INFLATION IN MALTA: TRENDS, PRESSURES AND RECOMMENDATIONS

A Document Prepared for the Malta Council for Economic and Social Development (MCESD)

MCESD
MALTA COUNCIL FOR
ECONOMIC & SOCIAL DEVELOPMENT

Section 1: Recent Developments in Inflation

1.1 General Trends in HICP

We begin by analysing recent trends and movements in inflation. The principal measure of inflation within the EU is the Harmonised Index of Consumer Prices (HICP), which is compiled by Eurostat and is designed to be comparable across member states. Figure 1 shows the monthly rate of inflation based on the HICP across Malta, the EU-27 and the Euro Area, over the period 2019 to 2024 Q2. As seen below, Malta's inflation rate over the last few years has largely mimicked movements in the HICP across its European counterparts, hovering at slightly below 2% in 2019, followed by a dip during 2020-2021 precipitated by the economic slowdown resulting from the COVID-19 pandemic, followed by a steep increase in 2022 due to supply chain disruptions caused by the recovery and the Russia-Ukraine conflict, with a further stabilization and decline thereafter.

Nonetheless, it is worth highlighting two key aspects of Malta's inflationary trajectory. Firstly, the post-COVID increase was markedly lower than that recorded by the EU-27 and Euro Area on average, largely due to the Maltese government's decision to subsidize energy prices amidst significant inflationary pressures resulting from oil and gas supply disruptions. Indeed, whereas inflation peaked at around 7.4% in Malta during October 2022, average peak inflation within the EU-27 and Euro Area was of 11.5% and 10.6% respectively, which attest to the cushioning effect of these subsidies on Maltese households and firms. Secondly, despite this softer increase, as well as the persistence of these energy subsidies, Malta's rate of inflation has, since March 2023, consistently been above the Euro Area average and, since September 2023, also outpaced the EU-27 average, reaching 3% in Q2 of 2024, relative to 2.8% and 2.6% in the EU-27 and Euro Area respectively. This will be dissected in further detail when analysing the key drivers of Malta's inflationary pressures as captured by the HICP in subsequent sections.

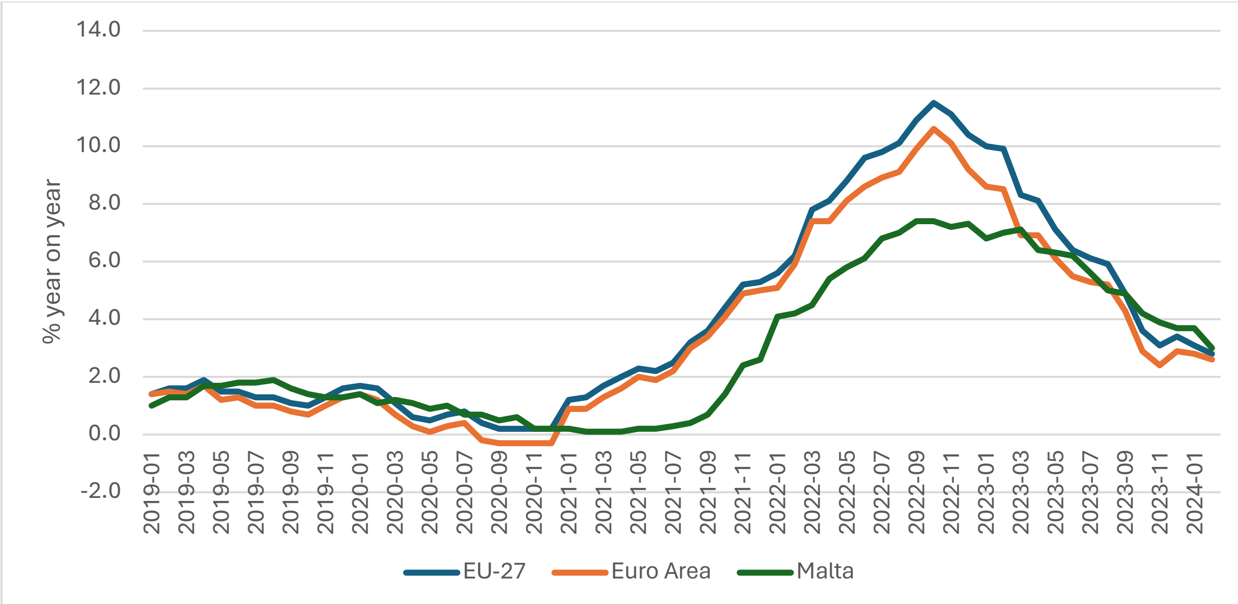

Figure 1: Annual HICP inflation, 2019-2024 (Source: Eurostat, 2024)

To supplement this analysis, Figure 2 provides a comparison of inflation in Malta relative to other small EU member states, defined as having a population size of 2 million inhabitants or less. As shown in Figure 2, Malta's inflationary performance relative to these countries has been characterized by considerably less volatility, particularly when compared to countries like Estonia and Latvia, both of which experienced significantly higher levels of inflation in the post-COVID period. Malta's more recent inflation also compares favourably to this cohort of countries, with only Latvia (0.6%) and Cyprus (2.1%) recording a lower rate of inflation.

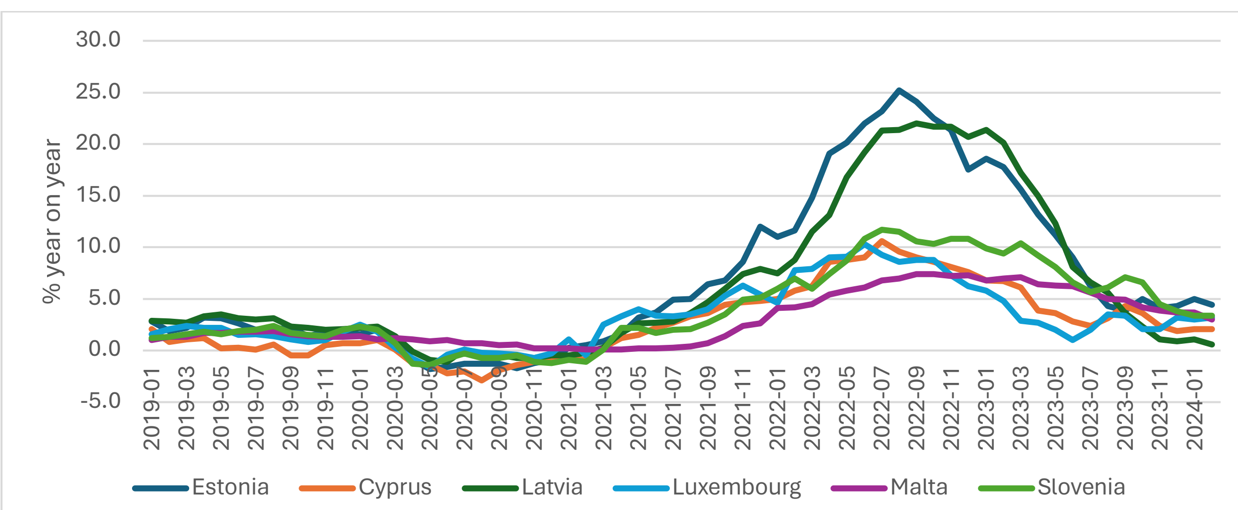

Figure 2: Annual HICP inflation for small EU member states (Source: Eurostat, 2024).

We now analyse the key components of Malta's aggregate rate of inflation in recent years. Figure 3 shows the average annual rate of inflation for each broad component used to calculate the HICP over the period January 2022 to February 2024. As seen below, food and non-alcoholic beverages recorded the highest average annual inflation rate over this period (10.6%), followed by housing, water, electricity, gas and other fuels (7.7%), and furnishings, household equipment and routine household maintenance (6.2%). Food and non-alcoholic beverages has consistently ranked as the top contributor to inflation in Malta since 2022, although in February 2024 inflation within this category dipped to 6.8%, arresting a 3-month increase which peaked at 10.1% inflation in January 2024. The second highest average rate of inflation over this period was recorded within the housing, water, electricity, gas and other fuels category.

Indeed, despite the aforementioned energy subsidies which have maintained utility prices fixed in recent years, inflation within this category has been largely driven by increases in rental prices, with an annual inflation rate of 16.5% recorded in February 2024 alone, reflecting the continued buoyancy of Malta's housing and rental market as the influx of foreign workers continues unabated. Another contributor to rising prices within this category is maintenance and repair services for dwellings, peaking at 21.5% annual inflation during October, November and December 2022 before gradually declining to 0.8% in February 2024, which also reflects elevated demand for such services as a result of increased real estate activity and rentals. In a similar vein, the third largest average annual rate of inflation was recorded within the furnishings, household equipment and routine household maintenance category, notably within the household maintenance category, furniture and appliances segments.

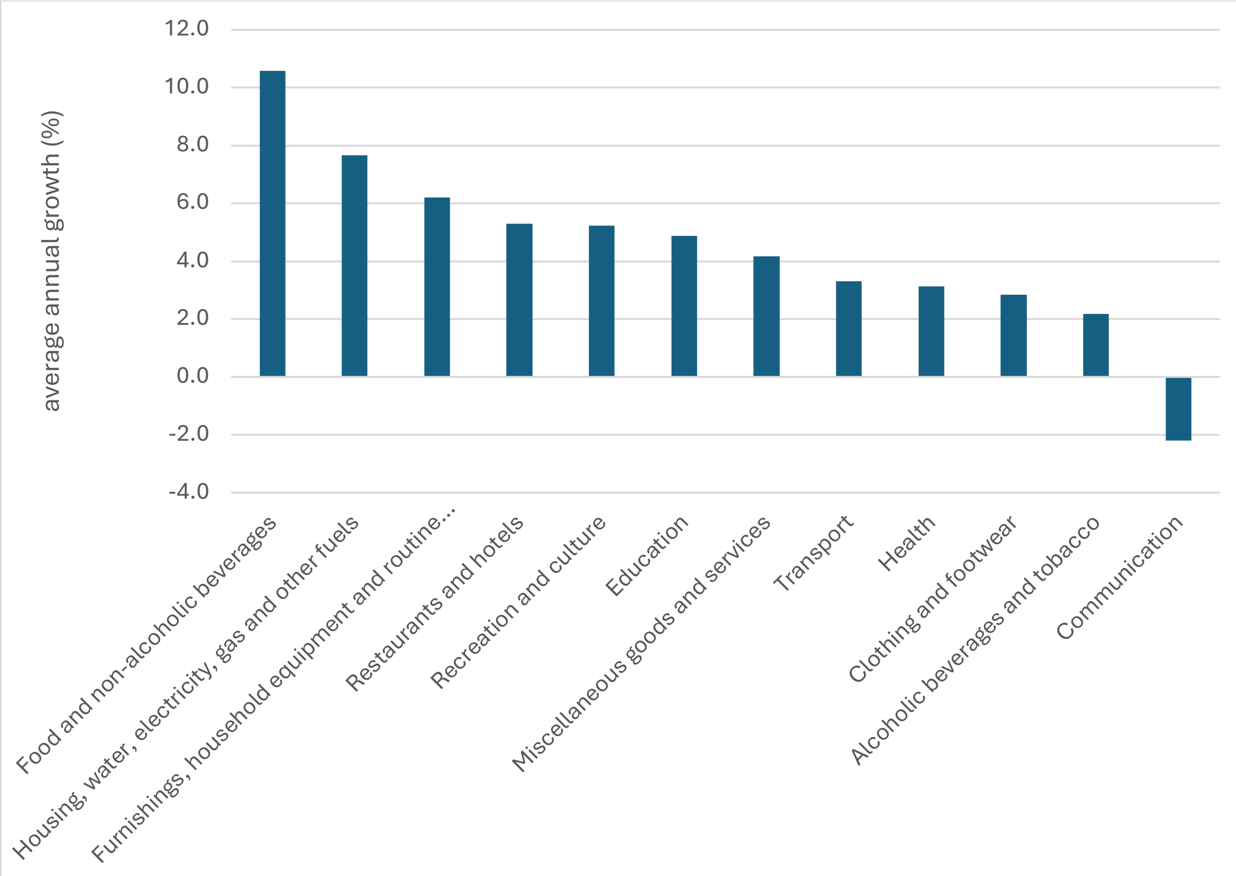

Figure 3: Annual average HICP inflation across key product and service categories in Malta, January 2022-February 2024 (Source: Eurostat, 2024).

1.2 Food Inflation

Given the importance of food and non-alcoholic beverages to overall inflation in Malta, it is worth delving into the numbers a little further to understand the main drivers of these recent trends. First, we provide a breakdown of the different categories of food and their respective annual average inflation over the period January 2022 to February 2024. As shown in Figure 4, over this time period the highest annual rate of inflation was recorded within the oils and fats subcategory (14.8%), followed by sugar, jam, honey, chocolate and confectionery (12.4%) and milk, cheese and eggs (12.2%), closely followed by several other categories of food including bread and cereals and vegetables. Inflation within the oils and fats category has largely been driven by rising olive oil prices, which grew annually by a staggering 41.8% in February 2024, reflecting dwindling olive yields in several key oil producing countries like Spain and Portugal due to droughts and extreme weather events which have decimated production. Prices are expected to keep rising in the immediate term, with olive oil production projected to remain below average amidst ongoing drought concerns, despite Spain's leading agricultural union, the Cooperativas Agro-alimentarias, estimating that production would rise to 755,000 tonnes of oil in 2024[1].

Similarly, albeit to a much lesser extent, the price of butter, margarine and other vegetable fats has also increased steadily over this time period, mainly due to higher cattle feed, milk and energy prices in butter-producing countries like Germany and Denmark, although these pressures have eased somewhat in recent months, with the price of butter plummeting by 4.7% year-on-year in February 2024, with margarine inflation similarly down to -4.8%. When it comes to the somewhat vast category of sugar, jam, honey, chocolate and confectionery, the key driver of inflation has been the increase in sugar prices globally, which has recorded double-digit annual growth since October 2022, peaking at 61% annual inflation in August 2023, once again on the back of extreme weather and drought in sugar-producing countries.

Concurrently, the price of cocoa has also risen sharply globally for similar reasons, and these developments, coupled with the aforementioned rise in butter and milk prices, have contributed towards upward domestic inflationary pressures for chocolate (16.7% in February 2024), confectionery items (13.1% in February 2024) and ice-cream (8.9% in Feb 2024), given the prevalence of such ingredients in these food items. As for milk, cheese and eggs, a somewhat contrasting picture emerges in recent months, with fresh milk prices in Malta largely reflecting the two prices increases announced by Malta Dairy Products Ltd. over the course of 2023. Preserved milk on the other hand experienced more consistent price increases over this period, peaking at 25% in June 2023 on the back of rising international milk prices amidst higher operating costs, with this trend also somewhat reflected in the price of cheese and curds. Egg prices have also increased sharply over this period, with inflation reaching 35% in March 2023 before moderating in recent months, albeit still recording 10.3% annual inflation in February 2024 due to higher animal feed and operating expenditures.

[1] https://www.euronews.com/business/2024/02/27/price-of-olive-oil-climbs-more-than-50-in-a-year-in-the-eu

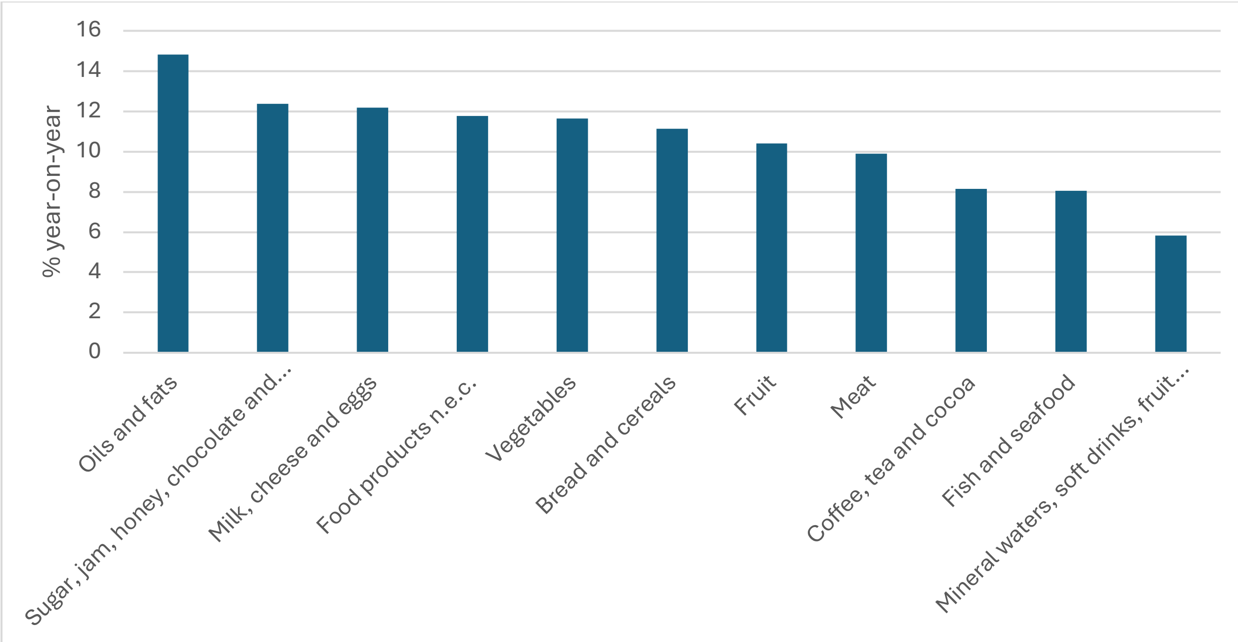

Figure 4: Breakdown of annual average HICP food inflation by main categories, January 2022-February 2024 (Source: Eurostat, 2024)

We can assess food inflation using alternative, broader categorizations, specifically focusing on processed, unprocessed or seasonal food, and their movements relative to aggregate food inflation. This is depicted in Figure 5. As shown below, in recent months much of the upward pressure on aggregate food inflation has been exerted by processed food, which has since August 2022 almost consistently recorded higher annual inflation relative to the aggregate. This is unsurprising given that this category includes food items like oils and fats, sugar, jam, honey, chocolate and confectionery and milk, cheese and eggs, all of which recorded the highest levels of inflation as per Figure 4 above. By contrast, since August 2022 unprocessed food like meat, fish, fruit and vegetables has generally recorded an annual inflation rate below the aggregate, with a notable exception between December 2023 and January 2024, with similar (albeit more volatile) trajectories exhibited in the seasonal food category.

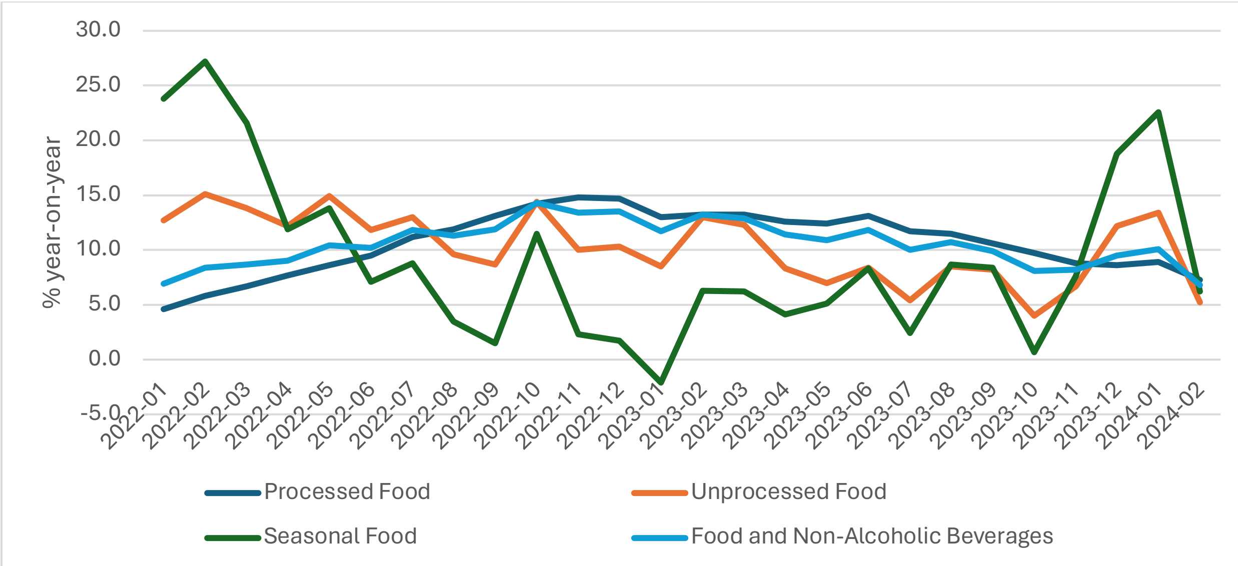

Figure 5: Annual HICP inflation for processed, unprocessed and seasonal food (Source: Eurostat, 2024)

1.3 Inflation in Goods and Services

Next, we consider inflation for non-energy industrial goods which comprise all consumer goods excluding food, energy and tobacco products. As shown in Figure 6, industrial goods inflation in Malta has primarily been driven by price increases in non-durables, which include products like electronic goods for personal care, pharmaceuticals, and household cleaning products, thus covering several items that form part of a typical weekly household shopping cart. Indeed, despite a recent decrease, annual inflation for this category of goods still reached 4.2% in February 2024, relative to the aggregate of 1.7%. In turn, inflation for semi-durable goods (e.g., clothing, footwear and books) has fluctuated significantly, albeit broadly below the aggregate for non-energy industrial goods, moderating to 1.7% in February 2024. By contrast, durable goods recorded a general price decrease in both January and February of 2024, driven by price reductions in automobiles and household appliances.

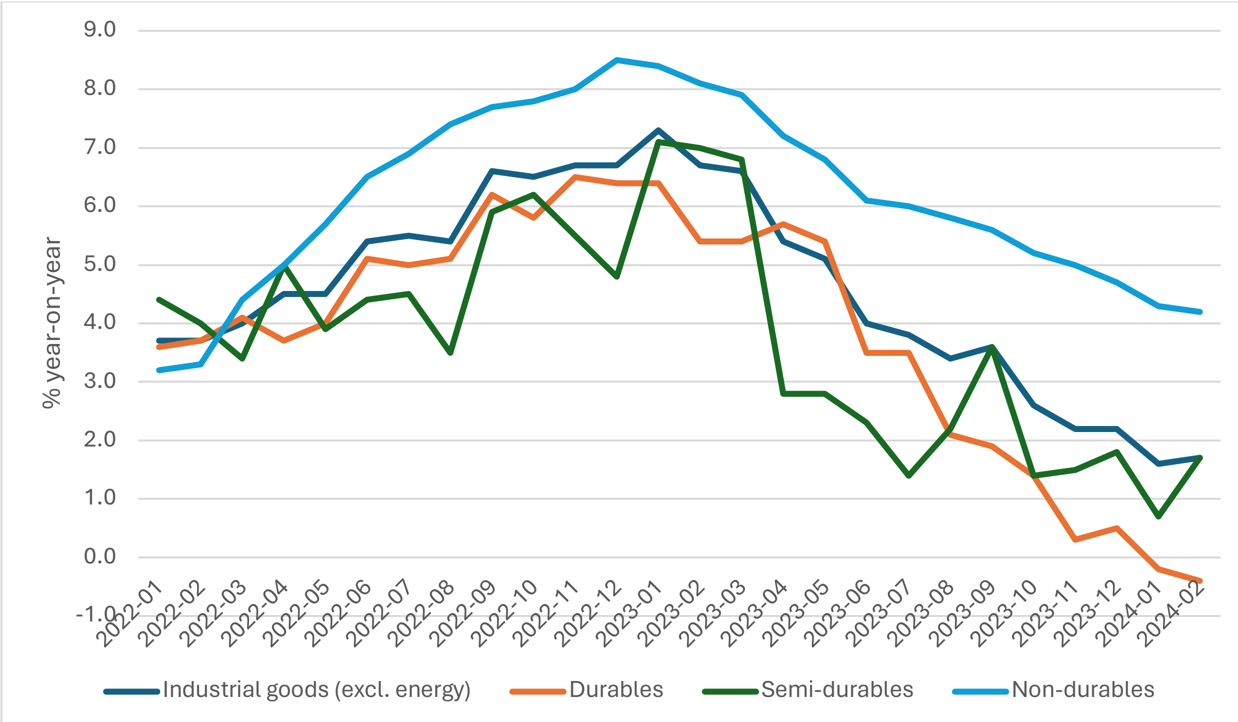

Figure 6: Annual HICP inflation across goods categories (Source: Eurostat, 2024)

We turn our focus to services. Figure 7 shows annual inflation for services in Malta relative to the EU-27 and the Euro Area. As shown below, inflation in services peaked locally at 7.5% in August 2022, significantly above the EU and Euro Area averages, before commencing a sharp downward trajectory such that by mid-2023, services inflation in Malta has consistently been below the EU and Euro Area averages. Indeed, in February 2024 annual services inflation stood at 2.8%, relative to 4.4% and 4% in the EU-27 and Euro Area respectively. Thus, the data indicates that domestic inflation is not being driven by services, but rather by rising goods prices.

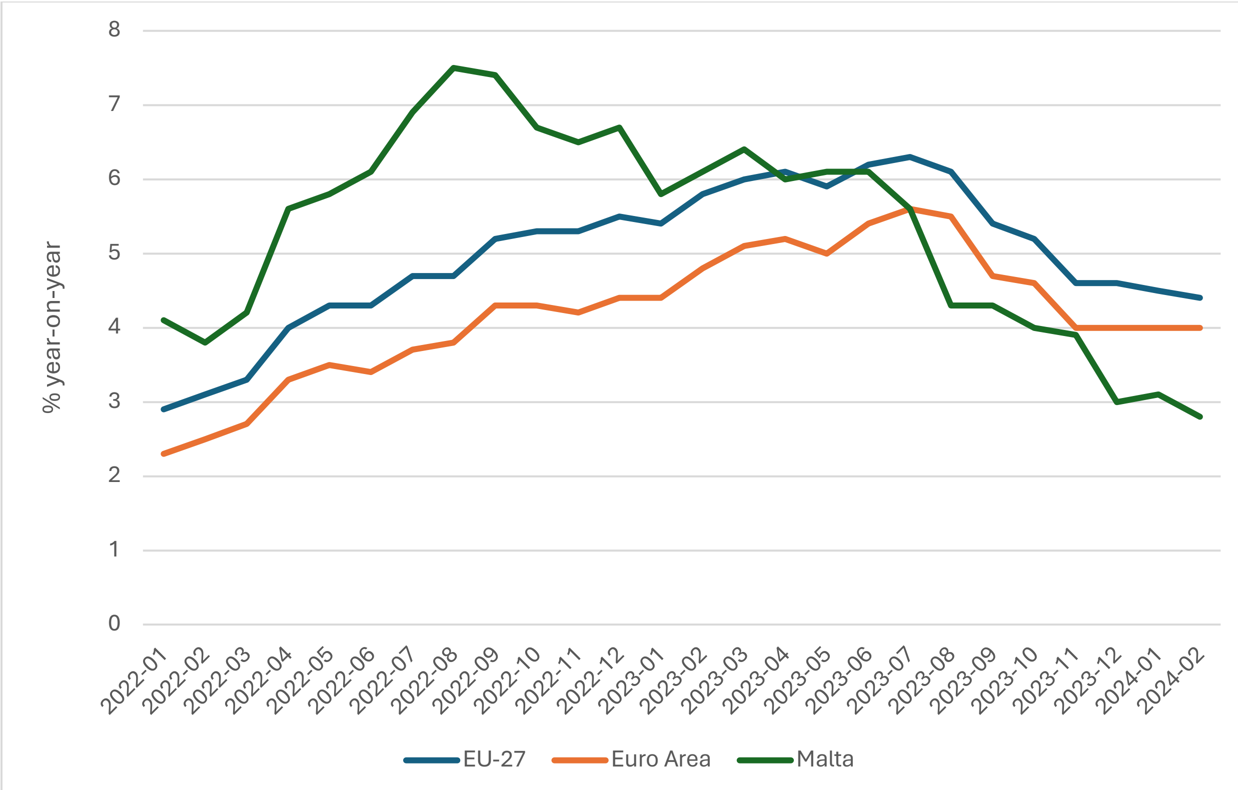

Figure 7: Annual HICP inflation across services (Source: Eurostat, 2024)

A deeper dive into the components of services inflation is provided in Figure 8. As seen below, the highest rate of inflation for services has consistently been recorded within the housing services segment, which despite recent moderation still reached 6.5% in February 2024, which is unsurprising given that this includes rent, maintenance and repair services for dwellings and other domestic services. Inflation in transportation has fluctuated significantly in recent years, capturing not only repair services but also private transportation like taxis, with inflation dipping until September 2023 before rising somewhat to almost 5% in February 2024. By contrast, the communications sector has recorded several months of annual deflation since August 2023, reaching -8.5% in February 2024.

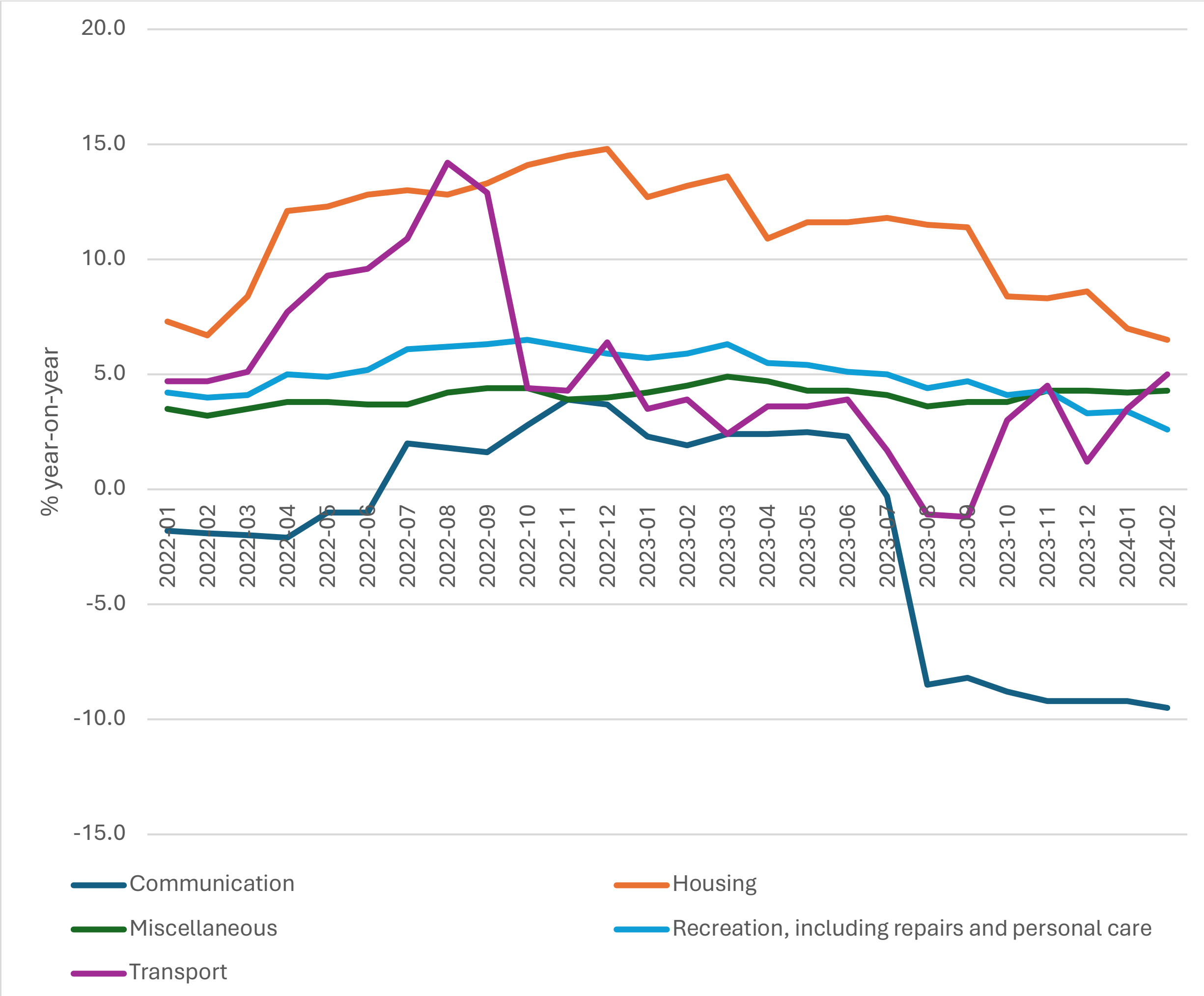

Figure 8: Breakdown of annual HICP inflation in services by key categories (Source: Eurostat, 2024)

1.4 A Measure of Inflationary Persistence

We can now analyse the persistence of domestic inflation relative to the EU-27 and Euro Area. We start with core inflation, which is a measure of long-run or persistent inflation, excluding elements that are typically subject to transitory movements due to short run price volatility, namely food, energy, alcohol and tobacco. Recent movements in core inflation are provided in Figure 9. As seen below, although Malta's core inflation rate was above the EU and Euro Area average for the duration of 2022, this trend was reversed beyond February 2023, with domestic core inflation plummeting to 2.4% by February 2024, compared to 3.5% and 3.1% in the EU and Euro Area respectively. This suggests that Malta's current inflationary pressures are largely being driven by transitory movements, predominantly rising food prices as discussed earlier, although it is still worth noting that core inflation is above the ECB's medium-term target of 2% annual inflation.

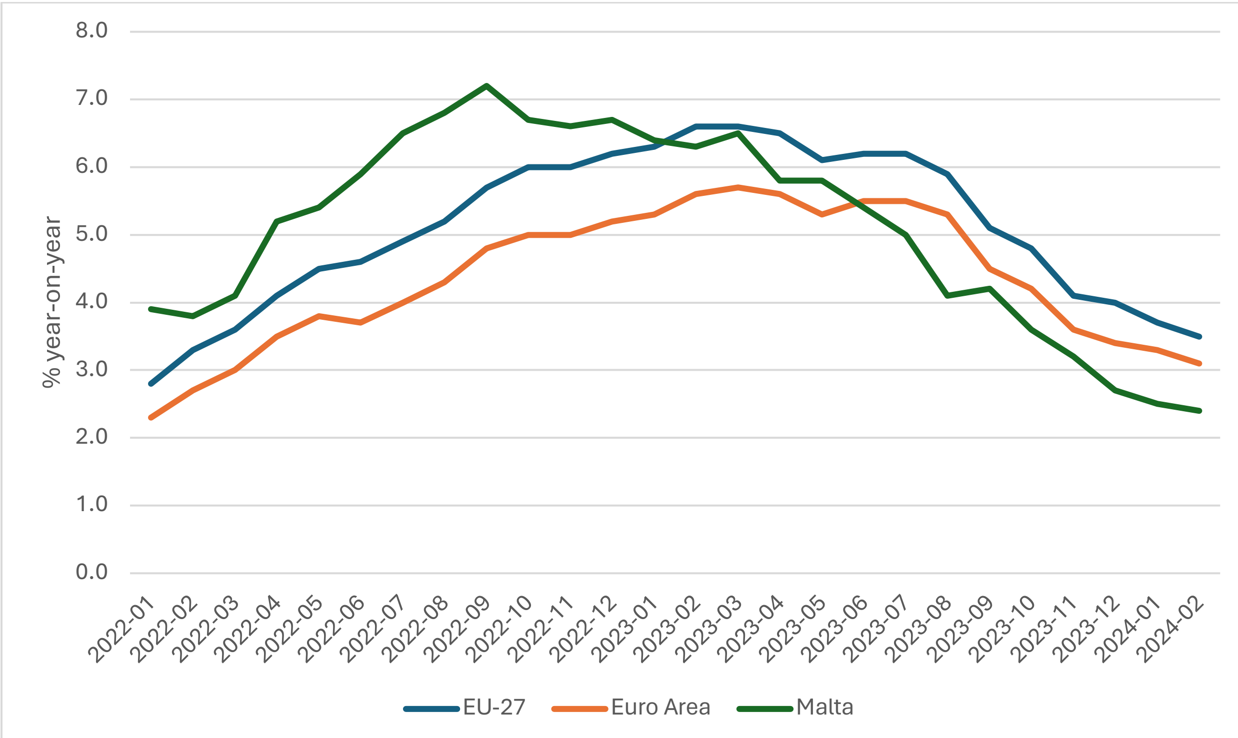

Figure 9: Core HICP inflation across Malta, the EU-27 and Euro Area (Source: Eurostat, 2024)

Therefore, Malta's recent inflationary pressures have largely been driven by food prices, together with upward movements in prices for housing-related services like rent, repair and maintenance activities. These trends have important distributional implications, as highlighted in Grech et al. (2024)[2], who report that these impacts have been particularly acute for low-income households and retirees. Indeed, they characterize the gap between inflation for the lowest income quartile relative to the highest income quartile, as well as between retired and non-retired households, as being historically high, although they do qualify this by stating that recent refinements to the COLA mechanism have helped to significantly alleviate this burden on pensioners, with rising purchasing power for the lowest pension earners predicted for 2024. Nonetheless, the study serves to highlight the disproportionately burdensome impact of inflation on lower income households, which would only serve to entrench existing disparities despite the largely transitory nature of these inflationary pressures.

[2] Grech, A.G., Borg, I. and Antonaroli, V. (2024). The Cost of Inflation: How Has the Recent Surge in Inflation Impacted Lower-Income Households in Malta? Central Bank of Malta Policy Notes No. 1/2024.

Section 2: Drivers of Recent Inflation

In this section we analyze the specific domestic and international factors that have contributed towards the inflationary trends and pressures in Malta described in the previous section.

2.1 International Pressures

2.1.1 Global Geopolitical Events

We begin by taking a macro perspective on the key drivers of inflation. Figure 10 shows Malta's annual monthly inflation rate over the period January 2019 to February 2024, with key global/European events superimposed to provide further insight. As expected, the March 2020-July 2021 period was characterized by very low levels of inflation as the world grappled with the outbreak of COVID-19 and the ensuing economic slowdown as various containment measures kicked-in. Subsequently, inflation shot upwards from 0.3% in July 2021 to 2.6% in December 2021 fueled by pent-up demand coupled with supply-chain issues and shortages, with production struggling to keep up with demand, partly due to continued containment measures in key global production hubs like China and their zero-COVID policy, while human resource shortages also contributed to spiraling wage costs as several third country nationals left the EU during the pandemic. The Russia-Ukraine conflict only served to further stoke inflationary pressures further, raising energy prices and exacerbating supply chain issues across the globe, while raising the price of food to hitherto unprecedented levels given that Ukraine is a major producer and exporter of agricultural commodities like wheat, maize and oilseeds, as well as fertilizers. Indeed, during this period annual inflation in Malta peaked at 7.4% during September-October 2022, largely due to food price inflation, despite the aforementioned subsidies on energy which helped keep electricity prices constant for households and firms.

As seen below, towards the beginning of 2023 inflationary pressures began to moderate, and subsequently declined sharply after March 2023, which coincides with the European Commission's adoption of the State Aid Temporary Crisis and Transition Framework, which enabled member states to enact extensive support measures in key sectors that had been hit hard by economic uncertainties, disruptions to their supply chains and elevated levels of inflation, notably energy. For example, between March 2022 and June 2023 the German government paid out a total of €72.8 billion in state aid, with 85% of this amount directed at energy and gas companies to stabilize the market. This constitutes over half the total state aid paid to industry within the EU over this period, with the Italian government spending €39.2 billion and Spain spending €12 billion to further ease inflation concerns. Other major global events have, as yet not seemingly translated in additional upward inflationary pressures domestically, although it is imperative to monitor developments to assess their potential impact on imported prices. For example, the Israel-Gaza conflict has thus far had a limited impact on energy and gas prices in Europe, despite earlier warnings by the International Monetary Fund (IMF) and Goldman Sachs, although an escalation could have significant knock-on effects on both energy and food prices. Conversely, the Red Sea crisis has had a significant impact on global supply chains and international trade of goods, raising insurance prices and causing severe delivery delays in shipments across the world, although so far these impacts have been contained without any notable spike in inflation. Once again, it is important to note that the duration and intensity of these disruptions may change this outlook as transportation costs continue to rise, with impacts likely to be particularly acute for Mediterranean countries.

The extension of the EU's Emissions Trading Scheme (ETS) to incorporate the maritime sector is also expected to result in higher transportation costs in Malta, with some local operators already announcing price hikes, although so far, the immediate impacts have been contained somewhat amidst longer-term concerns regarding both logistics costs and the future of Malta's transshipment industry. Nonetheless, this generally positive outlook in relation to potential pressures on global supply chains mirrors developments and trends captured by the New York Federal Reserve Bank's Global Supply Chain Pressures Index (GSCPI), which aggregates various data sources for transportation costs and manufacturing, including price inflation, in order to provide a concise measure of current global supply chain conditions. Despite hovering significantly above its long-run average for most of the last few years, the index dipped below the mean in February 2023 and has largely remained there ever since, reflecting easing global inflationary pressures.

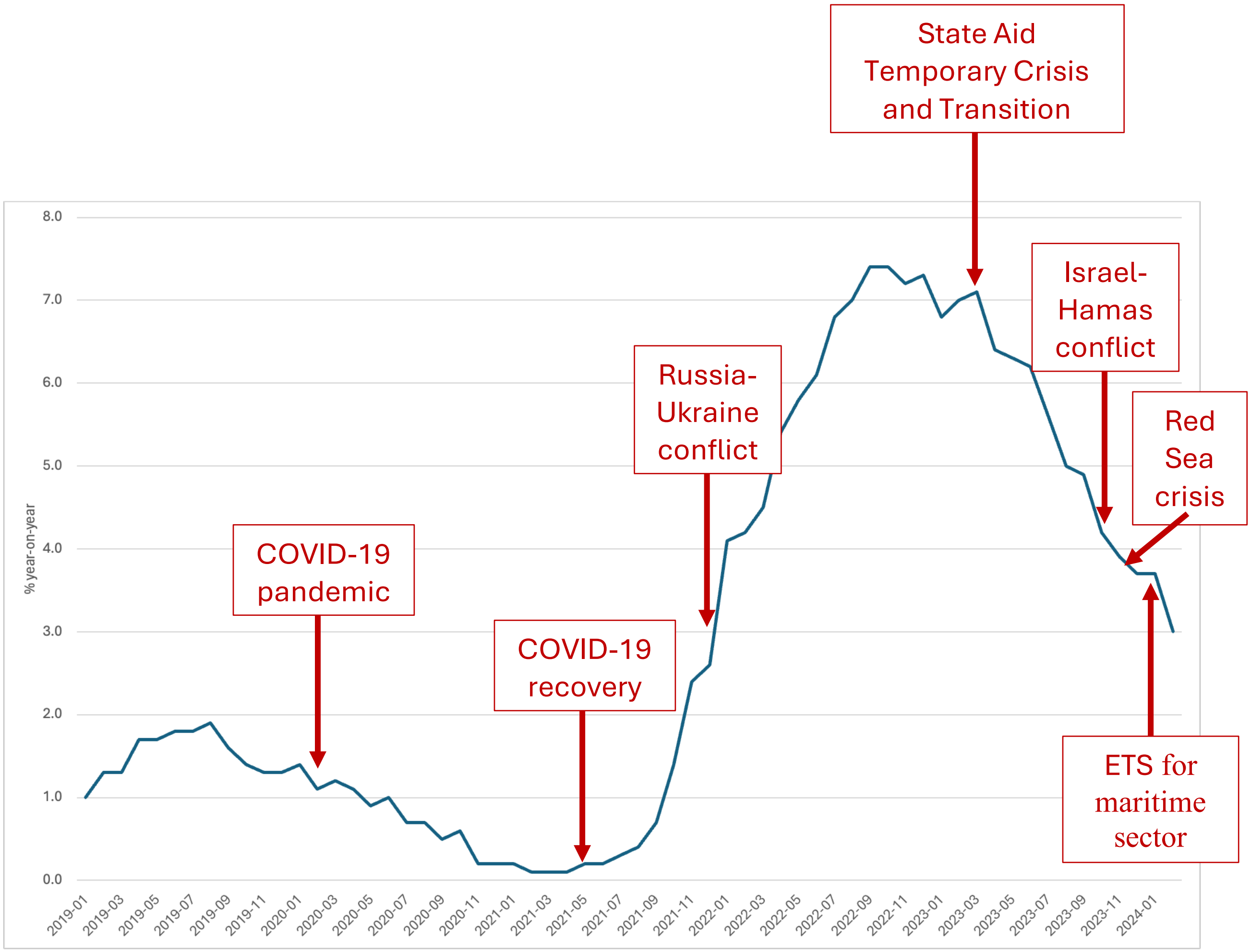

Figure 10: Timeline of international events and domestic HICP inflation (Source: Eurostat, 2024)

2.1.2 Global Commodity Prices

Beyond the impact of single, large-scale events, it is important to assess movements in major commodity prices and transportation costs to properly understand the underlying causes of inflationary pressures both internationally and domestically. We begin with energy, with Figures 11 and 12 showing the evolution of crude oil (Brent) and natural gas prices in Europe respectively over the period January 2019 to February 2024. As seen below, in both cases prices dipped during the COVID-19 pandemic, recovering sharply thereafter and spiking during 2022 as a result of the Russia-Ukraine conflict before falling and moderating in recent months. It is interesting to note that in both cases, but particularly in the case of oil, prices have stabilised above pre-COVID levels, indicating some element of persistence in the increase in prices amidst ongoing geo-political tensions uncertainties.

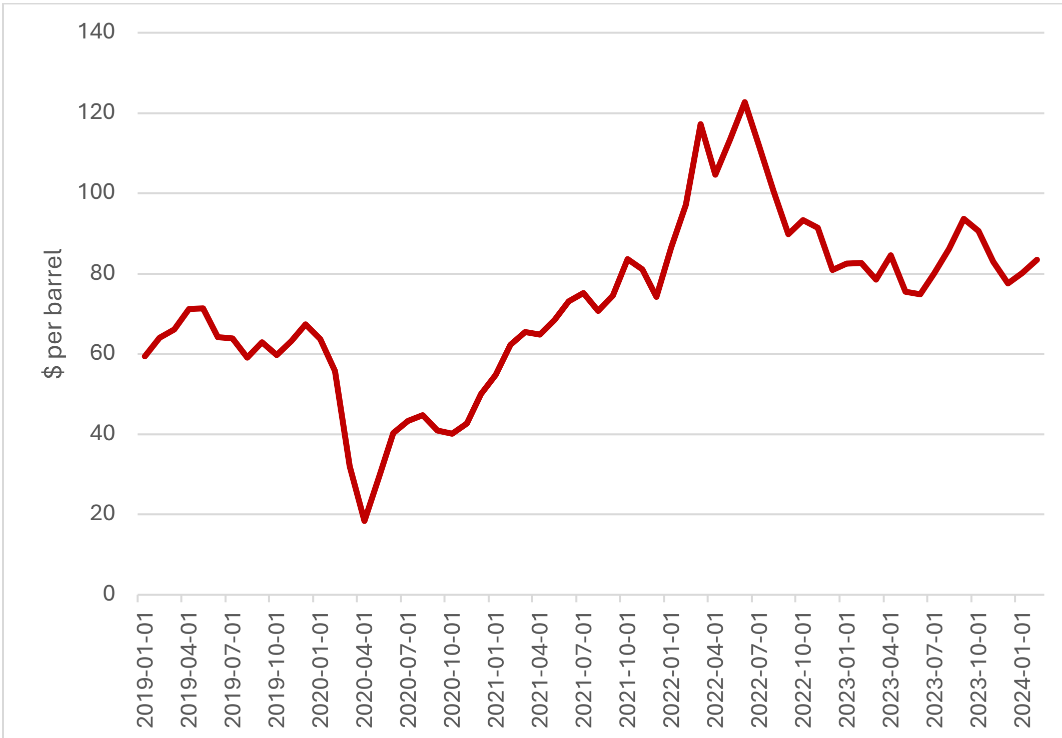

Figure 11: Brent crude oil prices (Source: Bloomberg, 2024)

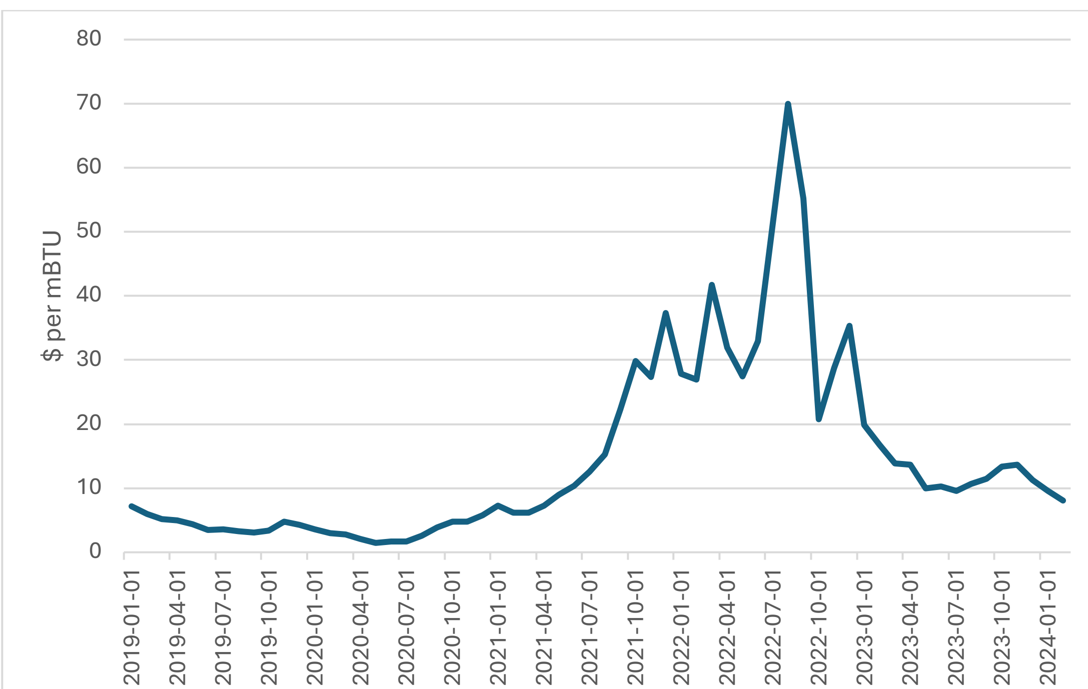

Figure 12: Price of natural gas (Source: Bloomberg, 2024)

We now turn to global food inflation, given its relevance within the Maltese context. To this end, Figure 13 shows the UN's Food and Agriculture Organization (FAO)'s Food Price Index together with its various subindices, reflecting global price movements across various food items. As shown below, in the post-COVID period the sharpest increase in prices was observed within the vegetable oils subindex, largely fuelled by the price of soybeans, rapeseed and sunflower oils as demand rallied globally while harvests struggled to keep up, although prices have subsequently fallen significantly as harvest yields in key cultivating countries like Brazil increased rapidly. Cereals prices also rose steeply in 2021-2022, with global production taking a significant hit as a result of the Russia-Ukraine conflict, although pressures have also eased recently as other countries like Brazil and Argentina increased production of various cereals to make up for the shortfall. Similarly, dairy prices also soared during 2022 amidst declining milk production in the Ukraine and rising feed costs, although once again prices have fallen in recent months. The outlier is the price of sugar, whose upward trajectory has persisted unabated, largely reflecting droughts and extreme weather which have curtailed output in key exporting nations like Brazil, Thailand and India.

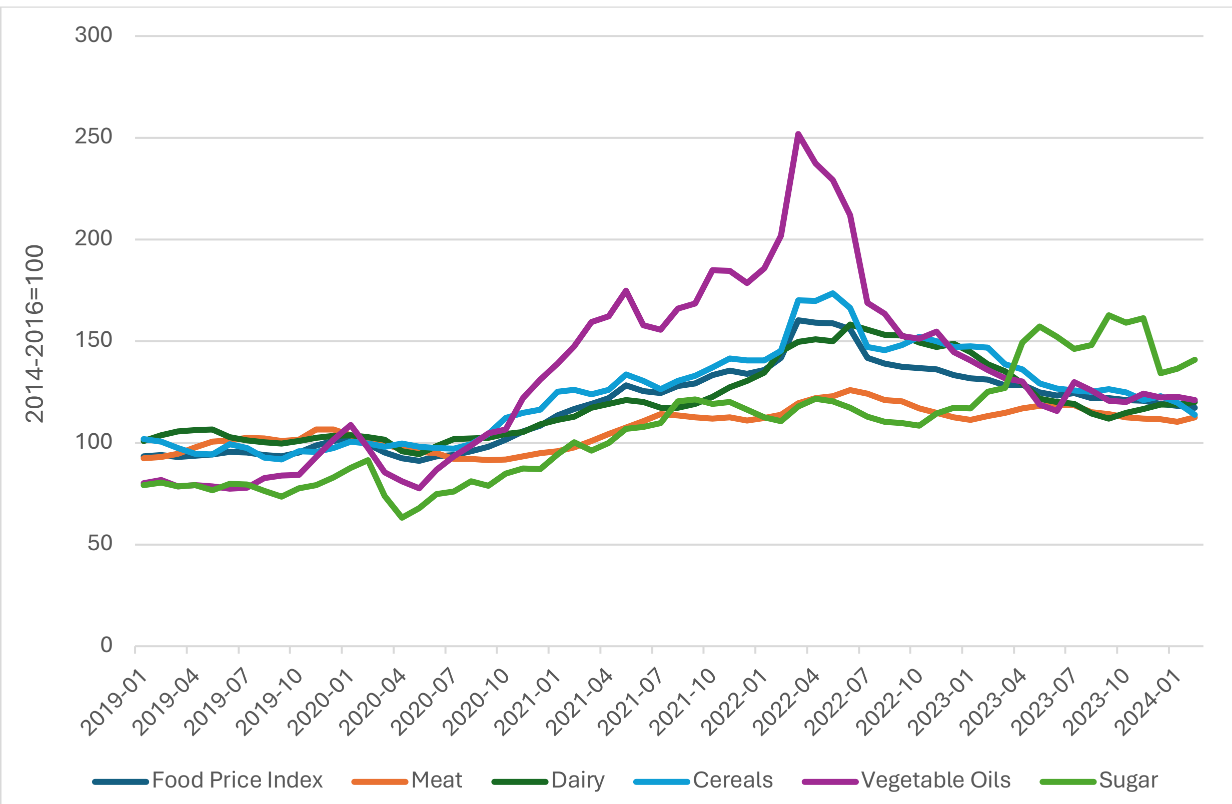

Figure 13: FAO Food Price Index and subcategories (Source: FAO, 2024)

The final commodity group to consider is metals, given their ubiquity in key industries like manufacturing and construction coupled with their widespread use in various consumer goods. Figure 14 shows price movements for aluminum. Once again, we observe a spike in prices during early 2022 due to severe supply chain issues caused by geopolitical uncertainty and a reduction in production of alumina within the Ukraine, followed by moderation and relative stabilization around the $2,200 per tonne mark, above its pre-COVID mean level of around $1,800, indicating some level of persistence. This is broadly in line with other base metal prices amidst ongoing global economic uncertainty and supply chain issues, countered somewhat by a significant increase in production by the likes of China.

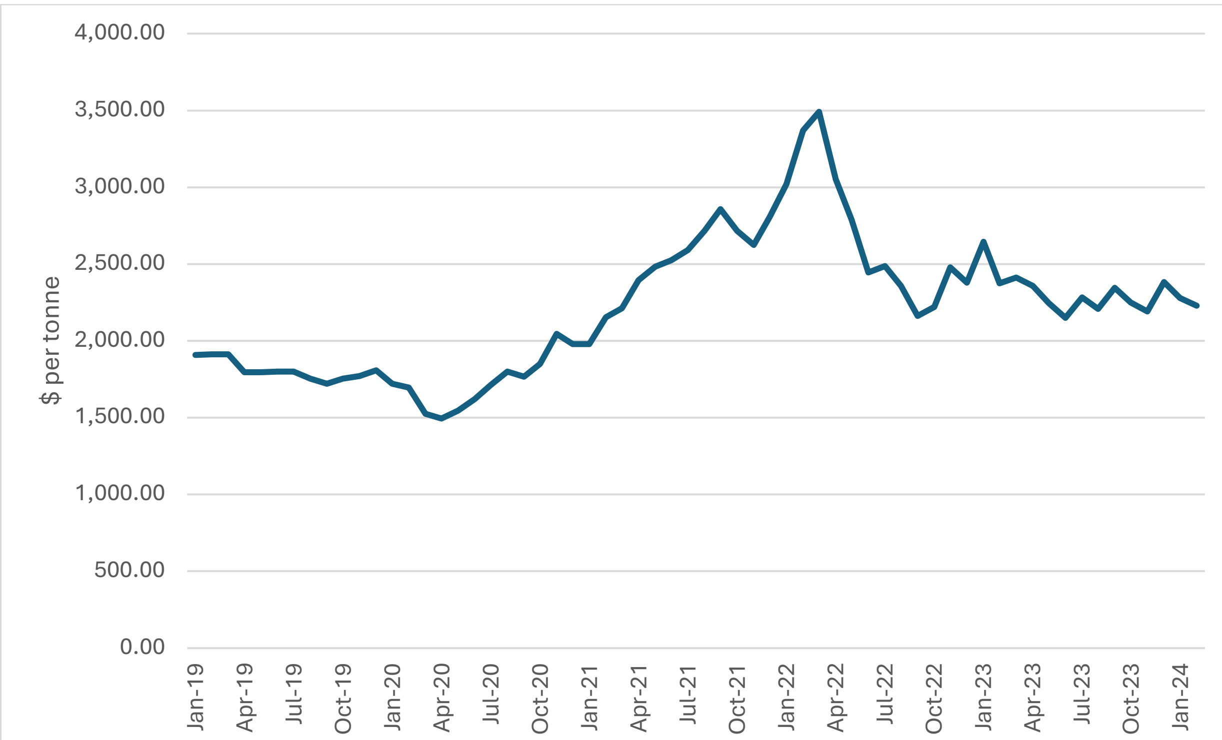

Figure 14: Aluminium global prices (Source: LME, 2024)

Thus, from a commodities perspective we can conclude that prices across energy, food and base metals have moderated from the precipitous heights recorded in 2022, although in all cases prices have not yet returned to their pre-COVID levels, indicating some degree of persistence in inflationary pressures despite successive rounds of monetary tightening across the globe, with ongoing geopolitical tensions and economic uncertainties fueling such pressures further.

2.1.3 Transportation Costs

Transportation costs are particularly pertinent for the Maltese Islands given our reliance on maritime and air transportation for international trade in goods and raw materials. To this end, a natural starting point is the Baltic Dry Index, as shown in Figure 15, which provides an indication of the freight cost of shipping raw materials. We observe a clear spike in mid-2021 on the back of improved economic activity as the pandemic subsided, followed by a steep decline in the latter part of the 2021 and significant volatility ever since, although once again the mean value for February 2024 was above its 2019 average, reflecting concerns related to the Red Sea crisis coupled with increased demand for metals from China. These trends are also broadly reflected in Dewry's Containerized Freight Index (CFI), which measures the cost of freight shipping between a number of the world's leading ports, with a sharp increase in freight costs in 2021-early 2022, followed by a decline and a recent rally on the back of escalating tensions in the Red Sea. This recent increase is even more pronounced in Dewry's World Container Index (WCI), which has increased from US$1,382 per 40 ft container on 30th November 2023 to US$2,929 on 28th March 2024, once again due to increased shipping diversions away from the Suez Canal due to the Red Sea crisis. According to Platt's (S&P, 2024), this increase in freight charges is even more pronounced for cargo destined for the Mediterranean from North Asia, with costs more than trebling since the start of 2024.

Figure 15: Baltic Dry Index (Source: Bloomberg, 2024)

We also consider air freight costs via the Baltic Airfreight Index (BAI). As shown below in Figure 16, a familiar pattern re-emerges, with a post-COVID increase until mid-2022 followed by a decline and recent uptick, above pre-COVID levels. This recent spike can in part be attributed to a modal shift in freight towards air transportation due to the aforementioned disruptions to marine transportation, particularly for cargo coming from China. Therefore, based on the data it is clear that while maritime and air freight costs have fallen considerably since 2022, there is still an element of persistence to transportation cost inflation, largely as a result of geopolitical tensions that have disrupted maritime shipping in the Suez Canal.

Figure 16: Baltic Airfreight Index (Source: Baltic Exchange, 2024)

2.1.4 Inflation Across Malta's Main Trading Partners

We now assess inflationary trends in Malta's main trading partners, specifically in relation to imported goods and raw materials. Based on Eurostat data for 2023, the top five import partners for Malta were Italy, Germany, France, Spain and the UK. Figure 17 shows annual inflation in each country over the period January 2022 to February 2024. As shown below, most of these countries experienced high levels of volatility in annual inflation over this period, rising significantly more than Malta's inflation, although by February 2024 only France (3.2%) and the UK (3.4%) recorded a higher rate of inflation than Malta's 3%, indicating that inflationary pressures across Malta's key import partners have largely eased off. As indicated earlier, rising food prices have been the largest contributor to Malta's recent inflationary performance; therefore, it makes sense to further assess food price inflation across Malta's primary food import partners, who based on Eurostat data are Italy, the Netherlands, Spain, the UK and France. Therefore, Figure 18 provides a breakdown of food inflation across these countries. Once again, we observe significant volatility in food price movements across countries. However, it is also apparent that since December 2023 Malta has recorded the highest level of annual food price inflation across this cohort of countries, outpacing even the UK who in prior months had recorded double-digit inflation. It is also pertinent to note that in both Italy and Netherlands, who by far constitute Malta's largest food importer partners, food inflation has consistently been below that recorded domestically, with food inflation of 3.9% and 0.8% respectively relative to Malta's 6.8% in February 2024. This data thus indicates that for the most part, inflation across Malta's main import partners has dipped below domestic levels, particularly when it comes to food price inflation.

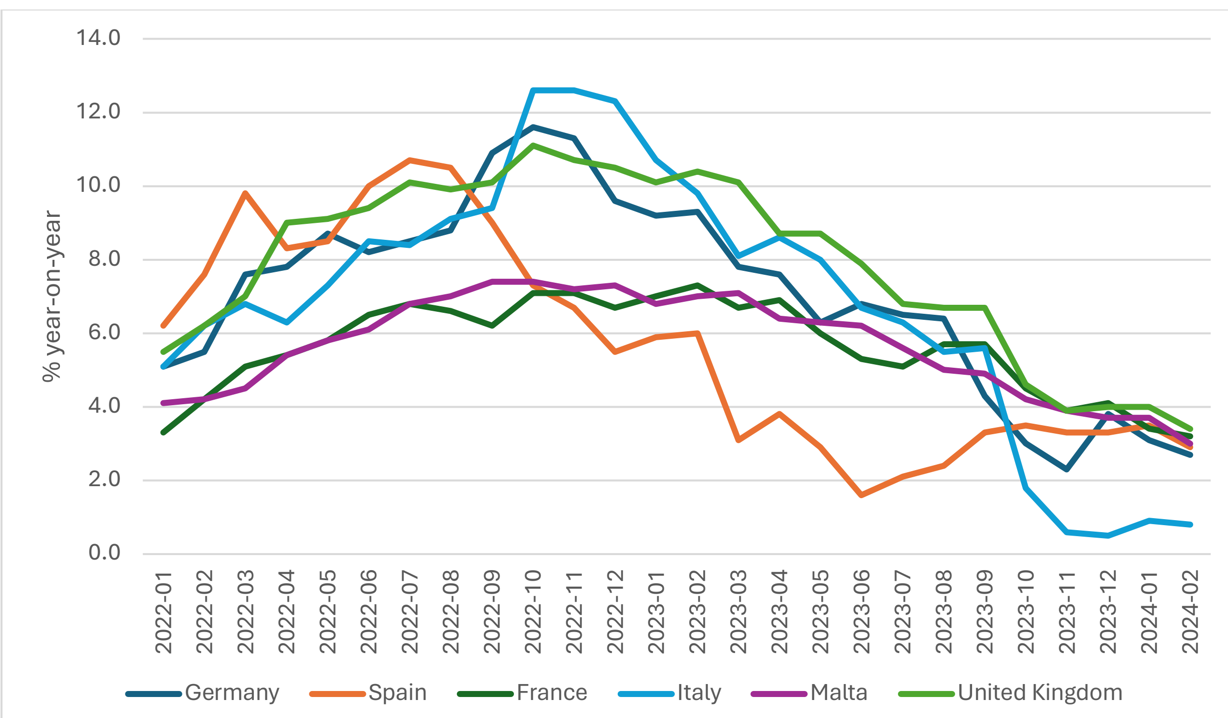

Figure 17: Comparison of annual HICP inflation across key trading partners (Source: Eurostat, 2024)

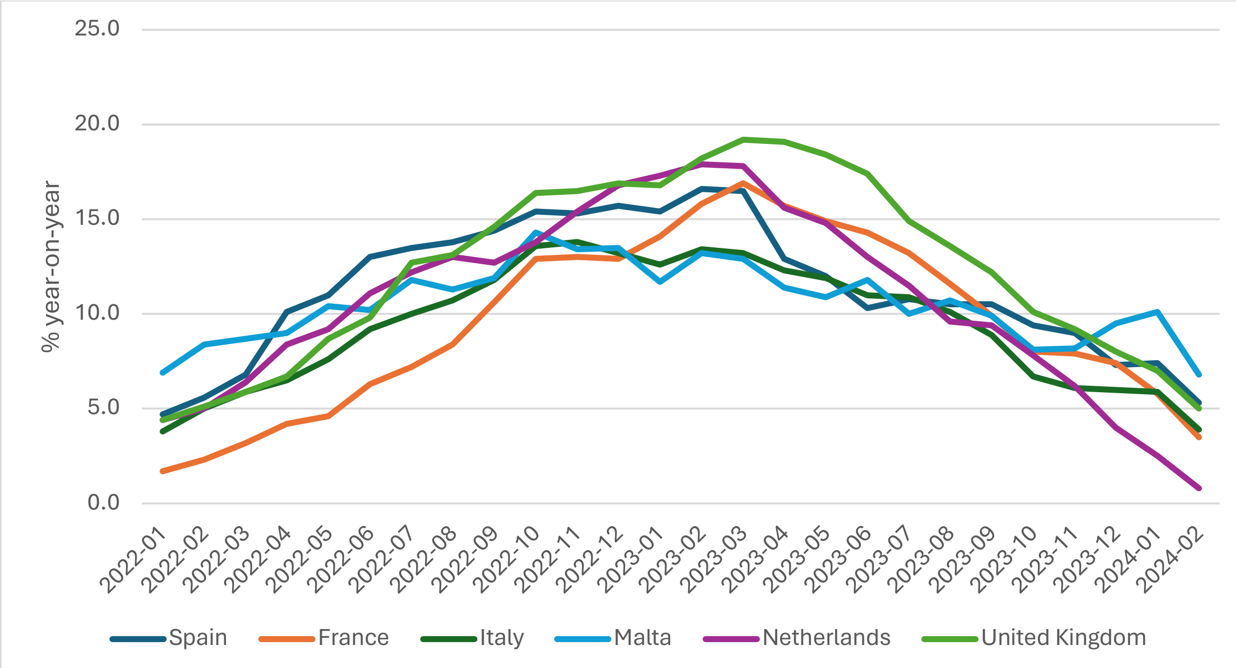

Figure 18: Comparison of HICP food price inflation across key importers (Source: Eurostat, 2024)

To summarise, this section has sought to dissect the various potential international sources of domestic inflationary pressures. We have seen how rising geopolitical tensions, notably within the Red Sea, have contributed towards higher shipping freight costs and, to a lesser extent, air freight charges, although these costs have eased significantly relative to 2022. We have also seen how inflation across Malta's main import trading partners has declined in recent months, in most cases falling below Malta's current levels, with this trend being particularly evident for food price inflation. Thus, based on this analysis, it is difficult to argue that Malta's recent inflationary trends have solely been driven by international pressures or higher prices among the country's import partners, hence pointing towards additional pressures closer to home.

2.2 Local Pressures

2.2.1 Aggregate Demand

We now delve into various potential domestic drivers of recent inflationary trends experienced in Malta. The first and most obvious starting point is domestic demand and income, as captured by Gross domestic Product (GDP), since an expansion in economic activity would naturally place upward pressure on inflation, particularly if fueled by higher consumption expenditure. Figure 19 shows annual real GDP growth over the period 2012-2023. As shown below, Malta's GDP growth has consistently and substantially outperformed its EU and Euro Area counterparts, recording the highest level of annual growth across all member states in 2023, with recent projections indicating that this will also be the case in 2024. For context, in 2023 average GDP growth in the EU and Euro Area was approximately 0.4% apiece, while in Malta growth reached 5.6%, which attests to the magnitude of difference in growth trajectories. A key driver of domestic growth has been household consumption expenditure, which grew by 7.8% in 2023 relative to 2022, while exports of goods and services also recorded a steep increase of 8.7% over this period, fueled by record tourist arrivals coupled with growth in financial services, gaming and professional services. Therefore, Malta's continued and elevated level of economic growth may have contributed towards recent inflationary pressures, although it is worth noting that this gap was also present during the period 2012-2019 and yet domestic inflation was consistently either on par or below the EU and Euro Area average, which suggests that other more recent phenomena may be behind recent inflationary pressures. Indeed, a key difference between GDP growth in 2012-2019 and that recorded in 2021-2023 is that in the former period, household consumption expenditure averaged an annual growth rate of 3.9%, while in the latter period consumption grew by an average of 9%, driven in part by pent-up demand that was unleashed following the pandemic.

A cursory glance at the various components of household consumption shows that over this period, expenditure growth exceeded the EU and Euro Area averages across practically all major categories, with the highest levels of average growth recorded in restaurants and hotels (+45.3%), education (+22.2%) and recreation and culture (+20.8%). However, it is pertinent to note that average consumption growth in 2021-2023 across the top three highest inflation categories was relatively modest, with food and beverages spending increasing by 2.6%, housing, water, electricity and gas contracting by 0.4% and spending on furnishings and household equipment growing by 2.8%. Therefore, while increasing levels of domestic consumption expenditure may have contributed towards inflation across a number of categories of goods and services in Malta, including food service activities like restaurants, this does not seem to be the case for those categories that have experienced the highest levels of inflation in recent years, notably food and beverages. It is important to note that although consumption expenditure for housing-related services has recorded modest growth, significant demand pressures are predominantly exerted via investment expenditure in property, with gross investment in dwellings growing by almost 24% between 2020 and 2023.

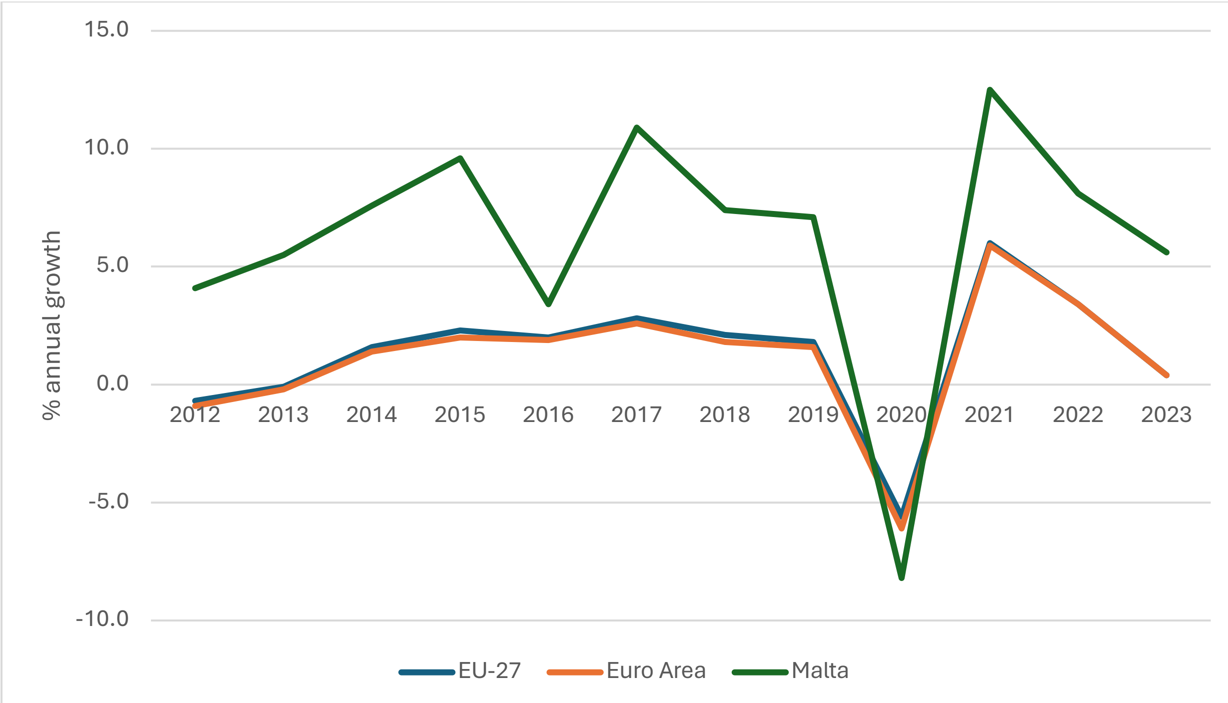

Figure 19: Household annual consumption expenditure (Source: Eurostat, 2024)

2.2.2 Labour Market Developments and Costs

Having assessed the demand-side of inflationary pressures, we now turn to the supply-side. The first issue to consider is Malta's labour market, which in recent years has recorded record-low levels of unemployment amidst buoyant job creation and an influx of foreign workers, who now account for almost 34% of total domestic employment, up from just under 5% in 2013 (Jobsplus, 2024). We can therefore assess labour market tightness to assess whether Malta's supply of labour can in fact sufficiently fill the available vacancies within the job market, since tightness would indicate an upward pressure on wages and thus contribute towards inflation.

To this end, we analyse the concept of labour market slack, which measures the magnitude of unmet demand for work by individuals seeking employment, relative to the availability of work. Specifically, labour market slack is measured using the number of unemployed individuals within the economy as per the usual International Labour Organization's (ILO) definition, in addition to three supplementary indicators, namely part-time workers who self-report as being underemployed (i.e., seeking full-time work), people seeking a job but not immediately available to work, and people who are available to work but are currently not seeking employment, with the latter two groups capturing the potential additional labour force. This final figure is then expressed as a percentage of the total extended labour force (including the two aforementioned categories). Figure 20 shows the evolution of labour market slack within the Maltese economy since 2018 relative to the EU average. As seen below, the extent of unmet labour demand within the country has fallen steadily since 2018, with the exception of a brief jump in 2020, reaching 3.9% in Q3 2023, less than a third of the EU-average rate of slack, which stood at 12% in the same period. This suggests that Malta's labour market is indeed characterised by considerable tightness, with skills shortages reported in key sectors like ICT, manufacturing, construction, financial services and gaming, which may result in upward pressure on wages in order to attract and retain workers.

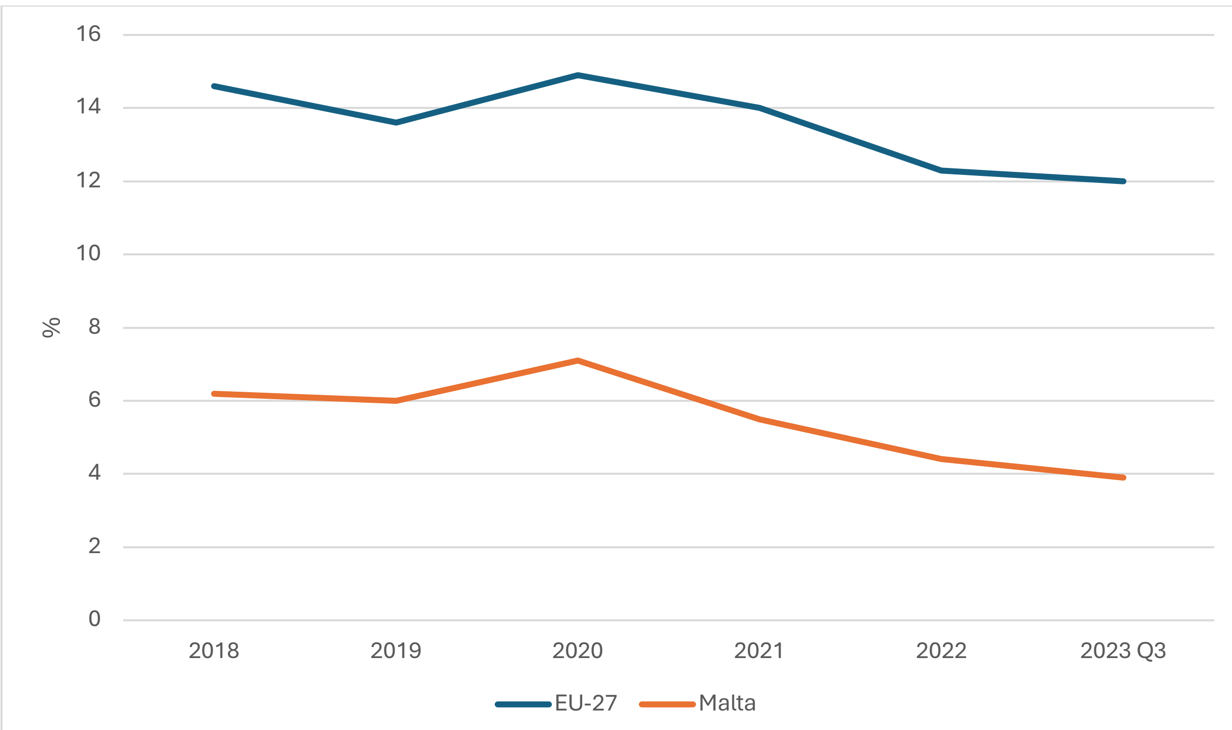

Figure 20: Labour market slack (Source: Eurostat, 2024)

Given these findings, we can assess whether labour market tightness has indeed translated into higher labour costs for businesses across the Maltese economy. Figure 21a and b shows annual growth in the labour cost index (LCI) over the period 2019 to 2023 across industry and services, wherein the LCI is a measure of labour costs including wages and salaries, non-wage costs and taxes net of subsidies. As seen below, growth in labour costs for industry and construction outstripped the EU and Euro Area averages in 2021 and 2022, largely driven by rising labour costs within the manufacturing sector, before moderating somewhat in 2023. On the flipside, labour cost growth has generally lagged behind the EU and Euro Area averages in the services sectors, dipping into negative territory in 2019 before rebounding thereafter, peaking at 4.6% in 2023. Thus, labour market tightness in Malta has clearly contributed towards labour cost inflation within the manufacturing sector, but this does not appear to be the case across services, with labour cost inflation lagging below that in other EU countries.

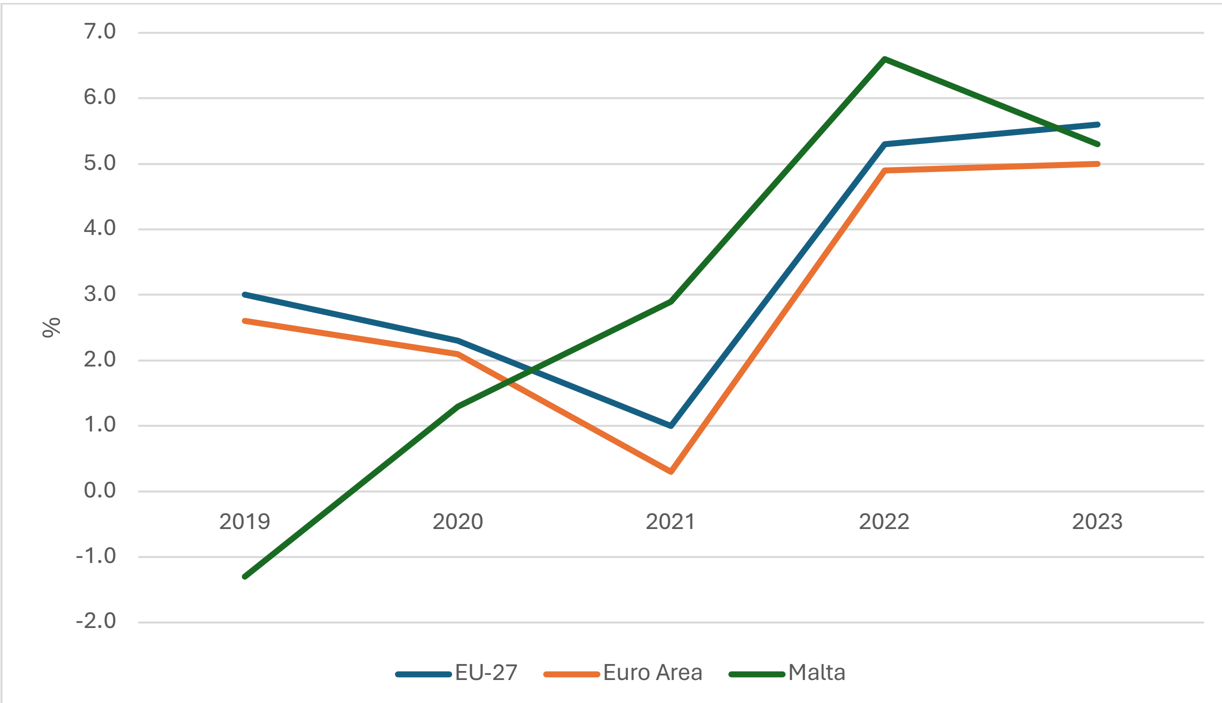

Figure 21a: Annual growth in Labour Cost Index across industry and construction (Source: Eurostat, 2024)

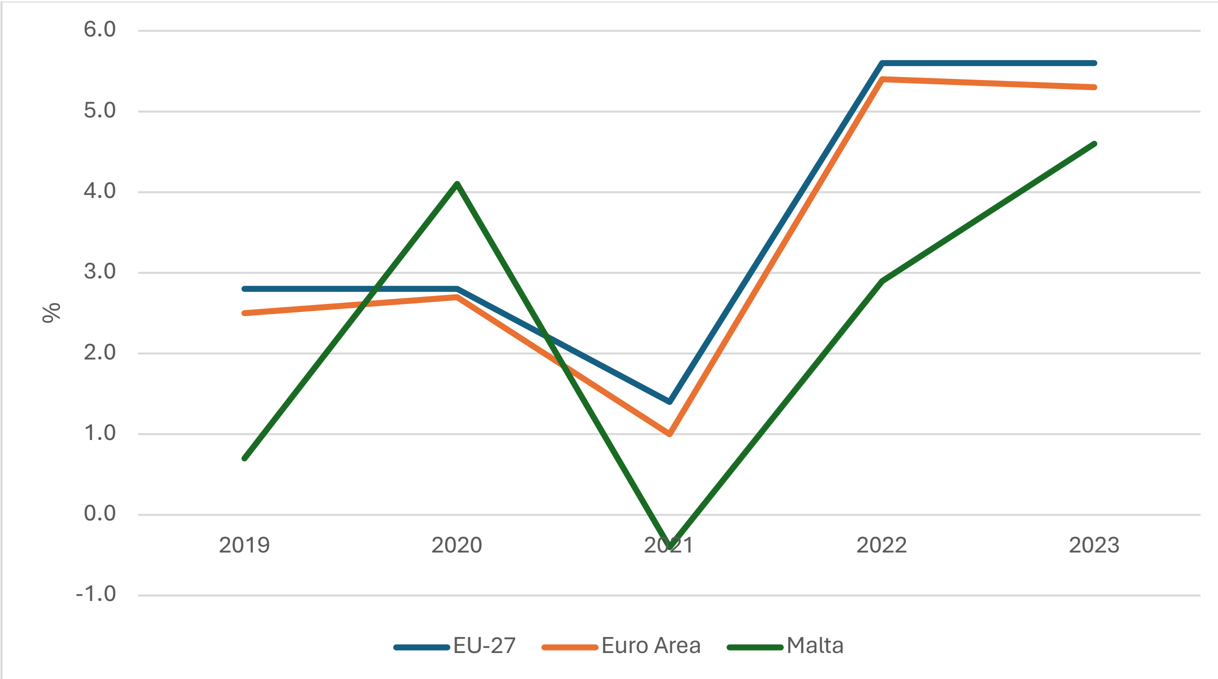

Figure 21b: Annual growth in Labour Cost Index across services (Source: Eurostat, 2024)

If we recall the main drivers of domestic inflation in recent years, namely food and beverages, and housing-related equipment and services (including rent), then based on the above analysis it does not appear that such inflationary pressures are being caused by labour cost inflation. Nonetheless, to properly understand the contribution of labour costs to inflation within these sectors, a more granular analysis is undertaken using the latest available structural business statistics (SBS). For comparative purposes, data for the other small member states cited earlier will also be included. Beyond labour costs per person employed, we also include expenses related to services provided by agency workers, given the increased prevalence of workers engaged by employment and temping agencies both in Malta and across the EU to fill vacancies across key sectors like tourism.

Table 1 summarises these costs across different high-inflation sectors for the most recent year of data availability (2021). In relation to labour costs, it is evident that within those sectors related to housing equipment or services, Malta's costs per head are consistently below the EU average and are generally at the low-to-middle end of the spectrum for small states. This indicates that labour costs constitute a relatively smaller proportion of total costs within these sectors relative to their European counterparts. In terms of their likely contribution to inflationary pressures, while time series data is lacking, the annual growth in the labour cost index for both the construction and real estate sectors in Malta has lagged behind the EU and Euro Area averages in 2022 and 2023, suggesting that the contribution of higher labour costs to domestic inflation is somewhat limited. A similar result can be observed within the food and beverage sectors, with labour costs per head also generally falling short of the EU average and lying in the middle of the pack of small EU member states, although in the case of non-specialised retail stores (like supermarkets) domestic labour costs are on the higher end of the small countries under review. However, what does emerge from the table is the significantly higher agency costs that Maltese businesses face on average relative to their European counterparts across most sectors, notably within the wholesale food and beverages sector and food service activities. These findings underscore an additional cost element that has become part of Maltese business activities within these sectors, reflecting the tightness of the domestic labour market and thus the increased reliance on employment agencies to fill vacancies in these sectors, which nonetheless comes at a cost beyond wages or salaries, and which in turn may contribute towards higher inflationary pressures, particularly in situations when labour turnover is high and tightness persists. In fact, a survey on wage inflation published by the Malta Employers Association (MEA) in July 2023 reported that 56% of businesses forming part of the sample of respondents faced wage inflation that exceeded inflation within the country, impacting their ability to compete, with the majority citing labour market shortages as a key driver of higher wages. An important point worth noting is that unit labour costs omit other significant pertinent expenditures related to high labour turnover, notably re-training and recruitment costs, apart from the bureaucratic and administrative costs related to the hiring of third-country nationals. In fact, a recent survey conducted by the Malta Chamber of SMEs in January 2024 highlights the increase in the cost of employment, which includes these additional costs, as the key driver of rising prices among Maltese SMEs.

Table 1: Unit labour costs and expenditure on employment agency services, 2021 (Source: Eurostat, 2024)

	Unit labour costs per person employed	**Expenses on services provided through agency workers (average per enterprise)**
Electrical, plumbing and other construction installation activities		
EU-27	€24.10	€5,445.34
Estonia	€13.87	€598.62
Cyprus	€17.90	€0.00
Latvia	€9.52	€15.21
Luxembourg	€43.71	€46,866.36
Malta	€14.06	€2,285.29
Slovenia	€18.82	€2.01
Building completion and finishing activities		

EU-27	€16.66	€1,727.64
Estonia	€10.71	€93.96
Cyprus	€13.25	€0.00
Latvia	€6.20	€0.00
Luxembourg	€40.67	€10,066.29
Malta	€6.18	€2,016.67
Slovenia	€12.56	€4.30
Wholesale food and beverages		
EU-27	€24.59	€32,514.02
Estonia	€16.94	€1,173.59
Cyprus	€18.17	€0.00
Latvia	€13.17	€76.17
Luxembourg	€59.53	€6,493.51
Malta	€21.63	€10,488.28
Slovenia	€25.41	€18.52
Retail food and beverages in specialised stores		
EU-27	€10.72	€1,237.16
Estonia	€8.42	€68.49
Cyprus	€12.01	€0.00
Latvia	€7.33	€0.00
Luxembourg	€32.44	€3,501.26
Malta	€10.62	€518.36
Slovenia	€13.67	€97.56
Retail sale in non-specialised stores with food, beverages or tobacco predominating		
EU-27	€18.00	€9,097.25
Estonia	€11.01	€3,120.39
Cyprus	€13.59	€0.00
Latvia	€8.57	€332.28
Luxembourg	€31.04	€20,085.11
Malta	€15.00	€3,624.80
Slovenia	€19.90	€63,349.51
Retail furniture, lighting and other household equipment		

EU-27	€20.73	€8,998.49
Estonia	€13.45	€571.43
Cyprus	€14.84	€0.00
Latvia	€8.22	€219.78
Luxembourg	€42.76	€2,783.02
Malta	€17.28	€7,762.56
Slovenia	€22.66	€1,581.92
Food and beverage service activities		
EU-27	€10.30	€1,150.24
Estonia	€8.44	€521.46
Cyprus	€9.71	€0.00
Latvia	€5.52	€40.43
Luxembourg	€28.62	€2,001.65
Malta	€10.45	€6,069.57
Slovenia	€12.67	€114.75

2.2.3 Productivity, Profitability, Competition and Market Concentration

Labour costs are only one piece of the puzzle, since these must be analysed in light of productivity and profitability within each sector. These are important considerations since they provide an indication of the efficiency of operations and thus the ability of businesses to absorb any cost increases without necessarily passing them on to consumers or end users in terms of higher prices, which in turn creates inflationary pressures. Table 2 provides an estimate of the ratio between labour productivity (proxied by value added per worker) and labour costs per head, together with an estimate of the gross operating margin of businesses businesses across each sector. When it comes to housing-related services (except for retail), the productivity-to-labour costs ratio is higher than the EU average, indicating that the labour costs within these sectors are low relative to the value created by workers. On the other hand, the ratios for activities related to wholesale food and beverages and food service activities are consistently below the EU average and generally on the lower end when compared to the other small countries, with the sole exception being non-specialised retail services for food and beverages where the ratio is high compared to other small states. These findings are also largely mirrored in the profit margins data in the second column, where it is evident that for most food and beverages sectors, margins are significantly below the EU average. Thus, the data indicate that within the wholesale food and beverages sector and food service activities there is limited leeway to potentially absorb higher costs, which may have contributed towards higher inflation within these sectors in recent years.

Table 2: Value added relative to labour costs, and gross margins, 2022 (Source: Eurostat, 2024)

	Value Added per € 1 of Labour Costs	**Gross Operating Surplus-to-Output**
Electrical, plumbing and other construction installation activities		
EU-27	€2.38	12.2%
Estonia	€1.85	6.8%
Cyprus	€1.81	12.0%
Latvia	€1.87	10.7%
Luxembourg	€1.41	8.9%
Malta	€3.05	19.0%
Slovenia	€2.09	10.4%
Building completion and finishing activities		
EU-27	€3.50	15.3%
Estonia	€1.93	9.0%
Cyprus	€1.93	13.7%
Latvia	€1.86	7.6%
Luxembourg	€1.37	7.5%
Malta	€11.43	38.1%
Slovenia	€2.54	15.9%
Wholesale food and beverages		
EU-27	€2.74	23.2%
Estonia	€2.19	14.7%
Cyprus	€2.01	26.6%
Latvia	€2.32	21.2%
Luxembourg	€3.97	14.9%
Malta	€1.71	8.5%
Slovenia	€2.54	26.5%
Retail food and beverages in specialised stores		
EU-27	€3.17	24.2%
Estonia	€1.63	6.7%

Cyprus	€2.20	25.6%
Latvia	€1.89	19.6%
Luxembourg	€1.42	10.0%
Malta	€3.07	17.3%
Slovenia	€2.37	17.1%
Retail sale in non-specialised stores with food, beverages or tobacco predominating		
EU-27	-	16.2%
Estonia	€1.83	15.8%
Cyprus	€2.41	34.3%
Latvia	€1.85	19.6%
Luxembourg	€1.52	13.6%
Malta	€2.75	20.7%
Slovenia	€1.70	19.7%
Retail furniture, lighting and other household equipment		
EU-27	€2.45	21.0%
Estonia	€2.51	23.4%
Cyprus	€2.30	27.1%
Latvia	€2.45	28.6%
Luxembourg	€1.71	21.7%
Malta	€1.76	14.0%
Slovenia	€2.08	24.7%
Food and beverage service activities		
EU-27	€2.15	-
Estonia	€1.52	-
Cyprus	€1.82	-
Latvia	€1.74	-
Luxembourg	€1.33	-
Malta	€1.36	-
Slovenia	€1.99	-

This issue must be explored further as part of a wider analysis related to the smallness of the domestic market. Indeed, as a small economy this generally means that Malta has fewer operators within the market than larger territories, which may give rise to oligopolies. On the one hand, market power and limited competition may give rise to higher prices due to tacit collusion and lack of competition. On the flipside, if long-term commercial viability is dependent on size, operators must necessarily grow their market share to survive, thus precipitating aggressive competitive practices. This often results in margin squeeze, lack of investment, and lack of productivity gains over time, which may also have inflationary repercussions, especially when wage inflation is significant.

Table 3 presents the number of firms within each market segment, once again based on SBS data. Several interesting points are worth noting. Firstly, the concentration of enterprises per 1,000 inhabitants in most cases is comparable or even higher than the EU average and relative to the other small states. For housing-related services, in fact, the number of enterprises is consistently above the EU average, thus indicating that in such markets the degree of competition, at least in terms of number of market players if not market share, appears to be strong. The same can be said for most food and beverages sectors, where the number of firms per 1,000 inhabitants is also above the EU average and generally high relative to the other small states. These figures provide a somewhat rudimentary indication of competition levels within these sectors since they only take into account enterprise numbers rather than market share.

Table 3: Number of enterprises per 1,000 inhabitants, 2022 (Source: Eurostat, 2024)

	Number of enterprises per 1,000 inhabitants
Electrical, plumbing and other construction installation activities	
EU-27	2.06
Estonia	2.39
Cyprus	2.24
Latvia	1.07
Luxembourg	1.33
Malta	2.69
Slovenia	2.51
Building completion and finishing activities	
EU-27	2.64
Estonia	1.90
Cyprus	1.94
Latvia	1.31
Luxembourg	1.60
Malta	4.91
Slovenia	4.83

Wholesale food and beverages	
EU-27	0.45
Estonia	0.63
Cyprus	1.01
Latvia	0.47
Luxembourg	0.63
Malta	1.01
Slovenia	0.26
Retail food and beverages in specialised stores	
EU-27	0.94
Estonia	0.22
Cyprus	0.82
Latvia	0.25
Luxembourg	0.57
Malta	1.83
Slovenia	0.19
Retail sale in non-specialised stores with food, beverages or tobacco predominating	
EU-27	0.81
Estonia	0.31
Cyprus	1.66
Latvia	0.67
Luxembourg	0.36
Malta	1.21
Slovenia	0.20
Retail furniture, lighting and other household equipment	
EU-27	0.28
Estonia	0.21
Cyprus	0.39
Latvia	0.15
Luxembourg	0.33
Malta	0.42
Slovenia	0.08
Food and beverage service activities	
EU-27	3.46

Estonia	2.17
Cyprus	6.17
Latvia	1.54
Luxembourg	3.72
Malta	5.24
Slovenia	4.05

To understand the extent of competition or lack thereof within these sectors, a more nuanced analysis is required that delves into the concentration of market share. Table 4 presents the distribution of net turnover recorded in 2022 within each sector (wherever data is available), broken down by enterprise size, to understand whether market share is largely concentrated among small and micro entities or whether it can be attributed to larger firms, which would suggest a situation more akin to an oligopoly. A number of salient findings emerge. Firstly, in the building completion and finishing sector, micro enterprises dominate the market, reflecting the sectoral landscape, which is characterized by the presence of micro businesses, with small businesses collectively accounting for over 90% of net turnover. Secondly, 59% of turnover within the wholesale sector for food and beverages is attributable to small enterprises, even though they represent over 95% of the total number of enterprises within the sector. In turn, medium enterprises, which comprise 3% of total firms, generate almost 28% of turnover, while the remaining 2% are large businesses who collectively account for around 13% of turnover. Thus, although small enterprises are a key player within this sector, the presence of a few medium and large food wholesalers is a critical characteristic of the sector in terms of their individual market share, which may have important competitive implications, although it is worth noting that significantly higher concentration levels are observed at the EU level, where large firms account for over 38% of the market despite only comprising 0.4% of total firms.

By contrast, retail in specialized stores is characterized by micro and small entities, which collectively account for over 80% of the market, unsurprising given the nature of the business, although it is interesting to note that the remaining 20% of the market is captured by only a handful of medium and large enterprises within this sector. On the other hand, non-specialised retail sale is characterized by the dominance of large and medium-sized firms, who account for over three quarters of the market, which again is not surprising since this category largely comprises of supermarkets and other generalist stores that also sell food and beverages, and is typical of this sector across the EU, although it is worth noting that they only comprise 1.4% of total firms within the sector, pointing towards significant concentration of market power. Finally, 65% of market share across the food and beverage service sector is due to small and micro enterprises, even though they account for over 98%

of total enterprises, with the remaining 2% of medium and large entities capturing 35% of the market, comparable to the rest of the EU-27.

Table 4: Distribution of net turnover by enterprise size, 2022 (Source: Eurostat, 2024)

	0-9 employees	**10-19 employees**	**20-49 employees**	**50-249 employees**	**250+ employees**
Building completion and finishing	74.21%	6.09%	10.35%	7.13%	2.20%
Wholesale of food, beverages and tobacco	27.38%	13.81%	18.04%	27.74%	13.03%
Retail sale of food, beverages and tobacco in specialised stores	45.84%	11.68%	22.90%	11.38%	8.21%
Retail sale in non-specialised stores with food, beverages or tobacco predominating	18.79%	4.99%	3.53%	25.61%	49.93%
Food and beverage service activities	36.35%	11.87%	16.62%	16.82%	18.33%

The above analysis yields a number of interesting implications regarding the extent of domestic inflationary pressures, albeit with the usual caveats regarding the need for caution in causal interpretations. What is clear is that the food and beverages sectors are somewhat characterized by the presence of a handful of medium to large enterprises that account for a significant portion of their respective market, particularly in non-specialised retail, although this is largely comparable to the situation within the rest of the EU. Nonetheless, it is also worth noting that this sector is also experiencing low levels of value added per Euro of labour costs spent, indicative of low levels of productivity and profit margins, which limit their ability to absorb higher costs from imported food, not to mention the higher-than-average burden from expenditures related to employment agency services that reflect domestic labour market tightness.

2.2.4 Systemic Domestic Pressures

We now present a number of other pertinent factors, idiosyncratic to the Maltese Islands, that may have an additional, longer-term bearing on domestic inflation.

We start off with one of the most oft-discussed issues in the country, namely traffic. A recent European Commission report highlighted traffic as one of Malta's most pressing socioeconomic concerns, estimating that the external costs of traffic are equal to €400 million annually in terms of congestion, noise and air pollution, equivalent to 3.6% of GDP (EC, 2022). From an inflationary standpoint, increased traffic leads to both higher labour costs due to increased time spent in traffic while also raising the cost of transportation and service provision.

Figure 22 shows the number of passenger cars per square kilometre in Malta and other select small states. As seen below, Malta far outstrips the other countries in this cohort and the EU-27 average, with a total of just over 1,000 passenger cars per km2 recorded in 2022, relative to the EU average of 57.1 and the 172 passenger cars reported in Luxembourg, the second ranked country in this group. This underscores the extent of car usage and traffic congestion in Malta, given the large number of passenger vehicles relative to the size of the country, without even considering other vehicles that are a mainstay on Maltese roads like trucks and lorries. Clearly, the extent of traffic congestion also depends on other factors including the quality of roads and public transport infrastructure. To this end, the aforementioned EU report also characterized Malta's road network as "inefficient", coupled with a lack of "soft" mobility infrastructure like pavements and bicycle lanes which further exacerbates congestion and discourages a modal shift. In addition, the report also states that the public transport system requires an improvement in service quality in terms of comfort, availability and punctuality to further entice drivers away from private car use.

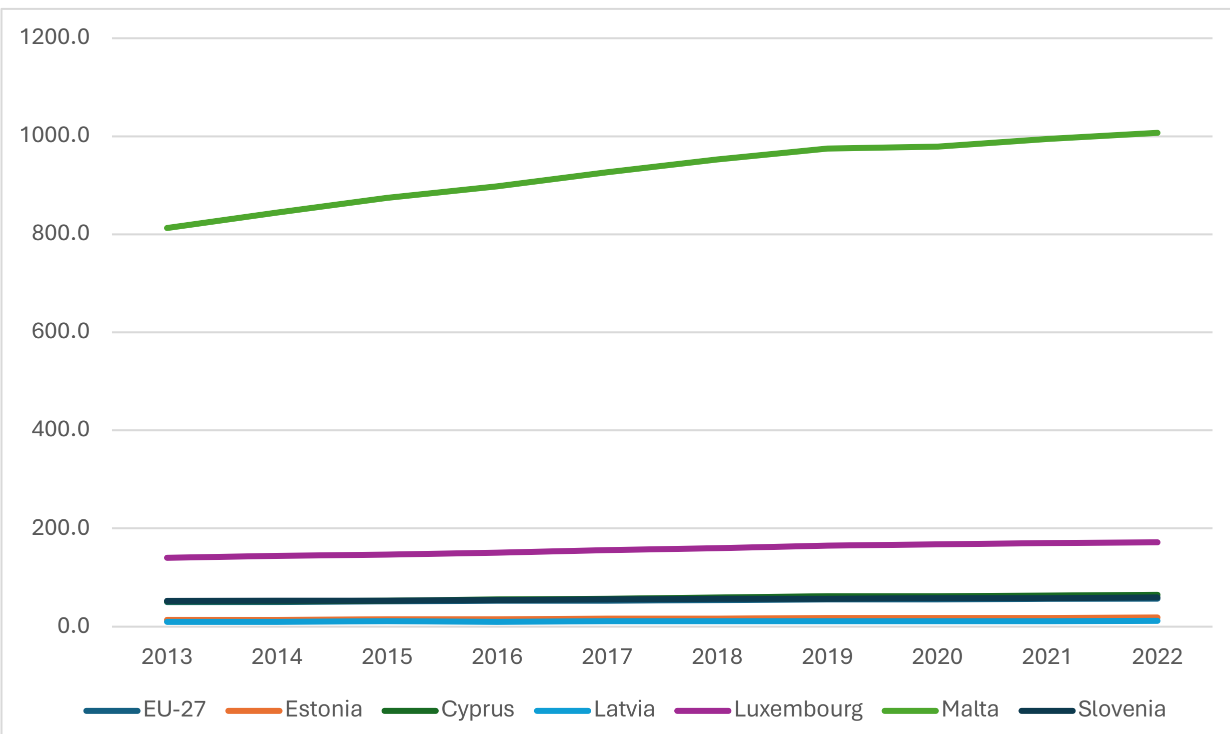

Figure 22: Passenger cars per 1 km^2 of geographical area (Source: Eurostat, 2024)

Another important issue is the ease of doing business in Malta, since such administrative and bureaucratic factors may result in additional costs to businesses, particularly start-ups and SMEs, further placing upward pressure on prices. Unfortunately, timely and accurate data on such matters is somewhat sparse, with the most comprehensive dataset of this kind compiled by the World Bank as part of its Doing Business report, although this has been discontinued since 2020. This data analyses business regulations and provides a quantitative score across several key domains, resulting in a final aggregate ranking for 191 countries. As of 2020, Malta ranked 88th in the world, the lowest score within the EU. Table 5 subdivides the Maltese Doing Business rank into its individual elements, in order to obtain a better sense of what is driving this performance.

As seen below, Malta ranks very low when it comes to registering property (152nd), obtaining credit (144th) and resolving insolvency (121st). In relation to registering a property, the key issues flagged concern the number of procedures required to legally register a property (any interaction of the buyer or the seller with external parties), which in Malta are equal to 7 (relative to the OECD average of 4.7), the cost of registering a property, which were estimated at 13.5% of the property value (OECD average of 4.2%), and the aforementioned quality of land administration index, with a score of 12.5 out of 30. The low score for obtaining credit was mainly driven by the strength of legal rights index, which measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending (score of 2 out of 12), as well as a low credit bureau coverage rate (0%). Finally, when it comes to resolving insolvency, this score was primarily driven by the low proportion of money that creditors recover from an insolvent firm at the end of insolvency proceedings (estimated at US$0.39 cents for every dollar owed), the length of time it takes to recover such money (around 3 years), and the strength of the insolvency framework index, which incorporates commencement of proceedings, management of debtor's assets, reorganization proceedings and creditor participation (score of 5.5 out of 16).

By contrast, Malta does reasonably well in terms of dealing with construction permits (57th), protection minority investor rights (51st), trading across borders (48th) and enforcing contracts (41st). It is also important to note that Malta's overall performance score in the Doing Business index jumped by over 6% between 2016 and 2020, mainly fuelled by significant improvements related to starting a business, with the number of procedures required to register a new entity halving over this period, coupled with an estimated 52% drop in the cost of setting up a new business (World Bank, 2020). Nonetheless, these results point towards a business environment that would benefit from further rationalisation and streamlining of processes in order to reduce bureaucratic and administrative costs, potentially through the wider deployment of digital technologies within this field.

Table 5: Malta rankings for costs of doing business, 2020 (Source: World Bank, 2020)

Doing Business Element	**Malta Global Ranking, 2020**
Starting a Business	86th
Dealing with Construction Permits	57th
Getting Electricity	73rd
Registering Property	152nd
Getting Credit	144th
Protecting Minority Investors	51st
Paying Taxes	78th
Trading across Borders	48th
Enforcing Contracts	41st
Resolving Insolvency	121st

A supplementary factor relates to access to finance, which is an essential business consideration since it relates to both the availability of such finance to support expansion or investment activities, as well as the cost of such financing. Indeed, the availability of finance to invest in R&D and new technologies may assist in improving efficiency and thus curtail any persistent or burgeoning inflationary pressures, while improving competitiveness. Within this context, a focus on access to finance for SMEs is particularly pertinent given the predominance of such firms within the Maltese economic landscape. To this end, the European Investment Fund's annual SME Access to Finance Index (ESAF) provides a good touchpoint to assess Malta's performance in this regard relative to other EU member states. As per the latest version of the ESEF, published in 2023, Malta currently ranks 22nd out of 27 in the EU, a lowly ranking largely driven by weak performance in credit and leasing, equity and macro factors, although the country has improved its ranking by two positions between 2022 and 2023.

In terms of credit and leasing, Malta's score is impacted by the relatively high proportion of SMEs who have not used a bank overdraft, credit line or credit card overdraft in the 6 months prior to the study, while the country's poor equity performance reflects the non-existent nature of IPO and venture capital investment markets (at least at the time of the publication of the ESEF), coupled with the low percentage of SMEs using equity capital. In terms of macro factors, only 21.6% of SMEs stated that there are no financial obstacles to their operations, down from 34.9% in the previous year, which further attests to the difficulties faced by domestic SMEs in accessing financial resources. Thus, although once again the methodology employed in the compilation of this index is questionable, particularly the focus on bank overdraft and credit line usage by SMEs, the broader results do indicate that SMEs in Malta face unique challenges in accessing finance to support their business endeavours, which may limit the scope of investment, innovation and efficiency improvements.

A final factor to consider is the housing market, both from an ownership and rental perspective. As highlighted earlier, rents and housing-related goods and services have experienced a sharp increase in prices in recent years, reflecting buoyant demand for property coupled with rising costs of raw materials. In tandem, these factors also have an impact on the price of property and, more broadly, the issue of housing affordability in Malta. Comparative data published by the ECB indicates that Malta has (as at March 2024) the lowest cost of borrowing for households in relation to property purchases within the Euro Area at 2.1%, relative to 3.8% average within the Euro Area, and significantly below the cost of borrowing in other small countries like Latvia (5.83%), Estonia (5.79%) and Cyprus (4.63%). This trend is also observable in the cost of borrowing for non-financial corporations, where once again Malta has the lowest costs within the Euro Area at 3.76%. These low borrowing costs have contributed towards higher investment in property within the Maltese Islands, both by households and businesses alike, which in turn feeds into higher property prices as well as prices for housing-related goods and services. Figure 23 plots the annual growth in house prices in Malta as per the House Price Index (HPI) relative to the EU-27 and Euro Area averages. As seen below, although house price inflation slowed down somewhat in 2020 during the pandemic, prices rebounded thereafter, even exceeding the EU and Euro Area averages in 2023.

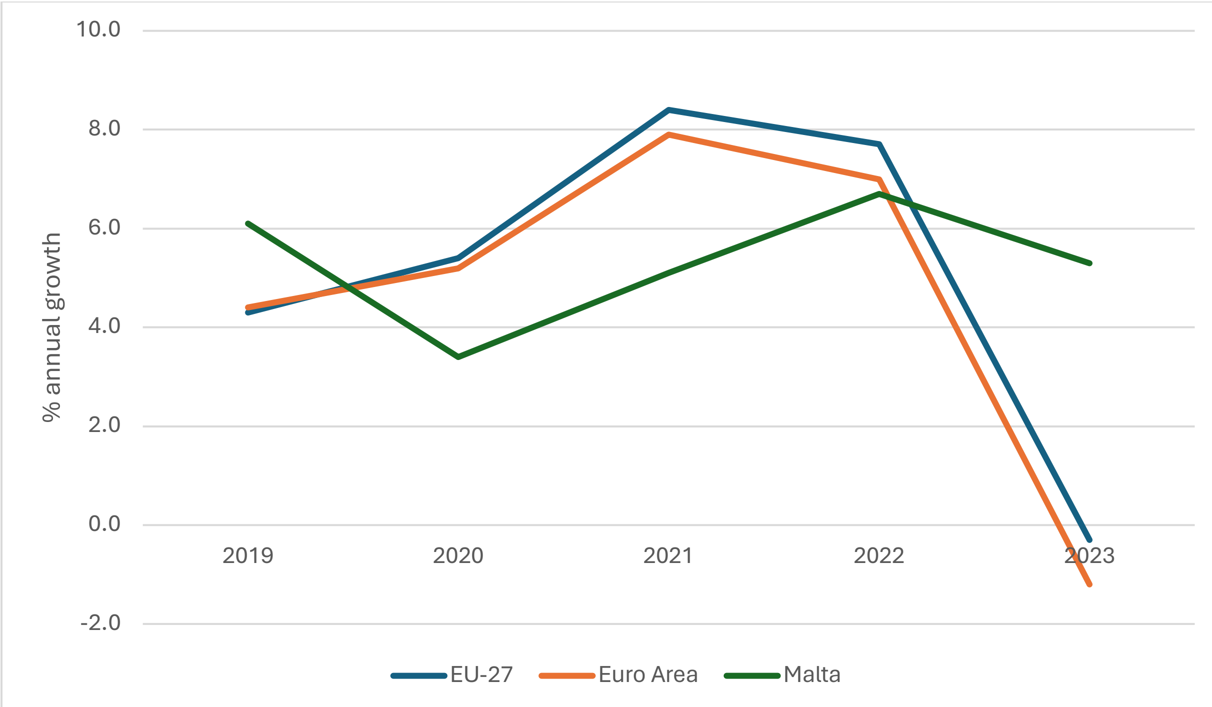

Figure 23: House Price Index, annual average growth rate (Source: Eurostat, 2024)

The difference is even starker when considering monthly rental prices in Malta versus the rest of the EU and Euro Area, which are shown in Figure 24. With the exception of a temporary dip in February 2022, rental prices in Malta have consistently increased and exceeded the EU and Euro Area averages, despite a recent moderation in rent increases. Such increases in rent further fuel wage expectations, particularly among foreign workers, which in turn exacerbates inflationary pressures across the economy.

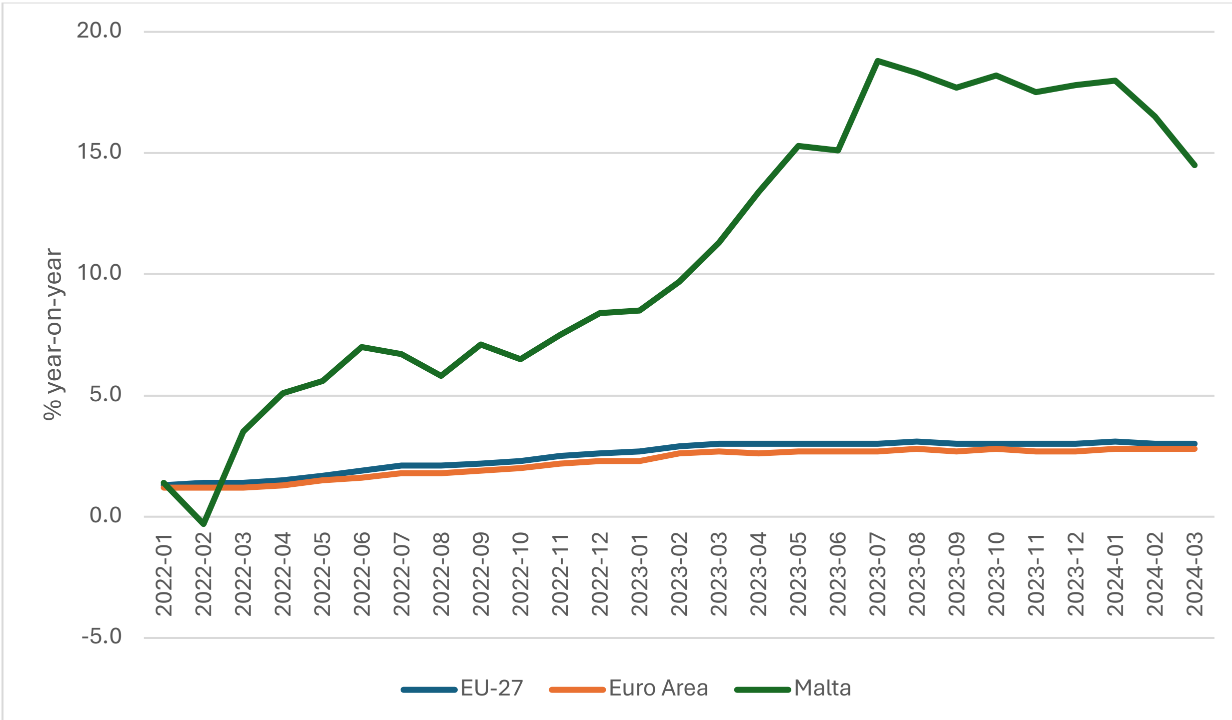

Figure 24: Actual rentals for housing, year-on-year growth (Source: Eurostat, 2024)

Section 3: Inflation Outlook and Policy Context

3.1 Global Risks

Recent data published by leading international organisations like the IMF point towards a global easing of inflationary pressures, although significant risks persist. Malta is no different – indeed, the latest projections published in April 2024 by the European Commission point towards a gradual decline in annual inflation, with the HICP expected to reach 2.9% in 2024 before dropping to 2.7% in 2025, with the Commission specifically noting the impact of recent government initiatives like Stabbilta' as mitigating factors. Nonetheless, Malta's international exposure to price movements means that inflation is still expected to be above the EU-27 average of 2.3% in 2024 and 2% in 2025. By contrast, while the Central Bank of Malta also projects that annual inflation in 2024 will reach 2.9%, an altogether steeper decline is projected for 2025 to 2.2%, before falling further to 1.9% in 2026. These projections are more aligned with those published by the IMF, with inflation expected to also reach 2.9% in 2024 before dropping to 2.1% in 2025.

Regardless, while all three sets of projections point towards an overall easing in inflationary pressures in Malta during 2024, annual inflation is still expected to surpass the EU average, with ensuing impacts on businesses, households and external competitiveness. In addition, a number of important risks may further drive inflation upwards, including:

- Ongoing tensions in Ukraine and potential escalation of hostilities.
- The crisis in the Middle East and the risk of an escalation in tensions between Israel and Iran.
- The ongoing Red Sea crisis which is having a significant impact on shipping from Asia towards the Mediterranean.
- Electoral outcomes in key countries like France, the UK and the U.S., which may lead to significant policy shifts.
- The prospect of new EU regulations and directives, including the Corporate Sustainability Reporting Directive (CSRD) which shall come into force in 2025 for large, listed companies and public interest entities, the Carbon Border Adjustment Mechanism which following a transitional period will come into force in 2026, the transposition of Extended Producer Responsibility (EPR) provisions by the end of 2024 as part of the Single Use Plastics Directive, as well as revisions to REACH which may have important implications for manufacturing. Other potential EU directives in the pipeline which may have wide-ranging impacts on inflation and the domestic economy as a whole include the proposed revisions to the Energy Taxation Directive to incorporate an aviation fuel tax.
- Concurrently, the extended Emissions Trading Scheme (ETS) to incorporate the maritime sector came into force in January 2024, and may result in further inflationary pressures for shipping-dependent economies like Malta.
- Continued climate change impacts on international agricultural yields, particularly for sugar, cocoa and olives, which may further put upward pressure on basic food and beverage items.
- Rising protectionism across the world, particularly amidst a recent surge of cheap exports emanating from China which raise competitiveness concerns, but which would result in higher prices.

The above only represents an indicative list of potential risks which may have an impact on domestic inflation. A more nuanced assessment would take into account the views of social partners and relevant stakeholders who have a more direct involvement in the Maltese economic landscape and are hence more attuned to potential domestic risks.

3.2 Domestic Policy Landscape

We conclude this section by presenting a brief summary of the existing major policy initiatives undertaken by the Maltese government to soften the inflationary impact on businesses and citizens alike.

The first policy is the government's subsidies on energy, which guarantee a fixed price for all consumers regardless of consumption levels, income or final use, enacted in response to the unprecedented surge in oil and gas prices following the Russia-Ukraine conflict in 2022. The direct effect of these subsidies is visible from the HICP, with fuel prices largely flatlining since the introduction of the subsidy, in stark contrast to the rest of the EU where energy prices increased drastically, as attested in Figure 1, with significant knock-on effects across other product categories. This policy comes at a cost – for example, in 2023 the Maltese government spent €320 million, approximately 1.7% of GDP, with expenditure earmarked to reach similar figures in 2024 despite public statements by both the European Commission and the IMF urging the government to wind-down such subsidies. Nonetheless, these subsidies have assisted in preventing domestic inflation from spiraling even further, particularly in 2022-2023. Indeed, a Policy Note published by the Central Bank of Malta (CBM, 2022) reports that inflation would have doubled in the absence of these subsidies, with the government stating that without this support, Maltese families would have had to spend an additional €3,000 per year on average on energy.

A second set of subsidies aimed at curbing inflation relate to cereal, flour and animal feed. The subsidy was first launched in May 2022 in response to the global spike in cereal and wheat prices precipitated by the Russia-Ukraine conflict, with €30 million allocated to support importers, manufacturers and wholesalers of grains and similar products, as part of the State Aid Temporary Crisis Framework. The scheme was subsequently extended in November 2023 with another €12 million budgeted for these subsidies, ensuring stability in the price of bread, flour and animal feed, given the significant effects that such price increases would have on basic food items.

The third major policy intervention related to rising living costs was the increase in the national minimum wage announced in October 2023, and which came into effect as from January 2024. The policy was conceived as part of the work of the Low Wage Commission, which was set up specifically for this purpose, bringing together representatives from academia as well as various leading unions and employer associations. This policy introduced an immediate increase in minimum wages of between €14.81 to €20.81 per week in 2024, including the statutory increase provided via the COLA mechanism, with further gradual increases of between €12 and €18 per week also in the pipeline over the period 2024 to 2027. This policy will help to protect low-income earners from the various pressures associated with rising prices, safeguarding living standards over the coming years, while minimising any potential negative impacts on employers and the broader economic landscape, having been endorsed by both employer associations and trade unions.

A fourth policy worth noting is the Stabbilta' initiative, announced in January 2024 as the government's flagship policy to tackle food price inflation. Under this scheme, supermarkets and food retailers were voluntarily brought on board to reduce the recommended retail price of 15 essential food and beverage categories by a minimum of 15% as from February 2024, and which is expected to remain in force until the end of 2024. As part of the initiative, a dedicated website was created showing which retailers have signed up to the scheme, together with the various food items impacted by the price cuts. Although it is premature to assess the success or otherwise of this scheme, a granular assessment of inflationary movements across these product categories may at least provide an indication of whether these pressures have subsided in the months following the introduction of the scheme. Figure 25 shows annual inflation (based on HICP data) over the last 12 months across various relevant food and beverage categories, with the red dotted line indicating the commencement of the Stabbilta' scheme. As seen below, across almost all product categories we can observe a drop in inflation, coinciding with the introduction of the scheme in February 2024, with the decrease persisting in March 2024. The sole exception is tea, reflecting broader global pressures from extreme weather events in cultivating countries that have impacted crop yields coupled with the ongoing Red Sea crisis that has hindered container ship transportation, resulting in higher tea prices.

Although we have seen an easing of food price inflation since February 2024, it is impossible to ascertain any causal links with the introduction of the Stabbilta' scheme, given that this would require a more sophisticated long-term of analysis that is beyond the scope and timeframe of this report. This analysis must also consider wider trends at the global and European level, which may also have contributed to a slowdown in inflationary pressures. Table 6 presents a comparison of annual inflation in March 2024 across Malta, the EU-27 and the Euro Area for each of the relevant categories. As seen below, across five of the categories listed below (highlighted in yellow), Malta's annual inflation is either equal to or below that observed within the EU and Euro Area, with this difference being particularly high for breakfast cereals and preserved milk. On the other hand, annual inflation in Malta for March 2024 is higher across three product categories despite their inclusion in the Stabbilta' scheme, namely poultry, frozen vegetables and coffee, with inflation for margarine and vegetable fats lying in between the EU and Euro Area averages. Therefore, although we can observe that domestic inflation in certain food and beverage categories targeted by the Stabbilta' scheme is below the EU and Euro Area averages, in other categories included under this scheme domestic inflation still exceeds the EU and Euro Area averages, reflecting persistence in both international pressures, notably transportation costs and climate-related commodity shortages, as well as domestic pressures including low productivity and profit margins that limit the ability of businesses to absorb higher imported costs, driving prices upwards.

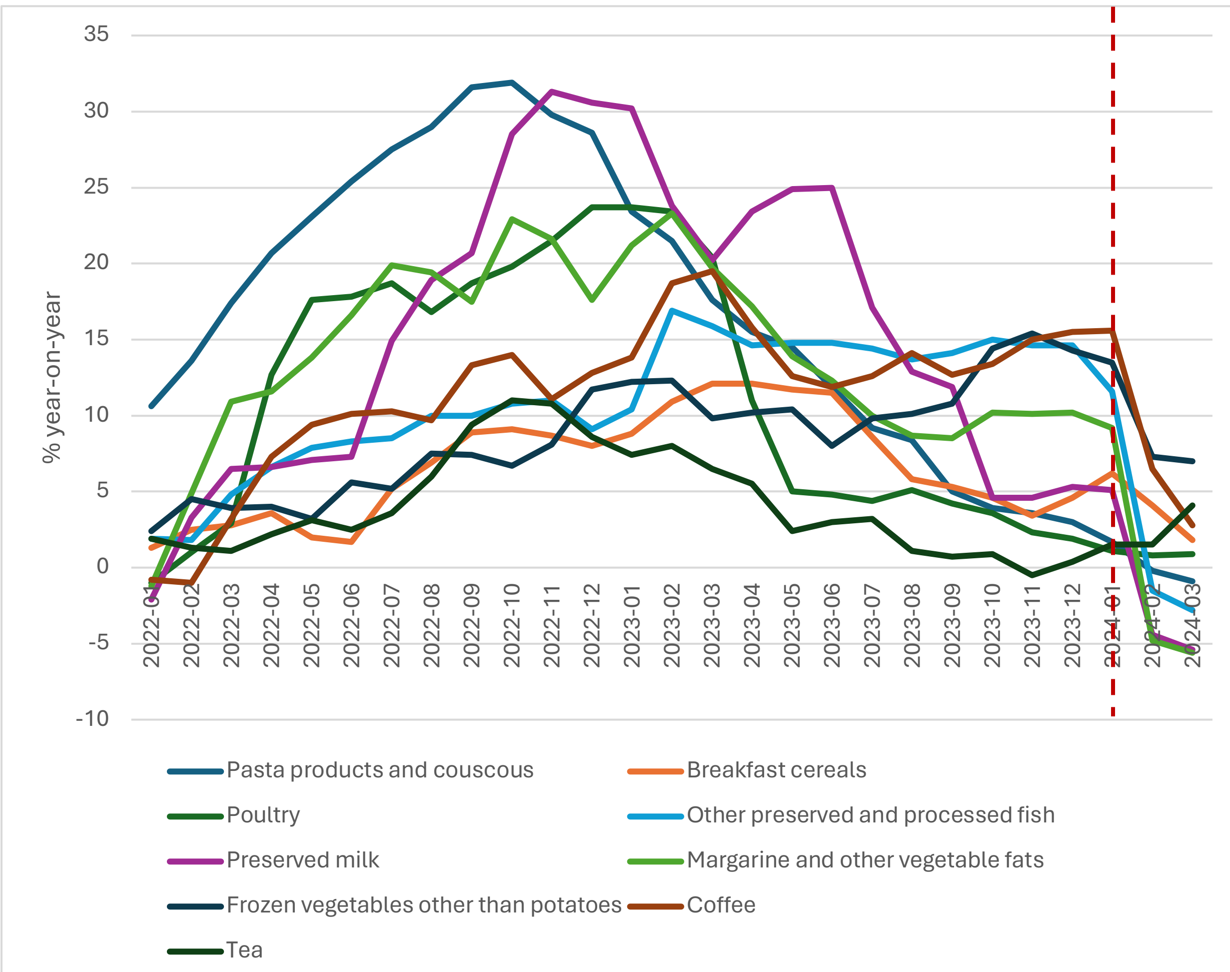

Figure 25: Annual HICP inflation by select food and beverage categories (Source: Eurostat, 2024)

Table 6: HICP for select food and beverage categories, March 2024 (Source: Eurostat, 2024)

	EU-27	**Euro Area**	**Malta**
Pasta products and couscous	-0.6	-0.4	-0.9
Breakfast cereals	3.0	3.2	1.8
Poultry	-1.8	-0.4	0.9
Other preserved or processed fish	3.2	3.5	-2.8
Preserved milk	-0.6	-1.2	-5.4
Margarine and other vegetable fats	-7.0	-4.8	-5.6
Frozen vegetables other than potatoes	4.9	5.6	7.0
Coffee	1.0	0.7	2.8
Tea	5.2	4.1	4.1

Section 4: Recommendations

Inflation continues to dominate public discourse, both locally and internationally, given its pernicious impact on purchasing power and thus the living standards of people, coupled with its broader implications for business costs and external competitiveness. Although the country has limited scope to influence imported inflation resulting from global geopolitical or climactic developments, a number of pertinent initiatives may be undertaken in the short-term to ease pressures and concerns, particularly for low-income earners, with a broader risk-based approach required to tackle more systemic, domestically driven inflation, both now and in the coming years.

4.1 Short-Term Recommendations

1. **Develop a strategy for inflation risk mitigation**

As mentioned above, the ability of government to effectively tackle international inflationary pressures is somewhat limited given our size and import reliance, despite the growing incidence of external shocks. Nonetheless, it is possible to manage this risk in a proactive manner. A risk-based approach to curtailing inflation involves developing a forward-looking risk mitigation strategy that seeks to identify emerging inflationary risks emanating from overseas and ascertaining Malta’s exposure to such risks across key goods and services segments and economic sectors. Such information would then allow the government, in tandem with the MCESD, to develop appropriate mitigation and management tools to limit the negative impact of potential inflationary pressures, ensuring that any policy not only has the full backing of social partners but, crucially, can be deployed without delay to further limit any negative economic and social repercussions.

2. Protection for Low-Income Households

There is a broader need to cushion the inflationary blow for low-income families, since as highlighted in the study by Grech et al (2024), rising living costs entrench existing disparities across income groups. The recent increase in the national minimum wage is undoubtedly an important initiative in this regard; however, this could be accompanied by a revision to the lower income tax bands to ensure that these increases to the minimum wage are tax exempt. Similarly, the additional Cost-of-Living Allowance (COLA) payment granted to low-income and vulnerable households like pensioners has had a notable impact in terms of supporting such groups, as attested by recent studies (e.g., Farrugia, 2023). Nonetheless, several social partners have also called for the COLA to be tax exempt, providing workers with an additional boost to purchasing power as intended by COLA in the first place, with such measures being particularly impactful for low-income households. Furthermore, the government may also consider linking social security benefits like children's allowances to inflation, to ensure that annual increases are adequately compensating for rising living costs.

3. Strengthen the Malta Competition and Consumer Affairs Authority (MCCAA)

The MCCAA plays a crucial role in ensuring that markets operate effectively within the Maltese Islands while protecting consumers from anti-competitive practices and abuse. This report has not sought to uncover any evidence of uncompetitive practices across the key inflation sectors of the economy. Indeed, we observe that both firm numbers and market power broadly in line with what is observed in other EU member states. Nonetheless, it is essential that the MCCAA is empowered to carry out its duties and pro-actively respond to any concerns regarding anti-competitive practices in Malta. This requires further public investment and strengthening of the MCCAA to ensure that it has the necessary resources to be able to fulfill this role in an efficient and effective manner.

4. Analysis of Domestic Emerging Inflationary Risks

This study has sought to outline the key international and domestic factors which are impacting inflation in Malta, as well as a number of emerging global risks. Nonetheless, given the unique idiosyncrasies of the domestic economy, a more in-depth study is warranted that assesses emerging domestic risks that may impact inflation both now and in the coming years. This would comprise detailed consultations and interviews with members of MCESD given their proximity to key market players within the domestic economic landscape and would assist in providing an important platform for the pro-active design of future inflation-related policies and initiatives by government, backed by social dialogue.

5. Develop an Exit Strategy for Existing Energy Subsidy Regime

As stated earlier on in this report, the energy subsidies that were introduced in 2022 had a significant impact in terms of preventing inflation from spiralling even further, as observed in several other EU member states during this period. Nonetheless, given the significant burden of this policy on public finances amidst repeated warnings by the European Commission and the IMF regarding its future sustainability, this recommendation proposes the development and communication of a strategy for the cessation of energy subsidies by government. As shown in the earlier macro analysis, although oil and gas prices have fallen from their 2022 peaks, they still have not fully returned to pre-COVID levels, amidst rising geopolitical tensions across the world. Evidently, an abrupt end to this policy would have a sharp negative impact on Maltese businesses and households accustomed to stable energy prices, not to mention the significant knock-on inflationary effects that would result, which would have important repercussions for economic and social wellbeing, particularly among the more vulnerable groups in society. Therefore, it is imperative that the government, in consultation with social partners, develops a strategy that details the gradual phasing-out of these subsidies over a specified period of time, with a clear start and end date, and that this is communicated effectively to all stakeholders and the general public, potentially with an extended timeline for the phasing-out of such subsidies for vulnerable groups.

4.2 Long-Term Recommendations

1. Promote Food Security

Recognition of the importance of food security is rising globally, not least locally as a result of both the COVID-19 pandemic as well as the recent surge in imported food prices. These latter concerns are only likely to grow in the future, with climate change already having a significant impact on crop yields across the globe, pushing prices up for key commodities like sugar, cocoa and olives. Put simply, food inflation is set to become a regular occurrence as opposed to a transitory shock. Within this context, from a risk management perspective it is imperative to actively promote domestic food security via modern, sustainable agricultural practices. This entails reversing years of decline within the agricultural sector and support for investment in cutting-edge farming technologies and skills, with the latter being complemented by campaigns to promote farming as an attractive future career path. Paradigms like aquaponics, vertical farming and regenerative farming have become increasingly pervasive across EU member states and offer significant potential to enhance agricultural productivity in Malta while respecting the tenets of sustainability. Clearly, Malta's size, resource and climactic realities mean that even with such initiatives, the country will still have to rely on imports to cater for the majority of its food and beverage requirements, meaning that the economy would still be susceptible to imported inflation. Nonetheless, in tandem with other initiatives like the risk mitigation strategy, which would include tangible goals like the diversification of Malta's food import sources, a shift towards greater food security may reap substantial socioeconomic benefits while reducing exposure to imported inflation. A prime example of a country that has adopted such an approach is Singapore, whose three-pronged food security strategy has elevated it to the top of the UN's Global Food Security Index. The strategy envisages that by 2030, domestic production will cater for 30% of the country's nutritional needs, through a combination of funding opportunities for farms to invest in high-tech farming systems and direct assistance via the allocation of land and sea-space to scale-up production using innovative technologies like multi-storey LED lighting vegetable farms and recirculating aquaculture systems.

2. Actively Encourage the Integration of Circular Economy Principles within Construction

Amidst significant focus on rising food prices, it is easy to ignore the spiraling cost of various construction and housing-related products and services, driven by rising investment in dwellings coupled with international price increases for key raw materials like metals. Once again, such increases are likely to become a regular occurrence due to rising geopolitical tensions across the world and higher transportation costs. Therefore, the adoption of circular practices within the construction industry presents a unique opportunity to utilize waste generated from construction and demolition activities, which account for 80% of annual total waste in Malta, as resources across a wide spectrum of uses, from reclaimed metals to the use of recovered aggregate in new concrete blocks, to even the construction of roads and pavements. This would have the dual benefit of reducing costs within the sector while contributing towards Malta's environmental sustainability goals and obligations. To encourage this transition, the government should seek to extend the inclusion of circular economy obligations in Public Procurement related to any construction or demolition activities and in the granting of development permits as well as across the entire spectrum of procurement. This is a clear opportunity for the public sector to lead by example and reward businesses aligning with sustainable priorities and ESG, proposing higher standards and better quality in their bids, beyond simply opting for the cheapest compliant bid. This would also serve to incentivize the proliferation of ESG practices and sustainability among businesses in Malta and provide a clear indication that the government is fully committed to the Triple Transition. In addition, there is a clear need to ramp up support measures for the deployment of circular technologies within the construction sector to improve both their short-term and long-term financial feasibility. Note that promotion of the circular economy should also be extended across the Maltese economy, including agriculture and fisheries (e.g., use of animal slurry for biofuel and fertilizers), manufacturing (e.g., development of circular materials) and tourism (e.g., use of grey water).

3. Tackle Skills Shortages and the Integration of Foreign Workers

Labour market tightness has become a key characteristic of Malta's economic landscape, contributing towards domestic inflationary pressures across several sectors. Therefore, a broad, strategic effort is required to tackle skills shortages within the country. Firstly, educational outcomes must be linked more closely with the skills required by the local economy, not simply now but in the future, with a focus on skills rather than specific subjects. Secondly, an important finding that emerges from this study is the disproportionate level of expenditure by Maltese businesses on the services provided by employment agencies, largely reflecting skills shortages which necessitate the deployment of foreign workers. A key reason for these inflated costs is the high rate of turnover among these workers, requiring new recruitment and training efforts. Therefore, apart from streamlining the processes required to engage such workers, a concerted effort is required by all stakeholders, including social partners like trade unions, to facilitate and promote the integration of such workers both at the workplace and in the Maltese Islands. One potential solution would be to encourage trade union membership for third country nationals, who in turn would assist these workers in their integration efforts, in conjunction with employers. Government may also seek, alongside employment agencies, to offer broader integration services for third country nationals, particularly in key economic sectors where skills shortages are particularly punitive. Thirdly, a more concerted effort is required to encourage workers of pensionable age to prolong their active involvement in the labour market, not simply to increase the pool of available talent but to ensure that the knowledge and experience acquired by such workers is effectively transmitted to the next generation. At present, the rate of employment for persons aged 65 and over in Malta is 6.9%, slightly above the EU and Euro Area averages but significantly lagging behind other small countries like Estonia (17.6%), Latvia (14.5%) and Cyprus (10.1%). Members of the MCESD have already put forward significant policy recommendations to boost active ageing, including the introduction of flexible retirement and part-time work for older employees, complemented by tax benefits for employers and favourable financial conditions for those workers who intend to draw their pensions at a later stage.

4. Address Systemic Challenges related to Traffic and Cost of Doing Business

Various long-term factors have, and will continue to, exacerbate inflationary pressures in Malta unless tangible actions are taken to address them. Chief among these challenges is traffic congestion, which apart from its pernicious environmental and social impacts is also resulting in significant economic issues for workers and businesses alike. Medium/long term solutions involve investment in improving the availability, connectivity and efficiency of public transport to ensure that it is a reliable, viable alternative to private passenger car use, which at the moment is on the rise despite the fact that public transport has been free of charge to all citizens since October 2022. Another initiative would involve incentivizing and expanding sea-based transportation, particularly in densely populated coastal areas, thus encouraging a modal shift away from Maltese roads. Finally, a new mass transit system of transportation may be considered, provided that the necessary feasibility and impact assessments are carried out to ensure the economic, social and environmental viability of any project. These initiatives would only constitute half of the story, since the challenge of discouraging private car usage will likely persist. Therefore, such projects must be complemented by traffic mitigation policies including parking fees in urban areas, congestion charges for car use in high-traffic zones and pay-as-you-drive license fees. A second factor relates to the cost of doing business, with World Bank data suggesting that these are among the highest within the EU. Significant efforts have already been undertaken by the government in this regard, as borne by the data itself. Nonetheless, further improvements can be made, particularly in supporting start-ups and SMEs, while the deployment of online systems and the digitalization of public services should further assist in promoting efficiency.

5. Improve Productivity Across Labour-Intensive Sectors

Continuously improving labour productivity is crucial to reining inflationary pressures in the long-term, enhancing efficiency and creating headspace in profit margins to absorb higher external costs. As attested by various editions of the National Productivity Board’s annual report, while certain sectors of the Maltese economy are characterised by high levels of productivity, others lag behind, notably highly labour-intensive sectors like tourism, construction and wholesale and retail trade. A strategic, focused approach is required to enhance productivity within these sectors, starting with upskilling of the workforce, with a focus on digital skills. At the same time, a concerted effort is needed to expand the provision and attractiveness of vocational education and training, including construction and housing-related areas like plumbing, which continue to be in high demand across the Maltese economy. This must be complemented by investment in digital and circular technologies that enhance efficiency while lowering costs, including automation, helping to ease labour market tightness and thus upward pressures on labour costs.