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Assessment of the 2020 Stability Programme for

Malta

(Note prepared by DG ECFIN staff)

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EXECUTIVE SUMMARY

- On 6 April 2020, the Commission provided guidelines to the Economic and Financial Committee on how the format and content of the 2020 Stability and Convergence Programmes can be streamlined in light of the exceptional circumstances related to the COVID-19 pandemic. This assessment takes into account the severe constraints that Member States faced in providing the information usually required in their Programmes. The assessment focuses on the near term in light of the high uncertainty attached to the projections.
- According to the 2020 Stability Programme, real GDP is projected to fall by 5.4% in 2020 before rebounding by 3.9% in 2021. The Commission 2020 spring forecast projects a somewhat larger dip in 2020 with real GDP falling by 5.8%, while the recovery in 2021 is expected to be stronger at 6%.
- Based on the outturn data, the general government balance ended in surplus of 0.5% of GDP in 2019. Amid the COVID-19 crisis, the Stability Programme projects a deficit of 7.5% of GDP in 2020 and 3.6% in 2021. The Commission 2020 spring forecast projects a somewhat smaller deficit of 6.7% of GDP in 2020 and 2.5% in 2021. Both forecasts assume an increase in the public debt-to-GDP ratio, bringing to an end the downward path recorded since 2014.
- In response to the COVID-19 pandemic, the government adopted an array of measures to provide support for businesses and households. They include measures to increase the capacity of the healthcare system, protect jobs, limit negative social impacts and alleviate liquidity constraints. The Stability Programme estimates the direct budgetary impact of these measures at 4.1% of GDP while the government's guarantees are estimated at 2.8% of GDP. No quantification is provided for tax deferrals.
- The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic.

1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2020 Stability Programme¹ of Malta covering the period 2020-2021 (hereafter called the Programme), which was submitted on 2 May². The note also assesses Malta's compliance with the preventive arm of the Stability and Growth Pact in 2019.

Malta is currently subject to the preventive arm of the Stability and Growth Pact (SGP).

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit the activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Malta is among those Member States that have triggered national escape clauses to suspend budgetary constraints set by their national fiscal rules, as part of the effort to accommodate the budgetary implications of the outbreak.

2. MACROECONOMIC DEVELOPMENTS

Malta's annual real GDP growth 4.4% in 2019 was driven by domestic demand underpinned by robust private consumption and investment.

The macroeconomic scenario underpinning the Programme projects that in 2020, Malta's economy will be severely affected by the COVID-19 pandemic. Malta introduced partial-lockdown measures to contain the spread of the virus including a travel ban, the closure of educational institutions, restaurants, bars and non-essential retail outlets, and public sector and private sector employers were encouraged to allow their employees to work from home, wherever possible. These are expected to

¹ The Stability Programme submitted by Malta does not indicate that it also constitutes the national medium-term fiscal plan required under Article 4(1) of Regulation 473/2013.

² The Stability Programme contains only short-term budgetary projections, in line with the guidelines for a streamlined format of the 2020 Stability and Convergence Programmes in light of the COVID-19 outbreak, provided by the Commission services on 6 April 2020. The programme was submitted on 2 May 2020, i.e. after the deadline of 30 April established by the Regulation.

exert adverse effects mainly on the tourism industry, wholesale and retail sector, transportation and the accommodation and food services sector. Sectors such as construction and manufacturing have widely continued their operations.

The Programme expects real GDP to fall by around 5½% in 2020 driven mainly by a negative performance of net exports given a high openness of the Maltese economy, while domestic demand is expected to contribute positively due to strong growth of government consumption.³ For 2021 the Programme projects a recovery, with real GDP expected to grow at close to 4%. Net exports are projected to be the main driver of growth in that year as the tourism sector is expected to recover. Domestic demand would also contribute positively reflecting a rebound in private consumption and investment. The unemployment rate is projected to increase to 5.9% in 2020, mitigated by government measures, before declining to 3.7% in 2021.

Table 1: Comparison of macroeconomic developments and forecasts

	2019		2020		2021		2022	2023
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	4.4	4.4	-5.8	-5.4	6.0	3.9	n.a.	n.a.
Private consumption (% change)	2.4	2.4	-5.0	-0.8	4.0	1.8	n.a.	n.a.
Gross fixed capital formation (% change)	7.2	7.2	-7.0	-4.0	5.0	8.6	n.a.	n.a.
Exports of goods and services (% change)	1.7	1.7	-9.3	-12.1	12.0	6.8	n.a.	n.a.
Imports of goods and services (% change)	2.1	2.1	-7.2	-8.0	10.8	5.6	n.a.	n.a.
<i>Contributions to real GDP growth:</i>							n.a.	n.a.
- Final domestic demand	4.3	4.3	-1.3	1.8	2.4	1.8	n.a.	n.a.
- Change in inventories	0.2	0.2	-0.1	0.0	0.1	0.0	n.a.	n.a.
- Net exports	-0.2	-0.1	-4.4	-7.2	3.4	2.1	n.a.	n.a.
Output gap ¹	3.8	4.1	-5.2	-4.5	-2.5	-3.8	n.a.	n.a.
Employment (% change)	5.6	5.7	-1.8	-3.3	2.8	3.2	n.a.	n.a.
Unemployment rate (%)	3.4	3.4	5.9	5.9	4.4	3.7	n.a.	n.a.
Labour productivity (% change)	-1.1	-1.2	-4.1	-2.2	3.1	0.7	n.a.	n.a.
HICP inflation (%)	1.5	1.5	0.7	1.0	1.1	1.4	n.a.	n.a.
GDP deflator (% change)	2.3	2.3	1.8	1.8	1.3	2.0	n.a.	n.a.
Comp. of employees (per head, % change)	2.4	1.9	3.4	1.6	2.8	2.8	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	11.7	11.6	8.6	1.8	10.7	4.0	n.a.	n.a.

Note:

¹In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Commission 2020 spring forecast (COM); Stability Programme (SP).

³ The Stability Programme mentions also three other alternative scenarios but these are not further developed.

According to the Commission 2020 spring forecast (hereafter Commission forecast), real GDP is expected to contract by around 5¾% due to both a fall in domestic and external demand. On the domestic side, the increase in public consumption also driven by pandemic-related outlays on medical supplies will not fully outweigh a plunge in private consumption due to the lockdown and closure of nonessential businesses and a fall in investment. The halted tourism translating into a substantial decline of exports coupled with a somewhat lower decline in imports mirroring mainly falling domestic demand will result in a negative contribution also from net exports. In 2021, the economy is projected to grow by 6% as an easing of general restrictions re-stimulates domestic demand.

The risks are skewed towards the downside. Malta is a small open economy and hence its economic outlook is highly sensitive to global uncertainties and performance of its trading partners, which will have an impact on the timing of the resumption of tourism activity. In the medium term, Malta is expected to continue growing more strongly than the EU average.

The macroeconomic projections underlying the Programme have been endorsed by the Malta Fiscal Advisory Council, an independent fiscal council established with the Fiscal Responsibility Act. The endorsement took the form of a letter dating 30 April 2020 addressed to the Minister of Finance, published on the Malta Fiscal Advisory Council's website. The Malta Fiscal Advisory Council concludes that the macroeconomic projections for 2020 and 2021 prepared by the Ministry for Finances 'lie within its endorsable range'.

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT AND DEBT DEVELOPMENTS AND MEDIUM-TERM STRATEGY AND TARGETS⁴

In 2019, the government surplus declined to 0.5% of GDP from 1.9% a year earlier. The favourable economic environment translated into strong growth in income taxes and social contributions. Nevertheless, higher outlays on intermediate consumption, wages and capital outpaced increases in revenues. The headline balance fell short of the targets of 1.4% of GDP and 0.9% of GDP presented in the 2019 Stability Programme and 2020 Draft Budgetary Plan, respectively. Compared to the 2020 Budgetary Plan, VAT receipts, income taxes and capital transfers turned out lower than expected and were only partly outweighed by stronger-than-expected sales receipts. Expenditure turned out lower than planned due to lower investment outlays.

The Programme projects a major worsening of public finances in 2020 with the deficit reaching 7.5% of GDP amid the COVID-19 pandemic, including the impact of automatic stabilisers. The fiscal package to tackle the negative impact of the pandemic is estimated to amount to 4.1% of GDP (see Section 3.2). Those measures together with negative GDP developments imply a sizeable increase in the expenditure-to-GDP ratio. At the same time, tax developments are projected to reflect

⁴ In light of the activation of the general escape clause, the measures taken in response to the coronavirus outbreak in 2020 are not treated as one-off and are thus not excluded from the estimation of the structural budget balance.

the decline in the tax base. In 2021, the deficit is projected to decline to 3.6% of GDP, based on the expected economic recovery and the ending of the COVID-19 related expenditure measures.

Table 2: General government budgetary position

(% of GDP)	2019	2020		2021		2022	2023	Change: 2019-2023
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	38.2	39.8	39.2	38.9	38.8	n.a.	n.a.	n.a.
<i>of which:</i>								
- Taxes on production and imports	12.1	12.2	11.5	12.2	11.8	n.a.	n.a.	n.a.
- Current taxes on income, wealth, etc.	13.8	14.8	14.3	14.3	14.3	n.a.	n.a.	n.a.
- Social contributions	6.1	6.4	6.3	6.2	6.1	n.a.	n.a.	n.a.
- Other (residual)	6.2	6.5	7.1	6.2	6.6	n.a.	n.a.	n.a.
Expenditure	37.7	46.5	46.7	41.5	42.4	n.a.	n.a.	n.a.
<i>of which:</i>								
- Primary expenditure	36.3	45.0	45.3	40.0	41.0	n.a.	n.a.	n.a.
<i>of which:</i>								
Compensation of employees+Intermediate consumption	18.7	21.9	22.0	20.6	21.0	n.a.	n.a.	n.a.
Compensation of employees	11.2	12.4	12.4	12.2	12.0	n.a.	n.a.	n.a.
Intermediate consumption	7.5	9.6	9.5	8.4	9.0	n.a.	n.a.	n.a.
Social payments	9.4	10.7	10.8	10.1	10.3	n.a.	n.a.	n.a.
Subsidies	1.5	4.2	3.9	1.6	1.5	n.a.	n.a.	n.a.
Gross fixed capital formation	3.8	4.7	5.3	4.4	4.9	n.a.	n.a.	n.a.
Other (residual)	2.9	3.4	3.3	3.3	3.3	n.a.	n.a.	n.a.
- Interest expenditure	1.4	1.5	1.4	1.5	1.4	n.a.	n.a.	n.a.
General government balance (GGB)	0.5	-6.7	-7.5	-2.5	-3.6	n.a.	n.a.	n.a.
Primary balance	1.9	-5.2	-6.1	-1.1	-2.2	n.a.	n.a.	n.a.
One-off and other temporary measures	0.0	0.0	0.1	0.0	0.1	n.a.	n.a.	n.a.
GGB excl. one-offs	0.5	-6.7	-7.6	-2.5	-3.7	n.a.	n.a.	n.a.
Output gap ¹	3.8	-5.2	-4.5	-2.5	-3.8	n.a.	n.a.	n.a.
Cyclically-adjusted balance ¹	-1.3	-4.2	-5.5	-1.3	-1.9	n.a.	n.a.	n.a.
Structural balance²	-1.3	-4.2	-5.6	-1.3	-2.0	n.a.	n.a.	n.a.
Structural primary balance ²	0.1	-2.8	-4.2	0.1	-0.6	n.a.	n.a.	n.a.
Gross debt ratio	43.1	50.7	54.5	50.8	55.5	n.a.	n.a.	n.a.

Notes:

¹Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

²Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme (SP); Commission 2020 spring forecasts (COM); Commission calculations.

In the medium term, the Programme plans to put the debt-to-GDP ratio back on a declining path to ensure that it remains below 60% of GDP and to revert to the medium-term objective (MTO) – a balanced budget in structural terms – once the exceptional circumstances cease to prevail. The MTO is more stringent than required by the Stability and Growth Pact.

The general government debt ratio declined further in 2019 to just above 43% of GDP mainly on account of a continuing primary surplus and accelerating nominal GDP. The stock-flow adjustment of almost 1% of GDP driven mainly by proceeds from the Individual Investor Programme prevented an even stronger fall in the debt ratio. The 2020 Stability Programme projects a hike in the debt-to-GDP ratio to 55.5% by 2021 mainly on account of ongoing headline deficits and persisting debt-increasing stock-flow adjustments underpinned by ongoing projected revenue from the Individual Investor Programme.

3.2. MEASURES UNDERPINNING THE PROGRAMME

The Maltese government adopted a broad range of measures to mitigate the negative impacts of the COVID-19 pandemic on the society and economy. Most importantly, funding for the health authorities was increased to support additional healthcare capacity. The government provides financial assistance to enterprises, the self-employed and employees. Wage supplements focus on saving jobs affected by the pandemic. Tax deferrals, loan guarantees and a subsidy on the interest rate on working capital loans obtained from local banks should alleviate liquidity constraints faced by enterprises in the current situation. On the social support side, measures include special unemployment and parent benefits, support for persons with disabilities and higher rent subsidies for individuals who have their job terminated due to COVID-19. The Programme estimates the size of the measures with a direct budgetary impact at 4.1% of GDP. The government allocated some 2.8% of GDP to guarantee company loans. The Programme does not quantify the size of tax deferrals.

By the end of April, the total number of applications for support reached nearly 19,000, covering 87,808 employees or about 45% of employees working in the private sector. In addition, thanks to the parental, disability or medical benefit 5,619 jobs were secured. These measures hence may have safeguarded around 93,000 jobs – some 49% of private-sector jobs. The initial two-month duration of these measures was extended for additional two months until the end of June. Overall, the measures taken by Malta are in line with the guidelines set out in the Commission Communication on a coordinated economic response to the COVID-19 outbreak.⁵ The measures appear timely, temporary and targeted at cushioning the shock induced by COVID-19. The full implementation of those measures, followed by a refocusing of fiscal policies towards achieving prudent medium term fiscal positions when economic conditions allow, will contribute to preserving fiscal sustainability in the medium term.

The Programme also recapitulates the discretionary measures for 2020 announced in the 2020 Draft Budgetary Plan, which assume primarily higher social spending. The net impact is negative amounting to some 0.3% of GDP.

The measures presented in the Programme have been reflected also in the Commission forecast, which assumes comparable fiscal impacts.

⁵ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020DC0112>

Table 3: Discretionary measures adopted/announced in response to COVID-19 outbreak

List of measures	Description	ESA Code (Expenditure / Revenue component)	Adoption Status	Budgetary impact (% of GDP - change from previous year)		
				2020	2021	
1	Economic Support Measures (COVID wage supplement, quarantine leave, support for teleworking activities)	D39 – E	Adopted	-2.35	2.22	
2	Subsidy on interest rates	D39 – E	Adopted	-0.15	0.14	
3	Social measures – Parent benefit, support for disabled, medical benefit, rent subsidy	D6 – E	Adopted	-0.28	0.27	
4	Health expenditure – intermediate consumption	P2 – E	Adopted	-0.54	0.34	
5	Health expenditure – various supplies	D6 – E	Adopted	-0.33	0.21	
6	Health-related capital expenditure	P51 – E	Adopted	-0.16	0.15	
7	COVID-19-related funding of compensations	D1 – E	Adopted	-0.16	0.16	
8	COVID-19-related funding of intermediate consumption	P2 – E	Adopted	-0.11	0.11	
				Total	-4.08	3.6

Source: Stability Programme

Table 4: Guarantees adopted/announced in response to COVID-19 outbreak

List of measures	Description	Adoption Status	Maximum amount of contingent liability* (% of GDP)	
1	Loan guarantees	Adopted		2.75
			Total	2.75

Source: Stability Programme

3.3. RISK ASSESSMENT

The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic. The pandemic could become more severe and last longer than assumed, requiring more stringent and longer lasting containment measures. This would result in worse economic and fiscal outcomes. It could also require further fiscal policy measures. That would result in worse fiscal outcomes but help to mitigate the economic impact.

The negative impact on the revenue may be accentuated by Malta's continued reliance on corporate income taxes (17.4% of total tax revenues in 2018), which tend to be more volatile than other sources of revenue. In addition, although the receipts from the International Investor Programme have surprised on the upside in the past, this may change in the years following the crisis. Finally, the fiscal balance could be

worsened as an additional risk stems from the considerable size of public guarantees issued in response to the crisis.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

4.1. COMPLIANCE WITH THE DEFICIT CRITERION

According to the Stability Programme, Malta's general government deficit in 2020 is expected to reach 7.5% of GDP, thereby exceeding the Treaty reference value of 3% of GDP. This provides *prima facie* evidence of the existence of an excessive deficit in Malta for purposes of the Treaty and the Stability and Growth Pact. The Commission has therefore prepared a report under Article 126(3) TFEU, which analyses Country's compliance with the deficit criterion of the Treaty. Overall, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.

4.2. COMPLIANCE WITH THE MTO OR THE REQUIRED ADJUSTMENT PATH TOWARDS THE MTO IN 2019⁶

In the Commission 2019 autumn forecast, Malta was expected to respect the MTO for 2019 set as a balanced budget in structural terms. Based on outturn data and the Commission forecast, the structural balance slid into a deficit of 1.3% in 2019, mainly due to a lower than expected headline surplus as well as a downward revision of potential GDP that results in a more positive output gap in the current forecast.

The growth of net public expenditure exceeded the rate allowed under the expenditure benchmark pillar. This led to a deviation of 0.1% of GDP in the underlying fiscal position, thus pointing to some deviation from the requirements of the Stability and Growth Pact in 2019. The structural balance was allowed to deteriorate in 2019 given Malta's projected overachievement of its MTO. However, the structural balance worsened by 1.3% of GDP, i.e. beyond the allowed structural deterioration of 0.9% of GDP, which points to some deviation. A somewhat larger deviation for the structural balance relative to the expenditure benchmark is driven by a difference in potential growth and the impact of investment smoothing. Over 2018 and 2019 taken together both pillars suggests compliance.

Based on the outturn data and the Commission forecast, the ex-post assessment suggests some deviation from the requirements of the Stability and Growth Pact in 2019.

⁶ The possible retroactive impact on output gap estimates as a result of the recession induced by the COVID-19 outbreak and the possibility of abnormal responses of government revenues to major swings in economic activity underline that compared to the structural balance the expenditure benchmark is likely to provide a more reliable and predictable indicator in times of severe economic downturn.

Table 5: Compliance with the requirements under the preventive arm

	(% of GDP)	2019	2020	2021
Background budgetary indicators¹				
(1)	Medium-term objective (MTO)	0.0	0.0	0.0
(2)	Structural balance ² (COM)	-1.3	-4.2	-1.3
Setting the required adjustment to the MTO				
(3)	Structural balance based on freezing (COM)	0.6		
(4) = (1) - (3)	Position vis-a-vis the MTO ³	At or above the MTO		
(5)	Required adjustment ⁴	0.0		
(6)	Required adjustment corrected ⁵	-0.9		
(8)	Corresponding expenditure benchmark ⁶	10.1		
Compliance with the required adjustment to the MTO				
		COM	COM	SP
Structural balance pillar				
(8) = Δ (2)	Change in structural balance ⁷	-1.3		
(9) = (8) - (6)	One-year deviation from the required adjustment ⁸	-0.5		
	Two-year average deviation from the required adjustment ⁸	0.5		
Expenditure benchmark pillar				
(10)	Net public expenditure annual growth corrected for one-offs ⁹	10.4		
(11) = (10) - (8)	One-year deviation adjusted for one-offs ¹⁰	-0.1		
	Two-year deviation adjusted for one-offs ¹⁰	0.0		
Finding of the overall assessment		Some deviation		

Legend

'Compliance' - the recommended structural adjustment or a higher adjustment is being observed.

'Some deviation' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'Significant deviation' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).



Notes

¹ The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

² Structural balance = cyclically-adjusted government balance excluding one-off measures.

³ Based on the relevant structural balance at year t-1.

⁴ Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

⁵ Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

⁶ Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

⁷ Change in the structural balance compared to year t-1. Ex post assessment (for 20XX-1) is carried out on the basis of Commission 20XX spring forecast.

⁸ The difference of the change in the structural balance and the corrected required adjustment.

⁹ Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

¹⁰ Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source:

Stability Programme (SP); Commission 2020 spring forecast (COM); Commission calculations.