INFLATION DEVELOPMENTS IN MALTA COMPARED WITH THE EURO AREA

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Inflation rates in Malta and the euro area have historically broadly moved in line with each other, indicating some convergence of the Maltese business cycle with that of our main trading partner. Micallef and Cyrus (2013) show that between 1999 and 2012, Malta has experienced higher inflation than the euro area in all but three years. Inflation differentials occurred during periods characterised by structural reforms in Malta. On the other hand, the differential that has emerged during 2022 reflects different causes.

This box looks at inflation developments in Malta over the January-October 2022 period, delving deeper into the distribution of price changes across sub-indices of the HICP at a more disaggregated level in Malta and the euro area.

**Euro area cross-country inflation heterogeneity**

Since the beginning of the year, we note a stark heterogeneity in HICP inflation rates in the euro area, with the highest average rate registered in Estonia and Lithuania, followed closely by Latvia (see Chart 1). Inflation in the Baltic States has been affected by the Russian-Ukraine conflict through their energy dependence on Russia. Furthermore, inflation differentials across the eurozone might reflect different strategies adopted by governments to dampen inflationary pressures on consumers, with some countries opting for more direct intervention in the energy market, while others have relied on transfers to households.

Chart 1 shows that over the January-October 2022 period, Malta registered the second lowest average inflation of 5.9%, which was just slightly above that in France at 5.7%. The main reason behind the relatively low inflation in Malta has been consumer energy prices, which in Malta have been frozen by the Government. Indeed, the contribution of energy inflation to overall inflation in Malta remained nil throughout the period.

By contrast, the annual rate of HICP inflation excluding energy in Malta was higher than the euro area average, and the fifth highest, preceded only by the Baltic countries and Slovakia. This suggests that core
inflation in Malta has been more dynamic than other euro area countries, which could reflect Malta’s generally stronger economic activity and other structural factors.

Distribution of inflation rates in Malta and the euro area average
This box also assesses whether the inflation differentials between Malta and other euro area countries is broad-based across HICP items, or if it is driven only by selected components of the consumption basket. Hence, we look at the distribution of price changes across sub-indices of the HICP at a very disaggregated level over time, to understand underlying inflationary pressures. Charts 2 and 3 show a distribution of price changes whereby subcomponents of 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%; iv) over 5%.

Historically, specifically since 1997, the proportion of the Maltese basket with inflation rates of 0% or negative has been larger than that of the euro area. Indeed, on average 26.8% of Malta’s basket items fall in this interval, while this figure stands at 20.2% for the euro area. Furthermore, historically, around 67% of the euro area basket of goods and services falls in the 0-2% and 2-5% intervals in almost equal parts. In both cases, the shares are higher than those in the Maltese basket. On the other hand, while 17.9% of the Maltese basket of goods and services falls in the over 5% interval, only 12.1% of the euro area basket falls in this interval.

Charts 2 and 3 show that in recent months, the share of subcomponents registering inflation rates in the lowest inflation classes has declined in...
both Malta and the euro area. As a result, there has been a substantial rise in the share of subcomponents, with year-on-year price increases of more than 5%.

Until August, the share of subcomponents classified as having grown more than 5% was higher for Malta than that in the euro area. However, the share of the basket where inflation was either at 0% or below was also higher than that in the euro area. This suggests that Malta’s inflation rate was below that of the euro area in part due to certain subcomponents that are of an administrative nature where prices are controlled by government. Among others, these include energy, post-secondary and tertiary education, passenger transport by bus, medical products as well as tobacco. On the other hand, at least until August, subcomponents that were not administered, increased more sharply than the euro area average.

However, this difference seems to have changed since September. Indeed, the share of subcomponents that have inflation rates above 5% within the euro area basket has exceeded that in Malta. Moreover, for Malta, the share of subcomponents within this interval has declined from 58.8% in September, to 57% in October, while that in the euro area has continued to increase. This could imply that underlying inflationary pressures are bottoming out in Malta, while those in the euro area have continued to increase. This could reflect the fact that the initial impact of rising energy costs in the euro area is now spreading to other goods and services, whereas in Malta the impact is somewhat limited to just imported inflation. Moreover, in Malta, the initial rise in non-energy prices could have been related to the spike in shipping rates, which now appears to be reversing.

Going forward, our projections show a broad-based decline in price pressures with the share of the Maltese basket of consumer goods and services’ inflation higher than 5% narrowing strongly (see Chart 4). On the other hand, the interval holding the share of basket of goods and services where price changes are 0% or lower, is expected to increase. This mainly reflects the extension of free public transport announced in the Budget 2023, which has resulted in a negative annual inflation rate of -14.0% in the road transport sub-sector as from October 2022. By the end of the projection horizon, the share of the 2-5% interval is expected to remain slightly above that prevailing in 2019, mainly reflecting some prevalence in wage pressures and imported inflation.

3 While past data takes into account around 330 sub-indices, projections include only 36 sub-indices.