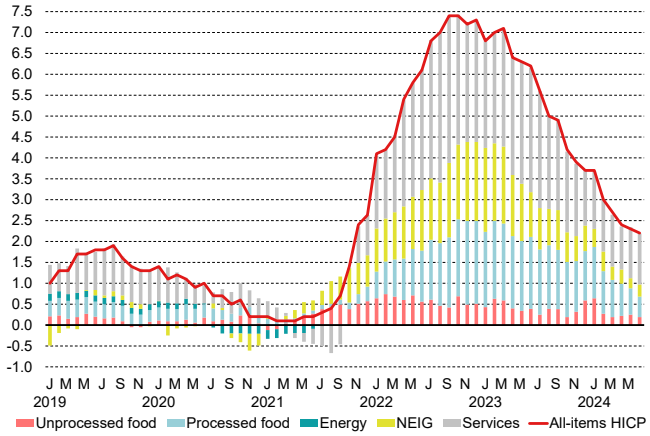
In the euro area, the share of items with price increases exceeding 5% also decreased during the second quarter of 2024. Furthermore, the share of items in this bracket remained significantly lower than that in Malta, with a difference of 10.0 percentage points in June. In part, this reflects higher price increases for some food products including milk, fish and vegetables, which in turn is reflected in a higher food inflation rate for Malta as compared to that of the euro area, as well as higher price increases for a number of household items. However, while items with price increases of between 2% and 5% accounted for almost 36% of the euro area basket in June, in Malta this share was significantly lower at 26.1%, as was the share of items with inflation rates of between 0% and 2%. On the other hand, Malta had a higher share of items with negative inflation rates.

Main components of inflation

The drop in Malta's HICP inflation relative to March stemmed from processed food inflation as all other main components retained the same contribution (see Chart 3.4).

Processed food inflation (including alcohol and tobacco) fell to 3.1% from 5.4% in March, supported by lower imported prices and the Stabbilta' scheme. Consequently, the contribution of processed food to HICP inflation decreased by 0.4 percentage points, standing at 0.5 percentage points in June. On the other hand, unprocessed food inflation edged up to 3.7% from 3.5% in March. As a result, overall food inflation including alcohol and tobacco, eased significantly during the quarter under review, standing at 3.3%, as compared to 5.0% in March, which is lower than the historical average of 3.6%.

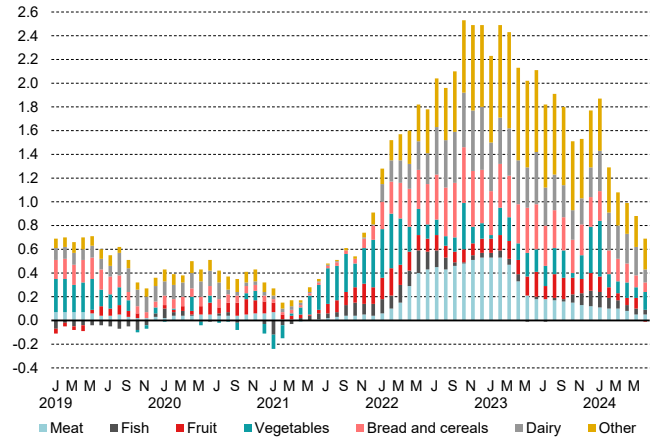
Chart 3.4
CONTRIBUTIONS TO YEAR-ON-YEAR HICP INFLATION
(percentage points; annual percentage change)



Source: SDW.

The main contributors to the moderation in processed food inflation since March were dairy products. These were followed by bread and cereals. Fruit, meat and fish products also contributed to the moderation in food inflation, although to a lesser extent (see Chart 3.5). On the other hand, there was an increase in the contribution from vegetables following higher vegetable prices.

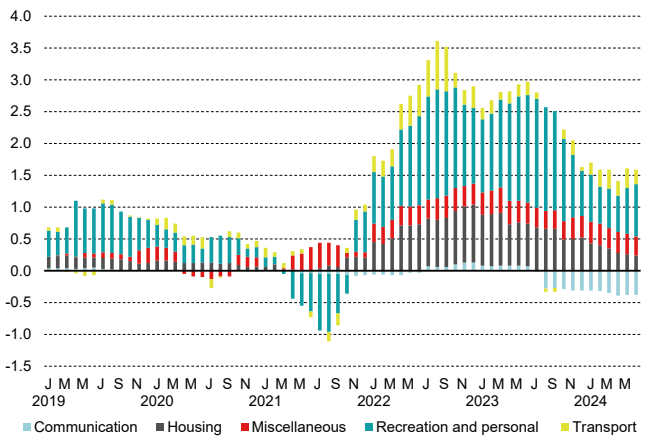
Chart 3.5
CONTRIBUTIONS FROM FOOD TO HICP INFLATION
(percentage points)



Source: SDW.

NEIG inflation eased marginally from 1.2% in March to 1.1% in June. Looking at the sub-components, prices of durables contracted at a faster pace dropping by 1.1% in annual terms, following a drop of 0.7% three months earlier. At the same time, prices of non-durables rose at a slower pace of 3.6%, down from 4.1% in March. On the other hand, prices of semi-durables rose by 1.3% year-on-year, up from 0.4% in March.

Chart 3.6
CONTRIBUTIONS FROM SERVICES TO HICP INFLATION
(percentage points)



Source: SDW.

Services inflation decreased from 2.7% in March to 2.3% in June, contributing 1.2 percentage points to overall HICP inflation (see Chart 3.6). This mostly reflected a smaller contribution from the housing component, largely reflecting lower price increases in rents. The contribution from transport services also decreased, though to a lesser extent, on the back of lower prices for international flights. Year-on-year declines in communication services also continued to dampen services inflation, extending the pattern of recent months.

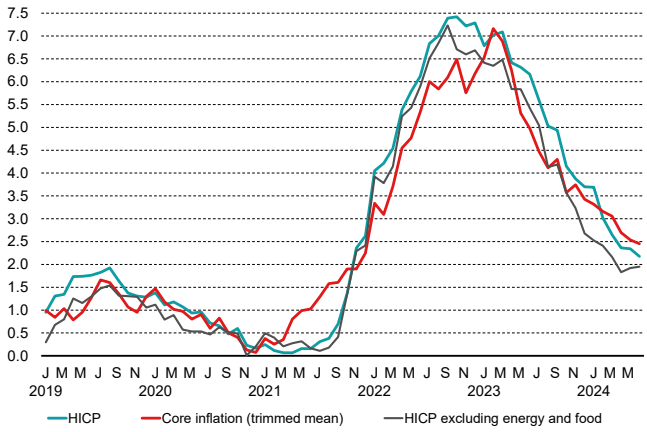
On the other hand, the contribution from the recreation and personal component, which is the main contributor to services inflation, increased as the prices charged for package holidays contracted at a slower pace than three months earlier. Meanwhile, the contribution from miscellaneous services remained largely unchanged.

Energy inflation was unchanged at 0.0% in June, 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 2.5% in June 2024, from 3.1% three months earlier (see Chart 3.7).[3] An alternative measure of underlying

Chart 3.7
HICP IN MALTA: OVERALL AND CORE MEASURE
(annual percentage change)



Sources: Eurostat; Central Bank of Malta estimates.

[3] 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.

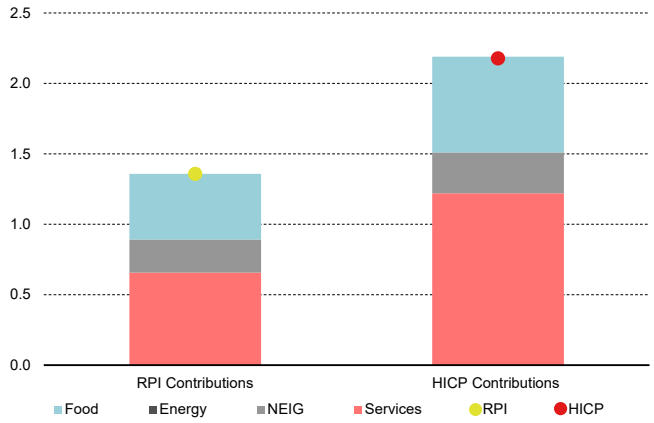
inflationary pressures – HICP excluding energy and food – also eased in June, reaching 2.0%, from 2.2% in March.

RPI inflation edges down

Annual inflation based on the RPI index fell to 1.3% in June, from 1.9% in March, mainly due to lower contributions from prices of food (see Table 3.2).[4] Despite the moderation, food remained the main contributor to RPI inflation. Prices of housing also contributed to reduce inflation, though to a lesser extent. On the other hand, the contribution from transport and communication turned less negative. Meanwhile, clothing and footwear had a neutral impact on overall RPI inflation as did energy tariffs.

While the methodology underlying RPI and HICP is similar, they differ in that the RPI includes private households only, while HICP covers also institutional households and foreign visitors to Malta. Consequently, the difference between HICP and RPI inflation in part reflects the different structure of weights applied to the two indices. Furthermore, unlike the RPI weights, which were last updated in 2017, weights applied to the HICP index are updated annually. Chart 3.8

Chart 3.8
RPI AND HICP MAIN CONTRIBUTIONS
(annual percentage changes; contributions)



Sources: Eurostat; NSO; Central Bank of Malta calculations.

Table 3.2
CONTRIBUTIONS TO YEAR-ON-YEAR RPI INFLATION
Percentage points

	2023						2024					
	July	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
Food	1.9	2.0	1.9	1.5	1.6	1.9	1.9	1.2	1.1	1.0	0.8	0.6
Beverages and tobacco	0.4	0.4	0.4	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Clothing and footwear	-0.1	-0.1	0.1	-0.1	-0.1	-0.1	0.0	0.1	-0.1	0.0	0.0	0.0
Housing	0.7	0.7	0.6	0.5	0.4	0.4	0.2	0.2	0.2	0.1	0.1	0.1
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	0.4	0.2	0.3	0.3	0.2	0.3	0.2	0.2	0.2	0.1	0.1	0.1
Transport and communications	0.0	-0.6	-0.5	0.0	-0.1	-0.3	-0.4	-0.5	-0.6	-0.8	-0.5	-0.4
Personal care and health	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.4
Recreation and culture	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Other goods and services	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.5	0.4	0.3
RPI (annual percentage change)	**4.7**	**4.0**	**4.1**	**3.7**	**3.6**	**3.6**	**3.2**	**2.3**	**1.9**	**1.6**	**1.5**	**1.3**

Source: NSO.

[4] 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.

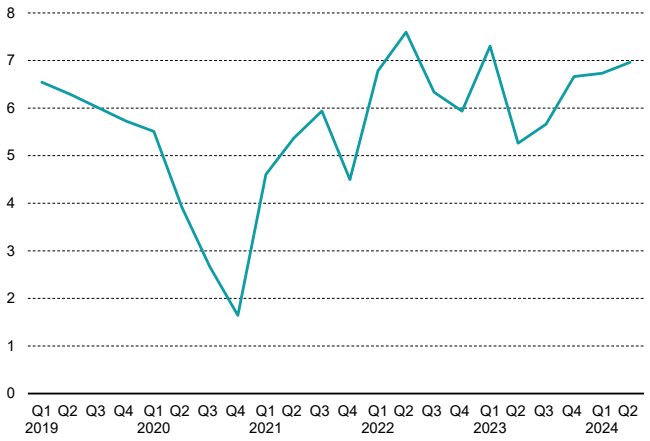
shows the contributions of the main sub-components to overall RPI and HICP inflation, respectively. While the contributions of HICP are official Eurostat figures, the RPI contributions are internal estimates based on an approximate mapping of individual RPI sub-items into corresponding HICP categories.[5,6] These estimates indicate that the largest difference between RPI and HICP in June, stemmed from services inflation.

The housing market

Residential property price inflation up from the previous quarter

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 7.0% in the second quarter of 2024, up from 6.7% in the previous quarter (see Chart 3.9).[7] Meanwhile, in the euro area, prices on average increased at an annual rate of 1.3%.

Chart 3.9
MOVEMENTS IN RESIDENTIAL PROPERTY PRICES
(annual percentage changes)



Source: Eurostat.

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 significant migrant worker flows continue to support demand for accommodation and hence, property prices.

Misalignment indicator suggest prices are moderately below fundamentals

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.[8,9] This indicator consists of five sub-indices that capture household, investor, and system-wide factors, with the weights being derived using principal component analysis.

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[5] The RPI grouping of sub-components is intended to be as close as possible to the HICP grouping. For example, restaurants services and take-aways were included within 'Services' sub-component rather than within the 'Food" sub-component.

[6] The contributions of RPI sub-components are made to sum to the overall inflation by allocating a residual chain-linking component to the aforementioned sub-components.

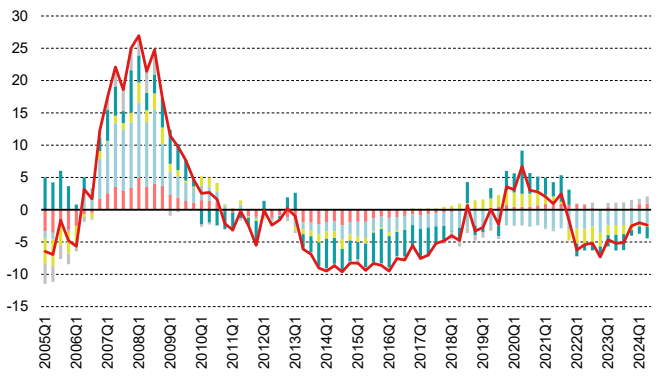
[7] 'Apartments' are defined as dwellings with self-contained rooms or a suite of rooms that have a separate entrance accessible from a common passageway, landing or stairway. 'Maisonettes' have a separate entrance that is accessible from the street and are either at ground-floor level with overlying 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.

[8] 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.

[9] 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.

According to this indicator, house prices, as measured by the NSO's PPI, were moderately below the level consistent with fundamentals in the second quarter of 2024. The degree of undervaluation increased somewhat when compared with the first quarter of 2024 (see Chart 3.10).[10] The misalignment was driven mainly by the house price to hypothetical borrowing ratio followed by the ratio of housing investment to GDP. By contrast, the loan borrowing constraint and house price to CPI ratio contributed positively to the misalignment index.

Chart 3.10
HOUSE PRICE MISALIGNMENT INDICATOR
(percentage points; based on transaction prices)



Source: Central Bank of Malta.

The housing investment-to-GDP ratio was the main contributor behind the widening of the negative misalignment gap.

Number of final deeds increased in both quarterly and annual terms

NSO data on residential property transactions show that 3,192 final deeds of sale were registered in the quarter under review, an increase of 1.0% compared to the number of sales concluded in the previous quarter, and 6.2% higher than the same level registered in the same quarter a year earlier (see Table 3.3). Over 90% of transactions concluded in the second quarter of 2024 involved purchases by individuals.

In the second quarter of 2024, increases were recorded in all regions, apart from the Southeastern region where the number of deeds decreased in annual terms. In value terms, there was a year-on-year increase of 9.4%.

At 3,493, the number of promise-of-sale agreements was 0.2% lower than the number registered in the previous quarter, and in line with the same quarter of 2023. Half of all regions recorded year-on-year increases while the other half recorded decreases.

Table 3.3
RESIDENTIAL PROPERTY TRANSACTIONS
Levels

	2022	2023				2024	
	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Residential transactions							
Promise of sale	3,353	3,118	3,494	3,076	3,502	3,499	3,493
Final deeds of sale	3,764	3,101	3,007	2,870	3,202	3,161	3,192

Source: NSO.

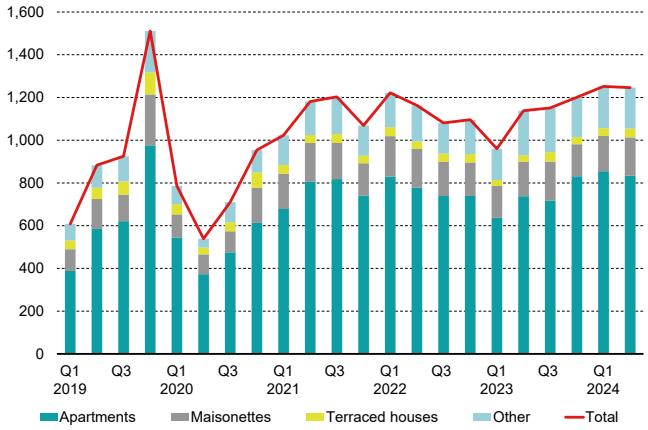
[10] A separate assessment based on advertised house prices can be found in Gatt, W., Micallef, B. and Rapa, N. (2018). "A macroeconometric model of the housing market in Malta", *Annual Research Bulletin*, Central Bank of Malta, pp. 11-18.

Mortgage transactions increase year-on-year[11]

In the second quarter of 2024, the number of new mortgage contracts stood at 1,246. When compared with the second quarter of 2023, they increased by 9.5% (see Chart 3.11). Increases were observed for all main property categories except for 'other' properties, reflecting fewer loans for houses of character. However, almost 90% of the increase reflected a larger number of loans financing apartments.

The total number of mortgage contracts in the second quarter of 2024 stood below the peak of 1,511 transactions recorded in the last quarter of 2019 but significantly above the average of 963 transactions per quarter recorded since 2017.

Chart 3.11
MORTGAGE CONTRACTS
(number of contracts)

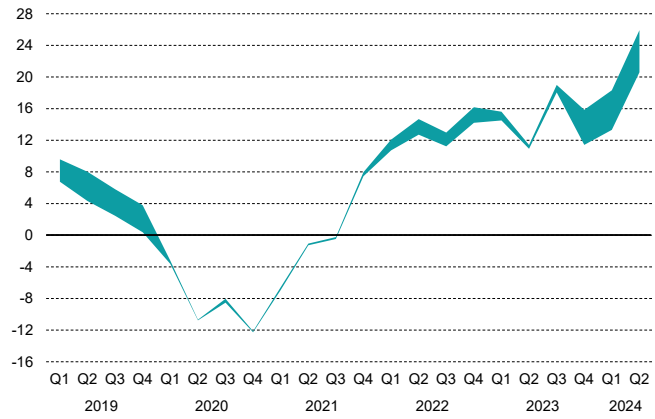


Source: Central Bank of Malta.

Advertised rent prices continue to increase at a significant rate

The annual rate of change of advertised rents collected by the Bank from internet sources increased in the second quarter of 2024.[12] The range of estimates from various methods indicate that rents have increased at annual rates of between 20.6% and 25.9% in the quarter under review (see Chart 3.12). Compared with the previous quarter, the rate of increase included in the range of estimates has widened slightly and shifted up. In the quarter under review, the level of advertised rents stood around 40% above the average in recent years.[13]

Chart 3.12
ADVERTISED RENTAL PRICES
(annual percentage change)



Source: Central Bank of Malta.

[11] 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.

[12] 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.

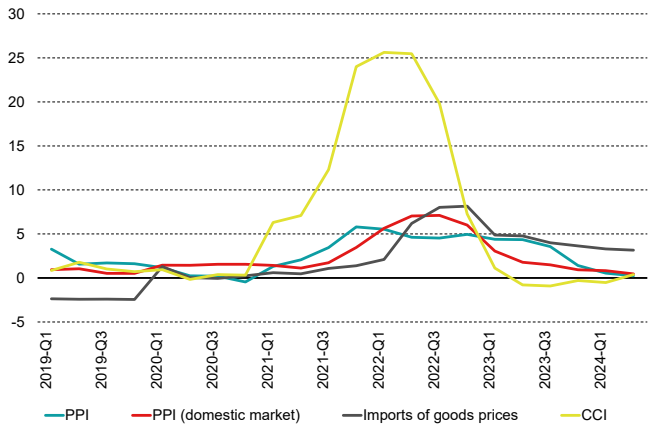
[13] This index is available from 2017Q4.

Cost indices

Most indicators of producer costs grow at a slower pace

The industrial producer price index is a measure of the prices of goods sold by producers in the industrial sector. Annual inflation according to this index eased to 0.2% on average in the quarter under review, down from 0.6% in the previous quarter (see Chart 3.13).[14] This moderation was largely driven by developments in producer prices for intermediate goods, whose annual rate of change became more negative, standing at -3.2% in the second quarter of 2024, compared to -1.3% previously. At the same time, producer prices of consumer goods rose at a marginally slower annual rate of 1.6% in this quarter, from 1.8% in the previous quarter. By contrast, the annual rate of change of producer prices of capital goods grew at a faster pace of 6.2% in the quarter under review, up from 3.3% in the previous quarter. Meanwhile, energy producer price inflation remained unchanged.

Chart 3.13
COST INDICATORS
(annual percentage growth)



Sources: Central Bank of Malta estimates; Eurostat data; NSO data.

Other indicators affecting the domestic market also show easing cost pressures. The domestic producer price index rose at a slightly slower annual rate of 0.5%, from 0.8% in the first quarter, mainly driven by slower growth in producer prices of consumer goods.[15] The imports of goods deflator also shows marginally weaker growth of 3.2%, from 3.3% in the first quarter of 2024.[16] The CCI for new residential buildings published by Eurostat increased in the second quarter of 2024, standing at 0.3% after it had declined by 0.5% in the previous quarter. Notwithstanding the recent declines, its level remains above that observed before 2020.

ULCs increase at a faster rate

Malta's ULC index – measured as the ratio of CPE to labour productivity – increased in annual terms, as well as in quarter-on-quarter terms in the second quarter of 2024.[17]

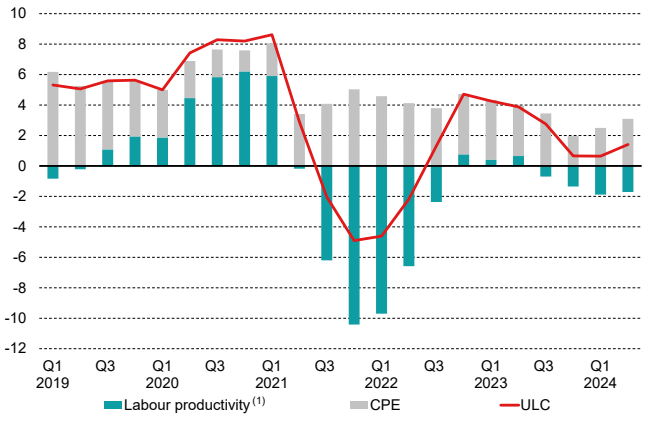
When measured on a four-quarter moving average basis in headcount terms, ULCs in Malta rose at an annual rate of 1.4%. This followed an increase of 0.6% in the previous quarter (see Chart 3.14). The pick-up in ULC growth largely reflects an acceleration in CPE. This rose by 3.1% in annual terms, from 2.5% in the first quarter. To some extent, the increase in ULC

[14] 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. The index used here refers to the B-E36 aggregate of the EU's statistical classification of economic activities.
[15] The domestic producer price index refers to the producer prices relating to the domestic market only, whilst the producer price index relates to the total market, i.e., including both the domestic and non-domestic markets.
[16] This index is derived from national accounts data published by the NSO.
[17] 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), pp. 53-63, Central Bank of Malta.

growth also reflected slower growth in productivity per person. This rose by an annual rate of 1.7% in the second quarter, from 1.9% in the previous one.

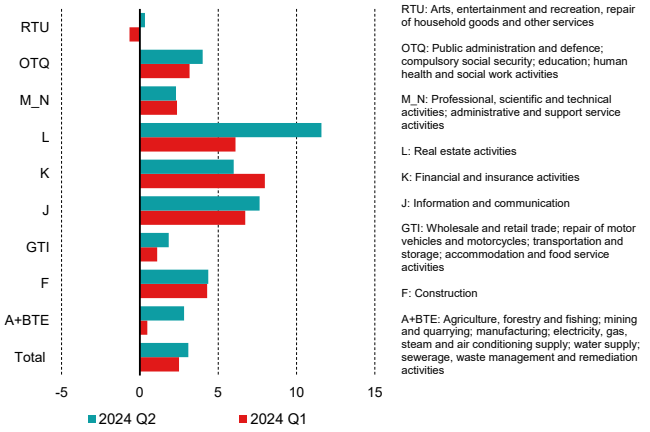
When measured on a four-quarter moving average basis, growth in CPE was fastest in the real estate activities sector, which had a year-on-year growth rate of 11.7% (see Chart 3.15). Wage growth was also significant in the information and communication sector, where compensation per person grew by 7.6%. Overall, compared with the previous quarter, CPE grew at a faster rate across most sectors, including the two aforementioned ones. Only two sectors displayed slower growth compared to the first quarter, these being the financial and insurance activities sector and the sector comprising professional, scientific and technical activities, which recorded increases of 6.0% and 2.3%, respectively.

Chart 3.14
DECOMPOSITION OF ULC (PER PERSON) IN MALTA
(annual percentage change; four-quarter moving average)



Sources: NSO; Central Bank of Malta estimates.
(1) A rise (drop) in productivity contributes negatively (positively) to ULC growth.

Chart 3.15
CPE BY SECTOR
(annual percentage growth; four-quarter moving average)



Source: NSO.