

Assessment of the Fiscal Forecasts

Update of Stability Programme 2018 - 2021

May 2018



MFAC
MALTA FISCAL ADVISORY COUNCIL



Assessment of the Fiscal Forecasts
Update of Stability Programme 2018 – 2021

31 May 2018

The Hon Prof Edward Scicluna B.A. (Hons) Econ, M.A. (Toronto),
Ph.D (Toronto), D.S.S (Oxon) MP
Minister for Finance
Maison Demandols
South Street
Valletta VLT 2000

Dear Minister

LETTER OF TRANSMITTAL

In terms of Article 13 of the Fiscal Responsibility Act, 2014 (Cap 534), I have the honour to transmit a report by the Malta Fiscal Advisory Council (MFAC) on the assessment of the fiscal projections contained in the Update of Stability Programme for the period 2018 to 2021.

The Council considers the planned stream of fiscal surpluses in the region of 1.0% of GDP for the period 2018 to 2020, and slightly higher, at 1.6% of GDP, in 2021, within its endorsable range. Likewise, the anticipated steady decline in the debt-to-GDP ratio, from 50.8% in 2017 to 35.6% by 2021, is deemed to be plausible.

The fact that the three other institutions which produce fiscal forecasts, namely the European Commission, the Central Bank of Malta and the International Monetary Fund, are all anticipating fiscal surpluses and declines in the debt ratio, further corroborates the Council's assessment of the plausibility of the balance and debt trajectories as anticipated by the Ministry for Finance.

The Council considers the revenue forecasts as generally prudent with the possibility of upside risks in relation to taxes on production and imports over the period 2018 to 2021. The Ministry's forecasts for this revenue component indicate a rather steep decline in the ratio when compared to GDP, which appears to be rather cautious. On the other hand, the item-by-item examination of risks to the expenditure forecasts indicates that on aggregate there could be possible downside risks in 2018, but upside risks for the period 2019 to 2021.

With respect to 2018, downside risks are related to gross fixed capital formation and ‘other’ expenditure. The planned increase in spending on gross fixed capital formation is more elevated, both in absolute and in growth terms, than the turnout in 2015, which itself was an exceptional year. In the case of ‘other’ expenditure, the downside risk, which applies to all the forecast years, is contingent on the possible savings in the event that there will be no recourse to the Contingency Reserve.

Over the period 2019 to 2021 the Council considers that there could be upside risks to expenditure, on a net basis. These reflect the upside risks associated with spending on compensation of employees and intermediate consumption, which are however partially mitigated by the before-mentioned downside risks relating to the ‘other expenditure’ category.

The upside risks associated with compensation to employees relate to the fact that the increase in the budget allocations for these years is tighter when compared to recent trends. In the case of intermediate consumption, this reflects the possibility that the underlying drivers of such expenditure could make it increasingly challenging to stay within the budgeted increases, particularly as the projected growth rates are generally below those recorded in recent years.

On balance, for 2018, the upside risks to total revenue and the concurrent downside risks to total expenditure allow for the possibility of a larger fiscal surplus. For the period 2019 to 2021, the magnitude of the upside risks to total expenditure appears to be larger than the magnitude of the upside risks to total revenues. This suggests that the yearly fiscal surplus could be less than planned during these years. This should nonetheless still safeguard the achievement of the planned stream of fiscal surpluses over the forecast horizon.

The Council acknowledges the Government’s drive towards expenditure restraint, particularly by moderating wage expectations, as well as the efficiency gains derived from the Comprehensive Spending Reviews which were undertaken in previous years. Nevertheless, expenditure pressures may still build up, particularly when the pattern of the planned increases in the allocations is lower than in previous years. Indeed, it has been a recurring phenomenon in recent years where successive Updates to the Stability Programme have resulted in upward revisions in the expenditure outlays, when compared to the original plans.

The Council therefore invites the Government to remain vigilant so as to ensure adhering closely to the fiscal plans as outlined in the Update of Stability Programme 2018 – 2021, since any significant departure could pose risks to the attainment of the fiscal surplus and debt targets as outlined in this Report.

Finally, the Council would also like to express once more its satisfaction at the ongoing constructive dialogue with the Ministry's officials responsible for the forecasting exercise.

Yours sincerely



Rene Saliba
Chairman

Table of Contents

Executive summary	4
1. Introduction	6
2. Overview of the fiscal projections	6
3. Assessment of methodologies used by the MFIN to prepare the fiscal projections	10
4. Assessment of the revenue projections for the period 2018 – 2021	13
5. Assessment of the expenditure projections for the period 2018 – 2021	22
6. Assessment of the trajectory for the fiscal balance and public debt for 2018 – 2021	35
7. Comparison with the other forecasts for the fiscal balance and public debt	37
8. Conclusion	43

List of Tables

Table 1: Fiscal aggregates in EUR millions	7
Table 2: Fiscal targets as percentage of nominal GDP	7
Table 3: Taxes on production and imports	15
Table 4: Identifiable effects impacting taxes on production and imports in 2018 and 2019	16
Table 5: Current taxes on income and wealth	17
Table 6: Social contributions	19
Table 7: Property income	20
Table 8: Other revenue	21
Table 9: Summary of risks to the revenue projections	22
Table 10: Gross fixed capital formation	31
Table 11: Contingency Reserve	33
Table 12: Summary of risks to the expenditure projections	34
Table 13: Summary of risks to the fiscal projections	35
Table 14: Fiscal forecasts prepared by the COM, the MFIN and the CBM	39

List of Charts

Chart 1: Yearly changes in the main revenue components	8
Chart 2: Yearly changes in the main expenditure components	9
Chart 3: MFIN's risk assessment of the budget balance forecast	11
Chart 4: Deviations in the 2017 budget components	12
Chart 5: Total government revenue	13
Chart 6: Revenue components	14
Chart 7: Total government expenditure	23
Chart 8: Expenditure components	24
Chart 9: Compensation of employees	25
Chart 10: Intermediate consumption	27
Chart 11: Social benefits	28
Chart 12: Gross fixed capital formation	31
Chart 13: Drivers of nominal government consumption growth	34
Chart 14: Public debt dynamics	36
Chart 15: Forecast debt developments between 2017 and 2021	37
Chart 16: Fiscal balance forecasts by different institutions	38
Chart 17: Differences between the forecasts prepared by the COM and the MFIN	40
Chart 18: Differences between the forecasts prepared by the CBM and the MFIN	40
Chart 19: Comparison of the revenue and expenditure projections by the IMF and MFIN	42
Chart 20: Public debt forecasts by different institutions	42

Abbreviations

CBM	Central Bank of Malta
COLA	Cost of Living Adjustment
COM	European Commission
DBP	Draft Budgetary Plan
EBU	Extra Budgetary Unit
ECB	European Central Bank
ESA	European System of National and Regional Accounts
EU	European Union
FRA	Fiscal Responsibility Act
FTS	Foundation for Tomorrow Schools
GDP	Gross Domestic Product
IIP	Individual Investor Programme
IMF	International Monetary Fund
ITC	International Trading Companies
MAT	Malta Air Travel
MCAST	Malta College for Arts Science and Technology
MCST	Malta Council for Science and Technology
MFAC	Malta Fiscal Advisory Council
MFIN	Ministry for Finance
MFSA	Malta Financial Services Authority
MGS	Malta Government Stock
MOSS	Mini One Stop Shop
MSE	Malta Stock Exchange
NDSF	National Development and Social Fund
NPISH	Non-Profit Institutions Serving Households
NSO	National Statistics Office
OECD	Organisation for Economic Co-operation and Development
pp	percentage point
SME	Small and medium-sized enterprises
UoM	University of Malta
US	United States
USP	Update of Stability Programme
VAT	Value Added Tax

Executive summary

This Report assesses the fiscal projections covering the period 2018 to 2021 contained in Malta's latest Update of Stability Programme, which was published by the Ministry for Finance on 30 April 2018. This assessment was carried out by the Malta Fiscal Advisory Council in line with the requirements prescribed in the Fiscal Responsibility Act, 2014 (Cap. 534).

In 2017, a fiscal surplus equivalent to 3.9% of nominal GDP was recorded. The Government plans to maintain the headline fiscal balance in surplus, with a stream of surpluses in the region of 1.0% of GDP for the period 2018 to 2020, and slightly higher, at 1.6% of GDP, in 2021. The anticipated stream of fiscal surpluses and the expansion in nominal GDP are expected to contribute to a decline in gross debt in each of the forecast years, both in absolute terms and as percentage of nominal GDP. The debt-to-GDP ratio is thus projected to fall from 50.8% of GDP in 2017 to 35.6% of GDP by 2021.

Total revenue is projected to increase throughout the forecast horizon, but at a slower pace than nominal GDP. The revenue-to-GDP ratio is thus envisaged to drop from 40.5% in 2017, to 37.4% by 2021. Total expenditure is expected to grow in each of the forecast years. In 2018 total expenditure is anticipated to grow faster than nominal GDP, lifting the expenditure-to-GDP ratio higher than in 2017. The trajectory for the expenditure ratio is seen on a declining path throughout the rest of the forecast horizon, to reach 35.8% by 2021. During this period, total expenditure is projected to grow at a slower pace than nominal GDP.

The methods used by the Ministry for Finance to prepare the fiscal projections remained largely the same as in the previous forecast rounds. Likewise, the Council's approach to evaluate the plausibility of the anticipated trajectory for total revenue and total expenditure continued to focus on the evaluation of each component separately. This assessment is mainly based on the fiscal assumptions underpinning the Update of Stability Programme which are employed by the Ministry for Finance; existing tax and expenditure laws; announced fiscal measures; information obtained from public sources; as well as supplementary information made available by the Ministry and the National Statistics Office through internal discussions and communications. The Council does not prepare its independent revenue forecasts but relies on expert judgment, based on historical trends and identified regular patterns in the actual fiscal data.

The Fiscal Council's assessment considers the revenue forecasts as generally prudent with the possibility of upside risks in relation to taxes on production and imports over the period 2018 to 2021. On the other hand, the item-by-item examination of risks to the expenditure forecasts indicates that on aggregate there could be possible downside risks in 2018, but upside risks for the period 2019 to 2021.

With respect to 2018, downside risks are related to gross fixed capital formation and 'other' expenditure. In the case of gross fixed capital formation these relate to the fact that the planned increase for 2018, is more elevated both in absolute and in growth terms than the turnout in 2015, which itself was an exceptional year. In the case of 'other' expenditure, the downside risk, which applies to all the forecast years, is contingent on the savings possible should there be no recourse to the Contingency Reserve.

Over the period 2019 to 2021 the Council considers that there could be upside risks to expenditure, on a net basis. These reflect the upside risks associated with compensation of employees and intermediate consumption, which are however partially mitigated by the before-mentioned downside risks relating to the ‘other expenditure’ category. The upside risks associated with compensation to employees relate to the fact that the increase in the budget allocations for these years is tighter when compared to recent trends. In the case of intermediate consumption, this reflects the possibility that the underlying drivers of such expenditure could make it increasingly challenging to stay within the budgeted increases, particularly as the projected growth rates are generally below those recorded in recent years.

The targets for the fiscal balance are within the endorsable range of the Council. This factor, combined with the projected expansion in nominal GDP (which has been endorsed by the Council in its previous report), and the justifications offered in the Update of Stability Programme regarding the stock-flow adjustments, also lead the Council to consider the projections for the public debt-to-GDP ratio to lie within its endorsable range.

For 2018, the upside risks to total revenue and the concurrent downside risks to total expenditure allow for the possibility of a larger fiscal surplus. For the period 2019 to 2021, the magnitude of the upside risks to total expenditure appears to be larger than the magnitude of the upside risks to total revenues. This suggests that the yearly fiscal surplus could be less than planned during these years.

The Council views very positively the fact that the three other institutions which produce fiscal forecasts, namely the European Commission, the Central Bank of Malta and the International Monetary Fund, are all anticipating fiscal surpluses and declines in the debt ratio. The magnitude of the differences across the institutions is also rather contained. This further corroborates the Council’s assessment of the plausibility of the balance and debt trajectories as anticipated by the Ministry for Finance, and helps mitigate the extent of the uncertainty relating to the attainment of such targets.

The Council acknowledges the Government’s efforts to contain expenditure growth, particularly by moderating wage expectations, as well as the efficiency gains derived from the Comprehensive Spending Reviews which were undertaken in previous years. At the same time, the Council encourages continuous vigilance, especially in view of the fact that in absolute terms expenditure is still rising across the forecast horizon. Such vigilance is important since expenditure pressures may build up, particularly when the pattern of the planned increases in the allocations is lower than in previous years. Indeed, it has been a recurring phenomenon in recent years where successive Updates to the Stability Programme have resulted in upward revisions in the expenditure outlays, when compared to the original plans. The Council notes that this happened against a background where even revenues were repeatedly exceeding the original projections. The Council accordingly invites the Government to take appropriate measures to adhere closely to the fiscal plans as outlined in the Update of Stability Programme 2018 – 2021, since any significant departure could pose risks to the attainment of the fiscal surplus and debt targets as outlined in this Report.

1. Introduction

Members of the European Union (EU) are required to submit to the European Commission (COM) an Update of Stability Programme (USP) by 30 April of each year. Malta's latest USP, which is prepared by the Ministry for Finance (MFIN), presents the government's updated macroeconomic outlook and fiscal projections, covering the period from 2018 to 2021.¹ The fiscal projections are based on the revenue and expenditure categories compiled in accordance with the European System of National and Regional Accounts (ESA 2010).² To strengthen confidence in the reliability of the fiscal projections, Article 13, sub-article 3 (a), of the Fiscal Responsibility Act (FRA) prescribes that the Malta Fiscal Advisory Council (MFAC) "shall endorse, as it considers appropriate the macroeconomic and fiscal forecasts prepared by the Ministry for Finance and provide an assessment of the official forecasts". Article 13, sub-article 4, further requires that the MFAC makes public all its assessments.

The aim of this Report is to evaluate the fiscal projections contained in the latest USP. This complements the previous report published by the MFAC, wherein the Council had endorsed the macroeconomic forecasts for the period 2018 to 2021, which forecasts form the basis for these fiscal projections.³ The cut-off date for this Report is 18 May 2018. The Report is structured as follows. Section 2 presents an overview of the main fiscal aggregates outlined in the USP. Section 3 analyses the methodologies adopted by the MFIN and the performance of the previous round of fiscal forecasts which formed part of the Draft Budgetary Plan (DBP) for 2018. Section 4 examines the extent to which, the forecasts for the main revenue components can be considered plausible, and whether there could be any upside or downside risks to the baseline forecasts. Section 5 carries out the same type of assessment for the main expenditure projections. It also analyses the developments in nominal government consumption. Section 6 examines the extent to which the projections for the fiscal balance for the period 2018 to 2021 lie within the endorsable range of the MFAC and examines the plausibility of the planned trajectory for public debt. Section 7 compares the MFIN's fiscal forecasts to those prepared by the COM, the Central Bank of Malta (CBM) and the International Monetary Fund (IMF). Section 8 concludes with an overall assessment.

2. Overview of the fiscal projections

In 2017, a fiscal surplus of €436.6 million was recorded, equivalent to 3.9% of nominal GDP (see Table 1 and Table 2). This followed the fiscal surplus amounting to 1.0% of nominal GDP which was achieved in 2016, which represented the first instance of a fiscal surplus, since the compilation of ESA fiscal data for Malta.

¹ Malta's latest USP is available on <https://ec.europa.eu/info/sites/info/files/2018-european-semester-stability-programme-malta-en.pdf>.

² ESA methodologies are mandatory across EU Member States to ensure comparability of data across countries.

³ The MFAC's assessment of the latest macroeconomic forecasts contained in the USP (2018 – 2021) was published on 30 April 2018 and is available on www.mfac.org.mt.

Table 1: Fiscal aggregates in EUR millions (2017 – 2021)

	2017	2018	2019	2020	2021
Total revenue	4,494.6	4,655.2	4,917.8	5,185.5	5,500.8
Taxes on production and imports	1,408.1	1,484.0	1,540.6	1,618.2	1,706.6
Current taxes on income & wealth	1,569.8	1,743.4	1,885.4	2,017.4	2,161.4
Capital taxes	19.3	21.5	21.3	22.1	22.2
Social contributions	702.9	759.6	804.9	839.5	876.8
Property income	85.2	103.4	101.7	104.2	106.7
Other revenue	709.3	543.4	563.9	584.3	627.1
Total expenditure	4,057.9	4,523.2	4,797.8	5,058.5	5,267.8
Compensation of employees	1,271.1	1,367.3	1,429.7	1,487.9	1,553.4
Intermediate consumption	754.0	807.7	867.2	903.5	936.0
Social payments	1,138.4	1,207.7	1,252.3	1,296.1	1,337.0
Interest expenditure	206.7	191.1	186.5	179.5	175.5
Subsidies	132.2	142.2	158.9	160.6	165.4
Gross fixed capital formation	249.0	358.3	429.5	487.5	501.6
Capital transfers payable	103.5	204.1	176.7	173.9	187.2
Other expenditure	203.0	244.8	296.9	369.5	411.7
Fiscal balance	436.6	132.0	120.0	127.0	233.0
One-off & temporary effects (net)	-17.3	7.0	7.2	7.2	7.2
Cyclical effects	109.2	66.8	41.0	23.7	14.4
Structural balance	344.7	58.2	71.8	96.1	211.4
Gross debt	5,646.5	5,506.3	5,500.8	5,421.5	5,238.3
<i>Nominal GDP</i>	<i>11,108.6</i>	<i>12,034.7</i>	<i>12,933.9</i>	<i>13,795.7</i>	<i>14,713.0</i>
<i>Output gap (% of potential GDP)</i>	<i>1.0</i>	<i>1.0</i>	<i>0.4</i>	<i>0.0</i>	<i>-0.6</i>

Source: MFIN

Table 2: Fiscal targets as percentage of nominal GDP

	Total revenue	Total expenditure	Fiscal balance	Structural balance*	Gross debt
2017	40.5	36.5	3.9	3.6	50.8
2018	38.7	37.6	1.1	0.6	45.8
2019	38.0	37.1	0.9	0.7	42.5
2020	37.6	36.7	0.9	0.9	39.3
2021	37.4	35.8	1.6	1.8	35.6

* as percent of potential GDP

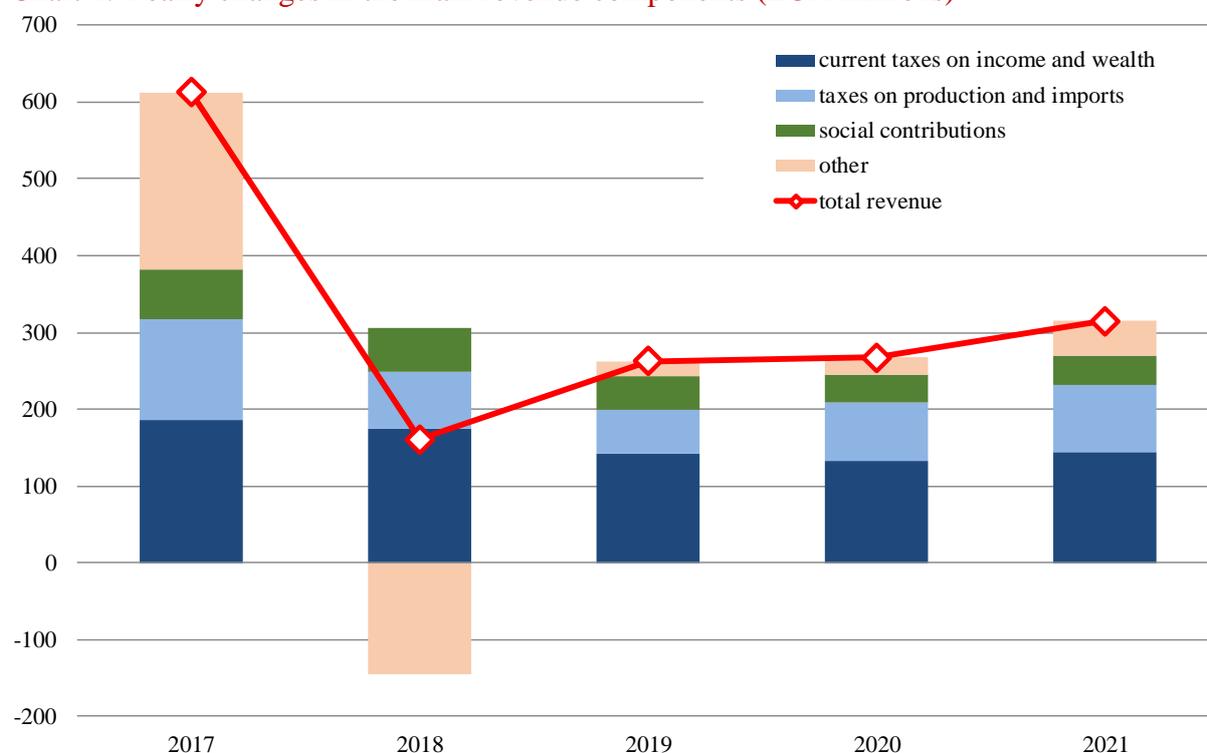
Source: MFIN

The Government plans to maintain the headline fiscal balance in surplus, with a stream of surpluses in the region of 1.0% of GDP for the period 2018 to 2020, and slightly higher, at 1.6% of GDP, in 2021. If achieved, this would correspond to six consecutive yearly fiscal surpluses.

Total revenue is projected to increase throughout the forecast horizon, but at a slower pace than nominal GDP. The revenue-to-GDP ratio is thus envisaged to drop from 40.5% in 2017, to 37.4% by 2021. Total expenditure is also expected to grow in each of the forecast years. In 2018, the expenditure-to-GDP ratio is expected to be higher than in 2017. Thereafter, the trajectory for the expenditure ratio is seen on a declining path in each of the forecast years, to reach 35.8% by 2021.

In 2017, total revenue was €612.6 million higher than in 2016, with the absolute increase considerably higher than in recent years. This development followed the exceptionally higher yield from market output, which is classified under the ‘other’ component in Chart 1. Growth in taxes on production and imports was also rather pronounced in 2017 compared to previous years. In 2018, the anticipated increase in revenue is less buoyant, mainly due to the assumed decline in market output. With regards to the traditional three sources of tax revenue (taxes on production and imports, current taxes on income and wealth and social contributions), the annual increments being projected are rather stable in absolute terms.

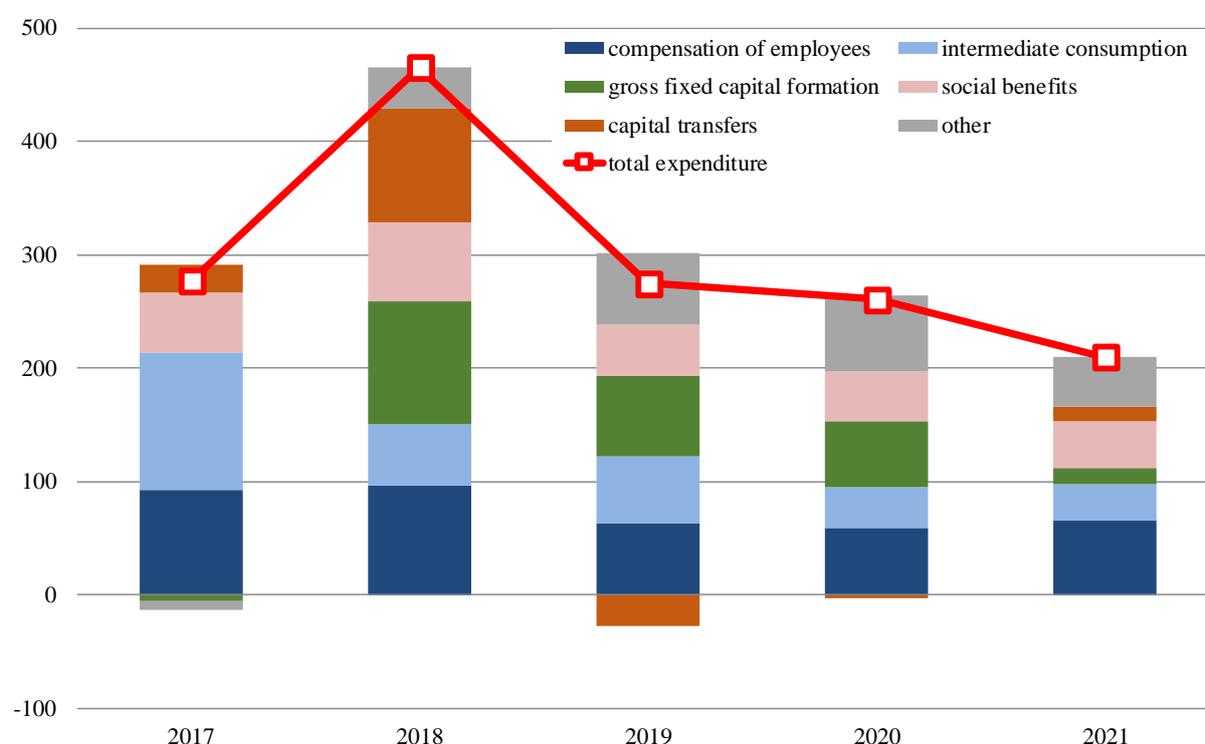
Chart 1: Yearly changes in the main revenue components (EUR millions)



Source: MFN

The yearly changes in total expenditure are expected to be somewhat more volatile across the years (see Chart 2). The planned expenditure increase in 2018 is dominated by higher capital transfers and higher spending on gross fixed capital formation. The latter reflects the higher spending in relation to roads, the environment, health and education. With regards to compensation of employees, which over the last seventeen years has maintained a rather constant share at just under a third of total expenditure, the projected annual increase is more stable. The actual increase in 2017 and that planned for 2018 are however generally higher than those anticipated for the period 2019 to 2021 which go back to the average annual increases of less than €70 million recorded between 2013 and 2017. Similarly, intermediate consumption is expected to rise yearly by smaller amounts than in 2017, which year included one-off elements.

Chart 2: Yearly changes in the main expenditure components (EUR millions)



Source: MFIN

The anticipated stream of fiscal surpluses and the expansion in nominal GDP are expected to contribute to a decline in gross debt in each of the forecast years, both in absolute terms and as percentage of nominal GDP. The debt-to-GDP ratio is thus projected to fall from 50.8% of GDP to 35.6% of GDP, between 2017 and 2021, which amounts to a decline of €408.2 million in absolute terms.

Developments in the structural balance largely mirror those in the headline fiscal balance. Throughout the period 2018 to 2021, the impact of one-off effects is limited to around €7.0 million a year. The trajectory for the structural balance is slightly less positive between 2017

and 2019, also owing to the positive output gap throughout this period.⁴ Indeed, a positive output gap, implies that tax revenues are being inflated by the buoyant economic conditions, a factor which is corrected for in the estimation of the structural balance. In 2020, the difference between the headline and the structural balance is marginal, since the output gap is expected to close off in that year. Thereafter, the structural balance (as percentage of potential GDP) is slightly more positive than the headline balance (as percentage of nominal GDP), since the output gap is expected to become negative.

3. Assessment of the methodologies used by the MFIN to prepare the fiscal projections

The methodologies used by the MFIN to prepare the fiscal projections remained largely the same as in the previous forecast rounds. These are centred around the bottom-up and the top-down approaches. The former is cash-based and supported by expert input gathered from line ministries, past observed trends and specific knowledge and information provided by line ministries. These projections, which are prepared along the Consolidated Fund framework, are then reviewed by the MFIN and assessed against the top-down approach, which is based on the ESA framework. The top-down approach is driven by the estimated relationships between the fiscal revenue and expenditure variables and their respective macroeconomic proxy bases. The bottom-up and top-down forecasts are fine-tuned through internal discussions among the staff involved in such projections.

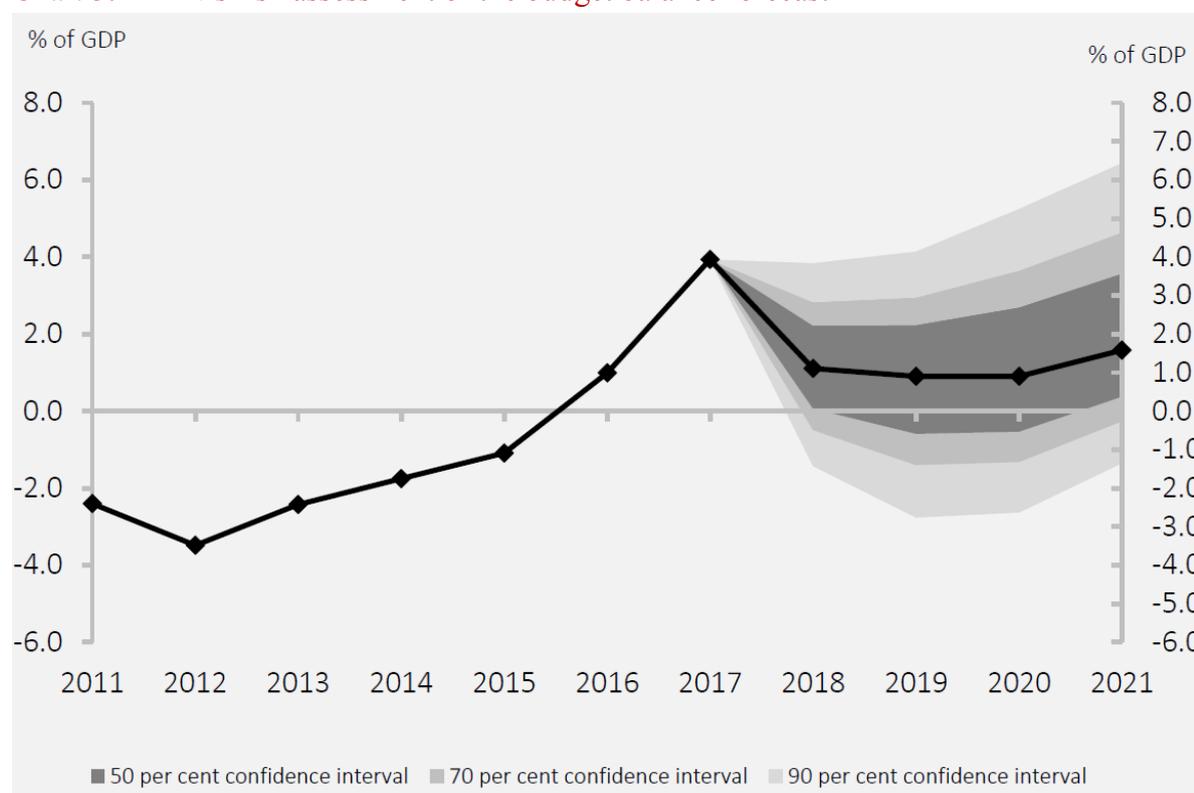
The approach used for the finalisation of the fiscal forecasts allows the expert decentralised input to be combined with broad consistency checks. The fiscal figures presented in the USP can be interpreted as being both projections and targets. On one hand, they are the ‘likely’ outturns envisaged by the MFIN, but also the ‘targets’ which the MFIN feel confident in attaining, and which they will work for to attain, over the forecast horizon. To this effect, ‘fiscal forecasts’ and ‘fiscal targets’ are used interchangeably in this Report.

A risk assessment is also prepared by the MFIN and published in the USP. This risk assessment analyses the effect of identifiable macroeconomic risks on the projected baseline budget balance. This is done via the imposition of shocks to variables within the macroeconomic modelling framework. The choice of scenarios is based on the MFIN’s judgement and information obtained on current economic conditions, both local and international, together with knowledge and possible risks observed from meetings with key stakeholders. The scenarios considered in the latest USP are the following: [1] a purely model-based scenario without any economic judgement [2] improved economic growth for Malta’s main trading partners [3] weaker economic growth for Malta’s main trading partners [4] alternative economic growth scenarios derived from different models [5] updated Consensus Forecasts available beyond the MFIN’s cut-off date [6] higher world prices [7] lower world prices [8]

⁴ The output gap compares the actual real GDP to the estimated potential GDP. When actual real GDP exceeds potential GDP, a positive output gap is said to exist. When actual real GDP is below potential GDP, a negative output gap is said to exist.

stronger medium-term private investment [9] a lower rate of realisation of one-off investment projects [10] the possible impact of the United States (US) protectionist measures on the Maltese economy [11] a more aggressive tightening of monetary policy by the European Central Bank (ECB). The estimated impact of the before-mentioned macroeconomic shocks is summarised in a fan chart which shows the confidence level for various possible outturns for the fiscal balance (see Chart 3). As from this forecast round, the MFIN’s evaluation of such risks incorporates the variance resulting from the past forecast error of fiscal projections. The 90% confidence interval shows a range of around 7.5pp for 2021, with the balance of risks, as seen by the MFIN, being mainly on the upside throughout the forecast horizon, implying a greater probability that the macroeconomic shocks produce a fiscal surplus larger than the baseline.⁵ The MFAC considers useful if the separate impact of each identified scenario is presented in a way which is more easily identifiable for enhanced transparency.

Chart 3: MFIN’s risk assessment of the budget balance forecast



Note: The chart is reproduced from the USP 2018-2021 document

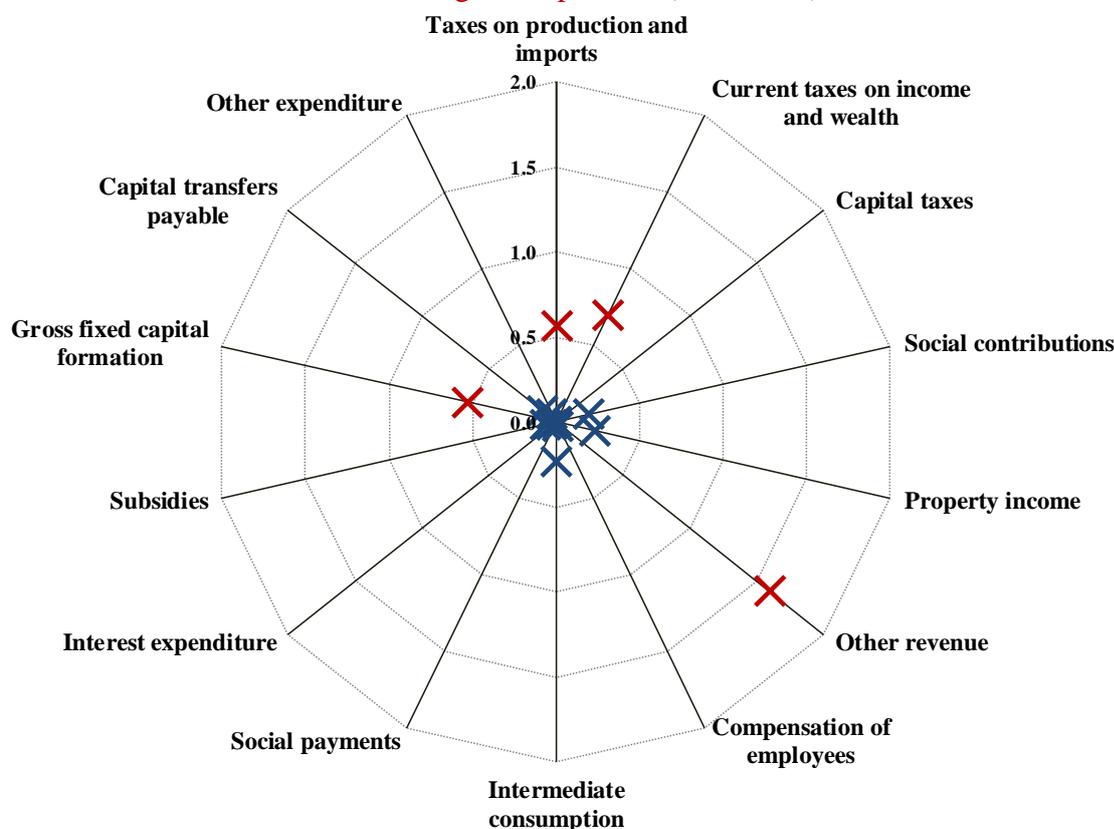
Source: MFIN

The quality of the forecasting framework can be assessed ex-post by evaluating the extent to which the MFIN’s forecasts differ from the actual turnout. In this case, the fiscal forecasts prepared in the previous round, that is in October 2017, as part of the DBP, are compared to the actual turnout, according to the first vintage published by the NSO. The absolute difference

⁵ A confidence interval provides the probability that a parameter falls between the indicated range of values.

between the actual and targeted amounts are expressed as a percentage of the actual nominal GDP (see Chart 4). Deviations are considered as significant if they exceed 0.5% of GDP.⁶

Chart 4: Deviations in the 2017 budget components (% of GDP)



Note: Blue crosses indicate instances where the deviation amounted up to 0.5% of GDP, while the red crosses indicate deviations which exceeded 0.5% of GDP.

Source: MFIN

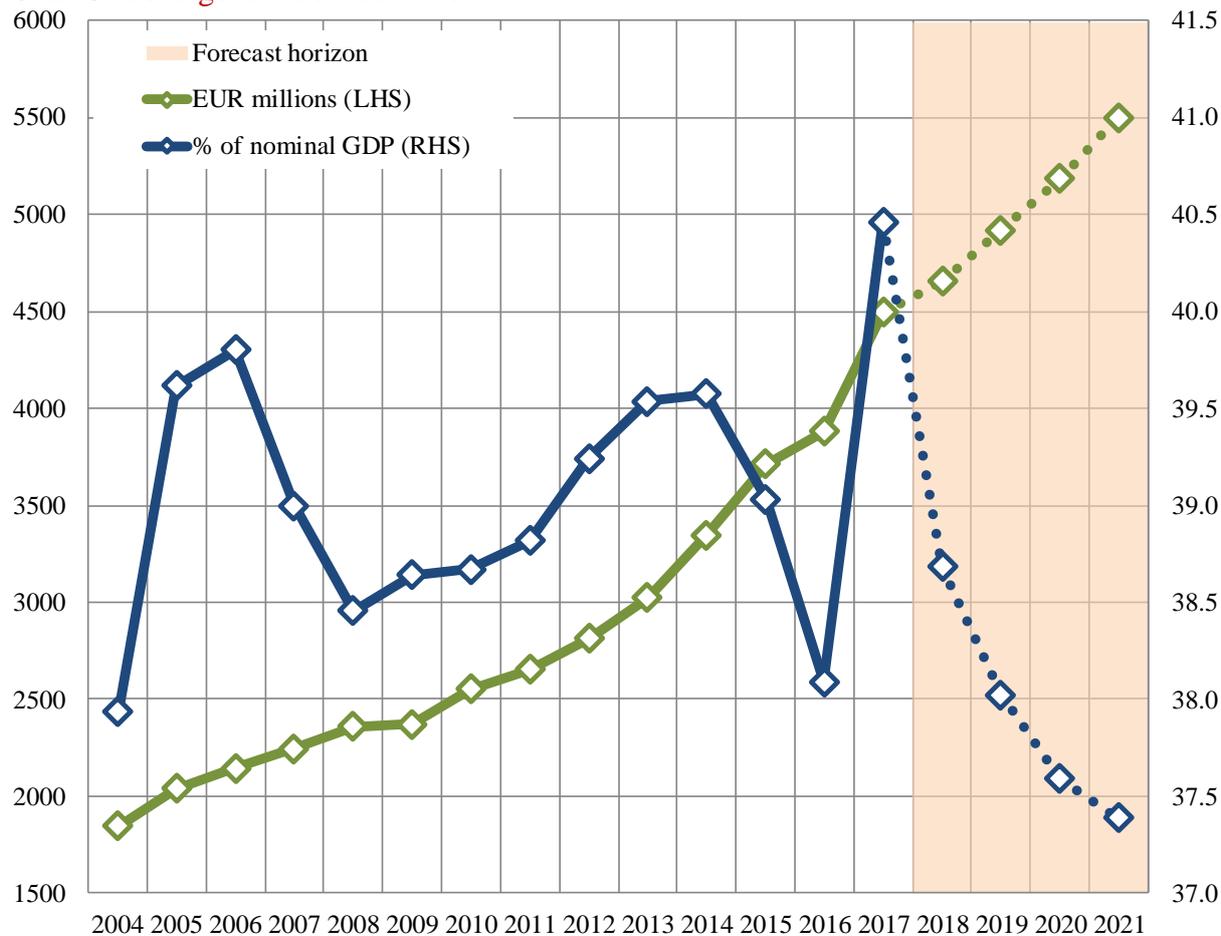
Out of the expenditure components, a significant deviation was noted only in the case of gross fixed capital formation, which was much lower than anticipated. The expenditure deviations with respect to the other components were of a smaller magnitude. In the case of revenue, multiple significant deviations were recorded. Taxes on production and imports and current taxes on income and wealth were significantly more buoyant than anticipated. This corroborates the general level of prudence traditionally embedded in the revenue forecasts prepared by the MFIN. However, in 2017, the largest deviation was recorded in the ‘other’ revenue component, in turn driven by the much higher than expected proceeds from the IIP.

⁶ Deviations from targets are normal as most revenues and certain expenditure items are beyond the direct control of government. The threshold for significance was set by the MFAC at 0.5% of GDP, to focus attention to the larger deviances, which exert the largest impact on the fiscal balance. The choice of the 0.5% of GDP threshold is subjective, but consistent with the 0.5% of GDP threshold used by the COM to determine significant deviation in relation to its assessment of the Members’ compliance with European fiscal rules.

4. Assessment of the revenue projections for the period 2018 – 2021

In absolute terms, total revenue is projected to extend its linear upward trend between 2018 and 2021 (see Chart 5). However, the revenue-to-GDP ratio is expected to drop in each of the forecast years, as nominal GDP is expected to rise at a faster pace. As may be observed from Chart 5, the spike in the revenue ratio, which occurred in 2017, is expected to be more than reversed, over the forecast horizon. Indeed, the revenue-to-GDP ratio is projected to fall to 37.4%, by 2021, which would be the lowest ratio since Malta joined the EU in 2004.

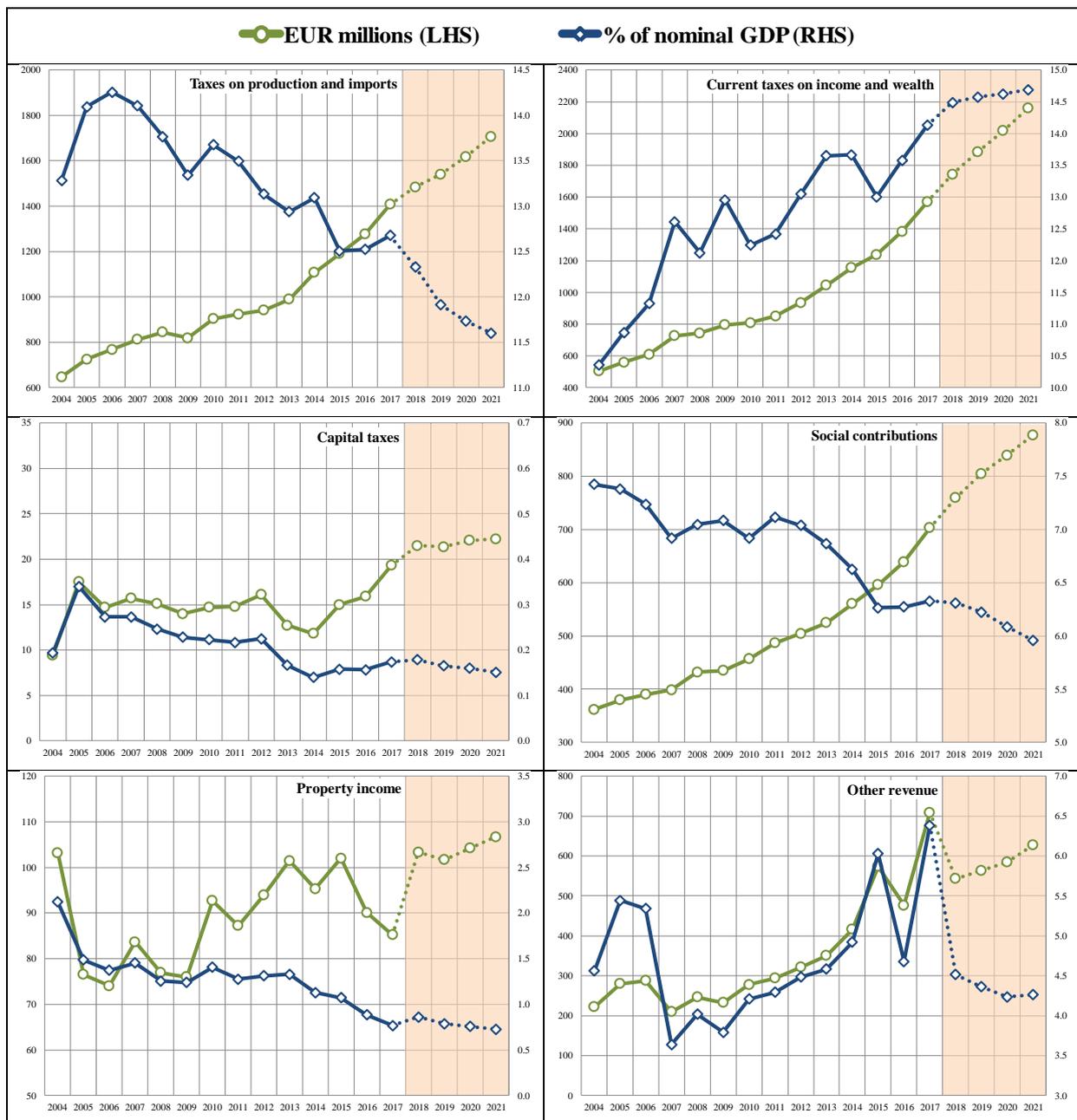
Chart 5: Total government revenue



Source: MFIN

To evaluate the plausibility of the anticipated trajectory for total revenue, each component is evaluated separately (see Chart 6). This approach permits a more in-depth analysis, since each component may be influenced by completely different factors. The MFAC’s assessment is mainly based on the fiscal assumptions underpinning the USP employed by MFIN; existing tax and expenditure laws; announced fiscal measures; information obtained from public sources; as well as supplementary information made available by the MFIN and the NSO through internal discussions and communications. The MFAC does not prepare its independent revenue forecasts but relies on expert judgment, based on historical trends and identified regular patterns in the actual fiscal data.

Chart 6: Revenue components



Source: MFIN

4.1. Taxes on production and imports (D.2)

Definition: Compulsory, unrequited payments, in cash or in kind, which are levied by general government, or by the institutions of the European Union, in respect of the production and importation of goods and services, the employment of labour, the ownership or use of land, buildings or other assets used in production. Such taxes are payable irrespective of profits made.⁷

Taxes on production and imports are projected to rise by 5.4% in 2018 and by 3.8% in 2019 (see Table 3).⁸ In both years, growth is partially dampened by the downside effect of certain measures, whose impact, on a net basis, were estimated by the MFIN at €10.9 million and €9.2 million respectively (see Table 4). Thereafter, growth is expected to stabilise at 5.0% in 2020 and 5.5% in 2021. In these two years, growth is exclusively driven by the expansion in the applicable tax bases, as no other identifiable factors are embedded in the forecasts. Indeed, these growth rates mirror the projected rise in nominal consumption in 2020 and 2021, based on the combined impact of private consumption growth in real terms and the inflation rate.

Table 3: Taxes on production and imports

	Growth rate (%)	Absolute change (EUR millions)	Private consumption growth in real terms (%)	Inflation rate (%)	Implied elasticity for taxes on production and imports	Implied elasticity for Value Added Tax
2016	7.2	85.9	3.0	0.9	6.1	5.5
2017	10.3	132.0	4.3	1.3	0.9	1.4
2018	5.4	75.9	4.4	1.6	0.8	1.2
2019	3.8	56.6	3.8	1.8	0.6	0.8
2020	5.0	77.6	3.6	1.9	0.8	1.1
2021	5.5	88.4	3.3	2.0	0.9	1.3

Source: MFIN

Apart for 2019, the implied elasticity for VAT is higher than unity throughout the forecast horizon.⁹ This can be justified by the assumption of shifting composition of consumption

⁷ This revenue component is dominated by VAT (representing around 60% of the total), with other important contributors being levies on petroleum; levies on cigarettes and tobacco; property taxes; gaming taxes; motor vehicle registration tax; taxes on spirits, alcohol and beverages; duties on insurance products and taxes on cement.

⁸ The Table includes information about macroeconomic variables which influence taxes on production and imports.

⁹ Implied elasticity represents compares the percentage change in the tax to the percentage change in the macroeconomic base which drives such tax. For example, an implied elasticity of 1.3 for VAT, for 2021, means that for a hypothetical 10% rise in consumption, VAT would rise by 13%.

expenditure towards products with higher VAT rates. This is also corroborated by the fact that the actual data indicates an implied elasticity higher than unity both for 2016 and 2017. Indeed, in 2016 it was exceptionally high, at 5.5.¹⁰

Table 4: Identifiable effects impacting taxes on production and imports in 2018 and 2019

	2018	2019
Measures announced in the Budget for 2018		
<i>Concession on the purchases of property</i>	-5.8	5.8
<i>Reduction in the VAT for SMEs</i>	-1.5	
Non-repetition of temporary revenue boost in previous year		
<i>Concession on stamp duty on business inheritance</i>	-5.0	
Net impact of other lagged effects from previous years' measures	1.4	
Impact from VAT directive on electronic commerce		-15.0
Net effect	-10.9	-9.2

Source: MFIN

On the other hand, the lower implied elasticity for 2019 follows the expected negative effect of the VAT directive on electronic commerce, where under the new rules, VAT will be paid in the Member State of the consumer.¹¹ The loss resulting from this change was estimated by the MFIN at €15.0 million, which was the amount earned in 2017.

With regards to the implied revenue elasticity for taxes on production and imports, this is below unity in each of the forecast years. This is in line with the implied elasticity calculated for 2017, and based on the assumption that the indirect tax components apart from VAT grow at a slower pace than nominal consumption. This may be the case when certain taxes are levied on quantities rather than values, and is also a reflection of the general level of prudence embedded in the projections.

According to the projections prepared by the MFIN, the ratio of taxes on production and imports to nominal GDP, would fall from 12.7% in 2017, to 11.6% by 2021. This is a rather steep decline and appears to be rather cautious. On this basis, the MFAC considers that there

¹⁰ In the USP 2017 – 2020, the implied elasticity for VAT was reported at 1.0, which is more in line with the figures being employed by the MFIN throughout the forecast horizon.

¹¹ The effect refers to the loss of commission from the Mini One Stop Shop (MOSS), as per Council Implementation Directive (EU) No 1042/2013. The MOSS allows taxable persons supplying telecommunication services, television and radio broadcasting services and electronically supplied services to non-taxable persons in Member States, in which they do not have an establishment, to account for the VAT due on those supplies via a web-portal in the Member State in which they are identified. VAT collected is eventually forwarded to the Member State where purchases are affected. However, a percentage of VAT used to be retained by the Member State. As from 2019, all VAT collected will be transferred and no more proceeds will be retained from this scheme. For further details refer to <http://www.consilium.europa.eu/en/press/press-releases/2017/12/05/vat-on-electronic-commerce-new-rules-adopted/>.

could be upside risks to the projections for taxes on production and imports throughout the forecast horizon.

4.2. Current taxes on income and wealth (D.5)

*Definition: Compulsory, unrequited payments levied periodically by general government on the income and wealth of institutional units.*¹²

In 2018, growth in current taxes on income and wealth is projected at 11.1% (see Table 5). This is expected to decelerate to 8.1% in 2019 and then settle around 7.0% in the outer forecast years. Income tax reductions applicable for 2018 were estimated by the MFIN to amount to €18.7 million. These consist of €10.6 million tax rebate for workers, €4.5 million rebate for pensioners and €3.6 million in the form of tax credits for students pursuing their studies at Masters and PhD levels. No other identifiable effects are embedded into the other forecast years.

Table 5: Current taxes on income and wealth

	Growth rate (%)	Absolute change (EUR millions)	Growth in compensation of employees (%)	Growth in profits proxy (%)*	Implied elasticity for personal income tax	Implied elasticity for corporate income tax
2016	11.8	146.4	7.1	7.1	2.0	1.0
2017	13.4	185.9	6.8	10.6	1.4	1.6
2018	11.1	173.6	7.1	9.2	1.6	0.9
2019	8.1	142.0	6.8	7.9	1.2	0.8
2020	7.0	132.0	6.3	6.9	1.1	0.8
2021	7.1	144.0	6.2	7.0	1.2	0.9

*The proxy is based on the difference between nominal GDP and compensation of employees.

Source: MFIN

The implied elasticity slightly above unity for personal income tax captures the progressivity of the personal income tax system in Malta. This is in line with the developments recorded in 2016 and 2017. On the other hand, the elasticity below unity in the case of corporate income tax is prudent, when evaluated against the actual implied elasticities for 2016 and 2017, and the general practice of using an elasticity of at least unity in the economic literature.¹³ This

¹² This revenue component is driven to a large extent by taxes on employment income, on interest income and on profits. Another relevant contributor to this revenue item is the annual car circulation tax.

¹³ See for example Appendix 'A' in Kramer et al. (2006) "A disaggregated framework for the analysis of structural developments in public finances", ECB working Paper Number 579, available on <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp579.pdf>.

assumption allows for the combined downside effect created by lags in collection, tax exemptions, and mismatch between the proxy base used and the actual tax base. It also allows for the fact that in 2017 there were some €41.0 million one-off revenues resulting from a decision by Eurostat on the recording of tax revenues derived from International Trading Companies (ITC).¹⁴

Overall, the MFAC considers the projections for current taxes on income and wealth to be plausible, with neutral risks throughout the forecast horizon.

4.3. Capital taxes (D.91)

*Definition: Taxes levied at irregular and very infrequent intervals on the values of the assets or net worth owned by institutional units or on the values of assets transferred between institutional units as legacies, gifts between persons, or other transfers.*¹⁵

Capital taxes represent only a small share of total revenue, merely amounting to around 0.2% of GDP. The MFIN's forecasts feature a small increase for 2018, from €19.3 million to €21.5 million, thereafter remaining practically stable around this level. In view of the observed historical stability of this revenue item, the MFAC considers the approach adopted by the MFIN to be reasonable and does not identify any upside or downside risks for this revenue category.

4.4. Social contributions (D.61)

*Definition: The actual or imputed contributions made by households to social insurance schemes to make provision for social benefits to be paid.*¹⁶

In 2018, social contributions are projected to rise by 8.1%, at a slightly slower pace than the 10.0% growth recorded in 2017 (see Table 6). In 2017, economic growth was particularly tax-rich, as suggested by the fact that the implied elasticity during that year was estimated at 1.5. The MFIN's projections assume that the elasticity will drop to 1.1 in 2018 and thereafter drop below unity. In the case of the 2018 elasticity, the MFIN's choice appears to reflect the need to avoid a too drastic drop, compared to a year earlier and in view of the fact that even in 2016, the elasticity was unity.

¹⁴For further details refer to <http://ec.europa.eu/eurostat/documents/1015035/7756561/Final-findings-EDP-dialogue-visit-MT-8-10-Jun-2016.pdf>.

¹⁵ This revenue component consists mainly of taxes imposed on certain property transfers.

¹⁶ This revenue component captures the national insurance contributions paid by employees, their employers and the self-employed.

Table 6: Social contributions

	Growth rate (%)	Absolute change (EUR millions)	Growth in compensation of employees (%)	Implied elasticity
2016	7.2	43.0	7.1	1.0
2017	10.0	63.6	6.8	1.5
2018	8.1	56.7	7.1	1.1
2019	6.0	45.3	6.8	0.9
2020	4.3	34.6	6.3	0.7
2021	4.5	37.4	6.2	0.7

Source: MFIN

This choice of elasticity presumes that the developments in the labour market, are in line with those in previous years. This entails that the higher yield driven by incomes below the applicable income cap for social security payments, compensates for the fact that no further social contributions are paid on growth in those incomes which exceed the applicable cap. On the other hand, the application of implied elasticities below unity, between 2019 and 2021, is in line with the theoretical expectation based on the existence of a cap on annual payments. No new measures are applicable to social contributions throughout the entire forecast horizon.

On balance, the MFAC considers that the risks to social contributions are neutral across all the years of the forecast horizon.

4.5. Property income (D.4)

Definition: Accrues when the owners of financial assets and natural resources put them at the disposal of other institutional units. The income payable for the use of financial assets is called investment income, while that payable for the use of a natural resource is called rent. Property income is the sum of investment income and rent.¹⁷

According to the USP 2018 – 2021, in 2018 property income is projected to amount to €103.4 million, or €18.2 million higher than in 2017 (see Table 7). It is then expected to stabilise around that level, hovering slightly above the €100.0 million mark in each of the remaining forecast years.

These projections mirror similar projections which had been presented a year earlier in the USP 2017 – 2020, and in October 2017, as part of the DBP for 2018. The rise in property income

¹⁷ Property income represents mainly the dividends received from the CBM, and to a lesser extent the companies listed on the Malta Stock Exchange (MSE) and the Malta Financial Services Authority (MFSA), together with rent earned from government properties and interest earned on holdings of bonds and other loans.

expected to take place between 2017 and 2018 is driven by the fact that dividends from a public listed company operating in the banking sector have been shifted from 2017 to 2018, following the change in the accounting year of this bank. This fact also explains why the target for property income in 2017 was missed.

Table 7: Property income (EUR millions)

	USP 2017 - 2020	DBP 2018	USP 2018 - 2021
2016	92.0	94.2	90.1
2017	109.8	111.5	85.2
2018	103.6	105.0	103.4
2019	104.6	-	101.7
2020	105.6	-	104.2
2021	-	-	106.7

Source: MFIN

On balance, the MFAC considers that the risks to property income are neutral across all years of the forecast horizon.

4.6. Other revenue

*Definition: Other revenues not elsewhere classified.*¹⁸

Other revenue is projected to decline in 2018 but increase in each of the other forecast years (see Table 8). The two most relevant factors explaining these movements are the patterns expected for the inflows of EU funds and the revenue generated through the IIP.

The projections for EU funds assume that after a slow start in 2016 and 2017, the absorption rate will increase as from 2018. In absolute terms, the amount of EU funds is assumed to increase throughout the forecast horizon. This profile is plausible, as the absorption rate tends to increase as the programming period advances, as was the case under the previous funding cycle. However, the extent of the possible increase remains uncertain. Indeed, the take up of EU funds in 2017 was lower than anticipated in the latest DBP.

¹⁸ This budget item represents residual revenue components, mainly accounted for by market output and capital transfers. Market output consists primarily of revenues derived from permits and charges for the services offered by the public sector, and the revenues accruing from the IIP. The latter includes both the 30% share which is recorded in the Consolidated Fund and the 70% which goes directly to the National Social and Development Fund (NSDF). Capital transfers receivable relate mainly to the absorption of EU funds.

Table 8: Other revenue

	Total	% of GDP	EU funds	% of GDP	IIP	% of GDP	Residual	% of GDP
2016	476.7	4.7	54.1	0.5	171.5	1.7	251.1	2.5
2017	709.3	6.4	73.3	0.7	285.3	2.6	350.7	3.2
2018	543.4	4.5	100.7	0.8	110.0	0.9	332.7	2.8
2019	563.9	4.4	123.5	1.0	93.0	0.7	347.4	2.7
2020	584.3	4.2	124.4	0.9	104.0	0.8	355.9	2.6
2021	627.1	4.3	149.4	1.0	116.0	0.8	361.7	2.5

Source: MFIN

In relation to the target revenues from the IIP for 2018, the estimate of €110 million appears plausible if developments during the first quarter continue for the rest of the year. Indeed, during the first three months of 2018, the intake amounted to €28.5 million.¹⁹

At the same time, the projected yield from the IIP, ranging between €93.0 million in 2019 and €116.0 million in 2021, is prudent, when considering that the actual yield in 2016 and 2017 was much higher.

On the other hand, the estimates for the residual elements within the ‘other revenue’ category are projected to scale down in 2018 and to moderately increase thereafter, but at a slower pace than GDP, thereby resulting in a decline in the ratio-to-GDP.

By its nature, the trajectory for ‘other revenue’ remains uncertain, owing to the diverse components making up this revenue item. Under one scenario, downside risks may exist because the take up of EU funds may progress more slowly than envisaged, while the yield from the IIP may not be as high as anticipated. On the other hand, it is equally possible that such targets could be achieved and possibly surpassed, as past data shows that a rapid acceleration in the take up of EU funds and higher proceeds from the IIP are both feasible. On balance, since the direction of specific identifiable risks cannot be detected by the MFAC with reasonable certainty, the risk assessment for this revenue item is treated as broadly neutral across the forecast horizon,

4.7. Total government revenue

Overall, the MFAC thus considers the projections for total government revenue for the period 2018 to 2021 to be within its endorsable range. The MFAC’s assessment concludes that there could be an upside risk to taxes on production and imports but no identifiable factors which

¹⁹ This figure represents the gross yield.

indicate a clear upside or downside risk in the case of the other revenue components. As a result, there is an upside risk outlook for total revenue projections over the period 2018 to 2021 (see Table 9).

Table 9: Summary of risks to the revenue projections

	2018	2019	2020	2021
Taxes on production and imports	↑↑	↑↑	↑↑	↑↑
Current taxes on income and wealth	↔	↔	↔	↔
Capital taxes	↔	↔	↔	↔
Social contributions	↔	↔	↔	↔
Property income	↔	↔	↔	↔
Other revenue	↔	↔	↔	↔
Total revenue	↑↑	↑↑	↑↑	↑↑

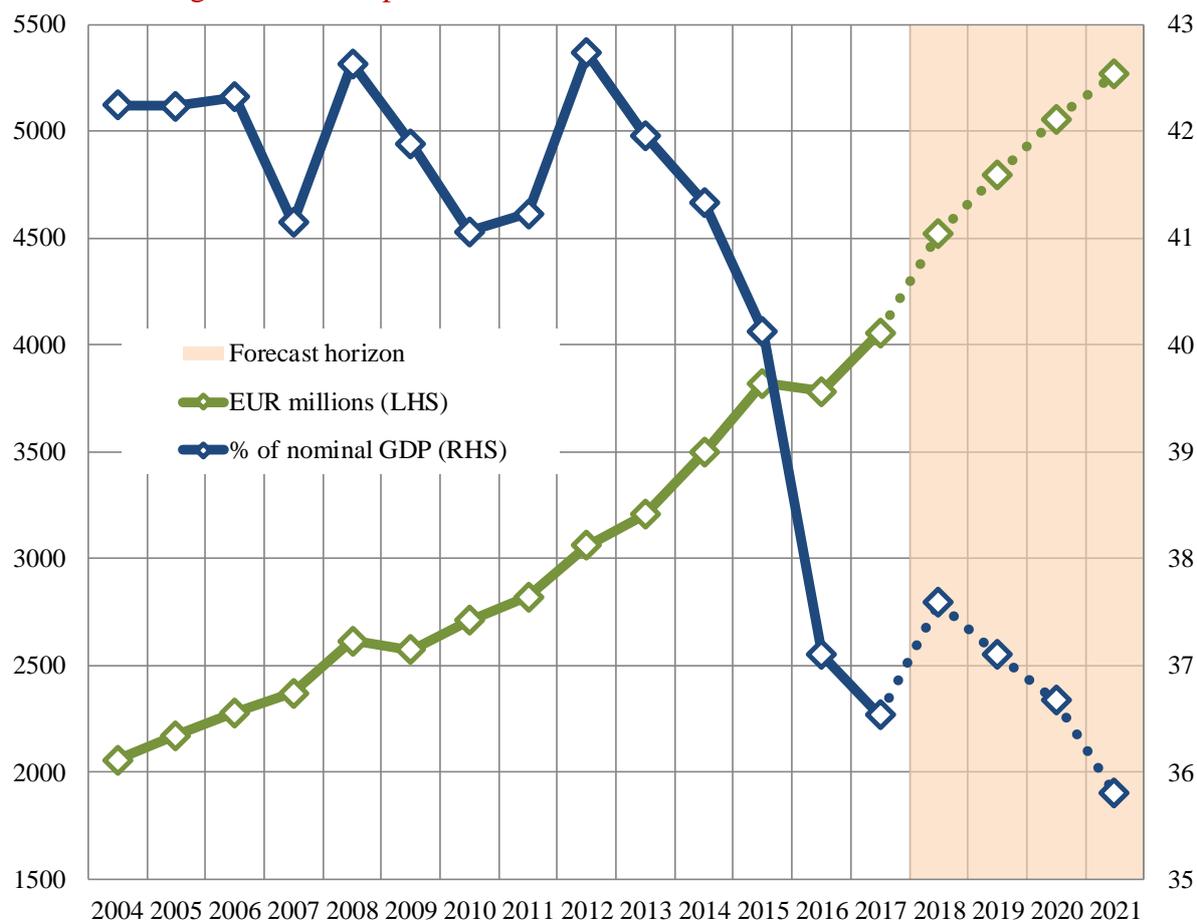
Note: ↔ indicates neutral risks, ↑ indicates upside risks and ↓ indicates downside risks. All risks are assessed with respect to the specific revenue component and based on the information made available to the MFAC by the cut-off date. For the purposes of risk identification, the materiality principle is used, where any deviations (up or down) which are less than 0.1% of GDP are considered as stable, thus carrying a neutral risk assessment.

Source: MFAC

5. Assessment of the expenditure projections for the period 2018 – 2021

Total expenditure is expected to increase in absolute terms in each of the forecast years (see Chart 7). In 2018, total expenditure growth, at 11.5%, is expected to outpace nominal GDP growth. Thereafter, between 2019 and 2021, expenditure growth is anticipated to moderate to 6.1%, 5.4% and 4.1% respectively, which is a slower pace than nominal GDP growth. The planned containment of expenditure growth is the result of slow growth across multiple components. If these projections materialise, the expenditure-to-GDP ratio will fall to 35.8% of GDP by 2021, which is the lowest ratio since Malta joined the EU, despite more than doubling in absolute terms since 2004. The expenditure projections are assessed in a disaggregated manner, adopting the same approach used in the case of the revenue projections (see Chart 8).

Chart 7: Total government expenditure



Source: MFIN

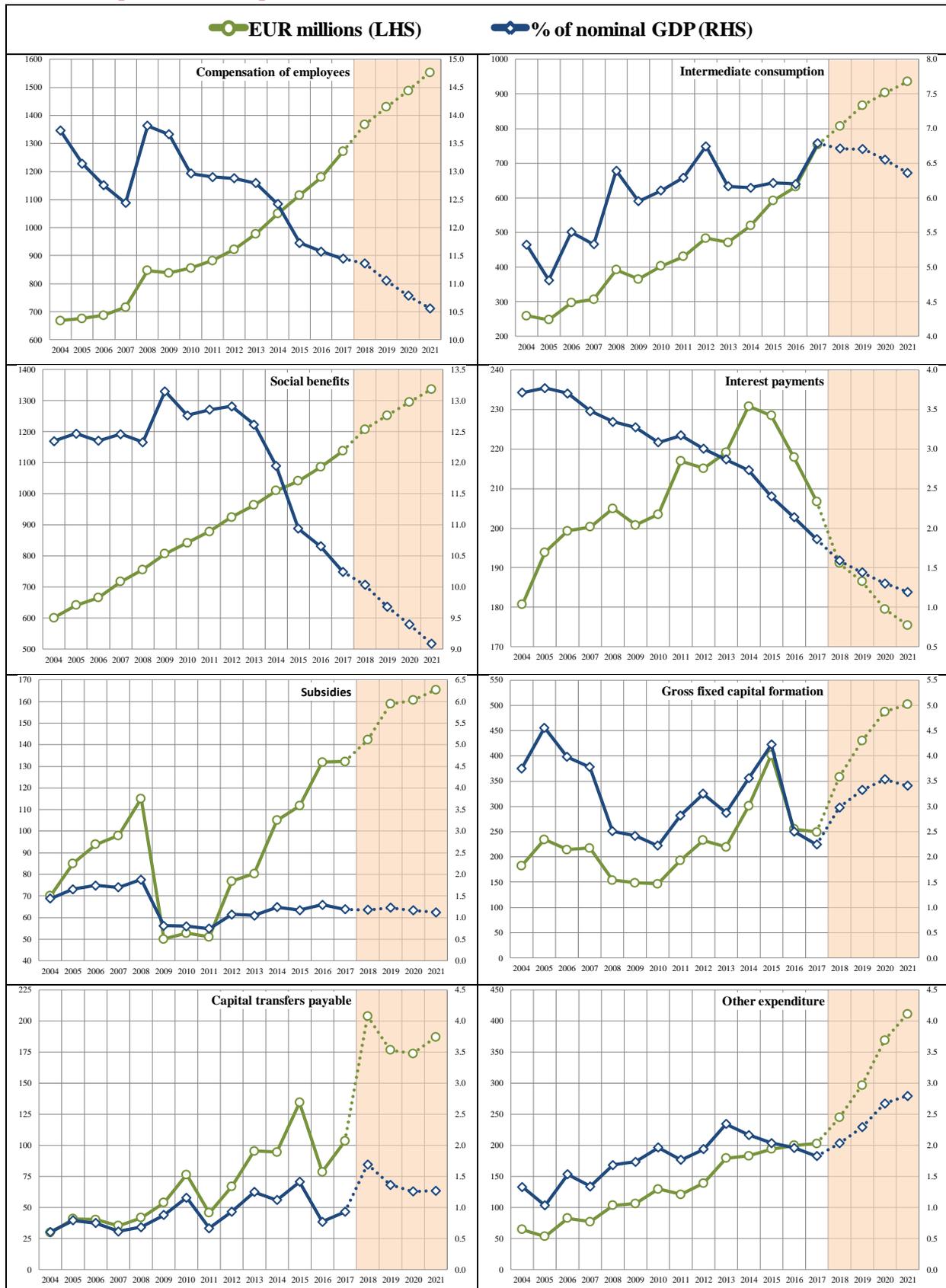
5.1. Compensation of employees (D.1)

Definition: The total remuneration, in cash or in kind, payable by an employer to an employee in return for work done by the latter during an accounting period.²⁰

Spending on compensation of employees is driven by the number of public sector employees and their average wage. Since employment within the government departments has been decentralised, the projections for compensation of employees effectively show the allocated budget for this item. Ministries are free to determine their employment levels, based on the planned recruitment, as envisaged in the ministries' and departments' business and financial plans (including human resources plans). The recruitment costs must however remain within the parameters of the approved budgetary estimates.

²⁰ This budget item consists of the wages and salaries of civil servants, and employees in local councils and government entities. These include Extra Budgetary Units (EBUs) that are funded fully or in large part by subventions from the Government and are therefore classified within the general government sector for ESA purposes.

Chart 8: Expenditure components



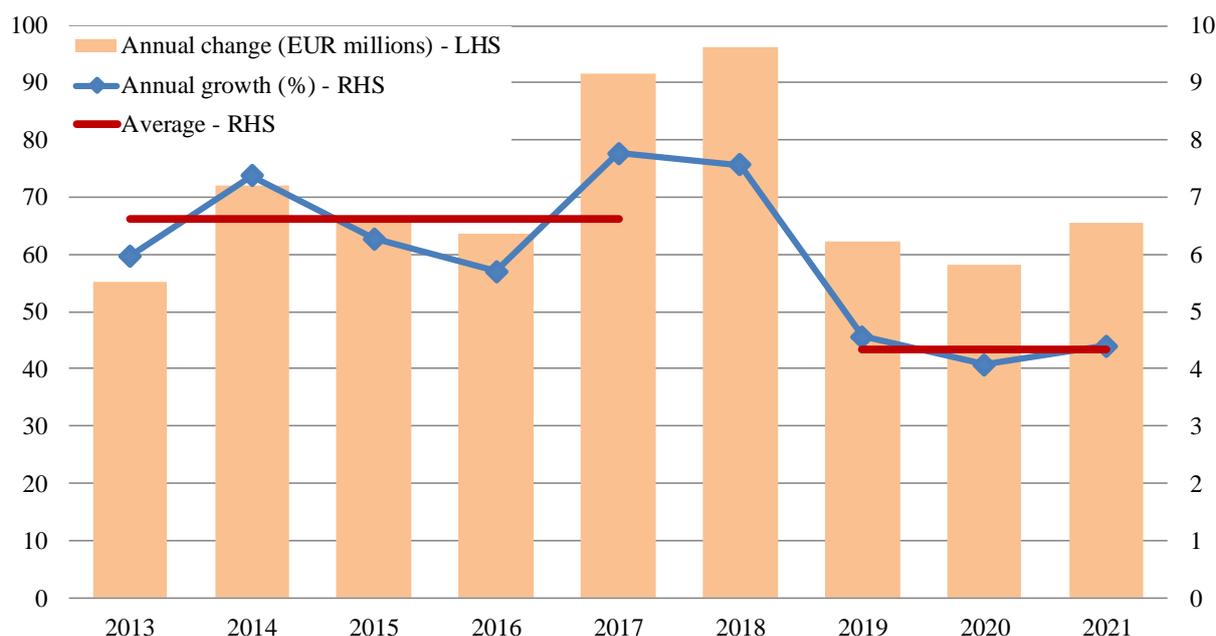
Source: MFIN

On the other hand, the average wage over the forecast horizon is conditioned by the collective agreement for civil servants, which spans over eight years, from 2017 to 2024. Additional spending would result in the case of any wage drift such as when employees are promoted, or receive bonuses.

The increases awarded to the civil servants under the new collective agreement average 2.7% per annum for the period 2018 to 2021.²¹ These increases are inclusive of any cost of living adjustments (COLA) which the Government may award in respect of these years. However, this collective agreement does not cover other elements of the Government’s wage bill, such as those pertaining to certain sectors such as health and education, as well as those employees in public sector entities and the extra budgetary units, who are covered by different collective agreements or compensation packages.²² However, the USP states that “allowances were made to other collective agreements currently being negotiated”.

The budgeted increase in compensation of employees for 2018 stands at 7.6%, which is comparable to the growth recorded in 2017 (see Chart 9). This increase includes the estimated impact of sectoral agreements expected to impact 2018.

Chart 9: Compensation of employees



Source: MFIN

Another relevant factor is the increase in the retirement age from 61 to 62 taking place in 2018, which means that fewer public sector employees would be retiring. The same factor applies to 2019 when the pensionable age will increase further, to 63. For the period 2019 to 2021, the

²¹ This estimate reflects how the maximum salary for three representative scales, scale 5, scale 10 and scale 15 is changing in each respective year according to Appendix A of the Collective Agreement for Employees in the Public Service.

²² The collective agreement covers around 30,000 employees from a total of around 45,000 employees in the public sector.

growth rates for compensation of employees lie within the range of 4.0% and 5.0%.²³ These are below the average growth rate recorded in the five-year period 2013 – 2017, which stood at 6.6%.

The deceleration in the growth rate for the wage bill is conditional on the adherence to the negotiated wages, and the assumption that any new collective agreements negotiated throughout the forecast horizon are comparable to that already in place for the civil servants. It also hinges on the ongoing moderation of annual growth in compensation per employee economy-wide (as per macro-economic forecasts) at slightly above 3.0%. This perspective is influenced by the relatively high labour supply elasticity in some sectors. Another possible consideration is that going forward, non-monetary factors, such as initiatives promoting greater flexibility and better work-life balance assume rising importance in the reward system.

Overall, the MFAC considers that the risks for the attainment of the target for compensation of employees to be neutral for 2018 but on the upside for the period 2019 to 2021, particularly since the increase in the budget allocations is tighter when compared to recent trends.

5.2. Intermediate consumption (P.2)

*Definition: Goods and services consumed as inputs by a process of production, excluding fixed assets whose consumption is recorded as consumption of fixed capital. The goods and services are either transformed or used up by the production process.*²⁴

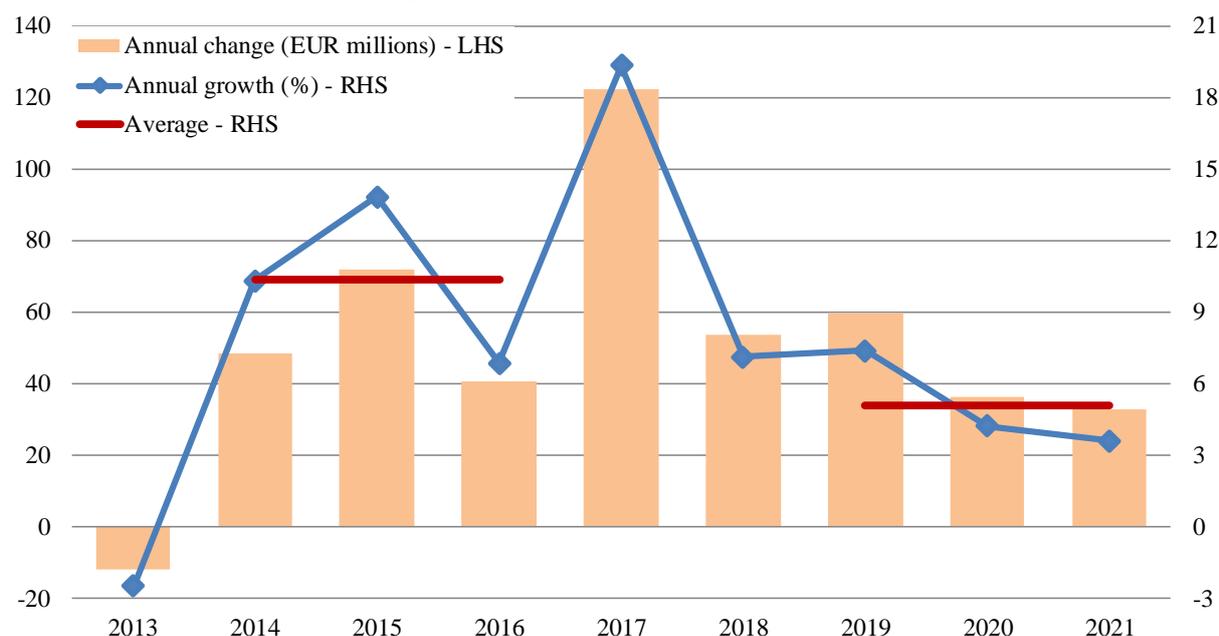
Spending on intermediate consumption rose by 19.3% in 2017, significantly faster than in the previous years (see Chart 10). This was partly driven by Malta's responsibility for the Presidency of the Council of the EU during the year. Other factors related to higher health-related expenditure and the holding of the general elections. In 2018 and 2019 intermediate consumption is projected to grow by 7.1% and 7.4%, whereas in 2020 and 2021, lower growth is projected, respectively at 4.2% and 3.6%.

For 2018, some savings will be achieved through the non-repetition of one-off expenditures incurred in 2017. On the other hand, additional expenditures are anticipated due to Valletta being the European Capital of Culture in 2018. No additional specific factors impacting intermediate consumption are identifiable throughout the forecast horizon.

²³ Throughout the Report various averages are calculated using different timeframes. This approach is subjective and the aim is to focus on the more 'similar' years by excluding those years wherein special factors are clearly identifiable.

²⁴ Intermediate consumption consists of a vast array of expenditures incurred as part of the activities carried out by the Government. A significant proportion is associated with the health sector, and includes other special expenditures such as the initiative of free child care, the organisation of international summits and other similar initiatives, and payments in relation to the provision of public services (such as lighting, transport and water services). This item also captures the activities of the Environmental Landscapes Consortium Ltd and Engineering Resources Ltd, which have assumed some of the employees previously employed in the ship repair and energy sectors, following the restructuring which has been undertaken in these sectors.

Chart 10: Intermediate consumption



Source: MFIN

Historically, developments in intermediate consumption can be rather volatile. Still, the planned containment of annual expenditure growth on intermediate consumption between 2019 and 2021 to average 5.1%, compared to the average growth of 10.1% recorded during the period 2014 to 2016, appears to be rather ambitious. To an extent this may also reflect some savings arising from reforms associated with the Comprehensive Spending Reviews which have been undertaken in recent years.

Nevertheless, fast GDP growth, a growing and ageing population, are likely to maintain upward pressure on this expenditure component. Although intermediate consumption is a volatile component of government expenditure, the general pattern is for the ratio of intermediate consumption to GDP to rise over time. Indeed, elements such as health related expenditure may grow faster than GDP.²⁵ Hence, the targeted slowdown in expenditure growth as from 2020 may be rather challenging.

Thus, on balance the MFAC considers that the risks for the attainment of the target for intermediate consumption to be neutral for 2018 but on the upside for the period 2019 to 2021.

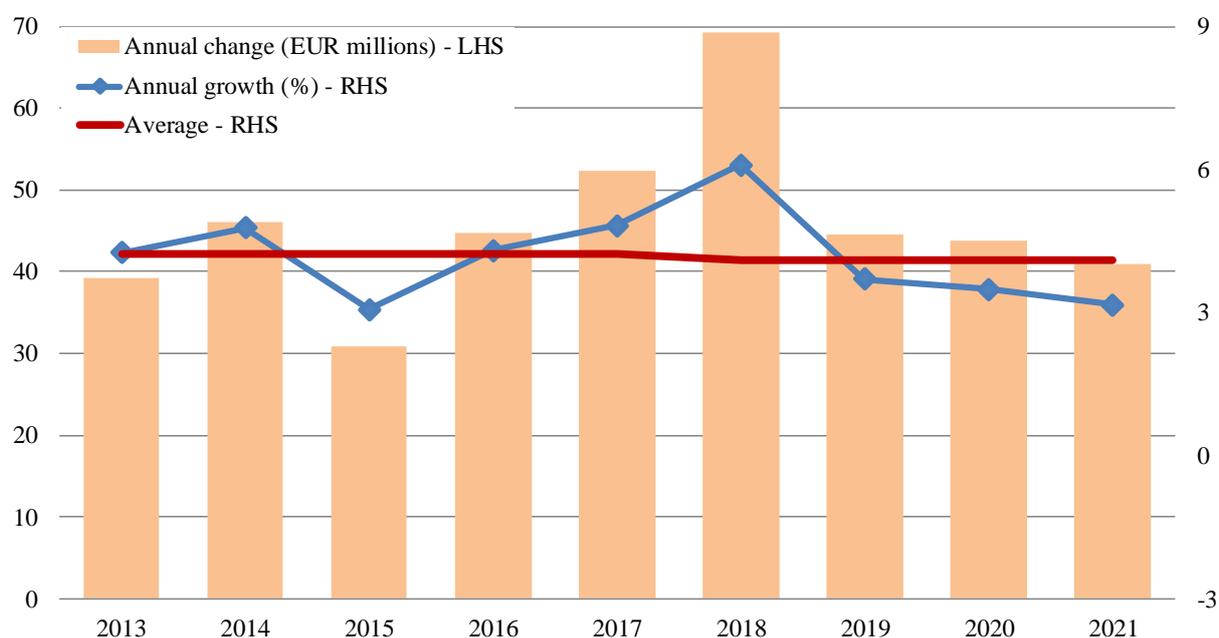
²⁵ In a 2011 statement by the Organisation for Economic Co-operation and Development (OECD), the institution remarked that “Health spending continues to rise faster than economic growth in most OECD countries, maintaining a trend observed since the 1970s”. Source: <http://www.oecd.org/newsroom/healthspendingcontinuestooutpaceeconomicgrowthinmostoecdcountries.htm>.

5.3. Social benefits and social transfers in kind (D.62, D.632)

Definition: Benefits payable in cash to households by social security funds and other benefits payable by employers in the context of other employment related social insurance schemes. In kind benefits refer to individual goods and services provided for free or at prices that are not economically significant to individual households by government units and Non-Profit Institutions Serving Households (NPISH), whether purchased on the market or produced as non-market output by government units or NPISHs. They are financed out of taxation, other government income or social security contributions, or out of donations and property income in the case of NPISHs.²⁶

Outlays on social benefits are project to rise by 6.1% in 2018 and then at a more contained pace, slightly above 3.0% in the remaining forecast years (see Chart 11). The acceleration in growth in 2018 results from the 2018 Budget measures addressing the adequacy of pensions (such as in disability pensions and other vulnerable groups), which however, is expected to be dampened by the expenditure-reducing effect of the tapering of social benefits and the further extension of the retirement age to 62 in 2018. This effect will recur in 2019, as the retirement age is set to rise to 63.

Chart 11: Social benefits



Source: MFIN

The projections extend the downward trajectory for the social benefits-to-GDP ratio observed in recent years. This ratio is set to decline from 10.2% in 2017, to 9.1% by 2021. In recent

²⁶ This budget item consists of the various welfare programmes, both contributory and non-contributory, such as pensions, children allowances, social assistance and stipends. The direct provision of pharmaceutical products accounts for the bulk of social transfers in kind, with another element consisting of the provision of free school transport.

years, the annual growth rates for outlays on social benefits have fluctuated within a relatively narrow range. The projections extend such patterns. Indeed, whereas the average growth rate amounted to 4.2% for the five-year period 2013 to 2017, the average rate of growth over the forecast horizon 2018 to 2021 is perfectly in line, at 4.1%.

The projections embed a gradual rise in contributory and non-contributory beneficiaries over the forecast horizon. The average contributory benefit is expected to rise from €6,442 in 2017 to €7,100 by 2021, while the average non-contributory benefit is projected to rise from €1,716 to €1,869 during the same period. These increases are influenced by the cost-of-living adjustment (COLA) anticipated over the forecast horizon, which is €1.75 for 2018, €2.91 in 2019, and €3.49 in both 2020 and 2021.

On balance, the MFIN's calculations for outlays on social payments appear plausible. No specific upside or downside risks can be identified, supporting the MFAC's view of neutral risks for social benefits over the forecast horizon.

5.4. Interest expenditure (D.41)

Definition: Property income receivable by the owners of a financial asset for putting it at the disposal of another institutional unit.²⁷

Interest payments are projected to amount to €191.1 million in 2018, €15.6 million less than in 2017. Interest payments have been declining since 2015. The projections feature further interest savings over the remaining years, albeit of a smaller magnitude, €4.6 million in 2019, €7.0 million in 2020 and €4.0 million in 2021.

The USP assumes that the short-term interest rate will gradually increase from 0.0% in 2017 to 0.35% by 2021, while the long-term interest rate will remain stable at 1.2% throughout the forecast horizon, close to its level in 2017, which was 1.3%. Throughout the forecast horizon the implied interest rate is projected to extend its downward trend, dropping from 3.6% in 2017 to 3.2% by 2021.

Savings on interest payments are driven by two factors. The outstanding level of debt is projected to decline from around €5.6 billion in 2017 to slightly more than €5.2 billion in 2021, consequent to the anticipated stream of fiscal surpluses. Additional savings are driven by the roll over savings, since the new debt will carry lower interest rates than the maturing debt, in view of the interest rate assumptions underpinning the USP.

Overall, the MFAC considers the risk to the projections for interest payments to be neutral over the forecast horizon.

²⁷ This budget item consists of the interest payments made on public debt.

5.5. Subsidies (D.3)

Definition: Current unrequited payments which general government or the institutions of the European Union make to resident producers.²⁸

The budgeted amounts for subsidies are higher in each of the forecast years. The increases for 2018 and 2019 were estimated at €10.0 million and €16.7 million, respectively. However, the projected increases for 2020 and 2021 amount to only €1.7 million and €4.8 million. Despite these variations, the share of subsidies to GDP is expected to remain practically stable in the region of 1.1%-1.2% of GDP throughout the forecast horizon. This is comparable to the ratio in evidence since 2012.

Overall, the MFAC considers the risk to the projections for subsidies to be neutral over the forecast horizon.

5.6. Gross fixed capital formation (P.51)

Definition: Resident producers' acquisitions, less disposals, of fixed assets during a given period plus certain additions to the value of non-produced assets realised by the productive activity of producer or institutional units. Fixed assets are produced assets used in production for more than one year.²⁹

Spending on gross fixed capital formation is planned to increase in each of the forecast years, from €249.0 million in 2017, to €501.6 million in 2021 (see Chart 12). This is in sharp contrast with the declines recorded in 2016 and 2017. The spike which occurred in 2015 was exceptional since this was the last year when EU funds pertaining to the programming period 2007 – 2013 could be spent. Hence, the decline which occurred in 2016 was to be expected, due to the normal slow start in the utilisation of EU funds at the start of the programming period. However, the further decline which took place in 2017 suggests that attaining the expenditure targets in the case of gross fixed capital formation can be challenging because of difficulties in the operational aspects of projects. Indeed, in 2017, expenditure on gross fixed capital formation was significantly lower than had been indicated in the previous year's USP and in the latest DBP (see Table 10).

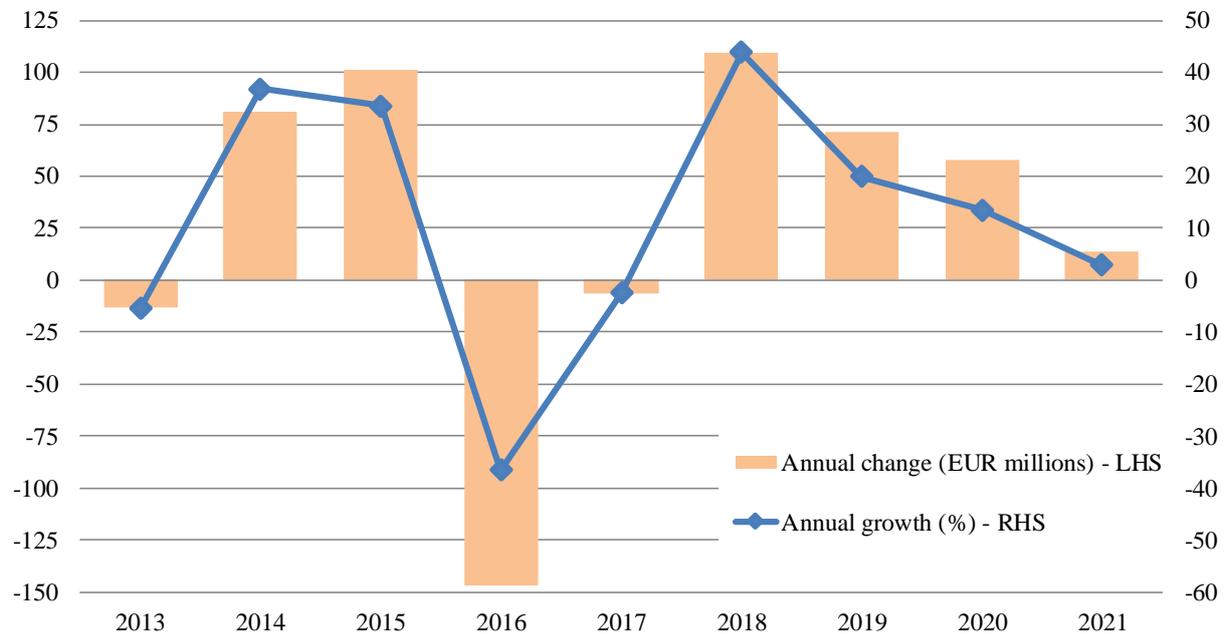
Gross fixed capital formation can be a rather volatile expenditure component. Elevated spending on gross fixed capital formation is indeed possible, but can be challenging. The projections rely to a significant extent on the assumed profile of higher absorption of EU funds. The USP refers to the fact that increases in capital expenditure will be devoted to roads, the

²⁸ This budget item consists mainly of the subsidies paid to the transport, energy and agricultural sectors.

²⁹ This budget item consists of the capital expenditure undertaken by the various ministries and EBU's.

environment, health, and education. They also include an allowance of €35.0 million for projects financed from the NSDF.

Chart 12: Gross fixed capital formation



Source: MFIN

Table 10: Gross fixed capital formation (EUR millions)

	USP 2017 - 2020	DBP 2018	USP 2018 - 2021
2016	251.9	250.8	255.2
2017	293.1	308.3	249.0
2018	343.2	361.0	358.3
2019	336.9	-	429.5
2020	345.0	-	487.5
2021	-	-	501.6

Source: MFIN

On balance, the MFAC considers that the risks for the attainment of the target for gross fixed capital formation to be on the downside for 2018 but neutral for the period 2019 – 2021. This assessment acknowledges the fact that the planned increase for 2018, is more elevated both in absolute and in growth terms than the turnout in 2015, which in turn was an exceptional year. On the other hand, the growth rates anticipated for the outer forecast years appear more feasible.

5.7. Capital transfers payable (D.9)

*Definition: capital transfers require the acquisition or disposal of an asset, or assets, by at least one of the parties to the transaction. Whether made in cash or in kind, they result in a commensurate change in the financial, or non-financial, assets shown in the balance sheets of one or both parties to the transaction.*³⁰

Capital transfers are projected to practically double in 2018, rising to €204.1 million, from €103.5 million in 2017. Out of the €100.6 million rise in 2018, €63.5 million is ascribed to the capitalization of Malta Air Travel (MAT) Ltd for the purchase of landing slots from Air Malta. This factor creates a base effect, which explains the subsequent drop of €27.4 million in 2019. Since this drop is lower than the capitalization amount, it implies that an allowance for higher capital transfers was made. This also reflects the fact that some capital transfers are tied to EU funds, which in turn are assumed to pick up over the forecast horizon.

The MFAC acknowledges the extent of discretion available to the Government over this expenditure item. Overall, the MFAC considers the projections for capital transfers to be plausible with neutral risks throughout the forecast horizon. The forecast of a relatively stable ratio for capital transfers as percentage of nominal GDP, slightly higher than in recent years appears plausible, while acknowledging that yearly fluctuations are possible.

5.8. Other expenditure

*Definition: Other expenditures not elsewhere classified.*³¹

In absolute terms, ‘other expenditure’ is expected to increase in each of the forecast years at a faster pace than nominal GDP. As a result, its ratio to GDP is expected to increase from 1.8% in 2017 to 2.8% in 2021. This expenditure component is expected to experience the second fastest growth in percentage terms, after gross fixed capital formation. This may also reflect the expansion of certain Government activities which impact this expenditure item.

Owing to the heterogeneity of this expenditure item, it is hard to project such expenditure at an aggregate level. Specific factors which have been identified are higher expenditures out of the funds collected from the IIP (part of the NSDF), as well as transfers to EBUs. This expenditure category also features the annual allocation for the Contingency Reserve, equivalent to 0.1%

³⁰ This budget item consists mainly of transfers to public sector entities to cover their capital expenditure. These include Wasteserv, Foundation for Tomorrow Schools (FTS), Malta Enterprise, Malta College for Arts Science and Technology (MCAST), Malta Council for Science and Technology (MCST) and the University of Malta (UoM). Part of this expenditure is also matched by EU funds.

³¹ This budget item represents residual expenditure components, mainly accounted for by current transfers to the numerous government entities to fund their operations. Within this aggregate there is also included the annual budget allocation equivalent to 0.1% of GDP for the Contingency Reserve. Sale of government land is treated as a negative value among these components.

of GDP. An allocation of €11.6 million has thus been made in 2018, €12.4 million in 2019, and €15.2 million in 2020 and 2021 (see Table 11). Should no recourse be made throughout the forecast horizon, by 2021 the notional balance would reach 0.5% of GDP, which is the maximum set by article 34 of the FRA. The FRA makes it clear that recourse to the Contingency Reserve is only possible to cover exceptional circumstances.

Table 11: Contingency Reserve (EUR millions)

	Allocation	Utilisation	End of year balance
2015	8.3	8.3	0.0
2016	9.0	-	9.0
2017	9.8	-	18.8
2018	11.6	-	30.4
2019	12.4	-	42.8
2020	15.2	-	58.0
2021	15.2	-	73.2

Source: MFIN

Overall, the MFAC considers the allocation for expenditure in this category as prudent, since the budget allows for generous increases. Downside risks exist throughout the forecast horizon, on the assumption that no recourse is made to the Contingency Reserve during these years.

5.9. Total government expenditure

The item-by-item examination of risks to the expenditure forecasts outlined in the previous sections indicates that on aggregate there could be possible downside risks in 2018 but upside risks for the period 2019 to 2021 (see Table 12). With respect to 2018, downside risks are related to gross fixed capital formation and ‘other’ expenditure. Over the remaining three-year forecast horizon, the upside risks on a net basis are driven by the upside risks associated with compensation of employees and intermediate consumption, which are however partially mitigated by downside risks relating to the ‘other expenditure’ category.

The projections for the various expenditure components and for market output, determine the forecast for nominal government consumption, which in 2017 accounted for 15.3% of GDP.^{32,33} On this basis, nominal government consumption is expected to grow fast and then decelerate. Growth in government consumption is expected to spike in 2018, up by 21.0% (see Chart 13). In 2019, it is then expected to grow in line with nominal GDP, up by 7.9%. In the outer forecast years, growth in government consumption is projected to decelerate to below nominal GDP growth, at 4.7% and 4.8% respectively in 2020 and 2021.

³² Market output represents a revenue item which is deducted from the expenditure components.

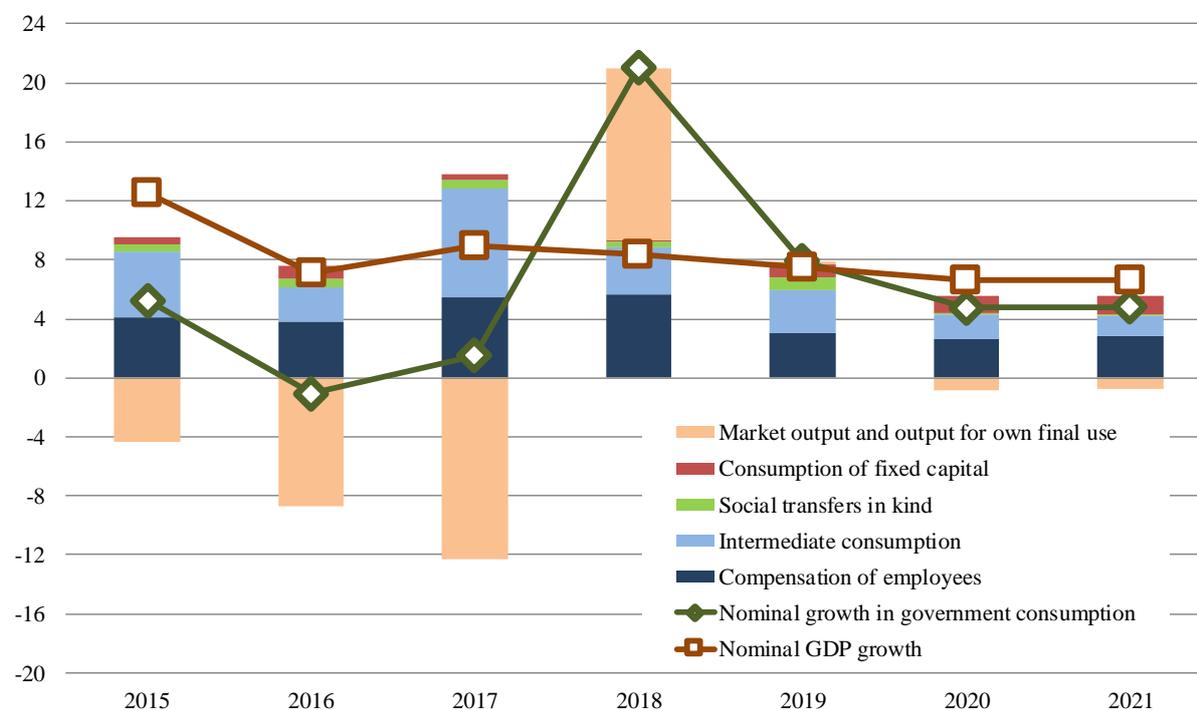
³³ The value for nominal government consumption is not equal to total expenditure.

Table 12: Summary of risks to the expenditure projections

	2018	2019	2020	2021
Compensation of employees	↔	↑	↑	↑
Intermediate consumption	↔	↑	↑	↑
Social benefits	↔	↔	↔	↔
Interest expenditure	↔	↔	↔	↔
Subsidies	↔	↔	↔	↔
Gross fixed capital formation	↓	↔	↔	↔
Capital transfers payable	↔	↔	↔	↔
Other expenditure	↓	↓	↓	↓
Total expenditure	↓	↑	↑	↑

Source: MFAC

Chart 13: Drivers of nominal government consumption growth (% , pp)



Source: MFIN

The surge in nominal government consumption in 2018 is ascribed to the anticipated lower yield from market output (which comprises the total revenues from the IIP, both the 30% channeled through the Consolidated Fund as well as the 70% transferred to the NSDF) since

the value of market output is deducted from the other components of government consumption. Since market output (which includes the revenues from the IIP) is projected to be lower in 2018 than in 2017, this creates an upward effect.³⁴ This effect more than offsets the decline in the contribution to growth stemming from intermediate consumption compared to a year earlier. Otherwise, the contribution from compensation of employees is expected to be comparable to that in 2017.

With regards to the period 2019 to 2021, the impact from market output is expected to be marginal, thus contributing to the relative stability in government consumption growth over these years. Throughout this period, the profile for government consumption mainly reflects the planned expenditure containment with regards to compensation of employees and intermediate consumption, compared to earlier years. This explains the anticipated slowdown in growth to below that in nominal GDP.

6. Assessment of the trajectory for the fiscal balance and public debt for 2018 – 2021

The targets for the fiscal balance are within the endorsable range of the MFAC. The MFAC’s assessment of the revenue projections concluded there are upside risks over the entire forecast horizon (see Table 13). With regards to expenditure, the assessment identified possible downside risks in 2018, but upside risks between 2019 and 2021. For 2018, the upside risks to total revenue and the concurrent downside risks to total expenditure allow for the possibility of a larger fiscal surplus. For the period 2019 to 2021, the magnitude of the upside risks to total expenditure appears to be larger than the magnitude of the upside risks to total revenues. This suggests that the yearly fiscal surplus could be less than planned during these years.

Table 13: Summary of risks to the fiscal projections

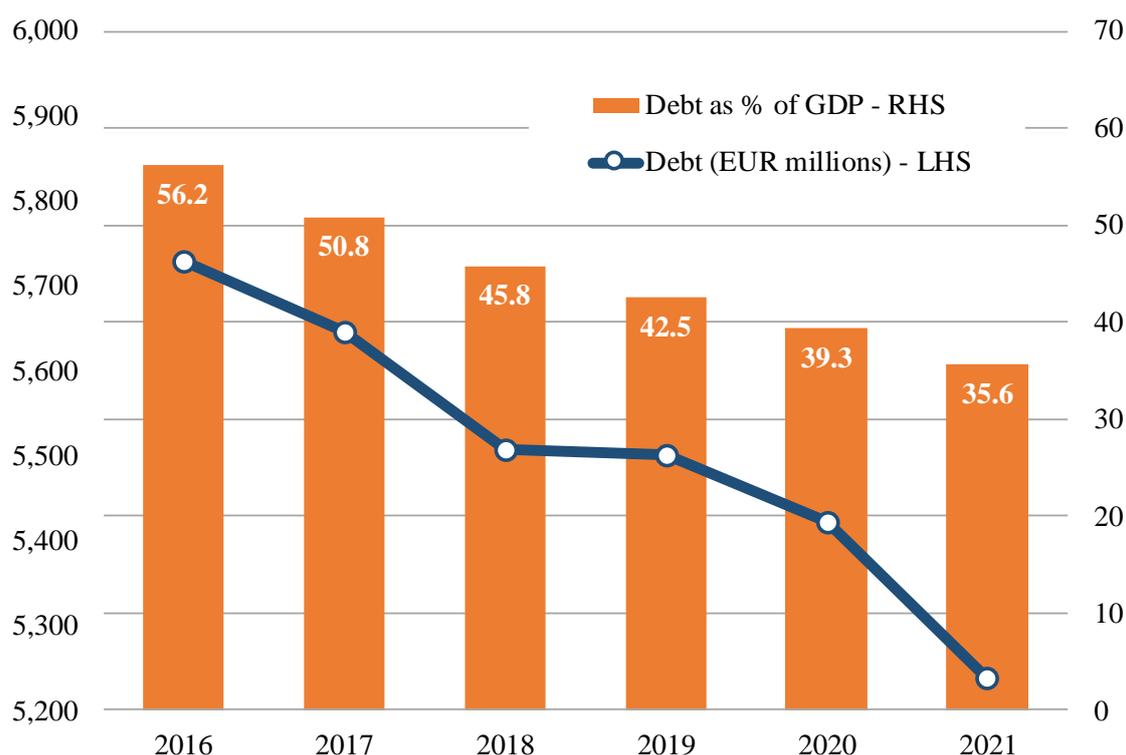
	2018	2019	2020	2021
Total revenue	↑↑	↑↑	↑↑	↑↑
Total expenditure	↓↓	↑↑	↑↑	↑↑
Fiscal balance	↑↑	↓↓	↓↓	↓↓

Source: MFAC

Turning to the public debt projections, these show that the outstanding level is expected to decrease in each of the forecast years (see Chart 14). This reflects the planned yearly fiscal surplus of around €130 million between 2018 and 2020 and €233 million in 2021. Another factor contributing to the downward push in the debt-to-GDP ratio relates to the expansion of the nominal GDP, which acts as the denominator, over the forecast horizon. Consequently, the debt-to-GDP ratio is planned to fall to 35.6% by 2021.

³⁴ The IIP revenue which is deducted from government consumption is added to exports thereby have a neutral effect on nominal GDP.

Chart 14: Public debt dynamics



Source: MFIN

The plausibility of the trajectory for the public debt ratio depends on the extent to which the underlying drivers of the public debt ratio are considered plausible. The projected primary surplus, real economic growth and inflation are expected to generate the downward push in the debt ratio (see Chart 15).³⁵ This is partially offset by the upward push created by interest payments and stock-flow adjustments.³⁶ Since the macroeconomic and fiscal outlook for the period 2018 to 2021 have been deemed to be within the endorsable range of the MFAC, the estimated impacts of the various drivers for the debt ratio are consequently also deemed to be plausible. The additional item which impacts the outstanding level of debt relates to stock-flow adjustments. According to the USP, the factors identified by the MFIN are estimated to be slightly negative for 2018, therefore pushing down the public debt ratio. On the other hand, the effects are positive for the rest of the forecast horizon, creating an upward push on the debt in each of these years. Overall stock-flow adjustments are expected to exert an upward push on the public debt between 2018 and 2021.

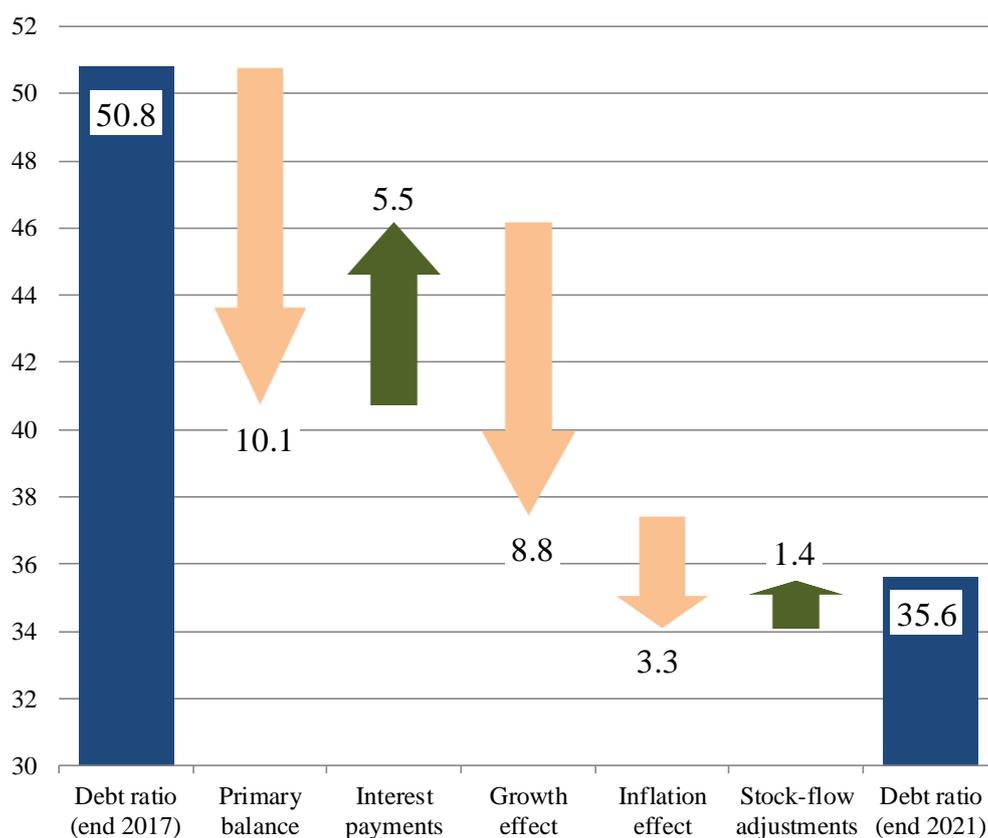
The USP indicates the full list of stock flow adjustments over the period 2018 to 2021. These include contributions to special Malta Government Stock (MGS) Sinking Funds (€50 million annually), equity acquisitions (€63.5 million in 2018 and €2.6 million annually thereafter) and currency issue (around €16.0 million per annum).³⁷ These estimates are based on the plans by the MFIN, and the MFAC considers the projections for the public debt-to-GDP ratio to lie within its endorsable range.

³⁵ The combined effect of real GDP growth and inflation reflects nominal GDP growth.

³⁶ Stock-flow adjustments relate to transactions which impact the debt but not the fiscal balance or vice versa.

³⁷ The issue of currency relates to currency coins issued by the CBM on behalf of the Government.

Chart 15: Forecast debt developments between 2017 and 2021 (% of GDP)



Source: MFIN

7. Comparison with the other forecasts for the fiscal balance and public debt

The plausibility of the MFIN’s projections can also be evaluated by comparing them to the forecasts which are prepared by other institutions, namely the COM, the CBM and the IMF. An important caveat is, however, the fact that these forecasts were prepared in different periods. Only the COM’s forecasts embed the latest official outturn for fiscal and macroeconomic developments for 2017, as published by the NSO on 23 April 2018.³⁸ The forecasts by the CBM and IMF were published before such data became available.³⁹ This is an important caveat since the fiscal outturn for 2017, resulted in a much higher fiscal surplus than any institution had anticipated.

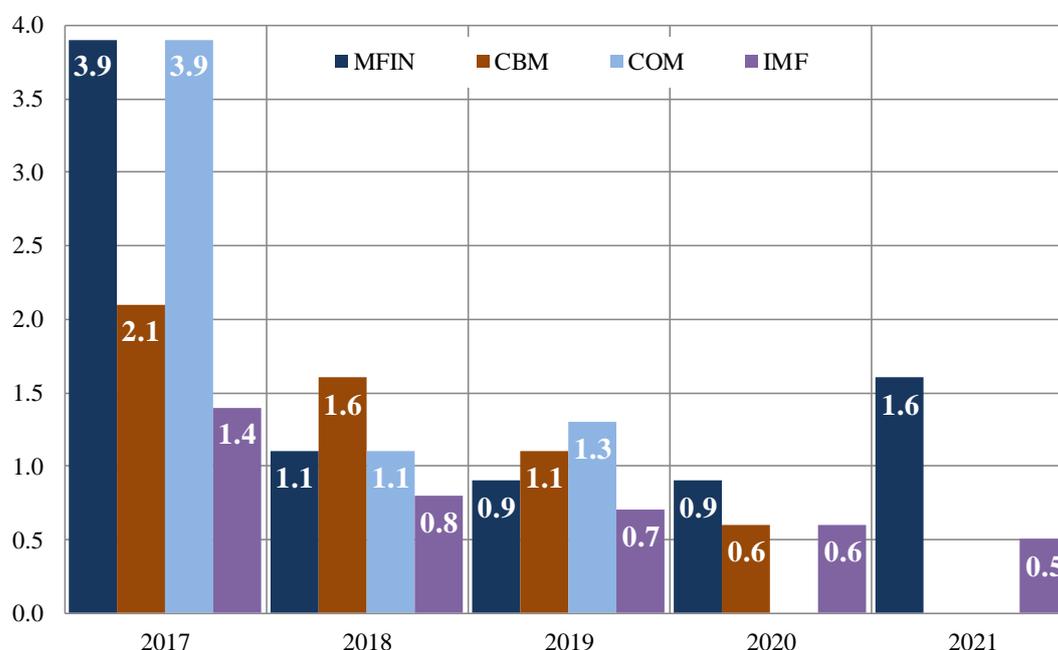
³⁸ NSO News Release 062/2018, available on https://nso.gov.mt/en/News_Releases/View_by_Unit/Unit_A2/Public_Finance/Documents/2018/News2018_06_2.pdf.

³⁹ The cut-off for the data used by the CBM was 30 November 2017, while in the case of the IMF, its report was finalised in January 2018.

7.1. Fiscal balance

For 2018, the COM's forecast for the fiscal balance is virtually identical to that prepared by the MFIN (see Chart 16 and Table 14). Both institutions are projecting the fiscal surplus to amount to 1.1% of GDP. In absolute terms the difference is negligible, at €2.0 million. However, the COM is projecting lower total revenue and total expenditure when compared to the MFIN (see Chart 17). The revenue differences mainly relate to taxes on income and wealth and 'other revenue', which are slightly lower than those indicated in the USP. On the other hand, the COM's lower expenditure projections mainly reflect lower outlays on gross fixed capital formation and 'other expenditure'. On the contrary, the COM anticipates higher spending on intermediate consumption. The differences across the other categories are marginal.

Chart 16: Fiscal balance forecasts by different institutions (% of GDP) *



* No forecasts are available for 2020 and 2021 by the COM. No forecasts are available for 2021 by the CBM.

Source: MFIN, COM, CBM, IMF

For 2019, the COM is projecting a slightly higher fiscal surplus, equivalent to 1.3% of GDP, or €50.0 million more than the MFIN. The COM's projections for total revenue and total expenditure are again lower than the MFIN's. Whereas the COM's forecast for total revenue differs by just €10.8 million, that for total expenditure is larger, at €60.8 million. According to the COM's estimates, current taxes on income and wealth, social contributions and the 'other revenue' categories are expected to yield less than indicated in the USP, but their impact is partially offset by the expectation of higher taxes on production and imports. In the case of expenditure, lower outlays on gross fixed capital formation, subsidies and 'other expenditure' are expected to more than make up for the higher expected outlays on compensation of employees, intermediate consumption, social payments and interest expenditure.

Table 14: Fiscal forecasts prepared by the COM, the MFIN and the CBM

	2018			2019			2020*	
	EUR millions			EUR millions			EUR millions	
	COM	MFIN	CBM	COM	MFIN	CBM	MFIN	CBM
Total revenue	4,604.0	4,655.2	4,658.6	4,907.0	4,917.8	4,941.8	5185.5	5,229.6
Taxes on production and imports	1,485.0	1,484.0	1,474.7	1,565.0	1,540.6	1,561.0	1618.2	1,650.5
Current taxes on income & wealth	1,718.0	1,743.4	1,687.4	1,871.0	1,885.4	1,824.4	2017.4	1,953.4
Social contributions	751.0	759.6	717.5	799.0	804.9	755.5	839.5	794.0
Other revenue**	650.0	668.2	779.0	672.0	686.9	800.9	710.4	831.7
Total expenditure	4,470.0	4,523.2	4,465.2	4,737.0	4,797.8	4,803.2	5058.5	5,148.6
Compensation of employees	1,368.0	1,367.3	1,366.3	1,466.0	1,429.7	1,466.9	1487.9	1,573.1
Intermediate consumption	826.0	807.7	1,204.1	897.0	867.2	1,270.0	903.5	1,338.8
Social payments	1,119.0	1,125.6	819.6	1,169.0	1,152.5	871.4	1193.1	926.4
Interest expenditure	194.0	191.1	206.5	189.0	186.5	206.2	179.5	209.8
Subsidies	144.0	142.2	142.0	154.0	158.9	151.7	160.6	161.0
Gross fixed capital formation	324.0	358.3	342.2	388.0	429.5	401.8	487.5	464.8
Other expenditure**	495.0	531.0	384.5	474.0	573.5	435.2	646.4	474.7
Fiscal balance	134.0	132.0	193.4	170.0	120.0	138.6	127.0	81.1

* The COM's forecasts are not available for 2020.

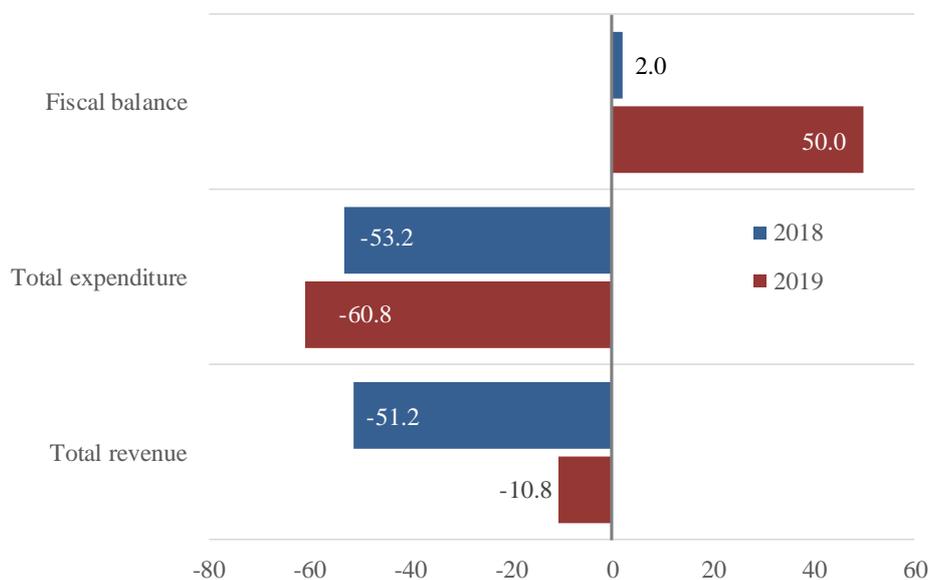
** The values for other revenue and other expenditure do not correspond to the same values described in the other sections in this Report since they include revenue and expenditure items which are not separately identified in the COM's projections.

Source: MFIN, COM, CBM

The available fiscal forecasts produced by the CBM and the IMF were based on estimated rather than actual data for 2017. Specifically, the CBM and the IMF had estimated the fiscal surplus for 2017 to amount to 2.1% of GDP and 1.4% of GDP respectively, which turned out to be much lower than the actual turnout of 3.9%. To an extent this initial discrepancy can explain some of the divergences between the forecasts produced by the MFIN and those of the CBM and the IMF, across the forecast horizon.

The CBM's forecasts portray a pattern of a gradual decline in the size of the fiscal surplus, to 1.6% of GDP in 2018, 1.1% in 2019 and 0.6% in 2020. Apart from 2020, where the MFIN's forecast for the fiscal surplus is higher than that of the CBM, in 2018 and 2019 the CBM's forecasts indicate a higher ratio for the fiscal surplus. In absolute terms, the CBM's projected fiscal balance is higher than the MFIN's target by €61.4 million in 2018 and by €18.6 million in 2019, but is €45.9 million lower in 2020 (see chart 18).

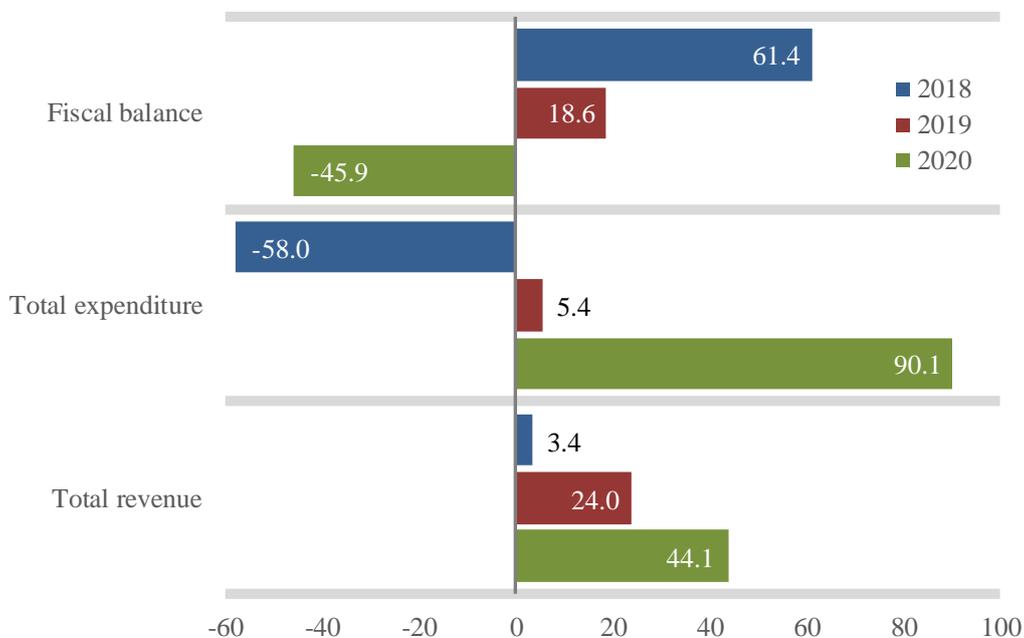
Chart 17: Differences between the forecasts prepared by the COM and the MFIN (EUR millions) *



* Figures represent the absolute differences between the COM's forecasts when compared to the MFIN's projections. A positive figure indicates a higher forecast by the COM while a negative figure indicates a lower forecast by the COM. Figures may not add up due to rounding.

Source: MFIN, COM

Chart 18: Differences between the forecasts prepared by the CBM and the MFIN (EUR millions) *



* Figures represent the absolute differences between the CBM's forecasts when compared to the MFIN's projections. A positive figure indicates a higher forecast by the CBM while a negative figure indicates a lower forecast by the CBM. Figures may not add up due to rounding.

Source: MFIN, CBM

The CBM's larger fiscal surplus in 2018 mainly stems from the higher total revenue forecasts and the lower total expenditure projections. On the revenue side, the main difference relates to the 'other revenue' category, which is significantly higher than indicated in the USP. On the expenditure side, the CBM is projecting much higher spending on intermediate consumption but much lower 'social payments' and 'other expenditure'.

For 2019, the CBM's forecast for total revenue is €24.0 million higher than that projected by the MFIN. Taxes on production and imports and the 'other revenue' are expected to yield more than indicated in the USP, with the impact being partially offset by the lower projections for taxes on income and wealth and social contributions. The CBM also expects total expenditure to be slightly higher when compared to the MFIN, by €5.4 million. This reflects higher expected outlays on compensation of employees, intermediate consumption and interest payments which are almost fully offset by lower expenditure on social benefits and 'other expenditure'.

For 2020, the CBM's projections for total revenue and total expenditure are again both higher than estimated by the MFIN. Total revenue is projected to be €44.1 million higher, while total expenditure is expected to be €90.1 million. The differences mainly arise from the taxes on production and imports and the other revenue categories. On the other hand, the higher projected total expenditure mainly is accounted for by the higher outlays on compensation of employees, intermediate consumption and interest expenditure.

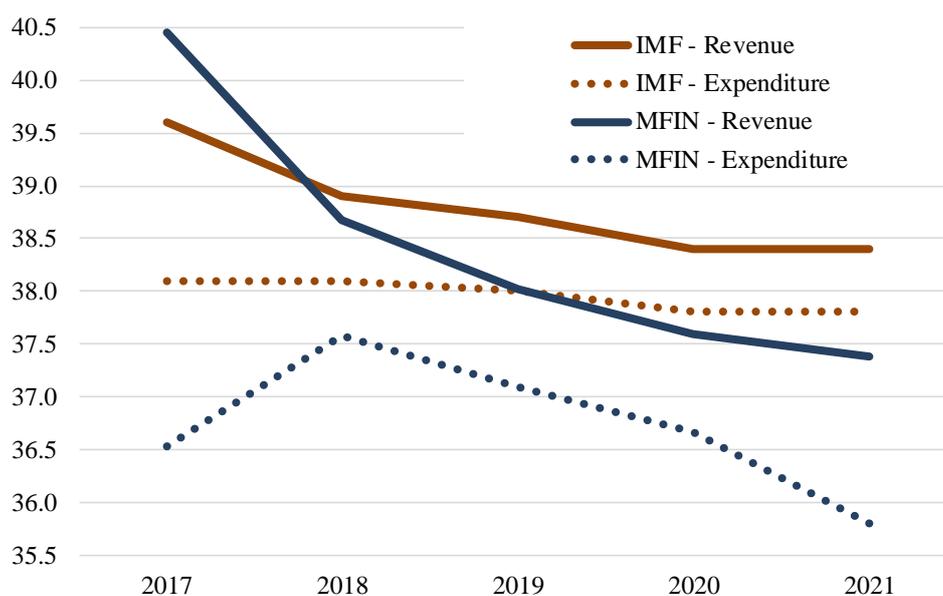
The IMF's projections for the fiscal balance also indicate a surplus for all years up to 2021. However, the projections by the IMF are for a slightly lower surplus. The IMF's forecast for the fiscal surplus is between 0.2 pp and 0.3 pp smaller, between 2018 and 2020, when compared to the MFIN's target. However, the difference is more significant for 2021, since the IMF is projecting a surplus of 0.5% of GDP, compared to the MFIN's estimate of 1.6% of GDP. These discrepancies reflect a different profile for the revenue and expenditure to GDP ratio across the two institutions (see Chart 19). The revenue projections by the IMF exhibit a more gradual decline than that of the MFIN. However, the IMF's expenditure projections basically indicate a flat ratio, as opposed to the decline planned by the MFIN. To some extent these deviations also reflect the fact that the MFIN's projections rely on detailed information, whereas the IMF's approach generally uses assumptions of stable relationships with respect to GDP, unless supported by specific reasons and information to the contrary.

7.2. Public debt

With regards to the debt projections, despite the higher projected fiscal surplus, the COM's forecast for the public debt-to-GDP ratio is slightly higher than indicated by the MFIN (see Chart 20). According to the COM, the debt ratio will decline from 50.8% of GDP in 2017 to 43.4% in 2019. This is ascribed to the fact that in absolute terms, the value for nominal GDP projected by the COM is lower than that of the MFIN. The forecast for the public debt ratio by

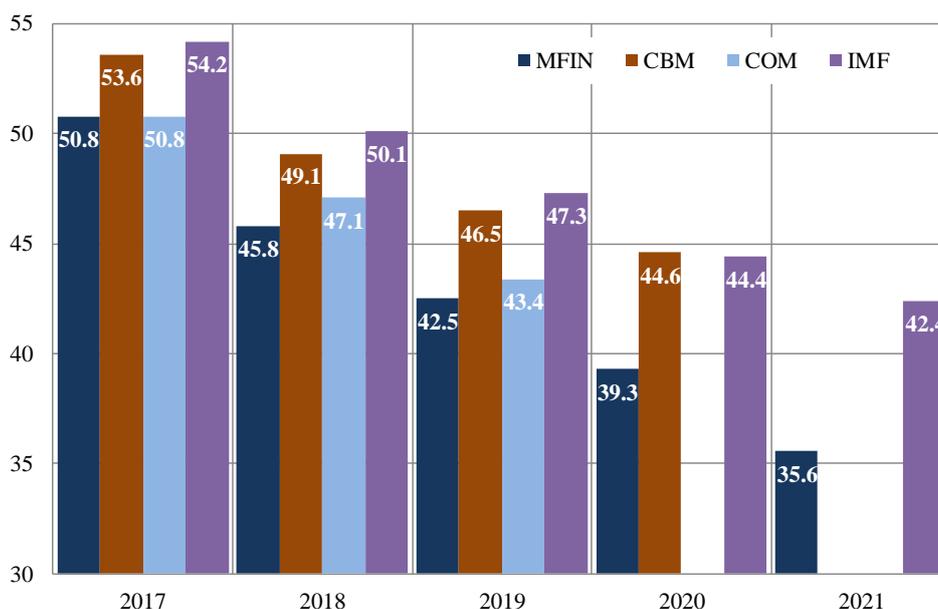
the IMF and the CBM are also slightly higher, by around 5 pp in 2019 and 2020. In 2021, the difference between the MFIN and the IMF's debt projection is slightly more. Over the forecast horizon, both institutions see the ratio of public debt-to-GDP ratio on a declining path, to 44.6% of GDP by 2020 in the case of the CBM and to 42.4% of GDP by 2021 in the case of the IMF. There are also some differences across the institutions in relation to the debt forecasts in absolute terms. For example, whereas for 2019 the COM's projected debt is at €5.6 billion, the CBM's estimate for the same years is at €5.8 billion.

Chart 19: Comparison of the revenue and expenditure projections by the IMF and the MFIN (% of GDP)



Source: MFIN, IMF

Chart 20: Public debt forecasts by different institutions (% of GDP)



* No forecasts are available for 2020 and 2021 by the COM. No forecasts are available for 2021 by the CBM.

Source: MFIN, COM, CBM, IMF

8. Conclusion

The fiscal projections underpinning the latest USP have been prepared using the same approaches adopted during the previous forecast rounds. The in-built prudence has regularly enabled the Government to attain the announced fiscal targets and in some cases, achieve even better results.

In the MFAC's view, the risks to the fiscal balance appear to be on the upside for 2018, mainly in view of the upside risks identified in relation to taxes on production and imports and the possibly slower-than-anticipated progress in capital expenditure (the net impact on the balance depends on whether the variances relate to EU-funded, or locally-funded projects). However, the risks are on the downside for the period 2019 to 2021, mainly as growth in compensation of employees and intermediate consumption may exceed the budgeted amounts (even after allowing for the fact that the Contingency Reserve may be unutilised). Their combined effect is thought to exceed the upside risk associated with taxes on production and imports.

The MFAC acknowledges the Government's efforts to contain expenditure growth, particularly by moderating wage expectations through collective agreements, as well as the efficiency gains derived from the Comprehensive Spending Reviews such as those undertaken in health and education which were undertaken in previous years. At the same time, the Council warrants continuous vigilance, especially in view of the fact that in absolute terms expenditure is still rising across the forecast horizon. This is important since expenditure pressures may still build up, particularly when the pattern of the planned increases in the allocations is lower than in previous years. Indeed, it has been a recurring phenomenon in recent years where successive USPs have resulted in upward revisions in the expenditure outlays, when compared to the original plans. The Council notes that this happened against a background where even revenues were repeatedly exceeding the original projections.

The MFAC views very positively the fact that the three other institutions which produce fiscal forecasts, namely the COM, CBM and IMF, are all anticipating fiscal surpluses and declines in the debt ratio. The magnitude of the differences across the institutions is also rather contained. This further corroborates the MFAC's assessment of the plausibility of the balance and debt trajectories as anticipated by the MFIN, and helps mitigate the extent of the uncertainty relating to the attainment of such targets.

Overall, the MFAC considers the targets for a fiscal surplus, and a decline in the debt-to-GDP ratio, in each of the forecast years, to be feasible and plausible, and within its endorsable range. The justifications provided by the MFIN in the USP, and through further internal communication, suggest that such fiscal targets are indeed achievable. This is conditional on the macroeconomic scenario not diverging significantly from the official forecasts (as endorsed by the MFAC) and the equally important proviso that the Government adheres closely to the plans outlined in the USP.

Malta Fiscal Advisory Council

St. Calcedonius Square, Floriana FRN 1530

Tel: +356 22479200 Fax: +356 22479219

Email: info@mfac.org.mt www.mfac.org.mt



MFAC
MALTA FISCAL ADVISORY COUNCIL