Malta:
Annual Report 2018

In line with Article 41 of the Fiscal Responsibility Act

Ministry for Finance

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1. Introduction

The Annual Report is prepared in accordance to the Fiscal Responsibility Act (Cap. 534) and is the fourth report since the enactment of the Act.

The Annual Report provides information on the execution of the Budget for 2018 and compares the outcomes with the strategic objectives and priorities outlined in the fiscal strategy and the fiscal targets as announced in the Budget for 2018. It analyses how the Government has observed the principles and rules stipulated in the Fiscal Responsibility Act. In addition, it assesses whether the fiscal and budgetary policies in the completed budget year are in line with the medium-term objective stipulated in the fiscal strategy. It provides explanations regarding any deviations from the Government's medium-term objectives and how these are to be addressed. It also explains the outcome of the Budget in the context of the Government's European commitments in terms of the Stability and Growth Pact.

The Annex of this report also includes the final execution data for the indicators provided in the Medium Term Fiscal Plan.

2. Meeting the 2018 Budgetary Estimates

This section provides information on the execution of the 2018 Budget as announced on 9 October 2017. It also compares the 2018 outcome with the strategic objectives and priorities of the fiscal strategy and targets as announced in the 2018 Budget.

The cash-based position in this section relates to the Central Government's Consolidated Fund. All allocations provided from the Consolidated Fund are either authorised by the House of Representatives under an Appropriation Act or are permanently appropriated by the House under the Constitution and other relevant legislation.

The revenue and expenditure figures presented in this Section are based on actual cash transactions and are not normally subject to revision. Financial transactions, such as proceeds from loans, proceeds from sale of financial assets, and revenue from other accounts of Government are not taken into consideration. Likewise, direct loan repayments, contributions to sinking funds, acquisition of equity, as well as transfers into other accounts of Government, are excluded from the total expenditure. In this sense, data presented in this section will differ from the data in Section 4 which presents the data for General Government in line with the ESA 2010 definition.

In the Budget for 2018, the Government set a Consolidated Fund deficit target of €21.4 million. Table 2 of the Annex presents Government's final fiscal position for 2018 compared to the targets as initially set out in the annual budget for 2018.

In 2018, tax revenue was €201.8 million more than was forecast, supported by stronger growth in domestic consumption and a significantly more buoyant property market. As a result, indirect tax revenues were more buoyant than expected, as higher than estimated revenue from VAT (+€92.5 million) and from licences, taxes and fines (+€57.3 million) outweighed lower than expected revenue from customs and excise duties (-€4.9 million).

Meanwhile, direct tax revenue was €57.0 million more than was forecast, mainly due to higher social contributions. The stronger than expected performance of the labour market resulted in higher than expected proceeds from social contributions (+€47.8 million) andincome tax (+€9.1 million).

Non-tax revenue was €7.9 million higher than planned for in the Budget, mainly due to higher than budgeted revenue from fees of office (+€18.9 million), reflecting higher proceeds from the Individual Investor Programme and the Residency and Visa Programme, miscellaneous receipts (€16.2 million) and reimbursements (€14.7 million). As a result, these positive developments were not offset by the lower than estimated revenue from grants and the Central Bank of Malta.

On the expenditure side, in response to requirements arising for the provision of public services as the year progressed, the recurrent expenditure outturn was €134.7 million above the original budget.

A higher than planned contribution was transferred to government entities engaged in water, waste water and energy operations, health care related activities, financial intelligence, and tourism in 2018. Higher than planned outlays amounting to €39.0 million were recorded in respect of salaries and wages paid to employees primarily in the education sector andhealth sector. Meanwhile, higher than planned expenditure of €31.8 million on programmes and initiatives was mainly in respect of education, including child care, as well as renewable energy.

These developments were in part compensated for by €8.6 million lower than estimated interest payments, against the background of the ensuing low interest rate environment and the Treasury's debt management strategy.

Government's capital expenditure witnessed a more pronounced increase than estimated in the 2018 Budget, as an additional €132.4 million in capital expenditure was recorded in 2018. This resulted in significant cash flow mismatches between outlays and receipts of EU Funds as spending on EU funded projects, including local co-financing, amounted to €306.5 million, compared to €179.0 million estimated in the 2018 Budget. The significantly higher disbursement was required in order to utilise fully and in a timely manner the cumulative total financial target of committed EU funded expenditure by end 2018. In addition, nationally-funded capital expenditure also exceeded target by €5.0 million.

2.2 Update on the performance of the main fiscal measures

The proceeds from the Individual Investor Programme were €80.1 million higher than estimated in the 2018 Budget. The 2018 Budget provided an allocation of €35.0 million to finance expenditure from the NDSF. In January 2018, the Fund awarded a grant of €950,000 to Mater Dei Hospital's Cardiology Department for it to upgrade its two catheterisation suites. A further €55 million were committed towards other initiatives related to social housing and healthcare, however no expenditure materialised in this respect by the end of 2018.

2.3 General Government Public Debt

Actual general Government gross debt for 2018 was €40.0 million higher than the 2018 Budget projections, mainly on account of a €31.9 million reclassification of certain PPPs within general Government, as recommended by Eurostat. Higher than anticipated outstanding Treasury Bills balance of €5.0 million was also recorded when compared to the 2018 projected Budget estimates. On the other hand, lower than anticipated outstanding Malta Government Stocks from €4,732.2 million projected in the 2018 Budget estimates, to an actual level of €4,709.4 million, was recorded.

Table 3 of the Annex presents the composition of actual general Government public debt for 2018 compared to the estimates presented in the 2018 Budget.

3. Respecting the Principles and Rules within the Fiscal Responsibility Act

The following section of the Annual report analyses how the Government has respected the principles and rules stipulated in the Fiscal Responsibility Act and explains any deviations from the Act.

Malta's institutional fiscal framework was strengthened significantly with the enactment of the Fiscal Responsibility Act (FRA) in 2014, which requires that the national fiscal authorities achieve a Medium-Term Objective (MTO) of a balanced budget after correcting for the economic cycle. The Act also requires that the general Government debt is lower than 60 per cent of GDP over the medium and long term.

Subsequently, a number of additional changes were legislated in 2018 to ensure full consistency with the Directive on Budgetary Frameworks as well as other amendments intended to ensure clarity in the administration of the Act. The main amendments transposing the Directive may be summarised as follows:

1. Clearly specifying that the sensitivity analysis includes clear reference to the interest rate scenario and that such analysis is to be also included in the Annual Budget

2. Clearly specifying that the fiscal risk assessment shall be carried out by the Malta Fiscal Advisory Council
3. The evaluation of macroeconomic forecasts shall similarly be conducted in terms of fiscal forecasts.

In terms of the Act, Ministries, Departments and Government Entities are required to prepare their three-year business and financial plans which are based on the (most recently announced) medium-term fiscal strategy. In this regard, in 2018, the Ministry for Finance issued circular MFIN 1/18 to request the submission of the Ministries' 2019 – 2021 Business and Financial Plans. MFIN assessed the plans received by each Ministry/Department/Entity in order to compile the three-year fiscal projections. Along the budgetary process, two rounds of bilateral meetings were held with each line Ministry, one at Permanent Secretarial level and the second at Ministerial level. The business and financial plans were discussed in detail, clarifications were sought and statements incorporating the three-year revenue and expenditure projections for 2019 - 2021, at Ministry level, were incorporated into the 2019 Financial Estimates which were approved by Parliament in December 2018.

3.1 Respecting the Budget Balance Rule

Table 4 of the Annex presents cyclical developments in 2018 compared to the targets presented in the 2018 Update of the Stability Programme.

In 2018, the general Government surplus stood at 2.0 per cent of GDP. This exceeded the surplus target of 0.5 per cent of GDP planned in the 2018 Budget, which was subsequently revised to 1.1 per cent of GDP in the 2018 Update of the Stability Programme. The Government also succeeded in recording a general Government surplus net of proceeds from the Individual Investor Programme (IIP).

In structural terms, it corresponds to a structural surplus of 1.6 per cent of potential GDP in 2018. In spite of the deterioration from the structural surplus of 3.3 per cent of potential GDP for the previous year, these developments are in full compliance with the provisions of both the Stability and Growth Pact (SGP) and the FRA. Indeed, Malta complied with the national budget balance rule with a margin and remained well above its MTO of a balanced budgetary position in structural terms.

3.2 Respecting the Debt Rule

Government debt has declined below the 60 per cent reference value in 2015, and has fallen continuously ever since, reaching 46.0 per cent of GDP in 2018.

Compared to the 2018 Stability Programme target, the debt-to-GDP ratio was revised upwards by 0.2 percentage points, primarily due to a higher stock flow adjustment (SFA) including the re-classification of certain PPPs within general Government.

4. Meeting the 2018 targets as established in the Medium Term Fiscal Plan

This section assesses if the fiscal and budgetary policies in 2018 and its results were in line with the medium-term objective stipulated in the National Medium Term Fiscal Plan as published in April 2018. The section also explains in more detail the deviations, if any, from the Government's medium-term objectives and how these are to be addressed.

The assessment of deviations with the targets established in the 2018 Medium Term Fiscal Plan is undertaken in terms of data classified according to the European System of Accounts (ESA) 2010, and consequently the data presented in this section is not comparable to that classified in Section 2. Moreover, actual data in this section may still be subject to further revisions. It is pertinent to note that the targets for 2018, as outlined in Spring 2018, were different from those underlying the 2018 Budget presented in October 2017 due to updated fiscal information available and revised macroeconomic assumptions upon which the fiscal projections are based. Table 1 of the Annex presents the macroeconomic assumptions which underpinned the 2018 Budget and the 2018 Update of the Stability Programme, together with the latest 2018 estimates available. Meanwhile, Table 5 of the Annex presents Government's final fiscal position for

2018 compared to the targets revised in the 2018 Update of the Stability Programme.

During 2018, the general Government recorded a surplus of €250.8 million, compared to the target surplus of €132.0 million outlined in the 2018 Update of the Stability Programme. In terms of GDP, the general Government balance has improved from a planned surplus of 1.1 per cent of GDP to a surplus of 2.0 per cent of GDP.

The better than expected outturn mainly reflected a stronger than anticipated revenue outcome, which turned out €128.1 million higher than expected. Revenue from taxes on production and imports was more buoyant than expected by €106.6 million, mainly reflecting a stronger performance in domestic consumption patterns and a significantly more buoyant property market. Market output also turned out €99.5 million higher than expected, while revenue from social contributions was €5.2 million higher than anticipated in in the National Medium Term Fiscal Plan as published in April 2018. Meanwhile, revenue from current taxes on income and wealth was €92.9 million lower than estimated. This was mainly due to an accelerated administrative process of refunds, which reduced the amount of funds transferred to central Government despite the increase in gross receipts, thus rendering the results not directly comparable to 2017.

General Government expenditure was marginally higher than projected by €9.3 million, as higher than targeted expenditure on intermediate consumption and current transfers was for the most part offset by lower than planned expenditure on social payments and capital transfers. Expenditure on intermediate consumption was €26.7 million higher than targeted, mainly reflecting higher than planned expenditure towards residential care, operations and maintenance expenditure, capital expenditure classified under this category of expenditure, and a higher than planned contribution to government entities operating in financial intelligence, water and waste water operations and higher expenditure towards health care related activities. Higher than planned current transfers amounting to €20.4 million were primarily related to compensation payments, public social partnerships and EU own resources. Meanwhile, lower than expected expenditure on social payments of €32.2 million. Total capital outlays were €30.6 million lower than projected due to lower than projected expenditure in 2018 on projects financed from the National Development and Social Fund, which were partly mitigated by higher GFCF.

4.1 General Government Public Debt

The 2018 actual ratio of general Government debt-to-GDP presented in the 2019 Stability Programme was 0.2 percentage points higher at 46.0 per cent of GDP, when compared to the target presented in the 2018 Stability Programme. Table 6 in the Statistical Annex presents a comparison of the targeted debt dynamics and the actual outturn.

In spite of a higher than expected contribution of 0.9 percentage points from the primary balance, the change in the gross debt ratio was 0.9 percentage points weaker than anticipated, due to a higher than expected debt-increasing stock-flow adjustment of 2.0 percentage points of GDP, Meanwhile, the 'snowball effect' also contributed more to a stronger reduction in the debt ratio than originally anticipated. This was mainly due to a higher than expected real GDP growth complemented by a marginally better than expected interest expenditure.

5. Moving towards the MTO in the Preventive Arm

The following section explains the outcome of the 2018 Budget in the context of the Government's European commitments, in particular in terms of the Stability and Growth Pact (SGP).

Malta is currently subject to the preventive arm of the Stability and Growth Pact (SGP) and should preserve a sound fiscal position which ensures compliance with the Medium-Term Objective (MTO). On 13 July 2018, the Council did not address a recommendation to Malta in the context of fiscal compliance under the European Semester since the Council was of the opinion that Malta complies with the Stability and Growth Pact.

In 2018, Malta reported headline and structural budget surpluses, in line with the provisions of the Stability and Growth Pact. The structural balance reached a surplus of 1.6 per cent of potential GDP in 2018, well above the medium-term objective of a balanced budgetary position in structural terms. When excluding proceeds from the IIP, the budget balance was still in a surplus position in 2018, both in nominal and structural terms. On account of these developments, the debt-to-GDP ratio, which in 2017 was already below the 60 per cent of GDP threshold, has declined further to 46.0 per cent of GDP in 2018.

Under the European Semester in July 2018, the Council considered that Malta complied with the Stability and Growth Pact. Based on the latest Commission assessment, the structural balance in 2018 was re-estimated at a surplus of 1.4 per cent of potential GDP, thus above the medium-term budgetary objective. Meanwhile, at 46.0 per cent of GDP, the debt ratio remained below the 60 per cent of GDP Treaty reference value.

Over the medium term, the European Commission forecast expects Malta's structural balance to remain positive, suggesting that the achievement of the medium-term objective of a balanced structural budget is sustainable. Nevertheless, the Commission recommends that expenditure developments are monitored carefully in the short and the medium term to safeguard fiscal sustainability in line with the SGP. Meanwhile, according to the Commission forecasts, the debt-to-GDP ratio, which in 2016 was already below the 60 per cent of GDP threshold, is expected to remain below that threshold and to decrease further over the medium term.

6. Annex Tables

Macroeconomic Forecast vs Estimates for 2018

(growth %)

Table 1

	Forecast Autumn 2017*	Forecast Spring 2018**	Estimate March 2019***
Gross Domestic Product (at current Market Prices)	**7.6**	**8.3**	**8.9**
Private Final Consumption Expenditure	5.6	6.1	8.2
General Government Final Consumption Expenditure	7.1	17.4	15.9
Gross Fixed Capital Formation	9.8	6.4	0.6
Exports of Goods and Services	4.3	5.3	4.3
Imports of Goods and Services	3.4	5.0	3.6
Compensation of Employees	6.5	7.1	7.2
Operating Surplus and Mixed Income	8.9	9.3	9.7
Tourism Earnings	**6.2**	**10.3**	**2.7**
Employment	**3.8**	**3.8**	**5.6**
Inflation	**1.5**	**1.6**	**1.7**

*Source: 2018 Budget, Published in October 2017

**Source: 2018 Stability Programme, published on 30 April 2018

***Source: NSO News Release 038/2019 - Gross Domestic Product 2018

Actual Fiscal Developments vs Budget Targets for 2018

Consolidated Fund

(Millions of Euro)

Table 2

	Jan/Dec 2018 Approved Estimate*	Jan/Dec 2018 Actual**	Variance
Recurrent Revenue	**4,350.1**	**4,559.8**	**209.7**
Tax Revenue	**3,965.9**	**4,167.8**	**201.8**
Indirect Tax Revenue	*1,481.9*	*1,626.8*	*144.9*
Customs and Excise Duties	317.0	312.1	-4.9
Licenses, Taxes, and Fines	329.4	386.7	57.3
Value Added Tax	835.5	928.0	92.5
Direct Tax Revenue	*2,484.0*	*2,541.0*	*57.0*
Income Tax	1,564.0	1,573.1	9.1
Social Security	920.0	967.8	47.8
Non-Tax Revenue	**384.1**	**392.0**	**7.9**
Fees of Office	63.3	82.2	18.9
Reimbursements	34.4	49.1	14.7
Central Bank of Malta	50.0	35.0	-15.0
Rents	32.2	30.4	-1.8
Dividends on Investments	43.8	45.8	2.0
Repayment of Interest on Loans	0.3	0.0	-0.2
Grants	127.7	100.8	-26.9
Miscellaneous	32.5	48.6	16.2
Total Expenditure	**4,371.5**	**4,630.0**	**258.5**
Recurrent Expenditure	**3,686.7**	**3,821.4**	**134.7**
Personal Emoluments	849.1	888.1	39.0
Operations and Maintenance	194.6	210.7	16.1
Programmes and Initiatives	2,230.0	2,261.8	31.8
Contributions to Government Entities	413.0	460.8	47.8
Interest Payments	**212.1**	**203.6**	**-8.6**
Capital Expenditure	**472.6**	**605.0**	**132.4**
Government Consolidated Fund Balance	**-21.4**	**-70.2**	**-48.8**

*Source: Financial Estimates 2018, Ministry for Finance; as announced in October 2017

**Source: NSO News Release 051/2019 - Government Finance Data: January-December 2018

Actual General Government Public Debt vs Budget Targets for 2018

(Millions of Euro)

Table 3

	Jan/Dec 2018 Estimate*	Jan/Dec 2018 Actual**	Variance
General Government Public Debt	**5,624.7**	**5,664.7**	**40.0**
Composition of Gross Public Debt			
Malta Government Stocks	4,732.2	4,709.4	**-22.8**
Malta Government Retail Savings Bonds	192.5	192.6	**0.1**
Treasury Bills	285.0	290.0	**5.0**
Domestic Loans with Commercial Banks	0.0	0.0	**0.0**
Foreign Loans	1.1	1.1	**0.0**
EBU's/Local Councils	154.8	184.1	**29.3**
Currency	87.9	84.4	**-3.5**
Rerouting/PPP	0.0	31.9	**31.9**
EFSF (Debt Re-Routing)	171.2	171.2	**0.0**

*Source: Treasury

**Source: Treasury / NSO News Release 060_2019

Cyclical Developments

(percentage points of GDP [1])

Table 4

	Jan/Dec 2018 Estimate*	Jan/Dec 2018 Actual**	Variance
General Government Balance	1.1	2.0	0.9
One-off and other temporary measures [2]	0.1	0.1	0.1
General Government Balance net of One-offs	1.0	1.9	0.9
Output Gap Estimates	1.0	0.7	-0.3
Cyclically-Adjusted Budget Balance	0.6	1.7	1.1
Structural Balance	0.6	1.6	1.0
Structural Adjustment	-3.0	-1.7	1.4

(1) GDP for 2018 used in the 2018 SP was an estimate, while GDP for 2018 used in the 2019 SP was actual

(2) A plus sign means deficit-reducing one-off measures

*Source: 2018 Stability Programme, published April 2018
**Source: 2019 Stability Programme, published April 2019

Actual Fiscal Developments vs Medium Term Target for 2018

European System of Accounts

(Millions of Euro)

Table 5

	Jan/Dec 2018 Estimate*	Jan/Dec 2018 Actual**	Variance
Revenue	**4,655.2**	**4,783.3**	**128.1**
Components of revenue			
Taxes on production and imports	1,484.0	1,590.6	106.6
Current taxes on income and wealth	1,743.4	1,650.4	-92.9
Capital taxes	21.5	20.7	-0.8
Social contributions	759.6	764.8	5.2
Property income	103.4	96.0	-7.4
Market Output and Output for own final use	407.4	506.9	99.5
Other revenue	135.9	153.9	17.9
Expenditure	**4,523.2**	**4,532.4**	**9.3**
Components of expenditure			
Compensation of employees	1,367.3	1,376.1	8.8
Intermediate consumption	807.7	834.3	26.7
Social payments in cash and in kind	1,207.7	1,175.4	-32.3
Interest expenditure	191.1	187.7	-3.4
Subsidies	142.2	157.6	15.4
Gross fixed capital formation	358.3	370.6	12.4
Capital Transfers Payable	204.1	168.6	-35.4
Other expenditure	244.8	262.0	17.2
General Government Balance	**132.0**	**250.8**	**118.8**
Primary Balance	**323.1**	**438.6**	**115.5**

*Source: 2018 Stability Programme, published April 2018
**Source: 2019 Stability Programme, published April 2019

The Dynamics of Government Debt

(percentage points of GDP [1])

Table 6

Percentages of GDP	Jan/Dec 2018 Estimate*	Jan/Dec 2018 Actual**	Variance
Gross debt	45.8	46.0	0.2
Change in gross debt ratio	-5.1	-4.2	0.9
Contributions to changes in gross debt			
Primary balance	-2.7	-3.6	-0.9
Snowball Effect	-2.3	-2.6	-0.3
Interest expenditure	1.6	1.5	-0.1
Real GDP growth	-2.9	-3.1	-0.2
Inflation Effect	-1.0	-1.0	0.0
Stock-flow adjustment	-0.1	1.9	2.0
p.m. implicit interest rate on debt	3.4	3.3	-0.1

Developments in the debt- to-GDP ratio depend on:

$$\frac{D_t}{Y_t}-\frac{D_{t-1}}{Y_{t-1}}=\frac{PD_t}{Y_t}+\left(\frac{D_{t-1}}{Y_{t-1}}\cdot\frac{i_t-y_t}{1+y_t}\right)+\frac{SFA_t}{Y_t}$$

where t denotes a time subscript, D, PD, Y and SFA are the government debt, primary deficit, nominal GDP and the

stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth.

[1] GDP for 2018 used in the 2018 USP was an estimate, while GDP for 2018 used in the 2019 USP was actual

*Source: 2018 Stability Programme, published April 2018

**Source: 2019 Stability Programme, published April 2019