ECONOMIC SURVEY

1. THE EURO AREA AND THE EXTERNAL ENVIRONMENT[1]

In the first quarter of 2026, real GDP contracted in the euro area, whereas it grew at a faster pace in both the United States and the United Kingdom. The unemployment rate remained unchanged in the euro area but decreased slightly in both the United States and the United Kingdom.

The outbreak of the conflict in the Middle East led to a surge in energy prices, pushing up inflation in key advanced economies. In the euro area, inflation rebounded to 2.6% in March, compared to 2.0% in December, while in the United States inflation rose to 3.3% in March, from 2.7% three months earlier. In contrast, in the United Kingdom inflation dropped to 3.3% in March from 3.4% in December. The ECB, the US Federal Reserve (Fed) Bank and the Bank of England kept interest rates unchanged during the quarter under review.

Brent oil and European natural gas prices rebounded strongly amid supply disruptions resulting from the conflict in the Middle East, which started on 28 February 2026.

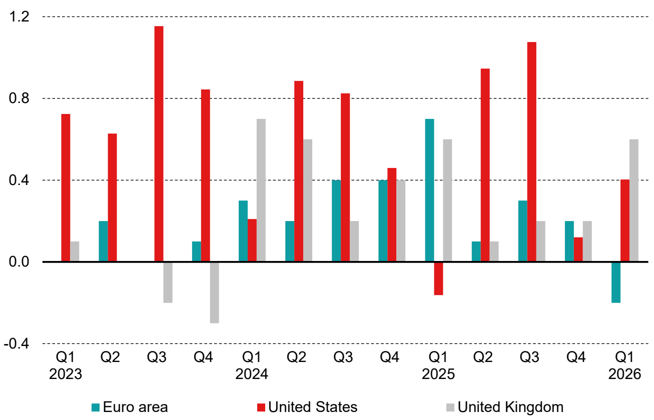
Economic and financial developments in the euro area

Economic activity in the euro area contracts

Economic activity in the euro area shrank in the first quarter. In real terms, GDP fell by 0.2% on a quarter-on-quarter basis, as against a 0.2% increase in the previous quarter (see Chart 1.1). The contraction in economic activity was heavily influenced by a double-digit fall in GDP in Ireland. In terms of sectoral gross value added (GVA), in real terms the decline in GDP mainly stemmed from a decline in manufacturing, while smaller falls were recorded in construction as well as in financial services. Taken together, these outweighed modest growth in wholesale and retail trade, real estate activities and other services sector categories.

In terms of expenditure components, domestic demand contributed marginally to GDP during the quarter under review. Higher private as well as government consumption expenditures were almost completely offset by declines in gross fixed capital formation (GFCF) and inventories. Net exports pulled GDP down by 0.3 percentage points, reflecting a combination of an increase in imports and a decrease in exports (see Table 1.1).

Chart 1.1
REAL GDP GROWTH IN SELECTED ADVANCED ECONOMIES
(percentage changes over the preceding period)



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

[1] On 1 January 2026, Bulgaria became the 21st member of the euro area after the Council of the European Union (EU) had formally approved the country's accession in July 2025, with a Bulgarian lev conversion rate of 1.95583 levs per euro. Accordingly, all data series concerning the euro area comprise statistics pertaining to the group of 21 Member States that constitute the euro area. The only exception relates to HICP inflation data. In this case, the statistics pertain exclusively to the countries forming the euro area taking into consideration the changing composition of the euro area.

Table 1.1
CONTRIBUTIONS TO QUARTERLY REAL GDP GROWTH IN THE EURO AREA[1]
Percentage points; quarter-on-quarter percentage change

	2024				2025				2026
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Private consumption	0.3	0.1	0.3	0.2	0.2	0.1	0.1	0.2	0.1
Government consumption	0.0	0.2	0.1	0.1	-0.1	0.1	0.2	0.1	0.1
GFCF	-0.5	-0.5	0.3	0.2	0.6	-0.3	0.3	0.2	-0.1
Changes in inventories[2]	-0.1	0.3	0.5	-0.1	-0.4	0.5	0.1	0.1	-0.1
Exports	0.1	0.8	-0.7	0.1	1.4	-0.4	0.3	-0.3	-0.1
Imports	0.5	-0.6	-0.2	-0.1	-1.0	0.1	-0.6	-0.1	-0.2
GDP	**0.3**	**0.2**	**0.4**	**0.4**	**0.7**	**0.1**	**0.3**	**0.2**	**-0.2**

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.

Meanwhile, the European Commission's Economic Sentiment Indicator (ESI) rose on average compared to the previous quarter. The ESI for the euro area rose to 99 in January, its highest level since April 2023, albeit it dropped in the following two months, after the outbreak of the war in the Middle East. The increase in the ESI over the quarter mainly reflected an improvement in sentiment in industry, services and in retail trade. By contrast, sentiment among consumers and in the construction sector worsened.

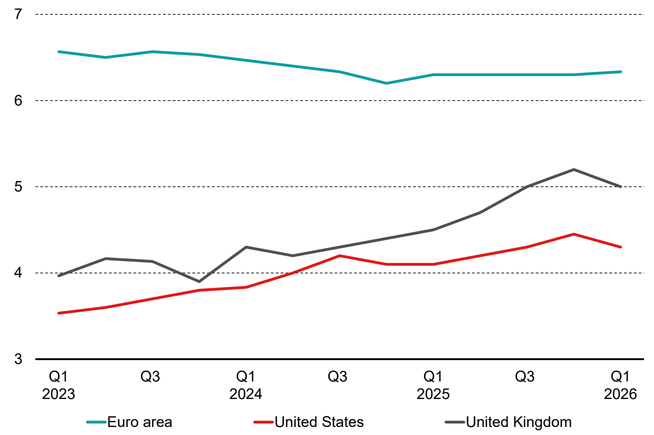
Labour market remains reasonably strong

The labour market in the euro area remained reasonably resilient, though there were some signs of weakening demand. Employment growth moderated, easing to a quarterly rate of 0.1% during this period, down from 0.2% in the preceding quarter.[2] Meanwhile, the seasonally adjusted unemployment rate stood at 6.3% in March, unchanged from December 2025. It averaged 6.3% in the quarter under review, also unchanged from the previous quarter (see Chart 1.2).

Inflation rebounds

Inflation in the euro area rebounded in the first quarter, exceeding the ECB's 2% medium-term target. The annual rate of inflation based on the HICP stood at 2.6% in March, compared to 2.0% in December 2025 (see Chart 1.3). The increase in overall inflation mainly reflected a surge in energy prices, reinforced by

Chart 1.2
UNEMPLOYMENT RATE
(percentage of the labour force; quarterly average; seasonally adjusted)

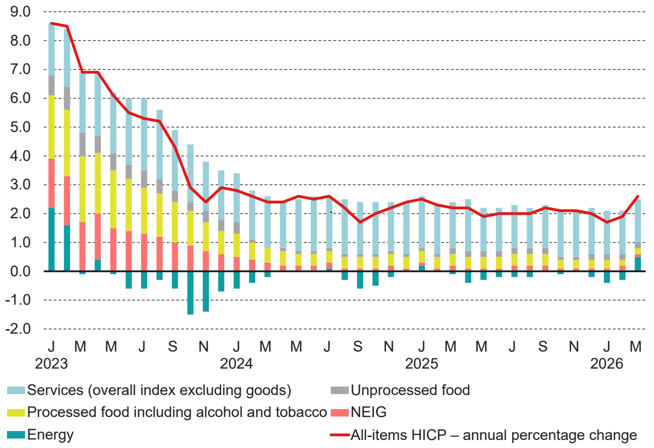


Sources: Bureau of Labor Statistics, US; Eurostat; Office for National Statistics, UK.

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

higher contributions from unprocessed food and non-energy industrial goods (NEIG). On the other hand, the contributions from processed food (including alcohol and tobacco) and services to inflation declined.

Chart 1.3
CONTRIBUTIONS TO HICP INFLATION IN THE EURO AREA
(percentage points; annual percentage change)



Source: ECB.

Turning to the major HICP components, the annual rate of change of energy prices turned markedly positive, as it reached 5.1% in March, as against -1.9% in December. This reflected a spike in energy prices in the wake of the war in the Middle East as well as base effects. The annual rate of unprocessed food inflation rose to 4.2% in March, from 3.5% three months before, while annual NEIG inflation increased to 0.5% in March, from 0.3% in December. By contrast, the annual rate of processed food inflation fell to 1.7% in March, from 2.1% three months earlier, and services inflation decreased slightly to an annual rate of 3.3% in March, from 3.4% in December.

Underlying inflationary pressures remained stable during the review period, with the annual rate of HICP inflation excluding energy and food (HICPX) standing at 2.3% in March, unchanged from December.

Real GDP growth projections revised down, inflation revised up in 2026 and 2027

According to the Eurosystem staff macroeconomic projections for the euro area, published in June 2026, real GDP growth is expected to slow down to 0.8% in 2026.[3] Economic growth is then projected to rebound to 1.2% in 2027 and to 1.5% in 2028 (see Table 1.2).

Table 1.2
MACROECONOMIC PROJECTIONS FOR THE EURO AREA[(1)]
Annual percentage changes

	2025	2026	2027	2028
Real GDP	**1.5**	**0.8**	**1.2**	**1.5**
Private consumption	1.5	0.8	1.0	1.4
Government consumption	1.6	1.6	1.0	1.3
GFCF	3.1	1.8	1.7	2.1
Exports	2.1	1.1	2.6	2.9
Imports	3.8	1.6	2.4	3.0
HICP	**2.1**	**3.0**	**2.3**	**2.0**
HICP excluding energy and food	2.4	2.5	2.5	2.2

Source: ECB.

(1) Eurosystem staff macroeconomic projections for the euro area, June 2026.

[3] The cut-off date for the technical assumptions was 21 May 2026. The projections for the international environment were finalised on 20 May and those for the euro area were finalised on 27 May 2026.

Economic growth is expected to remain subdued in the near term, as higher energy prices and greater uncertainty weigh on domestic demand. Private consumption is projected to slow down considerably in 2026, before recovering in line with rising real disposable income. Over the medium term, increased government spending on infrastructure and defence as well as investment related to artificial intelligence (AI) should boost domestic demand. On the external side, export growth is expected to remain constrained by persistent competitiveness challenges.

Compared to the previous projection exercise, the latest projections were conditioned on notably higher oil prices for 2026 and higher oil prices for 2027-28 amid the war in the Middle East, a slightly stronger euro, higher interest rates and an increase in the effective US tariff rate on imports from the euro area. On the other hand, gas price assumptions were revised down modestly for the short term but they were revised upwards later in the horizon. Electricity prices were revised up slightly on average over the projection horizon.

Compared to the March projections, real GDP growth was revised downwards by 0.1 percentage points for both 2026 and 2027 and revised up by 0.1 percentage points for 2028. The downward revision of real GDP growth in 2026 mainly related to a weaker outlook for consumption as the conflict in the Middle East is now assumed to last slightly longer than previously foreseen, with a stronger impact on real incomes. Towards the end of the projection horizon, the reduction in energy commodity prices, a recovery in real disposable income and improving confidence implied slightly stronger growth in 2028.

Turning to the outlook for prices, the Eurosystem staff foresee headline HICP inflation rising to an average of 3.0% in 2026 from 2.1% in 2025, before easing to 2.3% in 2027 and 2.0% in 2028. The increase in headline inflation in 2026 reflects a sharp rise in energy inflation. As the energy shock is set to fade, inflation is expected to decline to target in 2028.

Compared to the March projections, headline HICP inflation was revised up by 0.4 percentage points for 2026 and 0.3 percentage points for 2027, whereas it was revised downwards by 0.1 percentage points for 2028. The upward revisions to headline inflation resulted from revisions to all components, and reflected recent upside surprises, higher energy and food commodity price assumptions and stronger likely effects of the war in the Middle East on NEIG. On the other hand, the downward revision of headline inflation for 2028 reflected likely developments in the price of oil, as captured by futures prices.

HICPX is expected to increase to an average of 2.5% in both 2026 and 2027, from 2.4% in 2025, but then ease to 2.2% in 2028. Compared to the March projections, the outlook for underlying inflation was revised upwards by 0.2, 0.3 and 0.1 percentage points for 2026, 2027 and 2028, respectively. The revisions in underlying inflation over the projection horizon reflect higher services in 2026 and 2027 and more elevated NEIG inflation throughout the projection horizon.

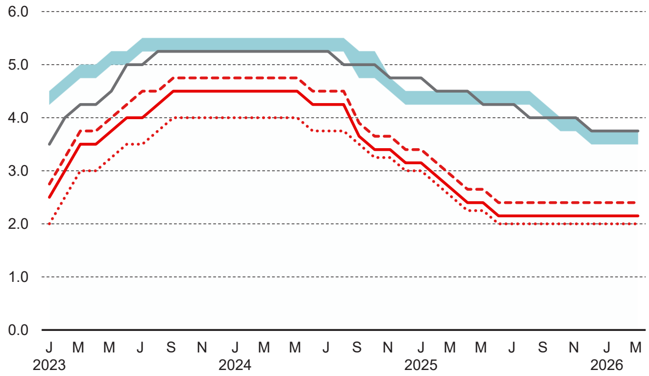
The Eurosystem staff projections were prepared against a backdrop of high uncertainty, related to the war in the Middle East and the size and persistence of the consequent energy price shock. Accordingly, Eurosystem staff prepared three distinct scenarios, namely an adverse, a severe and a milder scenario. The adverse and, in particular, the severe scenarios assume a sharper and more persistent increase in energy prices and higher uncertainty than those considered in the baseline. This results in higher inflation and a lower GDP growth, when compared to the baseline.

On the other hand, the milder scenario assumes that oil prices would normalise more quickly than in the baseline. Hence, inflation would moderate faster while GDP growth would recover earlier and more robustly than foreseen in the baseline scenario.

ECB keeps interest rates unchanged

During the quarter under review, the Governing Council kept the three key ECB interest rates unchanged. Thus, the interest rates on the deposit facility, the MROs and the marginal lending facility stood at 2.00%, 2.15% and 2.40%, respectively. In March, the Governing Council noted that inflation had been at around the 2% target, longer-term inflation expectations were well anchored, and the economy had shown resilience over recent quarters. However, the Council acknowledged the war in the Middle East had made the outlook significantly more uncertain, affirming that it was well positioned to navigate this uncertainty. The Governing Council also stated that it would continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance and that it was not pre-committing to a particular rate path (see Chart 1.4).[4]

Chart 1.4
OFFICIAL INTEREST RATES
(percentages per annum; end of month)

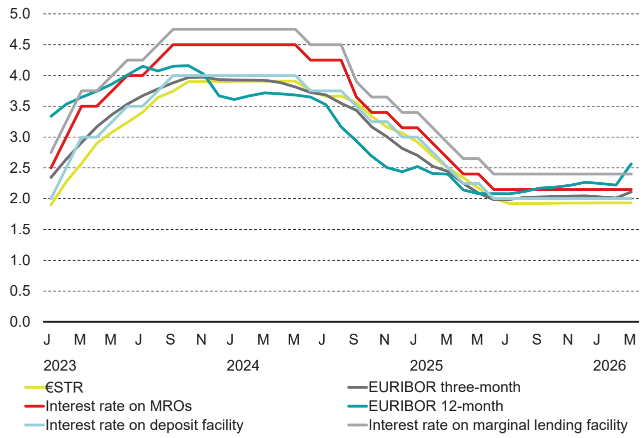


Sources: ECB; Fed; Bank of England.

Money market rates rise further out the curve

Money market interest rates in the euro area remained unchanged in the short term but rose gradually further out the curve. Hence, the euro short-term rate (€STR) averaged 1.93% in March, unchanged from three months before (see Chart 1.5).[5] The three-month euro interbank offered rate (EURIBOR) edged up to average 2.11% in March, compared to 2.05% in December. The 12-month EURIBOR

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



Source: ECB.

4 After having left the three key ECB interest rates unchanged in April, in June, the Governing Council raised them by 25 basis points in line with its commitment to setting monetary policy to ensure that inflation stabilises at the 2% target in the medium term. Accordingly, the interest rates on the deposit facility, the MROs and the marginal lending facility increased to 2.25%, 2.40% and 2.65%, respectively. The Council stated that with this decision, it remained well positioned to navigate the uncertainty caused by the war in the Middle East. The Governing Council reaffirmed that it was not pre-committing to a particular rate path.

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.

averaged 2.57% in March, up from 2.27% three months earlier.[6] It thus stood further above the deposit facility rate, compared to December, indicating that market players had started to factor in the possibility of monetary policy tightening in the year ahead.

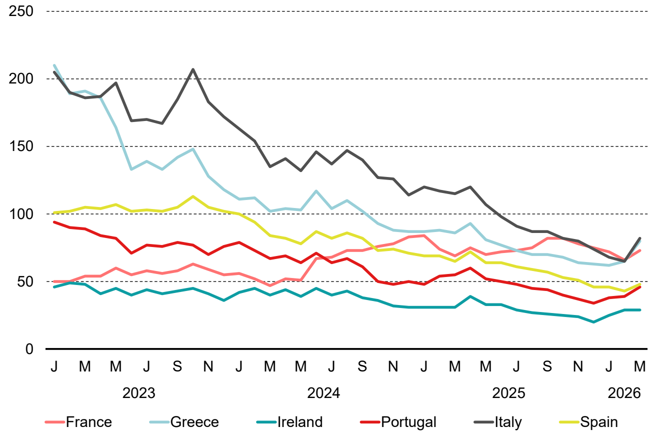
Euro area government bond yields rise slightly further

Sovereign bond yields rose modestly in the euro area, in the context of surging energy prices, large sovereign debt issuance by European governments and decreased bond demand as institutional pension funds shifted their investment strategies. The ten-year benchmark government bond yield in the euro area increased to 3.39% at end-March 2026, from 3.24% three months earlier.

Looking at individual sovereign bonds, German ten-year bond yields continued to increase during the quarter, standing at 2.91% at end-March, up by 10 basis points when compared to end-December 2025. Increased German government borrowing to finance higher spending on infrastructure and defence helped push up yields. French bond yields followed, rising by 8 basis points, to 3.64% at end-March. Government bond yields also rose in most other jurisdictions, including Italy, Greece, Spain, Portugal and Ireland.

Consequently, spreads against the ten-year German bond narrowed slightly in France, widened modestly in Spain and saw more pronounced increases in Italy, Portugal and Greece (see Chart 1.6). As regards the other euro area countries, spreads against the German benchmark tended to narrow.

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.

The euro weakens against both the US dollar and in nominal effective terms

During the quarter under review, the euro exchange rate depreciated by 2.1% against the US dollar. The euro started the year on a continued strong footing versus the US currency, but it lost ground in the wake of the outbreak of the war in the Middle East. The latter boosted the US dollar especially against the currencies of energy-importing economies. This reflected the United States' position as a major energy exporter and its relative resilience to spikes in oil and gas prices as well as the euro area's dependence on energy imports (see Chart 1.7). The euro weakened slightly versus the British pound, losing 0.5% over the quarter, amid narrow fluctuations. Favourable interest-rate differentials in light of persistently elevated inflation in the United Kingdom and the country's position as a smaller net energy importer supported the British pound.

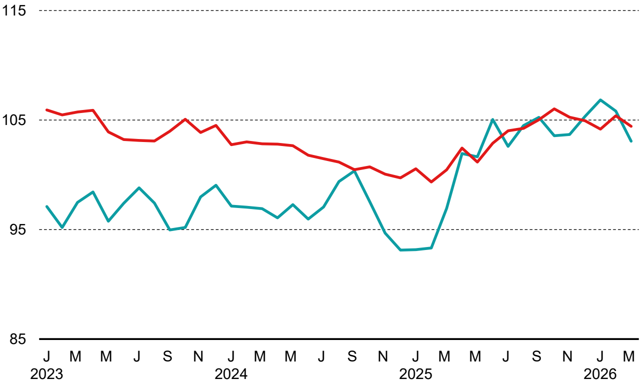
The euro depreciated by 0.4% against the Japanese yen, mainly reflecting narrowing interest-rate differentials between Japan and the euro area. The euro also fell against other major

[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.

currencies, including the Norwegian krone, the Australian dollar, the Chinese renminbi, the Singapore and Hong Kong dollars and the Swiss franc. By contrast, the euro rose against other major currencies, including the Korean won, the Polish zloty, the Swedish krona and the Czech koruna.

Overall, the nominal effective exchange rate (EER) of the euro against the EER-17 group of countries dropped by 1.2% in the three months to end-March.[7]

Chart 1.7
EXCHANGE RATE MOVEMENTS OF THE EURO AGAINST OTHER MAJOR CURRENCIES
(index of end-of-month rates; Jan. 2022=100; an increase in the index implies euro appreciation)



Source: ECB.

Other advanced economies

US economic growth rebounds

In the United States, real GDP grew at a quarterly rate of 0.4% in the first quarter, up from 0.1% in the preceding quarter (see Chart 1.1). The expansion in economic activity was primarily driven by an increase in fixed investment, with AI-related spending driving a rise in non-residential investment. Real GDP growth was also supported by personal consumption as well as government expenditures, which recovered following the shutdown in the previous quarter. On the other hand, imports rose more than exports, which, together with a further drop in private inventory investment, exerted a contractionary impact on real GDP growth.

Labour market conditions improved modestly. Non-farm payroll data show that employment increased by 0.1% on average during the review period, as against a marginal drop in the previous quarter. The rise during the first quarter reflected an increase in employment in the private sector that outpaced a decline in government employment. In turn, within the private sector, employment growth was driven by services and construction. Within the services sector, education and health, followed by professional and business services, recorded the most pronounced growth in employment. Meanwhile, the unemployment rate eased to 4.3% in the quarter under review, from 4.5% recorded in the previous one (see Chart 1.2).[8] The participation rate averaged 62.0% during the first quarter.

Headline inflation rose in the quarter under review, reflecting a surge in energy prices that outpaced an easing in inflation across all the other major components of the consumer price index (CPI). Thus, the annual CPI inflation rate stood at 3.3% in March, up from 2.7% three months earlier (see Chart 1.8). Annual energy inflation rose to 12.5% in March, from 2.3% in December 2025. By contrast, food and beverages inflation fell to 2.6% in March, compared to 3.0% three months earlier. Services inflation declined, while remaining elevated, falling to 3.1% in March, from 3.3%

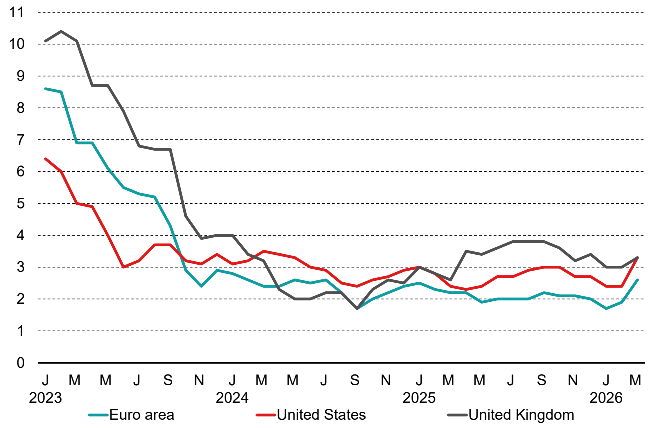
[7] The EER-17 is based on the weighted averages of the euro exchange rate against the currencies of Australia, Canada, China, Czech Republic, Denmark, Hong Kong, Hungary, Japan, Norway, Poland, Romania, Singapore, South Korea, Sweden, Switzerland, the United Kingdom and the United States.

[8] Unemployment data for October 2025 were not available due to the shutdown in the federal government. Therefore, the quarterly figure is the average of the observations for November and December 2025.

in December. The annual rate of change of prices of goods, excluding food and energy, dropped to 1.2% in March, compared to 1.4% in December. As a result, underlying inflation, as measured by inflation excluding food and energy, stood at 2.6% in March, unchanged from three months before.

During the review period, the Federal Open Market Committee (FOMC) decided to maintain the target range for the federal funds rate at 3.50%-3.75% (see Chart 1.4). Following its March meeting, the FOMC stated that economic activity was expanding at a solid pace, job gains remained low, while inflation remained somewhat elevated. The FOMC added that the implications of developments in the Middle East for the US economy were uncertain. The Committee reaffirmed that it was attentive to the risks to both sides of its dual mandate and reiterated its commitment to supporting maximum employment and returning inflation to its 2% objective.[9]

Chart 1.8
CONSUMER PRICE INFLATION
(annual percentage changes)



Sources: Bureau of Labor Statistics, US; Eurostat; Office for National Statistics, UK.
Note: US Consumer Price Inflation data for October 2025 are unavailable.

UK economic growth expands at a faster pace

Real GDP in the United Kingdom grew by 0.6%, on a quarter-on-quarter basis, in the first quarter, compared to 0.2% in the previous three months (see Chart 1.1). Growth was mainly driven by households and, to a lower extent, government consumption expenditure. An increase in inventories also contributed to real GDP growth. Meanwhile, GFCF deducted from GDP growth as lower investment in intellectual property products and dwellings outweighed an increase in business investment. GDP growth was also negatively affected by a deterioration in net trade, which reflected an increase in imports that outpaced a rise in exports.

Labour market conditions improved somewhat. The employment rate stood at 75.0%, on a quarterly-average basis in the first quarter, unchanged from the previous three months. Meanwhile, the unemployment rate, which had been on a general upward trend since the second quarter 2024, appears to have stabilised, falling to 5.0%, on average, during the review period, compared to 5.2% in the previous quarter (see Chart 1.2).

Consumer price inflation in the United Kingdom eased marginally during the quarter under review, with the annual inflation rate falling to 3.3% in March, compared to 3.4% three months earlier (see Chart 1.8). This mainly reflected lower inflation in the food, alcoholic beverages and tobacco component, as well as lower NEIG inflation, which outweighed higher energy inflation. Thus, the annual rate of change of food, alcoholic beverages and tobacco prices fell to 3.6% in March from 4.7% three months earlier. NEIG inflation eased to 0.8% in March, from 1.0% in December 2025. By contrast, the annual rate of change of energy prices surged to 4.9% in March from 1.7% in

[9] In April and June 2026 meetings, the FOMC decided to maintain the target range for the federal funds rate at 3.50%-3.75%. Following its June meeting, the FOMC stated that inflation remained elevated relative to the Committee's 2% goal, in part reflecting supply shocks, and that it would deliver price stability.

December. Meanwhile, services inflation remained unchanged at 4.5%. Consequently, underlying inflationary pressures eased slightly further though remaining elevated, with the annual rate of inflation based on the CPI excluding energy, food, alcoholic beverages and tobacco dropping to 3.1% in March, compared to 3.2% in December.

During the quarter under review, the Monetary Policy Committee (MPC) decided to maintain the Bank Rate at 3.75%. Following its March meeting, the Committee stated that it would continue to monitor closely the situation in the Middle East and its impact on global energy supply and energy prices. The MPC affirmed that it stood ready to act as necessary to ensure that CPI inflation remained on track to meet the 2% target in the medium term.[10]

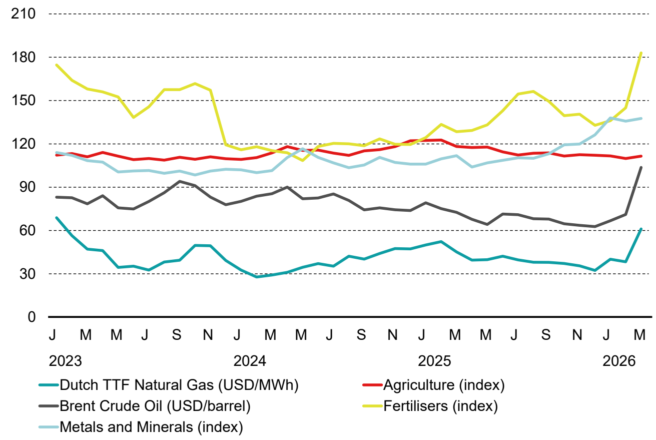
Commodities

Oil and natural gas prices increase sharply

Oil prices surged during the first quarter as the outbreak of war between the United States and Iran led to attacks on energy infrastructure in the Middle East and disruptions to tanker movements through the Strait of Hormuz that severely curtailed supply.[11] Overall, the price of Brent crude oil averaged USD 103.69 per barrel in March, 65.3% higher than the level prevailing three months earlier. Similarly, the price of European natural gas soared. The conflict in the Middle East resulted in an abrupt shift in market conditions, that reversed a trend of market rebalancing observed earlier. Accordingly, the average price of Dutch TTF natural gas stood at USD 61.11 per megawatt hour in March, 88.9% higher than in December 2025 (see Chart 1.9).

World Bank data show that non-energy commodity prices rose by 4.2% during the quarter under review as higher prices for fertilizers as well as metals and minerals outweighed slightly lower prices for agricultural products. Meanwhile, the prices of precious metals were up by 14.8%, mainly reflecting record central bank buying, retail and investment demand, amid heightened geopolitical uncertainty and elevated inflation.[12]

Chart 1.9
COMMODITY PRICES
(monthly averages, USD, indices: 2010 = 100)



Sources: World Bank, Central Bank of Malta calculations.

[10] In April and June 2026 meetings, the MPC decided to maintain the Bank Rate at 3.75%. Following each of these meetings, the Committee reiterated that it would continue to monitor closely the situation in the Middle East and how its impact propagated through the economy. The MPC reaffirmed that it stood ready to act as necessary to ensure that CPI inflation remained on track to meet the 2% target in the medium term.

[11] Oil Market Report - April 2026.

[12] Central Bank Gold Buying 2026.