Medium-Term Fiscal Strategy for Malta
2020-2023

Ministry for Finance and Employment
December 2020

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.

This document is based on statistical information available up to the 30th of September, 2020

Fiscal Responsibility Act, 2014
(Cap 534)

Statement of Fiscal Responsibility
by the Prime Minister and Minister for Finance and Financial Services

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

16 December 2020

1. Medium-Term Fiscal Policy Strategy

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Following four years of consecutive fiscal surpluses and a declining Government debt, the Covid-19 pandemic has had an unprecedented impact on the economy and public finances. This called for unprecedented measures on the part of Government to support the economy. Such intervention has been facilitated by the triggering of the General Escape clause. In this context, the build-up of public savings in the last few years have proved to be quite opportune and allowed the Government to provide the necessary support without putting financial stability at risk. The Government is of the view that the short-term emergency support measures are essential to support the productive capacity of the economy and prevent a potentially transient economic shock from undermining medium to long-term fiscal sustainability. This medium-term fiscal strategy is being prepared in the context of unprecedented uncertainty in the economic outlook and hence, unlike previous years, the medium-term outlook beyond 2021 represents a tentative no-policy-change projection which will be updated once a more stable economic situation unfolds.

1.1 Short-Term Outlook

1.1.1 Economic Situation and Risks to the Short-Term Outlook

During the first half of 2020, the Covid-19 pandemic led to a series of unprecedented stresses on the global economy, including Malta. The effect of this shock distinguishes itself from previous global crises because the declines in demand were also complemented with supply disruptions resulting from the mandatory imposition of various country-wide lockdowns and social distancing measures which severely impacted economic activity, particularly in the hospitality sectors, mass transport networks and cultural activities. The pandemic further resulted in unanticipated strains on public health care systems.

International and domestic institutions hastily responded to the outbreak by loosening monetary policies and providing fiscal stimulus to cushion the economic setback.

Whilst Malta was not immune from the same adverse effects, and despite the reliance of the Maltese economy on the hospitality industry, other important sectors such as remote gaming, information and communications, pharmaceuticals, electronics, construction and real estate proved to be notably resilient and mitigated some of the economic repercussions of the pandemic.

In addition, the economy was sustained by an unprecedented level of Government support at a time when a significant liquidity squeeze could have put Malta's corporate sector in jeopardy. Furthermore, the robust growth rates registered in previous years must also have strengthened corporate balance sheets such that no major corporate insolvencies were recorded. Government support also prevented mass unemployment or a significant deterioration in labour market conditions, thus preventing major social disruptions in society. Banks were also well capitalised before the crisis and hence could respond by providing moratoria on loan repayments which so far have prevented a significant increase in non-performing loans.

In the first half of 2020, the pandemic caused a contraction in economic activity of 6.1 per cent in nominal terms and 7.7 per cent in real terms. Despite the extent of the decline, these growth rates stood above the average growth rates of -8.3 per cent and -9.0 per cent recorded in the EU27 and Euro Area (EA). The situation going forward continues to be overshadowed with uncertainty with respect to both the duration of the virus as well as the intensity at which it reproduces. Against this background, the Maltese economy is expected to contract by 7.4 per cent in real terms during 2020.

The outlook for 2021 is subject to a high degree of uncertainty and is contingent on the severity of the virus, behavioural changes of domestic consumers and firms and the availability of a vaccine. The baseline projection is consistent with a gradual recovery in economic activity from the third quarter of 2020, and a modest recovery in 2021 assuming that an effective vaccine becomes available during the first half of next year. As a result, the Maltese economy is expected to resume its positive performance and grow by 5.0 per cent in real terms in 2021. Growth in the headline components are expected to turn positive, although the recovery is assumed to be gradual. The recovery is expected to be well balanced, supported by both domestic and external demand.

Whilst the uncertainty surrounding these projections is extremely high, our analysis now suggests that following the downscaling of growth prospects over the course of the year, a mild upside risk for 2020 and a marginal downside risk for 2021 is projected.

1.1.2 The Current Fiscal Situation

The effect on public finances of the Covid-19 pandemic in 2020 was quite severe on public finances. From the revenue side, a substantial fall in tourist expenditure and household spending led to a deterioration in the indirect tax revenue whilst corporate losses underlined a significant drop in direct tax revenue. Furthermore, Government expenditure increased substantially reflecting the fiscal impact of Covid-19 related support measures as well as measures legislated by means of the 2020 Budget. Nevertheless, proceedings from personal income tax revenue and social security contributions were relatively shielded by the contained impact on the labour market. Against this background the fiscal situation deteriorated, and the surplus of 0.5 per cent of Gross Domestic Product (GDP) recorded in 2019 is expected to turn into a deficit of 9.4 per cent of GDP in 2020. The debt ratio is expected to rise to 55.0 per cent of GDP in 2020.

1.1.3 The Fiscal Response to the Pandemic

The central role played by Government in mitigating the severe impact of the crisis in 2020 is evident. In total, Government stimulus measures (including the 2021 Budget measures) amounted to 7.3 per cent of GDP, of which Covid-related measures in 2020 added up to 5.4 per cent of GDP. These exclude 1.5 per cent of GDP in tax deferrals aimed at further supporting corporate liquidity. Budget 2021 measures in support of the recovery account for 1.8 per cent of GDP. The structural effort in 2020 is estimated at 5.0 per cent of GDP, the magnitude of which is indicative of the extent to which fiscal policy was expansionary in 2020. Such unprecedented support avoided mass corporate insolvencies or significant layoffs which could have seriously damaged the economy and undermined fiscal sustainability.

During the initial phases of the pandemic, a broad range of policy measures was implemented to limit the impact of the pandemic. The initial policy response sought to lower the number of infections, to avoid an overloading of the acute health system and to limit the number of casualties. To this end, in an initial response, the Maltese Government intervened to contain the spread of the virus through a series of prevention, containment, control and treatment measures, implemented and enforced across sectors and within society. In addition, further healthcare funding was necessary to address hospital capacity, medical equipment and protective gear. Subsequently, fiscal policy measures were put in place to cushion the economic impact, in particular:

Wage Support Measures: The Wage Supplement measure provided funds to businesses and self-employed, affected by the Covid-19 pandemic, to support enterprises in retaining their employees. A one-off lump sum grant was also provided with respect to those employees on mandatory quarantine due to the possible contact with individuals that are at risk of infection.

Liquidity Support Measures: Other measures were intended to ease liquidity problems, including the deferral of tax payments, loan guarantees and interest rate subsidies to support access to credit, whilst also supporting business to facilitate remote working through measures supporting investment in telework equipment.

Social Support Measures: On the social side, a number of measures were introduced for individuals who were made redundant or who were unable to work. The parental benefit targeted working parents in the private sector, who could not go to work or carry out their functions through teleworking arrangements and were required to stay at home to take care of their school-aged children. The additional unemployment benefit scheme catered for employees who lost their jobs due to Covid-19. Moreover, the medical benefit scheme and the disability benefit scheme were granted to working disabled and vulnerable people who could not carry out their work functions due to being ordered to stay home for medical reasons.

Government's Economic Recovery Plan following Covid-19: Following the lifting of several restriction imposed as a result of the pandemic and the re-opening of non-essential retail establishments and services, on 8 June the Government announced a recovery plan aimed at regenerating the Maltese economy based on the following three pillars:

i. *Reducing Business Costs:* The Tax Deferral Scheme, was extended. Utility bills and commercial rents for businesses affected by the pandemic were subsidised, fuel prices reduced and commercial licenses were refunded. Contributions to support businesses to invest were granted.

ii. *Stimulating Domestic Demand:* In order to stimulate domestic expenditure, the Government granted a €100 voucher to residents aged 16 and over to be spent locally at hotels, licensed accommodations, restaurants, bars or diving schools and at retail outlets that were required to close during the pandemic. Other measures included tax refunds and a more generous in-work benefit scheme for low-income households. The stamp-duty on the transfer of residential property was reduced, in addition to the reduction in the tax rate associated with sales of property and the extension and wider coverage of the first-time buyer scheme.

iii. *Direct Business Support:* The wage supplement scheme was extended till the end of October apart from other schemes which directly supported business operations related to logistics, digital promotion, underwriting facilities, participation in international fairs and an export credit guarantee scheme for the establishment of new export markets. In addition, assistance to nursing homes and an allocation to NGOs to mitigate the impact of the pandemic on their income was granted.

   Furthermore, over the medium-term, the Government shall carry out several capital and infrastructural projects in industrial areas, including the extension of the Life Sciences Park, the upgrade of the Kordin Business Incubation Centre, investment at the Marsa ex-landfill and a new logistics hub.

Budget 2021: The 2021 Budget aims to continue to sustain the economic recovery, post pandemic, safeguard employment, ensure social protection and invest in sustainable development. The 2021 Budget will keep assisting companies to retain employment, bolstering their investment initiatives and helping start-ups with the implementation of innovative technology projects. Initiatives in this context include the extension of the economic regeneration initiatives in place in 2020 up to March 2021, including the wage supplement scheme and the re-issue of the economic regeneration vouchers, as well as an increase in the minimum threshold for Value Added Tax (VAT) exempt trading to reduce the administrative burden on Small and Medium-Sized Enterprises (SMEs) and through the extended concession on the stamp duty payable on the transfer of family businesses.

The forthcoming year's Budget builds on previous years' initiatives aimed at reducing further the risk of poverty for the most vulnerable in society, by enhancing further the adequacy of pensions, a higher tax refund rate, a children's allowance supplement, a higher rate of supplementary assistance, whilst also addressing past injustices and assisting in the purchase of residential property by means of the extension of existing reduced stamp duty schemes.

In view of the Government's intention of achieving a carbon neutral economy by 2050, the 2021 Budget outlined initiatives that ensure that the environment, which is crucial for achieving sustained economic growth and a better quality of life, is indeed prioritised. These include measures incentivising the circular economy, by seeking circular consumption and production patterns, exploring waste prevention and management while ensuring the responsible re-use of resources and enhancing green procurement to safeguard the environment. These initiatives create opportunities to build a strong green economy to transform Malta into a modern, resource-efficient and competitive economy – in line with the European Green Deal vision.

By means of funds allocated in the 2021 Budget, the Maltese Government will continue to invest in Malta's infrastructure to be able to meet, both the current and the future economic, social and environmental challenges. Initiatives in this respect include the continuation of arterial road construction projects, as well as roads in residential and rural areas, the regeneration of ports and improvement of facilities for the maritime sector, industrial infrastructure, the modernisation of health facilities, investment in higher education institutions and schools, sports facilities, and social housing.

In addition, in terms and for the purposes of Article 31 of the Fiscal Responsibility Act, the annual contribution to the 'Contingency Reserve' account is expected to amount to €13.3 million in 2021.

1.2 Medium-Term Outlook

On 13 March 2020, the European Commission (EC) adopted a Communication on a coordinated economic response to the Covid-19 outbreak. It proposed that the Union institutions should apply the full flexibility existing within the European Union (EU) fiscal framework, with a view to helping Member States to address the outbreak and deal with its fallout. On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact (SGP). In that Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the Covid-19 outbreak, the current conditions permit activation of the clause. On 23 March 2020, the Council supported that view. More recently, in the Annual Sustainable Growth Strategy 2021, the EC confirmed that fiscal policy should continue to support the recovery in 2021. In light of this need and the still high uncertainty about the economic consequences of the pandemic, the general escape clause will remain active in 2021. In spring 2021, taking into account updated macroeconomic projections, the Commission will reassess the situation and take stock of the application of the general escape clause.

It is to be noted, that the Fiscal Responsibility Act (FRA) is intrinsically tied to the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and the SGP, such that any decision to activate the escape clause at a European level should have the same effect as a formal announcement by Government on the presence of exceptional circumstances. Indeed, the FRA defines exceptional circumstances in the same way as the SGP. In line with the Council agreement, the Government of Malta considers the current circumstances as exceptional.

The FRA envisages the suspension of the budgetary rule in the presence of exceptional circumstances. This applies to both the departure from the Medium-Term Objective (MTO), as well as the adjustment path towards it such that, as long as exceptional circumstances prevail, any departure from the MTO in that year and any lack of sufficient adjustment towards the MTO in any of the years that the exceptional circumstances prevail do not constitute a breach of the rules.

It is the express view of the Government that once exceptional circumstances cease to exist, the Government will support a fiscal strategy to revert to the MTO of a balanced budget in structural terms and ensure that the debt ratio remains below 60 per cent of GDP. It is however premature at this stage to anticipate when these exceptional circumstances will cease to exist. In this context, the Medium-Term Fiscal Strategy presented here includes the budget measures for 2021 but is based on a no-policy-change assumption in 2022/23. The plan will be revised once exceptional circumstances cease to exist, after which the Government will continue to pursue policies aimed at achieving prudent medium-term fiscal positions.

1.3 Government's Expenditure Priorities

The Government is committed to implement its work programme on the basis of the 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 as well as the additional support at EU level provided under the next Generation EU and including the SURE programme which will itself partly finance the wage support provided to enterprises. Inevitably, the Covid-19 pandemic required a reassessment of Government's expenditure priorities to address the exceptional circumstances.

The new Prime Minister announced a new socio-economic vision expected 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.** In the coming year, 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. **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, equality and fair opportunities.
3. **Investing in education**, which is crucial to sustaining medium to long-term economic growth. By targeting education, we will ensure a dignified life for the entire population, so that everyone is enabled to fulfil his or her 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, the creation of prosperity and leading to 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 Country Specific Recommendations (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.

Against the above background, Malta is currently preparing its Recovery and Resilience Plan. More specifically, the Plan will outline the Government's strategy to improve the economy's resilience and adjustment capacity, mitigating the social and economic impact of the crisis whilst outlining structural reforms that address relevant priorities emanating from the European Semester. This will be achieved through investments, inter alia, in health, education and tourism, and in the green and digital transitions.

1.4 Public Investment Programme

Malta's Partnership Agreement presents the overarching strategy and identifies the priorities in the allocation of EU funds. In this regard, the Partnership Agreement has identified three funding priorities which are considered as the main overarching objectives for the 2014-2020 programming period, namely:

1. Fostering competitiveness through innovation and the creation of a business-friendly environment;
2. Sustaining an environmentally-friendly and resource efficient economy; and
3. Creating opportunities through investment in human capital and improving health and well-being. The latter has been recently more focused and adapted to support also measures in response to the coronavirus outbreak.

The main overarching objectives will be addressed through two Operational Programmes and their respective priority axis. The Priority Axes of the first Operational Programme are the following:

1. Investing in research, technological development and innovation;
2. Consolidating investment within the ICT sector;
3. Enhancing Malta's competitiveness through investment in SMEs;
4. Shifting towards a low-carbon economy;
5. Protecting the environment - investing in natural and cultural assets;
6. Sustainable Urban Development;
7. Shifting towards a more low-carbon transport sector;
8. Investing towards a more socially-inclusive society, including the financing of new Covid-related operations;
9. Investing in education, training and lifelong learning;
10. Investing in a more environmentally-friendly society;

11. Investing in TEN-T Infrastructure; and
12. Technical Assistance.

The second Operational Programme targets employment, education, social inclusion and health and is aimed at achieving inclusive growth. The priority axes of the second Programme are:

1. Investing in the employability and adaptability of human capital;
2. Towards a more inclusive society;
3. Investing in people through Education, Training and Life-Long Learning;
4. Building the Institutional Administrative Capacity;
5. Technical Assistance; and
6. Enabling job maintenance in the context of the Covid pandemic crisis.

These objectives and priority axes in general also apply to the national funds earmarked for capital investment. In addition to the co-financing element of EU-funded projects, locally financed investments are mostly targeted to road, education and health infrastructure (including support related to the Covid-19 pandemic), waste management and environmental management.

The 2021-2027 Partnership Agreement shall set Government's strategic framework governing various funds under the new Cohesion Policy. The Partnership Agreement also acts as a valuable tool to ensure a smooth transition between programming periods as well as to ensure complementarity and coordination between different EU funding instruments. The 21-27 Partnership Agreement will thus aim to foster complementarities with funding under the Next Generation EU, amongst others, including investments under ReactEU, the Just Transition Fund and the Resilience and Recovery Facility.

Investment under the 2021-2027 Partnership Agreement will aim to enable Malta to recover from the impact of the pandemic, as well as facilitate the transition and transformation of key sectors. In this context, EU funds shall continue to foster an environment which encourages public and private investment, economic growth and the creation of jobs and better employment opportunities in key areas, in line with both European and national targets, as well as in line with the objectives of each specific Fund.

1.5 Fiscal Risk Statement

Given the significant uncertainty resulting from the Covid-19 pandemic, this plan is surrounded by an unusually high level of uncertainty. Indeed, as indicated earlier, these projections rest on a number of assumptions, particularly the evolution of the virus and the efforts at identifying and distributing a suitable vaccine against the virus. As a result, it is difficult to make projections over the short-term. Any departure from short-term projections will undoubtedly affect long-term targets. Indeed, the requirement at an EU level to present medium-term projections in the Stability and Convergence Programmes of Member States has been put on hold. Nevertheless, in line with the Fiscal Responsibility Act, a medium-term plan has been formulated despite the exceptional circumstances. In this context, some of the main risks surrounding this plan are being highlighted.

The major risk stems from the pandemic and its economic impact which undoubtedly have repercussions on the ability of Government to reach the 2021 targets and comply with the spending commitments contained in this plan. The economic risks surrounding the Plan have been highlighted in detail in Chapter 4 of this document. More specifically, there seems to be an upside risk for the attainment of a lower budget deficit throughout the short-term forecast horizon reflecting the marginal upside risk to the growth forecasts identified in this Plan. However, the fiscal risk emanating from the possible macroeconomic scenarios contemplated in the Plan is on the downside over the medium-term. It is however worth noting that, in the worst-case scenarios contemplated in the risk assessment, the budget balance as a percentage of GDP deteriorates by 0.7 percentage points in 2021, 1.7 percentage points in 2022 and 2.2 percentage points in 2023.

The macroeconomic projections for 2020 and 2021, presented in the 2021 Draft Budgetary Plan (DBP) and which are contained in this Plan, were assessed by the Malta Fiscal Advisory Council (MFAC) and were considered to be within their endorsable range, whilst acknowledging the high degree of uncertainty. The MFAC also carried out comparisons with the forecasts prepared by other independent institutions, particularly the Central Bank of Malta (CBM), the EC, the International Monetary Fund (IMF), and other credit rating agencies, and these indicated broad similarity with the official forecasts. Nevertheless, on the basis of the assessment carried out on the individual GDP expenditure components, the MFAC considers there is 'the possibility of an overall downside risk outlook vis-à-vis the profile for real GDP for the period 2020 and 2021'.

The fiscal outturn is sensitive to the length of the period during which the Covid-19 mitigation measures are expected remain in place, which in turn are conditional on the way in which the economy absorbs and reacts to the pandemic-induced demand and supply shocks. The MFAC considers that the attainment of the fiscal targets is challenging and subject to downside risk for the fiscal balance over the forecast horizon. These challenges translate into an upside risk to the profile for the public debt ratio. Nevertheless, the MFAC is of the opinion that the magnitude of these risks appears contained, since the official fiscal forecasts are corroborated by similar fiscal forecasts for Malta produced by other reputable institutions. Based on the assessment carried out on the individual revenue and expenditure components, the MFAC observed that during 2020-2021, there could be downside risks vis-à-vis the fiscal balance, reflecting the joint impact of a downside risk on the revenue side and an upside risk on the expenditure side of the budget.

In this context, it is also worth highlighting that independent forecasts by the EC project the deficit to reach 9.4 per cent of GDP in 2020, the same target projected in this Plan. In 2021, the deficit is projected to decrease to 6.3 per cent of GDP in the Commission's Autumn forecasts, while in the Draft Budget Plan and in this Medium-Term Fiscal strategy the deficit is projected to decrease to 5.9 per cent of GDP. This is consistent with the upside risk to the deficit identified above for 2021 as identified by the MFAC. More specifically, compared to the government plans, higher deficit ratios in the Commission forecast for 2021 are largely explained by the projected expenditure side. While the Commission assumes somewhat higher revenues from indirect taxes due to a projected stronger rebound in private consumption, and higher social contributions, this is more than outweighed by higher estimated expenditure on compensation of employees, intermediate consumption and social payments by the Commission. Having said that, the Commission considers that risks related to the fiscal targets appear more on the positive side as the evolution of the deficit in 2021 could turn out more favourable as a result of the higher growth from the implementation of measures financed by the Recovery and Resilience Facility, which the DBP does not include in the macroeconomic projections. Indeed, the identification and eventual implementation of these programmes can significantly bolster the recovery over the medium-term, thus presenting upside risks to the macroeconomic forecasts presented in this Plan and hence on the fiscal targets.

Apart from the macroeconomic risks surrounding these fiscal projections, the MFAC outlined additional risks relating to contingent liabilities, particularly the Covid-related guarantees granted by Government, an upside risk vis-à-vis subsidies in the eventuality that some support measures may be needed beyond the first quarter of 2021, as well as calls for support by state-owned enterprises. In total, estimates of contingent liabilities, including Covid-related guarantees amount to 9.5 per cent of GDP in 2020/21 and are expected to go down to just above 8 per cent by 2023. With reference to risks from calls for support by state-owned enterprises, at the moment, preliminary discussions are currently underway with the DG Competition, following a request for state-aid to Air Malta, which has been disproportionately affected by the Covid pandemic.

Another uncertainty in terms of revenue relates to both estimated amount and timing for the recovery of the deferred taxes. Although such deferrals pose a risk to the deficit target for 2020 (as deferrals have been accrued for that year), there is no risk for 2021 and beyond. Even in cash terms, should the collection of deferrals diverge from the baseline for 2021, its impact has been neutralised on the debt projections and hence, the risk is actually on the upside for the debt dynamics in 2021 and beyond.

2. Recent Economic Performance

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In 2019, the Maltese economy recorded a real growth rate of 4.9 per cent, equivalent to 7.2 per cent in nominal terms. The real growth rate was 3.4 percentage points higher than that of the European Union (EU), which means that Malta continued to be among the top performers in the European economy. The domestic demand component was the main driver for growth, contributing to 6.3 percentage points, while a negative contribution of 1.4 percentage points was recorded for net exports while changes in inventories had an added marginal positive contribution to growth.

The overall positive economic performance was supported by growth in both household and Government consumption. Private consumption was sustained by a strong labour market and increases in disposable income. In addition, the growth in Government consumption mainly reflected higher compensation of public sector employees. There was also an improvement in investment activity when compared to the previous years, reflecting developments in both public and private investment. From an external standpoint, real exports and imports of goods and services recovered significantly from the slowdown of 2018, driven by improved external and domestic demand conditions.

Gross Value Added (GVA) at basic prices increased by 7.9 per cent in 2019. This growth was primarily attributable to the services sector, which contributed 7.3 percentage points to growth in GVA, while the industry sector contributed 0.5 percentage points to overall growth. Consequently, the services sector marginally increased its strong share in GVA at 89.2 per cent, while industry maintained a share of 9.9 per cent of GVA. Delving deeper into the individual sectors, the highest growth rates were in the Professional Services sector which grew by 12.8 per cent, followed by the Construction sector (11.2 per cent), the Real Estate sector (9.0 per cent) and the Public Administration sector (8.8 per cent). The sector that contributed the most towards GVA growth was the Professional Services sector with a contribution of 2.2 percentage points, followed by the Public Administration sector and the Wholesale and retail sector, which contributed 1.5 and 1.4 percentage points respectively.

In 2019, compensation of employees increased by 8.4 per cent in nominal terms, reaching €5,803.4 million. Gross operating surplus and mixed income growth remained strong at 7.3 per cent in nominal terms, reaching €6,163.7 million. Meanwhile, subsidies on production and imports recorded an increase of 6.5 per cent, reaching €215.8 million, while taxation on production and imports rose by 2.8 per cent, reaching €1,638.8 million.

2.1 Economic Conditions in the First Half of 2020

During the first half of 2020, the Covid-19 pandemic led to a series of unprecedented stresses on the global economy, including Malta. Although financial aid packages implemented by Government mitigated some of the economic consequences of the pandemic, over the first half of 2020, Malta's Gross Domestic Product (GDP) contracted by 6.1 per cent in nominal terms and 7.7 per cent in real terms. Nevertheless, the decline in the GDP was lower than the Eurozone average.

The decrease in the national GDP reflected declines in both private consumption expenditure and gross fixed capital formation. In fact, private consumption expenditure decreased by 11.1 per cent in the first half of 2020, and Gross Fixed Capital Formation (GFCF) contracted by 12.9 per cent. Public consumption expenditure exhibited a growth rate of 12.4 per cent in the first half of 2020, mainly reflecting higher healthcare expenditure as a result of the outbreak of the pandemic. From an external standpoint, in the first half of 2020, Malta recorded a negative contribution from net exports of goods and services. In the first six months of 2020, imports declined by 3.7 per cent. This was outweighed by the drop in exports of 5.2 per cent, reflecting subdued external conditions, elevated global uncertainty and weak tourism exports.

2.1.1 The External Position

Over the past five years, Malta has generally registered strong current account surpluses. These surpluses were grounded on substantial net export figures in the services account thanks to various components including the personal, cultural and recreational services component and the travel component. In contrast to previous historical trends, the current account registered a deficit of 4.9 per cent of GDP in the first half of 2020 as result of the global pandemic. The historically large net exports of the travel component suffered a significant decline reaching 1.6 per cent of GDP, which is a drop of 5.9 percentage points when compared to the corresponding period in 2019. Other components within the services account remained relatively stable, except for the personal, cultural and recreational activities component and the Other business services components. Whilst the former experienced an increase in net exports of 8.9 percentage points, the latter experienced an increase in its net imports figure of 7.5 per cent in the first half of 2020 when compared to the corresponding period in 2019. These large increases essentially offset each other when calculating the overall services balance.

Flows of income are typically recorded within the primary income account. In terms of compensation of employees, Malta's trend is stable and only accounts for a small fraction of total income flows. In contrast, direct investment and portfolio investment income account constitute a large share of total income flows. In the first half of 2020, Malta registered an increase in its net payments figure for direct investment from 69.8 per cent of GDP in the first half of 2019, to 75.3 per cent of GDP in the corresponding period in 2020. Portfolio investment net receivables have also increased from 59.0 per cent of GDP to 62.5 per cent of GDP when comparing the first half of 2019 with that of 2020. The overall primary income account net payment figure also increased by 2.1 percentage points over the same period.

In terms of investment positions, Malta enjoyed a net asset position of 54.6 per cent of GDP as at the end of 2019. This is mostly thanks to large asset positions held by Maltese investors abroad in terms of direct, portfolio and other investments. In terms of liabilities, most of the foreign liabilities which Maltese investors have are in the form of direct investments.

2.1.2 Global Economic Conditions

During 2019, the global economy continued to expand, albeit at a moderate pace. According to the International Monetary Fund's (IMF) most recent Economic Outlook, the global economy expanded by 2.8 per cent in 2019, which was 0.7 percentage points lower than the growth recorded for 2018.

The Covid-19 pandemic continues to influence global economic activity. As a result of the pandemic, the global economy is projected to contract sharply by 4.4 per cent in 2020, before recovering to 5.2 per cent in 2021 and gradually slowing to 3.5 per cent in the medium-term. The IMF revised their projections upwards from their June forecast of -4.9 per cent, based on better than anticipated second quarter GDP outturn in large advanced economies. However, the IMF anticipates a slower recovery in 2021 reflecting a more moderate decline projected for 2020 and expectations that social distancing will persist.

Besides the economic disruption brought about by the pandemic, further downside risks for the Euro Area (EA) include geopolitical tensions, uncertainty on the relationship between the EU and United Kingdom (UK), a stronger Euro relative to other major currencies, global manufacturing weaknesses, weak productivity growth and ageing populations. According to the European Commission's (EC) latest forecast, the EA economy is expected to contract by 7.8 per cent in 2020, before recovering at an annual growth rate of 4.2 and 3.0 per cent in 2021 and 2022 respectively.

2.2 The Medium-Term Scenario

The effect of this pandemic distinguishes itself from previous economic crises because the declines in demand were also complemented with supply restrictions resulting from the mandatory imposition of various country-wide lockdowns in countries with which Malta trades. Furthermore, the pandemic also created unanticipated strains on global health care systems. International and domestic institutions hastily responded to the outbreak by loosening monetary policies while providing fiscal stimulus to cushion the economic setback. However, the situation going forward continues to be overshadowed with uncertainty with respect to both the duration of the virus as well as the intensity at which it reproduces.

Against this background, the Maltese economy is expected to contract by 7.4 per cent in real terms during 2020, with a modest recovery in 2021 of 5.0 per cent in real terms. Given the high degree of openness of the economy, international developments are projected to weigh on Malta's net export performance. Indeed, the main contributor to the decline in real GDP for 2020 is a negative net exports balance of 6.7 percentage points. Domestic demand is also expected to act as a headwind to growth, contributing negatively by 1.1 percentage points. On the other hand, inventory accumulation during the first half of the year is assumed to contribute 0.4 percentage points to growth. In 2021, growth in the headline components are expected to turn positive, although the recovery is assumed to be gradual. Indeed, domestic demand is anticipated to contribute 3.3 percentage points to growth, while net exports shall contribute 1.7 percentage points in 2021.

Over the outer years, economic growth is expected to be more balanced and reach 5.4 per cent in 2022 and 4.3 per cent in 2023. In 2022, economic growth is expected to be mainly driven by domestic demand, which is expected to contribute 2.8 percentage points to growth, while the contribution of net exports is also expected to remain positive, contributing 2.6 percentage points to growth. This positive development in external demand is expected to withstand in 2023, as the contribution of net exports is projected to equal 2.1 percentage points, while domestic demand is expected to contribute 2.2 percentage points. It is pertinent to note the significant uncertainty underlying medium-term projections. These projections are based on the assumption that health conditions will return to pre-Covid as from 2022. It is also pertinent to note that the institutions which are relied upon for the external assumptions have not provided an update of these assumptions, as is customary in normal times, and hence these forecasts rely on the national judgements of the medium term global economic conditions.

Chart 2.1 illustrates the forecasted growth rates of GDP, together with a detailed breakdown of the expenditure aggregates. Table 2.1 presents the main macroeconomic indicators for the years 2018-2023. The figures for 2018 and 2019 represent actual data published by the National Statistics Office (NSO), while the data from 2020 onwards represent the projections of the Ministry for Finance and Financial Services (MFIN). The macroeconomic forecasts take into account the latest available data and are provided in Table 1a, 1b, 1c and 1d of the Statistical Appendix.

Chart 2.1
GDP Growth Rate

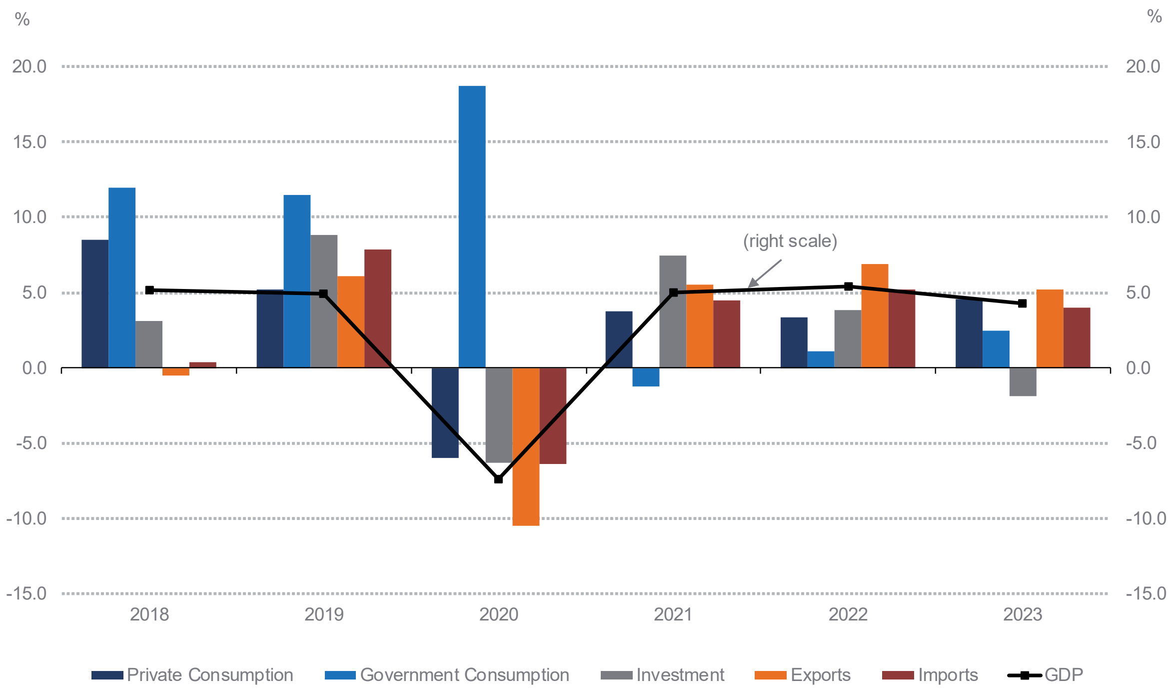


Table 2.1
Main Macroeconomic Indicators

	2018	2019	2020p	2021p	2022p	2023p
GDP growth at current market prices (%)	7.3	7.2	-6.3	6.4	7.1	5.9
GDP growth at Chain Linked Volumes by period (Reference year 2010) (%)[1]	5.2	4.9	-7.4	5.0	5.4	4.3
Expenditure Components of GDP						
at Current Market Prices by period (%)						
Private final consumption expenditure[2]	9.4	7.3	-5.2	5.0	4.6	5.9
General government final consumption expenditure	14.6	14.1	20.6	1.1	3.6	4.5
: net of Individual Investor Programme (IIP) proceeds	*10.0*	*10.3*	*14.5*	*1.8*	*-5.3*	*-1.1*
Gross fixed capital formation	4.0	10.0	-5.0	8.8	5.5	-0.4
Exports of goods and services	1.6	8.0	-9.5	6.8	8.2	6.6
: net of Individual Investor Programme (IIP) proceeds	*1.9*	*8.4*	*-9.4*	*6.8*	*8.2*	*6.8*
Imports of goods and services	1.9	9.5	-5.3	5.7	6.4	5.3
Expenditure Components of GDP						
at Chain Linked Volumes by period (Reference year 2010) (%)						
Private final consumption expenditure[2]	8.5	5.2	-6.0	3.7	3.4	4.6
General government final consumption expenditure	12.0	11.5	18.7	-1.2	1.1	2.5
Gross fixed capital formation	3.1	8.8	-6.3	7.5	3.8	-1.9
Exports of goods and services	-0.5	6.1	-10.5	5.5	6.9	5.2
Imports of goods and services	0.4	7.9	-6.4	4.5	5.2	4.0
Inflation rate (%)	1.7	1.5	0.9	1.3	1.4	1.5
Employment growth (National Accounts Definition) (%)[3]	6.5	6.5	-0.7	2.3	4.4	4.9
Unemployment rate (Harmonised definition, Eurostat) (%)	3.7	3.6	4.8	4.0	3.9	3.7
Compensation per employee (% change)[4]	3.7	2.8	0.8	2.3	2.2	2.1
Labour productivity (% change)	-0.8	-0.8	-8.1	2.6	1.0	-0.5
Nominal Unit Labour Cost (% change)	4.5	3.7	9.7	-0.2	1.2	2.6
Real Unit Labour Costs (% change)	2.5	1.8	8.5	-1.7	-0.5	1.1

(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) Total Employment based on National Accounts Definition

(4) Compensation per employee actual figures and forecasts based on unpublished FTEs.

2.2.1 Assumptions for Projections

The macroeconomic forecasts presented in this Stability Programme are based on the following assumptions, obtained from independent forecasts provided by Consensus Forecasts:

1. Economic activity in Malta's main trading partners is expected to decrease by 6.3 per cent in 2020, then recover at a rate of 4.6, 1.3 and 1.4 per cent in 2021, 2022 and 2023 respectively.
2. World prices are projected to decline by 1.8 per cent in 2020, before growing at a yearly average rate of 1.1 per cent in the remaining forecast horizon.
3. Oil prices are expected to reach an average of US $41.2 per barrel in 2020, before increasing to US $47.6 in 2021 and US $48.9 in 2022 and 2023.
4. The short-term interest rate is expected to remain unchanged at the current spot rate of 0.0 per cent throughout the forecast horizon. On the other hand, the long-term interest rate is expected to average at 0.6 per cent in 2020, and then reach 0.7 per cent in 2021. This rate was retained over the outer years, consistent with an upward sloping yield curve.
5. The USD/EUR exchange rate is expected to average 1.1396 in 2020 and 1.1910 in 2021, representing an appreciation of the Euro of 1.9 per cent in 2020 and 4.5 per cent in 2021. The Euro will continue to appreciate by 0.5 per cent in 2022 over the previous year, before stabilising in 2023.
6. The STG/EUR exchange rate is expected to average 0.9045 in 2020 and 0.9001 in 2021, representing an appreciation of the Euro of 3.6 per cent in 2020 and a deprecation of the Euro of 0.5 per cent in 2021. The Euro is then expected to depreciate with respect to the STG by 0.2 per cent over the previous year, and then remain stable in 2023.
7. It is assumed that, starting from the third quarter of 2020, changes in inventories will not contribute materially to GDP growth.

2.2.2 Risks to Outlook

The medium-term outlook for the Maltese economy is overshadowed with uncertainty with respect to both the duration of the virus as well as its rate of transmission. There is also uncertainty on the effectiveness of the policies implemented by Governments. These risk factors will be explored in more detail in Chapter 4. Nevertheless, it is worth highlighting that the balance of risks shows upside risk for 2020, and downward risks for the outer years.

2.2.3 Private Final Consumption Expenditure

Private consumption is projected to decline by 6.0 per cent in 2020, as the partial lockdown throughout the first half of the year impaired consumers' ability to spend. Private consumption is expected to partially recover in 2021, recording a growth rate of 3.7 per cent, while in 2022 and 2023, it is projected to grow by 3.4 per cent and 4.6 per cent respectively.

2.2.4 General Government Final Consumption Expenditure

Government consumption expenditure is expected to continue growing at a strong pace, partly absorbing the negative shock to aggregate demand. Underpinning this growth are the Government support measures, particularly those aimed at sustaining employment and ensuring that businesses remain liquid, which are reflected in significant increases in expenditure on intermediate consumption and compensation of employees. Indeed, public consumption is forecasted to increase by 18.7 per cent in 2020. In 2021, Government consumption is expected to decrease by 1.2 per cent, while over the outer years, it is projected to grow by an average rate of 1.8 per cent. This implies that the share of public consumption in real GDP will average at 20.4 per cent over the projection period.

2.2.5 Gross Fixed Capital Formation

The inherently volatile nature of gross fixed capital formation makes it relatively challenging to forecast. Hence, when forecasting investment, economists within MFIN take a relatively prudent approach, factoring in only those projects that have a strong political commitment or a high probability of realisation, while assuming a relatively high import content. From communication with key stakeholders, it seems that several investment projects which were put on hold during the first half of the year have resumed course. However, due to the prevailing uncertainty underlying the economic landscape, a conservative approach to projecting investment was nonetheless adopted. As a result, gross fixed capital formation is projected to decline by 6.3 per cent in 2020, while the ratio of imports of capital goods to overall investment was maintained at its secular trend. Gross fixed capital formation is expected to recover in 2021, recording a growth rate of 7.5 per cent while in the outer years, investment activity is expected to gradually moderate and record an average growth of 1.0 per cent between 2022 and 2023. Moreover, the investment to GDP ratio is expected to marginally increase and average at 22.8 per cent over the forecast horizon, from the ratio of 22.6 per cent recorded in 2019.

2.2.6 External Balance of Goods and Services

In 2020, net exports are expected to be the main driver in the contraction of GDP, while over the forecast horizon, the contribution of net exports is set to turn positive from 2021 onwards, on the back of a recovery in export growth. The external balance as a percentage of GDP is expected to reach 7.6 per cent in 2020 before stabilising at an average of 11.0 per cent over the forecast horizon. The subdued outlook in Malta's main trading partners is reflected in an anticipated decline of 10.5 per cent in exports for 2020. Despite the worsening of growth assumptions for main trading partners and a stronger Euro compared to the earlier Spring forecasts published in the Stability Programme Update, the pandemic brought about an adaptation of spending behaviour which resulted in some sectors outperforming expectations. This helped to mitigate the worsening external demand conditions relative to the earlier Spring forecasts. In 2021, a steady recovery in Malta's main trading partners is anticipated to result in an increase in exports by 5.5 per cent. Growth in real exports will then further pick up by 6.9 per cent in 2022 as the global economy rebounds from the pandemic, before gradually moderating to 5.2 per cent in 2023. Imports are expected to decline by 6.4 per cent in 2020. This is reflective of the lower domestic demand for imports, the lower external demand for domestic production as well as subdued investment. In the outer years growth in imports is set to gradually moderate in line with the expected recovery in economic activity. In particular, imports are projected to increase by 4.5, 5.2, and 4.0 per cent in 2021, 2022, and 2023, respectively. It is worth mentioning that in Malta, investment activity tends to be highly import-intensive, and thus, year-on-year movements in investment are partially offset by imports of capital goods, thereby minimising the impact of volatile investment flows on GDP in the medium-term.

2.2.7 Sectoral Balances

The current account forecasts are shown in Table 1d. Over recent years, Malta recorded a strong current account surplus, but due to the pandemic, the latest data indicates that the current account was in deficit up to the second quarter of 2020. A reduction in the positive net exports balance is expected to be the main contributor of the anticipated current account deficit in 2020 and 2021. This is mostly owing to the tourism sector which was severely impacted by the pandemic. In terms of primary incomes and transfers, in 2020 the net payment position is expected to increase, and then gradually decline in the outer years. As a result of the expected appreciation of the Euro relative to the Dollar exchange rate in the short-term, Malta's attractiveness for foreign investors to invest their capital will improve, while Maltese investors will find it less profitable to invest abroad. This will inevitably result in larger net payments in the short-term. As the expected impact of the Covid-19 crisis dampens and the exchange rate stabilises, the primary income balance will gradually start to improve.

2.2.8 Productivity and Employment Growth

The labour market continued to yield positive developments in 2019, as employment growth stood at 6.5 per cent (as per National Accounts definition). This reflected strong labour demand conditions, supported by the inflows of migrant workers and improved business prospects. Employment growth was further supported by ongoing efforts by the Government in promoting and sustaining active labour market policies, which included work-life balance measures, family-friendly measures, in-work benefits and the tapering of benefits, and lower taxes on labour.

Despite the economic contraction, employment is expected to show a mild decline of 0.7 per cent when compared to 2019, as the Government wage supplement encouraged employers to retain employees. In 2021, a pick-up in economic activity is projected to generate an employment growth of 2.3 per before reaching an average of 4.7 per cent in the outer years. Combined with a decline in the labour supply following the voluntary repatriation of several workers, the unemployment rate based on the Harmonised definition is projected to stand at 4.8 per cent in 2020 and decline to 4.0 per cent in 2021, before averaging at 3.8 per cent in the outer years.

Compensation of employees increased by 8.4 per cent in 2019, and it is expected to record a marginal increase of 0.1 per cent in 2020, before increasing by 4.8 per cent, 6.7 per cent and 7.1 per cent in 2021, 2022 and 2023 respectively, as heightened job demand generates increasing employment combined with upward wage pressures. Concomitantly, growth in compensation per employee is projected to grow by 0.8 per cent in 2020, before growing at 2.3 per cent, 2.2 per cent and 2.1 per cent in 2021, 2022 and 2023 respectively. It is pertinent to note that although average wages in 2020 have declined in the sectors which were significantly exposed to the crisis, these were mitigated by rising average wages in the sectors which recorded a positive increase and also by public sector wage growth.

Real labour productivity decreased by 0.8 per cent in 2019 and it is expected to decrease by 8.1 per cent this year. This decline is consistent with the drop in real GDP outpacing the anticipated drop in employment. In 2021, real labour productivity is projected to increase by 2.6 per cent, before slowing down in the outer years, at 1.0 per cent in 2020 and -0.5 per cent in 2021. Nominal unit labour costs increased by 3.7 per cent in 2019 and are projected to rise by 9.7 per cent in 2020, prior to recording a decline of 0.2 per cent in 2021. Over the outer years, an average growth rate of 1.9 per cent is expected. Moreover, real unit labour costs are projected to increase by 8.5 per cent in 2020 before decreasing by an average growth rate 0.4 per cent over the forecast horizon.

2.2.9 Inflation

In 2019, the inflation rate (measured as the twelve-month moving average of the Harmonized Index for Consumer Prices (HICP)) was 1.5 per cent. This was primarily driven by energy prices, unprocessed food and services prices, and partly offset by a moderate growth in processed food prices and the decline in non-energy industrial goods.

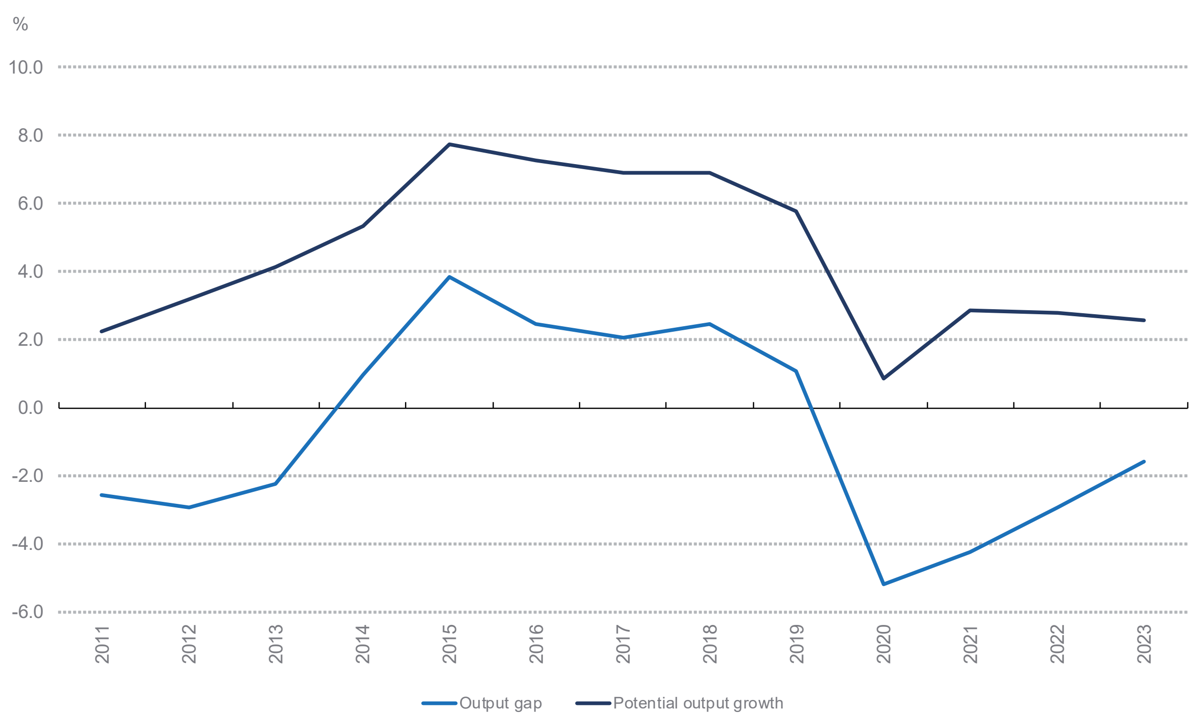
The inflation rate is expected to average 0.9 per cent by the end of 2020 as the appreciation of the Euro and subdued domestic demand instigate downward price pressures particularly in energy and industrial goods. The HICP is expected to increase to 1.3 per cent in 2021 before increasing further to 1.4 per cent and 1.5 per cent in 2022 and 2023 respectively, as domestic and external demand gradually recover.

2.2.10 Comparison to Commission's Latest Forecast

In November, the EC published its Autumn forecast in which Malta's GDP is expected to contract by 7.3 per cent in 2020 and rebound partially by 3.0 per cent in 2021 before accelerating to some 6.25 per cent in 2022, approaching its 2019 level.

For 2020, this is 0.1 percentage points above the latest round of forecasts produced by MFIN, and 2.0 percentage points below for 2021. Although the aggregate GDP forecast is close to MFIN forecasts for 2020, the composition of the growth components differs slightly from the ones produced in the latest round of forecasts by MFIN, which was to be expected given the high uncertainty surrounding the macroeconomic environment. The Commission expects the negative contribution from the domestic and the external side to be more balanced in 2020 (-3.6 per cent and -4.1 per cent respectively) while MFIN are expecting a worse contribution from net exports (-6.7 percentage points) and a less pessimistic outlook from domestic demand (-1.1 percentage points). In 2021, domestic demand is projected to be the main driver of growth for the Maltese economy in both forecasts. The Commission forecasts are however projecting no contribution from net exports while MFIN forecasts expect a contribution of 1.7 percentage points, thus resulting in a higher projected growth rate for Malta in 2021. These differences led to significant base effects and thus variations in the forecasts for 2022 produced by EC and MFIN.

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



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 MFIN's estimation pertain to differences in the macroeconomic forecasts. Developments in the potential output and output gap are presented in Chart 2.2. The average potential output growth stood at 5.2 per cent during the period 2010 to 2019. As a result of the impact of the pandemic, over 2020 and 2021, potential output growth is expected to decrease to an average growth rate of 1.9 per cent before averaging at 2.7 per cent in the outer years. The main contributions to potential output are the labour input supported to a lesser extent by capital accumulation while total factor productivity is projected to contribute negatively.

The output gap is indicative of the cyclical developments prevailing in the Maltese economy. With the exception of the year 2004, the period 2002 to 2008 has been a period where the Maltese economy operated above its potential level. The output gap turned negative between 2009 and 2013 following the international recession and the subsequent contraction of the domestic economy in 2009. The output gap turned positive as from 2014 and was estimated at 1.09 per cent in 2019. The output gap is expected to remain negative till 2023.

Table 1a

Macroeconomic Prospects

Percentages unless otherwise indicated	ESA Code	Level 2018[1]	Level 2019[1]	Percentage change over previous period 2018	2019	2020[2]	2021	2022	2023
1. Real GDP	B.1g	11,799.1	12,379.6	5.2	4.9	-7.4	5.0	5.4	4.3
2. Nominal GDP	B.1g	12,491.0	13,390.0	7.3	7.2	-6.3	6.4	7.1	5.9
Components of real GDP									
3. Private consumption expenditure[3]	P.3	5,645.2	5,939.3	8.5	5.2	-6.0	3.7	3.4	4.6
4. Government consumption expenditure	P.3	1,897.3	2,114.6	12.0	11.5	18.7	-1.2	1.1	2.5
5. Gross fixed capital formation	P.51	2,571.2	2,798.2	3.1	8.8	-6.3	7.5	3.8	-1.9
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53			0.7	0.7	1.2	1.1	1.1	1.1
7. Exports of goods and services	P.6	16,963.0	18,002.6	-0.5	6.1	-10.5	5.5	6.9	5.2
8. Imports of goods and services	P.7	15,352.5	16,560.0	0.4	7.9	-6.4	4.5	5.2	4.0
Contribution to real GDP growth[4]									
9. Final domestic demand		10,113.7	10,852.2	6.4	6.3	-1.1	3.3	2.8	2.2
10. Change in inventories and net acquisition of valuables	P.52+P.53			0.0	0.0	0.4	0.0	0.0	0.0
11. External balance of goods and services	B.11	1610.5	1442.6	-1.2	-1.4	-6.7	1.7	2.6	2.1

[1] € million

[2] Projections from 2020 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 2018[1]	2019[1]	Percentage change over previous period 2018	2019	2020[2]	2021	2022	2023
1. GDP deflator[3]		119.3	121.9	2.1	2.3	1.1	1.4	1.7	1.6
2. Private consumption deflator		112.0	114.3	0.9	2.1	0.9	1.1	1.2	1.3
3. HICP (Average 2015=100)		104.0	105.5	1.7	1.5	0.9	1.3	1.4	1.5
4. Public consumption deflator		118.6	121.4	2.6	2.6	1.6	2.4	2.4	1.9
5. Investment deflator		111.3	112.6	0.9	1.2	1.3	1.2	1.6	1.5
6. Export price deflator (goods and services)		118.0	120.1	2.1	1.9	1.2	1.1	1.2	1.3
7. Import price deflator (goods and services)		113.8	115.5	1.5	1.6	1.1	1.1	1.2	1.3

(1) Index (base 2010 unless otherwise indicated)

(2) Projections from 2020 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. For this reason, the GDP deflator quoted in this table for 2014 and 2015 reflects the actual difference between nominal and real GDP growth rates for the year.

Table 1c

Labour Market Developments

Percentages unless otherwise indicated	ESA Code	Level 2018	Level 2019	Percentage change over previous period 2018	2019	2020[1]	2021	2022	2023
1. Employment, persons (National Accounts Definition, Domestic Concept)		237,922	253,296	6.5	6.5	-0.7	2.3	4.4	4.9
2. Employment, hours worked (National Accounts Definition, Domestic Concept) ('000s)		477,746	508,618	6.5	6.5	-0.7	2.3	4.4	4.9
3. Unemployment rate (Harmonised definition, 1000 persons)		9,088	9,006	3.7	3.6	4.8	4.0	3.9	3.7
4. Labour Productivity, persons (Real GDP per person employed)		49,592	48,874	-0.8	-0.8	-8.1	2.6	1.0	-0.5
5. Labour Productivity, hours worked (Real GDP per hour worked)		24.7	24.3	-0.8	-0.8	-8.1	2.6	1.0	-0.5
6. Compensation of employees (€ million)	D1	5,353.6	5,803.4	9.5	8.4	0.1	4.8	6.7	7.1
7. Compensation per employee (€)		22,502	22,912	3.7	2.8	0.8	2.3	2.2	2.1

[1] Projections from 2020 onwards

Table 1d

Sectoral Balances

% of GDP

	ESA Code	2018	2019	2020	2021	2022	2023
1. Net lending/ borrowing		7.1	5.2	-5.1	-4.4	-1.6	1.2
vis-à-vis the rest of the world	B.9						
of which:							
Balance on goods and services		15.6	13.9	7.9	9.9	11.6	13.7
Balance of primary incomes and transfers		-9.4	-9.5	-13.6	-14.4	-13.3	-12.6
Capital account		0.9	0.8	0.6	0.1	0.2	0.1
2. Net lending/ borrowing of the private sector	B.9	4.4	4.1	3.1	0.4	1.6	4.0
3. Net lending/ borrowing of general Government	EDP B.9	2.0	0.5	-9.4	-5.9	-4.2	-3.7
4. Statistical discrepancy		0.7	0.7	1.2	1.1	1.0	1.0
Current Account		5.7	4.8	-7.4	-4.5	-1.7	1.1

3. General Government Budgetary Developments

3. General Government Budgetary Developments

Four years of consecutive fiscal surpluses and a continuing decline in the Government debt burden have put Malta's public finances on a sound footing. These improvements in Government's finances have provided the necessary fiscal space to allow fiscal policy to act in a countercyclical manner also ensuring the long-term sustainability of public finances. These developments are considered favourably by rating agencies and have resulted in positive rating actions in recent years, which in addition to recent reform efforts, have helped to encourage investment in a number of important areas.

Against the background of the unprecedented and extraordinary circumstances surrounding the Covid-19 situation, backed by a solid financial position, the Maltese Government immediately launched a series of financial packages to address the health emergency needs of the country, eased liquidity pressures on businesses, and safeguarded jobs and household incomes. Acting pro-actively, the Government also launched a comprehensive recovery plan to regenerate the Maltese economy upon the gradual reopening of the economy from its partial lockdown. The 2021 Budget builds on this recovery plan and seeks to ensure that Malta returns to the path of economic growth witnessed in recent years.

3.1 Fiscal Developments in 2019

In 2019, the general Government surplus stood at 0.5 per cent of Gross Domestic Product (GDP), while the debt-to-GDP ratio declined to 42.6 per cent of GDP.

3.1.1 General Government Revenue in 2019

In 2019, the general Government revenue-to-GDP ratio declined by 0.8 percentage points to 37.7 per cent of GDP.

The tax revenue ratio remained relatively unchanged at around 26 per cent of GDP in 2019. Revenue from taxes on production and imports registered a decline of 0.5 percentage points of GDP, mainly due to lower than estimated growth in Value Added Tax (VAT) revenue and lower proceeds from taxes on financial and capital transactions. These developments were partly driven by the loss in retained revenue during the transitory period of the regulation on VAT on electronic services, as well as the extension of ongoing measures targeting stamp duty. Meanwhile, the ratio to GDP of current taxes on income and wealth increased by 0.4 percentage points, mainly underpinned by strong labour market conditions and the robust state of the Maltese economy.

The ratios of property income and social contributions declined marginally in 2019 by 0.3 percentage points of GDP in aggregate. The lower ratio to GDP of property income is related to lower profits from the Central Bank of Malta and lower distributed dividends from public listed companies.

3.1.2 General Government Expenditure in 2019

In 2019, the ratio of general Government expenditure to GDP increased by 0.7 percentage points to 37.3 per cent, reflecting increases in Government consumption, in particular higher expenditure on intermediate consumption. Intermediate consumption increased by 0.7 percentage points to 7.2 per cent of GDP in 2019 mainly on account of higher expenditure by Extra Budgetary Units (EBUs) and by central Government on residential homes, and on medicines and surgical materials.

Reviews of Government spending are contributing to the achievement of improved efficiency in public spending, reduction of waste and value for money. As a result of these efforts, as well as the expenditure-reducing effect of measures legislated in previous Budgets, in particular the tapering of social benefits and the gradual extension of the retirement age by virtue of the 2006 pension reform initiatives, the ratio of social payments declined by a further 0.2 percentage points to 9.2 per cent of GDP. Indeed, the lower ratio for social payments resulted in spite of a number of 2019 Budget measures addressing the adequacy of pensions, including disability pensions, and other vulnerable groups.

As a result of the Treasury's debt management strategy as well as the low interest rate environment, expenditure on interest payments declined in both absolute and relative terms in 2019.

Expenditure on subsidies and on compensation of employees as a share of GDP remained relatively unchanged in 2019, the latter reflecting moderate increases in public service salaries.

Meanwhile, the increase in the expenditure to GDP ratio also resulted from higher capital expenditure, in particular as gross fixed capital formation increased by 0.6 percentage points of GDP. Higher capital expenditure was directed to roads, the environment, health and education and included higher infrastructure expenditure financed from both the European Union (EU) and local funds.

3.1.3 Meeting the 2019 targets as established in the 2019 Medium-Term Fiscal Plan

This section assesses the fiscal and budgetary policies in 2019 against the medium-term objectives outlined in the 2019 Medium-Term Fiscal Plan published on 30 April 2019. It is important to note that the targets for 2019, as outlined in Spring 2019, were different from those underlying the 2019 Budget presented in October 2018 due to updated fiscal information available and revised macroeconomic assumptions upon which the fiscal projections are based. Developments in the general Government budgetary execution in 2019, between subsequent forecasts, are outlined in Table 3.1.

During 2019, the general Government recorded a surplus of €64.1 million, compared to the target surplus of €120.3 million outlined in the 2019 Update of the Stability Programme. These developments reflected a more subdued than anticipated revenue outcome, which turned out €72.1 million lower than expected but in part this was offset by general Government expenditure, which was also marginally lower than projected by €15.9 million.

The most notable lower than estimated proceeds were from taxes on production and imports, which yielded €52.8 million less revenue than was forecasted. This component of revenue increased by 2.6 per cent, compared to an estimated growth of 4.7 per cent forecast in the 2019 Update of the Stability Programme. The more robust growth registered in the labour market resulted in higher than expected proceeds amounting to €30.6 million from current taxes on income and wealth, which increased by 10.7 per cent, compared to an estimated growth of 8.8 per cent forecast in the previous Update. At the same time, lower revenue from social contributions of €17.5 million is due to a lower-than-estimated State Contribution.

'Other revenue', most notably capital transfers and investment grants turned out €44.6 million lower than expected. The performance of 'other revenue', primarily reflected

Table 3.1

General Government Budgetary Execution and Prospects

€ millions

	ESA Code	2019 Budget Forecast	2019 USP 2019 Forecast	Actual	2020 Budget Forecast	2020 USP 2020 Forecast	2021 Budget Forecast
Net lending (+)/net borrowing (-)							
1. **General Government**	S.13	**165.0**	**120.3**	**64.1**	**193.0**	**-951.9**	**-1,180.0**
2. Central Government	S.1311	166.2	121.5	58.2	194.2	-950.7	-1,178.8
3. State Government	S.1312	-	-	-	-	-	-
4. Local Government	S.1313	-1.2	-1.2	5.9	-1.2	-1.2	-1.2
5. Social Security funds	S.1314	-	-	-	-	-	-
For the General Government							
6. **Total Revenue**	TR	**5,054.0**	**5,124.4**	**5,052.3**	**5,523.6**	**4,997.1**	**4,727.5**
Of which							
Taxes on Production and Imports	D.2	1,613.8	1,665.8	1,613.0	1,804.9	1,471.0	1,413.5
Current Taxes on Income, Wealth, etc.	D.5	1,935.4	1,796.4	1,827.0	2,007.0	1,820.0	1,722.2
Capital Taxes	D.91	26.5	27.2	26.1	27.9	18.7	19.3
Social Contributions	D.61	807.3	817.5	800.1	870.6	797.4	789.5
Property Income	D.4	66.2	68.5	81.8	74.6	69.7	81.5
Other [(a)]		604.8	749.0	704.4	738.5	820.2	701.4
7. **Total Expenditure**	TE	**4,889.0**	**5,004.1**	**4,988.2**	**5,330.6**	**5,949.0**	**5,907.5**
Of which							
Compensation of employees	D.1	1,467.7	1,490.3	1,479.5	1,567.9	1,584.6	1,578.9
Intermediate Consumption	P.2	888.1	936.9	968.7	1,055.4	1,212.8	1,232.3
Social Payments	D.6	1,290.9	1,275.1	1,238.0	1,308.6	1,378.0	1,368.6
Interest Expenditure	D.41	187.8	186.5	182.9	175.2	177.1	126.0
Subsidies	D.3	176.8	165.4	195.0	195.7	499.6	633.2
Gross Fixed Capital Formation	P.51	464.2	525.1	519.3	573.8	672.2	606.4
Capital Transfers	D.9	157.0	168.6	107.3	151.9	100.9	50.7
Other [(b)]		256.5	256.2	297.6	302.2	323.9	311.5
8. **Gross Debt** [(c)]		**5,660.1**	**5,755.8**	**5,709.0**	**5,690.7**	**6,939.7**	**6,895.7**

Notes:

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

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

[(c)] As defined in Council Regulation (EC) No 479/2009 (OJ L 145, 10.6.2009, p. 1).

a lower than planned absorption of EU funds which was only partly outweighed by stronger-than-expected market output.

Meanwhile, higher than targeted expenditure on intermediate consumption and subsidies was more than offset by lower than planned expenditure on capital transfers, social payments and gross fixed capital formation. Expenditure on intermediate consumption was €31.8 million higher than targeted, registering a 19.2 per cent year-on-year increase, compared to an anticipated growth of 12.3 per cent in the 2019 Update of the Stability Programme. These developments were the result of higher than planned EBUs' intermediate consumption, medical and surgical materials, contribution to government entities operating in financial intelligence, and higher than planned expenditure towards operations and maintenance. Higher than planned subsidies amounting to €29.6 million were primarily related to the national regulator of financial markets. Meanwhile, lower than expected capital transfers and gross fixed capital formation were mainly on account of a lower than planned absorption of pre-financed expenditure than was accrued to 2019 in the 2019 Update of the Stability Programme.

3.2 Updated Budgetary targets in 2020 and 2021

The final outcome in 2019, the evaluation of general Government budgetary developments during the current year, as well as the revised macroeconomic projections, constitute the basis for the revised projections. In addition, revisions also reflect fiscal policy measures put in place to cushion the economic impact of the Covid-19 pandemic on revenues, incomes and liquidity during the current year, as well as the fiscal impact of

Table 3.1a

General Government Budgetary Prospects

Divergence from previous forecasts

€ millions

		Autumn 2019 compared to Autumn 2020				Spring 2020 compared to Autumn 2020			
	ESA Code	Divergence due to out-turn in *t-1*	Divergence due to up-dated macro-economic projections	Other revi-sions	**Total fore-cast revi-sion**	Divergence due to out-turn in *t-1*	Divergence due to up-dated macro-economic projections	Other revi-sions	**Total fore-cast revi-sion**
Net lending (+)/net borrowing (-)									
1. **General Government**	S.13	**-105.9**	**-730.6**	**-536.4**	**-1,373.0**	**13.4**	**-208.1**	**-33.3**	**-228.1**
2. Central Government	S.1311	-105.9	-730.6	-536.4	-1,373.0	13.4	-208.1	-33.3	-228.1
3. State Government	S.1312	-	-	-	-	-	-	-	-
4. Local Government	S.1313	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
5. Social Security funds	S.1314	-	-	-	-	-	-	-	-
For the General Government									
6. **Total Revenue**	TR	**-105.9**	**-706.6**	**16.5**	**-796.1**	**13.4**	**-173.9**	**-109.1**	**-269.6**
Of which									
Taxes on Production and Imports	D.2	-39.9	-453.3	101.7	-391.5	25.1	-152.3	69.7	-57.6
Of which									
Value Added Type Taxes (VAT)	D.211	-82.2	-390.4	202.5	-270.2	0.0	-127.8	138.1	10.3
Taxes on Financial and Capital Transactions	D.214C	-2.6	-18.3	-32.3	-53.2	3.1	-18.2	-19.1	-34.2
Current Taxes on Income, Wealth, etc.	D.5	-46.7	-196.0	-42.1	-284.8	-11.6	-29.2	-57.0	-97.8
Of which									
Taxes on Individual or Household Income	D.51M	-11.5	-88.8	-51.2	-151.6	-8.4	12.9	-51.2	-46.7
Taxes on the income or profits of Corporations	D.51O	-38.1	-106.4	11.6	-132.9	-4.3	-42.0	-5.8	-52.2
Capital Taxes	D.91	-1.1	-1.8	-5.7	-8.6	0.0	-0.8	1.5	0.7
Social Contributions	D.61	-18.2	-55.6	-7.3	-81.1	-0.1	8.5	-16.2	-7.8
Of which									
Employers' Actual Pension Contributions	D.611	-16.1	-24.3	4.7	-35.7	31.1	5.1	4.2	40.4
Households' actual social contributions	D.613	-2.0	-33.1	-12.2	-47.3	-31.3	3.0	-13.4	-41.6
Property Income	D.4	-	-	6.9	6.9	-	-	11.7	11.7
Other [(a)]		-	-	-37.1	-37.1	-	-	-118.8	-118.8
7. **Total Expenditure**	TE	**0.0**	**24.0**	**552.9**	**576.9**	**0.0**	**34.3**	**-75.8**	**-41.6**
Of which									
Compensation of employees	D.1	-	-	11.0	11.0	-	-	-5.7	-5.7
Intermediate Consumption	P.2	-	-	176.8	176.8	-	-	19.5	19.5
Social Payments	D.6	-	24.0	36.0	60.0	-	34.3	-43.7	-9.4
Of which									
Unemployment expenditure		-	24.0	-	24.0	-	34.3	-	34.3
Interest Expenditure	D.41	-	-	-49.2	-49.2	-	-	-51.1	-51.1
Subsidies	D.3	-	-	437.5	437.5	-	-	133.6	133.6
Gross Fixed Capital Formation	P.51	-	-	32.6	32.6	-	-	-65.8	-65.8
Capital Transfers	D.9	-	-	-101.2	-101.2	-	-	-50.3	-50.3
Other [(b)]		-	-	9.3	9.3	-	-	-12.4	-12.4

Notes:

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

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

the measures underlying the 2021 Draft Budget. Table 3.1a distinguishes the changes to the 2020 forecasts between successive reports due to the impact of the actual outturn in 2019 (base effect), macroeconomic determinants, and other changes. Table 3.2 presents the general Government expenditure and revenue targets, broken down by main components.

As of 2020, the general Government gross debt is expected to increase by 12.3 percentage points to 55.0 per cent of GDP, reflecting the impact of the Covid-19 pandemic. The debt-to-GDP ratio is expected to increase by a further 3.6 percentage points in 2021 to reach 58.6 per cent but still below the European Commission's 60 per cent Maastricht threshold. The expected increase in the debt-to-GDP ratio in 2020 is mainly on the back of the negative primary balance together with an expansionary contribution stemming from the nominal growth, interest expenditure and the stock-flow adjustment (SFA) which is mainly due to the contribution to the Malta Government Stock sinking fund. Additionally, in 2020 part of the positive stock flow is attributed to the positive balance in the revenue accruals which is not included in the central Government deficit.

Table 3.2

Expenditure and Revenue Targets

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

% GDP

	2018	2019	2020	2021	2022	2023
General Government (S13)						
1. Total revenue target	**38.5**	**37.7**	**37.7**	**39.0**	**38.2**	**37.9**
of which						
1.1. Taxes on production and imports	12.6	12.0	11.3	12.5	12.6	12.9
1.2. Current taxes on income, wealth, etc	13.2	13.6	13.7	13.9	13.4	13.1
1.3. Capital taxes	0.2	0.2	0.2	0.2	0.2	0.2
1.4. Social contributions	6.1	6.0	6.3	6.1	6.2	6.2
1.5. Property income	0.8	0.6	0.6	0.6	0.6	0.5
1.6. Other [1]	5.7	5.3	5.6	5.6	5.3	5.0
p.m.: Tax burden	32.2	32.0	31.6	32.9	32.6	32.5
(D.2+D.5+D.61+D.91-D.995)[2]						
2. Total expenditure target	**36.6**	**37.3**	**47.1**	**44.9**	**42.4**	**41.6**
of which						
2.1. Compensation of employees	11.0	11.0	12.6	12.5	12.2	12.0
2.2. Intermediate consumption	6.5	7.2	9.8	9.1	8.8	8.5
2.3. Social payments	9.5	9.2	10.9	10.4	10.0	9.8
of which Unemployment benefits [3]	0.2	0.2	0.3	0.3	0.2	0.2
2.4. Interest expenditure	1.5	1.4	1.0	1.2	1.2	1.2
2.5. Subsidies	1.4	1.5	5.0	3.0	1.7	1.6
2.6. Gross fixed capital formation	3.2	3.9	4.8	5.1	4.9	4.8
2.7. Capital transfers	1.3	0.8	0.4	0.9	0.9	0.9
2.8. Other [4]	2.1	2.2	2.5	2.7	2.6	2.7
3. General Government Balance	**2.0**	**0.5**	**-9.4**	**-5.9**	**-4.2**	**-3.7**
4. Primary Balance	**3.5**	**1.8**	**-8.4**	**-4.8**	**-2.9**	**-2.5**

[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.

3.2.1 Updated budgetary plans for 2020

While the outbreak of the pandemic exerted adverse effects on the broad economy in general, some sectors were more severely impacted than others by the partial-lockdown measures. In particular, tourism-related industries and the wholesale and retail trade sectors have been adversely affected by the pandemic. These developments are expected to impact proceeds from taxes on production and imports. The Government support measures, particularly those aimed at sustaining employment, are to an extent expected to mitigate the severity of the downturn on compensation of employees, such that the anticipated drop in employment is expected to be modest compared to the drop in output. In addition, the support measures aimed at sustaining corporate liquidity and profitability are aimed at reducing the risk of corporate insolvencies and expected to minimise the timeframes within which the more severely hit sectors recover. As a result of these factors, the 2020 fiscal target for general Government has been revised to a deficit of 9.4 per cent of GDP.

The general Government revenue to GDP ratio is expected to remain stable compared to 2019, at 37.7 per cent of GDP. The projections for general Government revenue were revised downwards by 1.5 percentage points, to reflect lower anticipated proceeds of 0.8 percentage points from taxation. Against the background of the anticipated negative macroeconomic developments in 2020, taxes on production and imports were revised downwards by 0.3 percentage points. In the revised forecasts, revenues from current taxes on income and wealth were also revised downwards, such that as a share to GDP, the ratio is expected to remain relatively unchanged compared to 2019. The lower impact on direct taxation is on account of the expected success of government support in shoring up employment during the pandemic. It is worth noting that as per Eurostat's note on statistical implications of some policy measures in the context of the Covid-19 pandemic[1], 'when payment deadlines are changed (lengthened) or the submission deadlines for tax declaration are postponed, for taxes where the accrual is implemented using time-adjusted cash, the time-lag used for time-adjusted cash should be reviewed so as to still reflect well the time when the economic activity generating the tax liability took place.' Indeed, the estimated fiscal impact of deferrals, estimated at 1.4 per cent of GDP is accrued entirely to 2020.

The ratio of general Government expenditure to GDP is expected to increase by 9.8 percentage points to 47.4 per cent in 2020. The increase in the expenditure-to-GDP ratio is mainly set to come from the fiscal impact of Covid-19 related measures as well as measures legislated by means of the 2020 Budget. The projections for general Government expenditure have been revised significantly upwards by 0.4 percentage points, compared to projections outlined in the 2020-2021 Update of the Stability Programme. Higher ratios to GDP for subsidies of 1.1 percentage points, and higher ratios for intermediate consumption and social payments of 0.3 percentage points each are anticipated. The main changes to the expenditure forecast in 2020 are mainly on account of fiscal measures introduced to mitigate the effects of Covid-19 pandemic.

National policy response to Covid-19 and budgetary implications

A broad range of policy measures was implemented to limit the impact of the pandemic. The initial policy response sought to lower the number of infections, to avoid an overloading of the acute health system and to limit the number of casualties. To this end, in an initial response, the Maltese Government intervened to contain the spread of the virus through a series of prevention, containment, control and treatment measures, implemented and enforced across sectors and within society. In addition, further healthcare funding was necessary to address hospital capacity, medical equipment and protective gear. Subsequently, 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. Following the lifting of several restrictions imposed as a result of the pandemic and the re-opening of non-essential retail establishments and services, the Maltese Government provided support to the rebound and recovery.

3.2.2 Budgetary plans for 2021

Against the background of the strong underlying macroeconomic fundamentals, the Maltese Government is well-positioned to put in place measures to minimise the impact of the Covid-19 pandemic, thus ensuring that the economy returns as quickly as possible to the path of economic growth. Indeed, the easing in general restrictions are expected to relaunch domestic demand and investment, supported by the recovery packages announced by the Maltese Government. Net exports are also set to contribute to the rebound as global trade gradually normalises.

The targets underlying the 2021 Draft Budget remain subject to a significant degree of uncertainty in light of the ongoing impact of the pandemic on the global economy. Nevertheless, cognisant of the positive bearing that fiscal consolidation and sustainable debt levels have on potential growth, the Government will continue to prioritise fiscal consolidation once the pandemic is over. Indeed, the budget balance is expected to improve to a deficit of 5.9 per cent of GDP in 2021, which also includes an allocation of over 5 per cent of GDP towards gross fixed capital formation in 2021. In structural terms, the general Government deficit is expected to improve from 7.0 per cent in 2020 to 4.0 per cent in 2021. Meanwhile, the debt ratio is expected to increase by 3.6 percentage points of GDP to 58.6 per cent of GDP in 2021, and to remain below the 60 per cent Maastricht Treaty threshold. The positive impact of nominal growth will be more than offset by the upward pressure that the projected primary deficit, interest payments and the stock flow adjustment are expected to have on the debt ratio.

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.

In 2021, tax revenues are expected to broadly follow economic developments. Tax revenues are expected to grow by around 12 per cent, with an implied elasticity of tax revenue to GDP under the no-policy change scenario estimated at 1.2. As a result, on a no-policy change basis, the tax burden would increase by 1.6 percentage points to 33.2 per cent of GDP. This development mainly reflects a higher ratio for taxes on production and imports and for current taxes on income, as the economic recovery in 2021 is expected to be tax-rich.

At unchanged policies, total expenditure would decline by 0.6 percentage point of GDP, as lower ratios for subsidies and intermediate consumption are in part offset by higher capital outlays.

Discretionary measures

A list of the main discretionary measures underpinning the expenditure and revenue targets for 2021 is presented in Table 3.3. The net impact on the budget balance of temporary and permanent discretionary revenue measures for 2021 (including those implemented in previous budgets but which will still have an impact in 2021) is estimated at 0.14 per cent of GDP. Meanwhile, incremental discretionary expenditure measures (including those implemented in previous budgets but which will still have an impact in 2021), are expected to improve the budget balance of 2021 by 3.6 per cent of GDP, as the

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	2018	2019	2020	2021	2022	2023
General Government (S13)							
1. Total revenue at unchanged policies	TR	**38.5**	**37.7**	**37.7**	**39.3**	**38.3**	**38.1**
of which							
1.1 Taxes on production and imports	D.2	12.6	12.0	11.3	12.7	12.7	12.9
1.2 Current taxes on income and wealth	D.5	13.2	13.6	13.7	14.1	13.4	13.1
1.3 Capital taxes	D.91	0.2	0.2	0.2	0.2	0.2	0.2
1.4 Social contributions	D.61	6.1	6.0	6.3	6.1	6.2	6.2
1.5 Property income	D.4	0.8	0.6	0.6	0.6	0.6	0.5
1.6 Other revenue [2]		5.7	5.3	5.6	5.6	5.3	5.1
p.m.: Tax burden		32.2	32.0	31.6	33.2	32.6	32.6
(D.2+D.5+D.61+D.91-D.995)[3]							
2. Total expenditure at unchanged policies	TE	**36.6**	**37.3**	**47.1**	**46.5**	**42.7**	**41.9**
of which							
2.1 Compensation of employees	D.1	11.0	11.0	12.6	12.5	12.2	12.0
2.2 Intermediate consumption	P.2	6.5	7.2	9.8	9.2	8.8	8.5
2.3 Social payments	D.6M	9.5	9.2	10.9	10.6	10.2	10.0
of which *Unemployment benefits* [4]		0.2	0.2	0.3	0.3	0.2	0.2
2.4 Interest expenditure	D.41	1.5	1.4	1.0	1.2	1.2	1.2
2.5 Subsidies	D.3	1.4	1.5	5.0	4.4	1.7	1.6
2.6 Gross fixed capital formation	P.51	3.2	3.9	4.8	5.0	4.9	4.9
2.7 Capital Transfers Payable	D.9	1.3	0.8	0.4	0.9	0.9	1.0
2.8 Other expenditure [5]		2.1	2.2	2.5	2.7	2.7	2.7
3. General Government Balance		**2.0**	**0.5**	**-9.4**	**-7.1**	**-4.4**	**-3.9**
4. Primary Balance		**3.5**	**1.8**	**-8.4**	**-5.9**	**-3.2**	**-2.6**

[1] Data for 2018-2020 is equivalent to the data presented in Table 4.a. The no-policy change scenario for the forthcoming year (2021) 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.

extraordinary measures implemented in 2020 are mostly phased out on the assumption that the pandemic will be controlled at some point during the year.

The 2021 Budget aims to continue to sustain the economic recovery, post pandemic; safeguard employment; ensure social protection and invest in sustainable development. This will be achieved through the introduction of measures, as follows:

1. Assisting companies to retain employment, bolstering their investment initiatives and helping start-ups with the implementation of innovative technology projects;
2. Reducing further the risk of poverty for the most vulnerable in society, including by enhancing the adequacy of pensions;
3. Incentivising the circular economy, by seeking circular consumption and production patterns; exploring waste prevention and management while ensuring the responsible

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 (% of GDP)					
						2018	2019	2020	2021	2022	2023
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	-0.02	-0.00	-0.34	0.20	0.30	0.00
Post Covid-19 Economic Regeneration Plan	Reduced Excise Duty	D2 - R	Accruals	Temporary & Adopted	June 2020 Economic Regeneration Plan	0.00	0.00	-0.06	0.06	0.00	0.00
Budget measures enabling business activity		D2 - R	Accruals	Permanent & Adopted	2019 - 2021	-0.00	-0.00	0.00	-0.06	0.00	0.00
Personal income tax	Fiscal incentives for private pensions	D5 - R	Accruals	Permanent & Adopted	2019 - 2021	0.00	-0.01	-0.00	-0.03	0.00	0.00
Individual Investor Programme	Revenue from the Individual Investor Programme	P10 - R	Accruals	Permanent & Adopted	2014	-0.56	-0.42	-0.30	-0.04	-0.05	-0.14
Other revenue measures, including measures legislated in previous budgets			Accruals	Permanent & Adopted		-0.13	-0.18	-0.04	0.01	-0.03	-0.02
COVID-19 Support Measure	Various medical supplies and equipment in relation to COVID-19	P2, P51 - E	Accruals	Temporary & Adopted	2020 - 2021	0.00	0.00	-0.88	0.85	0.02	0.00
COVID-19 Support Measure	Cargo Transportation and Repatriation	P2 - E	Accruals	Temporary & Adopted	COVID-19 Support Measure	0.00	0.00	-0.40	0.40	0.00	0.00
COVID-19 Support Measure and Post Covid-19 Economic Regeneration Plan	Malta Enterprise and MIMCOL Schemes	D3 - E	Accruals	Temporary & Adopted	2020 - 2021	0.00	0.00	-3.34	2.06	1.27	0.00
COVID-19 Support Measure	Government-guaranteed loans schemes	D3 - E	Accruals	Temporary & Adopted	COVID-19 Support Measure	0.00	0.00	0.00	-0.09	0.02	0.07
COVID-19 Support Measure	Short Term Social Measures	D6 - E	Accruals	Temporary & Adopted	COVID-19 Support Measure	0.00	0.00	-0.14	0.14	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	2016 - 2021	-0.02	-0.27	-0.38	-0.12	0.07	0.05
Other expenditure measures, including measures legislated in previous budgets and projects financed from the National Development and Social Fund			Accruals	Permanent & Adopted		0.06	0.05	-0.54	0.36	-0.04	-0.04
						-0.67	**-0.83**	**-6.42**	**3.74**	**1.57**	**-0.08**

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.

re-use of resources and enhancing green procurement to safeguard the environment;

4. Creating opportunities to build a strong green economy to transform Malta into a modern, resource-efficient and competitive economy – in line with the European Green Deal vision;
5. Continuing to invest in the Island's infrastructure to be able to meet, both the current and the future economic, social and environmental challenges.

In addition, in terms and for the purposes of Article 31 of the Fiscal Responsibility Act, the annual contribution to the 'Contingency Reserve' account is expected to amount to €13.3 million in 2021.

2021 Expenditure and Revenue Targets

While the revenue to GDP ratio is expected to recover in 2021, the expenditure ratio to GDP is expected to decline in 2021, such that the general Government balance is expected to improve to -5.9 per cent of GDP.

Total revenue is expected to increase to 39.0 per cent of GDP in 2021, resulting in an increase of 1.3 percentage points of GDP in the tax revenue ratio. The ratio of taxes on production and imports is expected to increase by 1.2 percentage points of GDP as domestic demand conditions commence their recovery. The ratio of current taxes on income and wealth is expected to increase by 0.2 of a percentage point of GDP, mainly on account of anticipated wage developments.

The ratio of general Government expenditure to GDP is expected to decline by 2.2 percentage points to 44.9 per cent in 2021, largely reflecting a decline of 2.0 percentage points in the subsidies to GDP ratio as Covid-19 related measures are phased out during 2021. A lower ratio for intermediate consumption is offset by added capital outlays.

3.3 Medium-Term Fiscal Strategy

Malta's medium-term fiscal strategy reflects the baseline macroeconomic projections contained in this plan. The effect of this pandemic distinguishes itself from previous crises because the declines in demand were also complemented with supply restrictions, in spite of loosening monetary policies and fiscal stimulus to cushion the economic setback. Uncertainty is expected to remain with respect to both the duration of the virus as well as the intensity at which it reproduces.

Against this background, over the outer years of the forecast period, economic growth is expected to be more balanced, mainly driven by domestic demand, while the contribution of net exports is also expected to be positive. Over 2020 and 2021, potential output growth is expected to average around 2 per cent before averaging at 2.7 per cent in the outer years. Inflation is expected to increase to 1.4 per cent in 2022 and to 1.5 per cent in 2023 as domestic and external demand gradually recover. The projected pick-up in economic activity in the outer years of the forecast period is expected to generate an average employment growth of 4.7 per cent in the outer years while unemployment is expected to average 3.8 per cent in the outer years of the forecast horizon.

3.3.1 Structural Budget Balance and the Medium-Term Budgetary Objective

While the level of uncertainty regarding the short- and medium-term path for the economy is unprecedented, the fiscal starting position in Malta is sound. The Maltese Government adopted a prudent fiscal policy approach in recent years to build fiscal buffers – running headline budget surpluses and establishing a Contingency Reserve Fund – to prepare for an economic shock. As a result of this prudent approach, the economy can absorb a short-term increase in borrowing, particularly since financing conditions remain favourable.

Based on the outlined macroeconomic projections and estimates of the business cycle generated using the commonly agreed methodology, and expected developments in one-off and other temporary measures over the medium-term, the outlined trajectory is translated into a structural deficit of 7.0 per cent of potential GDP in 2020 decreasing gradually to 2.8 per cent of potential GDP by 2022, before increasing again to 3.1 per cent of potential GDP in 2023. It is worth noting that projections for the outer years of the forecasting period are mostly based on a no-policy-change assumption. These projections shall be revised in due course once the recovery is firmly established and extraordinary fiscal support is no longer necessary. Indeed, it is the express view of the Government that once these exceptional circumstances cease to prevail, the Government will support a fiscal strategy to revert to the Medium-Term Objective of a balanced budget in structural terms and ensure that the debt ratio remains below 60 per cent of GDP.

Table 3.4

Analysis of the Developments in the General Government Balance

(percentage points)

	2018	2019	2020	2021	2022	2023
Change in Revenue Ratio	**0.37**	**-0.81**	**-0.04**	**1.27**	**-0.74**	**-0.32**
Discretionary factors underpinning fiscal consolidation	-0.70	-0.61	-0.74	0.14	0.22	-0.16
Revenue increasing measures	-0.66	-0.52	-0.21	-0.18	-0.14	-0.21
Revenue reducing measures	-0.03	-0.09	-0.49	0.13	0.36	0.05
One-off and temporary revenue measures	-0.02	-0.00	-0.03	0.20	0.00	0.00
Tax revenue buoyancy	0.49	-0.04	0.02	1.06	-0.59	-0.02
Other revenue	0.58	-0.16	0.67	0.07	-0.38	-0.14
Change in Expenditure Ratio	**-1.60**	**-0.68**	**-9.84**	**2.20**	**2.50**	**0.76**
Discretionary factors underpinning fiscal consolidation	0.03	-0.22	-5.68	3.60	1.34	0.08
Expenditure increasing measures	-0.06	-0.22	-5.71	3.64	1.38	0.11
Expenditure reducing measures	0.10	-0.01	0.03	-0.03	-0.03	-0.03
Change in Gross Fixed Capital Formation	-0.81	-0.63	-0.63	-0.43	0.19	0.12
Other expenditure	-0.82	0.17	-3.54	-0.97	0.97	0.55
Change in the General Government Balance	**-1.24**	**-1.50**	**-9.89**	**3.47**	**1.76**	**0.43**

Note:

Positive represents an improvement in the General Government balance

The primary balance is expected to improve from a deficit of 8.4 per cent of GDP in 2020 to a deficit of 2.5 per cent of GDP in 2023, reflecting a relatively stable ratio to GDP of interest payments and a general Government deficit which is expected to decline over the medium-term forecast horizon. In view of the outlined developments in the primary balance and the expansionary contribution stemming from interest expenditure and the stock-flow adjustment, over the medium-term the debt-to-GDP ratio is expected to increase to 60.4 per cent by 2023, mainly on the back of the negative primary balances.

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.

3.3.2 Revenue forecasts

Against the background of the outlined medium-term macroeconomic forecasts and plausible elasticity assumptions, the total revenue ratio is expected to decline from 39.0 per cent of GDP in 2021 to 37.9 per cent of GDP by 2023.

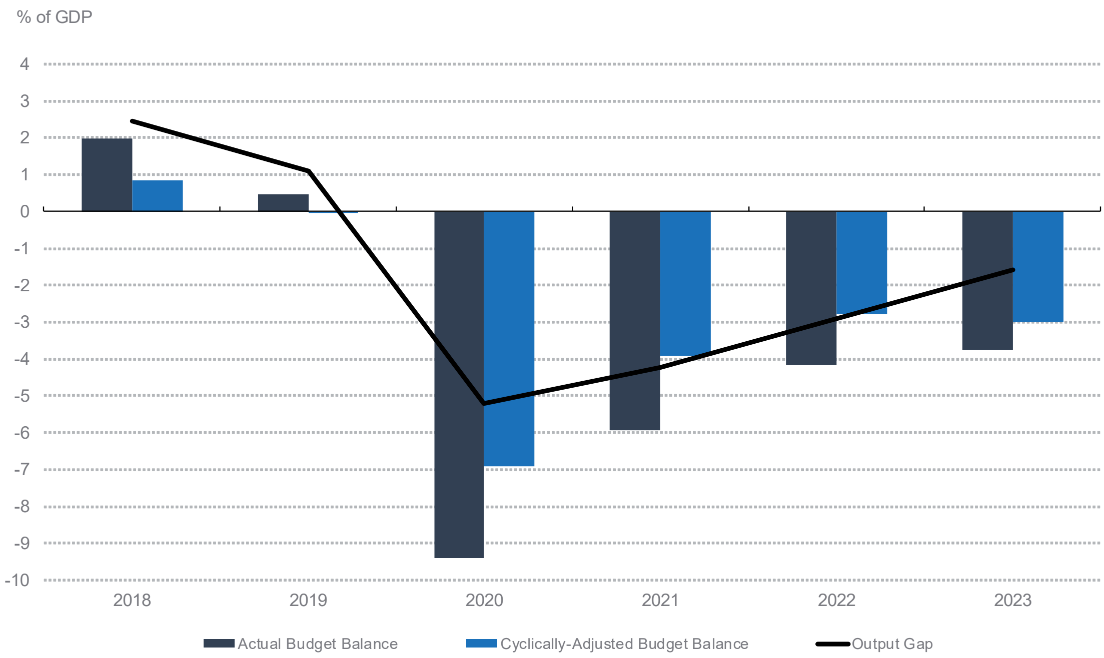
Tax receipts are expected to decline by 0.4 percentage points of GDP to 32.5 per cent of GDP by the end of the forecasting period. These developments are partly driven by a stronger growth in the indirect tax base compared to nominal GDP, as a result of which revenue from taxes on production and imports are expected to increase to 12.9 per cent of GDP in 2023. Meanwhile, primarily due to a slower growth in gross operating surplus compared to GDP growth, the ratio to GDP of current taxes on income and wealth is expected to decline in the outer years of the forecast period to 13.1 per cent of GDP. Meanwhile, social security contributions are expected to remain relatively stable at an average of around 6.2 per cent of GDP by the end of the forecast period.

Table 3.5
Cyclical Developments
(percentage points of GDP)

	ESA Code	2018	2019	2020	2021	2022	2023
Net lending (+) / net borrowing (-) by sub-sector [1]	B.9						
1. General Government Balance	S.13	2.0	0.5	-9.4	-5.9	-4.2	-3.7
2. Central Government	S.1311	1.9	0.4	-9.4	-5.9	-4.2	-3.7
3. State Government	S.1312	-	-	-	-	-	-
4. Local Government	S.1313	0.0	0.0	-0.0	-0.0	-0.0	-0.0
5. Social security funds	S.1314	-	-	-	-	-	-
6. Interest expenditure	D.41	1.5	1.4	1.0	1.2	1.2	1.2
7. Primary balance[2]		3.5	1.8	-8.4	-4.8	-2.9	-2.5
8. One-off and other temporary measures[3]		0.2	0.1	0.1	0.1	0.1	0.1
9. Real GDP growth (%)		5.2	4.9	-7.4	5.0	5.4	4.3
10. Potential GDP growth (%)		6.9	5.8	0.9	2.9	2.8	2.6
11. Output gap (% of potential GDP)		2.4	1.1	-5.2	-4.2	-2.9	-1.6
12. Cyclical budgetary component (% of potential GDP)		1.1	0.5	-2.5	-2.0	-1.4	-0.7
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		0.9	-0.0	-6.9	-3.9	-2.8	-3.0
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		2.4	1.3	-5.9	-2.7	-1.5	-1.8
15. Structural balance (13 - 8) (% of potential GDP)		0.7	-0.1	-7.0	-4.0	-2.8	-3.1

[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



Proceeds from 'other revenue' are expected to decline by 0.6 percentage points to 5.0 per cent of GDP by 2023 as capital transfers related to investment grants are expected to remain relatively stable in level terms.

3.3.3 Expenditure Targets

The general Government expenditure ratio is expected to follow a declining trend to 41.6 per cent of GDP by 2023.

The ratio of current expenditure-to-GDP is expected to decline over the medium-term by 3.1 percentage points to 36.1 per cent in 2023, capital expenditure is forecast to decline marginally by 0.1 percentage points of GDP compared to 2021. Indeed, by means of the planned capital programme, the Maltese Government will give precedence to the national infrastructure needs over the forecast horizon, together with the national economic and social priorities, and consistent with Government's objectives for sustainable economic growth.

The ratio to GDP of subsidies is expected to decline by 1.5 percentage points and to revert back to historical levels once the temporary Covid-related fiscal support is lifted, in particular once the recovery in the labour market is well established. Similar trends are expected for social payments, which are set to resume their declining trend relative to GDP recorded in recent years and are expected to decline to 9.8 per cent of GDP by the end of the forecast horizon.

Expenditure on compensation of employees is expected to decline by 0.4 percentage points of GDP to 12.0 per cent in 2023, whilst the ratio of intermediate consumption to GDP is set to decline to 8.5 per cent of GDP during the period under review. Meanwhile, expenditure on interest payments as a share of GDP is expected to remain relatively unchanged at around 1.2 per cent of GDP by 2023.

3.4 Debt levels and developments

Government debt has declined below the 60 per cent Treaty reference value in 2015 and has fallen continuously ever since, reaching a debt-to-GDP ratio of 42.6 per cent in 2019. In this regard, Malta continues to be one of the Member States with the lowest debt ratio in the Euro Area. As of 2020, the level of Public debt relative to GDP is forecasted to rise and reach 55.0 per cent, reflecting the impact of the Covid-19 pandemic. The debt-to-GDP ratio is expected to continue to rise and reach 58.6 per cent in 2021. By 2023, Malta's debt-to-GDP ratio is expected to further increase by another 0.9 percentage points over 2022 to 60.4 per cent.

The Government's reliance on short-term funding is expected to increase over the medium-term period when compared to the dynamics exhibited in recent years. During 2019, short-term debt accounted for 5.3 per cent of total Government debt and is expected to increase to 6.1 per cent in 2020. Short-term debt funding is predicted to rise in the following years and reach 8.0 per cent in 2023. Additionally, the share of maturing stocks in total Government debt is expected to decrease from 7.6 per cent in 2019 to 6.7 per cent in 2020. Furthermore, the proportion of maturing stocks in total Government debt is projected to remain on a downward trajectory, with the ratio reaching 4.4 per cent in 2022 and decreasing to 3.9 per cent in 2023.

3.4.1 Projected Debt developments

Debt developments depend on net lending, which can be attributed to movements in the primary balance and interest expenditure, GDP growth and the stock flow which is made up of financial transactions and accruals that do not affect lending. Developments in the debt ratio for the Programme period and the contributors to developments in the debt-to-GDP ratio are presented in Table 3.6 and Statistical Appendix Table 4. The debt-to-GDP ratio is expected to be on the rise throughout the forecast horizon reaching 60.4 per cent in 2023, mainly on the back of the negative primary balances together with an expansionary contribution stemming from interest expenditure and the stock-flow adjustment.

After increasing by €64.0 million over 2018, together with a higher level of GDP, the debt-to-GDP ratio for 2019 fell to 42.6 per cent. The debt ratio is expected to rise by 12.4 and 3.6 percentage points in 2020 and 2021 respectively , and expected to continue on a rising path to reach 59.5 per cent of GDP in 2022 reflecting the fiscal policy measures put in place to cushion the economic impact of the Covid-19 pandemic. On a no-policy change assumption, the debt burden in 2023 is expected to reach 60.4 per cent. The Developments in the gross Government debt are illustrated in Chart 3.2. Over the medium-term horizon, the projected increase in the gross debt ratio is mainly driven by the primary deficits. Expansionary contributions stemming from interest expenditure and the stock flow adjustment will also contribute to the increase in the debt ratio. The expansionary contribution of the interest expenditure is expected to remain constant at 1.2 per cent of GDP throughout the forecast horizon while stock flow adjustment is expected to moderate to 0.2 per cent of GDP in 2023.

In 2019, the Stock Flow Adjustment (SFA) is estimated to have resulted in a 1.0 percentage point increase in the debt-to-GDP ratio mainly due to the contribution to the Malta Government Stock sinking fund and the adjustments made to the deficit in ESA10. In 2020, stock flow transactions are expected to have a marginal impact on the debt ratio part of it attributed to the positive balance in the revenue accruals which is not included in the central Government deficit, the contribution to the special MGS Sinking Fund and the equity acquisitions mainly related to the payment to ESM, IP Holdings LTD and the Malta development bank. SFA are expected to remain positive over the medium term

Table 3.6

The Dynamics of Government Debt[1]

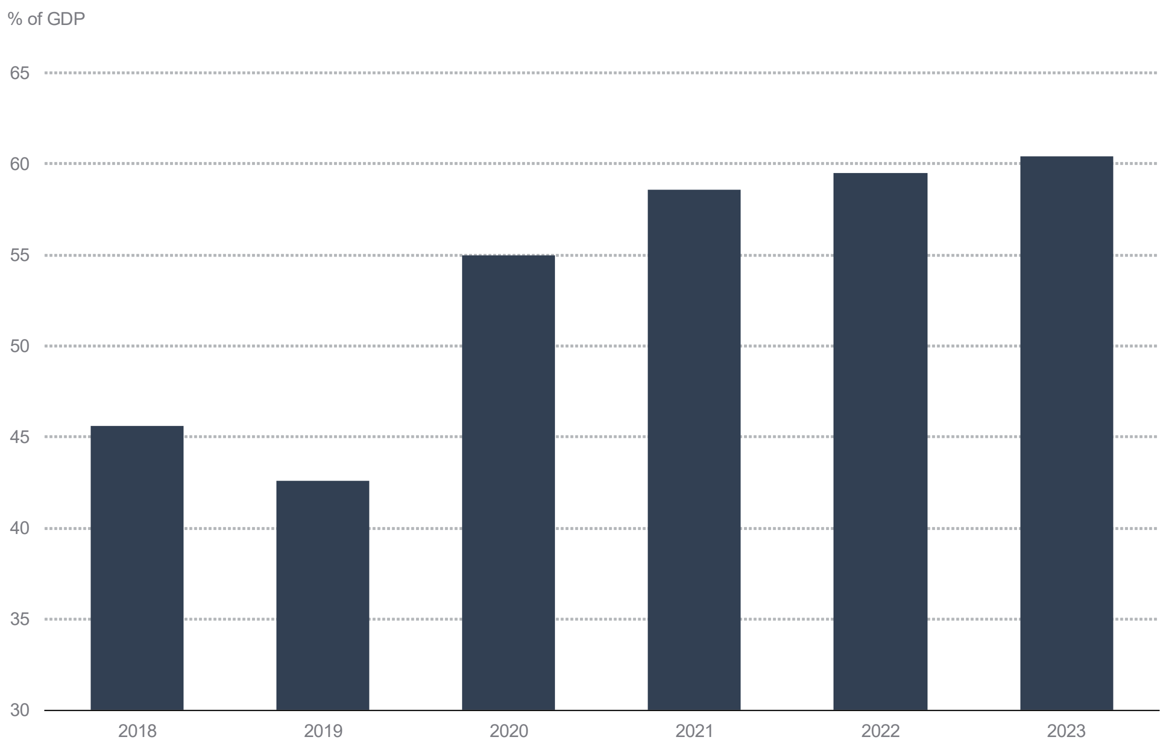
% of GDP

	2018	2019	2020	2021	2022	2023
Gross debt	45.2	42.6	55.0	58.6	59.5	60.4
Change in gross debt ratio	-3.6	-2.6	12.4	3.6	0.9	0.9
Contributions to changes in gross debt						
Primary balance	-3.5	-1.9	8.4	4.7	2.9	2.5
Snowball Effect	-1.8	-1.7	3.9	-2.1	-2.6	-2.1
Interest expenditure	1.5	1.4	1.0	1.2	1.2	1.2
Real GDP growth	-2.4	-2.1	3.4	-2.6	-3.0	-2.5
Inflation Effect	-0.9	-0.9	-0.5	-0.7	-0.9	-0.8
Stock-flow adjustment	1.7	1.0	0.1	1.1	0.6	0.5
p.m. implicit interest rate on debt	3.4	3.2	2.2	2.3	2.3	2.2

[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



mainly due to the ESA rerouted debt, equity acquisitions and contributions to sinking fund. Further details on the SFA can be found in Annex Table 10.

3.4.2 Comparison with the April 2019 Update of the Stability Programme

As illustrated in the Statistical Appendix Table 6, the ratios of general Government debt-to-GDP presented in this Medium-Term Fiscal Strategy are expected diverge significantly for the medium-term when compared to the ratios presented in the Stability Update of 2019. Debt-to-GDP ratio presented in the programme are higher mainly due to the negative primary balances presented in this programme.

For 2019, the debt-to-GDP ratio was revised downwards by 0.1 percentage points to 42.6 per cent of GDP while debt-to-GDP ratios for 2020 and 2021 were revised upwards by 15.6 and 22.4 percentage points, respectively. For 2023, debt-to-GDP was again revised upwards by 26.3 percentage points.

In the 2019 Update, the debt-to-GDP ratio was expected to follow a downward path from a level of 42.7 per cent in 2019 to a level of 33.2 per cent in 2022. On the other hand, in this Update of the Medium-Term Fiscal Strategy, the debt-to-GDP ratio is estimated to increase to a level of 59.5 per cent by 2022.

Footnote:

[1] Eurostat (European Commission) Directorate D: Government Finance Statistics (2020) 'Note on statistical implications of some policy measures in the context of the Covid-19 pandemic', 30 March 2020 (updated 9 April 2020).

Table 2a

General Government Budgetary Prospects

% of GDP

		ESA code	2018(*)	2019(*)	2018	2019	2020	2021	2022	2023
Net Lending (EDP B9) by sub-sector										
1.	General Government	S13	246.8	64.1	2.0	0.5	-9.4	-5.9	-4.2	-3.7
2.	Central Government	S1311	241.0	58.2	1.9	0.4	-9.4	-5.9	-4.2	-3.7
3.	State Government	S1312	-	-	-	-	-	-	-	-
4.	Local Government	S1313	5.9	-1.2	0.0	0.0	-0.0	-0.0	-0.0	-0.0
5.	Social security funds	S1314	-	-	-	-	-	-	-	-
General Government										
6.	Total revenue	TR	4,814.7	5,052.3	38.5	37.7	37.7	39.0	38.2	37.9
7.	Total expenditure	TE	4,567.9	4,988.2	36.6	37.3	47.1	44.9	42.4	41.6
8.	Net lending / borrowing	B9	246.8	64.1	2.0	0.5	-9.4	-5.9	-4.2	-3.7
9.	Interest expenditure	D41	192.9	182.9	1.5	1.4	1.0	1.2	1.2	1.2
10.	Primary balance(1)		439.7	247.0	3.5	1.8	-8.4	-4.8	-2.9	-2.5
11.	One-off and other temporary measures(2)		19.0	10.1	0.2	0.1	0.1	0.1	0.1	0.0
Selected Components of Revenue					32.1	31.9	31.4	32.7	32.4	32.3
12.	Total Taxes (12=12a+12b+12c)		3,243.5	3,466.1	26.0	25.9	25.2	26.6	26.2	26.1
12a.	Taxes on production and imports	D2	1,572.4	1,613.0	12.6	12.0	11.3	12.5	12.6	12.9
12b.	Current Taxes on Income, Wealth, etc.	D5	1,650.4	1,827.0	13.2	13.6	13.7	13.9	13.4	13.1
12c.	Capital Taxes	D91	20.7	26.1	0.2	0.2	0.2	0.2	0.2	0.2
13.	Social Contributions	D61	764.8	800.1	6.1	6.0	6.3	6.1	6.2	6.2
14.	Property Income	D4	95.3	81.8	0.8	0.6	0.6	0.6	0.6	0.5
15.	Other(3)		711.2	704.4	5.7	5.3	5.6	5.6	5.3	5.0
16=6.	Total Revenue	TR	4,814.7	5,052.3	38.5	37.7	37.7	39.0	38.2	37.9
p.m.:	Tax Burden (D2+D5+D6111+D6131+D91-D995)(4)		4,024.3	4,286.1	32.2	32.0	31.6	32.9	32.6	32.5
Selected Components of Expenditure										
17.	Compensation of employees + intermediate consumption	D1+P2	2,187.0	2,448.1	17.5	18.3	22.4	21.6	21.0	20.6
17a.	Compensation of employees	D1	1,374.2	1,479.5	11.0	11.0	12.6	12.5	12.2	12.0
17b.	Intermediate consumption	P2	812.8	968.7	6.5	7.2	9.8	9.1	8.8	8.5
18.	Social payments (18=18a+18b)		1,181.0	1,238.0	9.5	9.2	10.9	10.4	10.0	9.8
	of which Unemployment benefits (5)		23.3	26.7	0.2	0.2	0.3	0.3	0.2	0.2
18a.	Social transfers in kind supplied via market producers	D632	89.5	117.0	0.7	0.9	1.2	0.9	0.9	0.9
18b.	Social transfers other than in kind	D62	1,091.5	1,121.0	8.7	8.4	9.7	9.5	9.1	8.9
19=9.	Interest expenditure	D41	192.9	182.9	1.5	1.4	1.0	1.2	1.2	1.2
20.	Subsidies	D3	179.0	195.0	1.4	1.5	5.0	3.0	1.7	1.6
21.	Gross fixed capital formation	P51G	405.6	519.3	3.2	3.9	4.8	5.1	4.9	4.8
22.	Capital transfers	D9	164.4	107.3	1.3	0.8	0.4	0.9	0.9	0.9
23.	Other(6)		258.0	297.6	2.1	2.2	2.5	2.7	2.6	2.7
24=7.	Total Expenditure	TE	4,567.9	4,988.2	36.6	37.3	47.1	44.9	42.4	41.6
p.m.:	Government consumption (nominal)	P3	2,015.9	2,351.3	16.1	17.6	22.6	21.5	20.8	20.5

(*) € 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

% of GDP

	2019(1)	2019	2020	2021	2022	2023
1. Total revenue at unchanged policies	5,052.3	37.7	37.7	39.3	38.3	38.1
2. Total expenditure at unchanged policies	4,988.2	37.3	47.1	46.5	42.7	41.9

(1) € million

Table 2c

Amounts to be excluded from the expenditure benchmark

% of GDP

		2018[1]	2019[1]	2018	2019	2020	2021	2022	2023
1.	Expenditure on EU programmes fully matched by EU funds revenue	234.8	147.2	1.9	1.1	1.8	2.0	1.8	1.8
1a.	*of which* Investment fully matched by EU funds revenue[2]	53.8	55.8	0.4	0.4	0.9	1.0	0.9	0.9
2.	Cyclical unemployment benefit expenditure[3]	-3.8	-5.2	-0.0	-0.0	0.1	0.0	0.0	0.0
3.	Effect of discretionary revenue measures	-64.5	-63.0	-0.7	-0.6	-0.7	0.1	-0.2	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

% of GDP

	COFOG Code	2018	2023
1. General public services	1	5.5	6.2
2. Defence	2	0.6	0.8
3. Public order and safety	3	1.2	1.4
4. Economic affairs	4	5.3	6.1
5. Environmental protection	5	1.3	1.7
6. Housing and community amenities	6	0.3	0.4
7. Health	7	5.3	6.3
8. Recreation, culture and religion	8	1.0	1.3
9. Education	9	5.2	6.1
10. Social protection	10	10.7	11.4
11. Total Expenditure	TE	36.6	41.6

Table 4

General Government Debt Developments

% of GDP

	ESA Code	2018	2019	2020	2021	2022	2023
1. Gross debt		45.2	42.6	55.0	58.6	59.5	60.4
2. Change in gross debt ratio		-3.6	-2.6	12.4	3.6	0.9	0.9
Contributions to changes in gross debt							
3. Primary balance		-3.5	-1.9	8.4	4.7	2.9	2.5
4. Interest expenditure	EDP D.41	1.5	1.4	1.0	1.2	1.2	1.2
5. Stock-flow adjustment		1.7	1.0	0.1	1.1	0.6	0.5
p.m. implicit interest rate on debt(1)		3.4	3.2	2.2	2.3	2.3	2.2

(1) Proxied by interest expenditure divided by the debt level of the previous year.

Table 5

Cyclical Developments

% of GDP

	ESA Code	2018	2019	2020	2021	2022	2023
1. Real GDP growth (%)		5.2	4.9	-7.4	5.0	5.4	4.3
2. General Government balance	EDP B.9	2.0	0.5	-9.4	-5.9	-4.2	-3.7
3. Interest expenditure	EDP D.41	1.5	1.4	1.0	1.2	1.2	1.2
4. One-off and other temporary measures(1)		0.2	0.1	0.1	0.1	0.1	0.1
of which							
One-offs on the revenue side: general Government		0.2	0.1	0.1	0.1	0.1	0.1
One-offs on the expenditure side: general Government		0.0	0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		6.9	5.8	0.9	2.9	2.8	2.6
contributions:							
- labour (hours)		3.9	3.0	0.7	2.0	1.9	2.0
- capital		1.2	1.4	0.3	1.2	1.2	1.0
- total factor productivity		1.8	1.4	-0.1	-0.3	-0.4	-0.4
6. Output Gap		2.4	1.1	-5.2	-4.2	-2.9	-1.6
7. Cyclical Budgetary Component		1.1	0.5	-2.5	-2.0	-1.4	-0.7
8. Cyclically-Adjusted Balance (2-7)		0.9	-0.0	-6.9	-3.9	-2.8	-3.0
9. Cyclically-Adjusted Primary Balance (8+3)		2.4	1.3	-5.9	-2.7	-1.5	-1.8
10. Structural Balance (8-4)		0.7	-0.1	-7.0	-4.0	-2.8	-3.1

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

Table 7

Divergence from latest SP

% GDP

	ESA Code	2018	2019	2020	2021	2022	2023
Real GDP growth							
Previous Update		6.6	6.1	5.7	5.1	5.0	-
Current Update		5.2	4.9	-7.4	5.0	5.4	4.3
Difference		-1.4	-1.2	-13.1	-0.1	-	-
General Government net lending/ net borrowing	EDP B.9						
Previous Update		2.0	0.9	1.0	1.1	1.1	-
Current Update		2.0	0.5	-9.4	-5.9	-4.2	-3.7
Difference		-0.0	-0.4	-10.4	-7.0	-	-
General Government net lending projection at un-changed policies	EDP B.9						
Previous Update		-	-	-	-	-	-
Current Update		2.0	0.5	-9.4	-7.1	-4.4	-3.9
Difference [1]		-	-	-	-	-	-
Total Revenue	TR						
Previous Update		38.8	38.1	36.7	35.7	35.2	-
Current Update		38.5	37.7	37.7	39.0	38.2	37.9
Difference		-0.3	-0.4	1.0	3.3	-	-
Total Expenditure	TE						
Previous Update		36.8	37.2	35.7	34.7	34.1	-
Current Update		36.6	37.3	47.1	44.9	42.4	41.6
Difference		-0.2	0.1	11.4	10.2	-	-
General Government gross debt							
Previous Update		46.0	42.7	39.4	36.2	33.2	-
Current Update		45.2	42.6	55.0	58.6	59.5	60.4
Difference		-0.8	-0.1	15.6	22.4	-	-

[1] This difference refer to both deviations stemming from changes in the macroeconomic scenario and those stemming from the effect of policy measures taken between the submission of the SP and the submission of the DBP. Differences are also due to the fact that the no-policy change scenario is defined differently for the purpose of this Code of Conduct with respect to the Stability Programme.

Table 8b

Basic Fiscal Assumptions

	ESA Code	2018	2019	2020(f)	2021(f)	2022(f)	2023(f)
Implied Elasticity with respect to respective Tax Base							
Taxes on Production and Imports	D2	1.5	0.4	0.6	1.4	0.8	0.8
of which Value Added Taxes	D212	1.8	0.2	0.6	1.8	1.2	1.2
Current Taxes on Income, Wealth, etc.	D5	0.7	1.5	0.9	1.3	0.4	0.5
of which Current Taxes on Income, Wealth, etc. [Corporate] [1]	D5	-0.6	1.2	1.1	1.7	2.7	2.0
Net social contributions	D61	0.9	0.5	0.8	1.0	1.0	0.9
General Government Adjustments (€ millions)		**317.0**	**57.8**	**40.8**	**-36.9**	**-36.5**	**-37.1**
Other accounts payable and receivable		166.4	-48.5	63.9	3.9	13.9	13.9
Treasury Clearance Fund & Contingency Reserve		40.9	27.0	14.1	13.3	14.3	15.1
Social and Investment Fund - IIP - Revenue		133.1	105.4	20.0	26.0	26.0	26.0
Social and Investment Fund - IIP - Expenditure		-1.0	0.0	-25.0	-20.0	-30.0	-40.0
Re-routing/PPP adjustments		-23.0	-44.9	-32.2	-60.1	-60.5	-52.2
Others		0.5	18.9	0.0	0.0	-0.2	0.0
Social Security Benefits							
COLA (€)		1.75	2.33	3.49	4.08	4.08	4.08
Contributory Benefits (€ millions)		778.9	806.6	878.0	912.6	964.5	1,019.5
Number of CB Beneficiaries (persons)		116,660	118,929	121,557	124,148	124,700	124,700
Non-Contributory Benefits (€ millions)		186.3	202.9	206.6	202.5	214.3	221.4
Number of NCB Beneficiaries (persons)		113,267	113,935	114,999	116,614	118,317	118,317

[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 9

Contingent liabilities

% of GDP

	2018	2019	2020	2021	2022	2023
Public guarantees	8.6	7.4	9.5	9.5	8.8	8.2

Note:

The data for Contingent liabilities for 2018 to 2019 is actual, while data for 2020 to 2023 is an estimate.

Table 10

Stock Flow Adjustment Statement

Millions of Euros

	2019	2020	2021	2022	2023
General Governemnt deficit (-) / surplus (+) (ESA10)	**-67.1**	**1180.0**	**788.0**	**597.0**	**567.0**
ESA Adjustments	57.8	40.8	-36.9	-36.5	-37.1
Contribution to Sinking Fund (Local)	0.0	0.0	0.0	0.0	0.0
Contribution to Sinking Fund (Foreign)	0.1	0.1	0.1	0.1	0.1
Contribution to Special MGS Sinking Fund	50.0	50.0	30.0	30.0	30.0
Equity Acquisition	18.8	37.1	10.5	10.5	10.5
EFSF/ESM Credit Line Facility	0.0	4.5	4.5	4.5	4.5
Courts and other deposits	-15.0				
Stock Premium paid to Church	1.4	0.0	0.3	0.1	0.2
Advances made by Government					
Repayment of Loans to Government	0.0	-0.9	-2.2	-2.8	-2.8
Sale of Assets	-1.0	-0.9	-0.9	-0.9	-0.9
Sale of Non-Financial Assets	-	-	-	-	-
EBUs	2.3	0.0	0.0	0.0	0.0
Currency	5.6	6.5	7.0	7.7	8.4
Movement in Bank Account	19.8	-	-	-	-
ESA Rerouted Debt	43.0	32.2	60.1	60.7	52.2
Increase/(Decrease)in cash balance	-40.9	-0.0	-0.2	-1.0	-0.6
Increase/(Decrease) in Non-Consolidated Debt	74.6	1349.4	860.3	669.4	631.5
Total Consolidation	**-10.6**	**-162.6**	**69.4**	**16.3**	**8.7**
Increase/(Decreaese) in Consolidated Debt	**64.0**	**1186.8**	**929.7**	**685.7**	**640.2**
SFA	**131.1**	**6.8**	**141.7**	**88.7**	**73.2**

4. Sensitivity Analysis

4. Sensitivity Analysis

The accuracy of macroeconomic forecasts is essential, especially in the case of a small and open economy like Malta. 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). This is also a reflection of the significant structural change which the Maltese economy has experienced in the last few years.

The macroeconomic forecast presented in Chapter 2 contains the baseline forecast. It is a contingent forecast based on several exogenous assumptions regarding the evolution of a number of variables. 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 macroeconomic forecasts.

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 as completed by the Economic Policy Department (EPD) within the Ministry for Finance and Financial Services (MFIN) shows a tendency to underestimate GDP growth and hence a downward bias in the GDP growth projections in previous years. This is partly due to persistently upward statistical revisions in the releases of National Accounts and Balance of Payments data issued. While the one-year ahead forecasts display a Root-Mean Squared Error (RMSE) of 3.9, 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 subsequent recovery, and the statistical revisions had a significant influence on this evaluation in such a limited sample 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 and 2017 which are symptomatic of significant upward revisions in the national accounts data.

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 the macroeconomic forecasts, seven alternative model-based growth projections were carried out as follows:

1. Improved global economic growth based on the upper bound of the Consensus forecasts.
2. Weaker global economic growth based on the lower bound of the Consensus forecast.
3. Higher investment scenario, which assumes that investor certainty is restored in the beginning of 2021 and that the projects which were postponed in the baseline will resume.

4. Higher interest rate scenario and a steepening yield curve reflecting a reluctance to hold fixed income assets as a result of heightened economic uncertainty.
5. Quick recovery scenario, which assumes that the structural damage caused by the pandemic will rapidly reverse following the dissemination of a vaccine in early 2021. This scenario incorporates the possibility that tourism will recover at a more rapid pace than the baseline scenario, and that Malta will focus on attracting tourists with a higher expenditure per head.
6. Prolonged Covid-19 scenario, which assumes that the pandemic causes permanent structural damage to certain industries. In 2021, tourism will recover at a slower pace than the baseline case, such that tourist numbers remain at 60 per cent of 2019 levels. Meanwhile, the sectors which depend on tourism such as Wholesale and Retail Trade, Accommodation and Transport, will permanently operate at 80 per cent of 2019 levels.
7. A scenario with stronger employment growth in 2020 but a decline in wages in 2021, which assumes that the Government measures to support employment provide a greater support to the labour market and lead to a mild growth in employment in 2020, rather than the decline suggested in the baseline. However, the consequent loss of productivity and the escalating unit labour costs will trigger a downward revision in wages in 2021.

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 economic conditions prevailing at the time and also informed by the various meetings with economic stakeholders and regulators operating within the Maltese economy, carried out in the early stages of the forecasting exercise.

Among the alternative forecasts, a more detailed description is provided for the alternative growth and interest rate scenarios as required by the Directive. In the light of the prevailing uncertainty surrounding the global economy, two contrasting growth scenarios are modelled.

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 in the baseline scenario, where the global growth rate increases by 1.8 percentage points in 2020, and by 2.9 percentage points in 2021. The outer years are left unchanged from the baseline scenario. The relatively higher than expected economic growth in Germany, France, Italy, the United Kingdom (UK), and the United States (US) is based on the Consensus Forecasts of September 2020, assuming the most optimistic growth figure for each trading partner for the forecast years 2020 and 2021. The outcome of this scenario is a marginal upward revision to the budget balance in 2020, while real GDP growth would be revised upwards by 0.5 percentage points. In 2021, real GDP growth would increase by 4.1 percentage points more than in the baseline scenario, while the budget balance would ameliorate by 0.5 percentage points. Real GDP would improve by 2.8 and 1.0 percentage points in 2022 and 2023 respectively while the budget balance increases by 1.0 and 1.3 percentage points in 2022 and 2023 respectively.

4.2.2 Weaker Global Economic Growth

This scenario models the downside risk of a weaker than expected economic growth rate in Malta's main trading partners on the Maltese economy. The relatively lower than expected economic growth in Germany, France, Italy, the UK, and the US is based on the Consensus Forecasts of September 2020, assuming the lowest growth figure for each trading partner for the forecast years 2020 and 2021. In this analysis, global growth declines by 1.6 percentage points in both forecast years and is left unchanged for the outer years. The outcome of this scenario is that the Maltese economy would contract by 0.5 percentage points more than the baseline scenario in 2020. The budget balance would decline by 0.1 percentage points relative to the baseline. In 2021, the effect of lower global growth is more significant, with real GDP growth decreasing by 2.3 percentage points, and budget balance declining by 0.4 percentage points. In the outer years, real GDP would be 1.7 and 0.7 percentage points lower, while the budget balance would decline by 0.7 and 0.9 percentage points in 2022 and 2023 respectively.

4.2.3 Interest rate scenario

This scenario assumes that long-term interest rates increase by 25.0 basis points in the third quarter of 2021, thereby steepening the yield curve compared to the baseline scenario. This scenario attempts to reflect a reluctance of investors to hold fixed income assets due to heightened uncertainty on medium-term growth prospects. In response to higher interest rates, the Euro will appreciate relative to competing currencies. The effect of this scenario would be lower real investment growth leading to a decline of 0.1 percentage points in real GDP in 2021 and a virtually unchanged budget balance. In 2022, an increase in GDP of 0.7 percentage points is projected, while 2023 will experience a decrease of 0.1 percentage points. The budget balance will remain unchanged relative to the baseline in the outer years.

4.3 Alternative Model Forecasts

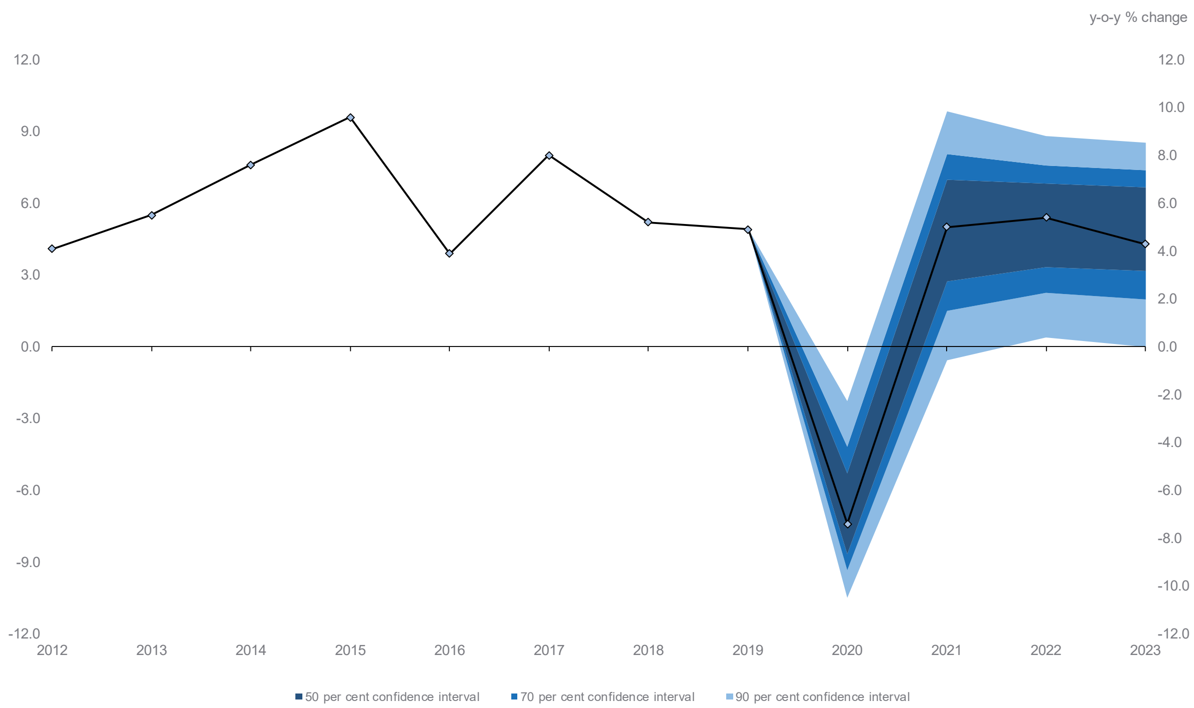
Moreover, the EPD has developed seven alternative forecasting models ranging from model-free statistical forecast (Random Walk and Holt-Winters Seasonal Smoothing Method), model-based univariate forecasts (2 ARIMA models) and model-based multivariate forecasts (2 VAR models and one VECM model). These models help EPD benchmark the results inferred from STEMM and can be used to generate alternative growth forecasts.

For 2020, the alternative models give a range of growth forecasts from -2.9 per cent to -12.4 per cent. The average of all models suggested GDP is set to fall by approximately 8.1 per cent, while the average of VAR models produced an estimate of -7.2 per cent, which is very close to the baseline forecast. For 2021, growth forecasts range from -3.8 per cent to 5.4 per cent. The average of all models suggests a growth rate of 1.5 per cent while the VAR model average indicates GDP growth of 4.8 per cent. The latter is consistent with the baseline forecast. For 2022, growth forecasts range from -2.1 per cent to 6.1 per cent. The average of all models suggests a growth rate of 3.1 per cent while the VAR model average indicates GDP growth of 1.8 per cent. For 2023, growth forecasts range from 1.2 per cent to 6.5 per cent. The average of all models suggests a growth rate of 3.7 per cent while the VAR model average indicates GDP growth of 3.6 per cent.

4.4 Uncertainty and the Balance of Risk Underlying the Macroeconomic Projections

The uncertainty surrounding the macroeconomic projections is based on the past forecast error variance of GDP. This is equal to 0.4 for the current year forecast, and 2.8 for the one-year ahead forecast, 2.3 for the two-year ahead forecast, and 1.8 for the three-year ahead forecast. The balance of risk is based on the Pearson skewness indicator of the model generating alternative forecast for GDP documented above. The

Chart 4.1
Fan Chart with GDP Growth Forecasts



indicator shows mild upside risks for 2020 but marginal downside risks for 2021, 2022 and 2023. Chart 4.1 depicts a representation of the uncertainty and the balance of risk surrounding the macroeconomic forecasts presented in this Programme.

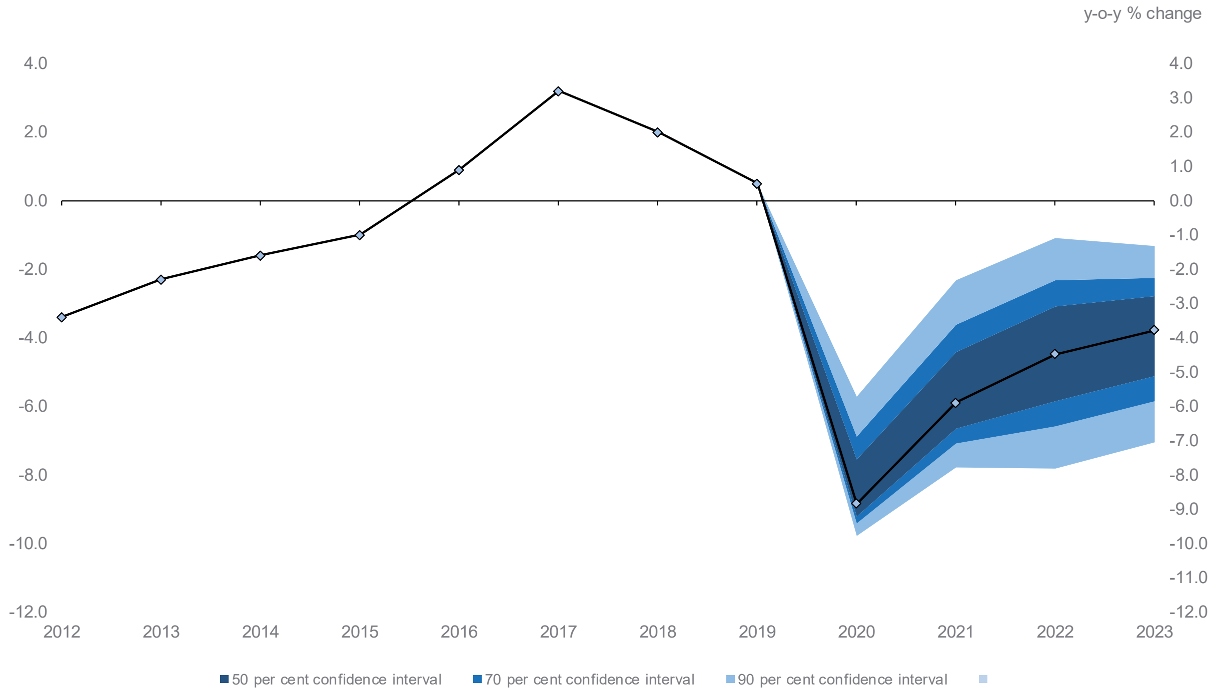
4.5 Risks to Fiscal targets

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 an upside risk for the attainment of a lower budget deficit throughout the short-term forecast horizon. In the worst case scenarios contemplated in the risk assessment, the budget balance as a percentage of GDP deteriorates by 0.7 percentage points in 2021, 1.7 percentage points in 2022 and 2.2 percentage points in 2023.

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 hence the structural commitments presented in this Programme. Alternative output gap projections consistent with the above economic scenarios have been carried out. Compared to the baseline scenario, as shown in Chart 2.3, alternative output gap projections range from -1.6 percentage points in 2020 up to -2.2 percentage points in

Chart 4.2
Fan Chart with Budgetary Targets



2023 under the lower-bound scenario and from 3.5 percentage points in 2020 down to 0.3 percentage points in 2023 under the upper-bound scenario.

Chart 4.3
Output gap: Risk assessment