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CENTRAL BANK OF MALTA

RECENT DEVELOPMENTS IN PRIVATE CONSUMPTION AND FORECAST IMPLICATIONS

BOX 1: RECENT DEVELOPMENTS IN PRIVATE CONSUMPTION AND FORECAST IMPLICATIONS¹

Since the re-opening of the economy after the COVID-19 pandemic, private consumption in Malta has strongly recovered. Consumption exceeded pre-pandemic levels by 2022, and acted as one of the main drivers for economic growth. During the first three quarters of 2023, growth in private consumption averaged 8.0% year-on-year. This strong growth may be somewhat puzzling in the current context of high inflation. Indeed, the remarkable resilience of private consumption stands in sharp contrast to developments in real disposable income, which is estimated to have declined slightly during the first three quarters of 2023. It is therefore important to discern the underlying drivers behind the resilience of private consumption, to better understand its medium-term implications.

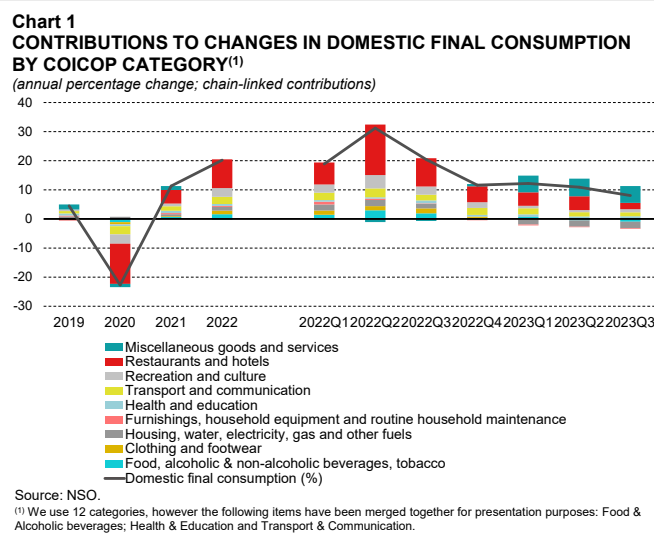
Contributions to consumption

To do this, we first decompose consumption using two-digit data on the Classification of Individual Consumption by Purpose (COICOP), which yields data for 12 items of expenditure incurred by both residents and non-residents. In this subsection we utilise the concept of ‘total domestic consumption’ which includes all consumption expenditures in Malta, irrespective of whether these refer to expenditures by residents or non-residents.

Growth in total domestic consumption rose very sharply during 2021 and 2022, driven by all categories of consumption, but especially restaurants and hotels (see Chart 1). The latter in turn partly mirrored the strong recovery in tourism levels following their sharp drop during the pandemic in 2020.

Growth in domestic consumption started to slow down somewhat in 2023, but it remained very strong with a year-on-year increase of 8.0% during the first three quarters of the year. In contrast with 2021 and 2022, the largest contributor to growth in domestic consumption in 2023 was not restaurant and hotels. Instead, this was driven by miscellaneous goods and services, which includes expenditure on personal care, insurance, and financial services, among others. This was followed by restaurants and hotels, and recreation and culture.

Although most categories of consumption remained



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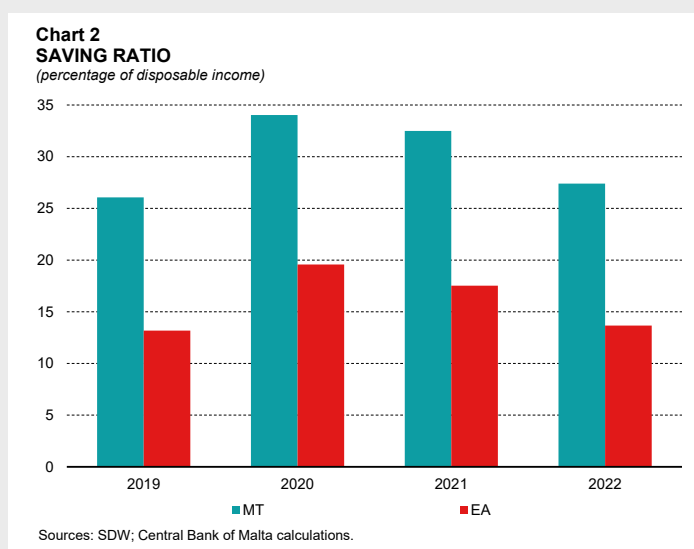
very resilient during 2023 despite the high inflationary environment, we can observe some declines in certain categories. In particular, spending on housing, water, and electricity contributed negatively to growth in consumption during the first three quarters of 2023, which may reflect relatively high inflation related to services for the maintenance and repair of dwellings. Moreover, consumption of food and non-alcoholic beverages as well as furnishings, household equipment and routine household maintenance also fell, also reflecting relatively high levels of inflation in these categories.

Developments in savings and distribution of pandemic-related excess savings

As outlined in Chart 2 the savings ratio to disposable income in Malta is estimated to have stood at 26.1% in 2019, which was 12.9 percentage points higher than that in the euro area. This difference further increased to 13.7 percentage points in 2022. This, coupled with fixed energy prices, shielded Maltese households, and facilitated consumption smoothing during the recent period of high inflation.

As shown in Borg (2022),² the pandemic had brought about an involuntary increase in saving levels due to the containment measures that prohibited certain categories of consumption. Households accumulated excess savings during this period, as they were forced to cut back on spending, while fiscal measures such as the wage supplement scheme supported incomes. Excess savings are hereby estimated as the difference between real savings accumulated in 2020, 2021, and 2022, and a counterfactual scenario whereby the saving ratio is kept equal to that in 2019 for all subsequent years. Between 2020 and 2022, excess savings as a percentage of disposable income are estimated to have amounted to 8.0%, 6.4% and 1.3%, respectively.

As outlined by Battistini and Gareis (2023),³ understanding the composition of excess savings across different asset classes allows us to identify whether the allocation has been more inclined towards liquid or illiquid assets. When looking at the asset class proportion relative to the pre-pandemic trend, it is evident that between 2020 and 2022, Maltese households invested their excess savings in more



² See Borg, I. (2022). "[Box 1: Pandemic-related excess savings – how will this affect private consumption in the coming years.](#)" in *CBM Outlook for the Maltese Economy 2022*:3.

³ See Battistini, N., & Gareis J. (2023). "[Excess savings: To spend or not to spend](#)". The ECB Blog.

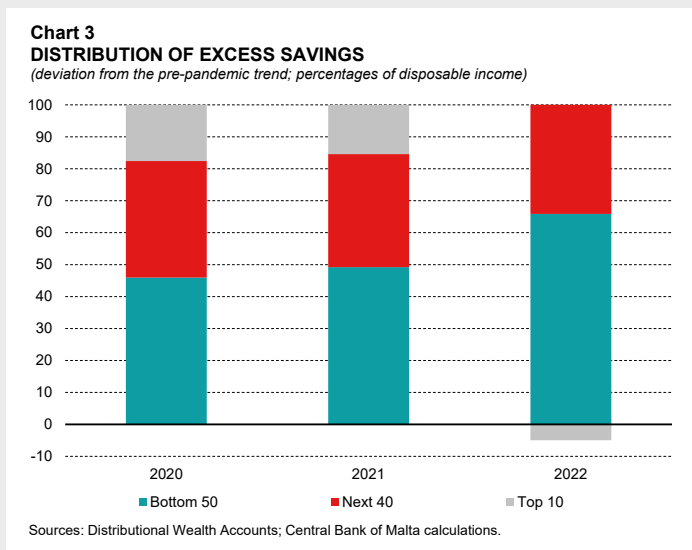
liquid assets. The latter refers to deposits, with the allocation amounting to 6.2%, 4.9% and 1.4% of disposable income, respectively, between 2020 and 2022. On the other hand, the share of illiquid financial assets, such as debt securities and shares, declined across the three years. The liquidity of financial instruments that attracted excess savings suggests that the latter could easily be utilised for consumption during the re-opening period, which might have provided a strong impulse to consumption.

Moreover, as argued in Battistini et al. (2023), the distribution of such excess savings could be very important to understand recent developments in consumption. In particular, distribution towards richer households is likely to lead to lower private consumption growth going forward, as these income groups have a lower marginal propensity to consume.

Using a similar methodology to Battistini et al. (2023), we distribute the excess savings estimated above into three income groups based on their net wealth portfolio. The income groups utilised are the poorest households (Bottom 50) to the richest households (Top 10) based on their net wealth.

Chart 3 draws on data from the experimental Distributional Wealth Accounts (DWA), which contain data on the share of assets in the portfolio of each household group, and Bank estimates of the saving ratio and disposable income. The chart indicates that households in the bottom half of the distribution held most of the excess savings from 2020 to 2022, at 46.0%, 49.2% and 65.9% respectively. This was followed by middle and upper middle-income households. The richest 10% of households held a small share of excess savings with 2022 having a negative share of -5.0%. This reinforces the consumption impulse of these excess savings given that the poorest households generally have a much higher marginal propensity to consume relative to wealthy households.

The savings ratio in Malta is estimated to have decreased below the 2019 levels in 2023, suggesting that these excess savings are being depleted. This is consistent with an indicator for current savings collected in the European Commission's monthly consumer survey (see Chart 4).⁴ This indicator gauges households' attitude towards saving, taking



⁴ This refers to question 10 in the consumer survey as outlined in the European Commission's [Business and Consumer Surveys User Guide](#).

into account the current economic environment. In December 2023, present savings (demeaned) stood at 10.7, significantly below 2019 levels, which averaged at 33.3. This supports the view that households have been utilising both their savings accumulated during the pandemic as well as their regular savings to smoothen consumption.

Forecast implications

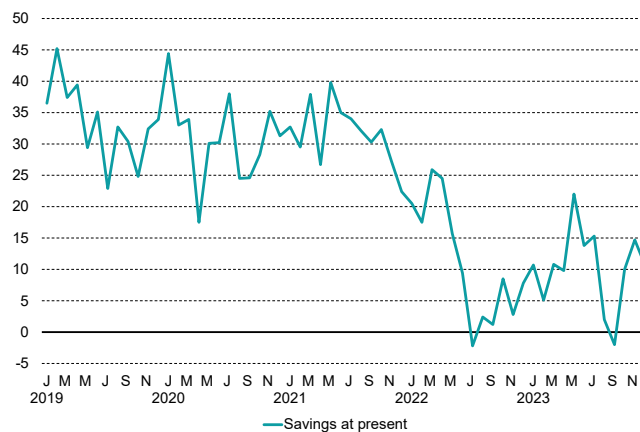
Chart 5 also draws on data collected in the consumer survey, in particular the confidence indicator and its decomposition on the left-hand side and future savings on the right-hand side. The former looks into households' perceptions and expectations on the general economic situation, their financial situation and future consumption. In the last half of 2023, consumer confidence has been declining steadily, standing at -2.4

in December 2023. The main contributor to this decline has been consumer's expectations on the economic environment. On the other hand, expectations on major purchases such as furniture and electronic equipment have remained strong. This suggests that private consumption will remain relatively strong over the forecast horizon, though less so than in 2023. Similarly, the savings expectations indicator,⁵ which gauges households' perception on their ability to save in the next 12 months, has been recovering from the sharp declines witnessed in 2022. This suggests that the saving ratio should begin to stabilise.

Given these indicators, as well as our assessment that excess savings have already been depleted by 2023, we expect real consumption growth to decline from a high of

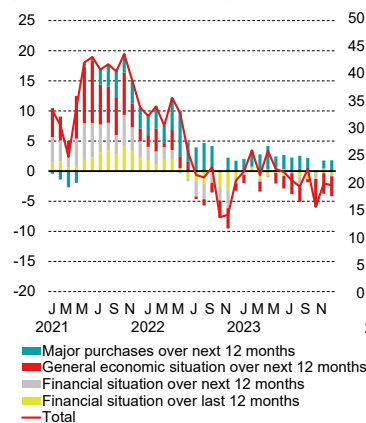
⁵ This refers to question 11 in the consumer survey as outlined in the European Commission's [Business and Consumer Surveys User Guide](#).

Chart 4
PRESENT SAVINGS
(demeaned net balances; seasonally adjusted)



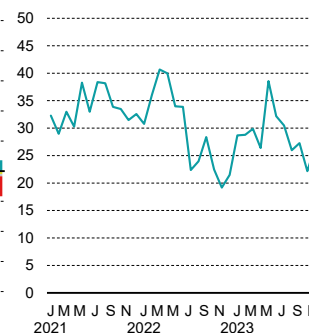
Sources: European Commission; Business and Consumer Survey, Central Bank of Malta calculations.

Chart 5
CONTRIBUTIONS TO THE CONFIDENCE INDICATOR
(seasonally adjusted; demeaned)



Sources: European Commission; Business and Consumer Survey, Central Bank of Malta calculations.

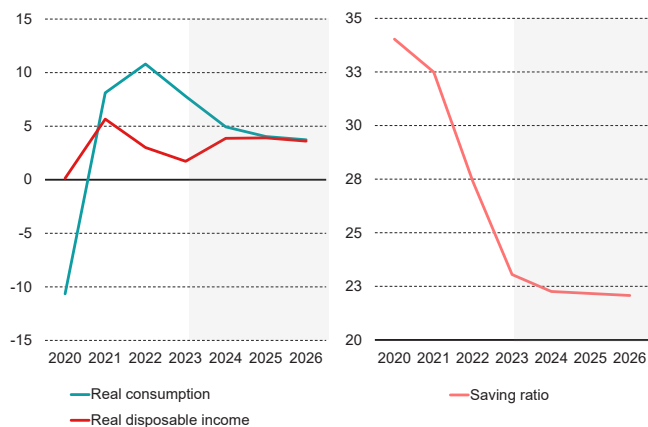
SAVINGS OVER NEXT 12 MONTHS
(seasonally adjusted; demeaned)



Sources: European Commission; Business and Consumer Survey, Central Bank of Malta calculations.

10.8% in 2022 to 3.6% by the end of the forecast horizon (see Chart 6). On the other hand, we expect growth of real disposable income to accelerate marginally in 2024 and stabilise at around 3.8% between 2024 and 2026. As a result, the saving ratio is projected to stabilise at around 22.1% which is close to the average of the last ten years.

Chart 6
PROJECTIONS
(annual percentage change; contributions; ratio)



Source: Central Bank of Malta.