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## **Assessment of the 2019 Stability Programme for**

### **Malta**

*(Note prepared by DG ECFIN staff)*

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## **EXECUTIVE SUMMARY**

Malta is subject to the preventive arm of the Stability and Growth Pact. With gross public debt below 60% of GDP, Malta is compliant with the debt criterion.

The Maltese economy performed remarkably well in 2018, with real GDP growth reaching 6.6%, mainly driven by record-high private consumption growth. According to the Commission 2019 spring forecast, the economic expansion is expected to continue with the support of buoyant domestic demand, but the brisk pace of growth will ease slightly. Employment growth is expected to moderate, while the unemployment rate is projected to remain below 4%. The inflow of foreign workers helps to contain wage growth. The macro-economic scenario included in the Stability Programme is plausible.

In 2018, the general government budget balance reached a surplus of 2% of GDP. Economic growth translated into a strong increase in consumption tax revenue but also revenue from income taxes and social contributions, mirroring favourable economic conditions. The Stability Programme projects a decline in the fiscal surplus to 0.9% of GDP in 2019, after which the headline balance should reach 1% of GDP in 2020 and 1.1% of GDP in 2021 and 2022. The structural balance reached 1.4% of GDP in 2018 and is projected to worsen in 2019 before improving again in 2020. Risks to the fiscal outlook appear to be balanced, as the projection of tax revenues may be somewhat conservative while some expenditure items may be underestimated. In the long term, Malta faces medium term risks with respect to sustainability of its public finances.

Overall, Malta is expected to continue respecting the MTO in 2019 and 2020. Nevertheless, expenditure developments should be monitored carefully in the short and the medium term, especially in light of possible future risks to the robustness of revenues, to safeguard compliance in line with the SGP.

## **1. INTRODUCTION**

On 30 April 2019, Malta submitted its 2019 Stability Programme (hereafter called Stability Programme), covering the period 2019-2022.

Malta is currently subject to the preventive arm of the the Stability and Growth Pact (SGP) and should preserve a sound fiscal position which ensures compliance with the medium-term budgetary objective (MTO).

This document complements the Country Report published on 27 February and updates it with the information included in the Stability Programme

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2019 spring forecast (hereafter called Commission forecast). Section 3 presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium-term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on the Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

## **2. MACROECONOMIC DEVELOPMENTS**

The Maltese economy performed remarkably well in 2018 with real GDP growth reaching 6.6%, only slightly below the growth rate achieved in 2017. Economic growth was mainly driven by record-high private consumption growth benefiting from robust labour market developments. Investment contracted yet another year. Net exports made a positive contribution to GDP growth.

According to the Stability Programme, economic growth is expected to remain high at 6.2% in 2019 before slowing to 5.7% in 2020. While domestic demand would be the most important growth driver in both years, its role would diminish in 2020 as the contribution from net exports is expected to turn positive again. Private consumption is set to decelerate in line with slowing employment growth. Investment is projected to grow close to 14% in 2019 as several large-scale investment projects in the transport and aviation, tourism, information technology, telecommunications, real-estate and healthcare sectors are expected to materialise. The lower growth in investment in 2020 reflects a base effect arising from strong investment in the previous year, including due to the expected acceleration of EU financed projects.

The macroeconomic scenario in the Stability Programme is more optimistic compared to both the 2018 Stability Programme and the 2019 Draft Budgetary Plan (hereafter DBP), reflecting the better-than-expected growth in 2018. Higher real GDP growth in 2019 and 2020 is projected mainly due to a more dynamic assumption on private consumption and investment.

The real GDP growth projection for both 2019 and 2020 are broadly in line with the Commission forecast, although the growth rates presented in the Stability Programme are higher and there are some differences with regard to the composition of real GDP growth. In particular, the Stability Programme expects a stronger recovery in investment activity in 2019 and a faster growth of private consumption given a somewhat more favourable outlook for the labour market. In 2020, the Stability Programme assumes a faster pick-up in exports leading to a higher contribution of net exports while household consumption and investment activity

are projected to be more subdued compared to the Commission forecast. The growth composition in the Stability Programme appears to be somewhat more favourable for direct taxes as the growth of wages and employment is projected to be higher than in the Commission forecast.

Based on the information in the Programme, the positive output gap as recalculated by Commission, following the commonly agreed methodology, is estimated to close gradually by 2022, although it would turn marginally negative in 2021. The Commission forecast points to a similar dynamics in cyclical developments although the positive output gap is projected to be somewhat higher with the discrepancy decreasing over time.

Overall, the macroeconomic assumptions underpinning the Stability Programme appear to be plausible.

**Table 1: Comparison of macroeconomic developments and forecasts**

	2018		2019		2020		2021	2022
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	6.6	6.6	5.5	6.2	4.8	5.7	5.1	5.0
Private consumption (% change)	7.3	7.3	5.0	5.8	4.1	3.9	3.4	3.3
Gross fixed capital formation (% change)	-3.7	-3.7	10.1	13.7	7.8	5.4	5.7	3.1
Exports of goods and services (% change)	2.1	2.1	2.4	2.4	2.8	4.2	3.6	3.5
Imports of goods and services (% change)	1.3	1.3	3.2	3.4	3.0	3.1	2.5	2.0
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	4.3	4.3	6.0	7.0	4.4	3.7	3.1	2.6
- Change in inventories	0.9	0.9	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	1.4	1.4	-0.5	-0.8	0.3	2.1	2.0	2.4
Output gap <sup>1</sup>	1.3	0.8	1.1	0.7	0.3	0.1	-0.1	0.0
Employment (% change)	5.6	5.6	4.0	4.6	3.4	4.3	4.1	3.8
Unemployment rate (%)	3.7	3.7	3.8	3.8	3.9	3.9	4.0	4.0
Labour productivity (% change)	0.9	1.4	1.4	1.4	1.3	1.6	1.0	1.1
HICP inflation (%)	1.7	1.7	1.8	1.9	1.9	2.0	1.8	1.8
GDP deflator (% change)	2.2	2.1	2.3	2.9	2.2	2.4	2.2	2.0
Comp. of employees (per head, % change)	1.6	2.9	2.4	3.3	2.5	3.2	3.2	3.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	11.7	11.7	10.8	10.9	10.5	14.0	16.2	19.1

Note:

<sup>1</sup>In % 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 2019 spring forecast (COM); Stability Programme (SP).

### 3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

#### 3.1. DEFICIT DEVELOPMENTS IN 2018 AND 2019

In 2018, the headline government surplus reached 2% of GDP, well above the target of 1.1% of GDP presented in both the 2018 Stability Programme and the 2019 DBP. Compared to the 2019 DBP target, the shortfall in income taxes was more than compensated by a slower than expected growth in social payments. Assessing the 2018 outturn vis-à-vis 2017, buoyant

household consumption, coupled with a hike in tourism, translated into a strong increase in consumption tax revenue, in particular VAT. Social contributions grew in line with nominal GDP. A more efficient administrative process of refunds reduced receipts from the corporate income tax, despite an overall increase in gross receipts, and led to a decline in the ratio of income taxes to GDP. A hike in received capital transfers reflected an improved utilisation of EU funds. Spending, which outpaced revenue growth and rose compared to the previous year, was driven primarily by capital expenditure. Gross fixed capital formation together with capital transfers increased by 1.2 percentage points of GDP, financed both from EU and national means. Investment was mainly directed to roads, waste management, health and education. A hike in capital transfers was largely due to a transfer to Air Malta. The current spending increased mainly on account of accelerating intermediate consumption. Social spending, on the other hand, grew slower than nominal GDP despite a number of implemented measures to address adequacy of pensions. The growth of the public wage bill was in line with nominal GDP.

For 2019, the Stability Programme targets a surplus of 0.9% of GDP, which is in line with the 2018 Stability Programme, but below the target of 1.3% of GDP presented in the 2019 DBP. The upward revision of nominal GDP in the Stability Programme impacts the GDP ratios, which are projected to decline compared to the 2019 DBP. Removing the denominator effect, both revenue and expenditure are set to increase with the latter growing at a swifter pace. On the revenue side, the downward revision of income taxes is more than compensated by a higher than expected intake of taxes on production and imports and other non-tax revenue. On the expenditure side, the expected increase in compensation of employees is compensated by lower social spending. The projected increase of government outlays compared to the 2019 DBP is thus mainly due to the intermediate consumption and planned acceleration in investment.

The Stability Programme is broadly in line with the Commission forecast although the latter projects a slightly higher surplus of 1.1% of GDP. The main driver of the difference appears to be an assumption on the drawdown on EU funds. The Stability Programme projects higher investment which is expected to be largely financed by EU resources.

### **3.2. MEDIUM-TERM STRATEGY AND TARGETS**

In nominal terms, the budget balance is targeted to reach 0.9% of GDP in 2019 and to remain close to 1.0% of GDP over the medium-term. More precisely, the headline surplus is projected to reach 1% of GDP in 2020 and increase marginally to 1.1% of GDP in 2021 and 2022. While the fiscal target for 2020 is slightly more ambitious compared to the 2018 Stability Programme surplus of 0.9% of GDP, it is less demanding in 2021 where it had been originally set at 1.6% of GDP. The Stability Programme also commits to continue ensuring compliance with the MTO – a balanced budgetary position in structural terms – over the programme horizon. The MTO is more stringent than required by the Pact.

The main goal of the Stability Programme is to assure a structural budget surplus net of the Individual Investors Programme (IIP) over the period 2020-2022. Based on the information in the Stability Programme, the recalculated structural balance<sup>1</sup> is projected to deteriorate by 0.8 percentage points to 0.6% of GDP in 2019. In the subsequent years the structural balance is

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<sup>1</sup> Recalculated by the Commission on the basis of the information in the programme according to the commonly agreed methodology.

expected to improve to 0.9% of GDP in 2020 and further to 1.1% of GDP in 2021 as the positive output gap closes. Discounting the IIP proceeds of 1.5% of GDP in 2018, the structural balance would be negative in that year. The IIP revenue is projected to decline to 0.9% of GDP in 2019 and further to 0.7% of GDP in 2020. Thus, net of the IIP receipts the structural balance would remain negative in 2019 and turn positive as from 2020. The differences between structural balances presented in the Stability Programme and recalculated structural balances are relatively small (0.1 percentage point in 2019 and 0.2 percentage points in 2020).

In 2020, revenue and expenditure growth is expected to lag behind that of nominal GDP. Due to this denominator effect, the projected revenue and expenditure ratios are set to decline. The revenue ratio is expected to decrease by 1.4 percentage points to 36.7 mainly due to an unexplained drop in 'other revenues'. The decline in the expenditure-to-GDP ratio is broad-based with small downward adjustments in several components including compensation of employees, intermediate consumption and social spending. While the aforementioned outlays still grow in nominal terms, investment is projected to decline also in level terms. The Commission forecast projects a slightly worse surplus outcome at 0.9% of GDP. Non-tax revenue is assumed to decline faster under the Commission forecast. However, unlike the Stability Programme, the Commission forecast assumes that the growth of taxes will be more aligned with that of GDP, leading to a higher expected revenue while overall, compared to the Stability Programme, the revenue is projected to fall less as a share of GDP. The Commission forecast assumes a close link with GDP also for expenditure, expecting a constant ratio to GDP. This leads to a projected higher spending on most of the items including wages, social payments and investment.

Looking at the entire programme horizon, both the revenue and expenditure ratios are projected to decrease further in terms of GDP. The decline of the tax revenue ratio over the programme period appears to be a result of the prudent elasticity assumptions and slower projected growth of tax bases compared to nominal GDP, in particular for indirect taxes. The decline in the expenditure ratio to GDP is driven mainly by developments in intermediate consumption, compensation of employees and social payments. After peaking in 2019 at 3.9% of GDP, the investment ratio is projected to decline to 3.2% of GDP by the end of the programme horizon.

Fiscal measures are quantified for 2019 in line with the 2019 DBP. On the revenue side, they include the IIP, the introduction of the VAT directive on electronic commerce, incentives for private pension savings and an additional impact from change in the income tax thresholds for low income earners. On the expenditure side, the measures generally increase government outlays and include in particular re-distribution measures, support for school transport and additional financing of projects from the National Development and Social Fund (see Section 3.3). No new additional measures are presented for 2020 and beyond.

**Table 2: Composition of the budgetary adjustment**

(% of GDP)	2018	2019		2020		2021	2022	Change: 2018-2022
	COM	COM	SP	COM	SP	SP	SP	SP
<b>Revenue</b>	<b>38.8</b>	<b>38.2</b>	<b>38.1</b>	<b>38.0</b>	<b>36.7</b>	<b>35.7</b>	<b>35.2</b>	<b>-3.7</b>
<i>of which:</i>								
- Taxes on production and imports	12.9	12.9	12.4	13.0	12.1	11.7	11.5	-1.4
- Current taxes on income, wealth, etc.	13.4	14.0	13.3	14.1	13.3	13.2	13.1	-0.3
- Social contributions	6.2	6.1	6.1	6.1	6.0	6.0	5.9	-0.3
- Other (residual)	6.3	5.2	6.3	4.8	5.4	4.8	4.7	-1.6
<b>Expenditure</b>	<b>36.8</b>	<b>37.1</b>	<b>37.2</b>	<b>37.1</b>	<b>35.7</b>	<b>34.7</b>	<b>34.1</b>	<b>-2.7</b>
<i>of which:</i>								
- Primary expenditure	35.3	35.7	35.8	35.8	34.5	33.5	33.0	-2.3
<i>of which:</i>								
Compensation of employees	11.2	11.1	11.1	11.1	10.8	10.7	10.5	-0.7
Intermediate consumption	6.8	6.8	7.0	6.8	6.8	6.6	6.4	-0.4
Social payments	9.5	9.7	9.5	9.7	9.1	8.9	8.7	-0.8
Subsidies	1.3	1.3	1.2	1.3	1.2	1.1	1.1	-0.2
Gross fixed capital formation	3.0	3.5	3.9	3.5	3.3	3.1	3.2	0.2
Other (residual)	3.5	3.2	3.2	3.3	3.2	3.1	3.1	-0.4
- Interest expenditure	1.5	1.4	1.4	1.3	1.2	1.2	1.1	-0.4
<b>General government balance (GGB)</b>	<b>2.0</b>	<b>1.1</b>	<b>0.9</b>	<b>0.9</b>	<b>1.0</b>	<b>1.1</b>	<b>1.1</b>	<b>-0.9</b>
<b>Primary balance</b>	<b>3.6</b>	<b>2.5</b>	<b>2.3</b>	<b>2.2</b>	<b>2.2</b>	<b>2.2</b>	<b>2.2</b>	<b>-1.4</b>
One-off and other temporary	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
<b>GGB excl. one-offs</b>	<b>2.0</b>	<b>1.1</b>	<b>0.9</b>	<b>0.9</b>	<b>1.0</b>	<b>1.0</b>	<b>1.1</b>	<b>-0.8</b>
Output gap <sup>1</sup>	1.3	1.1	0.7	0.3	0.1	-0.1	0.0	-0.9
Cyclically-adjusted balance <sup>1</sup>	1.4	0.6	0.6	0.7	0.9	1.1	1.1	-0.5
<b>Structural balance<sup>2</sup></b>	<b>1.4</b>	<b>0.6</b>	<b>0.6</b>	<b>0.7</b>	<b>0.9</b>	<b>1.1</b>	<b>1.1</b>	<b>-0.5</b>
Structural primary balance <sup>2</sup>	2.9	2.0	1.9	2.0	2.2	2.3	2.2	-0.9

Notes:

<sup>1</sup>Output 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.

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

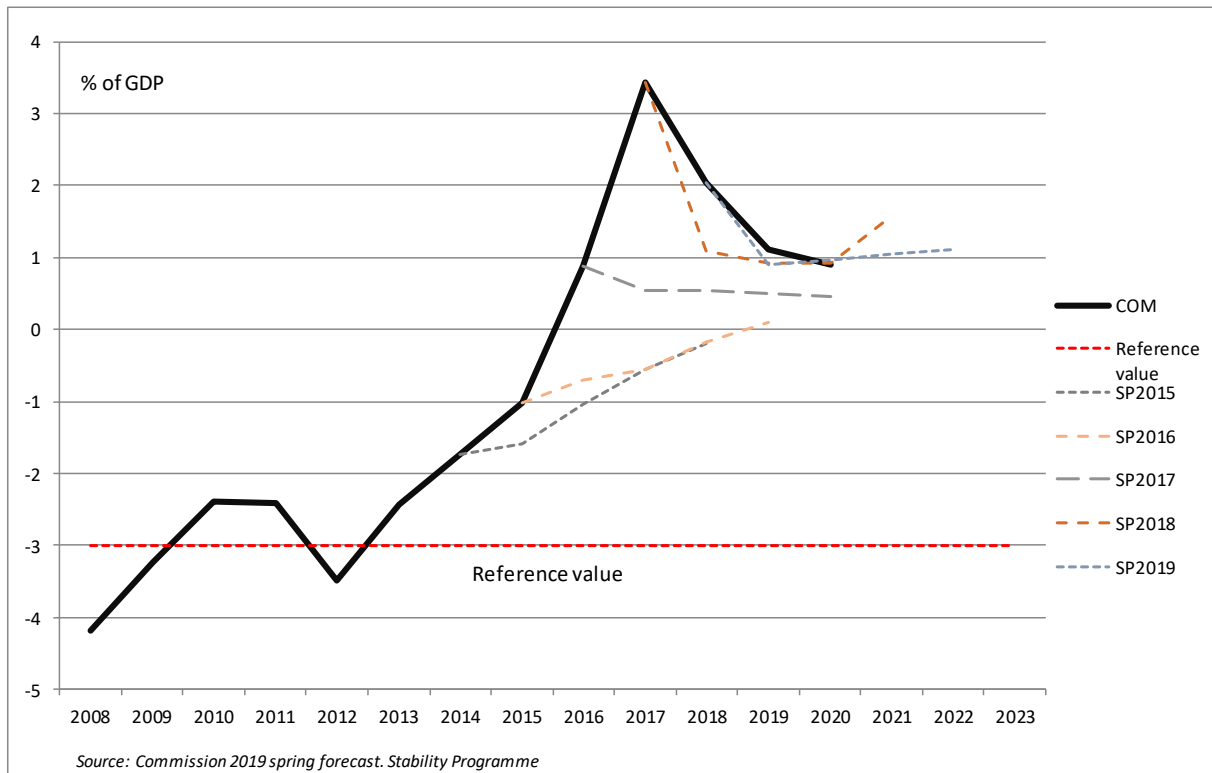
Source:

Stability Programme (SP); Commission 2019 spring forecasts (COM); Commission calculations.

In the past, the general government balance has been underestimated. A prudent forecasting of revenues by the Maltese authorities appears to have been an important element. This is both true for the estimation of the budgetary impacts of revenue measures (in particular the IIP) and the projection of tax revenue measures by applying prudent revenue elasticities. Positive surprises in economic developments, which also tended to be more tax-rich, were an additional element that boosted tax revenue. According to the Stability Programme, the fiscal surplus is expected to reach a slightly higher level compared to the previous programme for 2020, while it is expected to be lower in 2021 (Figure 1).



**Figure 1: Government balance projections in successive programmes (% of GDP)**



### 3.3. MEASURES UNDERPINNING THE PROGRAMME

For 2019, the measures underpinning the Stability Programme are in line with those presented in the 2019 budget, which was submitted to the Parliament on 22 October 2018. On the revenue side, a negative impact on revenue is expected from the implementation of the VAT directive on electronic commerce<sup>2</sup>, provision of incentives for contributions to private pensions and revision in the income tax bands for lower income earners. After peaking in 2017, the revenue from the IIP is projected to continue declining in 2019. The extension of the reduced rate of stamp duty on documents for first time and second time buyers, for the acquisition of a property in Gozo as well as for people with disabilities is expected to have a neutral impact vis-à-vis 2018.

On the expenditure side, measures include redistribution policies to improve housing affordability and pension adequacy (e.g. increasing pensions, while extending the possibility to continue working beyond the statutory retirement age also to public sector employees). They are complemented by policies regarding the integration of vulnerable individuals in society (e.g. an increase in the rate of children's allowance so that beneficiaries earning the new increased minimum wage and low income families remain eligible to the maximum rate; an increase in allowances for disability and children; the introduction of unemployment benefits for self-employed individuals). Additional spending is dedicated to the extension of the school transport network to children in independent and church schools. The expenditure will be also impacted by expenditure measures legislated in previous budgets which are primarily financed from the National Development and Social Fund. Overall, the

<sup>2</sup> Based on this directive, VAT from electronic services (e.g. e-gaming) is to be paid to the country where the customer is a resident.

discretionary measures introduced in the 2019 budget and those from previous budgets and still having an impact are estimated to have an overall negative impact on the fiscal surplus in 2019 of some 0.9% of GDP.

The Stability Programme does not include any additional discretionary measure for 2020 and beyond. The fiscal balance will hence be positively impacted by the reversal of reduced stamp duties on documents for the transfer of immovable property in 2020. The revenue from the IIP is set to decline further in 2020, but stabilise afterwards. The planned financing of projects from the National Development and Social Fund is expected to continue increasing over the programme horizon.

Measures presented in the Stability Programme are also included in the Commission forecast. No one-offs are planned in 2019 or the coming years.

### Main budgetary measures included in the Programme

Revenue	Expenditure
<b>2018</b>	
<ul style="list-style-type: none"> <li>• Individual Investor Programme (-0.4% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Impact of 2006 pension reform initiatives (-0.1% of GDP)</li> <li>• Re-distribution measures (0.1% of GDP)</li> <li>• Tax relief measure (0.1% of GDP)</li> <li>• Use of the National Development Social Fund (NDSF) (0.1% of GDP)</li> </ul>
<b>2019</b>	
<ul style="list-style-type: none"> <li>• Individual Investor Programme (-0.5% of GDP)</li> <li>• VAT directive on electronic commerce (-0.1% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Re-distribution measures (0.1% of GDP)</li> <li>• Extension of the school transport network (0.1% of GDP)</li> <li>• Use of the NDSF (0.1% of GDP)</li> </ul>
<b>2020</b>	
<ul style="list-style-type: none"> <li>• Individual Investor Programme (-0.1% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Use of the NDSF (0.1% of GDP)</li> </ul>
<b>2021</b>	
	<ul style="list-style-type: none"> <li>• Use of the NDSF (0.2% of GDP)</li> </ul>
<b>2022</b>	
	<ul style="list-style-type: none"> <li>• Use of the NDSF (0.1% of GDP)</li> </ul>
<p><u>Note:</u> The table refers to the main measures included in the 2019 Stability Programme that have an incremental budgetary impact over the programme period. The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.</p>	

### 3.4. DEBT DEVELOPMENTS

The general government debt declined to 46.0% of GDP in 2018 from 50.2% of GDP a year earlier. A relatively high debt-increasing stock-flow adjustment of almost 2% of GDP (related among others to the IIP revenues and equity acquisition in Malta Air Travel Limited and Air Malta Aviation Services Limited) was overcompensated by favourable primary balance developments and an accelerating nominal GDP. The 2018 debt outcome was slightly above the projections presented in the 2018 Stability Programme, but below the 2019 DBP (Figure 2). The better-than-expected outcome vis-à-vis the 2019 DBP was due both to a better primary balance and a positive surprise in nominal GDP growth.

**Table 3: Debt developments**

(% of GDP)	Average 2013-2017	2018	2019		2020		2021	2022
			COM	SP	COM	SP	SP	SP
<b>Gross debt ratio<sup>1</sup></b>	<b>59.1</b>	<b>46.0</b>	<b>42.8</b>	<b>42.7</b>	<b>40.2</b>	<b>39.4</b>	<b>36.2</b>	<b>33.2</b>
Change in the ratio	-3.5	-4.2	-3.2	-3.2	-2.7	-3.4	-3.2	-3.0
<i>Contributions<sup>2</sup>:</i>								
<b>1. Primary balance</b>	<b>-2.2</b>	<b>-3.6</b>	<b>-2.5</b>	<b>-2.3</b>	<b>-2.2</b>	<b>-2.2</b>	<b>-2.2</b>	<b>-2.2</b>
<b>2. “Snow-ball” effect</b>	<b>-3.0</b>	<b>-2.5</b>	<b>-1.9</b>	<b>-2.5</b>	<b>-1.5</b>	<b>-2.0</b>	<b>-1.5</b>	<b>-1.3</b>
<i>Of which:</i>								
Interest expenditure	2.4	1.5	1.4	1.4	1.3	1.2	1.2	1.1
Growth effect	-4.1	-3.0	-2.3	-2.6	-1.9	-2.2	-1.9	-1.7
Inflation effect	-1.2	-1.0	-1.0	-1.2	-0.9	-1.0	-0.8	-0.7
<b>3. Stock-flow adjustment</b>	<b>1.8</b>	<b>1.9</b>	<b>1.3</b>	<b>1.6</b>	<b>1.1</b>	<b>0.9</b>	<b>0.6</b>	<b>0.5</b>
<i>Of which:</i>								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

<sup>1</sup> End of period.

<sup>2</sup> The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

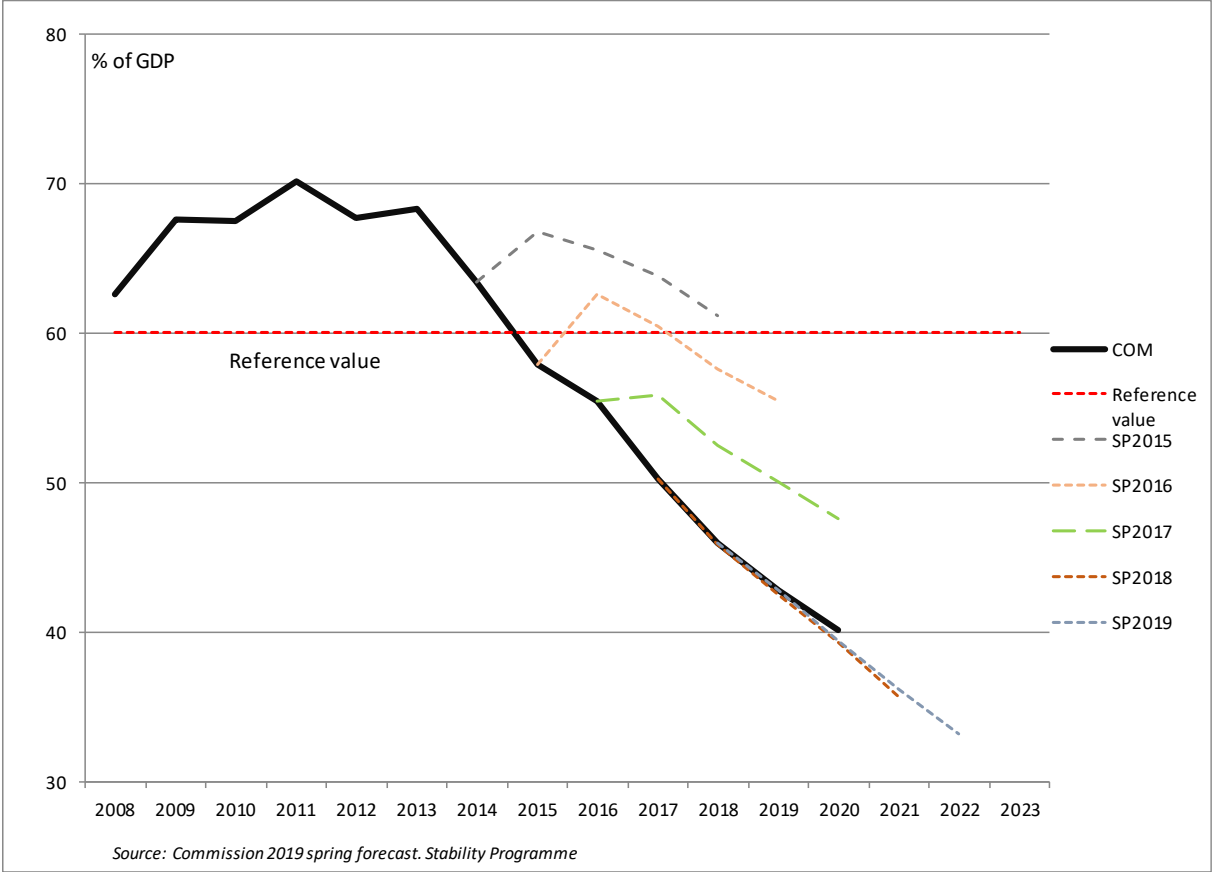
Commission 2019 spring forecast (COM); Stability Programme (SP), Commission calculations.

In 2019, the Stability Programme projects the debt-to-GDP ratio to decline to 42.7% of GDP, which is lower compared to the 2019 DBP and in line with the Commission forecast. The more pronounced decline in the debt-to-GDP ratio mirrors an assumption of an accelerating nominal GDP growth. In the subsequent years, the Stability Programme projects the debt-to-GDP ratio to remain on a downward path decreasing by more than 3 percentage points annually to 33.2% of GDP in 2022. The reduction would be driven by primary surpluses and strong growth of the nominal GDP. In addition, the debt-increasing impact of stock-flow adjustment is expected to weaken over the programme horizon as the impact of the IIP revenues wears off. The Commission forecast projects a somewhat slower reduction in the

debt-to-GDP ratio in 2020, mainly due to a less upbeat assumption on GDP growth and a somewhat higher assumption on stock-flow adjustment.

The Stability Programme projects a continuing decline in government guarantees provided on debt of non-government units from 9.5% of GDP in 2017 to 6.4% of GDP in 2022.

**Figure 2: Government debt projections in successive programmes (% of GDP)**



**3.5. RISK ASSESSMENT**

Overall, risks related to the fiscal targets seem balanced. On the revenue side, the outcome could turn out better than expected on two main accounts. First, the IIP revenues are difficult to forecast and in the past they have surprised on the upside compared to original plans. Second, while the Stability Programme presents a more optimistic macroeconomic scenario compared to the Commission forecast, the tax elasticities used for tax revenue projections appear to be rather conservative. A cautious forecast of tax revenues hence may present an upside risk.

On the expenditure side, the investment plans in 2019 seem quite ambitious and hence spending could turn out lower than planned. Nevertheless, in 2020, risks appear to be tilted to the negative side mainly on account of a rather slow growth in social spending assumed in the Stability Programme which, in combination with a fast growth of nominal GDP, leads to a significant drop in the share of social spending on GDP.

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

Malta is subject to the preventive arm of the Stability and Growth Pact and should ensure compliance with its MTO. Under the European Semester in July 2018 the Council considered that Malta complied with the Stability and Growth Pact.

**Table 4: Compliance with the requirements under the preventive arm**

(% of GDP)	2018	2019	2020
<b>Background budgetary indicators<sup>1</sup></b>			
Medium-term budgetary objective (MTO)	0.0	0.0	0.0
Structural balance <sup>2</sup> (COM)	1.4	0.6	0.7
<b>Setting the required adjustment to the MTO</b>			
Structural balance based on freezing (COM)	0.9	0.6	-
Position vis-à-vis the MTO <sup>3</sup>	At or above the MTO	At or above the MTO	At or above the MTO
Required adjustment <sup>4</sup>	0.0	0.0	0.0
Required adjustment corrected <sup>5</sup>	-3.1	-0.9	-0.6
Corresponding expenditure benchmark <sup>6</sup>	15.5	10.1	9.8
<b>Compliance with the required adjustment to the MTO</b>			
	COM	SP	COM
<b>Structural balance pillar</b>			
Change in structural balance <sup>7</sup>	<b>Compliance</b>		
One-year deviation from the required adjustment <sup>8</sup>			
Two-year average deviation from the required adjustment <sup>8</sup>			
<b>Expenditure benchmark pillar</b>			
Net public expenditure annual growth corrected for one-offs <sup>9</sup>	<b>Compliance</b>		
One-year deviation adjusted for one-offs <sup>10</sup>			
Two-year deviation adjusted for one-offs <sup>10</sup>			
<b>Finding of the overall assessment</b>			
<b>Compliance</b>			
<b>Legend</b>			
'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).			
<b>Notes</b>			
<sup>1</sup> 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 point is allowed in order to be evaluated as having reached the MTO.			
<sup>2</sup> Structural balance = cyclically-adjusted government balance excluding one-off measures.			
<sup>3</sup> Based on the relevant structural balance at year t-1.			
<sup>4</sup> Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mœcum on the Stability and Growth Pact, 2018 edition, p.38.). In case of a SDP, the requirement corresponds to the Council recommendation when available; otherwise it refers to the Commission recommendation to the Council.			
<sup>5</sup> Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.			
<sup>6</sup> 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.			
<sup>7</sup> Change in the structural balance compared to year t-1. Ex post assessment (for 2018) is carried out on the basis of Commission 2019 spring forecast.			
<sup>8</sup> The difference of the change in the structural balance and the corrected required adjustment.			
<sup>9</sup> Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)			
<sup>10</sup> 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.			
<b>Source:</b> Stability Programme (SP); Commission 2019 spring forecast (COM); Commission calculations.			

The (recalculated) structural balance in the Stability Programme is projected to deteriorate to 0.6% of GDP in 2019 before improving to 0.9% of GDP in 2020. Malta is thus expected to remain above its medium-term objective also in 2019 and 2020, which is confirmed also by the Commission forecast albeit with a somewhat lower structural balance. Based on the information provided in the Stability Programme, the nominal balance is expected to remain in surplus or be balanced even if corrected for the projected IIP revenue. The structural balance adjusted for IIP proceeds, however, would remain negative in 2019, while turning into a small surplus as from in 2020. Given this, expenditure developments should be monitored carefully in the short and the medium term, especially in light of possible future risks to the robustness of revenues, to safeguard fiscal sustainability in line with the SGP.

## **5. DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS**

Malta does not appear to face fiscal sustainability risks in the short run.

Based on the Commission forecasts and a no-fiscal policy change scenario beyond the forecast horizon, government debt, projected at 42.8% of GDP in 2019, is expected to decrease to 16.7% in 2029, thus remaining below the 60% of GDP Treaty threshold. Over this horizon, government debt is highest in 2019. Sensitivity analysis shows similar risks.<sup>3</sup> Overall, the debt sustainability analysis highlights low risks for the country in the medium term. The full implementation of the Stability Programme would put debt on a clearly decreasing path by 2029, remaining below the 60% of GDP reference value in 2029.

The medium-term fiscal sustainability risk indicator S1<sup>4</sup> is at -4.8 percentage points of GDP, primarily related to the favourable initial budgetary position (contributing -3.4 percentage points of GDP) and the low level of government debt (-1.6 percentage points of GDP). This indicator thus signals low risks in the medium term. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at -6.0 percentage points of GDP. Based on the debt sustainability analysis and the S1 indicator, overall medium-term fiscal sustainability risks are, therefore, low. Fully implementing the fiscal plans in the Stability Programme would decrease those risks.

The long-term fiscal sustainability risk indicator S2 is at 3.4 percentage points of GDP. In the long term, Malta therefore appears to face medium fiscal sustainability risks, primarily related to the projected ageing costs contributing 5.0 percentage points of GDP. Full implementation of the programme would nonetheless put the S2 indicator at 3.3 percentage points of GDP, leading to a similar long-term risk.<sup>5</sup> The debt sustainability analysis discussed above points to low risks so that, overall, long-term fiscal sustainability risks are assessed as medium for Malta.

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<sup>3</sup> Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Fiscal Sustainability Report 2018 for more details).

<sup>4</sup> See the note to Table 7 for a definition of the indicator.

<sup>5</sup> The projected costs of ageing that are used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the projections of the 2018 Ageing Report.

**Table 5: Debt sustainability analysis and sustainability indicators**

Time horizon		Commission Scenario		Stability Programme Scenario		
<b>Short-term</b>		<b>LOW risk</b>				
<b>S0 indicator</b> <sup>[1]</sup>		0.1				
Fiscal subindex		0.0	LOW risk			
Financial & competitiveness subindex		0.1	LOW risk			
<b>Medium-term</b>		<b>LOW risk</b>				
<b>DSA</b> <sup>[2]</sup>		LOW risk				
<b>S1 indicator</b> <sup>[3]</sup>		-4.8	LOW risk	-6.0	LOW risk	
of which	Initial Budgetary Position	-3.4		-3.8		
	Debt Requirement	-1.6		-2.6		
	Cost of Ageing	0.3		0.4		
	of which	Pensions	-0.6		-0.4	
		Health care	0.6		0.5	
		Long-term care	0.3		0.2	
		Other	0.0		0.1	
<b>Long-term</b>		<b>MEDIUM risk</b>				
<b>DSA</b> <sup>[2]</sup>		LOW risk				
<b>S2 indicator</b> <sup>[4]</sup>		3.4	MEDIUM risk	3.3	MEDIUM risk	
of which	Initial Budgetary Position	-1.6		-1.9		
	Cost of Ageing	5.0		5.2		
	of which	Pensions	1.9		2.1	
		Health care	1.8		1.7	
		Long-term care	1.0		0.9	
		Other	0.3		0.4	
Source: Commission services; 2019 stability/convergence programme.						
Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2019 forecast until 2020. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.						
[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.						
[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.						
[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2033. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2021 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.						
[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.						
* For more information see Fiscal Sustainability Report 2018.						

## 6. FISCAL FRAMEWORK

Based on the national legislation (Fiscal Responsibility Act, Art 8(2a)) the budgetary position of the general government shall be in balance or in surplus. This requirement is deemed to be met if the annual structural balance of the general government is at the medium-term budgetary objective (Fiscal Responsibility Act, Art 8(3)). When not at the MTO, the legislation requires that the structural balance should converge towards the MTO in

accordance with the 1997 Surveillance and Coordination Regulation (Fiscal Responsibility Act, Art 8(4a)). Based on the information provided in the Stability Programme, both the nominal and the structural balance were in surplus in 2018 and are projected to remain there in 2019 and 2020.

The general government debt rule requires that if the debt ratio exceeds 60% of GDP, the debt ratio is to be reduced in accordance with the 1997 Excessive Deficit Regulation until it reaches 60% of GDP. The general government debt reached 46% of GDP in 2018 and, based on the information provided in the Stability Programme, it is projected to continue declining in 2019 and 2020.

Based on the information provided in the Stability Programme, the past, planned and forecast fiscal performance in Malta appears to comply with the requirements of the applicable national numerical fiscal rules applied to the general government. In its assessment of the 2019 DBP, the Malta Fiscal Advisory Council (MFAC) also concluded ex ante compliance with the fiscal rules.

Malta considers the Stability Programme to be the national medium-term fiscal plan (NMTFP) pursuant to Art. 4(1) of the Two-Pack Regulation 473/2013. The Stability Programme indicates that it constitutes the national medium-term fiscal plan, which implies that Malta complies with the obligation to make public by 30 April its national medium-term fiscal plan as required by Art. 4(1) of Regulation No 473/2013. Member States are also required to include in their national medium-term fiscal plans (or national reform programmes) indications on the expected economic returns on non-defence public investment projects that have a significant budgetary impact. Such assessment is, however, neither part of the Stability Programme nor the National Reform Plan.

### **The macroeconomic forecast underlying the Stability Programme**

The macroeconomic forecast underlying the Stability Programme were prepared by the Ministry of Finance and endorsed by the MFAC in a letter of endorsement published on 30 April 2019 on the website of the MFAC. The MFAC considered that macroeconomic forecasts lie within its endorsable range. A detailed assessment is to be published by the MFAC at a later stage. The MFAC evaluates also the fiscal forecasts presented in the Stability Programme. However, the assessment was not yet available at the time of writing this report.

## **7. SUMMARY**

In 2018, Malta remained above its medium-term objective and recorded both headline and structural budget surpluses.

According to both the information provided in the Stability Programme and the Commission forecast Malta is expected to continue to remain above its medium-term objective in 2019 and 2020. The debt-to-GDP ratio reached 46% in 2018 and, according to the Stability Programme and the Commission 2018 spring forecast, it is projected to decline further. Nevertheless, expenditure developments should be monitored carefully in the short and the medium term, especially in light of possible future risks to the robustness of revenues, to safeguard compliance in line with the SGP.



## 8. ANNEXES

**Table I. Macroeconomic indicators**

	2001-2005	2006-2010	2011-2015	2016	2017	2018	2019	2020
<b>Core indicators</b>								
GDP growth rate	2.1	2.0	5.6	5.7	6.7	6.6	5.5	4.8
Output gap <sup>1</sup>	0.3	-0.1	-0.8	1.5	1.1	1.3	1.1	0.3
HICP (annual % change)	2.5	2.4	1.7	0.9	1.3	1.7	1.8	1.9
Domestic demand (annual % change) <sup>2</sup>	1.4	2.2	3.6	1.2	-1.2	6.5	7.6	5.5
Unemployment rate (% of labour force) <sup>3</sup>	7.3	6.6	6.0	4.7	4.0	3.7	3.8	3.9
Gross fixed capital formation (% of GDP)	20.0	20.7	19.1	23.6	20.4	18.8	20.0	20.8
Gross national saving (% of GDP)	15.4	15.8	21.1	27.7	29.5	29.6	29.3	29.9
<b>General Government (% of GDP)</b>								
Net lending (+) or net borrowing (-)	-5.5	-2.9	-2.2	0.9	3.4	2.0	1.1	0.9
Gross debt	67.9	64.9	65.5	55.5	50.2	46.0	42.8	40.2
Net financial assets	-48.2	-49.7	-49.1	-43.3	-34.6	n.a	n.a	n.a
Total revenue	37.1	38.9	39.1	37.4	39.2	38.8	38.2	38.0
Total expenditure	42.6	41.8	41.3	36.5	35.7	36.8	37.1	37.1
<i>of which: Interest</i>	3.7	3.4	2.8	2.1	1.8	1.5	1.4	1.3
<b>Corporations (% of GDP)</b>								
Net lending (+) or net borrowing (-)	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Net financial assets; non-financial corporations	-107.0	-109.1	-71.8	-74.5	-68.8	n.a	n.a	n.a
Net financial assets; financial corporations	-0.1	-8.5	-30.9	-12.6	-0.2	n.a	n.a	n.a
Gross capital formation	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Gross operating surplus	23.9	25.1	n.a	n.a	n.a	n.a	n.a	n.a
<b>Households and NPISH (% of GDP)</b>								
Net lending (+) or net borrowing (-)	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Net financial assets	182.0	180.9	181.8	173.8	162.6	n.a	n.a	n.a
Gross wages and salaries	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Net property income	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Current transfers received	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Gross saving	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
<b>Rest of the world (% of GDP)</b>								
Net lending (+) or net borrowing (-)	-2.3	-4.3	3.1	4.1	10.9	11.7	10.8	10.5
Net financial assets	-26.7	-13.6	-30.1	-43.5	-59.0	n.a	n.a	n.a
Net exports of goods and services	0.0	-1.1	7.0	13.8	21.3	21.4	19.8	19.0
Net primary income from the rest of the world	-0.9	-3.6	-4.2	-8.4	-9.3	-8.5	-9.0	-8.5
Net capital transactions	1.0	1.5	1.9	0.3	0.5	0.6	1.0	1.0
Tradable sector	45.7	40.1	37.0	35.5	34.8	33.8	n.a	n.a
Non tradable sector	42.4	47.3	50.8	53.1	53.6	54.2	n.a	n.a
<i>of which: Building and construction sector</i>	6.5	4.5	3.7	3.1	3.2	3.2	n.a	n.a
Real effective exchange rate (index, 2000=100)	90.9	100.1	104.0	100.1	101.4	102.3	100.1	99.4
Terms of trade goods and services (index, 2000=100)	97.9	99.2	100.3	101.2	102.0	102.1	102.0	101.9
Market performance of exports (index, 2000=100)	73.0	89.3	105.9	116.4	117.6	116.9	116.6	116.3

**Notes:**

<sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2015 market prices.

<sup>2</sup> The indicator on domestic demand includes stocks.

<sup>3</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

**Source:**

AMECO data, Commission 2019 spring forecast

### **Mandatory variables not included in the Stability Programme**

The Stability Programme does not include several mandatory variables for the basic assumptions including nominal effective exchange rate, GDP growth for the world excluding EU, EU GDP growth, growth of relevant foreign markets, and world import volumes (excluding EU). Not included mandatory variables do not impede the Commission's ability to assess the Stability Programme on the basis of the Programme's assumptions.