FOREWORD

During the second quarter of 2024, annual real gross domestic product (GDP) growth rose by 4.4%, following a 7.6% increase in the preceding quarter. Growth was mainly driven by net exports, as the contribution of domestic demand, while still positive, was smaller. When adjusting for imports, exports remained the main driver of GDP growth.

Potential output growth is estimated to have stood at 5.4% in the second quarter of 2024, below that of 6.1% estimated for the first 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 into a slightly smaller positive output gap. This implies a slight easing in the degree of over-utilisation of the economy's productive capacity.

The Bank's Business Conditions Index (BCI) edged down further in the second quarter and was in line with its historical average. This partly reflects GDP growth which was broadly in line with its long run average. At the same time, growth in other sub-components such as the issuance of development permits for residential buildings and the Economic Sentiment Indicator (ESI) was below average.

Developments in the labour market remained positive. The unemployment rate remained low from a historical perspective and was well below that in the euro area. Meanwhile, the job vacancy rate and the labour market tightness indicator while declining slightly, remained high in relation to recent outcomes.

Consumer price pressures eased further during the quarter under review. Annual inflation, as measured by the Harmonised Index of Consumer Prices (HICP), stood at 2.2% in June, down from 2.7% in March. This moderation stemmed from lower processed food inflation as all other main components retained the same contribution. Meanwhile, annual inflation based on the Retail Price Index (RPI), which only considers expenditure by Maltese residents, edged down to 1.3% in June, from 1.9% in March due to lower contributions from prices of food.

Annual growth in the industrial producer price index eased to 0.2% in the second quarter, down from 0.6% in the previous quarter. Other indicators such as the domestic producer price index, and the goods imports deflator also show some easing in cost pressures. On the other hand, the construction cost index (CCI) increased in annual terms, after it had declined in the previous quarter. Malta's unit labour cost (ULC) index, measured on a four-quarter moving average basis, rose at an annual rate of 1.4%, following a rise of 0.6% in the preceding quarter, largely reflecting an acceleration in compensation per employee (CPE).

In the second quarter of 2024, the current account surplus widened compared with a year earlier. This was due to higher net receipts from services, and to a lesser extent, a narrowing of the merchandise trade deficit. By contrast, net outflows on the primary income accounts increased and net inflows on the secondary income account decreased. On a four-quarter moving sum basis, the current account balance registered a surplus equivalent to 7.0% of GDP in the second quarter of 2024.

When measured on a four-quarter moving sum basis, the general government deficit ratio narrowed by 0.4 percentage points, from 3.8% in the first quarter of 2024 to 3.4% in the second quarter. Meanwhile, the general government debt-to-GDP ratio declined by 0.5 percentage point to 46.7%, compared with 47.2% in the first quarter.

Over the 12 months to June, Maltese residents' deposits with monetary financial institutions (MFIs) in Malta increased, reflecting higher balances belonging to households and insurance companies. The annual rate of change exceeded that recorded in March. Credit to Maltese residents also expanded at a faster pace, as both credit to general government and credit to other residents picked up. According to the Bank's Financial Conditions Index (FCI), in the second quarter of 2024, financial conditions remained loose from a historical perspective, and also loosened further when compared with the previous quarter. As a result, financial conditions according to the FCI were the most accommodative since 2021. The recent improvement was driven by domestic factors, although foreign factors also contributed.

During the year to June, the weighted average interest rate offered to households and NFCs on their outstanding deposits stood above its year-ago level, increasing by 13 basis points, to reach 0.37%. This was largely driven by higher rates on time deposits belonging to NFCs and households, as well as by rates on household deposits redeemable at notice up to three months. Meanwhile, over the same period, the weighted average lending rate paid by households and NFCs to resident MFIs decreased by 7 basis points, to 3.51%, driven by lower rates charged to both households and NFCs.

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

The primary market yield on Treasury bills increased between March and June. The secondary market yields on five-year and ten-year Malta Government Stocks (MGS) also rose over this period, while the MSE Equity Price Index declined.

After leaving its official rates unchanged for the preceding eight months, the Governing Council of the European Central Bank (ECB) lowered the three key policy rates by 25 basis points in June, since the inflation outlook had improved markedly, underlying inflation eased, and monetary policy kept financing conditions restrictive. Accordingly, the interest rates on the deposit facility, the main refinancing operations (MROs) and the marginal lending facility were decreased to 3.75%, 4.25% and 4.50%, respectively.

In light of persisting domestic price pressures, the Governing Council reiterated that it would keep policy rates sufficiently restrictive for as long as necessary to ensure that inflation would return to its 2% medium-term target in a timely manner. The Governing Council restated that it would continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction.

The Governing Council also confirmed that it would reduce the Eurosystem's holdings of securities under the pandemic emergency purchase programme (PEPP) by €7.5 billion per month, on average, over the second half of the year.

In September, the Governing Council decided to lower the deposit facility rate (DFR), by 25 basis points. Additionally, the spread between the MRO and the DFR was set at 15 basis points. By contrast, the spread between the rate on the marginal lending facility and the rate on the MROs was kept unchanged at 25 basis points. Accordingly, the DFR was decreased to 3.50% and the interest rates on the MROs and the marginal lending facility were decreased to 3.65% and 3.90%, respectively.

Furthermore, in October, the Governing Council decided to lower the three key ECB interest rates by 25 basis points as inflation continued to moderate. Accordingly, the interest rates on the deposit facility, the MROs and the marginal lending facility were decreased to 3.25%, 3.40% and 3.65%, respectively.