FOREWORD

In the second quarter of 2026, annual real gross domestic product (GDP) rose by 4.5%, following a 4.2% increase in the preceding quarter. Growth was driven by domestic demand, even when adjusting for imports.

On a four-quarter moving average basis, the level increase in potential output relative to the previous quarter was similar to that in GDP, and thus the output surplus remained unchanged at 0.9%.

Overall, the Bank's Business Conditions Index (BCI) indicated that the pace of economic activity moderated compared to the first quarter but remained broadly in line with its long-run average.

The labour market continued to perform positively with activity and employment rates rising. In the second quarter of 2026, the unemployment rate rose on a year earlier but was well below that in the euro area. The labour market remained tight but showed some signs of moderation, with both the vacancy rate and the labour market tightness indicator decreasing.

Annual inflation, as measured by the Harmonised Index of Consumer Prices (HICP) declined to 2.0% in June, from 2.3% in March. This mostly reflected lower contributions from food and services inflation. Meanwhile, annual inflation based on the Retail Price Index (RPI), which amongst other methodological differences only considers expenditure by Maltese residents, stood at 2.5% in June, down from 2.7% in March.

In the second quarter of 2026, Malta's unit labour cost (ULC) index, measured on a four-quarter moving average basis, rose at a slower annual rate compared with the previous quarter. This reflected slower growth in compensation per employee and faster growth in productivity per person. Other non-labour cost indicators regularly monitored by the Bank showed mixed results.

In the second quarter of 2026, the current account surplus decreased when compared with a year earlier. This mostly reflected higher net outflows in the primary and secondary income account, and lower net receipts from services. When measured on a four-quarter moving sum basis, the current account surplus stood at 5.5% of GDP.

Meanwhile, the general government deficit-to-GDP ratio widened owing to strong growth in expenditure. When measured on a four-quarter moving sum basis, the deficit stood at 3.5% of GDP. The general government debt-to-GDP ratio increased to 47.0% in June, from 45.7% in March.

The Bank's Financial Conditions Index (FCI) suggests that financing conditions in the second quarter of 2026 were more favourable compared with the previous quarter. In June, Maltese residents' deposits with monetary financial institutions (MFIs) in Malta continued to increase at a strong pace. Meanwhile, credit to Maltese residents grew at a faster pace compared with the previous quarter.

The weighted average interest rate offered to households and non-financial corporations (NFCs) on their outstanding deposits declined when compared to a year earlier, while that for outstanding loans was unchanged. The spread between the two rates thus widened over this period.

During the second quarter of 2026, 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 European Central Bank (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 main refinancing operations (MROs) and the marginal lending facility were 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.

In September, the Governing Council raised the key ECB interest rates by a further 25 basis points. The Council reaffirmed that it would follow a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance.