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Assessment of the 2017 stability programme for

Malta

(Note prepared by DG ECFIN staff)

CONTENTS

1. INTRODUCTION

On 2 May 2017, Malta submitted its April 2017 stability programme (hereafter called stability programme), covering the period 2017-2020. The document is endorsed by the government and was presented to the national parliament for a debate.

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

This document complements the Country Report published on 22 February 2017 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 2017 spring forecast. The following section presents the recent and planned budgetary developments, according to the stability programme. In particular, it includes an overview of 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's forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview of long-term sustainability risks and Section 6 presents recent developments and plans regarding the fiscal framework. Section 7 provides a summary of conclusions.

2. MACROECONOMIC DEVELOPMENTS

The stability programme projects real GDP growth to decline gradually over the forecast horizon from 5% in 2016 to 3.4% in 2020, as the rather buoyant growth seen in domestic demand normalises. Growth is projected to be driven by strong private consumption expenditure and robust export growth. Following several years of very strong growth, investment is expected to contract in all but one year of the programme horizon, reflecting the expiration of some temporary boosts. The macroeconomic projections underpinning the stability programme have been revised upwards compared to the previous stability programme reflecting the better-than-expected economic growth in 2016. Higher real GDP growth in 2017 and 2018 reflect stronger private consumption and exports, which more than compensate for a more subdued investment outlook.

The real GDP growth projection for 2017 is broadly in line with the Commission 2017 spring forecast (hereafter called Commission forecast), while for 2018 the growth projection is slightly lower than the Commission due to a lower contribution from domestic demand. The projections for the later years of the programme horizon are more cautious than those of the Commission’s potential output growth estimates. The stability programme's growth composition in 2017 and 2018 is somewhat more tax rich than the Commission forecast, in terms of direct taxes due to higher wage growth projections. The cyclical position of the economy was quite strong in 2016 as evidenced by the highly positive output gap, as recalculated by the Commission following the commonly agreed methodology. Thereafter, the recalculated output gap is estimated to close gradually. It is estimated to turn slightly negative in 2019 and remain broadly unchanged in 2020. The recalculated output gap is broadly in line with the Commission forecast over the forecast horizon. Overall, the macroeconomic scenario underpinning the stability programme is plausible for 2017 and cautious for 2018-2020.

The stability programme discusses the sensitivity of the underlying macroeconomic scenario to seventeen alternative scenarios, including both upside and downside shocks to domestic and external demand. Projections are considered as prudent, with the balance of risks tipped rather to the upside. An analysis of the impact of the different scenarios on the budget balance indicates that under the most adverse scenario the budget balance would turn into a deficit of up to 0.3% of GDP within the programme horizon. The stability programme's macroeconomic scenario does not include the macroeconomic impact of structural reforms, which is discussed and quantified in detail in the National Reform Programme.

Table 1: Comparison of macroeconomic developments and forecasts

	2016		2017		2018		2019	2020
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	5.0	5.0	4.6	4.3	4.4	3.7	3.5	3.4
Private consumption (% change)	3.8	3.8	3.5	3.6	3.3	3.1	2.7	2.4
Gross fixed capital formation (% change)	-1.3	-1.3	0.5	-1.3	-3.0	-3.1	2.1	-5.7
Exports of goods and services (% change)	4.0	4.0	3.6	3.4	4.5	4.4	4.6	4.3
Imports of goods and services (% change)	1.1	1.1	3.4	3.2	2.8	2.7	4.3	2.7
Contributions to real GDP growth:								
- Final domestic demand	1.0	1.0	3.8	3.7	1.6	0.9	2.5	0.6
- Change in inventories	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	4.2	4.2	0.8	0.6	2.8	2.8	1.0	2.8
Output gap[1]	1.6	1.9	0.6	0.9	0.2	0.3	-0.3	-0.2
Employment (% change)	3.7	3.7	3.0	3.2	2.8	2.9	2.7	2.5
Unemployment rate (%)	4.7	4.7	4.9	4.6	4.9	4.7	4.8	4.8
Labour productivity (% change)	1.3	1.1	1.6	1.1	1.6	0.8	0.8	0.9
HICP inflation (%)	0.9	0.9	1.6	1.5	1.8	1.8	1.8	1.9
GDP deflator (% change)	1.6	1.6	1.6	1.9	1.8	2.1	2.3	2.5
Comp. of employees (per head, % change)	2.4	2.3	3.0	3.6	3.1	3.6	3.5	3.4
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	8.7	8.7	8.1	7.3	10.5	9.8	10.4	12.7

Note:

[1]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 2017 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2016 AND 2017

In 2016, the budgetary situation has improved markedly. After a headline deficit of 1.3% of GDP in 2015, Malta achieved a surplus of 1.0% of GDP in 2016. This better-than-expected outcome is explained by the high growth rate of current revenue. In particular, income tax revenues increased substantially due to both favourable labour market conditions and high corporate profits. In addition, higher-than-expected proceeds from the International Investor Programme (IIP) (1.7% of GDP) contributed to the fiscal surplus. Current expenditure continued to increase but at a slower pace than in previous years. This was despite increases in public sector wages and intermediate consumption, which included costs associated with Malta's presidency of the EU. Finally, despite a sharp decline in the absorption of EU funds, as a result of the start of a new programming period, and a lower capital injection into the national airline, net capital expenditure increased by 0.3 pps. of GDP.

The headline balance projection for 2016 in the current stability programme was much better than the target set in both the 2016 stability programme and the 2017 Draft Budgetary Plan submitted in October 2016, which targeted a deficit of 0.7% of GDP. Part of the difference is explained by stronger-than-expected nominal growth. As a result of the growth in corporate profits and the stronger labour market, income tax and social contribution turned higher than expected. The proceeds related to the IIP, which were estimated at 1.0% of GDP in the 2016 stability programme and in the 2017 Draft Budgetary Plan, turned out 0.7 pps. of GDP higher than expected, contributing substantially to the budgetary surplus. Finally, despite higher subisidies, capital expenditure was lower than targeted due to the beginning of a new programming period for EU funds.

According to the programme, Malta's (recalculated) structural balance[1] is estimated to have improved markedly (by 3 pps. of GDP) in 2016, due to the improvement in the headline balance as well as the improving cyclical conditions. The output gap is estimated to have decreased to 1.6% of GDP in 2016, down from the 2.6% of GDP peak in 2015.

In 2017, the programme expects the headline surplus to decline to 0.5% of GDP, partly as a result of a less favourable macro-economic scenario compared with the previous year. This is above the target set in both the 2017 Draft Budgetary Plan and the previous stability programme given the higher than expected budgetary outcome in 2016 and the upward revision in the macroeconomic conditions (with real GDP growth of 4.2% against 3.5% previously projected).

In 2017, total current revenues as a share of GDP are expected to decrease by 0.7 pp. The drop is explained mainly by a reduction in the proceeds from the IIP, which are projected to scale down to 1.0% of GDP (from 1.7% of GDP in 2016). On the contrary, total current taxes are expected to increase by 6.6% in nominal terms compared to 2016, slightly above nominal GDP, also due to the prudent elasticities underpinning the programme compared to the average of recent years. Current expenditure, in turn, is projected to decrease by around 0.4 pps. of GDP, compared to an increase of 0.8 pps. of GDP reported in 2016. In fact, the increase in intermediate consumption, related also to costs associated with Malta's presidency of the EU, is compensated by a reduction in social transfers (despite the social measures introduced with the 2017 Budget, which seem to be offset by the tapering of social benefits included in the previous budgets), interest expenditure and subsidies. Public wages are expected to remain broadly stable, notwithstanding the new collective agreement for the public sector - which was renewed in April 2017 with effect from 1st January 2017 and might entail higher increases - and additional costs related to the Malta's presidency of the EU. Capital expenditure net of the EU funds is set to increase by 0.3 pps. mainly thanks to some investment financed by the National Development and Social Fund, which collected the revenues received from the IIP scheme. Still, the implementation of investment projects co-financed by the EU seems to lag behind.

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[1] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the programme according to the commonly agreed methodology.

In structural terms, the recalculated fiscal effort for 2017 is estimated at 0.1 pps. This is due to the reduction of the positive output gap.

The Commission forecast projects the 2017 general government balance at the same level of the stability programme, with some differences in terms of composition. In particular, in the Commission forecast, lower current revenues and higher current expenditure are compensated by lower net capital expenditure as a share of GDP. In structural terms, the Commission projects the structural balance in 2017 to remain constant. The difference compared to the national plans is due to a lower estimate of the output gap.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

Malta's stability programme aims at maintaining the general government balance in surplus at 0.5% of GDP and at steadily bringing down the debt-to-GDP ratio over the programme period. As a consequence, the recalculated structural balance is planned to improve and to remain above the medium-term objective (MTO) - a balanced budgetary position in structural terms- over the programme horizon. The medium-term objective is in line with the requirements of the Stability and Growth Pact.

The general government balance targets have been substantially modified in the latest stability programme compared to the previous programmes. In the past programmes the plan was to reduce the deficit and, to some extent, progressively approach the MTO. In fact, the 2016 stability programme targeted a reduction of the deficit, to a surplus of 0.1% of GDP in 2019, with the consolidation spread unequally over the programme period. Following the higher-than-expected fiscal outcome for 2016 and a better economic environment, the targets and the fiscal policy have been revised upward substantially. As a result, the Stability Programme targets the general government surplus to remain stable over the programme period (see Figure 1).

In 2018, in line with the moderation of the macroeconomic conditions and prudent elasticities, current revenue is projected to decrease by 0.8 pps. of GDP, despite stable proceeds from the IIP. Current expenditure is also expected to decrease, as compensation of employees, social spending and interest expenditure are decreasing. Intermediate consumption, after the peak in 2017 related to the costs associated with the EU presidency and the Health Concession Agreements, is expected to drop by 0.4 pps. of GDP. However, still to be specified discretionary measures are expected to increase current expenditure for about 0.2% of GDP in 2018. Overall, current expenditure is expected to decrease by 0.8 pps. of GDP in 2018. Finally, despite the pick up in the absorption of EU funds, net capital expenditure is expected to decrease marginally by around 0.1 pps. of GDP.

When looking at the entire programme horizon, both the revenue and expenditure ratios are projected to decrease in terms of GDP. The current revenue ratio is planned to decline over the programme period as a result of the moderation in the proceeds coming from the IIP, prudent elasticity assumptions and a slower projected growth in the tax base, in particular for indirect taxes, than nominal GDP in the outer years of the programme. Current expenditure in terms of GDP is also planned to decrease, with compensation of employees, social spending and interest expenditure contributing the most to the reduction, while intermediate consumption is set to remain stable. Net capital expenditure is projected to decline to around 2.6% of GDP in the following years, despite the projected stable absorption of EU funds.

However, the planned consolidation effort is underpinned by measures only for 2017. Details on the quantification of some specific measures targeted at tapering social benefits are provided as well as the impact of the ongoing Ministerial Spending Review and the Comprehensive Spending Review. However, these specific measures are not sufficient to underpin the programme targets as of 2018. In particular, the programme includes new additional unspecified measures which are expected to increase expenditure for about 0.2% of GDP in 2018 (see Section 3.3).

In structural terms, the recalculated structural balance for 2018 is estimated to remain in surplus at 0.3% of GDP. After 2018, the programme projects a (recalculated) structural surplus of around 0.6% of GDP in 2019 and 0.5% in 2020.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2016	2017		2018		2019	2020	Change: 2016-2020
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	**39.1**	**38.3**	**38.5**	**38.1**	**38.3**	**37.5**	**36.8**	**-2.3**
of which:								
- Taxes on production and imports	12.8	12.7	12.6	12.5	12.3	12.0	11.8	-1.0
- Current taxes on income, wealth, etc.	13.9	14.1	14.2	14.3	14.1	14.1	13.9	0.0
- Social contributions	6.5	6.4	6.5	6.4	6.4	6.3	6.2	-0.2
- Other (residual)	6.0	5.1	5.3	4.9	5.5	5.1	4.9	-1.1
Expenditure	**38.1**	**37.9**	**38.0**	**37.3**	**37.7**	**37.0**	**36.3**	**-1.8**
of which:								
- Primary expenditure	35.9	35.8	36.0	35.4	35.9	35.3	34.7	-1.2
of which:								
Compensation of employees	12.0	12.1	12.0	12.0	11.7	11.4	11.2	-0.7
Intermediate consumption	6.4	6.5	6.8	6.4	6.4	6.4	6.3	-0.1
Social payments	10.9	10.6	10.6	10.3	10.3	10.1	10.0	-0.9
Subsidies	1.3	1.3	1.1	1.2	1.1	1.1	1.0	-0.3
Gross fixed capital formation	2.5	2.6	2.8	2.8	3.1	2.9	2.8	0.2
Other (residual)	2.7	2.7	2.8	2.7	3.4	3.4	3.4	0.7
- Interest expenditure	2.2	2.0	2.0	1.9	1.8	1.7	1.6	-0.6
General government balance (GGB)	**1.0**	**0.5**	**0.5**	**0.8**	**0.5**	**0.5**	**0.5**	**-0.6**
Primary balance	**3.2**	**2.5**	**2.5**	**2.7**	**2.4**	**2.2**	**2.1**	**-1.2**
One-off and other temporary	-0.1	-0.2	-0.2	0.0	0.1	0.1	0.1	0.2
GGB excl. one-offs	**1.1**	**0.7**	**0.7**	**0.8**	**0.5**	**0.4**	**0.4**	**-0.7**
Output gap[1]	1.6	0.6	0.9	0.2	0.3	-0.3	-0.2	-1.9
Cyclically-adjusted balance[1]	0.3	0.2	0.1	0.7	0.4	0.6	0.6	0.3
Structural balance[2]	**0.4**	**0.4**	**0.3**	**0.7**	**0.3**	**0.6**	**0.5**	**0.1**
Structural primary balance[2]	2.6	2.4	2.2	2.5	2.2	2.3	2.1	-0.5

Notes:

[1]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.

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

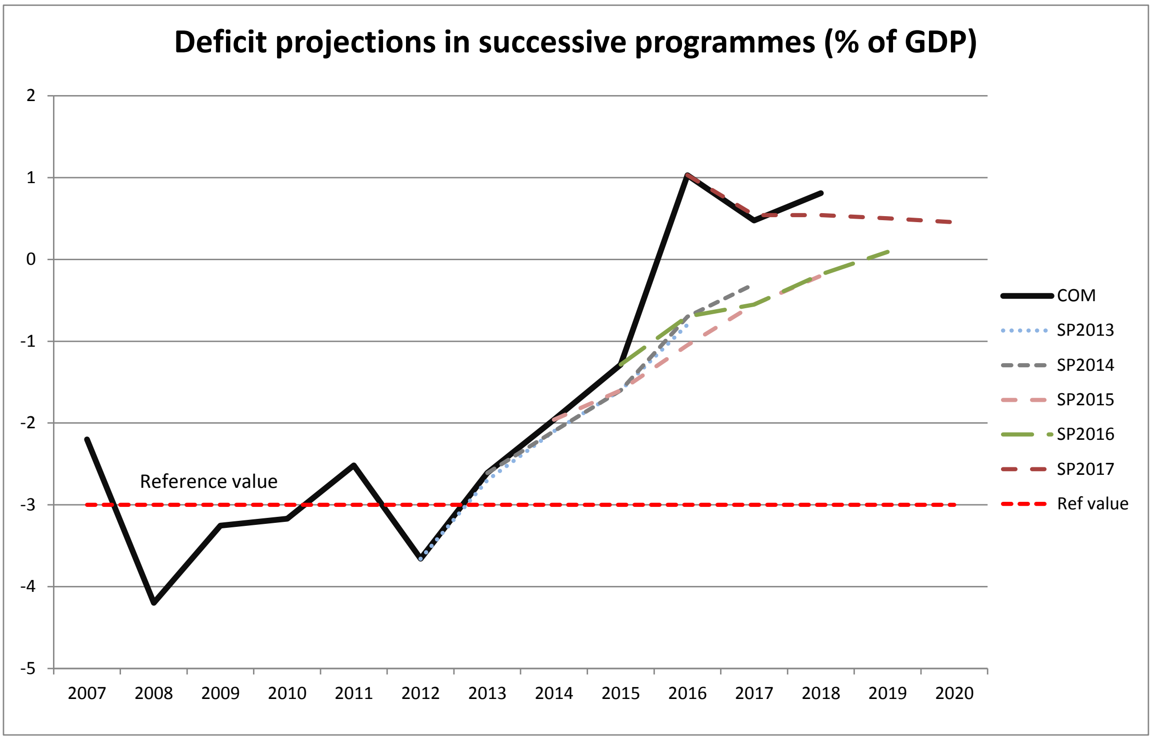
Source:

Stability Programme (SP); Commission 2017 spring forecasts (COM); Commission calculations.

The Commission forecast projects a higher surplus of 0.8% of GDP in 2018. Compared with the authorities, the Commission expects current tax revenues to be higher due to a more favourable macroeconomic scenario (both for private consumption and labour market). Without including the additional expansionary measures put forward in the stability programme for 2018, which was published after the cut-off date of the Commission forecast, the Commission expects current expenditure to be higher, particularly compensation of employees and intermediate consumption. Finally, the Commission expects a less dynamic net capital expenditure.

The Commission forecast expects Malta's structural surplus to improve by 0.3 pps. of GDP in 2018 under a no-policy-change assumption. For 2018, the Commission forecast does not include the new additional measures put forward in the stability programme (see Section 3.3).

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



– *Source: Commission 2017 spring forecast; stability programmes.*

3.3. MEASURES UNDERPINNING THE PROGRAMME

The measures underpinning the stability programme are those included in the 2017 budget presented to Parliament on 17 October 2016 and subsequently approved on 7 December 2016. The revenue-increasing measures, worth about 0.2% of GDP, include the increase in excise duties on goods which are harmful to health and the environment (namely on construction-related material, cigarettes and tobacco, non-alcoholic beverages, toiletries and washing preparations, glass and ceramic tiles, and non-biodegradable plastic bags used for waste collection) and the granting of a partial one-year concession on stamp duty for the transfer of business from parents to their children. These measures are almost entirely offset by the gradual introduction over the next two years of a tax exemption on pension income of up to

EUR13,000 per annum, the extension of the stamp duty exemption for first-time buyers until the end of 2017, and the phasing-out of the eco-contribution.

On the expenditure side, the programme includes several measures targeted at social justice, in particular addressing social inequality and pro-actively targeting those in/at risk of poverty, with a particular emphasis on low income brackets and pensioners (e.g. the introduction and the extension of a number of measures such as the extension of the in-work benefit, increase in the supplementary allowance, increase in the minimum pension, reform of the disability pension, increase in the rental subsidy, extension of the Care at Home Project, and other initiatives for students in difficulty and free public transport to youth). In addition, the budget foresees spending part of the funds in the National Development Social Fund in both public investments and other current expenditure. Finally, there is a compensation payment. Altogether, the expenditure measures are estimated to increase the deficit by nearly 0.4% of GDP.

Overall, the measures included in the 2017 budget are estimated to have a net deficit-increasing impact of around 0.3% of GDP, which is assessed as plausible.

The stability programme also reports the costs associated with Malta's presidency of the EU as one-off measures, at 0.1% and 0.3% of GDP respectively, in 2016 and 2017. These costs are related to current expenditure and exclude all the costs associated with public wages.

Finally, in addition to the measures already included in the budget for the previous years, the stability programme announces new additional unspecified measures which are expected to increase expenditure by 0.2% and 0.1% of GDP respectively in 2018 and 2019 and to reduce it by 0.2% of GDP in 2020.

Main budgetary measures (in % of GDP)

Revenue	**Expenditure**
2016	
• Increase in several excise duty rates and respective increase in VAT (0.2% of GDP) • Phasing-out of the eco-contribution (-0.1% of GDP) • Widening of the income tax rates (-0.1% of GDP) • International Investor Programme (1.7% of GDP)	• Tapering of benefits and Youth Guarantee (-0.1% of GDP) • Social measures (0.1% of GDP) • Reduction in current expenditure (-0.2% of GDP)
2017	
• Increase in several excise duty rates and respective increase in VAT, and concessions on stamp duties on inheritance (0.4% of GDP) • Phasing-out of the eco-contribution (-0.1% of GDP)	• Tapering of benefits and Youth Guarantee (-0.1% of GDP) • Reduction in current expenditure (-0.1% of GDP) • Social measures (0.2% of GDP)

• Widening of the income tax rates (-0.1% of GDP) • International Investor Programme (1.0% of GDP)	• Use of the NSDF (0.2% of GDP) • Compensation payments (0.1% of GDP)
2018	
• Increase in several excise duty rates and respective increase in VAT (0.3% of GDP) • Phasing-out of the eco-contribution (-0.1% of GDP) • Widening of the income tax rates (-0.1% of GDP) • International Investor Programme (0.9% of GDP)	• Tapering of benefits and Youth Guarantee (-0.2% of GDP) • Reduction in current expenditure (-0.1% of GDP) • Social measures (0.2% of GDP) • Use of the NSDF (0.3% of GDP) • Compensation payments (0.1% of GDP) • Measures to be specified (0.2% of GDP)
2019	
• Increase in several excise duty rates and respective increase in VAT (0.3% of GDP) • Phasing-out of the eco-contribution (-0.1% of GDP) • Widening of the income tax rates (-0.1% of GDP) • International Investor Programme (0.8% of GDP)	• Tapering of benefits and Youth Guarantee (-0.2% of GDP) • Reduction in current expenditure (-0.1% of GDP) • Social measures (0.2% of GDP) • Use of the NSDF (0.3% of GDP) • Compensation payments (0.1% of GDP) • Measures to be specified (0.1% of GDP)
2020	
• Increase in several excise duty rates and respective increase in VAT (0.3% of GDP) • Phasing-out of the eco-contribution (-0.1% of GDP) • Widening of the income tax rates (-0.1% of GDP) • International Investor Programme (0.7% of GDP)	• Tapering of benefits and Youth Guarantee (-0.2% of GDP) • Reduction in current expenditure (-0.1% of GDP) • Social measures (0.2% of GDP) • Use of the NSDF (0.3% of GDP) • Compensation payments (0.1% of GDP) • Measures to be specified (-0.2% of GDP)

Note: 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.

3.4. DEBT DEVELOPMENTS

The general government debt-to-GDP ratio decreased to 58.3% of GDP in 2016, from 60.6% of GDP in 2015, despite a high debt-increasing stock-flow adjustment (amounting to 2.5% of GDP) which was related, among others, to the IIP revenues and cash buffer.

In the stability programme, the general government gross debt ratio is planned to decrease by 2.4% of GDP in 2017, reaching 55.9% of GDP, as the projected primary surplus and the positive impact of nominal growth more than offset a large stock-flow adjustment, reflecting the adjustments to the deficit in ESA2010 terms on account of the IIP revenue receivable, partly offset by a decrease in the cash buffer.

The debt-to-GDP ratio is projected to decrease further over the programme period, to reach 47.6% in 2020. The stock-flow adjustment is projected to decrease substantially in 2018 to 0.2% of GDP and to stabilize at 0.9% of GDP in 2019. Despite this, the projected increasing primary surplus, the acceleration of inflation, the positive (even if moderating) impact of real GDP growth, as well as the planned decrease in interest expenditure are sufficient to keep the debt ratio on a declining path.

Compared to the 2017 Draft Budgetary Plan, the debt-to-GDP ratio decreased faster in 2016, by 2.3 pps. of GDP, compared to a planned decrease of 1.4 pps of GDP, given better-than-expected primary balance and strong nominal GDP growth. However, a precise comparison of debt-to-GDP ratios from different programmes is not possible due to the significant revisions to nominal and real GDP that occurred in December 2016.

According to the Commission forecast, the debt ratio is projected to decrease further to 55.8% of GDP in 2017 and to 52.5% of GDP in 2018. The difference compared to the stability programme targets is due to the higher expected primary surplus (on a no-policy-change basis) and higher nominal GDP growth projections in the Commission forecast, which compensate for a higher projection for the stock-flow adjustment.

The general government debt-to-GDP ratio seems to have been overestimated over time. This was mainly due to upward data revisions to nominal GDP in the latest years and to the contribution of the better-than expected general government balance registered in 2016. As a result, according to the stability programme, the debt-to-GDP ratio is expected to reach lower levels compared to the previous programme (see Figure 2).

Table 3: Debt developments

(% of GDP)	Average 2011-2015	2016	2017		2018		2019	2020
			COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**66.4**	**58.3**	**55.8**	**55.9**	**52.5**	**52.5**	**50.0**	**47.6**
Change in the ratio	-1.4	-2.4	-2.5	-2.4	-3.3	-3.4	-2.5	-2.4
Contributions[2] *:*								
1. Primary balance	**-0.4**	**-3.2**	**-2.5**	**-2.5**	**-2.7**	**-2.4**	**-2.2**	**-2.1**
2. "Snow-ball" effect	**-1.5**	**-1.6**	**-1.3**	**-1.4**	**-1.4**	**-1.2**	**-1.2**	**-1.2**
Of which:								
Interest expenditure	2.8	2.2	2.0	2.0	1.9	1.8	1.7	1.6
Growth effect	-3.0	-2.9	-2.5	-2.4	-2.3	-2.0	-1.7	-1.6
Inflation effect	-1.3	-0.9	-0.9	-1.1	-1.0	-1.1	-1.1	-1.2
3. Stock-flow adjustment	**0.6**	**2.5**	**1.4**	**1.6**	**0.8**	**0.3**	**0.9**	**0.9**

Notes:

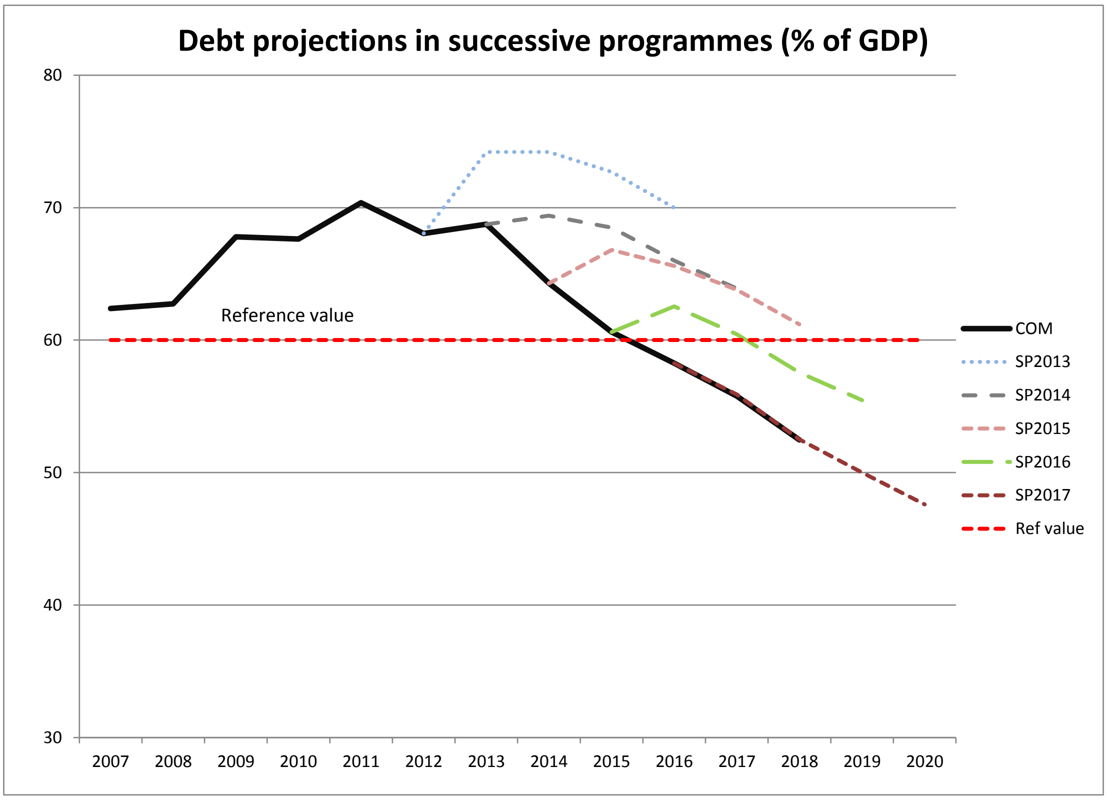
[1] End of period.

[2] 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 2017 spring forecast (COM); Stability Programme (SP), Comission calculations.

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



– *Source: Commission 2017 spring forecast; stability programmes.*

3.5. RISK ASSESSMENT

The achievement of the expenditure targets are subject to risks. Current expenditure could be higher due to implementation risks in view of upcoming elections and slippages in budgetary execution. In addition, state-owned enterprises, namely Air Malta, could also require additional subsidies. The setting up of the national development bank might entail additional public expenditure. On the contrary, while in the past ambitious investment targets have not been met, the targets for public investment included in the programme seem achievable.

The revenue targets include the impact of a revenue measure introduced with the 2014 Budget, namely the IIP, for which a precise estimate of the expected revenue it has so far proven difficult to obtain. On the other hand, revenue projections in the stability programme seem somewhat cautious, relying on conservative elasticities, thus pointing to a marginal upside risk to the revenue projections due also to upside risks in the growth forecast in period 2018-2020.

Overall, while risks related to the fiscal targets seem balanced, there could be differences in the components of government revenue and expenditure relative to those presented in the programme.

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

Box 1. Council recommendations addressed to Malta

On 12 July 2016, the Council addressed recommendations to Malta in the context of the European Semester. In particular, in the area of public finances the Council recommended to Malta, in view of the high risk of a significant deviation, to achieve a fiscal adjustment of at least 0.6 % of GDP towards the medium-term objective in 2016 and in 2017, by taking the necessary structural measures.

Malta is subject to the preventive arm of the Stability and Growth Pact. The general government balance posted a surplus of 1.0% of GDP in 2016 and it is expected to remain in surplus throughout the programme period. This is confirmed by the Commission forecast for the years 2017 and 2018. The general government debt decreased to 58.3% of GDP in 2016 and government plans expect it to decrease further to 47.6% of GDP by 2020, i.e. to remain well below the 60% of GDP threshold from the Pact.

Malta's structural balance reached a surplus of 0.4% of GDP in 2016, above its medium-term objective of a balanced budgetary position in structural terms. According to the information provided in the stability programme, with a (recalculated) structural surplus of 0.3% of GDP planned in both 2017 and 2018, Malta is expected to remain above its medium-term objective also in 2017 and 2018. This is confirmed based on the Commission forecast, which projects even higher structural surplus, especially in 2018 under a no-policy-change assumption.

According to the stability programme as well as the Commission forecast, the debt-to-GDP ratio, which in 2016 was below the 60%-of-GDP threshold, is expected to remain below that threshold and to decrease further over the programme horizon.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2016	2017		2018	
Initial position[1]					
Medium-term objective (MTO)	0.0	0.0		0.0	
Structural balance[2] (COM)	0.4	0.4		0.7	
Structural balance based on freezing (COM)	0.4	0.4		-	
Position vis-a -vis the MTO[3]	Not at MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2016**	**2017**		**2018**	
	COM	**SP**	**COM**	**SP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.6	Compliant			
Required adjustment corrected[5]	0.6				
Change in structural balance[6]	3.0				
One-year deviation from the required adjustment [7]	2.4				
Two-year average deviation from the required adjustment [7]	0.9				
Expenditure benchmark pillar					
Applicable reference rate[8]	1.3				
One-year deviation adjusted for one-offs[9]	1.3				
Two-year deviation adjusted for one-offs[9]	0.2				
PER MEMORIAM: One-year deviation [10]	1.1				
PER MEMORIAM: Two-year average deviation [10]	0.0				
Conclusion					
Conclusion over one year	Compliance				
Conclusion over two years	Compliance				

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] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) is carried out on the basis of Commission 2015 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] 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.

[9] 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.

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law 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 2017 spring forecast (COM); Commission calculations.

5. LONG-TERM SUSTAINABILITY

Malta does not appear to face fiscal sustainability risks in the short run. Both the fiscal and macro-financial and competitiveness sides of the economy do not seem to pose potential challenges.[2]

Based on the Commission forecast and a no-policy-change scenario beyond the forecast, government debt, at 58.3% of GDP in 2016, is expected to decrease further to 28.3% of GDP by 2027. This points to low risks for debt sustainability in the medium term. The full implementation of the stability programme would nonetheless put the debt on a slightly increasing path, reaching 30.3% of GDP by 2027.

The medium-term fiscal sustainability risk indicator S1 stands at -3.3 pps. of GDP based on the Commission forecast, primarily reflecting the initial budgetary position of the structural primary balance in 2016. This indicates low risks in the medium term. The full implementation of the stability programme would put the indicator at -3.8 pps. of GDP, leading to similar medium-term risk classification. Overall, risks to fiscal sustainability over the medium term are, therefore, low. Fully implementing the fiscal plans in the stability programme would increase those risks.

The long-term fiscal sustainability risk indicator S2 (which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path) is at 2.8% of GDP, based on the Commission forecast. In the long-term, Malta therefore appears to face medium fiscal sustainability risks, primarily related to the projected ageing costs, contributing with 4.0 pp. of GDP. Full implementation of the programme would put the S2 indicator at 3.0% of GDP, but it would remain in the medium-risk classification.

The stability programme reports on the initiatives in the area of pensions. Some measures were introduced with the 2016 Budget, targeted at addressing sustainability and adequacy. These measures followed the proposals of the Pension Strategy Group and entered into force in March 2016. A full assessment of these measures will follow the peer review in the Economic and Policy Committee, which has not yet taken place. However, an initial assessment indicates that the measures to achieve sustainability may be fully offset by those aimed at ensuring adequacy. Therefore, these measures do not fully respond to the identified long-term challenges. In addition, the 2017 Budget introduced a number of measures targeted at increasing pension income. With regard to the third pillar pensions, a working group was set up, tasked with recommending a scheme which provides fiscal benefits for employers who set up a voluntary pension scheme at the place of work. The scheme was proposed in the Budget for 2016. Following the working group’s proposals, in the 2017 Budget a measure intended to incentivise the take-up of voluntary occupational pensions was announced. In addition, a National Strategy for Retirement Income and Financial Literacy (now repositioned as Retirement and Finance Capability) was launched in January 2017 and a coordination body for the implementation was launched. This repositioning intends to focus on financial capability as an instrument of poverty prevention during the lifecycles and retirement of vulnerable groups.

[2] This conclusion is based on the short-term fiscal sustainability risk indicator S0, which incorporates 12 fiscal and 13 financial-competitiveness variables. The fiscal and financial-competitiveness sub-indexes (reported in table 5) are based on the two sub-groups of variables respectively. For sustainability risks arising from the individual variables, by country, see the Commission's Debt Sustainability Monitor 2016 (page 57).

Table 5: Sustainability indicators

Time horizon			No-policy Change Scenario		Stability / Convergence Programme Scenario	
Short Term			**LOW risk**			
S0 indicator [1]			0.1			
Fiscal subindex			0.0	LOW risk		
Financial & competitiveness subindex			0.2	LOW risk		
Medium Term			**LOW risk**			
DSA [2]			LOW risk			
S1 indicator [3]			-3.3	LOW risk	-3.8	LOW risk
of which						
	Initial Budgetary Position		-3.8		-3.4	
	Debt Requirement		-0.6		-1.2	
	Cost of Ageing		1.0		0.7	
	of which					
		Pensions	0.1		-0.1	
		Health-care	0.5		0.5	
		Long-term care	0.2		0.2	
		Other	0.1		0.2	
Long Term			**MEDIUM risk**		**MEDIUM risk**	
S2 indicator [4]			2.8		3.0	
of which						
	Initial Budgetary Position		-2.0		-1.6	
	Cost of Ageing		4.8		4.6	
	of which					
		Pensions	2.1		1.9	
		Health-care	1.5		1.3	
		Long-term care	0.9		0.8	
		Other	0.4		0.5	

Source: Commission services; 2017 stability/convergence programme.

Note: the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2017 forecast covering until 2018 included. 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 2015 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 2031. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2019 for No-policy Change 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 2015 and Debt Sustainability Monitor 2016.

6. FISCAL FRAMEWORK

The 2016 budgetary outcome appears in line with the national budget balance rule, which requires that, when not at the MTO, the structural balance should converge towards the MTO in accordance with the 1997 Surveillance and Coordination Regulation (Fiscal Responsibility Act, Art 8(4a)). This rule would imply an improvement of the structural balance of more than 0.5% of GDP relative to 2015. The other fiscal rule in place in Malta, i.e. the general government debt rule, would imply a reduction in the debt ratio in accordance with the 1997 Excessive Deficit Regulation until the ratio reaches 60% of GDP.

The general government balance recorded a surplus of 1.0% of GDP in 2016, after a deficit of 1.3% of GDP in 2015. This position represents a sizeable upward revision compared to the general government deficit of 0.7% of GDP projected in the 2017 Draft Budgetary Plan. In structural terms, it corresponds to a structural surplus of 0.4% of GDP in 2016, pointing to an improvement in the structural balance of 3 pps. of GDP. Therefore, Malta complied with the national budget balance rule with a margin and also achieved already the MTO of a balanced budgetary position in structural terms. In addition, the general government debt decresed below the 60%-of-GDP threshold already in 2016, with a value of 58.3%. For 2017-2020, the stability programme targets are in compliance with the national fiscal rules, as the structural balance is expected to remain positive and above the MTO. Thus, 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.

As regards general government expenditure, there is no expenditure rule in place and the Fiscal Responsibility Act only makes an indirect reference to it in the eventuality that the country receives a warning from the COM as a result of a significant deviation in its budgetary policy. In its assessment of the 2017 Draft Budgetary Plans, the Malta Fiscal Advisory Council (MFAC) drew attention to the need to closely monitor expenditure growth. In particular, they pointed to actions to be taken to keep expenditure growth under control as, at that time, the expenditure dynamic for 2017 based on the Commission forecast was expected to exceed slightly the benchmark.

The stability programme indicates that it constitutes the national medium-term fiscal plans, as required by Art. 4(1) of Regulation No 473/2013. However, there are no explicit indications on the expected economic returns on non-defence public investment projects that have a significant budgetary impact neither in the stability programme nor in the National Reform Programme.

The economic growth projections underpinning the stability programme were endorsed by the MFAC. The MFAC concluded that the projections appear plausible and prudent, while concurring with the authorities in that the balance of risks is tilted to the upside. The forecasting process was deemed sound and detailed, taking into account the views of international organisations, but there is room to further coordinate the activities of entities involved in data collection. The endorsement is available on the website of the MFAC. At the time the stability programme was submitted, the MFAC was still in the process of evaluating the fiscal plans included in the programme.

The MFAC is an independent body established in January 2015. Its mandate includes endorsing the macroeconomic and fiscal projections of the government, assessing fiscal performance and assessing compliance of the fiscal stance with respect to the Fiscal Responsibility Act and the SGP. The government is obliged to consider the MFAC's opinion and if it does not accept it, the Minister of Finance is to explain the reasons for rejecting it before parliament within two months of receiving the opinion.

7. SUMMARY

In 2016, Malta recorded headline and structural budget surpluses, in line with the provisions of the Stability and Growth Pact.

According to both the information provided in the stability programme and the Commission 2017 spring forecast Malta will continue to remain above its medium-term objective in 2017 and 2018. In addition, the debt-to-GDP ratio decreased below 60% in 2016 and, according to the stability programme and the Commission 2017 spring forecast, and it is projected to decline further. Therefore, Malta is projected to meet the requirements under the preventive arm of the SGP in both 2017 and in 2018.

8. ANNEXES

Table I. Macroeconomic indicators

	1999-2003	2004-2008	2009-2013	2014	2015	2016	2017	2018
Core indicators								
GDP growth rate	3.3	2.7	1.9	8.3	7.4	5.0	4.6	4.4
Output gap [1]	1.0	0.8	-2.0	1.6	2.6	1.6	0.6	0.2
HICP (annual % change)	2.5	2.6	2.1	0.8	1.2	0.9	1.6	1.8
Domestic demand (annual % change) [2]	3.3	2.9	0.8	2.6	13.2	0.9	4.3	1.9
Unemployment rate (% of labour force) [3]	7.2	6.7	6.6	5.8	5.4	4.7	4.9	4.9
Gross fixed capital formation (% of GDP)	20.4	21.3	18.5	17.2	24.7	23.4	22.9	21.3
Gross national saving (% of GDP)	16.4	16.6	18.4	26.2	29.1	30.2	28.4	29.3
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-6.6**	**-3.2**	**-3.0**	**-2.0**	**-1.3**	**1.0**	**0.5**	**0.8**
Gross debt	**64.1**	**66.4**	**68.5**	**64.3**	**60.6**	**58.3**	**55.8**	**52.5**
Net financial assets	**n.a**	**-49.2**	**-51.2**	**-53.0**	**-50.2**	**n.a**	**n.a**	**n.a**
Total revenue	35.5	39.0	38.8	39.5	39.9	39.1	38.3	38.1
Total expenditure	42.1	42.1	41.8	41.5	41.2	38.1	37.9	37.3
of which: Interest	3.8	3.6	3.1	2.7	2.5	2.2	2.0	1.9
Corporations (% of GDP)								
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	**n.a**	**-110.4**	**-89.1**	**-70.6**	**-58.8**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**n.a**	**-5.6**	**-25.6**	**-31.0**	**-34.4**	**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	25.2	24.4	24.9	n.a	n.a	n.a	n.a	n.a
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**
Net financial assets	**n.a**	**185.8**	**180.3**	**194.5**	**189.8**	**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
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-3.6**	**-2.4**	**0.2**	**11.3**	**7.1**	**8.7**	**8.1**	**10.5**
Net financial assets	**n.a**	**-20.4**	**-14.4**	**-39.9**	**-46.3**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	-1.2	-1.4	2.3	12.6	7.8	11.9	11.7	13.7
Net primary income from the rest of the world	-0.7	-2.4	-4.4	-4.6	-4.1	-5.7	-5.4	-5.1
Net capital transactions	0.3	1.8	1.6	1.7	1.8	0.8	1.6	1.5
Tradable sector	49.7	41.6	38.0	36.1	35.6	35.0	n.a	n.a
Non tradable sector	39.2	45.6	49.5	51.6	52.3	52.8	n.a	n.a
of which: Building and construction sector	5.8	5.4	4.0	3.6	3.8	3.3	n.a	n.a
Real effective exchange rate (index, 2000=100)	87.4	97.2	103.6	105.0	101.4	101.9	101.9	101.7
Terms of trade goods and services (index, 2000=100)	97.7	98.7	99.7	100.9	100.9	101.3	100.8	100.8
Market performance of exports (index, 2000=100)	78.0	75.5	103.1	107.2	105.9	106.7	106.4	106.5

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

[3] 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 2017 spring forecast