Malta Economic Outlook

January 2023

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Contents

Executive Summary

During 2022, the world witnessed the war in Ukraine, high and increasing inflation rates, persistent supply side issues, an energy crisis, and the looming threat of recession, all while recovering from the economic shocks of a global pandemic. In a bid to rein in inflation, many central banks increased interest rates, signalling the end of a decade of record low rates, with the success of such measures still to be gauged.

During the first nine months of 2022, the Maltese economy expanded by 7.6%[1] in real terms but was not immune to global economic developments. In November 2022, the annual inflation rate stood at 7.2%[2], up from just 2.4% a year earlier. The inflation rate would stand even higher had the government not opted to subsidise the energy bills for Maltese businesses and households, with the resultant negative pressures on public finances. Tourism related sectors, being mainly accommodation, food services, transport and car rentals, exhibited encouraging signs of recovery. Nonetheless, inbound tourists during the period January to October 2022, remained at 17.8%[3] below the levels of 2019, with Malta still finding it challenging to fully regain the air connectivity lost during the pandemic.

Going forward, energy prices, inflation, interest rates and economic growth will also depend on how the conflict in Ukraine will evolve. A prolonged war will worsen energy shortages and is likely to play in favour of Russia. The threat of recession grows larger, both in Europe and the United States, while central banks are expected to raise interest rates further in a bid to dampen demand and hence contain inflation.

The Central Bank of Malta projects the Maltese economy to expand by 6.8% overall during 2022[4], with economic growth moderating to circa 3.6% per annum thereon, until 2025. In contrast, the European Commission is forecasting an average GDP growth rate of 3.2% in 2022, for the Euro area, and 0.3% in 2023[5]. Locally, inflation is expected to decrease in 2023, albeit remaining above average at 4.5%, as higher costs are being passed on to import and consumer prices with a lag. In 2023, inflation in the Euro area is similarly expected to decline but remain relatively high at 6.1%[6].

Turning our attention to the local property market, asking property prices increased by 5.2% in Q3 2022, when compared to a year earlier. During the period January to October 2022, the number of residential property permits increased by 28.3%, over the corresponding period in 2021, while commercial permits increased by 11.7%[7]. In 2022, the number of final deeds involving households as buyers decreased by 1.6% in number, but increased by 4.5% in value. Of some concern is the fact that in 2022, promise of sale agreements decreased by 22.1%, when compared to 2021[8]. The year-on-year decreases, which were first noted in July 2021, were persistent across most months and impacted promise of sale agreements involving both households and firms as potential buyers.

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[1] National Statistics Office – Gross Domestic Product: Q3/2022, News Release 218/ 2022 dated 29 November 2022

[2] National Statistics Office – Harmonised Index of Consumer Prices: November 2022, News Release 229/ 2022 dated 16 December 2022

[3] National Statistics Office – Inbound Tourism: October 2022, News Release 221/ 2022 dated 5 December 2022

[4] Central Bank of Malta – Outlook for the Maltese Economy 2022:4

[5] European Commission – Autumn 2022 Economic Forecast: The EU economy at a turning point

[6] European Commission – Autumn 2022 Economic Forecast: The EU economy at a turning point

[7] Central Bank of Malta – Economic Update 12/2022

[8] National Statistics Office – Residential Property Transactions, various 2022/3 releases

Main Economic Indicators

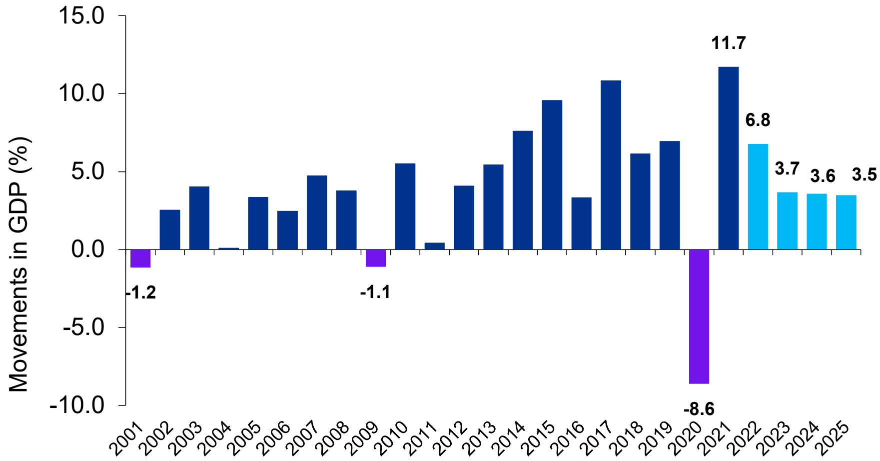
Gross Domestic Product

1.1 Annual GDP Growth Rates

The output of the Maltese economy reached pre-pandemic levels again in 2021 and grew by 7.6% in real terms[9] during the period January to September 2022[10]. The above average growth was driven by an increase of 10.7% in household consumption and an increase of 19.3% in net exports. The continued recovery in tourism dependent sectors, primarily accommodation, transport, and administrative and support services – which includes car rentals, also boosted economic growth.

The Central Bank of Malta (CBM) projects the Maltese economy to expand by 6.8% in real term overall during 2022[11], with economic growth moderating to circa 3.6% per annum thereon, until 2025. The following chart shows the movements in gross domestic product (GDP) over the period 2001 to 2025. The dark blue columns represent past real growth rates, the purple columns represent past negative contraction rates, while the light blue columns show CBM projected real growth rates for the years 2022 through 2025.

Figure 1: Movements in GDP in real terms



Source: NSO data; CBM projections; KPMG Analysis

[9] Real terms refers to an adjusted figure which eliminates the effect of inflation.

[10] National Statistics Office – Gross Domestic Product: Q3/2022, News Release 218/ 2022 dated 29 November 2022

[11] Central Bank of Malta – Outlook for the Maltese Economy 2022:4

1.2 Sector Movements

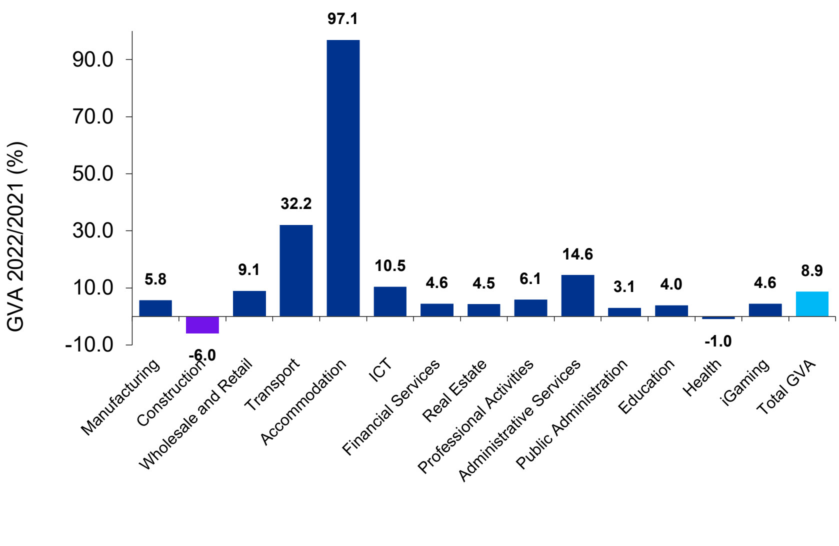
The following chart shows the movements in the gross value added (GVA) of selected sectors between the January – September 2022 period and the corresponding period in 2021. During the period, the economy's total GVA expanded by 8.9% in real terms.

The tourism dependent sectors and sectors which in 2021 were impacted by lockdown measures are still recovering from the pandemic and, as expected, exhibited the largest rates of growth. The downturn in construction is attributable to a decline in the construction of buildings following years of exceptional growth and a contraction in government expenditure on capital projects which impacted infrastructural projects.

Going forward, one would expect the recovery in tourism related sectors to continue, particularly as the number of inbound tourists between January and October 2022 was still 17.8%[12] below that in 2019, leaving further room for improvement. Tourism authorities are also committed to regaining the lost air connectivity during the pandemic and potentially improving on it. Nonetheless, labour shortages remain a headache for tourism operators trying to fill vacancies in catering and accommodation establishments. The output of the construction industry may benefit from the increase of 28.3% in the number of residential permits issued between January and October 2022[13].

Nonetheless, the government is expected to maintain its current stance on infrastructural expenditure, in view of the pressures posed on public finances by the energy subsidy, with the resultant negative effects on the civil engineering segment.

Figure 2: Movements in Sector GVA



Source: NSO data; KPMG Analysis

[12] National Statistics Office – Inbound Tourism: October 2022, News Release 221/ 2022 dated 5 December 2022

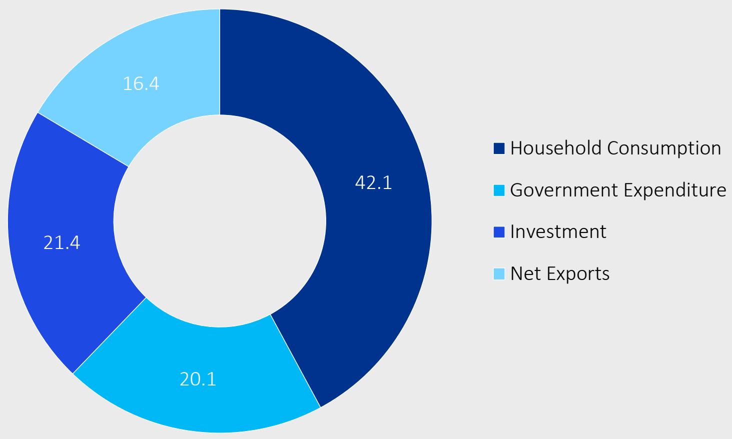
[13] National Statistics Office – Residential Property Transactions, various 2022 releases

1.3 GDP Expenditure Movements

From an expenditure point of view, GDP is the sum of household consumption, government expenditure, investment, and net exports – being exports less imports.

The following chart shows the GDP share of each expenditure component for the year 2021. During the period January – September 2022, household consumption increased by 10.5% in real terms [2021: 7.2%], government expenditure increased by 3.3% [2021: 7.3%], and investment decreased by 1.8% [2021: 6.6%]. Net exports increased by 19.3% [2021: 47.8%]. During the pandemic, household consumption and net exports contracted the most, while government expenditure was increased in a bid to shore up the country's output, which now explains the respective annual movements in 2022 vis-à-vis the previous year.

Figure 3: GDP Shares of Expenditure Components - 2021



Source: NSO data; KPMG Analysis

1.4 GDP Outlook

According to the CBM's latest outlook, Malta's GDP in real terms is projected to grow by 6.8% in 2022, which would translate into a 4.5% growth rate for Q4 2022. The projections reflect increased economic activity during the first half of the year, primarily driven by strong growth in export and private consumption.

The faster than anticipated recovery during 2022, led to a more moderate forecast of 3.7% for 2023, also driven by high inflation rates and recessionary threats in the international environment.

Table 1: Projections for Real Economic Activity

% Change on previous period	2021	2022	2023	2024	2025
GDP	10.3	6.8	3.7	3.6	3.5
Private consumption expenditure	7.1	8.9	4.9	4.8	4.1
Government consumption expenditure	6.7	4.6	4.2	3.8	3.8
Gross fixed capital formation	17.3	-5.4	3.4	-0.5	2.2
Exports of goods and services	9.0	6.9	2.5	3.2	3.1
Imports of goods and services	8.0	5.3	2.8	3.0	3.1

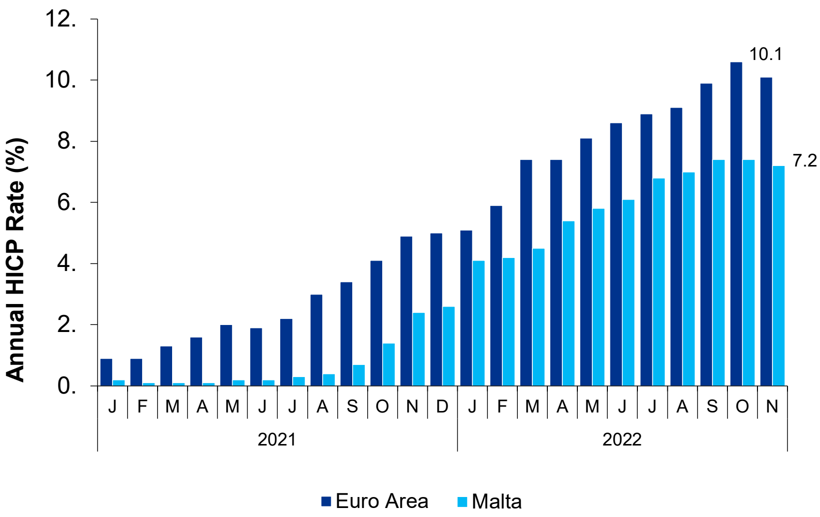
Source: CBM Projections; KPMG Analysis

Inflation

2.1 Consumer Inflation

Inflation has reached unprecedented levels globally. The war between Ukraine and Russia impacted the supply of oil and gas, and grains, explaining the particularly high rates of energy and food inflation. China's zero-covid policy, in place until a few weeks ago, continued to have a negative impact on a wide range of consumer goods, including technology, retail, motor vehicles, and other. These supply issues come at a time when demand is high post pandemic, fuelled also by months of financial support measures to households and business, provided by many governments internationally, in a bid to support their respective economies.

Figure 4: Annual HICP Rate (%)



Source: NSO data; Eurostat; KPMG Analysis

Locally, the annual rate of consumer inflation, measured by the Harmonised Index of Consumer Prices (HICP), stood at 7.2% in November 2022, compared to just 2.4% a year earlier[14]. The annual rate of inflation in the Euro area stood at 10.1%, compared to 4.9% in November 2021[15]. The following chart compares the annual movements in the HICP rate in Malta and the Euro area from January 2021 to date. The inflation rate in Malta would stand even higher had the government not opted to subsidise the energy bills for Maltese businesses and households.

[14] National Statistics Office – Harmonised Index of Consumer Prices: November 2022, News Release 229/ 2022 dated 16 December 2022

[15] https://ec.europa.eu/eurostat/databrowser/view/prc_hicp_manr/default/table?lang=en viewed on 21 December 2022

2.2 Consumer Inflation Drivers

The following table shows the share of the different divisions in the HICP and their respective annual inflation rates, as of November 2022. As can be noted from the following table, food has the largest weight in the index, accounting for 17.9% of the movements in the HICP. Additionally, it also had the highest annual inflation rate. The division weights are based on the final consumption expenditure of all individuals in Malta, including spending by private households, institutional households and foreign visitors, and are reviewed annually.

Table 2: Inflation Drivers - November 2022

HICP Division	Division Weight (%)	Annual Inflation Rate (%)
Food	17.9	13.4
Alcohol	3.9	2.7
Clothing	4.2	4.2
Housing and fuels	10.0	10.4
Furnishings and household equipment	8.7	9.4
Health	4.9	3.5
Transport	12.4	4.0
Communication	4.0	2.6
Recreation	7.9	5.6
Education	2.6	4.7
Restaurants and hotels	15.0	6.4
Miscellaneous	8.4	4.2
All Items	**100.0**	**7.2**

Source: NSO; Eurostat; KPMG Analysis

2.3 Industrial Producer Price Index

While movements in consumer prices generally receive the most attention, other measures of inflation provide equally valuable insights.

The industrial producer price index (IPPI) measures the development of transaction prices from the point of view of the producers. IPPIs also provide information per main industrial grouping[16] and domicile of transacting parties[17]. In November 2022, the overall IPPI increased at an annual rate of 5.7%, [2021: 6.3%, 2020: -0.5%] with domestic transactions registering the largest jump in prices, at 7.7% [2021: 4.1%, 2020: 1.7%][18].
IPPIs capture price movements prior to the retail level and can be an early indicator of inflationary pressures in the economy.

16 Main industrial groupings – intermediate goods, energy, capital goods, consumer goods (further subdivided in durable and non-durable goods). Refer to https://metadata.nso.gov.mt/concepts.aspx for more information.

17 Transactions are classified as domestic, non-domestic, non-domestic Euro area, and non-domestic non-Euro area. Domestic transactions are transactions conducted among local resident enterprises. All other transactions are conducted between Maltese enterprises and enterprises domiciled in the respective geographical region.

18 National Statistics Office – Industrial Producer Price Indices: November 2022, News Release 232/ 2022 dated 21 December 2022

2.4 Inflation Outlook

The CBM expects consumer price inflation to moderate to 4.5% for 2023[19]. Energy prices are expected to remain unchanged, in line with the Government's policy of keeping energy prices stable. On the other hand, wage inflation, persistent imported inflation and higher international commodity prices are expected to put further pressure on prices.

Table 3: Projections for Prices and Costs

% Change on previous period	2021	2022	2023	2024	2025
Overall HICP	0.7	6.1	4.5	2.3	2.0
Compensation per employee	4.8	4.1	4.9	4.0	3.7

Source: CBM Projections; KPMG Analysis

[19] Central Bank of Malta – Outlook for the Maltese Economy 2022:4

Interest Rates

During 2022, the European Central Bank (ECB) reversed the trend of low or negative interest rates which persisted for more than the past decade. The deposit facility rate increased from -0.5% in July 2022 to 2.0% in December 2022 – an increase of 2.5 percentage points, aimed at reining in inflation. Gabriel Maklouf, a governing council member of the ECB, was quoted as saying that the Bank will likely increase interest rates by smaller increments during 2023, should further hikes be needed[20].

Locally, the composite interest rate paid by monetary financial institutions (MFIs) in October 2022 on Maltese residents' outstanding deposits stood at 0.14%[21], unchanged from a month earlier. Meanwhile, the composite rate charged on outstanding loans increased marginally by 1 basis point, to 3.24%. As a result, the spread between the two rates widened slightly to 310 basis points.

Domestic banks rely heavily on their local deposit base to fund outstanding loans and as a result the increase in ECB rates has not been reflected in increases in the banks' base rates as yet. Whether the base rates will increase in the future will primarily depend on the interest rates expectations of depositors, the individual responses of the main market players, and potential future interest rate hikes by the ECB.

An increase in the base rates of local MFIs would impact existing and potential credit borrowers across different borrower classes. An increase in the bank's base rates would:

- Make existing personal, home, and business loans less affordable by increasing the monthly repayment amounts due.
- Make potential personal, home, and business loans less affordable and likely decrease the amount that a potential borrower could be loaned. In turn, this would impact the market for the assets being acquired, primarily the residential property market.

20 https://www.reuters.com/markets/europe/ecbs-makhlouf-sees-smaller-interest-rate-hikes-2023-if-needed-2022-11-27/

21 Central Bank of Malta – Economic Update 12/2022

The Labour Market

4.1 The Labour Force Survey

Malta currently has a tight labour market, with most businesses finding it challenging to retain staff and fill vacant positions. The Labour Force Survey for Q3 2022[22], estimated the total number of persons in employment at 284,571 – an increase of 5.1% when compared to the previous year. The unemployment rate stood at 2.9%, down from 3.3% a year earlier.

4.2 Foreign Workers

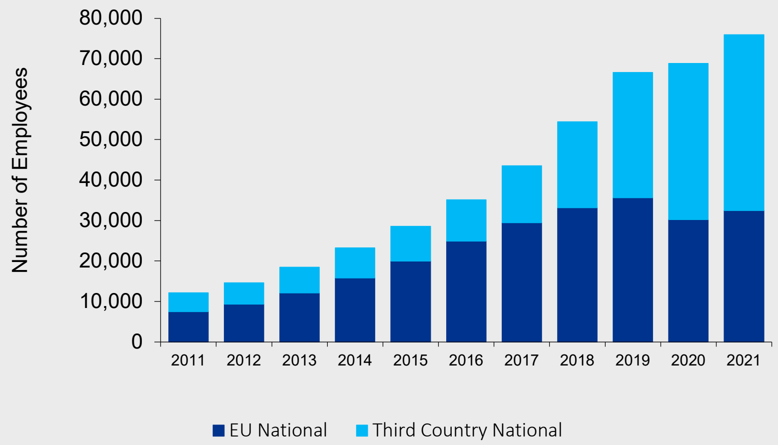
Employed foreign nationals in Malta amounted to 77,825 at the end of 2021. Of these workers, 41.7% were EU nationals, 55.9% were third country nationals (TCNs), and the other 2.4% were other Europeans[23].

The pandemic brought about a shift in the composition of foreign workers. Up to 2019, EU nationals made up more than half of foreign workers in Malta, while by 2021 the percentage of workers hailing from EU member states had decreased to 41.7%. This was attributable to both a downward shift in the number of EU nationals, which decreased by circa 3,189 employees between 2019 and 2021, as well as a significant increase in the number of TCN employees, which increased by 12,552 during the same period.

The composition of foreign workers matter in view of the different type of jobs generally performed by each category. As per Jobsplus records, TCNs were employed mainly in elementary jobs or services and sales workers. In contrast, EU nationals were employed as clerks, support workers, or professionals. The shift coincided with the increase in popularity of food and other delivery services, as well as an increase in ride hailing apps.

The following chart shows the composition and movement in the number of foreign workers over the period 2011-2021. Other European nationals were excluded in view of their marginal number to date.

Figure 5: Foreign Workers



Source: Jobsplus; KPMG Analysis

[22] National Statistics Office – Labour Force Survey: Q3/2022, News Release 228/ 2022 dated 15 December 2022

[23] https://jobsplus.gov.mt/resources/publication-statistics-mt-mt-en-gb/labour-market-information/foreigners-data viewed on 21 December 2022

4.3 Labour Market Outlook

The following table presents the CBM projections for the labour market. As can be noted, no major shifts are envisaged.

Table 4: Projections for the Labour Market					
	2021	2022	2023	2024	2025
Total employment (% △ on previous period)	2.9	4.9	2.9	2.3	2.2
Unemployment Rate (% of labour supply)	3.5	3.0	3.0	3.2	3.3

Source: CBM Projections; KPMG Analysis

The Property Market

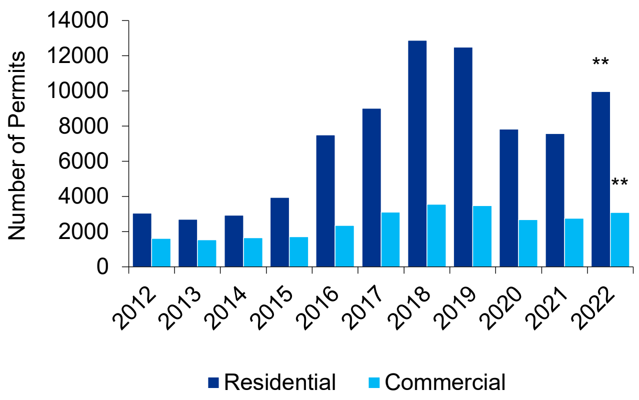
5.1 Residential and Commercial Permits

During the period January to October 2022, a total of 8,311 residential permits were issued, being an increase of 28.3% over the corresponding period in 2021. The number of residential permits issued so far in 2022 is the third highest pro-rata issued over the past decade, with the exception of 2018 and 2019 – during which an average of 12,685 permits [Pro-rata up to October: 10,571] were issued annually. Such a significant increase in the number of residential units raises the question of potential over supply in the years to come, unless met with an equal increase in demand.

Commercial permits issued between January and October 2022, amounted to 2,585 and represented an increase of 11.7% over the corresponding period in 2021. The average number of commercial permits issued to date is in line with the average of the past five-year period.

The following table shows the number of permits issued for residential units and the number of commercial permits issued between the years 2012 to 2022. Figures for 2022 are an estimate for the whole year based on actual data for the period January to October 2022**.

Figure 6: Residential and Commercial Permits



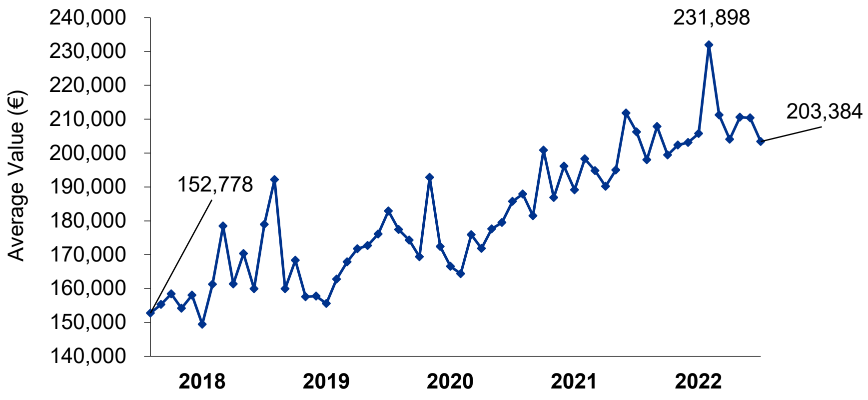
Source: CBM Data; KPMG Analysis

5.2 Final Deeds of Sale

During the period January to December 2022, a total of 13,079 final deeds of sale involving individuals as final buyers were registered - a decrease of 1.6% over 2021 [2021: 30.8%][24]. The value of these same deeds represented an increase of 4.5% over 2021 [2021: 45.9%].

The following chart shows the average value appearing on final deeds of sale involving individuals as final buyers on a monthly basis. While the data cannot be interpreted as a movement in average prices, since no property details are available per specific deed, it can be used as a proxy. In December 2022, the average value of final deeds stood at €203,384, being a decrease of -1.4% over December 2021, and a decrease of 3.3% over November 2022.

Figure 7: Monthly Average Value of Final Deeds Involving Households as Buyers



Source: NSO; KPMG Analysis

Between the period January 2018 and December 2022, the compound annual growth rate (CAGR) for the average value of final deeds involving households as buyers, stood at 7.4% per annum.

This means that, on average, the average value of final deeds involving households as buyers grew at a rate of 7.4% per annum, from €152,778 as at January 2018, to €203,384 as at December 2022.

24 National Statistics Office – Residential Property Transactions, various 2022/3 releases

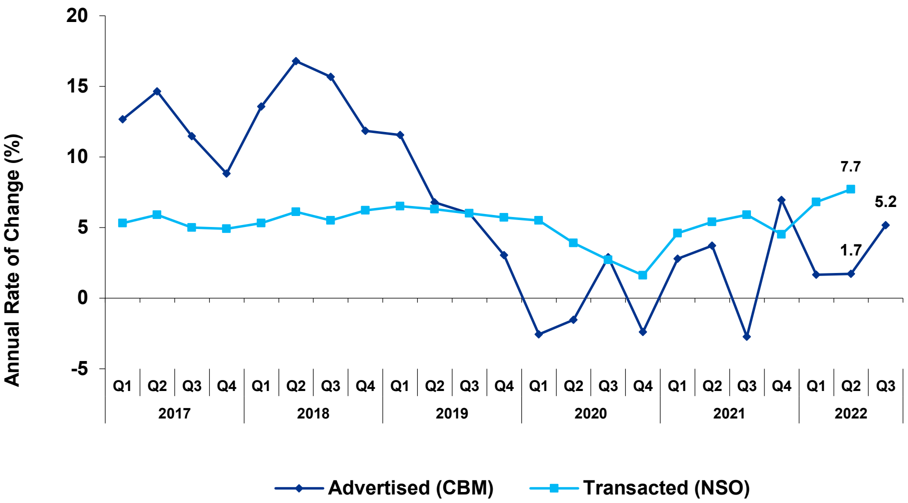
5.3 Promise of Sale Agreements

A total number of 11,086 promise of sale agreements involving individual potential buyers were registered in 2022. This represents a decrease of 22.0% over the previous year. Interestingly, in Q4 2022, the highest number of promise of sale agreements by region were registered in the Birkirkara, Il-Gżira, L-Imsida, Ta' Xbiex and San Ġwann region, with 13.5% of total, followed by Gozo, with 12.4% of total.

5.4 Property Price Indices

The following chart compares the annual movements in advertised prices issued by the CBM, and the movements in transacted prices, as per the Commissioner of Inland Revenue, issued by the NSO. As can be noted, both indices showed dips during 2020. The index of advertised prices evidences higher variability, in that advertised prices reflect seller expectations. Other differences between the two indices include timing differences and negotiation buffers.

Figure 8: Residential Property Price Indices



Source: NSO; CBM; KPMG Analysis

5.5 Residential Property Market Outlook

The impact of the increase in supply on market prices, if all the permits issued result in new dwellings, will depend on:

The movement in resident population in the coming years

The growth in resident population experienced over the past decade appears to have moderated in the last two years. The authorities have also indicated that they will no longer pursue the aggressive foreign labour policies adopted in the past ten years.

The continued recovery of the tourism sector

Approximately 25% of inbound tourists[25], reside in non-collective accommodation, which translates mainly to self-catering properties. The additional recovery of the tourism sector will impact the market for holiday leases, and in turn the attractiveness of buying such properties for investment purposes.

Movements in hotel bed stocks

A study by the Malta Hotels and Restaurants Association carried out in 2022 showed that Malta would need 4.7 million tourists to cater for the planned increases in hotel bed stock. In comparison, Malta hosted 2.8 million tourists in 2019. While such estimates did not take into consideration future hotel closures, a dramatic increase in bed stock, without the corresponding increase in number of tourists, would result in increased rate competition across the accommodation sector, driving prices down and hence yields. Such an event would discourage investors from acquiring property intended for holiday leases.

Regulatory Policies

The CBM's Directive 16 was issued with the scope of reining in potential vulnerabilities in the property market by limiting access to finance for second properties, at a time when regulators were concerned that the property market was potentially overheating. While the CBM has not hinted to a reversal in this directive, should this occur, lending for the acquisition of second properties by small individual investors may be made easier, hence resulting in an increase in buyer demand.

Interest Rates

Any increase in interest rates in the lending rates of local banks will increase borrowing costs and decrease the amount a potential buyer is able to borrow, resulting in decreased demand for property.

[25] National Statistics Office – Inbound Tourism: October 2022, News Release 221/ 2022 dated 5 December 2022

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