Medium-Term Fiscal Strategy for Malta

2021-2024

Ministry for Finance and Employment

July 2021

The following symbols have been used throughout this document:

. . .	to indicate that data are not available;
—	to indicate that the figure is negligible;
0	to indicate that the figure is zero;
-	to indicate that data are not applicable or cannot be determined;
n/c	to indicate that there is no change in the data.

Figures may not add up due to rounding.

This document is based on statistical information available up to the 30th of April, 2021

Fiscal Responsibility Act, 2014

(Cap 534)

Statement of Fiscal Responsibility

by the Prime Minister and Minister for Finance and Employment

In accordance with the requirements of Article 15 (8) of the Fiscal Responsibility Act, 2014, we hereby attest to the reliability and completeness of information contained in this Medium-Term Fiscal Strategy and to compliance with the principles of fiscal responsibility.

Robert Abela
Prime Minister

Clyde Caruana
Minister for Finance and Employment

July 2021

1. Medium-Term Fiscal Policy Strategy

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Following four years of consecutive fiscal surpluses and a declining Government debt the COVID-19 pandemic has had a negative impact on the economy and public finances in Malta. This called for a number of measures on the part of Government to support the economy. Such intervention has been facilitated by the triggering of the General Escape clause. In this context, the fiscal space created in the last few years was instrumental in enabling Government to provide the necessary support without putting financial stability at risk. The Government is of the view that the short-term emergency support measures are essential to support the productive capacity of the economy and prevent a potentially transient economic shock from undermining medium to long-term fiscal sustainability. This medium-term fiscal strategy is being prepared in the context of unprecedented uncertainty in the economic outlook and hence, unlike previous years, the medium-term outlook beyond 2021 represents primarily a tentative no-policy-change projection which will be updated once a more stable economic situation unfolds.

1.1 Short-Term Outlook

1.1.1. Economic Situation and Risks to the Short-Term Outlook

During 2020 and continuing in the first half of 2021, the COVID-19 pandemic led to a series of unprecedented stresses on the global economy, including Malta. The effect of this shock distinguishes itself from previous global crises because the declines in demand were also complemented with supply disruptions resulting from the mandatory imposition of various country-wide lockdowns and social distancing measures which severely impacted economic activity, particularly in the hospitality sectors, mass transport networks and cultural activities. The pandemic further resulted also in unanticipated strains on public health care systems.

International and domestic institutions hastily responded to the outbreak by loosening monetary policies and providing fiscal support to cushion the economic setback.

Whilst Malta was not immune from the same adverse effects, and despite the reliance of the Maltese economy on the hospitality industry, other important sectors such as remote gaming, information and communications, pharmaceuticals, electronics, construction and real estate proved to be notably resilient and mitigated some of the economic repercussions of the pandemic.

In addition, the economy was sustained by an unprecedented level of Government support at a time when a significant liquidity squeeze could have put Malta's corporate sector in jeopardy. Furthermore, the robust growth rates registered in previous years have sheltered corporate balance sheets such that no major corporate insolvencies were recorded. Government support also prevented mass unemployment or a significant deterioration in labour market conditions, thus preventing major social disruptions in society. Banks were also well capitalised before the crisis and hence could respond by providing moratoria on loan repayments which so far have prevented a significant build-up of non-performing loans.

In 2020, the pandemic caused a contraction in economic activity of 5.7 per cent in nominal terms and 7.0 per cent in real terms. The situation going forward continues to be overshadowed with uncertainty with respect to both the duration of the virus as well as the intensity at which it reproduces.

The outlook for 2021 is subject to a high degree of uncertainty given the current circumstances. The baseline projection is consistent with a very gradual recovery in economic activity particularly after the third quarter of 2021, and a stronger recovery in 2022. As a result, the Maltese economy is expected to resume its positive performance and grow by 3.8 per cent in real terms in 2021. Growth is expected to be driven mainly by the recovery in exports and investment and supported by the Government stimulus measures which were extended from last year. Meanwhile, consumption is expected to recover more gradually in 2021 and more strongly in 2022. The economy is expected to surpass its 2019 level by the end of 2022. Growth is expected to moderate thereafter, but remain above potential growth estimated at 3 per cent in the outer years. This will result in a very gradual correction of the output gap by 2024.

Whilst the uncertainty surrounding these projections is rather elevated, our analysis now suggests that following the downscaling of growth prospects over the course of the year, a mild upside risk for 2021 is identified. Nevertheless, downside risk for 2022 is projected indicating that the recovery in that year is expected to be fragile and warrants caution from a fiscal policy perspective.

1.1.2. The Current Fiscal Situation

The effect of the COVID-19 pandemic in 2020 was significant on public finances. From the revenue side, a substantial fall in tourist expenditure and household spending led to a deterioration in indirect tax revenue whilst corporate losses underlined a significant drop in direct tax revenue. Furthermore, Government expenditure increased substantially reflecting the fiscal impact of COVID-19 related support measures as well as measures legislated by means of the 2020 Budget. Nevertheless, proceeds from personal income tax revenue and social security contributions were relatively shielded by the contained impact of the pandemic on the labour market. Against this background, the fiscal situation deteriorated and the surplus of 0.4 per cent of Gross Domestic Product (GDP) recorded in 2019 turned into a deficit of 10.1 per cent of GDP in 2020 whilst the debt ratio rose to 54.3 per cent of GDP.

1.1.3. The Fiscal Response to the Pandemic

The central role played by Government in mitigating the severe impact of the crisis in 2020 is evident. In total, Government stimulus measures (including the 2020 Budget measures) amounted to 5.8 per cent of GDP, of which COVID-related temporary measures in 2020 added up to 5.0 per cent of GDP. These exclude 1.5 per cent of GDP in tax deferrals aimed at further supporting corporate liquidity. The structural effort in 2020 is estimated at 5.7 per cent of GDP, the magnitude of which is also indicative of the extent to which fiscal policy was expansionary in 2020.

Budget 2021 measures in support of the recovery originally accounted for 2.2 per cent of GDP but were later extended to a total stimulus of 5.3 per cent of GDP, inclusive of the support to the National Airline. Of the 2021 measures, 4.6 per cent of GDP are temporary in nature. Such unprecedented support avoided mass corporate insolvencies or significant layoffs which could have seriously damaged the economy and undermined fiscal sustainability.

During the initial phases of the pandemic, a broad range of policy measures were implemented to limit the impact of the pandemic. The initial policy response sought to lower the number of infections, to avoid an overloading of the acute health system and to limit the number of casualties. To this end, in an initial response, the Maltese Government

intervened to contain the spread of the virus through a series of prevention, containment, control and treatment measures, implemented and enforced across sectors and within society. In addition, further healthcare funding was necessary targeting hospital capacity, medical equipment and protective gear. Subsequently, fiscal policy measures were put in place to cushion the economic impact, in particular:

Wage Support Measures: The Wage Supplement Scheme provided funds to businesses and self-employed, affected by the COVID-19 pandemic, to support enterprises in retaining their employees. A one-off lump sum grant was also provided with respect to those employees on mandatory quarantine due to the possible contact with individuals that are at risk of infection.

Liquidity Support Measures: Other measures were intended to ease liquidity problems, including the deferral of tax payments, loan guarantees, loan moratoria and interest rate subsidies to support access to credit, whilst also supporting business to facilitate remote working through measures supporting investment in telework equipment.

Social Support Measures: On the social side, a number of measures were introduced for individuals who were made redundant or who were unable to work. The parental benefit targeted working parents in the private sector, who could not go to work or carry out their functions through teleworking arrangements and were required to stay at home to take care of their school-aged children. The additional unemployment benefit scheme catered for employees who lost their jobs due to COVID-19. Moreover, the medical benefit scheme and the disability benefit scheme were granted to working disabled and vulnerable people who could not carry out their work functions due to being ordered to stay home for medical reasons.

Government's Economic Recovery Plan following COVID-19: Following the lifting of several restrictions imposed as a result of the pandemic and the re-opening of non-essential retail establishments and services, on 8th June the Government announced a recovery plan aimed at regenerating the Maltese economy based on the following three pillars:

- *Reducing Business Costs:* The Tax Deferral Scheme, was extended. Utility bills and commercial rents for businesses affected by the pandemic were subsidised, fuel prices were reduced and commercial licenses were refunded. Contributions to support businesses to invest were granted.

- *Stimulating Domestic Demand:* In order to stimulate domestic expenditure, the Government granted a €100 voucher to residents aged 16 and over to be spent locally at hotels, licensed accommodations, restaurants, bars or diving schools and at retail outlets that were required to close temporarily during the pandemic. Other measures included tax refunds and a more generous in-work benefit scheme for low-income households. The stamp-duty on the transfer of residential property was reduced, in addition to the reduction in the tax rate associated with sales of property and the extension and wider coverage of the first-time buyer scheme.

- *Direct Business Support:* The wage supplement scheme was extended until the end of October. Other schemes which directly supported business operations related to logistics, digital promotion, underwriting facilities, participation in international fairs and an export credit guarantee scheme for the establishment of new export markets. In addition, assistance to nursing homes and an allocation to non-governmental

organisations (NGOs) to mitigate the impact of the pandemic on their income was granted.

Furthermore, over the medium-term, the Government shall carry out several capital and infrastructural projects in industrial areas, including the extension of the Life Sciences Park, the upgrade of the Kordin Business Incubation Centre, investment at the Marsa ex-landfill and a new logistics hub.

Budget 2021: The 2021 Budget continued to sustain the economic recovery, safeguard employment, ensure social protection and invest in sustainable development. This included measures aimed to assist companies to retain employment, bolstering their investment initiatives and helping start-ups with the implementation of innovative technology projects. Initiatives in this context included the extension of the economic regeneration initiatives in place in 2020 up to March 2021, including the wage supplement scheme and the re-issue of the economic regeneration vouchers, as well as an increase in the minimum threshold for Value Added Tax (VAT) exempt trading to reduce the administrative burden on Small and Medium-Sized Enterprises (SMEs) and the extended concession on the stamp duty payable on the transfer of family businesses.

The 2021 Budget built on previous years' initiatives aimed at reducing further the risk of poverty for the most vulnerable in society, by enhancing further the adequacy of pensions, a higher tax refund rate, a children's allowance supplement, a higher rate of supplementary assistance, whilst also addressing past injustices and assisting in the purchase of residential property by means of the extension of existing reduced stamp duty schemes.

In view of the Government's vision of achieving a carbon neutral economy by 2050, the 2021 Budget outlined initiatives that ensure that the environment, which is crucial for achieving sustained economic growth and a better quality of life, is indeed prioritised. These included measures incentivising the circular economy, by seeking circular consumption and production patterns, exploring waste prevention and management while ensuring the responsible re-use of resources and enhancing green procurement to safeguard the environment. These initiatives create opportunities to build a strong green economy to transform Malta into a modern, resource-efficient and competitive economy – in line with the European Green Deal vision.

By means of funds allocated in the 2021 Budget, the Maltese Government continues to invest in Malta's infrastructure to be able to meet, both the current and the future economic, social and environmental challenges. Initiatives in this respect included the continuation of arterial road construction projects, as well as roads in residential and rural areas, the regeneration of ports and improvement of facilities for the maritime sector, industrial infrastructure, the modernisation of health facilities, investment in higher education institutions and schools, sports facilities, and social housing.

Extension of COVID Measures in 2021: Beyond the 2021 Budget initiatives, several policy measures which had been put in place to cushion the impact of the pandemic in 2020, were extended beyond the expiry date contemplated in the 2021 Budget. This was necessary in order to somewhat cushion the economy from the negative impact of the containment measures re-introduced in the first quarter of 2021. In particular, in the case of companies and self-employed persons that suffered a significant downturn in their turnover and liquidity as a result of the economic constraints arising from the coronavirus pandemic and, as a result face substantial cash flow difficulties, the

settlement of provisional tax, social security contributions of self-employed persons and VAT falling due in August 2020 up to and including December 2021 was extended, such that eligible taxes may be settled from May 2022 with no interest or penalties charged. Both the COVID-19 Business Assistance Programme and the reduced tax rates applicable on the transfer of immovable property were also extended and widened in scope. In addition, new incentives underpinning the Tourism Recovery Plan are in place to support the tourism industry, which was severely hit by the pandemic. Importantly, the wage supplement scheme was extended till the end of the year.

In addition, in terms and for the purposes of Article 31 of the Fiscal Responsibility Act, the annual contribution to the 'Contingency Reserve' account is expected to amount to €13.3 million in 2021.

1.2 Medium-Term Outlook

On 13th March 2020, the European Commission adopted a Communication on a coordinated economic response to the COVID-19 outbreak. It proposed that the Union institutions should apply the full flexibility existing within the European Union (EU) fiscal framework, with a view to helping Member States to address the outbreak and deal with its fallout. On 20th March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact (SGP). In that Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit activation of the clause. On 23rd March 2020, the Council supported that view. More recently, in the Annual Sustainable Growth Strategy 2021, the European Commission confirmed that fiscal policy should continue to support the recovery in 2021. In light of this need and the still high uncertainty about the economic consequences of the pandemic, the general escape clause will remain active in 2021. In spring 2021, taking into account updated macroeconomic projections, the Commission will reassess the situation and take stock of the application of the general escape clause.

It is to be noted that the Fiscal Responsibility Act (FRA) is intrinsically tied to the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and the Stability and Growth Pact, such that any decision to activate the escape clause at a European level should have the same effect as a formal announcement by Government on the presence of exceptional circumstances. Indeed, the FRA defines exceptional circumstances in the same way as the Stability and Growth Pact. In line with the Council agreement, the Government of Malta considers the current circumstances as exceptional.

The FRA envisages the suspension of the budgetary rule in the presence of exceptional circumstances. This applies to both the departure from the Medium-Term Objective (MTO), as well as the adjustment path towards it such that, as long as exceptional circumstances prevail, any departure from the MTO in that year and any lack of sufficient adjustment towards the MTO in any of the years that the exceptional circumstances prevail do not constitute a breach of the rules.

It is the express view of the Government that once exceptional circumstances cease to exist, the Government will support a fiscal strategy to revert to the Medium-Term Objective of a balanced budget in structural terms and ensure that the debt ratio remains below 60 per cent of GDP. It is however premature at this stage to anticipate when these exceptional circumstances will cease to exist. In this context, the Medium-Term Fiscal Strategy presented here includes the budget measures for 2021 and their

recent extension, but is based largely on a no-policy-change assumption in 2022/24. The plan will be revised once exceptional circumstances cease to exist, after which the Government will continue to pursue policies aimed at achieving prudent medium-term fiscal positions.

1.3 Government's Expenditure Priorities

The Government is committed to implement its work programme on the basis of the Electoral Manifesto. It is also committed to make the best use of remaining EU funds from the 2014-2020 Programming period as well as the 2021-2027 Programming period as well as the additional support at EU level provided under the next Generation EU and including the SURE programme which will itself partly finance the wage support provided to enterprises. Inevitably the COVID-19 pandemic required a reassessment of Government's expenditure priorities to address the exceptional circumstances.

The Prime Minister announced a new socio-economic vision expected to serve as the basis for the country's economic strategy. Five key priorities were chosen for the long-term strategy, aiming to re-focus Government action by having a more targeted, cohesive and effective action plan. The long-term economic vision rests on five principles:

1. Good Governance. In the coming year, the Government will continue implementing measures and reforms which strengthen the rule of law, the regulatory and supervisory authorities and the fight against money laundering and the financing of terrorism. This will ensure that the democratic and institution functions are strengthened and safeguarded.
2. Economic Growth translates into a higher quality of life for all citizens. Malta's future economic growth depends on the transition towards an economic model, inspired by the principles of circular, green and blue economy, stimulated by a high level of competitiveness and innovation whilst sustaining social cohesion.
3. Investing in education, which is crucial to sustaining medium to long-term economic growth. By targeting education, a dignified life for the entire population is ensured, so that everyone is enabled to fulfil their potential within a healthy environment. In addition, the creation of new opportunities is contingent on the development and renewal of the country's skills base and addressing mismatches.
4. The fourth principle is that of supporting the renewal of Malta's infrastructure through the ongoing investments in roads, transport and technology thus supporting the country's competitiveness, and the creation of prosperity which shall contribute towards a higher quality of life.
5. The final principle is that of achieving a carbon neutral economy by 2050 with intermediary goals being set every ten years. This will ensure that the environment, which is crucial for achieving sustained economic growth and a better quality of life, is indeed prioritised. Consideration must also be given to strategic documents contributing to the vision of carbon neutrality. These include the National Energy and Climate Plan, the Low Carbon Development Strategy, the National Strategy for the Environment, Waste Management Strategies and Malta's Sustainable Development Vision for 2050.

These priorities clearly align with the reform priorities espoused by the Country Specific Recommendations within the European Semester process, while also tackling the areas identified by national authorities. The Government will ensure that these principles will guide the policy objectives to be pursed through the national budget as well as through the use of European funds, especially the Recovery and Resilience Facility.

Against the above background, Malta is currently concluding its Recovery and Resilience Plan outlining the Government's strategy to improve the economy's resilience and adjustment capacity, mitigating the social and economic impact of the crisis whilst outlining structural reforms that address relevant priorities emanating from the European Semester. This will be achieved through investments, inter alia, in health, education and tourism, and in the green and digital transitions.

1.4 Public Investment Programme and Structural Reforms

Malta's Partnership Agreement presents the overarching strategy and identifies the priorities in the allocation of EU funds. In this regard, the Partnership Agreement has identified three funding priorities which are considered as the main overarching objectives for the 2014-2020 programming period, namely:

1. Fostering competitiveness through innovation and the creation of a business-friendly environment;
2. Sustaining an environmentally-friendly and resource efficient economy; and
3. Creating opportunities through investment in human capital and improving health and well-being. The latter has been recently more focused and adapted to support also measures in response to the coronavirus outbreak.

The main overarching objectives will be addressed through two Operational Programmes and their respective priority axis.

These objectives and priority axes in general also apply to the national funds earmarked for capital investment. In addition to the co-financing element of EU-funded projects, locally financed investments are mostly targeted to road, education and health infrastructure (including support related to the COVID-19 pandemic), waste management and environmental management.

The 2021-2027 Partnership Agreement shall set Government's strategic framework governing various funds under the new Cohesion Policy. The Partnership Agreement also acts as a valuable tool to ensure a smooth transition between programming periods as well as to ensure complementarity and coordination between different EU funding instruments. The 2021-2027 Partnership Agreement will thus aim to foster complementarities with funding under the Next Generation EU, amongst others, including investments under ReactEU, the Just Transition Fund and the Resilience and Recovery Facility.

Investment under the 2021-2027 Partnership Agreement will aim to enable Malta to recover from the impact of the pandemic, as well as facilitate the transition and transformation of key sectors. In this context, EU funds shall continue to foster an environment which encourages public and private investment, economic growth and the creation of jobs and better employment opportunities in key areas, in line with both European and national targets and also in line with the objectives of each specific Fund.

Malta has drafted its Recovery and Resilience Plan (RRP) as part of NextGenerationEU, specifically aiming for the green and digital transformations of European economies, while also targeting the country-specific recommendations embedded within the European Semester process, ensuring economic coordination amongst Member States. Malta's plan addresses 6 main pillars; 1. Renovation of buildings, 2. Decarbonisation of

Transport, 3. Education, 4. Digitisation 5. Health and 6. Strengthening the Institutional Framework. These pillars are characterised with a mix of complementary reforms and investments aimed at strengthening the Maltese economy and enabling it to withstand future shocks to the economy.

Malta's RRP is expected to yield a positive economic impact by addressing structural weaknesses of the economy. Based on the projects being considered, the impact could range between 0.3 per cent of GDP to 0.5 per cent of GDP in 2022, and reach a maximum cumulative impact of 0.7 per cent of GDP in 2025. The impact persists, with estimates using the QUEST model indicating a positive impact even in 2050 suggesting a notable structural improvement in the economy as a result of the RRP. The projects are expected to improve resilience, especially in terms of improvements in productivity and efficiency while improving the robustness of institutions. The RRP also targets the social pillar by improving sustainable living and investing in future generations.

1.5 Fiscal Risk Statement

Given the significant uncertainty resulting from the COVID-19 pandemic, this medium-term plan remains surrounded by an unusually high level of uncertainty. Indeed, as indicated earlier, these projections rest on a number of assumptions, particularly with regards to the epidemiological evolution of the virus as well as global efforts towards the distribution of vaccines and their effectiveness in light of emerging variants of COVID-19. As a result, it is difficult to make projections over the short-term. Any departure from short-term projections will undoubtedly affect long-term targets.

The economic risks surrounding the medium-term plan have been highlighted in detail in Chapter 4 of this document. More specifically, there seems to be an upside risk for the attainment of a lower budget deficit in 2021 reflecting the marginal upside risk to the growth forecasts identified in this plan. However, the fiscal risk emanating from the possible macroeconomic scenarios contemplated in this plan is on the downside for 2022 as downside risks to the expected recovery have been identified. It is however worth noting that, in the worst-case scenarios contemplated in the risk assessment, the budget balance as a percentage of GDP deteriorates by 0.1 percentage point in 2021, 0.4 percentage points in 2022, and 0.5 percentage points in 2023 and 0.7 percentage points in 2024.

The macroeconomic and fiscal projections for the period 2021 to 2024, presented in this Plan, were assessed by the Malta Fiscal Advisory Council (MFAC) and, whilst acknowledging the high degree of uncertainty, were considered to be within their endorsable range.

The fiscal outturn in 2021 and over the medium-term is sensitive to the economic recovery and the period during which the fiscal support measures are expected to remain in place, as the adverse impact of the pandemic on public finances is expected to persist over several years. The MFAC considers that there could be downside risks to the total revenue profile mainly in terms of non-tax revenue, and an overall upside risk for current expenditure. Based on the assessment carried out on the individual revenue and expenditure components, the MFAC observed that during 2021 to 2024, there could be an overall downside risk outlook vis-à-vis the fiscal balance, reflecting the joint impact of a downside risk on the revenue side and an upside risk on the expenditure side of the budget. Nevertheless, the MFAC is of the opinion that the magnitude of these risks appears contained, since the official fiscal forecasts are corroborated by similar fiscal

forecasts for Malta produced by other reputable institutions, which all show a correction in the fiscal deficit by 2024, though to varying degrees.

Forecasts by the European Commission (EC) project the deficit-to-GDP ratio to reach 11.8 per cent in 2021 and 5.5 per cent in 2022, slightly lower than the government plans of 12.0 per cent and 5.6 per cent, respectively. Indeed, the EC's revenue and expenditure forecasts for 2021 and 2022 are only slightly higher. The Commission expects a more vigorous growth in private consumption, which together with the gradual revival of tourism, are expected to support the government's intake from indirect taxation, such that in 2021, the EC produced a slightly higher estimate for indirect taxes and 'other' revenue, but a slightly lower forecast for direct taxes. For 2022, the EC estimated lower direct tax revenue, which is more than offset by much higher expected revenue from 'other' sources. In terms of expenditure, the EC forecasts higher capital expenditure in both 2021 and 2022. Overall, the Commission considers that the evolution of the deficit in both years could turn out more favourable, even as a result of the higher growth from the implementation of measures financed by the Recovery and Resilience Facility.

Apart from the macroeconomic risks surrounding these fiscal projections, additional risks relate to contingent liabilities, particularly the COVID-related guarantees granted by Government, as well as risks related to further support to enterprises.

Another uncertainty in terms of revenue relates to both estimated amount and timing for the recovery of the deferred taxes. Given their extension in 2021, such deferrals pose a risk to the deficit target for both 2020 and 2021 (as deferrals have been accrued for both years) only in the eventuality that some of the amounts deferred are uncollectable.

The Maltese Government takes note of the outlined risks and the opinion of the MFAC, and is continuously monitoring the situation to ensure appropriate action is taken if deemed necessary.

2. Economic Outlook

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2.1 Economic Conditions for 2020

In 2020, the Maltese economy contracted by 7.0 per cent in real terms, or by 5.7 per cent in nominal terms. Declining net exports were the main contributor to such contraction, with the external side of the economy contributing a negative 5.9 percentage points towards growth. Domestic demand also declined, accounting for a negative contribution of 1.7 percentage points, while inventories contributed 0.6 percentage points.

The restrictive measures imposed to contain the spread of COVID-19, most notably in the second quarter of 2020, resulted in a significant drop in household consumption, which contracted by 7.6 per cent, notwithstanding a stable labour market and disposable income, which were supported by government measures. The contraction in consumption was primarily driven by declines in consumption on restaurants and hotels, transportation, and recreation services. The increased uncertainty and deteriorating external environment derived from the pandemic were reflected in investment, which contracted by 4.5 per cent, particularly driven by transport equipment and housing construction. Subdued external conditions, elevated global uncertainty and weak tourism exports were also reflected in deteriorations in both exports and imports, with exports contracting at a faster rate than imports. Indeed, exports decelerated by 7.8 per cent, while imports declined by 4.1 per cent, thus deepening the negative contribution of net demand to Gross Domestic Product (GDP) growth. By contrast, the impact of the pandemic on the Maltese economy was cushioned by public consumption, which grew by 16.1 per cent.

In terms of output, Gross Value Added (GVA) at basic prices fell by 4.3 per cent over the previous year. The contraction in GVA was primarily driven by the services sector, which negatively contributed 4.2 percentage points to growth in GVA. Consequently, the share of the services sector in the total economy in terms of GVA marginally declined from 89.3 per cent in 2019, to 89.0 per cent in 2020. The services sectors mostly affected by the pandemic were the Tourism sector and the other contact-intensive services sector. The Wholesale and Retail, Transportation, and Accommodation sector contracted by 33.0 per cent, resulting in a negative contribution of 6.6 percentage points to growth. The Professional, Scientific and Technical activities sector, and the Agriculture and Fishing sector also contributed negatively by 0.7 and 0.1 percentage points, respectively.

By contrast, some sectors proved to be resilient to the economic effects of the pandemic, including the Information and Communication sector (which grew by 15.3 per cent), the Arts Entertainment and Recreation sector (9.6 per cent growth), the Financial and Insurance Services sector (4.9 per cent) and the Construction sector (4.3 per cent growth).

As a result of government policies supporting income and employment, the labour market remained robust and compensation of employees increased by 2.4 per cent in nominal terms, reaching €5,984.2 million. However, the brunt of the pandemic was absorbed in corporate profits, as gross operating surplus and mixed income contracted by 3.4 per cent to €6,106.3 million. Subsidies on production and imports surged by 207.6 per cent to reach €663.9 million, while revenue from taxation on production and imports declined by 14.7 per cent to €1,397.2 million.

The COVID-19 pandemic and related worldwide containment measures to slow the spread of the virus had a severe impact on global economic activity. Indeed, the International

Monetary Fund's (IMF) most recent World Economic Outlook estimates the global economy to have contracted by 3.3 per cent in 2020.

In view of the launch of vaccination programmes in some countries, adaptive economic activity to subdued contact-intensive activity, and additional policy measures to support economies, the IMF projects the global economy to recover by 6.0 per cent in 2021 and by 4.4 per cent in 2022. However, the strength of the recovery is expected to be uneven across countries.

Fiscal policy support is set to boost global activity, while most countries are expected to lower their deficits in 2021, as revenues rise, and expenditures decline as part of the recovery process. Furthermore, developments in global trade will mirror the recovery in economic activity, with global trade projected to grow by 8.4 per cent in 2021, before moderating to 6.5 per cent in 2022. Since the pandemic has significantly affected cross-border tourism and business travel, the recovery in services trade is expected to lag behind that of merchandise volumes.

The balance of payments for Malta has undergone significant changes in terms of developments within the current account during the past year. Historically, Malta has enjoyed sizable surplus values thanks to a robust net export services balance, driven primarily by the personal, cultural, and recreational services net export balance and the travel net export balance. In 2020 this trend came to a halt as trade flows across the world were disrupted. As a result, the current account recorded a deficit of 4.0 per cent of GDP from a surplus of 5.8 per cent of GDP in 2019.

In terms of goods and services, the travel sector trade flows were highly impacted both in terms of inflows and outflows as commercial flights either came to a halt or diminished substantially. On the other hand, the personal, cultural and recreational services sector registered substantial increases in its export figures in 2020 whilst maintaining the same level of imports overall. This increase in net exports partially offset the decline in net exports from the travel sector. In tandem with the export increases in the personal cultural and recreational services component, other business services registered substantial increases in imports whilst its exports remained stable. All-in-all the gains in net exports made during 2020 from all services industries were not enough to counter the losses caused by the pandemic.

The primary income net payments balance has remained stable since 2018 and somewhat increased in 2020. The direct investment net payables balance increased from 67.2 per cent of GDP in 2019 to 72.2 per cent of GDP in 2020. Here direct investment incurrence of liabilities increased slightly, whilst the net acquisition of financial assets remained stable. Portfolio investment net receipts increased from 56.7 per cent of GDP in 2019 to 59.5 per cent of GDP in 2020, owning to increases in net acquisitions of financial assets.

2.2 The Medium-Term Scenario

Economic activity in Malta is still being firmly constrained by the pandemic. The rapid resurgence in infection rates in the beginning of 2021, led the public health authorities to also announce that non-essential establishments were to temporarily discontinue operations. Against this background, in 2021, GDP is expected to grow by 3.8 per cent in real terms and 5.9 per cent in nominal terms.

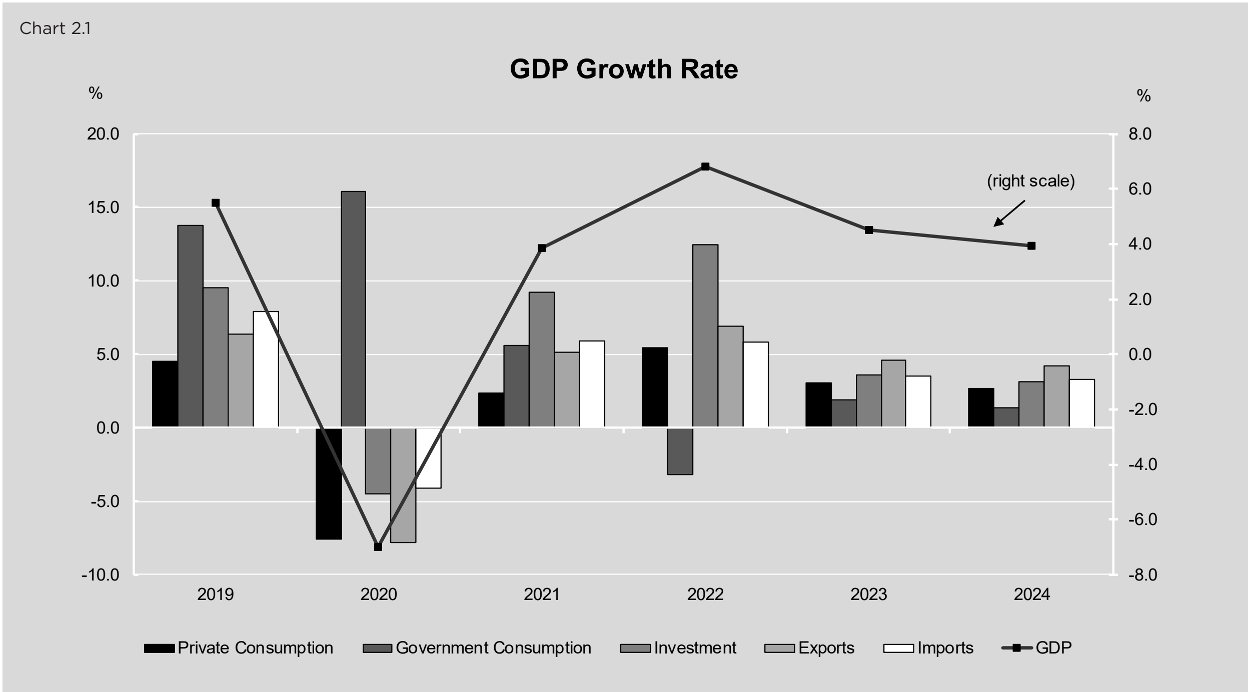
The domestic component is expected to be the main driver of the partial recovery in 2021. Indeed, the domestic component of the economy is expected to contribute 4.5 percentage points to growth in 2021, supported by positive contributions from both private and public consumption as well as gross fixed capital formation. From the third quarter of 2021, the vaccination progress in Malta and abroad is expected to have made sufficient progress to allow for the gradual resumption of ordinary activity and liberating pent-up demand.

Net exports are projected to continue to weigh on growth in 2021 with a negative net exports balance of 0.7 percentage points as international developments and travel restrictions continue to weigh on exports, particularly in tourism whilst the strengthening of domestic demand boosts the growth in imports.

The outlook for 2022 is subject to the assumption that the vaccination rollout would be complete by the end of 2021 and there will be a resolution of the health crisis in 2022 followed by a gradual tapering of containment measures. Indeed, the Maltese economy is expected to resume its positive performance and grow by 6.8 per cent in real terms in 2022.

As current policy measures are expected to be successful in averting permanent negative structural effects, real GDP is expected to stand 3.0 per cent above its 2019 levels by the end of 2022. Domestic demand is projected to be the main driver of this growth with an expected contribution of 4.9 percentage points followed by a positive net export contribution of 1.9 percentage points.

Over the outer years, economic growth is expected to be more balanced, reaching 4.5 per cent in 2023 and 4.0 per cent in 2024. In both years, domestic demand is expected to be positive, contributing 2.7 and 2.3 percentage points to growth in 2023 and 2024 respectively. The contribution of net exports is also positive at 1.8 per cent and 1.7 per cent in 2023 and 2024, respectively.



Main Macroeconomic Indicators

Table 2.1

	2019	2020	2021p	2022p	2023p	2024p
GDP growth at current market prices (%)	8.0	-5.7	5.9	8.9	6.7	6.2
GDP growth at Chain Linked Volumes by period (Reference year 2010) (%)[1]	5.5	-7.0	3.8	6.8	4.5	4.0
Expenditure Components of GDP						
at Current Market Prices by period (%)						
Private final consumption expenditure[2]	6.7	-6.5	3.7	7.1	4.4	4.0
General Government final consumption expenditure	16.7	18.5	7.9	-0.7	3.9	3.5
: net of Individual Investor Programme (IIP) proceeds	*12.3*	*14.1*	*7.7*	*0.1*	*3.5*	*3.3*
Gross fixed capital formation	10.7	-3.6	10.4	13.9	4.8	4.3
Exports of goods and services	8.5	-7.3	6.5	8.5	6.2	5.8
: net of Individual Investor Programme (IIP) proceeds	*8.9*	*-7.3*	*6.5*	*8.5*	*6.3*	*5.9*
Imports of goods and services	9.6	-3.7	6.8	7.0	4.6	4.2
Expenditure Components of GDP						
at Chain Linked Volumes by period (Reference year 2010) (%)						
Private final consumption expenditure[2]	4.5	-7.6	2.4	5.4	3.0	2.7
General Government final consumption expenditure	13.8	16.1	5.6	-3.2	1.9	1.3
Gross fixed capital formation	9.5	-4.5	9.2	12.5	3.6	3.2
Exports of goods and services	6.4	-7.8	5.1	6.9	4.6	4.2
Imports of goods and services	7.9	-4.1	5.9	5.8	3.5	3.3
Inflation rate (%)	1.5	0.8	1.3	1.5	1.6	1.7
Employment growth (National Accounts Definition) (%)[3]	6.5	4.1	2.2	3.5	3.2	3.0
Unemployment rate (Harmonised definition, Eurostat) (%)	3.6	4.3	4.3	3.9	3.8	3.7
Compensation per employee (% change)[4]	2.6	-0.8	1.2	2.1	2.1	2.1
Labour productivity (% change)	-0.9	-10.7	1.6	3.2	1.3	0.9
Nominal Unit Labour Cost (% change)	3.5	11.1	-0.3	-1.1	0.8	1.2
Real Unit Labour Costs (% change)	1.0	9.7	-2.4	-3.1	-1.4	-1.1

[1] Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. This non-additivity, similar to that in other countries' national accounts, is due to mathematical reasons and reflects the fact that chain-linked volumes are calculated by separately extrapolating both totals and their sub-components.

[2] Includes NPISH final consumption expenditure.

[3] Total Employment based on National Accounts Definition.

[4] Compensation per employee actual figures and forecasts based on unpublished FTEs.

Chart 2.1 illustrates the projected growth rates of GDP, together with a detailed breakdown of the expenditure aggregates. Table 2.1 presents the main macroeconomic indicators for the years 2019-2024. The figures for 2019 and 2020 represent actual data published by the National Statistics Office (NSO), while the data for 2021 to 2024 represent the scenario-based projections of the Ministry for Finance and Employment (MFE). The macroeconomic forecasts take into account the latest available data and further details are provided in Tables 1a, 1b, 1c and 1d of the Statistical Appendix.

2.2.1 Assumptions for Projections

The macroeconomic forecasts presented in this Stability Programme are based on the following assumptions:

- Economic activity in Malta's main trading partners is expected to increase by 4.4 per cent in 2021, and then by 3.9 per cent in 2022. Over the outer years, growth is expected to moderate to 1.2 per cent in both 2023 and 2024.
- World prices are projected to increase by 2.2 per cent in 2021, to then increase by 1.5 per cent in 2022, and by 1.1 per cent thereafter.
- Oil prices are assumed to increase from an annual average price of $41.8 per barrel in 2020 to $61.2 in 2021, then marginally increase to $61.9 in 2022. This price level will be retained throughout the outer years.
- The Dollar/Euro exchange rate is expected to appreciate from a yearly average of 1.1533 Dollars per Euro in 2020 to 1.2058 Dollars per Euro in 2021 and then appreciate in 2022 to 1.2180 Dollars per Euro. Further Euro strength is expected in the outer years, reaching 1.2225 Dollars per Euro in 2023 and 1.2240 Dollars per Euro in 2024.
- The Sterling/Euro exchange rate is expected to depreciate from an annual average of 0.9026 Pounds per Euro in 2020 to 0.8740 Pounds per Euro in 2021 and then to appreciate in 2022 to 0.8768 Pounds per Euro. In 2023 and 2024, the Sterling/Euro exchange rate is expected to marginally decline to 0.8709 Pounds per Euro and 0.8687 Pounds per Euro respectively.
- The short-term interest rate is projected to remain unchanged at around 0.0 per cent over the projection horizon in line with the European Central Bank (ECB) projections, while the long run interest rate is assumed to remain stable during the forecast horizon at 0.3 per cent.
- Changes in inventories are assumed not to contribute to GDP growth.
- 70 per cent of the population will be vaccinated by the third quarter of 2021 and the economy will start to recover in the fourth quarter of 2021. Moreover, it is assumed that the virus will not persist throughout 2022 and vaccine doses will not need to be administered on a recurrent annual basis.
- Whilst travel restrictions will be alleviated, tourist numbers will reach around 30.0 per cent of the total number of inbound tourists in 2019 and recover further to 75.0 per cent of 2019 tourism numbers in 2022.

These assumptions are outlined in Table 8 of the Statistical Appendix.

2.2.2 Risks to Outlook

The medium-term outlook for the global economy is one of steady growth. Despite an expected improvement in economic activity, the situation going forward remains overshadowed with uncertainty. Risks related to the epidemiological evolution, and the efficiency and effectiveness of vaccination rollout and take-up both in Malta and abroad remain skewed towards the downside. These risk factors, amongst others, will be explored in more detail in Chapter 4.

2.2.3 Private Consumption

Private consumption growth for 2021 is projected to increase by 2.4 per cent. This figure reflects the closing down of non-essential outlets throughout the second quarter of the year but also takes into account the potential of a strong resurgence in pent-up demand towards the latter half of the year as people are able to resume their recreational spending.

Whilst a stronger recovery in the third quarter of the year is possible, this could easily fuel a resurgence of the virus compelling us to maintain prudent assumptions for the third quarter of the year with respect to recovery prospects for consumer demand. The recovery in consumer demand is thus mostly delayed to 2022 when private consumption is expected to grow by 5.4 per cent. In the outer years, private consumption is projected to grow by 3.0 per cent and 2.7 per cent in 2023 and 2024, respectively.

2.2.4 General Government Final Consumption Expenditure

Following significant growth in 2020, public consumption growth is projected to further increase by 5.6 per cent in 2021 as Government sustains its economic support. In 2022, Government expenditure is expected to decline by 3.2 per cent. In the outer years general Government final consumption expenditure is projected to grow by an average rate of 1.6 per cent. This implies that the share of public consumption in real GDP will average at 19.9 per cent over the projection period.

2.2.5 Gross Fixed Capital Formation

The inherently volatile nature of gross fixed capital formation makes it relatively challenging to forecast. Hence, when forecasting investment, economists within the MFE take a relatively prudent approach, factoring in only those projects that have a strong political commitment or a high probability of realisation, while assuming a relatively high import content. Based on communications with key stakeholders, several investment projects which were put on hold during 2020 due to uncertainty have resumed course and as the economy continues to recover, investment is expected to pick up. Accordingly, gross fixed capital formation is projected to increase by 9.2 per cent in 2021 followed by a 12.5 per cent projection in 2022 as firm and investor sentiment is restored and the numerous projects in the pipeline are commenced. In the outer years, investment activity is expected to gradually moderate and record an average growth of 3.4 per cent between 2023 and 2024. Moreover, the investment to GDP ratio is expected to marginally increase from 23.3 per cent in 2020 to an average of 25.3 per cent over the forecast horizon.

2.2.6 External Balance of Goods and Services

From an external perspective, a recovery in Malta's main trading partners along with a resumption of normality towards the second half of the year is expected to result in an increase of 5.1 per cent in exports in 2021. Tourism numbers are expected to remain low throughout the first half of the year. In the third quarter, only a modest growth in tourist numbers is assumed and in the fourth quarter a strong revival of tourist numbers will bring annual tourist numbers to around 30.0 per cent of 2019 levels.

Offsetting the increase in exports, is an increase in imports of 5.9 per cent in 2021. It is worth mentioning that in Malta, investment activity tends to be highly import-intensive, and thus, year-on-year movements in investment are offset by imports of capital goods, thereby minimising the impact of volatile investment flows on GDP in the medium-term. The strength of domestic demand, the recovery in exports and the strong Euro against the Dollar further supports this increase in imports. Furthermore, the strength of the Euro negatively affects cost competitiveness and weakens export growth prospects. The external balance as a percentage of GDP is expected to reach 9.3 per cent in 2021 before stabilising at an average of 12.9 per cent over the forecast horizon.

Continued growth of Malta's main trading partners along with a recovery in tourism is anticipated to result in an increase in Malta's exports by 6.9 per cent in 2022 before gradually moderating to an average growth of 4.4 per cent in the outer years.

In the outer years, growth in imports is set to gradually move in line with the expected recovery in economic activity. In particular, imports are projected to increase by 5.8, 3.5, and 3.3 per cent in 2022, 2023, and 2024, respectively.

2.2.7 Sectoral Balances

Table 1d in the Statistical Appendix shows expected developments based on internal forecasts for the balance of payments headline indicators. Although the current account has historically shown strong surplus trends, this all changed in 2020. The COVID-19 pandemic has primarily impacted the historically sizeable net export position of the travel component reflected in balance on goods and services item within the current account to reflect a much lower net export figure in 2020. Forecasted values for this item suggest that the balance on goods and services will gradually recover as the situation regarding the pandemic is expected to improve and services exports related to travel resumes.

In terms of the forecasted values of the primary income balances and transfers, a continued increasing trend in the net payment balance is expected to continue. In 2020, Malta managed to maintain its attractiveness in terms of foreign direct investment whereby direct investment liabilities stocks continued to increase despite the crisis. Pre-crisis trends for other investment assets and portfolio investment assets were also largely unaffected by the pandemic and previous increasing trends in these items continued towards the same trajectory. These developments are also reflected in a continued increasing trend for forecasted net payments balance. Return on investments for each of these three types of investments were projected to remain stable over time as both long-term and short-term interest rates are expected to remain low and stable.

2.2.8 Productivity and Employment Growth

Policy measures were instrumental to alleviate the impact of the pandemic on the labour market. In fact, the labour market sustained its positive performance in 2020, as employment growth stood at 4.1 per cent (National Accounts definition). Nevertheless, value added per employee registered a decline in 2020, though less so when measured per hour.

In 2021, a pick-up in economic activity is projected to generate an employment growth of 2.2 per cent before reaching an average of 3.2 per cent in the outer years. The unemployment rate, based on the Harmonised definition, is projected to stand at 4.3 per cent in 2021 before declining to 3.9 per cent in 2022 and reaching 3.8 and 3.7 per cent in 2023 and 2024 respectively.

Compensation of employees is projected to increase by 3.4 per cent in 2021 before rising further by 5.7 per cent in 2022 and averaging 5.2 per cent in the outer years as heightened job demand generates upward wage pressures. Concomitantly, growth in compensation per employee is projected to grow modestly by 1.2 per cent in 2020, before growing at 2.1 per cent in 2022 and averaging out at 2.1 per cent in the outer years.

In 2021, real labour productivity is projected to increase by 1.6 per cent, reflecting the return to normal working hours as firms seek to recover the productivity losses of the

pandemic. This growth is expected to continue in 2022 as labour productivity is projected to increase by 3.2 per cent before averaging a growth rate of 1.1 per cent in the outer years. Nominal unit labour cost is expected to decline by 0.3 per cent in 2021, prior to decelerating further by 1.1 per cent in 2022 and rising by 0.8 per cent and 1.2 per cent in 2023 and 2024, respectively. Moreover, real unit labour costs are projected to decrease by 2.4 per cent in 2021, before declining by 3.1 per cent in 2022 and declining further by 1.4 per cent and 1.1 per cent in the outer years.

2.2.9 Inflation

In 2020, the inflation rate (measured as the twelve-month moving average of the Harmonized Index for Consumer Prices (HICP)) stood at 0.8 per cent, down from 1.5 per cent in 2019. Inflation was primarily driven by food prices and services but offset by declines in energy prices and prices of non-energy industrial goods. The inflation rate is expected to increase to 1.3 per cent in 2021. Underlying this acceleration in inflation is the increase in oil prices together with increases in services inflation resulting from base effects following the suppression experienced in 2020. Prices are expected to rise further in 2022 to 1.5 per cent, as economic activity continues to recover. Prices will further increase by 1.6 per cent and 1.7 per cent in 2023 and 2024 respectively.

2.2.10 Comparison with the Commission's Winter Forecast

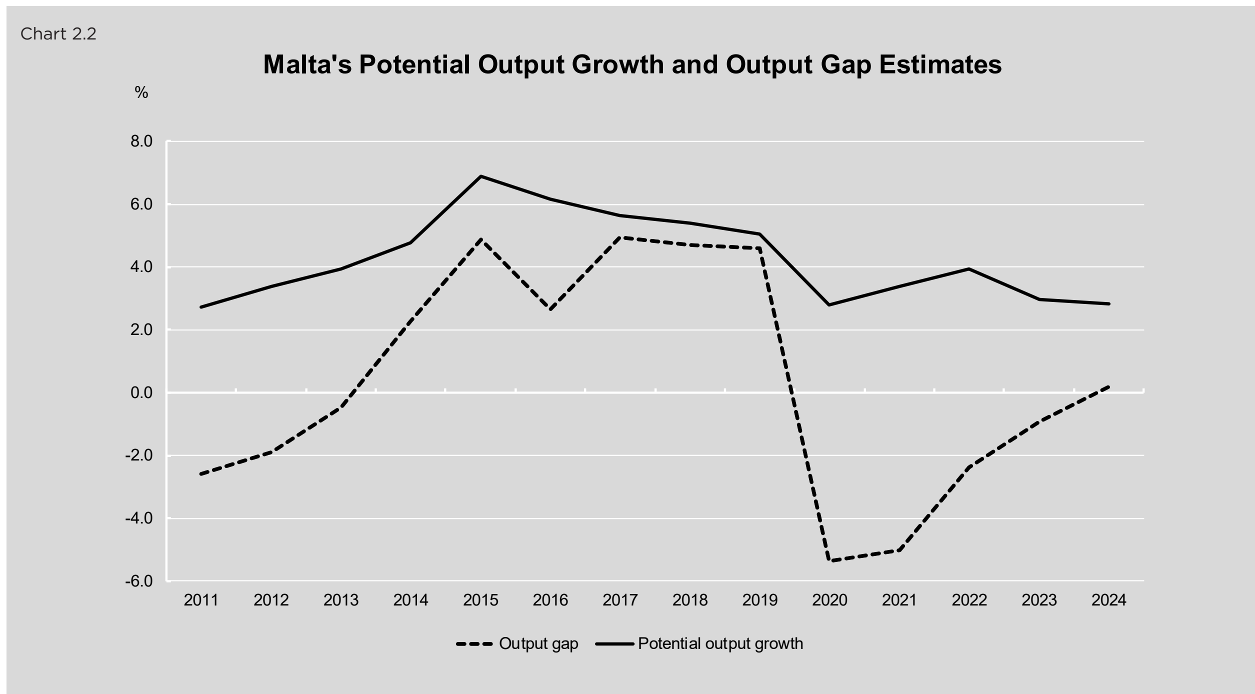
The winter forecasts published by the EC project a growth rate for Malta of 4.5 per cent and 5.4 per cent in 2021 and 2022, respectively. For 2021, this is 0.7 percentage points above MFE's forecast expectations, while for 2022, this is 1.4 percentage points lower. While the MFE forecast is projecting domestic demand to be the key driver of Malta's growth in 2021, the EC forecast is projecting growth to be mainly driven by net exports and domestic consumption. For 2022, the MFE forecast is projecting domestic demand to be the main driver of economic growth followed by a strong net export contribution, while the EC forecast is projecting net exports as the main contributor to GDP growth followed by domestic demand.

2.3 Potential Output and Output Gap

The estimation of potential output and the output gap within this Update of the Stability Programme is based on the commonly agreed Production Function method. The main differences between the EC's and MFE's estimation pertain to differences in the macroeconomic forecasts. Developments in the potential output and output gap are presented in Chart 2.2.

From 2011 to 2019, potential output growth averaged at 4.9 per cent, reaching a peak in 2015. Due to the current pandemic, in 2020, potential output growth stood at a comparatively lower rate of 2.8 per cent. Potential output is expected to average at around 3.3 per cent over the forecast period, standing at 2.9 per cent in 2024. Owing to a resilient labour market, labour input is expected to be the main contributor to potential GDP growth, supported to a lesser extent by capital accumulation on account of a positive investment outlook. Concurrently, total factor productivity is projected to negatively contribute to potential output.

The output gap is indicative of the cyclical developments prevailing in the Maltese economy. The output gap was negative from 2011 to 2013 following the international recession and the subsequent contraction of the domestic economy in 2009. The output gap turned positive from 2014 to 2019, as the Maltese economy operated above its



potential level. Due to a substantial contraction in 2020 attributable to the COVID-19 pandemic, the output gap turned negative in 2020. The output gap is expected to remain negative until 2023, turning slightly positive in 2024 as the Maltese economy is expected to gradually recover from the current pandemic over the forecast horizon.

3. General Government Balance, Measures and Government Debt

3. General Government Balance, Measures and Government Debt

Malta's public finance sustainability had been improving in recent years, thanks to prudent fiscal policy, strong growth, and favourable financing conditions. Indeed, the consistent improvement in the fiscal position allowed Malta to gain fiscal headroom, supported by the sustained strengthening of the institutional capacity in Malta's fiscal framework, particularly the institutionalisation of the Comprehensive Spending review, the setting up of a performance budgeting framework, the repeal of the Financial Administration and Audit Act with the Public Finance Management Act (Cap. 601) and measures pursuant to the International Monetary Fund (IMF) Fiscal Transparency Evaluation (FTE).

Following the outbreak of the pandemic, Government's overarching objective has been to plan ahead for the economic recovery, shoring-up household income and keeping firms afloat while restrictions remain in place. Discretionary policies have complemented the full operation of automatic fiscal stabilisers[1], as a result of which the general Government balance turned into deficit territory. Indeed, the severe economic situation and the large fiscal policy response have led to a budget deficit of just above 10 per cent of Gross Domestic Product (GDP) in 2020, whilst general Government debt is estimated to have increased by over 12 percentage points to 54.3 per cent of GDP. It is pertinent to note that although the fiscal support measures in Malta were among the strongest in the European Union (EU), such that the deficit recorded in 2020 was one of the highest in the EU, the impact on the debt ratio has been relatively much less pronounced than in other Member States and ranked in the middle of the rise in debt ratios among the EU. Indeed, the rise in the debt ratio was even less than the EU average of 13.2 percentage points of GDP and the debt ratio remains ranked amongst the lowest in the EU. Indirect support, such as credit guarantees and tax deferrals, have complemented direct measures.

Once the pandemic subsides, the pace of the increase in debt is expected to slow down and be reversed to avoid any feedback loop between higher public debt and borrowing costs. This shall be achieved by reducing the fiscal deficit in a gradual, orderly manner that takes into account the need to continue providing some counter-cyclical support to the economy. The sequencing of deficit-reduction involves a phasing out of temporary support measures once the health crisis abates and restrictions on mobility and economic activity are lifted. Provided that the economic recovery gains momentum, as projected in this Programme, a cyclical improvement in the public finances is expected to support the elimination of the deficit over time. On this basis, the baseline assumption is that the general Government balance shall decline below the 3 per cent reference value by the end of the forecast scenario.

Over the medium-term, fiscal discipline shall be maintained, returning the public debt-to-GDP ratio to a firm downward trajectory.

3.1 Fiscal Developments in 2020

The general Government balance for 2020 amounted to a deficit of €1,300.2 million, a worsening of €1,350.3 million over the surplus recorded in 2019. Total revenue decreased by €378.1 million to €4,677.8 million, while expenditure amounted to €5,977.9 million, increasing by €972.1 million. As a share of GDP, the general Government balance was equivalent to a deficit of 10.1 per cent, worsening by 10.5 percentage points when compared to the surplus of 0.4 per cent that was registered in 2019. General Government debt increased by €1,257.2 million over 2019 and stood at €6,960.0 million. Coupled with

a decrease in GDP, the debt-to-GDP ratio for 2020 increased to 54.3 per cent. Fiscal developments in 2020 were largely impacted by the COVID-19 pandemic and subsequent Government measures to mitigate the associated economic, social and health risks.

General Government revenue declined by 7 per cent. Tax revenue (excluding social contributions) declined by 11 per cent, largely on account of the adverse effects that the outbreak of the pandemic exerted on the broad economy in general, but especially considering that some sectors were more severely hit, in particular tourism-related industries and the wholesale and retail trade sectors. These developments negatively affected proceeds from taxes on production and imports, which declined by 15 per cent in 2020, such that the ratio-to-GDP declined by 1.2 percentage points to 10.7 per cent of GDP. Government support measures, particularly those aimed at sustaining employment, lessened the severity of the pandemic on the labour market and shored-up revenue from current taxes on income and wealth, which declined by 8 per cent in 2020, primarily from lower tax revenue from corporate income and profits. In addition, revenue from social contributions increased by 5 per cent year-on-year, such that the ratio-to-GDP increased by 0.7 percentage points to 6.6 per cent of GDP. The remaining non-tax revenue components and capital receipts remained relatively unchanged at around 6 per cent of GDP in aggregate.

The ratio of general Government expenditure to GDP increased by 9.8 percentage points to 46.6 per cent in 2020. The increase in the expenditure-to-GDP ratio mainly resulted from the fiscal impact of COVID-19 related measures, and to a lesser extent from measures legislated by means of the 2020 Budget. Expenditure increased for most expenditure components, other than interest expenditure, but most notably towards subsidies and intermediate consumption. Indeed, the ratio to GDP of subsidies increased from 1.4 per cent in 2019 to 5.0 per cent in 2020, largely due to additional spending in relation to the COVID-19 Business Assistance Programme, which includes the wage supplement scheme, as well as the Economic Regeneration Voucher Scheme. The ratio of intermediate consumption to GDP also increased by 2.3 percentage points to 9.5 per cent of GDP, as further healthcare funding was necessary to address hospital capacity, medical equipment and protective gear, and for repatriation flights to bring home Maltese nationals and residents, and to carry cargo and urgent medical supplies for hospitals, following the ban on travel.

National policy response to COVID-19 and budgetary implications

A broad range of policy measures was implemented to limit the impact of the pandemic. The initial policy response sought to lower the number of infections, to avoid an overloading of the acute health system and to limit the number of casualties. To this end, in an initial response, the Maltese Government intervened to contain the spread of the virus through a series of prevention, containment, control and treatment measures, implemented and enforced across sectors and within society. In addition, further healthcare funding was necessary to address hospital capacity, medical equipment and protective gear requirements. Subsequently, fiscal policy measures were put in place to cushion the economic impact on revenues, incomes and liquidity, consisting of discretionary polices with a direct impact on the budget, as well as liquidity-oriented measures. Following the lifting of several restrictions imposed as a result of the pandemic and the re-opening of non-essential retail establishments and services, the Maltese Government provided support to the rebound and recovery.

3.1.1 Comparison with the 2020 Update of the Stability Programme for 2020

This section assesses the fiscal and budgetary policies in 2020 against the objectives outlined in the 2020 Update of the Stability Programme published in April 2020. It is important to note that the targets for 2020, as outlined in spring 2020, were different from those underlying the 2020 Budget presented in October 2019 due to updated fiscal information available and revised macroeconomic assumptions due to the pandemic outbreak. Developments in the general Government budgetary execution in 2020, between subsequent forecasts, are outlined in Table 3.1a.

General Government Budgetary Developments in 2020

Divergence from previous forecasts

Table 3.1a — € millions

	ESA Code	USP 2020 compared to USP 2021				DBP 2020 compared to USP 2021			
		Divergence due to out-turn in *t-1*	Divergence due to updated macro-economic projections	Other revi-sions	**Total forecast revision**	Divergence due to out-turn in *t-1*	Divergence due to updated macro-economic projections	Other revi-sions	**Total forecast revision**
Net lending (+)/net borrowing (-)									
1. **General Government**	S.13	**13**	**-162**	**-199**	**-348**	**-132**	**-664**	**-697**	**-1,493**
2. Central Government	S.1311	13	-162	-199	-358	-132	-664	-697	-1,493
3. State Government	S.1312	-	-	-	-	-	-	-	-
4. Local Government	S.1313	10	10	10	10	0	0	0	0
5. Social Security funds	S.1314	-	-	-	-	-	-	-	-
For the General Government									
6. **Total Revenue**	TR	**13**	**-159**	**-174**	**-319**	**-132**	**-671**	**-43**	**-846**
Of which									
Taxes on Production and Imports	D.2	25	-172	48	-99	-66	-467	100	-433
Of which									
Value Added Type Taxes (VAT)	D.211	0	-131	140	9	-82	-394	205	-272
Taxes on Financial and Capital Transactions	D.214C	3	-31	-25	-53	-3	-24	-45	-72
Current Taxes on Income, Wealth, etc.	D.5	-12	-10	-108	-130	-47	-165	-106	-317
Of which									
Taxes on Individual or Household Income	D.51M	-8	30	43	65	-12	-70	42	-40
Taxes on the income or profits of Corporations	D.51O	-4	-41	-148	-192	-38	-94	-141	-273
Capital Taxes	D.91	0	-1	5	4	-1	-2	-2	-5
Social Contributions	D.61	-0	24	19	44	-18	-37	26	-30
Of which									
Employers' Actual Pension Contributions	D.611	31	11	9	52	-16	-16	8	-24
Households' actual social contributions	D.613	-31	13	18	-1	-2	-23	18	-7
Property Income	D.4			23	23			18	18
Other [(a)]				-161	-161			-79	-79
7. **Total Expenditure**	TE		**3**	**26**	**29**		**-7**	**655**	**647**
Of which									
Compensation of employees	D.1			-18	-18			-1	-1
Intermediate Consumption	P.2			9	9			166	166
Social Payments	D.6		3	-34	-31		-7	45	38
Of which									-7
Unemployment expenditure			3		3		-7		-7
Interest Expenditure	D.41			-7	-7			-5	-5
Subsidies	D.3			143	143			447	447
Gross Fixed Capital Formation	P.51			-98	-98			0	0
Capital Transfers	D.9			41	41			-10	-10
Other [(b)]				-10	-10			12	12

Notes:

[(a)] P.11 + P.12 + P.131 + D.39rec + D.7rec + D.9rec (other than D.91rec).

[(b)] D.29 + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

During 2020, the general Government recorded a deficit of €1,300.2 million, compared to the estimated deficit of €951.9 million outlined in the 2020 Update of the Stability Programme. These developments reflected a more subdued than anticipated revenue outcome, which turned out €319.3 million lower than expected, as well as marginally higher general Government expenditure, which was €28.9 million higher than estimated.

'Other revenue' turned out €160.9 million lower than expected, reflecting lower-than-expected market output, which was €127 million short of expectations, as well as lower than planned absorption of EU funds and other current transfers. Lower than estimated proceeds were also recorded from current taxes on income and wealth, which declined by 8 per cent over 2019 levels, in spite of expectations that this revenue component would have remained relatively stable in 2020. The shortfall resulted from stronger behavioural reactions observed in 2020 for proceeds from taxes on profits, which was more sensitive to the economic cycle than estimated in spring 2020, as well as due to the severity of the downturn on profits, whose impact was more pronounced compared to estimates in earlier forecasts. In addition, in June 2020, the tax rate associated with sales of property was reduced, as a result of which revenue from taxes on holding gains for both households and corporations was lower than estimated in spring 2020. Revenue from taxes on production and imports yielded €99 million less revenue than was forecast in the 2020 Update of the Stability Programme. This component of revenue was largely affected by more subdued developments in tourist expenditure than anticipated, together with weaker than expected consumption by domestic households. In addition, economic regeneration measures announced in June 2020, including the reduction in the stamp-duty on the transfer of residential property and the wider coverage of the first-time buyer scheme resulted in additional loss of revenue from taxes on production and imports. Meanwhile, higher-than-estimated revenue from social contributions of €44 million is in part due to Government support measures, particularly those aimed at sustaining employment, which mitigated the severity of the downturn on compensation of employees, compared to the drop in output.

Meanwhile, higher than targeted expenditure on subsidies and capital transfers was in part offset by lower than planned expenditure on gross fixed capital formation, social payments and compensation of employees. Expenditure on subsidies was €143 million higher than targeted in the 2020 Update of the Stability Programme, reflecting the extension of the COVID-19 Business Assistance Programme, which includes the wage supplement scheme, beyond the timeframes envisaged in spring 2020, as well as the Economic Regeneration Voucher Scheme announced in June 2020. Meanwhile, lower than expected gross fixed capital formation of €98 million was mainly on account of a lower than planned absorption of EU-financed expenditure than was planned in the 2020 Update of the Stability Programme.

3.2 Budgetary plans for 2021

The outlook for 2021 is highly contingent on the economic recovery in Malta's trading partners, the persistence of supply disruptions due to the severity of the economic shock as well as the speed at which the confidence and behaviour of domestic consumers and firms will return to normality. Updated budgetary plans for 2021 assume a modest economic recovery in 2021, in reflection of effective vaccine distribution developments, strong Government support, and a recovery in foreign incomes. Domestic demand is projected to be the main driver of this growth, with net exports acting as a slight headwind due to the global surge of infections throughout the first half of the year which weighs on tourism growth.

In spite of these assumed developments, the extension of the temporary social and economic support measures beyond the first quarter of 2021 and assistance to the national airline are expected to result in the general Government balance to worsen further in 2021, to a deficit of €1,630.4 million or 12.0 per cent of GDP. Indeed, the increase of 2.1 percentage points in the general Government expenditure ratio more than outweighs the expected marginal increase of 0.2 percentage points in the general Government revenue ratio.

On the assumption that restrictions are gradually eased during the year, the tax yield is expected to improve in tandem with the gradual economic recovery. Revenue from taxes is expected to increase by 5 per cent, benefitting from increased spending over the remainder of the year, as well as the 'base effect' of heavily impacted receipts last year, the assumed recovery in profits and the sustained positive performance of the labour market. General Government expenditure is expected to remain elevated and

Expenditure and Revenue Targets

(General Government expenditure and revenue targets, broken down by main components)

Table 3.2 % GDP

	ESA Code	2019	2020	2021	2022	2023	2024
General Government (S13)							
1. Total revenue target	TR	**37.2**	**36.5**	**36.7**	**36.6**	**36.2**	**35.7**
of which							
1.1. Taxes on production and imports	D.2	11.9	10.7	10.6	11.4	11.5	11.5
1.2. Current taxes on income, wealth, etc	D.5	13.4	13.2	13.0	13.0	12.8	12.8
1.3. Capital taxes	D.91	0.2	0.2	0.1	0.2	0.2	0.2
1.4. Social contributions	D.61	5.9	6.6	6.3	6.2	6.1	6.1
1.5. Property income	D.4	0.6	0.7	0.6	0.6	0.5	0.5
1.6. Other [1]		5.2	5.1	6.0	5.3	5.1	4.7
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[2]		31.5	30.7	30.3	30.9	30.7	30.6
2. Total expenditure target	TE	**36.8**	**46.6**	**48.7**	**42.2**	**40.1**	**38.6**
of which							
2.1. Compensation of employees	D.1	10.9	12.2	12.5	12.0	11.8	11.6
2.2. Intermediate consumption	P.2	7.2	9.5	9.9	8.5	8.2	7.9
2.3. Social payments	D.6M	9.1	10.5	10.4	9.8	9.6	9.5
of which Unemployment benefits [3]		0.1	0.2	0.2	0.2	0.2	0.2
2.4. Interest expenditure	D.41	1.3	1.3	1.2	1.1	1.1	1.1
2.5. Subsidies	D.3	1.4	5.0	4.3	1.6	1.5	1.4
2.6. Gross fixed capital formation	P.51	3.9	4.5	5.4	4.7	4.6	4.0
2.7. Capital transfers	D.9	0.8	1.1	2.3	2.0	1.1	0.9
2.8. Other [4]		2.2	2.4	2.8	2.5	2.4	2.2
3. General Government Balance		**0.4**	**-10.1**	**-12.0**	**-5.6**	**-3.9**	**-2.9**
4. Primary Balance		**1.7**	**-8.8**	**-10.8**	**-4.5**	**-2.8**	**-1.8**

[1] P.10 + D.39rec + D.7rec + D.9rec (other than D.91rec).

[2] Tax revenue, including those collected by the EU and including an adjustment for uncollected taxes and social contributions D.995), if appropriate.

[3] Includes cash benefits (D.621 and D.624) and in kind benefits (D.632) related to unemployment benefits.

[4] D.29pay + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

increase by 11 per cent over the level recorded in 2020, as temporary economic support is expected to remain in place at least until the end of 2021, with support to AirMalta being extended also in 2022.

Table 3.2 presents the general Government expenditure and revenue targets, broken down by main components.

Discretionary measures

A list of the main discretionary measures underpinning the expenditure and revenue targets for 2021 is presented in Table 3.3. The net impact on the budget balance of temporary and permanent discretionary revenue measures for 2021 (including those implemented in previous budgets but which will still have an impact in 2021) is estimated at 0.03 per cent of GDP. Meanwhile, incremental discretionary expenditure measures (including those implemented in previous budgets but which will still have an impact in 2021), are expected to improve marginally the budget balance of 2021 by 0.1 per cent of GDP, as some of the extraordinary measures implemented in 2020 are not expected to remain in place in 2021, while additional measures are planned to assist the recovery from the adverse effects of the pandemic.

The 2021 Budget aims to continue to sustain the economic recovery, post pandemic, safeguard employment, ensure social protection and invest in sustainable development. The 2021 Budget will keep assisting companies to retain employment, bolstering their investment initiatives and helping start-ups with the implementation of innovative technology projects. Initiatives in this context include the extension of the economic regeneration initiatives in place in 2020 up to March 2021, including the wage supplement scheme and the re-issue of the economic regeneration vouchers, as well as an increase in the minimum threshold for Value Added Tax (VAT) exempt trading to reduce the administrative burden on Small and Medium-Sized Enterprises (SMEs) and through the extended concession on the stamp duty payable on the transfer of family businesses.

The 2021 Budget builds on previous years' initiatives aimed at reducing further the risk of poverty for the most vulnerable in society, by enhancing further the adequacy of pensions, a higher tax refund rate, a children's allowance supplement, a higher rate of supplementary assistance, whilst also addressing past injustices and assisting in the purchase of residential property by means of the extension of existing reduced stamp duty schemes.

In view of the Government's intention of achieving a carbon neutral economy by 2050, the 2021 Budget outlined initiatives that ensure that the environment, which is crucial for achieving sustained economic growth and a better quality of life, is indeed prioritised. These include measures incentivising the circular economy, by seeking circular consumption and production patterns, exploring waste prevention and management while ensuring the responsible re-use of resources and enhancing green procurement to safeguard the environment. These initiatives create opportunities to build a strong green economy and transform Malta into a modern, resource-efficient and competitive economy – in line with the European Green Deal vision.

By means of funds allocated in the 2021 Budget, the Maltese Government will continue to invest in Malta's infrastructure to be able to meet, both the current and the future economic, social and environmental challenges. Initiatives in this respect include the continuation of arterial road construction projects, as well as roads in residential and rural areas, the regeneration of ports and improvement of facilities for the maritime

Table 3.3

Discretionary measures adopted/announced according to the Programme[1]

	Measures	ESA Code (Expenditure / Revenue component)	Date of adoption	Budgetary Impact (% of GDP - change from previous year)					
				2019	2020	2021	2022	2023	2024
Temporary measures[2]	Reduced tax on the transfer of immovable property	D2, D5 - R	2020 - 2021	-0.00	-0.42	0.18	0.40	0.00	0.00
	Reduced Excise Duty	D2 - R	2020	0.00	-0.06	0.06	0.00	0.00	0.00
	Budget measures enabling business activity	D2 - R	2019 - 2021	-0.00	0.00	-0.06	0.00	0.00	0.00
	Fiscal incentives for private pensions	D5 - R	2019 - 2021	-0.01	-0.00	-0.03	0.00	0.00	0.00
	Various medical supplies and equipment in relation to COVID-19	P2 - E	2020 - 2021	0.00	-0.58	0.18	0.40	0.00	0.00
	Cargo Transportation and Repatriation	P2 - E	2020	0.00	-0.39	0.39	0.00	0.00	0.00
	Tourism Regeneration Plan	D3 - E	2021	0.00	0.00	-0.15	0.15	0.00	0.00
	Short Term Social Measures	D6 - E	2020	0.00	-0.11	0.10	0.02	0.00	0.00
	COVID-19 Business Assistance Programme and the Economic Regeneration Voucher Scheme	D3 - E	2020 - 2021	0.00	-3.33	0.80	2.53	0.00	0.00
	Subtotal			**-0.01**	**-4.89**	**1.46**	**3.51**	**0.00**	**0.00**
Non-temporary measures[2]	Revenue from the Individual Investor Programme	P10 - R	2014	-0.42	-0.22	-0.12	-0.06	-0.04	-0.04
	Government-guaranteed loans schemes	D3 - E	2020	0.00	-0.01	-0.08	0.02	0.07	0.00
	Housing Programmes	D6 - E	2020	0.00	-0.03	0.03	0.00	0.00	0.00
	Measures to address housing affordability, pension adequacy and the integration of vulnerable individuals in society; cash payments by Government to households	D6 - E	2016 - 2021	-0.27	-0.37	-0.12	0.08	0.06	0.05
	Financial support to the national airline	D9 - E	2021 - 2022	0.00	0.00	-1.03	0.05	0.98	0.00
	Other revenue measures, including measures legislated in previous budgets			-0.18	-0.04	0.01	-0.03	-0.02	-0.02
	Other expenditure measures, including measures legislated in previous budgets and projects financed from the National Development and Social Fund			0.05	-0.17	0.01	-0.04	-0.04	-0.00
	Subtotal			**-0.82**	**-0.83**	**-1.30**	**0.02**	**1.00**	**-0.01**
	Total			**-0.83**	**-5.73**	**0.16**	**3.53**	**1.00**	**-0.01**

[1] Excluding those measures that are planned to be financed by grants under the RRF.

[2] For the purpose of this table, temporary measures refer to those discretionary measures that have no budgetary impact beyond 2022, which corresponds to the end of the Commission spring 2021 forecast horizon. By contrast, those measures adopted or announced for 2020, 2021 or 2022 that continue to have a fiscal effect of 0.1 per cent of GDP or greater until at least 2023 are considered as 'non-temporary' for the purpose of this table.

sector, industrial infrastructure, the modernisation of health facilities, investment in higher education institutions and schools, sports facilities, and social housing.

Several policy measures which had been put in place to cushion the impact of the pandemic in 2020, were extended in 2021. In particular, in the case of companies and self-employed persons that suffer a significant downturn in their turnover and liquidity as a result of the economic constraints arising from the coronavirus pandemic, the settlement of provisional tax, social security contributions of self-employed persons and VAT falling due in August 2020 up to and including December 2021 was extended, such that eligible taxes may be settled from May 2022 with no interest or penalties charged. Both the COVID-19 Business Assistance Programme and the reduced tax rates applicable on the transfer of immovable property were also extended and widened in scope. In addition, new incentives underpinning the Tourism Recovery Plan are in place to support the tourism industry, which was severely hit by the pandemic.

In terms and for the purposes of Article 31 of the Fiscal Responsibility Act, the annual contribution to the 'Contingency Reserve' account is expected to amount to €13.3 million in 2021.

2021 Expenditure and Revenue Targets

While the revenue to GDP ratio is expected to recover sightly in 2021, the expenditure ratio to GDP is expected to increase further in 2021, such that the general Government balance is expected to worsen to -12.0 per cent of GDP.

Total revenue is expected to increase by 0.2 percentage points to 36.7 per cent of GDP in 2021. In spite of the expected increase in taxation revenue, which will be broad-based and supporting a partial recovery across both direct and indirect taxes, the aggregate tax yield is forecast to increase at a lower rate than nominal GDP growth over the same period. As a result, the ratio to GDP of all components of tax revenue is expected to be lower in 2021, when compared to the shares in the previous year. Meanwhile, non-tax revenue is expected to increase, particularly 'other' revenue, reflecting higher capital transfers and investment grants receivable.

The ratio of general Government expenditure to GDP is expected to increase by 2.1 percentage points to 48.7 per cent in 2021, largely reflecting higher capital outlays, including the assistance to the national airline.

3.2.1 Comparison with the 2020 Update of the Stability Programme for 2021

The final outcome in 2020, the evaluation of general Government budgetary developments during the current year, as well as the revised macroeconomic projections, constitute the basis for the revised projections. In addition, revisions also reflect fiscal policy measures put in place to cushion the economic impact of the COVID-19 pandemic on revenues, incomes and liquidity, the extension of some of these measures beyond their original deadline and other additional measures for the current year, as well as the fiscal impact of the measures underlying the 2021 Budget. Table 3.1b distinguishes the changes to the 2021 forecasts between successive reports due to the impact of the actual outturn in 2020 (base effect), macroeconomic determinants, and other changes.

During 2021, the general Government is expected to record a deficit of €1,630.4 million, compared to the estimated deficit of €485.6 million outlined in the 2020 Update of the Stability Programme. These developments reflect a more subdued than anticipated revenue outcome in 2020, which turned out €253 million lower than expected, as well

General Government Budgetary Prospects in 2021

Divergence from previous forecasts

Table 3.1b — € millions

	ESA Code	USP 2020 compared to USP 2021				DBP 2020 compared to USP 2021			
		Divergence due to out-turn in *t-1*	Divergence due to updated macro-economic projections	Other revisions	**Total forecast revision**	Divergence due to out-turn in *t-1*	Divergence due to updated macro-economic projections	Other revisions	**Total forecast revision**
Net lending (+)/net borrowing (-)									
1. **General Government**	S.13	**-253**	**-92**	**-799**	**-1,145**	**-848**	**-153**	**-849**	**-1,850**
2. Central Government	S.1311	-253	-92	-799	-1,145	-848	-153	-849	-1,850
3. State Government	S.1312	-	-	-	-	-	-	-	-
4. Local Government	S.1313	0	0	0	0	0	0	0	0
5. Social Security funds	S.1314	-	-	-	-	-	-	-	-
For the General Government									
6. **Total Revenue**	TR	**-253**	**-90**	**92**	**-251**	**-848**	**-122**	**128**	**-843**
Of which									
Taxes on Production and Imports	D.2	-113	-33	-3	-149	-461	-6	-5	-472
Of which									
Value Added Type Taxes (VAT)	D.211	10	-41	-13	-44	-292	-6	-11	-309
Taxes on Financial and Capital Transactions	D.214C	-71	2	21	-48	-79	-5	12	-72
Current Taxes on Income, Wealth, etc.	D.5	-191	-43	77	-156	-350	-87	56	-381
Of which									
Taxes on Individual or Household Income	D.51M	76	-2	-13	61	-44	-38	-2	-83
Taxes on the income or profits of Corporations	D.51O	-263	-40	90	-213	-304	-48	56	-296
Capital Taxes	D.91	-3	2	-1	-1	-5	-0	-5	-11
Social Contributions	D.61	54	-17	-6	31	-32	-28	-6	-66
Of which									
Employers' Actual Pension Contributions	D.611	55	-8	4	51	-26	-13	5	-34
Households' actual social contributions	D.613	-1	-9	-14	-24	-7	-16	-13	-36
Property Income	D.4			15	15			2	2
Other [(a)]				10	10			86	86
7. **Total Expenditure**	TE		**2**	**892**	**894**		**31**	**977**	**1,008**
Of which									
Compensation of employees	D.1			84	84			49	49
Intermediate Consumption	P.2			119	119			207	207
Social Payments	D.6		2	22	24		31	3	34
Of which									
Unemployment expenditure			2		2		31		31
Interest Expenditure	D.41			-26	-26			-16	-16
Subsidies	D.3			375	375			376	376
Gross Fixed Capital Formation	P.51			72	72			149	149
Capital Transfers	D.9			178	178			149	149
Other [(b)]				68	68			59	59

Notes:

[(a)] P.11 + P.12 + P.131 + D.39rec + D.7rec + D.9rec (other than D.91rec).

[(b)] D.29 + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

as more subdued estimated macro-economic developments in 2021. These are expected to be in part offset by the expected behavioural responses in respect to the relative tax bases, as well as the revised fiscal impact of fiscal policy measures. The principal revisions compared to the estimates outlined in the 2020 Update of the Stability Programme relate to current taxes on income and wealth and to taxes on production and imports. For the most part, these revisions are related to the lower than anticipated outturn in 2020.

Meanwhile, higher than targeted expenditure compared to the estimates outlined in the 2020 Update of the Stability Programme of €894 million is mainly towards subsidies,

capital transfers and intermediate consumption. Higher than estimated expenses primarily relate to outlays on the COVID-19 Business Assistance Programme and the Economic Regeneration Voucher Scheme for 2021, the financial assistance to the national airline, and added outlays towards the health sector beyond what was envisaged in spring 2020, respectively.

3.3 The Medium-Term Budgetary Outlook, Structural Budget Balance and the Medium-Term Budgetary Objective

While the level of uncertainty regarding the short- and medium-term path for the economy is unprecedented, cognisant of the positive bearing that fiscal consolidation and sustainable debt levels have on potential growth, the Government will continue to prioritise fiscal consolidation once the pandemic is over. The Maltese Government remains committed to put the debt-to-GDP ratio back on a declining path once the recovery is firmly established, and the extraordinary fiscal support introduced during the crisis is lifted. Indeed, it is the express view of the Government that once these exceptional circumstances cease to prevail, the Government will support a fiscal strategy to revert to the Medium-Term Objective of a balanced budget in structural terms and ensure that the debt ratio declines below 60 per cent of GDP.

Indeed, provided that the macroeconomic projections underlying this Programme materialise, the budget balance is expected to improve to a deficit of 2.9 per cent of GDP by 2024. In structural terms, the general Government deficit is expected to improve from 9.6 per cent in 2021 to 3.0 per cent by 2024. As a result of the prudent approach adopted in pre-COVID budgets, the economy can absorb a short-term increase in borrowing, especially considering that financing conditions remain favourable. It is worth noting that in view of the current level of economic uncertainty, projections for 2022 to 2024 are technical in nature and in particular are not inclusive of any specific additional policy measures in respect of COVID-19 or other budgetary expenditure. These estimates are indicative in nature and are set for review to take into account the situation post-pandemic and the overall fiscal strategy. An analysis of the developments in the general Government balance is presented in Table 3.4, while further details on the cyclical developments over the medium-term are illustrated in Table 3.5 and Chart 3.1.

The assumed economic recovery is expected to boost taxation receipts over the course of the next year and, by end-2022, tax revenue is estimated to exceed the level that was recorded prior to the pandemic. Indirect taxes are expected to be the main drivers, as consumer spending is expected to rebound strongly next year. In contrast, the direct taxation yield is projected to increase more modestly. Over the remainder of the forecast horizon, the aggregate tax yield is forecast to increase at an annual average rate of 5.9 per cent, slightly below the assumption for nominal GDP growth over the same period.

General Government expenditure is estimated to decline by 5.6 per cent in 2022, as the temporary support is expected to be eased as the public health situation improves and the economy recovers from the exceptional impact of the pandemic. Over the outer years of the forecast period, the growth in general Government expenditure is expected to turn positive and is forecasted to increase at an annual average rate of 1.8 per cent, to an extent reflecting developments in overall price levels in the economy.

The Recovery and Resilience Facility (RRF) lies at the heart of the EU's response to COVID-19. Work is ongoing in finalising the national Recovery and Resilience Plan (RRP) setting out reforms and investments to be supported by the facility. Projected receipts

Analysis of the Developments in the General Government Balance

(percentage points)

Table 3.4

	2019	2020	2021	2022	2023	2024
Change in Revenue Ratio	**(1.11)**	**(0.72)**	**0.22**	**(0.06)**	**(0.41)**	**(0.52)**
Discretionary measures underpinning fiscal developments	(0.61)	(0.74)	0.03	0.31	(0.06)	(0.06)
Tax revenue buoyancy	(0.27)	(0.25)	(0.66)	0.24	(0.15)	(0.04)
Other revenue	(0.22)	0.27	0.85	(0.61)	(0.19)	(0.43)
Change in Expenditure Ratio	**(0.44)**	**(9.79)**	**(2.08)**	**6.48**	**2.08**	**1.54**
Discretionary measures underpinning fiscal developments	(0.27)	(5.16)	0.09	3.24	1.08	0.06
Change in Gross Fixed Capital Formation	(0.61)	(0.59)	(0.84)	0.80	0.14	0.52
Other expenditure	0.44	(4.03)	(1.34)	2.44	0.86	0.95
Change in the General Government Balance	**(1.54)**	**(10.51)**	**(1.86)**	**6.42**	**1.67**	**1.01**

Note: positive represents an improvement in the general Government balance

Cyclical Developments

(percentage points of GDP)

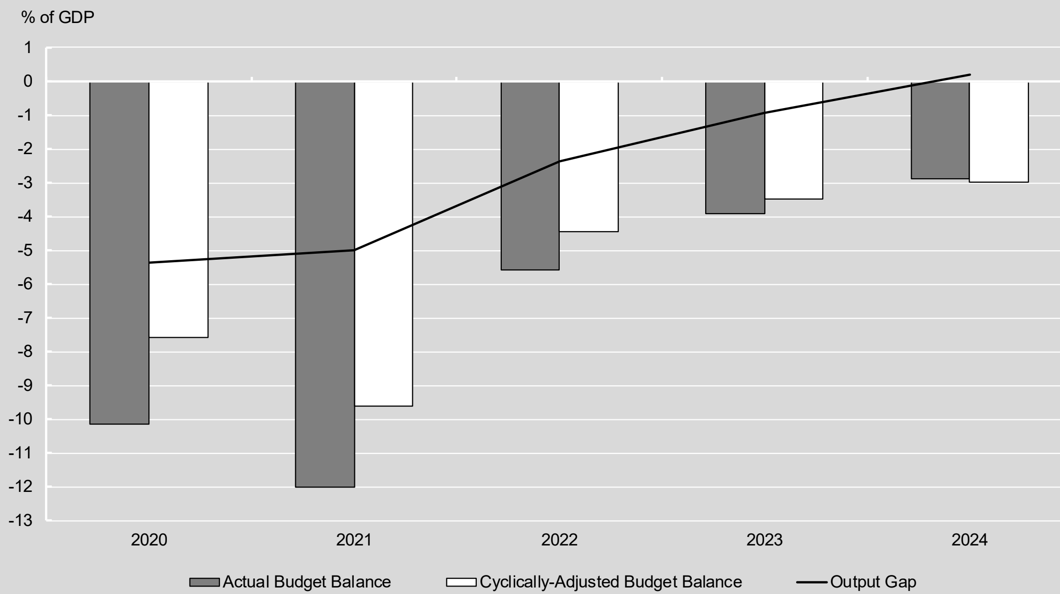
Table 3.5

	ESA Code	2019	2020	2021	2022	2023	2024
Net lending (+) / net borrowing (-) by sub-sector [1]	B.9						
1. General Government Balance	S.13	0.4	-10.1	-12.0	-5.6	-3.9	-2.9
2. Central Government	S.1311	0.3	-10.2	-12.0	-5.6	-3.9	-2.9
3. State Government	S.1312	-	-	-	-	-	-
4. Local Government	S.1313	0.0	0.1	-0.0	-0.0	-0.0	-0.0
5. Social security funds	S.1314	-	-	-	-	-	-
6. Interest expenditure	D.41	1.3	1.3	1.2	1.1	1.1	1.1
7. Primary balance [2]		1.7	-8.8	-10.8	-4.5	-2.8	-1.8
8. One-off and other temporary measures [3]		0.0	0.0	0.0	0.0	0.0	0.0
9. Real GDP growth (%)		5.5	-7.1	3.8	6.9	4.5	4.0
10. Potential GDP growth (%)		5.0	2.8	3.4	3.9	3.0	2.8
11. Output gap (% of potential GDP)		4.6	-5.4	-5.0	-2.4	-0.9	0.2
12. Cyclical budgetary component (% of potential GDP)		2.2	-2.6	-2.4	-1.1	-0.4	0.1
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		-1.8	-7.6	-9.6	-4.4	-3.5	-3.0
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		-0.5	-6.2	-8.4	-3.3	-2.4	-1.9
15. Structural balance (13 - 8) (% of potential GDP)		-1.9	-7.6	-9.6	-4.5	-3.5	-3.0

[1] TR-TE= B.9.

[2] The primary balance is calculated as (B.9) plus (D.41, item 6).

[3] A plus sign means deficit-reducing one-off measures.



and expenditure financed from the RRF are outlined in Appendix Tables 9a and 9b. It is worth noting that projected revenue from RRF grants, including estimates of cash disbursements of RRF grants from the EU, is incorporated on a technical basis in amounts equivalent to projected expenditure.

Expenditure and Revenue Targets under the No-Policy Change Assumption

General Government expenditure and revenue targets under a no-policy-change assumption are outlined in Table 3.2a.

As outlined, no additional discretionary revenue measures are factored into the projections for 2022 onwards, such that tax revenues are expected to broadly follow economic developments, as general Government revenue is expected to grow by around 6.3 per cent annually, with growth being frontloaded in 2022. As a result, on a no-policy change basis, the tax burden would average 30.7 per cent of GDP, similar to the level recorded in 2020.

At unchanged policies, total expenditure would have declined more swiftly in 2022, however over the medium-term, the difference is largely insignificant, and primarily reflects expenditure towards projects financed from the National Development and Social Fund.

3.4 Debt levels and developments

Malta's debt-to-GDP ratio had fallen below the 60 per cent Treaty reference value in 2015 and kept on declining ever since, reaching a debt-to-GDP ratio of 42.0 per cent in 2019. The general Government debt was 12.3 percentage points higher by the end of 2020, reaching 54.3 per cent, reflecting the impact of the COVID-19 pandemic and the

Expenditure and Revenue Projections under the no-policy change scenario [1]
(General Government expenditure and revenue projections at unchanged policies broken down by main components)

Table 3.2a — % GDP

	ESA Code	2019	2020	2021	2022	2023	2024
General Government (S13)							
1. Total revenue at unchanged policies	TR	**37.2**	**36.5**	**36.7**	**36.6**	**36.2**	**35.7**
of which							
1.1 Taxes on production and imports	D.2	11.9	10.7	10.6	11.4	11.5	11.5
1.2 Current taxes on income and wealth	D.5	13.4	13.2	13.0	13.0	12.8	12.8
1.3 Capital taxes	D.91	0.2	0.2	0.1	0.2	0.2	0.2
1.4 Social contributions	D.61	5.9	6.6	6.3	6.2	6.1	6.1
1.5 Property income	D.4	0.6	0.7	0.6	0.6	0.5	0.5
1.6 Other revenue [2]		5.2	5.1	6.0	5.3	5.1	4.7
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[3]		31.5	30.7	30.3	30.9	30.7	30.6
2. Total expenditure at unchanged policies	TE	**36.8**	**46.6**	**48.7**	**43.5**	**40.4**	**38.8**
of which							
2.1 Compensation of employees	D.1	10.9	12.2	12.5	12.0	11.8	11.6
2.2 Intermediate consumption	P.2	7.2	9.5	9.9	8.5	8.2	7.9
2.3 Social payments	D.6M	9.1	10.5	10.4	9.9	9.7	9.6
of which U*nemployment benefits* [4]		0.1	0.2	0.2	0.2	0.2	0.2
2.4 Interest expenditure	D.41	1.3	1.3	1.2	1.1	1.1	1.1
2.5 Subsidies	D.3	1.4	5.0	4.3	1.7	1.5	1.4
2.6 Gross fixed capital formation	P.51	3.9	4.5	5.4	4.7	4.7	4.1
2.7 Capital Transfers Payable	D.9	0.8	1.1	2.3	3.0	1.1	0.9
2.8 Other expenditure [5]		2.2	2.4	2.8	2.5	2.4	2.3
3. General Government Balance		**0.4**	**-10.1**	**-12.0**	**-6.8**	**-4.1**	**-3.1**
4. Primary Balance		**1.7**	**-8.8**	**-10.8**	**-5.7**	**-3.0**	**-2.0**

[1] Data for 2019-2021 is equivalent to the data presented in Table 4.a. The no-policy change scenario for the forthcoming year (2022) onwards involves the extrapolation of revenue and expenditure trends after deducting the impact of temporary measures of the current year and before adding the impact of the measures included in the forthcoming year's budget.

[2] P.10 + D.39rec + D.7rec + D.9rec (other than D.91rec).

[3] Tax revneue, including those collected by the EU and including an adjustment for uncollected taxes and social contributions D.995), if appropriate.

[4] Includes cash benefits (D.621 and D.624) and in kind benefits (D.632) related to unemployment benefits.

[5] D.29pay + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

subsequent Government measures set to mitigate the economic, social and health risks associated with it. In spite of this, Malta continues to be amongst the Member States with the lowest debt ratio in the Euro Area. The level of public debt relative to GDP is expected to increase further to 65.0 per cent by 2021 and is forecasted to remain above the Maastricht reference value of 60 per cent by the end of the projected period at 65.6 per cent of GDP in 2024. Nevertheless, once the exceptional circumstances will be withdrawn and the Maltese economy will start its recovery path, the Government will aim to reduce the debt ratio below 60 per cent of GDP in line with the fiscal rules enshrined in the Fiscal Responsibility Act and the Stability and Growth Pact.

The Dynamics of Government Debt[1]

Table 3.6

Percentages of GDP	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
Gross debt	42.0	54.3	65.0	65.8	66.0	65.6
Change in gross debt ratio	-2.9	12.3	10.7	0.8	0.3	-0.5
Contributions to changes in gross debt						
Primary balance	-1.7	8.8	10.8	4.5	2.8	1.8
Snowball Effect	-2.0	3.8	-1.9	-4.2	-3.0	-2.8
Interest expenditure	1.3	1.3	1.2	1.1	1.1	1.1
Real GDP growth	-2.3	3.2	-2.0	-4.2	-2.8	-2.5
Inflation Effect	-1.0	-0.7	-1.0	-1.1	-1.3	-1.3
Stock-flow adjustment	0.8	-0.3	1.8	0.5	0.5	0.5
p.m. implicit interest rate on debt	3.2	3.0	2.3	1.9	1.8	1.7

[1] Developments in the debt- to-GDP ratio depend on: $\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} \cdot \frac{i_t - y_t}{1 + y_t}\right) + \frac{SFA_t}{Y_t}$

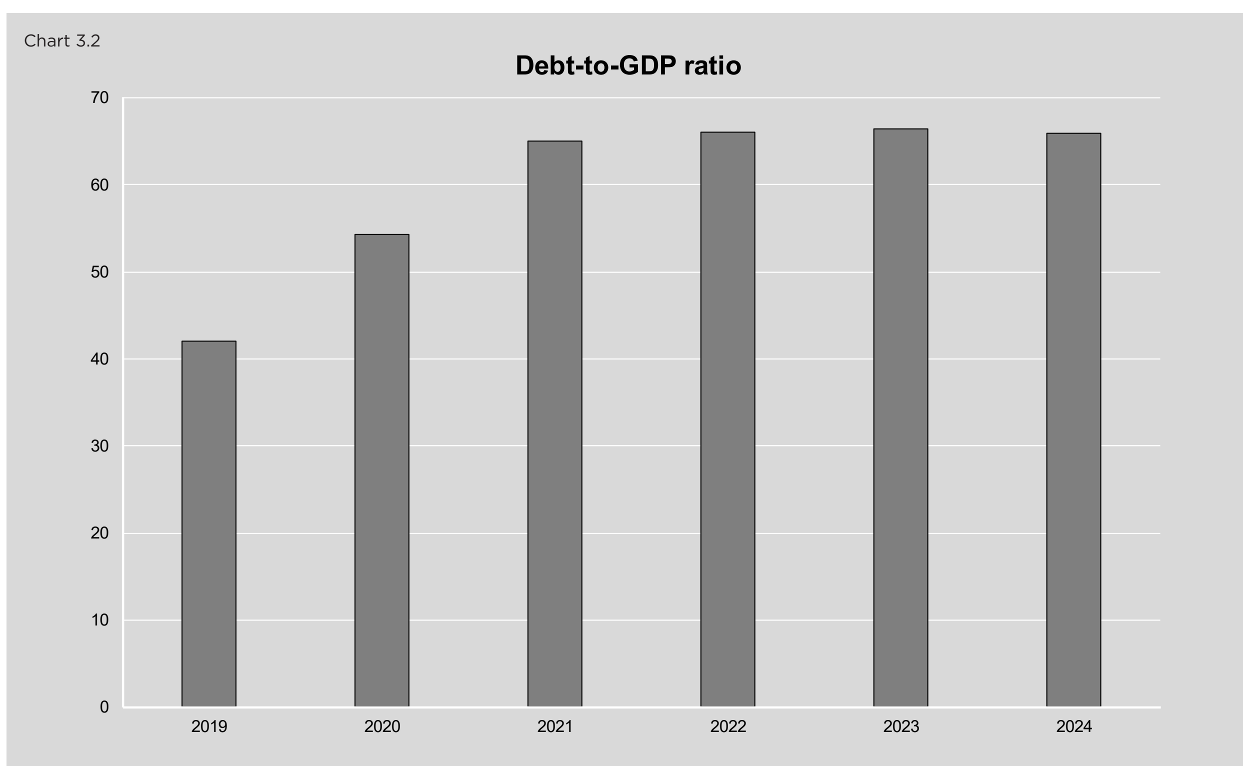
where t denotes a time subscript, D, PD, Y and SFA are the government debt, primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth.

During 2020, short-term debt accounted for 8.4 per cent of total Government debt and is expected to increase to 8.9 per cent in 2021. Short-term debt funding is predicted to stabilise in the following years and reach 6.2 per cent in 2024. Additionally, the share of maturing stocks in total Government debt is expected to decrease from a level of 6.6 per cent in 2020 to 5.2 per cent in 2021 and is projected to remain on a downward trajectory, with the ratio reaching 3.6 per cent in 2024.

3.4.1 Projected Debt developments

Debt Developments depend on the net lending which can be decomposed into the primary balance and interest expenditure, GDP growth and the stock flow (deficit-debt adjustment), which captures those transactions or factors that influence government debt but are not reflected in the government balance and is thus made up of financial transactions and accruals that do not affect lending. Developments in the debt ratio for the Programme period and the contributors to developments in the debt-to-GDP ratio are presented in Table 3.6 and Statistical Appendix Table 4.

General Government debt increased by €1,257.2 million over 2019 and stood at €6,960.0 million in 2020. Coupled with a decrease in GDP, the debt-to-GDP ratio for 2020 increased to 54.3 per cent. This, mainly on the back of the negative primary balance together with an expansionary contribution stemming from the nominal growth and interest expenditure. The debt ratio is forecasted to increase by 10.7 percentage points in 2021 and by a further 0.8 percentage points to reach 65.8 per cent of GDP in 2022, continuing on an upward trend in 2023 and marginally declining to 65.6 in 2024. Developments in the gross Government debt are illustrated in Chart 3.2. The expected rise in the debt-to-GDP ratio over the medium-term horizon is mainly driven by the negative primary



balances (primary deficit) together with an expansionary contribution stemming from the stock-flow adjustment and interest expenditure which is expected to moderate throughout the forecast horizon, from 1.3 per cent of GDP in 2020 to 1.1 per cent of GDP throughout 2022 to 2024.

For 2020, a stock flow adjustment (SFA) of -0.3 per cent of GDP was recorded suggesting the debt increased by less than implied by the 10.1 per cent deficit. SFA in 2020 was lower than anticipated mainly as a result of higher volume of consolidations, lower ESA rerouted debt, lower contributions to the Special MGS Sinking Fund and the end of year adjustment for Court and Other Deposits. In 2021, stock flow transactions are expected to have a positive impact of 1.8 per cent on the debt ratio while beyond 2021, stock flow transactions are expected to stabilise to 0.5 per cent. The positive SFA in 2021 is mainly underpinned by the equity acquisitions and the tax deferral schemes which are not included in the central Government deficit on a cash basis. Further details on the SFA can be found in Annex Table 10.

3.4.2 Comparison with the Debt Projections Published in the 2020 Update of the Stability Programme

As illustrated in the Statistical Appendix Table 6, the ratios of general Government debt-to-GDP presented in this programme are expected to be broadly the same up till 2020 but differ substantially for the coming year to the ratio presented in the previous Update of the Stability Programme. Debt-to-GDP ratios presented in this update are higher mainly due to higher projected primary deficits.

For 2020, the debt-to-GDP ratio was revised marginally downwards by 0.2 percentage points to 54.3 per cent of GDP while debt-to-GDP ratios for 2021 was revised upwards by 9.5 percentage points.

In the 2020 Update, the debt-to-GDP ratio was expected to follow an upward path from a level of 54.5 per cent in 2020 to a level of 55.5 per cent in 2021. On the other hand, in this Update of the Stability Programme, the debt-to-GDP ratio is estimated to rise to a ratio of 65.0 per cent by 2021, reaching 65.6 per cent by 2024. These revisions primarily relate to the extension of fiscal support measures, a stronger negative effect of the COVID-19 pandemic on economic activity in 2020 and a weaker than expected economic recovery in 2021.

4. Sensitivity Analysis

4. Sensitivity Analysis

The accuracy of macroeconomic forecasts is essential, especially in the case of a small and open economy like Malta. Gross Domestic Product (GDP) forecast errors have historically proved to be relatively higher for Malta than for larger and less open economies within the European Union (EU). This is also a reflection of the significant structural change which the Maltese economy has experienced in the last few years.

The macroeconomic forecast presented in Chapter 2 contains the baseline forecast. It is a contingent forecast based on several exogenous assumptions regarding the evolution of a number of variables. Since some of these variables have a significant impact on our macroeconomic projections, a sensitivity analysis of relevant variables underlines the risk assessment of the baseline macroeconomic forecasts.

This chapter seeks to provide an assessment of forecast certainty and the balance of risk surrounding the macroeconomic forecasts in this Programme. The analysis is in line with the requirements of the Council Directive 2011/85/EU of the EU on the requirements for budgetary frameworks of the Member States.

4.1 The Accuracy of Past Forecasting Performance

The updated analysis on the accuracy of past forecasting performance as completed by the Economic Policy Department (EPD) within the Ministry for Finance and Employment (MFE) shows a tendency to underestimate GDP growth and hence a downward bias in the GDP growth projections in previous years. This is partly due to persistently upward statistical revisions in the releases of National Accounts and Balance of Payments data. While the one-year ahead forecasts display a Root-Mean Squared Error (RMSE) of 4.71, it is notable that the sample size employed is rather small and that the earliest forecast available is that of 2004. The recession of 2009, the strong subsequent recovery, the unprecedented 2020 pandemic and the considerable statistical revisions which frequently occur, had a significant influence on this evaluation in such a limited sample and limit comparability with the forecast accuracy displayed by other economies with a longer tradition of forecasts. It is noteworthy that over successive vintages of forecasts, the RMSE has widened, mainly due to the relatively large forecast errors in 2014, 2015 and 2017 which are symptomatic of significant upward revisions in the National Accounts data.

The evaluation of the risk and uncertainty of the current macroeconomic projections underlying this Programme is based on an ex ante analysis of past forecast errors which determine the level of uncertainty. Ex post, a number of alternative but plausible economic scenarios generated with the forecasting model used by the EPD are also simulated to determine the balance of risks surrounding the baseline projections.

4.2 The Balance of Risks

To determine the balance of risks surrounding macroeconomic forecasts, seven alternative model-based growth projections were carried out as follows:

1. Improved global economic growth based on the upper bound of the Consensus Forecasts.

2. Weaker global economic growth based on the lower bound of the Consensus Forecasts.
3. Higher interest rate scenario resulting in a steepening of the yield curve, reflecting rising inflation expectations and a reluctance to hold fixed income assets due to heightened economic uncertainty.
4. More upbeat tourism outlook for 2021, assuming a rapid and more effective vaccination campaign in Malta and abroad, leading to a prompt easing of restrictive measures on mobility and travel. This scenario considers the possibility that slightly higher inbound tourism than anticipated in the baseline scenario would ensue in the second half of 2021.
5. Downside tourism scenario for 2022, reflecting the risk that COVID-19 persists, with more contagious variants and a slow and ineffective global roll-out of vaccinations, having a negative effect on consumer sentiment. This would result in lower inbound tourism for 2022 than expected in the baseline.
6. Higher investment scenario, which assumes that a number of planned investment projects are pursued throughout 2021 supported by a more certain outlook, low financing costs and supportive policies.
7. Structurally lower consumption scenario, in which uncertainty and weak consumer confidence prevail in 2022, sustaining a high level of precautionary savings.

These represent scenarios that are plausible alternatives to the baseline projections. While economic judgement influences the choice of these scenarios, this judgement is also underpinned by the constant monitoring of economic conditions prevailing at the time and also informed by the various meetings with economic stakeholders and regulators operating within the Maltese economy, carried out in the early stages of the forecasting exercise.

Among the alternative forecasts, a more detailed description is provided for the alternative growth and interest rate scenarios as required by the Directive. In the light of the prevailing uncertainty surrounding the global economy, two contrasting growth scenarios are modelled.

4.2.1 Improved Global Economic Growth

In this scenario, the growth rates of Malta’s key trading partners are assumed to be higher than originally anticipated in the baseline scenario, where the global growth rate increases by 1.3 percentage points in 2021, and by 1.2 percentage points in 2022. The outer years are left unchanged from the baseline scenario. The relatively higher than expected economic growth in Germany, France, Italy, the United Kingdom (UK), and the United States (US) is based on the Consensus Forecasts of March 2021, assuming the most optimistic growth figure for each trading partner for the forecast years 2021 and 2022.

The outcome of this scenario is a marginal upward revision to the budget balance in 2021, while real GDP growth would be revised upwards by 0.7 percentage points. In 2022, real GDP growth would increase by 0.8 percentage points more than in the baseline scenario, while the budget balance would improve by 0.2 percentage points. Real GDP growth would improve by 0.2 percentage points in 2023 and decline by 0.1 percentage point in 2024, and the budget balance increases by 0.3 percentage points in both outer years.

4.2.2 Weaker Global Economic Growth

This scenario models the downside risk of a deterioration in the international economic outlook relative to the baseline forecast. It assumes a weakening in external demand equivalent to 1.3 percentage points in 2021, and a decline of 1.8 percentage points in 2022. The relatively lower than expected growth projections for Germany, Italy, France, the UK, and the US are based on the Consensus Forecasts March 2021 publication, assuming the lowest plausible growth figures for each trading partner.

The deterioration in world demand mainly contributes to a reduction in the demand for Maltese exports, which is more pronounced than the decline in imports, resulting in a real GDP growth decline of 0.7 percentage points in 2021 from the baseline scenario, followed by a decline of 1.0 percentage point in 2022. Real GDP growth would decline by 0.3 percentage points in 2023 and is unaffected in 2024. The budget balance is projected to decrease by 0.1 and 0.2 percentage points in 2021 and 2022 respectively, and then to further decline by an average of 0.4 percentage points in the outer years.

4.2.3 Interest Rate Scenario

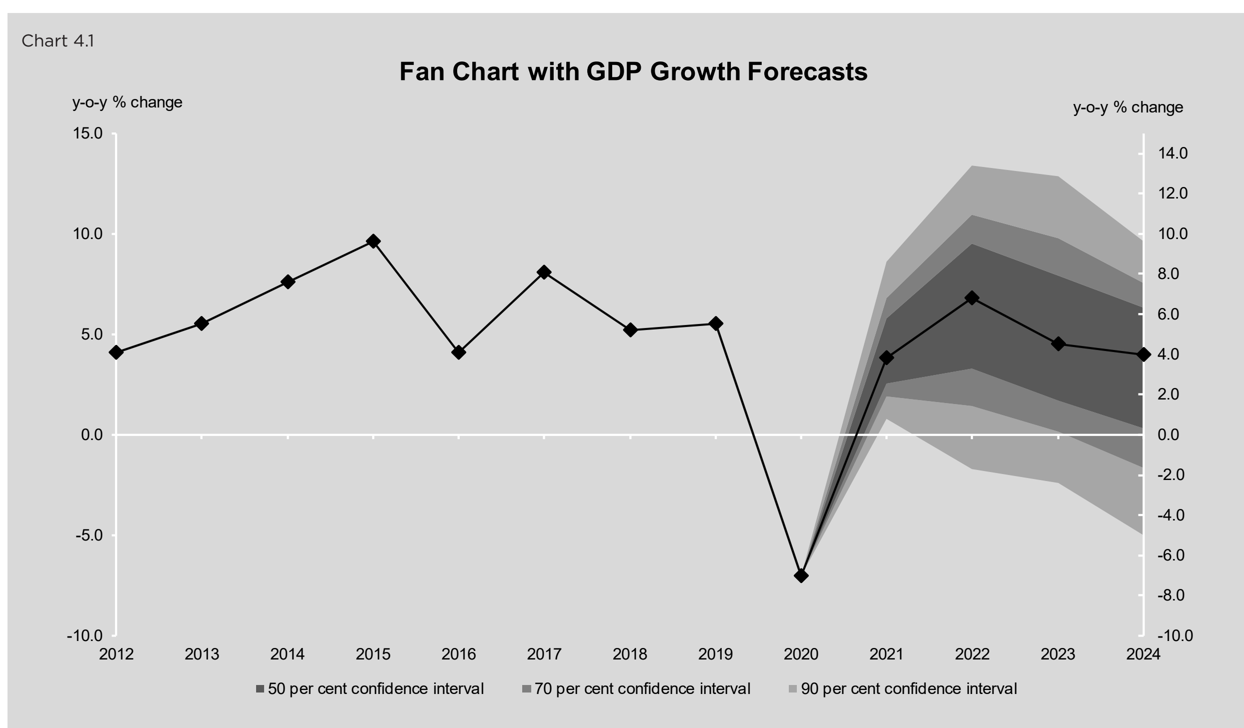
This scenario assumes that long-term interest rates increase by 25.0 basis points in 2021 and will be held fixed throughout the forecast horizon, thereby steepening the yield curve compared to the baseline scenario. This scenario attempts to reflect an increase in inflationary expectations, and a reluctance of investors to hold fixed income assets due to heightened uncertainty on medium-term growth prospects. The effect of this scenario would be a decline in real investment growth leading to a decline of 0.1 and 0.2 percentage points in real GDP growth in 2021 and 2022 respectively. The budget balance is virtually unchanged in both years. Real GDP growth would decline by 0.1 percentage point from the baseline in 2024. The budget balance would only deviate from the baseline in 2024, declining by 0.1 percentage point.

4.3 Alternative Model Forecasts

Six alternative forecasting models were also developed, ranging from model-free statistical forecast (Random Walk and Holt-Winters Seasonal Smoothing Method), model-based univariate forecasts (2 ARIMA models) and model-based multivariate forecasts (2 VAR models and one VECM model). These models help MFE benchmark the results inferred from STEMM and can be used to generate alternative growth forecasts. Of special interest are the two VAR models, one which is demand driven with exogenous assumptions and one which is mainly supply driven based on employment and prices. The former is closest to the Keynesian-type baseline model while the latter captures better supply side conditions which in recent years have predominantly determined growth conditions in the Maltese economy.

On average, these models collectively suggest a slightly lower GDP growth for 2021 of 2.5 per cent, but the average of the VAR models alone point towards a higher growth of 4.3 per cent. The latter is marginally more optimistic, albeit very close to the baseline forecast. Economists at the MFE chose to be purposely conservative in the baseline forecast in view of the uncertain developments ahead. In fact, the alternative models provide a wide range within which the growth outcome for 2021 can occur.

From 2022 onwards, the alternative models suggest GDP growth which averages at around 4.3 per cent, in line with the baseline forecast. The VAR models alone suggest that growth should be considerably higher, reaching 6.6 per cent in 2022, and averaging



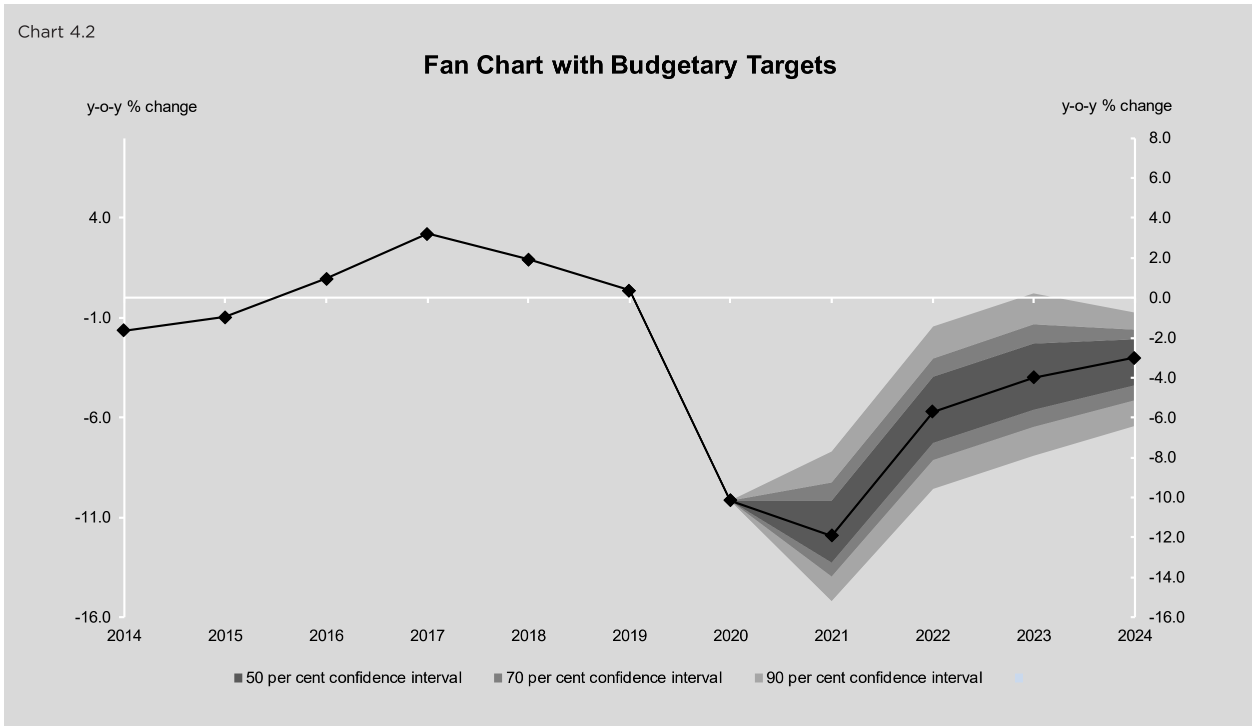
at 5.2 per cent in the outer years. Therefore, there may be considerable upside risk throughout the outer years.

4.4 Uncertainty and the Balance of Risk Underlying the Macroeconomic Projections

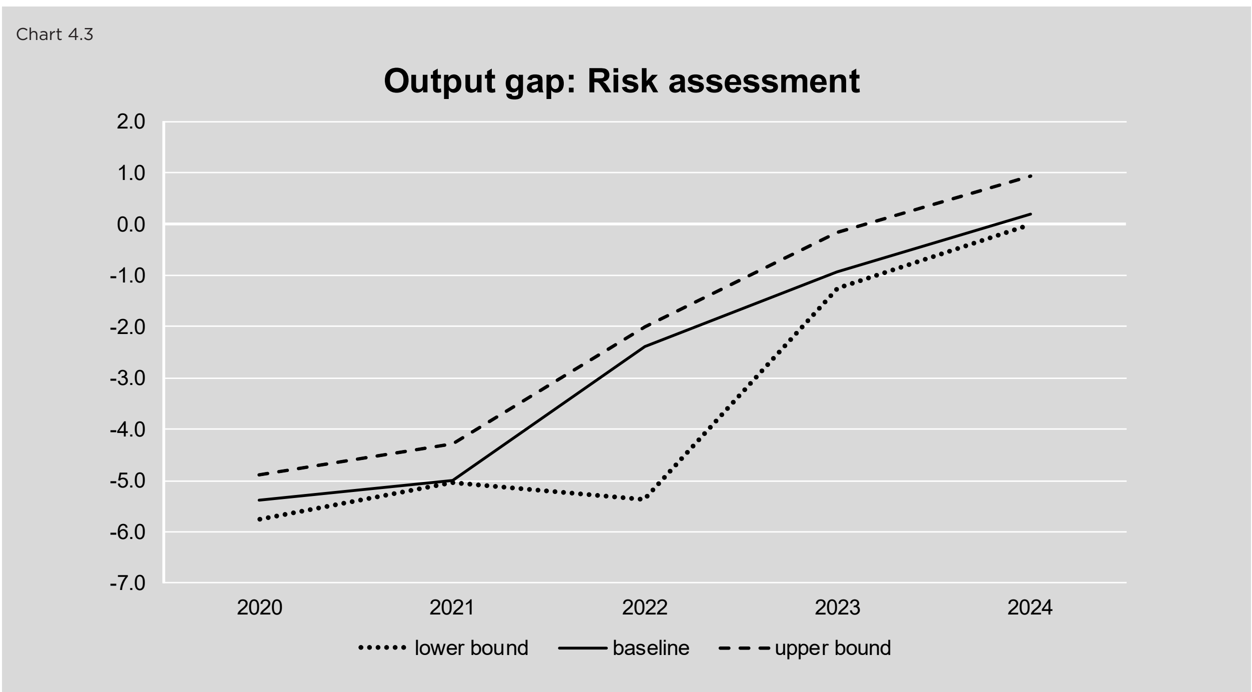
The uncertainty surrounding the macroeconomic projections is based on past forecast error standard deviation of GDP. This is equal to 2.4 for the current year forecast and 4.61 for the one-year ahead forecast, 4.64 for the two-year ahead forecast, and 4.49 for the three-year ahead forecast. The balance of risk is based on the Pearson skewness indicator of the model generating alternative forecast for GDP documented above. The indicator shows upside risks for 2021 and 2023, but downside risks for 2022 and 2024. Chart 4.1 depicts a representation of the uncertainty and the balance of risk surrounding the macroeconomic forecasts presented in this Programme.

4.5 Risks to Fiscal Targets

The alternative macroeconomic scenarios documented above, can influence the attainment of the deficit targets thus underpinning alternative fiscal conditions. Chart 4.2 illustrates the range of possible budget balance outcomes conditional upon the realisation of these alternative scenarios. The evaluation of fiscal risk conditional on macroeconomic risks also incorporates the variance resulting from the past forecast error of fiscal projections, based on a methodology similar to that used for deriving the macroeconomic risk assessment. As a result, the risk assessment is also presented in the form of a probabilistic fan chart. There seems to be mild upside risks for the attainment of a lower budget deficit throughout the short-term forecast horizon. In the worst-case scenarios contemplated in the risk assessment, the budget balance as a percentage of



GDP deteriorates by 0.1 percentage points in 2021, 0.4 percentage points in 2022, and 0.5 and 0.7 percentage points in 2023 and 2024 respectively.



4.6 Alternative Output Gap projections and risks to Structural Fiscal Targets

This assessment has been extended to cover risks to the output gap projections and hence the structural commitments presented in this Programme. Alternative output gap projections consistent with all the above economic scenarios have thus been carried out.

Compared to the baseline scenario, as shown in Chart 4.3, alternative output gap projections range from -5.0 in 2021 up to 0.0 in 2024 under the lower-bound and from -4.3 in 2021 up to 0.9 in 2024 under the upper-bound scenario.

5. Quality of Public Finances

5. Quality of Public Finances

The Maltese Government is of the view that the soundness and long-run sustainability of public finances are necessary conditions to prepare our economic and societal systems to become more resilient to future crises. Other components also need to be considered, including for example, growth-supportive, non-distortionary tax systems, sound fiscal governance, and efficient and effective public spending and investment. These other elements can help make public spending more efficient and indirectly promote growth potential. Indeed, growth can be supported when public expenditure is oriented more towards investment rather than consumption. Moreover, the structure and efficiency of tax systems and good fiscal governance can be important factors for long-run growth by supporting public policies' performance and facilitating structural reforms.

5.1 Improving the Structure and Efficiency of Revenue Streams

The Government's taxation strategy seeks to ensure that revenue streams from taxation are sustainable and supportive to the attainment of its fiscal, economic and welfare goals. In recent years, reforms have focused on shifting the tax burden away from labour, widening tax bases whilst tackling environmental concerns, further simplifying the tax system, and combatting tax evasion and avoidance. These reforms are undertaken in a context of risks to tax revenues, including the loss in retained revenue during the transitory period of the regulation on Value Added Tax (VAT) on electronic services. Revenue streams have been adversely affected by the pandemic, through lower economic activity as well as through the mitigation measures involving the deferral of various tax payments.

In order to minimise any disincentive effects income taxation may have on employment, tax rebates have been granted to persons in employment. A beneficial rate on overtime has also been introduced for low-income earners.

Priority is also given to tax simplification to alleviate the administrative costs associated with the computation of tax liability. Through VAT grouping, legal independent entities having fixed establishments in Malta, and which have financial, economic and organisational ties between them, can register as a single taxable person for VAT purposes. In addition, the Government introduced detailed tax consolidation regulations which permit groups of companies to calculate their profits/losses on a group basis. Moreover, heavier fines are being imposed for cases related to tax evasion, acting as a deterrent against evasion of excise duty.

Furthermore, the Government continued with its fight against tax evasion and unjust competition. Heavier fines have been imposed for both Court and out-of-Court cases related to evasion of excise duty on cigarettes and other tobacco products. In addition, Customs' incessant emphasis on clamping down on tax evasion where Malta's borders are concerned, has also included the creation of a new Canine Unit, extensive investment in x-ray scanning facilities, the procurement of an intelligence analytical software for investigation purposes and the creation of a professional Anti-Money Laundering Team. All Customs personnel pertaining to the Canine Unit, Customs Intelligence Service, Scanning Team and Anti-Money Laundering Team has gone through, or are currently undergoing, an extensive professional training programme offered by international experts.

A legal notice containing the EU Anti-Tax Avoidance Directives Implementation Regulations was published in a bid to address tax avoidance, with all the regulations being in force. Recent amendments to all the Revenue Acts were introduced with the aim of strengthening the powers of the Commissioner in the fight against tax evasion by giving this office more powers of investigation and allowing for the sharing of information, with the aim to help in the fight against financial crimes.

The current developments unfolding at the OECD Inclusive Framework for BEPS include a re-visiting of the tax allocation rules of the largest multinationals (Pillar 1) and the granting of additional taxing rights where jurisdictions have not exercised their primary taxing rights, or where income is subject to low rates of tax (Pillar 2). These developments are monitored with a view to assess the potential impact on foreign direct investment and consequently tax revenue and to consider alternative policy options to consider keeping in mind that implementation of any agreement reached at the Inclusive Framework may be as early as 2023.

5.2 Sound fiscal governance

A sound national fiscal governance framework, which influences how budgetary policy is developed and implemented, is an important factor for fiscal performance insofar as it can help contain the deficit bias of fiscal policy making, reduce the cyclicality of fiscal policy and improve the efficiency of public spending. Indeed, the continuous strengthening of the institutional capacity of Malta's fiscal framework sustained the consistent improvement in the Government's fiscal position in recent years.

- The financial and economic crisis and the resulting increases in deficits and debt level in the European Union (EU) was followed by a profound reform of the Stability and Growth Pact. The resulting six-pack and two-pack reforms sought to strengthen and deepen budgetary surveillance by making it more continuous and integrated. These reforms put stronger emphasis on medium-term planning, better synchronised and more transparent budgeting processes, procedures to foster the use of unbiased macroeconomic forecasts for budget planning, as well as independent monitoring of compliance with fiscal rules at national level. These regulations have led to a significant reform to Malta's budgetary system and processes. At the national level, one of the main responses to these reforms has been the **Fiscal Responsibility Act**, which was enacted by Parliament on 8 August 2014. The Act outlines the main principles of fiscal responsibility and the objectives of fiscal policy. It establishes fiscal rules which bind national fiscal authorities in achieving a balanced structural budget, or in its absence, converge towards the medium-term budgetary objective, and to maintain the public debt at sustainable levels (lower than 60 per cent of GDP) over the medium and long-term. It is worth noting that at the current juncture, the budgetary constraints set by national fiscal rules are suspended, as part of the effort to accommodate the budgetary implications of the pandemic outbreak.

  The Fiscal Responsibility Act also establishes rolling 3-year business and financial plans which are based on the (most recently announced) medium-term fiscal strategy. In this regard, in 2020, the Ministry for Finance and Employment (MFE) issued circular MFIN 1/20 to request the submission of the Ministries' 2021-2023 Business and Financial Plans. Despite the challenges brought about by the pandemic, MFE assessed the plans and held two rounds of bilateral meetings 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 2021-2023,

at Ministry level, were incorporated into the 2021 Financial Estimates which were approved by Parliament in December 2020.

The Act also establishes a Fiscal Council that is tasked with assessing and endorsing macroeconomic and fiscal forecasts, securing compliance with fiscal rules, and with determining the existence of exceptional circumstances (when relevant) and assessing progress in corrective action plan implementation (where relevant).

Several changes were legislated in 2018 to ensure full consistency of the Fiscal Responsibility Act (FRA) with the Directive on Budgetary Frameworks, as well as other amendments intended to ensure clarity in the administration of the Act.

- The **Comprehensive Spending Reviews** reinforced the Maltese Government's strategy to ensure the achievement of a more efficient and effective approach to public spending, improving on the policy process while also ensuring that public spending is reflective of changing priorities and changing social needs. During the period 2014 to 2018, the Maltese Government completed a series of reviews in social security, in health and in education. In 2018, following the review at the Management Efficiency Unit (MEU) which was completed in January, the Spending Review exercise was carried out at the Malta College for Arts, Science and Technology (MCAST) and was completed in August 2018.

  The Comprehensive Spending Reviews process was institutionalised through assistance from the Structural Reform Support Programme. In 2018, a unit was set up within the Ministry's Performance and Evaluation Directorate (MFE), which itself forms part of the Budget Affairs Division of the Ministry. The Directorate supports the Ministry in enhancing accountability for public expenditure whilst ensuring that public funds are spent effectively and efficiently to achieve the government's desired outcomes. The Directorate oversees initiatives aimed to strengthen the value-for-money culture within government and enhance programme evaluation capabilities.

  Based on this set-up, a spending review exercise was carried out at the Malta Police Force in 2019, with the scope of providing insight and understanding of the policy process within the Malta Police Force and then make recommendations as to how the policy process could be reformed to generate better, and more effective use of existing resources. The report recommended the following – (1) The Separation of Investigations from Prosecution; (2) Implementing a Fully Integrated System to Allow Better Flows of Information; (3) Better Use of Retired Police Officers; (4) The Move to Regional Hubs; (5) Reorganisation of the Malta Police Force; (6) Police Staff Development; and (7) Deploying Civilian Staff within the Malta Police Force.

  Subsequently, a review on long-term care beds commenced in early 2020. Although the study was suspended because of the COVID-19 pandemic outbreak, the panel outlined some recommendations, relating to (1) the Budget for Government Homes; (2) Institutional Care vs Care in the Community (with reference to sheltered housing, live-in carer and the carers' allowance); (3) Contractual Services; (4) Dispensing of medicines; (5) more effective use of staff resources (during peak and off-peak times); (6) Buying of beds and Medical Supplies; and (7) Staff Training.

- At the request of the Maltese Government, during 2018 Malta undertook a **Fiscal Transparency Evaluation (FTE)** exercise in conjunction with the IMF's Fiscal Affairs Department. In line with Government's objective for effective fiscal management and

accountability, this evaluation provided an in-depth assessment of public finances that substantiate economic decisions, including of the costs and benefits of policy changes and potential risks to public finances. Pursuant to the IMF Fiscal Transparency Evaluation (FTE), several recommendations were taken on board, while discussions within the Ministry are ongoing with regards to the implementation of the remaining recommendations.

- In July 2019, the Financial Administration and Audit Act was repealed by Act XXI of 2019 titled **Public Finance Management Act (Cap. 601)**, which regulates amongst others, financial management in Government to ensure the effective and efficient management of all assets and liabilities, cash flow, and revenue and expenditure of the Government.

5.3 Efficient and effective public spending

Public expenditure, in particular investment in human capital through education and health spending, technical progress and public infrastructure, may contribute to economic growth depending on public sector outputs and the efficiency with which public expenditure yields these outputs.

5.3.1 Pre-pandemic developments in public spending

Economic growth can be supported when public expenditure is oriented more towards investment than consumption. Between 2015 and 2019, when an average annual economic growth of 9.1 per cent was recorded, current expenditure increased by an annual average of 6.9 per cent whilst capital expenditure including gross fixed capital formation increased by an annual average of 10.0 per cent per annum. Overall, total expenditure rose by an annual average of 7.4 per cent, lagging revenue growth and contributing to the fiscal consolidation observed during this period, demonstrating the beneficial role that strong potential growth could have on public finance sustainability. The more moderate growth in current expenditure was mainly influenced by the moderate growth in social expenditure following the 2006 pension reform initiatives, record low unemployment levels, and historically low interest rates, because of which interest expenditure followed a declining trend even in nominal terms since 2014.

5.3.2 Public Sector Productivity

This section delves into how the various functions of government are using the resources at their disposal to efficiently deliver public services. This aims to supplement the comprehensive spending review as well as the sustained renewal of the public service. Indeed, following the renewal of the public service from 2013 onwards, the public service is devising a new 5-year strategy, that should enter into force in 2022, based on three key pillars that are service, technology and people. The strategy shall ensure that technology is continuously up to date to make sure that any new services would be offered digitally by default, reducing unnecessary bureaucracy and continue providing a 24x7 service.

5.3.2.1 Measuring Public Sector Productivity in Malta

This section quantitatively evaluates the productivity growth in Malta's public sector[1]. It is beyond the scope of the study to produce statistical estimates supplementing input-based estimates in the national accounts. However, the various measures of public sector outputs are useful indicators of productivity and are consequently considered a

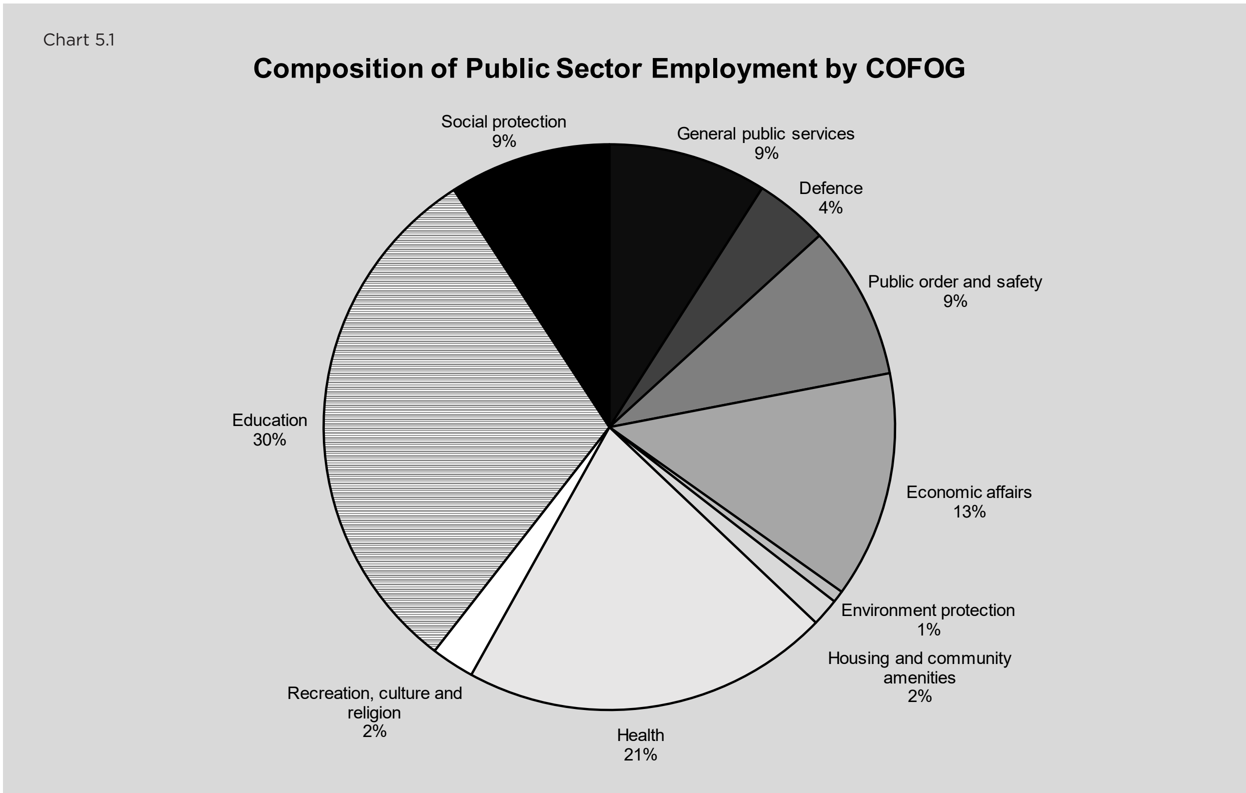
potentially important input in collective bargaining or simply as a summary assessment of key performance indicators in the public sector or performance budgeting.

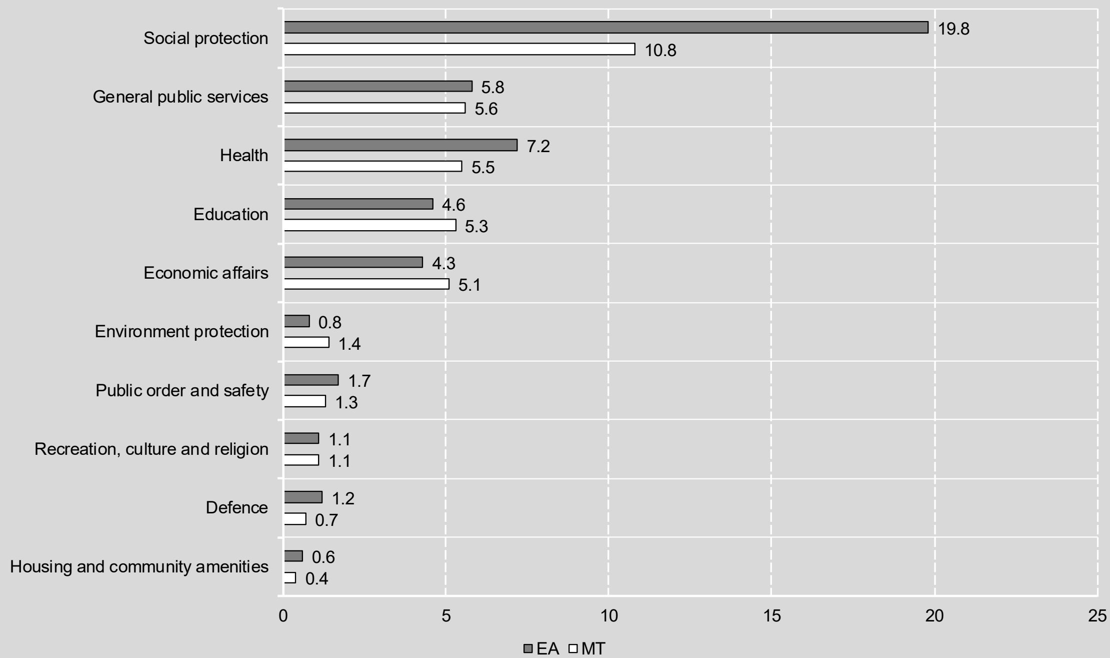
Assessing public sector productivity is challenging, since in such studies, it is the outcomes which are of interest, and not just of the output itself. To measure the growth in public sector productivity, this study will be using the same methodology applied in the 2019-2022 Medium Term Fiscal Strategy for Malta (MTFS). The system takes into account outputs and inputs related to the provision of healthcare, education, social care, public order and safety, defence and other public services. This is achieved by weighting indices of outputs and outcomes per unit of inputs to compute an overall figure for productivity growth within the public sector.

5.3.2.2 Public Sector Inputs

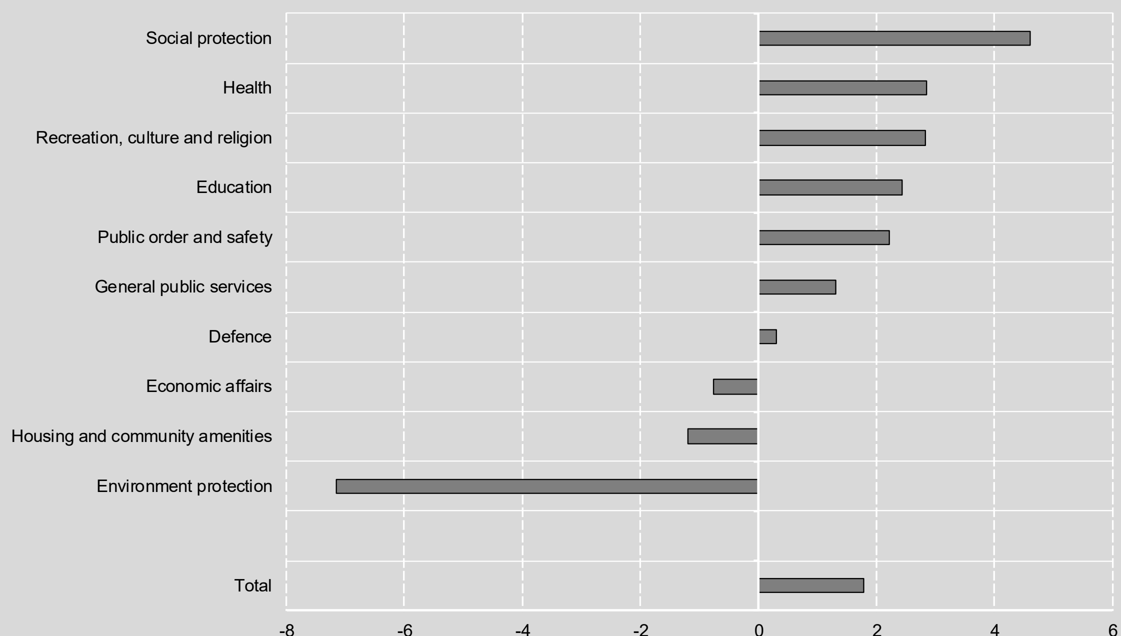
Similar to previous updates, production inputs considered will be limited to labour inputs and the labour figures are based on estimates provided by the National Statistics Office (NSO) and have been segregated according to the Classification of the Functions of the Government (COFOG). Since a comparative analysis of employment by COFOG within the Euro Area was not possible a comparison of expenditure as a share of Gross Domestic Product was performed. Results show that in 2019, the Maltese Government expenditure generally follows a somewhat similar pattern to that of the Euro Area (EA) with the main exception being social protection and health.

Chart 5.1 shows that the highest levels of expenditure can be attributed to social protection in both Malta and the EU average. However, expenditure on social protection in the Euro Area, as a percent of GDP is much larger than that in Malta with the gap widening further compared to 2018. Expenditure on health, whilst substantial, is also relatively less in Malta when compared to the EA. Malta also spends relatively less on





Defence, Public Order and Safety, Housing and General Public Services but generally spends relatively more on Education, Economic Affairs, and Environment protection. Compared to previous years, government expenditure as a percentage of GDP has risen



in almost all sectors, primarily reflecting the increasing demand for public services as Malta becomes more affluent.

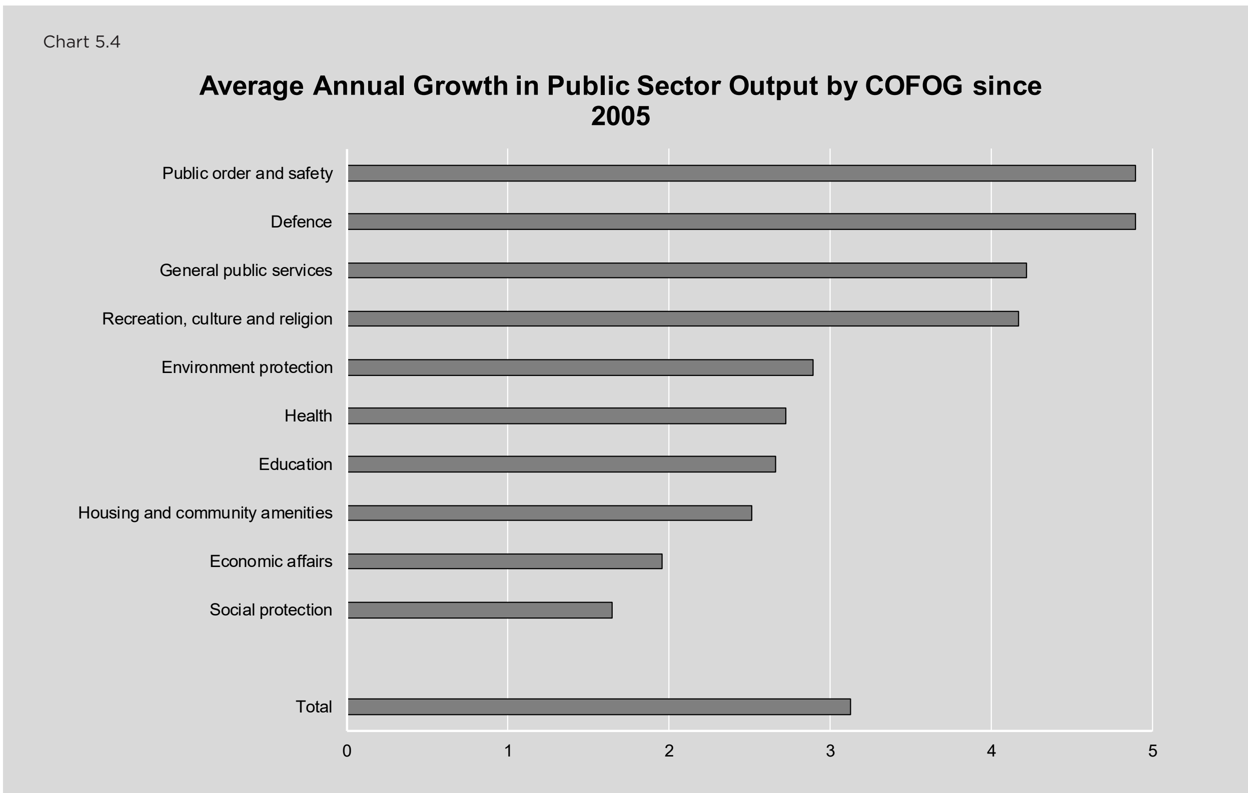
In relative terms, the composition of employment in 2019 has remained almost unchanged from the previous year. Chart 5.2 shows that half of government employment can be attributed to Education and Health, comprising 30.0 per cent and 21.0 per cent of government employees, respectively. These are followed by Economic Affairs which amounts to 13.0 per cent. Social Protection, General Public Services and Public Order and Safety account for 9.0 per cent of public employment in each sector.

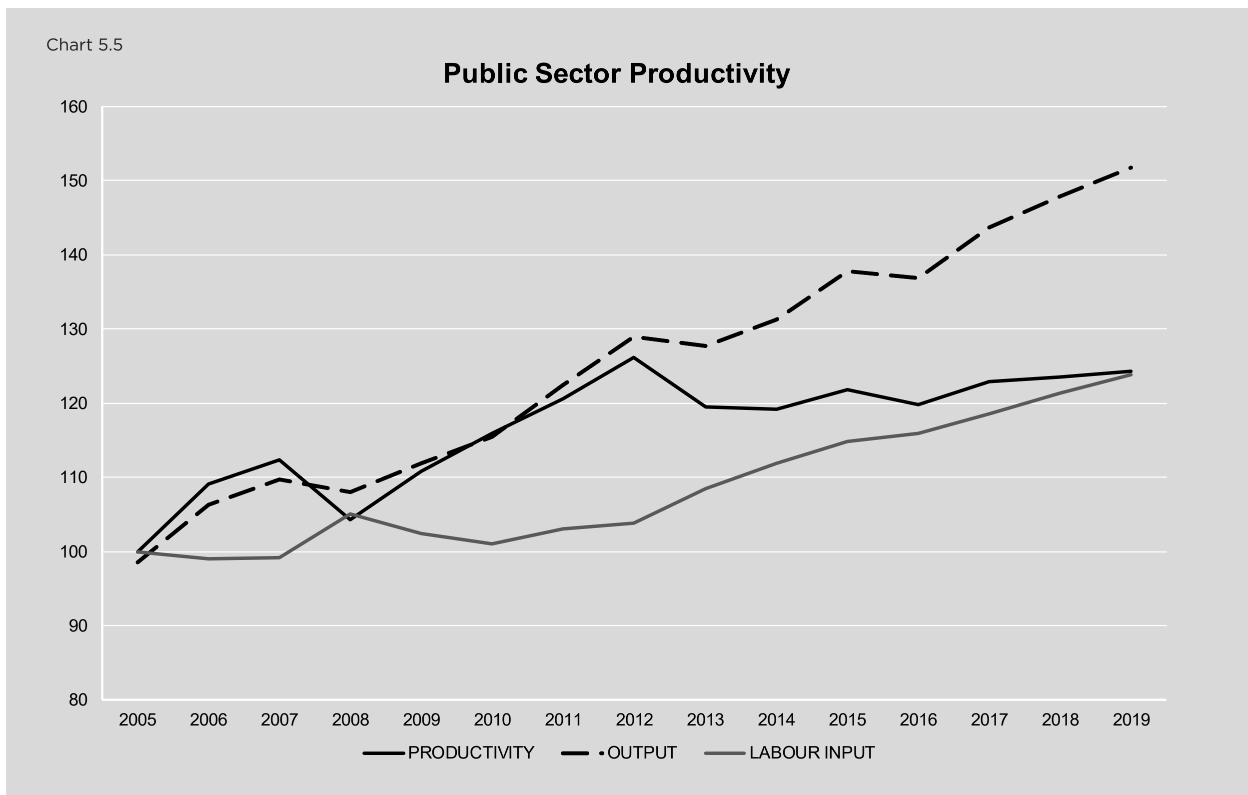
Between 2005 and 2019, employment growth averaged at 1.5 per cent per annum (or 2.3 per cent since 2010). The largest growth was recorded in Social Protection and Health with figures rising by 3.9 per cent and 2.4 per cent, respectively. Chart 5.3 outlines that the largest declines were recorded in the Environment Protection and Housing Community Amenities categories, however this was underpinned by the reclassification of employees to other COFOG categories.

5.3.2.3 Public Sector Outputs

A number of indicators, which cover a mix of both volume and quality, were used to construct a measure of output for each of the COFOG categories. The methodology and indicators used for this study were the same as in the 2019-2022 MTFS[2]. Most of the selected indicators, particularly for Health and Social Protection, were only available from 2005, so the index captures productivity gains in the last decade.

Chart 5.4 underlines that output levels grew across all COFOG configurations. The highest increase was recorded in the Public Order and Safety and Defence sectors (both at 4.9 per cent), followed by the General Public Services and Recreation, Culture and Religion





sectors (both at 4.2 per cent) whilst the lowest growth in output was registered in the Social Protection category (1.7 per cent). Taking the entire public sector into account, the average annual growth in public sector output since 2005 was of 3.1 per cent.

5.3.2.4 Public Sector Productivity

The Ministry for Finance and Employment (MFE) estimates indicate that real public sector labour productivity has increased by an annual average of 1.6 per cent per annum since 2005. Chart 5.5 illustrates public sector productivity trends and the corresponding developments in output and employment.

The nominal value of public sector labour productivity can be estimated using real public-sector labour productivity together with a measure of any price changes related to public service provision. In the absence of a specific deflator from the output side, the GDP deflator was used as a measure of prices. This indicator is useful when benchmarking wage increases in the public sector. The nominal value of productivity in the public sector was thus estimated to have increased by an annual average of 3.8 per cent per annum since 2005 (or 3.0 per cent since 2010).

Footnotes:

[1] Details on the methodology can be found at: https://mfin.gov.mt/en/epd/Documents/Artilces/Article_Public_Sector_Productivity.pdf

[2] For further details on the methodology see: Demanuele, Mifsud and Vella, Measuring Public Sector Productivity in Malta, 2017; in https://finance.gov.mt/en/epd/Documents/Artilces/Article_Public_Sector_Productivity.pdf

Statistical Appendix

Macroeconomic Prospects

Table 1a

Percentages unless otherwise indicated	ESA Code	Level 2019[1]	Level 2020[1]	Percentage change over previous period 2019	2020	2021[2]	2022	2023	2024
1. Real GDP	B.1g	12,488.7	11,614.4	5.5	-7.0	3.8	6.8	4.5	4.0
2. Nominal GDP	B.1g	13,592.2	12,823.8	8.0	-5.7	5.9	8.9	6.7	6.2
Components of real GDP									
3. Private consumption expenditure[3]	P.3	5,915.7	5,464.8	4.5	-7.6	2.4	5.4	3.0	2.7
4. Government consumption expenditure	P.3	2,140.5	2,486.1	13.8	16.1	5.6	-3.2	1.9	1.3
5. Gross fixed capital formation	P.51	2,833.0	2,705.9	9.5	-4.5	9.2	12.5	3.6	3.2
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53			0.7	1.4	1.4	1.3	1.2	1.2
7. Exports of goods and services	P.6	18,075.2	16,660.6	6.4	-7.8	5.1	6.9	4.6	4.2
8. Imports of goods and services	P.7	16,562.6	15,881.8	7.9	-4.1	5.9	5.8	3.5	3.3
Contribution to real GDP growth[4]									
9. Final domestic demand		10,889.2	10,656.8	6.3	-1.7	4.5	4.9	2.7	2.3
10. Change in inventories and net acquisition of valuables	P.52+P.53			0.0	0.6	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	1512.5	778.8	-0.8	-5.9	-0.7	1.9	1.8	1.7

[1] € million

[2] Projections from 2021 onwards

[3] Includes NPISH final consumption expenditure

[4] Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. This non-additivity, similar to that in other countries' national accounts, is due to mathematical reasons and reflects the fact that chain-linked volumes are calculated by separately extrapolating both totals and their sub-components.

Price Developments

Table 1b

Percentages unless otherwise indicated	ESA Code	Level 2019[1]	2020[1]	Percentage change over previous period 2019	2020	2021[2]	2022	2023	2024
1. GDP deflator[3]		122.6	124.4	2.5	1.3	2.1	2.1	2.2	2.2
2. Private consumption deflator		114.2	115.7	2.2	1.1	1.4	1.5	1.3	1.2
3. HICP (Average 2015=100)		105.5	106.4	1.5	0.8	1.3	1.5	1.6	1.7
4. Public consumption deflator		122.4	124.9	2.9	2.4	2.2	2.5	2.0	2.1
5. Investment deflator		112.5	113.5	1.2	0.9	1.1	1.3	1.2	1.1
6. Export price deflator (goods and services)		120.8	121.5	2.1	0.5	1.3	1.4	1.5	1.5
7. Import price deflator (goods and services)		115.8	116.3	1.7	0.4	0.8	1.1	1.0	0.9

[1] Index (base 2010 unless otherwise indicated)

[2] Projections from 2021 onwards

[3] Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. Indeed, summing up the deflators of the components of GDP would not add up to the actual GDP deflator observed for the year. For this reason, the GDP deflator quoted in this table for 2014 and 2015 reflects the actual difference between nominal and real GDP growth rates for the year.

Labour Market Developments

Table 1c

Percentages unless otherwise indicated	ESA Code	Level 2019	Level 2020	Percentage change over previous period 2019	2020	2021[1]	2022	2023	2024
1. Employment, persons (National Accounts Definition, Domestic Concept)		251,232	257,859	6.5	4.1	2.2	3.5	3.2	3.0
2. Employment, hours worked (National Accounts Definition, Domestic Concept) ('000s)		504,474	517,781	6.5	4.1	2.2	3.5	3.2	3.0
3. Unemployment rate (Harmonised definition, 1,000 persons)		9,557	11,628	3.6	4.3	4.3	3.9	3.8	3.7
4. Labour Productivity, persons (Real GDP per person employed)		49,710	45,042	-0.9	-10.7	1.6	3.2	1.3	0.9
5. Labour Productivity, hours worked (Real GDP per hour worked)		24.8	22.4	-0.9	-10.7	1.6	3.2	1.3	0.9
6. Compensation of employees (€ million)	D1	5,846.4	5,984.2	8.6	2.4	3.4	5.7	5.3	5.2
7. Compensation per employee (€)		23,271	23,207	2.6	-0.8	1.2	2.1	2.1	2.1

[1] Projections from 2021 onwards

Sectoral Balances

Table 1d

Percentages of GDP	ESA Code	2020	2021	2022	2023	2024
1. Net lending/ borrowing		-3.3	-1.5	-0.2	0.8	1.9
vis-à-vis the rest of the world	B.9					
of which:						
Balance on goods and services		7.0	9.3	11.1	13.0	14.9
Balance of primary incomes and transfers		-10.9	-11.1	-11.5	-12.4	-13.2
Capital account		0.6	0.3	0.2	0.2	0.2
2. Net lending/ borrowing of the private sector	B.9	5.5	9.2	4.3	3.7	3.9
3. Net lending/ borrowing of general Government	EDP B.9	-10.1	-12.0	-5.6	-3.9	-2.9
4. Statistical discrepancy		1.3	1.2	1.1	1.1	1.0
Current Account		-4.0	-1.8	-0.4	0.6	1.7

General Government Budgetary Prospects

Table 2a

Percentages of GDP		ESA code	2019(*)	2020(*)	2019	2020	2021	2022	2023	2024
Net Lending (EDP B9) by sub-sector										
1.	General Government	S13	50.1	-1,300.2	0.4	-10.1	-12.0	-5.6	-3.9	-2.9
2.	Central Government	S1311	44.2	-1,308.7	0.3	-10.2	-12.0	-5.6	-3.9	-2.9
3.	State Government	S1312	-	-	-	-	-	-	-	-
4.	Local Government	S1313	8.5	-1.2	0.0	0.1	-0.0	-0.0	-0.0	-0.0
5.	Social security funds	S1314	-	-	-	-	-	-	-	-
General Government										
6.	Total revenue	TR	5,055.9	4,677.8	37.2	36.5	36.7	36.6	36.2	35.7
7.	Total expenditure	TE	5,005.8	5,977.9	36.8	46.6	48.7	42.2	40.1	38.6
8.	Net lending / borrowing	B9	50.1	-1,300.2	0.4	-10.1	-12.0	-5.6	-3.9	-2.9
9.	Interest expenditure	D41	183.0	170.2	1.3	1.3	1.2	1.1	1.1	1.1
10.	Primary balance(1)		233.1	-1,130.0	1.7	-8.8	-10.8	-4.5	-2.8	-1.8
11.	One-off and other temporary measures(2)		2.8	2.2	0.0	0.0	0.0	0.0	0.0	0.0
Selected Components of Revenue										
12.	Total Taxes (12=12a+12b+12c)		3,466.1	3,084.8	25.5	24.1	23.8	24.6	24.5	24.5
12a.	Taxes on production and imports	D2	1,613.0	1,372.3	11.9	10.7	10.6	11.4	11.5	11.5
12b.	Current Taxes on Income, Wealth, etc.	D5	1,827.0	1,689.8	13.4	13.2	13.0	13.0	12.8	12.8
12c.	Capital Taxes	D91	26.1	22.6	0.2	0.2	0.1	0.2	0.2	0.2
13.	Social Contributions	D61	800.1	841.1	5.9	6.6	6.3	6.2	6.1	6.1
14.	Property Income	D4	81.8	92.6	0.6	0.7	0.6	0.6	0.5	0.5
15.	Other(3)		708.0	659.3	5.2	5.1	6.0	5.3	5.1	4.7
16=6.	Total Revenue	TR	5,055.9	4,677.8	37.2	36.5	36.7	36.6	36.2	35.7
p.m.:	Tax Burden (D2+D5+D6111+D6131+D91-D995)(4)		4,286.1	3,941.8	31.5	30.7	30.3	30.9	30.7	30.6
Selected Components of Expenditure										
17.	Compensation of employees + intermediate consumption	D1+P2	2,457.0	2,788.1	18.1	21.7	22.4	20.6	20.0	19.5
17a.	Compensation of employees	D1	1,481.2	1,566.6	10.9	12.2	12.5	12.0	11.8	11.6
17b.	Intermediate consumption	P2	975.9	1,221.5	7.2	9.5	9.9	8.5	8.2	7.9
18.	Social payments (18=18a+18b)		1,238.0	1,346.8	9.1	10.5	10.4	9.8	9.6	9.5
	of which Unemployment benefits (5)		19.7	31.0	0.1	0.2	0.2	0.2	0.2	0.2
18a.	Social transfers in kind supplied via market producers	D632	117.0	143.8	0.9	1.1	1.0	0.9	0.9	0.8
18b.	Social transfers other than in kind	D62	1,121.0	1,202.9	8.2	9.4	9.3	8.9	8.7	8.6
19=9.	Interest expenditure	D41	183.0	170.2	1.3	1.3	1.2	1.1	1.1	1.1
20.	Subsidies	D3	195.1	642.9	1.4	5.0	4.3	1.6	1.5	1.4
21.	Gross fixed capital formation	P51G	525.1	574.1	3.9	4.5	5.4	4.7	4.6	4.0
22.	Capital transfers	D9	110.4	142.3	0.8	1.1	2.3	2.0	1.1	0.9
23.	Other(6)		297.3	313.7	2.2	2.4	2.8	2.5	2.4	2.2
24=7.	Total Expenditure	TE	5,005.8	5,977.9	36.8	46.6	48.7	42.2	40.1	38.6
p.m.:	Government consumption (nominal)	P3	2,358.5	2,774.7	17.4	21.6	22.1	20.1	19.6	19.1

(*) € million

(1) The primary balance is calculated as (B9, item 8) plus (D41, item 9)

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

(3) P10 + D39rec + D7rec + D9N (ie D9 other than D91rec)

(4) Including those collected by the EU and including an adjustment for uncollected taxes and social contributions D995), if appropriate

(5) Includes social benefits other than social transfers in kind (D62) and social transfers in kind via market producers (D632) related to unemployment benefits

(6) D29pay + D4Npay (ie D4 other than D41pay) + D5pay + D7pay + P5M + NP + D8

No policy change projections

Table 2b

Percentages of GDP	2020[1]	2020	2021	2022	2023	2024
1. Total revenue at unchanged policies	4,677.8	36.5	36.7	36.6	36.2	35.7
2. Total expenditure at unchanged policies	5,977.9	46.6	48.7	43.5	40.4	38.8

[1] € million

Amounts to be excluded from the expenditure benchmark

Table 2c

	Percentages of GDP	2019[1]	2020[1]	2019	2020	2021	2022	2023	2024
1.	Expenditure on EU programmes fully matched by EU funds revenue	147.2	149.0	1.1	1.2	2.3	1.8	1.8	1.5
1a.	*of which* Investment fully matched by EU funds revenue[2]	55.8	63.7	0.4	0.5	1.1	0.8	0.8	0.7
2.	Cyclical unemployment benefit expenditure[3]	-8.3	3.9	-0.1	0.0	0.0	-0.0	-0.0	-0.0
3.	Effect of discretionary revenue measures	-63.0	-105.2	-0.6	-0.7	0.0	0.3	-0.1	-0.1
4.	Revenue increases mandated by law	-	-	-	-	-	-	-	-

[1] € million

[2] Based on an estimate of Gross Fixed Capital Formation financed from EU funds

[3] The cyclical unemployment benefit expenditure is estimated based on the difference between the unemployment rate and NAWRU. Data for the total unemployment benefit expenditure is defined in COFOG under the code 10.5

General Government Expenditure by Function

Table 3

	Percentages of GDP	COFOG Code	2019	2024
1.	General public services	1	5.5	6.2
2.	Defence	2	0.7	0.7
3.	Public order and safety	3	1.2	1.2
4.	Economic affairs	4	5.3	4.8
5.	Environmental protection	5	1.4	1.3
6.	Housing and community amenities	6	0.4	0.3
7.	Health	7	5.5	5.4
8.	Recreation, culture and religion	8	1.1	1.0
9.	Education	9	5.3	5.3
10.	Social protection	10	10.5	12.2
11.	Total Expenditure	TE	36.8	38.6

General Government Debt Developments

Table 4

Percentages of GDP	ESA Code	2019	2020	2021	2022	2023	2024
1. Gross debt		42.0	54.3	65.0	65.8	66.0	65.6
2. Change in gross debt ratio		-2.9	12.3	10.7	0.8	0.3	-0.5
Contributions to changes in gross debt							
3. Primary balance		-1.7	8.8	10.8	4.5	2.8	1.8
4. Interest expenditure	EDP D.41	1.3	1.3	1.2	1.1	1.1	1.1
5. Stock-flow adjustment		0.8	-0.3	1.8	0.5	0.5	0.5
p.m. implicit interest rate on debt(1)		3.2	3.0	2.3	1.9	1.8	1.7

(1) Proxied by interest expenditure divided by the debt level of the previous year.

Cyclical Developments

Table 5

Percentages of GDP	ESA Code	2019	2020	2021	2022	2023	2024
1. Real GDP growth (%)		5.5	-7.1	3.8	6.9	4.5	4.0
2. General Government balance	EDP B.9	0.4	-10.1	-12.0	-5.6	-3.9	-2.9
3. Interest expenditure	EDP D.41	1.3	1.3	1.2	1.1	1.1	1.1
4. One-off and other temporary measures[1]		0.0	0.0	0.0	0.0	0.0	0.0
of which							
One-offs on the revenue side: general Government		0.0	0.0	0.0	0.0	0.0	0.0
One-offs on the expenditure side: general Government		-0.0	-0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		5.0	2.8	3.4	3.9	3.0	2.8
contributions:							
- labour (hours)		4.0	2.6	2.8	2.7	1.7	1.5
- capital		2.0	1.6	1.8	2.1	2.0	1.9
- total factor productivity		-0.9	-1.3	-1.1	-0.8	-0.6	-0.5
6. Output Gap		4.6	-5.4	-5.0	-2.4	-0.9	0.2
7. Cyclical Budgetary Component		2.2	-2.6	-2.4	-1.1	-0.4	0.1
8. Cyclically-Adjusted Balance (2-7)		-1.8	-7.6	-9.6	-4.4	-3.5	-3.0
9. Cyclically-Adjusted Primary Balance (8+3)		-0.5	-6.2	-8.4	-3.3	-2.4	-1.9
10. Structural Balance (8-4)		-1.9	-7.6	-9.6	-4.5	-3.5	-3.0

[1] A plus sign means deficit-reducing one-off measures

Divergence from latest SP

Table 6 % GDP

	ESA Code	2019	2020	2021	2022	2023	2024
Real GDP growth							
Previous Update		4.4	-5.4	3.9	-	-	-
Current Update		5.5	-7.0	3.8	6.8	4.5	4.0
Difference		1.1	-1.6	-0.1	-	-	-
General Government net lending/ net borrowing	EDP B.9						
Previous Update		0.5	-7.5	-3.6	-	-	-
Current Update		0.4	-10.1	-12.0	-5.6	-3.9	-2.9
Difference		-0.1	-2.6	-8.4	-	-	-
General Government net lending projection at unchanged policies	EDP B.9						
Previous Update		-	-	-	-	-	-
Current Update		0.4	-10.1	-12.0	-6.8	-4.1	-3.1
Difference		-	-	-	-	-	-
Total Revenue	TR						
Previous Update		38.2	39.2	38.8	-	-	-
Current Update		37.2	36.5	36.7	36.6	36.2	35.7
Difference		-1.0	-2.7	-2.1	-	-	-
Total Expenditure	TE						
Previous Update		37.7	46.7	42.4	-	-	-
Current Update		36.8	46.6	48.7	42.2	40.1	38.6
Difference		-0.9	-0.1	6.3	-	-	-
General Government gross debt							
Previous Update		43.1	54.5	55.5	-	-	-
Current Update		42.0	54.3	65.0	65.8	66.0	65.6
Difference		-1.1	-0.2	9.5	-	-	-

Long-term Sustainability of Public Finances

Table 7

	2007	2010	2019	2020	2030	2040	2050	2060	2070
Total expenditure	N.A	N.A	17.9	19.2	17.8	18.5	20.4	23.7	25.9
Of which: age-related expenditures									
Pension expenditure	8.9	9.9	7.1	7.7	6.6	6.6	8.1	10.1	10.9
Social security pension			7.1	7.7	6.6	6.6	8.1	10.1	10.9
Old-age and early pensions			4.6	5.2	4.7	5.1	6.5	8.6	9.3
Other pensions (disability, survivors)			2.4	2.6	1.8	1.5	1.5	1.5	1.5
Occupational pensions (if in general government)			N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Health care			5.4	6.0	5.9	6.4	6.8	7.3	8.0
Long-term care (this was earlier included in the health care)			1.1	1.2	1.5	1.8	2.0	2.4	3.0
Education expenditure			4.3	4.2	3.9	3.7	3.6	3.9	4.1
Other age-related expenditures			N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Interest expenditure			N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Total revenue									
Of which: property income			N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Of which: from pensions contributions (or social contributions if appropriate)	8.3	8.4	7.9	8.7	8.5	8	7.7	7.4	7.0
Pension reserve fund assets			N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Of which: consolidated public pension fund assets (assets other than government liabilities)			N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Systemic pension reforms									
Social contributions diverted to mandatory private scheme			N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Pension expenditure paid by mandatory private scheme			N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Assumptions									
Labour productivity growth			1.7	1.5	2.1	1.7	1.6	1.6	1.5
Real GDP growth			4.4	-5.8	3.9	2.1	1.3	1.2	1.4
Participation rate males (aged 20-64)			89.4	89.9	91.5	90.4	89.3	89.4	89.6
Participation rates females (aged 20-64)			68.8	70.1	79.1	81.1	81.1	81.5	81.8
Total participation rates (aged 20-64)			79.7	80.6	85.9	86.2	85.6	85.8	86.0
Unemployment rate (20-64)			3.0	5.3	3.9	3.9	3.9	3.8	3.8
Population aged 65+ over total population			18.7	18.9	21.0	22.3	25.6	30.4	32.4

Source: Ageing Report 2021

Stock of guarantees adopted/announced at December 2020 according to the Programme

Table 7a — % of GDP

	Measure	Date of adoption	Maximum amount of contingent liabilities (% of GDP)	Estimated take-up (% of GDP)
In response to COVID-19	Malta Development Bank - COVID-19 Guarantee Scheme	2020	2.7	1.0
	EU SURE loan instrument	2020	0.2	0.2
	Subtotal		**2.9**	**1.2**
Others	Non-financial corporations		7.8	6.0
	Financial corporations		3.7	1.9
	Households and NPISHs		0.1	0.1
	Subtotal		**11.6**	**8.0**
	Total		**14.5**	**9.1**

Basic Assumptions

Table 8

	2019	2020	2021(p)	2022(p)	2023(p)	2024(p)
Short-term interest rate (annual average)	0.0	0.0	0.0	0.0	0.0	0.0
Long-term interest rate (annual average)	0.7	0.5	0.3	0.3	0.3	0.3
USD/EUR exchange rate (average)	1.118	1.153	1.206	1.218	1.223	1.224
GBP/EUR exchange rate (average)	0.873	0.903	0.874	0.877	0.871	0.869
Malta's main trading partners real GDP growth	1.0	-6.4	4.4	3.9	1.2	1.2
Oil prices, (Brent, USD/barrel)	64.4	41.8	61.2	61.9	61.9	61.9
World prices weighted by main trading partners (y-o-y % change)	1.0	-0.9	2.2	1.5	1.1	1.1

Basic Fiscal Assumptions

Table 8b

	ESA Code	2019	2020	2021(f)	2022(f)	2023(f)	2024(f)
Implied Elasticity with respect to respective Tax Base							
Taxes on Production and Imports	D2	0.4	0.7	1.3	0.8	1.0	1.3
of which Value Added Taxes	D212	0.2	0.5	1.3	1.2	1.3	1.6
Current Taxes on Income, Wealth, etc.	D5	1.3	1.4	1.0	0.9	0.8	0.9
of which Current Taxes on Income, Wealth, etc. [Corporate] [1]	D5	1.2	-3.5	1.2	2.0	1.2	1.3
Net social contributions	D61	0.5	2.2	1.0	1.1	1.0	1.0
General Government Adjustments (€ millions)		**40.8**	**180.0**	**-36.9**	**-181.5**	**-37.1**	**-39.9**
Other accounts payable and receivable		-46.2	192.0	143.9	13.9	13.9	13.9
Treasury Clearance Fund & Contingency Reserve		27.0	0.1	13.4	14.3	15.1	16.2
Social and Investment Fund - IIP - Revenue		105.4	20.0	26.0	26.0	26.0	26.0
Social and Investment Fund - IIP - Expenditure		0.0	0.0	-20.0	-30.0	-40.0	-45.0
Re-routing/PPP adjustments		-44.9	-24.2	-60.1	-60.7	-52.2	-51.0
Others		-0.5	-7.9	-140.0	-145.0	0.0	0.0

[1] The elasticity with respect to the respective tax base does not capture developments in world GDP, although the latter influences developments in some components of taxes on the income and wealth of corporations.

RRF Impact on Projections - Grants

Table 9a — % of GDP

	ESA Code	2020	2021	2022	2023	2024	2025	2026
Revenue from RRF GRANTS								
RRF GRANTS as included in the revenue projections		0.0	0.3	0.8	0.6	0.3	0.1	0.0
Cash disbursements of RRF GRANTS from EU		0.0	0.3	0.8	0.6	0.3	0.1	0.0
Expenditure financed from RRF GRANTS								
Total Current Expenditure		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Capital Expenditure		0.0	0.3	0.8	0.6	0.3	0.1	0.0
of which:								
Gross fixed capital formation	P.51g	0.0	0.3	0.8	0.6	0.3	0.1	0.0
Capital transfers	D.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other costs financed by RRF GRANTS[1]								
Financial transactions		0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which:								
Reduction in tax revenue		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other costs with impact on revenue		0.0	0.0	0.0	0.0	0.0	0.0	0.0

[1] This covers costs that are not recorded as expenditure in national accounts

RRF Impact on Projections - Loans

Table 9b % of GDP

	ESA Code	2020	2021	2022	2023	2024	2025	2026
Cash flow from RRF loans projected in the programme								
Disbursements of RRF LOANS from EU		-	-	-	-	-	-	-
Repayments of RRF LOANS to EU		-	-	-	-	-	-	-
Expenditure financed from RRF loans								
Total Current Expenditure		-	-	-	-	-	-	-
Total Capital Expenditure		-	-	-	-	-	-	-
of which:								
Gross fixed capital formation	P.51g	-	-	-	-	-	-	-
Capital transfers	D.9	-	-	-	-	-	-	-
Other costs financed by RRF loans[1]								
Financial transactions		-	-	-	-	-	-	-
of which:								
Reduction in tax revenue		-	-	-	-	-	-	-
Other costs with impact on revenue		-	-	-	-	-	-	-

[1] This covers costs that are not recorded as expenditure in national accounts

Stock Flow Adjustment Statement

Table 10

Millions of Euros	2020	2021	2022	2023	2024
General Governemnt deficit (-) / surplus (+) (ESA10)	1,300.2	1,630.4	826.1	617.4	485.7
ESA Adjustments	180.0	-36.8	-181.5	-37.2	-39.9
Contribution to Sinking Fund (Local)	0.0	0.0	0.0	0.0	0.0
Contribution to Sinking Fund (Foreign)	0.1	0.1	0.1	0.1	0.0
Contribution to Special MGS Sinking Fund	20.0	30.0	30.0	30.0	20.0
Equity Acquisition	37.0	150.5	155.5	10.5	10.5
EFSF/ESM Credit Line Facility	0.0	4.5	4.5	4.5	4.5
Courts and other deposits	-36.8	0.0	0.0	0.0	0.0
Stock Premium paid to Church	0.0	0.3	0.1	0.2	0.1
Advances made by Government	0.0	0.0	0.0	0.0	0.0
Repayment of Loans to Government	-0.9	-2.2	-2.8	-2.8	-2.8
Sale of Assets	-0.9	-0.9	-0.9	-0.9	-0.9
Sale of Non-Financial Assets	-	-	-	-	-
EBUs	-8.1	0.0	0.0	0.0	0.0
Currency	1.2	9.3	5.1	5.7	6.2
Movement in Bank Account	-12.5	-	-	-	-
ESA Rerouted Debt	23.9	60.1	60.7	52.2	51.0
Increase/(Decrease) in cash balance	-58.2	-0.7	-0.1	-0.1	-0.8
Increase/(Decrease) in Non-Consolidated Debt	1,445.0	1,844.6	895.9	678.7	533.7
Total Consolidation	**-187.8**	**23.8**	**7.6**	**18.4**	**34.0**
Increase/(Decreaese) in Consolidated Debt	**1,257.2**	**1,868.4**	**903.5**	**697.1**	**567.6**
SFA	**-43.0**	**238.0**	**77.4**	**79.7**	**81.9**