Medium-Term Fiscal Strategy for Malta 2022-2025

Ministry for Finance and Employment
July 2022

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, 2022

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

18 July 2022

1. Medium-Term Fiscal Policy Strategy

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At the beginning of 2022, the world faced another hurdle, with conflict at the doorstep of Europe severely threatening the supply of necessities and essential supplies whilst unsettling transport and logistic networks. This continued to stoke inflationary pressures which had already been ignited by the supply chain disruptions of the COVID-19 pandemic. Once again, the Governments across the world, but especially in Europe, were obliged to intervene directly in the economy and support households and businesses to secure essential supplies at reasonable prices and support the continuation of economic activity. All this necessarily exerted a further fiscal cost at a time when debt levels are on the rise.

Although relatively far from the Ukrainian border, the Maltese economy remains vulnerable to trade shocks in view of the interconnectedness to the world economy. Although imports and exports from and to the conflict region are known to be relatively contained, the conflict between Russia and Ukraine affected the price and supplies of basic commodities such as grains, fertiliser, animal fodder and various metals. Moreover, the supply and price of oil and gas have been severely impacted. This led to soaring global prices of agricultural goods, processed food, various manufactured goods and even the cost of construction. As a result, the economic effect of the conflict spread beyond the borders of Russia and Ukraine affected global markets.

In this context the Maltese Government took the decision to insulate the domestic economy from the substantial increases in the price of energy and intervened to secure the supply and price of basic commodities such as wheat, grains and animal fodder. As a result, inflation in Malta, whilst clearly rising, remains contained, with Harmonised Index of Consumer Prices (HICP) inflation expected to reach 3.5 per cent in 2022. The Government is expected to spend more than €210 million (or 1.4 per cent of Gross Domestic Product (GDP)) to stabilise inflation following the global supply chain disruptions. In addition, COVID-related measures are expected to contribute €245 million (or 1.6 per cent of GDP) to public debt in 2022.

1.1 Short-Term Outlook

1.1.1 Economic Situation and Risks to the Short-Term Outlook

As global inflationary pressures persist, the purchasing power of consumers across the globe is expected to be eroded, greatly diminishing demand, especially for non-essential services. In addition, monetary conditions are expected to tighten as monetary authorities across the globe strive to fight the resulting inflationary pressures that are feared to have become more persistent, even if not yet entrenched in expectations over the longer term. In the context of these latest developments, the official macroeconomic projections were revised downwards from the Autumn forecasts presented in the Budget for 2022. Export growth prospects for 2022 were significantly reduced from 6.6 per cent projected last October to 3.6 per cent, with further reductions affected in the medium-term outlook in line with similar downward revisions to the growth projections of Malta's main trading partners. Furthermore, the rise in world commodity prices (estimated at 12.5 per cent at the time these projections were produced) and the weakening of the Euro exchange rate are expected to increase the price of imports in Malta, causing a negative terms of trade shock to the Maltese economy.

The Government's efforts to contain domestic inflation will support household consumption. Measures include subsidies to keep petroleum and electricity prices stable, a gas stabilisation fund, support to wheat and animal fodder importers, lower excise on petroleum and extra compensation to households for the increase in the cost of living. In addition, public investment, which has exceeded 4.2 per cent of GDP in the last two years, is targeted to remain at these elevated levels at least over the next two years, sustained by additional funds from the Recovery and Resilience Facility (RRF) towards high-quality investment projects and structural reforms as well as projects funded from the Multiannual Financial Framework (MFF) for the period 2021-2027. Together with the continuation of private investment activity, domestic demand conditions are expected to remain favourable and mitigate the decline in external demand.

Against this background, in 2022, GDP is expected to grow by 4.4 per cent in real terms and 7.4 per cent in nominal terms. Whilst wage growth is expected to reach 3.1 per cent in 2022, real wages are expected to decline, thus slowing down the rate of expansion of household consumption. Over the short to medium-term a normalisation of labour market conditions is anticipated consistent with a more moderate rate of expansion of the labour supply, employment and wage income. This is consistent with a more moderate growth in household consumption over the medium-term. External demand is also expected to normalise from pre-pandemic levels, in line with the independent external assumptions underlying these forecasts. As global supply disruptions persist, and monetary policy increasingly turns more hawkish, the growth in exports over the medium-term is also expected to average 3.1 per cent per annum.

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, an upside risk for 2022 is identified. Recent indicators, such as the very recent pick-up in tourism and the strong investment prospects are consistent with such a risk assessment. For the medium-term, our risk assessment suggests that risks are skewed on the downside as external conditions may deteriorate more strongly and inflationary pressures turn out to be sturdier and more persistent than anticipated. Nevertheless, the negative and persistent output gap envisaged in these projections suggest that these forecasts remain prudent even over the medium-term.

Estimates based on the European Commission's methodology for estimating potential output, suggest that over the medium-term Malta's growth potential will stabilise from an average of 6.5 per cent in the five years leading to the pandemic to an average of 3.5 per cent over the next three years underlying this Plan. This decline is however underlined primarily by the prudent assumptions for labour supply and the labour market whilst capital accumulation and total factor productivity are expected to remain positive and elevated. As a result, labour productivity is expected to continue to increase at a healthy rate suggesting that the Maltese economy should continue to advance in per capita terms and sustain its economic development path despite the more moderate economic growth prospects.

1.1.2 The Current Fiscal Situation

In 2021, the fiscal situation in Malta turned out to be better than anticipated last Autumn as the budget deficit reached 8.0 per cent of GDP, compared to the 11.1 per cent of GDP projected in Autumn of the previous year. Likewise, the increase in debt was lower than anticipated and remained below the 60.0 per cent target. Whereas the debt ratio was projected to reach 61.3 per cent of GDP, it increased to 57.0 per cent of GDP in 2021. The better-than-expected fiscal performance in 2021 can be significantly attributable to the faster than expected economic recovery which led to a faster growth in revenue. Meanwhile, total expenditure was close to the revised estimates.

A comparison with the original targets presented in October 2020 for the 2021 budget reveals substantial variances in expenditure which were only partially offset by higher than anticipated revenue. This primarily reflected the extension of COVID-19 measures which led to increased subsidies and intermediate consumption. As a result, the budget deficit which was projected to reach 5.9 per cent of GDP in 2021 turned out to be higher. Despite this deterioration in the fiscal position, the debt ratio turned out to be lower than the 58.6 per cent of GDP projected originally mainly due to the strong pace of economic growth registered over the course of the year.

1.1.3 Fiscal Support Measures

Measures in 2022 aimed at supporting companies and households to withstand the impact of higher commodity prices are expected to exceed €230 million (or 1.5 per cent of GDP). This comes on top of €250 million (or 1.6 per cent of GDP) in measures aimed at mitigating the impact of COVID-19 in 2022, including the extension of the Wage Supplement Scheme. Nevertheless, the total impact of discretionary measures is expected to fall from €973.4 million in 2021 to €791.8 million in 2022 and thus still contribute 1.2 per cent of GDP towards the reduction in the deficit. Over the course of 2023 and 2024, most of this support will be phased out and by 2025 around 95.0 per cent of the expenditure-based support for COVID-19 and price stabilisation measures are projected to have been phased out.

1.2 Medium-Term Outlook

In its latest fiscal policy guidance for 2023, the European Commission proposed that the so called "general escape clause" of the Stability and Growth Pact (SGP) will continue to apply in 2022. This will allow fiscal policy to adjust to the evolving situation to address the immediate challenges posed by this present crisis. Based on the Commission 2022 Winter forecast, the general escape clause is expected to be deactivated as of 2023. This will however be reassessed on the basis of the Commission 2022 spring forecast in view of the high uncertainty that still prevails.

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 had the same effect as a formal announcement by the 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. 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 60.0 per cent of GDP. In this context, the Medium-Term Fiscal Strategy presented here includes the budget measures for 2022 and the new measures to control inflationary pressures imported from abroad.

Nevertheless, it is notable that the budget deficit is expected to decline below the 3.0 per cent threshold in 2024 and continue declining thereafter. This is partly underpinned by the gradual phasing out of the support measures, in line with the Commission's fiscal policy guidance. A structural effort of 2.5 per cent of GDP over 2023 and 2024 is being projected, with a further reduction in 2025 such that the structural balance will reach 2.0 per cent of GDP by 2025.

1.3 Government's Expenditure Priorities

The Government is committed to implement its work programme on the basis of the recent 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. Furthermore, the Government will utilise the additional support at EU level provided under the Next Generation EU, including the SURE programme which will partially finance the Wage Supplement Scheme. Inevitably the COVID-19 pandemic and the inflationary pressures brought about by the challenges in the global supply chains and the conflict in Ukraine require a constant reassessment of the Government's expenditure priorities to address the exceptional circumstances.

It is pertinent to note that in June 2021, the Government had announced a new socio-economic vision 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.** 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.

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 axes. 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 the 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 is also implementing its Recovery and Resilience Plan (RRP) as part of the 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. The plan was assessed by the Commission and approved by the Council in 2021. Malta's RRP identifies six components:

1. Addressing climate neutrality through enhanced energy efficiency, clean energy and a circular economy;
2. Addressing carbon-neutrality by decarbonising transport;
3. Fostering a digital, smart and resilient economy;
4. Strengthening the resilience of the health system;
5. Enhancing quality education and fostering socio-economic sustainability; and
6. Strengthening the institutional framework.

The implementation of the reforms and investments outlined in Malta's RRP, as well as other necessary structural reforms and investments to tackle the above challenges will be directly contributing to several SDGs, the European pillar of Social Rights and to the relevant CSRs.

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

Significant economic uncertainty continues to surround this medium-term plan. Indeed, as indicated earlier, these projections rest on a number of assumptions, particularly the evolution of the virus, the potential escalation and persistence of conflict in eastern Europe, the persistent global supply chain disruptions and the potential worsening of inflationary pressures. As a result, it is difficult to make projections over the short-term with a high degree of certainty. Any departure from short-term projections will undoubtedly affect long-term targets.

The economic risks surrounding the medium-term plan are 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 2022 reflecting the prudent assumptions for domestic demand conditions. However, the fiscal risk emanating from the possible macroeconomic scenarios contemplated in this plan is on the downside for 2023 as downside risks to the expected recovery have been identified. There seems to be downside risks for the attainment to the budget balance throughout the forecast horizon. In the worst-case scenario contemplated in the risk assessment, which is one of persistent inflation coupled with a wage-price spiral, the budget balance as a percentage of GDP deteriorates by 0.5 and 0.3 percentage points in 2022 and 2023 respectively.

Apart from the macroeconomic risks surrounding these fiscal projections, additional risks relate to the COVID-related guarantees and the additional support to state-owned enterprises, particularly in the context of international market pressures on energy and other input costs.

The macroeconomic projections for 2022 and 2025, presented in this Plan, were assessed by the Malta Fiscal Advisory Council (MFAC). Based on the information available, and the information submitted to the Council, and after taking due consideration of the current global uncertainties, the Council considered the full set of macroeconomic forecasts for the period 2022 to 2025 prepared by the Ministry for Finance and Employment as part of the Update of Stability Programme 2022 – 2025 to lie within its endorsable range. In its assessment, the Fiscal Council opined that the balance of risks for the short-term is on the upside, but also acknowledged the prudent stance adopted by MFE given that these forecasts serve as the basis for the fiscal forecasts. The fiscal projections for 2022 to 2025 were also assessed by the MFAC. The Council considers the fiscal targets to also lie within its endorsable range.

Based on the assessment carried out by the MFAC, revenue from taxes on production and imports could be more than anticipated, given that tourist numbers (projected by the MFE, at 63.0% of 2019 levels in 2022) are on the cautious side while private consumption has been identified to have upside risks. On the other hand, the risk outlook for the other sources of revenue components (current taxes on income and wealth, social contributions and other revenue) is considered by the MFAC to be neutral. They consider these projections to be consistent with macroeconomic developments and discretionary measures. The Council points to the dependence of other revenue on the developments related to the new residency programme, noting the planned reductions in revenue from the IIP over the forecast horizon. Overall risk outlook of the MFAC in relation to total revenue is on the upside.

On the expenditure front, downside risks appear pertinent in the case of intermediate consumption in 2022, mainly in relation to pandemic-related expenditure, which may be less than planned. However, risks for intermediate consumption tilt on the upside in the medium-term. For the other expenditure component there is a downside risk, specifically in relation to the planned capital transfer to the national airline. On the other hand, the planned expenditure on compensation of employees and social payments both point towards neutral risk as they largely replicate pre-pandemic patterns. Similarly, the outlook for gross fixed capital formation is viewed as neutral but potentially upside in the outer forecast years. In turn, the risk outlook for subsidies remains highly uncertain given that expectations are highly dependent on the developments in the war between Russia and Ukraine and the subsequent longevity of the economic recovery.

The assessment carried out by the Council on the individual revenue and expenditure components suggests an overall upside risk outlook vis-à-vis the fiscal balance (possibility of a smaller deficit) in the short-term and a neutral risk outlook for the medium-term. For 2022, this reflects downside risk on the expenditure side of the budget, together with the possible upside risk on the revenue side.

In its assessment of the debt projections, the Council notes that the yearly increase in public debt over the period 2022 to 2025 is consistent with the macroeconomic and fiscal scenario, and the estimated SFA. In view of the upside risk profile for real GDP (i.e. higher economic activity than anticipated in the baseline scenario) for 2022 and the overall downside risk vis-à-vis the fiscal balance (i.e. lower fiscal deficit than projected in the baseline scenario), the Council considers a lower debt-to-GDP ratio to be possible in 2022. Furthermore, given the possibility of a more upbeat economic outlook and the carry-over effect of a lower debt in 2022, the Council considers that the balance of risks for the debt-to-GDP ratio in the medium-term to be positive (i.e. a lower debt-to-GDP ratio than projected in the baseline scenario is possible).

The Maltese Government takes note of the positive endorsement of both the macroeconomic and fiscal projections surrounding this Medium-Term Fiscal Strategy and the outlined risks 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 2021

In 2021, the Maltese economy grew by 9.4 per cent in real terms, or by 11.3 per cent in nominal terms. Domestic demand was the main contributor to this growth at 8.0 percentage points, while the external side of the economy contributed 1.8 percentage points. Inventories contributed a marginally negative 0.4 percentage points.

Following a weak start for the year 2021, due to a resurgence of Covid-19 infections and the introduction of some restrictions, private consumption bounced back strongly and grew by 6.2 per cent, supported by a resilient labour market. Consumption in restaurants and hotels grew the most (44.4 per cent), while other components which exhibited strong annual growth were recreation and culture (18.5 per cent), education (17.9 per cent), miscellaneous (11.5 per cent) and health (10.6 per cent). By the end of the fourth quarter of 2021, most components of consumption were higher than the levels recorded in the fourth quarter of 2019. Government consumption remained supportive of domestic growth conditions at 6.1 per cent, mainly driven by growth in intermediate consumption and compensation of employees. A combination of improved investor confidence, one-off investments in transport equipment and low base effects from the prior year reflected in robust investment growth of 19.3 per cent. The investment share in GDP reached 23.5 per cent of GDP during 2021, increasing from the 21.5 per cent of GDP recorded during 2019. On the external side, exports grew by 8.2 per cent despite a modest recovery in external demand conditions and a weakening euro exchange rate. However, periodic resurgences in Covid-19 infections prevented tourism exports from fully recovering. Imports grew by 7.6 per cent, driven predominantly by imports of capital goods and industrial supplies.

In terms of output, Gross Value Added (GVA) at basic prices grew by 11.4 per cent over the previous year. The growth in GVA was primarily driven by the services sector, which contributed 10.6 percentage points to GVA growth. Consequently, the share of the services sector of the total economy in terms of GVA, increased further from 89.4 per cent in 2020, to 89.7 per cent in 2021.Whilst growth in GVA was broad-based across all sectors, the subsectors mostly affected by the pandemic such as the tourism sector and other contact-intensive services continued to exhibit weaknesses. The Wholesale and Retail, Transportation, and Accommodation sector grew the most at 24.6 per cent, followed by the Information and Communication sector which grew by 15.8 per cent. Other significant growth rates were recorded in the Arts, Entertainment, and Recreation sector (14.9 per cent), the Non-Manufacturing Industrial sector (14.8 per cent) and the Public Administration sector (10.8 per cent).

As a result of the resumption in economic activity and government policies supporting income and employment, compensation of employees increased by 7.4 per cent in nominal terms, reaching €6,533.5 million. Corporate profits also fully recovered the decline witnessed during the previous year, as gross operating surplus and mixed income grew by 13.5 per cent to €7,101.4 million. Subsidies on production and imports grew by 0.8 per cent to reach €704.5 million, while revenue from taxation on production and imports increased by 13.1 per cent to €1,603.5 million.

Following the global recession witnessed during 2020, the International Monetary Fund's (IMF) most recent World Economic Outlook estimates the global economy to have grown by 6.1 per cent in 2021. This growth was underpinned by government support and easy financing conditions which enabled a resumption of economic activity and ensured that consumers' balance sheets remained strong.

In view of the conflict outbreak in Ukraine, rising inflation and an intensification of supply disruptions, together with the seemingly more aggressive stance adopted by global Central Banks to tighten financial conditions, the IMF revised its 2022 global economic outlook downwards from 4.4 per cent to 3.6 per cent in the April World Economic Outlook. A prolonged conflict between Russia and Ukraine shall continue to exacerbate supply disruptions and cause further inflationary shocks which will mostly impact those on low or fixed incomes. The infliction of sanctions will also have a substantial impact on financial markets and will dampen further the projected growth outlook for 2022.

In 2023, the IMF expects the global economy to grow by 3.6 per cent, a downward revision from the 3.8 per cent projected in January. There are further downside risks to the baseline scenario, particularly concerning an emergence of new Covid-19 variants which may result in further production disruptions and price pressures. Besides, as advanced economies commit towards a policy tightening stance, there is risk of denting the financial stability and economic recovery progress in emerging market economies.

When it comes to the balance of payments, Malta enjoyed sizable surplus in recent years thanks to the robust net export services balance, driven primarily by the personal, cultural, and recreational services net exports and the travel net export balance. In 2020, this trend came to a halt as trade flows across the world were disrupted to the extent that Malta recorded a deficit of 2.9 per cent of GDP. In 2021, the deficit widened to 5.9 per cent of GDP, primarily driven by a worsening of the goods and services balance. Although the services balance did improve notably from the previous year, this was more than offset by a higher deficit in the goods balance.

In 2020, the travel sector trade flows were highly impacted both as commercial flights either came to a halt or diminished substantially. In 2021, a notable rebound was made in travel net exports which grew by 96.0 per cent. Transport net exports also recovered substantially by 69.7 per cent. The personal, cultural, and recreational services sector, the other business services sector and the insurance and pension services sector continued their strong performance from the prior year and registered substantial increases in their export figures in 2021, whilst maintaining the same level of imports overall. These increases in net exports partially offset the decline in net exports from the financial services sector.

The primary income net payments balance improved from -9.4 per cent of GDP in 2020 to -8.1 per cent of GDP in 2021. The direct investment net payables balance decreased from -70.6 per cent of GDP to -64.1 per cent of GDP. Here, direct investment incurrence of liabilities decreased slightly, whilst the net acquisition of financial assets marginally increased. Portfolio investment net receivables balance decreased from 58.4 per cent of GDP in 2020 to 52.4 per cent of GDP in 2021.

2.2 The Medium-Term Scenario

The conflict in Ukraine, along with the Covid-19 pandemic, continue to have a severe impact on global economic activity. The situation remains highly fluid, and the outlook is subject to extraordinary uncertainty. The prices of energy and commodities, including wheat and grains, have surged, adding to inflationary pressures from supply chain disruptions and the rebound from the Covid-19 pandemic. Despite these external shocks, economic fundamentals in Malta bolstered by generally strong household and corporate balance sheets together with an expansionary fiscal policy are expected to continue to support domestic demand conditions and ensure a further resumption of growth, albeit at a more moderate pace when compared to 2021.

Against this background, in 2022, GDP is expected to grow by 4.4 per cent in real terms and 7.5 per cent in nominal terms. The domestic component is expected to be the main driver of the growth in 2022. Indeed, the domestic component of the economy is expected to contribute 3.6 percentage points to growth in 2022, supported by positive contributions from both private and public consumption as well as gross fixed capital formation.

Net exports are also projected to contribute to growth in 2022 with a positive balance of 0.8 percentage points as international developments and travel restrictions continue to be lifted, positively impacting tourism. Continued investment growth and further recovery in domestic demand will also boost the projected growth in imports.

The outlook for 2023 is subject to the assumption that the current disruptions causing inflationary pressures will eventually subside, both because of high base effects from the prior year as well as because high prices will eventually cause demand to slow down. However, prices are not assumed to revert to pre-pandemic levels. In 2023, the Maltese economy is expected to grow by 3.9 per cent in real terms and 5.8 per cent in nominal terms. Domestic demand is projected to be the main driver of this growth with an expected contribution of 3.1 percentage points followed by a positive net export contribution of 0.8 percentage points.

Over the outer years, growth is projected to converge towards historical average rates, as the fiscal stance is assumed to be less supportive and reflective of tighter financial conditions. Economic growth is expected to reach 3.7 per cent in 2024 and 3.5 per cent in 2025. In both years, domestic demand is expected to be the main driver of growth, contributing 2.8 and 2.5 percentage points to growth in 2024 and 2025 respectively. The contribution of net exports is also positive at 0.9 per cent in 2024 and 1.0 per cent in 2025.

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 2020-2025. The figures for 2020 and 2021 represent actual data published by the National Statistics Office (NSO), while the data for 2022 to 2025 represent the scenario-based projections of the Ministry for Finance and Employment (MFE). The macroeconomic forecasts take into account the latest available data and 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 3.1 per cent in 2022, and then by 2.2 per cent in 2023. Over the outer years, growth is expected to moderate to 1.7 per cent in 2024 and 1.6 per cent in 2025.

- World prices are projected to increase by 12.5 per cent in 2022, by 1.9 per cent in 2023, and by 1.3 per cent thereafter.

- Oil prices are assumed to increase from an annual average price of $70.7 per barrel in 2021 to $108.7 in 2022, then decline to $91.4 in 2023. This price level is expected to be retained throughout the outer years.

- The Dollar/Euro exchange rate is expected to depreciate from a yearly average of 1.1629 Dollars per Euro in 2021 to 1.1100 Dollars per Euro in 2022 and then appreciate

Chart 2.1
GDP Growth Rate

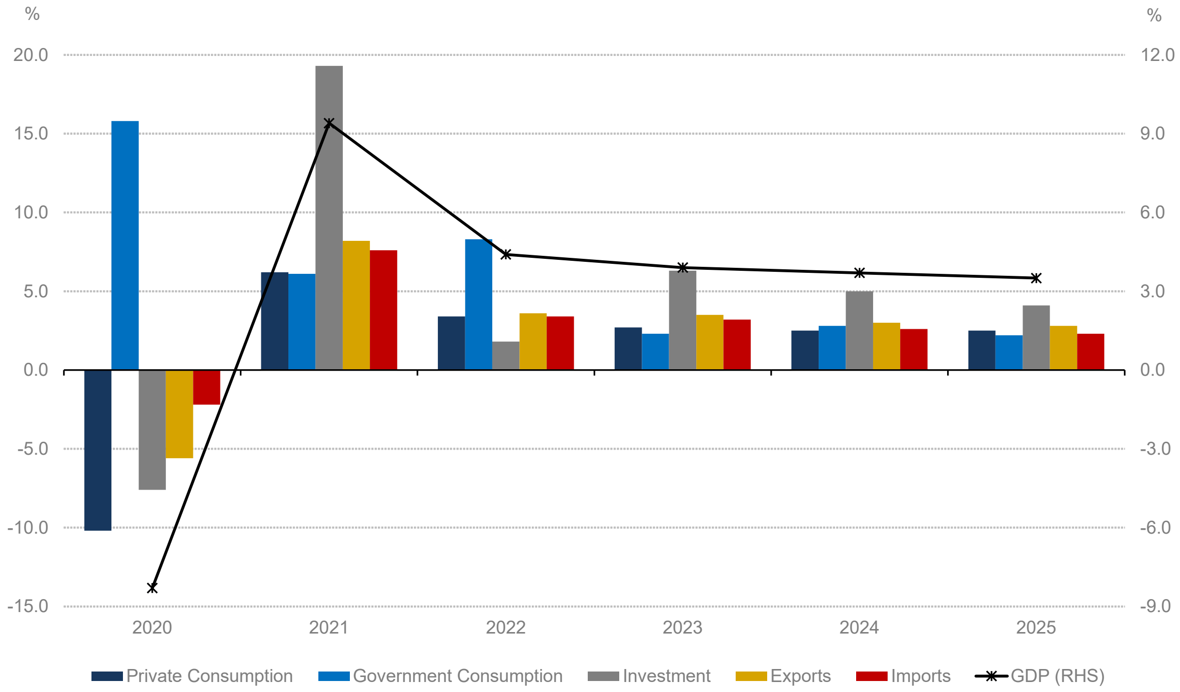


Table 2.1
Main Macroeconomic Indicators

	2020	2021	2022p	2023p	2024p	2025p
GDP growth at current market prices (%)	-7.0	11.3	7.5	5.8	5.7	5.0
GDP growth at Chain Linked Volumes by period (Reference year 2010) (%)[1]	-8.3	9.4	4.4	3.9	3.7	3.5
Expenditure Components of GDP at Current Market Prices by period (%)						
Private final consumption expenditure[2]	-9.2	7.5	7.0	4.6	4.2	4.0
General Government final consumption expenditure	18.3	8.6	12.3	3.5	4.8	4.1
Gross fixed capital formation	-6.7	20.6	4.4	7.7	6.4	5.4
Exports of goods and services	-5.0	10.7	7.8	4.9	4.4	4.0
Imports of goods and services	-1.7	10.0	7.8	4.3	3.7	3.4
Expenditure Components of GDP at Chain Linked Volumes by period (Reference year 2010) (%)						
Private final consumption expenditure[2]	-10.2	6.2	3.4	2.7	2.5	2.5
General Government final consumption expenditure	15.8	6.1	8.3	2.3	2.8	2.2
Gross fixed capital formation	-7.6	19.3	1.8	6.3	5.0	4.1
Exports of goods and services	-5.6	8.2	3.6	3.5	3.0	2.8
Imports of goods and services	-2.2	7.6	3.4	3.2	2.6	2.3
Inflation rate (%)	0.8	0.7	3.5	2.2	1.8	1.7
Employment growth (National Accounts Definition) (%)[3]	2.8	1.6	2.4	2.1	2.2	2.3
Unemployment rate (Harmonised definition, Eurostat) (%)	4.4	3.5	3.4	3.5	3.5	3.6
Compensation per employee (% change)[4]	-0.7	5.5	3.1	2.9	2.5	2.4
Labour productivity (% change)	-10.8	7.7	1.9	1.7	1.5	1.2
Nominal Unit Labour Cost (% change)	11.4	-2.1	1.2	1.2	1.0	1.2
Real Unit Labour Costs (% change)	9.9	-3.9	-1.7	-0.6	-0.9	-0.3

[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.

in 2023 to 1.1360 Dollars per Euro. Further euro strength is expected in the outer years, reaching 1.1640 Dollars per Euro in 2024 and 2025.

- The Sterling/Euro exchange rate is expected to depreciate from an annual average of 0.8527 Pounds per Euro in 2021 to 0.8357 Pounds per Euro in 2022 and then to appreciate in 2023 to 0.8384 Pounds per Euro. In 2024 and 2025, the Sterling/Euro exchange rate is expected to marginally increase to 0.8472 Pounds per Euro.

- The short-term interest rate is projected to increase to 0.25 per cent in 2022 and further increase to 1.13 per cent in 2023, in line with the European Commission's (EC) assumptions. The yield curve is assumed to steepen in 2022 as long-term yields accelerate to 1.16 per cent from the prior year's 0.5 per cent, but in 2023 the curve will then flatten as long-term yields modestly increase to 1.28 per cent. In the outer years, the short-term and long-term interest rates are kept stable.

- Inflationary pressures are assumed to be temporary and are not expected to lead to a wage-price spiral.

- Changes in inventories are assumed not to contribute to GDP growth.

- As travel restrictions are alleviated and economic activity picks up, tourist numbers in 2022 are expected to reach around 63.0 per cent of the total number of inbound tourists in 2019 and recover further to 83.0 per cent of 2019 tourism numbers in 2023.

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

2.2.2 Risks to Outlook

Despite an expected improvement in economic activity, the situation going forward remains overshadowed with uncertainty. Uncertainty related to the war in Ukraine along with the epidemiological evolution imply that the overall balance of risks remains 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 2022 is projected to increase by 3.4 per cent. This figure reflects projected strong employment and compensation per employee growth, along with a continued recovery in discretionary services spending as concerns about the pandemic dissipate. It is pertinent to note that despite the strong growth registered last year, household consumption has not yet recovered its 2019 levels, indicating scope for further increases in 2022. Furthermore, household balance sheets remain supportive of growing household consumption despite a forecast decline in real household disposable income. Nonetheless, the consumption forecast is purposely prudent in view of the reduced purchasing power of individuals due to rising prices and due to base effects from durable goods consumption which was pulled forward during the prior two years. In 2023, private consumption is expected to grow by 2.7 per cent on the back of modest employment growth and higher real compensation per employee growth. In the outer years, private consumption is projected to grow by 2.5 per cent in both 2024 and 2025.

2.2.4 General Government Final Consumption Expenditure

Following significant growth in 2021, public consumption growth is projected to further increase by 8.3 per cent in 2022, driven primarily by growth in intermediate consumption and compensation of employees. In 2023, government expenditure will continue to increase by 2.3 per cent. In the outer years, general government final consumption expenditure is projected to grow by an average rate of 2.5 per cent. This implies that the share of public consumption in real GDP will average at 20.6 per cent over the projection period.

2.2.5 Gross Fixed Capital Formation

The inherently volatile nature of gross fixed capital formation (GFCF) makes it relatively challenging to forecast. Hence, when forecasting investment, a relatively prudent approach is normally followed, factoring in only those projects that have a strong political commitment or a high probability of realisation, while assuming a relatively high import content.

Gross fixed capital formation is expected to increase by 1.8 per cent in 2022 as strong base effects from the prior year and uncertainty regarding the short-term outlook are likely to cause several projects to be deferred. In 2023, GFCF is assumed to grow by 6.3 per cent as firm and investor sentiment improve and numerous projects which have been publicly announced commence. In the outer years, investment activity is expected to gradually moderate and record an average growth of 4.6 per cent between 2024 and 2025. Moreover, the investment to GDP ratio is expected to marginally increase and average at 23.5 per cent over the forecast horizon.

2.2.6 External Balance of Goods and Services

From an external perspective, the Ukraine-Russia conflict exacerbated price pressures which were already showing signs of increase due to disruptions induced by the pandemic. The rapid acceleration in inflation dented the euro area economic recovery, leading forecasters to revise their projections of euro area growth downward by an average of 0.7 to 1.0 percentage points. Some economies with significant exposure to Russia and Ukraine revised their growth projections even more aggressively downwards. This deterioration in external conditions resulted in a downward revision in net exports from what was initially forecasted in the Draft Budget Plan 2022. As higher global prices dent external demand and supply shortages damage trade, exports are projected to increase by 3.6 per cent, mainly driven by services. In light of a potential resurgence in infections and rising prices of essentials like energy and food, tourism numbers are expected to remain conservative throughout 2022, reaching 63.0 per cent of 2019 levels.

Partially offsetting the increase in exports, is an increase in imports of 3.4 per cent in 2022. 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 and the continued recovery in exports further supports this increase in imports.

The modest growth of Malta's main trading partners along with continued recovery in tourism is anticipated to result in an increase in Malta's exports by 3.5 per cent in 2023 and converge to an average growth of 2.9 per cent in the outer years. In the outer years, growth in imports is set to move in line with the expected recovery in domestic activity. In particular, imports are projected to increase by 3.2, 2.6, and 2.3 per cent in 2023, 2024, and 2025, respectively. The external balance as a percentage of GDP is expected to reach 13.4 per cent in 2022 before stabilising at an average of 14.6 per cent over the forecast horizon.

2.2.7 Sectoral Balances

Table 1D shows in-house projections for the balance of payments headline indicators. The current account has historically shown strong surplus positions but the COVID-19 pandemic has considerably impacted the typically sizeable net export position of the travel component. However, as tourism is expected to continue recovering, the balance on goods and services is expected record substantial increases over the projection period.

In terms of the forecasted values of the balance on primary income and transfers, the net payment balance is expected to stabilise albeit slightly decrease over the forecast horizon, averaging at around 9.1 per cent of GDP. This is reflective of a continuation of the convergence between the return on direct investment liabilities and the return on portfolio investment assets. Moreover, a constant spread is assumed between the returns on other direct investment assets and other direct investment liabilities.

A stabilised balance on primary income and transfers coupled with a recovery in the goods and services balance shall see the current account balance turn to a surplus in 2022 and continue increasing over the outer years.

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 continued to sustain its positive performance in 2021, as employment growth stood at 1.6 per cent (National Accounts definition).

In 2022, a continued pick-up in economic activity is projected to generate an employment growth of 2.4 per cent before reaching an average of 2.2 per cent in the outer years. The unemployment rate, based on the Harmonised definition, is projected to stand at 3.4 per cent in 2022 before increasing to 3.5 per cent in 2023 and reaching 3.5 and 3.6 per cent in 2024 and 2025 respectively.

Compensation of employees is projected to increase by 5.7 per cent in 2022 as heightened job demand and inflation generate upward wage pressures, before moderating to 5.1 per cent in 2023 and averaging 4.8 per cent in the outer years. Concomitantly, growth in compensation per employee is projected to grow by 3.1 per cent in 2022, before growing at 2.9 per cent in 2023 and averaging out at 2.4 per cent in the outer years.

In 2022, real labour productivity is projected to increase by 1.9 per cent. This growth is expected to continue in 2023 as labour productivity is projected to increase by 1.7 per cent before averaging a growth rate of 1.3 per cent in the outer years. Nominal unit labour costs are expected to increase by 1.2 per cent in 2022 and 2023, before growing by an average of 1.1 per cent in 2024 and 2025, respectively. Moreover, real unit labour costs are projected to decrease by 1.7 per cent in 2022, before declining by 0.6 per cent in 2023 and declining further by 0.9 per cent in 2024, and 0.3 per cent in 2025.

2.2.9 Inflation

In 2021, the inflation rate (measured as the twelve-month moving average of the Harmonized Index for Consumer Prices (HICP)) was 0.7 per cent, down from 0.8 per cent in 2020. Inflation was primarily driven by food prices and prices of non-energy industrial goods but offset by declines in energy prices and some components of services. The inflation rate is expected to increase to 3.5 per cent in 2022, driven by disruptions in global supply-chains, causing bottlenecks and shortages and amplifying price pressures as a result of the conflict in Ukraine. In 2022, the acceleration in HICP is expected to be mainly driven by higher food prices, attributable to unprocessed food inflation, and to a lower extent processed food inflation, owing to shortages, increased shipping costs and adverse weather causing poor harvests globally. Additionally higher prices of services are also expected to positively contribute to overall HICP, as services demand continues to recover following the pandemic. The prices of non-energy industrial goods are also expected to increase, largely owing to surging price inflation in source markets along with substantial increases in shipping costs. Energy inflation is expected to remain stable in 2022 in line with the Government's commitment to absorb the rising energy prices. Prices are expected to normalise gradually in 2022 as the tightening of financial conditions offset the current global supply-demand mismatch. Consequently, HICP inflation is expected to decelerate in 2023 to 2.2 per cent, with lower contributions from all components following high base effects from the previous year and a deceleration in economic activity. Prices will further moderate to 1.8 per cent and 1.7 per cent in 2024 and 2025 respectively.

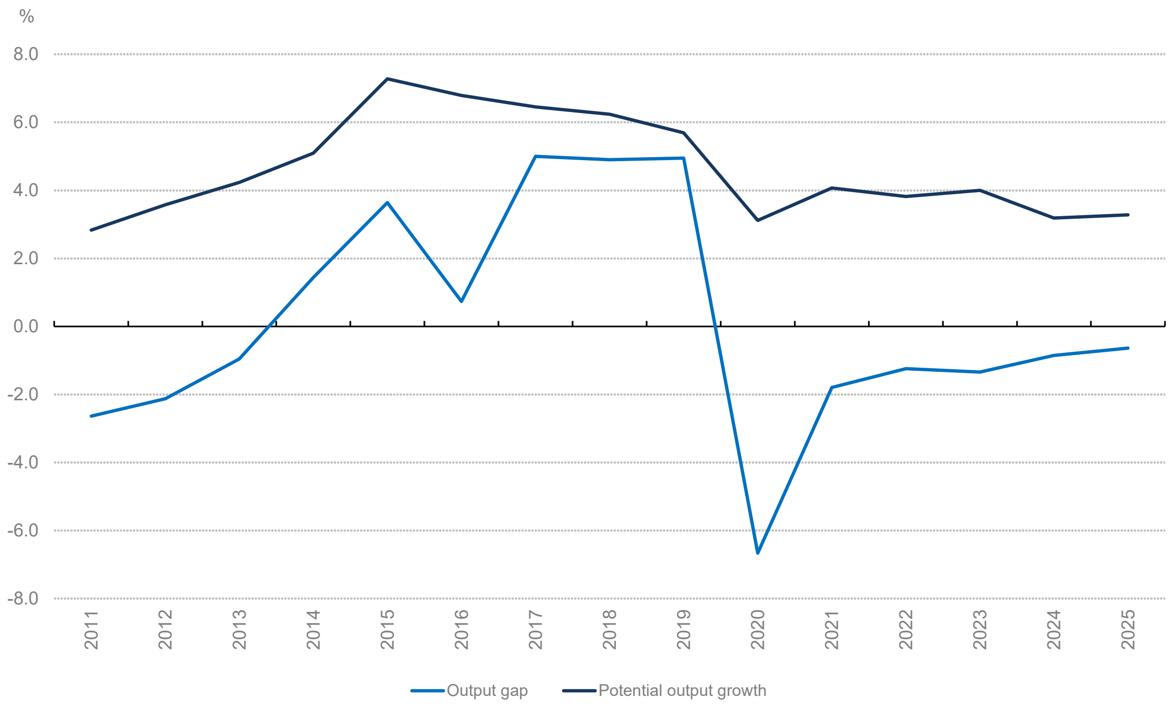
2.2.10 Comparison with the Commission's Winter Forecast

The winter forecasts published by the EC project a growth rate for Malta of 6.0 per cent and 5.0 per cent in 2022 and 2023, respectively. For 2022, this is 1.6 percentage points above this forecast's expectations, while for 2023, this is 1.1 percentage points higher. Both MFE and EC forecasts are projecting domestic demand to be the key driver of Malta's growth in 2022 and 2023. It is to be noted that the EC's Winter Forecast does not use the latest statistical data and were drawn up prior to the Ukraine and Russia conflict. That said, the EC forecasts are currently in the process of being revised.

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 estimations pertain to differences in

Chart 2.2
Malta's Potential Output Growth and Output Gap Estimates



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 5.4 per cent, reaching a peak in 2015. Due to the pandemic, in 2020, potential output growth stood at a comparatively lower rate of 3.1 per cent but this recovered to 4.1 per cent in 2021. Potential output is expected to average around 3.6 per cent over the forecast period, standing at 3.3 per cent in 2025. A positive investment outlook over the forecast horizon implies that capital accumulation is expected to be the main contributor to potential GDP growth, supported to a lesser extent by the labour contribution, as the labour market remains resilient. Total factor productivity is projected to contribute the least to potential output growth, but the contribution remains positive throughout the forecast horizon.

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 throughout the forecast horizon but converges progressively towards potential growth by 2025.

Table 1a

Macroeconomic Prospects

Percentages unless otherwise indicated	ESA Code	Level 2020(1)	Level 2021(1)	2020	2021	2022(2)	2023	2024	2025
				Percentage change over previous period					
1. Real GDP	B.1g	11,810.1	12,921.8	-8.3	9.4	4.4	3.9	3.7	3.5
2. Nominal GDP	B.1g	13,059.9	14,533.8	-7.0	11.3	7.5	5.8	5.7	5.0
Components of real GDP									
3. Private consumption expenditure(3)	P.3	5,460.4	5,800.1	-10.2	6.2	3.4	2.7	2.5	2.5
4. Government consumption expenditure	P.3	2,466.6	2,616.4	15.8	6.1	8.3	2.3	2.8	2.2
5. Gross fixed capital formation	P.51	2,542.3	3,032.1	-7.6	19.3	1.8	6.3	5.0	4.1
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53			1.5	1.0	1.0	0.9	0.9	0.9
7. Exports of goods and services	P.6	18,071.6	19,549.1	-5.6	8.2	3.6	3.5	3.0	2.8
8. Imports of goods and services	P.7	16,926.7	18,216.4	-2.2	7.6	3.4	3.2	2.6	2.3
Contribution to real GDP growth(4)									
9. Final domestic demand		10,469.3	11,448.5	-3.6	8.0	3.6	3.1	2.8	2.5
10. Change in inventories and net acquisition of valuables	P.52+P.53			0.6	-0.4	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	1,144.8	1,332.7	-5.3	1.8	0.8	0.8	0.9	1.0

(1) € million

(2) Projections from 2022 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.

Table 1b

Price Developments

Percentages unless otherwise indicated	ESA Code	Level 2020(1)	Level 2021(1)	2020	2021	2022(2)	2023	2024	2025
				Percentage change over previous period					
1. GDP deflator(3)		126.1	128.5	1.3	1.9	2.9	1.8	1.8	1.5
2. Private consumption deflator		115.7	117.2	1.0	1.3	3.5	1.9	1.7	1.5
3. HICP (Average 2015=100)		106.4	107.1	0.8	0.7	3.5	2.2	1.8	1.7
4. Public consumption deflator		126.5	129.7	2.5	2.5	3.6	1.3	2.0	1.9
5. Investment deflator		116.5	118.0	0.9	1.3	2.6	1.3	1.2	1.2
6. Export price deflator (goods and services)		122.1	125.2	0.6	2.5	4.0	1.3	1.3	1.2
7. Import price deflator (goods and services)		116.2	119.0	0.5	2.4	4.4	1.1	1.1	1.1

(1) Index (base 2010 unless otherwise indicated)

(2) Projections from 2022 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.

Table 1c

Labour Market Developments

Percentages unless otherwise indicated	ESA Code	Level 2020	Level 2021	Percentage change over previous period 2020	2021	2022[1][2]	2023	2024	2025
1. Employment, persons (National Accounts Definition, Domestic Concept)		259,176.0	263,216.0	2.8	1.6	2.4	2.1	2.2	2.3
2. Employment, hours worked (National Accounts Definition, Domestic Concept) ('000s)		520,425.4	528,537.7	2.8	1.6	2.4	2.1	2.2	2.3
3. Unemployment rate (Harmonised definition, 1000 persons)		11,866.6	9,801.5	4.4	3.5	3.4	3.5	3.5	3.6
4. Labour Productivity, persons (Real GDP per person employed)		45,567.8	49,092.1	-10.8	7.7	1.9	1.7	1.5	1.2
5. Labour Productivity, hours worked (Real GDP per hour worked)		22.7	24.4	-10.8	7.7	1.9	1.7	1.5	1.2
6. Compensation of employees (€ million)	D1	6,084.9	6,533.5	1.7	7.4	5.7	5.1	4.8	4.7
7. Compensation per employee (€)		23,477.9	24,821.7	-0.7	5.5	3.1	2.9	2.5	2.4

(1) Projections from 2022 onwards

(2) Forecasts based on FTEs, assuming no change in hours worked

Table 1d

Sectoral Balances

Percentages of GDP	ESA Code	2021	2022	2023	2024	2025
1. Net lending/ borrowing		-5.3	1.8	3.0	3.8	4.5
vis-à-vis the rest of the world	B.9					
of which:						
Balance on goods and services		3.2	13.4	14.0	14.6	15.2
Balance on primary income and transfers		-9.1	-9.6	-9.1	-9.0	-8.9
Capital account		0.6	-2.0	-1.9	-1.8	-1.7
2. Net lending/ borrowing of the private sector	B.9	4.5	6.4	6.5	5.9	3.8
3. Net lending/ borrowing of general Government	EDP B.9	-8.0	-5.4	-4.6	-2.8	-2.4
4. Statistical discrepancy		0.9	0.8	0.8	0.7	0.7
Current Account		-5.9	3.8	4.9	6.1	6.8

3. General Government Balance, Measures and Government Debt

3. General Government Balance, Measures and Government Debt

Prior to the pandemic, the Government succeeded in considerably improving the public finance situation, registering budget surpluses and reducing the debt-to-GDP ratio. Further to enabling the provision of timely and adequate healthcare (including for the COVID-19 vaccination programme), this fiscal space allowed the Government to take unprecedented steps to support jobs, livelihoods, and businesses throughout the pandemic. As a result, the general Government deficit increased significantly. However, in spite of the extraordinary economic challenge posed by the pandemic, the fiscal action taken by the Government over the past two years was crucial to support the economy when strict public health restrictions were in place and to provide the necessary fiscal stimulus to sustain the economic recovery.

In light of the conflict between Russia and Ukraine, and its expected economic impact on Malta, the Maltese Government is set to maintain a supportive budgetary policy in 2022. In view of the indirect consequences of the conflict in Ukraine, the Maltese authorities have intervened to shield households and businesses from the increases in the international price of oil which affects both the cost of energy as well as fuel for transportations purposes. In addition, the Government intervened to ensure stability in the price of cereals (including wheat) as well as security of supply. Measures in 2022 aimed at supporting companies and households to withstand the impact of higher commodity prices are expected to exceed €210 million (or 1.4 per cent of GDP). This comes on top of €245 million (or 1.6 per cent of GDP) in measures aimed to mitigate the impact of the pandemic in 2022, including the extension of the Wage Supplement Scheme. Nevertheless, the total impact of discretionary measures is expected to fall from €973.4 million in 2021 to €768.1 million in 2022 and thus still contribute 1.3 percentage points of GDP towards the reduction in the deficit.

The economic expansion is expected to boost taxation receipts over the course of this year, while general Government expenditure is estimated to decline in 2022, as the temporary support with regards to the pandemic is expected to be phased out, in line with the Government's commitment to contain expenditure as the public health situation improves and the economy recovers. Nationally financed investments are expected to remain elevated in 2022 and 2023. This expenditure is further sustained by additional funds from the RRF towards high-quality investment projects and structural reforms as well as projects funded from the Multiannual Financial Framework (MFF) for the period 2021-2027. This high level of investment is expected to boost Malta's growth potential. In recent years, the Government's investment efforts were targeting public infrastructure, in particular the arterial and urban roads' networks and other transportation facilities. In the coming years, the focus will shift to fiscal incentives to encourage innovative, green and digital investments by businesses. Through the Low Carbon Development Strategy (LCDS), the Government will also accelerate the ongoing efforts towards environmental sustainability.

Once economic conditions allow, the Government remains committed to gradually balance the budget over the economic cycle and ensure that the debt ratio remains below 60 per cent of GDP.

3.1 Fiscal Developments in 2021

The general Government balance for 2021 amounted to a deficit of €1,166.4 million, an improvement of €71.3 million over the deficit recorded in 2020. Total revenue increased by €635.2 million to €5,448.6 million, while expenditure amounted to €6,614.9 million, increasing by €563.9 million. As a share of GDP, the general Government balance was equivalent to a deficit of 8.0 per cent, decreasing by 1.5 percentage points when compared to the deficit of 9.5 per cent registered in 2020. General Government debt increased by €1,332.2 million over 2020 and stood at €8,097.4.0 million. The debt-to-GDP ratio for 2021 increased to 55.7 per cent. Fiscal developments in 2021 were mainly impacted by the COVID-19 pandemic and the subsequent extension and phasing out of Government measures used to mitigate the associated economic, social and health risks.

General Government revenue increased by 0.6 percentage points over 2020, in line with the strong economic recovery which took place. Tax revenue (excluding social contributions) increased by 1.2 percentage points to 25.0 per cent of GDP, as a result of the resumption in economic activity following the lifting of numerous COVID restrictions, and government policies supporting income and employment. Corporate profits fully recovered the decline witnessed during the previous year, and together with extended measures, particularly those aimed at sustaining employment, positively affected proceeds from current taxes on income and wealth which increased by 1.1 percentage points in 2021 from 12.9 per cent in 2020 to 14.0 per cent in 2021. Taxes on production and imports also registered a 0.1 percentage point increase, as despite a weak start to the year due to a resurgence of COVID-19 infections and restrictions, private consumption bounced back strongly, supported by a resilient labour market, although periodic resurgences in COVID-19 infections prevented tourism-related industries from fully recovering. Meanwhile, the ratio-to-GDP of social contributions, capital taxes and property income remained relatively unchanged, while ‘other’ revenue declined by 0.4 percentage points, mainly reflecting lower capital transfers and investment grants.

The ratio of general Government expenditure to GDP decreased by 0.8 percentage points to 45.5 per cent in 2021, on the basis of the phasing out of several support measures in 2021. Expenditure decreased for most expenditure components, other than ‘other’ expenditure, intermediate consumption and interest expenditure. The increase of 0.5 percentage points in the ratio of ‘other’ expenditure to GDP mainly reflects higher accrued EU Own Resources. Similarly, the higher ratio-to-GDP of interest expenditure is mainly on account of a provision for interest due on accrued EU Own Resources. The ratio-to-GDP of intermediate consumption increased by 0.3 percentage points to 9.4 per cent of GDP in 2021, largely due to higher intermediate consumption by EBUs, and additional spending in relation to elderly care and health care. Meanwhile, lower ratios-to-GDP were recorded for social payments (-0.75 percentage points), as expenditure on social benefits was more subdued compared to GDP growth, and subsidies (-0.47 percentage points) related to the Pandemic assistance scheme, which includes the COVID-19 Business Assistance Programme.

National policy response to COVID-19 and budgetary implications

The Government’s fiscal support has been crucial in safeguarding jobs during the pandemic and to provide the necessary fiscal stimulus during the economic recovery, having delivered a package of targeted, temporary support worth over €1.3 billion over 2020 and 2021, mainly in respect of the Malta Enterprise sustainable enterprise schemes, including the Wage Supplement Scheme, reduced taxation on the transfer of immovable property for both buyers and sellers, and the Economic Regeneration Voucher Scheme. In addition, the Government supported corporate liquidity by means of tax deferrals and the allocation of a €350 million fund to the MDB to set up and manage the MDB COVID-19 guarantee scheme with the purpose of guaranteeing loans granted by commercial banks to businesses facing cash flow disruptions.

The measures in support of the recovery were later extended as the second wave of the global virus hit the Maltese economy in the first half of 2021. In particular measures relating to 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 were 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 of revenue, fiscal support was provided by elements (also known as automatic stabilisers) built into the budget that mitigate fluctuations in economic activity, without the need for discretionary Government actions. Such support was particularly relevant in 2020, when a substantial fall in tourist expenditure and household spending led to a decline in indirect tax revenue, whilst corporate losses underlined a significant drop in direct tax revenue.

In spite of the extension of such temporary social and economic support measures beyond the first quarter of 2021, and the increase in the cost of discretionary revenue measures, the general Government deficit for 2021 declined to 8.0 per cent of GDP as the economic recovery materialised.

3.1.1 Comparison with the 2021 Update of the Stability Programme for 2021

This section assesses the fiscal and budgetary policies in 2021 against the objectives outlined in the 2021 Update of the Stability Programme (USP) published in April 2021. It is worth noting that the targets for 2021, as outlined in spring 2021, differ from those underlying the 2021 Budget presented in October 2020 due to updated fiscal information available. Developments in the general Government budgetary execution in 2021, between subsequent forecasts, are outlined in Table 3.1a.

In 2021, the general Government deficit stood at €1,166 million, that is €464 million lower than the €1,630 million forecast in the USP 2021. This was mainly due to a higher than expected revenue outcome, where the general Government revenue was €462 million higher than estimated. Total expenditure was very close to that anticipated in the 2021 USP with a marginal difference of €2 million.

Current taxes on income and wealth recorded the highest variance when compared to the estimate for 2021 and this emanated from both taxes due on household income as well as corporate profits. Such upswings are mainly attributed to a better than expected economic environment which resulted in higher than estimated income for households and corporations. Indeed, the lifting of measures associated with the COVID-19 pandemic, together with an extensive vaccination programme and the resulting easing of containment measures, has strengthened trade and supported domestic economic activity. In addition, the Government support measures proved to be effective at cushioning the impact on the labour market and in capturing undeclared economic activity from employment following the Wage Supplement Scheme. This was also partly reflected in a higher-than-expected revenue from social contributions of €55 million. Revenue from taxes on production and imports yielded €133 million more revenue than was forecasted in the 2021 USP. This component of revenue was largely affected by upward developments in tourist expenditure, together with stronger than expected consumption by domestic households. This was partly offset by the fiscal impact of extended reduced taxation on the transfer of immovable property for buyers, and new and extended fiscal measures resulting in lower excise applicable on petroleum products, as well as more moderate behavioural responses in respect to the relative tax bases than anticipated.

On the expenditure side, higher than targeted expenditure on subsidies, compensation of employees and interest expenditure was in part offset by lower than planned expenditure on capital transfers, gross fixed capital formation, and social payments. Expenditure on subsidies was €102 million higher than targeted in the 2021 USP, reflecting the extension of the COVID-19 Business Assistance Programme beyond the first quarter of 2021. Higher than expected interest expenditure is mainly on account of a provision for interest due on accrued EU Own Resources. Meanwhile, lower than expected capital transfers resulted from the revised support to the national airline, which did not materialise in

Table 3.1a

General Government Budgetary Developments in 2021

Divergence from previous forecasts

€ millions

	ESA Code	USP 2021 compared to USP 2022: Divergence due to outturn in *t-1*	USP 2021 compared to USP 2022: Divergence due to updated macro-economic projections	USP 2021 compared to USP 2022: Other revisions	USP 2021 compared to USP 2022: **Total forecast revision**	DBP 2021 compared to USP 2022: Divergence due to outturn in *t-1*	DBP 2021 compared to USP 2022: Divergence due to updated macro-economic projections	DBP 2021 compared to USP 2022: Other revisions	DBP 2021 compared to USP 2022: **Total forecast revision**
Net lending (+)/net borrowing (-)									
1. **General Government**	S.13	**0**	**634**	**-170**	**464**	**-23**	**305**	**-657**	**-374**
2. Central Government	S.1311	0	634	-170	464	-23	305	-657	-374
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	**0**	**630**	**-168**	**462**	**-23**	**282**	**-12**	**247**
Of which									
Taxes on Production and Imports	D.2	18	327	-211	133	-36	81	-132	-88
Current Taxes on Income, Wealth, etc.	D.5	-4	237	25	258	-18	240	-50	172
Capital Taxes	D.91	0	13	-1	12	4	-30	31	5
Social Contributions	D.61	-13	54	15	55	28	-9	76	95
Property Income	D.4	0	0	2	2	0	0	-1	-1
Other [(a)]		0	0	2	2	0	0	63	63
7. **Total Expenditure**	TE	**0**	**-4**	**2**	**-2**	**0**	**-23**	**644**	**621**
Of which									
Compensation of employees	D.1	0	0	67	67	0	0	102	102
Intermediate Consumption	P.2	0	0	19	19	0	0	139	139
Social Payments	D.6	0	-4	-17	-21	0	-23	25	2
Of which									
Unemployment expenditure		0	-4	0	-4	0	-23	0	-23
Interest Expenditure	D.41	0	0	51	51	0	0	55	55
Subsidies	D.3	0	0	102	102	0	0	280	280
Gross Fixed Capital Formation	P.51	0	0	-129	-129	0	0	-69	-69
Capital Transfers	D.9	0	0	-145	-145	0	0	47	47
Other [(b)]		0	0	53	53	0	0	66	66

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.

2021, as discussions with the European Commission are still underway. Gross fixed capital formation was also lower than estimated in the 2021 USP by €129 million, mainly on account of a lower than planned absorption of EU-financed expenditure.

3.2 Budgetary plans for 2022

The pre-pandemic level of output was already attained by the end of 2021. However, the outlook is subject to uncertainty, as the conflict in Ukraine has added to inflationary pressures from supply chain disruptions following the rebound from the COVID-19 pandemic. Despite these external shocks, economic fundamentals in Malta bolstered by generally strong household and corporate balance sheets together with an expansionary fiscal policy, are expected to continue to support domestic demand conditions and ensure a further resumption of growth, albeit at a more moderate pace when compared to 2021. Indeed, updated budgetary plans for 2022 make allowance for the extension of existing COVID-19 related measures, as well as support related to price and supply

Table 3.2

Expenditure and Revenue Targets

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

% GDP

	ESA Code	2020	2021	2022	2023	2024	2025
General Government (S13)							
1. Total revenue target	TR	**36.9**	**37.5**	**38.1**	**38.1**	**37.6**	**36.9**
of which							
1.1. Taxes on production and imports	D.2	10.7	10.8	11.5	11.9	12.2	12.1
1.2. Current taxes on income, wealth, etc	D.5	12.9	14.0	14.8	14.4	14.3	14.3
1.3. Capital taxes	D.91	0.2	0.2	0.1	0.1	0.1	0.1
1.4. Social contributions	D.61	6.4	6.3	6.1	6.0	5.9	5.8
1.5. Property income	D.4	0.6	0.6	0.4	0.5	0.5	0.4
1.6. Other [1]		6.0	5.6	5.1	5.1	4.5	4.1
p.m.: Tax burden		30.3	31.4	32.7	32.6	32.7	32.5
(D.2+D.5+D.61+D.91-D.995)[2]							
2. Total expenditure target	TE	**46.3**	**45.5**	**43.6**	**42.7**	**40.3**	**39.3**
of which							
2.1. Compensation of employees	D.1	12.1	12.2	12.1	12.1	12.2	12.2
2.2. Intermediate consumption	P.2	9.1	9.4	9.9	9.3	9.0	8.8
2.3. Social payments	D.6M	10.3	9.6	9.8	9.6	9.6	9.4
of which Unemployment benefits [3]		0.2	0.2	0.2	0.2	0.1	0.1
2.4. Interest expenditure	D.41	1.3	1.5	1.1	1.1	1.1	1.1
2.5. Subsidies	D.3	5.2	4.7	2.9	2.9	1.6	1.4
2.6. Gross fixed capital formation	P.51	4.5	4.2	4.1	4.2	3.7	3.4
2.7. Capital transfers	D.9	1.3	1.1	1.1	1.2	1.0	0.9
2.8. Other [4]		2.5	3.0	2.7	2.3	2.2	2.1
3. General Government Balance		**-9.5**	**-8.0**	**-5.4**	**-4.6**	**-2.8**	**-2.4**
4. Primary Balance		**-8.2**	**-6.6**	**-4.4**	**-3.5**	**-1.7**	**-1.3**

[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.

developments of energy and commodities. In addition, in 2022, investment is expected to remain elevated, further sustained by additional funds from the RRF towards high-quality investment projects and structural reforms as well as projects funded from the Multiannual Financial Framework (MFF) for the period 2021-2027.

In line with such developments, the economic expansion is expected to boost taxation receipts over the course of this year, while general Government expenditure is estimated to decline in 2022, reflecting the phasing out of the fiscal measures supporting the economy during the pandemic. This is expected to result in an improvement of the general Government balance in 2022 to a deficit of €844.0 million or 5.4 per cent of GDP. The total revenue ratio for the general Government is expected to increase by 0.7 percentage points, while the expenditure-to-GDP ratio is expected to narrow by 1.9 percentage points.

Revenue from taxes is expected to increase by 13.7 per cent, benefitting from positive contributions from private consumption and the rebound in tourism, the sustained growth in profits and the positive performance of the labour market. General Government expenditure is expected to increase slightly by 2.9 per cent over the level recorded in 2021, as the temporary economic support is expected to be phased out during 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 short-term fiscal developments are presented in Table 3.3. The net impact on the budget balance of temporary and permanent discretionary revenue measures for 2022 (including those implemented in previous budgets but which will still have an impact in 2022) is estimated at 0.13 per cent of GDP. Meanwhile, incremental discretionary expenditure measures (including those implemented in previous budgets but which will still have an impact in 2022), are expected to improve the budget balance of 2022 by 1.46 per cent of GDP.

The 2022 Budget aims to strengthen further the distributional policies enacted in recent years with the objective of strengthening social inclusion, promote social mobility and reduce poverty. All this whilst providing the conditions for the economy to sustain the recovery from the persistent impact of COVID-19 and creating employment within the framework of inclusive economic growth, whilst facilitating the twin Green and Digital transitions.

The 2022 Budget builds on previous years' initiatives aimed at reducing further the risk of poverty for the most vulnerable in society, by including a number of measures aimed at financially enhancing the pensioners' and elderly's income and also supporting the provision of informal long-term care. Most pensions, both contributory and non-contributory, will increase in excess of the customary cost of living adjustment (COLA). The taxable ceiling on pensions will also be raised. Other measures include the support to households that hire private help at home.

Furthermore, the Government will continue to support incomes through income supplements and bonuses linked to childbirth or adoption, with a specific focus on low-income households. The Government will also be increasing the stipend allowance provided to students by 10.0 per cent.

Table 3.3

Description of discretionary measures included in the draft budget

(Discretionary measures taken by General Government)

List of measures	Detailed description	Target (Expenditure / Revenue component) ESA Code	Accounting principle	Adoption Status	Introduced in Budget for…	Incremental Budgetary Impact					
						2020 % of GDP	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP
Post COVID-19 Economic Regeneration Plan	Reduced tax on the transfer of immovable property	D2, D5 - R	Accruals	Temporary & Adopted	June 2020 Economic Regeneration Plan	-0.47	-0.52	0.50	0.64	0.00	0.00
Post COVID-19 Economic Regeneration Plan	Reduced Excise Duty	D2 - R	Accruals	Temporary & Adopted	June 2020 Economic Regeneration Plan	-0.06	-0.06	0.01	0.10	0.00	0.00
Budget measures enabling business activity		D2 - R	Accruals	Permanent & Adopted	2019 - 2021	0.00	-0.06	0.00	0.00	0.00	0.00
Excise duty	Minimum excise duty applicable on petroleum products as from 9/11/2021	D2 - R	Accruals	Permanent & Adopted	2021	0.00	-0.03	-0.17	0.20	0.00	0.00
Efficiency in Revenue Collection	Revision in interest and penalties due on outstanding tax balances	D2, D5 - R	Accruals	Permanent & Adopted	2022	0.00	0.00	0.13	-0.01	-0.01	-0.01
Personal income tax	Fiscal incentives for private pensions	D5 - R	Accruals	Permanent & Adopted	2019 - 2021	-0.00	-0.03	0.00	0.00	0.00	0.00
Personal income tax	Income tax - Fixed Rate on part-time work	D5 - R	Accruals	Permanent & Adopted	2022	0.00	0.00	-0.03	0.00	0.00	0.00
Tax deferrals	Assumption of 5% unrecoverable deferred tax	D2, D5, D6 - R	Accruals	Permanent & Adopted	2020-2022	-0.06	-0.03	0.01	0.00	0.00	0.00
Individual Investor Programme	Revenue from the Individual Investor Programme	P10 - R	Accruals	Permanent & Adopted	2014	-0.20	-0.32	-0.26	-0.04	-0.02	-0.04
Other revenue measures, including measures legislated in previous budgets			Accruals	Permanent & Adopted		-0.03	-0.05	-0.06	-0.02	-0.02	-0.01
COVID-19 Support Measure	Various medical supplies and equipment in relation to COVID-19	P2 - E	Accruals	Temporary & Adopted	2020 - 2021	-0.66	0.09	0.23	0.21	0.06	0.00
COVID-19 Support Measure	Cargo Transportation and Repatriation	P2 - E	Accruals	Temporary & Adopted	COVID-19 Support Measure	-0.38	0.38	0.00	0.00	0.00	0.00
COVID-19 Support Measure and Post COVID-19 Economic Regeneration Plan	COVID-19 Business Assistance Programme and the Economic Regeneration Voucher Scheme	D3 - E	Accruals	Temporary & Adopted	2020 - 2021	-3.64	0.80	2.38	0.34	0.12	0.00
COVID-19 Support Measure	Government-guaranteed loans schemes	D3 - E	Accruals	Temporary & Adopted	COVID-19 Support Measure	-0.01	-0.06	-0.02	0.08	0.01	0.00
COVID-19 Support Measure	Support to the agricultural sector	D3 - E	Accruals	Temporary & Adopted	2021	0.00	-0.03	0.03	0.00	0.00	0.00
Price stabilisation support	Energy support measures and commodity price and supply security measures		Accruals	Temporary & Adopted	2020	-0.27	-0.16	-0.85	0.01	0.97	0.08
COVID-19 Support Measure	Short Term Social Measures	D6 - E	Accruals	Temporary & Adopted	COVID-19 Support Measure	-0.11	0.11	0.00	0.00	0.00	0.00
	Housing Programmes	D6 - E	Accruals	Permanent & Adopted	2020	-0.12	-0.01	-0.05	-0.01	-0.00	0.01
Re-distribution measures	Measures to address housing affordability, pension adequacy and the integration of vulnerable individuals in society; cash payments by Government to households	D6 - E	Accruals	Permanent & Adopted	2016 - 2021	-0.45	-0.06	-0.20	-0.01	0.05	0.06
AirMalta restructuring plan	Financial support to the national airline	D9 - E	Accruals	Temporary & Adopted	2021 & 2022	0.00	0.00	-0.06	-0.39	0.45	0.00
COVID-19 Support Measure	Tourism Support Schemes	D9 - E	Accruals	Temporary & Adopted	2021 & 2022	0.00	-0.09	0.05	0.04	0.00	0.00
Other expenditure measures, including measures legislated in previous budgets and projects financed from the National Development and Social Fund			Accruals	Permanent & Adopted		-0.10	-0.05	-0.07	0.02	-0.01	-0.03
						-6.55	**-0.17**	**1.59**	**1.18**	**1.62**	**0.07**

The impact is recorded in incremental terms - as opposed to levels - compared to the previous year's baseline projection. The total figure is the Total impact on the budget balance, as a revenue increasing measure is listed as positive, while an expenditure decreasing measure is also positive. The contrary applies for negative figures, such that a revenue decreasing measure is negative and an expenditure increasing measure is also negative. Simple permanent measures are recorded as having an effect of +/- X in the year(s) they are introduced and zero otherwise (the overall impact on the level of revenues or expenditures does not cancel out). If the impact of a measure varies over time, only the incremental impact is recorded in the table. By their nature, one-off measures are recorded as having an effect of +/- X in the year of the first budgetary impact and -/+ X in the following year, i.e. the overall impact on the level of revenues or expenditures in two consecutive years is zero. The measures may not add up to the total due to the marginal impact of measures legislated in previous' years Budget, but which might nonetheless have a marginal impact on the budget balance.

Several policy measures which had been put in place in previous years, intended to ensure affordable housing availability were extended, and widened in scope, while the temporary measures introduced to support the property market during the pandemic were not renewed.

The Budget for 2022 will continue to enhance the disposable income of low- and middle-income earners and incentivise people to work by extending and increasing measures which are aimed at making work pay. Such measures include the In-Work Benefit Scheme, the Tapering of Benefits and the reduction of tax burden on workers, through tax rebates and lower tax on part-time and overtime work. Free childcare services will be extended to evenings and weekends for people working shifts to ease labour supply shortages in specific sectors.

Even though many of the support measures in relation to the COVID-19 pandemic are being phased out, the Wage Supplement Scheme has been further extended to May 2022 to further help the most severely hit businesses to recover. Moreover, the incentives underpinning the Tourism Recovery Plan remain in place to support the tourism industry, which was severely hit by the pandemic.

Furthermore, in view of the indirect consequences of the war in Ukraine, the Maltese authorities have intervened to shield households and businesses from the increases in the international price of oil which affects both the cost of energy as well as fuel for transportations purposes. In addition, the Government intervened to ensure stability in the price of cereals (including wheat) as well as security of supply. The authorities are continuously monitoring price developments for energy and commodities to extend and recalibrate economic support as necessary.

2022 Expenditure and Revenue Targets

Total revenue as a share to GDP is expected to increase by 0.7 percentage points while total expenditure is forecasted to decline by 1.9 percentage points, resulting in an improvement in the deficit to 5.5 per cent in 2022.

In line with expected economic developments in 2022, direct and indirect taxes are expected to increase by 0.8 and 0.7 percentage points respectively as a per cent of GDP. This reflects both the continuous economic recovery, which will boost taxation receipts during 2022, as well as the phasing out of temporary COVID-related revenue measures. Meanwhile, the ratio-to-GDP of non-tax revenue is expected to decrease, particularly ‘other’ revenue, reflecting lower market output.

The ratio of general Government expenditure to GDP is estimated to decline by 1.9 percentage points in 2022, primarily reflecting a noticeable drop in subsidies of 1.8 percentage points of GDP as COVID-19 related temporary support measures are expected to be discontinued.

3.2.1 Comparison with the 2021 Update of the Stability Programme for 2022

The actual outturn for 2021 together with budgetary developments for the general Government and updated macroeconomic projections form the basis of the revised projections for 2022. In addition, revisions also take into consideration fiscal measures that remained in place to address the lingering economic impact of the COVID-19 pandemic as well as measures intended to support households and businesses from

Table 3.1b

General Government Budgetary Prospects in 2022

Divergence from previous forecasts

€ millions

	ESA Code	USP 2022 compared to USP 2021: Divergence due to outturn in *t-1*	Divergence due to updated macro-economic projections	Other revisions	**Total forecast revision**	USP 2022 compared to DBP 2022: Divergence due to outturn in *t-1*	Divergence due to updated macro-economic projections	Other revisions	**Total forecast revision**
Net lending (+)/net borrowing (-)									
1. **General Government**	S.13	**602**	**-270**	**-356**	**-24**	**308**	**-159**	**-148**	**1**
2. Central Government	S.1311	602	-270	-356	-24	308	-159	-148	1
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	**602**	**-272**	**203**	**533**	**308**	**-179**	**216**	**344**
Of which									
Taxes on Production and Imports	D.2	159	-210	161	111	-6	-128	71	-62
Current Taxes on Income, Wealth, etc.	D.5	374	-53	71	391	244	-42	114	316
Capital Taxes	D.91	6	-5	-4	-3	15	-19	1	-3
Social Contributions	D.61	63	-4	-21	38	55	9	-25	39
Property Income	D.4			-16	-16			-3	-3
Other [(a)]				12	12			57	57
7. **Total Expenditure**	TE	**0**	**-2**	**559**	**557**	**0**	**-20**	**364**	**344**
Of which									
Compensation of employees	D.1			112	112			39	39
Intermediate Consumption	P.2			274	274			118	118
Social Payments	D.6		-2	77	75		-20	23	3
Of which									
Unemployment expenditure			-2		-2		-20		-20
Interest Expenditure	D.41			3	3			0	0
Subsidies	D.3			223	223			204	204
Gross Fixed Capital Formation	P.51			-53	-53			-105	-105
Capital Transfers	D.9			-128	-128			7	7
Other [(b)]				51	51			78	78

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.

the increases in the international price of oil and commodities. Measures announced in the statutory Budget for 2022 are also included given their direct impact. Table 3.1b distinguishes the changes to the 2022 forecasts between successive reports due to the impact of the actual outturn in 2021 (base effect), revised macroeconomic determinants, and other changes.

During 2022, the general Government is expected to record a deficit of €850 million, compared to an estimated deficit of €826 million outlined in the 2021 Update of the Stability Programme.

These developments reflect a higher than expected revenue of €533 million for 2022. This consists of higher than expected revenue in 2021 of €602 million, which is in part offset by more subdued expected macroeconomic developments in 2022, which are expected to impact revenue negatively by €272 million. Other revisions are expected to result in €203 million additional revenue compared to what was projected in April

2021. The principal revisions attributed to current taxes on income and wealth compared to the estimates outlined in the USP 2021 reflect higher revenue in 2021, which is not considered to be of a temporary nature. In terms of taxes on production and imports, a higher outturn than expected in 2021 (€159 million) is more than offset by the fiscal impact of more subdued expected economic developments (€210 million). In addition, other revisions relate to higher assumed property-market related transactions in 2022 as the scheme allowing for reduced transaction taxes is expected to result in higher transactions in 2022 than anticipated in April 2021. This is in part offset by a higher fiscal cost in terms of losses in tax revenue factored into the projections.

Meanwhile, higher than targeted expenditure compared to the estimates outlined in the USP 2021 of €557 million are mainly attributed to revisions in intermediate consumption, subsidies and compensation of employees, in part offset by lower than anticipated capital transfers. Higher than estimated expenses primarily relate to added outlays on COVID-19 health and non-health related expenditure and other economic support related to energy and commodities, beyond what was envisaged in April 2021.

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

Prior to the COVID-19 pandemic, the Government succeeded in considerably improving the public finance situation, registering budget surpluses and reducing the debt-to-GDP ratio. The attained fiscal space aided the Government to take the necessary actions and implement the support measures needed to help the industries that were negatively affected by the pandemic causing the Government deficit and debt to increase. Even though the temporary pandemic-related support is expected to be phased out, the level of economic uncertainty remains high in light of the war in Ukraine, and the authorities are continuously monitoring price developments for energy and commodities to extend and recalibrate economic support as necessary. Such developments are expected to impact public finances over the medium-term. When economic conditions and socio-political tensions allow, 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.

Indeed, provided that the macroeconomic projections underlying this Programme materialise, the budget balance is expected to improve to a deficit of 2.4 per cent of GDP by 2025. In structural terms, the general Government deficit is expected to improve from 4.9 per cent in 2022 to 2.1 per cent by 2025. However, although projections for 2023 to 2025 include an allowance for support measures relating to price developments for energy and commodities, the situation remains very fluid. 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.

Over the medium-term, economic growth is projected to converge towards historical average rates. As a result, the aggregate tax yield is forecasted to increase at an annual average rate of 6 per cent, broadly in line with the assumed nominal GDP growth over the same period. Indirect taxes are expected to be the main drivers, as household balance sheets remain supportive of growing household consumption and tourist expenditure is expected to rebound strongly. In contrast, the direct taxation yield is projected to increase more modestly. On account of these developments, the ratio to GDP of total taxes is expected to remain broadly stable over the medium-term. Indeed, the decline in the revenue-to-GDP ratio mainly reflects developments in ‘other’ revenue, which is

Table 3.4

Analysis of the Developments in the General Government Balance

(percentage points)

	2020	2021	2022	2023	2024	2025
Change in Revenue Ratio	**0.20**	**0.63**	**0.65**	**(0.07)**	**(0.51)**	**(0.64)**
Discretionary factors underpinning fiscal consolidation	(0.81)	(1.09)	0.13	0.89	(0.04)	(0.05)
Tax revenue buoyancy	0.44	1.86	0.87	(1.00)	0.08	(0.18)
Other revenue	0.57	(0.14)	(0.35)	0.05	(0.56)	(0.41)
Change in Expenditure Ratio	**(10.26)**	**0.82**	**1.94**	**0.91**	**2.32**	**1.06**
Discretionary factors underpinning fiscal consolidation	(5.74)	0.92	1.61	0.14	1.66	0.12
Change in Gross Fixed Capital Formation	(0.61)	0.30	0.22	(0.12)	0.55	0.32
Other expenditure	(3.91)	(0.40)	0.11	0.90	0.11	0.61
Change in the General Government Balance	**(10.06)**	**1.45**	**2.58**	**0.85**	**1.80**	**0.42**

Note: positive represents an improvement in the general Government balance

Table 3.5

Cyclical Developments

(percentage points of GDP)

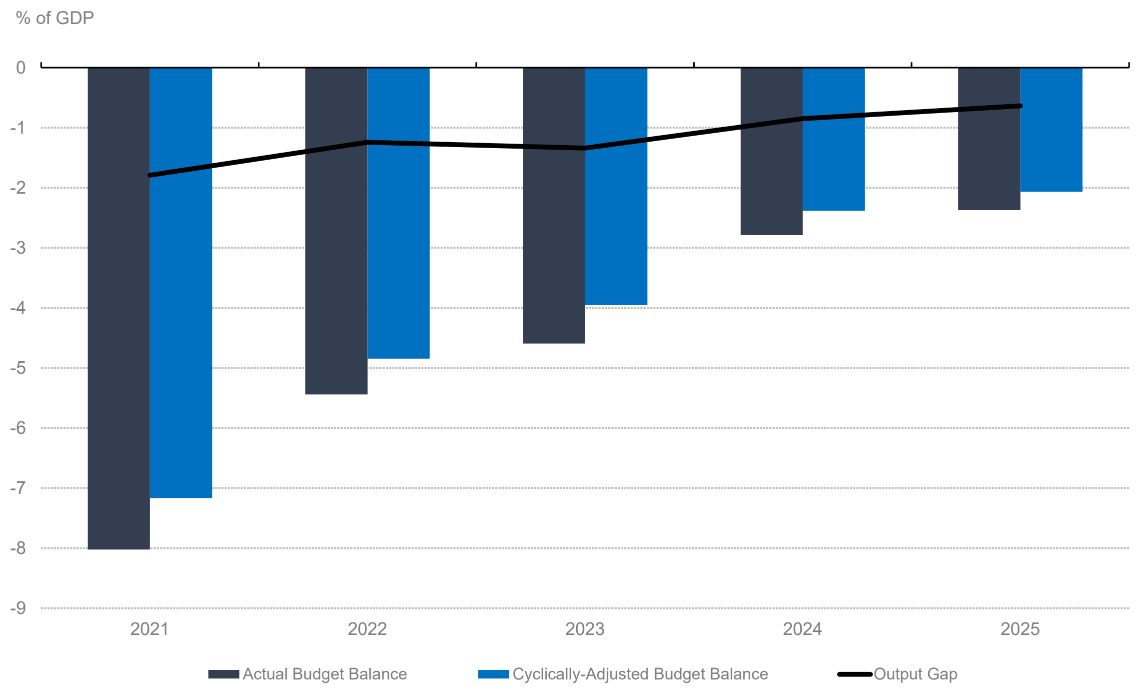
	ESA Code	2020	2021	2022	2023	2024	2025
Net lending (+) / net borrowing (-) by sub-sector [1]	B.9						
1. General Government Balance	S.13	-9.5	-8.0	-5.4	-4.6	-2.8	-2.4
2. Central Government	S.1311	-9.5	-8.1	-5.4	-4.6	-2.8	-2.4
3. State Government	S.1312	-	-	-	-	-	-
4. Local Government	S.1313	0.1	0.1	-0.0	-0.0	-0.0	-0.0
5. Social security funds	S.1314	-	-	-	-	-	-
6. Interest expenditure	D.41	1.3	1.5	1.1	1.1	1.1	1.1
7. Primary balance[2]		-8.2	-6.6	-4.4	-3.5	-1.7	-1.3
8. One-off and other temporary measures[3]		0.1	0.0	0.0	0.0	0.0	0.0
9. Real GDP growth (%)		-8.6	9.5	4.4	3.9	3.7	3.5
10. Potential GDP growth (%)		3.1	4.1	3.8	4.0	3.2	3.3
11. Output gap (% of potential GDP)		-6.7	-1.8	-1.2	-1.3	-0.9	-0.6
12. Cyclical budgetary component (% of potential GDP)		-3.2	-0.9	-0.6	-0.6	-0.4	-0.3
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		-6.3	-7.2	-4.8	-4.0	-2.4	-2.1
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		-5.0	-5.7	-3.8	-2.9	-1.3	-1.0
15. Structural balance (13 - 8) (% of potential GDP)		-6.4	-7.2	-4.9	-4.0	-2.4	-2.1

[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.

Chart 3.1
Actual and Cyclically-Adjusted Budget Balances



expected to decline by 1.0 percentage point from 5.1 per cent of GDP in 2022 to 4.1 per cent in 2025, reflecting anticipated capital transfers and investment grants receivable.

Over the outer years of the forecast period, the growth in general Government expenditure is expected to be more modest and increase at an annual average rate of 2 per cent, as the fiscal stance is assumed to be less supportive, to an extent reflecting the easing of the measures related to the pandemic. Investment expenditure is expected to remain elevated over the medium-term, further sustained by additional funds from the Recovery and Resilience Facility (RRF) towards high-quality investment projects and structural reforms. Projected receipts and expenditure financed from the RRF are outlined in Appendix Table 9.a and Appendix Table 9.b.

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.

No additional discretionary revenue measures are factored into the projections for 2023 onwards, such that tax revenues are expected to broadly follow economic developments. General Government revenue is expected to grow by an annual average of 3.6 per cent over the medium-term. As a result, on a no-policy change basis, the tax burden would average 32.6 per cent of GDP.

At unchanged policies, total expenditure would be higher over the medium-term, based on the premise that the temporary pandemic-related support would have remained in place.

Table 3.2a

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)

% GDP

	ESA Code	2020	2021	2022	2023	2024	2025
General Government (S13)							
1. Total revenue at unchanged policies	TR	**36.9**	**37.5**	**39.3**	**38.3**	**37.8**	**37.2**
of which							
1.1 Taxes on production and imports	D.2	10.7	10.8	12.3	11.9	12.1	12.1
1.2 Current taxes on income and wealth	D.5	12.9	14.0	15.0	14.5	14.4	14.3
1.3 Capital taxes	D.91	0.2	0.2	0.1	0.1	0.1	0.1
1.4 Social contributions	D.61	6.4	6.3	6.1	6.0	5.9	5.8
1.5 Property income	D.4	0.6	0.6	0.4	0.5	0.5	0.4
1.6 Other revenue [2]		6.0	5.6	5.4	5.3	4.8	4.4
p.m.: Tax burden		30.3	31.4	33.6	32.6	32.7	32.5
(D.2+D.5+D.61+D.91-D.995)[3]							
2. Total expenditure at unchanged policies	TE	**46.3**	**45.5**	**46.2**	**45.1**	**41.2**	**40.1**
of which							
2.1 Compensation of employees	D.1	12.1	12.2	12.1	12.1	12.2	12.2
2.2 Intermediate consumption	P.2	9.1	9.4	10.2	9.3	9.0	8.8
2.3 Social payments	D.6M	10.3	9.6	10.1	10.0	10.0	9.8
of which U*nemployment benefits* [4]		0.2	0.2	0.2	0.2	0.1	0.1
2.4 Interest expenditure	D.41	1.3	1.5	1.1	1.1	1.1	1.1
2.5 Subsidies	D.3	5.2	4.7	4.3	4.2	1.8	1.6
2.6 Gross fixed capital formation	P.51	4.5	4.2	4.2	4.3	3.8	3.5
2.7 Capital Transfers Payable	D.9	1.3	1.1	1.1	1.7	1.0	0.9
2.8 Other expenditure [5]		2.5	3.0	3.0	2.4	2.3	2.1
3. General Government Balance		**-9.5**	**-8.0**	**-6.9**	**-6.8**	**-3.5**	**-3.0**
4. Primary Balance		**-8.2**	**-6.6**	**-5.8**	**-5.7**	**-2.4**	**-1.9**

[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.

3.4 Debt levels and developments

Malta's debt-to-GDP ratio had fallen below the 60.0 per cent Treaty reference value in 2015 and kept on declining ever since, reaching a debt-to-GDP ratio of 40.7 per cent in 2019. The general Government debt was 12.7 percentage points higher by the end of 2020, reaching 53.4 per cent, reflecting the impact of the COVID-19 pandemic and the subsequent Government measures. The level of public debt relative to GDP is expected to increase further to 58.6 per cent by 2022 and is forecast to remain below the Maastricht reference value of 60.0 per cent by the end of the projected period at 57.2 per cent of GDP in 2025.

During 2021, short-term debt accounted for 7.0 per cent of total Government debt and is expected to increase to 7.6 per cent in 2022. Short-term debt funding is predicted to stabilise in the following years and reach 5.3 per cent in 2025. Additionally, the share of maturing stocks in total Government debt is expected to decrease from a level of 5.6 per cent in 2021 to 4.1 per cent in 2022 and is projected to remain on a downward trajectory, with the ratio reaching 3.5 per cent in 2025.

3.4.1 Projected Debt developments

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 €1,305.9 million over 2020 and stood at €8,284.4 million in 2021. The debt-to-GDP ratio for 2021 increased to 57.0 per cent on the back of the negative primary balance together with an expansionary contribution stemming from interest expenditure. The debt ratio is forecasted to increase by 1.6 percentage points in 2022 to reach 58.6 per cent of GDP, decline by a further 0.8 percentage point in 2023 to reach 59.4 and, thereafter declining to 58.6 per cent in 2024. Developments in the gross Government debt are illustrated in Chart 3.2. The expected developments in the debt-to-GDP ratio over the medium-term horizon are mainly driven by the negative primary balances (primary deficit).

The Stock flow adjustment for 2021 stood at 1.0 per cent indicating a higher increase in debt than implied by the -10.1 per cent deficit. This SFA was mainly the result of increases the movement of bank accounts, lower volume of consolidations, equity acquisitions, and contributions to the Special MGS Sinking Fund. In 2022, stock flow transactions are expected to have a minimal impact of 0.1 per cent on the debt ratio. The change in SFA adjustment in 2022 is mainly underpinned by contributions to the Special MGS

Table 3.6

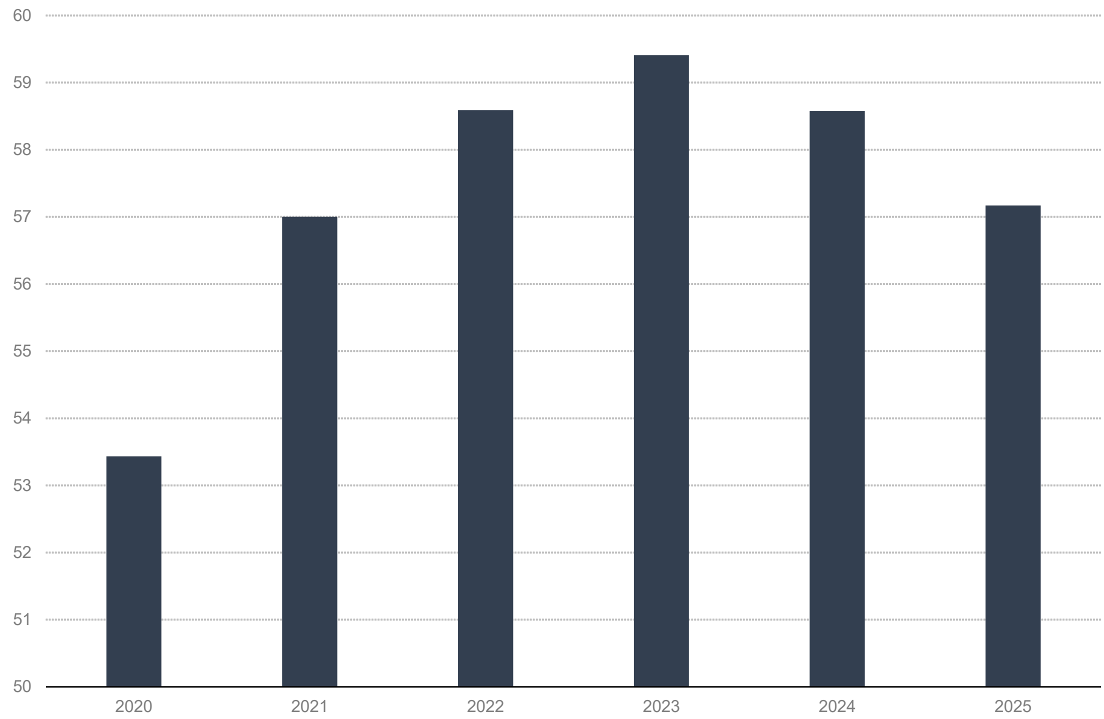
The Dynamics of Government Debt[1]

Percentages of GDP	2020	2021	2022	2023	2024	2025
Gross debt	53.4	57.0	58.6	59.4	58.6	57.2
Change in gross debt ratio	12.7	3.6	1.6	0.8	-0.8	-1.4
Contributions to changes in gross debt						
Primary balance	8.2	6.6	4.4	3.5	1.7	1.3
Snowball Effect	4.4	-4.0	-2.9	-2.1	-2.1	-1.7
Interest expenditure	1.3	1.5	1.1	1.1	1.1	1.1
Real GDP growth	3.7	-4.6	-2.3	-2.2	-2.1	-2.0
Inflation Effect	-0.6	-0.8	-1.6	-1.0	-1.0	-0.8
Stock-flow adjustment	0.2	1.0	0.1	-0.6	-0.4	-1.0
p.m. implicit interest rate on debt	3.0	3.0	2.0	1.9	1.9	2.0

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

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

Chart 3.2
Debt-to-GDP ratio



Sinking Fund and a higher volume of consolidations. Further details on the SFA can be found in Appendix Table 10.

3.4.2 Comparison with the Debt Projections Published in the 2021 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 differ substantially for the coming years to the ratio presented in the 2021 USP. Debt-to-GDP ratios presented in this update are lower mainly due to lower projected primary deficits.

For 2021, the debt-to-GDP ratio was revised downwards by 8.0 percentage points to 57.0 per cent of GDP while the debt-to-GDP ratio for 2022 was revised downwards by 7.2 percentage points.

In the 2021 Update, the debt-to-GDP ratio was expected to follow an upward path from a level of 65.0 per cent in 2021 to a level of 65.8 per cent in 2022, reaching a ratio of 65.6 per cent by 2024. On the other hand, in this Update of the Stability Programme, the debt-to-GDP ratio is estimated to peak at 59.4 per cent in 2023, thus remaining below the 60 per cent Maastricht threshold. These revisions primarily relate to a better outturn in 2021 than envisaged in the 2021 USP, for both fiscal and macroeconomic variables.

Table 2a

General Government Budgetary Prospects

Percentages of GDP		ESA code	2020(*)	2021(*)	2020	2021	2022	2023	2024	2025
Net Lending (EDP B9) by sub-sector										
1.	General Government	S13	-1,237.7	-1,166.3	-9.5	-8.0	-5.4	-4.6	-2.8	-2.4
2.	Central Government	S1311	-1,245.4	-1,174.2	-9.5	-8.1	-5.4	-4.6	-2.8	-2.4
3.	State Government	S1312	-	-	-	-	-	-	-	-
4.	Local Government	S1313	7.8	-1.2	0.1	0.1	-0.0	-0.0	-0.0	-0.0
5.	Social security funds	S1314	-	-	-	-	-	-	-	-
General Government										
6.	Total revenue	TR	4,813.4	5,448.6	36.9	37.5	38.1	38.1	37.6	36.9
7.	Total expenditure	TE	6,051.1	6,614.9	46.3	45.5	43.6	42.7	40.3	39.3
8.	Net lending / borrowing	B9	-1,237.7	-1,166.3	-9.5	-8.0	-5.4	-4.6	-2.8	-2.4
9.	Interest expenditure	D41	172.5	212.0	1.3	1.5	1.1	1.1	1.1	1.1
10.	Primary balance(1)		-1,065.2	-954.4	-8.2	-6.6	-4.4	-3.5	-1.7	-1.3
11.	One-off and other temporary measures(2)		8.7	6.3	0.1	0.0	0.0	0.0	0.0	0.0
Selected Components of Revenue										
12.	Total Taxes (12=12a+12b+12c)		3,104.2	3,634.9	23.8	25.0	26.5	26.5	26.6	26.5
12a.	Taxes on production and imports	D2	1,395.1	1,575.7	10.7	10.8	11.5	11.9	12.2	12.1
12b.	Current Taxes on Income, Wealth, etc.	D5	1,686.6	2,029.8	12.9	14.0	14.8	14.4	14.3	14.3
12c.	Capital Taxes	D91	22.6	29.3	0.2	0.2	0.1	0.1	0.1	0.1
13.	Social Contributions	D61	839.9	914.9	6.4	6.3	6.1	6.0	5.9	5.8
14.	Property Income	D4	84.3	81.4	0.6	0.6	0.4	0.5	0.5	0.4
15.	Other(3)		784.9	817.4	6.0	5.6	5.1	5.1	4.5	4.1
16=6.	Total Revenue	TR	4,813.4	5,448.6	36.9	37.5	38.1	38.1	37.6	36.9
p.m.:	Tax Burden (D2+D5+D6111+D6131+D91-D995)(4)		3,960.2	4,568.7	30.3	31.4	32.7	32.6	32.7	32.5
Selected Components of Expenditure										
17.	Compensation of employees + intermediate consumption	D1+P2	2,775.6	3,128.9	21.3	21.5	22.0	21.4	21.2	21.0
17a.	Compensation of employees	D1	1,584.9	1,769.6	12.1	12.2	12.1	12.1	12.2	12.2
17b.	Intermediate consumption	P2	1,190.7	1,359.3	9.1	9.4	9.9	9.3	9.0	8.8
18.	Social payments (18=18a+18b)		1,347.1	1,389.5	10.3	9.6	9.8	9.6	9.6	9.4
	of which Unemployment benefits (5)		23.0	25.7	0.2	0.2	0.2	0.2	0.1	0.1
18a.	Social transfers in kind supplied via market producers	D632	144.1	146.0	1.1	1.0	1.1	1.1	1.1	1.0
18b.	Social transfers other than in kind	D62	1,202.9	1,243.4	9.2	8.6	8.7	8.5	8.5	8.4
19=9.	Interest expenditure	D41	172.5	212.0	1.3	1.5	1.1	1.1	1.1	1.1
20.	Subsidies	D3	678.2	685.7	5.2	4.7	2.9	2.9	1.6	1.4
21.	Gross fixed capital formation	P51G	585.1	607.4	4.5	4.2	4.1	4.2	3.7	3.4
22.	Capital transfers	D9	167.3	161.9	1.3	1.1	1.1	1.2	1.0	0.9
23.	Other(6)		325.3	429.6	2.5	3.0	2.7	2.3	2.2	2.1
24=7.	Total Expenditure	TE	6,051.1	6,614.9	46.3	45.5	43.6	42.7	40.3	39.3
p.m.:	Government consumption (nominal)	P3	2,757.4	3,046.7	21.1	21.0	21.9	21.4	21.3	21.1

(*) € 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

Table 2b

No policy change projections

Percentages of GDP	2021(1)	2021	2022	2023	2024	2025
1. Total revenue at unchanged policies	5,448.6	37.5	39.3	38.3	37.8	37.2
2. Total expenditure at unchanged policies	6,614.9	45.5	46.2	45.1	41.2	40.1

(1) € million

Table 2c

Amounts to be excluded from the expenditure benchmark

	Percentages of GDP	2020[1]	2021[1]	2020	2021	2022	2023	2024	2025
1.	Expenditure on EU programmes fully matched by EU funds revenue	149.0	127.4	1.1	0.9	1.7	1.9	1.4	1.1
1a.	*of which* Investment fully matched by EU funds revenue[2]	63.7	36.3	0.5	0.2	0.8	0.9	0.7	0.5
2.	Cyclical unemployment benefit expenditure[3]	-2.3	-4.0	-0.0	-0.0	-0.0	-0.0	-0.1	-0.1
3.	Effect of discretionary revenue measures	-119.6	-150.0	-0.8	-1.1	0.1	0.9	-0.0	-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

Table 3

General Government Expenditure by Function

	Percentages of GDP	COFOG Code	2020	2025
1.	General public services	1	6.3	6.3
2.	Defence	2	0.8	0.7
3.	Public order and safety	3	1.4	1.3
4.	Economic affairs	4	9.5	4.9
5.	Environmental protection	5	1.8	1.3
6.	Housing and community amenities	6	0.4	0.4
7.	Health	7	6.4	5.5
8.	Recreation, culture and religion	8	1.5	1.0
9.	Education	9	6.0	5.4
10.	Social protection	10	12.1	12.4
11.	Total Expenditure	TE	46.3	39.3

Table 4

General Government Debt Developments

Percentages of GDP	ESA Code	2020	2021	2022	2023	2024	2025
1. Gross debt		53.4	57.0	58.6	59.4	58.6	57.2
2. Change in gross debt ratio		12.7	3.6	1.6	0.8	-0.8	-1.4
Contributions to changes in gross debt							
3. Primary balance		8.2	6.6	4.4	3.5	1.7	1.3
4. Interest expenditure	EDP D.41	1.3	1.5	1.1	1.1	1.1	1.1
5. Stock-flow adjustment		0.2	1.0	0.1	-0.6	-0.4	-1.0
p.m. implicit interest rate on debt(1)		3.0	3.0	2.0	1.9	1.9	2.0

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

Table 5

Cyclical Developments

Percentages of GDP	ESA Code	2020	2021	2022	2023	2024	2025
1. Real GDP growth (%)		-8.6	9.5	4.4	3.9	3.7	3.5
2. General Government balance	EDP B.9	-9.5	-8.0	-5.4	-4.6	-2.8	-2.4
3. Interest expenditure	EDP D.41	1.3	1.5	1.1	1.1	1.1	1.1
4. One-off and other temporary measures(1)		0.1	0.0	0.0	0.0	0.0	0.0
of which							
One-offs on the revenue side: general Government		0.1	0.1	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 (%)		3.1	4.1	3.8	4.0	3.2	3.3
contributions:							
- labour (hours)		1.2	1.3	1.2	1.4	0.6	0.8
- capital		1.4	2.0	1.8	1.9	1.9	1.8
- total factor productivity		0.5	0.8	0.8	0.7	0.7	0.7
6. Output Gap		-6.7	-1.8	-1.2	-1.3	-0.9	-0.6
7. Cyclical Budgetary Component		-3.2	-0.9	-0.6	-0.6	-0.4	-0.3
8. Cyclically-Adjusted Balance (2-7)		-6.3	-7.2	-4.8	-4.0	-2.4	-2.1
9. Cyclically-Adjusted Primary Balance (8+3)		-5.0	-5.7	-3.8	-2.9	-1.3	-1.0
10. Structural Balance (8-4)		-6.4	-7.2	-4.9	-4.0	-2.4	-2.1

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

Table 6

Divergence from latest SP

% GDP

	ESA Code	2020	2021	2022	2023	2024	2025
Real GDP growth							
Previous Update		-7.0	3.8	6.8	4.5	4.0	-
Current Update		-8.6	9.5	4.4	3.9	3.7	3.5
Difference		-1.6	5.7	-2.4	-0.6	-0.3	-
General Government net lending / net borrowing	EDP B.9						
Previous Update		-10.1	-12.0	-5.6	-3.9	-2.9	-
Current Update		-9.5	-8.0	-5.4	-4.6	-2.8	-2.4
Difference		0.6	4.0	0.2	-0.7	0.1	-
General Government net lending projection at unchanged policies	EDP B.9						
Previous Update		-10.1	-12.0	-6.8	-4.1	-3.1	-
Current Update		-9.5	-8.0	-6.9	-6.8	-3.5	-3.0
Difference		0.6	4.0	-0.1	-2.7	-0.4	-
Total Revenue	TR						
Previous Update		36.5	36.7	36.6	36.2	35.7	-
Current Update		36.9	37.5	38.1	38.1	37.6	36.9
Difference		0.4	0.8	1.5	1.9	1.9	-
Total Expenditure	TE						
Previous Update		46.6	48.7	42.2	40.1	38.6	-
Current Update		46.3	45.5	43.6	42.7	40.3	39.3
Difference		-0.3	-3.2	1.4	2.6	1.7	-
General Government gross debt							
Previous Update		54.3	65.0	65.8	66.0	65.6	-
Current Update		53.4	57.0	58.6	59.4	58.6	57.2
Difference		-0.9	-8.0	-7.2	-6.6	-7.0	-

Table 7

Long-term Sustainability of Public Finances

	2007	2010	2020	2030	2040	2050	2060
Total expenditure	N.A	N.A	19.2	17.8	18.5	20.4	23.7
Of which: age-related expenditures							
Pension expenditure	8.9	9.9	7.7	6.6	6.6	8.1	10.1
Social security pension			7.7	6.6	6.6	8.1	10.1
Old-age and early pensions			5.2	4.7	5.1	6.5	8.6
Other pensions (disability, survivors)			2.6	1.8	1.5	1.5	1.5
Occupational pensions (if in General Government)			N.A.	N.A.	N.A.	N.A.	N.A.
Health care			6.0	5.9	6.4	6.8	7.3
Long-term care (this was earlier included in the health care)			1.2	1.5	1.8	2.0	2.4
Education expenditure			4.2	3.9	3.7	3.6	3.9
Other age-related expenditures			N.A.	N.A.	N.A.	N.A.	N.A.
Interest expenditure			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.
Of which: from pensions contributions (or social contributions if appropriate)	8.3	8.4	8.7	8.5	8	7.7	7.4
Pension reserve fund assets			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.
Systemic pension reforms							
Social contributions diverted to mandatory private scheme			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.
Assumptions							
Labour productivity growth			1.5	2.1	1.7	1.6	1.6
Real GDP growth			-5.8	3.9	2.1	1.3	1.2
Participation rate males (aged 20-64)			89.9	91.5	90.4	89.3	89.4
Participation rates females (aged 20-64)			70.1	79.1	81.1	81.1	81.5
Total participation rates (aged 20-64)			80.6	85.9	86.2	85.6	85.8
Unemployment rate (20-64)			5.3	3.9	3.9	3.9	3.8
Population aged 65+ over total population			18.9	21.0	22.3	25.6	30.4

Source: Ageing Report 2021

Table 7a

Stock of guarantees adopted/announced at December 2021 according to the Programme

% 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	2.4	1.3
	EU SURE loan instrument	2020	0.2	0.2
	Subtotal		**2.6**	**1.5**
Others	Non-financial corporations		6.9	5.1
	Financial corporations		3.2	1.6
	Households and NPISHs		0.1	0.1
	Subtotal		**10.2**	**6.8**
	Total		**12.8**	**8.2**

Table 8

Basic Assumptions

	2020	2021	2022(p)	2023(p)	2024(p)	2025(p)
Short-term interest rate (annual average)	0.00	0.00	0.25	1.13	1.13	1.13
Long-term interest rate (annual average)	0.48	0.50	1.16	1.28	1.28	1.28
USD/EUR exchange rate (average)	1.153	1.163	1.110	1.136	1.164	1.164
GBP/EUR exchange rate (average)	0.903	0.853	0.836	0.838	0.847	0.847
Malta's main trading partners real GDP growth	-6.3	4.8	3.1	2.2	1.7	1.6
Oil prices, (Brent, USD/barrel)	41.8	70.7	108.7	91.4	91.4	91.4
World prices weighted by main trading partners (y-o-y % change)	-2.4	9.7	12.5	1.9	1.3	1.3

Table 8b

Basic Fiscal Assumptions

	ESA Code	2021	2022(f)	2023(f)	2024(f)	2025(f)
Implied Elasticity with respect to respective Tax Base						
Taxes on Production and Imports	D2	1.1	1.1	0.9	0.9	0.9
of which Value Added Taxes	D212	1.5	1.2	1.2	1.2	1.2
Current Taxes on Income, Wealth, etc.	D5	1.9	3.7	0.3	1.0	1.0
of which Current Taxes on Income, Wealth, etc. [Corporate] [1]	D5	4.7	3.0	-1.5	1.1	0.7
Net social contributions	D61	1.2	0.8	0.8	0.8	0.8
General Government Adjustments (€ millions)		**76.6**	**-55.8**	**-146.8**	**-139.7**	**-216.3**
Other accounts payable and receivable		46.1	58.0	-60.6	10.0	10.0
Treasury Clearance Fund & Contingency Reserve		15.3	0.0	0.0	0.0	0.0
Social and Investment Fund - IIP - Revenue		23.8	12.0	8.0	6.0	3.0
Social and Investment Fund - IIP - Expenditure		-7.5	-29.6	-29.1	-35.7	-44.3
Re-routing/PPP adjustments		-11.8	-15.0	-5.0	0.0	0.0
Others		10.6	-81.2	-60.0	-120.0	-185.0

[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.

Table 9a
RRF Impact on Projections - Grants

% 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	0.0	0.4	0.5	0.6	0.4	0.0
Cash disbursements of RRF GRANTS from EU[1]		0.0	0.3	0.4	0.6	0.6	0.2	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	0.0	0.4	0.5	0.6	0.4	0.0
of which:								
Gross fixed capital formation	P.51g	0.0	0.0	0.4	0.5	0.6	0.4	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 [2]								
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] As per MT RRP

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

Table 9b
RRF Impact on Projections - Loans

% 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

Table 10

Stock Flow Adjustment Statement

€ millions

	2021	2022	2023	2024	2025
General Governemnt deficit (-) / surplus (+) (ESA10)	1,166.3	850.0	759.0	487.0	435.0
ESA Adjustments	76.6	-55.8	-146.8	-139.7	-216.3
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	0.0	0.0
Contribution to Special MGS Sinking Fund	30.0	25.0	25.0	25.0	25.0
Equity Acquisition	34.5	5.0	0.5	0.5	0.5
EFSF/ESM Credit Line Facility	-	-	-	-	-
Courts and other deposits	-0.4	-	-	-	-
Stock Premium paid to Church	0.3	0.1	0.2	0.1	0.2
Advances made by Government	-	-	-	-	-
Repayment of Loans to Government	-2.2	-2.8	-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	-0.3	0.0	0.0	0.0	0.0
Currency	3.1	11.9	5.7	6.2	5.3
Movement in Bank Account	118.0	-	-	-	-
ESA Rerouted Debt	11.8	15.0	5.0	0.0	0.0
Increase/(Decrease) in cash balance	**-76.6**	**0.7**	**0.9**	**2.0**	**3.0**
Increase/(Decrease) in Non-Consolidated Debt	**1,360.4**	**848.3**	**646.0**	**377.5**	**249.1**
Total Consolidation	-53.5	18.0	16.2	32.6	8.5
Increase/(Decreaese) in Consolidated Debt	**1,306.9**	**866.3**	**662.2**	**410.1**	**257.6**
SFA	**140.6**	**16.3**	**-96.8**	**-76.9**	**-177.4**

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, in addition to significant revisions in national accounts data.

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, such as global economic growth or world prices. 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.

In recognition of the risks surrounding macroeconomic forecasts, especially due to the prevailing uncertainty in the global economy, 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 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 issued. While the one-year ahead forecasts display a Root-Mean Squared Error (RMSE) of 5.13, 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 Covid-19 crisis in 2020 and the frequent and considerable statistical revisions tend to exert a disproportionate influence on this evaluation over such a limited sample period and limit comparability with the forecast accuracy displayed by other economies with a longer tradition of forecasts.

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, ten alternative model-based growth projections were carried out as follows:

1. Improved economic growth in main trading partners: based on the upper bound of the Consensus Forecasts.

2. Weaker economic growth in main trading partners: based on the lower bound of the Consensus Forecasts.
3. Higher interest rate scenario: including an increase in both short-term and long-term interest rates, with the former increasing more than the latter, flattening the yield curve. The increase in short-term interest rates signals the prospect of monetary tightening to control rising prices, while the flattening of the yield curve reflects lower real growth and inflation expectations.
4. Severe decline in global economic growth scenario: based on a substantial downward revision in economic projections for main trading partners mirroring the revision in the outlook for the German economy by the German Council of Economic Experts[1]. This shock seeks to capture the worst-case economic ramifications evaluated to date of the conflict between Russia and Ukraine.
5. Higher investment scenario: which assumes that a number of planned investment projects which are not included in the baseline projections commence throughout 2022 and continue in the outer years, supported by dissipating economic uncertainty, Malta's attractiveness for investors, stable financing costs and investment incentives.
6. Adverse tourism scenario: reflecting the risk that Covid-19 infections persist throughout 2022 and 2023, leading to various containment measures which hinder the recovery in tourism. This scenario also captures the risk that the war in Ukraine may have a negative effect on tourist sentiment in Europe.
7. More upbeat tourism outlook for 2022: assuming that some tourist flows are diverted to southern Europe away from conflict zones and an easing of restrictive measures on mobility and travel results in the release of pent-up demand for travelling, leading to higher tourism numbers than anticipated in the baseline scenario.
8. Weaker growth in services exports: assuming that Malta loses market share in some key service sectors.
9. Persistent inflation and wage-price spiral scenario: reflecting the risk that labour market shortages and pressure on employers to raise wages due to high inflation leads to a substantial increase in wages, setting off a wage-price spiral. Consequently, this scenario assumes that inflationary pressures intensify in 2022, and persist during the remainder of the forecast horizon.
10. Lower real wages scenario: as wage growth fails to keep up with stronger than anticipated inflationary pressures. This results in a deceleration of real wages throughout the forecast horizon, having an adverse impact on household consumption.

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 the economic conditions prevailing at the time of preparation and the various meetings with economic stakeholders and regulators operating within the Maltese economy.

Among the alternative forecasts, a more detailed description is provided for the alternative global growth and interest rate scenarios as required by the Fiscal Responsibility Act.

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, where the global growth rate increases by 1.0 percentage point in 2022, and by 0.9 percentage points in 2023, compared to the baseline. 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 2022, assuming the most optimistic growth figure for each trading partner for the forecast years 2022 and 2023.

The improved global economic situation in this scenario contributes to an increase in Maltese exports, leading to an upward revision of 0.3 percentage points in real GDP growth for 2022, compared to the baseline, while the budget balance would remain unchanged. In 2023, real GDP growth would further improve by 0.3 percentage points, and remains unaffected in the outer years, while the budget balance would improve by 0.1 percentage points from 2023 onwards.

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 1.0 percentage points in 2022, and a decline of 1.2 percentage points in 2023. The relatively lower than expected growth projections for Germany, Italy, France, the UK, and the US are based on the Consensus Forecasts March 2022 publication, assuming the lowest plausible growth figures for each trading partner.

The deterioration in world demand mainly contributes to weaker export growth, which is more pronounced than the decline in imports. This subdued performance results in a decline in real GDP of 0.3 percentage points in both 2022 and 2023, when compared to the baseline scenario. In 2024, real GDP growth would not be affected, while it would marginally decrease by 0.1 percentage points in 2025. In this scenario, the budget balance would decrease by 0.1 percentage points in both 2022 and 2023, before declining by an average of 0.2 percentage points in the outer years.

4.2.3 Interest Rate Scenario

In this scenario, short-term interest rates are assumed to increase by 25.0 basis points in 2022 and by 75.0 basis points in 2023, and then remain fixed throughout the forecast horizon. Long-term interest rates are assumed to increase by 60.0 basis points in 2022, and to only increase marginally in 2023, thus flattening the yield curve as the spread between short-term and long-term rates falls. This scenario attempts to reflect more aggressive monetary policy tightening in 2022 and 2023, in order to control rising prices, as well as a deceleration in growth expectations.

The effect of this scenario would be a decline in real investment growth, leading to a decline of 0.2 percentage points in real GDP growth in 2022. GDP growth would remain unchanged in 2023, while it would decline by 0.1 percentage point in 2024. The budget balance would deteriorate by 0.1 percentage points in both 2022 and 2023. In 2024, the budget balance would decline by 0.1 percentage points, relative to the baseline, while in 2025 it would deteriorate by 0.2 percentage points.

4.3 Alternative Model Forecasts

Eight alternative forecasting models were also developed, ranging from model-free statistical forecast (2 Holt-Winters Seasonal Smoothing Method), model based univariate forecasts (ARIMA model), model-based multivariate forecasts (3 VAR models) to autoregressive models. These models help economists at the MFE corroborate the results attained using their core econometric model. Of special interest are the 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 real GDP to grow by 6.1 per cent in 2022, higher than the baseline projection, while the average of the VAR models alone point towards a slightly higher growth of 6.3 per cent. Therefore, these alternative models are more optimistic than the baseline scenario presented in Chapter 2. However, given the prevailing risks and uncertainty, economists at the MFE chose to be prudent in the baseline macroeconomic forecast, given the current global scenario. In fact, the alternative models provide a wide range within which the growth outcome for 2022 can occur.

From 2023 onwards, the alternative models suggest GDP growth which averages at around 4.4 per cent, in line with the baseline forecast.

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 2.87 for the current year forecast and 2.91 for the one-year ahead forecast, 2.87 for the two-year ahead forecast, and 3.05 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 mild upside risks for 2022, but downside risks in the outer years. Chart 4.1 depicts a representation of the uncertainty and the balance of risk surrounding the macroeconomic forecasts presented in this Programme.

Chart 4.1
Fan Chart with GDP Growth Forecasts

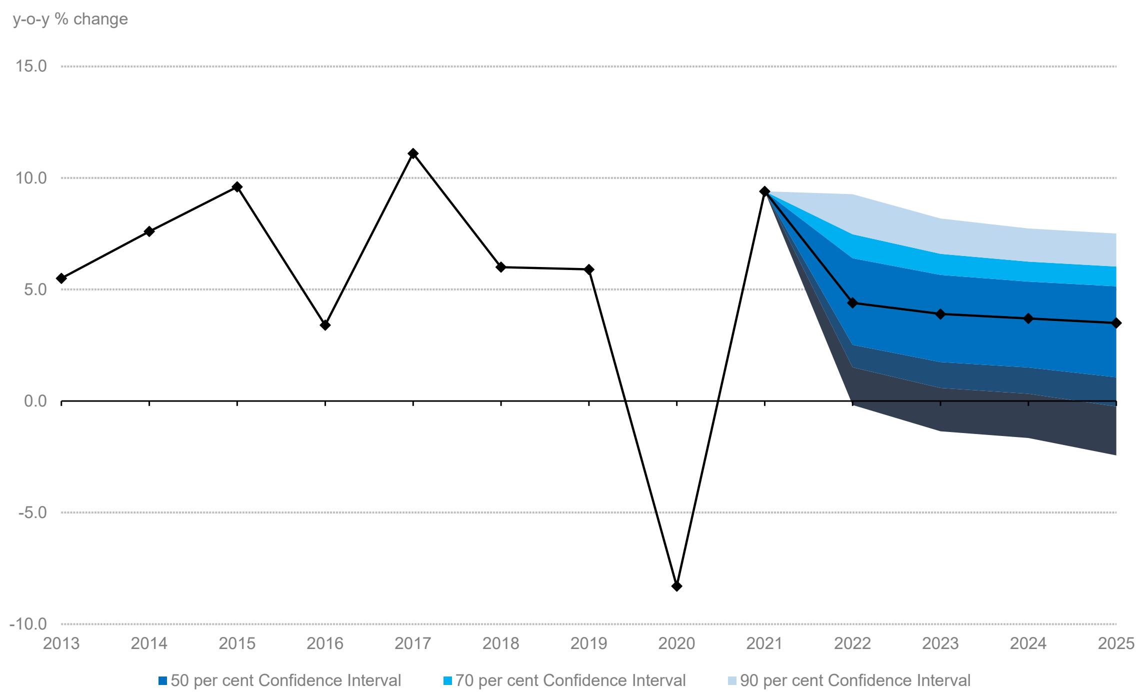
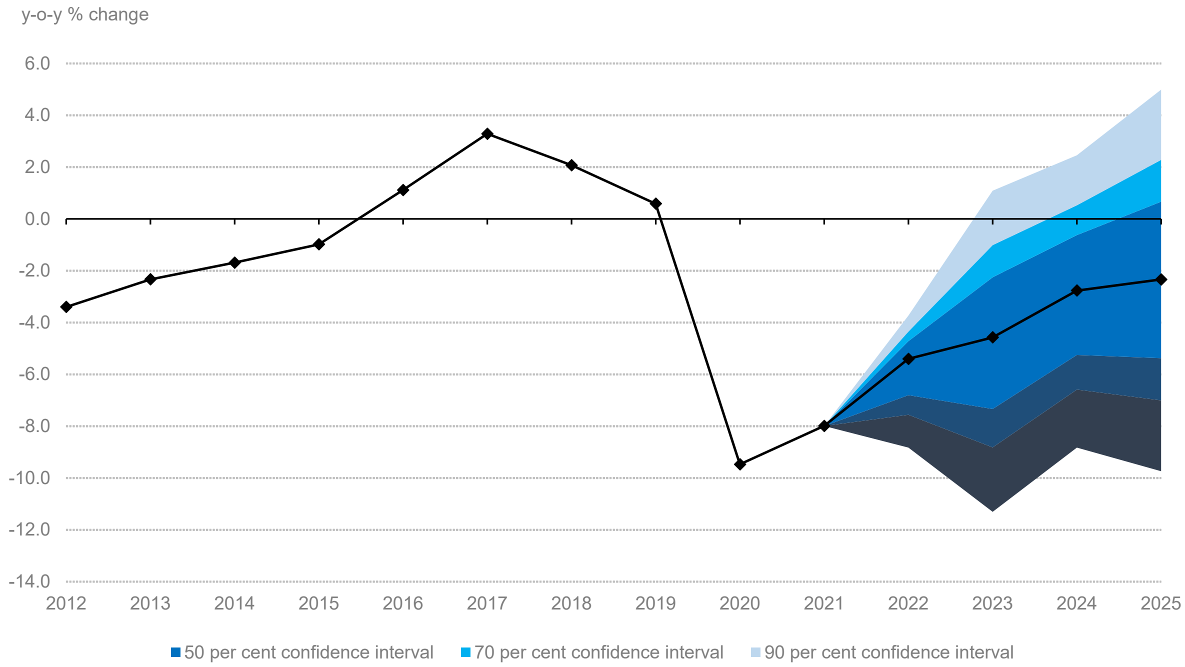


Chart 4.2
Fan Chart with Budgetary Targets



4.5 Risks to Fiscal Targets

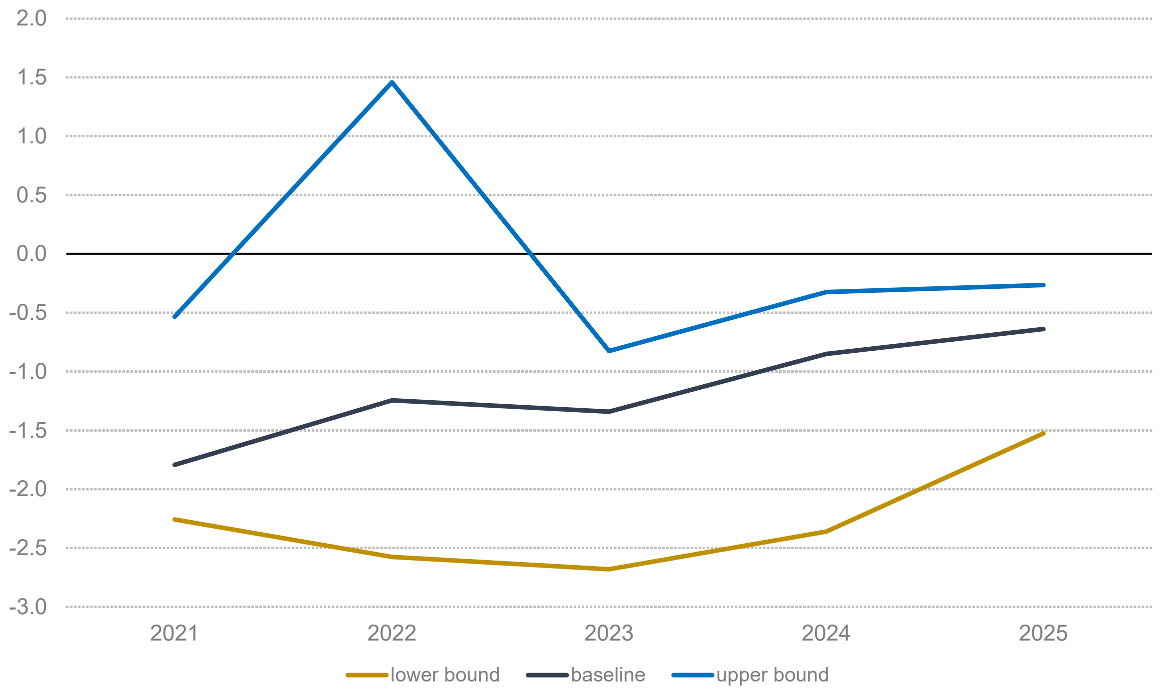
The alternative macroeconomic scenarios documented above, can influence the attainment of the deficit targets thus underpinning alternative fiscal conditions. Chart 4.2 illustrates the range of possible budget balance outcomes conditional upon the realisation of these alternative scenarios. The evaluation 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 downside risks for the attainment to the budget balance throughout the forecast horizon. In the worst-case scenarios contemplated in the risk assessment, which are persistent inflation and wage-price spiral, the budget balance as a percentage of GDP deteriorates by 0.5 and 0.3 percentage points in 2022 and 2023 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 of the above economic scenarios have thus been carried out.

Compared to the baseline scenario, as shown in Chart 4.3, alternative output gap projections (per cent of potential output) range from -2.7 in 2023 up to -1.5 in 2025 under lower-bound estimates and from -0.8 in 2023 up to 1.5 in 2022 under upper-bound estimates.

Chart 4.3
Output gap: Risk assessment



Footnotes:

[1] https://www.sachverstaendigenrat-wirtschaft.de/en/economic-outlook-2022.html?returnUrl=%2Fen%2Findex.html&cHash=947ab5169ca191577209dd3c7bbc212a

5. Quality of Public Finances

5. Quality of Public Finances

The Maltese Government is of the view that at this stage of Malta's economic development, further prosperity and the improvement in the quality of life of Maltese citizens is increasingly dependent on the quality of economic growth rather than the quantity. This applies also to public finances where the efficiency and effectiveness of public spending and taxation become more integral to the growth of the economy's potential in support of higher living standards. In addition, sustainability in public finances promotes the better utilisation of resources in the economy and the creation of fiscal space to allow fiscal policy to stabilise the economy when required.

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, enforcing the payment of tax arrears, further simplifying the tax system, and combatting tax evasion and avoidance.

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. A repayment programme of thirty months for these deferred taxes has now been established whereby taxpayers will have 30 months starting from June 2022 up to December 2024 to repay the deferred taxes. A further pandemic related mitigation measure that allows the surrender of capital allowances by companies to other companies within the same group will also have an impact on revenues collected during 2022. Nevertheless, revenue streams still have been recovering well this year as levels are much higher than predicted in the Budget 2022.

In order to minimise the effects income taxation may have on the incentive to work, the eligibility to the tax relief on overtime income has been widened and the beneficial rate on part-time work has been further reduced. Moreover, a measure has been introduced that will grant an exemption on pension income that has so far qualified for a rebate. This measure will be implemented over a 5-year period.

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 have gone through, or are currently undergoing, an extensive professional training programme offered by foreign experts.

A legal notice containing the EU Anti-Tax Avoidance Directives Implementation Regulations was published in 2020 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.

The current developments unfolding at the OECD Inclusive Framework for BEPS and at the EU Council include a re-visiting of the tax allocation rules of the largest multinationals (Pillar 1), 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), and a new EU Commission proposal for a directive to tackle the misuse of shell companies within the EU. These developments are being monitored with a view to ensure that Malta's competitiveness is safeguarded.

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. Major efforts in recent years included the adoption of the Fiscal Responsibility Act in 2014, the Public Finance Management Act in 2019, the conduct of Comprehensive Spending Reviews and the undertaking of a Fiscal Transparency Exercise with the support of the IMF. More recently the Government has sought to substantially improve its fight against money laundering and tax evasion by strengthening the rule of law and the institutional framework and ensuring that the framework operates freely and independently to enforce the provisions of the law.

5.2.1 Money laundering

In April 2021, Malta was assigned by Moneyval a re-rating from "partially compliant" to "largely compliant" and "compliant" for nine Financial Action Task Force (FATF) Recommendations on technical compliance. Though this improvement is encouraging, the Government will continue to emphasise its commitment towards implementing the necessary reforms to address issues related to money laundering. Amongst the improvements made towards achieving such an objective, Malta has made efforts in the sharing of intelligence, the collection of statistics and the analysis of the intelligence gathered. This meant that several sectoral risk assessments were completed and presented to the FATF evaluators. These tools are presently being used to help the competent authorities to prioritise efforts and resources, as well as to address better the private sector through appropriate outreach techniques. Moreover, in June 2021, Malta made a high-level political commitment to work with the FATF and Moneyval in order to strengthen the effectiveness of its Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regime. Malta has worked incessantly to address the set FATF national action plan in a sustainable and effective way. Through the implementation of the FATF action plan, the strategic deficiencies related to the detection of inaccurate company ownership information and sanctions on gatekeepers who fail to obtain accurate beneficial ownership information, together with the pursuit of tax-based money laundering cases utilising financial intelligence, are being addressed.

In order to address the FATF action plan, during 2021 the National Coordinating Committee on Combating Money Laundering and Funding of Terrorism (NCC) has worked further on the intelligence shared by other entities, the risk assessment of commercial partnerships with a specific emphasis on Beneficial Ownership, and the national risk assessment on tax offences and related money laundering. This assessment was coordinated by the NCC and with intelligence shared from the Financial Intelligence Analysis Unit (FIAU), the Malta Business Registry (MBR), the Office of the Commissioner for Revenue (OCfR), the Office of the Attorney General, the Financial Crimes Investigations Department (FCID), Komunita' Malta, the Department of Customs and the Central Bank of Malta. This risk assessment will feed into the Update of the National Risk Assessment (NRA).

In its February 2022 Plenary, the FATF made the initial determination that Malta has substantially completed its action plan and has conducted an on-site visit in the first week of April to verify that the implementation of Malta's AML/CFT reforms has begun and is being sustained, and that the necessary political commitment remains in place to sustain implementation and improvement in the future. It was decided that Malta is therefore no longer subject to the FATF's increased monitoring process, and that Malta is to continue working with MONEYVAL to sustain its improvements in its AML/CFT system.

Over the past four years, the FIAU stepped up its efforts to increase human resources. As a result, the FIAU managed to carry out a record number of on-site and off-site AML/ CFT supervisory examinations on subject persons (i.e. obliged entities) across different industry sectors to monitor compliance with AML/CFT obligations. The FIAU has also been active in taking the necessary enforcement action against subject persons found to be in breach of their AML/CFT obligations. The FIAU's analytical (FIU) function also saw an increase in submissions of Suspicious Transaction Reports or Suspicious Activity Reports (STRs/SARs), which led to increasing disseminations to competent authorities and foreign FIU counterparts. The FIAU also dedicated resources to carry out strategic analyses with the aim to achieve a better understanding of ML/FT threats and vulnerabilities affecting the Maltese jurisdiction.

During 2021, the FIAU carried out a strategic analysis on the misuse of Maltese-registered companies, focusing on beneficial ownership concealment. Along with other Maltese authorities, the FIAU also carried out other strategic analyses and a risk assessment focused on tax evasion and tax related money laundering.

Following proposals by the FIAU to prevent money laundering through the use of high value cash payments, the Use of Cash (Restriction) Regulations came into force in March 2021. This new set of regulations prohibits any person from making or receiving payments, or from carrying out transactions in cash, equivalent to or exceeding €10,000 in relation to specific high-risk goods.

Over the past three years, various reforms have been ongoing at the MFSA, including organisational restructuring, a significant increase in staffing and in training provided to staff, investments in technological systems, an overhaul of most supervisory procedures, including a complete shift towards risk-based methodology, and an increased focus on AML/CFT. These measures were taken on board in parallel with reviews and subsequent recommendations submitted by Moneyval, the European Banking Authority (EBA) and the International Monetary Fund (IMF).

In 2021, the Malta Gaming Authority (MGA) carried out prudential and conduct supervision audits which integrated elements pertinent to AML/CFT. This includes supervision over Know Your Client (KYC) procedures and adherence, registration data, identity and verification statuses, KYC documentation, player due diligence, conformity with the risk-based approach, and other applicable measures.

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, contribute to long-term economic growth and support the progress of society. What follows is a systematic analysis of the evolution of public sector outputs and the efficiency with which public expenditure yields these outputs. This section evaluates how the various functions of the government utilise 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, in 2021, a new five-year strategy for the renewal of the public service was launched. The strategy[1] is based on three key pillars; service, technology and people. The strategy shall ensure the persistency in up-to-date technology in order to make sure that any new services would be offered digitally by default, reducing unnecessary bureaucracy and continue providing a 24x7 service.

Footnote:

[1] https://publicservice.gov.mt/en/Documents/Achieving-A-Service-of-Excellence-2021.pdf