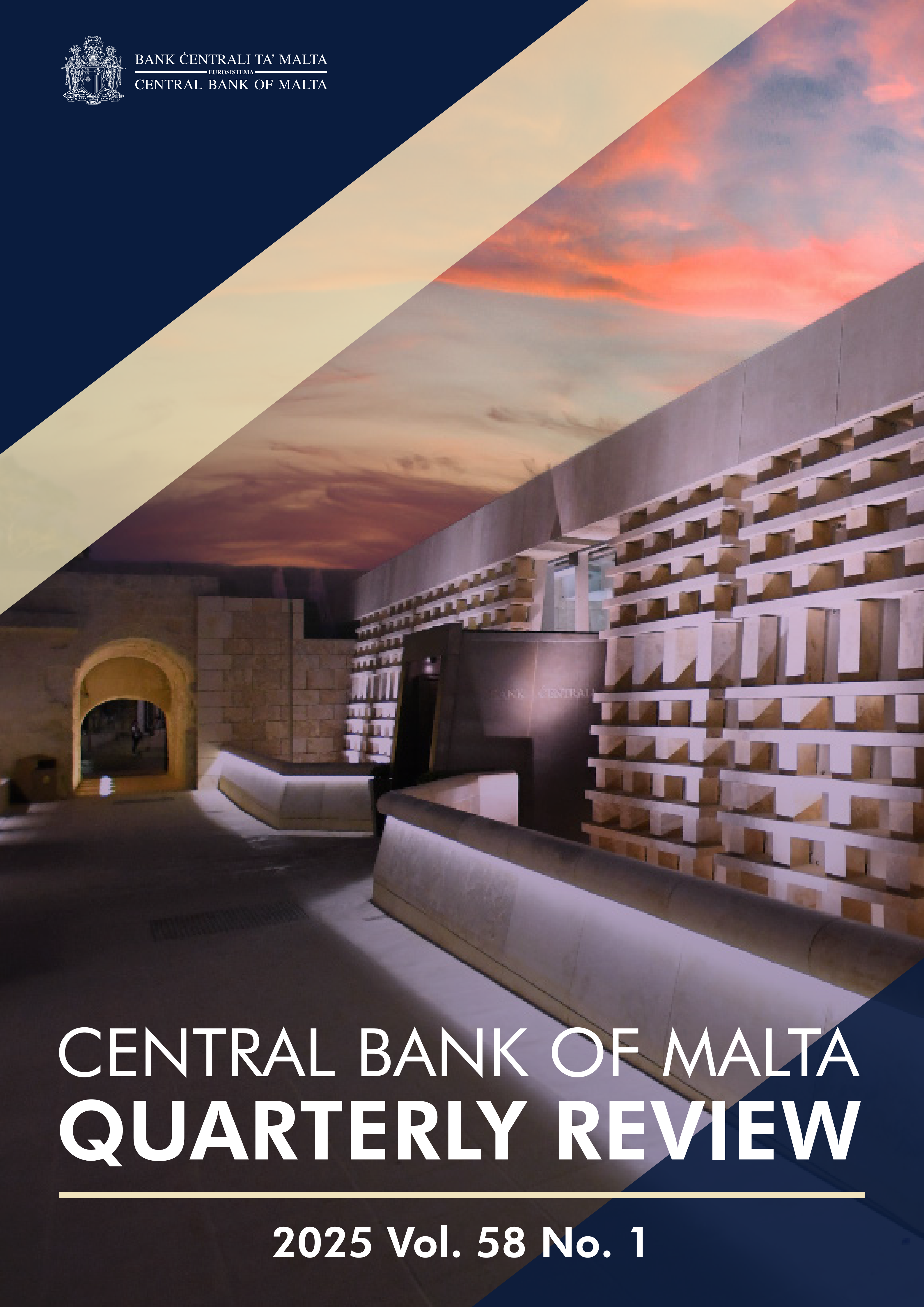
BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA



CENTRAL BANK OF MALTA QUARTERLY REVIEW

2025 Vol. 58 No. 1

Address
Pjazza Kastilja
Valletta VLT 1060
Malta

Telephone
(+356) 2550 0000

Fax
(+356) 2550 2500

Website
www.centralbankmalta.org

Contact
https://www.centralbankmalta.org/contact-us

The cut-off date for statistical information in this Review is 13 January 2025. However, the cut-off date for government finance statistics is extended to 22 January 2025. Figures in tables may not add up due to rounding.

ISSN 1811-1254 (online)

CONTENTS

ABBREVIATIONS

BCI	Business Conditions Index
BLS	Bank Lending Survey
CCI	construction cost index
COICOP	Classification of Individual Consumption by Purpose
COVID-19	coronavirus disease 2019
CGS	COVID-19 Guarantee Scheme
CPE	compensation per employee
CPI	Consumer Price Index
DFR	deposit facility rate
EA	Euro Area
ECB	European Central Bank
EEI	Employment Expectations Indicator
EER	Effective Exchange Rate
EPU	Economic Policy Uncertainty
ESI	Economic Sentiment Indicator
EU	European Union
EUI	Economic Uncertainty Indicator
EURIBOR	Euro Interbank Offered Rate
EUROMOD	Tax-benefit microsimulation model for the European Union
€STR	euro short-term rate
FC	financial corporation
FCI	Financial Conditions Index
Fed	Federal Reserve
FOMC	Federal Open Market Committee
GDP	gross domestic product
GFCF	gross fixed capital formation
GVA	gross value added
HICP	Harmonised Index of Consumer Prices
LFS	Labour Force Survey
LSGS	Liquidity Support Guarantee Scheme
MDB	Malta Development Bank
MFI	monetary financial institution
MGS	Malta Government Stocks
MPC	Monetary Policy Committee
MRO	main refinancing operation
MSE	Malta Stock Exchange
NEIG	non-energy industrial goods
NFC	non-financial corporation
NSO	National Statistics Office
PPI	Property Price Index
RPI	Retail Price Index
UK	United Kingdom
ULC	unit labour cost
US	United States

FOREWORD

During the third quarter of 2024, real gross domestic product (GDP) rose by 4.9% on an annual basis. Growth was driven by domestic demand as net exports had a broadly neutral effect. When adjusting for imports, domestic demand remained the main driver of economic growth.

Potential output growth is estimated to have stood at 5.0% in the third quarter of 2024, below that of 5.5% estimated for the second quarter. On a four-quarter moving average basis, the level increase in potential output relative to the previous quarter was comparable to that in GDP. As a result, the output gap is estimated to have remained unchanged from that of the second quarter, at 1.6%. This implies some degree of over-utilisation of the economy's productive capacity.

The Bank's Business Conditions Index (BCI) edged down marginally in the third quarter but remained slightly above its historical average. The positive index partly reflected GDP growth which was broadly in line with its long run average. At the same time, growth in credit, tax receipts, and industrial production was also above average.

The Bank's Economic Policy Uncertainty (EPU) Index, which monitors economic policy uncertainty by synthesising information gleaned from Maltese news portals, declined to 69.6 in the third quarter, from 73.7 in the preceding quarter and thus remained well below its historical average. The decline reflected subdued economic and political uncertainty during the summer months, following heightened uncertainty earlier in the year due to discussions around inflation and the EU parliamentary elections.

Developments in the labour market remained positive. The unemployment rate remained low and was well below that in the euro area. Meanwhile, the job vacancy rate increased slightly and the labour tightness indicator, also increased.

Consumer price pressures eased further during the quarter under review. Annual inflation, as measured by the Harmonised Index of Consumer Prices (HICP), stood at 2.1% in September, down from 2.2% in June. This was driven by a smaller contribution from processed food and non-energy industrial goods (NEIG) inflation. Meanwhile, annual inflation based on the Retail Price Index (RPI), which only considers expenditure by Maltese residents, eased to 1.2% in September, from 1.3% in June.

Industrial producer prices fell by an annual 0.9% after they had increased marginally in the second 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) recorded a slightly higher annual growth rate. Malta's unit labour cost (ULC) index, measured on a four-quarter moving average basis, rose at an annual rate of 2.3%, following a rise of 1.4% in the previous quarter, largely reflecting an acceleration in compensation per employee (CPE).

In the third quarter of 2024, the current account surplus narrowed compared with a year earlier. This was mainly due to a wider merchandise trade deficit and higher net outflows on the primary income account. By contrast, net receipts from services increased and the balance on the secondary income account turned positive. On a four-quarter moving sum basis, the current account surplus was equivalent to 6.3% of GDP.

When measured on a four-quarter moving sum basis, the general government deficit ratio narrowed by 0.5 percentage points to 2.9%. Meanwhile, the general government debt-to-GDP ratio declined by 1.1 percentage points to 45.3%.

Over the 12 months to September, Maltese residents' deposits with monetary financial institutions (MFIs) in Malta increased, mostly reflecting higher balances belonging to households. The annual rate of change exceeded that recorded in June. Meanwhile, credit to Maltese residents grew at a more moderate pace, due to slower growth in credit to residents outside the general government. By contrast, credit to general government rose at a faster pace. According to the Bank's Financial Conditions Index (FCI), in the third quarter of 2024, financial conditions remained loose from a historical perspective but were marginally less favourable compared with the previous quarter. The less favourable financial conditions reflected changes in both foreign and domestic factors.

During the year to September, the weighted average interest rate offered to households and non-financial corporations (NFCs) on their outstanding deposits stood 13 basis points above its year-ago level, reaching 0.40%. 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 20 basis points, to 3.41%, driven by lower rates charged to both households and NFCs, although the decline in the latter was more significant. The spread between the two rates amounted to 301 basis points and was lower both in annual and quarterly terms.

Data on new business, which may be more indicative of the transmission of monetary policy impulses, show an increase in both the weighted average deposit rate and the weighted average lending rate over the year to September. The spread between the two rates stood at 58 basis points.

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

In September, following an updated assessment of its inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission, the Governing Council of the European Central Bank (ECB) lowered the deposit facility rate (DFR) – the rate through which it steers the monetary policy stance – by 25 basis points, to 3.50%. Additionally, in September, changes in the interest rate corridor which had been announced back in March 2024 became effective. In particular, the spread between the interest rate on the main refinancing operations (MROs) and the DFR was reduced to 15 basis points, while the spread between the rate on the marginal lending facility and the rate on the MROs was kept unchanged at 25 basis points. As a result, the rate on MROs and the rate on the marginal lending facility were decreased to 3.65% and 3.90%, respectively.

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.

In October and again in December, the Governing Council decided to successively lower the three key ECB interest rates by 25 basis points. Accordingly, the DFR, the rate on MROs and the marginal lending facility rate were decreased to 3.00%, 3.15% and 3.40%, respectively. At the December meeting, whilst reiterating that it was not pre-committing to a particular rate path, the Governing Council dropped its restrictive bias with regard to policy rates.

ECONOMIC SURVEY

1. THE EXTERNAL ENVIRONMENT AND THE EURO AREA

In the third quarter of 2024, real GDP expanded at a stronger pace in the United States, was flat in the United Kingdom and grew at a faster rate in the euro area. During the quarter under review, the unemployment rate rose modestly in the United States and the United Kingdom, whereas it eased slightly in the euro area.

Consumer price inflation eased in the United States, the United Kingdom and in the euro area, mainly reflecting energy price dynamics. In the United States, inflation fell to 2.4% in September from 3.0% in June, in the United Kingdom, inflation declined to 1.7% in September from 2.0% in June, while, in the euro area, inflation declined to 1.7% in September from 2.5% three months earlier. The Federal Reserve, the Bank of England and the ECB lowered their key interest rates during the quarter under review.

Brent oil prices continued to fall in the review period, reflecting concerns about the outlook for global demand. By contrast, the price of European natural gas rose further mainly on the back of geopolitical developments which could reinforce already tight global market conditions.

Key advanced economies

US economic activity expands at a slightly faster pace

In the United States, real GDP grew at a quarterly rate of 0.8% in the third quarter, up from 0.7% in the preceding quarter (see Table 1.1). Higher personal consumption expenditure was the main contributor to growth, followed by government consumption. Both components, moreover, rose at a faster pace compared to the second quarter. Fixed private investment also contributed to growth, albeit to a lesser extent than in the previous quarter. Non-residential fixed investment also rose at a slightly faster rate, driven by outlays on equipment and intellectual property products. In contrast, residential investment shrank at a more pronounced pace. Net exports contributed negatively to economic growth, as imports notably outpaced exports. Also, a decline in private inventory investment deducted from GDP growth.

Meanwhile, labour market conditions remained favourable. Non-farm payroll data show that employment grew by 0.3% on average during the quarter, slightly less than in the previous quarter. These data suggest that the increase in employment was largely driven by private services.

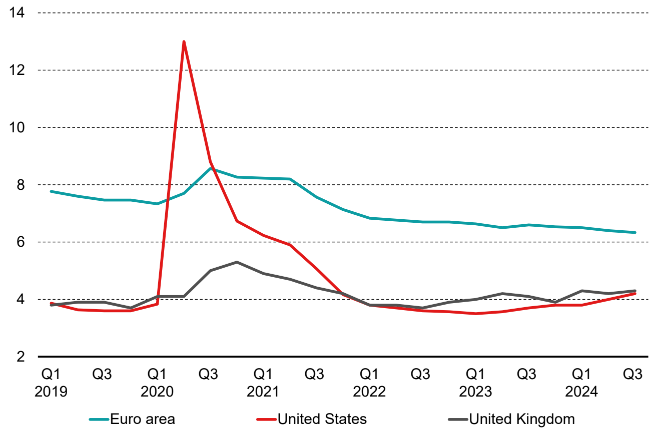
Table 1.1
REAL GDP GROWTH IN SELECTED ADVANCED ECONOMIES
Quarter-on-quarter percentage changes; seasonally and working day adjusted

	2022		2023				2024		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
United States	0.7	0.8	0.7	0.6	1.1	0.8	0.4	0.7	0.8
Euro area	0.6	-0.1	0.0	0.1	0.0	0.0	0.3	0.2	0.4
United Kingdom	0.1	0.3	0.1	0.0	-0.1	-0.3	0.7	0.4	0.0

Sources: Bureau of Economic Analysis, US; Eurostat; Office for National Statistics, UK.

In turn, within private services, employment growth was most pronounced in education and health, followed by leisure and hospitality. Government employment also increased during the review period. The participation rate rose to 62.7% during the review period, from 62.6% in the previous quarter. On average, the unemployment rate increased to 4.2% in the third quarter, compared to 4.0% in the previous quarter (see Chart 1.1).

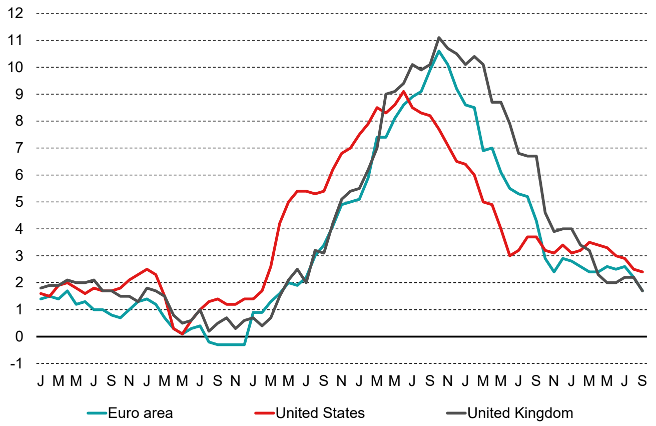
Chart 1.1
UNEMPLOYMENT RATE
(percentage of the labour force; quarterly average; seasonally adjusted)



Sources: Bureau of Labor Statistics, US; Eurostat; Office for National Statistics, UK.

Headline inflation continued to ease in the quarter under review, largely reflecting a marked decline in energy prices and a drop in commodities prices, excluding food and energy. Thus, the annual inflation rate based on the consumer price index (CPI) stood at 2.4% in September, compared to 3.0% three months earlier (see Chart 1.2). Annual energy inflation fell to -6.8% in September, as against 1.0% in June. The prices of commodities, excluding food and energy, fell by -1.0% in the year to September, a smaller fall than the -1.8% drop in the twelve months to June. Services inflation eased slightly, but remained high, declining to 4.7% in September, from 5.0% three months earlier. Meanwhile, food inflation (including beverages) stood at 2.2% in September, unchanged from June. However, underlying inflation, as measured by inflation excluding food and energy, remained somewhat elevated, standing at 3.3% in September, the same as in June.

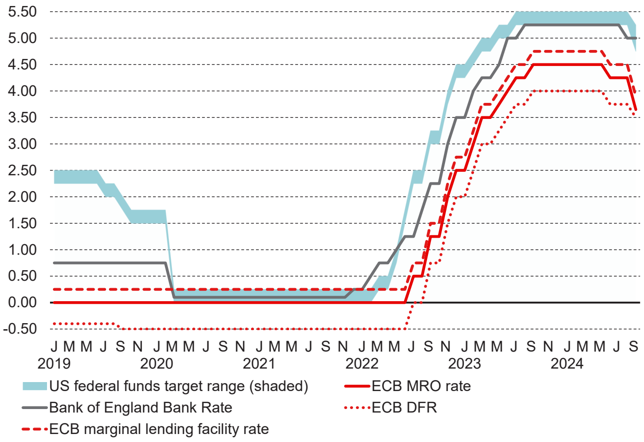
Chart 1.2
CONSUMER PRICE INFLATION
(annual percentage changes)



Sources: Bureau of Labor Statistics, US; Eurostat; Office for National Statistics, UK.

On 18 September, the Federal Open Market Committee (FOMC) decided to lower the target range for the federal funds rate by 0.50 percentage points to 4.75-5.00%, judging that inflation had made further progress toward the 2% objective, though it remains somewhat elevated (see Chart 1.3). This was the first adjustment in the federal funds rate since July 2023. The Committee restated that it would be prepared to adjust the stance of monetary policy as appropriate if risks emerged that could impede the attainment of its goals. The FOMC also reaffirmed that it would continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities.[1]

Chart 1.3
OFFICIAL INTEREST RATES
(percentages per annum; end of month)



Sources: ECB; Federal Reserve; Bank of England.

UK economic growth stagnates

Real GDP growth in the United Kingdom slowed down to 0% in the review period, following a 0.4% expansion recorded in the second quarter (see Table 1.1). A marked decrease in inventories counterbalanced increases in consumption expenditures by households and government, higher business investment, as well as an improvement in the trade balance. The latter reflected a drop in imports that outweighed lower exports.

Labour market conditions were stable. The employment rate rose to 74.9%, on a quarterly-average basis, from 74.6% in the previous three months, while the unemployment rate averaged 4.3% during the review period, up slightly from 4.2% in the previous quarter (see Chart 1.1).

Consumer price inflation in the United Kingdom rebounded in July and August but then dropped in September, with the annual inflation rate hitting 1.7% that month, compared to 2.0% in June (see Chart 1.2). Energy prices fell further during the quarter, and did so at a slightly faster pace than that recorded in the previous quarter. Thus, the annual rate of energy price inflation fell to -16.2% in September, compared to -16.0% three months before. Although most of the other major components of inflation continued to ease, both food and especially services inflation remained high, with the latter standing at 4.9% in September. In contrast, non-energy industrial goods (NEIG) inflation rose to 0.2% in September, as against -0.1% in June. The annual rate of inflation based on the CPI excluding energy, food, alcohol and tobacco fell to 3.2% in September, from 3.5% in June.

On 1 August 2024, the Bank of England's Monetary Policy Committee (MPC) announced that it had reduced the Bank Rate by 25 basis points, to 5.0%. This was the first change in the Bank Rate since August 2023. The MPC stated that it was appropriate to reduce the degree of policy restrictiveness as the impact from past external shocks had abated and some progress was registered in moderating risks of persistence in inflation. However, the Committee reiterated that monetary policy needed to continue to remain restrictive for sufficiently long until the risks to inflation returning sustainably to the 2% target in the medium term would have dissipated further. Indeed, on 18 September, the MPC kept the Bank Rate unchanged (see Chart 1.3).[2] It also noted that a gradual approach to the removal of monetary restrictiveness seemed appropriate.

[1] On 7 November and again on 18 December 2024, the FOMC decided to lower the target range for the federal funds rate by 0.25 percentage points, bringing the target range down to 4.25-4.50%.

[2] On 6 November 2024, the MPC reduced the Bank Rate by 25 basis points, to 4.75%, reflecting the continued progress in disinflation. The Committee restated that it would continue to monitor closely the risks of inflation persistence and would decide the appropriate degree of monetary policy restrictiveness at each meeting. On 18 December, the MPC kept the Bank Rate unchanged.

The euro area

GDP in the euro area continues to recover

Economic activity in the euro area continued to gradually recover in the third quarter of 2024. In real terms, GDP rose by 0.4% on a quarter-on-quarter basis, compared to 0.2% recorded in the previous quarter, with the acceleration driven by domestic demand (see Table 1.2). Growth continued to be mainly driven by the services sector whereas the construction sector continued to contract. The Economic Sentiment Indicator (ESI) remained broadly unchanged, below the long-term average. Improved confidence among firms in the construction sector, reflecting builders' improved assessments of their order books and their employment expectations, the still strong dynamics in contact-intensive services and improving consumer confidence were offset by a decrease in confidence in both industry and the retail sector.

Table 1.2

CONTRIBUTIONS TO QUARTERLY REAL GDP GROWTH IN THE EURO AREA[(1)]

Percentage points; quarter-on-quarter percentage change

	2022		2023				2024		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Private consumption	0.5	-0.5	0.1	0.3	0.1	0.0	0.2	0.0	0.4
Government consumption	0.0	0.1	0.1	0.1	0.2	0.2	0.0	0.3	0.1
GFCF	0.2	0.0	0.2	-0.1	0.0	0.3	-0.5	-0.5	0.4
Changes in inventories[(2)]	0.0	0.0	-0.8	0.3	-0.6	-0.5	0.0	0.2	0.4
Exports	0.8	0.1	-0.4	-0.6	-0.6	0.2	0.6	0.8	-0.8
Imports	-0.9	0.2	0.8	0.0	0.8	-0.1	0.1	-0.5	-0.1
GDP	**0.6**	**-0.1**	**0.0**	**0.1**	**0.0**	**0.0**	**0.3**	**0.2**	**0.4**

Source: Eurostat.

[(1)] Data are seasonally and working day adjusted. Figures may not add up due to rounding.

[(2)] Including acquisitions less disposals of valuables

In the third quarter, domestic demand contributed 1.3 percentage points to GDP growth. In turn, the expansion in domestic demand mainly reflected increases in private consumption expenditure as well as business inventories and gross fixed capital formation (GFCF). The latter reflected a notable rise in investment in intellectual property products, whereas investment in machinery and equipment, as well as in construction, contracted. Government consumption rose moderately. In contrast, net exports deducted 0.9 percentage points from GDP growth, as exports declined while imports rose slightly.

Labour market remains strong

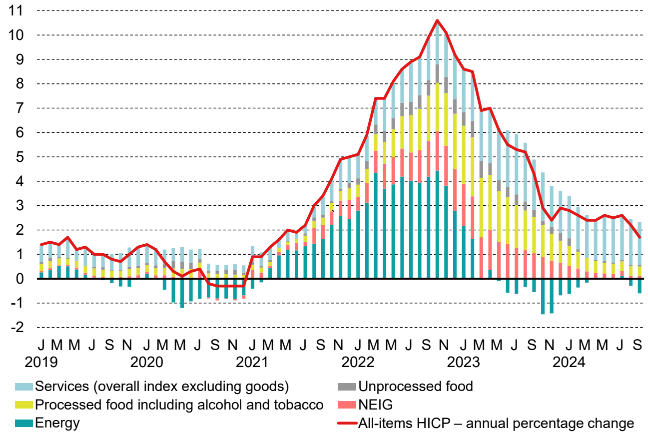
The labour market in the euro area remained robust during the third quarter. Employment continued to expand, growing at a quarterly rate of 0.2% during the review period, the same as in the preceding quarter.[3] Meanwhile, the seasonally adjusted unemployment rate fell to 6.3% in September, compared to 6.4% in June. Similarly, it averaged 6.3% in the quarter under review, down from 6.4% in the second quarter (see Chart 1.1).

[3] Employment data refer to the national accounts, total employment domestic concept. Data are seasonally and calendar adjusted.

Inflation resumes its downward path

Inflationary pressures in the euro area eased in the third quarter, following a marginal rebound in the previous three months. The annual rate of inflation based on the HICP stood at 1.7% in September, down from 2.5% in June (see Chart 1.4). The decrease in overall inflation was broad-based, but largely reflected a drop in energy prices.

Chart 1.4
CONTRIBUTIONS TO HICP INFLATION IN THE EURO AREA
(percentage points; annual percentage change)



Source: ECB.

Turning to the major HICP components, energy prices dropped at an annual rate of 6.1% in September, as against an increase of 0.2% in June. This drop partly reflects a base effect, as energy prices had risen sharply in September 2023. The annual rate of NEIG inflation slowed down to 0.4% in September, compared to 0.7% three months earlier. Similarly, services inflation eased to an annual rate of 3.9% in September, from 4.1% three months earlier, though it remained elevated. Also, the annual rate of processed food inflation eased marginally to 2.6% over the review period, compared to 2.7% in June. On the other hand, unprocessed food prices increased at an annual rate of 1.6% in September, up from 1.3% in June.

Underlying inflationary pressures moderated further, on average, during the review period. One measure of underlying inflation, the annual rate of HICP inflation excluding energy and food prices, edged down to 2.7% in September, from 2.9% in June.

Real GDP expected to continue to recover gradually, inflation projected to ease further

According to the Eurosystem staff macroeconomic projections for the euro area, published in December 2024, real GDP growth in the euro area is estimated to increase to 0.7% in 2024. Real GDP is then expected to expand further by 1.1%, 1.4% and 1.3% in 2025, 2026 and 2027, respectively (see Table 1.3). Although the euro area economy continued to expand moderately during 2024, recent indicators point to a weakening of growth in the short term. Persistently weak consumer confidence as well as elevated geopolitical and policy uncertainty are expected to induce households to postpone their consumption. However, subsequently, Eurosystem staff foresee a strengthening of economic growth mainly on the back of rising real wages and robust labour markets which, alongside an easing of financing conditions, will likely reinforce domestic demand. Also, the dampening effects of past monetary policy tightening are expected to fade over the projection horizon. Although fiscal policies are surrounded by heightened uncertainty, a degree of consolidation is expected. Meanwhile, funds from the Next Generation EU programme should underpin economic growth until the expiry of the programme in 2027. The projections assume that the trade policies of Europe's key trading partners remain unchanged, implying that foreign demand is expected to expand and support euro area exports. The unemployment rate will likely continue to fall to historically low levels while productivity is expected to pick up over the next three years.

Table 1.3
MACROECONOMIC PROJECTIONS FOR THE EURO AREA[1]
Annual percentage changes

	2023	2024	2025	2026	2027
GDP	**0.5**	**0.7**	**1.1**	**1.4**	**1.3**
Private consumption	0.8	0.9	1.3	1.3	1.2
Government consumption	1.5	2.3	1.2	1.2	1.0
GFCF	1.8	-1.7	1.2	2.2	1.6
Exports	-0.2	1.0	1.6	3.0	3.0
Imports	-0.7	0.1	2.3	3.1	2.9
HICP	**5.4**	**2.4**	**2.1**	**1.9**	**2.1**
HICP excluding energy and food	4.9	2.9	2.3	1.9	1.9

Source: ECB.
(1) Eurosystem staff macroeconomic projections for the euro area, December 2024.

Compared to the September 2024 projections, the latest projections are conditioned on lower oil and electricity prices but higher gas prices, a weaker exchange rate and lower interest rates. Real GDP growth is revised downwards by 0.1, 0.2 and 0.1 percentage points for 2024, 2025 and 2026, respectively. These revisions reflect weaker investment, mainly owing to revisions to data for the first half of 2024, and net exports in the short term that are partly offset in 2024 by government consumption. Private consumption growth for 2025-2026 was also revised downwards in light of a reassessment of the dynamics of household savings. Having said that, private consumption is still expected to be the main locomotive of economic growth.

Turning to the outlook for prices, Eurosystem staff foresee HICP inflation to decline to an average of 2.4% in 2024 from 5.4% in 2023, and to ease further to 2.1% and 1.9% in 2025 and 2026, respectively. In 2027, it is set to rebound slightly to 2.1%. HICP inflation is expected to increase in late 2024, mainly reflecting base effects in the energy component. Inflation is then expected to decline and eventually fluctuate around the ECB's 2% target from the second quarter of 2025. The introduction of new climate change mitigation measures is expected to bring about a marginal rise in inflation in 2027.

HICP inflation excluding energy and food is expected to lessen to an average of 2.9% in 2024 from 4.9% in 2023, and ease further to 2.3% in 2025 and 1.9% in 2026 and 2027, respectively. The decline in HICP inflation excluding energy and food in the near term is set to be driven mainly by the services component. Although wage growth is expected to remain elevated at first, it will likely fall gradually as inflation compensation pressures wane. Meanwhile, external price pressures are expected to remain modest.

Compared to the September 2024 projections, the outlook for headline HICP inflation is revised downwards by 0.1 percentage points in both 2024 and 2025, as an upward revision to food inflation is outweighed by a downward revision to energy inflation. The inflation projection remains unchanged for 2026. Underlying inflation expectations are kept unaltered for 2024 and 2025. However, they are revised downwards by 0.1 percentage points for 2026, mainly reflecting the impact from downward revisions to the outlook for economic growth and wages.

ECB cuts interest rates further

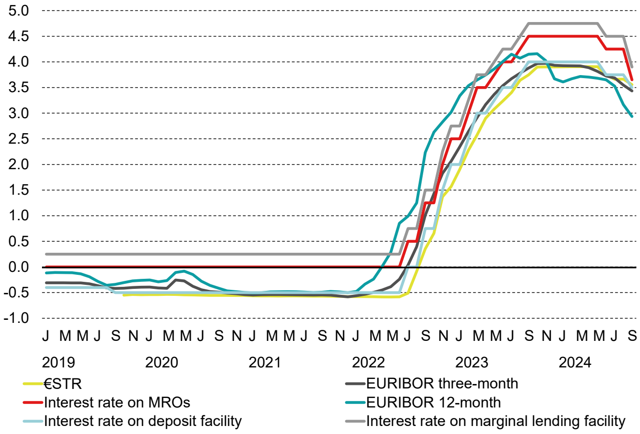
In light of the Governing Council's updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission, on 12 September, the Council decided to lower the DFR – the rate through which it steers the monetary policy stance – by 25 basis points. Additionally, as the Governing Council had announced on 13 March 2024, some changes to the operational framework for implementing monetary policy took effect from 18 September. In particular, the spread between the DFR and the interest rate on the MROs 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.

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.[4]

Money market rates drop further

Money market interest rates in the euro area continued to fall during the review period, reflecting the reductions in official interest rates and market expectations of further interest rate cuts. Hence, the euro short-term rate (€STR) averaged 3.56% in September, compared to 3.75% in June, as it responded to the September reduction in official interest rates (see Chart 1.5).[5] The three-month euro interbank offered rate (EURIBOR) averaged 3.43% in September, as against 3.72% three months earlier. The 12-month EURIBOR averaged 2.94% in September, compared to 3.65% in June.[6] The 12-month EURIBOR thus fell further below the DFR, indicating market players' more pronounced expectations of further reductions in key policy rates.

Chart 1.5
KEY MONEY MARKET INTEREST RATES
(percentages per annum; market rates − monthly averages; ECB rates − end of month)



Source: ECB.

[4] On 17 October and again on 12 December 2024, the Governing Council decided to lower the three key ECB interest rates by 25 basis points. Accordingly, the DFR, the rate on MROs and the marginal lending facility rate were decreased to 3.00%, 3.15% and 3.40%, respectively. At the December meeting, whilst reiterating that it was not pre-committing to a particular rate path, the Governing Council dropped its restrictive bias with regard to policy rates.

[5] The €STR is a reference rate based on money market data collected by the Eurosystem, reflecting the wholesale euro unsecured overnight borrowing costs of banks located in the euro area. The €STR is published on each T2 business day based on transactions conducted and settled on the previous T2 business day.

[6] The EURIBOR is an interest rate benchmark indicating the average rate at which principal European banks lend unsecured funds on the interbank market in euro for a given period.

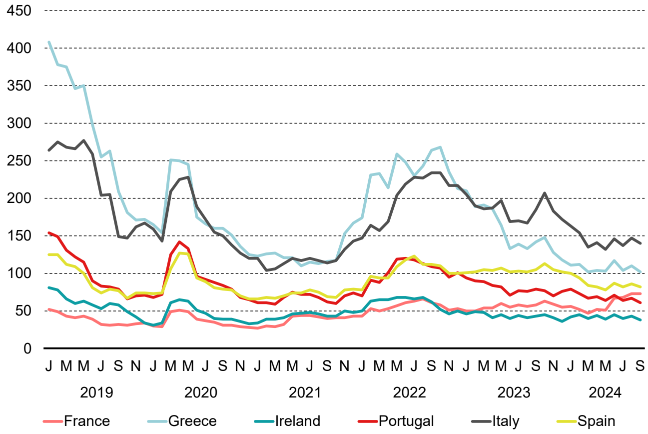
Euro area government bond yields fall

The euro area ten-year benchmark government bond yield fell during the third quarter, mainly because market participants reviewed their expectations about inflation and official interest rate dynamics in the euro area, as well as developments in the US Treasury bond market. This yield averaged 2.83% in September, compared to 3.17% three months earlier.

Individual sovereign bond yields fell to varying degrees across almost all euro area countries. In Germany, ten-year sovereign bond yields decreased by 31 basis points to 2.17%. Yields fell by 46 basis points, to 3.19%, in Greece and by 41 basis points, to 2.78%, in Portugal. Notable declines in yields also occurred in Ireland, Italy and Spain, where they fell by 38 basis points, to 2.55%, 37 basis points, to 3.57%, and 36 basis points, to 2.99%, respectively. Meanwhile, in France yields dropped by 25 basis points, to 2.90%. Bond yields in almost all the remaining euro area jurisdictions were down.

Spreads between yields on the ten-year German bonds and those on the bonds issued by most of the other euro area jurisdictions narrowed, notably in the case of Greece and Portugal, where they fell by 15 and 10 basis points, respectively (see Chart 1.6). Among the largest euro area countries, spreads also narrowed in Italy and Spain. By contrast, the spread between German benchmark yields and those on French government bonds widened by 6 basis points, by the end of the quarter.

Chart 1.6
SELECTED EURO AREA GOVERNMENT BOND YIELD SPREADS
(difference vis-à-vis German ten-year government bond yields in basis points)

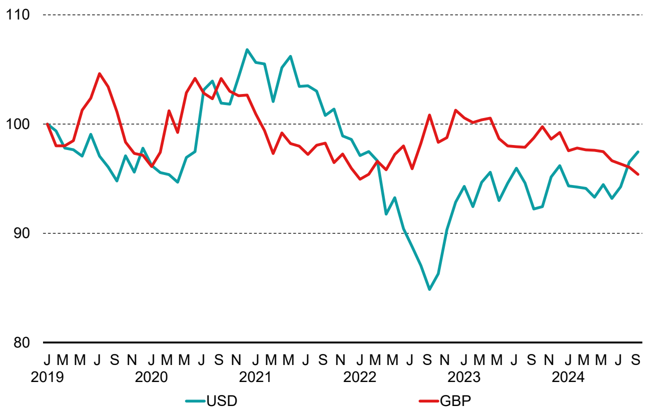


Sources: ECB; Central Bank of Malta calculations.

The euro rebounds versus the US dollar and in effective terms

The euro appreciated by 4.6% against the US dollar, rebounding notably from the previous quarter, as the latter was undermined by market views that US interest rates were likely to fall at a faster pace than previously expected (see Chart 1.7). The euro also registered gains against the Hong Kong dollar, the Canadian dollar, the Australian dollar, the Chinese renminbi and a number of other

Chart 1.7
EXCHANGE RATE MOVEMENTS OF THE EURO AGAINST OTHER MAJOR CURRENCIES
(index of end-of-month rates; Jan. 2019=100; an increase in the index implies euro appreciation)



Source: ECB.

European currencies. Overall, the nominal effective exchange rate (EER) of the euro against the EER-18 group of countries rose by 0.5% in the three months to end-September 2024.[7]

By contrast, the euro depreciated by a further 1.3% versus the British pound as the latter continued to be underpinned by relatively high interest rates. The single currency also fell against the Japanese yen, which was bolstered by the Bank of Japan's announcement of a tightening monetary policy stance. The euro also depreciated against the Swiss franc and incurred smaller losses versus the Polish zloty, the Singapore dollar and the Korean won.

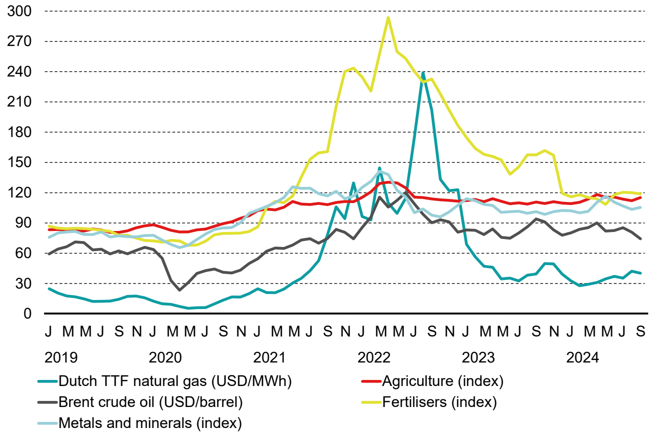
Commodities

Oil prices drop further whereas natural gas prices continue to rise

Oil prices continued to ease in the third quarter, amid concerns about forecast physical demand globally, especially in view of a slowing economy and changes in energy consumption patterns in China. Towards the end of the review period, however, oil prices rebounded somewhat in the context of the beginning of the Israeli bombing of Lebanon coupled with the possible threat of an escalation in the Middle East. Overall, the price of Brent crude oil averaged USD 74.3 per barrel in September, 10.0% lower than the level prevailing three months earlier. By contrast, the price of European natural gas increased further in the quarter under review, mainly reflecting a tighter global LNG market, geopolitical instability and uncertainty surrounding the renewal of a transit agreement governing pipeline flows of Russian gas through Ukraine. The average price of Dutch TTF natural gas stood at USD 40.2 per megawatt hour in September, or 8.4% higher than in June (see Chart 1.8).

World Bank data show that non-energy commodity prices fell by 1.7% during the quarter under review. This reflected lower prices for metals and minerals and, to a lower extent, agricultural products, which outweighed higher prices for fertilizers. Meanwhile, prices of precious metals were up by 9.0%.

Chart 1.8
COMMODITY PRICES
(monthly averages, indices: 2010 = 100)



Sources: World Bank; Central Bank of Malta calculations.

[7] The EER-18 is based on the weighted averages of the euro exchange rate against the currencies of Australia, Bulgaria, Canada, China, Czech Republic, Denmark, Hong Kong, Hungary, Japan, Norway, Poland, Romania, Singapore, South Korea, Sweden, Switzerland, the United Kingdom and the United States.

2. OUTPUT AND EMPLOYMENT

Annual real GDP growth rose by 4.9% in the third quarter of 2024. Growth was driven by domestic demand. When adjusting for imports, domestic demand remained the main driver of GDP growth, but external trade also had a positive effect.

Sectoral data show that the expansion in output was primarily driven by the services sector, although the manufacturing sector and construction also contributed to the economic expansion.

During the third quarter of 2024, developments in the labour market remained positive. The unemployment rate remained low and well below that in the euro area.

The labour market remained tight. The number of job vacancies increased by around 7% when compared to the third quarter of 2023. Meanwhile, the job vacancy rate increased slightly and the labour tightness indicator, which is the ratio of the job vacancy rate to the unemployment rate, increased both on a quarterly and an annual basis.

Potential output and Business Conditions Index

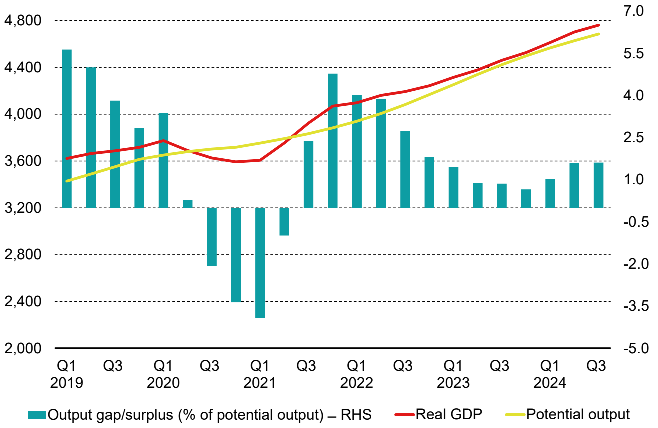
Potential output grows at a slower rate, but output gap remains unchanged

The Bank estimates that potential output growth stood at 5.0% in the third quarter of 2024, below that of 5.5% estimated for the second quarter of 2024.

On a four-quarter moving average basis, the level increase in potential output relative to the previous quarter was comparable to that in GDP. As a result, the output gap remained unchanged from that of the second quarter, at 1.6% (see Chart 2.1).

This implies some degree of over-utilisation of the economy's productive capacity.

Chart 2.1
CYCLICAL POSITION OF THE MALTESE ECONOMY
(four-quarter moving averages; EUR millions; as percentage of potential GDP)



Sources: NSO; Central Bank of Malta estimates.

BCI suggests growth is standing slightly above historical average

The Bank's BCI edged down marginally in the third quarter of 2024, while remaining slightly above its historical average (see Chart 2.2).[1]

[1] The BCI is a synthetic indicator, which includes information from a number of economic variables such as the term structure of interest rates, industrial production, an indicator for the services sector, economic sentiment, tax revenues and private sector credit. By construction, it has an average value of zero over the estimation period since 2000. A full time series can be found at In-House Economic Indicators section on the website. For further details on the methodology underlying the BCI, see Ellul, R., (2016), "A real-time measure of business conditions in Malta," *Working Paper* 04/2016, Central Bank of Malta.

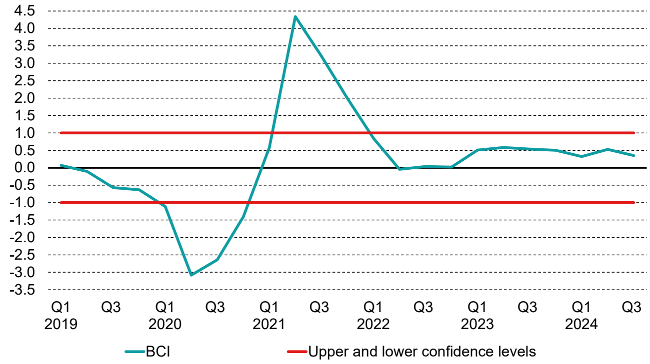
The positive index partly reflects GDP growth which was broadly in line with its long run average. At the same time, growth in credit, tax receipts, and industrial production was also above average.

Economic Policy Uncertainty (EPU) declines

The Bank's EPU index declined to 69.6 in the third quarter of 2024, down from 73.7 in the second quarter, remaining well below its historical average (see Chart 2.3).[2]

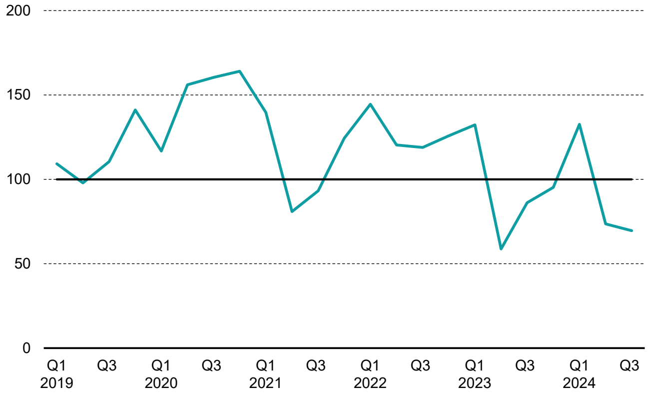
This decrease reflects a period of subdued economic and political uncertainty during the summer months, following heightened uncertainty earlier in the year driven primarily by discussions around inflation and the EU parliamentary elections.

Chart 2.2
BCI
(standardised)



Source: Central Bank of Malta.
The red lines in the Chart represent the range enclosing one standard deviation on either side of the BCI's long-run value. Repeated readings below the lower band signal that economic activity is significantly below normal economic activity. Readings above the upper band indicate that activity is signficantly above normal levels.

Chart 2.3
EPU INDEX



Source: Central Bank of Malta.
The index is normalized to 100. Higher values reflect elevated economic and political uncertainty in Malta, while lower values indicate reduced levels of uncertainty.

GDP and industrial production

Real GDP growth largely driven by domestic demand

Real GDP rose by 4.9% on an annual basis.[3] Growth was driven by domestic demand as net exports had a broadly neutral effect (see Table 2.1).

Domestic demand rose by an annual 6.1% in the third quarter of 2024. This increase was largely driven by private consumption, and to a lesser extent government consumption and GFCF. Overall, domestic demand added 4.9 percentage points to GDP growth in the third quarter of 2024.

Private consumption expenditure increased by an annual 5% in the third quarter of 2024, adding 2.4 percentage points to real GDP growth in the quarter under review.

[2] The EPU Index measures the frequency of economic, policy, and uncertainty-related terms in news articles to quantify the level of policy uncertainty. By construction, it has an average value of 100 over the estimation period since 2004. A full time series can be found at EPU Index section on the website. For further details on the methodology underlying Malta's EPU index, see Sant, K., and Spiteri, S., (2024), "Economic Policy Uncertainty: An Index for Malta", *Working Paper* 07/2024, Central Bank of Malta.

[3] The analysis of GDP in this chapter of the *Quarterly Review* is based on NSO *News Release* 225/2024, which was published on 27 November 2024.

Table 2.1
GDP[(1)]

	2023		2024		
	Q3	Q4	Q1	Q2	Q3
	Annual percentage changes				
Private final consumption expenditure	12.4	12.1	9.0	6.6	5.0
Government final consumption expenditure	4.2	7.8	1.2	5.4	10.5
GFCF	-20.7	-22.5	5.8	3.9	5.3
Domestic demand	**1.5**	**0.7**	**6.6**	**5.7**	**6.1**
Exports of goods and services	1.4	4.6	7.6	5.6	3.8
Imports of goods and services	-3.6	0.4	6.3	3.3	4.4
GDP	**7.4**	**6.0**	**8.1**	**8.0**	**4.9**
	Percentage point contributions				
Private final consumption expenditure	5.6	5.3	4.1	3.1	2.4
Government final consumption expenditure	0.7	1.4	0.2	0.9	1.6
GFCF	-4.9	-6.1	1.1	0.8	0.9
Changes in inventories	-0.1	0.0	0.0	0.0	0.0
Domestic demand	**1.3**	**0.6**	**5.4**	**4.7**	**4.9**
Exports of goods and services	1.8	5.8	9.4	6.8	4.7
Imports of goods and services	4.3	-0.4	-6.7	-3.5	-4.7
Net exports	**6.1**	**5.4**	**2.7**	**3.3**	**0.0**
GDP	**7.4**	**6.0**	**8.1**	**8.0**	**4.9**

Sources: NSO; Central Bank of Malta calculations.

[(1)] Chain-linked volumes, reference year 2020.

Data on the Classification of Individual Consumption by Purpose (COICOP) show that all categories of spending increased in annual terms. However, the strongest increase in absolute terms was recorded in spending on restaurants and accommodation services. This was followed by higher spending on housing and utilities, s, on recreation, sport and culture, and on transport.

COICOP data measure domestic consumption and thus, include the expenditure of non-residents in Malta while excluding the expenditure of Maltese residents abroad. Certain COICOP categories continued to be supported by a strong increase in non-residents expenditure in Malta. Nonetheless, the remaining part of domestic consumption, referring to the expenditure of Maltese residents, also rose. Meanwhile, the expenditure of Maltese residents abroad also increased on its year-ago level, partly reflecting an increase in trips over the same period.

Government consumption expenditure increased by 10.5% in annual terms in the third quarter of 2024. This is largely due to higher outlays on intermediate consumption and on compensation of employees. The former rose mainly due to higher spending in the public administration and health sectors. Compensation of employees surged partly due to additional allowances to the education sector following the signing of a new collective agreement. Overall, government consumption added 1.6 percentage points to GDP growth.

Real GFCF increased by 5.3% in the third quarter of 2024, largely reflecting an increase in outlays on intellectual property. Smaller increases were also recorded in spending on non-residential construction and machinery and equipment, while dwelling investment rose only marginally and outlays on cultivated biological resources decreased. GFCF contributed 0.9 percentage points to overall growth.

The contribution of changes in inventories in the third quarter of 2024 was zero.

Meanwhile, imports rose by 4.4%, while exports increased by 3.8% on a year earlier. Nevertheless, when expressed in absolute terms, these increases were of a comparable magnitude. As a result, net exports contributed 0 percentage points to annual real GDP growth. A higher surplus from trade in services was counterbalanced by a wider deficit from trade in goods.

The contributions shown in Table 2.1 are consistent with the approach normally followed in official databases and economic publications. However, they do not account for the variation in import content across different expenditure components and thus, fail to represent the true underlying relative contribution of domestic and external demand to economic growth.

Table 2.2 presents import-adjusted contributions, which address this limitation by apportioning imports to the respective demand components.[4]

Table 2.2
IMPORT-ADJUSTED CONTRIBUTIONS TO GDP GROWTH[(1)]

	2023		2024		
	Q3	Q4	Q1	Q2	Q3
	Percentage point contributions				
Private final consumption expenditure	4.2	3.5	2.8	2.3	1.4
Government final consumption expenditure	0.7	1.2	0.2	0.8	1.3
GFCF	-1.4	-2.2	0.6	0.6	0.4
Changes in inventories	-0.2	-0.1	-0.1	-0.1	0.0
Domestic demand	**3.2**	**2.5**	**3.5**	**3.6**	**3.1**
Exports of goods and services	**4.2**	**3.6**	**4.6**	**4.4**	**1.8**
GDP	**7.4**	**6.0**	**8.1**	**8.0**	**4.9**

Source: Central Bank of Malta estimates.
[(1)] Chain-linked volumes, reference year 2020.

As in the traditional approach, import-adjusted contributions continued to show that domestic demand remained the main contributor to real GDP growth in the third quarter of 2024. Moreover, private consumption remains the main driver of growth in domestic demand. In contrast with the traditional approach, however, the contribution of external trade turns positive under this approach.

Services remain the main driver of economic growth

Data based on the output approach show that in the third quarter of 2024, real gross value added (GVA) rose by 5.7% in annual terms and added 5.2 percentage points to GDP growth (see Table 2.3).[5]

[4] The process with which components are adjusted is currently being reviewed to consider the August 2024 benchmark revision to the national accounts.
[5] The difference between GDP and GVA is made up of taxes on products, net of subsidies.

Table 2.3
CONTRIBUTION OF SECTORAL GVA TO REAL GDP GROWTH
Percentage points

	2023		2024		
	Q3	Q4	Q1	Q2	Q3
Agriculture, forestry and fishing	-2.0	-0.4	0.0	0.2	0.9
Mining and quarrying; utilities	0.1	0.5	-0.3	-0.4	0.5
Manufacturing	0.1	0.2	0.5	0.6	0.5
Construction	0.1	0.3	0.4	0.4	0.2
Services	4.1	3.9	5.0	3.8	3.1
of which:					
Wholesale and retail trade; repair of motor vehicles; transportation; accommodation and related activities	-0.6	0.1	1.1	0.8	1.1
Information and communication	0.0	-0.3	-0.2	-0.2	0.0
Financial and insurance activities	0.0	-0.1	0.5	0.7	0.2
Real estate activities	1.5	1.2	1.0	0.8	0.4
Professional, scientific, administrative and related activities	1.8	2.1	1.8	0.5	0.9
Public administration and defence; education; health and related activities	0.6	0.7	0.7	0.9	0.9
Arts, entertainment; household repair and related services	0.7	0.2	0.0	0.2	-0.4
GVA	**2.5**	**4.6**	**5.6**	**4.6**	**5.2**
Taxes less subsidies on products	**4.9**	**1.4**	**2.5**	**3.4**	**-0.2**
Annual Real GDP growth (%)	**7.4**	**6.0**	**8.1**	**8.0**	**4.9**

Source: NSO.

Services remained the main driver behind the latest economic expansion, adding 3.1 percentage points to real GDP growth. Growth in services was partly spurred by the wholesale and retail sector which contributed 1.1 percentage points. At the same time, the sector comprising professional, scientific, administrative and related activities and that comprising public administration and defence, education, health and related activities, contributed 0.9 percentage points each.

The manufacturing sector added 0.5 percentage points to growth, while the construction sector added 0.2 percentage points.

Net taxes on products were broadly unchanged in annual terms.

Nominal GDP growth remains strong

Nominal GDP rose by 8% in annual terms in the third quarter of 2024. This increase was driven in almost equal measure by compensation of employees and operating surplus, as net taxes rose only marginally in annual terms.

Chart 2.4 shows the main contributors to growth in the GDP deflator. Annual growth in the GDP deflator stood at 2.9% in the third quarter of 2024.

ULCs explain most of the increase in the GDP deflator in the third quarter, followed by unit profits.

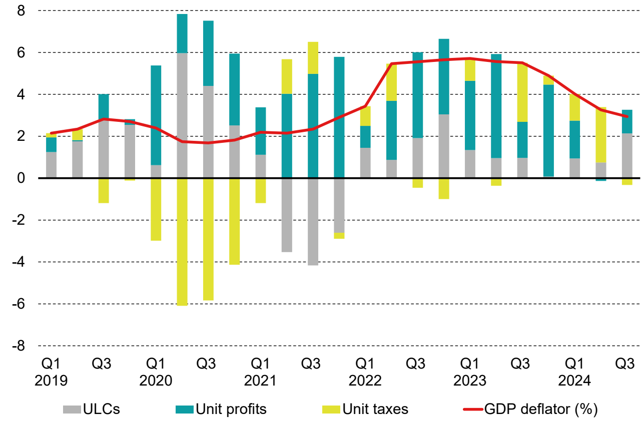


Chart 2.4
CONTRIBUTIONS TO GDP DEFLATOR
(annual percentage change; percentage point contribution)

Source: NSO.

Industrial production increases at a slower pace

Industrial production rose at an annual rate of 1.4% in the third quarter of 2024 – thus at a more moderate pace when compared with the increase of 4.2% recorded in the second quarter.[6]

Production in the manufacturing sector increased at an annual rate of 1.8%, after rising by 5.7% in the preceding quarter. By contrast, production in the quarrying sector accelerated. Meanwhile, production in the energy sector contracted at a slower pace. The rate of decline stood at 7.6% – less than half the contraction of 18.1% recorded in the second quarter of 2024.[7]

In the manufacturing sector, the strongest increase in output was reported by firms classified under 'other manufacturing' – which includes firms that produce medical and dental instruments. Production also increased significantly among firms that manufacture certain types of machinery and equipment. Other strong increases were also recorded among firms involved in the manufacture of wood and products, motor vehicles, trailers and semi-trailers as well as furniture. Double digit growth rates were recorded in these sectors. Meanwhile, smaller increases were recorded among firms involved in the production of electrical equipment, rubber and plastic products, fabricated metal products as well as food and beverages.

During the quarter under review output fell markedly among firms involved in the production of wearing apparel, printing and reproduction of recorded media, chemicals and chemical products as well as computer, electronic and optical products. Smaller declines were recorded in other selected sectors including textiles and basic pharmaceutical products.

Business and consumer surveys

During the third quarter of 2024, the European Commission's ESI for Malta decreased to 93.8, from 97.0 in the preceding quarter, thus falling further below its long-term average of around 100.0. Furthermore, the overall indicator stood below that in the euro area, which averaged 96.2 (see Chart 2.5).[8,9]

[6] Methodological differences may account for divergences between developments in GVA in the manufacturing sector and industrial production. GVA nets input costs from output to arrive at value added and is expressed in nominal terms. Industrial production is a measure of the volume of output and takes no account of input costs. The sectoral coverage between the two measures also differs since industrial production data also include the output of the energy and quarrying sectors.

[7] Industrial production in the energy sector excludes energy generated abroad and imported through the interconnector.

[8] The ESI summarises developments in confidence in five surveyed sectors: industry; services; construction; retail; and consumers. Quarterly data are three-month averages.

[9] Long-term averages are calculated over the entire period for which data are available. For the consumer and industrial confidence indicators, data for Malta became available in November 2002, while for services and construction data became available in May 2007 and May 2008, respectively. The long-term average of the retail confidence indicator is calculated as from May 2011, when it was first published. The long-term average of the ESI is computed from November 2002.

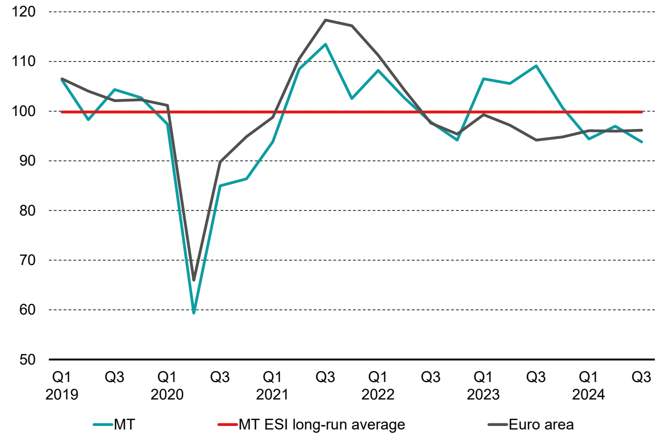
When compared with the second quarter of 2024, confidence deteriorated in the retail sector and to a lesser extent in the construction sector and in industry. By contrast, it improved slightly in the services sector and among consumers.

When accounting for the weights assigned to each sector, and the time variation of the confidence indicator for each sector, the decrease in the ESI relative to the second quarter of 2024 was mainly driven by industry.[10] This sector largely also explains why the overall ESI stood below the long-term average (see Chart 2.6).

Sentiment among retailers declined and fell below its long-term average[11]

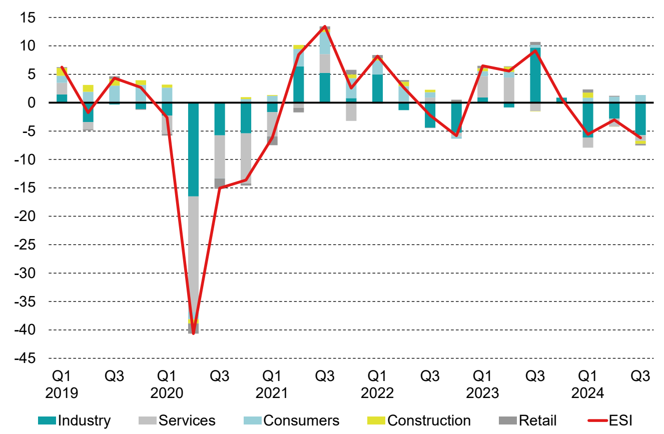
The indicator of sentiment in the retail sector stood at -9.9 in the third quarter of 2024, down from 3.6 in the previous quarter, and fell below its long-term average of 0.3. All components of the indicator contributed to the latest decrease in sentiment. However, the recent fall in sentiment was largely driven by a significant deterioration in the assessment of business activity over the previous three months, which fell significantly into negative territory and, to a lesser extent, by the near-term business outlook (though remaining slightly positive) (see Chart 2.7).

Chart 2.5
ESI
(seasonally adjusted; percentage points)



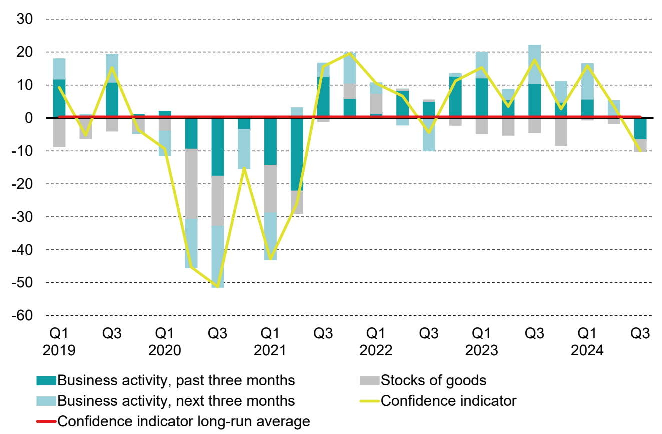
Source: European Commission.

Chart 2.6
ESI
(seasonally adjusted; demeaned)



Sources: European Commission; Central Bank of Malta workings.

Chart 2.7
RETAIL CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

---

[10] Weights are assigned as follows: industry 40%; services 30%; consumers 20%; construction 5%; and retail trade 5%.

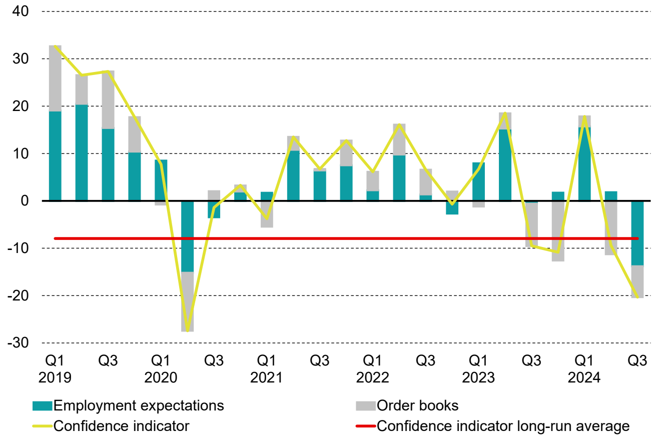
[11] The retail confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to survey questions relating to the present and future business situation and stock levels.

Confidence in the construction sector weakens[12]

In the third quarter of 2024, the indicator measuring confidence in the construction sector fell further below its long-term average of -7.9. It averaged -20.3, down from -9.4 in the previous three-month period (see Chart 2.8).

Contrary to the second quarter of 2024, employment expectations fell into negative territory.

Chart 2.8
CONSTRUCTION CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)

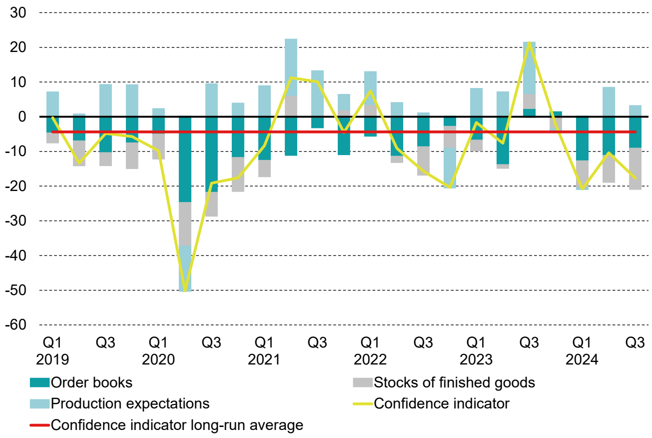


Source: European Commission.

Industrial confidence remains below its long-term average[13]

The industrial confidence indicator decreased to -17.7, from an average of -10.4 in the previous three-month period and remained well below its long-term average of -4.4 (see Chart 2.9). This mainly reflected a deterioration in production expectations for the months ahead (though these remained positive).

Chart 2.9
INDUSTRIAL CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

Confidence in the services sector improves[14]

The confidence indicator in the services sector increased to 15.3, from 14.9 in the previous quarter. Nevertheless, sentiment in this sector remained below its long-term average of 19.4

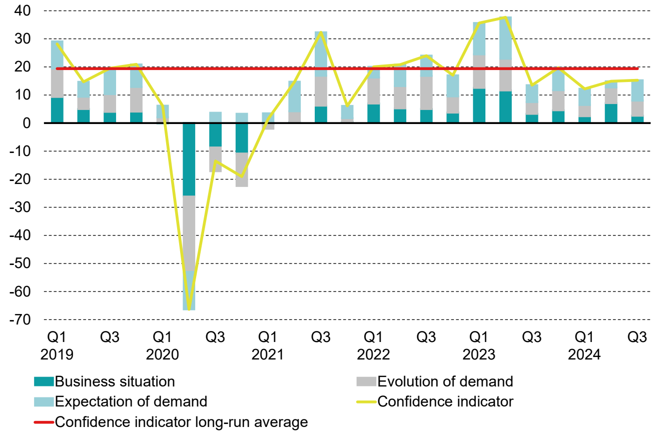
[12] The construction confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to two survey questions, namely those relating to order books and to employment expectations over the subsequent three months.

[13] The industrial confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to a subset of survey questions relating to expectations about production over the subsequent three months, to current levels of order books and to stocks of finished goods.

[14] The services confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to survey questions relating to the business climate, the evolution of demand in the previous three months, and demand expectations in the subsequent three months.

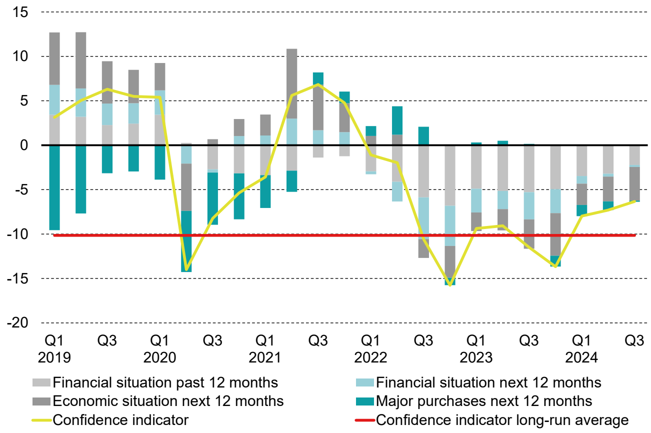
(see Chart 2.10). The latest improvement was largely driven by firms' expectations of demand for the next three months.

Chart 2.10
SERVICES CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

Chart 2.11
CONSUMER CONFIDENCE INDICATOR
(seasonally adjusted; percentage points)



Source: European Commission.

Consumer confidence improves but remains negative[15]

The consumer confidence indicator averaged -6.3 during the third quarter of 2024, above the -7.3 recorded in the previous quarter, and its long-run average of -10.1 (see Chart 2.11). The improvement in consumer sentiment mainly reflected a less negative assessment of their finances and less negative expectations of major purchases.

Employment Expectations Indicator (EEI) increases above its long-run average

The EEI – which is a composite indicator of employment expectations in industry, services, retail trade and construction – increased in the third quarter of 2024. During the third quarter of 2024, it averaged 100.9, above 96.0 in the preceding quarter, and marginally above its long-term average of around 100.0. The index also stood above the euro area average of 98.8.[16]

During the quarter under review, employment expectations were positive across all productive sectors, except in the construction sector and in industry. The most positive reading was recorded in the services sector.

[15] The consumer confidence indicator is the arithmetic average of the seasonally adjusted balances (in percentage points) of replies to a subset of survey questions relating to households' assessment and expectations of their financial situation, their expectations about the general economic situation, and their intention to make major purchases over the subsequent 12 months. The computation of this indicator was changed as reflected in the January 2019 release of the European Commission.

[16] The EEI is based on question 7 of the industry survey, question 5 of the services and retail trade surveys and question 4 of the construction survey, which gauge the respondent firms' expectations as regards changes in their total employment over the next three months. Before being summarised in one composite indicator, each balance series is weighted on the basis of the respective sector's importance in overall employment. The weights are applied to the four-balance series expressed in standardised form. Further information on the compilation of the EEI is available in European Commission (2020). *The Joint Harmonised EU Programme of Business and Consumer Surveys User Guide.*

Demeaned data suggest that the increase relative to the preceding quarter was mostly driven by the services sector (see Chart 2.12). This sector largely explains why the overall EEI stood above its long-term average.

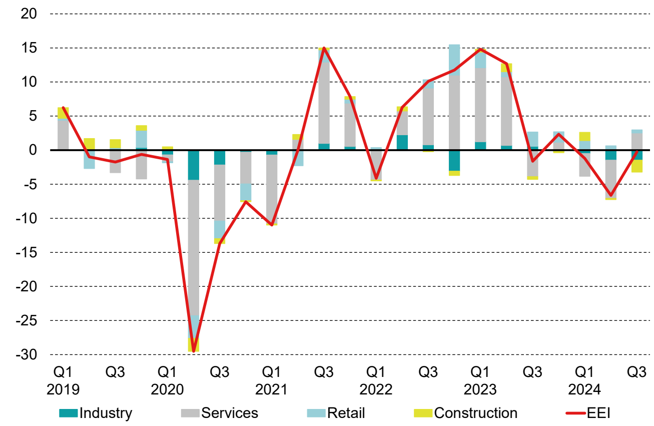
Economic Uncertainty Indicator (EUI) increases

The European Commission's EUI is a composite indicator which measures how difficult it is for sectors to make predictions about their future financial or business situation. In Malta, this indicator increased to 14.6 in the third quarter of the year, from 9.1 in the preceding quarter (see Chart 2.13). The indicator however remained below that in the euro area, which averaged 17.7.[17,18]

Higher uncertainty was recorded across all surveyed sectors, although the strongest increases were recorded in the services and construction sectors.

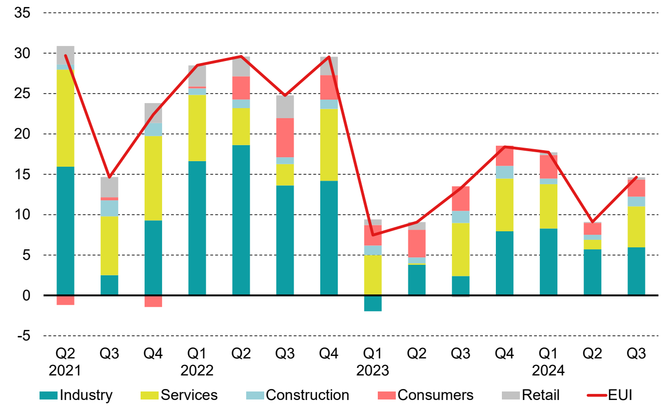
When considering each sector's weight and past volatility, industry and the services sector had the highest contributions to uncertainty during the quarter under review.

Chart 2.12
EEI
(seasonally adjusted; demeaned)



Sources: European Commission; Central Bank of Malta workings.

Chart 2.13
EUI[(1)]
(not seasonally adjusted)



Sources: European Commission; Central Bank of Malta.
(1) Data for Malta is available from May 2021.

17 The EUI is made up of five balances (in percentage points) which summarise managers'/consumers' answers to a question asking them to indicate how difficult it is to make predictions about their future business/financial situation. The series are not seasonally adjusted. The five-balance series are summarised in one composite indicator using the same weights used to construct the ESI. The questions asked correspond to Q51 of the industry survey, Q31 of the services survey, Q41 of the retail trade and construction surveys and Q21 of the consumer survey.

18 Data on consumer uncertainty became available in October 2020, while data for industry, services, retail, and construction became available in May 2021.

The labour market[19]

Labour force and activity rate increases at a slower pace

Labour Force Survey (LFS) data show that in the third quarter of 2024, the labour force grew by 13,701 persons, or 4.3% on an annual basis, slower than the 5.6% increase recorded in the previous quarter (see Table 2.4).[20]

The activity rate stood at 82.9% in the quarter under review, higher than the 81.8% recorded a year earlier.[21] This was due to increases in both the female participation rate, and that of males, although the increase in the former was more significant. While the male participation rate increased by 0.3 percentage points to 88.9%, that of females increased by 1.9 percentage points to 75.5%. Both rates exceeded the corresponding rates for the euro area.

Employment increases at a slower pace

Employment rose by 5.0% in annual terms, following a rise of 6.2% in the previous quarter. The increase in absolute terms was driven by full-time employment, as this rose by 15,810 persons, or 5.8% on a year earlier. This increase mainly stemmed from the sectors comprising construction, human health, financial and insurance activities and education.

Table 2.4
LABOUR MARKET INDICATORS BASED ON THE LFS
Persons; annual percentage changes

	2023 Q3	2024 Q3	Annual change %
Labour force	**319,727**	**333,428**	**4.3**
Employed	307,937	323,207	5.0
By type of employment:			
Full-time	270,997	286,807	5.8
Part-time	36,940	36,400	-1.5
Unemployed	11,790	10,221	-13.3
Activity rate (%)	**81.8**	**82.9**	
Male	88.6	88.9	
Female	73.6	75.5	
Employment rate (%)	**78.7**	**80.3**	
Male	85.1	86.0	
Female	71.0	73.2	
Unemployment rate (%)	**3.7**	**3.1**	
Actual hours worked (per week)	**32.1**	**33.9**	

Source: NSO.

[19] This section draws mainly on labour market statistics from two sources: the LFS, which is a household survey conducted by the NSO based on definitions set by the International Labour Organization (ILO) and Eurostat; and administrative records compiled by Jobsplus according to definitions established by domestic legislation on employment and social security benefits.

[20] The LFS defines the labour force as all persons aged 15 and over who are active in the labour market. This includes those in employment, whether full-time or part-time, and the unemployed, defined as those persons without work but who were actively seeking a job during the previous four weeks and available for work within two weeks of the reference period.

[21] The activity rate measures the number of persons in the labour force aged between 15 and 64 as a proportion of the working age population, which is defined as all those aged 15 to 64 years.

The number of persons in part-time jobs – which also includes those employed full-time on reduced hours – declined by 540, or 1.5% in annual terms. This decrease was mostly driven by the sector comprising administrative and support service activities, the education and health sectors, and accommodation and food service activities.

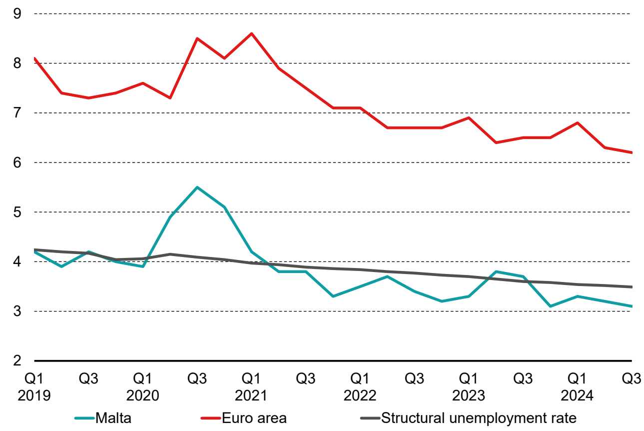
In the third quarter of 2024, the overall employment rate reached 80.3%, 1.6 percentage points higher than the rate prevailing during the same period of 2023.[22] Both the female and male employment rate increased in annual terms. However, the female rate recorded a more significant increase. The female employment rate rose by 2.2 percentage points to 73.2%, while that of males rose by 0.9 percentage points to 86.0%. These increases were driven by those over 24 years, as the employment rate for the 15-24 age bracket decreased among both males and females.

During the quarter under review, average weekly hours worked derived from the LFS increased to 33.9, from 32.1 a year earlier (see Table 2.4).[23] This increase was reported by both full-time and part-time employees.

The unemployment rate declines further

The unemployment rate based on the LFS fell to 3.1%, from 3.7% a year earlier (see Table 2.4). This reflects continued strong demand for labour.[24] Labour market conditions remained more favourable than those in the euro area, where the unemployment rate on average stood at 6.2% (see Chart 2.14).

Chart 2.14
UNEMPLOYMENT RATE
(per cent)



Sources: Eurostat; NSO; Central Bank of Malta.

During the quarter under review, the unemployment rate also stood below the Bank's structural measure of 3.5%.[25] This indicates a degree of labour market tightness, which is also confirmed by the Bank's Business Dialogue publication and other indicators (see below).

Jobsplus data show that the number of persons on the unemployment register decreased on a quarterly basis but increased in annual terms.

[22] The employment rate measures the number of persons aged between 15 and 64 employed on a full-time or part-time basis as a proportion of the working-age population.

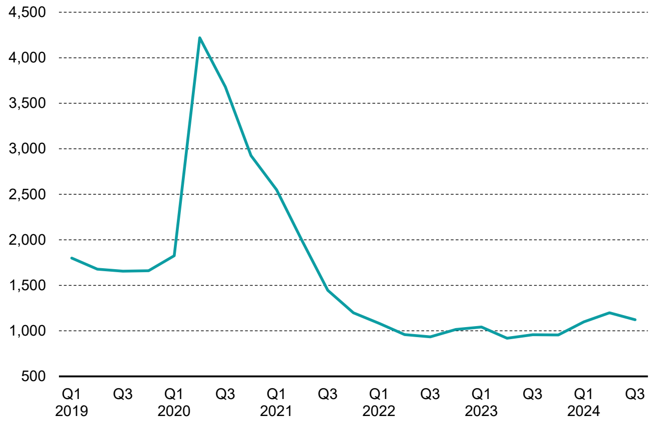
[23] Actual hours refer to the number of hours actually spent at the place of work during the reference week for LFS. A person may work extra hours (e.g. overtime, variable hours) or work less hours than usual (e.g. vacation leave, education, sick leave or slack work) due to various reasons. Owing to increased flexibility at workplaces coupled with technology, the place of work may also include one's home. In this regard, actual hours worked also include the hours of work conducted by persons who telework.

[24] According to the LFS, the unemployed comprise persons aged between 15 and 74 years who are without work, available for work and who have actively sought work during the four weeks preceding the Survey. In contrast, the number of unemployed on the basis of the Jobsplus definition includes only those persons registering for work under Part 1 and Part 2 of the unemployment register.

[25] The structural unemployment rate in this chapter refers to the non-accelerating inflation rate of unemployment (NAIRU), that is, the unemployment rate that is consistent with stable inflation. This measure of the unemployment rate is based on an unobserved components model (UCMPF). For further details, see Borg, I. (2023), "Box 1: Latest Estimates of the NAIRU" *Outlook for the Maltese Economy* 2023:1, pp. 7-9 and Ellul, R. (2019), "Box 1: An Unobserved Components Model for potential output in Malta" *Quarterly Review* 2019:2, pp. 17-21.

During the third quarter of 2024, the average number of persons on the unemployment register stood at 1,123, compared with 1,198 in the second quarter of 2024 and with 957 a year earlier (see Chart 2.15).

Chart 2.15
REGISTERED UNEMPLOYED
(number of persons)

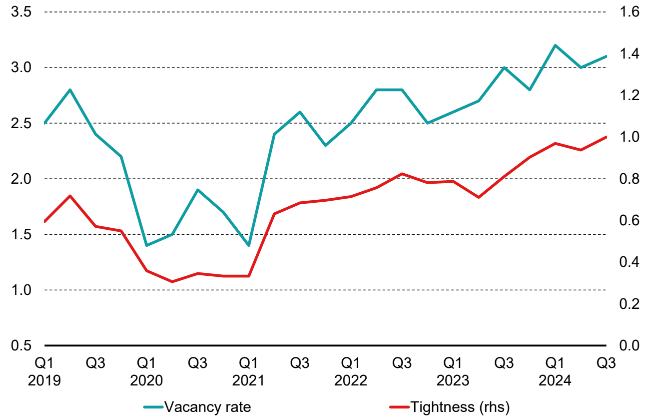


Source: NSO.

The vacancy rate increased slightly

In absolute terms the number of vacancies increased from 8,013 in the third quarter of 2023 to 8,579 in the same quarter of 2024, that is, a 7.1% increase. The sector comprising professional, scientific and technical activities accounted for around 60% of this increase.

Chart 2.16
VACANCY RATE AND LABOUR MARKET TIGHTNESS INDICATOR
(per cent)



Sources: Eurostat; NSO; Central Bank of Malta.

Eurostat's job vacancy rate for industry, construction and services also increased over this period, reaching 3.1% from 3.0% a year earlier (see Chart 2.16).[26] The highest vacancy rates were recorded in the mining and quarrying sector (6.2%), in the information and communication sector (5.5%), and in the arts and entertainment sector (4.8%).

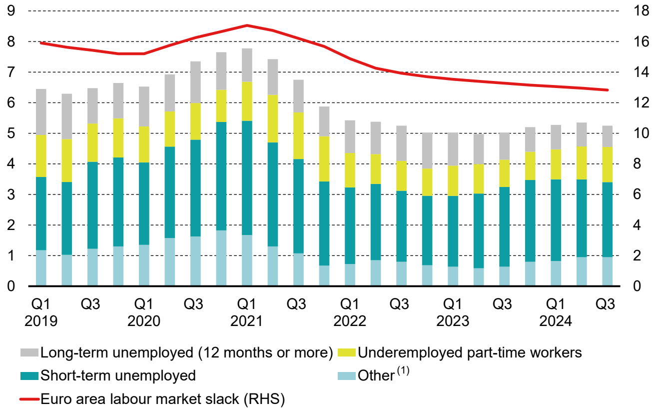
The ratio of the job vacancy rate to the unemployment rate is an indicator of the imbalance between labour demand and supply and, therefore, of labour tightness. During the quarter under review, this ratio stood at 1.0, higher than in the previous quarter, and above the ratio of 0.8 recorded a year earlier. Market conditions thus remained very tight compared to recent outturns. This contrasts with the euro area average, where the tightness indicator declined to 0.4. Labour market conditions in the euro area continue to be significantly less tight compared to those in Malta.

To measure better labour market slack (unemployed and underutilised labour), one can consider an extended labour force definition, which in addition to the unemployed, also includes persons available to take up work but not seeking it, persons seeking work but not immediately available, and underemployed part-time workers. By this measure, on a four-quarter moving average basis, labour market slack was equivalent to 5.3% of the extended labour force in the third quarter of

[26] The job vacancy rate measures the number of job vacancies as a percentage of total jobs (occupied and vacant). Data for Malta are available since 2017.

the year (see Chart 2.17).[27] This rate appears to have stabilised in recent quarters, to a level which is well below its average of around 8.0% estimated since 2010. It is also significantly lower than the rate of 12.8% recorded for the euro area over the four quarters to September 2024.

Chart 2.17
LABOUR MARKET SLACK
(percentage of extended labour force; four-quarter moving average)



Sources: ECB-SDW; Eurostat; Central Bank of Malta's estimates.
(1) Persons seeking work, but not immediately available and Persons available to take up work but not seeking.

The gap between the broader measure of labour market slack and the unemployment rate declined considerably since its recent peak in early 2021, indicating a reduction in the share of underutilised labour. However, this decline was somewhat interrupted in recent quarters as the gap registered a slight uptick since the last quarter of 2023.

During the four quarters ending in September, 60% of the labour market slack stemmed from unemployment (primarily from short-term unemployment). The remaining part of slack was broadly equally distributed across underemployed part-time workers, i.e., those working part-time but willing and able to work additional hours, and the 'other' component in Chart 2.17.

[27] For further details on the methodology underlying the measure of labour market slack, see Ellul, R. (2019). "Labour Market Slack," *Quarterly Review* 2019:1, pp. 37-41, Central Bank of Malta. Given that this methodology partly relies on internal estimation, the slack indicator reported in this *Review* may differ slightly from that published by Eurostat.

BOX 1: THE EVOLUTION OF THE LABOUR INCOME SHARE IN MALTA[1]

Typically defined as the proportion of GVA paid to workers, the long-run stability of the labour share of income was for many years accepted as a ‘stylised fact’ in macroeconomic theory.[2,3] However, a multitude of empirical evidence has since documented widespread declines in the labour share of numerous advanced countries over more recent years.[4] From an accounting point of view, a persistent fall in labour shares reflects overall wage growth not keeping up with the growth in labour productivity. Evidence of such declining trends in labour shares suggests that the historical consensus around may no longer hold and has further fuelled research interest in cross-country developments in the labour share of income.

While arguably rather straightforward to conceptualise, persistent issues surround the measurement of the labour income share. In its most basic form, it can be represented by the share of employees’ compensation – comprising wages, salaries and social contributions paid by employers – in the country’s GVA measured at basic prices. However, this measurement does not account for the labour income of the self-employed, and despite being a good indication of the employees’ share of national income, the resulting estimates are implicitly a lower bound of the share of national income attributed to all people in employment. In light of the difficulty to extract the *labour* income (as opposed to other forms of income such as return to capital employed that also accrues as self-employed income) of the self-employed from published data, a number of possible adjustments have been put forward as a proxy in related literature. These typically rely on the use of national accounts data on ‘mixed income’, or adjustments based on the workforce composition, with both strategies suffering from their own respective limitations.

Notwithstanding these measurement issues, continuous analyses of developments in the labour share of income remain crucial in view of the potential repercussions on consumption expenditure, investment, and aggregate demand, among others.[5] For example, depending on the marginal propensity of consumption, a higher labour share might stimulate domestic demand and consumption, with potential implications for inflation. In light of these economic implications, this article sets out to examine developments in Malta’s aggregate labour share in recent years. This analysis is further complemented by an in-depth study of sectoral developments in the labour share, particularly in view of Malta’s continued transition towards a more services-oriented economy over the recent decades.

---

1 Prepared by Nathaniel Debono, a Senior Research Economist within the Modelling Office of the Central Bank of Malta. Helpful comments by Mr Alexander Demarco, Dr Aaron G. Grech, Mr Noel Rapa and Mr Owen Grech are gratefully acknowledged. The views expressed in this article are the author’s own and do not necessarily reflect those of the Central Bank of Malta.

2 GVA is the sum of *compensation of employees* (including the employers’ social security contributions) and *gross operating surplus and mixed income*.

3 Kaldor, N. (1961). “Chapter 10: Capital Accumulation and Economic Growth”, In Lutz, Friedrich; Hague, Douglas (eds.). Capital Accumulation and Economic Growth, pp. 177-222.

4 See for example Estrada, A. and Valdeolivas, E. (2012). “The fall of the labour income share in advanced economies”, *Banco de Espana Occasional Paper* No. 1209, and Dao, M. C., Das, M., Koczan, Z., and Lian, W. (2017). “Why is Labor Receiving a Smaller Share of Global Income? Theory and Empirical Evidence”, *IMF Working Paper* WP/17/169.

5 Archanskaia, E., Meyermans, E., and Vandeplas, E. (2019). “The labour income share in the euro area”, *Quarterly Report on the Euro Area (QREA)*, Directorate General Economic and Financial Affairs (DG ECFIN), European Commission, vol. 17(4), pp. 41-57, March.

The aggregate labour share of income in Malta

Given the continuous debate surrounding the measurement of the labour income share, the following analysis of the aggregate labour income share in Malta centres around two methods. The most straightforward methodology adopted yields what is commonly termed the '*unadjusted labour share*' (or '*wage share*'). Denoted by LS_t^u and shown in equation (1), this is given by the share of employees' compensation (CE_t) in GVA measured at basic prices:

$$LS_t^u = \frac{\mathrm{CE_t}}{\mathrm{GVA_t}} \quad (1)$$

As this measure does not consider the income earned by the self-employed, '*adjusted labour share*' estimates are derived by assuming that, on average, the self-employed earn the same average wage as employees. This assumption is commonly adopted both in similar studies and in the construction of labour share estimates by other institutions.[6] The calculation of these estimates, denoted by LS_t^{adj}, is shown in equation (2), where TE_t represents the hours worked by those in employment (including self-employed) and E_t represents the number of hours worked by employees.[7,8]

$$LS_t^{adj} = \frac{\mathrm{CE_t}}{\mathrm{GVA_t}} * \frac{\mathrm{TE_t}}{\mathrm{E_t}} \quad (2)$$

Chart 1 shows the evolution of the aggregate labour share of income in Malta between 1995 and 2023. By definition, *unadjusted* labour share estimates are consistently smaller than those which adjust for self-employed income. Having said that, the two indicators follow very similar trends, even if the underlying gap between the two has somewhat narrowed over time. These dynamics reflect the marginal decline in the share of hours worked by the self-employed in Malta's labour input, from 18.8% in 1995 to 16.6% in 2023.

Chart 1
THE AGGREGATE LABOUR SHARE OF INCOME IN MALTA
(per cent)

Source: Author's calculations using national accounts data from Eurostat.
Note: Qualitatively similar results are obtained if such calculations are based on the number of *persons* in employment. Dotted lines represent the linear trend of each indicator of the labour share.

[6] For example, the European Commission's AMECO database calculates an *adjusted* wage share based on this method, assuming that the self-employed in the economy earn the same average compensation as employees.

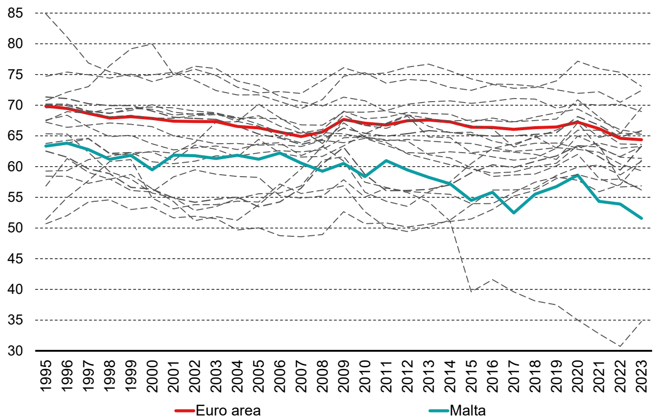
[7] A separate *adjusted* labour share is calculated considering total employment and total employees in terms of the *number of persons*, rather than *hours worked*. This yields slightly smaller but qualitatively similar labour share estimates to those based on the number of *hours worked*.

[8] A separate *adjusted* labour share is also derived assuming that the self-employed earn the same compensation as the employees working in the sector, rather than the economy-wide compensation. This approach yields very similar results to those constructed following equation (2).

Notwithstanding some volatility, the recent developments in Malta's labour income share can be dissected into a number of episodes characterised by particular trends. In the early part of the period considered, both methodologies show a downward trend, with the *adjusted* labour share dipping below 60% in the year 2000. The labour share remained broadly constant above 60% for a number of years thereafter, before declining again in the years leading to 2010. A particularly pronounced and (relatively) lengthy decline was observed between 2011 and 2015, at which point the *adjusted* labour share of income stood at 8.9 percentage points lower than the corresponding 1995 value.[9] A partial reversal of the downward trend in the labour income share was recorded during the years 2018-2020, before declining again in the following three years, according to the latest data available. Labour share movements around the year 2020 are influenced by labour market developments during the COVID-19 pandemic, when employment and work compensation in Malta were well-insulated by the timely implementation of job-retention schemes. These dynamics helped drive the labour share upwards in 2020, which was then reversed during the ensuing economic recovery as such schemes were gradually phased out.

Chart 2 compares the labour income share in Malta to that in the rest of the euro area (EA) between 1995 and 2023. This analysis shows that Malta's labour income share has been consistently lower than the average recorded in the EA, which has hovered between 65% and 70%, and this discrepancy has widened further since the decade starting in 2010. In more recent years, Malta's labour share has been among the lowest in the EA bloc.[10] The results for the EA presented in Chart 2 also show substantial cross-country heterogeneities in the evolution of the labour share in the EA but are overall indicative of declining labour shares in the long run. In fact, labour shares in 2023 were lower than their corresponding 1995 estimates in 15 of the 20 EA member states, including Malta, and also on average in the EA.

Chart 2
THE (ADJUSTED) LABOUR INCOME SHARE IN THE EURO AREA
(per cent)



Source: Author's calculations using national accounts data from Eurostat.
Notes: Dashed lines represent country-specific (*adjusted*) labour share estimates in the EA.

[9] The corresponding difference in the *unadjusted* labour share between 1995 and 2015 values stood at 6.1 percentage points.

[10] Qualitatively similar results are obtained when analyses are based on *unadjusted* labour income share estimates.

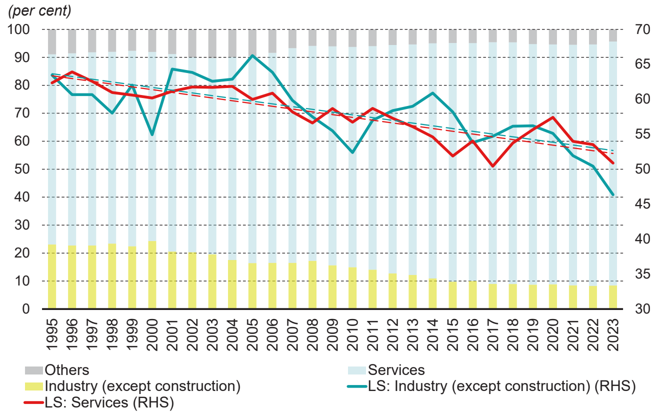
Sectoral developments in Malta’s labour income share

Movements in the aggregate labour share of income mask potentially important heterogeneities in labour shares at the sectoral level. In particular, changes in the aggregate labour share could reflect developments both *within* and *across* sectors. For instance, a decline in the labour share in all economic sectors drives the aggregate labour share down, *ceteris paribus*. However, declines in the economy-wide labour share do not necessarily imply a drop in the remuneration of those in employment but may simply reflect changes in the sectoral composition of the economy. For example, even if within-sector labour shares remain constant, the aggregate labour share will invariably decline as an economy transitions from high-labour-share industries to sectors with relatively low labour shares. In this light, and in view of the Maltese economy’s continued transition to a more services-oriented economy in recent decades, this section delves into the sectoral developments of Malta’s labour share.

Chart 3 shows the *adjusted* labour share of income within the Maltese *industry* (NACEs B-E) and *services* (NACEs G-U) sectors, which together have been responsible for more than 90% of the GVA generated in Malta since 1995. In both (broad) economic sectors, the share of GVA attributed to labour has been on a long-term decline. Indeed, the labour share in *industry* declined by 17 percentage points between 1995 and 2023, while that in *services* declined by more than 11 percentage points over the same period. Among the most notable developments, periods of sustained drops in the *industry’s* labour share are observed between 2005 and 2010 and again in the years following 2014, with a partial upturn being recorded in between. In more recent years, the *industry’s* labour share has again been on the decline since 2020. The overall labour share in the *services* sectors has also followed a generally downward trend since 1995 but has been somewhat less volatile. Indeed, the only partial prolonged increase in this sector’s labour share was recorded between 2018 and 2020, following which this declined again to around 51% by 2023.

While the evolution of the labour share in Maltese *industry* largely reflects developments in the manufacturing sector, that in the *services* economy is characterised by significant heterogeneity in the

Chart 3
SECTORAL DEVELOPMENTS IN MALTA'S LABOUR INCOME SHARE
(per cent)



Source: Author's calculations using national accounts data from Eurostat.
Note: Columns represent the respective sectors' contribution to aggregate GVA (thus summing to 100%), while the line charts represent the *adjusted* labour share in the *Industry* (NACEs B-E) and *Services* (NACEs G-U) sectors. The *Others* sector captures the *Agriculture* and *Construction* sectors.

services sub-sector labour intensities. In this light, Charts 4a-4f illustrate the respective labour shares calculated for six *services* sub-sectors, which together account for 92% of the total GVA generated by the *services* economy in Malta between 1995 and 2023.[11] Large sectoral disparities are noted, with some sectors' labour share typically recorded at around 40%-60%

Chart 4a
THE LABOUR INCOME SHARE – WHOLESALE AND RETAIL TRADE, TRANSPORT, ACCOMMODATION AND FOOD SERVICE ACTIVITIES
(per cent)

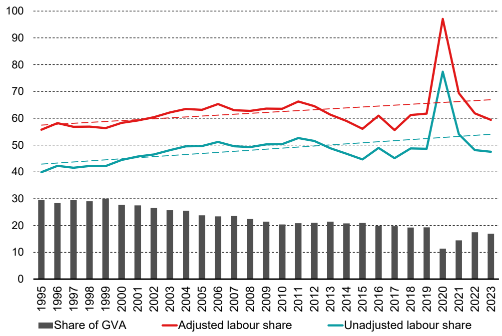


Chart 4b
THE LABOUR INCOME SHARE – INFORMATION AND COMMUNICATION
(per cent)

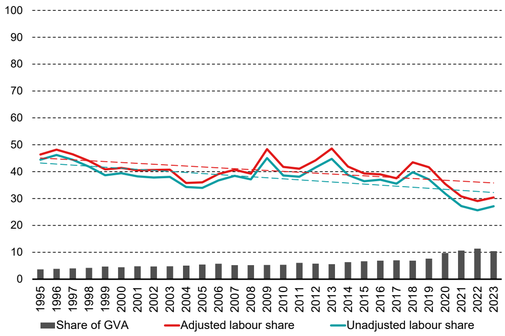


Chart 4c
THE LABOUR INCOME SHARE – FINANCIAL AND INSURANCE ACTIVITIES
(per cent)

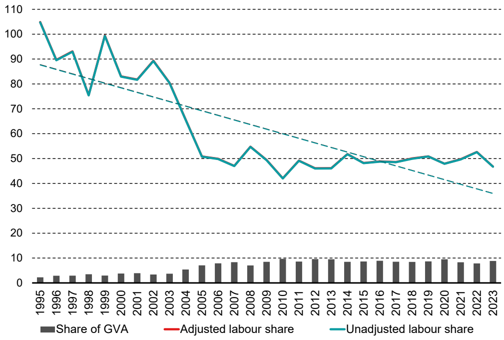


Chart 4d
THE LABOUR INCOME SHARE – PROFESSIONAL, SCIENTIFIC AND TECHNICAL ACTIVITIES; ADMINISTRATIVE AND SUPPORT SERVICE ACTIVITIES
(per cent)

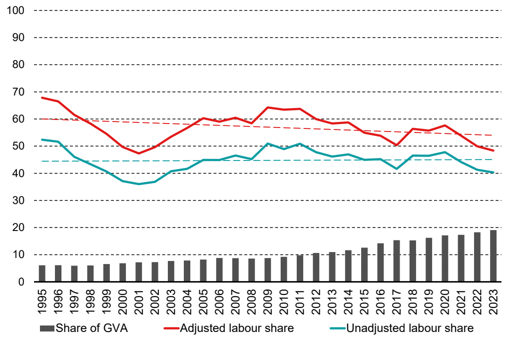


Chart 4e
THE LABOUR INCOME SHARE – PUBLIC ADMINISTRATION, DEFENCE, EDUCATION, HUMAN HEALTH AND SOCIAL WORK ACTIVITIES
(per cent)

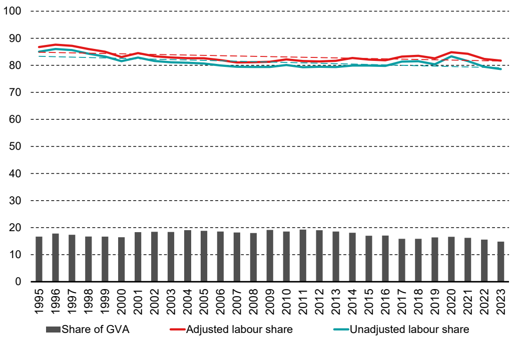
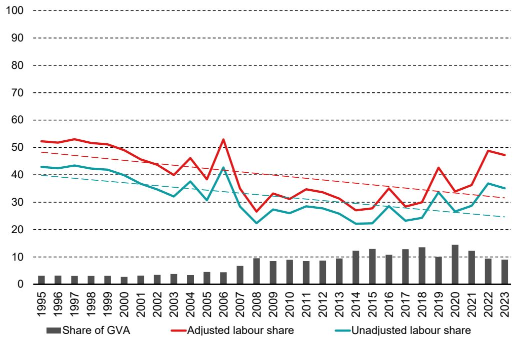


Chart 4f
THE LABOUR INCOME SHARE – ARTS, ENTERTAINMENT AND RECREATION; OTHER SERVICE ACTIVITIES
(per cent)



Source: Author's calculations using national accounts data from Eurostat.
Note: In each chart, columns represent the respective sector's contribution to aggregate GVA, while the line charts represent the adjusted and unadjusted labour share of the respective sector, calculated in line with equations (1) and (2) in the text. The adjusted and unadjusted labour share estimates for the Financial and Insurance activities are broadly identical due to the relative lack of self-employed workers in this sector.

[11] In the *Real estate activities* sector, which contributes to less than 10% of total economy GVA and is not shown for brevity, labour share estimates have hovered below 10% throughout the sample.

(e.g. *Information and communication* and *Professional, scientific and technical activities; administrative and support service activities*), while in *Public administration, defence, education, human health, and social work activities*, more than 80% of the GVA generated is typically attributed to labour income.[12]

Charts 4a-4f also uncover sectoral heterogeneities in the evolution of the respective sectors' labour share over time. For instance, falling labour shares are recorded in sectors which have gained added economic importance in recent years, namely the *Information and Communication* (see Chart 4b) and the *Arts, entertainment and recreation and other services activities* (see Chart 4f), although the downward trend in the latter sector has started to reverse in more recent years. Drops in the share of labour income from 1995 levels are also recorded in the *Financial and insurance activities* sector (see Chart 4c), although this is largely driven by a pronounced fall in the first part of the sample, following which this sector's labour share stabilised at around 50%. In contrast, the *Wholesale and retail trade, transport, accommodation, and food service activities* sector saw its labour share rise somewhat since 1995, at a time when its contribution to the aggregate GVA declined from 30% in 1995 to 17% in 2023.[13] Other sectors, namely the *Professional, scientific and technical activities; administrative and support service activities* (see Chart 4d), and the *Public administration, defence, education, human health, and social work activities* (see Chart 4e) have been marked by a general stability in their labour share in the long run.

Shift-share decomposition of labour income share developments in Malta

In this section, a shift-share analysis is performed to formally disentangle movements in Malta's labour income share estimates over the period 1995-2023 into "*within-sector*" effects, i.e. changes in the labour share driven solely by changes in sector-specific labour shares, and "*between-sector*" effects, i.e. changes in the labour share solely due to changes in the economy's sectoral composition. Starting from the original expression to calculate the *adjusted* economy-wide labour share:

$$LS_t^{adj} = \sum_i \omega_t^i \cdot als_t^i \qquad (3)$$

Where ω_t^i is the share of sector i in the total economy GVA in period t and als_t^i is the *adjusted* labour share of sector i in period t, calculated as $\frac{\mathrm{CE_t^i}}{\mathrm{GVA_t^i}} * \frac{\mathrm{TE_t^i}}{\mathrm{E_t^i}}$. Then, the change in the aggregate labour share between 1995 and 2023 can be decomposed as follows:

$$LS_{2023}^{adj} - LS_{1995}^{adj} = \left\{\sum_i \omega_{1995}^i \cdot \Delta als_{2023}^i\right\} + \left\{\sum_i als_{1995}^i \cdot \Delta\omega_{2023}^i\right\} + \left\{\sum_i \Delta\omega_{2023}^i \cdot \Delta als_{2023}^i\right\} \quad (4)$$

Where Δk represents the change in the value of k between the years 1995 and 2023, in general. Expressed in this way, the first term represents the "*within*" effect, capturing the changes in the overall labour share that are strictly due to changes in sector-specific labour

12 The relatively high labour income share in these sectors reflects the fact that *Public administration* activities are typically not for profit. Thus their 'profit' component is typically very low, as it largely reflects private sector activity, such as in education and health activities.

13 The spike in this sector's labour share in 2020 is largely due to events related to the COVID-19 pandemic. The restrictions put in place at the time led to lower sectoral activity (as manifested by a drop in this sector's GVA), but the job-retention schemes in place helped preserve employees' compensation, implicitly leading to an increase in this sector's labour share during the year.

shares over time. The second term is the "*between*" effect, quantifying the change in aggregate labour share purely due to shifts in the economy's sectoral structure. The third term is an "*interaction term*", which reflects the extent to which sector-specific labour shares move in the same direction as the GVA share of the respective sector.[14]

Table 1 presents the sector-specific shift-share decomposition of the changes in *adjusted* labour shares in Malta between 1995 and 2023.[15] The labour share in Malta declined by 11.7 percentage points between 1995 and 2023, of which 7.9 percentage points are attributed purely to "*within*" effects. This implies that had the sectoral composition of the Maltese economy remained identical to that of 1995, the overall labour share would have declined by 7.9 percentage points. These "*within*" effects are predominantly driven by the *Industry*

Table 1

SHIFT-SHARE ANALYSIS OF CHANGES IN THE (ADJUSTED) LABOUR SHARE IN MALTA: 1995-2023

Percentage points

	NACE	Within effects	Between effects	Interaction term
B-E	Industry (except Construction)	-4.05	-9.69	2.61
F	Construction	-0.60	-1.21	0.20
G-I	Wholesale and retail trade; repair of motor vehicles and motorcycles; Transportation and storage; Accommodation and food service activities	1.12	-7.42	-0.49
J	Information and communication	-0.60	3.11	-1.07
K	Financial and insurance activities	-1.34	6.86	-3.80
L	Real estate activities	-0.24	0.13	-0.04
M-N	Professional, scientific and technical activities; Administrative and support service activities	-1.22	8.69	-2.49
O-Q	Public administration and defence; compulsory social security; Education; Human health and social work activities	-0.85	-1.96	0.11
R-U	Arts, entertainment and recreation; Other service activities; Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use; Activities of extraterritorial organisations and bodies	-0.16	3.03	-0.29
	Total (*NACE B-U*)	**-7.93**	**1.54**	**-5.27**

Source: Author's calculations using national accounts data from Eurostat.
Notes: The overall economy-wide change in the labour share between 1995 and 2023 can be calculated as the sum of the "*within*" effects, "*between*" effects and the interaction term. The NACE A: 'Agriculture' sector is excluded from the analysis.

[14] For related studies which employ a similar shift-share decomposition, see for example Archanskaia, A., Meyermans, E. and Vandeplas, A. (2019). "The labour income share in the euro area", *Quarterly Report on the Euro Area (QREA)*, Directorate General Economic and Financial Affairs (DG ECFIN), European Commission, 17(4), pp. 41-57.

[15] Qualitatively similar results are obtained when the analysis is based on *unadjusted* labour shares. In this scenario, the "*within*" effect, "*between*" effect and "*interaction term*" are quantified at -6.40 percentage points, 2.08 percentage points, and -5.27 percentage points, respectively.

sector, which was relatively important to the Maltese economy in 1995 and registered pronounced declines in its labour share in the period up to 2023 (see Chart 3). The overall negative "*interaction term*" (-5.3 percentage points) reflects falling labour shares in sectors which gained added importance to Maltese economic activity over time. These sectors are predominantly services-oriented, with the most notable being *Information and communication*, *Financial and insurance activities*, and the *Professional, scientific and technical activities; administrative and support service activities*. In contrast to these two effects, the overall "*between*" effect is positive and markedly smaller. This suggests that, had the sector-specific labour shares remained constant at 1995 levels, the subsequent changes in the structural composition of the Maltese economy would have boosted the overall labour share by 1.5 percentage points between 1995 and 2023. The small positive sectoral composition effect is largely driven by developments in *Financial and insurance activities*, and the *Professional, scientific and technical activities; administrative and support service activities*, which had relatively high labour shares in 1995 and whose share in the economy's GVA increased further in the following years. On the other hand, the falling GVA share of the *Industry* and *Wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities* exert substantial downward pressure on the "*between*" effect.

Concluding remarks

This analysis documents the main developments in the labour share of income in Malta between 1995 and 2023. It uncovers a long-term decline in this share, manifested by drops in the labour share of both the *Industry* and *Services* sectors. Moreover, a shift-share analysis confirms that the overall decline in Malta's labour share over time has predominantly been driven by drops in sector-specific labour shares, further compounded by the fact that such falling labour shares were recorded in sectors which gained added importance to the Maltese economy. In contrast, changes in the sectoral structure of the Maltese economy have been a relatively minor contributor to the developments in Malta's aggregate labour share between 1995 and 2023.

While this study analyses the recent evolution of Malta's labour share, further work is needed to determine the underlying causes behind these developments. Global evidence of falling labour shares has been commonly attributed to a number of factors, including rapid technological advances, increased globalisation, and changes in markets' regulation and structure.[16] Other studies have also found a role for demographic factors, labour market structure and policies, and employees' skill levels, all of which could potentially be important considerations to understand the recent developments of the labour income share in the Maltese context.[17,18] Further research could especially focus on the role of these factors in explaining the sectoral heterogeneities in the level and evolution of the labour share, as documented in this analyses.

[16] See for example Dao, M. C., Das, M., Koczan, Z., and Lian, W. (2017). "Why is Labor Receiving a Smaller Share of Global Income? Theory and Empirical Evidence", *IMF Working Paper* WP/17/169.

[17] d'Albis, H., Boubtane, E., and Coulibaly, D. (2021). "Demographic changes and the labor income share", *European Economic Review*, 131(6): 103614.

[18] Dimova, D. (2019). "The Structural Determinants of the Labor Share in Europe", *IMF Working Paper* WP/19/67.

Determining the reasons behind the declining labour share in Malta is crucial in view of its important policy implications. For instance, if such a decline is driven by productivity-enhancing technological progress, which in turn increases labour incomes, falling labour shares would reflect a positive economic development.[19] In contrast, with capital returns typically being more unevenly distributed than labour income, declines in the labour share of income in favour of a higher capital share may also be indicative of higher income inequality, with potential implications for fiscal policy.[20,21] Moreover, these considerations should be contextualised within existing evidence that higher-skill workers typically enjoy higher labour income shares than workers with relatively lower skills.[22] As such, besides the resulting productivity gains, continuous investment in the skill levels of Malta's workforce could also be a crucial tool to broaden the sharing of productivity gains and enhance workers' welfare.

[19] Bellocchi, A., Marin, G. and Travaglini, G. (2023). "The labor share puzzle: Empirical evidence for European countries", *Economic Modelling*, 124 (2023).
[20] Moreira, S. F. (2022). "Inside the decline of the labor share: Technical change, market power, and structural change", *Journal of Economic Dynamics and Control*, 145(3): 104566.
[21] Atesagaoglu, O. E., Yazici, H. (2021). "Optimal Taxation of Capital in the Presence of Declining Labor Share", *Bristol Economics Discussion Paper* 21/739, School of Economics, University of Bristol, UK.
[22] See footnotes 5 and 17.

3. PRICES, COSTS AND COMPETITIVENESS

Consumer price pressures eased further during the quarter under review. Annual inflation, as measured by the HICP, stood at 2.1% in September, down from 2.2% in June. This was driven by a smaller contribution from processed food and NEIG inflation. Annual inflation based on the RPI – which only considers expenditure by Maltese residents – fell to 1.2% in September, from 1.3% in June.

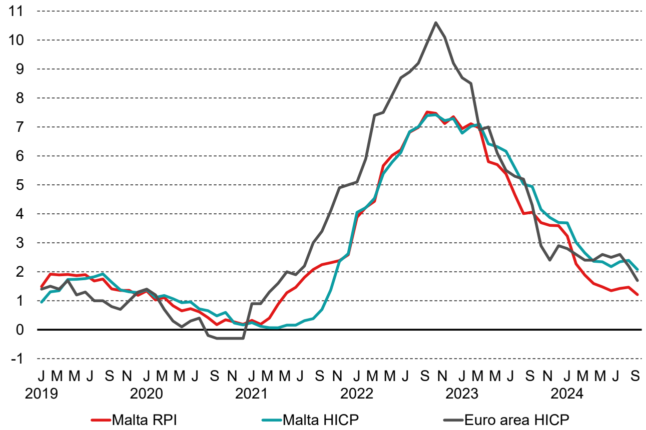
When measured over four quarters, ULCs increased at a faster pace in the third quarter of 2024, with its growth rate reaching 2.3%, from 1.4% in the previous quarter. Meanwhile, annual growth in other input cost indicators regularly monitored by the Bank generally continued to moderate, with the exception of the CCI which recorded a slightly higher year-on-year growth rate than that observed in the second quarter.

Inflation

HICP inflation eases

Annual HICP inflation eased slightly to 2.1% in September, from 2.2% in June (see Table 3.1).[1] Chart 3.1 shows that overall HICP inflation in Malta stood higher than that recorded in the euro area, which ended the quarter at 1.7%. Malta's higher inflation rate in September when compared to that of the euro area reflects a higher contribution from food and energy inflation (see Chart 3.2). In Malta, the latter retained an unchanged contribution, while the contribution of energy inflation turned negative in the euro area. On

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								
	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.
Unprocessed food	4.0	6.7	12.2	13.4	5.2	3.5	4.3	5.2	3.7	5.8	3.9	4.5
Processed food including alcohol and tobacco	8.2	7.3	7.1	7.4	6.1	5.4	4.7	3.9	3.1	3.0	2.8	2.7
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	2.6	2.2	2.2	1.6	1.7	1.2	1.3	0.9	1.1	0.7	0.4	0.2
Services (overall index excluding goods)	4.0	3.9	3.0	3.1	2.8	2.7	2.1	2.4	2.3	2.7	3.2	2.7
All Items HICP	4.2	3.9	3.7	3.7	3.0	2.7	2.4	2.3	2.2	2.3	2.4	2.1

Source: Eurostat.

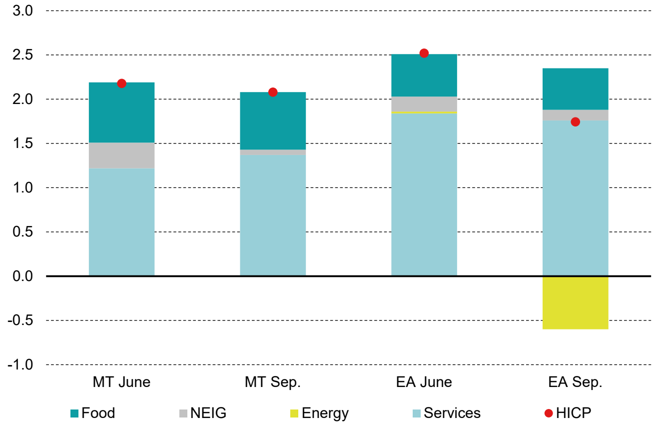
[1] The HICP weights are revised on an annual basis to reflect changes in overall consumption patterns. In 2024, the weight allocated to services stood at 44.7%, while that of NEIG was 27.5%. Food accounted for 21.5% of the index, while the share allocated to energy stood at 6.2%. These were revised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

the other hand, the contribution of services to HICP inflation in September was lower in Malta than in the euro area.

Core inflation, or the annual rate of change of HICP excluding energy and food, stood at 1.9%, and thus well below the 2.7% recorded in the euro area.

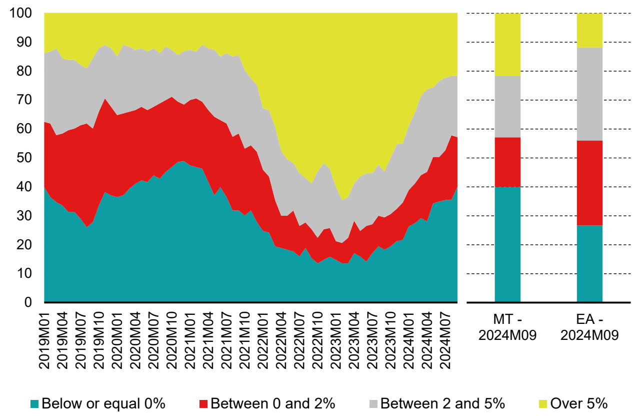
Chart 3.3 shows a distribution of price changes whereby subcomponents of the HICP are categorised into four classes of inflation rates: i) below or equal to 0%; ii) between 0% and 2%; iii) between 2% and 5%; and iv) over 5%.[2] This analysis indicates whether developments in inflation are broad-based across HICP items or driven only by selected components of the consumption basket.

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.

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 1.7 percentage points to reach 21.7%. Likewise, the bracket holding items with inflation between 2% and 5% decreased by 5.1 percentage points since June 2024, to stand at 21.1% in September.

On the other hand, the bracket holding items with negative inflation rates grew by 5.1 percentage points, standing at 40.0%. The increase in this bracket mainly reflects a drop in the prices of a number of household items, including cleaning equipment and small household appliances. Similarly, the bracket holding items with inflation between 0% and 2% increased by 1.7 percentage points, to stand at 17.1% over the same period.

In the euro area, the share of items with price increases exceeding 5% also decreased during the third quarter of 2024. Furthermore, the share of items in this bracket remained significantly lower than that in Malta, with a difference of 9.9 percentage points in September. In part, this reflects

[2] The calculation of the shares in this chart does not take into account the weights of individual HICP sub-components. This analysis includes 175 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, 30.6% of items in Malta's basket fell in the 0% or negative inflation rates interval, while this figure stood at 17.6% 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 39.5% 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.

higher inflation for some food products – including fish and vegetables – as compared to that in the euro area. Maltese data also show higher inflation rates for a number of household items such as cookers, food processing appliances and cleaning and maintenance products. Increases in international passenger freight rates were also higher in Malta. However, while items with price increases of between 2% and 5% accounted for 32.2% of the euro area basket in September, in Malta this share was significantly lower at 21.1%, 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.

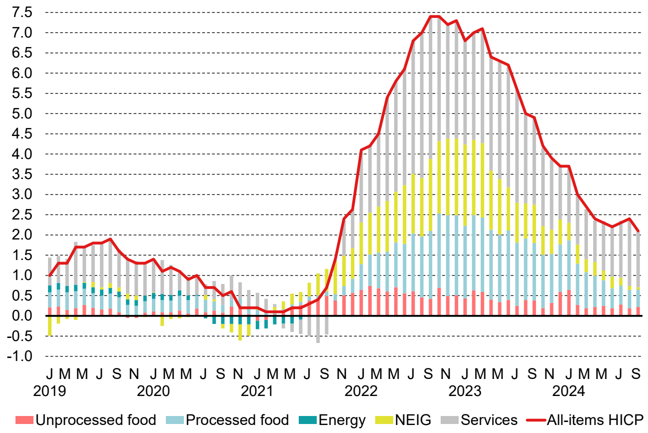
Main components of inflation

The drop in Malta's HICP inflation between June and September stemmed from processed food and NEIG inflation. Unprocessed food and energy inflation retained the same contribution, while the contribution from services inflation increased (see Chart 3.4).

Processed food inflation (including alcohol and tobacco) fell to 2.7% from 3.1% in June, supported by lower imported prices and the Stabbilta' scheme. Consequently, the contribution of processed food to HICP inflation decreased by 0.1 percentage points, standing at 0.4 percentage points in September. On the other hand, unprocessed food inflation edged up to 4.5% from 3.7% in June and retained a similar contribution to June's. As a result, overall food inflation including alcohol and tobacco, eased slightly during the quarter under review, standing at 3.2%, as compared to 3.3% in June. This is lower than the historical average of 3.6%.

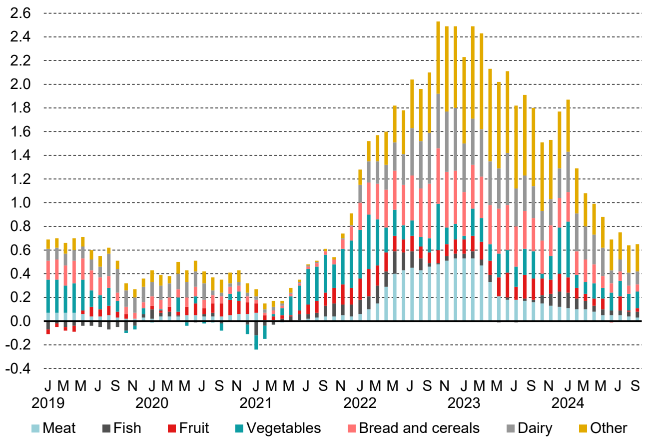
The moderation in food inflation since June partly reflected a decline in contributions from the prices of sugar, chocolate and confectionery items which form part of the 'other' category. This was followed by smaller contributions from the prices of bread and cereals and meat products. Vegetable products 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 fish and fruits following higher prices for fresh fish and fruits.

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



Source: SDW.

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



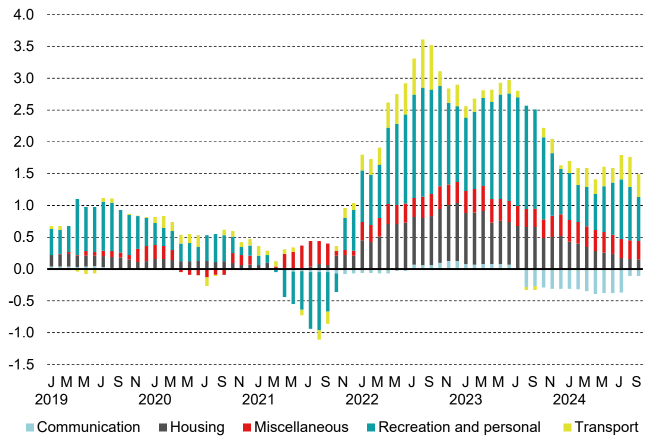
Source: SDW.

NEIG inflation fell from 1.1% in June to 0.2% in September. Looking at the sub-components, prices of durables contracted at a faster pace of 1.6% in annual terms, following a drop of 1.1% three months earlier. At the same time, prices of non-durables rose at a slower pace of 2.7%, down from 3.6% in June. At the same time, prices of semi-durables contracted by 0.1% year-on-year, following a growth of 1.3% in June.

Services inflation increased from 2.3% in June to 2.7% in September, contributing 1.4 percentage points to overall HICP inflation (see Chart 3.6). This mostly reflected a smaller negative contribution from the communication component, as prices of communication services contracted at a slower rate. Furthermore, the contribution from transport services increased on the back of higher prices for international flights.

On the other hand, the contribution from the recreation and personal component, which is the main contributor to services inflation in Malta, decreased as the prices charged for hairdressing, restaurants and accommodation services rose at a slower pace when compared to three months earlier. At the same time, the contribution from housing fell, mainly reflecting weaker growth in rental prices. Meanwhile the contribution from miscellaneous services remained largely unchanged.

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



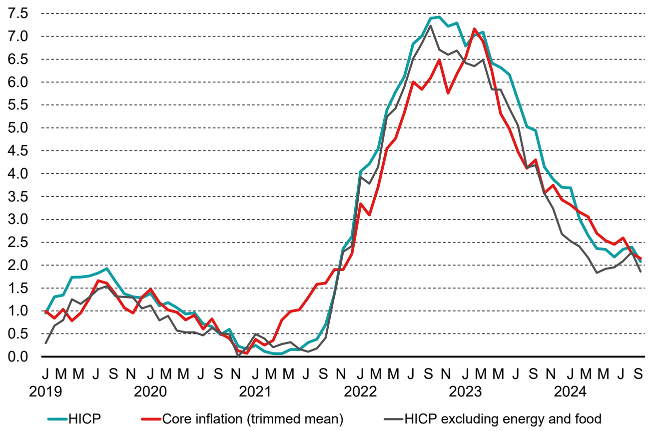
Source: SDW.

Energy inflation remained at 0.0% in September, 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 2.1% in September 2024, from 2.5% three months earlier (see Chart 3.7).[3]

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.

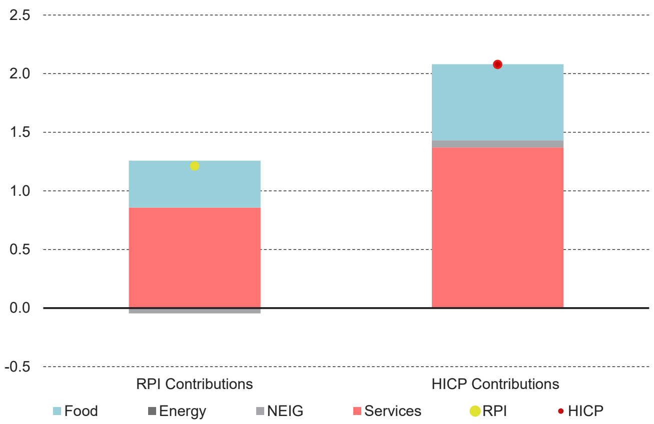
An alternative measure of underlying inflationary pressures – HICP excluding energy and food – also eased slightly in September, reaching 1.9%, from 2.0% in June.

RPI inflation edges down

Annual inflation based on the RPI index fell to 1.2% in September, from 1.3% in June, reflecting mixed developments across components. While the contributions of food, housing, household equipment and personal care and health decreased, the contribution of transport and communication turned less negative while that of recreation and culture also rose marginally (see Table 3.2).[4] Despite the moderation, food remained the main contributor to RPI inflation, followed by personal care and health.

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 shows the contributions of the main sub-components to overall RPI and HICP inflation, respectively. While the contributions of HICP are official

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								
	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.
Food	1.5	1.6	1.9	1.9	1.2	1.1	1.0	0.8	0.6	0.6	0.5	0.5
Beverages and tobacco	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Clothing and footwear	-0.1	-0.1	-0.1	0.0	0.1	-0.1	0.0	0.0	0.0	0.1	0.0	0.0
Housing	0.5	0.4	0.4	0.2	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0
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	0.3	0.2	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.0	0.0	-0.1
Transport and communications	0.0	-0.1	-0.3	-0.4	-0.5	-0.6	-0.8	-0.5	-0.4	-0.2	0.0	-0.1
Personal care and health	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.4	0.3	0.3	0.3
Recreation and culture	0.1	0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other goods and services	0.5	0.5	0.5	0.4	0.4	0.4	0.5	0.4	0.3	0.4	0.3	0.3
RPI (annual percentage change)	**3.7**	**3.6**	**3.6**	**3.2**	**2.3**	**1.9**	**1.6**	**1.5**	**1.3**	**1.4**	**1.5**	**1.2**

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.

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 inflation in September, stemmed from services and food inflation.

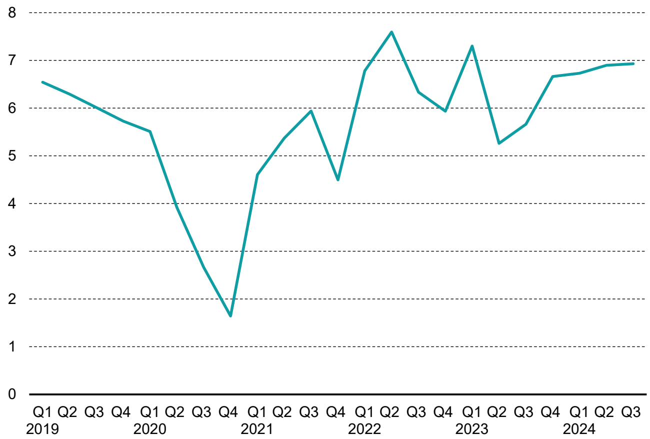
The housing market

Residential property price inflation unchanged 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 6.9% in the third quarter of 2024, unchanged from the previous quarter (see Chart 3.9).[7] Meanwhile, in the euro area, prices on average increased at an annual rate of 2.6%.

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.

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



Source: Eurostat.

Misalignment indicator suggests 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.

---

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. Nonetheless, figures should be interpreted with caution as they might not reflect HICP grouping entirely.

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.

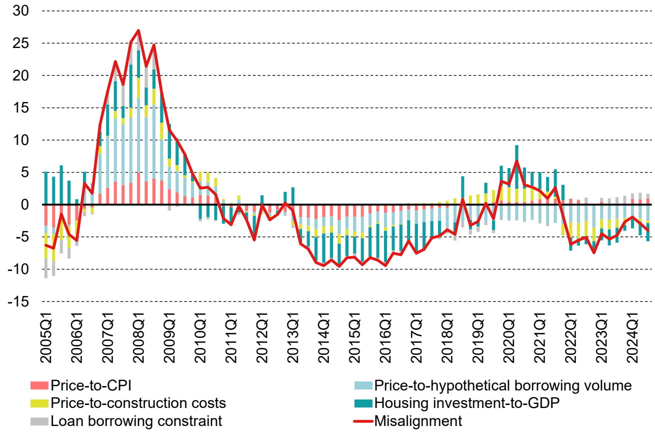
7 'Apartments' are defined as dwellings with self-contained rooms or a suite of rooms that have a separate entrance accessible from a common passageway, landing or stairway. 'Maisonettes' have a separate entrance that is accessible from the street and are either at ground-floor level with overlying habitation, 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 below the level consistent with fundamentals in the third quarter of 2024. The degree of undervaluation increased somewhat when compared with the second quarter of 2024, largely reflecting a more negative contribution from the housing investment-to-GDP ratio (see Chart 3.10).[10]

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



Source: Central Bank of Malta.

The latter also explains most of the misalignment for this quarter, followed by the house price-to-hypothetical borrowing ratio. The house price-to-construction cost ratio also contributed, albeit in a more limited way. By contrast, the loan borrowing constraint and house price-to-CPI ratio contributed positively to the misalignment index.

Number of final deeds decline in quarterly terms but increase in annual terms

NSO data on residential property transactions show that 3,006 final deeds of sale were registered in the quarter under review, a decline of 5.7% compared to the number of sales concluded in the previous quarter, but 4.7% higher than the number of deeds registered a year earlier (see Table 3.3). Around 93% of transactions concluded in the third quarter of 2024 involved purchases by individuals.

The year-on-year increase in deeds in the third quarter of 2024 reflected a larger number of transactions in the Northern region, followed by the Northern Harbour and Southern Harbour regions. The other regions recorded decreases. In value terms, there was a year-on-year increase of 1.9%, although the increase in the case of individual buyers was more significant, at almost 14%.

Table 3.3
RESIDENTIAL PROPERTY TRANSACTIONS
Levels

	2023				2024		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Residential transactions							
Promise of sale	3,116	3,492	3,076	3,501	3,497	3,492	3,108
Final deeds of sale	3,101	3,007	2,870	3,202	3,161	3,187	3,006

Source: NSO.

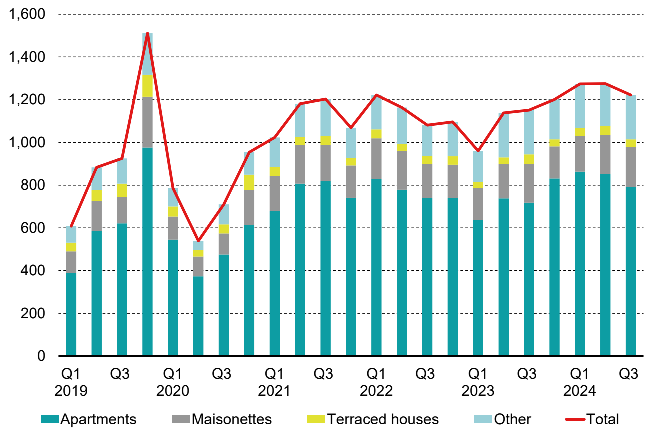
[10] A separate assessment based on advertised house prices can be found in Gatt, W., Micallef, B. and Rapa, N. (2018), "A macroeconometric model of the housing market in Malta", *Annual Research Bulletin*, Central Bank of Malta, pp. 11-18.

At 3,108 the number of promise-of-sale agreements was 11% lower than the number registered in the previous quarter, and up by 1.0% from the same quarter of 2023. The year-on-year increase in the quarter under review was mainly driven by the Southern Harbour and Western regions.

Mortgage transactions increase year-on-year[11]

In the third quarter of 2024, the number of new mortgage contracts stood at 1,222. When compared with the third quarter of 2023, they rose by 6.2% (see Chart 3.11). Increases were observed for all main property categories except for terraced houses, farmhouses and villas. However, the biggest contributors to the latest increase were apartments and maisonettes.

Chart 3.11
MORTGAGE CONTRACTS
(number of contracts)



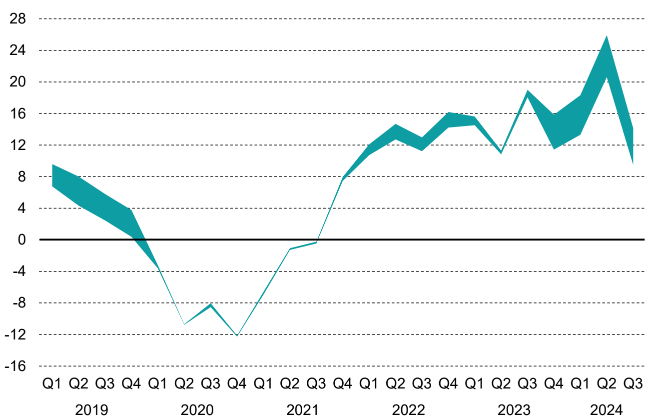
Source: Central Bank of Malta.

The total number of mortgage contracts in the third quarter of 2024 stood below the peak of 1,511 transactions recorded in the last quarter of 2019, but above the average of 973 transactions per quarter recorded since 2017.

Advertised rent prices continue to increase

The annual rate of change of advertised rents collected by the Bank from internet sources recorded another significant increase in the third quarter of 2024.[12] The range of estimates from various methods indicate that rents have increased at annual rates of between 9.5%and 14.1% in the quarter under review (see Chart 3.12).

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.

Compared with the previous quarter, the rate of increase included in the range of estimates has narrowed slightly and shifted down. In the quarter under review, the level of advertised rents was almost a third higher than its average in recent years.[13]

Cost indices

Most indicators of producer costs grow at a slower pace

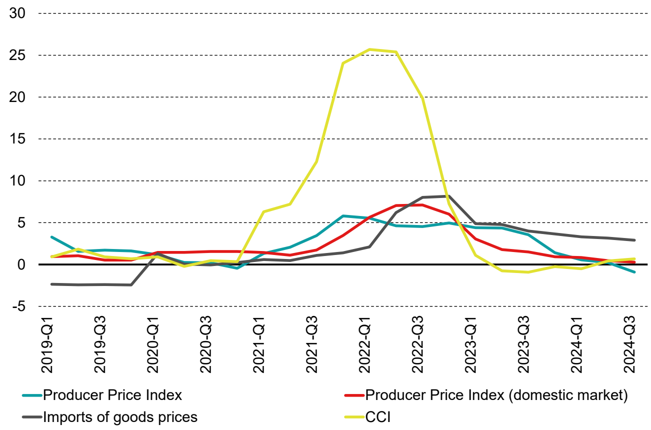
The industrial producer price index is a measure of the prices of goods sold by producers in the industrial sector. Annual inflation according to this index stood at -0.9% on average in the quarter under review, down from 0.2% in the previous quarter (see Chart 3.13).[14] This drop was driven by developments in producer prices for capital goods, intermediate goods and consumer goods. The annual rate of change of the latter grew at a slower pace of 0.8% in this quarter, down from 1.6% in the previous quarter. At the same time, the annual rate of change of producer prices of capital goods grew at a slower pace of 3.5% in the quarter under review, down from 6.2% in the previous quarter. Meanwhile, the annual rate of change of producer prices of intermediate goods became more negative, standing at -5.0% in the third quarter of 2024, compared to -3.3% in the second quarter. Energy producer price inflation remained unchanged.

Other indicators affecting the domestic market also show easing cost pressures. The domestic producer price index rose at a slightly slower annual rate of 0.3%, from 0.5% in the second quarter, mainly driven by slower growth in producer prices of consumer goods.[15] The imports of goods deflator also shows somewhat weaker growth of 2.9%, from 3.2% in the second quarter of 2024.[16] The CCI for new residential buildings published by Eurostat increased at a slightly higher rate in the third quarter of 2024, standing at 0.7% after it had increased by 0.4% in the previous quarter. Notwithstanding the recent declines, its level remains above that observed before 2020.

ULCs increase at a faster rate on a four-quarter moving average basis

Malta's ULC index – measured as the ratio of CPE to labour productivity – increased in annual terms, but decreased slightly in quarter-on-quarter terms in the third quarter of 2024.

Chart 3.13
COST INDICATORS
(annual percentage growth)



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

[13] This index is available from 2017Q4.

[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.

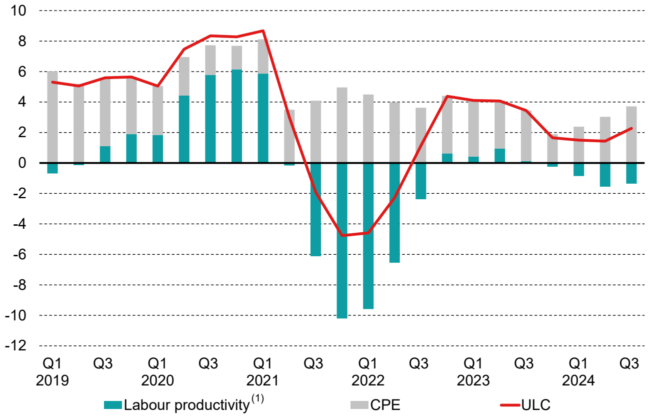
[15] The domestic producer price index refers to the producer prices relating to the domestic market only, whilst the producer price index relates to the total market, i.e., including both the domestic and non-domestic markets.

[16] This index is derived from national accounts data published by the NSO.

When measured on a four-quarter moving average basis in headcount terms, ULCs in Malta rose at an annual rate of 2.3%. This followed an increase of 1.4% in the previous quarter (see Chart 3.14). The pick-up in in ULC growth largely reflects an acceleration in CPE. This rose by 3.7% in annual terms, from 3.0% in the second quarter. To some extent, the increase in ULC growth also reflected slower growth in productivity per person. This rose by an annual rate of 1.4% in the third quarter, from 1.6% in the previous one.

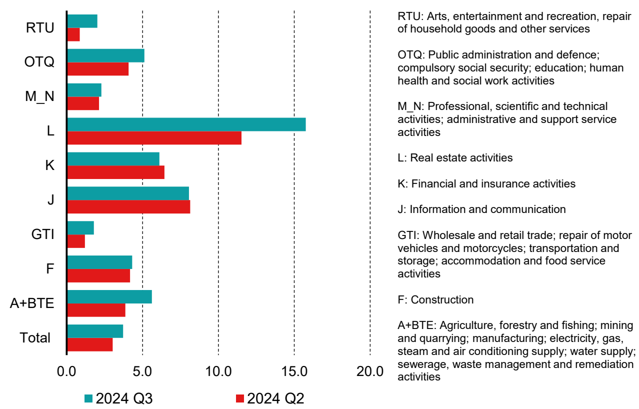
When measured on a four-quarter moving average basis, growth in CPE was fastest in the real estate activities sector (see Chart 3.15). Wage growth was also significant in a number of other sectors, including the information and communication sector and financial and insurance services. Overall, compared with the previous quarter, compensation per employee grew at a faster rate in most sectors.

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.

BOX 2: INFLATION PERSISTENCE OVER TIME: DEVELOPMENTS AND CONTRIBUTING FACTORS[1]

This box examines the persistence of inflation in Malta and compares its evolution over time and across various subcomponents with that of the euro area. Using time-varying autoregressive models and Bayesian techniques, the study highlights the increasing trend of inflation persistence in Malta, particularly since the onset of the COVID-19 pandemic and the subsequent global economic disruptions. The analysis identifies key factors that might have contributed to this persistence, including supply shocks, inflation expectations, and labour market tightness.

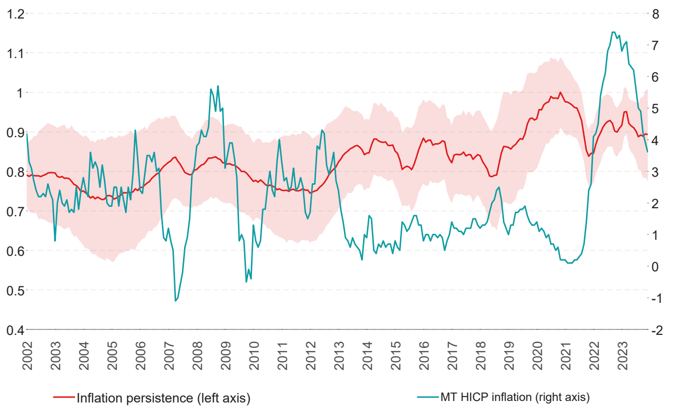
How inflation persistence in Malta has evolved for headline and its main subcomponents

The uneven global economic recovery from the pandemic in 2020 and 2021, as well as the onset of the Russia-Ukraine War in 2022, brought about significant supply-imbalances that caused an extraordinary episode of very high inflation. As a small open economy, Malta also underwent a period of elevated inflation. According to the HICP, inflation in Malta peaked at 7.4% in October 2022, the highest rate recorded since the index's inception in 1997. The recent surge in inflation in Malta closely mirrors that of the euro area, which has also experienced both a higher peak and a longer duration of inflation above its historical average.

In this box we analyse the recent developments in inflation persistence, defined as the tendency for past inflation to stay near where it has been recently, absent any other economic counteracting forces (Fuhrer, 2009). To this end, separately for each inflation series of interest, we estimate an autoregressive model featuring time-varying parameters and stochastic volatility and we define the month-specific persistence parameter as the sum of the autoregressive coefficients.[2]

Chart 1 shows the estimated evolution of Maltese inflation persistence for headline HICP from

Chart 1
TIME-VARYING PERSISTENCE ESTIMATES OF OVERALL INFLATION



Source: Author's estimates.
Notes: Left-hand axis shows the estimated time-varying persistence parameters. Right-hand axis shows annual percentage changes.

[1] Prepared by Germano Ruisi, Principal Research Economist of the Economic Research Department at the Central Bank of Malta. The analysis presented in this box is based on the authors' study: Ruisi and Borg (2024), "Inflation persistence over time: Developments and contributing factors", Central Bank of Malta *Policy Note*. Helpful comments by Mr Alexander Demarco, Dr Aaron G. Grech, Mrs Rita Schembri, Dr Massimo Giovannini, Mr Noel Rapa, Mr John Farrugia, and all the participants in an internal seminar are gratefully acknowledged. The views expressed are the author's own and do not necessarily reflect the views of the Central Bank of Malta.

[2] For more details on the model please refer to Ruisi and Borg (2024) "Inflation persistence over time: Developments and contributing factors", Central Bank of Malta *Policy Note*.

2002 to 2023, along with the 68% credible bands. It also plots the series of headline HICP inflation.

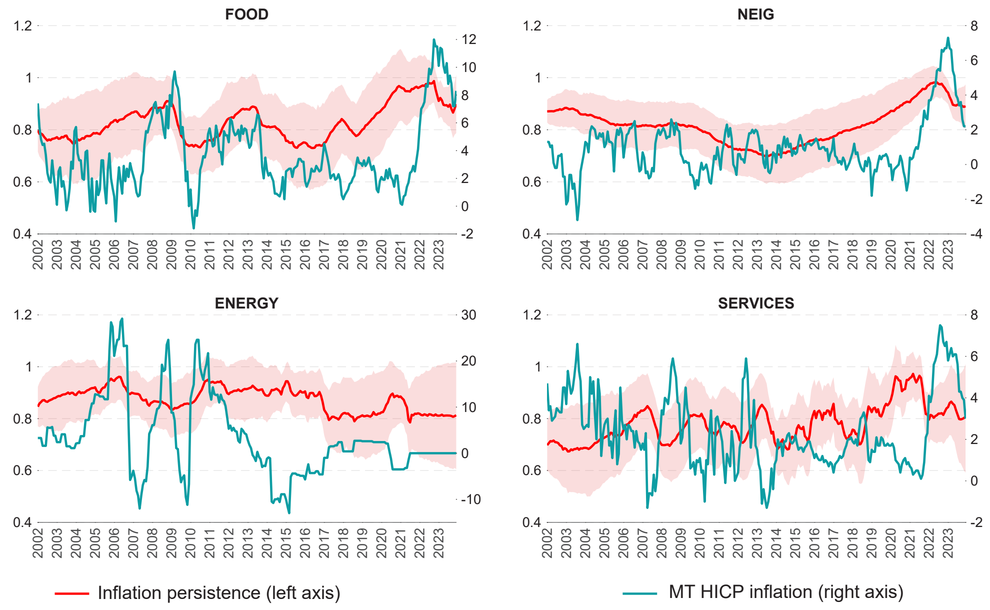
Despite the erratic movements in HICP inflation between 2002 and 2012, inflation persistence hovered close to 0.8. However, estimates of inflation persistence began trending upwards from 2012, stabilising at around 0.85 by 2019. This period, characterised by generally below-average inflation, suggests that the estimated inflation persistence reflects a persistently low inflation environment.

Inflation persistence increased sharply following the onset of the pandemic in 2020, peaking in November of the same year and coinciding with some of the lowest inflation rates since the declines experienced in 2010. This rise in persistence might be linked to the historically low inflation levels before the pandemic.

Since 2021, estimates of inflation persistence have been relatively unstable but have remained historically high throughout the high inflationary period that emerged in 2022. By the end of 2023, inflation persistence had settled at around 0.9, confirming that the last two years have been characterised by both high and persistent inflation.

Chart 2 delves into the subcomponents of HICP and shows how the drivers of persistence in headline inflation have been rather diverse over the last 20 years.

Chart 2
TIME-VARYING PERSISTENCE ESTIMATES OF SUBCOMPONENTS



Source: Author's estimates.
Note: Left-hand axis shows the estimated time-varying persistence parameters. Right-hand axis shows annual percentage changes.

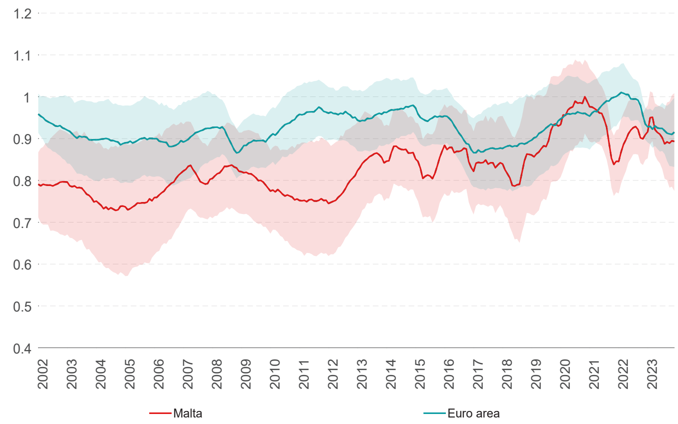
With regards to food inflation, persistence increased during the 2000s and peaked in 2008, mirroring a period of high food inflation due to the food price shock in 2007/2008.[3] Persistence then declined after 2013 as food inflation shifted from a rather prolonged period of high inflation to a lower inflation regime. As food inflation settled at persistently low levels between 2015 and 2021, inflation persistence rose and peaked in the latter part of this period. The increase in food inflation in the post-COVID period led to an elevated estimate of inflation persistence, which remained elevated even as food inflation moderated somewhat since mid-2023.

Turning to NEIG, estimates show a consistent decline in an otherwise elevated inflation persistence measure until 2013. This was followed by an upward trend in inflation persistence that occurred over the following decade. Despite the sudden increase in goods inflation since 2021, inflation persistence continued to increase markedly, and hovered close to 1 by 2022, suggesting that the sharp rise in goods inflation experienced in the post-COVID period was highly persistent. As goods inflation eased during 2023, the estimated inflation persistence also moderated but remained rather high from a historical perspective.

Persistence in energy inflation has been comparatively stable and high over the period under consideration, which might reflect the fact that this subcomponent is administered by the Maltese Government. In view of the Government's decision to keep energy prices unchanged throughout the period characterised by sharp increases in international energy commodity prices, energy inflation persistence remained stable unlike that in the other subcomponents.

Finally, persistence in services inflation was comparatively lower than other subcomponents across the sample under consideration. But, similarly to others subcomponent measures, as services inflation stabilised over the 2013-2021 period, the estimated persistence rose rapidly. Despite falling somewhat, persistence remained relatively elevated from a historical point of view during the high inflation period which started in 2022.

Chart 3
TIME-VARYING PERSISTENCE ESTIMATES OF MALTA AND THE EURO AREA



Source: Author's estimates.
Note: Chart shows the estimated time-varying persistence parameters for overall inflation in Malta and the euro area.

How has inflation persistence evolved in Malta vis-à-vis in the euro area

Chart 3 shows that Malta's inflation persistence has been consistently lower than that of the euro area up until 2019.

[3] The food price shock was a period which featured a dramatic increase in the price of international food commodities such as rice, corn, and wheat. It was driven by a confluence of factors such as higher oil prices, the depreciation of the U.S. dollar, weather shocks, etc. (see Heady and Fan, 2008). There could be other factors explaining the food price shock that occurred in 2007-2008 but there is no full consensus in the literature.

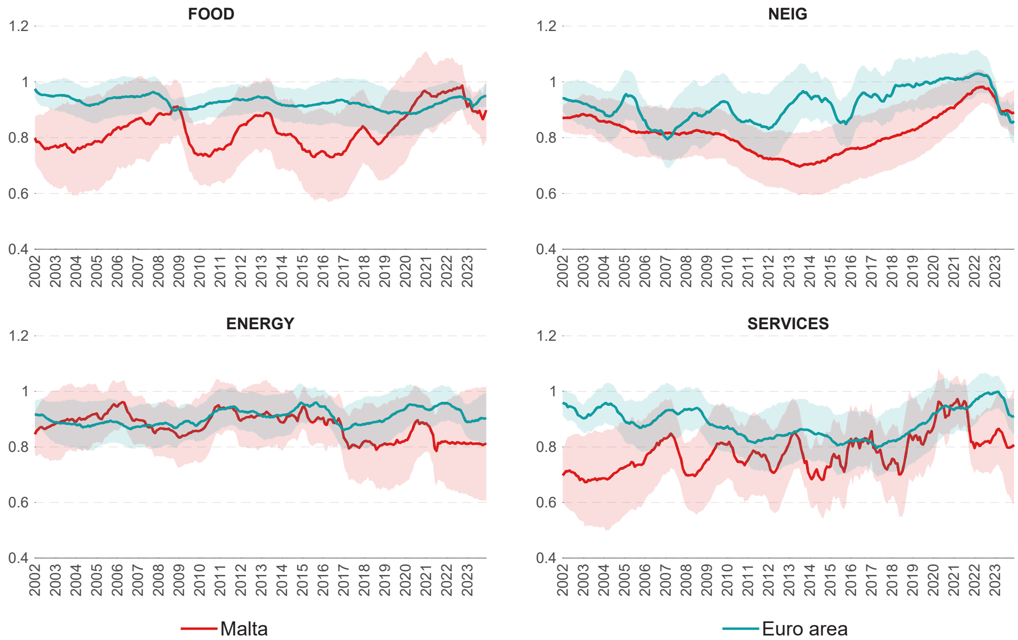
The dynamic nature of the time-varying estimation shows a gradual convergence towards euro area inflation persistence. A brief alignment with euro area persistence was observed in Malta during 2020 and 2021. Conversely, a spike in headline inflation in 2022 prompted a slight drop in Maltese inflation persistence, followed by a subsequent rise into 2023. Concurrently, the euro area experienced a peak in inflation persistence around mid-2022, tapering off gradually throughout 2023, resulting in a convergence with Malta's persistence by mid-2023.

Delving into subcomponents in Chart 4, a comparison shows some divergences in the drivers of headline inflation persistence dynamics.

Maltese food inflation's persistence was consistently lower than the euro area's between 2013 and 2017 but, subsequently, the two began to converge. The convergence during the recent inflationary period reflects the synchronization of the upward swing in food inflation dynamics between the euro area and Malta. This convergence could also reflect the fact that common international supply side shocks were the main drivers of inflation dynamics in both euro area and Malta during this period and by the fact that Malta's goods consumption basket has a large import content.

Estimates of energy inflation persistence for Malta reflect a significant influence from governmental price administration, contrasting with the euro area's more dynamic energy pricing. Pre-2017, energy inflation persistence of Malta and the euro area remained

Chart 4
TIME-VARYING PERSISTENCE ESTIMATES OF SUBCOMPONENTS – MALTA VS EURO AREA



Source: Author's estimates.
Note: Chart shows the estimated time-varying persistence parameters for subcomponent inflation in Malta and the euro area.

comparable, yet post-2017, Malta's estimates were consistently lower, driven mainly by the Maltese Government price stabilisation policies. This divergence intensified amid large shocks to euro area energy inflation versus Malta's zero-energy inflation.

Services inflation in Malta exhibits lower persistence compared to the euro area. This is true throughout most of the period under consideration with the exception of the period between 2015 and 2022 where the Malta's services inflation persistence has mirrored that of the euro area.

Factors that might explain the recent developments in inflation persistence

We seek tentative evidence of factors that might explain the recent developments in inflation persistence by extending the inflation persistence estimates to each of the 20 euro-area countries. Subsequently, by utilising a panel regression framework, we regress the estimated country-specific series of time-varying headline HICP inflation persistence on a set of common determinants.[4] The main results are shown in Table 1.[5]

Inflation expectations do play a role in explaining the evolution of inflation persistence, though there are variations across periods considered. Sellers' expectations in industry contributed negatively to overall inflation persistence until February 2021. Neri (2023) showed that long-term inflation expectations were generally well-anchored and had reached very low levels by 2019, which might explain the low impact of sellers' expectations on inflation persistence.

Table 1
SOURCES OF INFLATION PERSISTENCE

Prices expectations industry (till 2021M02)	-0.042	*
Prices expectations industry (since 2021M03)	0.131	***
Prices expectations consumers (till 2021M02)	-0.001	
Prices expectations consumers (since 2021M03)	-0.074	***
Equipment limiting production (till 2021M02)	0.170	***
Equipment limiting production (since 2021M03)	0.089	***
Unemployment cycle abs (till 2021M02)	1.393	***
Unemployment cycle abs (since 2021M03)	1.014	*
Trade openness	2.106	**
Dummy EA	-2.829	***
Dummy 2021M03 onwards	2.001	**
ECB shadow rate	-0.697	***
Cons	86.772	***
Observations	4895	
Within R-squared	0.251	

Source: Author's estimates.

[4] For more details on the model please refer to Ruisi and Borg (2024) "Inflation persistence over time: Developments and contributing factors", Central Bank of Malta *Policy Note*.

[5] Throughout this section, the dependent variable, i.e., inflation persistence, has been multiplied by one hundred for easier readability of the slope parameters of interest.

Conversely, since March 2021, sellers' price expectations contributed positively to inflation persistence. During this period, sellers' price expectations rose significantly, mainly due to sharp increases in input and financing costs as well as to pent-up demand from the pandemic.

Consumer price expectations do not seem to have been a factor driving inflation persistence prior to February 2021. To the contrary, they are found to be negatively related to inflation persistence post March 2021. Evidence from the ECB's Consumer Expectations Survey (CES) shows that consumers have primarily adjusted downwards their consumption (and increased savings) to cope with higher inflation (Bobasu et al., 2023). Hence, higher consumer expectations might have brought about a stronger downward adjustment in consumption, which in turn reduced inflationary pressures, thus reducing its persistence.

The coefficients on equipment shortages and labour market tightness, the latter captured by the absolute value of the unemployment cycle, are positive and statistically significant, both for the period prior and post 2021. Bernanke and Blanchard (2023) found that the two are major drivers for the increase in inflation occurring in the post-COVID period. From our results, we find that they are also positively correlated with inflation persistence.

Finally, the parameters associated with trade openness and the dummy are positive and statistically significant. Additionally, a country's entry into the euro area has generally been associated with a reduced overall inflation persistence as highlighted by the significant slope relative to the and to the ECB's policies as proxied by the shadow rate.

Conclusions

This box shows estimates of the persistence of inflation in Malta and compares their evolution over time and across various subcomponents with that of the euro area. Inflation persistence in Malta has trended upwards since 2012, generally reflecting a period of persistently low inflation and has then increased sharply since 2021. Overall, Maltese inflation persistence was lower than in the euro area until 2019 but has recently converged, both for headline and for its main subcomponents. The analysis also identifies key major factors that might have positively contributed to persistence, especially after March 2021 with supply shocks, sellers' and consumers' inflation expectations, and labour market tightness found to be correlated with inflation persistence measures.

4. THE BALANCE OF PAYMENTS

During the third quarter of 2024, the current account surplus narrowed when compared to the same quarter of the previous year. This was mainly due to a wider merchandise trade deficit and higher net outflows on the primary income account. By contrast, net receipts from services increased and the balance on the secondary income account turned positive.

In the quarter under review, net inflows on the capital account decreased when compared to the corresponding quarter of 2023, while the financial account showed higher net lending.

When measured over the four quarters to September 2024, the current account balance registered a surplus equivalent to 6.3% of GDP. This compares with a current account surplus of 2.9% of GDP in the euro area.

The cyclically-adjusted current account balance is estimated to have recorded a surplus of 9.5% during the quarter under review.

As balance of payments data are undergoing substantial revisions, readers are advised to exercise caution in interpreting changes over time.

In the third quarter of 2024, the tourism sector continued to register gains. The number of inbound tourists, nights stayed, and tourist expenditure in Malta all increased when compared with a year earlier.

The current account

The current account surplus narrows

Between July and September 2024, the current account of the balance of payments recorded a surplus of €451.2 million, €132.8 million lower than the surplus recorded in the same quarter of 2023 (see Table 4.1). This reflected a wider goods deficit and higher net outflows on the primary income account. These offset higher net receipts from services and a return to net inflows on the secondary income account.

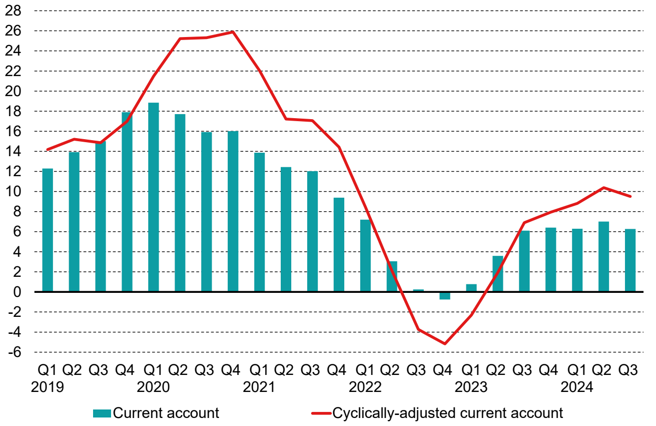
Table 4.1
BALANCE OF PAYMENTS
EUR millions

	Four-quarter moving sums						
	2023 Q3	2023 Q4	2024 Q1	2024 Q2	2024 Q3	2023 Q3	2024 Q3
Current account	**1,220.5**	**1,315.5**	**1,330.1**	**1,521.0**	**1,388.2**	**584.0**	**451.2**
Goods	-2,488.9	-2,446.6	-2,449.1	-2,443.1	-2,617.3	-577.0	-751.2
Services	6,001.9	6,153.2	6,292.4	6,606.1	6,711.3	1,768.7	1,873.9
Primary income	-2,217.8	-2,303.1	-2,477.2	-2,599.6	-2,712.8	-582.8	-696.0
Secondary income	-74.7	-88.0	-36.1	-42.5	6.9	-24.9	24.5
Capital account	**234.2**	**255.8**	**306.1**	**366.6**	**343.6**	**56.5**	**33.5**
Financial account[1]	**1,470.8**	**1,917.1**	**1,833.5**	**2,267.9**	**2,299.5**	**557.9**	**589.5**
Errors and omissions	**16.1**	**345.9**	**197.3**	**380.4**	**567.8**	**-82.6**	**104.8**

Sources: Eurostat; Central Bank of Malta.
[1] Net lending (+) / net borrowing (-).

On a four-quarter moving sum basis, the current account surplus widened to €1,388.2 million, from €1,220.5 million a year earlier. This reflected a higher surplus on the services account, and, to a lesser extent, higher net inflows related to secondary income.These offset a higher merchandise trade deficit and higher net outflows on the primary income account. The current account balance-to-GDP ratio reached 6.3%, from 6.1% a year earlier (see Chart 4.1). Malta's cyclically-adjusted current account surplus is estimated to have stood at 9.5% of GDP in the third quarter of 2024, and thus more positive than the headline measure (see Chart 4.1).[1]

Chart 4.1
CURRENT ACCOUNT
(four-quarter moving sums as a percentage of GDP)



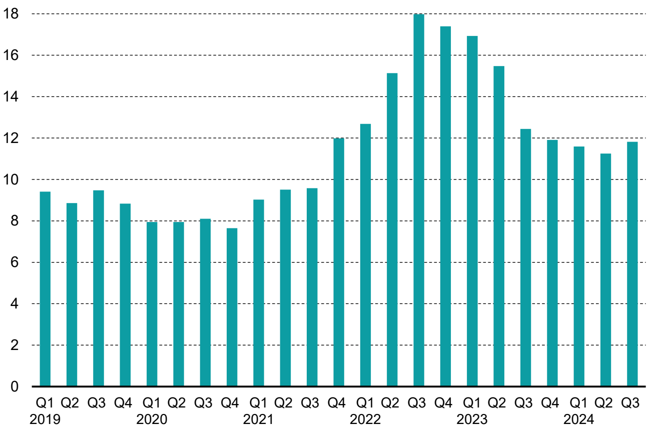
Sources: Eurostat; Central Bank of Malta.

The merchandise trade deficit widens

In the third quarter of 2024, the merchandise trade deficit stood at €751.2 million, up from €577.0 million in the corresponding period of 2023. This was driven by an increase in imports and a decrease in exports. The former mostly reflected an increase in imports of machinery and fuels.

The visible trade gap also increased when measured on a four-quarter cumulative basis, reaching €2,617.3 million, from €2,488.9 million in the same period a year earlier. This reflected a €96.0 million increase in goods imports, mainly because of an increase in imports of fuel and machinery, and a decrease in exports of €32.5 million. The share of the goods deficit in GDP declined to 11.8% during the third quarter of 2024, from 12.4% a year earlier (see Chart 4.2).

Chart 4.2
GOODS DEFICIT
(four-quarter moving sums as a percentage of GDP)



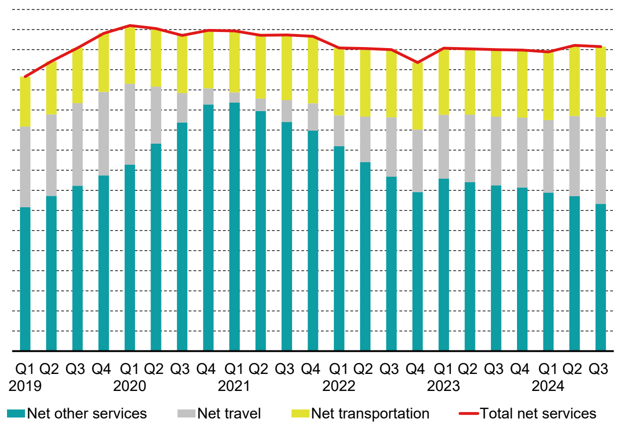
Sources: Eurostat; Central Bank of Malta.

[1] For more information on Malta's cyclically-adjusted current account see Grech, A. G., & Rapa, N., "An evaluation of recent shifts in Malta's current account position", in Grech, A.G., & Zerafa, S. (eds.), *Challenges and Opportunities of Sustainable Economic Growth: the Case of Malta,* Central Bank of Malta, 2017.

The surplus on services widens

In the quarter under review, net receipts on the services account amounted to €1,873.9 million, €105.2 million more than in the corresponding period of 2023. Both services exports and imports increased on a year earlier, however, the increase in the former was stronger.

Chart 4.3
SERVICES BALANCE
(four-quarter moving sums as a percentage of GDP)



Sources: Eurostat; Central Bank of Malta.

Higher net receipts from travel were the key factor behind the increase in the overall surplus on the services account, however, net receipts related to transport also contributed. By contrast, the surplus on 'other' services narrowed, mainly due to larger outflows stemming from professional and management consulting services.

On a four-quarter cumulative basis, the overall surplus from services stood at €6,711.3 million, an increase of €709.4 million over the surplus recorded a year earlier. The main contributors to this increase were the travel and transport components. The share of net services receipts in GDP stood at 30.3%, marginally from 30.0% registered during the same period of 2023 (see Chart 4.3).

Net outflows on the primary income account increase[2]

During the quarter under review, net outflows on the primary income account stood at €696.0 million, €113.2 million more than in the third quarter of 2023. This was mainly due to higher net payments related to direct investment and 'other' investment.

In the four-quarter period to September 2024, net outflows on the primary income account increased by €495.0 million, to stand at €2,712.8 million. Transactions relating to primary income continued to be strongly influenced by internationally-oriented firms, which transact predominantly with non-residents. During this period, net outflows on the primary income account amounted to 12.2% of GDP, up from 11.1% a year earlier.

Inflows on the secondary income account turn positive[3]

In the third quarter of the year, net flows on the secondary income account turned positive reaching €24.5 million. This contrasts with net outflows of broadly similar magnitude a year earlier.

In the four quarters to September 2024, these net inflows stood at €6.9 million whereas net outflows of €74.7 had been recorded in the same period of 2023. Given that net inflows on the secondary income account were small in absolute terms, they had a negligible share in GDP at the end of the review period.

[2] The primary income account shows income flows related mainly to cross-border investment and compensation of employees.
[3] The secondary income account shows current transfers between residents and non-residents.

Tourism

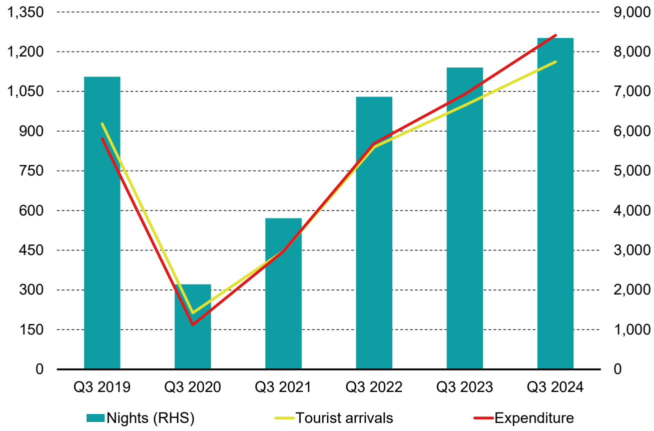
In the quarter under review, the number of inbound tourists amounted to 1,161,924, up from 997,564 a year earlier (see Chart 4.4). Visitors from the United Kingdom accounted for more than a quarter of the increase. Visitors from Italy and Poland also contributed significantly to the increase. In absolute terms, tourists visiting for holiday purposes accounted for nearly all of this rise. Visitors coming for business purposes increased somewhat, while those citing 'other' motives declined.

The total number of guest nights that tourists spent in Malta during the third quarter of 2024 totalled 8.3 million, up from 7.6 million a year earlier. Stays in 'other rented' accommodation accounted for most of this increase.[4]

In the third quarter of 2024, the share of non-residents in collective accommodation establishments stood at 91.6%, up from 90.9% a year earlier (see Chart 4.5).

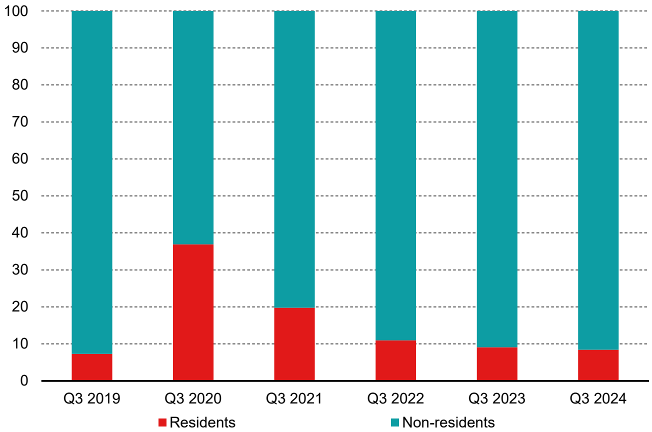
The total occupancy rate in collective accommodation establishments in the third quarter of 2024 rose to 80.6%, from 78.2% a year earlier (see Chart 4.6). The five-star category registered the largest increase of 5.3 percentage points. It was followed by the four-star and the "other" accommodation categories, which recorded a

Chart 4.4
TOURISM INDICATORS
(tourist arrivals and nights stayed in thousands; expenditure in EUR millions)



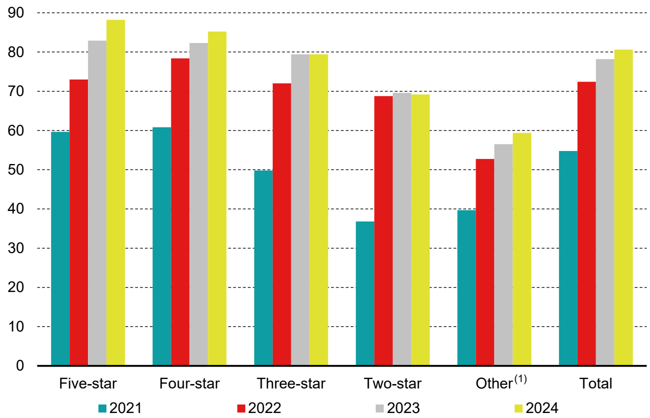
Source: NSO.

Chart 4.5
GUESTS IN COLLECTIVE ACCOMMODATION ESTABLISHMENTS
(per cent)



Source: NSO.

Chart 4.6
AVERAGE OCCUPANCY RATES IN THE THIRD QUARTER
(per cent)



Source: NSO.
(1) Includes guest houses, hostels and holiday complexes.

[4] Accommodation is divided into two categories – rented accommodation and non-rented accommodation. Rented accommodation is further divided into collective accommodation (comprising hotels, guesthouses, hostels, tourist villages, holiday complex, bed & breakfast and campsites), and 'other rented' accommodation (holiday furnished premises, host families, marinas, paid-convents, rented yachts and student dormitories). Non-rented accommodation comprises own private residence, staying with friends or relatives and other private accommodation.

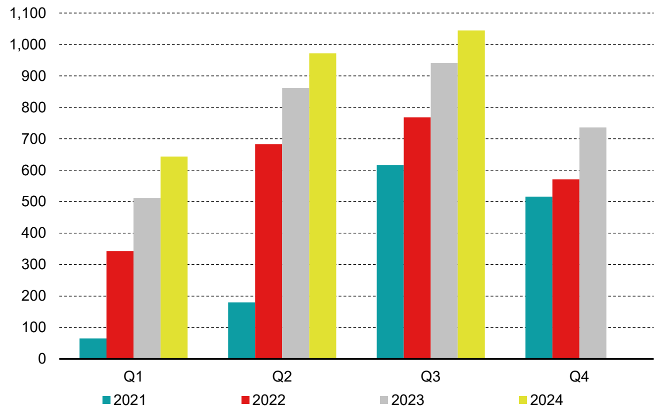
rise of 2.9 and 2.8 percentage points, respectively. Occupancy in the three-star category was stable, while it declined by 0.3 percentage points in the two-star category. The latter retained the lowest occupancy rate across hotel categories, at just below 70%.

Tourist expenditure in Malta totalled €1,262.1 million in the third quarter of 2024, up from €1,039.7 million a year earlier. All expenditure categories registered gains over this period.

Expenditure per capita increased to €1,086.2, from €1,042.2 in the third quarter of 2023, as expenditure per night increased, offsetting a shorter length of stay, which stood at 7.2 nights from 7.6 nights a year earlier.

According to Malta International Airport data, in the third quarter of 2024, average seat capacity stood at 1,044,437 seats per month, up from 941,518 a year earlier (see Chart 4.7).

Chart 4.7
AVERAGE MONTHLY SEAT CAPACITY(1)
(thousands)

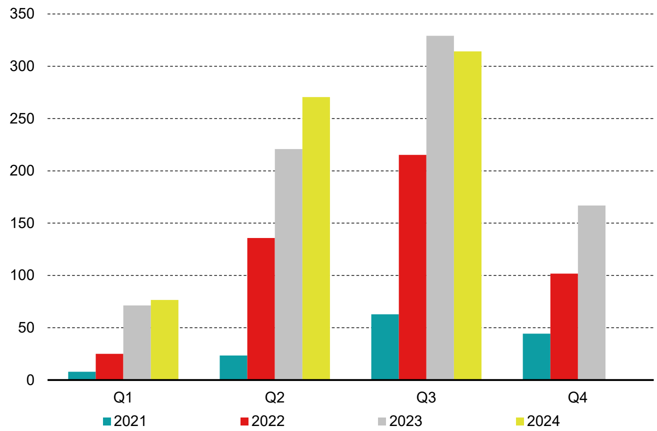


Source: MIA.
(1) Data include schedule and charter seats.

A total of 124 cruise liners visited Malta in the third quarter of 2024, 16 more than a year earlier. Foreign passengers reached 314,275 persons, down from 329,108 visitors in the third quarter of 2023 (see Chart 4.8).

The United Kingdom and the United States were the most important source markets for cruise passengers. Together they made up over 40% of total cruise passengers. Visitors from Italy followed, with a share of 17.8%. Passengers from the United States increased markedly compared with a year earlier. Passengers from the United Kingdom also rose, though to a lesser extent. The number of cruise passengers from the European Union, by contrast, declined compared with a year earlier, in part reflecting fewer calls from cruise liners popular with Italian visitors when compared with a year earlier.

Chart 4.8
CRUISE LINER PASSENGERS
(thousands)



Source: NSO.

The capital account

Net inflows on the capital account stood at €33.5 million in the third quarter of 2024, down from €56.5 million in the same quarter of 2023 (see Table 4.1). When measured on a four-quarter cumulative basis, however, capital inflows increased to €343.6 million, from €234.2 million during the 12 months to September 2023. Their share in GDP increased to 1.6% from 1.2% in the third quarter of 2023.

5. GOVERNMENT FINANCE

In the third quarter of 2024, the general government balance recorded a surplus in contrast to the deficit recorded in the corresponding period of 2023. When measured on a four-quarter moving sum basis, the general government deficit ratio narrowed by 0.5 percentage points, to reach 2.9%. The cyclically-adjusted deficit also narrowed.

The general government debt-to-GDP ratio declined by 1.1 percentage points to stand at 45.3% at the end of September. Meanwhile, the net financial worth as a share of GDP deteriorated.

Quarterly developments

General government balance registers a surplus in the third quarter

A surplus of €29.0 million for the general government balance was recorded in the third quarter of 2024. This contrasts with a deficit of €75.0 million registered in the corresponding period of 2023. In this period, a strong increase in government revenue offset a rise in government expenditure. The primary balance registered a surplus of €100.7 million in the quarter under review, in contrast to a primary deficit of €22.6 million a year earlier.

Tax inflows support revenue growth

In the third quarter of 2024, general government revenue increased by €339.3 million, or 20.5%, when compared with the same quarter of 2023 (see Table 5.1). This was mainly driven

Table 5.1
REVENUE, EXPENDITURE AND DEBT
EUR millions

	2023		2024			Change 2024Q3-2023Q3	
	Q3	Q4	Q1	Q2	Q3	Amount	%
Revenue	**1,655.1**	**1,722.8**	**1,679.8**	**1,992.8**	**1,994.4**	**339.3**	**20.5**
Taxes on production and imports	525.2	505.2	518.0	562.6	565.5	40.3	7.7
Current taxes on income and wealth	617.0	611.7	689.5	852.5	874.3	257.2	41.7
Social contributions	263.5	296.7	272.0	285.9	286.5	23.0	8.7
Capital and current transfers receivable	80.5	120.9	35.5	89.6	81.2	0.8	1.0
Other(1)	168.9	188.3	164.8	202.1	186.9	18.0	10.7
Expenditure	**1,730.1**	**2,323.3**	**1,798.6**	**1,951.8**	**1,965.4**	**235.3**	**13.6**
Compensation of employees	493.4	493.7	512.4	515.1	555.7	62.3	12.6
Intermediate consumption	322.5	454.7	351.0	427.5	402.1	79.6	24.7
Social benefits	379.1	400.7	504.0	464.9	408.4	29.2	7.7
Subsidies	148.2	275.9	118.0	93.9	184.3	36.1	24.4
Interest	52.4	64.2	63.9	60.2	71.7	19.3	36.8
Other current transfers payable	118.0	150.0	81.3	178.3	121.1	3.2	2.7
GFCF	163.3	270.4	122.5	154.8	177.7	14.3	8.8
Capital transfers payable	51.4	206.3	41.8	52.6	39.5	-11.9	-23.1
Other(2)	1.9	7.5	3.6	4.5	5.0	3.1	
Primary balance	**-22.6**	**-536.3**	**-54.9**	**101.2**	**100.7**	**123.3**	
General government balance	**-75.0**	**-600.4**	**-118.8**	**41.0**	**29.0**	**104.0**	
General government debt	**9,419.7**	**9,790.3**	**10,000.2**	**10,083.7**	**10,035.0**		

Source: NSO.

(1) "Other" revenue includes market output as well as income derived from property and investments.

(2) "Other" expenditure principally reflects changes in the value of inventories and in the net acquisition of valuables and other assets.

by higher tax revenue, particularly inflows from current taxes on income and wealth, which increased by €257.2 million. This is primarily due to higher income tax inflows from companies. Moreover, receipts from taxes on production and imports rose by €40.3 million, mainly reflecting higher inflows from customs and excise duties due to the timing of receipt of duties on petroleum products. Inflows from social contributions rose by €23.0 million, reflecting favourable labour market conditions. Income from sales increased and was the main factor behind the €18.0 million increase in 'other' revenue. Furthermore, inflows from capital and current transfers increased by a modest €0.8 million, mainly reflecting higher inflows from grants and capital taxes.

Expenditure growth underpinned by current spending

Total government expenditure increased by €235.3 million, or 13.6%, when compared with the third quarter of 2023. This increase mostly reflects higher current expenditure, particularly due to a rise in spending on intermediate consumption and compensation of employees. The former increased by €79.6 million largely due to higher outlays in the public administration, health, and residential care sectors. Spending on compensation of employees increased by €62.3 million, mainly due to higher outlays in the public administration, education, and health sectors. This partly reflects higher payments on allowances, following recently concluding collective agreements. Spending on subsidies increased by €36.1 million, due to the timing of payments on measures to retain fixed utility prices. Spending on social benefits rose by €29.2 million, largely on the back of higher spending on retirement pensions. Moreover, interest payments increased by €19.3 million while outlays on current transfers increased by €3.2 million.

Meanwhile, GFCF increased by €14.3 million, mostly due to a rise in domestically-financed projects. This was partly offset by a €11.9 million decline in capital transfers.

Debt falls

In September 2024, the stock of general government debt amounted to €10,035.0 million, €48.7 million lower than the level registered at end-June 2024. This reflects a decrease in short-term debt securities outstanding (composed of Treasury bills), which offset a rise in long-term debt securities outstanding (composed of MGS). The former fell by €172.8 million, with its share in total debt declining by 1.7 percentage points to 3.6%. Holdings of long-term debt securities increased by €127.2 million, with their share in total debt rising by 1.7 percentage points to 82.4%.

The value of loans outstanding decreased by €3.5 million, due to a decline in long-term loans. The share of loans outstanding in total debt remained broadly unchanged at 9.7%.

Headline and cyclically-adjusted developments

Headline deficit and debt ratios decline

When measured on a four-quarter moving sum basis, the general government deficit-to-GDP ratio narrowed, by 0.5 percentage points, to 2.9% in the quarter under review (see Chart 5.1). This was mostly driven by a 0.9 percentage-point rise in the revenue-to-GDP ratio, which reached 33.4%, due to a rise in the share of current revenue in GDP. This offset an increase in the expenditure-to-GDP ratio, which reached 36.3%. The latter increased due to a 0.4

percentage-point increase in the share of current expenditure in GDP.

Between June 2024 and September 2024, the debt-to-GDP ratio decreased by 1.1 percentage points, from 46.4% to 45.3% (see Chart 5.2). This reflects the posting of a surplus as well as negative deficit-debt adjustments, due to transactions in net trade receivables.

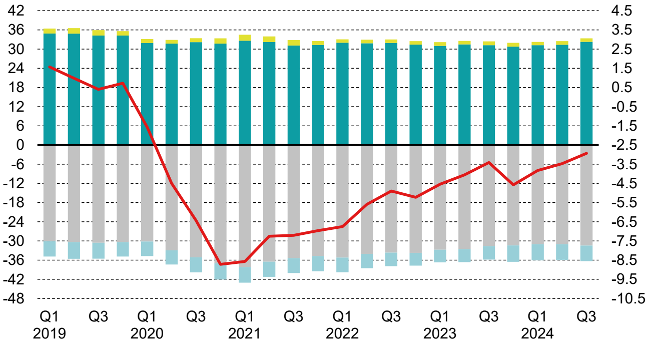
Net financial worth worsened

The market value of financial assets held by the general government increased to €6,488.2 million by September 2024, €336.4 million higher than the level three months earlier. This was mostly due to a rise in the value of deposits and of shares and other equity, which offset a decline in the value of other accounts receivable. Consequently, the share of financial assets in GDP rose to 29.3% from 28.3% in the previous quarter (see Chart 5.3).

The market value of financial liabilities increased by €570.5 million, to stand at €13,157.1 million. This is driven by a rise in the value of debt securities and other accounts payable. Consequently, the share of financial liabilities in GDP increased by 1.4 percentage points, to stand at 59.4%.

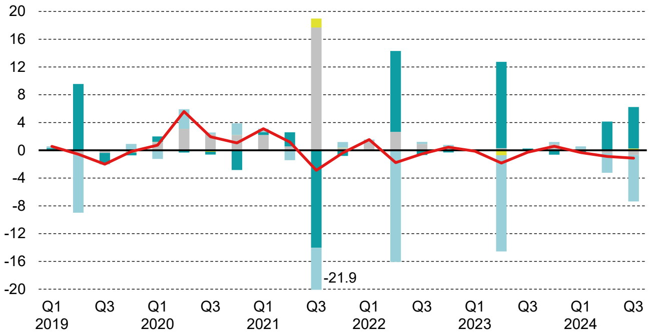
The resulting net financial worth of general government stood at -€6,668.9 million, a deterioration of €234.2 million compared with the previous quarter. The net financial worth of general

Chart 5.1
GENERAL GOVERNMENT REVENUE AND EXPENDITURE
(four-quarter moving sums; % of GDP)



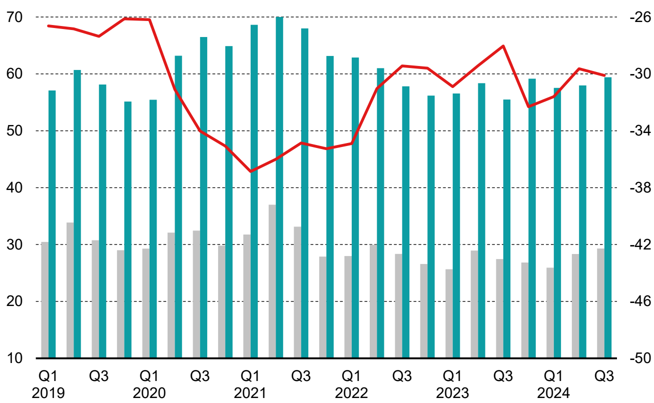
Sources: NSO; Central Bank of Malta.
(1) The term 'current revenue' represents most tax revenue as well as income from investments and sales. 'Capital revenue' mainly represents capital taxes and grants received.
(2) The term 'current expenditure' mainly represents spending on wages, social benefits and operational and maintenance expenses. 'Capital expenditure' mainly represents spending on investment and capital transfers.

Chart 5.2
CONTRIBUTION TO CHANGE IN DEBT
(percentage point change from previous quarter)



Source: Central Bank of Malta.
(1) Composed mainly of transactions in deposits held with the Central Bank of Malta.
(2) Also includes transactions related to shares and other equity and adjustments for valuation and volume effects.
(3) GDP data are four-quarter moving sums.

Chart 5.3
GENERAL GOVERNMENT NET FINANCIAL WORTH
(% of GDP) (1)



Sources: EUROSTAT; NSO.
(1) GDP data are four-quarter moving sums.

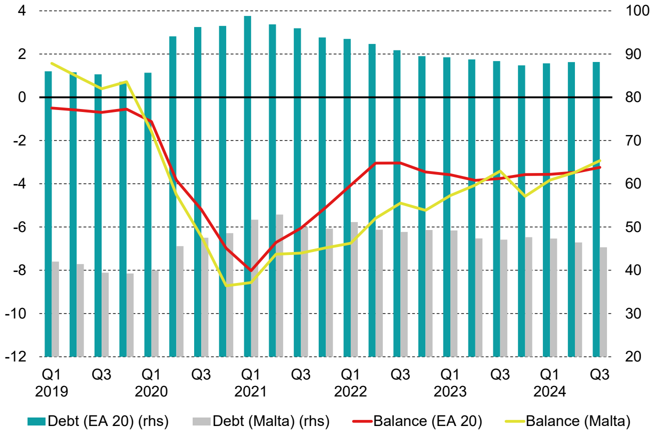
government as a share of GDP worsened by 0.5 percentage points, standing at -30.1% by end-September.

Over the same period, the euro area average net financial value as a share in GDP worsened by 1.3 percentage points, to stand at -57.1% of GDP. Thus, the net worth position of the Maltese general government remained more favourable than the euro area average.

Debt and deficit ratios compare favourably with the euro area's

During the quarter under review, the euro area general government deficit stood at 3.2% of GDP on a four-quarter moving sum basis, down from a deficit of 3.5% of GDP at end-June (see Chart 5.4). Over the same period, the euro area debt ratio stood at the same rate of 88.2% of GDP as the previous quarter.

Chart 5.4
GENERAL GOVERNMENT BALANCE AND DEBT
(four-quarter moving sums; % of GDP)



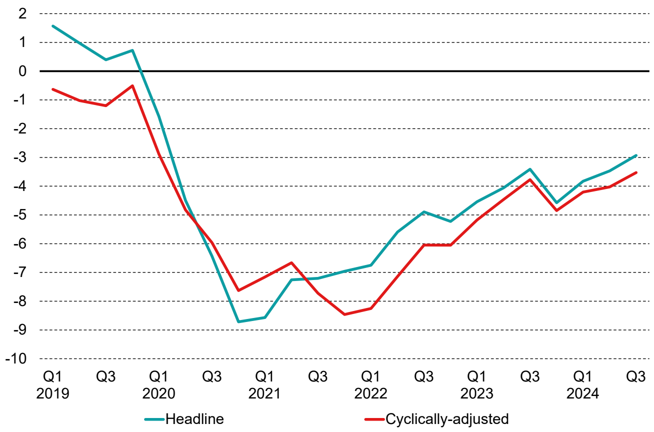
Sources: NSO; EUROSTAT.

The Maltese government deficit ratio narrowed at a faster rate than the euro area average. By the third quarter of 2024, the Maltese deficit ratio stood lower than the latter. Additionally, Malta's debt-to-GDP ratio remained well below the euro area average.

Cyclically-adjusted deficit narrows[1]

On a four-quarter moving sum basis, the cyclically-adjusted deficit narrowed by 0.5 percentage points compared to June, to stand at 3.5% of GDP in the quarter under review (see Chart 5.5). This is in line with the narrowing in the headline deficit ratio over the same period.

Chart 5.5
GENERAL GOVERNMENT BALANCE
(four-quarter moving sums; % of GDP)



Sources: NSO; Central Bank of Malta estimates.

[1] The cyclically-adjusted balance is corrected for the impact of the economic cycle on government tax revenue and unemployment assistance. This methodology is in line with the approach used by the European Commission but is based on own estimates for fiscal items' elasticities and the output gap. For an overview of the method used by the Commission, see Mourre, G., Astarita C., and Princen S. (2014), "Adjusting the budget balance for the business cycle: the EU methodology," *European Economy – Economic Papers* 536, (DG ECFIN), European Commission.

When compared with June, the share of cyclically-adjusted revenue in GDP increased by 0.9 percentage points (see Table 5.2). This was due to an increase in the share of current taxes on income and wealth.

Meanwhile, the share of cyclically-adjusted expenditure increased by 0.4 percentage points. This was mainly due to a rise in the share of intermediate consumption and to a lesser extent, in compensation of employees and interest payments.

Table 5.2
QUARTER-ON-QUARTER CHANGES IN CYCLICALLY-ADJUSTED FISCAL COMPONENTS
Percentage points of GDP

	2023		2024		
	Q3	Q4	Q1	Q2	Q3
Revenue	**-0.1**	**-0.5**	**0.3**	**0.3**	**0.9**
Current taxes on income and wealth	-0.2	-0.5	0.4	0.0	0.9
Taxes on production and imports	-0.1	0.0	0.1	0.2	0.0
Social contributions	-0.1	0.0	0.0	0.0	0.0
Other(1)	0.2	0.1	-0.2	0.2	0.0
Expenditure	**-0.8**	**0.6**	**-0.3**	**0.1**	**0.4**
Compensation of employees	-0.1	-0.1	-0.1	0.0	0.1
Intermediate consumption	0.0	0.2	-0.1	0.1	0.2
Social benefits	-0.1	-0.2	0.0	0.1	0.0
Interest payments	0.0	0.1	0.1	0.0	0.1
GFCF	0.1	0.2	0.0	-0.1	0.0
Other(2)	-0.7	0.6	-0.3	0.1	0.0
Primary balance	**0.7**	**-1.0**	**0.7**	**0.2**	**0.6**
General government balance	**0.7**	**-1.1**	**0.6**	**0.2**	**0.5**

Sources: NSO; Central Bank of Malta estimates.

(1) Includes market output, income derived from property and investments and current and capital transfers received.

(2) Mainly includes subsidies, current and capital transfers.

BOX 3: EVALUATING THE IMPACT OF TAX REBATES AND EXEMPTIONS ON THE FINANCIAL WELL-BEING OF PENSIONERS[1]

This box provides a brief overview of a 2024 Working Paper which evaluates the impact of two policies that are relevant for the financial well-being of pensioners.[2] The two policies are the 2017 Tax Rebate on Pensions and the 2022 Exempt Pension Income measures. Using the EUROMOD microsimulation model, the effects on pensioners' disposable income, work incentives and financial well-being are simulated for the 2017-2027 period.

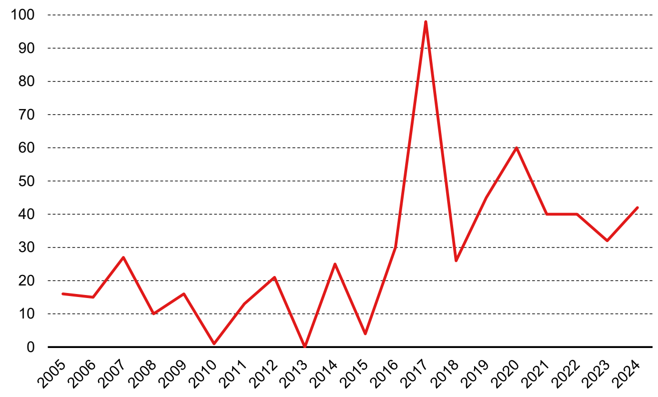
The 2006 Pension Reform and subsequent Budget Measures

Malta's present pension system has been shaped by a series of wide-ranging reforms and budget measures over the years. These reforms are necessary to ensure that the pension system remains sustainable, equitable and adequate, as it faces increasing pressures from various socio-economic factors. One of the primary drivers of these reforms stems from Malta's ageing population.

In December 2006, Parliament adopted a series of parametric reforms that significantly altered key aspects of the pension system. These changes include adjustments to the retirement age, early retirement provisions, the full two-thirds pension rate, the calculation formula, maximum pensionable income and the crediting of contributions. As part of these reforms, the pension age was gradually increased for both men and women.[3]

Beyond the 2006 reforms, pensions have remained a central focus of nearly every annual budget, with several measures introduced or amended to address evolving pension-related challenges. This is illustrated by an increase in the use of the term "pension/s" in recent budgets (see Chart 1).

Chart 1
NUMBER OF MENTIONS OF "PENSION/S" IN BUDGET SPEECHES (2005-2024)
(number of times)



Source: Author's NLP analysis from Ministry of Finance (2004-2023).

A notable measure introduced in the 2017 budget is the Tax Rebate on Pensions, which took effect on 1 January 2017. This rebate applies to individuals receiving any form of taxable pension income – including pensions,

[1] Prepared by Kurt Sant, Senior Economist within the Economic Analysis Department of the Bank. The views expressed in this article represent those of the author and should not be interpreted to reflect those of the Bank. Any errors are the author's own.

[2] Sant, K. (2024) "Evaluating the Impact of Tax Rebates and Exemptions on the Financial Well-Being of Pensioners", Central Bank of Malta *Working Paper* 08/2024.

[3] For further details on the pension reform and on its possible long-term impact see Grech, A.G. (2016) "The possible impact of pension age changes on Malta's potential output", Central Bank of Malta *Policy Note*.

charges, annuities, or annual payments – who were at least 61 years old in the year the pension was received.

Furthermore, in the 2022 budget, Government introduced the Exempt Pension Income measure, which provides a partial exemption on all pension income, gradually increasing to a full exemption by 2026, subject to a cap. According to Government, the aim of the policy is to encourage pensioners to remain active and continue working, with those earning additional income on top of their pension benefitting from a substantial reduction in their tax bill. Previously, under the 2017 tax rebate scheme, individuals received a rebate equal to the tax on their pension income (up to a certain limit). While this rebate exempted pension income from direct taxation, the untaxed portion was still considered/included when calculating tax rates on the remaining taxable income. The 2022 reform, however, fully exempts the specified portion of pension income from being factored into tax calculations.

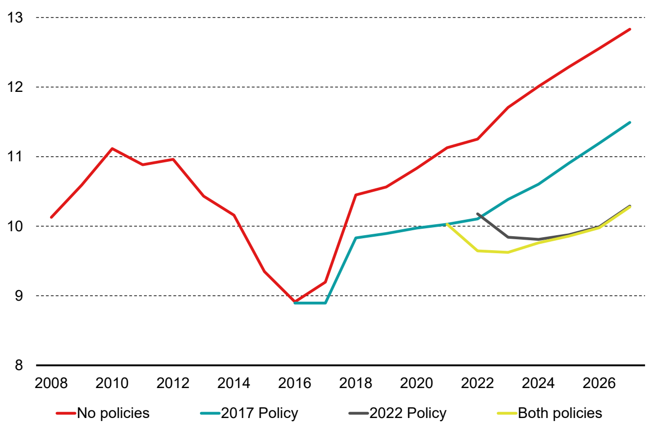
The 2017 Tax Rebate on Pensions implemented targeted tax relief for pensioners, potentially affecting their disposable income substantially. Likewise, the 2022 Exempt Pension Income measure provides a partial to full exemption from tax by excluding a portion of pension income from taxation. Both measures could have considerable implications for retirees' financial well-being and their decisions to remain in the workforce or delay retirement.

Using EUROMOD, a tax-benefit microsimulation model for the European Union, the study simulates the impact of the two policies based on three scenarios over the period 2017-2027, compared to a baseline 'do-nothing' scenario. This approach enables the isolation of effects of each policy, as well as their combined impact on key economic indicators, including household income and poverty rates.

Results

The results show that the tax policies implemented are effectively targeted, primarily benefiting pensioners, while exhibiting limited leakage to other labour status groups. A large majority of policy effects are concentrated among pensioners, with minimal benefits observed amongst self-employed individuals, employees and the unemployed. Crucially, the policies have substantially reduced the average tax burden for pensioners (see Chart 2). Specifically, the average tax burden for pensioners decreased from 11.3% to 9.6% in 2022 due to the combined effects of both policies. By 2027, this is

Chart 2
AVERAGE TAX BURDEN FOR PENSIONERS
(per cent)



Source: Author's calculations.

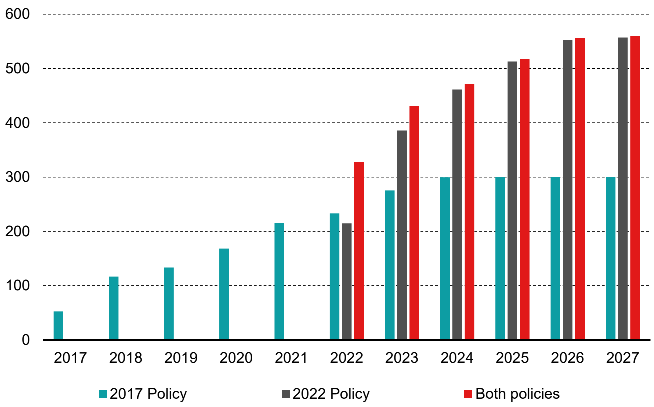
expected to stand at 10.3%, significantly lower than the 12.8% in a no-policy scenario. This reduction could encourage pensioners to postpone retirement and remain in the workforce longer, allowing them to retain a larger share of their income. However, this behavioural change cannot be modelled in EUROMOD and thus is not estimated in this study.

Results also show that over 73% of pensioner households – around 40,000 households – saw a rise in income as a result of these policies. Specifically, pensioner households saw an average increase in their annual equivalised disposable income from €52 in 2017 to €300 by 2025 due to the 2017 policy. The introduction of the 2022 tax exemption policy provided a significant immediate boost of €215, which is projected to rise to €557 by 2027. When both policies are considered together, pensioner households' disposable income rose from €328 in 2022 (2.0% of total income) to €560 by 2027 (3.2% of total income), indicating a substantial positive impact on their financial well-being (see Chart 3).

Despite these clear benefits to pensioners, the policies do not serve as a comprehensive solution for poverty alleviation. The at-risk-of-poverty rates of pensioners decreases from 26.6% in the baseline scenario to 25.6% with both policies in 2022, but other groups have seen negligible improvements, indicating that the current measures are insufficient for broader poverty alleviation. Furthermore, the analysis of income inequality, as measured by the Gini coefficient, shows a limited impact of these policies on the income distribution among lower deciles. In fact, the Gini coefficient under both policies dropped minimally, from 0.3221 to 0.3211 by 2027, highlighting the need for more inclusive reforms to achieve meaningful reductions in income inequality, although the budgetary costs would also be higher. It is worth noting, however, that the Gini coefficient was already relatively low to begin with, indicating a comparatively equitable income distribution even prior to the implementation of these policies.

Indeed, the fiscal cost of these policies remains contained. The 2017 policy was introduced with a cost of just under €5 million (0.04% of GDP). This cost is projected to rise to just below €30 million (0.11% of GDP) per year between 2024 and 2027. In contrast, the impact of the 2022 policy was estimated at €22 million in its first year, with this cost expected to reach around €65 million (0.24% of GDP) in 2027. The fiscal impact of both measures combined remains small when compared with the

Chart 3
ANNUAL CHANGE IN MEAN EQUIVALISED DISPOSABLE INCOME FOR PENIONERS
(euro per annum)



Source: Author's calculations.

level of Maltese economic activity (at approximately 0.24% of GDP per year between 2024 and 2027).

By the later years of the review period (2025-2027), the fiscal impact of the 2017 policy diminishes as the expanded parameters of the 2022 policy dominate. The 2022 exemption becomes so extensive that for many individuals the 2017 tax rebate loses relevance. Nonetheless, keeping in mind that the analysis presented in this paper does not internalise any labour supply decision changes, the overall effect of the 2017 policy may be understated. Indeed, internalising behavioural changes – such as individuals opting to work longer rather than retiring – would boost the impact that the 2017 policy would have on these estimates. On the other hand, these results suggest that if the 2017 policy is in fact administratively complex and costly to maintain, its benefit becomes questionable, especially when weighed against the expanding reach of the 2022 policy, which will eventually exempt 100% of pension income from taxation.

Conclusion

The 2017 Tax Rebate on Pensions and the 2022 Exempt Pension Income measures have had a significant and positive impact on pensioners' disposable income and overall financial wellbeing. They also appear to have achieved the goal of encouraging delayed retirement by substantially reducing the average tax burden. However, the limited benefits for the lowest-income pensioners and the minimal effects on other population groups underscore the fact that these policies alone do not address broader challenges such as poverty and income inequality. As Malta continues to face an ageing population and shifting demographic conditions, it is crucial to continue adapting the pension system to ensure its sustainability. These policies should be complemented by future reforms aimed at making the pension system more resilient in the face of these socio-economic challenges.

6. MONETARY AND FINANCIAL DEVELOPMENTS

According to the Bank's FCI, in the third quarter of 2024, financing conditions remained loose from a historical perspective, albeit less loose compared to the previous quarter.

In September, Maltese residents' deposits with MFIs in Malta increased from their year-ago level, mostly reflecting higher balances belonging to households.[1] The annual rate of change exceeded that recorded in the second quarter of 2024. Credit to Maltese residents grew at a more moderate pace compared to the previous quarter, driven by slower growth in credit to residents outside the general government sector.

The weighted average interest rate on outstanding deposits stood above its year-ago level, while the rate on outstanding loans decreased over this period. Thus, the spread between the two rates narrowed over this period.

In September, the primary market yield on Treasury bills decreased from that prevailing three months earlier. Meanwhile, secondary market yields on five and ten-year MGS also declined. As the fall in the domestic ten-year yield was more pronounced than that in the corresponding euro area benchmark, the spread between the two narrowed. Domestic share prices rose between June and September and were also higher compared with a year earlier.

Monetary and financial conditions

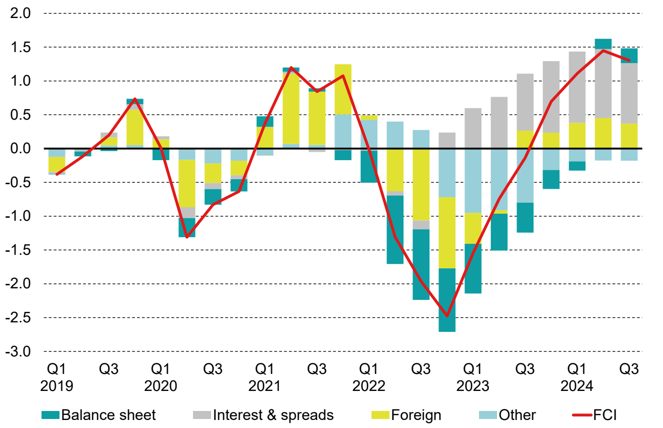
Financial conditions remain loose[2]

In the third quarter of 2024, the Bank's FCI continued to signal loose financial conditions from a historical perspective. However, compared with the previous quarter, conditions were marginally less favourable (see Chart 6.1).

The less favourable financial conditions reflected changes in both foreign and domestic factors. Foreign factors were affected by a small quarter-on-quarter increase in uncertainty between June and September.

The smaller loosening effect of domestic factors in turn mainly reflects a lower positive contribution from the 'interest & spreads' component, as the negative spread between the MFI lending rate and the MRO

Chart 6.1
CONTRIBUTIONS TO THE FCI
(contributions to the index)



Source: Central Bank of Malta estimates.

[1] Monetary data analysed in this chapter are compiled on the basis of the statistical standards found in the Statistics section of the Bank's website.
[2] This index is composed of various financial indicators, which are available at a high frequency. This section is based on quarterly averages for each indicator.

rate narrowed.[3] Meanwhile, the 'other' component recorded a slightly larger negative contribution compared to the previous quarter, as equity prices were on average lower.

Compared with the third quarter of 2023, financial conditions remained significantly looser, with the difference reflecting almost entirely developments in domestic factors. The stronger loosening effect of domestic factors mostly reflected an increase in the issues of NFC securities (part of the 'other' component) and lower negative contributions from real credit and real deposits (part of the 'balance sheet' component).

Maltese residents' deposits continue to increase

Total deposits held by Maltese residents with MFIs in Malta increased by 5.2% in the year to September, a faster rate of increase than the 2.2% growth observed in the year to June (see Table 6.1). Increases were broad-based across institutional sectors but predominantly driven by households.

Table 6.1
DEPOSITS OF MALTESE RESIDENTS

	EUR millions	Annual percentage changes				
	2024	2023		2024		
	Sep.	Sep.	Dec.	Mar.	June	Sep.
Overnight deposits	**20,313**	**-3.6**	**-0.2**	**-0.7**	**-0.5**	**2.2**
of which						
Households	14,482	0.0	1.8	1.2	2.3	3.8
NFCs	3,577	-6.2	-5.2	-1.7	-2.6	4.0
Deposits redeemable at notice of up to three months	**70**	**9.4**	**-26.0**	**-23.5**	**-33.4**	**-43.2**
of which						
Households	1	-5.5	-98.6	-99.0	-99.3	-98.0
NFCs	51	28.9	30.4	43.2	23.0	-7.5
Deposits with an agreed maturity of up to two years	**2,981**	**12.1**	**25.7**	**28.9**	**30.7**	**35.4**
of which						
Households	2,347	22.9	34.0	36.9	30.7	35.2
NFCs	318	-12.3	23.1	39.3	45.1	52.1
Deposits outside M3(1)	**1,023**	**-2.8**	**0.8**	**0.8**	**2.9**	**3.9**
of which						
Households	905	-3.1	-4.5	-5.5	-3.1	-1.6
NFCs	43	-6.4	-2.8	3.8	5.7	31.3
Total residents deposits(2)	**24,386**	**-2.2**	**1.7**	**1.7**	**2.2**	**5.2**
of which						
Households	17,735	1.8	3.8	3.7	4.5	6.5
NFCs	3,989	-6.2	-3.4	1.3	0.6	6.8

Source: Central Bank of Malta.

(1) Deposits outside M3 include deposits redeemable at notice of more than three months and deposits with an agreed maturity of over two years.

(2) Total residents deposits exclude deposits belonging to Central Government.

3 Although the DFR is the rate through which the Governing Council steers the monetary policy stance, in the Bank's FCI model the policy spread has historically been computed as the difference between the lending rate and the MRO rate, reflecting the significant importance of MROs in the past and different liquidity conditions that prevailed at the time. This approach is maintained to avoid breaks in the FCI series over time and facilitate the interpretation of the index over long horizons. As the MRO and DFR rate normally track each other closely, adjusting the calculation of the lending rate to policy rate spread to reflect the DFR instead of the MRO should not significantly affect the short-term dynamics of the FCI.

During the 12 months to September, Maltese residents' overnight deposits, which are the most liquid component, grew by 2.2%, following a 0.5% year-on-year decline recorded in June. The increase was driven by balances held by households and NFCs. The share of overnight deposits in total deposits decreased to 83.3% in September, compared to 84.1% three months earlier, as deposits with an agreed maturity of up to two years recorded a larger increase (see Chart 6.2).

The latter registered robust growth of 35.4% in the year to September, compared with 30.7% in June. Their share in overall deposits continued to increase, reaching 12.2% from 11.3% three months prior. The latest increase was driven by higher balances belonging to households, although balances held by NFCs also went up. This reflects more attractive terms on fixed deposit accounts being offered by certain credit institutions, in response to the current monetary policy stance.

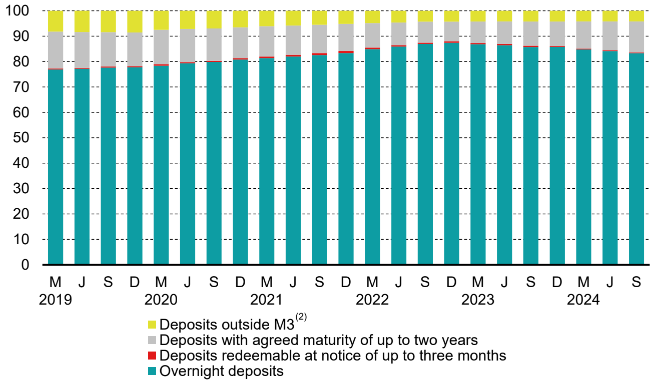
Deposits with an agreed maturity of up to three months (the smallest component) continued to decline, while retaining a small share of total deposits, at 0.3%.

Meanwhile, deposits classified outside M3 – which are mainly composed of deposits with agreed maturity of over two years – recorded an annual growth rate of 3.9% in September, compared to 2.9% three months earlier. Their share in total resident deposits remained unchanged at 4.2%.

Credit to residents grows at a slower pace

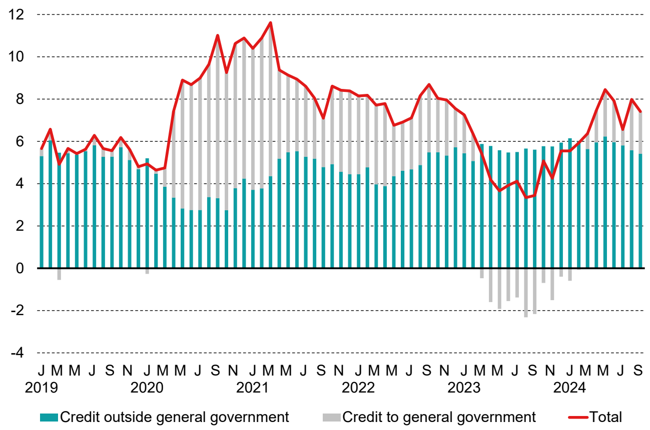
The annual rate of change of credit to Maltese residents moderated to 7.4% in September, from 7.9% in June. This moderation was driven by slower growth in credit to residents outside the general government sector. By contrast, credit to general government recorded faster growth compared to June (see Table 6.2 and Chart 6.3).

Chart 6.2
DISTRIBUTION OF TOTAL RESIDENT DEPOSITS[1]
(percentage points)



Source: Central Bank of Malta.
[1] Deposits exclude those belonging to central government.
[2] Deposits outside M3 include deposits redeemable at notice of more than three months and deposits with an agreed maturity of over two years.

Chart 6.3
CONTRIBUTIONS TO GROWTH IN CREDIT TO MALTESE RESIDENTS
(percentage points; annual percentage change)



Source: Central Bank of Malta.

Table 6.2
MFI CREDIT TO MALTESE RESIDENTS

	EUR millions	Annual percentage changes				
	2024	2023		2024		
	Sep.	Sep.	Dec.	Mar.	June	Sep.
Credit to general government	**4,870**	**-8.1**	**-1.5**	**2.9**	**8.0**	**8.4**
Credit to residents outside general government	**15,415**	**7.7**	**8.0**	**7.6**	**7.9**	**7.1**
Securities and equity	296	-3.3	-4.6	-4.3	-4.7	-7.7
Loans	15,119	7.9	8.4	7.8	8.2	7.4
of which:						
Loans to households	8,930	7.3	8.2	9.0	9.1	9.5
Mortgages	8,241	7.2	7.9	8.7	8.8	9.4
Consumer credit and other lending	689	8.5	12.2	12.4	13.4	10.8
Loans to NFCs[1]	5,081	9.1	8.8	5.4	6.3	3.0
Total credit to residents	**20,285**	**3.4**	**5.5**	**6.4**	**7.9**	**7.4**

Source: Central Bank of Malta.
[1] NFCs include sole proprietors and non-profit institutions serving households (NPISH).

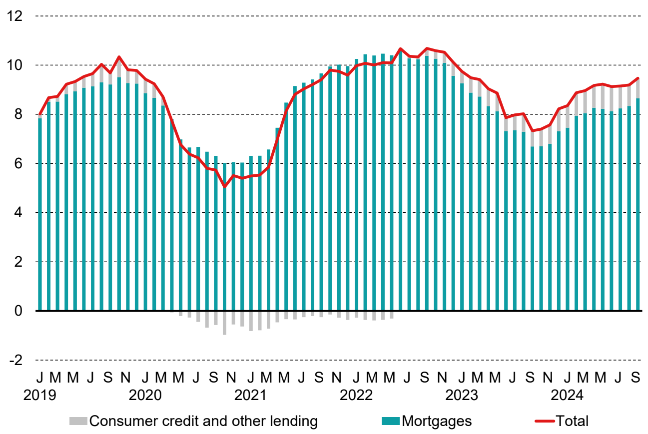
The latter grew by 8.4% in the year to September, following an increase of 8.0% over the year to June. The latest increase was driven by an increase in MFI holdings of Government stocks, which grew by 9.9%. By contrast, during the same quarter, MFI holdings of Treasury bills declined.

The annual growth of credit to residents outside general government decreased to 7.1% in September, from 7.9% three months prior. In part, this reflects a larger contraction in MFI holdings of securities issued by the private sector, which decreased by an annual 7.7%, following a decline of 4.7% in June.

Loans to private sector, though, also rose at a slower pace, although developments were mixed across different segments.

Annual growth in loans to households reached 9.5%, compared to 9.1% three months earlier, driven by faster growth in mortgage lending (see Chart 6.4). This grew by an annual 9.4% in September, from 8.8% in June. By contrast, growth in consumer credit moderated to 10.8% year-on-year, following a 13.4% increase in the year to June.

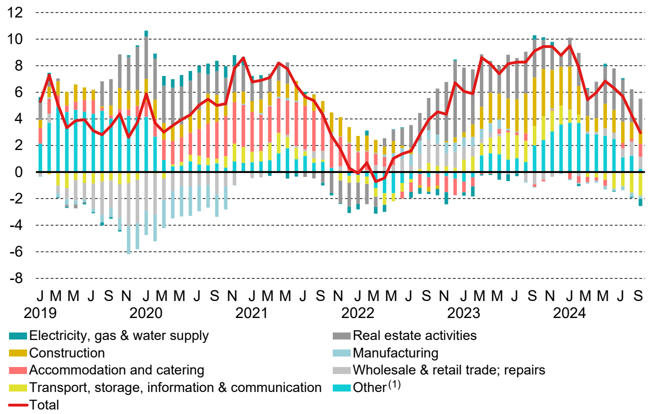
Chart 6.4
CONTRIBUTIONS TO GROWTH IN LOANS TO HOUSEHOLDS
(percentage points; annual percentage change)



Source: Central Bank of Malta.

Meanwhile, loans to NFCs rose at an annual rate of 3.0%, after 6.3% three months earlier (see Chart 6.5). Slower growth was recorded in lending to private NFCs.

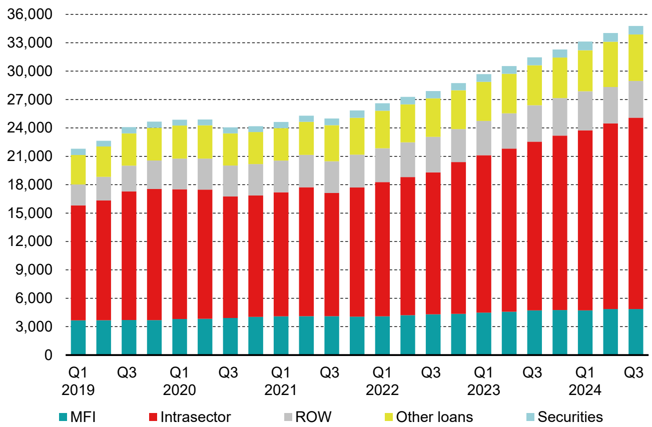
Chart 6.5
LOANS TO NFCs BY SECTOR
(percentage points; annual percentage change)



Source: Central Bank of Malta.
(1) Mainly includes entertainment, health, education, professional services, and administration.

Sectoral data show that the expansion in loans to NFCs in the year to September was largely driven by increased lending to the real estate sector, the construction sector and the sector comprising accommodation and food services. Loans to the trade and repair sector also increased. On the other hands, loans to the manufacturing sector, the energy sector and, in particular, the sector comprising information, communication, transport and storage decreased.

Chart 6.6
NFC DEBT BY SOURCE
(end-of-period stocks in EUR millions)



Source: Financial Accounts.

Financial accounts data show that the share of bank lending in total NFC debt in September 2024, decreased to 14.0%, compared to 14.3% in June, and from 15.0% recorded a year earlier (see Chart 6.6).

The share of intra-sectoral lending in total NFC debt reached a new high of 58.1%, from 57.7% recorded in June. This component continued to account for most of NFCs external financing.

The share of NFC debt from non-residents decreased marginally to 11.2%, from 11.3% in June, and from 12.2% recorded last year. Meanwhile, the share of 'other loans' increased marginally compared to June, at 14.1%. This component largely reflects loans from financial institutions other than MFIs, and households.

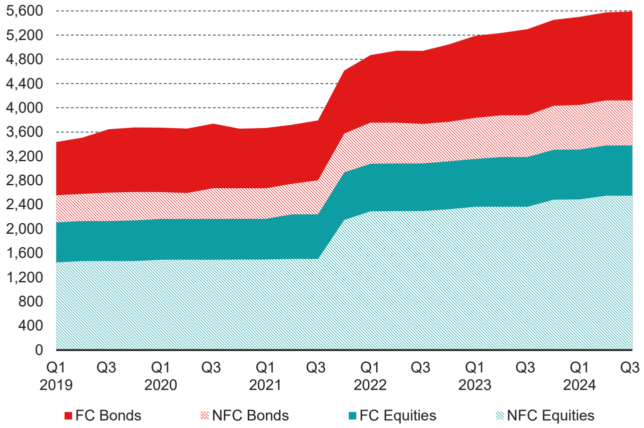
The share of securities decreased marginally to 2.6%, from 2.7% recorded a year earlier.

Stock of listed securities of NFCs and financial corporations increases

By September 2024, around €2,210.5 million in outstanding corporate debt securities were listed on the MSE by NFCs and financial corporations, 4.7% higher than the amount listed a year earlier (see

Chart 6.7).[4] 66.3% of this amount was issued by financial entities other than credit institutions.

Chart 6.7
OUTSTANDING SECURITIES OF NFCs AND FCs LISTED ON MSE
(EUR millions outstanding as at end-period)



Sources: MSE; Central Bank of Malta estimates.

Meanwhile, the outstanding amount of equity listed by the aforementioned institutions on the MSE increased by 6.0% in annual terms, to reach €3,378.7 million. Over three fourths of this volume was issued by NFCs, with FCs playing a secondary role. The increase over the year to September, was mostly driven by NFCs that operate within the real estate sector. The total amount of outstanding listed equity as of September 2024, exceeded that of bonds by 52.8%.[5]

Spread between deposit and lending rate narrows in annual terms

The weighted average deposit rate on outstanding balances belonging to households and NFCs increased by 13 basis points since September 2023, to reach 0.40% (see Table 6.3). This was largely driven by higher rates on time deposits belonging to NFCs and households, especially deposits with agreed maturity of up to two years. Rates on households' deposits redeemable at notice of up to three months also registered higher rates.

At the same time, the weighted average lending rate paid by households and NFCs on outstanding loans decreased by 20 basis points, to 3.41%. This decrease reflected lower rates charged to both households and NFCs, although the decrease in the NFC lending rate was more significant, amounting to 29 basis points. Meanwhile, rates charged to households decreased by 12 basis points, with rates on mortgage lending and consumer credit down, by 9 and 35 basis points, respectively.

The spread between the weighted average lending rate and the deposit rate on outstanding balances closed September at 301 basis points. This was lower than the spread recorded in the previous quarter and below the spread of 334 basis points recorded a year earlier.

During the year to September, both the deposit rate offered on new balances held by households and NFCs in Malta, and the lending rate to these sectors increased. By September, the weighted average deposit rate for households and NFCs increased to 2.64% while the lending rate to these two sectors increased to 3.22%.

Compared to the second quarter of 2024, interest rates on outstanding deposits with MFIs increased by 3 basis points, while rates on outstanding loans decreased by 10 basis points. As a result, the spread between the two rates narrowed slightly. By contrast the spread on new transactions widened compared to June, as the lending rate was stable while the deposit rate decreased.

---

[4] MSE data may differ from financial accounts data due to differences in valuation methodology and coverage. In particular, financial accounts data are at market value and include both listed and privately-placed securities. MSE data on corporates presented in Chart 6.7 are based on the official MSE list and thus exclude securities listed through Prospects. Chart 6.7 includes data on NFCs and FCs other than MFIs.

[5] Apart from the official MSE platform, small and medium-sized enterprises can also obtain finance through the specifically-geared platform – Prospects.

Table 6.3
INTEREST RATES ON DEPOSITS AND LOANS
Percentages per annum to residents of Malta; weighted average rates as at end of period

	2021	2022	2023	2023		2024	
	Sep.	Sep.	Sep.	Dec.	Mar.	June	Sep.
Total deposits(1)	**0.18**	**0.16**	**0.27**	**0.30**	**0.35**	**0.37**	**0.40**
of which							
Overnight deposits							
Households	0.02	0.04	0.05	0.05	0.05	0.05	0.05
NFCs	0.02	0.06	0.07	0.10	0.10	0.12	0.10
Savings deposits redeemable at notice							
Households	0.41	0.17	0.15	0.31	0.31	0.30	0.28
NFCs	0.08	0.05	0.45	0.47	0.74	0.60	0.57
Time deposits (less than two years)							
Households	0.53	0.54	1.58	1.79	2.05	2.07	2.15
NFCs	0.48	0.59	1.58	1.85	2.28	1.80	2.26
Time deposits (more than two years)							
Households	1.77	1.77	1.77	1.79	1.82	1.89	1.98
NFCs	1.05	1.60	1.38	1.74	1.83	1.38	1.92
Total loans(1)	**3.25**	**3.25**	**3.61**	**3.58**	**3.52**	**3.51**	**3.41**
of which							
Households and NPISH	3.05	2.94	2.87	2.85	2.82	2.81	2.75
NFCs	3.60	3.82	4.98	4.95	4.83	4.81	4.69
Spread(2)	**3.07**	**3.09**	**3.34**	**3.28**	**3.17**	**3.14**	**3.01**
ECB MROs rate	0.00	1.25	4.50	4.50	4.50	4.25	3.65

Source: Central Bank of Malta.

(1) Annualised agreed rates on outstanding euro-denominated amounts belonging to households (incl. NPISH) and NFCs.

(2) Difference between composite lending rate and composite deposit rate.

Liquidity support measures

By the end of September 2024, 424 facilities were still outstanding under the Malta Development Bank's (MDB) COVID-19 Guarantee Scheme (CGS) down from 468 facilities in June.[6] By end-September, the outstanding value of disbursed loans stood at €146.0 million, down from €169.8 million at end-June 2024. Almost all these loans will mature within the next three years.

The sector comprising wholesale and retail activities had the largest number of outstanding facilities benefitting from the scheme. This was followed by the sector comprising accommodation and food service activities, which also had the highest value of sanctioned loans in value terms.

A total of €24.5 million was disbursed under the Liquidity Support Guarantee Scheme (LSGS) in relation to the Temporary Crisis Framework.[7] Repayments for this loan have started. At the end of December 2023, this scheme was officially closed for new borrowers.

[6] The MDB CGS provided guarantees to commercial banks with the aim of enhancing access to new working capital loans for businesses. The scheme received applications until 30 June 2022. See MDB COVID-19 Guarantee Scheme for further details.

[7] This LSGS consisted of two measures: LSGS-A provides bank financing support to all undertakings affected by the extraordinary circumstances caused by the war in Ukraine, while LSGS-B was specific to fuel and oil importers. A total portfolio of €100 million and €50 million in working capital loans were available under LSGS-A and LSGS-B, respectively. Government guarantees cover 90% of each working capital loan under LSGS-A and 80% under LSGS-B.

Bank Lending Survey (BLS) indicates unchanged credit standards, terms and conditions in third quarter

According to the September BLS, in the third quarter of 2024, all participating banks reported unchanged credit standards and terms and conditions for lending to NFCs, mortgage lending as well as consumer credit and other lending. For the fourth quarter, the majority of banks foresaw no changes for all types of credit.

As regards demand, surveyed banks generally did not report changes for the third quarter, except for some decrease in demand for credit by NFCs. Meanwhile, all banks anticipated demand to remain unchanged in the final quarter of 2024.

The October BLS also posed ad hoc questions on changes in banks' access to wholesale and retail funding, and in their risk transfer capacity as a result of the prevailing situation in financial markets. No impacts were reported as regards access to retail funding, interbank unsecured money markets, debt securities and securitisation. Participating banks also said that the situation in financial markets had not affected their ability to transfer risks off balance sheet. This was expected to remain the case in the fourth quarter.

Respondent banks were also asked whether the ECB's monetary asset portfolio led to a change in their assets, or affected their cost of funds, balance sheet and capital position, and profitability. The majority of responding banks reported no changes and this scenario was expected to prevail also in the six months ahead. Nevertheless, half of the surveyed banks reported some increase in holdings of euro area sovereign bonds that was also expected to persist into the fourth quarter.

Participating banks were also asked to indicate if the ECB's monetary policy portfolio had led to changes in credit standards and terms and conditions, and lending volumes. None of these were affected. Moreoever, for the following six months, banks also expected no impact.

Respondent banks were asked to gauge the impact of the Eurosystems's third series of targeted longer-term refinancing operations. All respondents reported no impact on their bank's financial situation, lending policy and lending volumes. This also applies for the six months ahead.

Finally, participating banks were asked whether the ECB key interest rates decisions (both those already taken and those expected) led to a change in their profitability via interest and non-interest income. In this regard, the majority assessed non-interest income to have been unaffected, but reported a decline in net interest income. This assessment was expected to prevail also in the six months ahead.

The money market

During the third quarter of 2024, the Government issued €277.2 million in Treasury bills, €184.0 million less than the amount issued in the second quarter of 2024.

In the domestic primary market, the yield on three-month Treasury bills declined to 2.64% by the end of September, from 3.56% at end-June.

The capital market

During the third quarter of 2024, the Government issued two new MGS with a total value of €388.4 million.

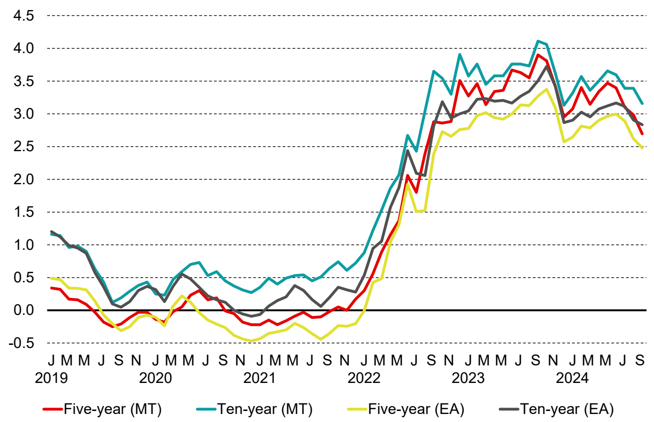
Three private sector institutions launched new bond issues on the MSE. Hili Finance Company plc issued €80.0 million in unsecured bonds, while Hal Mann Vella Group plc and Mercury Projects Finance plc issued secured bonds worth €23.0 million and €20.0 million, respectively.

By the end of September, 19 firms had bonds that were listed on the MSE through Prospects, an unchanged number compared with three months earlier.[8] There was also one company which had shares issued through Prospects.

In the secondary market, turnover in government bonds increased to €54.8 million, from €37.0 million in the second quarter of 2024. On the contrary, turnover in corporate bonds decreased to €30.9 million from €36.5 million, previously.

The yield on five-year Government bonds fell to 2.70% at the end of September, from 3.40% three months earlier (see Chart 6.8). The yield on ten-year bonds also declined, to reach 3.16% from 3.60% in June. Meanwhile, the euro area benchmark yield on five-year bonds fell to 2.48% from 3.00%, and that on ten-year bonds decreased to 2.83% from 3.17%. As the decline in the domestic ten-year yield was larger than that in the euro area benchmark, the spread between the two narrowed to 32 basis points from 43 basis points in June.

Chart 6.8
GOVERNMENT BOND YIELDS
(percentages per annum; end of month)

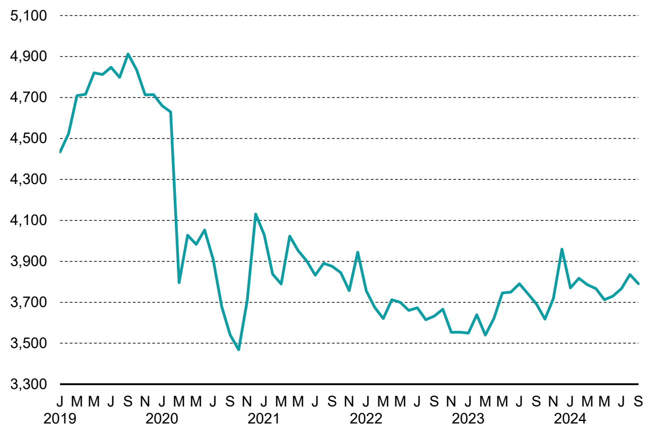


Sources: Central Bank of Malta; ECB.

MSE Share Index rises during the quarter

Share prices in Malta rose during the third quarter of 2024. The MSE Equity Price Index ended the quarter 1.6% above its level at end-June and was also 2.7% higher than its reading a year earlier (see Chart 6.9). The MSE Equity Total Return Index, which accounts for changes in equity prices and dividends, was 2.6% higher than its level at end-June.

Chart 6.9
MSE EQUITY PRICE INDEX
(end of month)



Source: MSE.

Equity turnover rose to €19.8 million during the third quarter of 2024, from €10.1 million in the previous quarter.

[8] Prospects is a multi-lateral trading facility operated by the MSE with the aim of facilitating access to capital markets for SMEs.