Medium-Term Fiscal Strategy for Malta 2023-2026

Ministry for Finance and Employment
July 2023

The following symbols have been used throughout this document:

. . . to indicate that data are not available;

— to indicate that the figure is negligible;

0 to indicate that the figure is zero;

- to indicate that data are not applicable or cannot be determined;

n/c to indicate that there is no change in the data.

Figures may not add up due to rounding.

Fiscal Responsibility Act, 2014

(Cap 534)

Statement of Fiscal Responsibility

by the Prime Minister and Minister for Finance and Employment

In accordance with the requirements of Article 15 (8) of the Fiscal Responsibility Act, 2014, we hereby attest to the reliability and completeness of information contained in this Medium-Term Fiscal Strategy and to compliance with the principles of fiscal responsibility.

Robert Abela
Prime Minister

Clyde Caruana
Minister for Finance and Employment

July 2023

1. Medium-Term Fiscal Policy Strategy

1. Medium-Term Fiscal Policy Strategy

After three successive years of ominous economic developments of an unprecedented scale, 2023 has been a rather benign year so far. The main advanced economies performed better than anticipated. The milder winter across the continent coupled with the concerted effort to reduce dependence on energy sources from Russia have improved economic resilience and strengthened confidence. The financial turmoil in the US banking system could have had much more serious consequences on the world economy. Although things could escalate further in the coming months, the shock has been relatively contained and economies have proven to be resilient. Inflationary pressures remain high but abating, with certain commodity prices reverting to their levels before the war in Ukraine broke out. Nevertheless, core inflation remains sufficiently high to create concerns of an economic contraction amongst major economies in the short term as tight monetary conditions are expected to persist.

The focus of attention is slowly turning to the fiscal position. Whilst the use of fiscal policy to stabilise economies during the pandemic has proved its effectiveness, public debt has soared as a consequence. As economic conditions normalise whilst inflation persists, the need to exit from expansionary fiscal policy without jeopardising the public investments necessary to honour the green commitments and strengthen security has become the main economic policy objective.

In the European context, the review of the economic governance framework has proceeded at a satisfactory pace and the Commission has just issued legislative proposals for the review of the Stability and Growth Pact in line with the orientations for a reform issued in the Commission's Communication of 9 November 2022. The reform puts debt sustainability at the core of the fiscal governance framework of the European Union (EU). At the same time the proposals take into account country-specificities and thus proposes differentiated fiscal strategies which are meant to be more credible and, in the process, aim to strengthen national ownership. The reforms propose a greater focus on medium term budgetary frameworks combined with a system designed to promote public investments and reforms necessary to address the green transition and the need to strengthen security.

The Government looks forward to the conclusion of this reform which should give more credibility to the use of fiscal policy in the EU, particularly in anticipation of the agreed lifting of the General Escape Clause in 2024. In this context, Malta is expected to register a deficit of 5.0 per cent of Gross Domestic Product (GDP) this year. This Programme is proposing a fiscal consolidation path over the medium term meant to bring the deficit credibly below the 3.0 per cent of GDP by 2026.

1.1 Short-Term Outlook

1.1.1. Economic Situation and Risks to the Short-Term Outlook

In 2022, the domestic economy proved to be stronger and more resilient than originally anticipated. The support provided by the Government to cushion the impact of high energy prices has proved to be effective in minimising the repercussions on the economy and prevented a surge in inflationary pressures. However, beyond this support, most sectors of the economy have registered significant growth. The strongest performer was undeniably tourism which has surpassed initial expectations. The strong performance in virtually all sectors of the economy clearly exceeded the performance of our major trading partners, indicating that it was supported by competitiveness gains.

In particular, exports of goods and services expanded by 6.4 per cent, compared to a forecast of 3.6 per cent as projected in last year's Programme. The stronger pace of economic expansion was matched by an increase in employment. This increased by 6.2 per cent in 2022, compared to a forecast increase of 2.4 per cent. This provided the basis for a stronger than anticipated increase in domestic demand as household consumption grew by 10.1 per cent in real terms, substantially exceeding the forecast growth of 3.4 per cent.

Two other related features of the performance of the domestic economy in 2022 stand out. The first feature concerns inflation. Although in Spring 2022 rising inflationary pressures were anticipated, these were expected to stabilise and were mainly anticipated to be imported from abroad. Inflation in 2022 proved to be stronger than expected and rather more persistent. It reached 6.1 per cent (almost double the Spring 2022 forecast of 3.5 per cent). The difference related primarily to the rising prices in housing related services, household equipment and house maintenance. The Retail Price Index (RPI) suggests that housing services increased by more than 19.0 per cent whilst prices of housing maintenance and equipment rose by more than 8.0 per cent.

This increase clearly goes beyond the rising cost of inputs from abroad considering that the price of major commodities declined in the second half of 2022. This suggests that some enterprises took the opportunity to test the market and raised their profit margins. This is the second notable feature characterising economic performance in 2022. This conclusion is supported by national accounts data. The latest release by the National Statistics Office (NSO) shows that operating surplus and mixed income (a measure which mainly captures corporate profits) surged by 16.2 per cent in 2022. This surpassed the increase in compensation of employees of 9.4 per cent. It is estimated that compensation of employees per capita in 2022 rose modestly by 2.8 per cent.

Looking ahead at 2023 and 2024, the risk of a higher and more persistent inflation outlook has been recognised in this Programme. Whilst at present the inflation rate stands at 6.8 per cent, base effects from the rising inflation of last year suggest that inflation should start to decelerate in the second half of this year. However, it will reach 5.7 per cent by the end of this year. Over the medium-term inflation will go down further reaching 2.0 per cent only in 2025, then rise again in 2026 to reflect the inflationary impact of regulatory developments.

Consistent with this scenario it is expected that wages per capita start to catch up, underlined by a continued tightness of the labour market. The factor distribution of income is expected to be skewed slightly towards wages, with the increase partly funded by the strong profit margins in the corporate sector. The risk remains, that inflation could exceed expectations if the domestic price pressures evident last year persist. However, this eventuality is not considered in the baseline scenario for growth.

These developments will support a further, yet more moderate increase in domestic demand. From the external side, exports are generally expected to slow down in most sectors of the economy and register a growth of 4.3 per cent reflecting with a lag the weakening of external demand conditions and an appreciation of the Euro exchange rate. Nevertheless, tourism is expected to exceed the pre-pandemic records whilst certain elements of manufacturing exports will continue to register very strong growth rates. Exports will pick up some momentum in the outer years of the Programme.

The pace of economic expansion over the medium-term has been revised upwards towards an average growth of 4.4 per cent, in contrast with the growth of 3.6 per cent projected in Spring of last year. This positive re-assessment of the strength of the economy is driven in part by the strengthening of potential output growth, currently

expected to grow by around 4.7 per cent per annum over the Programme period. The output gap is expected to close in 2023 and remain marginally on the negative side over the medium term.

Despite this rather favourable economic environment for Malta, the risks are tilted towards the downside especially for 2024 and 2025, with a more balanced risk assessment identified for this year and for 2026.

1.1.2. The Current Fiscal Situation

In 2022, the budget deficit declined to 5.8 per cent of GDP, very close to the targets presented in the budget in Autumn 2021 and the revised targets presented in last year's Programme. On the other hand, the debt ratio, originally anticipated to increase and exceed the 60 per cent threshold, actually declined to 53.4 per cent. This followed the strong pace of economic expansion, supported by the decision of the Maltese Government to insulate the economy from the ramifications of the international energy and food crisis.

1.1.3. Fiscal Support Measures

Measures in 2023 aimed at supporting companies and households to withstand the impact of higher commodity prices are expected to exceed €306.1 million (or 1.7 per cent of GDP). This target has been reduced by half what was expected in the Draft Budgetary Plan which had earmarked a package of around 3.4 per cent of GDP. These savings follow the decline in the energy prices which materialised in the second half of last year. Energy subsidies are anticipated to remain over the course of the Programme period, averaging 1.4 per cent of GDP. Should energy costs fall further, energy subsidies will follow suit. In 2023, the net impact of discretionary revenue and expenditure measures, is expected to improve the budget balance by 0.31 percentage points and 1.32 percentage points of GDP, respectively.

1.2 Medium-Term Outlook

In its latest fiscal policy guidance for 2023, the European Commission has clearly indicated that the general escape clause of the Stability and Growth Pact will be deactivated at the end of 2023.

Furthermore, whilst the fiscal surveillance cycle would reflect the spirit of the proposed reforms and orientations to the Economic Governance Framework, it will have to remain anchored in the current legal framework. To allow for an effective transition and given the specific economic situation characterised by high uncertainty, the surveillance of this Programme will not be guided by the 'matrix of adjustment requirements' that was used in the context of the preventive arm of the Stability and Growth Pact between 2015 and 2020.

Instead, the Commission proposed that some elements of the reform orientations being discussed could be incorporated into this fiscal surveillance cycle. To this effect, Member States were invited to submit Stability and Convergence Programmes that:

1. Include their medium-term fiscal and structural plans;
2. Set fiscal targets that ensure that the deficit does not exceed 3 per cent of GDP or is brought below 3 per cent of GDP within the period covered by the Stability or Convergence Programme, and credibly ensure that the deficit is maintained below 3 per cent of GDP at unchanged policies over the medium-term;

3. Comply with the fiscal adjustment criteria set out in the Commission reform orientations and ensuring plausible and continuous debt reduction, or for debt to be kept at prudent levels, in the medium-term.

The Commission will propose fiscal Country Specific Recommendations (CSRs) for 2024 that are in line with Member States' own targets, so long as those targets are consistent with ensuring that the public debt ratio is put on a downward path or stays at a prudent level and the budget deficit is below the 3 per cent of GDP reference value over the medium term.

The Commission will also propose to the Council to open deficit-based Excessive Deficit Procedures in spring 2024 on the basis of the outturn data for 2023, in line with existing legal provisions. It is pertinent to recall that according to the existing legal provisions for the years where the general government deficit is expected to exceed the reference value, a minimum annual adjustment of at least 0.5 per cent of GDP as a benchmark is to be maintained.

This Programme is projecting a deficit of 5.0 per cent of GDP in 2023. If this target is achieved, the above considerations imply that the fiscal strategy for 2024 should propose a structural effort of at least 0.5 per cent of GDP. This Programme proposes a slightly stronger adjustment of 0.7 per cent of GDP in structural terms which will bring the deficit down to 4.5 per cent of GDP in 2024. This adjustment also means that the structural primary balance will be reduced by 1.0 per cent of GDP. Taking into account the Commission orientations on the EGR, this effort is more ambitious than what the DSA framework deems to be necessary to keep the debt-to-GDP ratio at prudent levels below the 60 per cent. This Programme is consistent with an increase of the net primary expenditure of 3.3 per cent, which is also within the growth necessary to maintain debt at prudent levels.

Going forward, this Programme aims to correct the excessive deficit by 2026 in line with the Commission's fiscal policy guidelines for 2024 which recommend a correction of the excessive deficit within the period covered by the Programme. It is worth noting that this would imply an annual average structural effort of 0.7 per cent of GDP and an average annual reduction of the structural primary deficit of 0.9 per cent of GDP over the Programme horizon. This effort is more ambitious than the minimum requirements of both the present fiscal framework and the Commission's orientation for a future framework. The Government deems this to be a credible and realistic fiscal adjustment in the present circumstances. Targeting a slightly more ambitious fiscal effort is also deemed to promote debt dynamics which, not only remain below the 60 per cent threshold but also dynamics which converge to lower debt-to-GDP ratio over the long-term.

1.3 Government's Expenditure Priorities

The Government is committed to implement its work programme on the basis of the recent Electoral Manifesto. It is also committed to make the best use of remaining EU funds from the 2014-2020 Programming period as well as the 2021-2027 Programming period. Furthermore, the Government will utilise the additional support at EU level provided under the Next Generation EU.

It is pertinent to note that in June 2021, the Government had announced a new socio-economic vision to serve as the basis for the country's economic strategy. Five key priorities were chosen for the long-term strategy, aiming to re-focus government action by having a more targeted, cohesive and effective action plan. The long-term economic vision rests on five principles:

1. **Good Governance.** The Government will continue implementing measures and reforms which strengthen the rule of law, the regulatory and supervisory authorities and the fight against money laundering and the financing of terrorism. This will ensure that the democratic and institution functions are strengthened and safeguarded.

2. **Economic Growth** translates into a higher quality of life for all citizens. Malta's future economic growth depends on the transition towards an economic model, inspired by the principles of circular, green and blue economy, stimulated by a high level of competitiveness and innovation whilst sustaining social cohesion.

3. **Investing in education**, which is crucial to sustaining medium to long term economic growth. By targeting education, a dignified life for the entire population is ensured, so that everyone is enabled to fulfil their potential within a healthy environment. In addition, the creation of new opportunities is contingent on the development and renewal of the country's skills base and addressing mismatches.

4. The fourth principle is that of supporting the renewal of **Malta's infrastructure** through the ongoing investments in roads, transport and technology, thus supporting the country's competitiveness, and the creation of prosperity which shall contribute towards a higher quality of life.

5. The final principle is that of achieving a **carbon neutral economy by 2050** with intermediary goals being set every ten years. This will ensure that the environment, which is crucial for achieving sustained economic growth and a better quality of life, is indeed prioritised. Consideration must also be given to strategic documents contributing to the vision of carbon neutrality. These include the National Energy and Climate Plan, the Low Carbon Development Strategy, the National Strategy for the Environment, Waste Management Strategies and Malta's Sustainable Development Vision for 2050.

These priorities clearly align with the reform priorities espoused by the CSRs within the European Semester process, while also tackling the areas identified by national authorities. The Government will ensure that these principles will guide the policy objectives to be pursed through the national budget as well as through the use of European funds, especially the Recovery and Resilience Facility.

1.4 Fiscal Risk Statement

Significant economic uncertainty continues to surround this medium-term plan. Indeed, as indicated earlier, these projections rest on a number of assumptions, including on the macroeconomic outlook of Malta's main trading partners, the evolution of monetary conditions, the possibility of escalating financial sector disruptions, the value of the Euro exchange rate, the persistence and magnitude of domestic inflationary developments and its effect on the disposable income of households, the strength of tourist inflows, labour market dynamics and the evolution of continuing supply-chain disruptions.

The economic risks surrounding the medium-term plan are highlighted in detail in Chapter 4 of this document. The uncertainty surrounding the macroeconomic projections is based on past forecast errors. These tend to be relatively high for a small open economy like Malta, especially one that has been undergoing notable structural changes since EU membership, but particularly since 2013. The risk assessment shows balanced risks for 2023 and 2026, but downside risks in 2024 and 2025.

More specifically there seems to be an upside risk for the attainment of a lower budget deficit in 2023 and 2024 reflecting the prudent assumptions. However, the fiscal risk

emanating from the possible macroeconomic scenarios contemplated in this plan is on the downside for 2025 and 2026. In the worst-case scenarios contemplated in the risk assessment, which is consistent with a weakening of external macroeconomic conditions, the budget balance as a percentage of GDP deteriorates by 0.2 percentage points in 2024 and 0.3 percentage points in 2025 and 2026 respectively.

Apart from the macroeconomic risks surrounding these fiscal projections, additional risks relate to the additional support to state-owned enterprises, particularly in the energy and aviation sector. The return of energy price pressures could put further pressure on public finances in order to honour the commitment to minimise the impact through energy and food subsidies as well as direct support to Maltese households.

Nevertheless, it is pertinent to highlight that the relatively low debt-to-GDP ratio coupled with a very strong potential growth strengthen Malta's fiscal sustainability. In line with the debt sustainability analysis undertaken in preparation of this Programme, the attainment of the fiscal targets presented ensure that debt remains comfortably below the treaty reference value and should also start to decline as from 2026. This favourable dynamic should persist over the medium term, on a no-policy change assumption, even under a variety of adverse scenarios, including the stochastic simulations carried out in line with the Commission's standard DSA analysis.

The European Commission (EC) 2023 Spring forecast projects a lower real GDP growth of 3.9 per cent in 2023 and 4.1 per cent in 2024, mainly due to a lower contribution of net exports to growth. Nevertheless, the EC considers that the macroeconomic scenario underpinning the budgetary projections in the Stability Programme is realistic in 2023 and thereafter. The Commission 2023 Spring forecast projects a Government deficit of 5.1 per cent of GDP for 2023 and 4.5 per cent of GDP in 2024. This is in line with the deficit projected in the Stability Programme. The Commission 2023 Spring forecast projects a similar general Government debt-to-GDP ratio of 54.8 per cent at the end of 2023 and 56.1 per cent at the end of 2024.

The macroeconomic and fiscal projections for 2023 and 2026 presented in this Plan were also assessed by the Malta Fiscal Advisory Council (MFAC). Based on the information available to the Malta Fiscal Advisory Council, and after considering the inherent risks and uncertainty surrounding these projections, the Council considered the full set of macroeconomic and fiscal projections for the period 2023 to 2026 prepared by the Ministry for Finance and Employment (MFE) as part of the Update of the Stability Programme 2023 – 2026 to lie within its endorsable range.

In its assessment of the Update of the Stability Programme, the Council acknowledged that while the forecasts fall within an acceptable range, there are uncertainties that could significantly deviate from the projected outcomes. The short-term risks associated with economic growth lean slightly towards the upside for 2023, driven by stronger domestic developments. The Council is of the opinion that stronger consumption growth poses upside risks in the medium-term. Furthermore, the Council suggests that the projection of a negative output gap despite core inflation remaining above the 2.0 per cent threshold may be due to underestimation of actual economic growth or an overestimation of potential output growth. The Council's assessment is inclined towards the possibility that it is a mix of both these factors. Moreover, the Council highlights the importance of the assumptions employed in the macroeconomic projections and warns that any significant departure from these assumptions could impact the growth outlook. Inflationary pressures, both locally and abroad, and potential exogenous shocks to the domestic financial system are identified as prominent risks.

The MFAC noted that the fiscal projections align with the new fiscal rules and emphasize debt sustainability. The Council suggests that in the short term, total revenue could turn out to be stronger that projected by the MFE. The main fiscal risks to projections identified by the Council included: the expenditure on energy subsidies, subject to uncertainty due to ongoing geopolitical conflicts, the future of Air Malta, which may entail associated costs, and the global minimum level of taxation rules applicable to multinational investors. The Council advised the Government to prioritise achieving a prudent medium-term fiscal position following the deactivation of the general escape clause in 2024. Potential savings and higher revenues should be used to rebuild fiscal buffers, while deviations from targets should not result in reduced productive capital expenditure.

2. Economic Outlook

2. Economic Outlook

2.1 Economic Conditions for 2022

In 2022, the Maltese economy grew by 6.9 per cent in real terms, or by 12.5 per cent in nominal terms. Domestic demand was the main contributor to this growth at 10.9 percentage points, while the external side of the economy contributed negatively by 4.0 percentage points. Inventories contributed a marginally negative 0.1 percentage point.

Throughout 2022, the Maltese economy sustained its strong performance recorded throughout 2021. Private consumption continued its strong performance, with growth accelerating to 10.1 per cent from 8.1 per cent recorded during the previous year. Consumption in restaurants and hotels grew the most (78.6 per cent), while other components which exhibited strong annual growth were Recreation and culture (42.7 per cent), Education (26.6 per cent), Transport (25.6 per cent) and Food and Non-alcoholic beverages (20.4 per cent). Government consumption remained supportive of domestic growth conditions at 2.4 per cent, mainly driven by growth in intermediate consumption and compensation of employees. Significant one-off investments in transport equipment contributed to robust investment growth of 30.4 per cent. The investment share in Gross Domestic Product (GDP) reached 25.1 per cent of GDP during 2022, increasing from 20.3 per cent of GDP recorded during 2021. On the external side, exports grew by 6.4 per cent driven mainly by a stronger than expected rebound in tourism which more than offset the deceleration in external demand conditions towards the end of 2022. Imports grew by 9.7 per cent, driven predominantly by imports of capital goods and industrial supplies.

In terms of output, Gross Value Added (GVA) at basic prices grew by 13.7 per cent over the previous year. The growth in GVA was primarily driven by the services sector, which contributed 12.2 percentage points to GVA growth. Consequently, the share of the services sector of the total economy in terms of GVA reached 89.9 per cent in 2022. Whilst growth in GVA was broad-based across all sectors, the subsectors mostly affected by the pandemic such as the tourism sector and other contact-intensive services continued to outperform. The Wholesale and Retail, Transportation, and Accommodation sector grew the most at 31.7 per cent, followed by the Agriculture, Forestry and Fishing sector which grew by 21.0 per cent, the Manufacturing sector (16.2 per cent) and the Professional Services sector (15.3 per cent). Other significant growth rates were recorded in the Information and Communication sector (11.7 per cent), the Financial and Insurance Services sector (10.2 per cent), the Real Estate sector (9.7 per cent) and the Arts, Entertainment, and Recreation sector (8.3 per cent).

Throughout 2022, gross operating surplus and mixed income grew by 16.2 per cent to €8,428.0 million, while compensation of employees grew by 9.4 per cent to €7,496.0 million. Subsidies on production and imports grew by 21.2 per cent to reach €865.5 million, while revenue from taxation on production and imports increased by 12.7 per cent to €1,811.8 million.

The International Monetary Fund's (IMF) most recent World Economic Outlook estimates the global economy to have grown by 3.4 per cent in 2022. The global economic recovery from the pandemic was disrupted by the conflict in Ukraine, which exacerbated inflationary pressures and caused a cost-of-living crisis. The outbreak of the COVID-19 in China also dampened growth in 2022.

Going forward, global growth is expected to recede to 2.9 per cent in 2023, before recovering to 3.1 per cent in 2024. China's recent economic reopening is expected to

be a tailwind for global growth in 2023, but the tightening of financial conditions by central banks to fight inflation and Russia's war in Ukraine continue to weigh on economic activity.

The balance of risks to the growth projections remains skewed towards the downside. Disruptions in China's economy because of the pandemic can hold back the economic recovery. Meanwhile, an escalation in the conflict between Russia and Ukraine and further geopolitical fragmentation will also be headwinds to growth. Continued tightening by global Central Banks could inflict weakness on economies with high debt positions and lead to further disruptions in financial markets. On the contrary, a stronger than expected recovery in China and a faster disinflation are plausible upside scenarios.

In 2022, Malta recorded a balance of payments deficit of 5.8 per cent of GDP, primarily driven by a worsening of the goods balance due to high energy import prices and a significant imported aircraft investment. Although the services balance did improve notably from the previous year, this was more than offset by a higher deficit in the goods balance. Nonetheless, a notable rebound was made in travel net exports which grew by 150.7 per cent. The personal, cultural, and recreational services sector, the other business services sector and the insurance and pension services sector continued their strong performance from the previous year and registered substantial increases in their net export figures in 2022. These increases in net exports partially offset the decline in net exports from the financial services sector and the transport sector.

The primary income net payments balance declined from 11.5 per cent of GDP in 2021 to 12.0 per cent of GDP in 2022. The direct investment net payables balance increased from a negative 65.4 per cent of GDP to a negative 61.5 per cent of GDP. Here, direct investment incurrence of liabilities increased by 13.9 per cent, whilst the net acquisition of financial assets marginally decreased. Portfolio investment net receivables balance increased from 46.8 per cent of GDP in 2021 to 49.7 per cent of GDP in 2022.

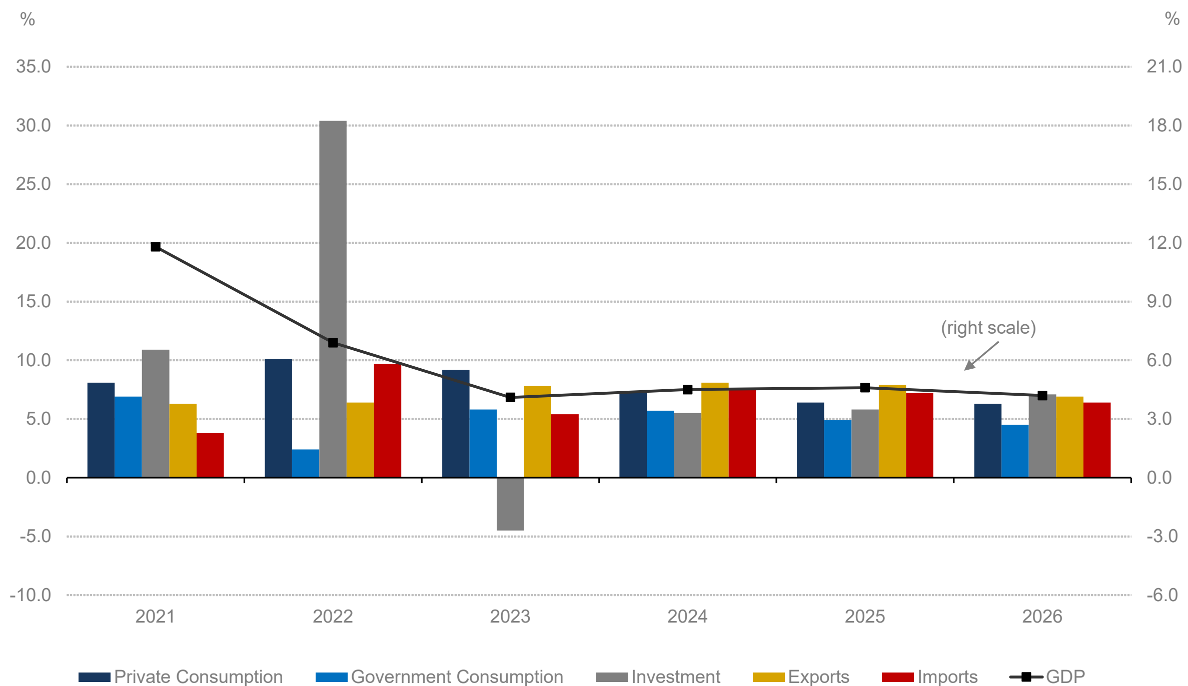
2.2 The Medium-Term Scenario

The global economic outlook remains clouded by high uncertainty. The fiscal support provided to households during the pandemic followed by the war in Ukraine triggered a global inflationary shock which required global central banks to increase their key interest rates and reduce the size of their balance sheets. This led to a deceleration in trade and economic growth, a strong appreciation of the dollar against most developed market currencies and liquidity concerns in the financial sector.

Despite these external shocks, economic fundamentals in Malta continue to support domestic demand conditions. While household purchasing power deteriorated in 2022, the fall in real wages was more than offset by sustained employment growth, and pent-up demand. Furthermore, the Maltese economy was further supported by a markedly better performance of the tourism sector. These factors are expected to persist in 2023, bolstered by an improvement in household purchasing power as inflationary pressures subside and continued population growth, albeit at a more moderate pace when compared to the previous years.

Against this background, in 2023, GDP is expected to grow by 4.1 per cent in real terms and by 8.6 per cent in nominal terms. The external component is anticipated to be the main driver of economic growth in 2023. Indeed, net exports are expected to contribute 3.5 percentage points to growth, as exports are expected to be supported by the strong performance of the tourism sector and further gains in market share. Domestic demand is projected to contribute 0.6 percentage points to growth in 2023. Sustained growth in private household consumption is expected to be outweighed by a decline in investment,

Chart 2.1
GDP Growth Rate



in view of strong base effects from the prior year, tighter financing conditions and high uncertainty.

In 2024, the Maltese economy is expected to grow by 4.5 per cent in real terms and by 7.7 per cent in nominal terms. Domestic demand is anticipated to be the main driver of economic growth, with a contribution of 3.2 percentage points, while net exports are expected to contribute 1.2 percentage points.

Over the outer years economic growth is expected to accelerate to 4.6 per cent in 2025 before reaching 4.2 per cent in 2026. In both years, domestic demand is expected to be the main driver of growth, contributing 3.3 and 3.2 percentage points in 2025 and 2026 respectively. The contribution of net exports is also positive at 1.3 percentage points in 2025, and 1.1 percentage points in 2026.

Chart 2.1 illustrates the projected growth rates of GDP, together with a detailed breakdown of the expenditure aggregates. Table 2.1 presents the main macroeconomic indicators for the years 2021-2026. The figures for 2021 and 2022 represent actual data published by the National Statistics Office (NSO), while the data for 2023 to 2026 represent the scenario-based projections of the Ministry for Finance and Employment (MFE). The macroeconomic forecasts take into account the latest available data and are provided in Tables 1a, 1b, 1c and 1d of the Statistical Appendix.

Table 2.1

Main Macroeconomic Indicators

	2021	2022	2023p	2024p	2025p	2026p
GDP growth at current market prices (%)	13.9	12.5	8.6	7.7	7.2	7.0
GDP growth at Chain Linked Volumes by period (Reference year 2010) (%)[1]	11.8	6.9	4.1	4.5	4.6	4.2
Expenditure Components of GDP at Current Market Prices by period (%)						
Private final consumption expenditure[2]	9.4	16.1	9.2	7.3	6.4	6.3
General Government final consumption expenditure	9.4	6.4	5.8	5.7	4.9	4.5
Gross fixed capital formation	13.6	39.2	-4.5	5.5	5.8	7.1
Exports of goods and services	8.4	11.3	7.8	8.1	7.9	6.9
Imports of goods and services	5.8	14.9	5.4	7.5	7.2	6.4
Expenditure Components of GDP at Chain Linked Volumes by period (Reference year 2010) (%)						
Private final consumption expenditure[2]	8.1	10.1	3.8	3.9	4.0	3.6
General Government final consumption expenditure	6.9	2.4	3.4	3.2	2.4	1.7
Gross fixed capital formation	10.9	30.4	-6.8	3.8	4.6	5.6
Exports of goods and services	6.3	6.4	4.3	5.2	5.3	4.2
Imports of goods and services	3.8	9.7	2.4	4.8	5.0	3.9
Inflation rate (%)	0.7	6.1	5.7	3.5	2.0	2.4
Employment growth (National Accounts Definition) (%)[3]	2.9	6.0	3.5	3.7	3.7	3.6
Unemployment rate (Harmonised definition, Eurostat) (%)	3.5	2.9	3.0	3.1	3.1	3.1
Compensation per employee (% change)[3]	4.6	2.8	5.3	3.9	2.8	2.8
Labour productivity (% change)[3]	8.6	0.8	0.6	0.7	0.8	0.6
Nominal Unit Labour Cost (% change)	-3.7	2.1	4.7	3.2	2.0	2.2
Real Unit Labour Costs (% change)	-5.5	-3.0	0.4	0.1	-0.5	-0.4

[1] Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. This non-additivity, similar to that in other countries' national accounts, is due to mathematical reasons and reflects the fact that chain-linked volumes are calculated by separately extrapolating both totals and their sub-components.

[2] Includes NPISH final consumption expenditure.

[3] Forecast for employement is based on FTEs.

2.2.1 Assumptions for Projections

The macroeconomic forecasts presented in this Stability Programme are based on the following assumptions:

- Economic activity in Malta's main trading partners is expected to marginally increase by 0.2 per cent in 2023, and then accelerate by 1.1 per cent in 2024. Over the outer years, growth is expected to increase by 1.5 and 1.2 per cent in 2025 and 2026 respectively.
- World prices are assumed to increase by 3.8 per cent in 2023 and by 1.4 per cent in 2024, before averaging at a growth rate of 2.3 per cent in 2025 and 2026.
- Oil prices are projected to decrease from an annual average of $100.8 per barrel in 2022, to $85.0 in 2023, before stabilising at $84.8 per barrel in 2024. This price level is retained for the outer years.
- The Euro/Dollar exchange rate is expected to appreciate from an annual average of 1.0476 in 2022 to 1.0895 Dollars per Euro in 2023, and to appreciate further to 1.1250 in 2025. Further euro strength is expected in the outer years, reaching an average of 1.1320 Dollars per Euro in 2024 and 2025.

- The Euro/Sterling exchange rate is expected to appreciate from 0.8685 in 2022 to 0.8919 Pounds per Euro in 2023, prior to depreciating to 0.8873 in 2024. In 2025 and 2026, the Sterling/Euro is assumed to depreciate to an average of 0.8858 in both years.
- The short-term interest rate is assumed to increase to 1.3 per cent in 2023. It is then projected to further increase to 1.5 per cent in 2024 and 2025, prior to decreasing to 1.3 per cent in 2026. Long-term interest rates are assumed to reach 3.1 per cent in 2023 and 2024, before increasing to 3.2 per cent in 2025 and decreasing to 3.0 per cent in 2026.
- While inflationary pressures are assumed to be sticky throughout 2023, a wage-price spiral is not expected. Upward price pressures are assumed to resume towards the end of the forecast horizon, in line with an increase in import prices resulting from the introduction of various regulatory measures that will have an impact on shipping costs.
- Changes in inventories are assumed not to contribute to GDP growth.

2.2.2 Risks to Outlook

The balance of risks to the growth outlook appears to be tilted to the downside, as high uncertainty continues to overshadow the economic outlook. While the economic impact of the war in Ukraine has now been largely assimilated by households and businesses, new risks are emerging. Tighter financing conditions could prove more challenging than previously envisaged as certain financial institutions on the international markets are showing signs of distressed balance sheets. Meanwhile, while inflation expectations remain contained, the inflationary outlook is dependent on supply-side exogenous shocks particularly in energy and food. Notwithstanding, some upside risks to growth are also emerging, including more resilient domestic demand, in addition to a more benign external environment driven by the re-opening of China and a depreciation of the dollar. These risk factors, amongst others, will be explored in more detail in Chapter 4.

2.2.3 Private Consumption

Private consumption for 2023 is expected to increase by 3.8 per cent. This growth reflects strong employment and sustained population growth. Households proved to be relatively resilient to the rising prices in 2022, as private consumption surpassed pre-pandemic levels, suggesting that households are in a good financial position to withstand any short-term declines in purchasing power. Decelerating inflation and an increase in compensation per employee, should lead to a less significant decline in household purchasing power compared to 2022. In 2024, private consumption is expected to grow by 3.9 per cent, on the back of further population growth, high employment growth and a further deceleration in inflation. In the outer years, private consumption is projected to grow by 4.0 per cent in 2025 and 3.6 per cent in 2026.

2.2.4 General Government Final Consumption Expenditure

Public consumption growth is projected to increase by 3.4 per cent in 2023, driven primarily by growth in intermediate consumption and compensation of employees. In 2024, Government expenditure will further increase by 3.2 per cent. In the outer years, general Government final consumption expenditure is projected to grow by an average rate of 2.0 per cent. This implies that the share of public consumption in real GDP will average at 18.4 per cent over the projection period.

2.2.5 Gross Fixed Capital Formation

The inherently volatile nature of gross fixed capital formation (GFCF) makes it relatively challenging to forecast. Hence, when forecasting investment, a relatively prudent

approach is normally followed, factoring in only those projects that have a strong political commitment or a high probability of realisation, while assuming a relatively high import content.

Gross fixed capital formation is expected to decline by 6.8 per cent in 2023, a result of large one-off investments which produced a large base for 2022. Furthermore, high uncertainty and tighter financing conditions are likely to cause some investment projects to be deferred. In 2024, GFCF is projected to partially recover by 3.8 per cent, as business and investor sentiment improve, despite some prevailing uncertainty and higher financing costs. In the outer years, investment activity is expected to gradually stabilize and record an average growth of 5.1 per cent between 2025 and 2026.

2.2.6 External Balance of Goods and Services

The external environment appears to have marginally improved since the Draft Budgetary Plan, albeit price pressures and the aggressive tightening response by global central banks continue to weigh on the external outlook. A stronger Euro is expected to reduce competitiveness of European exports, however this should be outweighed by the re-opening of China and easing supply chain disruptions. To this end, the European Commission (EC) revised growth for the Euro Area upwards by 0.6 percentage points since Autumn of 2022. The collapse of some banks outside the European Union (EU) initiated fears that financial contagion would spread to the European banks. Although concerns of global financial distress seem to have stabilized, financial market sentiment remains fragile. Consequently, despite the more upbeat prospects, global growth is assumed to remain weak.

Tourism exports surprised on the upside in 2022, as inbound tourism reached 83.0 per cent of pre-pandemic levels, markedly surpassing initial expectations. This is partially a result of the release of pent-up demand after two years of travel restrictions, as demand proved to be resilient in the face of higher holiday prices and prevalent uncertainty. These positive developments in the travel sector are expected to continue in 2023, as tourism numbers are anticipated to surpass pre-pandemic levels. The more optimistic tourism assumptions should support export growth, which is projected to grow by 4.3 per cent. Partially offsetting the increase in exports, is an increase in imports of 2.4 per cent in 2023, predominantly driven by strong domestic demand. In Malta, investment activity tends to be highly import-intensive, and thus, year-on-year movements in investment are offset by imports of capital goods, thereby minimising the impact of volatile investment flows on GDP in the medium-term.

As global economy activity picks up in 2024, both exports and imports are expected to increase at a stronger pace. Malta's exports are anticipated to grow by 5.2 per cent in 2024 and converge to an average growth of 4.8 per cent over the outer years. Imports are expected to move in line with domestic activity and are projected to increase by 4.8 per cent in 2024, before averaging at 4.5 per cent in the outer years. The external balance as a percentage of GDP is expected to reach 14.7 per cent in 2023, and to further increase throughout the forecast horizon, reaching 17.5 per cent in 2026.

2.2.7 Sectoral Balances

In 2022, the current account turned negative owing to higher energy prices and one-off investments in the aviation industry. In 2023, the anticipated deceleration in import prices is expected to yield a positive effect on the current account, particularly if short-term increases in import prices are passed on to export prices. Moreover, the strengthening of the euro should support these dynamics in the short term. However, over the medium-term, Malta could encounter some competitiveness pressures.

In terms of services, the continued growth of travel exports as well as gains in market share in information and technology, the personal, cultural and recreational sector, and the other business services sector are expected to reinforce the services balance.

As for primary income, a higher return on foreign assets held by Maltese entities and individuals should result in an improvement in the returns on foreign assets relative to the returns on foreign-owned domestic assets. This means that the primary income balance should improve. However, Malta remains an attractive country for investment, and any new flow of direct investment liabilities will lead to a higher volume of outflows in the primary income account.

Table 1.d in the appendix provides a summary of the forecasts for the balance of goods and services, consistent with the information presented in Tabel 2.1. It should be noted, however, that the present forecast round does not incorporate current account projections owing to a significant discrepancy between the National accounts and Balance of Payments statistics, along with an expected methodological revision in the latter.

2.2.8 Productivity and Employment Growth

The labour market continued to sustain its positive performance in 2022, as employment growth based on national accounts definition stood at 6.0 per cent. The unemployment rate maintained its downward trend, reaching a historic low of 2.9 per cent.

In 2023, employment growth is projected to reach 3.5 per cent, before reaching an average of 3.6 per cent in the outer years. The unemployment rate, based on the Harmonised definition, is projected to reach 3.0 per cent in 2023, a result of persistent labour market shortages and sustained economic growth, before averaging at 3.1 per cent throughout the outer years of the forecast horizon.

Tight labour market conditions and rising prices are expected to support an increase in compensation of employees, which are projected to grow by 9.0 per cent in 2023, before moderating to 7.8 per cent in 2024 and averaging 6.6 per cent in the outer years. This means that growth in compensation per employee is expected to reach 5.3 per cent in 2023, before slowing down to 3.9 per cent in 2024 and averaging at 2.8 per cent in the outer years.

In 2023, real labour productivity is anticipated to increase by 0.6 per cent and remain stable around 0.7 per cent in the subsequent years. Nominal unit labour costs are expected to increase by 4.7 per cent in 2023, by 3.2 per cent in 2024, by 2.0 per cent in 2025 and by 2.2 per cent in 2026. Moreover, real unit labour costs are projected to increase by 0.4 per cent in 2023 and 0.1 per cent in 2024, before declining by an average of 0.5 per cent in the outer years.

2.2.9 Inflation

In 2022, the inflation rate (measured as the twelve-month moving average of the Harmonized Index for Consumer Prices (HICP)) was 6.1 per cent, a significant increase from 0.7 per cent observed in 2021. Price pressures were broad-based across most product categories, albeit mostly driven by the prices of services and food. Inflationary pressures are gradually subsiding, mainly driven by declines in the prices of commodities and moderating economic activity. Moreover, the decrease in freight rates observed from the second quarter of 2022, should further reduce inflationary pressures, given Malta's strong dependency on maritime transportation. However, services inflation is set to remain elevated, owing to substantial wage growth. Moreover, the notable increase

in the Cost-of-Living Adjustment (COLA) of €9.90 per week, the staggered nature of wage and rent contracts, and the tight labour market are expected to keep inflation sticky. To this end, the inflation rate is expected to moderate slightly at 5.7 per cent in 2023, predominantly driven by services and food prices. Inflation is anticipated to further decelerate to 3.5 per cent in 2024 and to 2.0 per cent in 2025, before increasing again to 2.4 per cent in 2026. The latter increase follows an expected increase in the cost of shipping due to the introduction of various regulatory measures that are expected to have a significant impact on costs due to Malta's openness to trade and insularity.

2.2.10 Comparison with the Commission's Winter Forecast

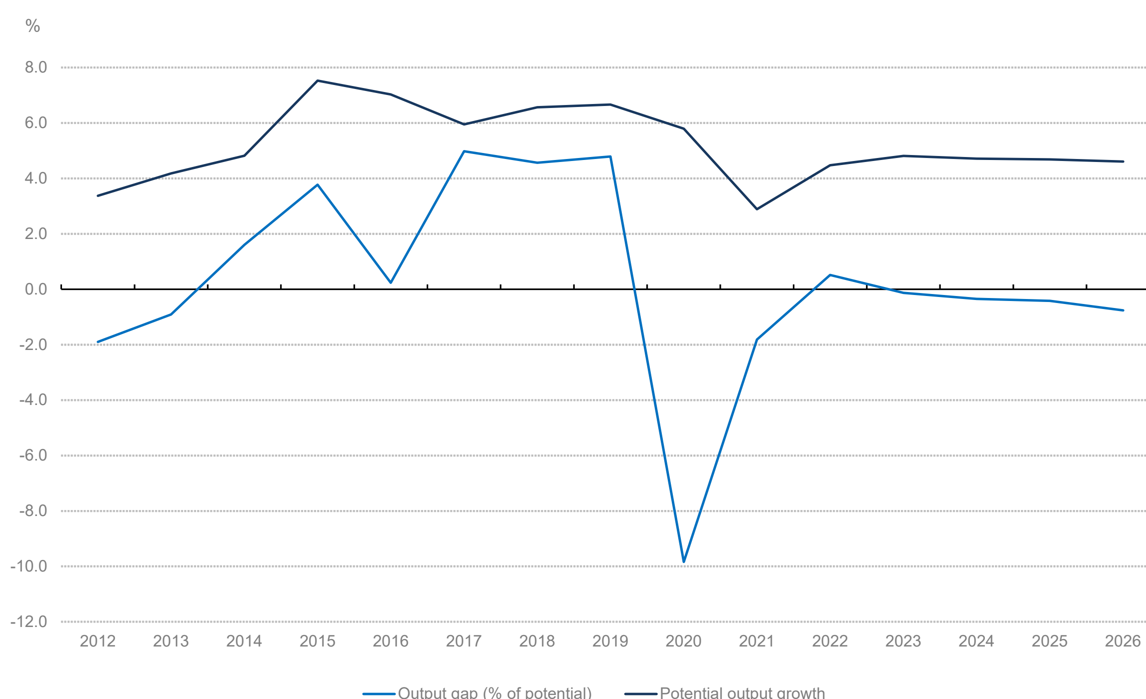
The winter forecasts published by the EC project a growth rate for Malta of 3.1 per cent and 3.7 per cent in 2022 and 2023, respectively. For 2023, this is 0.9 percentage points below this forecast's expectations, while for 2024, this is 0.4 percentage points below. It is to be noted that the EC's Winter Forecast does not use the latest statistical data. That said, the EC forecasts are currently in the process of being revised.

2.3 Potential Output and Output Gap

The estimation of potential output and the output gap within this Update of the Stability Programme is based on the commonly agreed Production Function method. The main differences between the EC's and MFE's estimation pertain to differences in the macroeconomic forecasts. Chart 2.2 depicts historical developments and projections for the potential output and the output gap.

From 2012 to 2019, potential output growth averaged at 5.8 per cent, reaching a peak in 2015. During this period, the output gap averaged at 2.1 per cent, indicating

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



that the Maltese economy was operating above its potential level. In 2020-2021, the rate of potential output growth experienced a deceleration due to the pandemic, but subsequently resumed to an upward trajectory in 2022. Consequently, the output gap became negative in 2020-2021, averaging -5.8 per cent. However, it turned positive in 2022, reaching 0.5 per cent, which can be attributed to the ongoing economic recovery.

During the projection period, it is anticipated that the potential output growth rate will maintain a consistent average of 4.7 percent. The anticipated primary driver of potential GDP growth is the labour contribution, which is expected to remain robust owing to a resilient labour market. Capital accumulation is expected to be the second most significant contributor, followed by an upward trajectory in the TFP contribution. As a result, it is predicted that the output gap would almost be closed by 2023 and then exhibit a downward trend until 2025, reflecting some level of caution in MFE's macroeconomic projections.

Table 1a

Macroeconomic Prospects

Percentages unless otherwise indicated	ESA Code	Level 2021[1]	Level 2022[1]	Percentage change over previous period 2021	2022	2023[2]	2024	2025	2026
1. Real GDP	B.1g	13,303.9	14,215.4	11.8	6.9	4.1	4.5	4.6	4.2
2. Nominal GDP	B.1g	15,001.9	16,870.3	13.9	12.5	8.6	7.7	7.2	7.0
Components of real GDP									
3. Private consumption expenditure[3]	P.3	5,891.7	6,488.0	8.1	10.1	3.8	3.9	4.0	3.6
4. Government consumption expenditure	P.3	2,628.2	2,692.0	6.9	2.4	3.4	3.2	2.4	1.7
5. Gross fixed capital formation	P.51	2,806.3	3,659.4	10.9	30.4	-6.8	3.8	4.6	5.6
6. Changes in inventories and net acquisition									
of valuables (% of GDP)	P.52+P.53			1.2	1.0	1.0	1.0	0.9	0.9
7. Exports of goods and services	P.6	22,941.7	24,404.5	6.3	6.4	4.3	5.2	5.3	4.2
8. Imports of goods and services	P.7	21,151.2	23,197.1	3.8	9.7	2.4	4.8	5.0	3.9
Contribution to real GDP growth[4]									
9. Final domestic demand		11,326.1	12,839.3	7.2	10.9	0.6	3.2	3.3	3.2
10. Change in inventories and net acquisition				-0.3	-0.1	0.0	0.0	0.0	0.0
of valuables	P.52+P.53								
11. External balance of goods and services	B.11	1,790.5	1,207.4	4.9	-4.0	3.5	1.2	1.3	1.0

[1] € million

[2] Projections from 2023 onwards

[3] Includes NPISH final consumption expenditure

[4] Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. This non-additivity, similar to that in other countries' national accounts, is due to mathematical reasons and reflects the fact that chain-linked volumes are calculated by separately extrapolating both totals and their sub-components.

Table 1b

Price Developments

Percentages unless otherwise indicated	ESA Code	Level 2021[1]	Level 2022[1]	Percentage change over previous period 2021	2022	2023[2]	2024	2025	2026
1. GDP deflator[3]		127.1	133.7	1.9	5.2	4.3	3.0	2.5	2.6
2. Private consumption deflator		116.7	123.0	1.2	5.4	5.3	3.3	2.3	2.5
3. HICP (Average 2015=100)		107.1	113.7	0.7	6.1	5.7	3.5	2.0	2.4
4. Public consumption deflator		128.2	133.1	2.3	3.9	2.3	2.4	2.4	2.7
5. Investment deflator		118.0	125.9	2.5	6.7	2.7	1.7	1.1	1.4
6. Export price deflator (goods and services)		124.6	130.4	2.0	4.7	3.3	2.8	2.4	2.6
7. Import price deflator (goods and services)		119.6	125.3	2.0	4.7	2.9	2.5	2.2	2.4

[1] Index (base 2010 unless otherwise indicated)

[2] Projections from 2023 onwards

[3] Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. Indeed, summing up the deflators of the components of GDP would not add up to the actual GDP deflator observed for the year.

Table 1c
Labour Market Developments

Percentages unless otherwise indicated	ESA Code	Level	Level	Percentage change over previous period					
		2021	2022	2021	2022	2023[1]	2024	2025	2026
1. Employment, persons[2]		266,870.0	283,001.0	2.9	6.0	3.5	3.7	3.7	3.6
2. Employment, hours worked[3]		535,875.0	568,266.0	2.9	4.0	3.5	3.7	3.7	3.6
3. Unemployment rate (%)[4]		1,794.0	998.0	3.4	2.9	3.0	3.1	3.1	3.1
4. Labour productivity, persons[5]		49,851.7	50,230.8	8.6	0.8	0.6	0.7	0.8	0.6
5. Labour productivity, hours worked[6]		24.8	25.0	8.6	0.8	0.6	0.7	0.8	0.6
6. Compensation of employees (€ million)	D1	6,852.1	7,496.0	7.8	9.4	9.0	7.8	6.7	6.5
7. Compensation per employee (€)		25,675.8	26,487.7	4.6	2.8	5.3	3.9	2.8	2.8

[1] Projections from 2023 onwards.

[2] Historic based on National Accounts Definition, Domestic Concept ('000s), forecasts based on FTEs.

[3] Historic based on National Accounts Definition, Domestic Concept ('000s), forecasts based on FTEs.

[4] Harmonised definition, Eurostat; 1000 persons.

[5] Real GDP per person employed (Forecasts based on FTEs).

[6] Real GDP per hour worked (Forecasts based on FTEs).

Table 1d
Sectoral Balances

Percentages of GDP	ESA Code	2022	2023	2024	2025	2026
1. Net lending/ borrowing		-2.9				
vis-à-vis the rest of the world	B.9					
of which:						
Balance on goods and services		8.4	14.2	15.7	16.8	17.5
Balance on primary income and transfers		-11.7				
Capital account		0.4				
2. Net lending/ borrowing of the private sector	B.9	1.9				
3. Net lending/ borrowing of general Government	EDP B.9	-5.8				
4. Statistical discrepancy		1.0				
Current Account		-3.3				

Table 8
Basic Assumptions

	2021	2022	2023(p)	2024(p)	2025(p)	2026(p)
Short-term interest rate (annual average)	0.00	1.00	1.30	1.50	1.50	1.30
Long-term interest rate (annual average)	0.48	2.40	3.10	3.10	3.20	3.00
EUR/USD exchange rate (average)	1.163	1.048	1.090	1.125	1.132	1.132
EUR/GBP exchange rate (average)	0.853	0.869	0.892	0.887	0.886	0.886
Malta's main trading partners real GDP growth	5.0	11.7	0.2	1.1	1.5	1.2
Oil prices, (Brent, USD/barrel)	70.7	100.8	85.0	84.8	84.8	84.8
World prices weighted by main trading partners (y-o-y % change)	9.7	26.8	3.8	1.4	2.2	2.3

3. General Government Balance and Debt

3. General Government Balance and Debt

The war between Russia and Ukraine challenged the prospects of economic recovery across the world after the COVID-19 pandemic. As inflationary pressures mounted from abroad, the Government adjusted its spending to support the economy and stabilise the prices and supply of basic commodities, allowing the economy to register a notable rate of economic expansion and generate more revenues to finance additional support from public funds. The Government has nonetheless met its deficit target for 2022 and registered a significantly lower debt ratio of 53.4 per cent of Gross Domestic Product (GDP), compared to a target of 57.0 per cent of GDP.

The overall objective of the fiscal policy strategy outlined in this Stability Programme is to support economic growth, while maintaining fiscal sustainability through a sound fiscal position in the medium-term. The Government is committed to continue to provide the necessary support to the economy and in the process protect vulnerable households and firms. These extraordinary measures, predominantly made up of price-support measures, have proved beneficial in maintaining inflationary pressures in Malta relatively contained. Nevertheless, the overall fiscal policy stance shall remain contractionary, with a targeted and credible decline in the deficit and the structural deficit, thus ensuring that the fiscal stance does not add additional pressures on domestic price levels.

The Government's prudent fiscal policy shall ensure debt sustainability, while raising potential growth in a sustainable manner and address the green and digital transitions and resilience objectives through investment and reforms.

The Government's strategy hinges on its long-term socio-economic vision resting on five principles, namely, (i) good governance, (ii) a higher quality of life for all citizens, (iii) investing in education, (iv) renewal of Malta's infrastructure and (v) achieving a carbon neutral economy by 2050. The 2023 National Reform Programme highlights the Government's key policy responses to the major challenges grouped under thematic areas encompassing Environment, Productivity, Macroeconomic Stability, Fairness and Governance and Taxation. The general direction of the Government's strategy is to address these key areas in a complementary manner such that multiple objectives can be reached through the same policy measure.

The Government's strategy is supported by the implementation of the national Recovery and Resilience Programme (RRP), which encompasses the main national policies for sustainable growth and competitiveness enhancement, and high-quality investment projects funded from the Multiannual Financial Framework (MFF) for the period 2021-2027.

European Union (EU) funds will support green transition and energy security and digital transformation. Along with fostering the development of a sustainable blue economy and enhancing the resilience of the fishing and the aquaculture sectors, funding will also help individuals obtain additional skills, employment opportunities, and social inclusion.

3.1 Fiscal Developments in 2022

The general Government balance for 2022 amounted to a deficit of €981.1 million, an improvement of €194.7 million over the deficit recorded in 2021. Total revenue increased by €493.8 million to €5,913.9 million, while expenditure amounted to €6,894.9 million,

increasing by €299.1 million. As a share of GDP, the general Government balance was equivalent to a deficit of 5.8 per cent, decreasing by 2.0 percentage points when compared to the deficit of 7.8 per cent registered in 2021. General Government debt increased by €739.5 million from 2021 to 2022, such that it stood at €9,003.4 million in 2022. The debt-to GDP ratio for 2022 decreased to 53.4 per cent from the 55.1 per cent in 2021. Fiscal developments in 2022 were mainly impacted by the ongoing effects of Russia's invasion of Ukraine, inflationary pressures on prices of energy and food that disrupted both the economy and society at large, and three years of COVID, including the phasing out of Government COVID-19 measures.

Despite the increase in the level of general Government revenue, its ratio to GDP decreased by 1.0 percentage points over 2021. Tax revenue (excluding social contributions) remained relatively stable at 24.4 per cent of GDP, but increased in absolute terms, with increases in all components of tax revenue. Corporate profits increased in the first half of 2022 due to a tilt of the factor distribution of income gains in favour of corporations. Proceeds from current taxes on income and wealth decreased by 0.1 percentage points in 2022 from 13.7 per cent in 2021 to 13.6 per cent in 2022. Taxes on production and imports remained somewhat the same in terms of percentage of GDP from 2021 to 2022, remaining at 10.5 per cent but they experienced an increase in absolute terms. Meanwhile, the ratio-to-GDP of capital taxes remained the same whilst that of social contributions and property income declined by 0.2 and 0.1 percentage points respectively reflecting the skewed factor income gains. On the other hand, 'other' revenue declined by 0.8 percentage points, mainly reflecting lower capital transfers and investment grants.

The ratio of general Government expenditure to GDP decreased by 3.1 percentage points to 40.9 per cent in 2022, however it did increase in absolute terms, reflecting the Government support due to inflationary pressures from abroad which was only partly offset by the phasing out of COVID-19 measures. The expenditure ratio decreased for all expenditure components, besides subsidies, which increased by 0.4 percentage points. Indeed, expenditure on subsidies increased on account of the cost of energy support measures, early retirement schemes to employees released by Air Malta plc and restructuring assistance to the national airline, in part offset by lower expenditure on the wage supplement scheme. All the other components experienced a decrease in the ratio to GDP from 2021 to 2022, in particular compensation of employees and 'other' expenditure, which registered a decrease of 1.1 and 0.6 percentage points, respectively. A 0.5 percentage point decline in the ratio to GDP was also recorded for intermediate consumptions and gross fixed capital formation.

Temporary discretionary measures, including the national policy response to COVID-19 and energy support measures

During the pandemic, Government's fiscal support was crucial in safeguarding jobs and in providing the necessary fiscal stimulus for the resumption of economic activity. Additional healthcare funding was necessary to address hospital capacity, medical equipment and protective gear requirements while fiscal policy measures were put in place to cushion the economic impact on revenues, incomes and liquidity, consisting of discretionary polices with a direct impact on the budget, as well as liquidity-oriented measures. Subsequently, allocation of the Government COVID-19 health related expenditure and supporting schemes assisting the tourism industry, businesses and employment were almost phased out by the end of 2022. The Malta Enterprise business assistance schemes, including the wage supplement scheme, were terminated in May 2022. Meanwhile, the contract signing period of the tax reduction measure on property purchases and sales, for promise of sales registered until the end of December 2021, was extended by nine

months until the end of June 2023. In 2022, COVID-19 related expenditure amounted to 2 per cent of GDP.

The war between Russia and Ukraine has destabilised international energy markets and in response, the Government has put in place support measures to stabilise the price and secure the supply of gas, petroleum, electricity, grains and animal fodder. These included minimum excise duty on petroleum products, compensation for the higher cost of imported electricity prices and petroleum products, and price support measures on commodities. In 2022, the cost of energy support measures amounted to 2.6 per cent of GDP.

In addition, the cost of early retirement schemes to employees released by Air Malta plc and restructuring assistance to the national airline amounted to 0.9 per cent of GDP in 2022.

In aggregate, the cost of temporary discretionary measures is estimated at 5.5 per cent of GDP. This suggests that the 2022 excessive deficit was predominantly related to the temporary support measures.

3.1.1 Comparison with the 2022 Update of the Stability Programme for 2022

This section assesses the fiscal and budgetary policies in 2022 against the objectives outlined in the 2022 Update of the Stability Programme (2022 USP) published in April 2022. It is important to note that the targets for 2022, as outlined in spring 2022, differ from those underlying the 2022 Budget presented in October 2021 due to updated fiscal information available and revised macroeconomic assumptions due to the war in Ukraine following the pandemic outbreak. Developments in the general Government budgetary execution in 2022, between subsequent forecasts, are outlined in Table 3.1a.

During 2022, the general Government recorded a deficit of €981 million, that is €131 million higher than the €850 million forecast outlined in the 2022 USP. This was mainly due to a more subdued than anticipated revenue outcome, which turned out €42 million lower than expected, as well as higher general Government expenditure, which was €89 million higher than estimated.

'Other revenue' turned out €72 million lower than expected, as lower than planned absorption of capital transfers and investment grants of €100 million was in part offset by higher market output, which was €28 million in excess of expectations. Moreover, taxes on production and imports recorded lower than estimated proceeds of €23 million when compared to the 2022 USP. This component of revenue was largely affected by lower than anticipated revenue from excise duties and consumption taxes. Of notable relevance is VAT revenue, which, though exceeding the original targets, has not kept pace with the better-than-expected growth in economic activity generated. Moreover, current taxes on income and wealth yielded €13 million lower revenue than estimated reflecting lower than estimated taxes on individual and household income, in part offset by higher revenue from taxes on the income and profits of corporations. Meanwhile, higher-than-estimated revenue from social contributions of €40 million is mainly due to better-than-expected macroeconomic developments in the underlying base.

Meanwhile, higher than targeted expenditure on subsidies and 'other' expenditure was in part offset by lower than planned expenditure on intermediate consumption, gross

Table 3.1a

General Government Budgetary Prospects in 2022

Divergence from previous forecasts

€ millions

	ESA Code	USP 2023 compared to USP 2022			
		Divergence due to out-turn in t-1	Divergence due to updated macro-economic projections	Other revisions	Total forecast revision [a]
Net lending (+)/net borrowing (-)					
1. General Government	S.13	**11**	**379**	**-522**	**-131**
2. Central Government	S.1311	11	379	-522	-131
3. State Government	S.1312	-	-	-	-
4. Local Government	S.1313	-0	-0	-0	-0
5. Social Security funds	S.1314	-	-	-	-
For the General Government					
6. Total Revenue	TR	**11**	**379**	**-433**	**-42**
Of which					
Taxes on Production and Imports	D.2	-17	116	-121	-23
Of which					
Value Added Type Taxes (VAT)	D.211	0	98	-75	23
Taxes on Financial and Capital Transactions	D.214C	-7	16	-15	-5
Current Taxes on Income, Wealth, etc.	D.5	32	225	-270	-13
Of which					
Taxes on Individual or Household Income	D.51M	-31	77	-74	-28
Taxes on the income or profits of Corporations	D.51O	63	147	-194	16
Capital Taxes	D.91	0	5	8	13
Social Contributions	D.61	-4	34	9	40
Of which					
Employers' Actual Pension Contributions	D.611	-0	14	-10	4
Households' actual social contributions	D.613	-4	21	4	21
Property Income	D.4	0	0	12	12
Other [b]		0	0	-72	-72
7. Total Expenditure	TE	**0**	**-0**	**89**	**89**
Of which					
Compensation of employees	D.1	0	0	-64	-64
Intermediate Consumption	P.2	0	0	-173	-173
Social Payments	D.6	0	-0	-35	-35
Of which					
Unemployment expenditure			-0	-0	-0
Interest Expenditure	D.41	0	0	-0	-0
Subsidies	D.3	0	0	391	391
Gross Fixed Capital Formation	P.51	0	0	-74	-74
Capital Transfers	D.9	0	0	-15	-15
Other [c]		0	0	60	60

Notes:

[a] Totals may not add up due to rounding

[b] P.11 + P.12 + P.131 + D.39rec + D.7rec + D.9rec (other than D.91rec).

[c] D.29 + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

fixed capital formation, compensation of employees and social payments. Expenditure on subsidies was €391 million higher than targeted in the 2022 USP, on account of the cost of energy support measures, early retirement schemes to employees released by Air Malta plc and restructuring assistance to the national airline, in part offset by lower expenditure on the wage supplement scheme. Expenditure on intermediate consumption was €173 million lower than estimated in spring 2022, reflecting lower expenditure on programmes and initiatives and capital expenditure classified under this category. In addition, lower than expected compensation of employees amounting to €64 million was recorded, mainly reflecting lower expenditure in respect of employees of Government entities.

3.2 Budgetary plans for 2023

The pre-pandemic level of output was already attained by the end of 2021 and increased further in 2022, despite the uncertainty brought about by the Russia-Ukraine conflict, which brought about inflationary pressures from supply chain disruptions from abroad. This increase in output came about because economic fundamentals in Malta, bolstered by generally strong household and corporate balance sheets, together with Government's stabilisation policies and better than foreseen tourism, continued to support domestic demand conditions and ensured a further resumption of growth, albeit at a slightly more moderate pace when compared to 2021. These positive developments are expected to continue in 2023 as well, supported by the strong anticipated performance of the tourism sector.

In line with such developments, the economic expansion is expected to boost taxation receipts over the course of this year. Meanwhile, the increase in general Government expenditure is estimated to be less pronounced compared to economic growth. This is expected to result in an improvement of the general Government balance in 2023 to a deficit of €913.3 million or 5.0 per cent of GDP. The total revenue ratio for the general Government is expected to increase by 0.6 percentage points, while the expenditure-to-GDP ratio is expected to narrow by 0.2 percentage points.

Table 3.2 presents the general Government expenditure and revenue targets, broken down by main components.

2023 Expenditure and Revenue Targets

Total revenue as a share to GDP is expected to increase by 0.6 percentage points, reflecting a 10.6 per cent increase over 2022 levels. Revenue from taxes, including social contributions, is expected to increase by 7.2 per cent, benefitting from positive contributions from private consumption and the rebound in tourism, the sustained growth in profits and the positive performance of the labour market. In terms of ratios to GDP, direct taxes are expected to decline by 0.3 percentage points of GDP, whilst indirect taxes are expected to remain unchanged. Meanwhile, the ratio-to-GDP of non-tax revenue is expected to increase by 1.0 percentage point, with 'other' revenue expected to experience a 1.3 percentage point increase. The latter reflects higher revenue from market output and from capital transfers and investment grants.

The ratio of general Government expenditure to GDP is estimated to decline by 0.2 percentage points in 2023. General Government expenditure is expected to increase by 8.1 per cent over the level recorded in 2022, reflecting inflationary pressures on the components of expenditure, in particular intermediate consumption and social benefits, as well as compensation of employees. Lower expenditure on subsidies is expected to

Table 3.2

Expenditure and Revenue Targets

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

% GDP

	ESA Code	2021	2022	2023	2024	2025	2026
General Government (S13)							
1. Total revenue target	TR	**36.1**	**35.1**	**35.7**	**34.2**	**34.0**	**33.7**
of which							
1.1. Taxes on production and imports	D.2	10.5	10.5	10.5	10.3	10.2	10.2
1.2. Current taxes on income, wealth, etc	D.5	13.7	13.6	13.4	13.3	13.2	13.3
1.3. Capital taxes	D.91	0.2	0.2	0.1	0.1	0.1	0.1
1.4. Social contributions	D.61	6.1	5.9	5.8	5.7	5.6	5.5
1.5. Property income	D.4	0.6	0.5	0.3	0.3	0.4	0.4
1.6. Other [1]		5.1	4.3	5.6	4.5	4.4	4.2
p.m.: Tax burden		30.6	30.4	30.0	29.6	29.3	29.2
(D.2+D.5+D.61+D.91-D.995)[2]							
2. Total expenditure target	TE	**44.0**	**40.9**	**40.7**	**38.5**	**37.6**	**36.6**
of which							
2.1. Compensation of employees	D.1	11.9	10.8	10.7	10.6	10.4	10.3
2.2. Intermediate consumption	P.2	8.6	8.1	8.5	8.2	8.0	7.8
2.3. Social payments	D.6M	9.3	8.8	8.8	8.8	8.6	8.4
of which Unemployment benefits [3]		0.2	0.2	0.1	0.1	0.1	0.1
2.4. Interest expenditure	D.41	1.1	1.0	1.2	1.5	1.5	1.4
2.5. Subsidies	D.3	4.6	5.0	3.7	2.9	2.6	2.2
2.6. Gross fixed capital formation	P.51	3.8	3.3	3.8	3.1	3.1	3.2
2.7. Capital transfers	D.9	1.2	0.9	1.3	1.0	1.0	1.0
2.8. Other [4]		3.4	2.8	2.7	2.5	2.4	2.3
3. General Government Balance		**-7.8**	**-5.8**	**-5.0**	**-4.3**	**-3.6**	**-2.9**
4. Primary Balance		**-6.7**	**-4.8**	**-3.8**	**-2.8**	**-2.1**	**-1.5**

[1] P.10 + D.39rec + D.7rec + D.9rec (other than D.91rec).

[2] Tax revenue, including those collected by the EU and including an adjustment for uncollected taxes and social contributions D.995), if appropriate.

[3] Includes cash benefits (D.621 and D.624) and in kind benefits (D.632) related to unemployment benefits.

[4] D.29pay + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

result in a 1.3 percentage point decline in its ratio to GDP. These developments are in part offset by higher ratios to GDP of gross fixed capital formation and capital transfers. Indeed, investment is expected to be supported by a substantial boost from EU financed projects, in particular reflecting the completion of EU-funded projects financed from the programming period 2014-2020, the Recovery and Resilience Funds (RRF), as well as the MFF for the period 2021-2027.

Discretionary measures

In 2023, the net impact of discretionary revenue and expenditure measures, including those implemented in previous budgets but which will still have an impact in 2023, is expected to improve the budget balance by 0.43 percentage points and 1.66 percentage points of GDP, respectively. A list of the main discretionary measures underpinning the medium-term fiscal developments are presented in Table 3.3.

Table 3.3

Description of discretionary measures included in the draft budget

(Discretionary measures taken by General Government)

List of measures	Detailed description	Target (Expenditure / Revenue component) ESA Code	Accounting principle	Adoption Status	Introduced in Budget for…	Incremental budgetary impact					
						2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP	2026 % of GDP
Post COVID-19 Economic Regeneration Plan	Reduced tax on the transfer of immovable property	D2, D5 - R	Accruals	Temporary & Adopted	June 2020 Economic Regeneration Plan	-0.29	0.05	0.22	-0.01	-0.01	-0.01
Post COVID-19 Economic Regeneration Plan	Reduced Excise Duty	D2 - R	Accruals	Temporary & Adopted	June 2020 Economic Regeneration Plan	-0.05	0.02	0.01	0.01	0.01	0.00
Budget measures enabling business activity		D2 - R	Accruals	Permanent & Adopted	2019 - 2021	-0.00	-0.00	-0.00	-0.00	-0.00	-0.00
Excise duty	Minimum excise duty applicable on petroleum products as from 9/11/2021	D2 - R	Accruals	Permanent & Adopted	2021	-0.03	-0.16	0.01	0.01	0.01	0.01
Efficiency in Revenue Collection	Revision in interest and penalties due on outstanding tax balances	D2, D5 - R	Accruals	Permanent & Adopted	2022	0.00	0.12	-0.01	-0.01	-0.01	-0.01
Personal income tax	Fiscal incentives for private pensions	D5 - R	Accruals	Permanent & Adopted	2019 - 2021	-0.03	0.00	0.00	0.00	0.00	0.00
Personal income tax	Income tax - Fixed Rate on part-time work	D5 - R	Accruals	Permanent & Adopted	2022	0.00	-0.03	0.00	0.00	0.00	0.00
Tax deferrals	Assumption of 5% unrecoverable deferred tax	D2, D5, D6 - R	Accruals	Permanent & Adopted	2020 - 2022	-0.02	0.01	0.01	0.00	0.00	0.00
Individual Investor Programme	Revenue from the Individual Investor Programme	P10 - R	Accruals	Permanent & Adopted	2014	-0.33	-0.34	0.21	-0.10	-0.02	-0.02
Other revenue measures, including measures legislated in previous budgets			Accruals	Permanent & Adopted		-0.05	-0.07	-0.02	-0.02	-0.02	-0.01
COVID-19 Support Measure	Various medical supplies and equipment in relation to COVID-19	P2 - E	Accruals	Temporary & Adopted	2020 - 2021	0.10	0.27	0.19	0.06	0.03	0.00
COVID-19 Support Measure	Cargo Transportation and Repatriation	P2 - E	Accruals	Temporary & Adopted	COVID-19 Support Measure	0.38	0.00	0.00	0.00	0.00	0.00
COVID-19 Support Measure and Post COVID-19 Economic Regeneration Plan	COVID-19 Business Assistance Programme and the Economic Regeneration Voucher Scheme	D3 - E	Accruals	Temporary & Adopted	2020 - 2021	0.86	2.01	0.74	0.00	0.00	0.00
COVID-19 Support Measure	Government-guaranteed loans schemes	D3 - E	Accruals	Temporary & Adopted	COVID-19 Support Measure	-0.06	0.01	0.06	0.00	0.00	0.00
COVID-19 Support Measure	Tourism Regeneration Plan	D3 - E	Accruals	Temporary & Adopted	2021	-0.03	0.01	0.02	0.00	0.00	0.00
Price stabilisation support	Energy support measures and commodity price and supply security measures		Accruals	Temporary & Adopted	2020	-0.14	-1.72	0.79	0.16	0.14	0.08
COVID-19 Support Measure	Short-Term Social Measures	D6 - E	Accruals	Temporary & Adopted	COVID-19 Support Measure	0.11	0.00	0.00	0.00	0.00	0.00
	Housing Programmes	D6 - E	Accruals	Permanent & Adopted	2020	-0.00	-0.04	-0.00	0.00	0.01	0.01
Re-distribution measures - energy and inflation	Extended COLA mechanism targeting vulnerable households	D6 - E	Accruals	Permanent & Adopted	2023	0.00	0.00	-0.07	0.01	0.00	0.00
Re-distribution measures	Measures to address housing affordability, pension adequacy and the integration of vulnerable individuals in society; cash payments by Government to households	D6 - E	Accruals	Permanent & Adopted	2021 - 2026	-0.04	-0.14	-0.33	0.09	0.09	0.09
AirMalta restructuring plan	Financial support to the national airline	D9 - E	Accruals	Temporary & Adopted	2022 & 2023	0.00	-0.86	0.31	0.55	0.00	0.00
COVID-19 Support Measure	Tourism Support Schemes	D9 - E	Accruals	Temporary & Adopted	2021 & 2022	-0.09	0.05	0.04	0.00	0.00	0.00
Other expenditure measures, including measures legislated in previous budgets and projects financed from the National Development and Social Fund			Accruals	Permanent & Adopted		-0.04	0.02	-0.09	0.10	0.02	0.02
						0.23	**-0.78**	**2.08**	**0.85**	**0.27**	**0.17**

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

The 2023 Budget extended re-distribution measures with the aim to continue strengthening social inclusion, promote social mobility and reduce poverty. Furthermore, as the adverse economic effects experienced during the pandemic continued to wane, the Russia-Ukrainian conflict has shifted government's support towards energy prices and food supplies in providing adequate assistance and thus minimising its direct impact on industries and the general public.

In order to reduce further the risk of poverty for the most vulnerable in society, the 2023 Budget included a number of measures which financially enhance the pensioners' and elderly's income as well as low-income households. Most pensions, both contributory and non-contributory, were increased in excess of the customary cost of living adjustment (COLA) while the non-taxable threshold was raised.

An extended COLA mechanism targeted towards vulnerable households was introduced, intended to target costs associated with the most fundamental needs of food, housing, utilities, household maintenance and health, which is in the form of a lump sum paid annually. The mechanism is triggered during a "period of high inflation" on the basis of two conditions:

1. Overall inflation exceeds 2.0 per cent;
2. The change in prices among at least three out of five components of the RPI index (Food, Housing, Water, electricity, gas and fuels, Household equipment and house maintenance cost, and Personal health care) deemed to be essential for vulnerable household, exceeds their five-year rolling average increase.

Around 80,000 vulnerable people (making up around 37,000 households) are benefitting from this new mechanism. The mechanism is benefitting individuals who are receiving social benefits and have earned less than an average income of €17,796. Going forward, the mechanism is expected to be retained every year, with the beneficiaries expected to change on the basis of their income, and number of individuals within said household. The mechanism is expected to have a permanent fiscal impact of €13 million (0.07 per cent of GDP).

The Budget for 2023 further enhanced the disposable income of low- and middle-income earners and incentivised people to work by extending and increasing measures aimed at making work pay. Such measures include the In-Work Benefit Scheme, the Tapering of Benefits and the reduction of tax burden on workers, through tax rebates and lower tax on part-time and overtime work. Furthermore, the Government has continued to support incomes through a further increase in children's allowance, an increase over and above COLA for public sector employees and an increase in stipends allowance to students on pro-rata basis.

Several policy measures which had been put in place in previous years, intended to ensure affordable housing availability were extended, and widened in scope, together with an additional grant for first time buyers payable over 10 years. In addition, the rent subsidy offered to families, for which value depends on the number of bedrooms per accommodation, was increased by €100 per month.

Several business aid measures were also substantiated, including tax incentives for transfers inter vivos of family businesses, tax incentives for social enterprises, and other financial assistance administered by Malta Enterprise for investment in digital projects,

projects that reduce energy and water consumption and investments reducing material waste.

Several environmental measures were outlined in the 2023 Budget, including an allocation of €700 million for urban greening projects over seven years, an organic processing plant to maximise the use of waste, and an extension of existing incentives to encourage the purchase of solar panels, solar water heaters, heat pumps and other such devices. In addition, electric and plug-in hybrid vehicles will still be exempted from registration tax and from payment of the annual road licence fee. Furthermore, following the implementation of free public transport as from October 2022 to reduce private vehicles usage, the Government will continue investing in the electrification of the bus fleet.

In the 2023 Budget, the Government had allocated over 8 per cent of total annual expenditure to cushion the impact of international energy prices on water and energy bills and fuel prices. As energy prices have somewhat stabilised at lower prices in recent months, the cost of energy support measures is expected to decline from 2.5 per cent of GDP in 2022 to 1.7 per cent of GDP in 2023, and to continue to decline further over the medium-term horizon up to 1.5 per cent of GDP by 2026.

In addition, in view of the possibility of the Government opening a second early retirement scheme for Air Malta workers, a provisional allocation of 0.5 percentage points of GDP is included in 2023.

3.2.1 Comparison with the 2022 Update of the Stability Programme for 2023

The actual outturn for 2022 together with the evaluation of budgetary developments for the general Government and updated macroeconomic projections constitute the basis for the revised projections for 2023. In addition, revisions also take into consideration the revised impact of fiscal measures, including those intended to support households and businesses from the increases in the international price of oil and commodities as well as the fiscal impact of the measures underlying the 2023 Budget. Table 3.1b distinguishes the changes to the 2023 forecasts between successive reports due to the impact of the actual outturn in 2022 (base effect), revised macroeconomic determinants, and other changes.

During 2023, the general Government is expected to record a deficit of €913.3 million, compared to an estimated deficit of €759.0 million outlined in the 2022 USP.

These developments reflect a higher than expected revenue of €255 million for 2023 due to the positive base effect of €59 million in 2022, better than expected estimated macro-economic developments in 2023, which are expected to impact revenue positively by €72 million and an additional €123 million revenue from other revisions projected in April 2023. The principal revisions are attributed to 'other' revenue, mainly due to higher market output and current taxes on income and wealth, the latter reflecting better than expected economic developments mostly impacting revenue from taxes on income of households. Another principle revision when compared to the estimates outlined in the 2022 USP relates to social contributions, reflecting a higher than anticipated outturn in 2022 and better than expected estimated underlying macro-economic developments in 2023.

Table 3.1b

General Government Budgetary Prospects in 2023

Divergence from previous forecasts

€ millions

	ESA Code	USP 2023 compared to USP 2022: Divergence due to outturn in *t-1*	Divergence due to updated macro-economic projections	Other revisions	**Total forecast revision** [(a)]
Net lending (+)/net borrowing (-)					
1. General Government	S.13	**59**	**72**	**-286**	**-154**
2. Central Government	S.1311	59	72	-286	-154
3. State Government	S.1312	-	-	-	-
4. Local Government	S.1313	-0	-0	-0	-0
5. Social Security funds	S.1314	-	-	-	-
For the General Government					
6. Total Revenue	TR	**59**	**72**	**123**	**255**
Of which					
Taxes on Production and Imports	D.2	12	3	-58	-43
Of which					
Value Added Type Taxes (VAT)	D.211	24	6	-16	14
Taxes on Financial and Capital Transactions	D.214C	2	-6	-61	-65
Current Taxes on Income, Wealth, etc.	D.5	2	44	33	80
Of which					
Taxes on Individual or Household Income	D.51M	-9	52	-33	10
Taxes on the income or profits of Corporations	D.51O	14	-8	62	69
Capital Taxes	D.91	11	-2	-7	1
Social Contributions	D.61	34	27	7	68
Of which					
Employers' Actual Pension Contributions	D.611	14	14	0	29
Households' actual social contributions	D.613	21	13	-0	33
Property Income	D.4			-29	-29
Other [(b)]				178	178
7. Total Expenditure	TE	**0**	**0**	**409**	**409**
Of which					
Compensation of employees	D.1			-45	-45
Intermediate Consumption	P.2			21	21
Social Payments	D.6		0	36	36
Of which					
Unemployment expenditure			0	0	0
Interest Expenditure	D.41			51	51
Subsidies	D.3			207	207
Gross Fixed Capital Formation	P.51			-3	-3
Capital Transfers	D.9			30	30
Other [(c)]				112	112

Notes:

[(a)] Totals may not add up due to rounding

[(b)] P.11 + P.12 + P.131 + D.39rec + D.7rec + D.9rec (other than D.91rec).

[(c)] D.29 + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

Meanwhile, higher than targeted expenditure compared to the estimates outlined in the 2022 USP of €409 million are mainly attributed to revisions in subsidies, reflecting the estimated cost of price-support measures introduced as support toward the economy to contain inflationary pressures and early retirement schemes to employees released by Air Malta plc.

It is worth noting that these revisions mainly reflect the impact of inflationary pressures which have proved to be stronger and more persistent than originally anticipated in Spring of last year. In particular a higher than anticipated impact of the €9.90 COLA increase is now incorporated in these revised estimates.

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

Cognisant of the responsibility in addressing social cohesion, inequality and poverty, during the medium-term, the Maltese Government is committed to keep providing the necessary support to the economy through price-support measures to contain any inflationary pressures, which have become more broad-based across different categories. This is having an extensive and comprehensive impact across large parts of the population, eroding household purchasing power. As evidenced by the recent crisis of COVID-19, fiscal policy should play a role in mitigating the economic and social impact of shocks. As price increases are having a disproportionate impact, it is difficult to exclude parts of the population from fiscal support in a context where the inflationary impact is wider. Notwithstanding, fiscal policy should avoid being expansionary, since this would exacerbate inflationary pressures. To this end, the overall-fiscal policy stance intends to remain contractionary, with a targeted decline in the deficit and the structural deficit. Moreover, the Government's prudent fiscal policy shall also ensure debt sustainability, while raising potential growth in a sustainable manner.

In 2023 the budget deficit is now targeted to reach 5.0 per cent of GDP (compared to the target of 5.5 per cent presented in the Draft Budget Plan). This means that the structural effort has been front-loaded this year. In anticipation of the lifting of the General Escape Clause in Spring 2024, this Programme targets a structural effort of 0.8 per cent exceeding the minimum effort of 0.5 per cent. This effort is targeted to be sustained over the medium term. Indeed, contingent on the macroeconomic projections underlying this Programme, the budget balance is expected to improve to a deficit of 2.9 per cent of GDP by 2026. In structural terms, the general Government deficit is expected to improve from 4.9 per cent in 2023 to 2.5 per cent by 2026. An analysis of the developments in the general Government balance is presented in Table 3.4, while further details on the cyclical developments over the medium-term are illustrated in Table 3.5 and Chart 3.1.

The assumed economic recovery is expected to boost taxation receipts. Direct taxes are expected to be the main drivers, in particular taxes on the income of households, as tight labour market conditions and rising prices are expected to support an increase in compensation of employees. In contrast, the indirect taxation yield is projected to increase more modestly. On account of these developments, the ratio to GDP of total taxes is expected to decline marginally over the medium-term. Nevertheless, the decline in the revenue-to-GDP ratio mainly reflects developments in 'other' revenue, which is expected to decline by 1.3 percentage points from 5.6 per cent of GDP in 2023 to 4.2 per cent in 2026, mainly reflecting developments in capital transfers and investment grants.

Table 3.4

Analysis of the Developments in the General Government Balance

(percentage points)

	2021	2022	2023	2024	2025	2026
Change in Revenue Ratio	**(0.05)**	**(1.07)**	**0.67**	**(1.48)**	**(0.24)**	**(0.32)**
Discretionary factors underpinning fiscal consolidation	(0.81)	(0.40)	0.43	(0.11)	(0.03)	(0.03)
Revenue increasing measures	(0.50)	(0.35)	0.12	(0.18)	(0.09)	(0.08)
Revenue reducing measures	(0.31)	(0.05)	0.31	0.07	0.06	0.05
One-off and temporary revenue measures	-	-	-	-	-	-
Tax revenue buoyancy	0.93	(0.19)	(0.59)	(0.42)	(0.24)	(0.12)
Other revenue	(0.18)	(0.48)	0.83	(0.95)	0.02	(0.17)
Change in Expenditure Ratio	**1.88**	**3.10**	**0.16**	**2.17**	**0.97**	**1.00**
Discretionary factors underpinning fiscal consolidation	1.04	(0.38)	1.66	0.96	0.29	0.20
Expenditure increasing measures	1.11	(0.33)	1.69	0.99	0.32	0.22
Expenditure reducing measures	(0.06)	(0.05)	(0.03)	(0.03)	(0.02)	(0.02)
Change in Gross Fixed Capital Formation	0.38	0.49	(0.30)	0.59	(0.00)	(0.13)
Other expenditure	0.46	2.98	(1.20)	0.62	0.68	0.93
Change in the General Government Balance	**1.82**	**2.02**	**0.83**	**0.69**	**0.73**	**0.68**

Note: positive represents an improvement in the general Government balance

Table 3.5

Cyclical Developments

(percentage points of GDP)

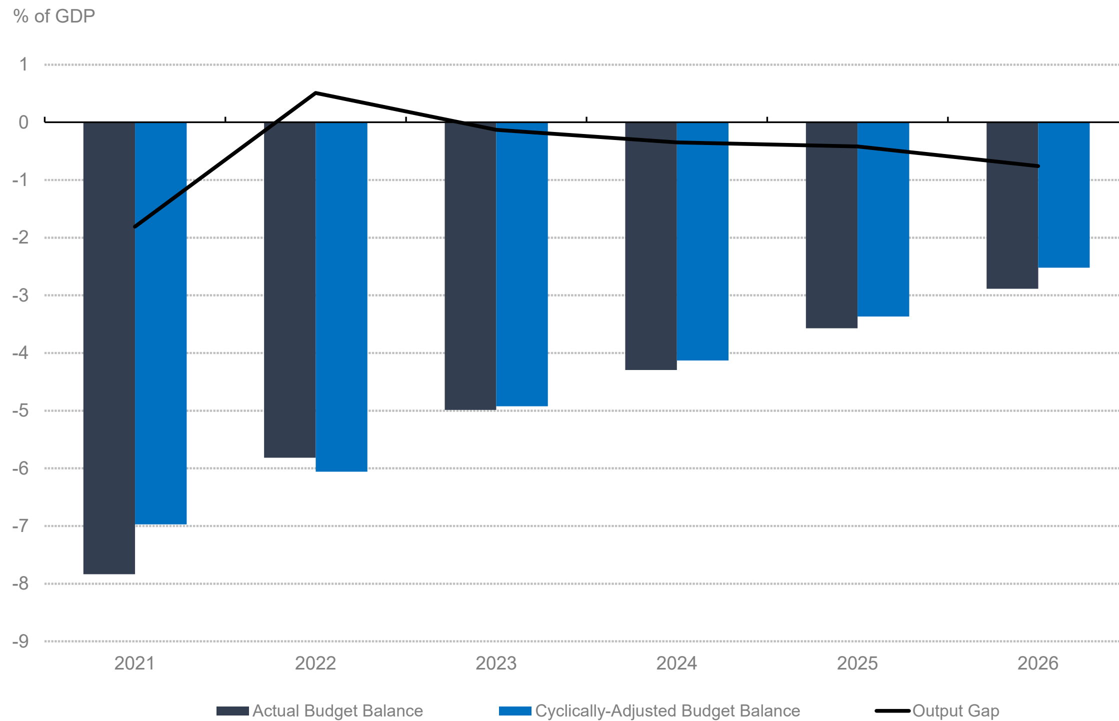
	ESA Code	2021	2022	2023	2024	2025	2026
Net lending (+) / net borrowing (-) by sub-sector [1]	B.9						
1. General Government Balance	S.13	-7.8	-5.8	-5.0	-4.3	-3.6	-2.9
2. Central Government	S.1311	-7.9	-5.8	-5.0	-4.3	-3.6	-2.9
3. State Government	S.1312	-	-	-	-	-	-
4. Local Government	S.1313	0.1	-0.0	-0.0	-0.0	-0.0	-0.0
5. Social security funds	S.1314	-	-	-	-	-	-
6. Interest expenditure	D.41	1.1	1.0	1.2	1.5	1.5	1.4
7. Primary balance[2]		-6.7	-4.8	-3.8	-2.8	-2.1	-1.5
8. One-off and other temporary measures[3]		0.0	0.0	0.0	0.0	0.0	0.0
9. Real GDP growth (%)		11.8	6.9	4.1	4.5	4.6	4.2
10. Potential GDP growth (%)		2.9	4.5	4.8	4.7	4.7	4.6
11. Output gap (% of potential GDP)		-1.8	0.5	-0.1	-0.4	-0.4	-0.8
12. Cyclical budgetary component (% of potential GDP)		-0.9	0.2	-0.1	-0.2	-0.2	-0.4
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		-7.0	-6.1	-4.9	-4.1	-3.4	-2.5
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		-5.8	-5.1	-3.7	-2.7	-1.9	-1.1
15. Structural balance (13 - 8) (% of potential GDP)		-7.0	-6.1	-4.9	-4.1	-3.4	-2.5

[1] TR-TE= B.9.

[2] The primary balance is calculated as (B.9) plus (D.41, item 6).

[3] A plus sign means deficit-reducing one-off measures.

Chart 3.1
Actual and Cyclically-Adjusted Budget Balances



Over the medium-term, the growth in general Government expenditure is expected to be more modest and increase at an annual average rate of 3.5 per cent. Nationally financed net primary expenditure[1] is expected to average a 3.9 per cent growth over the medium-term, compared to an annual growth of 4.9 per cent which would still ensure that from the end of the adjustment period, public debt would be on a plausibly declining path.

Whilst the Government shall sustain the necessary support to the economy to contain the inflationary pressures and protect vulnerable households and firms, yet the fiscal policy stance shall remain contractionary so not to add further pressures on domestic price levels. Investment expenditure is expected to remain high over the medium-term, further sustained by additional funds from the RRF towards sustainable growth, high-quality investment projects and structural reforms. Projected receipts and expenditure financed from the RRF are outlined in Appendix Table 9.a and Appendix Table 9.b.

Expenditure and Revenue Targets under the No-Policy Change Assumption

General Government expenditure and revenue targets under a no-policy-change assumption are outlined in Table 3.2a. At unchanged policies, general Government revenue would grow by an annual average of 5.8 per cent over the medium-term, compared to an average growth of 5.2 per cent underlying the 2023 USP targets.

At unchanged policies, total expenditure would increase by an average of 4.5 percentage points over the medium-term, compared to an average growth of 3.5 per cent underlying the medium-term budgetary targets.

Table 3.2a

Expenditure and Revenue Projections under the no-policy change scenario [1]

(General Government expenditure and revenue projections at unchanged policies broken down by main components)

% GDP

	ESA Code	2021	2022	2023	2024	2025	2026
General Government (S13)							
1. Total revenue at unchanged policies	TR	**36.1**	**35.1**	**35.7**	**34.9**	**34.6**	**34.3**
of which							
1.1 Taxes on production and imports	D.2	10.5	10.5	10.5	10.8	10.7	10.6
1.2 Current taxes on income and wealth	D.5	13.7	13.6	13.4	13.4	13.3	13.3
1.3 Capital taxes	D.91	0.2	0.2	0.1	0.1	0.1	0.1
1.4 Social contributions	D.61	6.1	5.9	5.8	5.7	5.6	5.5
1.5 Property income	D.4	0.6	0.5	0.3	0.3	0.4	0.4
1.6 Other revenue [2]		5.1	4.3	5.6	4.6	4.5	4.3
p.m.: Tax burden		30.6	30.4	30.0	30.1	29.9	29.7
(D.2+D.5+D.61+D.91-D.995)[3]							
2. Total expenditure at unchanged policies	TE	**44.0**	**40.9**	**40.7**	**39.8**	**38.7**	**37.6**
of which							
2.1 Compensation of employees	D.1	11.9	10.8	10.7	10.6	10.4	10.3
2.2 Intermediate consumption	P.2	8.6	8.1	8.5	8.2	8.0	7.8
2.3 Social payments	D.6M	9.3	8.8	8.8	8.8	8.6	8.4
of which U*nemployment benefits* [4]		0.2	0.2	0.1	0.1	0.1	0.1
2.4 Interest expenditure	D.41	1.1	1.0	1.2	1.5	1.5	1.4
2.5 Subsidies	D.3	4.6	5.0	3.7	4.2	3.8	3.3
2.6 Gross fixed capital formation	P.51	3.8	3.3	3.8	3.1	3.1	3.2
2.7 Capital Transfers Payable	D.9	1.2	0.9	1.3	1.0	1.0	1.0
2.8 Other expenditure [5]		3.4	2.8	2.7	2.5	2.4	2.2
3. General Government Balance		**-7.8**	**-5.8**	**-5.0**	**-4.9**	**-4.1**	**-3.3**
4. Primary Balance		**-6.7**	**-4.8**	**-3.8**	**-3.5**	**-2.6**	**-1.9**

[1] Data for 2021-2022 is equivalent to the data presented in Table 4.a. The no-policy change scenario for the forthcoming year (2023) onwards involves the extrapolation of revenue and expenditure trends after deducting the impact of temporary measures of the current year and before adding the impact of the measures included in the forthcoming year's budget.

[2] P.10 + D.39rec + D.7rec + D.9rec (other than D.91rec).

[3] Tax revneue, including those collected by the EU and including an adjustment for uncollected taxes and social contributions D.995), if appropriate.

[4] Includes cash benefits (D.621 and D.624) and in kind benefits (D.632) related to unemployment benefits.

[5] D.29pay + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

3.4 Debt levels and developments

In spite of the impact of the COVID-19 related economic support measures and the subsequent inflation mitigation measures, Malta continues to be amongst the Member States with the lowest debt ratio in the Euro Area. The level of public debt relative to GDP declined to 53.4 per cent in 2022 and is now forecast to remain well below the Maastricht reference value of 60 per cent by the end of the projected period at 56.1 per cent of GDP in 2026.

During 2022, short-term debt accounted for 9.2 per cent of total Government debt and is expected to decrease to 6.2 per cent in 2023. Short-term debt funding is predicted

to increase again in 2024 where subsequently it will gradually decrease reaching 4.6 per cent in 2026. Additionally, the share of maturing stocks in total Government debt is expected to decrease from a level of 4.2 per cent in 2022 to 3.6 per cent in 2023 and 2024. Maturing stocks are projected to reach the ratio of 5.6 per cent in 2026.

3.4.1 Projected Debt developments

Debt developments depend on the net lending which can be decomposed into the primary balance and interest expenditure, GDP growth and the stock flow (deficit-debt adjustment), which captures those transactions or factors that influence government debt but are not reflected in the government balance and is thus made up of financial transactions and accruals that do not affect lending. Developments in the debt ratio for the period under review and the contributors to developments in the debt-to-GDP ratio are presented in Table 3.6 and Statistical Appendix Table 4.

General Government debt increased by €739.5 million over 2021 and stood at €9,003.4 million in 2022. The debt-to-GDP ratio for 2022 decreased to 53.4 per cent. This was underlined by an improvement in the primary balance and a lower incurred interest expenditure. As in 2021, when GDP had risen substantially, the interest-growth differential exerted a debt-decreasing effect in 2022.

The debt ratio is forecast to gradually increase slightly until 2025 reaching 56.2 per cent of GDP, thereafter declining to 56.1 per cent of GDP in 2026. Developments in the gross Government debt are illustrated in Chart 3.2. The slight expected rise in the debt-to-GDP ratio over the medium-term horizon is mainly driven by developments in the projected primary deficits, and to a lower extent the increase in interest rate

Table 3.6

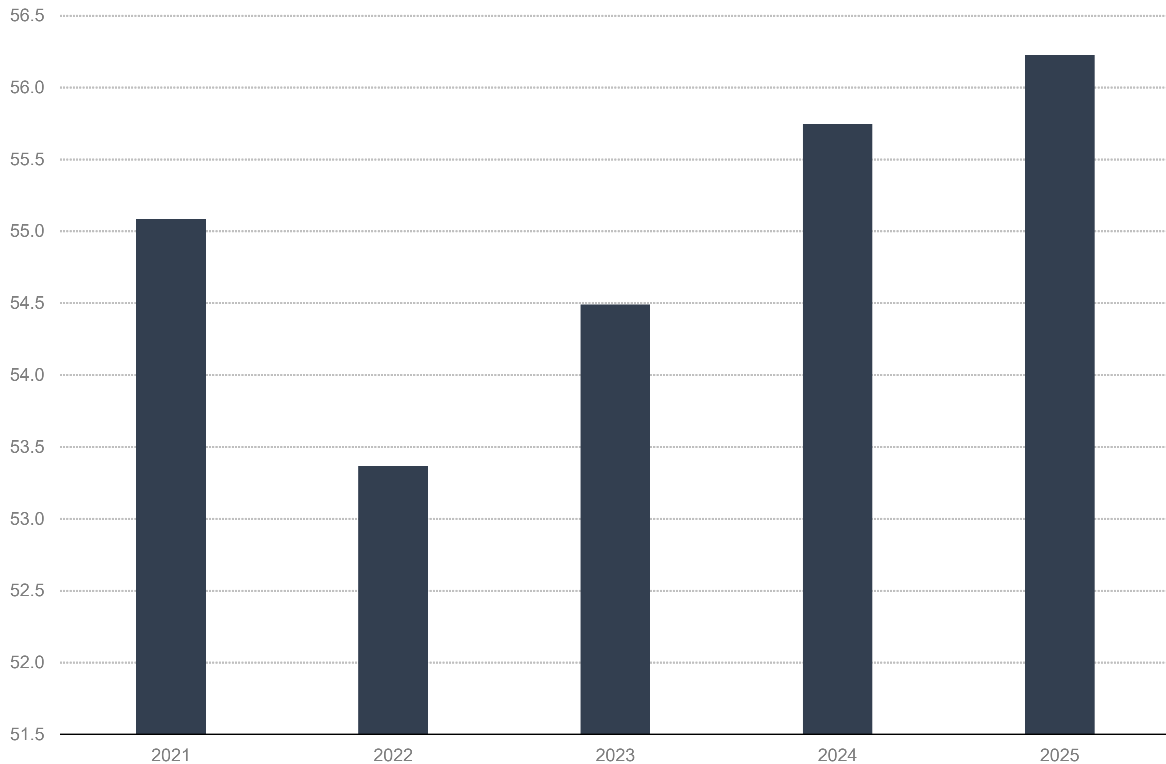
The Dynamics of Government Debt[(1)]

Percentages of GDP	2021	2022	2023	2024	2025	2026
Gross debt	55.1	53.4	54.5	55.7	56.2	56.1
Change in gross debt ratio	2.1	-1.7	1.1	1.3	0.5	-0.1
Contributions to changes in gross debt						
Primary balance	6.7	4.8	3.8	2.8	2.1	1.5
Snowball Effect	-5.3	-5.1	-3.0	-2.4	-2.3	-2.2
Interest expenditure	1.1	1.0	1.2	1.5	1.5	1.4
Real GDP growth	-5.6	-3.5	-2.1	-2.3	-2.5	-2.3
Inflation Effect	-0.9	-2.6	-2.1	-1.5	-1.3	-1.4
Stock-flow adjustment	0.7	-1.4	0.3	0.8	0.7	0.7
p.m. implicit interest rate on debt	2.4	2.0	2.5	2.9	2.8	2.7

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

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

Chart 3.2
Debt-to-GDP ratio



expenditure, as higher interest rates are expected to affect only gradually the implicit cost of public debt. Meanwhile, the projected increase in the GDP deflator is expected to have a debt-decreasing impact over the forecast horizon, while the interest-growth differential ('snowball effect') is set to continue decreasing the debt ratios.

The stock flow adjustment for 2022 stood at -1.4 per cent indicating that the increase in debt was lower than the registered deficit. This SFA was mainly the result of decreases in Other accounts receivable and payable, partly offset by increases in the holdings of Debt Securities and in Currency and deposits. Over the medium-term, stock flow transactions are expected to have a more moderate impact on the debt ratio. Further details on the SFA can be found in Appendix Table 10.

3.4.2 Comparison with the Debt Projections published in the 2022 Update of the Stability Programme

As illustrated in the Statistical Appendix Table 6, the ratios of general Government debt-to-GDP presented in this programme are expected to differ substantially for the coming years to the ratio presented in the previous Update of the Stability Programme. The lower debt-to-GDP ratios presented in this update are mainly driven by a stronger expected economic growth and higher inflation.

For 2022, the debt-to-GDP ratio was revised downwards by 5.2 percentage points to 53.4 per cent of GDP, while the debt-to-GDP ratio for 2023 was revised downwards by 4.9 percentage points.

In the 2022 Update, the debt-to-GDP ratio was expected to peak from a level of 58.6 per cent in 2022 to a level of 59.4 per cent in 2023 and declining to a ratio of 58.6 per cent by 2024. On the other hand, in this Update of the Stability Programme, the debt-to-GDP ratio is estimated to rise to a ratio of 54.5 per cent by 2023 and 55.7 per cent by 2024 and thus remaining below the 60 per cent Maastricht threshold.

Footnote:

[1] Expenditure net of discretionary revenue measures and excluding interest expenditure as well as cyclical unemployment expenditure and expenditure on Union programmes fully matched by revenue from Union funds.

Table 2a

General Government Budgetary Prospects

Percentages of GDP		ESA code	2021(*)	2022(*)	2021	2022	2023	2024	2025	2026
Net Lending (EDP B9) by sub-sector										
1.	General Government	S13	-1,175.7	-981.1	-7.8	-5.8	-5.0	-4.3	-3.6	-2.9
2.	Central Government	S1311	-1,183.5	-979.9	-7.9	-5.8	-5.0	-4.3	-3.6	-2.9
3.	State Government	S1312	-	-	-	-	-	-	-	-
4.	Local Government	S1313	-1.2	-1.2	0.1	-0.0	-0.0	-0.0	-0.0	-0.0
5.	Social security funds	S1314	-	-	-	-	-	-	-	-
General Government										
6.	Total revenue	TR	5,420.1	5,913.9	36.1	35.1	35.7	34.2	34.0	33.7
7.	Total expenditure	TE	6,595.8	6,894.9	44.0	40.9	40.7	38.5	37.6	36.6
8.	Net lending / borrowing	B9	-1,175.7	-981.1	-7.8	-5.8	-5.0	-4.3	-3.6	-2.9
9.	Interest expenditure	D41	169.9	166.0	1.1	1.0	1.2	1.5	1.5	1.4
10.	Primary balance(1)		-1,005.8	-815.1	-6.7	-4.8	-3.8	-2.8	-2.1	-1.5
11.	One-off and other temporary measures(2)		6.3	5.0	0.0	0.0	0.0	0.0	0.0	0.0
Selected Components of Revenue										
12.	Total Taxes (12=12a+12b+12c)		3,660.3	4,112.7	24.4	24.4	24.1	23.7	23.6	23.5
12a.	Taxes on production and imports	D2	1,578.3	1,777.5	10.5	10.5	10.5	10.3	10.2	10.2
12b.	Current Taxes on Income, Wealth, etc.	D5	2,052.7	2,299.1	13.7	13.6	13.4	13.3	13.2	13.3
12c.	Capital Taxes	D91	29.3	36.2	0.2	0.2	0.1	0.1	0.1	0.1
13.	Social Contributions	D61	914.8	990.6	6.1	5.9	5.8	5.7	5.6	5.5
14.	Property Income	D4	83.5	80.6	0.6	0.5	0.3	0.3	0.4	0.4
15.	Other(3)		761.5	729.9	5.1	4.3	5.6	4.5	4.4	4.2
16=6.	Total Revenue	TR	5,420.1	5,913.9	36.1	35.1	35.7	34.2	34.0	33.7
p.m.:	Tax Burden (D2+D5+D6111+D6131+D91-D995)(4)		4,594.0	5,123.6	30.6	30.4	30.0	29.6	29.3	29.2
Selected Components of Expenditure										
17.	Compensation of employees + intermediate consumption	D1+P2	3,071.8	3,196.2	20.5	18.9	19.2	18.8	18.4	18.0
17a.	Compensation of employees	D1	1,781.7	1,830.2	11.9	10.8	10.7	10.6	10.4	10.3
17b.	Intermediate consumption	P2	1,290.1	1,365.9	8.6	8.1	8.5	8.2	8.0	7.8
18.	Social payments (18=18a+18b)		1,389.1	1,489.1	9.3	8.8	8.8	8.8	8.6	8.4
	of which Unemployment benefits (5)		25.7	25.4	0.2	0.2	0.1	0.1	0.1	0.1
18a.	Social transfers in kind supplied via market producers	D632	151.0	162.4	1.0	1.0	1.0	0.9	0.9	0.8
18b.	Social transfers other than in kind	D62	1,238.0	1,326.7	8.3	7.9	7.9	7.9	7.7	7.6
19=9.	Interest expenditure	D41	169.9	166.0	1.1	1.0	1.2	1.5	1.5	1.4
20.	Subsidies	D3	695.4	849.4	4.6	5.0	3.7	2.9	2.6	2.2
21.	Gross fixed capital formation	P51G	576.1	563.9	3.8	3.3	3.8	3.1	3.1	3.2
22.	Capital transfers	D9	178.8	154.2	1.2	0.9	1.3	1.0	1.0	1.0
23.	Other(6)		514.8	476.2	3.4	2.8	2.7	2.5	2.4	2.3
24=7.	Total Expenditure	TE	6,595.8	6,894.9	44.0	40.9	40.7	38.5	37.6	36.6
p.m.:	Government consumption (nominal)	P3	3,018.7	3,213.7	20.1	19.0	18.6	18.2	17.8	17.4

(*) € million

(1) The primary balance is calculated as (B9, item 8) plus (D41, item 9)

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

(3) P10 + D39rec + D7rec + D9N (ie D9 other than D91rec)

(4) Including those collected by the EU and including an adjustment for uncollected taxes and social contributions D995), if appropriate

(5) Includes social benefits other than social transfers in kind (D62) and social transfers in kind via market producers (D632) related to unemployment benefits

(6) D29pay + D4Npay (ie D4 other than D41pay) + D5pay + D7pay + P5M + NP + D8

Table 2b

No policy change projections

Percentages of GDP	2022(1)	2022	2023	2024	2025	2026
1. Total revenue at unchanged policies	5,913.9	35.1	35.7	34.9	34.6	34.3
2. Total expenditure at unchanged policies	6,894.9	40.9	40.7	39.8	38.7	37.6

(1) € million

Table 2c
Amounts to be excluded from the expenditure benchmark

Percentages of GDP	2021[1]	2022[1]	2021	2022	2023	2024	2025	2026
1. Expenditure on EU programmes fully matched by EU funds revenue	127.4	122.0	0.8	0.7	1.6	0.8	0.9	0.8
1a. *of which* Investment fully matched by EU funds revenue[2]	36.3	32.1	0.2	0.2	0.7	0.4	0.4	0.4
2. Cyclical unemployment benefit expenditure[3]	-7.4	-5.2	-0.0	-0.0	-0.0	-0.0	-0.0	0.0
3. Effect of discretionary revenue measures	-105.9	-67.3	-0.8	-0.4	0.4	-0.1	-0.0	-0.0
4. Revenue increases mandated by law	-	-	-	-	-	-	-	-

[1] € million

[2] Based on an estimate of Gross Fixed Capital Formation financed from EU funds

[3] The cyclical unemployment benefit expenditure is estimated based on the difference between the unemployment rate and NAWRU. Data for the total unemployment benefit expenditure is defined in COFOG under the code 10.5

Table 3
General Government Expenditure by Function

Percentages of GDP	COFOG Code	2021	2026
1. General public services	1	6.3	5.9
2. Defence	2	0.7	0.6
3. Public order and safety	3	1.3	1.2
4. Economic affairs	4	8.9	4.7
5. Environmental protection	5	1.7	1.2
6. Housing and community amenities	6	0.5	0.4
7. Health	7	6.0	5.1
8. Recreation, culture and religion	8	1.5	1.0
9. Education	9	6.0	5.0
10. Social protection	10	11.1	11.5
11. Total Expenditure	TE	44.0	36.6

Table 4
General Government Debt Developments

Percentages of GDP	ESA Code	2021	2022	2023	2024	2025	2026
1. Gross debt		55.1	53.4	54.5	55.7	56.2	56.1
2. Change in gross debt ratio		2.1	-1.7	1.1	1.3	0.5	-0.1
Contributions to changes in gross debt							
3. Primary balance		6.7	4.8	3.8	2.8	2.1	1.5
4. Interest expenditure	EDP D.41	1.1	1.0	1.2	1.5	1.5	1.4
5. Stock-flow adjustment		0.7	-1.4	0.3	0.8	0.7	0.7
p.m. implicit interest rate on debt[1]		2.4	2.0	2.5	2.9	2.8	2.7

[1] Proxied by interest expenditure divided by the debt level of the previous year.

Table 5
Cyclical Developments

Percentages of GDP	ESA Code	2021	2022	2023	2024	2025	2026
1. Real GDP growth (%)		11.8	6.9	4.1	4.5	4.6	4.2
2. General Government balance	EDP B.9	-7.8	-5.8	-5.0	-4.3	-3.6	-2.9
3. Interest expenditure	EDP D.41	1.1	1.0	1.2	1.5	1.5	1.4
4. One-off and other temporary measures[1]		0.0	0.0	0.0	0.0	0.0	0.0
of which							
One-offs on the revenue side: general Government		0.0	0.0	0.0	0.0	0.0	0.0
One-offs on the expenditure side: general Government		-0.0	0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		2.9	4.5	4.8	4.7	4.7	4.6
contributions:							
- labour (hours)		0.5	1.0	0.0	2.1	2.1	2.1
- capital		1.5	2.6	0.0	1.9	1.8	1.8
- total factor productivity		0.9	0.9	0.0	0.8	0.8	0.8
6. Output Gap		-1.8	0.5	-0.1	-0.4	-0.4	-0.8
7. Cyclical Budgetary Component		-0.9	0.2	-0.1	-0.2	-0.2	-0.4
8. Cyclically-Adjusted Balance (2-7)		-7.0	-6.1	-4.9	-4.1	-3.4	-2.5
9. Cyclically-Adjusted Primary Balance (8+3)		-5.8	-5.1	-3.7	-2.7	-1.9	-1.1
10. Structural Balance (8-4)		-7.0	-6.1	-4.9	-4.1	-3.4	-2.5

[1] A plus sign means deficit-reducing one-off measures

Table 6

Divergence from latest SP

% GDP

	ESA Code	2021	2022	2023	2024	2025	2026
Real GDP growth							
Previous Update		9.5	4.4	3.9	3.7	3.5	-
Current Update		11.8	6.9	4.1	4.5	4.6	4.2
Difference		2.3	2.5	0.2	0.8	1.1	-
General Government net lending/ net borrowing	EDP B.9						
Previous Update		-8.0	-5.4	-4.6	-2.8	-2.4	-
Current Update		-7.8	-5.8	-5.0	-4.3	-3.6	-2.9
Difference		0.2	-0.4	-0.4	-1.5	-1.2	-
General Government net lending projection at unchanged policies	EDP B.9						
Previous Update		-8.0	-6.9	-6.2	-3.5	-3.0	-
Current Update		-7.8	-5.8	-5.0	-4.9	-4.1	-3.3
Difference		0.2	1.1	1.2	-1.4	-1.1	-
Total Revenue	TR						
Previous Update		37.5	38.1	38.1	37.6	36.9	-
Current Update		36.1	35.1	35.7	34.2	34.0	33.7
Difference		-1.4	-3.0	-2.4	-3.4	-2.9	-
Total Expenditure	TE						
Previous Update		45.5	43.6	42.7	40.3	39.3	-
Current Update		44.0	40.9	40.7	38.5	37.6	36.6
Difference		-1.5	-2.7	-2.0	-1.8	-1.7	-
General Government gross debt							
Previous Update		57.0	58.6	59.4	58.6	57.2	-
Current Update		55.1	53.4	54.5	55.7	56.2	56.1
Difference		-1.9	-5.2	-4.9	-2.9	-1.0	-

Table 8b

Basic Fiscal Assumptions

	ESA Code	2021	2022	2023(f)	2024(f)	2025(f)	2026(f)
Implied Elasticity with respect to respective Tax Base							
Taxes on Production and Imports	D2	0.8	0.5	0.9	0.9	1.1	1.1
of which Value Added Taxes	D212	1.3	0.7	1.0	1.0	1.2	1.2
Current Taxes on Income, Wealth, etc.	D5	1.6	0.9	1.0	0.9	1.0	1.2
of which Current Taxes on Income, Wealth, etc. [Corporate] [1]	D5	5.1	1.4	0.3	0.1	0.4	0.4
Net social contributions	D61	1.2	0.8	0.9	0.8	0.8	0.8
General Government Adjustments (€ millions)		**56.8**	**-80.8**	**29.1**	**85.6**	**99.4**	**99.4**
Other accounts payable and receivable		-38.0	-330.2	5.0	5.0	5.0	5.0
Treasury Clearance Fund & Contingency Reserve		15.3	-7.1	0.0	0.0	0.0	0.0
Social and Investment Fund - IIP - Revenue		23.8	22.9	49.0	39.0	39.0	39.0
Social and Investment Fund - IIP - Expenditure		-7.5	-16.6	-36.0	-25.0	-25.0	-25.0
Re-routing/PPP adjustments		-9.8	-13.1	20.0	20.0	5.0	0.0
Others		72.9	263.3	-8.9	46.6	75.4	80.4
Social Security Benefits							
COLA (€)		1.75	1.75	9.90	13.39	8.15	6.41
Contributory Benefits (€ millions)		915.0	965.9	1,082.1	1,179.6	1,259.0	1,346.6
Number of CB Beneficiaries (persons)		125,218	132,495	134,196	133,761	133,370	133,630
Non-Contributory Benefits (€ millions)		212.5	242.5	245.4	259.3	264.3	268.7
Number of NCB Beneficiaries (persons)		153,792	217,292	176,283	175,936	175,707	175,433

[1] The elasticity with respect to the respective tax base does not capture developments in world GDP, although the latter influences developments in some components of taxes on the income and wealth of corporations.

Table 9a

RRF Impact on Projections - Grants

% of GDP

	ESA Code	2020	2021	2022	2023	2024	2025	2026
Revenue from RRF GRANTS								
RRF GRANTS as included in the revenue projections		0.0	0.0	0.1	0.5	0.6	0.4	0.1
Cash disbursements of RRF GRANTS from EU[1]		0.0	0.3	0.0	0.4	0.1	0.0	0.0
Expenditure financed from RRF GRANTS								
Total Current Expenditure		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Capital Expenditure		0.0	0.0	0.1	0.5	0.6	0.4	0.1
of which:								
Gross fixed capital formation	P.51g	0.0	0.0	0.1	0.5	0.6	0.4	0.1
Capital transfers	D.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other costs financed by RRF GRANTS [2]								
Financial transactions		0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which:								
Reduction in tax revenue		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other costs with impact on revenue		0.0	0.0	0.0	0.0	0.0	0.0	0.0

[1] As per MT RRP

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

Table 9b

RRF Impact on Projections - Loans

% of GDP

	ESA Code	2020	2021	2022	2023	2024	2025	2026
Cash flow from RRF loans projected in the programme								
Disbursements of RRF LOANS from EU		-	-	-	-	-	-	-
Repayments of RRF LOANS to EU		-	-	-	-	-	-	-
Expenditure financed from RRF loans								
Total Current Expenditure		-	-	-	-	-	-	-
Total Capital Expenditure		-	-	-	-	-	-	-
of which:								
Gross fixed capital formation	P.51g	-	-	-	-	-	-	-
Capital transfers	D.9	-	-	-	-	-	-	-
Other costs financed by RRF loans[1]								
Financial transactions		-	-	-	-	-	-	-
of which:								
Reduction in tax revenue		-	-	-	-	-	-	-
Other costs with impact on revenue		-	-	-	-	-	-	-

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

Table 10

Stock Flow Adjustment Statement

€ millions

	2022	2023	2024	2025	2026
General Governemnt deficit (-) / surplus (+) (ESA10)	981.1	913.3	847.2	754.8	652.8
ESA Adjustments	-131.1	29.1	85.6	99.4	99.4
Contribution to Sinking Fund (Local)	0.0	0.0	0.0	0.0	0.0
Contribution to Sinking Fund (Foreign)	0.1	0.1	0.0	0.0	0.0
Contribution to Special MGS Sinking Fund	25.0	30.0	30.0	30.0	30.0
Equity Acquisition	45.0	12.5	0.1	0.1	0.0
EFSF/ESM Credit Line Facility	-	-	-	-	-
Courts and other deposits	-	-	-	-	-
Stock Premium paid to Church	0.1	0.2	0.1	0.2	0.1
Advances made by Government	-	-	-	-	-
Repayment of Loans to Government	-2.8	-2.8	-2.8	-2.8	-2.8
Sale of Assets	-0.9	-0.9	-0.9	-0.9	-0.9
Sale of Non-Financial Assets	-	-	-	-	-
EBUs	0.0	0.0	0.0	0.0	0.0
Currency	12.5	6.1	6.7	7.4	8.1
Movement in Bank Account	-94.9	-	-	-	-
ESA Rerouted Debt	18.1	20.0	20.0	5.0	0.0
Increase/(Decrease) in cash balance	**-16.3**	**2.7**	**0.1**	**0.0**	**0.1**
Increase/(Decrease) in Non-Consolidated Debt	**835.9**	**1,010.3**	**986.1**	**893.3**	**786.9**
Total Consolidation	-96.4	-33.4	25.6	1.5	18.2
Increase/(Decreaese) in Consolidated Debt	**739.5**	**976.9**	**1,011.7**	**894.8**	**805.1**
SFA	**-241.6**	**63.6**	**164.5**	**140.0**	**152.3**

4. Sensitivity Analysis

4. Sensitivity Analysis

Ensuring the accuracy of macroeconomic forecasts is important, especially in the case of a small and open economy like Malta. Given the role of macroeconomic forecasts in setting a foundation for economic and fiscal policy making, the assessment of past forecasting performance and the balance of risks is important to improve accuracy and maintain credibility of the forecasting exercise. Gross Domestic Product (GDP) forecast errors have historically proved to be relatively higher for Malta than for larger and less open economies within the European Union (EU). Larger forecast errors are expected for a small and open economy, due to an inherent vulnerability to external shocks. Furthermore, this is also a result of significant structural change which the Maltese economy has experienced during the years, in addition to frequent and significant revisions in national accounts data.

The macroeconomic forecast presented in Chapter 2 contains the baseline forecast contingent on several exogenous assumptions regarding the evolution of global economic growth, world prices and exchange rates. Since some of these variables have a significant impact on our macroeconomic projections, a sensitivity analysis of relevant variables underlines the risk assessment of the baseline. Furthermore, the baseline projection is also complemented by other alternative forecasting models.

In recognition of the risks surrounding macroeconomic forecast, especially due to the prevailing uncertainty in the global economy, this chapter seeks to provide an assessment of forecast certainty and the balance of risk surrounding the macroeconomic forecasts in this Programme. The analysis is in line with the requirements of Council Directive 2011/85/EU of the EU on the requirements for budgetary frameworks of the Member States.

4.1 The Accuracy of Past Forecasting Performance

The updated analysis on the accuracy of past forecasting performance by the Economic Policy Department (EPD) within the Ministry for Finance and Employment (MFE) shows a tendency to underestimate GDP growth and hence a downward bias in the GDP growth projections in previous years, over the entire forecast horizon. This is partly due to persistently upward statistical revisions in the growth rate releases in subsequent vintages of National Accounts data issued. While the one-year ahead forecasts display a Root-Mean Squared Error (RMSE) of 3.69, it is notable that the sample size employed is rather small and that the earliest forecast available is that of 2004. The recession of 2009, the unprecedented COVID-19 crisis in 2020 and subsequent strong recovery following the crises, and the frequent and considerable statistical revisions tend to exert a disproportionate influence on this evaluation over such a limited sample period and limit comparability with the forecast accuracy displayed by other economies with a longer tradition of forecasts. It is noteworthy that over successive vintages of forecasts, the RMSE has widened, mainly due to the relatively large forecast errors in 2014, 2015, 2017 and 2021.

The evaluation of the risk and uncertainty of the current macroeconomic projections underlying this Programme is based on an ex-ante analysis of past forecast errors which determine the level of uncertainty. Ex-post, a number of alternative but plausible economic scenarios generated with the forecasting model used by the EPD are also simulated to determine the balance of risks surrounding the baseline projections.

4.2 The Balance of Risks

To determine the balance of risks surrounding macroeconomic forecasts, ten alternative model-based growth projections were carried out as follows:

1. Improved economic growth in Malta's main trading partners, based on the upper bound of the Consensus Economics forecasts.
2. Weaker economic growth in Malta's main trading partners, based on the lower bound of the Consensus Economics forecasts.
3. Higher interest rate scenario, where monetary tightening is more pronounced than that assumed in the baseline with a higher European Central Bank (ECB) benchmark interest rate and a higher interest rate passthrough than the historical standard. Short-term interest rates are assumed to increase by more than long-term interest rates, flattening the yield curve, reflecting weaker short term growth prospects.
4. Improved medium-term private investment scenario, where a number of private investment projects excluded from the baseline projection are assumed to proceed throughout the outer years of the forecast period, as financial conditions normalize.
5. Euro appreciation scenario, assuming that the euro appreciates further, such that the EUR/USD exchange rate gradually returns to its long-term average. This scenario attempts to reflect stickier inflation in the Eurozone compared to other countries, which should warrant tighter monetary policy from the ECB. A direct implication of a stronger euro is lower import prices but weaker performance from export-oriented sectors.
6. Higher disposable income than that assumed in the baseline, assuming that compensation per employee grows at a stronger rate than assumed in the baseline as labour market tightness persists.
7. Persistent inflation scenario, reflecting the risk that employers finance an increase in wages by raising prices further in the face of strong demand rather than absorb it from the increase profit margins registered last year as is assumed in the baseline. This will be supported by a continued recovery in tourism in addition to higher import prices due to an increase in freight rates. Consequently, this scenario assumes that inflationary pressures do not abate in 2023 and remain persistently high over the outer years.
8. More upbeat tourism outlook, assuming that the release of pent-up demand following a period of travel restrictions continues throughout 2023 with a higher expenditure per tourist than the conservative estimate in the baseline. For the outer years, inbound tourism is assumed to increase in line with the long-term average.
9. Higher labour supply growth, which assumes that labour supply reattains the growth rates recorded prior to the COVID-19 crisis. The scenario assumes that the increase in labour supply is absorbed within the labour market through higher employment, partially mitigating labour market shortages, limiting wage pressures and resulting in stronger domestic demand.
10. Lower inflation scenario, reflecting a swifter resolution of supply chain disruptions and a more pronounced lagged effect of the transmission of monetary policy. For 2023, price increases are assumed to remain muted, taking into account the strong base effects from the previous year, moderating year-on-year inflation, especially in the second half of the year. Inflation is then assumed to gradually return below 2.0 per cent, increasing household disposable income and consumption.

These represent scenarios that are plausible alternatives to the baseline projections. While economic judgement influences the choice of these scenarios, this judgement is also underpinned by the constant monitoring of the economic conditions prevailing

at the time of preparation and also informed by the various meetings with economic stakeholders and regulators operating within the Maltese economy which were carried out during the early stages of the forecasting exercise.

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

4.2.1 Improved Global Economic Growth

In this scenario, the growth rates of Malta's key trading partners are assumed to be higher than originally anticipated. The higher economic growth rates in Germany, France, Italy, the United Kingdom (UK), and the United States (US) is based on the Consensus Economics Forecasts of March 2023, assuming the most optimistic growth figure for each trading partner for the forecast years 2023 and 2024. In this scenario, global economic growth, weighted by main trading partners, is increased by 0.6 percentage points in 2023, and by 0.8 percentage points in 2024, when compared to the baseline.

The improved global economic situation in this scenario contributes to an increase in Maltese exports, leading to an upward revision of 0.2 percentage points in real GDP growth for 2023, compared to the baseline, while the budget balance would remain unchanged. In 2024, real GDP growth would further improve by 0.6 percentage points, before increasing by an average of 0.3 percentage points in 2025 and 2026. The budget balance would improve by 0.2 percentage points in 2024 and 2025, prior to improving by 0.3 percentage points in 2026.

4.2.2 Weaker Global Economic Growth

This scenario models the downside risk of a deterioration in the international economic outlook relative to the baseline forecast. It assumes a weakening in external demand equivalent to 0.9 percentage points in 2023, and a decline of 1.0 percentage points in 2024. The relatively lower than expected growth projections for Germany, Italy, France, the UK, and the US are based on the Consensus Economics Forecasts March 2023 publication, assuming the lowest growth figure for each trading partner.

The deterioration in world demand mainly contributes to weaker export growth, which is more pronounced than the decline in imports. This subdued performance results in a decline in real GDP of 0.4 percentage points in 2023 and a further decline of 0.9 percentage points in 2024, when compared to the baseline scenario. In the outer years, real GDP growth would decrease by an average of 0.5 percentage points. In this scenario, the budget balance would decline by 0.1 and 0.2 percentage points in 2023 and 2024 respectively, while it would deteriorate by 0.3 percentage points in both 2025 and 2026.

4.2.3 Interest Rate Scenario

This scenario reflects a more aggressive monetary policy tightening as inflationary pressures persist, as well as high uncertainty surrounding the economic outlook. The ECB benchmark interest rate is gradually increased to 4.0 per cent in 2023, in line with market expectations. For 2024, the benchmark interest rate is left unchanged, before starting to decline in 2025, as inflationary pressures subside. While historically the pass-through to Maltese lending rates has not been complete, this scenario attempts to reflect the risk of a higher interest rate pass- through than the historical standard, especially in 2024. Consequently, in this scenario, short-term interest rates are assumed to increase by 30.0 basis points in 2023 and by 100.0 basis points in 2024. Long-term interest rates

are assumed to increase by 25.0 basis points in 2023, to then increase by 40.0 basis points in 2024, when compared to the baseline, thus flattening the yield curve as the spread between short-term and long-term rates narrows down.

The effect of this scenario would be a decline in real investment growth. Furthermore, higher interest rates would also lead to a readjustment in consumption patterns, in view of higher debt repayments, in addition to increased savings, producing a drag on household consumption. Although the impact on real GDP growth in 2023 is marginal, it would decline by 0.4 percentage points in 2024 when compared to the baseline. GDP growth would then recover in 2026, increasing by 0.5 percentage points, as financial conditions normalize, leading to increases in investment and household consumption. The budget balance would remain unchanged in 2023, before deteriorating by 0.1 percentage point in 2024, and by an average of 0.2 percentage points in the outer years, relative to the baseline.

4.3 Alternative Model Forecasts

Seven alternative forecasting models were also developed, ranging from model-free statistical forecast (2 Holt-Winters Seasonal Smoothing Method), model based univariate forecasts (2 ARIMA models), and model-based multivariate forecasts (3 VAR models). These models help economists at the MFE corroborate the results attained using their core econometric model. Of special interest are the VAR models, one which is demand driven with exogenous assumptions and one which is mainly supply driven based on employment and prices. The former is closest to the Keynesian-type baseline model while the latter better captures supply side conditions which was the primary determinant of economic growth in Malta over recent years.

On average, these models collectively indicate a real GDP growth rate of 4.6 per cent in 2023, above the baseline projection, while the average of the VAR models point towards a higher growth of 6.2 per cent. Therefore, the baseline projection presented in Chapter 2 is more conservative than the projections of the alternative models.

For 2024 onwards, the alternative models suggest GDP growth to average at around 3.8 per cent. The VAR models alone suggest that growth could be considerably higher, reaching 5.9 per cent in 2024, before averaging 5.5 per cent in the outer years. We believe that in the presence of supply-side constraints, particularly the persistent tightness in the labour market, the economy will remain constrained to grow below the growth in demand. The VAR with supply restrictions suggest that economic growth over the medium term will hover around 4.0 per cent over the next three years, which is in line with the baseline forecast presented in Chapter 2.

4.4 Uncertainty and the Balance of Risk Underlying the Macroeconomic Projections

The uncertainty surrounding the macroeconomic projections is based on past forecast error standard deviation of GDP. This is equal to 2.63 for the current year forecast and 2.81 for the one-year ahead forecast, 2.85 for the two-year ahead forecast, and 3.03 for the three-year ahead forecast. The balance of risk is based on the Pearson skewness indicator of the model generated alternative forecast for GDP documented above. The indicator shows balanced risks for 2023 and 2026, but downside risks in 2024 and 2025.

Chart 4.1
Fan Chart with GDP Growth Forecasts

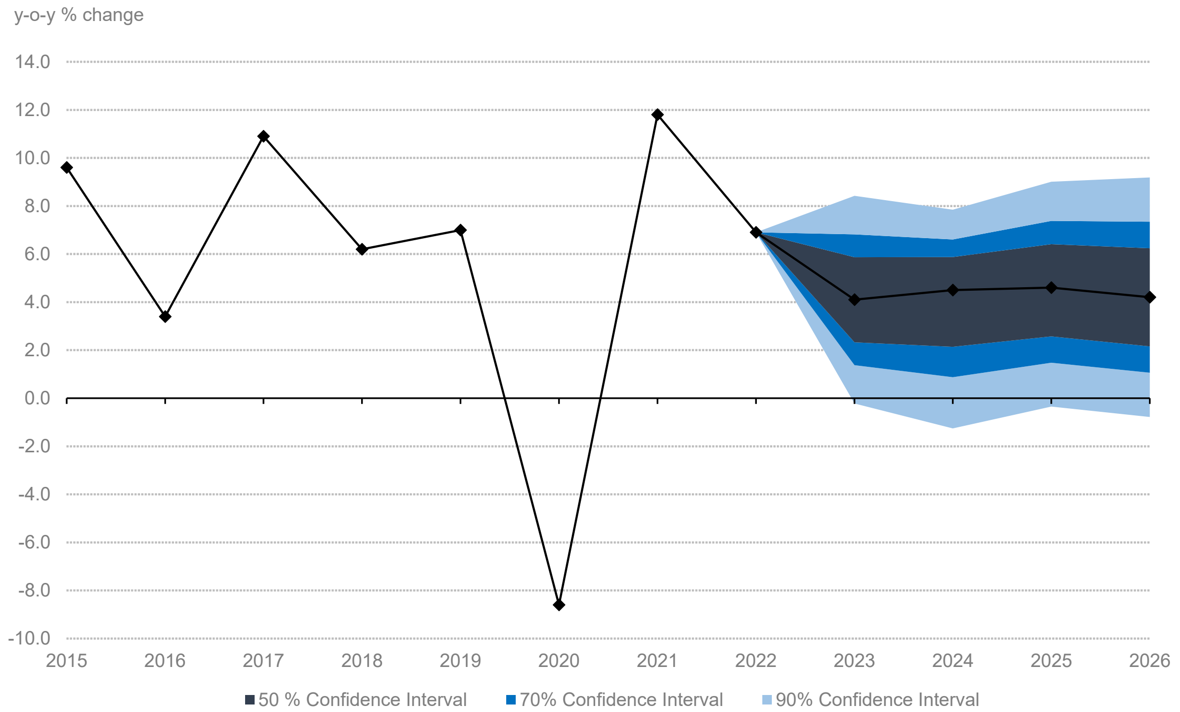


Chart 4.2
Fan Chart with Budgetary Targets

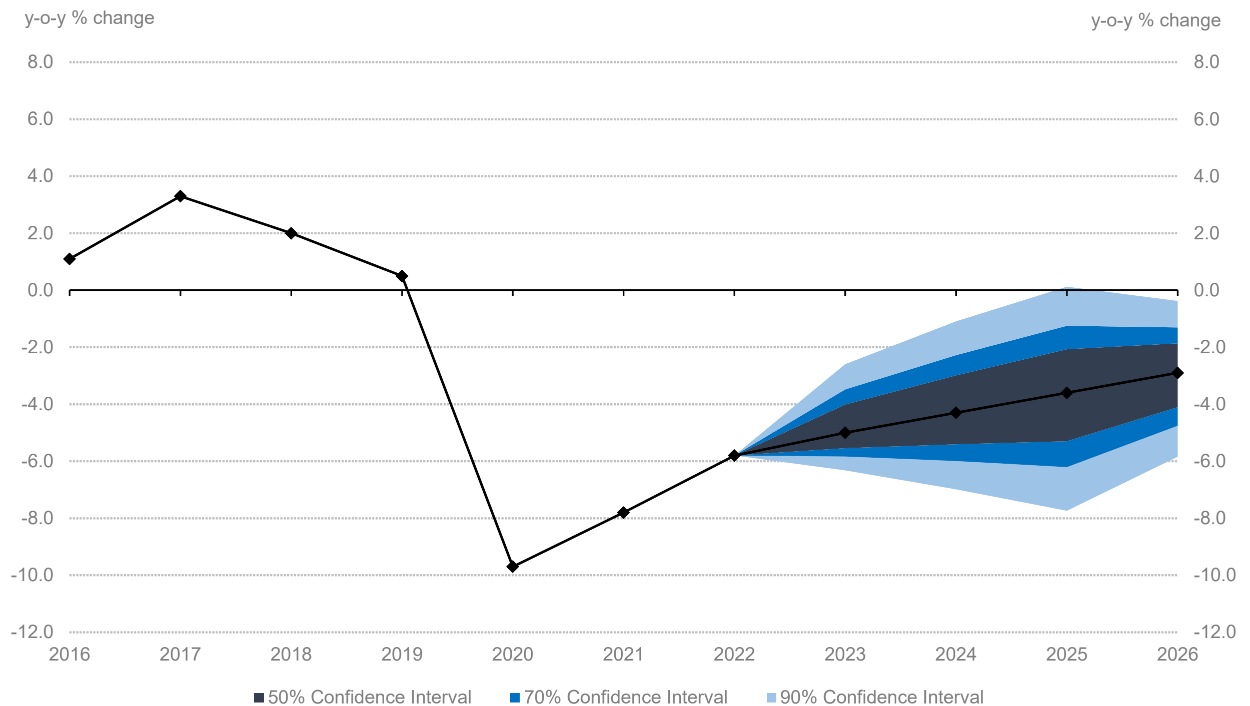


Chart 4.1 depicts a representation of the uncertainty and the balance of risk surrounding the macroeconomic forecasts presented in this Programme.

4.5 Risks to Fiscal Targets

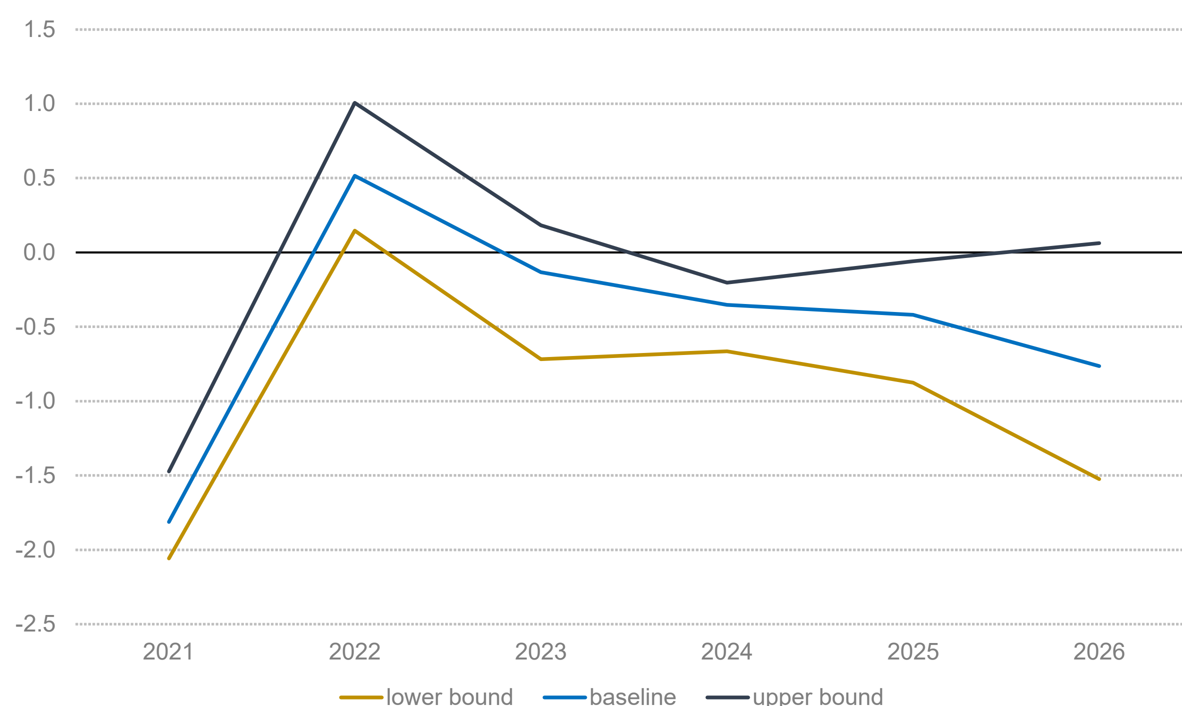
The alternative macroeconomic scenarios documented above, can influence the attainment of the deficit targets thus underpinning alternative fiscal conditions. Chart 4.2 illustrates the range of possible budget balance outcomes conditional upon the realisation of these alternative scenarios. The evaluation of fiscal risk conditional on macroeconomic risks also incorporates the variance resulting from the past forecast error of fiscal projections, based on a methodology similar to that used for deriving the macroeconomic risk assessment. As a result, the risk assessment is also presented in the form of a probabilistic fan-chart. There seems to be upside risks for the budget balance in 2023 and 2024, but downside risks in the outer years.

4.6 Alternative Output Gap projections and risks to Structural Fiscal Targets

This assessment has been extended to cover risks to the output gap projections and, consequently, the structural obligations outlined in this Programme. Thus, alternative output gap projections that are consistent with each of the aforementioned economic scenarios have been conducted.

Compared to the baseline scenario, alternative output gap projections (per cent of potential output) range from -1.5 in 2026 to -0.7 in 2023 and 2024 and, under lower-bound estimates range from -0.2 in 2024 to 0.1 in 2026 (Chart 4.3).

Chart 4.3
Output gap: Risk assessment



5. Sustainability of Public Finances

5. Sustainability of Public Finances

This Chapter seeks to assess Malta's long-term sustainability of public finances for the period 2019 to 2070. This assessment is based on the updated public expenditure projection results produced by the Ageing Working Group (AWG) for the 2021 Ageing Report, reflecting a series of population projections as carried out by EUROSTAT. The AWG produced long-term projections ahead of the finalisation of the 2021 Ageing Report, which the Economic and Financial Affairs Council (ECOFIN) mandated the Economic Policy Committee (EPC) to be endorsed and published by the autumn of 2021 at the latest.

The analysis of this Chapter includes pensions, health, long-term care, and education expenditure projections. These long-term projections provide an indication of the timing and scale of economic changes that would result from an ageing population in a 'no-policy change' scenario. The projections are helpful in highlighting the immediate and future policy challenges for Governments as a result of the expected future challenges caused by demographic change.

5.1 Long-Term Budgetary Projection Results for Malta

This section provides an analysis of the long-term sustainability of public finances for Malta for the period 2019 to 2070 based on commonly agreed assumptions for the European Union (EU) Member States. The modelling work for pension projections assumes a 'no policy change' scenario and reflects as strictly as possible the pension rules, both current as well as those applying in future in reflection of legislative reforms. The projections for pension expenditure exclude the impact of linking the contributory period to life expectancy, in light of the fact that the AWG methodology is based on current legislation.

The model used in projecting pension expenditure is the World Bank's Pension Reform Options Simulation Toolkit (PROST 15), being the same model used in the projection of pension expenditure for the previous AWG budgetary projections exercise. Staff from the Economic Policy Department within the Ministry for Finance and Employment (MFE) used PROST 15 to model the development of the current pension system and analyse various options for pension reform. The pension projections baseline was prepared by the World Bank with the assistance of expertise from the MFE and the Ministry for the Family, Children's Rights and Social Solidarity (MFCS). The results obtained were subject to a process of internal review by pension experts within Government and subsequently endorsed by the EPC following a peer review at the AWG. Statistical Appendix Table 7 shows the expenditure components of the long-term budgetary projections as a percentage of Gross Domestic Product (GDP) for the period 2013-2070 and the assumptions used.

5.1.1 Demographic Projections

Population projections as published by EUROSTAT were used as a primary input in the long-term age-related expenditure projections used by the European Commission in the assessment of the sustainability of public finances. As shown in Table 5.1, population projections (based on 2019 EUROSTAT projections) indicate that total population in Malta is projected to rise from 500,255 in 2019 to approximately 707,171 in 2070. These projections are substantially higher than the population projections presented for the 2018 Ageing Report While this significant revision partially reflects a broad upward

Table 5.1

Eurostat Population Projections

	2019	2020	2030	2040	2050	2060	2070
2018 Ageing Report							
Total population	450,320	454,686	489,917	506,385	513,362	519,458	520,761
Old-age dependency ratio (65+ yrs/15-64 yrs)	32.0	33.0	40.4	41.4	46.0	53.9	55.8
2021 Ageing Report							
Total population	500,255	513,228	591,469	636,775	669,833	694,592	707,171
Old-age dependency ratio (65+ yrs/15-64 yrs)	27.7	28.0	32.0	33.9	40.7	52.5	57.8

revision in the levels of the population, the main driver was primarily a result of the revision in net migration projections. Indeed, The AR 2021 population assumptions have substantially more net migration relative to the previous projection.

5.1.2 Assumptions Applied

In projecting pensions, the demographic assumptions reflect projections by Eurostat, while the macroeconomic assumptions reflect the commonly agreed methodology in the EPC. The assumptions used include the real GDP growth rate, labour productivity (growth rate per hour), inflation rate, labour participation rate by age and gender, unemployment rate by age and gender, population, fertility rate by age, mortality rate by age and gender, and net migration by age and gender.

Life expectancy at birth for men is assumed to rise by 6.3 years from 2019 to reach 86.8 years in 2070. For women, it is expected to reach 90.6 years, an increase of 6.1 years over 2019. This implies that despite some convergence, female life expectancy in 2070 is projected to remain 3.8 years higher than that of males. Meanwhile, life expectancy at 65 years for males and females is projected to increase by 4.3 and 4.6 years, respectively, over the whole period. Another important variable in the evolution of the demography is net migration, where such inflows are projected to decline from 12,757 in 2019 (net migration in 2021 stood at 4,639) to 3,784 in 2070. Net migration represents an important factor in determining developments in total population during the projection period, as indicated by the ratio of net migration as a percentage of total population which is projected to decrease from 2.6 per cent in 2019 to around 0.5 per cent in 2070. Latest estimates presented in Chapter 2 of this Programme show potential output growth at around 4.7 per cent between 2022 and 2026, suggesting a notable deceleration in potential growth is being assumed in these long-term projections.

In terms of macroeconomic assumptions, the labour force projections show a substantial rise in the overall participation rates, especially for women and older workers. Potential GDP is higher than the previous round of projections, averaging at 2.2 per cent compared to the 2.1 per cent projected during the last round. Potential GDP growth is projected to decline from 4.5 per cent in 2019 to 1.1 per cent in 2055 and thereby regain some momentum by 0.3 percentage points by end of 2070.

5.1.3 Demographic Developments

Population projections indicate that total population in Malta is projected rise from 500,255 in 2019 to approximately 707,171 in 2070. As shown in Table 5.2, the age structure of the population is expected to change significantly. While the share of the very young people (aged 0-14 years) in the total population is projected to decrease from a 13.7 per cent share in 2019 to 11.5 per cent share in 2070, the share of the people aged 65+ is projected to increase from 18.7 per cent to 32.4 per cent.

From an economic perspective, the most important change in demography concerns the working-age population (aged 15-64 years), which reflects the share of the population that will bear the financial 'burden' of the elderly. From a share of 67.6 per cent in 2019, this ratio is projected to subsequently fall to 56.1 per cent by 2070. The dynamics of the ageing process could be better appreciated by analysing the developments in the dependency ratios, which relate the number of individuals that are likely to be "dependent" on the support of others for their daily living, young people and the elderly, to the number of those individuals who can provide such support. Key indicators of age dependency presented in Table 5.2 are the old-age-dependency ratio (for persons aged 65 years and more) calculated relative to the number of individuals aged 15-64 years and the ageing of the aged ratio (80+ age bracket as a percentage of the 65+ age bracket).

The old-age dependency ratio (65+ year bracket as a percentage of the 15-64 age bracket) is projected to increase consistently from 27.7 per cent in 2019 to 57.8 per cent in 2070, an increase of 30.1 percentage points. Meanwhile, the ageing of the aged ratio, is projected to increase from 22.7 per cent in 2019 to 40.7 per cent by 2070. The youth dependency ratio is expected to first decrease from 20.3 per cent in 2019 to 18.2 per cent in 2040 and subsequently increase to 20.4 per cent by 2070. Thus, by 2070, the total dependency ratio, which is the combined burden of these two components of the economically active population, will amount to 78.2 per cent.

As a result of these demographic developments, the support ratio (persons in the 15-64 years bracket as a proportion of persons aged 65+) is expected to decline from 3.6

Table 5.2

Total Population, by Selected Age Groups

	2019	2020	2030	2040	2050	2060	2070
Age							
0-14 yrs	68,470	70,303	78,465	76,263	77,935	81,060	81,084
15-64 yrs	338,003	345,969	388,652	418,519	420,649	402,240	396,767
65+ yrs	93,783	96,957	124,352	141,993	171,249	211,293	229,320
Total	500,255	513,228	591,469	636,775	669,833	694,592	707,171
Share %							
0-14 years	13.7	13.7	13.3	12.0	11.6	11.7	11.5
15-64 years	67.6	67.4	65.7	65.7	62.8	57.9	56.1
65+ years	18.7	18.9	21.0	22.3	25.6	30.4	32.4
Ratio %							
Youth dependency ratio (0-14 yrs/15-64 yrs)	20.3	20.3	20.2	18.2	18.5	20.2	20.4
Old-age dependency ratio (65+ yrs/15-64 yrs)	27.7	28.0	32.0	33.9	40.7	52.5	57.8
Total dependency ratio	48.0	48.3	52.2	52.1	59.2	72.7	78.2
Ageing of the Aged Ratio (80+ yrs/65+ yrs)	22.7	22.8	30.7	35.6	32.8	33.3	40.7
Support ratio (15-64 yrs/65+ yrs)	3.6	3.6	3.1	2.9	2.5	1.9	1.7

Source: EUROSTAT

in 2019 to 1.7 in 2070. This means that while in 2019 there were more than 3 persons of working-age for every person that reached pension age, by 2070 this ratio is projected to decrease to less than 2 persons of working-age for every person of pensionable age.

5.1.4 Age-Related Public Expenditure

Age-related spending including pensions, health care, long-term care and education is projected to increase by 8.0 percentage points over the period 2019-2070. Chart 5.1 shows the age-related public expenditure as a share of GDP for this projection period and Table 5.3 shows the revenue from contributions and number of contributors.

Public expenditure on pensions is presently the most important age-related Government expenditure item and is expected to remain so for the foreseeable future. The pension projection exercise covers contributory and non-contributory old-age pension paid under the social security scheme. The coverage of pension schemes includes also the expenditure on non-contributory old-age pension together with the share paid on the contributory and non-contributory bonus payment. The voluntary private pensions system is still in its infancy as regards pension provision for old-aged persons, but its uptake is expected to rise in the future.

Over the projection period, pension expenditure is projected to decrease from 7.1 per cent of GDP in 2019 to 6.6 per cent in 2034, and then increase to 10.9 per cent in 2070. Over the period 2019 to 2034, public pension expenditure is expected to decline by 0.5 percentage points of GDP. This primarily reflects the increase in retirement age which is consistent with a later retirement of those in employment and also the indexation system

Chart 5.1
Age-related Public Expenditure Projections

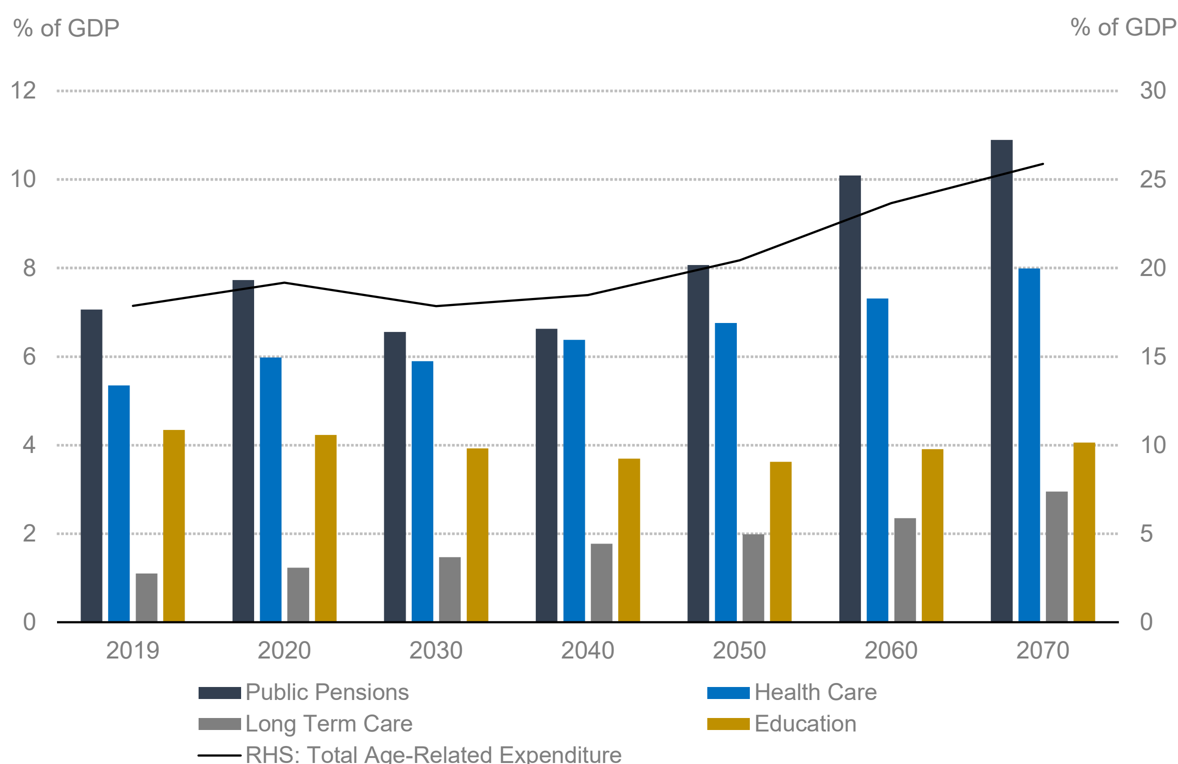


Table 5.3

Revenue from contributions and number of contributors

	2019	2030	2040	2050	2060	2070
Revenue from pension ontributions (% of GDP)	7.9	8.5	8.0	7.7	7.4	7.0
Number of contributors (in 1000s)	248	309	336	339	326	320

Source: European Commission Services

which limits the increase in pensions relative to the rate of economic growth. During the 2035-2060 period, the pension expenditure to GDP increases by 3.7 percentage points of GDP, while over the last remaining years expenditure adds-up further by 0.8 percentage points of GDP. Over the whole projection period, the increase amounts to 3.8 percentage points of GDP. Taking into consideration the entire projection horizon, this increase is entirely driven by the developments in the dependency ratio.

Compared with the baseline projections in the 2018 Ageing Report, public pensions expenditure as a percentage of GDP will be around 0.8 percentage points lower in the base year, but is then projected to increase to the same levels projected in the last round by 2070. The increase reflects both a higher number of persons entering into retirement in line with the upward revisions in population and employment, which puts an upward pressure on public spending in the medium to long-term as labour market entrants, including migrants, eventually reach retirement age. These effects are in part mitigated, especially in the short and medium-term by substantial improvements in macroeconomic assumptions, particularly those relating to the labour market.

These projections assume that migrants remain in Malta after reaching their retirement age and are entitled to pensions. This is unrealistic, especially in light of the fact that local studies established that foreign workers only stay in Malta for a temporary period, with the average length of stay of being 3.5 years with only 30.0 per cent of the migrants remaining in Malta for a period exceeding 6 years. This contrasts with the international experience, since while the OECD reports that between 20.0 to 50.0 per cent of the migrants return to their country of origin or move elsewhere within five years, in the case of Malta, 50.0 per cent of foreign workers leave the country already within two years. This indicates that the migrant turnover in Malta is significantly high and should have been taken into consideration by Eurostat in their assumptions if population projections were to yield more realistic pensions expenditure results.

The expected increase in pension expenditure over the entire period is primarily attributable to an increase in expenditure on old-age pensions (earnings-related) that increases from 4.2 per cent of GDP in 2019 to 8.9 per cent in 2070. However, up to 2030, expenditure on old-age pensions is expected to remain contained due to the impact of legislated increases in the pension age and indexation of the maximum pensionable income with the COLA. Thereafter, the increase in old-age pension expenditure is driven by the ageing process, in reflection of the projected demographic developments.

At the same time, one notes that the parametric changes introduced in the pension reform – more dynamic indexation of the ceiling on pensionable income, the statutory changes to indexation for old-age pensions and the crediting of contributions also contribute to raise expenditure. However, the increase in the pension age, the increase in the contribution period for full pension eligibility, the changes to the benefit formula, and the incentives to defer retirement will contain this projected increase in pension expenditure. The incentives to defer retirement enable potential pensioners to postpone their retirement by up to 4 years. At the same time, the lengthening of the contributory period translates into a lower accrual rate because of the relatively longer required length of service to qualify for the full pension benefit rate.

Expenditure on disability pensions and old-age (non-contributory) pensions are projected to stay relatively constant at 0.2 per cent and 0.3 per cent of GDP, while expenditure on survivors' pensions is projected to decrease from 1.2 per cent of GDP to 0.8 per cent of GDP by 2070. This decline reflects faster average economic growth, particularly in the first half of the projection period, which has an accumulating effect on GDP. Furthermore, it is expected that in future, more women will have an old-age pension in their own right reflecting the stronger labour market participation modelled in the projection leading to less reliance on survivorship pensions.

Expenditure on 'other pensions' is projected to decrease from 1.1 per cent of GDP to 0.5 per cent of GDP over the whole period. The decreasing contributions of other pensions (includes 'top-ups' and Treasury pensions) reflect a combination of factors. The 'top-up' pension covers benefits currently payable to persons in receipt of service pensions which includes former servicemen in receipt of overseas pensions. This expenditure category is projected to decrease in importance over time in line with the life expectancy of the recipients of this pension category. Similarly, expenditure on the Treasury Pension is projected to decrease in importance over time given that it has been closed to new Government of Malta employees since 1979.

Social security contributions are payable by all gainfully occupied persons between the age of 16 and their pension age.[1] The scheme allows for several types of contributions to extend coverage to all types of persons in employment. Employed persons pay Class One contributions, while the self-occupied pay Class Two contributions. Class One contributions imply that any person employed under a contract of service in Malta is in insurable employment and subject to the payment of these contributions. For each person, a tripartite contribution is payable: the employed person, the employer and the State each pay 10 per cent of the basic salary of the employee; with the contribution capped to the Maximum Pensionable Income. The rate of Class Two contributions is equally shared by the State and self-occupied persons, whereby the self-occupied pays 15 per cent and the State pays 7.5 per cent of their annual income that is subject to the same ceiling that applies for employees. As shown in Table 5.3, revenue from contributions is expected to decrease from 7.9 per cent of GDP to 7.0 per cent of GDP over the projection period as the capping of contributions limits the increase in contributions relative to the rate of economic growth, while the number of contributors is expected to increase from around 248,000 in 2019 reaching around 320,000 in 2070.

Another important contributor to the increase in age-related spending is healthcare. During the period 2019-2070, projections indicate that Malta is expected to record an increase of 2.6 percentage points of GDP in health care to reach 8.0 per cent and for the long- term care expenditure projections, expenditure is expected to increase by 1.9 percentage points of GDP to reach 3.0 per cent by 2070. These results reflect an ageing society and an increase in life-expectancy at birth over the projection period.

Additionally, education spending as a percentage of GDP is projected to decrease by 0.3 percentage points during the projection period to reach 4.1 per cent of GDP in 2070 in reflection of developments in the structure of the population.

5.2 Focus on Pension Reforms

The pension projections presented for the 2021 Ageing Report takes into account the legislated pension reforms, including measures that are to be phased in gradually. This section outlines briefly the main pension parameters of the contributory old-age pension also known as the two-thirds pension scheme. Pension reform in Malta is an ongoing process. The Government is sustaining its efforts to ensure adequate and sustainable pensions for current and future pensioners, as addressed in the ongoing pension reform process. The aim is to improve the current system primarily by strengthening further the first pillar and through the introduction of incentives pertaining to third pillar pensions.

In December 2006, the House of Representatives formally adopted a series of parametric reforms (Act No. XIX of 2006), aimed at enhancing the sustainability of the pension system while improving the adequacy of the pension enjoyed by retirees in the future. These reforms included raising the pension age from 61 to 65 by 2027; lengthening the contributory period from 30 to 40 years; adopting changes to the two-thirds pension calculation formula, the maximum pensionable income and the crediting of contributions. In addition, by virtue of the 2006 reform, in case of person born on or after the 1 January 1962, the pension shall be determined by taking the yearly average of the basic wage/ salary/net income/net earnings as the case may be, during the best 10 calendar years within the last 40 years immediately preceding his retirement or invalidity.

In 2016, the Government adopted also a number of reform measures intended to strengthen further adequacy and sustainability. In order to ensure a fair balance between the contributory period and the period spent in retirement across generations, the contribution period for a full pension was based on a stable ratio between years contributing and years drawing pension. Consequently, the contributory period was raised from 40 to 41 years for persons born after 1968.

Incentives to defer early retirement and lengthening working career were also introduced. The scheme is open to all employees, who would have fulfilled the contributory requirements and are eligible to retire at 61 years of age with a full pension. Those who continue working until 62 years will receive an increase of 5 per cent in their pension. The scale increases every year, whereby, a person who works until 63 years would receive an increase of 10.5 per cent. A person deferring retirement by 4 years and 5 years, to retire at 64 and 65, would receive an increase of 16.5 per cent and 23 per cent respectively. In addition, another amendment was affected to Article 64A whereby persons born on or after 1/1/1969, who want to access the early exit option, require 35 years of paid contributions with a maximum of 6 years of credits. Both measures are intended to lengthen careers and deter early retirement. The two measures, i.e. the incentives to encourage later retirement and the linking of the contributory period to the period spent in retirement, are expected to contribute to the strengthening of the long-term sustainability of public finances.

To further encourage pensioners to remain active and continue working beyond retirement age, in the Budget for 2023, the Government announced that over a period of five years starting from 2022, pension income will gradually no longer be considered as part of the taxable income. In 2022, 20 per cent of income deriving from pensions for

those in work was excluded from taxation, with 40 per cent of income from pensions excluded in 2023. This is in the context of all pensionable income becoming tax exempt over a 5-year period for those in work.

At the same time, the adequacy element was also safeguarded through the increase in the minimum pension, better credits for child rearing and family growth (which is designed to address gaps in the contributory periods particularly of women, arising due to family responsibilities and as a policy instrument contributing positively toward fertility increases) and the introduction of credits for human capital development and lifelong learning, alongside other measures.

Periodic reviews, within intervals not exceeding 5 years, are to be carried out (last review in 2020) with the outcome of the exercise reported to the House of Representatives. The Social Security Act requires the Pensions Strategy Group to put forward recommendations with a view to achieve further adequacy, sustainability and social solidarity in such a manner that a stable proportion is kept between the contribution periods and the period of time that the pension will be paid. In fact, in December 2020, the Ministry for Social Justice and Solidarity, the Family and Children's Rights received the Strategic Review report from the Chairperson of the Pension Strategy Group.

The Government has also focused on diversifying retirement income and reducing dependency on state pensions. Personal private pension schemes were launched in 2015 and tax benefits for such products were introduced. Accordingly, there are now a number of providers offering personal pension plans. Savers undertaking these plans can receive tax rebates on their savings for retirement. In 2017. the Government also implemented a measure intended to incentivize the take-up of voluntary occupational pensions. The Voluntary Occupational Pension Scheme Rules provide tax credits to both employees and employers (including self-occupied persons).

Furthermore, the Government launched the Home Equity Release, which allows home-owner pensioners to raise their annual financial income and improve their standard of living. This will serve as a financial supplement, together with the pension they receive, by allowing pensioners to convert part of their residential value in a stream of income.

During 2019, the Government strengthened the incentives for both the Third Pillar Pension Scheme as well as the Voluntary Occupational Pension Scheme, to encourage further take up of such products. In fact, the amount of financial investment that is tax- exempt was raised to a maximum of €2,000 each year and the reduction in taxes was increased from 15 per cent to 25 per cent. As from 2021, the amount of tax-exempt annual financial investment was raised from a maximum of €2,000 to €3,000 each year.

Footnote:

[1] Contributions are also payable by pensioners in gainful employment that retired after 5th January 2008. Pensioners who retired earlier than this date are allowed to work without prejudicing their pension rights in the ages of 61 years to 65 years without paying social security contributions, subject to a ceiling on earnings equivalent to the national minimum wage. For this group, ceiling on earnings is removed at age of 65 years and no further contributions are due.

Table 7

Long-term Sustainability of Public Finances

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

Source: Ageing Report 2021

6. Public Investment Programme and Structural Reforms

6. Public Investment Programme and Structural Reforms

6.1 Main Reform and Investment Priorities

The Government's prudent fiscal policy shall ensure debt sustainability, while raising potential growth in a sustainable manner and address the green and digital transitions and resilience objectives through investment and reforms. The Government's strategy hinges on its socio-economic vision resting on five principles, namely, (i) good governance, (ii) a higher quality of life for all citizens, (iii) investing in education, (iv) renewal of Malta's infrastructure and (v) achieving a carbon neutral economy by 2050.

The 2023 National Reform Programme highlights the Government's key policy responses to the major challenges grouped under thematic areas encompassing Environment, Productivity, Macroeconomic Stability, Fairness and Governance and Taxation. The general direction of the Government's strategy is to address these key areas in a complementary manner such that multiple objectives can be reached through the same policy measure. Environmental objectives are being given a significant priority and efforts to encourage the green transition are being made through energy efficiency and renewable energy. Such a motive resonates with the need for continual investment in the national research and innovation sectors aimed at enhancing productivity. On the other hand, the key dimensions of Fairness, Macroeconomic Stability and Governance and Taxation are intertwined through the challenge of using public funds in a manner which promotes sustainable and inclusive growth. A sound revenue collection and governance system should support the necessary robustness of public funds which in turn makes it possible to achieve Macroeconomic Stability through a fairer and more equal society.

The Government's strategy is supported by the implementation of the national Recovery and Resilience Programme (RRP), which encompasses the main national policies for sustainable growth and competitiveness enhancement, and high-quality investment projects funded from the Multiannual Financial Framework (MFF) for the period 2021-2027.

European Union (EU) funds will support the green transition foster energy security and promote the digital transformation. Along with fostering the development of a sustainable blue economy and enhancing the resilience of the fishing and the aquaculture sectors, funding will also help individuals obtain additional skills, employment opportunities, and social inclusion.

6.2 The 2023 National Reform Programme

6.2.1 Environment

Malta's economic vision places carbon neutrality at its core. The Government is committed to accelerate efforts to improve energy efficiency in buildings, increase investment in renewable energy, and promote the development of green spaces. Recent years have seen increased public investment in transport infrastructure, including arterial and urban roads, aimed at reducing congestion and improving air quality. The Government remains committed to reducing the transport sector's carbon footprint by supporting the electrification of vehicles and promoting the use of public transportation and alternative modes of transport.

The provision of onshore electric power supply through the Grand Harbour Clean Air Project aims at improving air quality. Following further studies, the design of the pipeline infrastructure has been upgraded to accommodate pure hydrogen. The consolidation and upgrading of national waste management infrastructure, will ensure that Malta will continue to positively progress in its green transition and enable Malta to transition towards a more circular economy.

6.2.2 Productivity

The administration of research and innovation and the digital transition remain amongst the key policy areas pursued by the Government. Substantial investment continues to take place in the area of digital transition, with six pilot projects of the National Artificial Intelligence Strategy underway and with a number of initiatives using artificial intelligence on the tourism side. With regards to research and innovation, the Malta Council for Science and Technology is currently in the process of updating the National R&I Strategic Plan for 2023-2027, following a public consultation.

6.2.3 Macroeconomic Stability

The conflict between Russian and Ukraine challenged the prospects of economic recovery across the world after the COVID-19 pandemic. As inflationary pressures mounted from abroad, the Government adjusted its spending to support the economy and stabilise the prices of basic commodities, allowing the economy to sustain a notable rate of economic expansion and generate more revenues to finance additional support from public funds. In spite of the added cost of energy-support measures, the Government still managed to stay close to the deficit target for 2022, whilst the debt ratio stood at 53.4 per cent of Gross Domestic Product (GDP), comfortably below the 60 per cent threshold. The Government's prudent fiscal policy in 2024 supported by a structural effort of 0.8 per cent shall ensure medium-term debt sustainability, while raising potential growth in a sustainable manner whilst addressing the green and digital transitions and resilience objectives through investments and reforms.

The sustainability and adequacy of the Maltese Pension System is another priority area aimed at enhancing Macroeconomic Stability, whilst reducing inequality. Several measures were introduced over the recent years, targeted at increasing the duration of working lives and to encourage diversification of retirement in order to reduce sole dependency on state pensions. In terms of adequacy, pensioners have been benefiting from annual increases in pensions, complimented by expansions of the non-taxable pension threshold.

6.2.4 Governance and Taxation

One of the Government's aims is to improve governance and strengthen Malta's judicial system and institutional capacities. The Government continued to introduce several measures as well as legislative amendments aimed at improving governance. Amongst these measures are those which seek to improve the efficiency of the law courts through the simplification of judicial proceedings. During 2022, the Government maintained sustainable effective judicial framework through training, and implementing an effective AML framework. In 2023, these reforms are going to be further supplemented with improvements to institutional capacities. More notably through the improvement in the rule of law and the money-laundering framework. This is to be achieved through the strengthening of the Malta Police Force (MPF) and the Financial Intelligence Analysis Unit (FIAU). Another target is to further digitalise the justice system in order to develop and enhance Malta's democracy.

6.2.5 Fairness

The Government's plan is to continue reinforcing distributional policies with the objective of promoting social inclusion and mobility, as well as reducing poverty. By prioritising measures that incentivise work and increasing measures aimed at making work pay, the Government is taking important steps towards ensuring that everyone has access to opportunities for economic advancement. Moreover, the Government's efforts to promote the inclusion of people with disabilities in the workforce and improve quality and access to education, shows a commitment to reduce early leaving from education and training and build a more equitable and inclusive society. The Government implemented a range of measures to tackle housing affordability, including an equity sharing scheme and other initiatives aimed at helping individuals become homeowners. The Government is also prioritising the strengthening of the healthcare system's resilience, particularly in light of the COVID-19 pandemic and the subsequent rise in healthcare expenditure. Overall, these policies demonstrate the Government's commitment to social welfare and public health, as well as its efforts to build a more inclusive and prosperous society.

6.3 The National Recovery and Resilience Plan

Malta's RRP, through its six components, outlines a comprehensive package of structural reforms and public investment projects aimed at effectively addressing challenges identified in the European Semester, including measures directly contributing to the green and digital transitions.

Malta's RRP is expected to yield a positive economic impact by addressing structural weaknesses of the economy. Based on the projects being considered, the impact could range between 0.3 per cent of GDP to 0.5 per cent of GDP in 2022, and reach a maximum cumulative impact of 0.7 per cent of GDP in 2025. The impact persists with estimates using the QUEST model indicating a positive impact even in 2050 suggesting a notable structural improvement in the economy as a result of the RRP. The projects are expected to improve resilience, especially in terms of improvements in productivity and efficiency while improving the robustness of institutions. The RRP also targets the social pillar by improving sustainable living and investing in future generations.

The Government remains committed to implement the RRP in line with the set milestones and targets. The implementation of the RRP has proceeded and is on track in line with the milestones and targets included in the Council Implementing Decisions of 5 October 2021. Malta and the Commission have agreed on operational arrangements of a technical nature, detailing aspects of the implementation with respect to timelines, indicators for the milestones and targets, and access to supporting documentation. Work is on schedule for the other milestones and targets.

Directly contributing to the green transition, through Component 1 and Component 2 of the current RRP, more than half of the RRP funding is being utilised to address climate neutrality by enhancing energy efficiency particularly in buildings, encouraging clean energy and a circular economy, and decarbonising the transport sector. This is set to increase further through the revised RRP by way of the investments included under the REPowerEU aimed towards reducing the overall reliance on fossil fuels, improving energy efficiency and speeding the transition to clean energy. These measures will also contribute to improving the air quality, the quality of life and overall health.

Nearly a fifth of the RRP funding is being absorbed by the digital dimension, namely Component 3, part of the investment in Component 4 and the investment in Component

6. Through the reforms and investments of Component 3, Malta seeks to fast track the digital transformation through policy reform, thereby contributing to long lasting impacts on the resilience of the Maltese economy in terms of domestic and international competitiveness. Malta will also be contributing to the digital transformation and resilience of the health system through part of the investment of Component 4 aimed at improving patient care, enhancing patient experiences, reducing waiting time and improving the quality of healthcare provision. Further contributions to the digital transformation are also set to be achieved through the investment in an integrated eFiling system across the justice system, as contained in the investment part of Component 6. These measures are aimed at improving business sentiment and trust in the Maltese institutions, which will in turn increase investment, efficiency and decrease bureaucracy.

Furthermore, through the other part of Component 4, the Government aims at improving the resilience of the health sector, leading to better health outcomes resulting in the population being more active in the labour market, raising productivity whilst sustaining future social protection expenditure. Through Component 5, the Government is focusing on enhancing the quality of education and fostering socio-economic sustainability, This Component's reforms and initiatives aim to bridge the gap between education provision and labour market needs, thereby resulting in enhanced fiscal sustainability in the long run.

6.4 The Multiannual Financial Framework for the period 2021-2027

EU funds will support green transition and energy security and digital transformation. Along with fostering the development of a sustainable blue economy and enhancing the resilience of the fishing and the aquaculture sectors, funding will also help individuals obtain additional skills, employment opportunities, and social inclusion.

Funds will specifically focus on improved environmental ambitions, including through investments in energy efficiency, enhanced energy mix and energy stability and security through the development of a second electricity interconnector, battery storage and pilot projects on renewable energy.

Additional investment to improve Malta's potable water networks and wastewater infrastructure with the aim of enhancing resource efficiency and wastewater treatment are also foreseen. Similarly, under the Cohesion Fund, support is foreseen for improved treatment of separately collected organic waste through investment in an organic processing plant, while also promoting enhanced sustainable multimodal urban mobility, and the use of alternative fuels in road transport to further support the uptake of electric vehicles.

Funding from the Just Transition Fund is aimed to support onshore electric power supply to further support Malta's decarbonisation efforts through targeted investment in the Grand Harbour and Malta Freeport.