

## FOREWORD

During the second quarter of 2025, real gross domestic product (GDP) rose by 2.7% in annual terms. Growth was mainly driven by domestic demand, although net exports also contributed positively. When adjusting for imports, external trade was the main contributor to growth.

Potential output is estimated to have grown by 5.1% in the second quarter of 2025, marginally below the growth of 5.2% estimated for the first quarter. On a four-quarter moving average basis, the level increase in potential output relative to the previous three months exceeded that of GDP. As a result, in the quarter under review, the output surplus narrowed to 1.5% from 2.1% in the first quarter, implying a further moderation in the degree of over-utilisation of the economy's productive capacity.

The Bank's Business Conditions Index (BCI) remained relatively unchanged in the second quarter, indicating that economic growth stood above its long-run average.

The Bank's Economic Policy Uncertainty (EPU) Index, which monitors economic policy uncertainty by synthesising information gleaned from Maltese news portals rose compared to the first quarter of the year and was also above its historical average of 100. The increase in uncertainty was largely driven by international developments, particularly the United States' evolving tariff policy and speculation over future interest rate adjustments by the central banks of key economies.

The labour market continued to show resilience amid a further increase in activity rates. According to the Labour Force Survey (LFS), employment rose by 4.5% in annual terms, following a rise of 4.3% in the previous quarter. The unemployment rate declined further and remained well below that in the euro area. Meanwhile, the job vacancy rate and the labour market tightness indicator rose further to reach a new peak.

Annual inflation, as measured by the Harmonised Index of Consumer Prices (HICP) increased to 2.5% in June, from 2.1% in March. This reflected larger contributions from food and services inflation, with price movements in the hospitality sector playing an important role. Meanwhile, annual inflation based on the Retail Price Index (RPI), which only considers expenditure by Maltese residents, increased to 2.4% in June from 2.1% in March, reflecting primarily a higher contribution from food prices.

Non-labour cost indicators regularly monitored by the Bank on a quarterly basis mostly showed moderate increases or falling costs in annual terms, with the deflator for imported goods being the only indicator among them with annual growth of more than 2%. Meanwhile, Malta's unit labour cost (ULC) index, measured on a four-quarter moving average basis, rose at an annual rate of 7.4%, following a rise of 6.1% in the previous quarter, mainly due to a fall in productivity.

In the second quarter of 2025, the current account surplus narrowed when compared with a year earlier. This was due to a larger merchandise trade deficit and, to a lesser extent, a shift in the secondary income account from net inflows to net outflows. On a four-quarter moving sum basis, the current account surplus was equivalent to 6.5% of GDP.

In the second quarter of the year, the general government balance registered a deficit, in contrast to the surplus recorded in the corresponding period a year earlier. When measured on a four-quarter

moving sum basis, the general government deficit-to-GDP ratio widened by 0.8 percentage points between March and June, to stand at 4.0% of GDP. The general government debt-to-GDP ratio rose to reach 46.9% at the end of June, from 46.7% at end-March.

In June, the annual rate of change of Maltese residents' deposits with monetary financial institutions (MFIs) exceeded marginally that recorded in March. Meanwhile, credit to Maltese residents grew at a slower pace compared with the previous quarter, driven by slower growth in credit to residents outside general government. The Bank's Financial Conditions Index (FCI) suggests that financing conditions were less loose from the previous quarter.

The weighted average interest rate offered to households and non-financial corporations (NFCs) on their outstanding deposits and loans decreased on a year earlier. The spread between the two rates narrowed from 314 basis points to 297 basis points.

During the year to June, both the deposit rate offered on new balances held by households and NFCs in Malta, and the lending rate paid by these sectors decreased. By June, the weighted average deposit rate for households and NFCs decreased to 1.92%, while the lending rate of these two sectors stood at 3.04%.

In June, the primary market yield on Treasury bills decreased from that prevailing three months earlier. Meanwhile, secondary market yields on five-year and ten-year Malta Government Stocks (MGS) also fell over this period. The Malta Stock Exchange (MSE) Equity Price Index was higher on a year earlier.

In April and June, the Governing Council of the European Central Bank (ECB) lowered its key interest rates by 25 basis points on each occasion, bringing the deposit facility rate (DFR), which is the relevant rate that steers the monetary stance, to 2.00%. Given the prevailing exceptional uncertainty, the Council confirmed that it would follow a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance, reaffirming that it would not pre-commit to a particular rate path.

During the third quarter of 2025, the Governing Council kept its policy rates unchanged. Euro area inflation stood at around the ECB's 2% medium-term target and the Governing Council's assessment of the inflation outlook remained broadly unchanged.