PRE-BUDGET
CONSULTATION DOCUMENT

2023

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GOVERNMENT OF MALTA
MINISTRY FOR FINANCE
AND EMPLOYMENT

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CONTENTS

FOREWORD

In 1980 Ronald Reagan and Margaret Thatcher harboured their version of the free market blueprint, which accelerated the downfall of the 'big state' politics, ushering in new affluence and wealth in their economies.

Those were relatively successful policies shadowed by a number of social shortfalls. Partly due to this, the gap between the Soviet Union and the West materialised, and wrote a new chapter in history, birthing the renaissance of the modern liberal democratic way of governing.

The Reagan & Thatcher movement became so successful that it became an ideology, a way of thinking and a political platform in and of itself. We see it mirrored today in various politicians and parties.

The problem with this ideology - and all ideologies for that matter - is that it restricts our eyesight to only the options that subscribe to a particular flavour. Ideology is often centered around narrow principles, not realism and pragmatism towards the circumstance.

A more comprehensive menu of options is available to those unchained from the confinements of narrow doctrines and who have the freedom to analyse the problem and potential solutions in the most rational approach possible.

THE GOVERNMENT'S APPROACH DURING THE COVID-19 PANDEMIC WAS A LOGICAL APPROACH TO SOLVING THINGS, AND WILL REMAIN SO WHILST WEATHERING THE ENERGY AND COST OF LIVING CHALLENGES.

The criticism of being too generous to businesses during the pandemic, and the criticism that we are too generous to workers through our COLA stances was levelled by the same Government in the span of twelve months, but frankly, I do think that in both instances Government chose sensibility.

If we applied rigid thinking based on political creed, the Maltese economy would have been worse off.

The modern age fiscal policymaker must be freed from the shackles of inflexible dogmas, and be able to adapt - being nimble is our greatest strength. This is especially important during ever-changing circumstances like the present day. And things are ever-changing as ever.

In July, the International Monetary Funded listed the war in Ukraine, inflation, recession, debt distress, China's compounding COVID-19 after-effects, geopolitical fragmentation and the social instability resulting from all this as the 'perfect storm'.

Often, just one or two of these issues in one single year would have sent people into a spiral. Seven is quite the list. Indeed, these are all indications of stagflation in the making.

These cues from abroad strengthen the Maltese Government's mission to ensure policy continuity towards fiscal responsibility, economic sustainability and the well-being of its citizens and businesses take precedence.

We must be able to manoeuvre flexibly, and should always be guided by the realities of a shifting landscape.

Malta's position of absorbing the added energy costs in the first quarter of this year was a contrarian approach in the infancy of the Ukraine war. The mainstream European advice was to maximise fiscal prudency at the altar of inflation and the free market. This economic support by other European states was previously mete out by the cupful – but as things deteriorate, it is now being dispensed by the barrel.

While the debt to GDP ratio of some European countries expands further, their dilemma in the coming months will be to either save their economy or expose their countries to debt levels that are simply unsustainable – well beyond the 100% mark.

How can such large debts, at a time of slower economic forecasts, be managed – is a question many European nations will need to somehow answer.

Heavier taxation – perhaps even through fresh minimum taxation levels proposals – could be the answer for them, although much of that will depend on what happens in the United States in November.

IN MALTA, THE SITUATION IS VERY DIFFERENT. THE GOVERNMENT'S AIM IS TO CONTINUE STRENGTHENING THE POLICY OF ABSORBING THE ENERGY EXCESS COST, WHILE ENSURING OUR DEFICIT REMAINS WITHIN CONTROL.

One of the Government's main challenges in the coming two to three years will be to minimise the percentage of deficit that becomes structural, and to continue navigating our endeavours towards lower levels.

The coming winter will prove to be a test on different fronts for Europe, and we are by no means exempted from the ill effects of decisions made in other European capitals.

But I draw courage from the resolve, and resilience of our country and its people.

We have shown our mettle time and again. We are unafraid of the future.

Not because there isn't anything to be fearful of but because we recognise the depth of the challenges ahead of us, and we have a clear plan for it.

CLYDE CARUANA
Minister for Finance and Employment

MACROECONOMIC DEVELOPMENTS

01

1.1 INTRODUCTION

THE WAR IN UKRAINE AND THE SUPPLY-CHAIN TURBULENCE BROUGHT BY THE PANDEMIC WILL HAVE A PROFOUND IMPACT IN THE COMING YEARS.

The Maltese economy has been resilient through all this mainly due to supportive policies implemented by the Government. A considerable part of this document is dedicated to evaluating the sustainability of these policies and the different outlooks of alternative approaches and their impact on the economic well-being of the country. In Europe, energy policy is on many fronts dictating economic and financial policy. At the same time, foreign policy and the geopolitics of war are shaping energy policy.

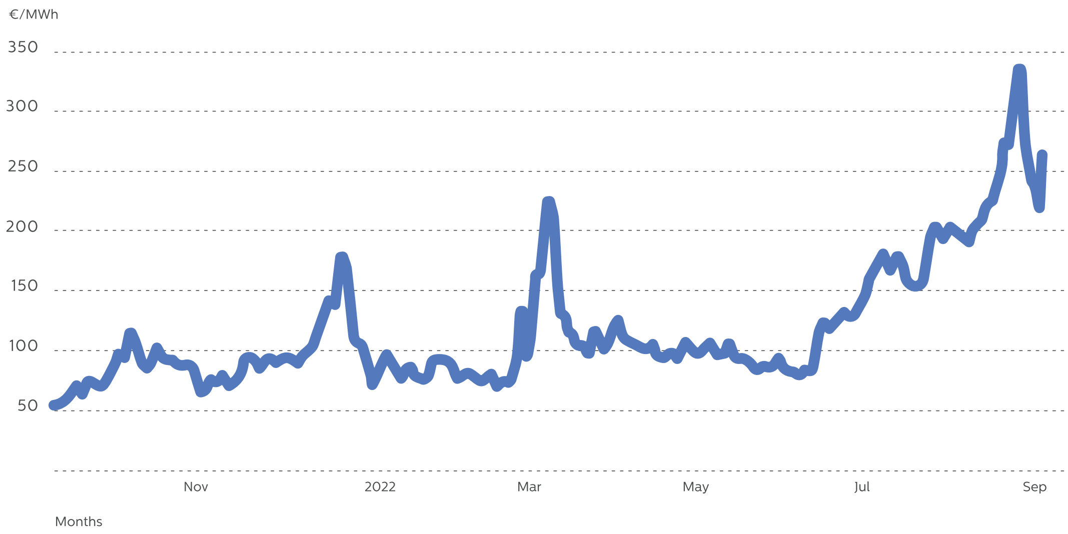
Continental foreign policy and the geopolitics of war have influenced the energy security of Europe. In turn, this has influenced the economic and financial stability, and the sustainability, of every European Member State's economy.

The gas market, such as the Dutch TTF Gas, a leading European benchmark price (EUR/MWh) for gas since volumes traded represent more than 14 times the amount of gas used by the Netherlands for domestic purposes, has seen meteoric increases over the past months.

Figure 1.1

Natural Gas EU Dutch TTF

Source: Tradingeconomics.com



These increases will have complex consequences – political, economic and financial in nature – which this document also aims to substantiate and provide context for policymakers and stakeholders.

1.2 ECONOMIC GROWTH

GLOBAL GROSS DOMESTIC PRODUCT (GDP) GROWTH AMOUNTED TO 5.8 PER CENT IN 2021, AFTER CONTRACTING BY 3.3 PER CENT IN 2020, WITH MOST G-20 ECONOMIES GAINING, AND SOME EVEN SURPASSING, THEIR PRE-PANDEMIC OUTPUT LEVELS.

In 2021, the European economy grew by 5.4 per cent, a recovery from the decline of 5.9 per cent caused by the pandemic in 2020.

In 2021, the Maltese economy recorded a real growth rate of 10.3 per cent, or 12.3 per cent in nominal terms. This growth figure was 4.9 percentage points higher than that of the European Union (EU), making Malta one of the quickest economies to recover following the pandemic. The domestic demand component was the main driver of this robust economic activity. The labour market continued to be consistent, with increased activity rates observed, particularly among females and older workers. This contributed to a record low unemployment rate.

On the external front, despite a resurgence in virus cases that initially prevented travel exports from recovering as expected, Malta still recorded a net export contribution of 2.6 percentage points.

In 2021, Malta registered the second largest growth rate for the year, surpassed just by Ireland, with a growth rate of 13.6 per cent. Malta exceeded the EU and EA averages by 4.9 and 5.0 percentage points, respectively. Despite the contraction of 8.3 per cent experienced in 2020 due to the COVID-19 pandemic, Malta still registered the third highest average growth rate (of 3.6 per cent) among Member States between 2016 and 2020.

Figure 1.2
Real GDP Growth
Source: Eurostat

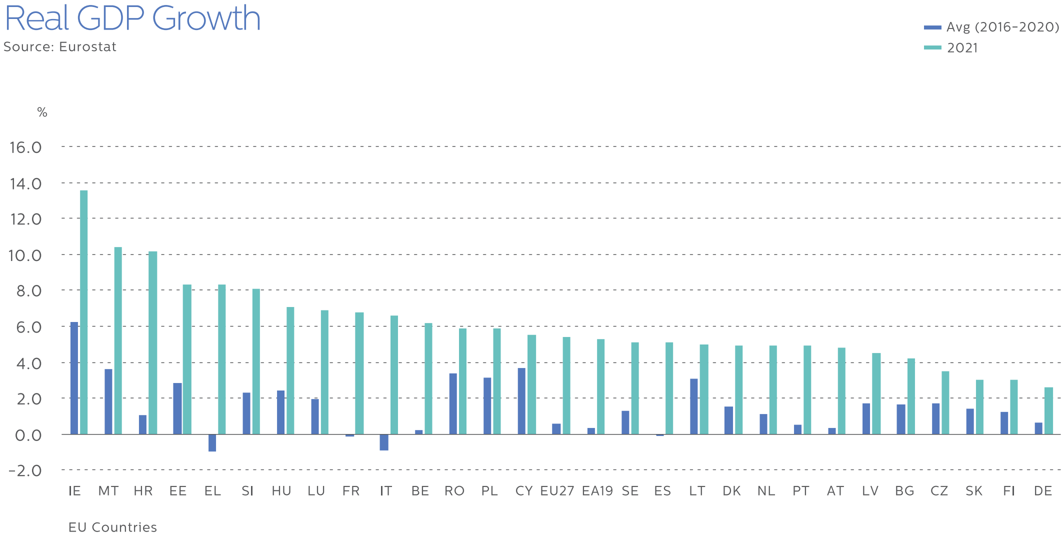


Figure 1.3
Real GDP Growth - Malta
Source: Eurostat

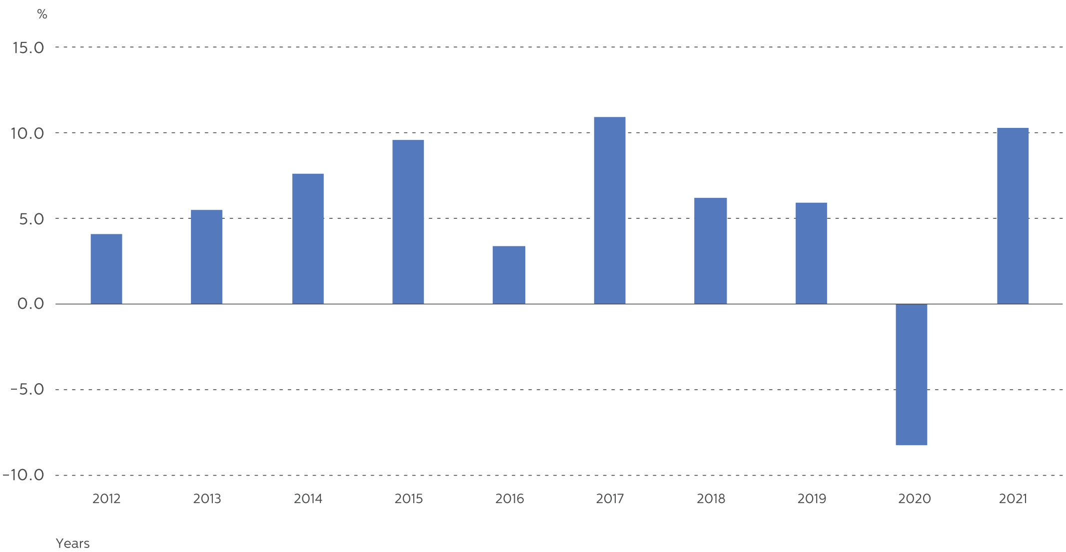
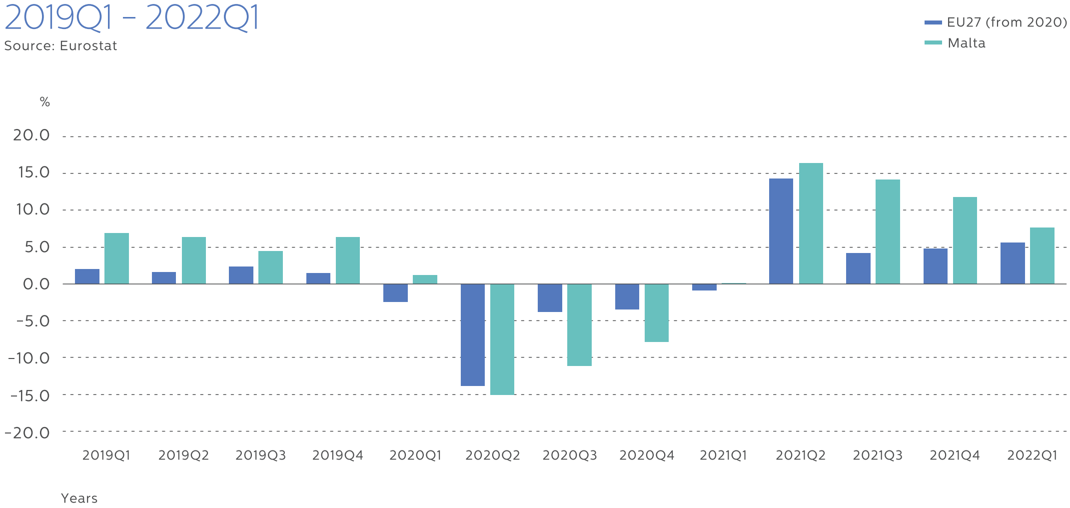


Figure 1.4

Real GDP Growth 2019Q1 - 2022Q1

Source: Eurostat



During the first half of 2022, the Maltese economy grew by 8.5 per cent in real terms over the corresponding period of last year. Growth in the first half of 2022 was relatively balanced, driven by domestic demand, contributing 4.9 percentage points, and net exports, which contributed 3.9 percentage points.

In nominal terms, total income grew by 13.3 per cent, mainly reflecting a 15.9 per cent (or €527.9 million) growth in gross operating surplus, 8.0 per cent (or €258.9 million) increase in compensation of employees, and 33.7 per cent (or €142.8 million) growth in taxes less subsidies on production and imports.

During the same period, total gross value added increased by 13.6 per cent. Growth was broad-based across all sectors, with the highest growth recorded in the wholesale and retail trade sector, which grew by 40.4 per cent. Other notable growth rates were recorded in the information and communication sector (18.5 per cent), the arts, entertainment, and recreation sector (14.4 per cent), the manufacturing sector (10.7 per cent), the agriculture, forestry and fishing sector (10.7 per cent), the professional, scientific and technical activities sector (10.6 per cent) and the financial and insurance sector (8.4 per cent).

Figure 1.5

Growth in Gross Value Added in 2022H1

Source: NSO

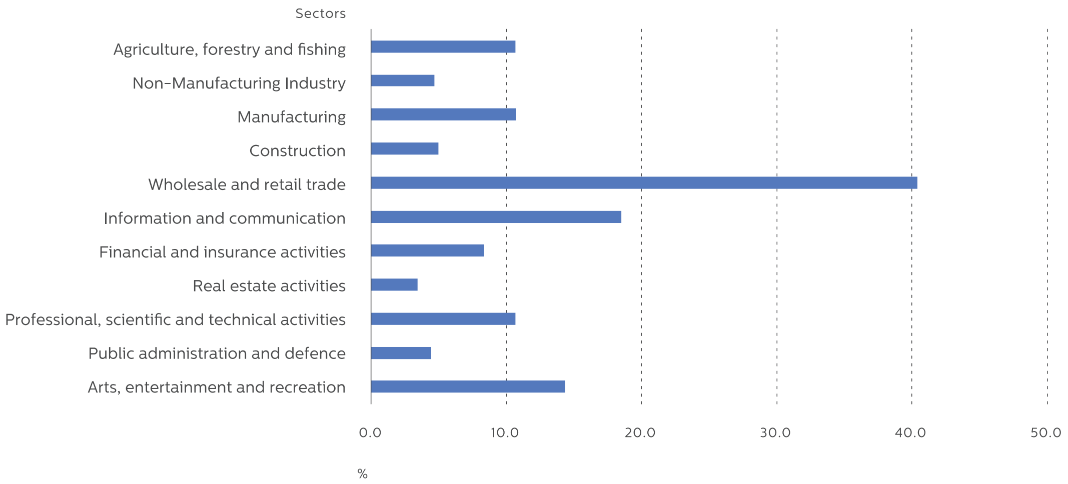
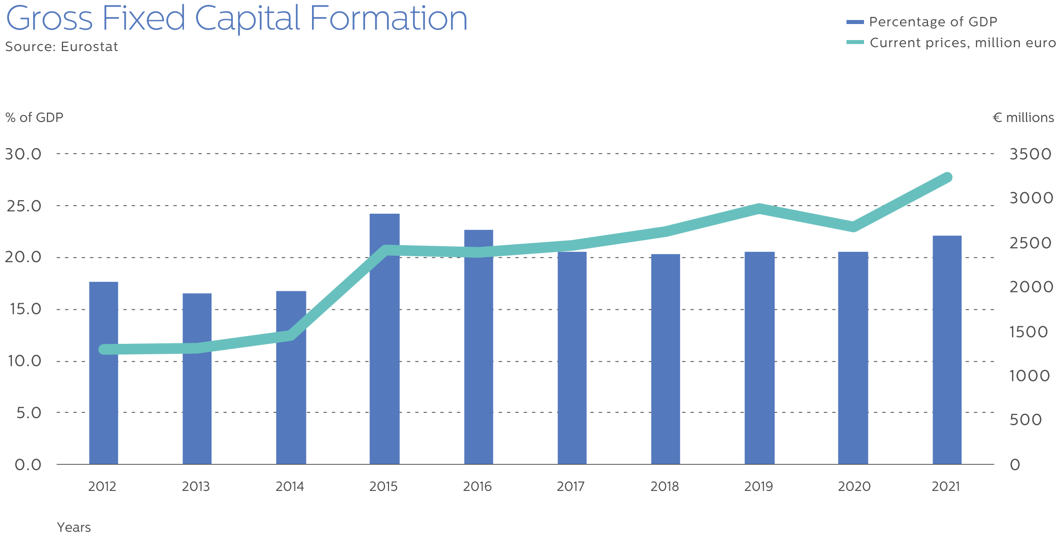


Figure 1.6

Gross Fixed Capital Formation

Source: Eurostat



Total investment in the Maltese economy has increased from €1296.6 million in 2012 to €3237.8 million in 2021. During the same period, it has also increased by 4.5 percentage points as a per cent of GDP, with its share rising from 17.6 per cent in 2012 to 22.1 per cent in 2021.

Liquidity support measures related to COVID-19

In a period where labour markets globally were vulnerable to the economic impact of the pandemic, the Maltese labour market proved resilient.

While total employment (as measured in the Labour Force Survey) in the European economy remained below pre-crisis levels in 2021, Malta registered positive employment growth in both 2020 and 2021, whereas in the latter year, employment growth stood at 2.3 per cent. A strong economic recovery sustained employment growth. At the same time, the Government support measures helped cushion the impact of the pandemic on the labour market through the Wage Supplement Scheme, which was extended until May 2022. In addition, to ease further liquidity pressures on businesses and households stemming from the outbreak of COVID-19 and the subsequent containment measures, the Government launched the tax deferral scheme, a moratorium on loan repayments granted by financial institutions and the Malta Development Bank COVID-19 Guarantee Scheme (CGS).

Through the Wage Supplement Scheme, €825 million in support was provided to firms and businesses to substantially cover partial wage costs in order to reduce the burden during COVID-19 restrictions and thus, prevent redundancies. The scheme was initially launched in 2020 and tapered out up to May 2022, aimed at helping firms and businesses during the recovery period. Table 1.1 below portrays the total number of beneficiaries and expenditures related to this scheme.

Table 1.1

Wage Supplement Scheme information as at August 2022

Source: Malta Enterprise

Year	Employees	Self-employed	Firms	Total Expenditure
2020	78,569	11,796	5,183	€342,113,279
2021	81,393	10,184	4,292	€381,218,894
2022	67,791	7,215	3,118	€101,561,856

Businesses could also apply to postpone the payment of taxes such as VAT and income tax through the tax deferral scheme. Starting from June 2022, the scheme's beneficiaries could pay the eligible taxes monthly over 30 months until the end of December 2024. During this period, the interest on the deferred tax is suspended.

7052 taxpayers applied for the deferral of VAT payments. The total deferred amount for the period March 2020 to December 2021 declared by these taxpayers amounted to €745 million. The remaining amounts that must be paid on this deferred VAT has decreased significantly and to date stands at €69 million.

4341 employers applied for the deferral of the Final Settlement System taxes (income tax and Social Security Contributions deducted on wages). The total estimated deferred amounts for March 2020 to June 2020 declared by these employers amounted to €144 million. The remaining amounts that must be paid on these taxes have also decreased drastically to around €14 million.

Furthermore, financial institutions also granted a moratorium on loan repayments (see Table 1.2).

Table 1.2

Loans subject to Moratorium

Source: Central Bank of Malta

(€ million)	2020	2021	2021 Q1	2021 Q2	2021 Q3	2021 Q4
Outstanding loans subject to a Moratoria	691.9	14.1	411.7	99.6	36.4	14.1

Loans subject to a moratorium have fallen consistently since August 2020, reaching very low levels by the end of 2021, as the moratoria period is gradually expiring for many loans, and economic activity continued to normalise in most sectors.

Indeed, as of the end of 2021, only seven loans were subject to a moratorium on repayments compared to 17 loans a month earlier. The value of such loans declined by €12.2 million from November and stood at €14.1 million, or 0.1% of total outstanding loans to Maltese residents. All the outstanding loans covered by moratoria were held by firms, as Maltese households no longer had such loans.

The most significant number and value of loans subject to a moratorium were held in the sector comprising professional, scientific and technical activities. This was followed by the accommodation and food services activities sector, with 0.6% of the loans held by this sector subject to a moratorium by the end of December. This contrasts with the end of 2020, when over 40.0% of outstanding loans in this sector were subject to a moratorium.

To further alleviate liquidity challenges, the Government launched the Malta Development Bank (MDB) COVID-19 Guarantee Scheme (CGS) to guarantee new loans granted by commercial banks for working capital purposes to businesses facing liquidity shortfalls as a result of the pandemic. The scheme enables credit institutions to leverage Government guarantees to a total portfolio volume of €777.8 million.

Table 1.3
Malta Development Bank COVID-19 Guarantee Scheme
Source: Central Bank of Malta

As at June 2022
(Number of facilities approved and still outstanding, EUR million)

	Total number of facilities (1)	Sanctioned Amount (2)
Manufacturing	55	24.5
Construction	35	46.9
Wholesale and retail trade; repair of motor vehicles and motorcycles	169	89.6
Transportation and storage and information and communication	39	45.2
Accommodation and food service activities	146	119
Professional, scientific and technical activities	37	20.4
Administrative and support service activities	38	13.7
Real estate activities	17	7.3
Others (3)	86	115.9
Total	**622**	**482.6**

(1) The number of facilities taken by various sectors
(2) The total number of loans sanctioned under the scheme as at end month, in Eur million
(3) Includes loans to education, health and social work, financial and insurance activities, arts, entertainment and recreation, other services activities and extra-territorial bodies and organisations, and the electricity, gas and water supply sector.

N.B. A drop in the number and value of sanctioned facilities may reflect the repayment in full of the facility by the customer, or a reduction in the facility's value and other adjustments.

By end-June 2022, 622 facilities were approved under the CGS, covering total sanctioned lending of €482.6 million (see Table 1.3). As the scheme provides guarantees on new loans for working capital and loan repayments, the number of loans disbursed under the scheme may be lower than the sanctioned amount. By the end of May, €466.4 million were disbursed, slightly lower than the €467.4 million disbursed in April.

By end-June, the sector that held the highest number of facilities was wholesale and retail with a total of 169 facilities amounting to €89.6 million in sanctioned loans. This was followed by accommodation and food services activities, with 146 facilities or €119.0 million in sanctioned loans.

In value terms, these were followed by the construction sector and the transportation, storage and information communication sector, with €46.9 million and €45.2 million, respectively.

1.3 LABOUR MARKET

MALTA'S BUOYANT LABOUR MARKET HAS PROVED STRONG ACROSS SEVERAL CATEGORIES.

Whilst Malta's total employment rate (ages 20-64) in 2021 stood at 78.6 per cent, the EU-27 and EA-19 averages stood at 73.1 and 72.5 per cent, respectively.

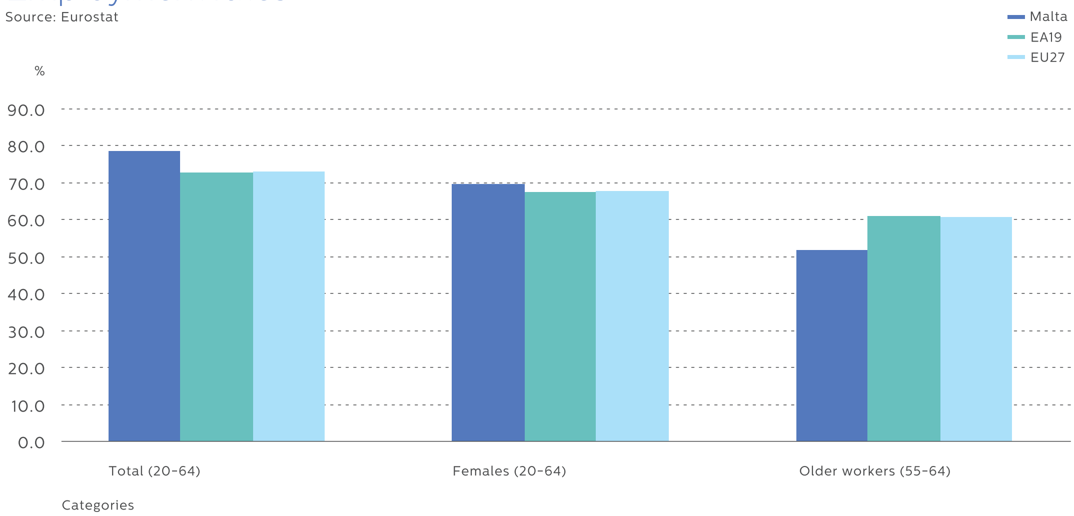
Moreover, the female employment rate in Malta has also performed relatively well, increasing by 11.6 percentage points between 2016 and 2021, surpassing both the EU and EA averages during this period. Such results prove the Government's consistent support and commitment to increasing the female employment rate across the years through several measures, including the Free Childcare, the Breakfast Club and the provision of after-school services as well as fiscal incentives to encourage women to re-enter the labour market. The employment of older workers also increased during the last five years, from 45.8 per cent in 2016 to 51.8 in 2021. The labour market participation rate of older workers also increased by 6.0 percentage points during the same period.

Nevertheless, the Government is cognisant that Malta's older workers' employment rate is still below the EU and EA averages; thus, in the coming years, it will strengthen its efforts on this front.

Figure 1.7

Employment rates

Source: Eurostat



Moreover, Jobsplus' administrative data indicates that as of April 2022, registered full-time employment increased by 5.2 per cent while part-time employment as a primary job increased by 6.4 per cent when compared to the same month in 2021.

Table 1.4

Employment growth by Nationality and Employment type (y-o-y change)

Source: Jobsplus administrative data

	2018/2017		2019/2018		2020/2019		2021/2020		Apr 2022/Apr 2021	
	Full-time	Part-time (primary)	Full-time	Part-time (primary)	Full-time	Part-time (primary)	Full-time	Part-time (primary)	Full-time	Part-time (primary)
Nationals	2.6%	-0.7%	1.6%	0.6%	0.6%	-6.4%	1.5%	5.9%	1.3%	6.0%
EU Nationals	14.5%	5.8%	9.0%	1.7%	-12.7%	-25.3%	8.1%	6.9%	7.9%	7.4%
TCNs	54.5%	-4.7%	46.7%	-0.3%	21.9%	136.5%	13.1%	5.1%	21.0%	9.4%

As per Table 1.4 above, the highest increase in employment when comparing April 2022 with April 2021 was registered amongst Third Country Nationals, where the number of full-time employees increased by 21.0 per cent and the number of part-time employees (as a primary job) increased by 9.4 per cent. This result is expected given that the Maltese labour market is nearing full employment with record low unemployment rates and a constantly declining inactivity rate. This limits the growth rate of employment of Maltese nationals relative to the other supply labour markets, posing a barrier to economic growth.

Through the support of the Government measures, Malta has also managed to maintain a low unemployment rate which is one of the lowest among its European peers. In 2021, the unemployment rate reached a historically low level of 3.5 per cent, which was 3.5 percentage points below the EU-27 average. Malta also fared relatively well in youth unemployment (ages 15 to 24), having the fourth lowest youth unemployment rate amongst Member States, standing at 9.6 per cent, compared to the EU-27 and EA-19 averages of 16.6 and 16.8 per cent, respectively.

Unemployment data covering the first three months of this year shows that Malta recorded the second lowest unemployment rate amongst the European Member States. The unemployment rate declined from 4.0 per cent in the first quarter of 2021, to 3.3 per cent in the first quarter of 2022. In July 2022, Malta's unemployment rate continued to decline to 2.9 per cent.

Figure 1.8

Unemployment rate

Source: Eurostat

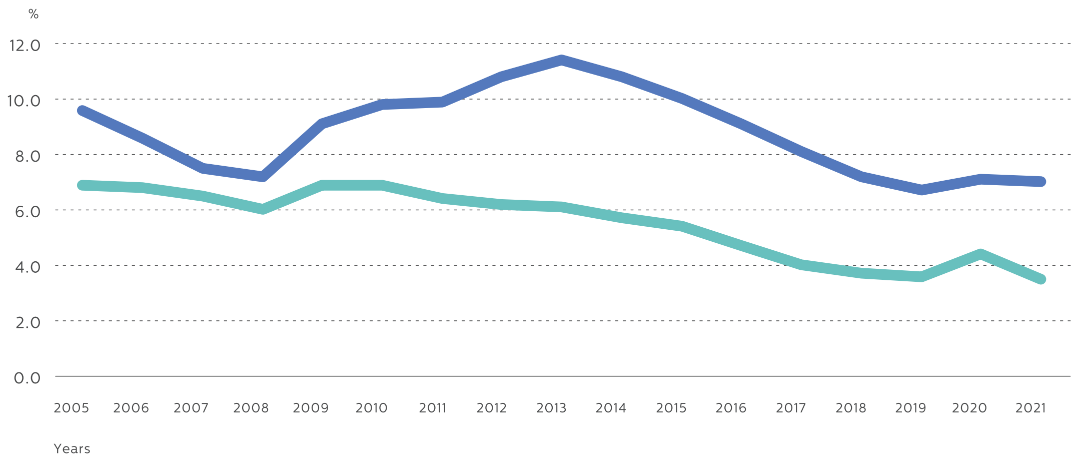
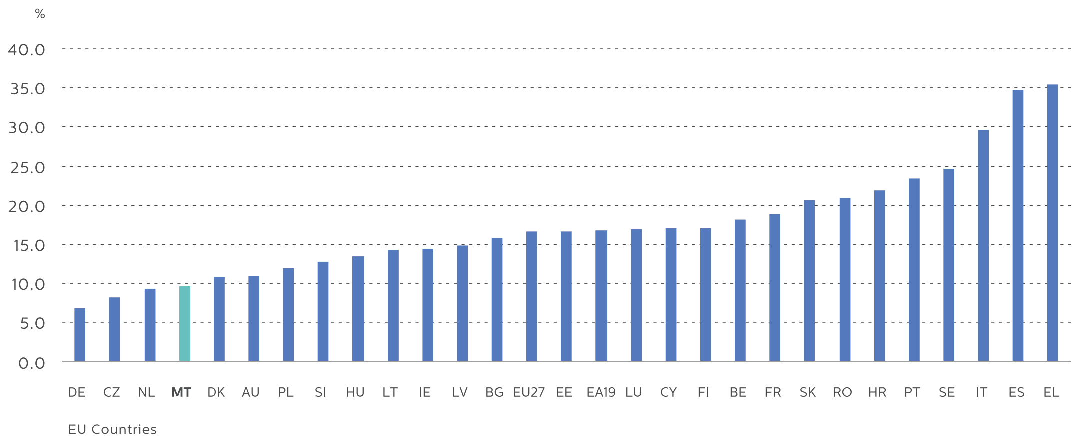


Figure 1.9

Youth unemployment – 2021

Source: Eurostat



Employment policy

The National Employment Policy launched in May 2014 was aimed at addressing several challenges amongst which included the low female participation rate, the relatively high unemployment rates, and the lack of incentives to move from social benefits to employment.

Such challenges have all been thoroughly addressed through that National Employment Policy by proposing reforms in a number of areas including free childcare, tapering of benefits and the in-work benefit scheme. Over the years, new challenges have emerged in the labour market, which called for the need of a new Employment Policy.

The National Employment Policy 2021-2030, which was launched in October 2021, provides a comprehensive evaluation of Malta's labour market and delves into the new challenges that are being faced by the employers and employees such as the labour market skills gap and skills shortages, digitisation and the creation of green jobs. The Policy also provides a number of recommendations with proposed measures to address the challenges.

Some of the recommendations proposed in the new National Employment Policy have already been implemented through the 2022 Budget. These include:

- The Launch of a National Skills Census - which will be completed by the end of the year;
- Fostering participation in apprenticeship and traineeship programmes by increasing investment in apprenticeship placements within the private sector;
- Encouraging participation in the labour force through high quality early learning and care with a focus on night care by extending the free childcare service for the benefit of employees who work atypical hours and shifts;
- Tax incentives aimed at continued work after retirement;
- Reduction in the overtime and part-time income tax rates.

The implementation of the Employment Policy will be embraced further through the coming Budget where further proposals will be executed such as measures to encourage pensionable age workers to extend their working careers and measures to address the labour market skills gap.

1.4 EDUCATION

SUSTAINED ROBUST ECONOMIC GROWTH RATES COUPLED WITH A STRONG LABOUR MARKET POLICY OF MAKING WORK PAY, HAVE UNDERPINNED THE POSITIVE RESULTS ACHIEVED IN THE LABOUR MARKET.

However, now more than ever, as reiterated in the National Employment Policy 2021-2030, is the time to focus on investment in Malta's human capital and hence, the quality of the labour force.

Malta's public expenditure on education is above the EU average and has more than doubled in the last ten years.

The mantra goes that in education, results can only be reaped in the long-term following the development and integration of policy reforms and for the added expenditure to be integrated into the system and produce better outcomes.

While education outcomes have resulted in a continued positive trajectory, more in-depth analysis is required to understand the value of the investment and the corresponding return. Malta's education system spends considerably more per head than many other European Member States and yet although improvements have been made, the outcomes in certain indicators still lag behind EU averages - the reasons behind this still need to be analysed and studied.

Figure 1.10

Total General Government Expenditure of Education, 2020 (% of GDP)

Source: Eurostat

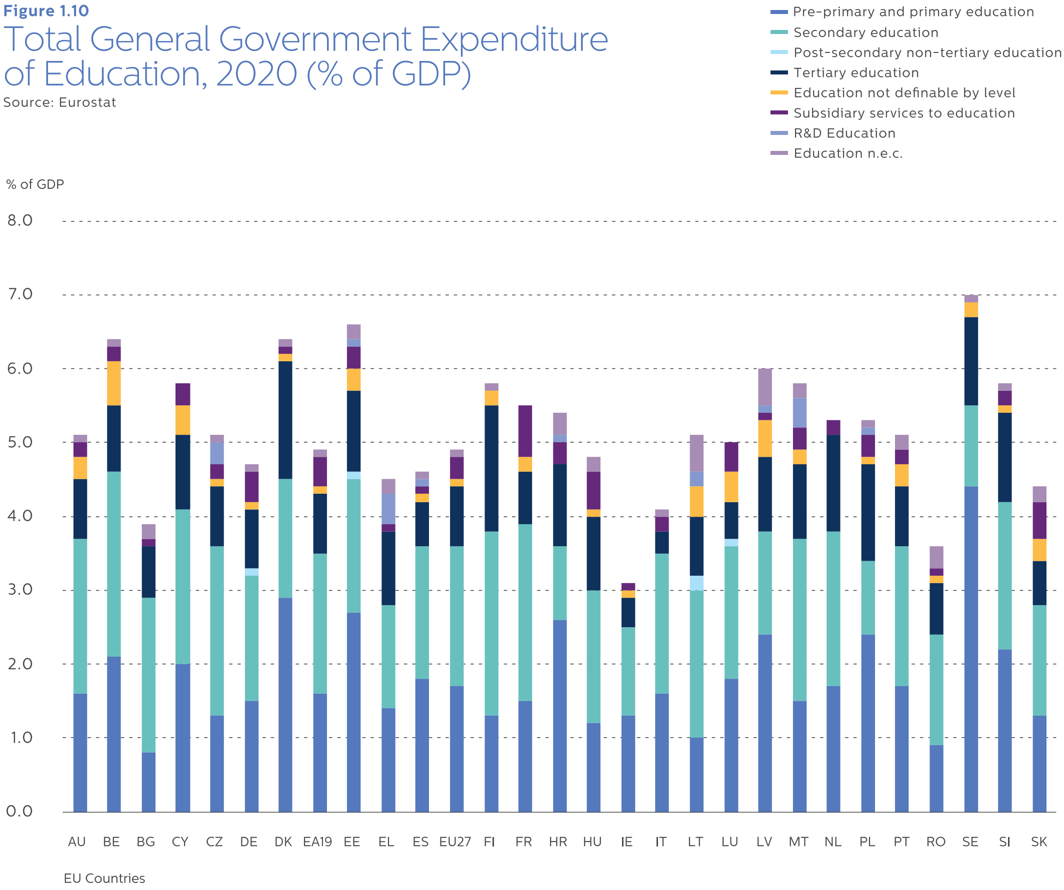


Figure 1.11

Total Government Expenditure on Education

Source: Eurostat

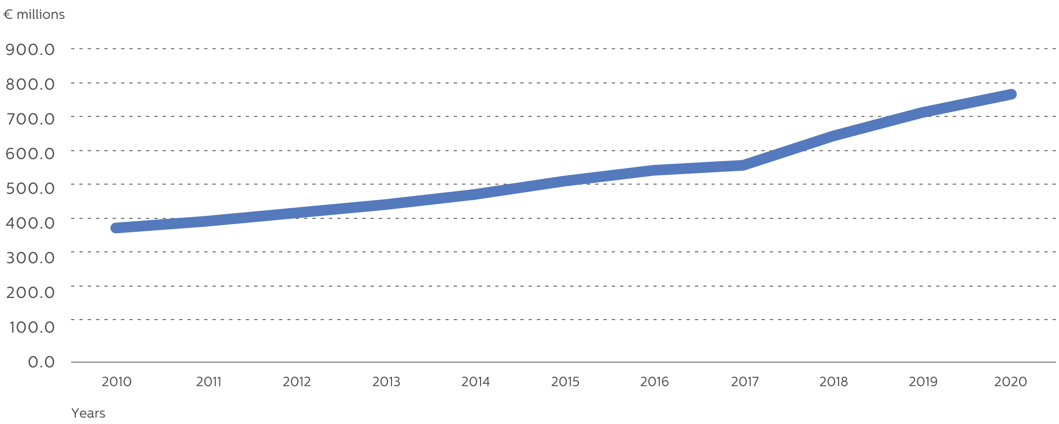
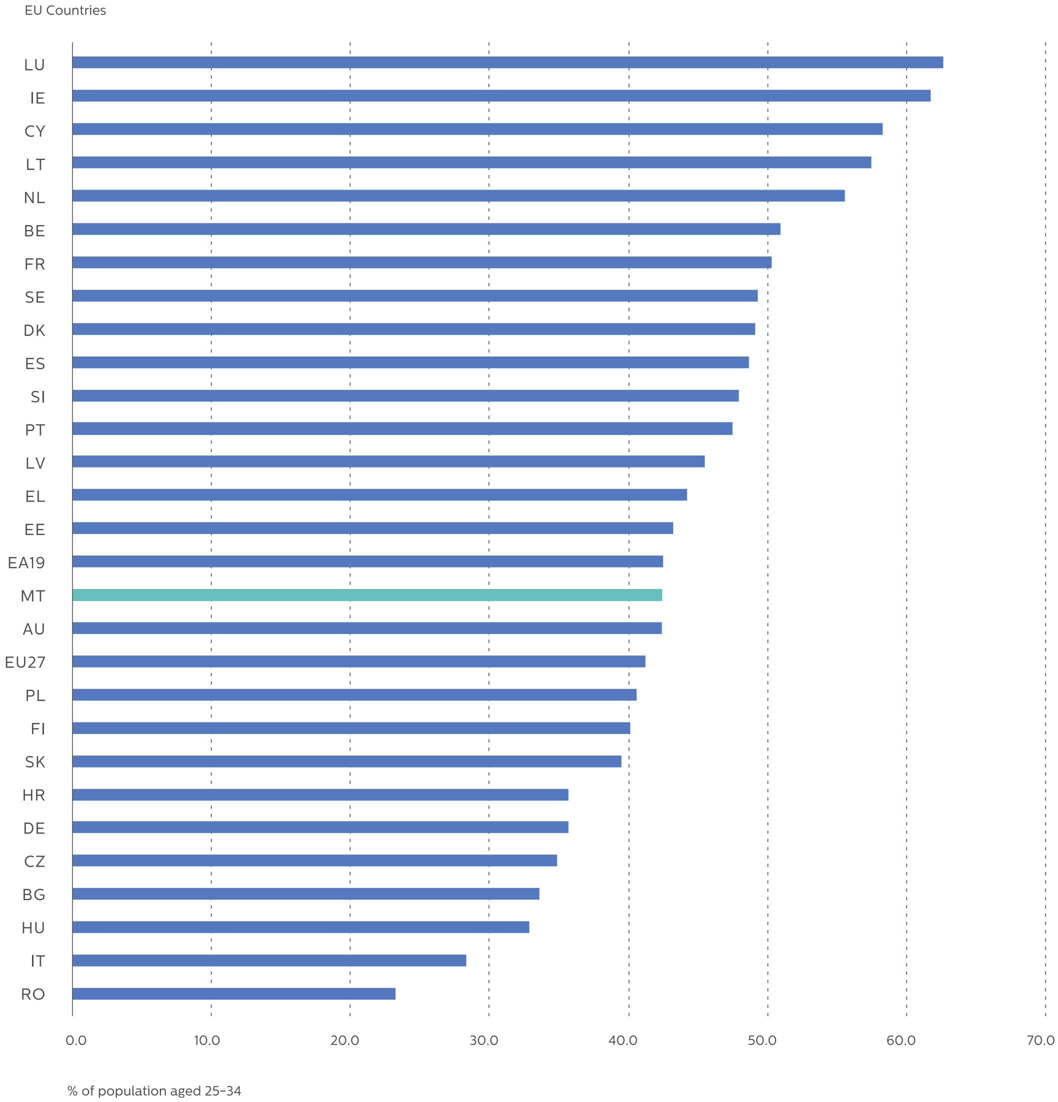


Figure 1.12

Population aged 25-34 with tertiary educational attainment (ISCED 5-8), 2021

Source: Eurostat



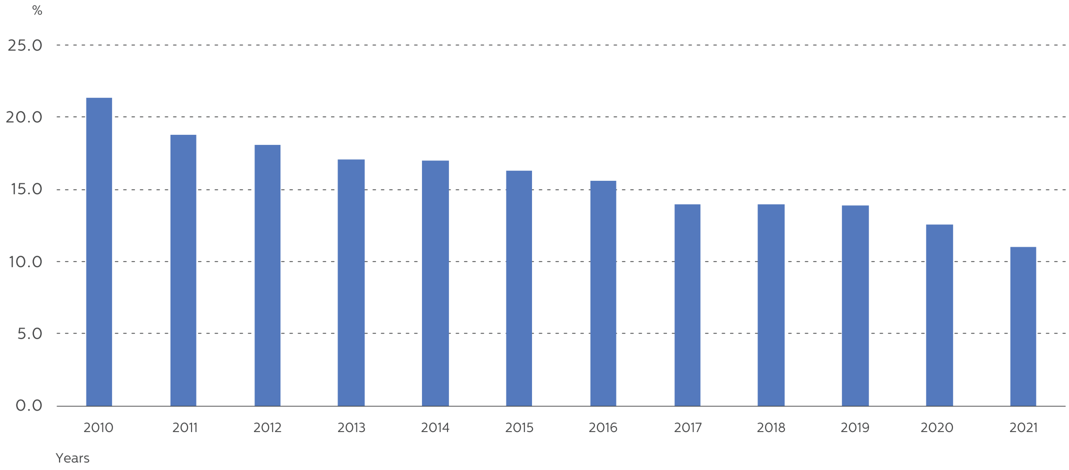
Reducing the Early School Leaving Rate

Malta's efforts for a more equitable, quality and inclusive education system have yielded a steady decline in early leavers from education and training (ELET) from 21.4 per cent in 2010 to 11.0 per cent in 2021. In fact, as from 2017, Malta has registered one of the highest percentage decreases in ELET across all the EU. Nevertheless, the rate is still higher than the EU average of 9.7 per cent.

Figure 1.13

ELET - Malta

Source: Eurostat



In order to continue reducing the ELET rate, Malta's National Policy Framework for Early Childhood Education and Care (ECEC) (2021) was launched. Through ESF funds, a consortium was set up to develop a road map to establish a monitoring and intervention programme in schools. In order to implement the said consortium, a pilot project will be set up before the national rollout programme. This would identify early leaving from education and training (ELET) risk factors at an early stage and intervene by liaising with stakeholders within the school, at home and within the community.

Furthermore, Malta's National Literacy Strategy 2021-2030 aims to raise literacy levels and to ensure access to professional development opportunities in literacy learning and teaching. Within this context, Malta's Recovery and Resilience Plan (RRP)'s reforms include the "Reading Recovery (RR)", an accredited school-based literacy programme for the lowest achieving children aged six to seven. Over the course of 2021 to 2024, a total of 85 school-based complementary education teachers working with the hardest-to-teach children shall participate in a year-long intensive training to learn to use the Reading Recovery (RR) methodology. Such programme, as well as a myriad of different initiatives and programmes, are possible through Malta's investment in the National Literacy Agency.

Malta has also increased its focus on mentoring and training for newly qualified teachers as well as enhanced its investment in the Institute for Education. In the academic year 2021/2022, the institute recorded significant increases in the participation rate for its qualification programmes.

Increasing the Adult Learning Participation Rate

Progress has been registered in the participation rate in adult learning. In 2021, data shows that adult learning is higher than the EU average (13.8 per cent vs. 10.8 per cent) and thus signalling a drastic improvement when compared to 2014 (7.7 per cent vs. 13.8 per cent). This is a result of a number of several initiatives in the promotion of lifelong learning.

Figure 1.14
Adult participation in learning
Source: Eurostat

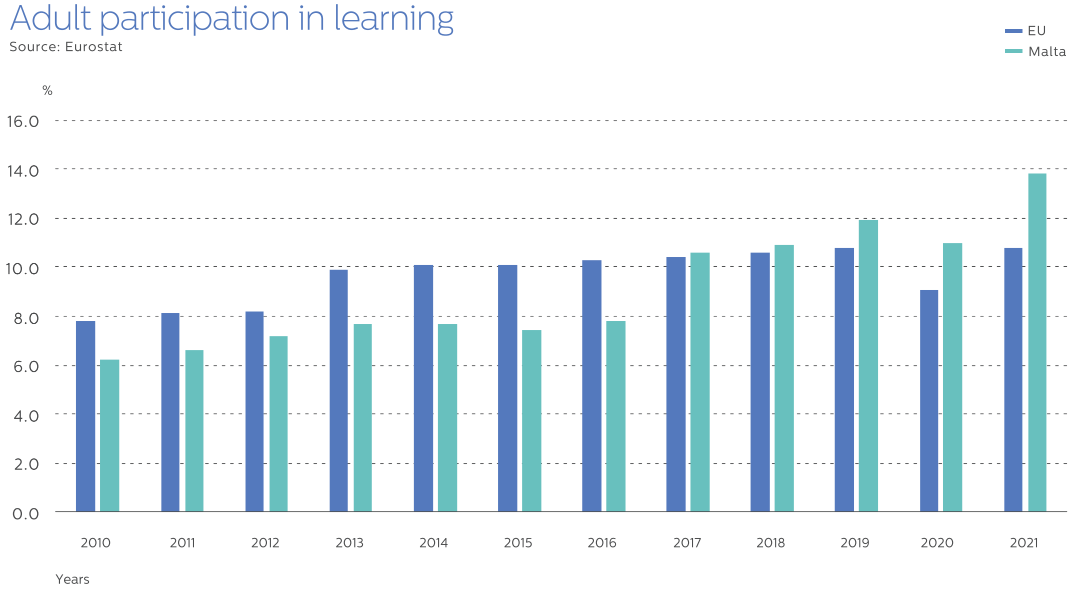
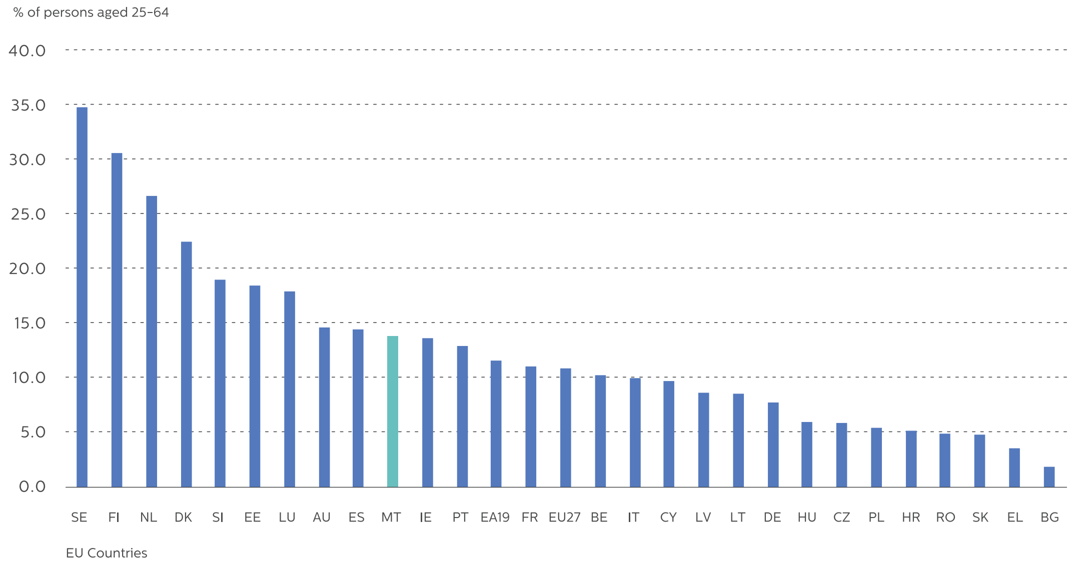


Figure 1.15

Participation rate in education & training (last 4 weeks), 2021

Source: Eurostat



Within the adult education sector, under Malta's RRP, reforms to be implemented include the establishment of a national hub, where any adult can come ask and be provided with guidance for the trajectory towards upskilling and reskilling; training of guidance educators to enable them to meet the demands of adult learners; possessing career and guidance is provided in every adult learning centre, where they would be accessible to all adult learners; and the launch of an e-College, with the aim of attracting at least 4,800 learners using the services provided through the new e-College platform.

The target group for such a platform will be adults from different socio-economic backgrounds, aged from 15 years and upwards who do not have MQF 3 qualifications or higher.

1.5 SOCIAL

THE MALTESE SOCIAL MODEL WAS SEVERELY TESTED BY THE COVID-19 PANDEMIC. THOUGH THE WORST OF THAT IS OVER, THE REPERCUSSIONS LINGER ON, MOSTLY IN TERMS OF MENTAL HEALTH.

This was further compounded by economic supply-chain disruptions and the war in Ukraine, which have led to a worldwide historic fall in income and massive job losses. The economic and social shocks have tested social cohesion and climate change considerations.

Through prudent, determined and pro-active action, Malta has spared itself the worst of the effects by rising to the challenges, through a combination of measures that ranged from an effective response from the health system, to targeted aid to protect jobs and incomes, and by strengthening of social protection.

In 2020, the at-risk-of-poverty or social exclusion rate (AROPE) which provides the share of persons who are either at-risk-of-poverty, severely materially and socially deprived, or residing in a household with low work intensity calculated using previous year's data decreased by 0.9 percentage points to 19.9 per cent, when compared to 2019. In 2021, the AROPE increased by 0.4 percentage points to 20.3 per cent reflecting the impact of the COVID-19 pandemic on households. The increase would have been much higher had the Government not intervened through supportive policies for families and businesses. The AROPE rate stood at 24.6% in 2013.

The strong record of economic growth in the last three quarters of 2021, and the sustained expansion in the first two quarters of 2022 have spawned a further decline in the number of social assistance and unemployment beneficiaries. The record national employment rate and increased female participation in the labour market have ensured that more people become financially independent.

Table 1.5

Selected Social Security Beneficiaries

Source: NSO

	Jan-Jun 2020	Jan-Jun 2021	Jan-Jun 2022
Social assistance beneficiaries	10,553	10,096	9,180
Unemployment benefit beneficiaries (incl. special)	3,354	1,520	723

The savings accrued from the drop in social benefit dependency continued to be channelled to finance increased and new social benefits, and better support for pensioners, families with children, low-income persons, and persons with a disability. The incomes of working parents with children under 23 years have been augmented through increased rates and extended income thresholds of the In-Work Benefit scheme, which has been a key measure of the Making Work Pay labour market policy introduced in recent years.

Table 1.6

Social Security Benefits Expenditure

Source: NSO

	€'000	€'000	€'000
	Jan-Jun 2020	Jan-Jun 2021	Jan-Jun 2022
Contributory Benefits	457,147	478,839	513,640
Non-Contributory Benefits	98,183	103,912	101,759
Total Social Security Benefits	**555,330**	**582,751**	**615,399**

NSO figures show that, in the first half of 2022, the total expenditure on contributory and non-contributory social benefits rose by €32.6m over the same period in 2021 and by €60.1m over the half of 2020. The increased expenditure on social benefits in the first half of 2022 pushed the total social protection expenditure in the same period to €987.6 million, putting its overall share of GDP at an estimated 14.7 per cent.

Table 1.7
Social Protection Expenditure
Source: NSO, MSPC

	January - June 2020	January - June 2021	January - June 2022 (Est)
Total Expenditure €m	876.65	925.38	987.60
% of GDP	**13.70**	**13.23**	**14.66**
Programmes & Entities €m	820.71	870.17	926.60
% of GDP	**12.82**	**12.44**	**13.76**

In the coming Budget, the Government will continue improving a number of social services, focusing primarily on pensioners and families, so that their exposure to the severe external risks being faced by all countries in the EU will be limited to the minimum extent possible.

1.6 TRADE AND INDUSTRIES

DURING THE FIRST SIX MONTHS OF 2022, BOTH IMPORTS AND EXPORTS OF GOODS (EXCLUDING SPECIFIC CHAPTERS) INCREASED BY 24.7 PER CENT AND 12.3 PER CENT RESPECTIVELY.

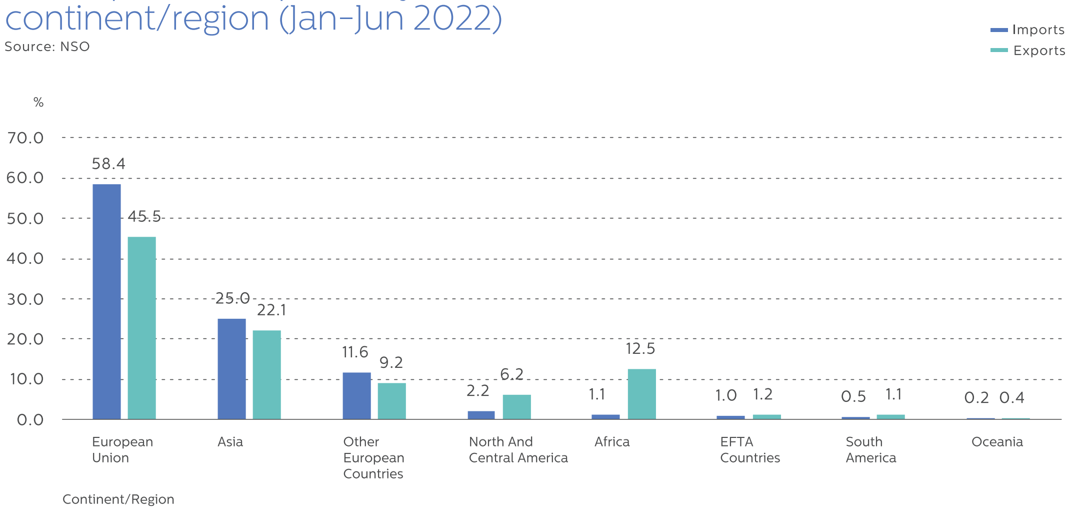
Trade

During this period the trade deficit in goods (excluding specific chapters) widened by €293.0 million when compared to the same period of the previous year, reaching €875.1 million.

Figure 1.16

Percentage of Trade in Goods (excl. specific chapters) by continent/region (Jan-Jun 2022)

Source: NSO



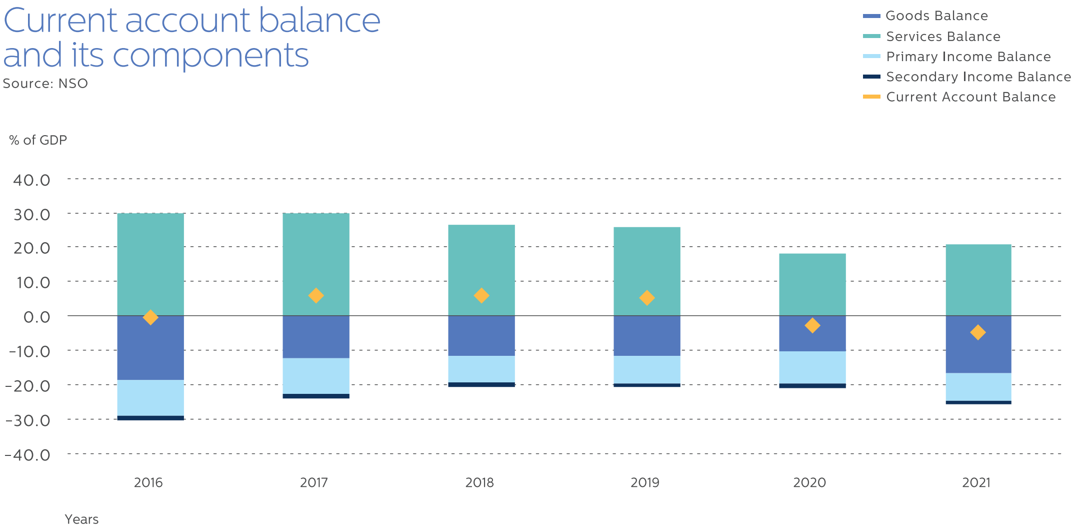
In the three years preceding the COVID-19 pandemic, Malta recorded a current account surplus averaging 5.5 per cent of GDP, underlined by a strong service net export balance.

However, the COVID-19 pandemic negatively impacted the current account balance leading to a current account deficit in 2020 and 2021. During the first quarter of 2022, Malta has similarly recorded a current account deficit, although this has decreased significantly from the previous quarter by 4.1 percentage points.

Figure 1.17

Current account balance and its components

Source: NSO



The net international investment position takes stock of the number of foreign assets and liabilities held in Malta. As at the end of 2021, Malta held around €269.0 bn in assets and €261.3 bn in liabilities. Most assets are categorised as portfolio investment, followed by direct investment and other investments; the more significant part of liabilities is held in the form of direct investment. The overall net international position by the end of 2021 stood at 52.9 per cent of GDP.

Tourism

Inbound tourists from January to December 2021 reached nearly 944 thousand or 34.9 per cent of 2019 tourists, an increase of 47.5 per cent over the same period in 2020, mainly driven by holiday travellers.

Total tourist expenditure for 2021 was estimated at €871 million, an increase of 91.3 per cent over 2020, while tourism expenditure per capita was estimated at €899, a 30.1 per cent increase over 2020. On average, tourists increased the length of their visit by 0.7 nights, with the majority, 55.5 per cent, staying for seven days or more.

During the first six months of this year, the number of inbound tourists reached 878 thousand or 74.2 per cent of 2019 tourists, a considerable increase compared to the corresponding period last year, reflecting the lifting of COVID-19 restrictions, abating pandemic fears and continued recovery of the tourism sector. Total expenditure by tourists from the corresponding period last year increased by €575 thousand, yet there was a decrease in per capita spending of 21.5 per cent and total nights spent of 51.4 per cent.

Tourism has been picking up pace in 2022 following the COVID-19 pandemic. During the first six months of this year, the number of inbound tourists reached 878,000 or 74.2 per cent of 2019 tourists, reflecting the lifting of COVID-19 restrictions, abating pandemic fears and continued recovery of the tourism sector. Total expenditure by tourists from the corresponding period last year increased by €575,000, yet there was a decrease in per capita spending of 21.5 per cent and total nights spent of 51.4 per cent.

The cruise liner industry, which generates close to €100 million in turnover, has also witnessed a strong recovery. This year, the Valletta Cruise Port is estimated to receive around half a million passengers, while the number of passengers is estimated to increase to 700,000 next year.

Figure 1.18

Leading inbound travel markets

Source: Eurostat, MFE

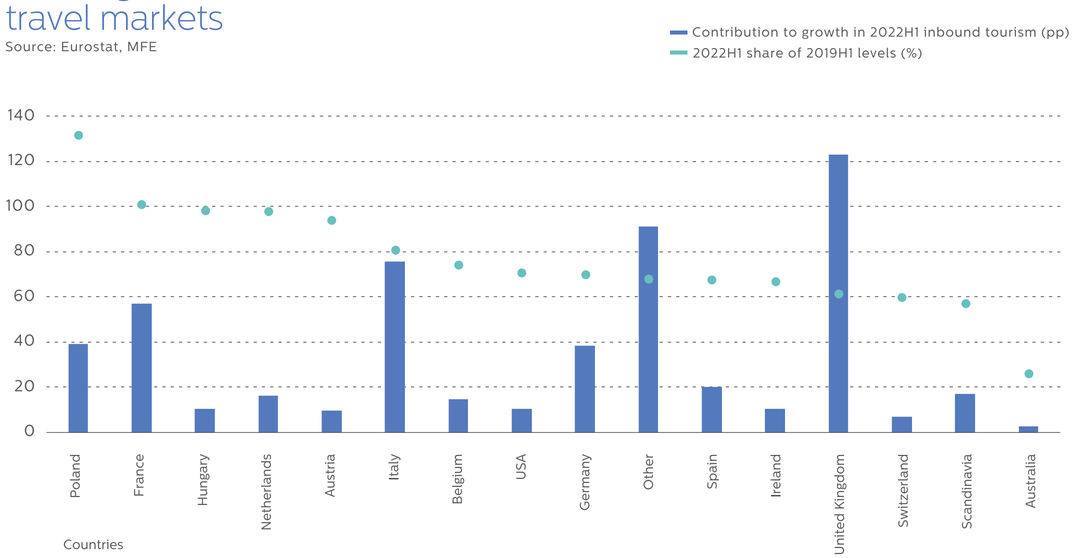
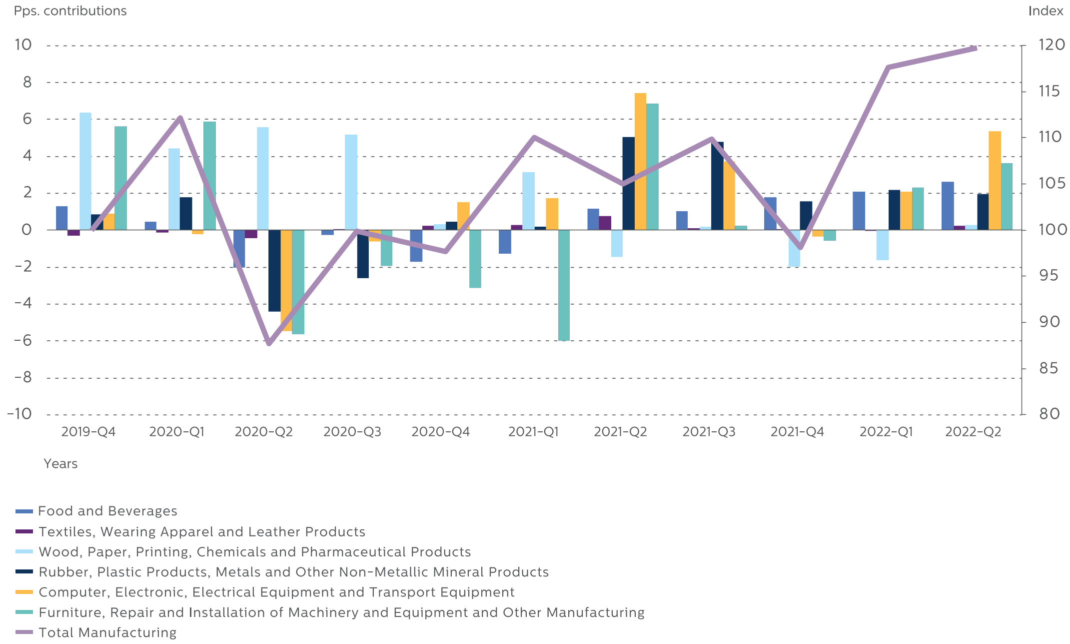


Figure 1.18 portrays the contribution of each of Malta's leading inbound travel markets to inbound tourism registered in the first half of 2022, as well as the recovery recorded in each segment. UK, Italy and France continued to be amongst the highest contributors to total inbound tourism while inbound tourism from Poland, France, Hungary and the Netherlands fully recovered, registering the same or higher tourism figures than pre-COVID-19.

Figure 1.19

Manufacturing Developments, GVA index (2019 = 100), and sectoral contributions

Source: Eurostat, MFE



The Manufacturing sector proved relatively resilient to the economic effects of the pandemic, where overall, the sector had already recovered to pre-pandemic levels of gross value added (GVA) by the start of 2021. This resiliency during the pandemic was mainly driven by growth in Wood, Paper, Printing, Chemicals and Pharmaceutical sectors due to a higher demand for these products. By contrast, manufacturing activities which are in part ancillary to the tourism sector were most affected. In fact, the Food and Beverages Manufacturing sector only recovered to its pre-pandemic levels of GVA in the second half of 2021, in line with the partial recovery in tourism.

Despite a deteriorating external economic outlook in the first half of 2022, GVA in the Manufacturing sector increased further by 10.7 per cent. Growth was broad-based across almost all Manufacturing sub-sectors, with the highest growth rate recorded in Food and Beverages, a result of easing COVID-19 containment measures and a recovery in tourism.

Other sub-sectors that recorded increases were the Computer, Electronic, Electrical Equipment and Transport Equipment (16.6 per cent), Furniture, Repair and Installation of Machinery and Equipment and Other Manufacturing (12.6 per cent), Rubber, Plastic Products, Metals and Other Non-Metallic Mineral Products (10.7 per cent), and Textiles, Wearing Apparel and Leather Products (7.6 per cent) Manufacturing sub-sectors. On the other hand, the Manufacture of Wood, Paper, Printing, Chemicals and Pharmaceutical Products experienced a contraction in GVA, decreasing by 3.0 per cent.

In the first half of 2022, labour productivity, measured as GVA generated per employee, increased by 4.1 per cent in the Manufacturing sector, indicating gains in competitiveness. During the same period, compensation per employee increased by 3.7 per cent, as wages decelerated in the second quarter of the year.

The Gaming Sector

The Arts Entertainment and Recreation sector, which encompasses the gaming sector, has been important in Malta's recent economic performance.

During the past decade, the industry experienced remarkable growth, increasing by an average of 9.2 per cent annually, and employing around 6.1 per cent of the workforce. This growth is particularly attributable to a steady increase in gambling and betting activities, which has close interlinkages with the Information and Communication sector.

Even in the past two years, when economic activity was negatively impacted by the pandemic, the Arts Entertainment and Recreation sector, remained robust, and managed to record growth of 8.0 per cent and 16.2 per cent respectively.

This growth continued during the first half of 2022, when the sector grew by 14.4 per cent, contributing 1.4 percentage points to overall GVA growth. Employment within the sector also increased during the same period, growing by 5.5 percentage points, and averaging 7.1 per cent of the workforce.

1.7 MONETARY DEVELOPMENTS

DURING THE PANDEMIC, PRIVATE DEBT TO GDP INCREASED SUBSTANTIALLY. THIS INCREASE IN DEBT TO GDP RATIO WAS MAINLY DRIVEN BY A DENOMINATOR EFFECT, PARTICULARLY BECAUSE THE FALL IN GDP PROVED TO BE SIGNIFICANT.

In nominal terms, household debt was primarily driven by an increase in long-term loans. In contrast, the increase in non-financial corporate debt was composed of a mixture of short and long-term debt securities and loans. The increase in short-term financing was paramount for non-financial corporations to meet short-term liquidity requirements.

As the economic recovery ensued, both the non-financial corporation debt to GDP balance and the household debt to GDP balance progressively receded. The non-financial corporation debt to GDP balance almost reached pre-pandemic levels. Household debt to GDP remained higher than pre-pandemic levels due to household borrowings throughout the pandemic to finance house purchases.

Figure 1.20

Household Debt as a % of GDP

Source: Central Bank of Malta

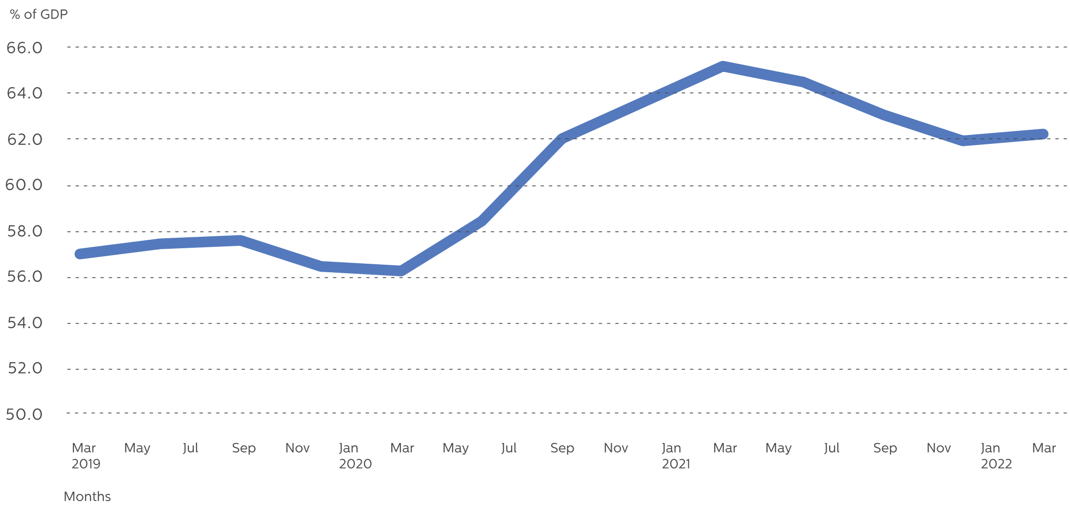


Figure 1.21

NFC Debt as a % of GDP

Source: Central Bank of Malta

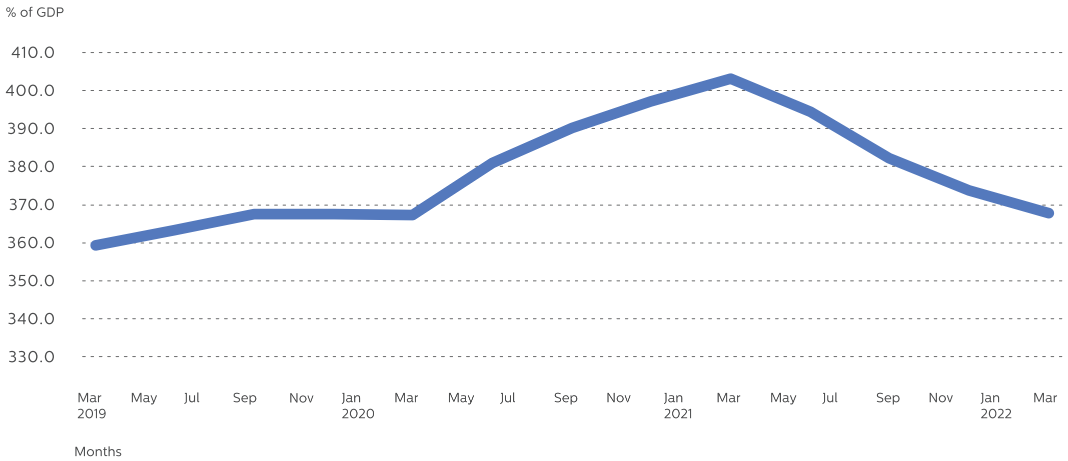
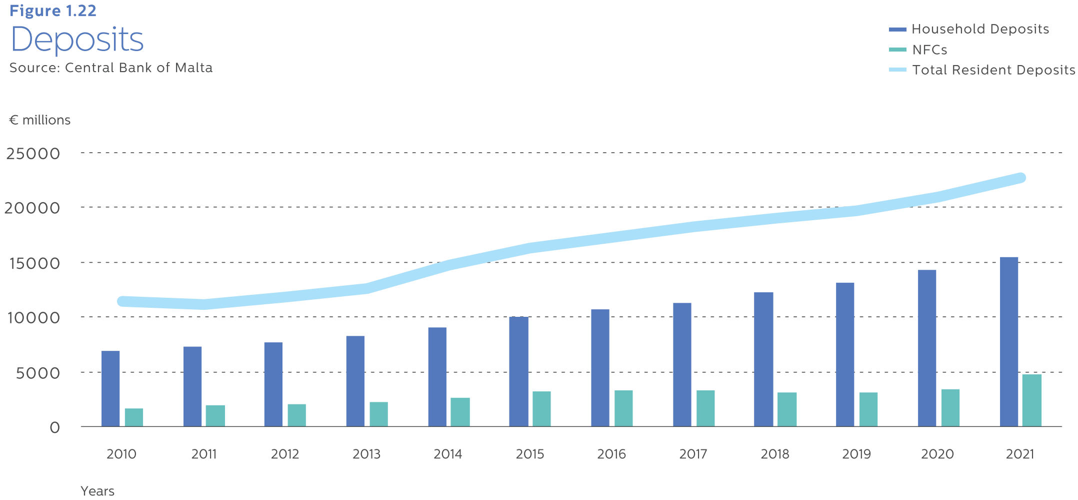


Figure 1.22 below portrays the total deposits held by Maltese residents with MFIs, which amounted to €22,679.8 million by the end of 2021 – equivalent to an 8.8 per cent increase over the previous year.

Figure 1.22

Deposits

Source: Central Bank of Malta



Moreover, growth in credit to residents grew in 2021. Whilst lending to households rose due to an increase in loans for house purchases, consumer credit and other lending decreased further. As of September 2021, households' debt stood at €7,533.6 million, an increase of €486.5 million from December 2020. Furthermore, loans to NFCs increased slightly in annual terms.

INFLATION

02

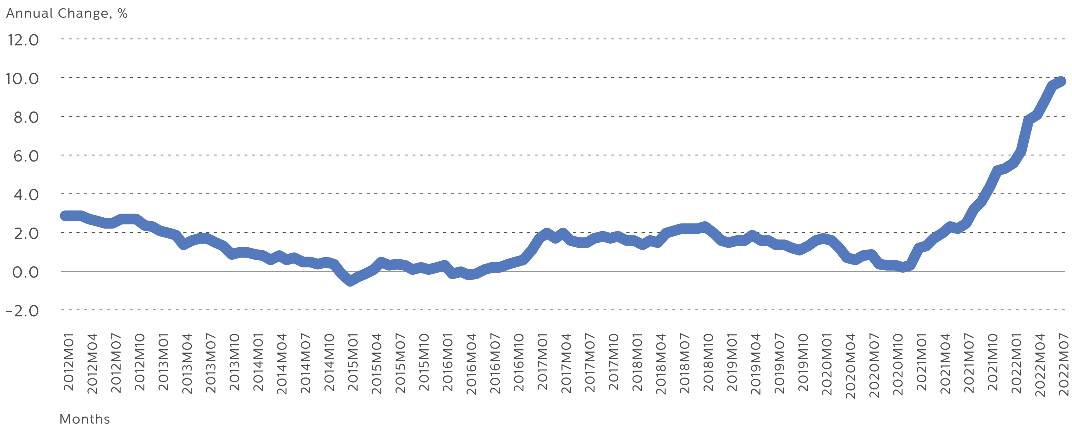
2.1 INTRODUCTION

AFTER A MULTI-DECADE SPAN OF TIMID PRICE GROWTH, THE GLOBAL ECONOMY IS FACING PRICE INCREASES WHICH HAVE NOT BEEN WITNESSED SINCE THE 1980S, ALONGSIDE WITH AN ENERGY CRISIS WHICH HAS NOT BEEN WITNESSED SINCE THE 1970S.

A series of unprecedented events, including a pandemic and the war in Ukraine, combined with record fiscal stimulus and monetary support, have revived the previously dormant inflationary pressures.

Inflation is being felt globally, with rates as high as 9.8 per cent in the EU, 8.5 per cent in the US and 10.1 per cent in the UK, in July 2022. The speed of price increases since the fall of 2021 has led to higher operating costs for firms, a widening of credit spreads, volatility in asset markets, and a drop in consumer confidence as wages fail to keep up with the rising prices.

Figure 2.1
HICP Inflation Rate of the EU from January 2012 to July 2022
Source: Eurostat



The root cause of this inflationary shock was the COVID-19 pandemic. Various COVID-19 outbreaks led to stop-starts in production, particularly in China; a blockage in the Suez Canal in March 2021 delayed shipping delivery times, and there were also insufficient workers to unload, store and deliver merchandise. This led to a substantial backlog of orders that ports and operators could not keep up with, and supply chain bottlenecks started to accumulate. The pandemic exposed weaknesses in the global supply chain that had functioned seamlessly till then.

These shocks created an inelasticity in supply which was exacerbated by expansionary demand side policy through loose monetary policy, as global Governments and Central Banks attempted to cushion the effects of the pandemic on the job market and financial markets, respectively. Combined with effective vaccine rollout programmes, this expansionary policy enabled economies to rebound rapidly and experience a so-called 'V'-shaped recovery. Yet producers and distributors could not keep up with the rise in demand as economies reopened whilst COVID-19 resurgences continued to stifle supply. This triggered price increases, particularly for final goods.

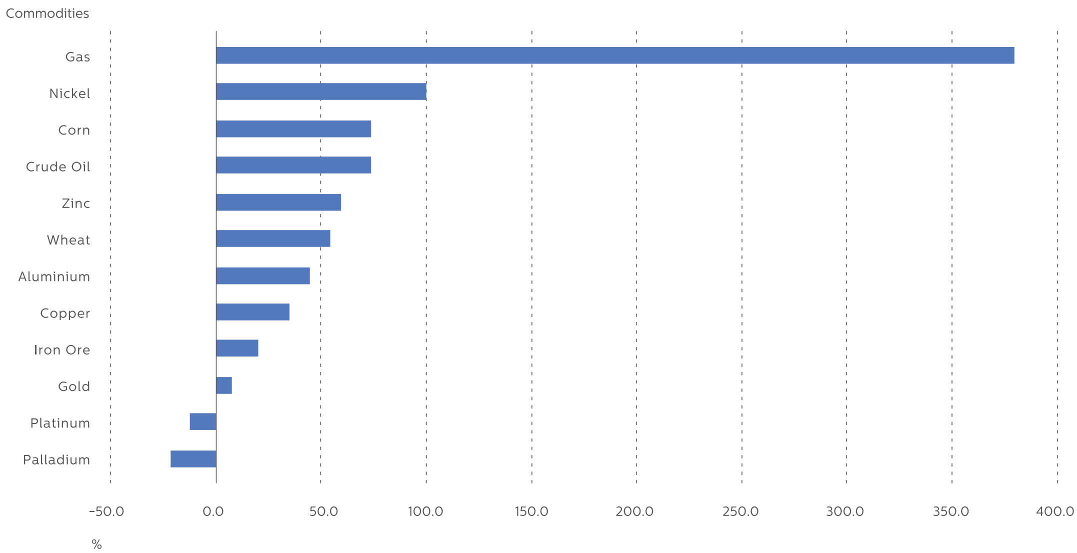
As the momentum in price growth started to moderate towards the beginning of 2022, the invasion of Ukraine by Russia compounded the inflationary pressures.

In this case, the inflation was primarily caused by supply disruptions in commodities and natural resources. The introduction of severe economic sanctions and the cutting of trade ties with Russia has resulted in retaliatory measures in the energy sector. This has resulted in substantial energy deficits, particularly in Germany, which have resulted in an explosion of gas prices in title trading facilities prices in Europe. The effects of this are grave, and to a certain extent difficult to quantify. The impact is not just the direct weight of the price increases, but also the consequential effect these prices will have on Germany. An economic and financial powerhouse in Europe, and a major global manufacturing hub, Germany's weakening economy could by its very nature become a separate and major challenge for European economies.

Figure 2.2

Change in average price from February 2020 to September 2022

Source: Daily FX, MFE



The rapid acceleration in prices since the start of 2022 has caused concerns among Central Banks, which are mainly responsible for maintaining price stability. While Central Banks initially considered inflation transitory, the war in Ukraine has added structural permanency. In fact, Central Banks in developed economies - with the sole exception of Japan- have abruptly halted their quantitative easing policies and some have started to raise benchmark interest rates. This sudden change in monetary policy from expansionary to contractionary unnerved the financial markets. The bond yields rose, while yield spreads between safer and riskier debt widened. The equities and speculative financial asset prices suffered from market corrections.

Inflation is predominantly caused by supply bottlenecks, and Central Banks have very limited influence to increase aggregate supply and tame inflation. By tightening monetary policy, Central Banks can cause aggregate demand to fall with the hope of controlling inflation, but at the expense of curtailing output and potentially pushing economies into a recession. Financial analysts hope that such steps would help prevent inflation expectations from becoming entrenched and avoid a costlier stagflation where a recession is intertwined with high inflation.

2.2 INFLATION DEVELOPMENTS

IN MALTA, TWO MEASURES OF INFLATION ARE REPORTED: THE RETAIL PRICE INDEX (RPI) AND THE HARMONISED INDEX OF CONSUMER PRICES (HICP).

The Retail Price Index (RPI) measures the cost of a representative basket of goods and services consumed by private households relative to the cost of the same basket at a fixed-base period.

It is the primary metric used for indexing wages, social benefits, rents and certain excise taxes. It is also used to calculate the Cost Of Living Adjustment (COLA).

The Harmonized Index of Consumer Prices (HICP) is a chain-linked index of inflation which uses a standard methodology across the EU Member States.

The weights of the HICP are updated annually and thus capture changes in consumption patterns over time. Whereas the RPI solely captures consumption by private households, the HICP also includes purchasing behaviour of institutional households and expenditure of tourists in Malta.

According to the Retail Price Index, Malta has witnessed rapid price growth over the first six months of 2022, with prices rising by an average of 5.1 per cent from January to June. The two main components driving the RPI growth rate in the first half of the year are food and housing. Food is contributing 1.9 percentage points while the housing contribution is at 0.9 percentage points. The next highest contributors are transport and communication at 0.6 percentage points, recreation and culture at 0.4 percentage points, and household equipment and household maintenance costs at 0.3 percentage points.

Nevertheless, from January to June, the average HICP inflation rate in Malta (5.0 per cent) was significantly lower than the euro area and the EU-27 averages of 7.1 per cent and 7.7 per cent, respectively. The result is that by June 2022, Malta had the lowest inflation rate in Europe.
In March 2022, the Maltese Government announced that it would be sheltering the economy from increasing energy prices and supporting the security of imported supplies of grain, wheat and animal fodder. This political commitment has been instrumental in containing costs for the private sector, allowing the domestic economy to remain competitive and supporting consumers. In the absence of this policy, Malta would be witnessing inflation rates that are higher than the European average.

Figure 2.3

HICP – June

Source: Eurostat

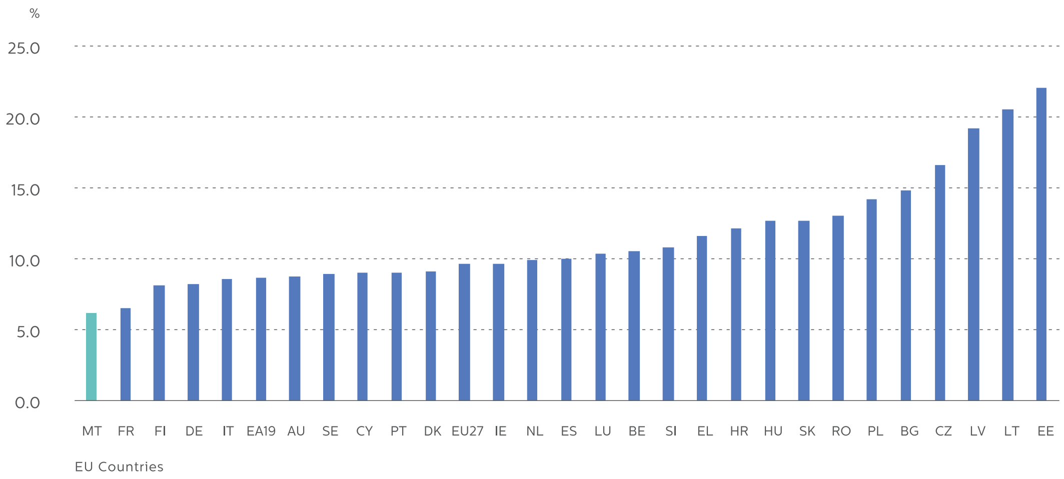
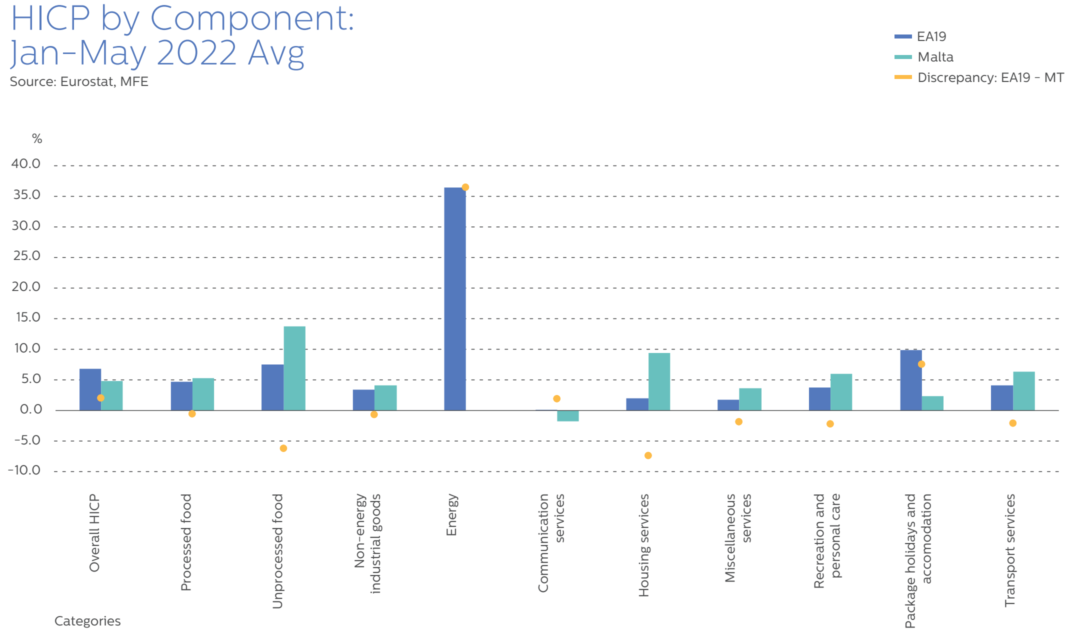


Figure 2.4 compares the recent increase in prices of various consumer categories in the euro area with the comparable categories in Malta. It is evident that in most categories prices in Malta are rising faster than in the euro area and the reason for a lower inflationary environment is predominantly due to the control of energy prices.

Figure 2.4

HICP by Component: Jan-May 2022 Avg

Source: Eurostat, MFE

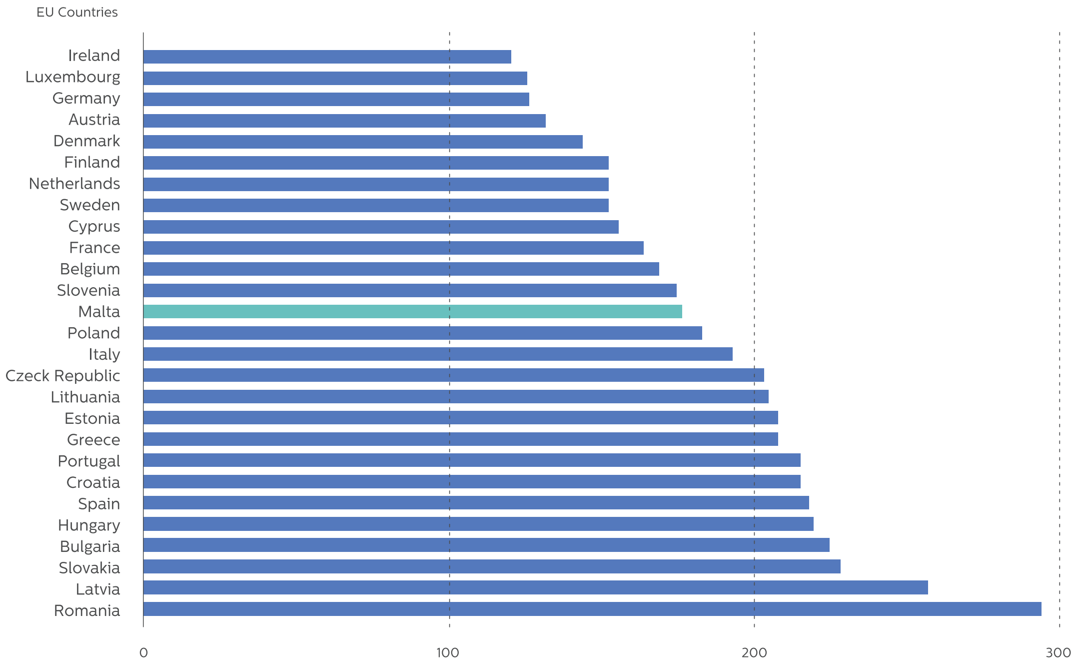


When it comes to processed and unprocessed food, HICP in Malta is 0.9 and 6.4 percentage points higher than in the euro area, respectively. This is because Malta imports a significant portion of its food, making it susceptible to rising prices of agricultural products in trading partner economies as well as higher freight costs.

Figure 2.5

Food weights in the consumption basket (per 1 000 units of spending)

Source: EIB estimates based on Eurostat



Note: The weights in the consumption basket add up to 1 000.

Nevertheless, according to EIB estimates, which calculates the deviation of each country's share of food in the average consumption basket with respect to the EU average, and weighs the inflationary shock according to the deviation, shows that the increase in the general prices of food is not the only factor contributing towards a higher inflation rate than the EU average when excluding the energy component.

Malta is also recording notably higher non-energy industrial goods inflation than the euro area average. This is once again because the industrial sector in Malta is heavily reliant on imports of industrial goods, exposing the economy to sharp increases in prices of materials as well as the added shipping cost component.

Inflation in housing services is also higher in Malta, mainly driven by services for the maintenance and repair of the dwelling and repair of household appliances. Meanwhile, higher inflation for transport services in Malta is being driven by maintenance and repair of personal transport equipment, while recreational and sporting events and restaurants, cafes and the like, explain the divergence in the recreation and personal care inflation component.

Figure 2.6

Share of imports from selected European countries

Source: Eurostat

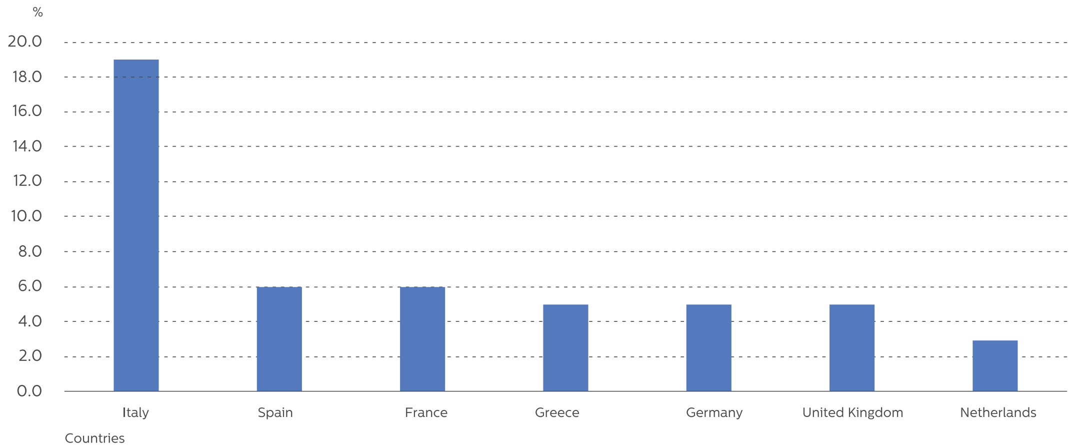
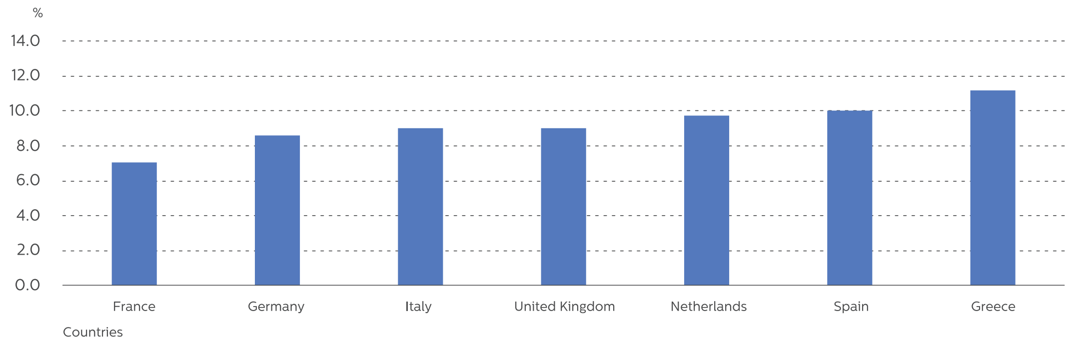


Figure 2.7

Inflation rate in selected European countries, June 2022

Source: Eurostat



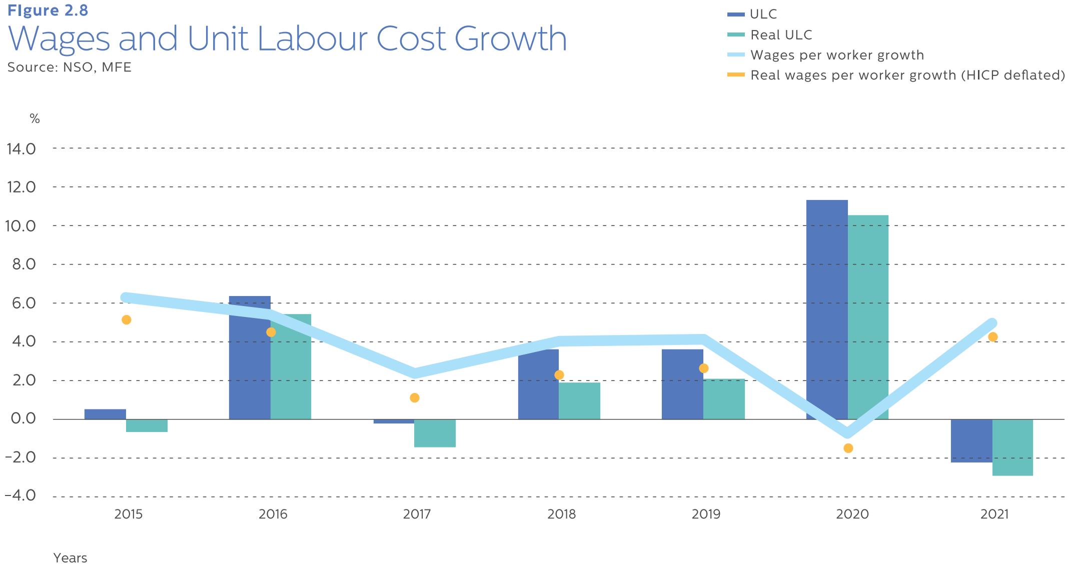
Around 65.0 per cent of the total imports of goods in Malta originate from Europe with the highest share of goods imported from Italy. The main European countries from which Malta imports its goods are recording drastic increases in their inflation rates and hence this explains the increase in the prices of non-energy related goods in Malta.

LABOUR COSTS

During 2021, average nominal wage growth in Malta grew by 5.1 per cent, while average real wages grew by around 4.4 per cent.

This growth was a result of both a low base effect from the drop in real wages encountered during 2020, as well as a strong recovery of economic activity following the alleviation of COVID-19 restrictions in the second half of 2021. Also, during the latter half of 2021, as economic activity picked up, employers started to encounter substantial shortages of skilled workers and had to increase wages to both retain and attract talent.

Figure 2.8
Wages and Unit Labour Cost Growth
Source: NSO, MFE



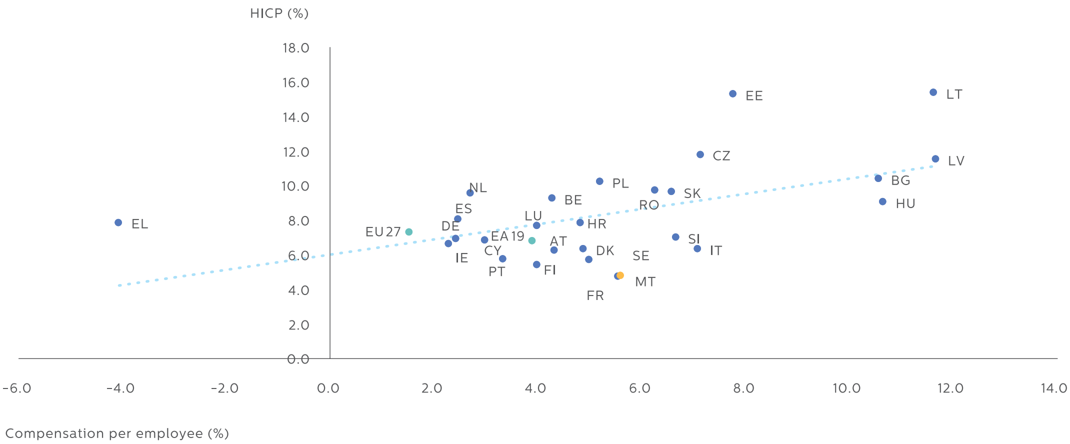
Despite the increase in wages per worker, growth in value added per worker was on average higher. Evidence of this is the decline in Unit Labour Costs (ULC) during the last three quarters of 2021. Unit labour costs essentially compare the wage costs per worker paid by employers with the productivity generated by each worker. Declining ULC imply that on average, increases in wage costs were more than compensated for through improved labour productivity.

Inflation will usually be reflected in wage growth (often with a lag to reflect staggered wage contracts but possibly also with a lead to reflect inflation expectations). Higher wages increase the costs of production which could be reflected eventually in higher final goods prices. In fact, figure 2.9 shows that there is a positive relationship between the growth in wages during 2021 and the average inflation from January to May 2022, among European Member States. If inflation expectations eventually de-anchor from the price stability objective, this may give rise to successive rounds of wage and price increases, a concept known as a wage-price spiral. However, at present, there is no indication that this is taking place in Europe and elsewhere. Monetary authorities are raising interest rates and engineering a monetary contraction to prevent such an outcome.

Figure 2.9

Average Wage Growth in 2021 vs. Average Inflation Jan – May 2022

Source: NSO, MFE



STRONG DEMAND

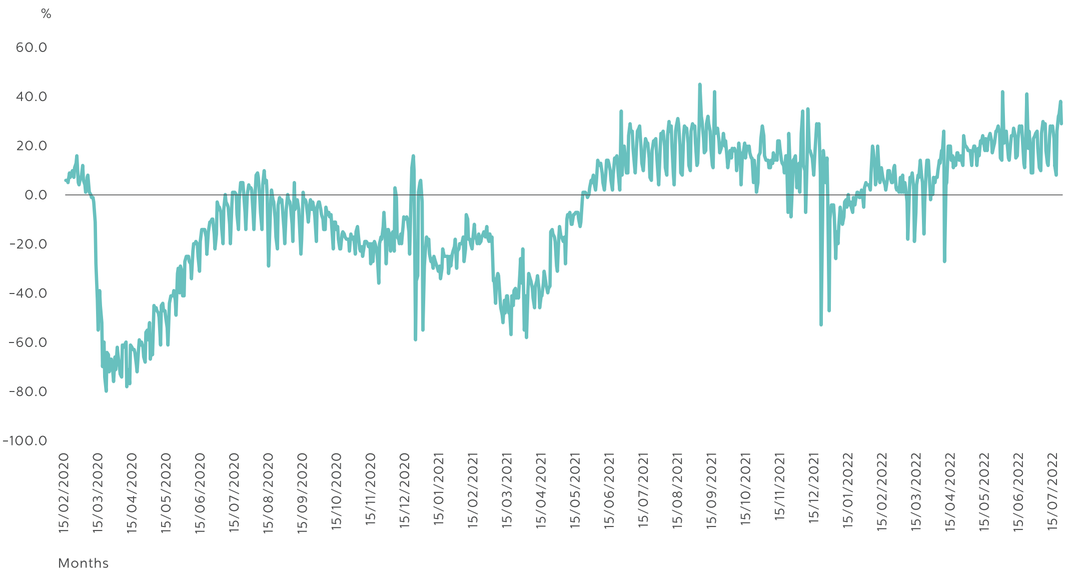
Consumer spending remained robust due to a resilient labour market and Government support during COVID-19.

These aspects, as well as the more natural pent-up demand during the pandemic restrictions, have helped the demand side of the chain. Consumer strength is also evident from the higher revenue earned by the Government from consumption taxes and the fact that retail and recreation mobility data remain positive compared to the pre-pandemic baseline.

Figure 2.10

Malta - Retail & Recreation Mobility: % Deviation from Baseline

Source: Google mobility, MFE



This strength in demand is reflected in the prices of services, which are growing at a faster rate in Malta than in the rest of the EU. A healthy labour market and a modest recovery in consumption growth may also be partially contributing to higher price pressures. One of the major downsides to this is that consistency in price increases for goods and services may become hard to keep up with for those with low income or on social support. Should this become structural in nature it would require Government intervention from a social and employment aspect.

ENERGY COSTS AND INFLATION

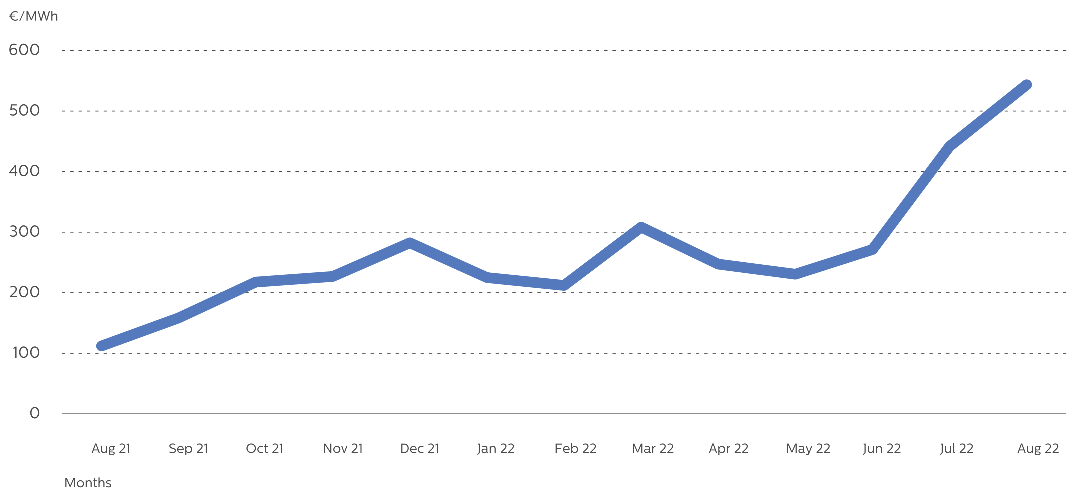
The problems in the supply of energy have been building up well before the pandemic.

Over the past years, and until recently, there was a global effort to push renewables into the market and push out fossil fuels. This policy was almost unanimous, at least publicly, with the vision emboldened with strong declarations during the 2021 United Nations Climate Change Conference in Scotland in November 2021. It was evident that this changeover was going to dent competitiveness and come at a price - one that most Western nations were happy to carry. Leading up to this was a strong social movement promoting renewables and green energy which led to a widespread downgrade in the fossil fuel industry to find investment. As energy prices increased in January 2022, and when they went through the roof following the Russian invasion of Ukraine, the Western economies made a total U-turn.

The European COP26 declarations are, at present and in the immediate future, dead and buried. Europe is now looking at reactivating the worst polluters among the fossil fuels, such as coal, in a desperate attempt to increase supply.

At a micro level, energy is an essential input for industrial firms as well as households. Energy has an inelastic demand, and it will take time to transition to zero carbon. The political commitment to move towards a greener future is also energy demanding. To be able to guarantee net zero emissions, a significant amount of energy is required in the short-term to build the renewable infrastructure like wind turbines, hydrogen storage and solar panels.

Figure 2.11
MPE - MGP Monthly Electricity Prices
Source: GME



The sanctions imposed on the Russian economy following its invasion of Ukraine resulted in the absence of a major oil supplier from the markets, which led to a sudden rise in energy prices. It also exposed the dependency of Europe on Russian gas, leaving the trading bloc vulnerable to gas rationing leading to a potential shortage of gas supplies next winter. This suggests that energy prices, particularly in Europe could go up further and exacerbate inflationary pressures.

The monthly average electricity prices as quoted by the GME (Gestore Mercati Energetici), which is the only body responsible for managing physical energy trading platforms in Italy, and thus determines the price of electricity bought from the interconnector, increased by nearly 400 per cent in the last twelve months. Indeed, the price rose from €0.11 per kWh in August 2021 to €0.54 per kWh in August 2022.

Nevertheless, the Government has shielded the Maltese economy from higher energy prices. Indeed, Government support in energy and food will amount to €472.5 million in 2022. This is the main explanation why Malta's overall inflation rate has been lower than that of other European Member States.

THE GERMAN ECONOMY

The pressure for gas supplies is nowhere as high as in Germany, which has found it increasingly difficult to guarantee energy to its vast industries for the coming winter. This can have a consequential effect on the whole of Europe, including Malta.

European directives stipulate that households take precedence over the industry, which means that there is a chance whereby the German Federal Network Agency must prioritise industries should supply dry up during winter.

The German economy is important to Europe, especially since it is considered a significant technical and manufacturing hub for the continent. A slowdown in the German supply chains could lead to further issues across the European supply chains.

Table 2.1

EU Goods Total: Exports divided by imports, 2002 - 2021 %, total = intra-EU + extra-EU

Source: Eurostat

	2002	2021
Austria	100	93
Belgium	109	107
Bulgaria	72	88
Croatia	46	66
Cyprus	12	37
Czechia	95	107
Denmark	114	103
Estonia	72	91
Finland	132	95
France	101	82
Germany	126	115
Greece	32	62
Hungary	91	100
Ireland	168	159
Italy	103	111
Latvia	56	86
Lithuania	70	92
Luxembourg	81	64
Malta	77	45
Netherlands	111	110
Poland	74	100
Portugal	65	77
Romania	78	75
Slovakia	87	100
Slovenia	95	99
Spain	76	92
Sweden	122	101

Germany is the leading European exporter among EU Member States and should energy push inflationary pressure upwards, it could have a knock-on effect on the rest of the continent.

Malta's EU imports are mainly from Italy, which have sizeable inflationary challenges. However, Germany follows them and therefore a further concern on the macroeconomic front.

There is also the fiscal aspect since the German economy is seen as a vital pillar for the Euro. The weakening of the euro currency over the past months is partly due to the nervousness around the short to medium-term effects of the energy crisis on the German economy. Germany is the main exporter to non-EU markets, primarily to the United States and China. Such a competitive deficit could potentially be a risk factor not just for the country itself, but also for the Euro.

Figure 2.12

Trade in goods by top 4 partners, 2021 (Exports)

Source: Eurostat

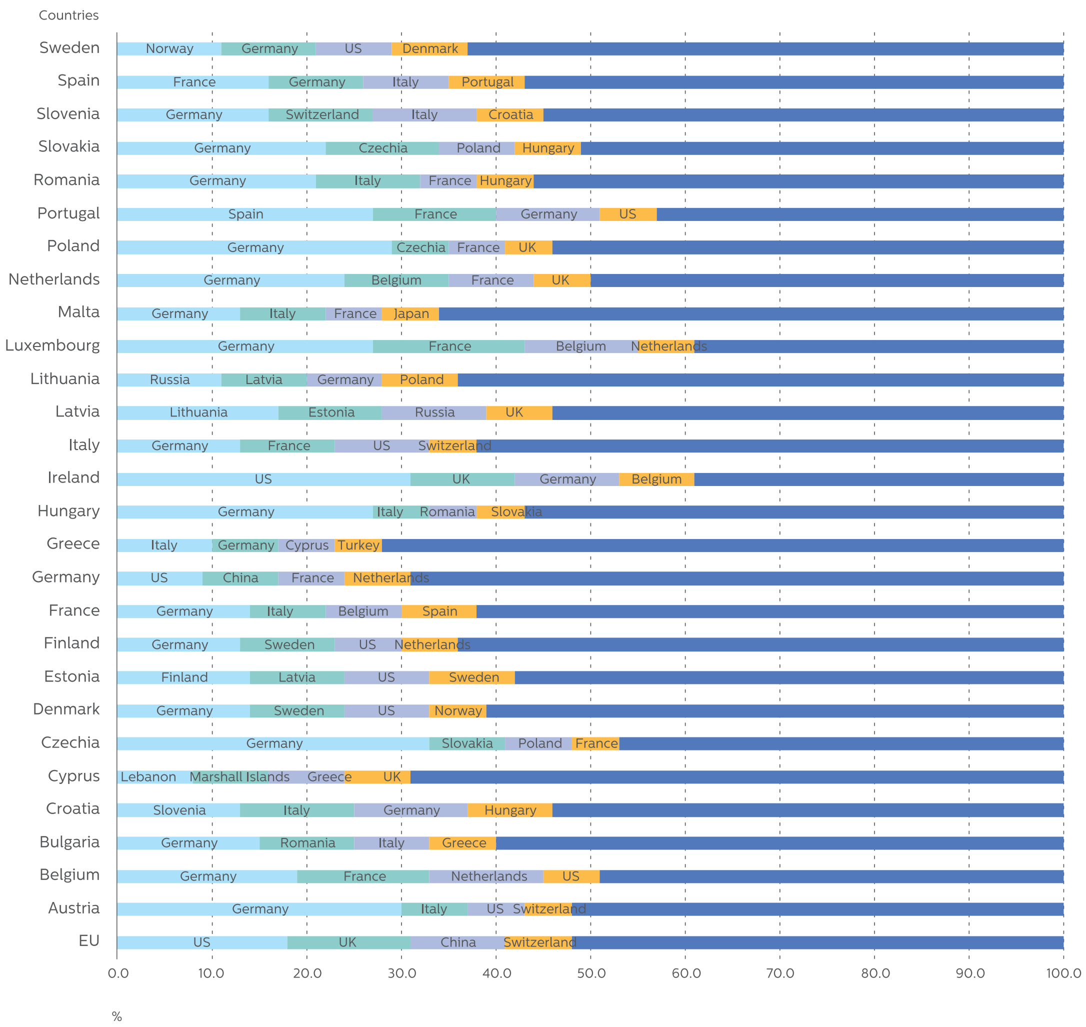
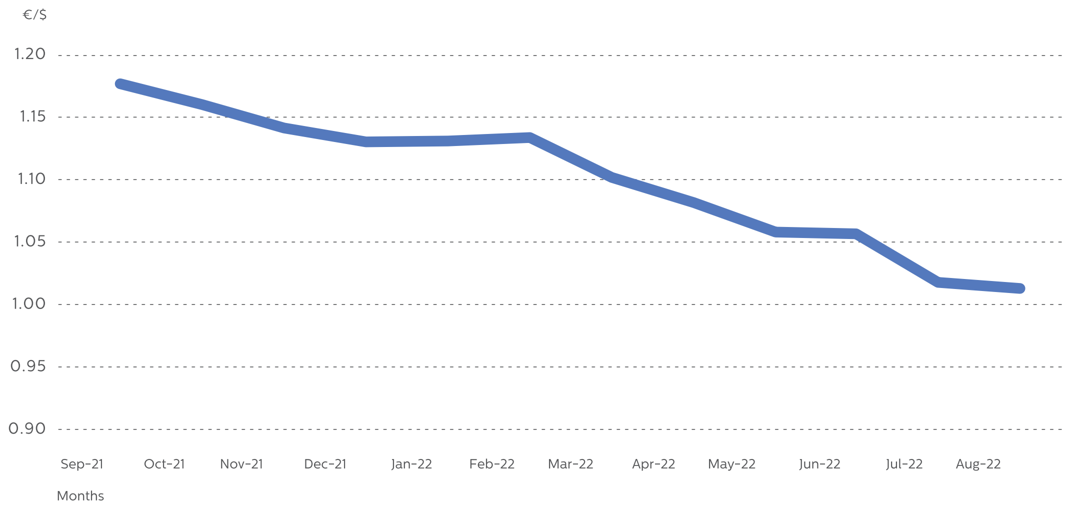


Figure 2.13

EUR/USD Exchange Rate

Source: Eurostat



FOOD INFLATION

The war in Ukraine also exposed several strategic dependencies, such as the global importance of Russia and Ukraine as suppliers of staple foods like wheat, corn and vegetable oils.

Together, Russia and Ukraine usually account for 30.0 per cent of the global wheat supply, along with 80.0 per cent of sunflower oil, while Ukraine accounts for 20.0 per cent of corn.

These agricultural commodities are essential in basic food production and importers are scrambling to secure supplies to prevent economic shortages. Ukrainian seaports were closed, preventing agricultural goods from departing Ukraine.

In July 2022 an agreement was signed in Istanbul for the reopening of three Ukrainian Black Sea ports which are critical for grain shipments following negotiations brokered by the United Nations and Turkey.

Russia and Ukraine established elements such as the ports involved, the establishment of a monitoring centre in Istanbul, and inspections routines for the vessels, with both sides agreeing not to attack or hinder the movement of the vessels. Nevertheless, it will take time until shipments can start functioning due to the significant controls being imposed.
Moreover, an insufficient supply of potash, which was previously predominantly supplied by Russia, has caused fertiliser prices to surge. With fertiliser prices increasing, farmers are likely to cut back on demand and thus crop yields would suffer.

In view of the present circumstances, it is unlikely that there will be any imminent relief in energy and food supplies, meaning that food inflation is likely to be stickier. Moreover, policymakers are bound to re-evaluate their economy's international supply chains and dependencies with a view to ascertain the security of their food imports.

In Malta, the Government has provided an emergency subsidy for importers of cereal, flour, and animal feed. The scheme will support companies active in the importation, manufacturing and wholesale of grains and other similar products.

2.3 THE IMPACT OF COVID-19 AND THE GOVERNMENT'S SUPPORT MEASURES ON THE MALTESE ECONOMY

THE RUSSIA-UKRAINE WAR TOGETHER WITH THE TWO-YEAR COVID-19 PANDEMIC HAVE CREATED WORLDWIDE PRICE INSTABILITY, ESPECIALLY IN FOOD AND ENERGY PRICES.

Over the past months, the Maltese Government has been absorbing part of these price increases, shifting the burden away from Maltese households and businesses.

This section presents the simulated economic impacts in the eventuality that the Government withdraws its support on electricity, fuel prices, and food prices. This scenario is compared to a baseline scenario that assumes model-based projections based on a continuation of current trends.

This exercise was conducted using the Economic Policy Department's Structural Annualised Econometric Model for Malta (SAMM).

FUEL AND ELECTRICITY PRICES

It has been estimated that in the absence of Government support, the price of diesel would have increased from €1.21 to €1.79 per litre, the price of petrol would have increased from €1.34 to 1.79 per litre, the price of LPG (liquified petroleum gas) would have increased from €15 to €23.30 per 12kg, whilst the price of electricity would have increased from 13c9 to 32c per kWh.

A counterfactual scenario of what would happen to the Maltese economy in the eventuality that these price increases are borne by domestic businesses and households, was modelled using the in-house SAMM model.

FOOD PRICES

It is estimated that lifting the Government's intervention to ensure stability in the prices of grains and cereals would result in a 1.5 percentage point increase in food inflation. Accordingly, the consumer price of food products was shocked to increase by 1.5 per cent compared to baseline level.

Holding the prices of other goods constant, the price increases in electricity, diesel, LPG, and food are assumed to persist throughout 2022.

Table 2.2 below summarises the main results.

Table 2.2

Impact of Price Increases on Macro Indicators in 2022 (p.p. changes from baseline growth)

Source: MFE

HICP	7.1
GDP	-2.3
Real household disposable income	-1.6
Profits	-2.1
Investment	-1.1

The most immediate effect of higher food and energy prices is on headline inflation, which would be expected to increase by 7.1 p.p. over and above baseline growth (assuming fixed weights in the consumption basket). A significantly higher inflation rate would negatively impact aggregate demand, resulting in a 2.3 p.p. decline in real GDP compared to baseline growth.

Beyond lower consumer spending, higher fuel and electricity prices are a headwind for the broader economy as they entail an increase in the production costs of all sectors. Moreover, a higher cost of fuel, especially diesel, would mean that anything transported via land or water transport would be adversely affected. Over and above these effects, businesses would endure cost pressures owing to higher wages, higher intermediate prices, and incomplete pass-through to final product prices. This would see aggregate profits decline by 2.1 per cent and investment spending drop by 1.1 per cent relative to baseline growth.

In terms of nominal value added, although most industries would be impacted, manufacturing industries would be severely hit, especially rubber and plastics (16.9 p.p.), machinery and transport equipment (18.0 p.p.), chemicals and chemical-related products (10.3 p.p.), furniture (10.2 p.p.), and computer, electronic and optical products (7.0 p.p.). Naturally, transport industries would also be severely impacted: water transport (42.7 p.p.); air transport (27.1 p.p.); land transport, post, and courier services (9.7 p.p.). Other critically affected industries would include water, sewerage, and waste (31.7 p.p.); fishing (-14.8 p.p.), food services activities (13.8 p.p.), sporting services and amusement and recreation services (10.6 p.p.), and repair and installation (8.3 p.p.).

DISTRIBUTIONAL ANALYSIS

The following analysis illustrates the distributional impact of the expected increase in prices of energy (including gas, diesel, petrol and electricity) and food on households had Government intervention not been in place.

The analysis is modelled using EUROMOD, which is a static tax and benefit micro-simulation model using the 2020 EU-SILC microdata2.

Impact on Poverty and Income Inequality

Table 2.3 illustrates the estimated impact on the at-risk-of-poverty (AROP) rate for different sub-groups of the population for each scenario, if the Government did not intervene. The results also illustrate the change in the poverty line (60% of median equivalised disposable income) and the Gini Coefficient, which is a measure of income inequality.

Table 2.3

Main Poverty Indicators

Source: MFE

Indicator	Baseline	Energy	Food	Total
Overall Poverty Rate (AROP):	15.35%	16.31%	15.40%	16.34%
Children	15.19%	15.53%	15.19%	15.53%
Working age	11.74%	12.46%	11.77%	12.46%
Working age and economically active	6.52%	7.02%	6.53%	7.02%
Elderly	28.82%	31.24%	29.01%	31.44%
Gini coefficient	0.2994	0.3064	0.2999	0.3069
60% of Median Equivalised Income	9883	9520	9868	9496

Without the mentioned Government intervention, the overall increase in energy prices for gas, diesel, petrol and electricity and food prices when compared to the 'Baseline', would have increased the poverty rate from 15.35 per cent to 16.34 per cent, nearly a full percentage point. The highest increase in poverty would be experienced by the elderly cohort with an increase of 2.62 percentage points. The Gini coefficient would have increased by 0.75 percentage points. Moreover, the poverty line would have also decreased from €9,883 to €9,496.

This is anticipated as the increase in expenditure on energy and food prices will affect all households. The highest increase in poverty is driven by the expected increase in energy prices, which amounts to 0.96 percentage points. Whereas the expected increase in food price, increased the overall poverty rate by 0.05 percentage points.

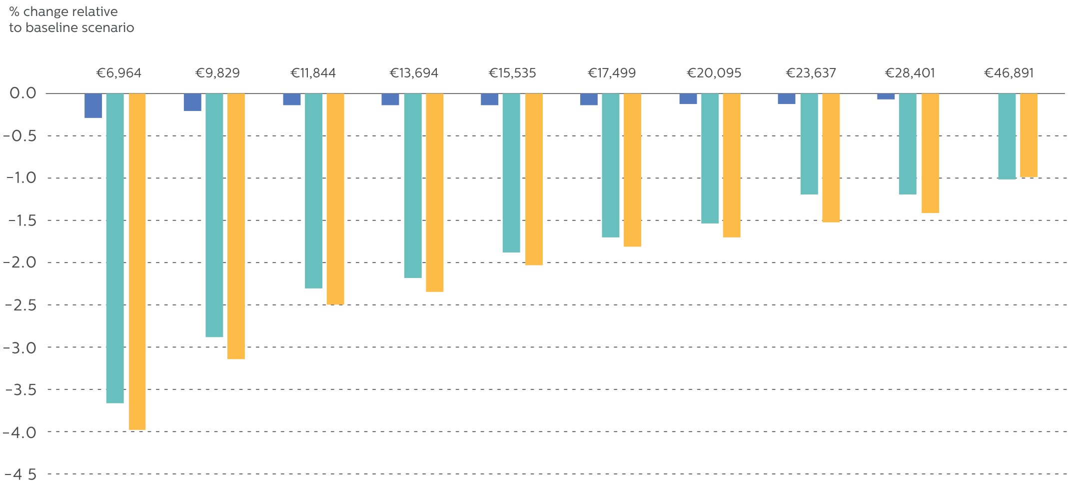
Impact on the Income Distribution

To determine which households benefit the most from the mentioned Government measures, the percentage change of equivalised household disposable income from the 'Baseline' needs to be analysed, which is illustrated in Figure 2.14. In all scenarios, if the Government would have not intervened, the highest decrease in disposable income is expected to be incurred in the bottom deciles. The total increase in energy and food prices is expected to decrease the equivalised disposable income by 7.7 per cent for the first decile and 6.2 per cent for the second decile.

Figure 2.14

Change in the household equivalised disposable income

Source: MFE



The decline in disposable income is mainly driven by the expected increase in energy prices, a decline of 7.3 per cent in the first decile, whereas the expected increase in food prices decreased disposable income by 0.5 per cent in the same cohort. Thus, the mentioned Government initiatives are effective in protecting households, especially low-income households.

In order to illustrate the effectiveness of the energy and food support measures, typical households were chosen and the expected average decrease in household income had the Government not intervened, was calculated through the Household Budgetary Survey (HBS) and MFE calculations. The results are shown in Table 2.4.

Table 2.4

Expected decrease in household income for each household by family type without Government Intervention

Source: MFE

Single person	€747
Couple, both working	€1,425
Single parent with one child	€1,074
Couple, one working, with two children	€1,553
Couple, both working, with two children	€1,671
Elderly Couple, both more than 65 years old	€993

2.4 CONCLUSION

AFTER TWO SUCCESSIVE YEARS OF MONETARY EASING AND FISCAL SUPPORT, GLOBAL POLICY MAKERS ARE DESPERATELY TRYING TO BRING INFLATION UNDER CONTROL.

In the US, the Federal Reserve has already raised interest rates by 150.0 basis points and during mid-June, it officially started reducing dollar liquidity using quantitative tightening. Fed officials also became more hawkish in their communication, signalling their commitment to bring inflation down to their target of 2.0 per cent.

In the Eurozone, the ECB recently announced a 75.0 basis point rate hike to signal a strong commitment to control inflation, since failure to do would lead to a strong depreciation of the euro which will exacerbate inflationary pressures, possibly raise inflation expectations, and threaten financial stability in the euro area. The presence of a fragmented sovereign debt market in the euro makes the task of the ECB increasingly perilous and delicate at the same time.

The Governments face an equally delicate balance. Economies have not yet fully recovered their productive capacities in certain sectors and the increasing inflationary pressures are having an impact on the most vulnerable in society with significant distributive effects. There is a clear need for support from the Government.

And yet fiscal support could lead to unintended consequences of stimulating demand further in the presence of supply shortages, which in itself could cause inflationary pressures. This calls for targeted support, including measures which are aimed at controlling inflationary pressures but, at the same time, avoid an outright expansionary fiscal policy which could itself be inflationary.

FISCAL SUSTAINABILITY

03

3.1 INTRODUCTION

PRESERVING FISCAL SUSTAINABILITY IS ONE OF THE KEY PRINCIPLES UNDERPINNING FISCAL OPERATIONS IN MALTA. IN 2020 AND 2021, THE GOVERNMENT STRONGLY INTERVENED TO PRESERVE JOBS AND SUPPORT BUSINESSES IN VIEW OF THE SIGNIFICANT IMPACT OF THE PANDEMIC ON ECONOMIC ACTIVITY.

This intervention was rendered possible by the fact that the Government created fiscal room for manoeuvre by running a surplus during the years 2016-19.

In 2021, the general Government balance reported a deficit of 8.0 per cent of GDP, an improvement from the deficit of 9.5 per cent reported in 2020. The debt-to-GDP ratio in 2021 stood at 56.4 per cent still standing below the 60.0 per cent Treaty requirements target which many other European Union Member States have fallen foul of.

As the COVID-19 support measures are being phased out, the Government's sustainability is under pressure due to the absorption of energy prices which have matched and overpassed considerably the COVID-19 support costs. Moreover, while the COVID-19 measures were financing local businesses and workers through direct funding in an internal manner, the structure of the absorption of foreign energy means that the financial cost is going out of the economy with zero productive or competitive add-on for the local economy.

These circumstances are the fundamental questions which underpin the current fiscal sustainability of the Government and its ability to continue doing so in the medium-term. The next budget will be addressing these questions in order to provide more visibility on the way the Government plans to manage and decrease its deficit in the coming years, especially since it is currently registering among the highest deficits in Europe.

Figure 3.1

General Government Balance, 2021

Source: Eurostat

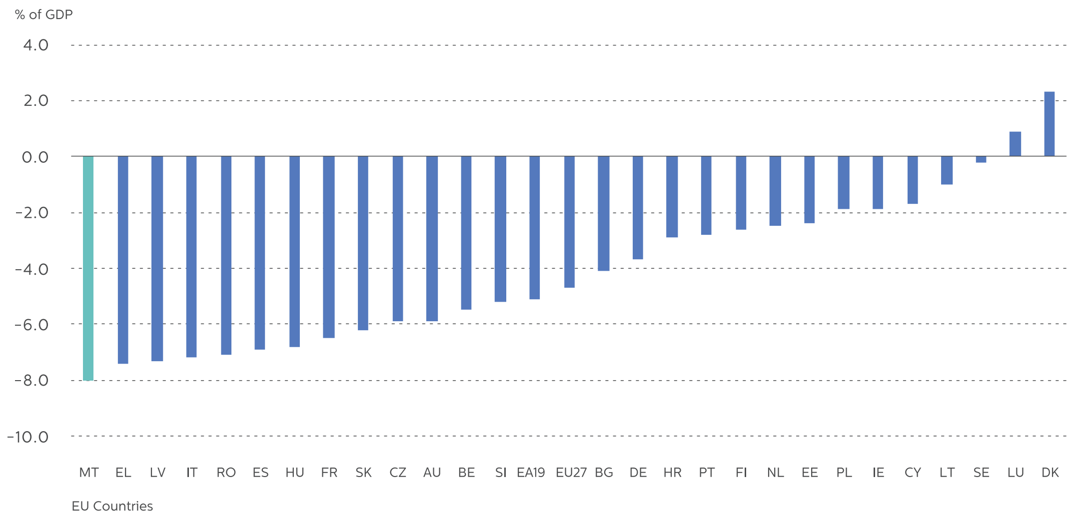
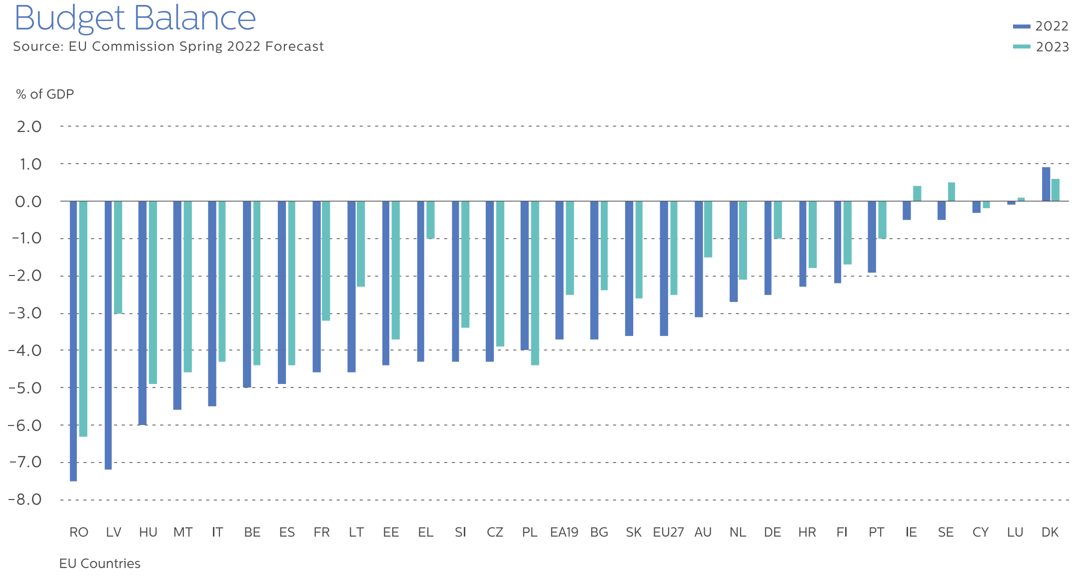


Figure 3.2

Forecasted Government Budget Balance

Source: EU Commission Spring 2022 Forecast



3.2 FISCAL DEVELOPMENTS IN 2021

ANALYSIS OF REVENUE AND EXPENDITURE

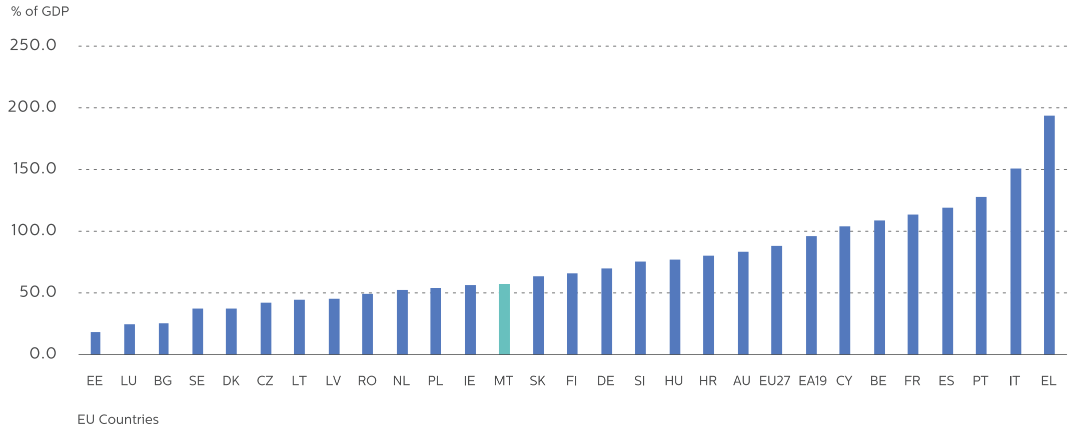
In 2021, the general Government balance has slightly improved from a deficit of €1,237.7 million in 2020 to €1,166.4 in 2021. As a share of GDP, this was equivalent to a deficit of 8.0 per cent, improving by 1.5 percentage points over the deficit recorded in 2020 of 9.5 per cent.

Total revenue increased by €635.2 million amounting to €5,448.6 million, while expenditure reached €6,614.9 million, increasing by €563.8 million as the persistence of the COVID-19 pandemic required the extension of a number of support measures to businesses and households. The General Government debt increased by €1,332.2 million over 2020 and stood at €8,097.4 million.

Figure 3.3

General Government Debt, 2021

Source: Eurostat



Despite Malta experiencing one of the largest general Government deficits in 2021, Malta's debt-to-GDP ratio still stands below the 60.0 per cent Maastricht criteria and well below the EU and EA averages.

3.3 FISCAL OUTLOOK

FISCAL SUPPORT MEASURES

When the COVID-19 pandemic hit the Maltese islands, the Government promptly implemented several policy measures to address its adverse effects mainly by safeguarding wellbeing, employment, households and businesses.

The initial policy response sought to lower the number of infections, to avoid an overloading of the acute healthcare system and to limit the number of casualties. Subsequently, fiscal policy measures were put in place to cushion the economic impact on revenues, incomes and liquidity, through discretionary policies with a direct impact on the budget, as well as liquidity-oriented measures. Several policy measures which had been put in place to cushion the impact of the pandemic in 2020, were extended in 2021 and 2022, as necessary.

In 2022, as the number of hospitalisations due to the COVID-19 pandemic decreased, allocation of Government health-related expenditure is expected to decline by almost €40 million. Tourism support schemes will gradually be phased out and reduced by around €7 million in 2022. The Malta Enterprise business assistance schemes, including the wage supplement scheme that has been discontinued since May 2022, will see the withdrawal of measures amounting to €260 million by the end of 2022. In total, COVID-19 measures are expected to be phased out from 4.8 per cent of GDP in 2021 to close to 1.8 per cent of GDP in 2022.

Table 3.1

COVID-19 Related Fiscal Support Measures

Source: MFE

Measures	2020	2021	2022(e)
Reduced tax on the transfer of immovable property	56.4	138.5	78.0
Reduced Excise Duty	7.3	16.2	16.0
Minimum Excise duty applicable on petroleum products as from 09/11/2021	0.0	4.2	31.0
Tax Deferrals	8.1	12.8	12.8
Various medical supplies and equipment in relation to COVID-19 ; educational support	74.1	81.9	43.0
Cargo Transportation and Repatriation	50.0	0.0	0.0
Malta Enterprise Schemes including the Wage Supplement Scheme	393.3	369.1	109.0
Economic Regeneration Voucher Scheme	43.8	44.7	0.0
Government-guaranteed loans schemes	0.7	9.6	12.5
Support to the agricultural sector	0.0	4.9	4.0
Short-Term Social Measures	18.0	4.6	0.0
Tourism Support Schemes	0.0	13.7	6.3
Total Estimated Cumulative Impact of COVID-19 related measures	**651.7**	**700.2**	**312.6**

On the other hand, energy support measures to stabilise the price of gas, petroleum, electricity, grains and animal fodder were implemented in 2022 together with a temporary economic stimulus to compensate for the higher cost of living. In view of the global economic turmoil, and the resultant inflationary pressures.

Furthermore, earlier during the year, the Government also provided a temporary economic stimulus to households to compensate for the higher cost of living. Price support measures, together with the economic stimulus cheque (€48 million) will amount to around €472.5 million in 2022, equivalent to around 3.0 per cent of GDP in 2022. In 2023, energy and food support measures are expected to increase to around €608 million, equivalent to around 3.6 per cent of GDP.

3.4 MALTA'S MEDIUM-TERM FISCAL STRATEGY

THE STABILITY AND GROWTH PACT

The Stability and Growth Pact (SGP), adopted in 1997 and enshrined in Articles 121 and 126 of the Treaty of the Functioning of the European Union (TFEU), guides national budgetary policies through a set of fiscal rules that limit budget deficits and public debt, relative to the country's GDP.

It is essentially one of the major economic policy coordination tools at the disposal of the EU and consists of two parts: the preventive arm and the corrective arm.

Within the SGP there is a margin of flexibility, including exemptions, when assessing compliance, for the purpose of finding a balance between stabilisation and fiscal sustainability. It is important to note that when deciding to open procedures against a Member State, a number of relevant factors are taken into consideration.

The General Escape Clause

The “severe economic downturn clause”, or as it is more generally known, “the general escape clause”, provides additional flexibility in the SGP. For the preventive arm, the general escape clause allows for a temporary departure from the adjustment path towards the MTO.

For the corrective arm, it allows the Commission to postpone the EDP, provided it does not endanger medium-term fiscal sustainability. This allows Member States to allow automatic stabilisers to operate and if necessary be supplemented by discretionary fiscal stimulus measures during a severe economic downturn.

ECONOMIC POLICY COORDINATION AFTER THE COVID-19 PANDEMIC

In light of the COVID-19 crisis, on the 23rd of March 2020, the European Council activated the general escape clause of the SGP for the first time.

The general escape clause has allowed Member States to respond quickly and forcefully through fiscal policy to address the pandemic and support the economy. Initially, in its communication on the 3rd of March 2021, the European Commission indicated that the deactivation of the clause should depend on a quantitative criterion, chosen to be the level of economic activity in the EU compared to pre-crisis levels (end-2019). The EU economy is expected to reach pre-pandemic levels of economic activity in 2022, according to the latest European Commission forecast. However, given the heightened uncertainty and strong downside risks to the economic outlook of the European economy due to the war in Ukraine, the European Commission, in its latest communication concluded that the EU economy is not yet out of the severe economic downturn, and it is justifiable for the general escape clause to be extended through 2023.

The application of the general escape clause does not suspend the procedures of the SGP, but only allows for a temporary deviation from its requirement as long as the clause remains activated. However, the European Commission decided not to propose opening EDPs since the outbreak of the pandemic, as fiscal policy needed to maintain focus on sustaining the recovery. Furthermore, exceptional uncertainty, stemming from the COVID-19 pandemic, the war in Ukraine, unprecedented energy price hikes and supply-chain disruptions, constrained the design of credible fiscal adjustment paths. In essence this uncertainty constrains the ability of the Commission to delineate a credible adjustment path and thus lead the Commission to conclude that opening EDPs could severely risk the recovery and potentially lead to pro-cyclical fiscal policy. In Autumn 2022, the Commission will re-assess the relevance of proposing to open EDPs based on the outturn data for 2021. In Spring 2023, the Commission will assess the relevance of proposing to open EDPs based on the outturn data for 2022.

THE EUROPEAN COMMISSION'S FORECAST REPORTS

The European Commission published the Fiscal Policy Guidance on 2nd of March 2022 pointing out that "on the basis of the Commission 2022 winter forecast, the general escape clause is expected to be deactivated as of 2023."

This will be reassessed based on the Commission 2022 spring forecast in view of the high uncertainty.

The Policy Guidance in March and the Spring Forecast documents in May strengthen the direction that the European Commission has outlined for the general escape clause to be deactivated.

In 2021, Malta registered the highest budget balance in the European Union at 8.0 per cent. According to the European Spring Forecast it is in line to register the second highest deficit this year, and the highest one again in 2023.

This means that the substantial fiscal deficits which the Government is registering must be within the parameters by the point of deactivation of this clause. Since the gap between the present and the maximum allowed parameter is considerable, the Government must prioritise a downward deficit trajectory in the short to medium-term and accelerate its efforts to be in closer proximity with the rest of the European Union economies.

3.5 GROWTH PROSPECTS

INTERNATIONAL SCENE

The European Commission Spring 2022 forecast expects global growth to be 3.2 per cent, a decline of 1.3 from the forecast produced in Autumn.

The European Commission highlights that the decline in growth prospects is expected for both emerging and advanced economies, following global inflation that is expected to remain higher and persist for longer.

The European Commission highlights that the variation will be uneven across advanced countries. Although the US has limited direct economic exposure to the Russia-Ukraine war, its short-term outlook has been negatively impacted through commodity price channels along with the continued strengthening of the US dollar weighing on exports and widening the trade deficit. Meanwhile, the UK economy's outlook is expected to be hindered by higher energy prices and fiscal tightening along with slow business investment. Japan's real GDP is also expected to grow at a slower rate in 2022, as the country experienced subdued growth amid the Omicron spread in the first quarter of the year. The Chinese economy decelerated in the second half of 2021 and is now faced with a more challenging external environment, weakening real estate sector and renewed disruptions caused by the COVID-19 pandemic, which are expected to weigh further on GDP growth in 2022 and 2023.

Russia's GDP is expected to experience a significant decline, of around 10.0 per cent in 2022. Russia's inflation rate already experienced sharp increases resulting from the imposition of sanctions and is expected to reach around 20.0 per cent in 2022, negatively influencing real incomes and consumption. The sanctions, along with the increased uncertainty, weakening outlook and tightening of financial conditions are also expected to affect the investment climate. Overall, the outlook for Russia relies primarily on the prospects for its commodity exports.

To the frustration of Western foreign and economic policy, the price of the Russian ESPO and Sokal energy prices have remained strong considering the circumstances, hovering at approximately 15-25 per cent less than their market counterparts over the past months and primarily driven by demand from China, India and other Asian countries.

The outlook for most emerging economies has worsened in varying degrees. While some emerging countries' commodity exporters will benefit from higher prices, others will experience worsening terms of trade along with a weaker external environment resulting from slower growth in goods trade. Higher food prices may also threaten food security and stability in parts of the European periphery and in North Africa that have high dependence on imported supplies from Ukraine and Russia and a high share of food in consumption baskets.

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. In terms of projected risks, 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.

The growth outlook for the EU economy has been considerably revised down in the European Commission Spring forecast and further down in its latest Summer forecast. Indeed, GDP growth is expected to slow down from 5.3 per cent in 2021 to 2.6 per cent in 2022 in the euro area and from 5.4 per cent in 2021 to 2.7 per cent in 2022 in the EU. Annual GDP growth is expected to decline further in 2023, to 1.5 per cent in the EU and 1.4 per cent in the euro area. Inflation forecast for the year 2022 for the EU and EA averages currently stand at 8.3 per cent and 7.6 per cent respectively. Inflationary pressures are expected to ease in 2023 albeit remaining at an elevated level, as the projected inflation rates stand at 4.6 per cent and 4.0 per cent for the EU and EA respectively in 2023.

THE MALTESE ECONOMY

Against this background, the Maltese economy is expected to grow by 4.6 per cent in real terms and 8.5 per cent in nominal terms in 2022. The domestic component is expected to be the main driver of the growth, 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, following a rebound in services exports particularly driven by tourism, in addition to the assumed depreciation of the Euro which should support exports. Continued investment growth and further recovery in domestic demand will also boost the projected growth in imports.

In 2023, the Maltese economy is expected to grow by 4.0 per cent in real terms and 6.0 per cent in nominal terms. Although net export growth is expected to decelerate in line with a general economic slowdown in Malta's main trading partners, this will be partially compensated by a continued recovery in tourism and easing inflationary pressures during the second half of 2022. Domestic demand is projected to be the main driver of this growth followed by net exports.

The outlook for 2023 is subject to the assumption that the supply side disruptions would eventually subside and the policy tightening regime would cause a demand-led deceleration in prices. That said, prices are not assumed to revert to pre-pandemic levels.
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 2.8 per cent (National Accounts definition).

In 2022, a continued pick-up in economic activity is projected to generate an employment growth of 2.7 per cent before reaching 2.3 per cent in 2023. 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.

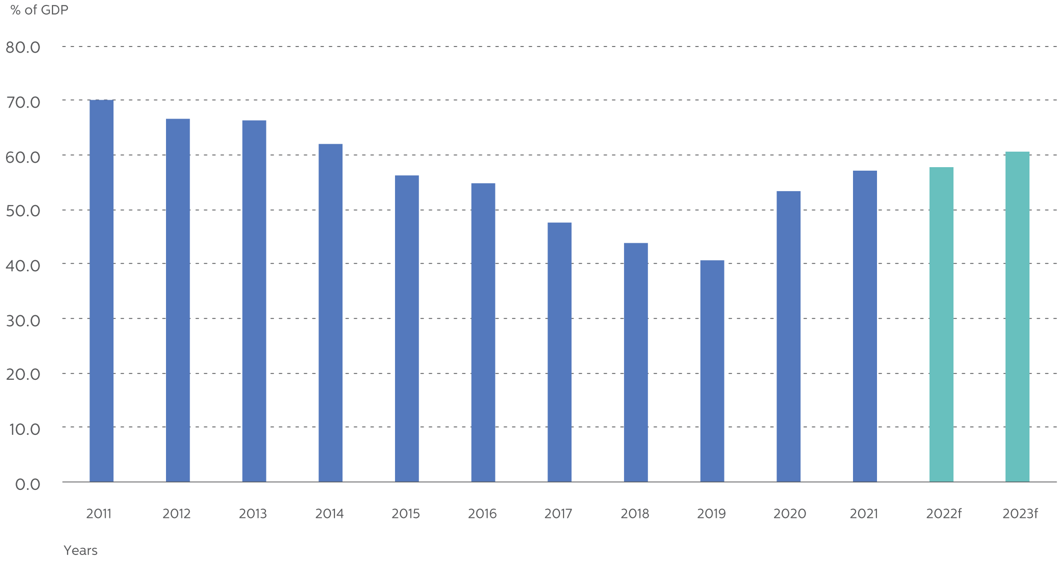
Compensation of employees is projected to increase by 6.1 per cent in 2022 due to heightened job demand and modest employment growth, before moderating to 5.6 per cent in 2023. Concomitantly, compensation per employee is projected to grow by 3.3 per cent in both 2022 and 2023, in line with projected high inflation, generating upward wage pressures. The inflation rate is expected to increase to 5.1 per cent in 2022, driven by disruptions in global supply-chains, causing bottlenecks and shortages and amplifying price pressures as a result of the war in Ukraine. In 2022, the acceleration in HICP is expected to be mainly driven by higher food prices, non-energy industrial goods and higher prices of services. Energy inflation is expected to remain stable in 2022 in line with the Government's commitment to absorb the rising energy prices. HICP inflation is expected to decelerate in 2023 to 2.4 per cent, with lower contributions from all components following high base effects from the previous year and a deceleration in economic activity as the tightening of financial conditions offset the current global supply-demand mismatch.

Malta's Fiscal Strategy

Despite the challenging circumstances, the Government is determined to consolidate public finances with specific actions addressing both the revenue and the expenditure side. On the revenue side, there is a determined effort to raise the efficiency of tax collection. Meanwhile on the expenditure side, the Government has embarked on a number of spending reviews with the scope of identifying savings that would support the consolidation effort and emerging needs without jeopardising the Government's main policy objectives. This will ensure that the deficit to GDP ratio would decrease gradually in the coming years while the debt-to-GDP ratio remains at a sustainable level.

The general Government balance is expected to decline to 5.8 per cent in 2022 and remain at the same level or slightly lower in 2023.

Figure 3.4
General Government Debt
Source: Eurostat



DEBT LEVELS AND DEVELOPMENTS

The Government debt declined below the 60.0 per cent Treaty requirements in 2015 and maintained a sustained downward trajectory, declining to 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 support measures. Moreover, debt-to-GDP ratio further increased by 3.0 percentage points in 2021 reaching 56.4 per cent.

The level of public debt relative to GDP is estimated to increase to 57.8 per cent of GDP in 2022. This mainly reflects the negative primary balance expected to persist in 2022 due to the extended COVID-19 support measures and the subsidies implemented by the Government to subside energy and other inflationary pressures. Although the overall underlying debt dynamics are expected to improve in 2023, the debt-to-GDP ratio is expected to increase in 2023 to 60.7 per cent of GDP.

TOWARDS A GREENER FUTURE

04

THE GOVERNMENT'S PLAN IN THE COMING BUDGET IS TO ENSURE A STRONG POST-PANDEMIC GREEN RECOVERY PATH AMID ALL THE GLOBAL CHALLENGES BEING CURRENTLY FACED.

Addressing the challenges in education and strengthening investment in the health and social systems needs to be coupled with investment towards reaching climate targets and enhancing the quality of the rural and urban environment.

4.1 REACHING CLIMATE NEUTRALITY BY 2050

IN ORDER TO REACH THE 2050 GOALS, ACTION NEEDS TO BE TAKEN NOW. THE GOALS ARE CLEAR, AND WORK WILL FOCUS ON HELPING FAMILIES, TRADERS AND OPERATORS TO ADAPT TO MORE SUSTAINABLE ENERGY USE AND TRANSPORT PRACTICES AND HENCE, REDUCING GREENHOUSE GAS EMISSIONS.

In this regard, a monitoring board has been set up specifically to ensure that all sectors concerned continue to grow whilst transitioning towards greener and low emissions practices. In 2023, in addition to the Low Carbon Development Strategy, Malta will also be updating its National Energy and Climate Plan. Furthermore, in order to provide the necessary national focus on environmental matters from now until 2050, the Government will be setting a National Environment Strategy 2050. This will bring together the country's environmental efforts while enabling and empowering the required green transition.

At a time of a global energy crisis, the Government is seeking ways to deliver its climate-neutral vision by encouraging and supporting private investments whilst decreasing its dependency on others. To achieve this, Malta is working on its energy connectivity and diversification of energy sources, supporting sustainable investment in Maltese enterprises and committing to green transport and infrastructure.

The investment in Malta's energy connectivity and diversification will enhance further the development of large-scale renewables and venture into innovative markets for the deployment of offshore renewable energy technologies and cleaner energy markets. The forthcoming Budget will focus on enabling both the public and private sector to invest further in smarter, greener and more sustainable operations and further encourage waste reductions and proper separation.
Through these sustainable choices, the quality of life is further augmented.

In this regard, EU Funds are essential to ensure that Malta continues onto the post-pandemic green recovery path.

4.2 REDUCING GHGS BY 19% FROM 2005 LEVELS

MALTA WAS RESPONSIBLE FOR EMISSIONS OF 2.6 MILLION TONNES OF CO2E IN 2019 – LESS THAN 0.1% OF TOTAL GHG EMISSIONS IN THE EU-27.

Between 2005 and 2014, Malta's emissions fluctuated between 3.2 and 3.5 MtCO2e. Emissions dropped significantly in 2015 and have remained steady at around 2.6 MtCO2e since then as a result of the changes in the national energy mix, notably the electricity interconnection with Sicily and the shift from heavy fuel oil to natural gas in local electricity generation. While energy industry emissions dropped by 63% between 2005 and 2019, emissions in the transport sector grew by 22 % over the same period.

Hence, the Government's commitment to attaining its 2030 target of -19% involves first and foremost investment towards the decarbonisation of transport. It will also focus on waste management and achieving recycling targets and increasing energy efficiency in buildings.

Transport

The electrification of the Maltese fleet is an absolute priority in the next ten years in order to continue reducing emissions. The target as established in Malta's Low Carbon Development Strategy is to reach over 10% of the fleet electrified by 2030.

As a result of an investment of around €14 million in incentive grants in 2021, 1,079 electric/plug-in hybrid vehicles and 2,917 pedelecs/motorcycles were registered until the end of December 2021. In 2022, the Government increased investment to €25 million and by the beginning of September 2022, registrations of certain categories of vehicles such as the new electric cars and used electric or plug-in hybrid had surpassed that recorded in 2021.

Table 4.1

Take-Up of Schemes and Expenditure (2021)

Source: Transport Malta

	Take-up amounts	Take up (€)	Allocated Budget (€)
Scrapping scheme	1208	1,668,882	1,670,000
New Electric Vehicles/ category L	1238	3,692,821	3,739,263
Cars	318		
Motorcycles	920		
Petrol Motorcycle	1997	2,727,831	2,806,891
LPG	177	70,200	70,200
Plug-in-hybrid /used electric	761	5,829,867	5,853,846

Table 4.2

Take-Up of Schemes and Expenditure (2022) up to 05/09/2022

Source: Transport Malta

	Take-up amounts	Take up (€)	Allocated Budget (€)
Scrapping scheme	618	914,013	700,000
New Electric Vehicles/ category L	1016	6,375,488	15,000,000
Cars	481		
Motorcycles	535		
Petrol Motorcycle	2121	3,227,763	2,370,000
LPG	99	41,800	60,000
Plug-in-hybrid /used electric	849	9,028,689	6,900,000

Through the RRP, €50.3m over the span of 3 years will be allocated to instigate a wider shift towards electric mobility and reduce emissions emanating from the road transport sector in Malta by promoting the uptake of new electric vehicles in the private sector, including the commercial sector through grant schemes. The schemes shall support the purchase of new passenger, passenger care and goods carrying vehicles, minibuses/ coaches, quadricycles/motorcycles and pedelecs. The scheme was launched in January 2022 and will be implemented through a rolling call up to 2024.
Malta will also be allocating €34 million of RRP funds to replace 102 diesel-powered buses with new fully electrically powered buses by 2025. Additionally, the scheduled public transport operator will be additionally increasing the fleet by introducing 25 new fully electrically powered buses by the end of 2022.

Charging Infrastructure

In order to support the commitment toward vehicle electrification, the Government needs to invest in Malta's charging infrastructure. Indeed, with the demand for the shift towards e-mobility constantly increasing with a present total of 10,000 new electric vehicle registrations, comes the requirement for an increase in charging infrastructure to sustain the shift.

A new policy and regulation have been launched to enable Charging Pillar Operators to become active players in the market. The second Malta-Italy interconnector will serve as an enabler for Malta's commitments toward the implementation of an additional 260 charging points with the introduction of fast charging technology to the existing 102 points, which has been successfully executed. In a span of 9 months, the new charging infrastructure system has started to be used by more than 900 new users.

The commitment is to install further charging points between 2022-2024.

Harbours Clean Air Projects

A number of capital projects are underway with a particular focus on the major regeneration of the Grand Harbour being implemented by the GHRC, undertaking the Government's vision for the Valletta Harbours, the restoration and regeneration of Valletta Grand Harbour and the surrounding areas. Initiatives projects include The Mall Garden, the Kalkara Regeneration Project, the Royal Opera House, Fort St Elmo and the Pieta promenade.

Investments will continue in the Grand Harbour and at Marsaxlokk Harbour to decarbonise the ports as much as possible. In the coming year, EU funds will continue to be used in support of environmental investment by providing shore-to-ship electricity infrastructure to cruise liners, container and cargo ships at these two main Tent-T ports. This will enable vessels to switch off their gas-oil or heavy-fuel-oil-fired engines and plug into shoreside electricity to energise their onboard systems whilst they are berthed at the port. The aim is to reduce the air emissions and reduce the level of noise emissions within the harbour area, thereby improving the surrounding environment and quality of life of all persons living and working within the region.

Energy-Efficiency in Buildings

The Government will see that the use of energy in buildings becomes more efficient with the aim of decarbonising the building stock in Malta in accordance with climate change targets. In addition, by conserving energy in the use of the building, the end consumer gains in lower electricity bills.

The Government has embarked on a series of schemes providing financial support to cover part of the costs of solar water heaters, roof insulation, double glazing and air-to-water heat pump systems installed for domestic use. Investment in grant schemes for energy efficiency measures in the domestic sector between 2013 and 2021 amounted to around €4 million with 6561 beneficiaries. The grant schemes provided grants for the purchase of solar water heaters, double glazing and roof insulation, and as of 2018 also on heat pump water heaters.

Table 4.3

Energy Efficiency Expenditure and Beneficiaries

Source: REWS

	2013	2014	2015	2016	2017	2018	2019	2020	2021
Grants Payments (€)	228,696	323,379	232,312	194,961	172,847	229,943	945,543	690,834	959,417
Number of beneficiaries	672	945	672	569	515	423	1169	769	827

The grant for domestic wells, the rainwater harvesting scheme, will continue to increase the use of second-class water in the domestic sector by supporting approximately 100 households. These schemes are expected to reduce dependency on standard energy sources, help in achieving renewable energy and decarbonization targets and increase the uptake of energy-saving equipment.

The support for alternative measures will also continue to be extended to voluntary organisations and methods to encourage alternative solutions. Amongst others, Budget 2023 will deliver another year of support for sports organisations investing in renewable energy, support for the installation of PVs on Government-owned premises, PV communal farms to assist households without access to adequate roof space, and energy efficiency support for the industry.

Moreover, the Resilience and Recovery Facility (RRF) will continue to finance the renovation of public schools to increase energy efficiency and the building of a pilot near-carbon-neutral school. This will complement infrastructure investments made in recent years to accommodate increases in student population and a sharper focus on vocational education and training.

Waste Management and Achieving Recycling Targets

Obtaining higher levels of waste separation and introducing waste prevention measures remain a top priority. Malta is bound to reduce its current 90% landfilling rate to a binding 10% by 2035. Moreover, recycling figures need to reach the 70% mark by 2030. In order to reflect the required level of sustainability and need for a circular economy, the Government remains focused on maximising resource use and efficiency.

A new Multi Material Recovery Facility (MMRF) is in its early stages of soft commissioning. This new plant will enhance the reuse and recycling potential of many waste streams which are currently being landfilled, by strengthening the separation of waste streams. It will also improve the efficiency of handling waste material and its preparation for export. Also, crucial in terms of efficiency leaps is the commissioning on a new Material Recovery Facility that will double Malta's efficiency through its fully automated state of the art machinery.

Greatly welcomed by the general public, WasteServ has also opened its first Reuse Centre at the Hal Far Civic Amenity site. Another three reuse centres are set to be opened by end 2022. These centres will promote the reuse concept as people will be able to take items such as: books, ceramics, toys and loose furniture, in exchange for a donation which will, in return be invested in environmental projects.

ECOHIVE Project

Central for the Government's long-term vision is the construction of the ECOHIVE complex, aimed at upgrading Malta's waste management facilities and improving its waste management performance. Partially supported through EU funding, the €500 million project is the largest ever investment in Malta's waste management infrastructure, which infrastructure, together with various policies, will allow Malta to reach its waste management targets.

Excavation and site preparation works for the Waste to Energy project have started. And the designs and tender preparations for the new Organic Processing Plant and the large-scale Material recovery facility are at a very advanced stage. Also, as part of the ECOHIVE Project, WasteServ will be constructing a Skip Management Facility. Bulky waste currently arriving in skips makes its way directly to the landfill. The Skip Management Facility will serve to divide mixed bulky waste into fractions in order to reduce the volume of waste sent directly to landfill while also preventing the landfilling of hazardous waste.

These efforts are being accompanied by several investments in the waste management sector including a framework for the management of Construction and Demolition (C&D) Waste, the reform and regionalization of municipal waste collection, as well as the feasibility assessment of expanding Extender Producer Responsibility (EPR) to certain waste streams. These are all reforms that the Government is committed to undertaking within Malta's Recovery and Resilience Plan.

Construction and Demolition Waste

Activity from the construction industry has increased considerably in recent years, with related waste generation standing at around 2.4 million tonnes in 2019.

The Construction and Demolition Waste Strategy for Malta 2021-2030 recognises the resource value of such waste and proposes concrete short and long-term measures designed to promote the shift towards a more circular economy, away from backfilling towards re-use and recycling.

By 2023, the focus will be placed on incentivising the crushing of material prior to backfilling, to restore void spaces to their original state, while respecting high environmental standards.

Furthermore, the industry will be adopting newly established standards for the construction industry to reduce the construction and demolition waste generated and ensure that the waste generated is suitable for treatment in line with the waste hierarchy. A new regulatory framework targeting C&D waste will also be developed through a collaborative effort of several Government entities.

Reducing traffic congestion

The removal of traffic bottlenecks has been and remains a priority as this will reduce traffic congestion in urban areas, giving prominence to more sustainable transport as well as promoting further modes of transport including cycling and pedestrian facilities.

In order to address congestion and pollution, from 2018 up till July 2022, €472 million from the national budget have been spent towards upgrading the road network. This upgrade is part of a holistic approach towards sustainability, air quality, reduction in cars and traffic congestion and modal shift.

Predictions from studies carried out on 7 major projects (St Andrews Road, Buqana Road, Marsa-Ħamrun Bypass, Santa Luċija Underpass, Tal-Balal Road, Marsa Junction and Central Link Project) indicate that this will lead to a reduction of 14% in costs of congestion over a number of years.

Malta will further aim to include investment in roads as part of potential investment under Cohesion policy for the upcoming programming period to ensure a sustainable and well-connected network.

Public Transport

One of the Government's objectives is to promote the use of public transport to reduce emissions and address congestion by granting free access to scheduled road public transport services to new cohort groups to comprise at least 103,000 people. Following the Budget of 2022, free Public Bus transport to all personalised tallinja card holders will be provided as from October 2022. This is expected to apply to some 400,000 tallinja card holders.

This measure would increase further the number of users of public bus transport, thus reducing further the use of private vehicles with the resultant positive impact on congestion and emissions.

Table 4.4

Total Number of Passengers using Public Transport

Source: MTIP

Year	Passengers
2011	33,152,731
2012	34,030,681
2013	39,438,822
2014	43,687,135
2015	42,160,228
2016	43,253,238
2017	48,053,045
2018	53,467,404
2019	57,409,385
2020	33,776,664
2021	35,207,174

Sea Transport

Table 4.5

Passenger Numbers - Sea Transport

Source: MTIP

Year	Gozo Malta - Fast Ferry	Bormla - Valletta Ferry
2021	364,672	200,149
2022 January - June	193,664	163,464

The Government has encouraged and supported ferry connections connecting coastal areas to encourage modal shift, including a fast ferry passenger service between Malta and Gozo, thereby encouraging car-free mobility between the two islands. The ferries have continued to produce encouraging results when it comes to usage.

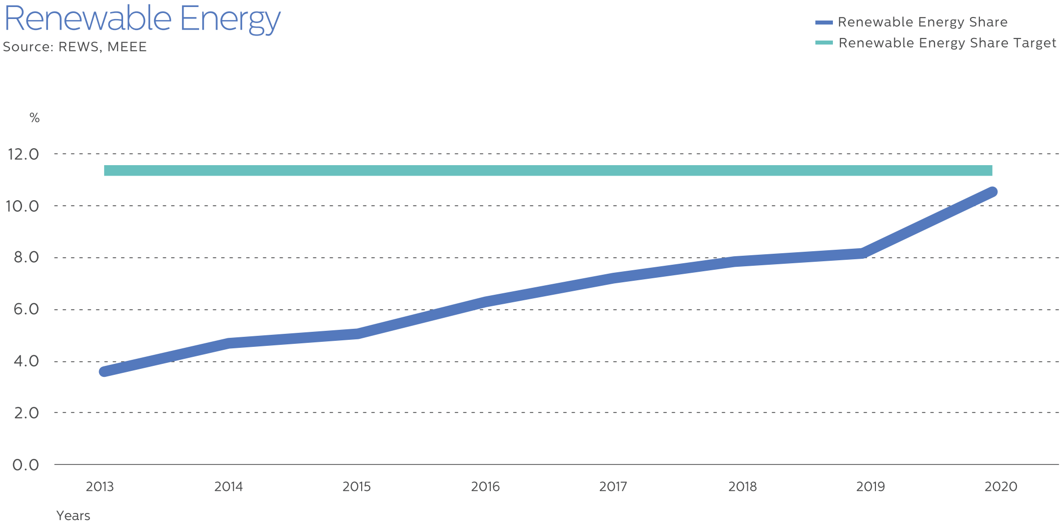
With an investment of over €30m ferry landing sites in Bormla and Sliema Ferry are being upgraded; works are also planned to upgrade the Marsamxett ferry services and new ferry services will be introduced in Buġibba, St. Paul's Bay. As part of this investment, landing sites will be upgraded to improve berthing and passenger waiting for facilities through the installation of shelters and installation of ramps to improve accessibility for mobility-impaired citizens. Furthermore, works on the seaside shall include the construction of piers, quay infrastructure, mooring facilities and sea defences to offer more sheltered and faster berthing facilities which will also be more resistant to inclement weather, thus making the service more reliable throughout the year.

Reaching the Renewable Energy Targets

The investment in Malta's energy connectivity and diversification will enhance further the development of large-scale renewables and venture into innovative markets for the deployment of offshore renewable energy technologies and cleaner energy markets.

As is constantly emphasised, it is in Malta's best interest to seek the diversification of energy sources. It is estimated that through the implementation of the Low Carbon Development Strategy, Malta and Gozo are set to increase, to 22 per cent by 2050, the share of renewables in the grid mix. This figure stood at 8.0 per cent in 2020. Additionally, under the Fit-for-55 package, Malta has committed to an 11.5 per cent RES target by 2030. With a current estimate of 10.71 per cent, Malta is on track to achieving this target.

Figure 4.1
Renewable Energy
Source: REWS, MEEE



The launch of a set of ambitious schemes, grants, and tariffs encouraging more people to invest in renewable energy has left positive results.

As from 2019 grant schemes on solar photovoltaic installations targeting households are funded fully from the national budget, three schemes of this type were launched to date including the 2021RES scheme. The grant scheme covers up to 50.0 per cent of the eligible costs incurred by the beneficiary to purchase the solar photovoltaic system subject to a maximum established for the scheme. The 2021RES scheme also offers grants for the installation of battery storage.

The total number of beneficiaries as at the end of 2021 for these nationally funded PV schemes was 2311 and the total amount of grants paid to these beneficiaries was €6.2 million.

Table 4.6
RES Expenditure and Beneficiaries
Source: REWS

	2019	2020	2021
Sum of Payment (€)	514,656	1,889,994	3,844,583
Number of beneficiaries	232	809	1270

Additionally, the Government has allocated 8MW as a Feed-In-Tariff scheme for PVs less than 40kWp for households, while also extending the existing households on a 20-year period. This measure does not only make financial sense to households but will enable more longevity of the existing technology and reduce waste.

A total of 16.56MW have also been allocated for medium to large renewable energy systems which would be able to supply 6,050 households in a single year, apart from the allocation for the mass scale projects beyond 1MW.

Off-shore Energy Sources

Malta's ambition is to continue to increase the number of onshore renewables by tapping into spaces that have yet not reached their potential. However, in order to reach ambitious targets, Malta needs to have large-scale offshore renewable projects. At present, deep sea-bed floating offshore wind technology is maturing at a fast pace. It is the Government's intention that Malta becomes part of this development. In this regard, a Pre-Market Consultation for economic activities in Malta's Exclusive Economic Zone has been launched. The Government shall also continue to pursue the hydrogen-ready pipeline project, which has now been secured as a EU Project of Common Interest. This opens the door for Malta to access new technologies, particularly green hydrogen originating from renewable sources. This is important to decarbonise the electricity sector in the longer term.

4.3 ENSURING ENERGY SECURITY

ENERGY SECURITY CONTINUES TO UNDERPIN OUR PATHWAY TOWARDS A CLIMATE-NEUTRAL ECONOMY AND THE GOVERNMENT IS SEEKING WAYS AND MEANS TO STRENGTHEN ITS LACK OF DEPENDENCY ON OTHER COUNTRIES FOR ENERGY SUPPLY.

This is being done by improving Malta's energy connectivity and diversification of energy sources.

In 2022, electricity demand growth has re-established at pre-pandemic levels. A new record in electricity demand has been recorded. This reflects projections, in line with the economic recovery and new demand drivers. Demand growth is expected to continue to progress in 2023 due to further efforts in the electrification of transport and as the facilities for onshore power for maritime vessels come online.

Distribution System Upgrades

Over the past months, Enemalta launched a €90 million investment programme spread over six years. This investment includes intervention at all levels of the distribution system. Implementation is currently ahead of target: new transformers at Tarxien and Marsaskala Distribution Centres are already in service. Another transformer at Mrieħel Distribution Centre will be energised in the coming weeks. 24 new substations have already been constructed and are operational together with several medium voltage reinforcements and multiple new low voltage feeders. New technology for voltage regulation has been introduced in the low voltage network.

This accelerated investment programme will continue in 2023. New substations will remain a priority together with major medium reinforcement projects including the network in Qrendi, Zurrieq and Siggiewi, an upgrade to the network in Valletta, reinforcement in the medium voltage system in Mosta, further improvement at Marsaskala and another medium voltage project in the network at Luqa, Ħandaq and Żebbuġ. Further substation automation will proceed as planned. Investment in the low voltage network will also be given precedence to ensure further improvement in the quality of service at the consumer level.

Preparatory works in the new link between Magħtab Terminal Station and Mosta Primary Distribution Centre will proceed so that the project implementation will commence in early 2024. Similarly, preparatory works for a new Distribution Centre in Naxxar will continue as announced. Transformers and switchgear at the New Hospital Distribution Centre will be upgraded.

Second Interconnector to Italy

As pledged, preparations for the installation of a second electricity interconnector cable between Malta and Italy are progressing well. Besides providing an additional 200MW source of electricity, the project will also deliver a more resilient electricity grid which will be able to accommodate large-scale renewable energy generation, particularly offshore and contribute toward Malta's decarbonisation and climate change targets.

In August, a specialised vessel commenced a Preliminary Marine Route Survey to analyse the marine route and take environmental samples in preparation for the permit requirements, both in Malta and Italy. Works are expected to be completed by early 2023. Concurrently, a tender for the Front-End Engineering Design has been awarded. This will determine the optimal onshore and offshore route for the interconnector and design all the protection required.
The Environmental Impact Assessments are expected to be submitted in the first half of 2023. The subsequent phase would be the decision on the development permits by the Competent Authorities in Malta and Italy.

Providing and Maintaining Gardens, Spaces, Parks and Valleys

The objective of the Government is to deliver, implement and execute urban greening projects in an efficient and cost-effective manner by minimising the reliance on public funds and maximising the utilisation of private investment such as through the use of PPPs and EU funding.

Various urban greening projects in the communities are being planned for the coming years such as the Inwadar Park. Furthermore, a number of projects in various localities Ħamrun, Mosta, Qormi and Żabbar, have been recently completed or will be completed in the next months.

4.4 CONCLUSION

IT IS SAFE TO EXPECT THAT ENERGY AND COST-OF LIVING CHALLENGES WILL BE THE MAIN ISSUES FOR EUROPEAN ECONOMIES IN THE COMING MONTHS. THE PROFOUND CHALLENGES AHEAD WILL BE SHAPING ECONOMIC AND FINANCIAL POLICY IN THE SHORT, MEDIUM AND LONG-TERM.

The Maltese economy has shown it can take a punch and still stand during the COVID-19 pandemic, by making sure the economic infrastructure remained in place for when better days came along.

Credit rating agencies and independent reports have consistently remarked that it can do so again during the coming months as energy and economic challenges continue to take the headlines across Europe.

If the Ukraine war was an earthquake, the vast economic and energy difficulties today are the aftershocks.

Malta needs to continue with a bold and strong approach to supporting workers, young people, the elderly and businesses.

The policies to address these challenges need to find the right balance between addressing the present issues and laying the foundations for tomorrow's well-being.

It would be counterproductive, if the Government sacrifices the future for today.

Like any sensible fiscal policy, it needs to find the right balance.

The past two years were about finding the balance between safeguarding people's livelihoods and people's lives.

The coming year will be about finding another balance - that of safeguarding Maltese families and businesses from the challenges ahead and safeguarding the fiscal sustainability of our country.

finance.gov.mt/2023

PRE-BUDGET
CONSULTATION DOCUMENT 2023

GOVERNMENT OF MALTA
MINISTRY FOR FINANCE
AND EMPLOYMENT