ECONOMIC SURVEY

1. THE EURO AREA AND THE EXTERNAL ENVIRONMENT

In the second quarter of 2026, real GDP rebounded in the euro area, while it grew at a constant pace in the United States and expanded at a slower pace in the United Kingdom. The unemployment rate remained unchanged in both the euro area and the United States but decreased slightly in the United Kingdom.

The conflict in the Middle East continued to drive major economic developments, particularly regarding inflation and inflation expectations, in the advanced economies during the review period. In the euro area, inflation rose to 2.8% in June, from 2.6% in March, while in the United States inflation increased to 3.5% in June, compared to 3.3% three months earlier. In contrast, in the United Kingdom inflation dropped to 2.6% in June, from 3.3% in March. The ECB raised key interest rates, while both the US Federal Reserve Bank and the Bank of England kept policy rates unchanged during the quarter under review.

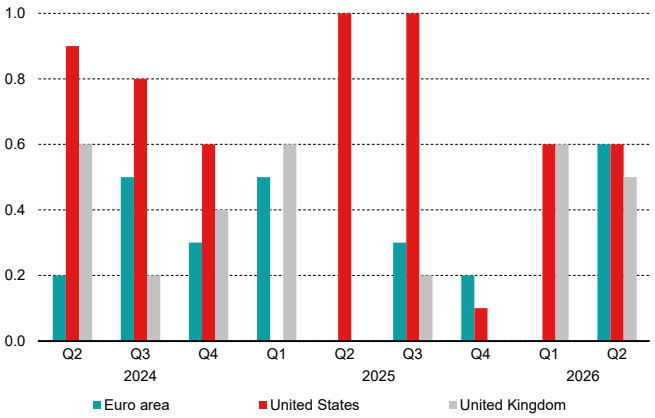
Brent oil prices receded by the end of the quarter, following an interim agreement between the United States and Iran over the conflict in the Middle East, though they remained at elevated levels. European natural gas prices also fell amid new sources of supply coupled with lower demand.[1]

Economic and financial developments in the euro area

Economic activity in the euro area expands

Economic activity in the euro area returned to growth in the second quarter. In real terms, GDP grew by 0.6% on a quarter-on-quarter basis, compared to zero growth in the previous quarter (see Chart 1.1). These movements were influenced by developments in Ireland, where a sharp drop in GDP in the first quarter was followed by a strong recovery in the second quarter. In terms of sectoral gross value added (GVA), in real terms the growth in GDP was broad-based across sectors and was especially pronounced in manufacturing.

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.

In terms of expenditure components, net exports was the main contributor to GDP growth, adding 0.9 percentage points to economic growth, as exports surged and outpaced a rise in imports. In contrast, domestic demand pulled GDP down by 0.3 percentage points, as a 0.5 percentage point decrease in the contribution from inventory

[1] After the end of the quarter, hostilities resumed, leading to renewed increases in prices of energy commodities.

Table 1.1
CONTRIBUTIONS TO QUARTERLY REAL GDP GROWTH IN THE EURO AREA[1]

Percentage points; quarter-on-quarter percentage change

	2024			2025				2026	
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Private consumption	0.1	0.3	0.3	0.2	0.1	0.1	0.3	0.0	0.2
Government consumption	0.2	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.0
GFCF	-0.5	0.3	0.2	0.5	-0.3	0.2	0.2	0.0	0.0
Changes in inventories[2]	0.2	0.5	-0.3	0.0	0.3	0.0	-0.4	0.4	-0.5
Exports	0.8	-0.6	0.3	0.9	-0.3	0.3	0.2	-0.3	1.6
Imports	-0.5	-0.2	-0.2	-1.0	0.1	-0.5	-0.2	-0.3	-0.7
GDP	**0.2**	**0.5**	**0.3**	**0.5**	**0.0**	**0.3**	**0.2**	**0.0**	**0.6**

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.

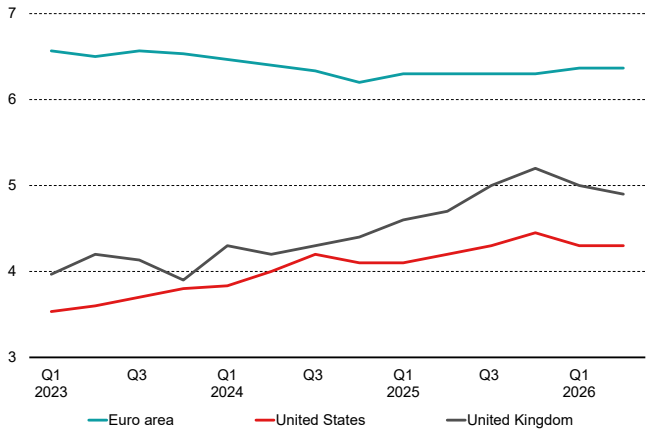
changes more than offset a 0.2 percentage point increase in the contribution from private consumption, which picked up compared to the previous quarter. Meanwhile, the contributions from government consumption expenditures and gross fixed capital formation (GFCF) remained practically unchanged during the quarter under review, together resulting in a negligible contribution to GDP growth (see Table 1.1).

During the quarter reviewed, the European Commission's Economic Sentiment Indicator (ESI) declined on average compared to the previous quarter. The ESI for the euro area dropped further in April in the context of the conflict in the Middle East. It rebounded slightly in May and increased noticeably in June, though it remained below its level in March as well as the historical average. The decrease in the ESI over the quarter reflected a drop in confidence in all sectors, particularly among consumers.

Labour market remains resilient

The labour market in the euro area remained resilient. Employment grew at a quarterly rate of 0.1% during this period, the same as in the preceding quarter.[2] Meanwhile, the seasonally adjusted unemployment rate stood at 6.4% in June, unchanged from March. It averaged 6.4% in the quarter under review, up slightly from the previous quarter, signalling a possible weakening of labour demand (see Chart 1.2).

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



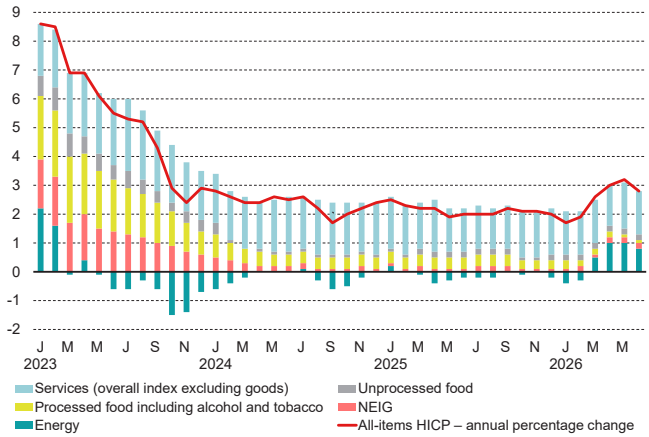
Sources: Bureau of Labor Statistics, US; Eurostat; Office for National Statistics, UK.

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

Inflation rises further

Inflation in the euro area continued to increase in the second quarter. The annual rate of inflation based on the HICP stood at 2.8% in June, compared to 2.6% in March (see Chart 1.3), further exceeding the ECB's 2% medium-term target. The increase in overall inflation mainly reflected an increase in energy prices, reinforced by a higher contribution from non-energy industrial goods (NEIG). These factors were dampened by an easing in food price inflation, while the contribution from services to HICP inflation, though still significant, remained largely unchanged.

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



Source: ECB.

Turning to the major HICP components in more detail, the annual rate of change of energy prices reached 8.5% in June, up from 5.1% in March. This reflected elevated energy prices in the context of the impact of the conflict in the Middle East on energy commodity prices, as well as base effects. The annual rate of NEIG inflation increased to 0.7% in June, from 0.5% in March. By contrast, the annual rate of unprocessed food inflation declined to 3.1% in June from 4.2% in March and the annual rate of processed food inflation fell to 0.9% in June, from 1.7% three months earlier. Meanwhile, services inflation stood at an annual rate of 3.2% in June, unchanged from March.

Underlying inflationary pressures intensified somewhat during the review period, with the annual rate of HICP inflation excluding energy and food (HICPX) edging up to 2.4% in June, from 2.3% three months earlier.

Real GDP growth and inflation projections revised upwards

According to the ECB staff macroeconomic projections for the euro area, published in September 2026, real GDP growth is expected to rebound to 1.4% and 1.5% in 2027 and 2028, respectively, after having slowed down to 0.9% in 2026 (see Table 1.2).[3]

Economic growth is expected to be robust in the near term, as uncertainty recedes, confidence improves and the energy supply shock stemming from the Middle East conflict is assumed to ease gradually. Over the medium term, domestic demand is expected to continue to be supported by a recovery in real incomes in the context of lower energy inflation and a resilient labour market. Rising government spending on infrastructure and defence, coupled with investments related to artificial intelligence (AI), is also expected to support growth in the later years of the projection horizon. Export growth is expected to pick up as foreign demand strengthens, although persistent competitiveness challenges will continue to dampen export performance.

Compared to the previous projection exercise, the latest projections were conditioned on lower oil and euro area farm gate prices as well as a weaker euro. On the other hand, taking into account

[3] The cut-off date for the technical assumptions and the global economy was 19 August 2026.

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

	2025	2026	2027	2028
Real GDP	**1.3**	**0.9**	**1.4**	**1.5**
Private consumption	1.5	1.0	1.0	1.3
Government consumption	1.5	1.9	1.1	1.3
GFCF	2.9	1.8	2.0	2.0
Exports	2.0	2.1	3.2	2.9
Imports	3.6	2.6	3.0	2.9
HICP	**2.1**	**3.0**	**2.5**	**2.1**
HICPX	2.4	2.5	2.6	2.3

Source: ECB.
[1] ECB staff macroeconomic projections for the euro area, September 2026.

developments until mid-August, gas and especially electricity price assumptions were revised markedly upwards, while international food prices and equity prices were also revised up. Meanwhile, interest-rates assumptions were broadly unchanged over the projection horizon.

Compared to the June projections, real GDP growth was revised upwards by 0.1 and 0.2 percentage points for 2026 and 2027, respectively, and it was kept unchanged for 2028. The upward revision of real GDP growth in 2026 mainly related to an improvement in the short-term investment outlook, stronger private consumption and a more benign international environment. The upward revisions for the second half of 2026 also led to significant carry-over effects in 2027.

Turning to the outlook for prices, ECB staff foresee headline HICP inflation rising to an average of 3.0% in 2026 from 2.1% in 2025, before easing to 2.5% in 2027 and 2.1% in 2028. The increase in headline inflation in 2026 reflects a sharp rise in energy inflation. Inflation is expected to decline in 2027 and 2028 as the energy shock is set to fade, albeit amid high uncertainty.

Compared to the June projections, headline HICP inflation was revised up by 0.2 percentage points for 2027 and 0.1 percentage points for 2028. Downward revisions to food inflation are broadly offset by upward revisions to energy inflation, leaving the inflation outlook in 2026 unchanged. For 2027, higher energy inflation and, to a lesser extent, NEIG inflation, outweighed downward revisions to food inflation. For 2028, a small upward revision to headline inflation is driven by the services component.

HICPX is expected to increase from 2.4% in 2025 to an average of 2.5% in 2026 and 2.6% in 2027, but then ease to 2.3% in 2028. Compared to the June projections, the outlook for underlying inflation was revised upwards by 0.1 percentage points for 2027 as well as for 2028. The revisions in underlying inflation reflect more elevated NEIG inflation in 2027 and higher services inflation in 2028, in consonance with a small upward revision to compensation per employee growth throughout the projection horizon.

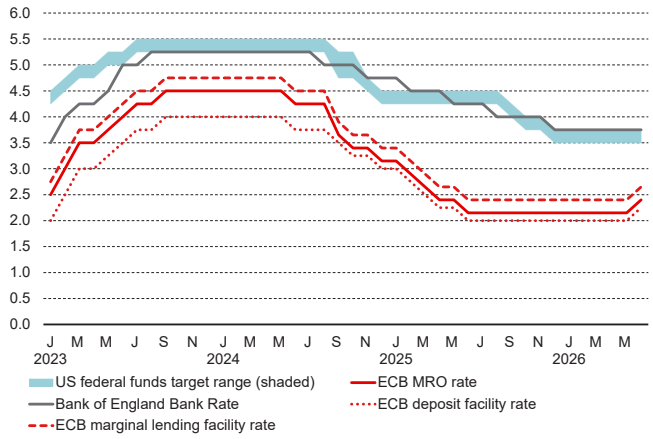
The ECB staff projections include updates of the milder, adverse and severe scenarios contained in the June 2026 projections as the war in the Middle East continued to create high uncertainty. In the milder scenario, inflation would moderate faster, while GDP growth would be slightly stronger

than in the baseline scenario. On the other hand, in the adverse and, in particular, the severe scenarios inflation would be higher and GDP growth lower.

ECB raises interest rates in response to inflationary pressures

During the quarter reviewed, the Governing Council tightened the monetary policy stance in response to the inflationary pressures generated by the war in the Middle East. In June, the Governing Council raised the three key ECB interest rates 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 rate, the MROs and the marginal lending facility were increased to 2.25%, 2.40% and 2.65%, respectively (see Chart 1.4). The Council stated that with this decision, it remained well positioned to navigate the uncertainty caused by the war in the Middle East and reaffirmed that it would follow a data-dependent and meeting-by-meeting approach to determine the appropriate monetary policy stance.[4]

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

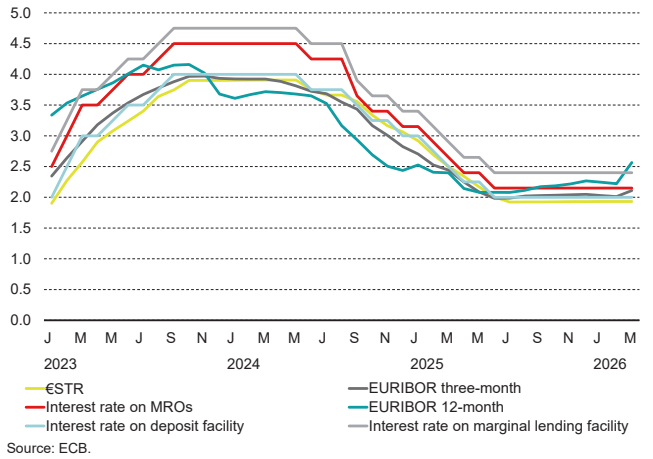


Sources: ECB; Federal Reserve; Bank of England.

Money market rates rise

Short-term interest rates in the euro area rose during the review period, as the tightening of the ECB's monetary policy stance began to be transmitted to the money market. Hence, the euro short-term rate (€STR) averaged 2.04% in June, up from 1.93% three months before (see Chart 1.5).[5] The three-month euro interbank offered rate (EURIBOR) increased to 2.34% on average in June, compared to 2.11% in March. The 12-month EURIBOR averaged 2.80% in June, up from 2.57% three months earlier.[6] It thus stood further

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



Source: ECB.

[4] In September, the Governing Council raised the key ECB interest rates by a further 25 basis points. Accordingly, the interest rates on the deposit facility rate, the MROs and the marginal lending facility increased to 2.50%, 2.65% and 2.90%, respectively. The Governing Council reaffirmed that it would follow a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance.

[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.

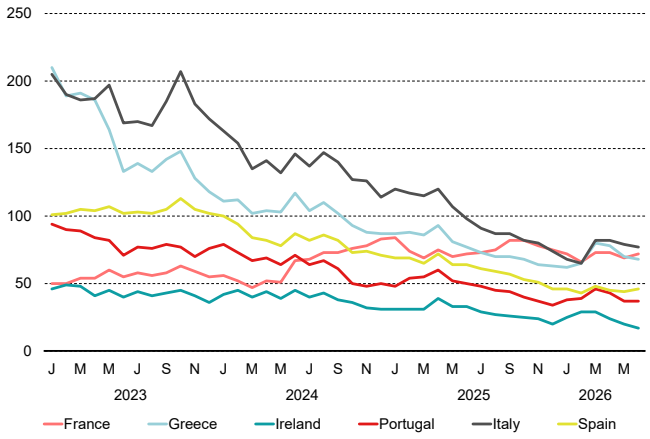
above the deposit facility rate, compared to March, indicating that market players factored in the possibility of further monetary policy tightening in the year ahead.

Euro area government bond yields rise slightly further

Sovereign bond yields rose modestly further in the euro area mainly on the back of elevated energy prices, which generated inflation concerns, and better-than-expected economic conditions, which led market players to expect higher interest rates in the future. Thus, the ten-year benchmark government bond yield in the euro area increased marginally, to 3.40% at end-June from 3.39% three months earlier. This apparent stability masks an increase during the first two months of the quarter, which was largely reversed in June as energy prices fell.

Looking at individual sovereign bonds, German ten-year bond yields increased further during the quarter, standing at 2.96% at end-June, up by 5 basis points when compared to end-March. Increased German government borrowing to finance higher spending on infrastructure and defence helped push up yields. French bond yields followed, rising by 4 basis points, to 3.68% at end-June. Government bond yields also rose in most other jurisdictions, including Spain. In contrast, sovereign bond yields fell in Ireland, Greece and Portugal, among others. Meanwhile, Italian bond yields ended the quarter at 3.73%, unchanged when compared to three months earlier.

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



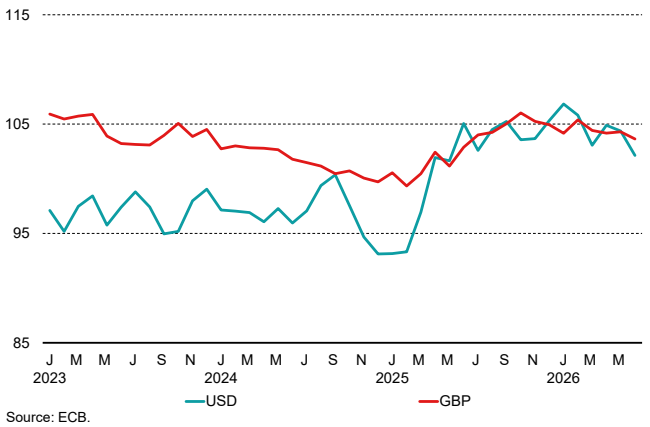
Sources: ECB; Central Bank of Malta calculations.

Consequently, spreads against the ten-year German bond narrowed marginally in France as well as in Spain, and narrowed more substantially in Greece, Ireland, Portugal and Italy (see Chart 1.6). By contrast, in most of the other euro area countries, spreads against the German benchmark widened to various extents.

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

During the quarter under review, the euro exchange rate weakened further against the US dollar, falling by 0.9% amid market concerns that elevated oil prices could fuel inflationary pressures especially in case of energy-importing economies (see Chart 1.7). Moreover, the

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.

release of strong economic data from the United States led market players to expect higher US interest rates, which would widen the interest rate gap between the euro area and the United States. The euro also weakened versus the British pound, losing 0.8% over the quarter, as the latter benefitted from better-than-expected economic growth in the United Kingdom, the unwinding of sterling short positions and favourable interest-rate differentials. The euro also lost ground against other currencies, including the Hungarian forint, the Chinese renminbi, and the Czech koruna. Overall, the nominal effective exchange rate (EER) of the euro against the EER-17 group of countries dropped by 0.8% in the three months to end-June.[7]

In contrast, the euro appreciated by 0.9% against the Japanese yen, mainly reflecting notable interest-rate differentials between the euro area and Japan. The euro also rose against other currencies, including the Romanian leu, the Swedish krona, and the Canadian dollar. The euro registered modest gains versus the Swiss franc.

Other advanced economies

US economy expands steadily

In the United States, real GDP grew at a quarterly rate of 0.6% in the second quarter, unchanged from the preceding quarter (see Chart 1.1). The expansion in economic activity was primarily driven by an increase in personal consumption, followed by fixed investment, mainly equipment and software, driven by the boom in artificial intelligence. To a marginal degree, residential investment also increased. On the other hand, imports rose more than exports. The deterioration in net trade, together with a further drop in private inventory investment and a small decrease in government expenditures, dampened real GDP growth.

Labour market conditions continued to improve. Non-farm payroll data show that employment increased by 0.2% on average during the review period, up from 0.1% in the previous quarter. Increased employment in the private sector accounted for almost all the rise during the second quarter, with government employment increasing marginally. In turn, within the private sector, employment growth was largely driven by services and, to a much lower extent, by the goods sector. Within the services sector, education and health, followed by trade, transportation and utilities, recorded the most pronounced growth in employment. Meanwhile, the unemployment rate stood at 4.3% in the quarter under review, unchanged from the previous one (see Chart 1.2).[8] The participation rate averaged 61.7% during the second quarter, compared to 62.0% during the previous quarter.

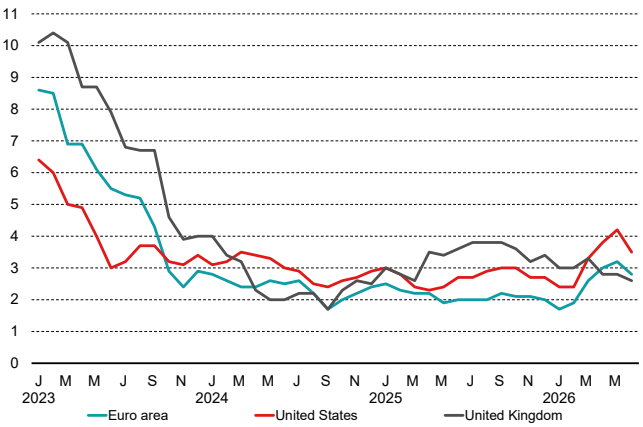
Headline inflation rose in the quarter under review, mainly driven by higher energy prices. A rebound in food and beverages inflation and a marginal increase in services inflation, also pushed inflation up. Hence, the annual consumer price inflation rate stood at 3.5% in June, up from 3.3% three months earlier (see Chart 1.8). Annual energy inflation rose to 15.7% in June, from 12.5% in March. Food and beverages inflation stood at 3.0% in June, up from 2.6% three months earlier. Services inflation edged up to 3.2% in June, from 3.1% in March. By contrast, the annual rate

[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.

of change of prices of goods, excluding food and energy, dropped to 0.8% in June, compared to 1.2% in March. As a result, underlying inflation, as measured by inflation excluding food and energy, stood at 2.6% in June, unchanged from three months before.

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.

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 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.[9]

UK economic growth eases slightly

Real GDP in the United Kingdom grew by 0.5%, on a quarter-on-quarter basis, in the second quarter, compared to 0.6% in the previous three months (see Chart 1.1). Looking at the main expenditure components, growth was mainly driven by exports, followed by GFCF and by household consumption. In turn, net trade improved as exports rose while imports remained unchanged. Meanwhile, the growth in GFCF mainly reflected a strong increase in spending on Information and Communication Technology equipment and other machinery and equipment, followed by dwellings. By contrast, a decline in government consumption expenditure and a contraction in inventories deducted from GDP.

Labour market conditions continued to improve modestly. The employment rate inched up to 75.1%, on a quarterly-average basis in the second quarter, from 75.0% in the previous three months. Meanwhile, the unemployment rate fell slightly further to 4.9%, on average, during the review period, compared to 5.0% in the previous quarter (see Chart 1.2).

Consumer price inflation in the United Kingdom fell during the quarter under review, with the annual inflation rate standing at 2.6% in June, compared to 3.3% three months earlier (see Chart 1.8). This reflected lower inflation in the food, alcoholic beverages and tobacco component, a decrease in services inflation as well as marginally lower NEIG inflation, which outweighed higher energy inflation. Thus, the annual rate of change of food, alcoholic beverages and tobacco prices fell to 1.8% in June from 3.6% three months earlier. Services inflation declined to 3.6% in June, from 4.5% in March. NEIG inflation eased to 0.7% in June, compared to 0.8% three months before. By contrast, the annual rate of change of energy prices increased to 5.7% in June from 4.9% in March. Consequently, underlying inflationary pressures abated further, though remaining elevated, with the annual rate of inflation based on the Consumer Price Index (CPI) excluding energy, food, alcoholic beverages and tobacco dropping to 2.6% in June, compared to 3.1% in March.

[9] In September, the FOMC decided to raise the target range for the federal funds rate by 25 basis points to 3.75%-4.00%. The FOMC stated that this policy action would support a timelier return to the Committee's 2% inflation goal.

During the quarter under review, the Bank of England decided to maintain the Bank Rate at 3.75%. The Bank reiterated that it would continue to monitor closely the situation in the Middle East and how its impact propagated through the economy. It 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.[10]

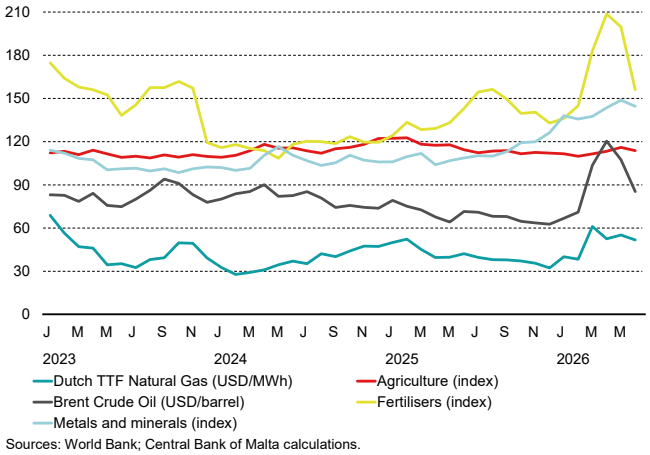
Commodities

Oil and natural gas prices decline during the second quarter

After having peaked in April, oil prices receded during the remainder of the second quarter. In June, oil prices dropped sharply following news of an interim agreement between the United States and Iran to end the war in the Middle East that underpinned a strong recovery in oil flows through the Strait of Hormuz.[11] Overall, the price of Brent crude oil averaged USD 85.40 per barrel in June, 17.6% lower than the level prevailing in March. The price of European natural gas also declined, amid strong volatility. Higher liquefied natural gas (LNG) output from new projects in North America and Africa as well as the improved supply from producers in Africa, Asia and Russia partly offset a decline in gas supply from the Middle East. Global demand for gas also fell, putting downward pressure on prices.[12] Accordingly, the average price of Dutch TTF natural gas stood at USD 51.76 per megawatt hour in June, 15.3% lower than in March (see Chart 1.9).

World Bank data show that non-energy commodity prices rose by 2.2% during the quarter under review as higher prices for metals and minerals as well as agricultural products outweighed lower prices for fertilisers. Meanwhile, the prices of precious metals fell by 13.2%, amid significant volatility, characterised by a sharp correction from record highs in January in the context of rising interest rate expectations, as well as profit-taking, despite heightened geopolitical tensions.[13]

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



Sources: World Bank; Central Bank of Malta calculations.

[10] In the July and September 2026 meetings, the Bank decided to maintain the Bank Rate at 3.75%. Following both meetings, the Bank stated that it judged the risks to the inflation outlook were tilted to the upside and it considered that the outlook could change materially as events in the Middle East unfolded. The Bank reiterated 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 - July 2026. In the following quarter, the ceasefire agreement between the United States and Iran broke down, leading to renewed increases in prices of oil and gas.

[12] Gas Market Report, Q3-2026.

[13] Precious metals retreat from record highs.