

Assessment of the Update of Stability Programme 2020-2021



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Dear Minister,

**OVERALL ASSESSMENT OF THE MACROECONOMIC
AND FISCAL FORECASTS PRESENTED IN THE
UPDATE OF STABILITY PROGRAMME 2020 – 2021**

As a follow-up to the letter of endorsement in relation to the macroeconomic forecasts, dated 30 April 2020, the Malta Fiscal Advisory Council is hereby presenting the full assessment report dealing with the Update of Stability Programme 2020 – 2021 (submitted to the European Commission at the end of April 2020), in terms of the Fiscal Responsibility Act. In view of the exceptional circumstances, the forecast horizon is limited to the current and next year. Compliance with the fiscal rules is not assessed in view of their temporary suspension, as per European Council agreement.

The Malta Fiscal Advisory Council acknowledges the high uncertainty created by COVID-19 and considers the macroeconomic and fiscal scenario for 2020 and 2021 to be within its endorsable range. The Council also confirms the existence of ‘exceptional circumstances’ which under national and European law allow for greater flexibility in the conduct of fiscal policy.

The assessment carried out on the individual GDP components suggests an overall downside risk outlook vis-à-vis the profile for real GDP for the period 2020 and 2021. This follows the possibility that the overall growth pattern for private consumption,

investment and exports is more subdued than indicated in the official forecasts and this effect outweighs the possibility of a higher-than-expected upward push from government consumption and the possibility that imports are less than expected. In relation to the relative resilience of the job market portrayed in the Programme's scenario, the Council notes that this is consistent with the assumption that the adverse shock is only of a temporary nature and factors in the various job-support measures which are in place.

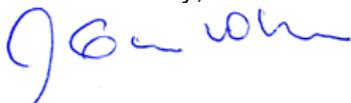
On the fiscal front, the assessment carried out on the individual revenue and expenditure components suggests an overall downside risk outlook vis-à-vis the fiscal balance for the period 2020 and 2021. This reflects the impact of a downside revenue risk related to current taxes on income and wealth and 'other' revenue, combined with an upside expenditure risk related to compensation of employees. The risk outlook vis-à-vis the other budget components is considered to be neutral.

The downside risks to real GDP growth and the fiscal balance are however both deemed to be contained since forecasts by other reputable institutions, which have factored in the impact of COVID-19, have produced a range of forecasts which are comparable to the scenario presented by the Government.

The Council highlights the importance to target again strong public finances once the downside effects of the pandemic ease out. The fiscal space which was available pre-COVID-19, because of the stream of fiscal surpluses and the low level of public debt, made it possible to implement aggressive fiscal measures to mitigate the negative supply and demand shocks. Rebuilding fiscal space would be useful to counteract any future adverse shocks.

Finally, the Council would like to express its sincere gratitude to the staff at the Ministry for Finance and Financial Services for the ongoing fruitful collaboration and assistance.

Yours sincerely,



John Cassar White
Chairman

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Abbreviations

CBM	Central Bank of Malta
COM	European Commission
COVID-19	Coronavirus disease 2019
DBP	Draft Budgetary Plan
ECB	European Central Bank
EFC	Economic and Financial Committee
EFSF	European Financial Stability Facility
ESA	European System of National and Regional Accounts
EU	European Union
FRA	Fiscal Responsibility Act
GDP	Gross Domestic Product
HICP	Harmonised Index of Consumer Prices
IFI	Independent Fiscal Institution
IIP	Individual Investor Programme
IMF	International Monetary Fund
LFS	Labour Force Survey
MFAC	Malta Fiscal Advisory Council
MFIN	Ministry for Finance
MGS	Malta Government Stock
MTO	Medium-Term Budgetary Objective
NDSF	National Development and Social Fund
NPISH	Non-Profit Institutions Serving Households
NSO	National Statistics Office
pp	percentage point
SFA	Stock-Flow Adjustments
SGP	Stability and Growth Pact
STEMM	Short-Term Quarterly Economic Forecasting Model
STG	sterling
USD	US dollar
USP	Update of Stability Programme

Executive Summary

This Report, whose cut-off date is 22 May 2020, assesses the macroeconomic and fiscal forecasts for 2020 and 2021 contained in the Update of Stability Programme, which the Ministry for Finance and Financial Services submitted to the European Commission on 30 April 2020.

These forecasts, which cover only two years in view of the agreement reached at the European level, lie within the endorsable range of the Fiscal Council. Notwithstanding the high level of uncertainty surrounding such forecasts, the Council considers the macroeconomic and fiscal scenario consistent with the COVID-19 related assumptions. Any material departure from such assumptions could however deviate the macroeconomic and fiscal outturn, possibly significantly, from that presented in the official forecasts.

The Programme anticipates that the Maltese economy will suffer a drop of 5.4% in real GDP in 2020, but real GDP is then expected to grow by 3.9% in 2021. The adverse shock to the tax base and the COVID-19 mitigation measures are projected to swing the fiscal balance into a deficit, estimated at 7.5% of GDP in 2020, but the fiscal imbalance is expected to narrow to 3.6% in 2021, following the expected economic recovery and the gradual phasing out of the support measures. COVID-19 is also expected to bring to halt the trend decline in the debt-to-GDP ratio, which is thus estimated to rise from 43.1% in 2019, to 55.5% by 2021.

The assessment carried out on the individual GDP components suggests an overall downside risk outlook vis-à-vis the profile for real GDP for the period 2020 and 2021. This follows the possibility that the overall growth pattern for private consumption, investment and exports is more subdued than indicated in the official forecasts and this effect outweighs the possibility of a higher-than-expected upward push from government consumption and import dynamics.

On the fiscal front, the assessment carried out on the individual revenue and expenditure components suggests an overall downside risk outlook vis-à-vis the fiscal balance for the period 2020 and 2021. This reflects the impact of a downside revenue

risk related to current taxes on income and wealth and 'other' revenue, combined with an upside expenditure risk related to compensation of employees.

The downside risks to real GDP growth and the fiscal balance are however both deemed to be contained since forecasts by other reputable institutions, which have factored in the impact of COVID-19, have produced a range of forecasts which are comparable to the scenario presented by the Government.

Chapter 1

Introduction

European Union (EU) Member States that share the euro as their currency must submit an Update of Stability Programme (USP) to the European Commission (COM) by the end of April each year.¹ Malta's USP 2020 – 2021 contains the official macroeconomic and fiscal forecasts prepared by the Ministry for Finance and Financial Services (MFIN). These reflect the first official estimates of the possible impact which COVID-19 could have on Malta's economy and public finances, and are an update to the previous forecast vintage which was published in October 2019, when the Draft Budgetary Plan (DBP) 2020 was submitted to the COM.²

The COVID-19 pandemic, with the severe economic shock, uncertainty and constraints it created, brought about changes both from a regulatory and operational perspective in relation to the Stability and Growth Pact (SGP). A so-called general escape clause within the SGP was activated, as proposed by the COM on 20 March 2020 and agreed by the European Council on 23 March 2020.^{3,4,5} The purpose of this escape clause, which had been introduced as part of the 'Six-Pack' reform of the SGP in 2011, is to facilitate the coordination of budgetary policies in times of severe economic downturn across the EU, a condition which the COM and the European Council agreed that was met as a result of the effects created by COVID-19.

¹ The documents submitted by each country in 2020 are available on https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/european-semester-timeline/national-reform-programmes-and-stability-convergence-programmes/2020-european-semester_en.

² The DBP for 2020 submitted by each country is available on https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draftbudgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2020_en.

³ The communication by the COM is available on https://ec.europa.eu/info/sites/info/files/economy-finance/2_en_act_part1_v3-adopted_text.pdf.

⁴ The statement by the EU Council is available on <https://www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis/>.

⁵ The escape clause is set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97.

Article 8(2) of the Fiscal Responsibility Act (FRA) also makes reference to exceptional circumstances.⁶ The FRA defines exceptional circumstances as “a period during which an unusual event outside the control of the State has a major impact on the financial position of the general government, or a period of severe economic downturn within the meaning of the Stability and Growth Pact”. In turn, Article 13(2) of the FRA requires the Malta Fiscal Advisory Council (MFAC) to assess whether in its opinion “exceptional circumstances exist or have ceased to exist”. To this effect in Malta’s USP 2020 – 2021 it was stated that “any decision to activate the escape clause at a European level should have the same effect as a formal announcement by Government on the presence of exceptional circumstances. Indeed, the FRA defines exceptional circumstances in the same way as the SGP. In line with the Council agreement, the Government of Malta considers the current circumstances as exceptional.”⁷ The MFAC takes note of this declaration and confirms that on the basis of the available information and its own assessment, the likely severe economic shock which could result from the COVID-19 pandemic meets the requirements for this period to be classified as an ‘exceptional circumstance’.

As a result of the agreement at the European Council and the shared assessment by the MFAC, Malta, being under the preventive arm of the SGP, is allowed to temporarily depart from the Medium-Term budgetary Objective (MTO), provided that this does not endanger fiscal sustainability in the medium term.⁸ This concession introduces flexibility in the conduct of fiscal policy as the country is permitted to depart from its MTO of keeping a structure balance in its public finances.⁹ This is deemed justifiable to allow for the necessary expansionary revenue and expenditure measures to address the severe challenges created by COVID-19.

On 6 April 2020, the COM also provided guidelines on how the format and content of the 2020 Stability and Convergence Programmes can be streamlined in view of the exceptional circumstances related to the COVID-19 pandemic. The minimum

⁶ The FRA ACT XXVII of 2014 as amended by Act VII of 2018 is available on <http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=12215&l=1>.

⁷ Quote from page 9 of Malta’s USP 2020 – 2021.

⁸ For further details about the SGP refer to https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact_en.

⁹ Structural balance is defined as “the actual budget balance net of the cyclical component and one-off and other temporary measures. The structural balance gives a measure of the underlying trend in the budget balance”. Source: <https://ec.europa.eu/info/sites/info/files/economy-finance/glossary.pdf>.

guidelines have been agreed with the Economic and Financial Committee (EFC) and are in line with the requirements of Regulation 1466/97.¹⁰ These guidelines recognised that the exceptional circumstances made it very challenging for the countries to provide the standard set of data and commentaries in their reports. This document was also provided to the Independent Fiscal Institutions (IFIs) of which the MFAC is a member.

These guidelines made a concession for the countries to limit their forecasts to a two-year period (in this case 2020 and 2021) rather than for the standard four-year period. This option was taken up by MFIN. They also allowed for a streamlined version making it possible for some content to be dropped from the USP.¹¹ Importantly, it was permissible for countries not to calculate potential output and the output gap, particularly as the severe economic shock created technical challenges to arrive at meaningful and robust estimates in these circumstances.¹² Estimates of potential output and the output gap would have been necessary to evaluate compliance with the fiscal rules but such information became unnecessary when these rules were temporarily lifted, both under the European and the Maltese legislation.

However, there remained in place the requirement that whenever the official macroeconomic forecasts are produced by the government, which is the case in Malta, these must be endorsed by an independent institution. To this effect, the MFIN forwarded to the MFAC the first macroeconomic forecasts on 24 April 2020, and the final set of macroeconomic forecasts on 28 April 2020.

On 30 April 2020, the Chairman of the MFAC addressed a letter to the Minister for Finance and Financial Services, stating that “based on the information available to the Malta Fiscal Advisory Council, and after taking due consideration of the uncertainty inherent in macroeconomic forecasts, and the added uncertainty brought about by the COVID-19 pandemic, the Council considers the full set of scenario-based macroeconomic forecasts for the period 2020 to 2021 prepared by the Ministry for

¹⁰ The EFC is a committee of the EU set up to promote policy coordination among the Member States. For further details refer to https://europa.eu/efc/index_en.

¹¹ Content which was dropped from Malta’s USP include commentaries on sensitivity analysis, the sustainability of public finances, the quality of public finances and institutional features of public finances.

¹² Potential output refers to the level of real GDP that is consistent with a stable rate of inflation. If actual output rises above its potential level, then constraints on capacity begin to bind and inflationary pressures build; if output falls below potential, then resources are lying idle and inflationary pressures abate. The output gap refers to the difference between actual output and estimated potential output at a point in time. Source: <https://ec.europa.eu/info/sites/info/files/economy-finance/glossary.pdf>.

Finance and Financial Services as part of the Update of Stability Programme to lie within its endorsable range".¹³

The FRA requires that the fiscal forecasts are also assessed by the MFAC and endorsed as appropriate. However, there is no requirement that such endorsement should take place prior to the submission of the USP to the COM. As in previous years, the detailed fiscal forecasts were thus forwarded to the Council after the submission of the USP, and accordingly their assessment and endorsement is reflected in this Report.

This Report, whose cut-off date is 22 May 2020, presents the analysis carried out by the MFAC as part of the endorsement process, in relation to both the macroeconomic and the fiscal scenarios presented in the USP. **Chapter 2** reviews the methodologies, assumptions and baseline scenario adopted by the MFIN to prepare the official macroeconomic and fiscal forecasts. **Chapter 3** evaluates the expected trajectory for the various macroeconomic variables in 2020 and 2021, identifying possible upside or downside risks associated with the MFIN's baseline scenario. **Chapter 4** compares the latest macroeconomic forecasts with the previous vintage produced by the MFIN and with the other available forecasts which incorporate the economic impact of COVID-19. **Chapter 5** presents an overview of the fiscal outlook and examines the extent to which the MFIN's baseline scenario for the main revenue and expenditure components, and public debt, is consistent and plausible, and indicates the direction of risk where relevant. **Chapter 6** compares the MFIN's fiscal scenario presented in the USP to the previous vintage contained in the DBP, and the latest available fiscal forecasts which factor in the impact of COVID-19 on public finances. **Chapter 7** then presents the Report's conclusions and recommendations.

¹³ A copy of the letter is available on <https://mfac.org.mt/publications/reports/reports-2020/>.

Chapter 2

Forecast methodologies and assumptions

2.1 Preparation of the macroeconomic forecasts

The MFIN continued to generate the preliminary macroeconomic forecasts through the econometric model STEMM (Short-Term Quarterly Economic Forecasting Model).^{14,15} STEMM is a Keynesian model with output determined by aggregate demand. Equation re-estimations are carried out when necessary, to ensure that these adequately reflect the developments and structural changes in the Maltese economy, as well as to address material official data revisions which take place from time to time.

Regression estimates are complemented with expert judgement which is gained through regular discussions with key stakeholders. The latter include government departments, authorities and large firms. These meetings offer the opportunity to discuss prospects and gather information about key issues which might have a bearing on the economic outlook, particularly at a sectoral level. This reinforces the sectoral focus underpinning the modelling framework employed by MFIN. Such meetings play a significant role in shaping the MFIN's outlook particularly for employment, exports and investment plans for some key sectors, as these might be driven by very specific factors. Given the small size of the Maltese economy, such an approach is particularly useful as sector-specific developments can drive the economy-wide outturn, and model equations may not be able to capture such specificities.¹⁶

Owing to the rapidly evolving exceptional circumstances, characterised by the pandemic and the crisis measures implemented by governments worldwide, the role of expert judgement became more important for this forecast round in order to evaluate how such unprecedented developments could impact the various GDP components.

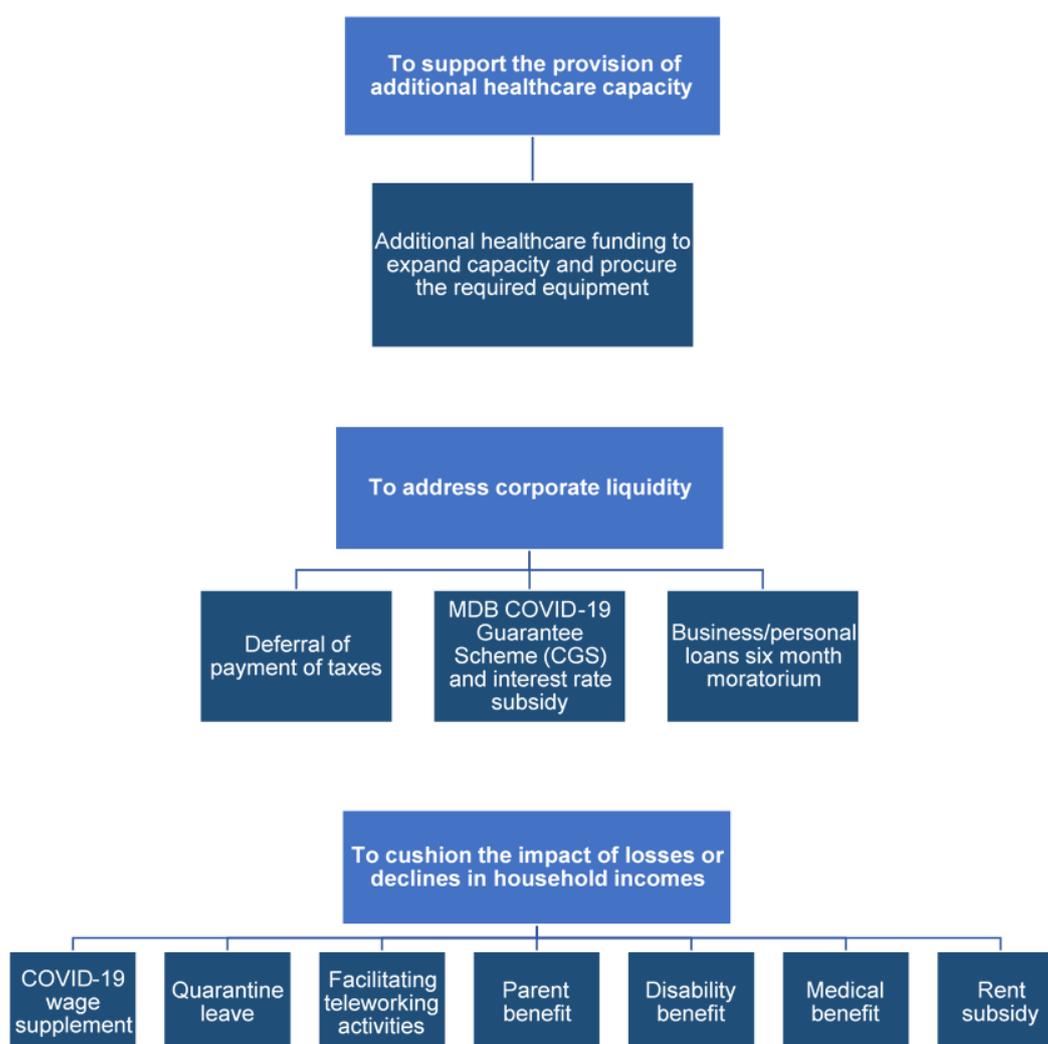
¹⁴ The model was originally developed in 2001 by the Economic Policy Department through the assistance of Cambridge Econometrics (UK). It is maintained on a regular basis by MFIN staff.

¹⁵ In July 2019 the MFIN published a report and a technical appendix outlining the key features of STEMM, including estimated equations and parameters. These documents are available on <https://mfim.gov.mt/en/epd/Pages/Library.aspx>.

¹⁶ The MFIN compiled a dossier with the relevant summary information collected from the stakeholders. Normally this dossier is forwarded to the MFAC, but since the information was collected prior to the first cases of COVID-19 in Malta, its content was superseded by events, and hence was not forwarded to the MFAC.

Important insight was gained by MFIN through the discussions with key stakeholders when the Government was drawing up the assistance packages to mitigate the economic shock created by COVID-19 (see Diagram 2.1). Apart from raising the budget allocation for the expansion of the additional health services, the main measures targeted primarily the facilitation of business cashflow and the provision of wage support for the effected workers. An important source of information for the forecast round was the number of businesses and workers which by the cut-off date of the forecast round had applied for the various types of financial assistance measures made available by the Government. This offered some indication of the extent of the immediate downside impact created by the pandemic.

Diagram 2.1: The main Government measures in response to COVID-19 17



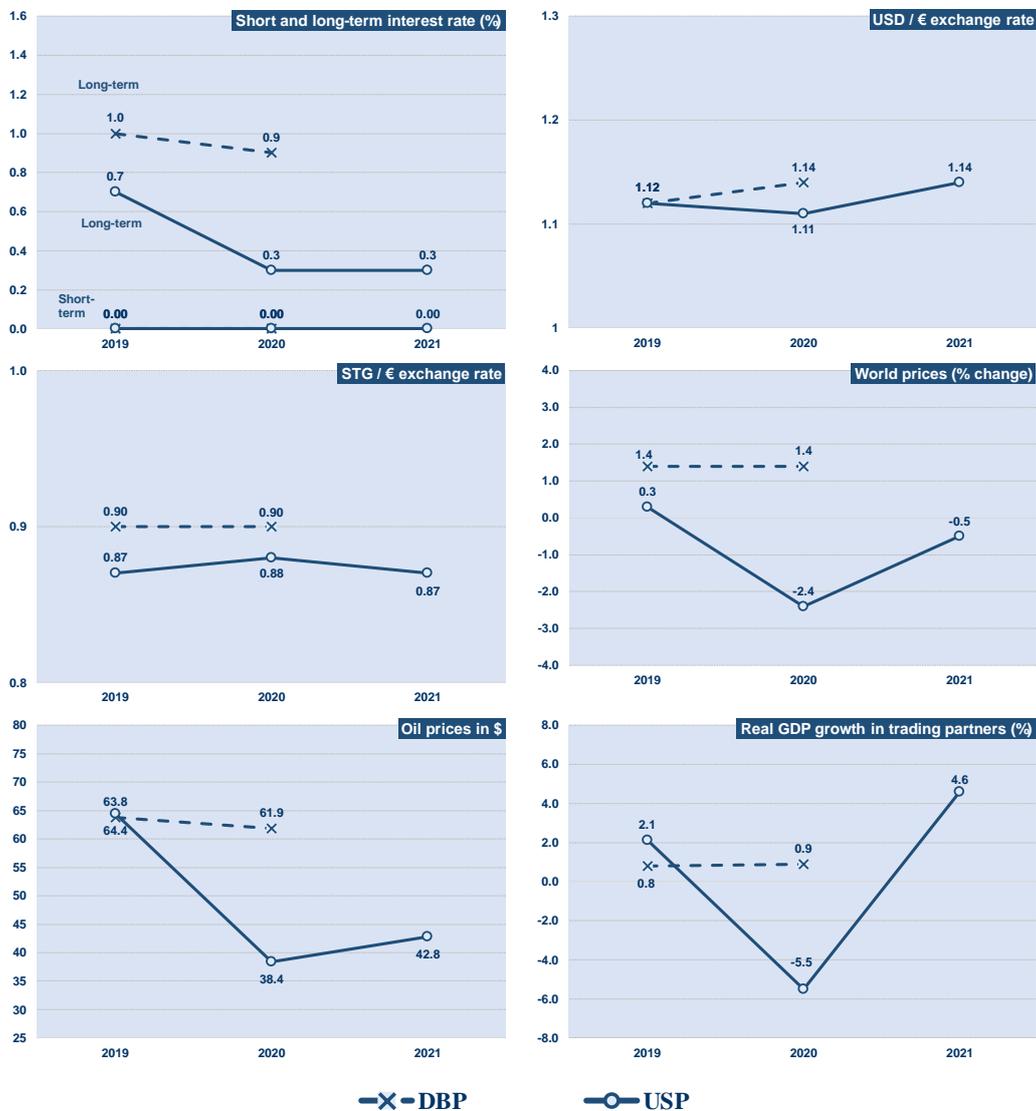
Source: MFIN

¹⁷ The list of measures implemented by the Government is provided in Table 1.1 and Table 1.2 of the USP 2020 – 2021.

2.2 Assumptions underpinning the macroeconomic forecasts

The MFIN adopt a set of assumptions for certain exogenous variables necessary to produce the macroeconomic forecasts and which are sourced from reputable sources. Chart 2.1 shows the trajectory of the exogenous variables used in the USP for 2020 – 2021 and compares them with the values used in the DBP 2020 (previous round). Normally the changes in the assumptions across the two forecast rounds would be contained, but in this case the changes are much more pronounced owing to the completely different economic circumstances as result of COVID-19.

Chart 2.1: Main macroeconomic assumptions



Note: 2019 refers to the estimated values while 2020 and 2021 are forecasts.

Source: MFIN

The exogenous variables are mainly related to the external sector. The assumptions specify the values for the short-term and long-term interest rates; the exchange rate of the euro with respect to the US dollar and sterling; world prices; oil prices and real GDP growth of Malta's main trading partners. The values for these exogenous variables are based on authoritative and reputable sources, predominantly from Consensus Economics (April 2020 edition), and in the case of the interest rate assumptions, from the European Central Bank (ECB). These assumptions have a cut-off date of 6 April 2020.

In view of the exceptional circumstances, the COM made available its own exogenous assumptions but the MFIN opted to continue using the same sources as in the previous forecast rounds, as the latter were more compatible with the modelling framework and equations used by the MFIN, and ensured consistency with the approaches used in prior rounds. Both sets exhibit similar patterns, but the values used are not identical. However, the MFAC considers this caveat of secondary importance since the role played by expert judgement and the choice of the baseline scenario by the MFIN played a bigger role in determining the macroeconomic forecast estimates presented in the USP.

Compared to the previous forecast round, the assumption of a zero per cent short-term interest rate has been retained. On the other hand, for 2020 the updated assumption for the long-term interest rate is lower than in the previous forecast round, at 0.3%, and assumed to remain the same in 2021.

In relation to the exchange rate, the euro is expected to depreciate slightly vis-à-vis the US dollar in 2020 and appreciate marginally in 2021. This contrasts with the expected euro appreciation indicated for 2020 in the DBP. The USP also assumes minimal changes in the euro-sterling exchange rate, though the euro is assumed marginally weaker than indicated in the DBP.

In contrast, there was a strong revision in the outlook for world prices, which the USP assumes will decline by 2.4% in 2020 and a further 0.5% in 2021. This contrasts with rising world prices which had been assumed in the DBP for 2020.

Major changes also relate to the assumed profile for oil prices. The USP assumes that oil prices will drop significantly in 2020, from \$64.4 per barrel in 2019 to \$38.4 per barrel and then to increase slightly in 2021, to \$42.8 per barrel. On the other hand, the

DBP had factored the oil price level for 2020 to be much higher than indicated in the USP.

With regards to external demand, which is proxied by the real GDP developments in Malta's main trading partners, the USP assumes a decline in real GDP of 5.5% in 2020, followed by a 4.6% rebound in 2021. The pandemic effects and mitigation measures worldwide changed completely the previous profile which was used in the DBP and which featured modest, yet positive rates of economic growth.

Another technical assumption relates to inventory adjustments.¹⁸ Inventories are assumed to generate no contribution to GDP growth throughout the forecast horizon. This pattern is normally employed in the USP, but differs from that used in the DBP, when intra-year developments permit the estimation of the inventory developments for the current year.

The elevated uncertainty created by COVID-19 necessitated additional assumptions, to be able to determine a plausible macroeconomic scenario to deal with the unprecedented situation whose effects were hard to quantify. Such considerations helped shape the MFIN's macroeconomic scenario for 2020 and 2021. These assumptions play a critical role, and follow a similar approach adopted by many other institutions, but their robustness is hard to assess in view of the constantly changing international and domestic circumstances.

The MFIN assumed that the economic shock emanating from COVID-19 "is a temporary shock and hence the impact on the longer-term outlook should remain limited". Furthermore, the MFIN's scenario factors in "the termination of the temporary social and economic support measures". The USP also states that "travel restrictions are assumed to start being gradually alleviated from summer, which is equivalent to a reduction of 43.5 per cent of the total number of inbound tourists in 2020". Underpinning the macroeconomic scenario presented by MFIN is that the gradual lifting of restrictive measures is not reinstated at a subsequent stage and that the economy does not suffer from another setback once the economic recovery is initiated. The MFIN also assumed that on average certain capital projects are only deferred by some 3 to 6 months.

¹⁸ Inventory changes include the effect of changes in actual inventories, as well as any statistical errors.

The combination of such assumptions presents a scenario which is broadly compatible with that underpinning the forecasts prepared by other independent institutions for Malta. This scenario also roughly corresponds to what has been labelled by the ECB as the 'mild scenario'.^{19,20}

Any significant departure from these assumptions could deviate the outturn, possibly significantly, from the outlook as presented in the official forecasts. To this effect, the USP indicates that an improved/worse global economic growth scenario, would add/deduct baseline real GDP growth by around one percentage point in 2020 and almost 3 percentage points in 2021. The USP also indicates that an adverse interest rate shock would have an impact contained to within one percentage point. However, in line with the COM's guidelines, the MFIN made use of the concession not carry out a full-scale sensitivity analysis corresponding to other alternative scenarios apart from indicating the possible impact of different foreign demand and interest rate assumptions.

2.3 The preparation of the fiscal forecasts

The preparation of the fiscal forecasts remained broadly the same as in previous rounds. However, in the context of the very fluid and uncertain conditions created by COVID-19, there was need to explore various scenarios up until the baseline scenario

¹⁹ For example, a research note prepared by ECB staff described three different illustrative alternative scenarios, which imply a range of economic effects spanning from mild to severe. In the 'mild' scenario, strict lockdown and further containment measures, as well as rapid advances in medical treatments, entail relatively short-lived strict lockdown periods (ending in the course of May 2020), a gradual return to normal activity thereafter and only temporary economic losses. In the 'medium' scenario, a short-lived strict lockdown period (also ending in the course of May 2020) is followed by relatively stringent and protracted containment measures, implying a delayed return to normal activity, as well as persistent output losses. In the 'severe' scenario, a longer-term strict lockdown period (ending in the course of June 2020) has only limited success in containing the spread of the virus, thus requiring ongoing tough containment measures to remain in place even after some loosening of the very strict lockdowns. The sustained efforts to prevent the spread of the virus would continue to significantly dampen activity across sectors of the economy until a vaccine (or another effective medical solution) were to become available. This is not expected to occur until around mid-2021. Therefore, this scenario envisages significant and permanent output losses. Source: https://www.ecb.europa.eu/pub/economic-bulletin/focus/2020/html/ecb.ebbox202003_01~767f86ae95.en.html?utm_source=ecb_linkedin&utm_medium=social&utm_campaign=200501_eb_box.

²⁰ The IMF also presented alternative scenarios to its baseline forecasts described as 'longer outbreak in 2020', 'new outbreak in 2021' and 'longer outbreak in 2020 plus new outbreak in 2021'. For further details refer to scenario box contained in chapter 1 of the World Economic Outlook (April 2020) available on <https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020>.

was selected. This was necessary to budget adequate resources for the temporary fiscal mitigation measures in place, and to ensure consistency with the macroeconomic outlook.

Government departments and entities provided their input through cash-based estimates of their anticipated revenues and expenditures. These cash-based forecasts are built on specific knowledge and information available at departmental level. These include past trends, expert judgment, knowledge about specific fiscal legislation, outstanding creditor and debtor balances and other ad-hoc factors. As in previous years, senior MFIN officials discussed and fine-tuned these projections, to ensure that these were as realistic as possible.

On the expenditure front there was close coordination across the public sector to ensure adequate additional funding for health and to cost the mitigation measures associated with the pandemic. There was strong involvement from the Ministry for Health to estimate the emergency additional spending on health-related compensation of employees, capital expenditure and intermediate consumption. Likewise, the Ministry for the Family, Children's Rights and Social Solidarity was greatly involved with respect to the costing of the additional social payments for income support. In turn, Malta Enterprise provided strong input for the estimation of the required budget for subsidies, since it acted as the lead entity responsible for the channelling of such payments to various enterprises. The costing of such measures relied on the estimated number of eligible beneficiaries and applied the same assumption vis-à-vis the duration of such measures.

This bottom-up approach was then supplemented with a top-down approach which is based on the European System of National and Regional Accounts (ESA). This process mainly related to the estimation of tax revenues where the bottom-up revenue forecasts were verified and fine-tuned with the estimated relationships between the fiscal variables and their respective macroeconomic proxy bases. The top-down projections act as an envelope, to ensure prudence and the overall consistency between the fiscal forecasts and the official macroeconomic outlook.

The fact that in recent years there has been an attainment, and in certain instances an overachievement of the headline targets for the fiscal balance and public debt, suggests that the current methodology used to forecast the various fiscal components is adequate and helps to achieve the targets. At the same time, the MFAC

acknowledges the major challenge associated with presenting a specific scenario for the additional COVID-19 spending in view of the open-ended programmes which were launched. Likewise, estimating the revenue performance during a pandemic is highly challenging as past empirical relationships (for example the relationship between indirect taxes and consumption, or corporate taxes and gross operating surplus) may be subject to change under these exceptional circumstances.

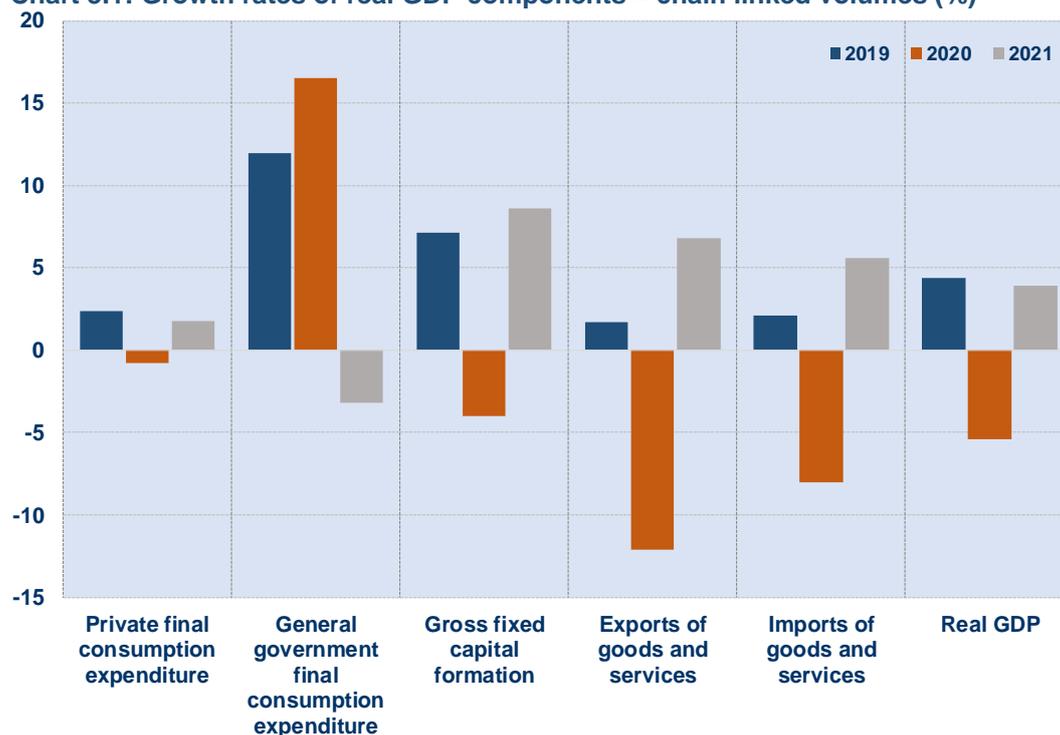
Chapter 3

Assessment of the macroeconomic forecasts 2020 – 2021

3.1 Macroeconomic outlook 2020 – 2021

Under the MFIN's baseline scenario, the Maltese economy is expected to experience a contraction in output in 2020, followed by a partial rebound in 2021.²¹ As a result of the impact which COVID-19 is expected to have on the economy, real GDP growth is expected to swing from 4.4% in 2019, to -5.4% in 2020, and 3.9% in 2021 (see Chart 3.1 and Table 3.1).²² Nominal GDP is also expected to follow a V-shaped pattern, moving from 6.8% growth in 2019, to a 3.6% drop in 2020, which is however anticipated to be fully recovered by a 5.9% expansion in the outer forecast year.

Chart 3.1: Growth rates of real GDP components – chain linked volumes (%)



Source: MFIN

²¹ The USP provides one scenario and therefore the figures can be interpreted as forecasts. The terms scenario, forecasts and projections are used interchangeably in the Report.

²² Figures for 2019 refer to the provisional data published by the NSO on 28 February 2020 (News Release 034/2020), while figures for 2020 and 2021 are the forecasts prepared by MFIN.

Table 3.1: Macroeconomic variables 2019 – 2021 (%)

	2019	2020	2021
<u>Real GDP components</u>			
Private final consumption expenditure*	2.4	-0.8	1.8
Gen. govt. final consumption expenditure	12.0	16.5	-3.2
Gross fixed capital formation	7.2	-4.0	8.6
Exports of goods and services	1.7	-12.1	6.8
Imports of goods and services	2.1	-8.0	5.6
Real GDP	4.4	-5.4	3.9
<u>Contribution to real GDP growth</u>			
Domestic demand (pp)	4.3	1.8	1.8
Inventories (pp)	0.2	0.0	0.0
Net exports (pp)	-0.1	-7.2	2.1
<u>Deflators</u>			
Private final consumption expenditure	1.5	1.2	1.5
Gen. govt. final consumption expenditure	2.4	2.0	2.4
Gross fixed capital formation	3.5	3.1	3.5
Exports of goods and services	1.9	0.8	1.1
Imports of goods and services	1.7	1.2	1.3
GDP deflator	2.3	1.8	2.0
<u>Labour market</u>			
Employment (National Accounts definition)	5.7	-3.3	3.2
Unemployment rate (%) (LFS definition)	3.4	5.9	3.7
Nominal compensation of employees	7.6	-1.8	6.0
Nominal compensation per employee	1.8	1.6	2.8
Labour productivity**	-1.2	-2.2	0.7
<u>Other macroeconomic variables</u>			
Inflation rate (%) (based on the HICP)	1.5	1.0	1.4
Nominal GDP	6.8	-3.6	5.9

Note: figures for 2020 and 2021 are forecasts

* includes NPISH

** real GDP per person employed

Source: MFIN

Growth trajectories over the projection horizon vary across the real GDP expenditure components. In 2020, only government consumption is expected to grow on a year earlier. Indeed, government consumption is projected to accelerate further on the double-digit growth recorded in 2019. This should be seen in view of the initiatives undertaken by the Government to address the challenges posed by COVID-19. This factor creates a base effect, which combined with a certain element of envisaged expenditure restraint, explains the small decline in government consumption anticipated in 2021.

Private consumption exhibits the least variation under the baseline scenario, declining marginally in 2020, and growing slightly more in 2021. The projected trajectory for gross fixed capital formation shows a similar pattern. However, the swings are larger as investment is modelled to react more strongly to the shock and subsequent recovery. In turn, exports, which include tourism, are expected to register the largest decline in 2020, as under the MFIN's baseline scenario they are the worst hit by the pandemic from an economic perspective. In contrast with the previous expenditure components, the export growth forecast for 2021 only allows for a partial recovery from the adverse shock in 2020. Such developments in domestic demand and exports are estimated to lower the volume of imports in 2020, but in the following year, imports are set to rise again, albeit not to the same extent as the original drop.²³

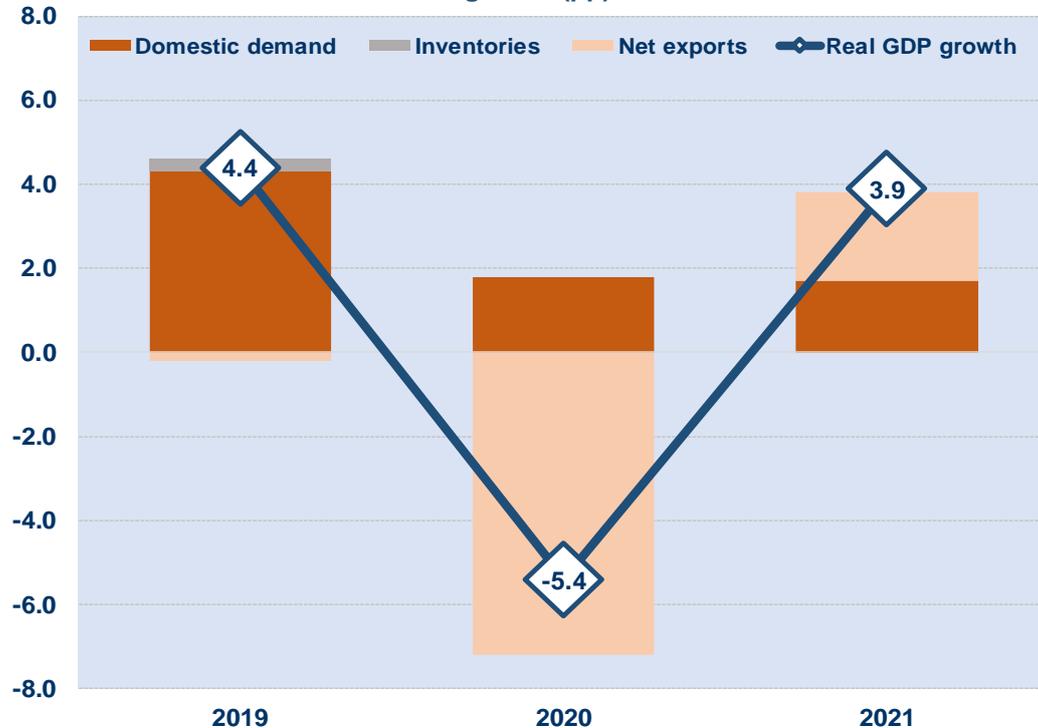
Despite the economic shock, in 2020 domestic demand is still expected to contribute positively to real GDP growth. The baseline scenario allows for the expansion in government consumption to fully compensate for the anticipated declines in private consumption and investment (see [Chart 3.2](#)). The drop in real GDP in 2020 is thus fully attributable to the large downside impact created by net exports.

The contribution to growth resulting from domestic demand in 2021 is expected to remain stable when compared to the previous year. The scenario is characterised by an anticipated upswing in private consumption and investment which offsets the scaling back in government consumption. On the other hand, net exports are expected to contribute positively to real GDP growth in 2021. This development explains the anticipated real growth for the outer forecast year. In turn, inventories are assumed to

²³ Given the high import content of gross fixed capital formation and exports in Malta, developments in these components play a significant role in influencing import growth dynamics.

exert no impact over both forecast years, which is the standard assumption employed by MFIN in the April forecast round.

Chart 3.2: Contributions to real GDP growth (pp)



Source: MFIN

An assessment of the forecasts for the various macroeconomic variables follows (see Chart 3.3). The analysis evaluates the extent to which the baseline scenario presented in the USP is plausible and internally consistent, and to assist the Fiscal Council in the identification of any possible upside or downside risks.

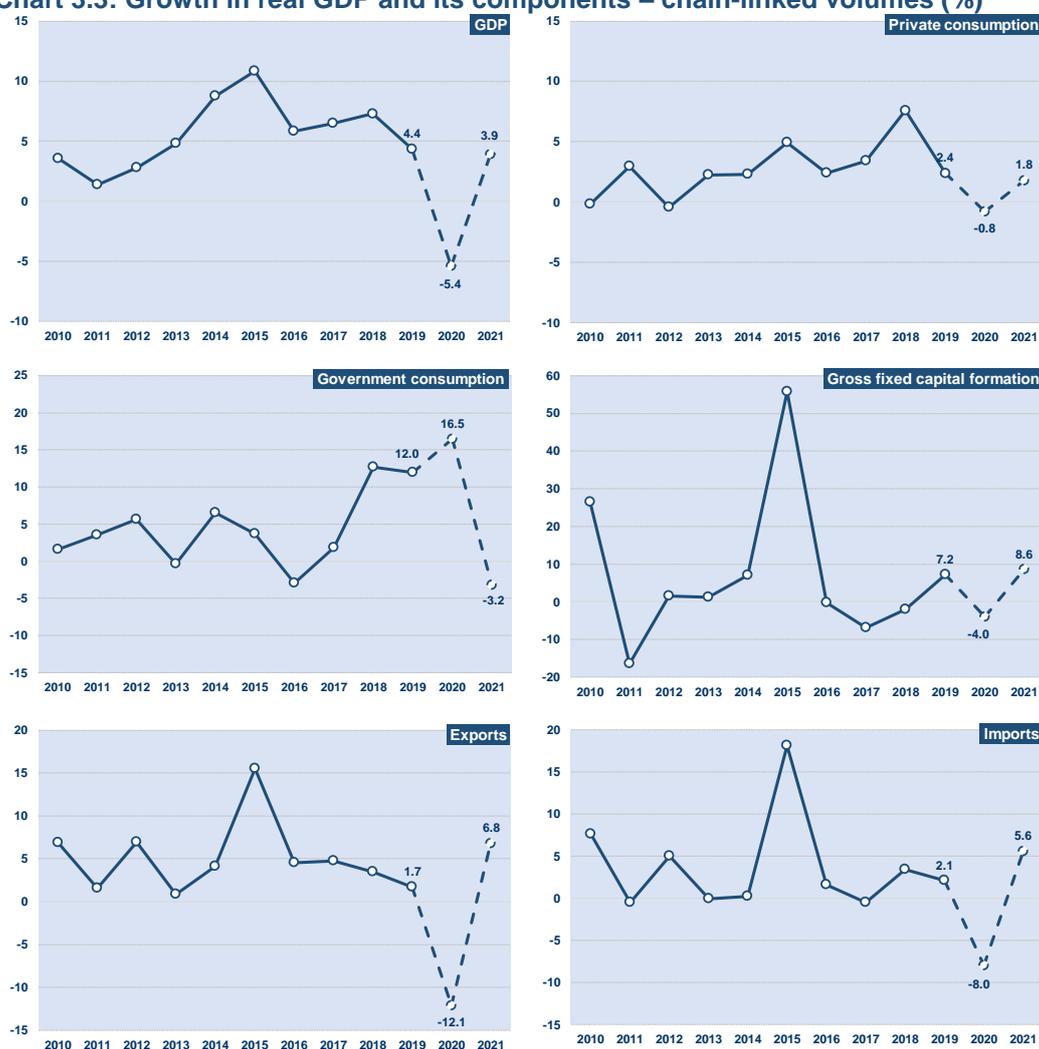
3.2 Private consumption

In 2020 private consumption is forecast to drop by 0.8% in real terms, while in 2021 it is expected to rise by 1.8%. The MFIN's scenario portrays a limited drop in household consumption, followed by some recovery, albeit to a rate of growth below those recorded during the previous five years.

The anticipated minor decline in consumption is supported by the adverse shock impacting its key determinants. Employment is expected to drop by 3.3%, lowering compensation of employees by 1.8% in nominal terms. The drop in real income is

larger, due in part also to the concurrent 1.2% estimated rise in the consumption deflator. Downward pressure on consumption expenditure is also consistent with the possible reduction in the size of the population in Malta, in view of the departure of some foreign workers from the country. A weakening of consumer confidence may also be brought about by the higher unemployment rate, as this is forecast to rise from 3.4% in 2019, to 5.9% in 2020. Another factor which the Fiscal Council considers relevant is that the full, or partial, closure of certain retail outlets and household services, which took place during some months of 2020, might have had an impact by restraining consumption of certain goods and services.

Chart 3.3: Growth in real GDP and its components – chain-linked volumes (%)



Source: NSO, MFIN

The projected marginal rise in private consumption in 2021 reflects the limited base effect of a year earlier and is compatible with the economic recovery considered in the

MFIN's baseline scenario. Indeed, job losses are expected to be practically fully reversed, as employment is forecast to rise by 3.2% on a year earlier. Consequently, the unemployment rate is expected to fall to 3.7%. Meanwhile, compensation of employees is expected to rise by 6.0% in nominal terms, and slightly less in real terms, in view of the 1.5% rise in the consumption deflator.

The outlook for private consumption, characterised by a marginal decline in 2020 and a recovery in 2021, is internally consistent with the expected dynamics of the rest of the economy as projected in the MFIN's baseline scenario. The slight decline in 2020 is compatible with the assumption that the adverse shock on private consumption created by the temporary restraints and income losses are to a significant extent cushioned by a more benign outturn during the months when such restraints are less severe or lifted completely, and incomes start to recover. This scenario is consistent with the possibility of a certain degree of consumption smoothing, also facilitated by the support measures offered by the government. In turn, the base effect created by the negative shock in 2020 offers support to the consumption recovery anticipated in 2021, conditional on the labour market responding positively to the fading away of the economic shock, and household behaviour reverting rather rapidly to past patterns.

3.3 Government consumption

Real government consumption is expected to grow by 16.5% in 2020 but it is then projected to contract by 3.2% in 2021. The MFIN's scenario portrays an extension of the double-digit growth recorded in 2019 and some retrenchment in the outer forecast, as a result of the base effect created by the COVID-19 related expenditure in 2020.

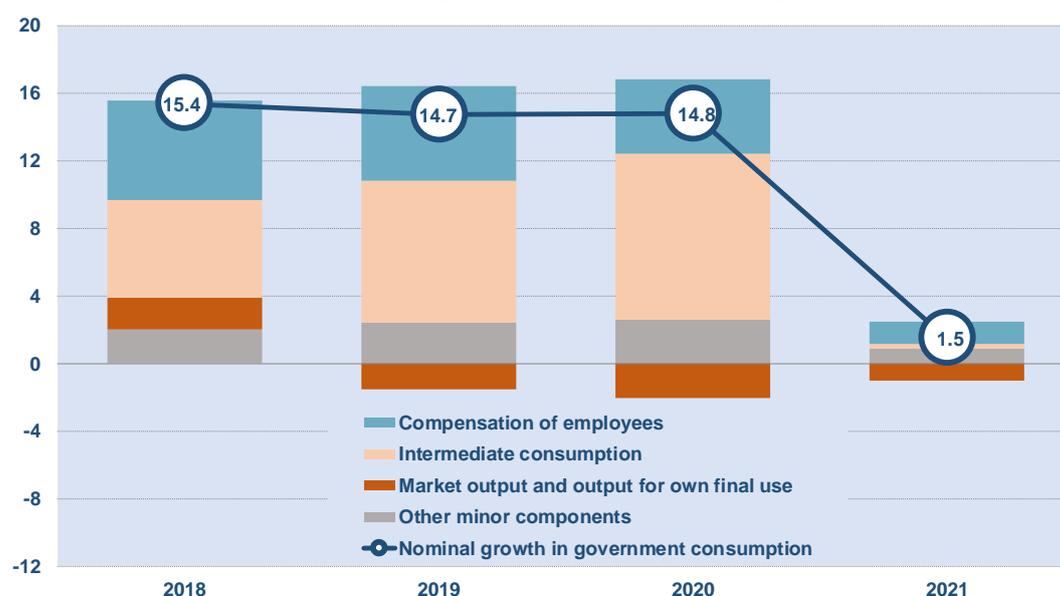
The reasons for the elevated growth in 2020 and the subsequent deceleration in 2021 can be traced to the government's fiscal plans and their resulting impact on the components making up government consumption.²⁴ The caveat is that data for such variables are only available in nominal terms. The materialisation of these plans would contribute to an estimated 14.8% growth in nominal government consumption in 2020, which is comparable to the 14.7% nominal growth recorded a year earlier (see [Chart 3.4](#)). A slightly stronger contribution to growth driven by intermediate consumption is

²⁴ Refer to chapter 5 in this Report for an assessment of the forecast trajectory for the relevant budget components.

broadly compensated for by a smaller contribution from compensation of employees. Otherwise, the growth in government consumption attributable to the remaining components is expected to be broadly similar as in 2019.²⁵ On the other hand, the deceleration in government consumption growth projected for 2021 reflects the planned containment in expenditure growth, with intermediate consumption experiencing the sharpest deceleration.

COVID-19 has resulted in higher health-related expenditure by government, thereby creating upward pressure primarily on intermediate consumption but also on public sector compensation of employees. The non-repetition of such expenditure paves the way for the scaling back of government consumption in 2021, as indicated in the baseline scenario.

Chart 3.4: Breakdown of nominal government consumption growth (pp, %)



Source: MFIN

3.4 Gross fixed capital formation

Gross fixed capital formation is expected to drop by 4.0% in 2020. Although public investment is expected to be higher than in 2019, this effect is overshadowed by the

²⁵ When estimating the value of government consumption, market output is deducted from the other expenditure components. Since the USP assumes that in 2020 market output will be more than in 2019, this corresponds to a deduction of a larger value, thus explaining the downward push to government consumption resulting from market output. This pattern was also recorded in 2019 and is expected to be repeated also in 2021.

expected decline in private investment. The MFIN's forecasts factor in the scenario whereby the pandemic weighs in on investor appetite in the short term. Nevertheless, it is assumed that the planned private sector projects are only postponed by a few months, thereby spilling onto the following year. This justifies why the investment downturn is expected to be more than fully reversed in 2021, with investment growing by 8.6% in real terms. The latter builds on the materialisation of several large-scale investment projects particularly in transport and aviation, tourism, real estate and health sectors. Such recovery is driven entirely by the private sector, as public investment is expected to be slightly lower than the year before, as a result of the non-recurrence of the exceptional pandemic-related capital expenditure.

Between 2015 and 2019, investment was the most volatile GDP component, with changes sometimes driven by lower public investment and in other cases attributable to lower private investment. This domestic demand component has thus experienced declines even during normal years. Indeed, gross fixed capital formation has exhibited significant swings across the years, making it challenging to achieve accurate forecasts for this GDP expenditure component. Moreover, it should be acknowledged that the assumption of high import content adopted by the MFIN for investment reduces the risk that forecast errors in this area spill unto the overall GDP growth forecasts.

In the context of the exceptional circumstances and associated high level of uncertainty, the investment decline described in the MFIN's baseline scenario for 2020 is considered to be plausible. In turn, the assumption employed by MFIN that the economic shock of COVID-19 is a temporary shock, such that its impact on the longer-term outlook should remain limited, paves the way for the anticipated rebound in 2021.

3.5 Exports of goods and services

According to the MFIN's scenario, in 2020 exports are expected to suffer the largest hit among the different GDP components, dropping by 12.1% in real terms. A 6.8% partial rebound is then forecasted for 2021. This scenario presents larger swings in Malta's exports when compared to the contraction and subsequent expansion of Malta's main trading partners, which was respectively estimated at -5.5% for 2020 and 4.6% for 2021. This pattern reflects the strong downside impact caused by the temporary lockdown on tourism activities during part of 2020, as well as the prospects vis-à-vis specific export-oriented sectors. It is also consistent with the empirical income

elasticity for Malta's exports which is higher than unitary with respect to foreign demand.²⁶ On the other hand, the exchange rate assumptions in the USP introduce rather limited changes and thus exert marginal effects on export dynamics over the forecast horizon.

The scenario is characterised by broad-based declines across the main export categories in 2020. An important contributor to the downside effect is created by the temporary complete halt of the tourism activities in place for certain months of the year. This effect is however partially dampened by the expectation of continued, albeit slower, growth in the remote gaming and other services sectors. In turn, the anticipated export recovery in 2021 is broad-based as all sectors are expected to register growth.

Owing to the small size of the economy, the performance of certain operators has the potential to create a large impact on the overall outturn. The assumed resilience of the remote gaming and other services sectors plays a determining role in cushioning the adverse shock which hit heavily the tourism sector. At the same time, operating within the complex network of global supply chains, adds to the uncertainty as the performance is highly dependent on the pace at which countries move from one phase to another of the pandemic emergency, and the activities which in turn are prioritised or prove to be more agile.

3.6 Imports of goods and services

In 2020 imports are forecast to decline by 8.0% in real terms, and then grow by 5.6% in 2021. These forecasts are significantly influenced by the import content assumed by MFIN for the domestic demand components and exports. Hence, any deviation from the anticipated profile for these expenditure components could have a material impact on the growth rates for imports over the forecast horizon.

The lower volume of imports in 2020 is compatible with the contraction in domestic production as a result of COVID-19. The main declines can be traced to capital goods, intermediate goods and fuel. These outweigh the increases across some other categories, notably on 'other' goods and services. On the other hand, the increase in

²⁶ Income elasticity is defined as the responsiveness of demand when income changes. The higher the income elasticity, the more sensitive demand for a product is to changes in income.

imports anticipated for 2021 is spread across all categories, with capital goods and 'other' business services being the main contributors.

3.7 Inflation and GDP deflators

The annual inflation rate, based on the HICP, is expected to remain low but still positive. The MFIN's scenario points to a deceleration in inflation from 1.5% in 2019 to 1.0% in 2020, followed by a small pick-up, to 1.4% in 2021.

In turn, developments in the GDP deflator over the forecast horizon are expected to mirror the patterns observed in recent years, despite the assumption of falling world prices. The GDP deflator is thus forecast to rise by 1.8% in 2020 and 2.0% in 2021. This builds on the scenario where the deflators for the various GDP components similarly maintain stable patterns vis-à-vis recent years. Both in 2020 and 2021 the investment deflator is expected to rise fastest, respectively by 3.1% and 3.5%, with the other deflators experiencing positive yet lower rates. The MFIN's scenario also indicates a slight deterioration in the terms of trade, as import prices are set to rise marginally faster than export prices over the forecast horizon.

The relative stability in the growth rates of the various deflators stands out against the background of strong swings in the different GDP components. The baseline scenario presents a situation where the adjustments to the economic shock take place via changes in activities, with limited impact on price dynamics. This approach was used for the full set of GDP expenditure components, thereby achieving consistency in terms of the underlying view of prices remaining relatively stable in the short term notwithstanding the economic implications of COVID-19.

3.8 Labour market

In 2020 employment is expected to decline by 3.3%, which is a smaller percentage than the 5.4% decline in real GDP. Indeed, the MFIN's scenario takes into account the various government initiatives aimed at safeguarding jobs. Under this scenario the retention of labour leads to lower productivity in 2020. Job losses are mostly concentrated in the tourism and manufacturing sectors. The downside effect on employment is partially mitigated by an expansion in public sector employment. The

job losses in 2020 are expected to raise the unemployment rate to 5.9% but this is anticipated to fall back to 3.7% by 2021. Indeed, employment is expected to rise by 3.2% in 2021, with the expansion distributed across all sectors, and tourism accounting for the largest share of job creation.

The relative resilience of the job market portrayed in the USP's scenario is consistent with the assumption that the adverse shock is only of a temporary nature and factors in the various job-support measures which are in place. Such resilience could become harder should the duration of the restraints on economic activity extend beyond what is factored in the MFIN's scenario.

3.9 Macroeconomic risk outlook

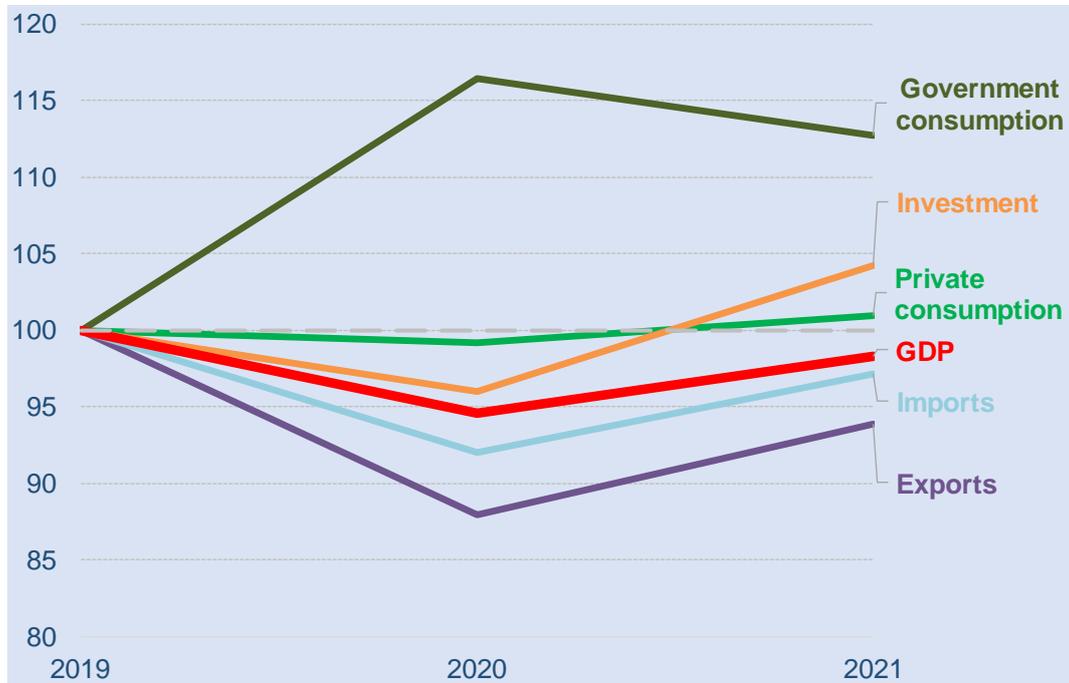
Owing to the highly uncertain duration and the severity of the COVID-19 effects, both from a health and economic perspective, the MFAC's risk outlook focuses on the joint profile pattern for each GDP component over the two forecast years rather than for each year separately (see [Chart 3.5](#)). The macroeconomic outlook is very sensitive to the assumptions employed, especially those related to the timing of recovery from COVID-19. Any material departure from such assumptions could deviate the outcome, possibly significantly, from those presented in the official forecasts.

The baseline scenario put forward by MFIN indicates very smooth consumption, resilient in 2020 and in 2021 recovering to slightly above the level prior to the shock. However, there is a risk that the drop in private consumption could be larger than expected in 2020, and this would create a negative base effect for the outer forecast year, making it more challenging to attain a level above that in 2019.

Likewise, there are downside risks vis-à-vis the investment profile. The decline in investment may be more pronounced and the subsequent recovery less vigorous. This risk emanates principally from the strong assumption employed by the MFIN that the investment plans made prior to the pandemic only experience delays ranging few months. Downside risks would follow in the eventuality that some of the planned projects are downscaled or postponed by a longer period than anticipated by the MFIN, and thus beyond the forecast horizon. The projected containment in the investment decline in 2020 and the successive rebound in 2021 may thus prove challenging to

attain, thereby placing downside risks for investment growth throughout the forecast horizon.

Chart 3.5: Real GDP components (2019 = 100)



Source: MFIN

Further downside risks relate to the export profile. This is mainly in view of the downside effect which would arise with any delay in the restart of tourism activities beyond that assumed in the baseline scenario. Additional downside risks could stem from sharper declines in foreign demand for Malta's exports, should global supply chains post COVID-19 operate with greater domestic production and less international trade.

Owing to the import content associated with private consumption, investment and exports, the downside risks related to these expenditure components translate into downside risks also for imports, which as a result, partly mitigate the downside risk on the GDP growth projections.

The assessment of the fiscal scenario, characterised by a surge in 2020, and limited retrenchment in 2021, points towards upside risks with respect to the profile for government consumption. Such risks mainly stem from the possibility that the necessary measures implemented by the Government could be higher than planned. The extent to which spending growth can be slowed down so suddenly also appears

rather ambitious when observing that even in pre-COVID years, high growth was recorded and there could be demands for higher public sector involvement.

The assessment carried out on the individual expenditure components suggests an overall downside risk outlook vis-à-vis the profile for real GDP for the period 2020 and 2021 (see Table 3.2). However, this downside risk is deemed to be contained in view of the fact that other reputable institutions producing macroeconomic forecasts, and which have factored in the impact of COVID-19 have produced a range of forecasts which are either very similar or actually more optimistic than the scenario presented by the MFIN.²⁷

Table 3.2: Summary of risks to the GDP expenditure components

	2020 – 2021
Private final consumption expenditure	⇓
General government final consumption expenditure	⇑
Gross fixed capital formation	⇓
Exports of goods and services	⇓
Imports of goods and services	⇓
Real GDP	⇓

Note: ⇔ indicates neutral risks, ⇑ indicates upside risks and ⇓ indicates downside risks.

Source: MFAC

²⁷ Refer to chapter 4 in this Report for the comparison with respect to the macroeconomic forecasts produced by the other institutions. Owing to the fluidity of the situation, the publication date of such forecasts is very relevant as the likelihood of certain scenarios can change depending on the progress of the pandemic and the policy decisions taken by governments worldwide.

Chapter 4

Comparison across different macroeconomic forecasts

4.1 Introduction

The macroeconomic scenario presented in the USP 2020 – 2021 can be further assessed by examining the similarity or otherwise with respect to the forecasts for the Maltese economy which are produced by other reputable institutions. Specifically, the macroeconomic forecasts presented in the latest USP are compared with those produced by the MFIN as part of the DBP 2020 (previous forecast round), and the forecasts by other institutions which by the Report's cut-off date (22 May 2020) had already factored in the economic impact of COVID-19 on Malta's economic outlook.²⁸ The latter include the macroeconomic forecasts produced by the COM, IMF, and two credit-rating agencies (Fitch and Moody's). The forecasts produced by other institutions, namely the Central Bank of Malta (CBM), and the remaining two major credit rating agencies (Standard and Poor's and DBRS) are not discussed in this Report since these did not yet include the impact of COVID-19 by the above-mentioned cut-off date.²⁹ The caveat remains that even the sets of alternative forecasts which are included and discussed in this Report may not necessarily be directly comparable, due to different information available at the time of publication, and the scenarios considered, particularly on the resulting economic implications of the ongoing COVID-19 pandemic. Other differences may also arise due to the different assumptions and methodologies employed by the various institutions. Nonetheless, the MFAC considers such comparisons as a valid benchmark to support the qualitative assessment carried out in Chapter 3.

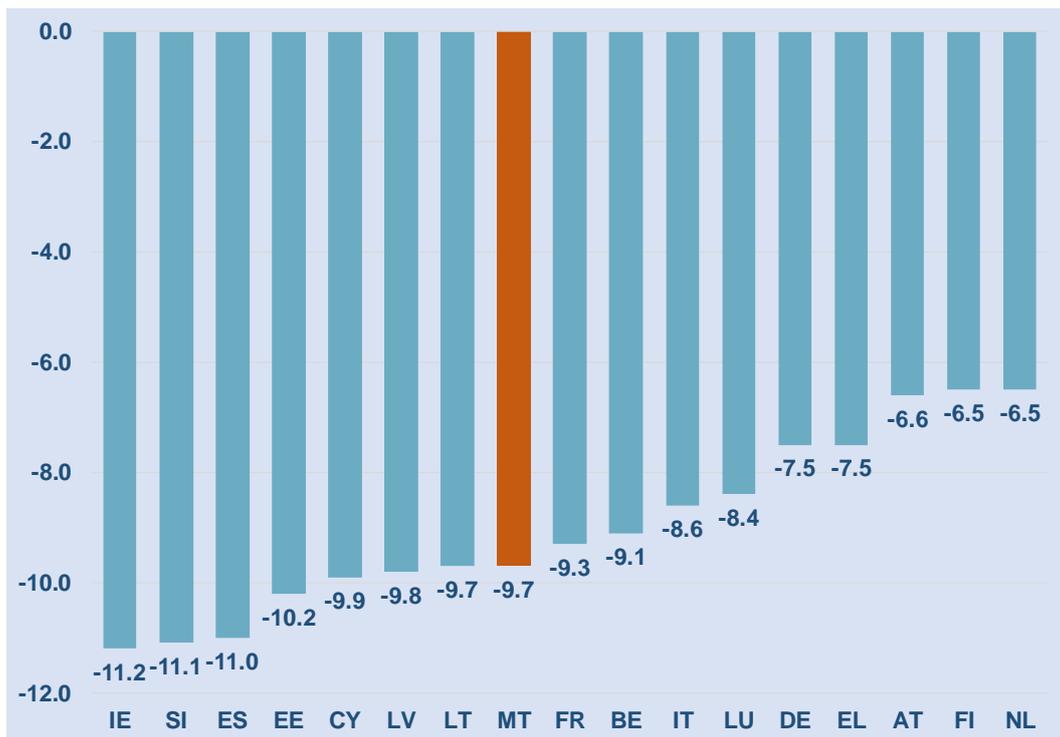
²⁸ The comparison between the projections contained in the USP and the forecasts in the DBP shows the magnitude of adverse shock created by COVID-19 on the various GDP components using the same models and prepared by the same institution.

²⁹ The latest CBM forecasts (published on 21 April 2020) show real GDP growth in 2020 and 2021 respectively at 3.8% and 3.6%. The CBM however stated that as a result of the containment measures imposed by the government, real GDP growth could fall by around 3.5 pp. The latest available forecasts by Standard and Poor's (published on 13 March 2020) show real GDP growth for Malta at 2.0% in 2020 and 3.7% in 2021. DBRS (published on January 2020) did not specify the real GDP growth forecasts for these two years.

4.2 Comparison with the DBP 2020

The 5.4% decline in real GDP for 2020, represents a downward revision of 9.7 percentage points (pp) compared to the previous vintage (see Table 4.1). In Malta's case, the difference between the forecasts contained in the DBP and the USP is close to the average downward revision noted across the other euro area countries (See Chart 4.1).

Chart 4.1: Revisions in real GDP growth between the USP and DBP (pp)



Note: The USP for Portugal and Slovakia were not available on the COM's dedicated website for the 2020 European Semester.

Source: DBP and USP of euro area countries

When compared to the DBP, Malta's USP reconfirms domestic demand as the main source of growth for 2020, with its intensity however being significantly moderated. This downward re-assessment reflects the change to negative growth in the updated outlook for private consumption and gross fixed capital formation, which is partially dampened by the anticipated stronger growth in government consumption. A significant revision was also carried out with respect to net exports, which in the DBP were anticipated to exert a marginal negative impact on GDP, but which in the USP are pulling growth strongly downwards. The latter reflects the larger contraction in exports than in imports which is factored in the USP.

Table 4.1: Macroeconomic forecasts by the MFIN and COM (%)

	2020			2021	
	MFIN DBP	MFIN USP	COM SPR	MFIN USP	COM SPR
<i>Growth rate in GDP components in real terms</i>					
Private consumption	4.0	-0.8	-5.0	1.8	4.0
Government consumption	4.9	16.5	12.8	-3.2	-1.2
Gross fixed capital formation	9.7	-4.0	-7.0	8.6	5.0
Exports of goods and services	1.6	-12.1	-9.3	6.8	12.0
Imports of goods and services	2.0	-8.0	-7.2	5.6	10.8
Real GDP	4.3	-5.4	-5.8	3.9	6.0
<i>Contributions to real GDP growth</i>					
Domestic demand (pp)	4.5	1.8	-1.3	1.8	2.4
Inventories (pp)	0.0	0.0	-0.1	0.0	0.1
Net exports (pp)	-0.2	-7.2	-4.4	2.1	3.4
<i>Deflators</i>					
Private consumption	1.4	1.2	-	1.5	-
Government consumption	2.3	2.0	-	2.4	-
Gross fixed capital formation	3.2	3.1	-	3.5	-
Exports of goods and services	2.2	0.8	-	1.1	-
Imports of goods and services	2.2	1.2	-	1.3	-
GDP	2.1	1.8	1.8	2.0	1.3
<i>Other macroeconomic variables</i>					
Inflation rate (HICP)	1.6	1.0	0.7	1.4	1.1
Employment growth*	4.1	-3.3	-1.8	3.2	2.8
Unemployment rate	3.5	5.9	5.9	3.7	4.4
Compensation per employee	2.8	1.6	3.4	2.8	2.8

* Figures may not be directly comparable due to different definitions used by the institutions.

Sources: MFIN, COM

The price dynamics have been mostly retained across the two forecast rounds. Growth in the 2020 GDP deflator was only lowered from 2.1% to 1.8%. Indeed, the change in the various expenditure deflators was broadly limited, in line with the scenario considered by MFIN whereby COVID-19 plays a rather limited effect on prices. The labour market impacts of COVID-19 are stronger, where the revised outlook is significantly negative and contrasts with the positive sentiment presented in the previous forecast round. Employment is thus no longer expected to expand by 4.1% but rather that it will contract by 3.3%. As a result, the unemployment rate has been raised from 3.5% in the DBP to 5.9% in the USP. In view of the active fiscal measures implemented to mitigate the effects of COVID-19, the positive growth rate in the compensation per employee was however retained across the two forecast rounds, albeit revised slightly downwards, from 2.8% to 1.6%.³⁰

4.3 Comparison with the forecasts produced by other institutions

The scenario presented in the USP and the Spring forecast round by the COM both use the data up to the fourth quarter of 2019 as published by the NSO (News Release 034/2020).³¹ Since both forecasts were prepared at approximately the same time, they are the most comparable, as they are based on similar information sets and external assumptions.

The magnitude of the 2020 expected contraction in real GDP is very similar across the two sets of forecasts, although that by the COM, estimated at 5.8%, is 0.4 pp more than that indicated in the MFIN's scenario. On the other hand, for 2021 the COM anticipates a full recovery, in view of the 6.0% forecast growth in real GDP, compared to the more conservative 3.9% upswing indicated by the MFIN.

The main difference between the COM's and the MFIN's outlook relates to domestic demand, whose contribution to real GDP growth for 2020 is anticipated to be negative by the former and positive by the latter. In turn, this divergence mainly stems from the significantly worse outlook for private consumption by the COM, which expects a drop of 5.0% in 2020 rather than the 0.8% fall indicated in the MFIN's scenario. There is

³⁰ The interplay between changes to the numerator (different sectoral wages) and change to the denominator (particularly the fall in employment) contribute to such dynamics.

³¹ The forecasts by the COM are available on https://ec.europa.eu/economy_finance/forecasts/2020/spring/ecfin_forecast_spring_2020_mt_en.pdf.

also a discrepancy in the outlook over the forecast horizon, in that by 2021 the MFIN places the level of private consumption again above the 2019 level (pre-COVID-19) whereas the COM anticipates that private consumption would still be below that level since the forecast growth rate in 2021 is less than the previous year's anticipated decline.

The COM's expected decline in gross fixed capital formation for 2020 also exceeds that estimated by the MFIN. Furthermore, the COM's forecast for 2021 shows a smaller pick-up in investment than considered by the MFIN. Thus, even in this case, there is some discrepancy. Whereas the MFIN's scenario is characterised by investment reverting higher in 2021 than in 2019, this would not be the case according to the COM's forecasts.

The COM's forecasts thus corroborate the downside risk vis-à-vis the profile for private consumption and gross fixed capital formation as indicated by the MFAC in its qualitative assessment carried out in Chapter 3 of this Report.

In the case of exports, both the COM and the MFIN expect a sharp contraction in 2020 and a rebound in 2021. However, the COM's export forecasts are relatively more optimistic since the decline is less pronounced and the subsequent increase is stronger vis-à-vis the MFIN's scenario.

On the other hand, there is broad similarity in the case of government consumption which both institutions see as rising rapidly in 2020, and to experience negative growth in 2021. The growth rates are also within close range to each other.

The combined forecasts for the individual domestic demand components and exports result in a slightly different profile for imports over the forecast horizon. While both institutions anticipate a decline and subsequent recovery in the outer forecast year, the COM's forecasts place the volume of imports (in level terms) in 2021 above that in 2019, which is not the case under the MFIN's scenario.

The COM's baseline forecasts thus do not replicate the possible downside risks to the trajectory for exports and imports, as well as the upside risks to government consumption, which were considered by the MFAC in Chapter 3.

With respect to the remaining macroeconomic variables, namely in relation to price and labour market dynamics, there are no material differences between the COM and the MFIN, with the outlook broadly shared by both institutions.

The other real GDP forecasts for the Maltese Economy which allow for meaningful comparisons (because they directly factor in the impact of COVID-19) are those produced by the IMF in its April 2020 World Economic Outlook and by the credit rating agencies Fitch and Moody's (see Chart 4.2).^{32,33} The IMF estimated Malta's real GDP to contract by 2.8% in 2020 and then to rebound strongly, by 7.0% in 2021. The IMF's forecasts are thus the most optimistic from the set, with the Maltese economy seen as relatively more resilient to COVID-19 effects than by the other institutions. The outlook for Malta's real GDP growth by the credit rating agencies are within closer range to the MFIN's scenario. Indeed, Fitch estimates growth to be -5.9% in 2020 and 3.6% in 2021, whereas Moody's forecasts -3.8% for 2020 and 3.2% for 2021, whereas Moody's forecasts -3.8% for 2020 and 3.2% for 2021.

Chart 4.2: Real GDP growth by institution (%)



Source: MFIN, COM, IMF, Fitch, Moody's

³² The forecasts contained in the Article IV report for Malta published by the IMF on 10 April 2020 did not factor the COVID-19 effects, as these were prepared before the first cases in Malta.

³³ The publication dates of the forecasts produced by the credit rating agencies were as follows: Fitch (April 2020); Moody's (April 2020).

4.4 Assessment

The revisions to the macroeconomic outlook carried out by MFIN in the USP largely reflect the impact of COVID-19. The scenario of an economic downturn in 2020 and a subsequent recovery in 2021 is in line with what other institutions are projecting for Malta. Notwithstanding the high level of uncertainty, the fact that the forecasts for real GDP growth by the other institutions are within a reasonably close range to those by the MFIN, supports the overall plausibility of the official macroeconomic forecasts contained in the USP.

Chapter 5

Assessment of the fiscal forecasts 2020 – 2021

5.1 Fiscal outlook 2020 – 2021

COVID-19 is anticipated to halt the stream of fiscal surpluses which were recorded between 2016 and 2019. The country is expected to register a fiscal deficit equivalent to 7.5% of GDP in 2020 and 3.6% of GDP in 2021 (see Table 5.1). In 2020 expenditure is projected to expand rapidly, by 19.6%, which, compounded with the 3.6% contraction in nominal GDP, would lift the expenditure-to-GDP ratio by 9.0 pp. On the other hand, revenue is only expected to fall by 1.0%, which is a smaller percentage than the forecasted drop in nominal GDP, thus raising the revenue-to-GDP ratio by 1.0 pp. In 2021, both the revenue and expenditure ratios are expected to scale back. The revenue ratio is projected to decrease, yet remain above the pre-pandemic level, whereas the expenditure ratio is expected to remain significantly higher.

Table 5.1: Main fiscal targets (% of nominal GDP)

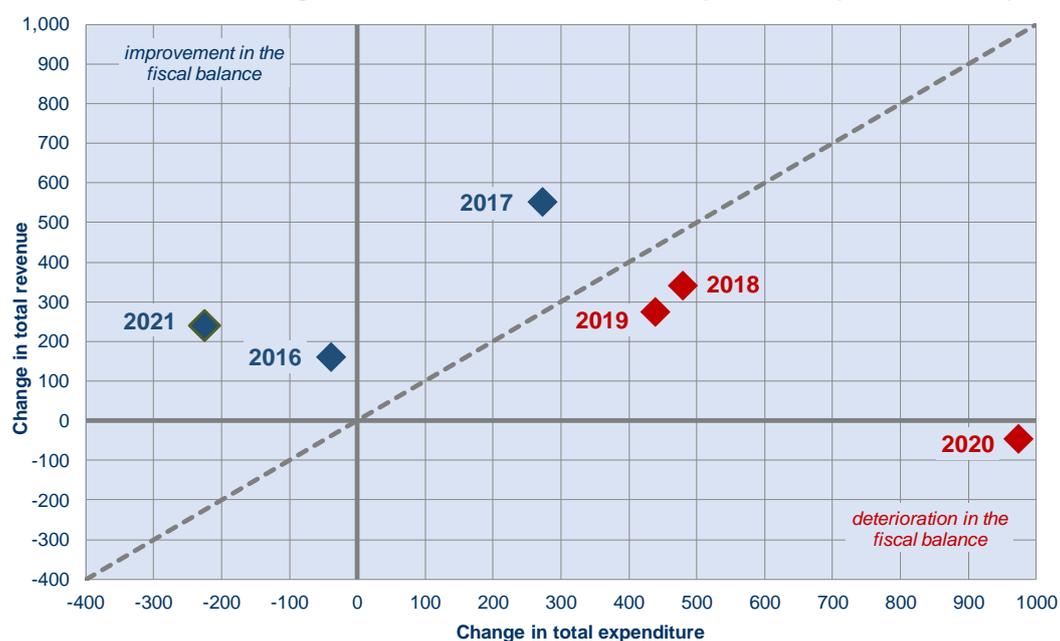
	Total revenue	Total expenditure	Fiscal balance	Gross debt
2019	38.2	37.7	0.5	43.1
2020	39.2	46.7	-7.5	54.5
2021	38.8	42.4	-3.6	55.5

Source: MFIN

The continuous decline in the debt-to-GDP ratio, which dropped from 68.4% in 2013 to 43.1% in 2019, its lowest level in over a decade, is also expected to be partially reversed as a result of COVID-19. Indeed, the debt ratio is expected to increase by 11.4 pp in 2020 and by a further 1.0 pp in 2021. However, the debt ratio is still expected to remain within the 60.0% ceiling, which is the threshold indicated in both the SGP and the FRA. The contributors to such debt dynamics are the anticipated stream of fiscal deficits and the Stock-Flow Adjustments (SFA) which are factored over the forecast horizon.

In 2020, the fiscal deficit is expected to amount to €951.9 million, which represents a deterioration in the fiscal balance of slightly more than €1.0 billion compared to the previous year (see Table 5.2). The projected deterioration is to a large extent expenditure-driven, as the absolute spike in expenditure exceeds by far the decline in revenue, particularly as the latter is expected to be contained (see Chart 5.1). In 2021, the target is for the fiscal imbalance to practically halve, with the improvement traceable to lower expenditure and higher revenue, in practically equal amounts.

Chart 5.1: Annual changes in total revenue and total expenditure (EUR millions)



Note: Anywhere above the dashed line (blue diamonds) indicates combinations of revenue and expenditure developments leading to an improvement in the fiscal balance, whereas anywhere below the dashed line (red diamonds) indicates combinations which lead to a contraction in the fiscal surplus (deterioration in the fiscal balance). Anywhere along the dashed line corresponds to a stable fiscal balance.

Source: MFIN

The decline in revenue anticipated for 2020 is largely ascribed to a fall in taxes on production and imports (see Chart 5.2). Indeed, taxes on income and wealth and social contributions are expected to be rather resilient. Moreover, ‘other revenue’ is forecast to be higher than in 2019, thereby dampening the overall drop in total revenue.³⁴ In turn, the bulk of the projected revenue increase for 2021 reflects the anticipated rebound in indirect taxes and the resumed growth in direct taxes. On the other hand, ‘other revenue’ is expected to be slightly less than a year earlier.

³⁴ Other revenue comprises capital taxes, property income and ‘other’ revenue.

Table 5.2: Fiscal targets in absolute terms (EUR millions)

	2019	2020	2021
Total revenue	5,045.3	4,997.1	5,237.9
Taxes on production and imports	1,601.2	1,471.0	1,592.1
Current taxes on income and wealth	1,827.0	1,820.0	1,928.6
Social contributions	800.1	797.4	828.4
Capital taxes*	26.1	18.7	19.0
Property income*	61.7	69.7	64.5
Other revenue*	729.2	820.2	805.3
Total expenditure	4,974.3	5,949.0	5,723.6
Compensation of employees	1,484.1	1,584.6	1,619.3
Intermediate consumption	985.9	1,212.8	1,220.8
Social payments	1,236.5	1,378.0	1,386.8
Gross fixed capital formation	505.9	672.2	664.5
Subsidies	195.0	499.6	203.7
Interest expenditure**	181.3	177.1	186.9
Capital transfers payable**	107.0	100.9	133.4
Other expenditure**	278.5	323.9	308.3
Fiscal balance	71.0	-951.9	-485.6
Gross debt	5,695.6	6,939.7	7,484.8
Nominal GDP	13,208.5	12,738.9	13,494.6

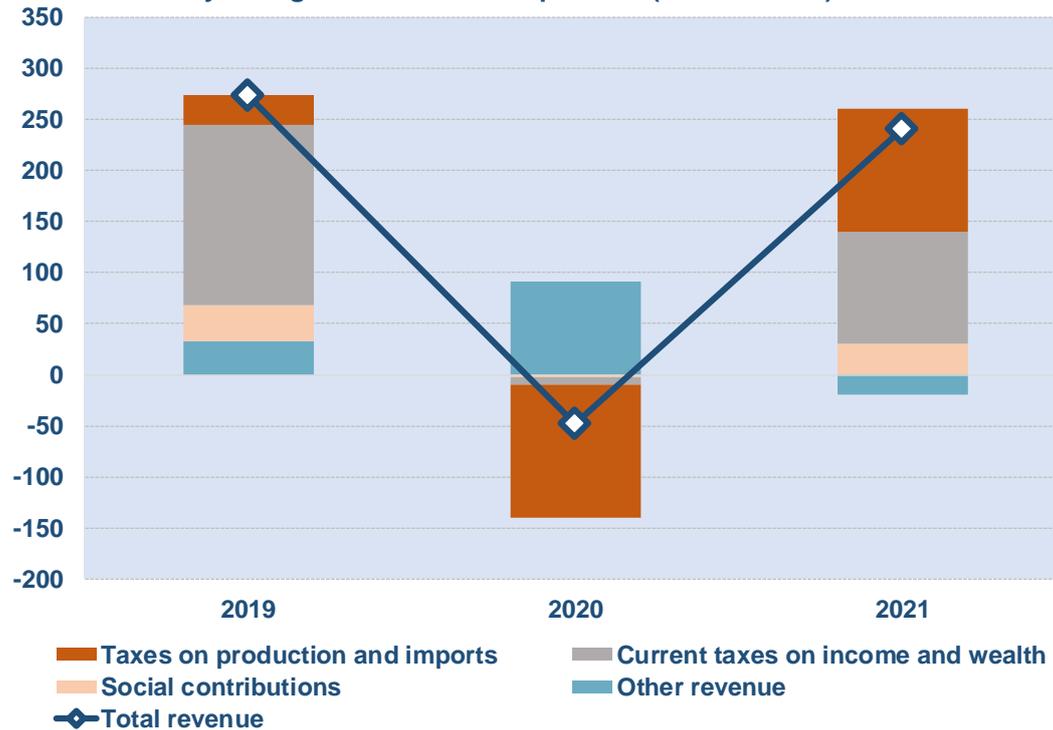
Note: The fiscal figures are compiled in line with the ESA methodology.

* Considered as 'other revenue' elsewhere in this Report.

** Considered as 'other expenditure' elsewhere in this Report.

Source: MFIN

Chart 5.2: Yearly changes in revenue components (EUR millions)



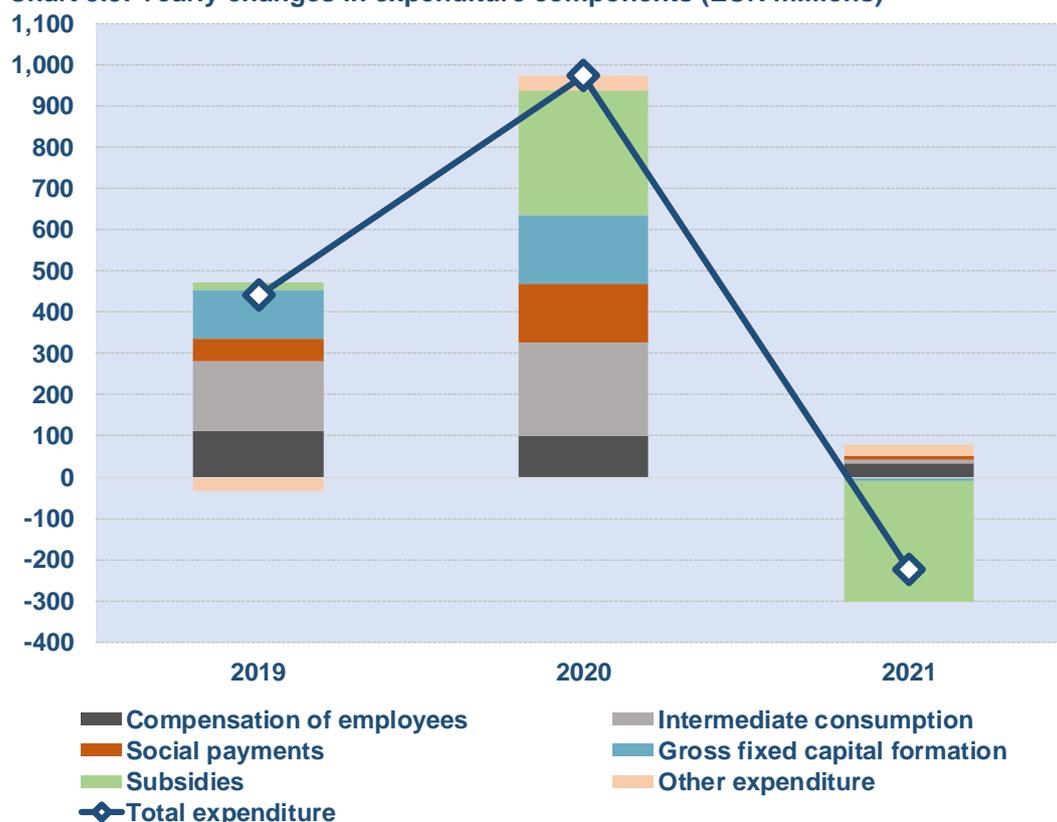
Source: MFIN

The planned expenditure increases for 2020 are spread across all main headings.³⁵ However, additional spending on subsidies and on intermediate consumption contribute most to the projected rise over 2019 (see Chart 5.3). The spike in subsidies is exceptional when seen in historical context and is entirely due to measures implemented to mitigate the effects of COVID-19. Such subsidies are not expected to be repeated in 2021, under the scenario employed by the MFIN, a factor which, compounded with the minor changes anticipated in the rest of the main expenditure headings explains the target drop in public spending in the outer forecast year.

A detailed analysis and assessment of the forecasts for the various revenue components within the budget is presented in the next section. This is then followed by a similar assessment with respect to the various expenditure elements. This contributes to the overall risk outlook over the forecast horizon vis-à-vis the fiscal balance and the debt targets which are stated in the USP 2020 – 2021.

³⁵ Other expenditure comprises interest expenditure, capital transfers payable and 'other' expenditure.

Chart 5.3: Yearly changes in expenditure components (EUR millions)



Source: MFIN

5.2 Assessment of the revenue projections

The forecasts for the different components making up total revenue are analysed separately. The assessment consists in a review of the projected trajectory for each variable, with a focus on the consistency with the macroeconomic scenario as presented in the USP, and the estimated magnitude of any fiscal measures, or known factors, which are relevant over the forecast horizon. As with the macroeconomic outlook, the fiscal projections are also very sensitive to the assumptions employed, especially vis-à-vis the magnitude of the economic shock caused by COVID-19, and the time until which the fiscal mitigation measures remain in place. Any material departure from the assumptions underpinning the latest USP could deviate the outcome, possibly significantly, from the official fiscal scenario for 2020 and 2021.

5.2.1 Taxes on production and imports

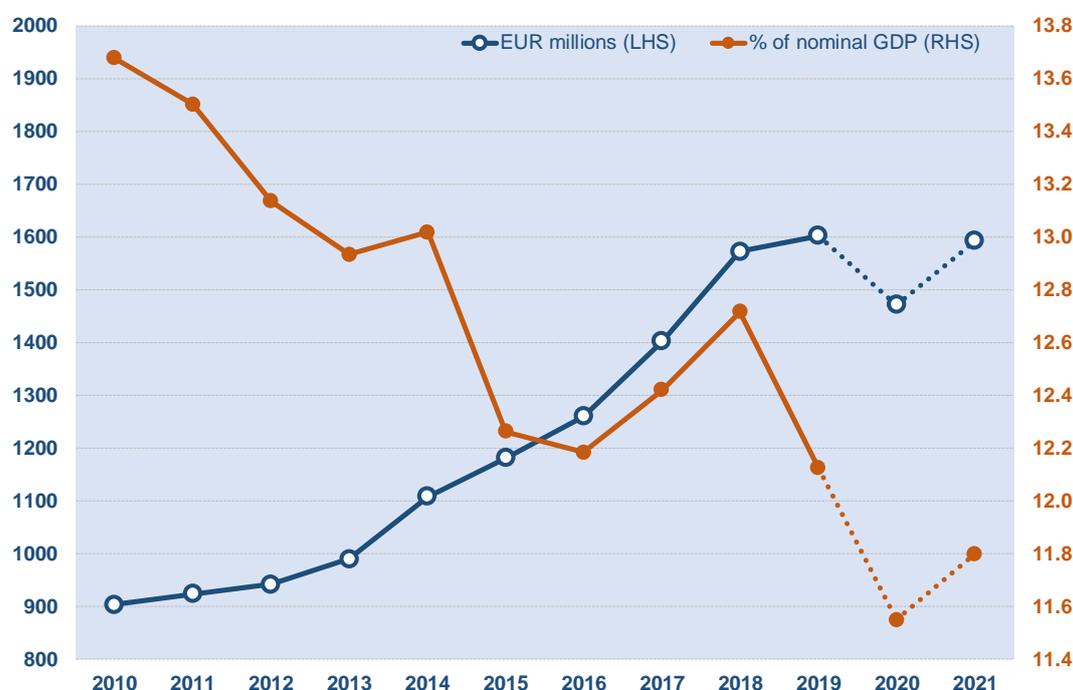
Taxes on production and imports are expected to drop by 8.1% in 2020 and rise by 8.2% in 2021 (see Table 5.3). At the end of the forecast horizon the intake from indirect taxes is thus expected to practically revert to the 2019 level. However, the materialisation of this scenario would still maintain the ratio of indirect taxes to nominal GDP below that recorded over the decade 2010 – 2019 (see Chart 5.4).

Table 5.3: Taxes on production and imports

	Taxes on production and imports		Growth in private consumption		Growth in tourism exports
	Growth (%)	Change (EUR millions)	Nominal (%)	Real (%)	Nominal (%)
2018	12.2	171.0	8.4	7.6	3.0
2019	1.8	28.9	3.9	2.4	7.9
2020	-8.1	-130.2	0.3	-0.8	-53.0
2021	8.2	121.1	3.4	1.8	38.2

Source: MFIN

Chart 5.4: Taxes on production and imports



Source: MFIN

The anticipated decline in indirect taxes in 2020 is fully attributable to the macroeconomic scenario, as on a net basis the downside impact of new measures in

place (the extension of concessions on the payment of property taxes and transfer of shares) is negligible (0.02% of GDP). The projected rebound in 2021 is likewise largely driven by the macroeconomic scenario.

Indirect taxes are projected to drop rather strongly in 2020 despite the level of private consumption is actually marginally higher on a year earlier in nominal terms and only slightly lower in real terms.³⁶ In turn, the 2021 rebound in indirect taxes is stronger than the forecast growth in consumption, both in nominal and in real terms, for that year. Owing to the exceptional circumstances created by COVID-19, the implied elasticity with respect to the consumption tax base which was reported by MFIN in the latest forecast round is larger than that published in recent years. Indeed, the previous USP (2019 – 2022) indicated such elasticity hovering mostly around unity. The main rationale for this change is due to the high volatility in the segment of the tax base which does not form part of household consumption, primarily tourism earnings. The latter are included with exports and are expected to fluctuate significantly throughout the forecast horizon, down by 53.0% in 2020 and up by 38.2% in 2021. This factor is estimated to exert a strong downside and then upside effect on indirect taxes over the forecast horizon, thus contributing to the volatility in indirect taxes. Other elements which influence the indirect tax base relates to construction activity, which in turn, forms part of investment.

5.2.2 Current taxes on income and wealth

The USP presents a resilient scenario for current taxes on income and wealth. Indeed, despite the economic downturn, direct taxes are only expected to drop by 0.4% in 2020. Consequently, the ratio of direct taxes to nominal GDP is indicated at a higher level than over the past decade (see [Table 5.4](#) and [Chart 5.5](#)).

The relative stability in direct taxes in 2020 reflects the scenario whereby the possible shortfall in personal taxes resulting from the expected decline in compensation of employees is largely compensated for by higher corporate taxes, consistent with the scenario of a 2.0% rise in gross operating surplus (which is itself supported by

³⁶ The bulk of indirect taxes are levied on values, hence related to developments in nominal consumption. In the case of taxes levied on quantities, the real growth in private consumption is the more appropriate proxy base.

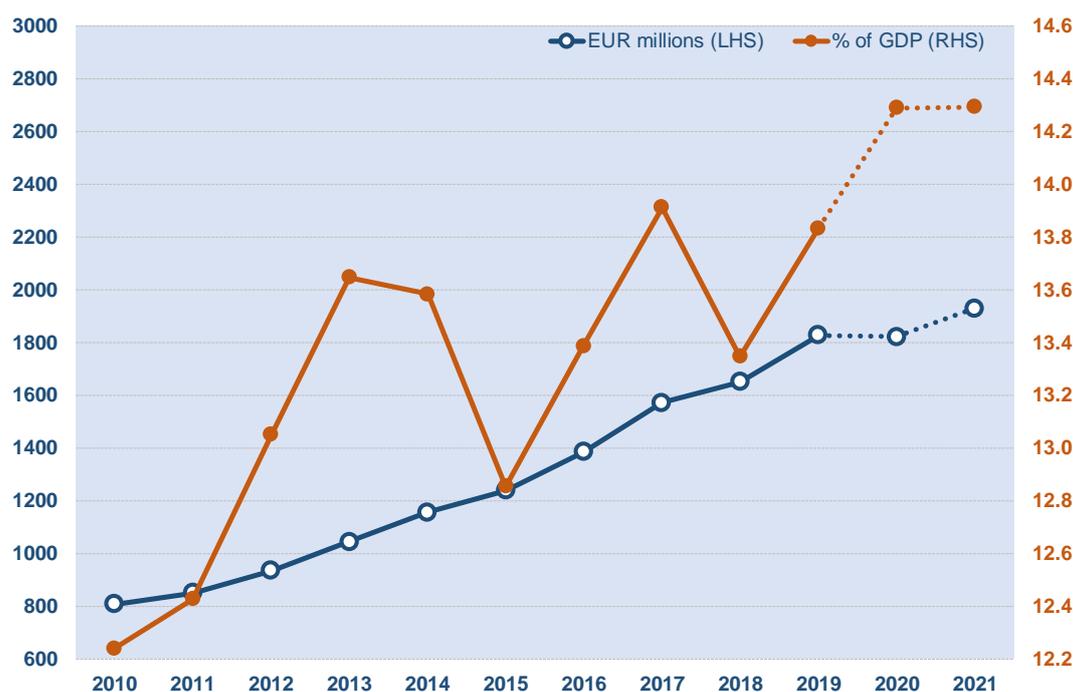
government subsidies as part of the COVID-19 measures supporting private enterprises).³⁷ On the other hand, the projected rise in direct taxes in 2021 reflects the rebound in compensation of employees which is dampened by the slower growth in gross operating surplus.

Table 5.4: Current taxes on income and wealth

	Growth (%)	Change (EUR millions)	Compensation of employees (%)	Gross operating surplus (%)
2018	5.1	80.6	7.7	11.4
2019	10.7	176.6	7.6	7.4
2020	-0.4	-6.9	-1.8	2.0
2021	6.0	108.6	6.0	0.2

Source: MFIN

Chart 5.5: Current taxes on income and wealth



Source: MFIN

Changes to direct taxes are minimal throughout the forecast horizon. Tax concessions on overtime payments are estimated to produce a permanent downside effect merely of 0.03% of GDP. Tax payment deferrals, applicable for some months of 2020, are

³⁷ Compensation of employees and gross operating surplus are the two most relevant proxy tax bases for direct taxes.

assumed not to have any effect on direct taxes because the ESA requires that revenues are adjusted on an accrual-basis.

The projected resilience of corporate taxes over the forecast horizon mirrors the modelling framework used by the MFIN. This reflects the same principles of the Provisional Tax system, whereby all companies and other persons liable to tax in Malta use the year [t-2] as a reference when determining what provisional tax should be paid in year [t]. Specifically, corporate taxes are linked to the economic developments of the previous years, and hence they are expected to react to the economic shock caused by COVID-19 with a lag. Nevertheless, the USP includes some declines in tax revenue vis-à-vis the direct taxes which are derived from the operations of companies whose activities are detached from the developments in the Maltese economy, reflecting the expected impact created by the adverse GDP developments abroad in 2020 and subsequent expected recovery in 2021.

5.2.3 Social contributions

Social contributions are forecast to drop by only 0.3% in 2020 and rise by 3.9% in 2021 (see Table 5.5). The ratio of social contributions to GDP is thus expected to continue hovering around 6.2%, extending the pattern observed since 2015 (see Chart 5.6). Such developments are driven entirely by the developments in the tax base and the statutory increase in the payment ceiling, as no additional policy changes or measures are being factored in the fiscal scenario. The payment deferrals applicable for some months of 2020 exert no impact on the expected revenue in view of the accrual methodology used for ESA data.

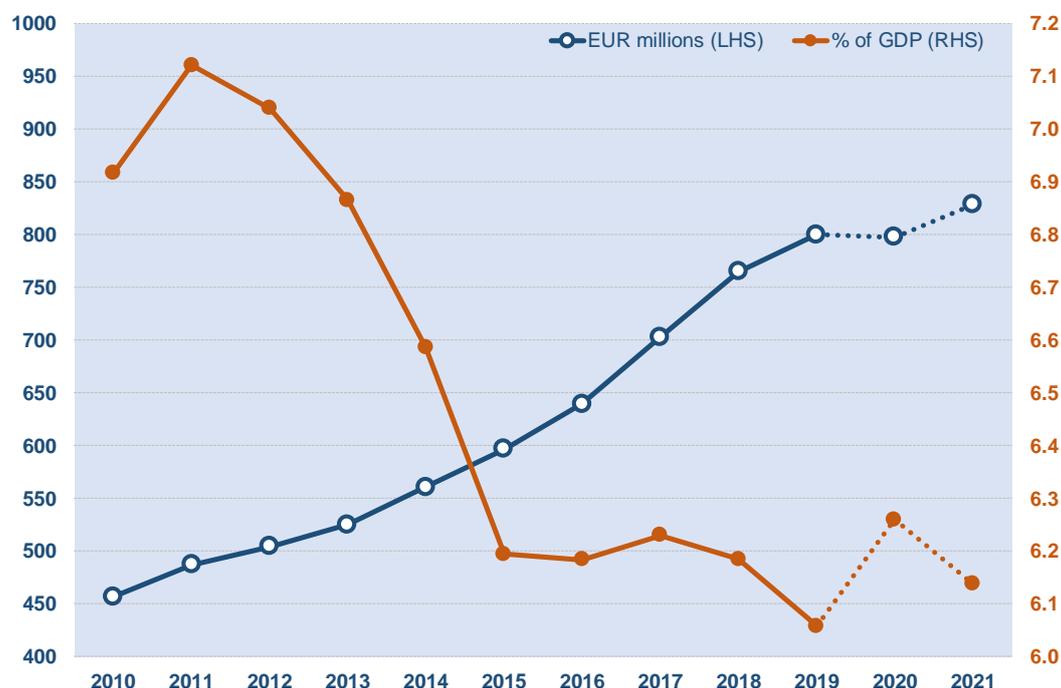
Table 5.5: Social contributions

	Growth (%)	Change (EUR millions)	Compensation of employees (%)
2018	8.8	61.9	7.7
2019	4.6	35.3	7.6
2020	-0.3	-2.7	-1.8
2021	3.9	31.0	6.0

Source: MFIN

Social contributions are expected to be less volatile than total compensation of employees, both in the downturn and in the upturn. This reflects the capping system on social contributions whereby any income changes above the ceiling have no effect on the payments due.³⁸ The USP 2020 – 2021 uses a lower implicit elasticity, when compared to the values shown in the previous' year USP, where the assumed elasticity used to be 0.9. The elasticity employed in the latest forecast vintage approximates that measured for 2019, when the growth in social contributions was only 4.6% when compared to the 7.6% growth in compensation of employees.

Chart 5.6: Social contributions



Source: MFIN

5.2.4 Other revenue components

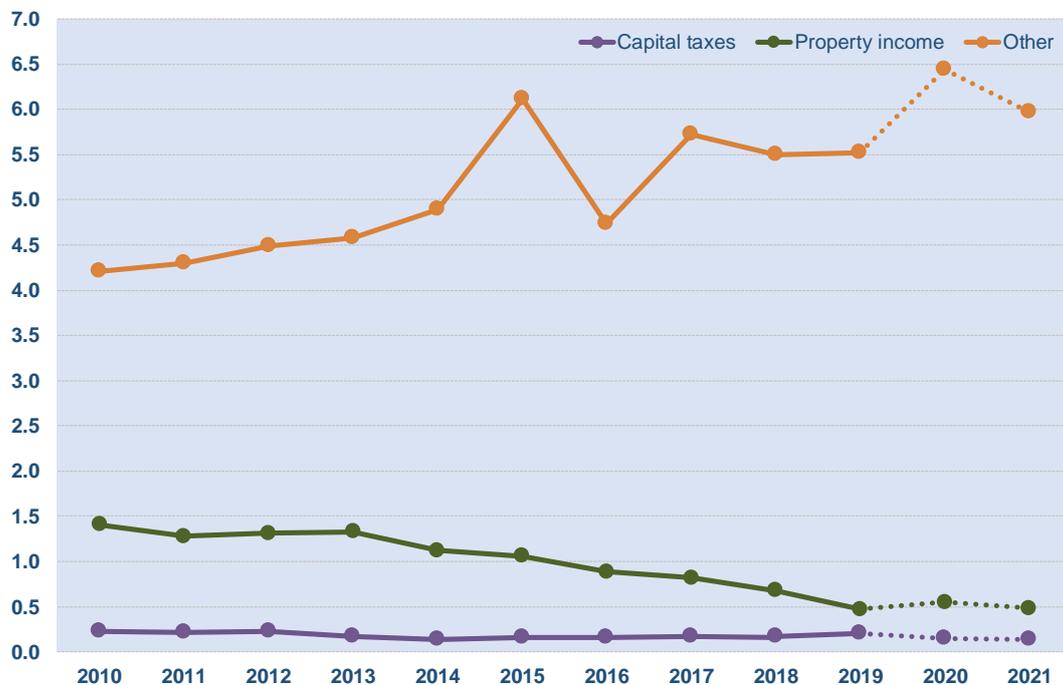
Taxes on production and imports, current taxes on income and wealth, and social contributions account for the bulk of total revenue. In 2019, their combined share made up 83.8% of total revenue, and throughout the forecast horizon the share is expected to remain higher than four-fifths. The remaining revenue components consist of capital

³⁸ The cap means that once the maximum annual amount payable has been reached, additional income does not lead to more social security payments, hence producing a theoretical elasticity below unity. Likewise, when incomes remain above the ceiling, any fall in income does not lower the social contributions which need to be paid.

taxes, property income and 'other' revenue. The latter includes EU funds, as well as market output, which includes the proceeds from the Individual Investor Programme (IIP). The forecast trajectories for the revenue components as percentage of nominal GDP are shown in [Chart 5.7](#).

The total expected yield from these components is set to rise by €91.1 million in 2020. This contrasts with the declines projected for the three main revenue components. Around one-half of the expected increase relates to the assumption of higher market output, including proceeds from the IIP. The other main contributor to the increase relates to EU funds.

Chart 5.7: Other revenue components (% of nominal GDP)



Source: MFN

Even in 2021, the revenue performance of these miscellaneous sources combined is expected to differ from the three main tax sources. Indeed, whereas the latter are expected to experience growth, the other revenue components are projected to decline slightly, by €14.9 million, although proceeds from the IIP revenues are assumed to remain stable on a year earlier.

Property income and capital taxes are assumed to fluctuate closely with nominal GDP throughout the forecast horizon. The fiscal scenario maintains their ratios to nominal

GDP stable and low, respectively at 0.5% and 0.1%. As a result, these items play a marginal part in the overall fiscal scenario for 2020 and 2021.

5.3 Assessment of the expenditure projections

The forecasts for the different expenditure components are analysed separately. The assessment mainly consists in a review of the projected trajectory for each variable and the estimated magnitude of the fiscal measures or known factors which are relevant over the forecast horizon. The outlook is very sensitive to the assumption about the duration of the measures, which, when announced were open-ended.

5.3.1 Compensation of employees

Spending on compensation of employees is projected to grow by 6.8% in 2020 and by 2.2% in 2021 (see Table 5.6 and Chart 5.8). The budget allocation on public sector wages over the forecast horizon is rising more moderately compared to the previous two years. Nevertheless, in view of the contraction in nominal GDP, the ratio of compensation of employees to nominal GDP is expected to rise in 2020. Despite some retrenchment anticipated in relation to 2021, this ratio is expected to remain above that recorded in recent years.

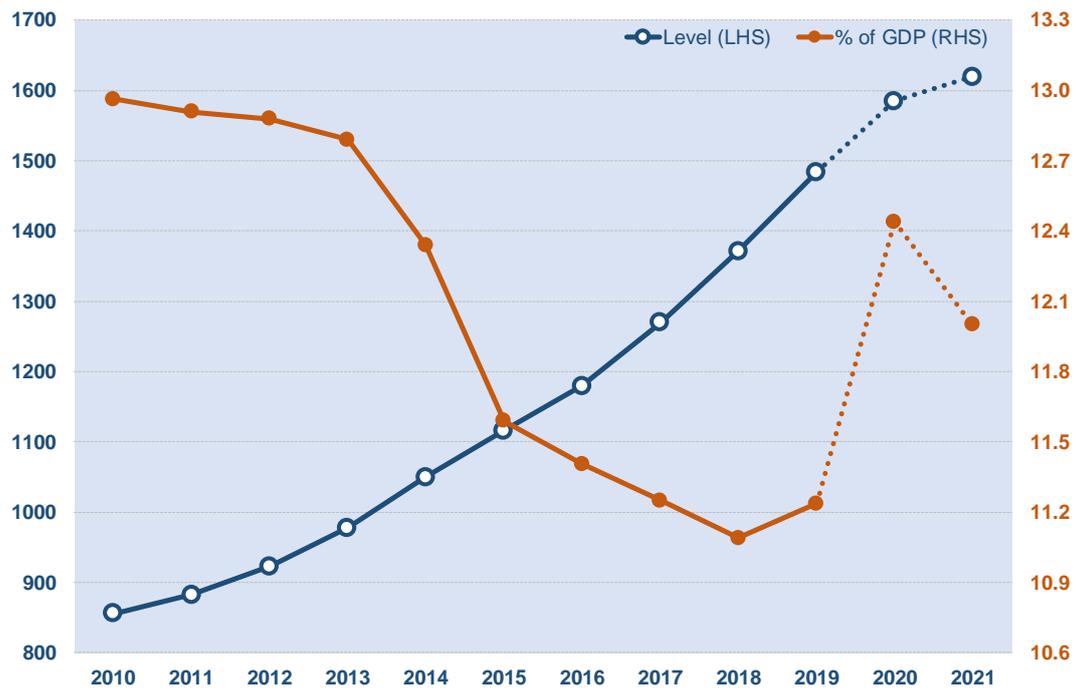
Table 5.6: Compensation of employees

	Yearly growth rate (%)	Yearly absolute change (EUR millions)
2018	8.0	101.9
2019	8.2	112.8
2020	6.8	100.5
2021	2.2	34.7

Source: MFIN

The USP shows that COVID-19 related additional expenditure on compensation of employees amounts to some 0.3% of GDP. This notwithstanding, the budgeted rise in compensation of employees is decelerating in 2020 and moderating further in 2021. The lower growth in the outer forecast year is planned despite any significant base effect created by COVID-19 in 2020.

Chart 5.8: Compensation of employees



Source: MFIN

Spending on compensation of employees is driven by the number of public sector employees and their average wage. Since employment within 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' plans. Still, the current policy requires that recruitment costs remain within the parameters of the approved budgetary estimates, unless otherwise authorised.

When compared to the fiscal plans indicated in the USP of the previous year, the upward revision for 2020 amounts to €7.2 million while for 2021 the budget allocation has been lowered by €49.0 million (see Table 5.7). This would imply a stronger degree of moderation in the public sector wage bill than in recent years, which could be challenging to achieve. This also when considering that the current collective agreement for civil servants produces yearly increases in the region of €20 million,

there could be needs for higher public sector employment in certain areas, and wage drift patterns could persist.³⁹

Table 5.7: Forecast vintages for compensation of employees (EUR millions)

	USP 2018	USP 2019	USP 2020
2017	1,271.1	1,268.1	1,269.4
2018	1,367.3	1,376.1	1,371.3
2019	1,429.7	1,490.3	1,484.1
2020	1,487.9	1,577.4	1,584.6
2021	1,553.4	1,668.3	1,619.3

Source: MFIN

5.3.2 Intermediate consumption

In 2020 intermediate consumption is expected to rise by €226.9 million or 23.0% (see Table 5.8). This component registered steady growth in recent years, both in absolute terms and as percentage of nominal GDP. COVID-19 is expected to contribute additional upward pressures in 2020. Indeed, the USP estimates that €83.2 million additional spending on intermediate consumption will be incurred as a result, the bulk in the form of temporary higher health spending. This strong base effect explains the limited growth in the outer forecast year.

Table 5.8: Intermediate consumption

	Yearly growth rate (%)	Yearly absolute change (EUR millions)
2018	14.0	100.2
2019	20.6	168.1
2020	23.0	226.9
2021	0.7	8.0

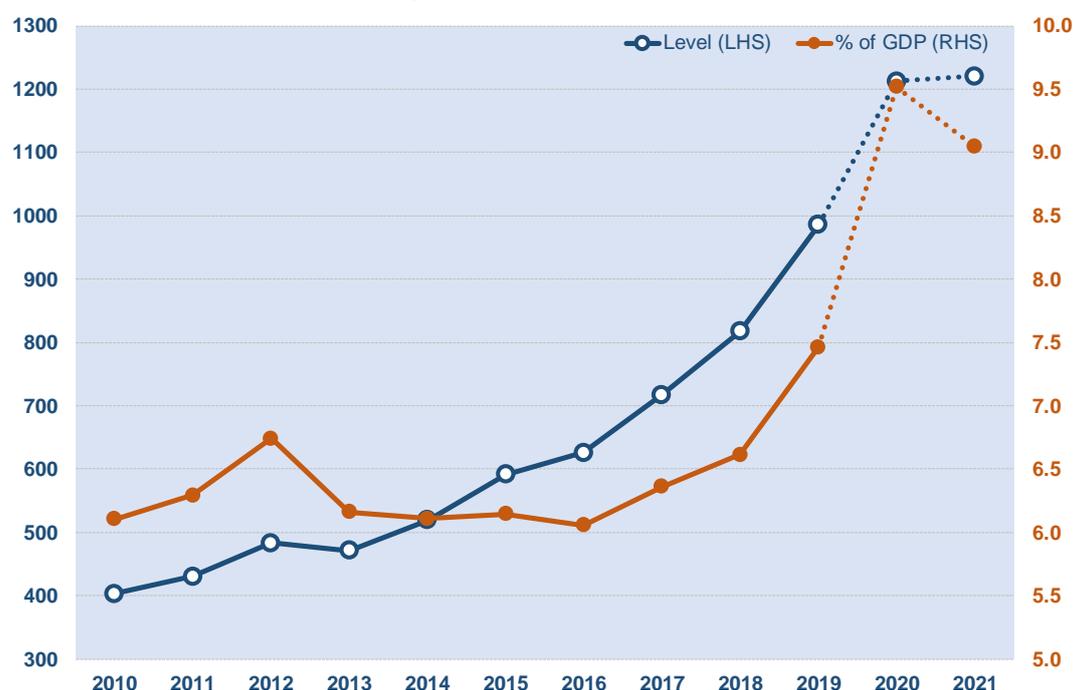
Source: MFIN

Intermediate consumption is expected to shoot up to 9.5% of GDP in 2020. In 2021 it is then projected to remain much higher than over the past decade (see Chart 5.9).

³⁹ Wage drift is defined as the difference in the wage paid to a worker as compared to the negotiated wage. The increase could be due to several reasons such as overtime, bonus payment or promotion.

However, the budgeted average growth in intermediate consumption over the two forecast years, at 11.8% is below the 17.3% average growth recorded between 2018 and 2019. Since intermediate consumption has a rather strong discretionary element, it is often influenced by special factors, which nonetheless over time have tended to be replaced by other expenditure, effectively limiting the possibility for intermediate consumption to revert to lower levels. Upward revisions to the initial budget have also regularly taken place, and these tended to be larger for the outer forecast year (see Table 5.9).

Chart 5.9: Intermediate consumption



Source: MFIN

Table 5.9: Forecast vintages for intermediate consumption (EUR millions)

	USP 2018	USP 2019	USP 2020
2017	754.0	719.4	717.6
2018	807.7	834.3	817.7
2019	867.2	936.9	985.9
2020	903.5	987.1	1,212.8
2021	936.0	1,028.1	1,220.8

Source: MFIN

For example, the fiscal plans included in the USP 2018 had initially targeted a budget of €867.2 million on intermediate consumption for 2019, which was revised upwards to €936.9 million in the USP 2019, and which according to the USP 2020 amounted to €985.9 million. Likewise, the upward revision in budget spending on intermediate consumption for 2020 goes way beyond the additional spending as a result of COVID-19. This could also be explained by a certain degree of prudence in the budgeting for this item in view of the high uncertainty regarding the needs to address the health and economic challenges posed by COVID-19.

5.3.3 Social payments

Social payments are expected to rise by 11.4% in 2020, equivalent to an additional €141.5 million (see Table 5.10). As a result, the downward trend in the ratio of social payments to nominal GDP is expected to be temporarily reversed to the ratio recorded in 2015 (see Chart 5.10).

Table 5.10: Social payments

	Yearly growth rate (%)	Yearly absolute change (EUR millions)
2018	4.2	47.3
2019	4.7	55.5
2020	11.4	141.5
2021	0.6	8.8

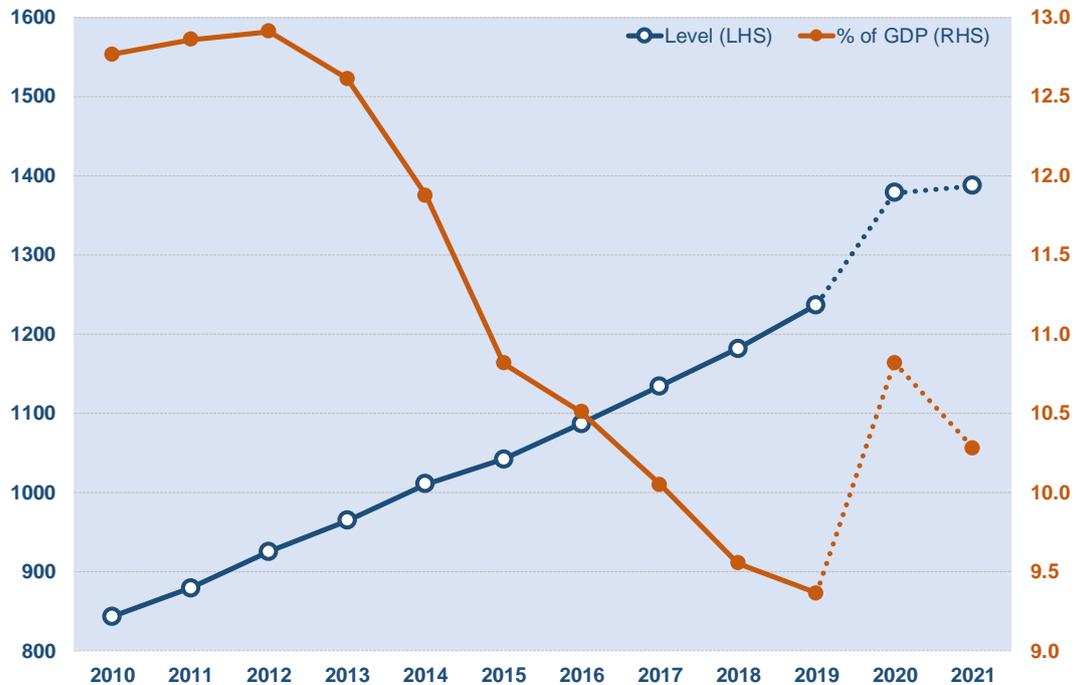
Source: MFIN

Slightly more than half of the estimated increase reflects temporary assistance measures as a result of COVID-19, primarily through the provision of free medicines and short-term benefits. Slightly less than one-third reflects additional spending as a result of income redistribution measures applicable as from 2020. In turn, the base effect created by the temporary COVID-19 assistance explains the deceleration in the expected outlays on social payments in the outer forecast year.

The upward pressures on social payments resulting from the expanding pool of beneficiaries are topped up with the introduction of new temporary initiatives to support incomes. The open-ended nature of these initiatives implies that the budget adequacy depends critically on the extent to which the effects of COVID-19 recede, paving the

way for the phasing out of such initiatives. The assumed duration of such fiscal measures is consistent with the temporary nature of the shock and other assumptions characterising the macroeconomic scenario.

Chart 5.10: Social payments



Source: MFIN

5.3.4 Gross fixed capital formation

Spending on gross fixed capital formation is planned to maintain very strong momentum in 2020, rising by €166.2 million or 32.9% (see Table 5.11). Of this, some €20.0 million represents additional health-related capital spending as a result of COVID-19. In contrast, in 2021 public investment is expected to register a small drop on a year earlier (see Chart 5.11).

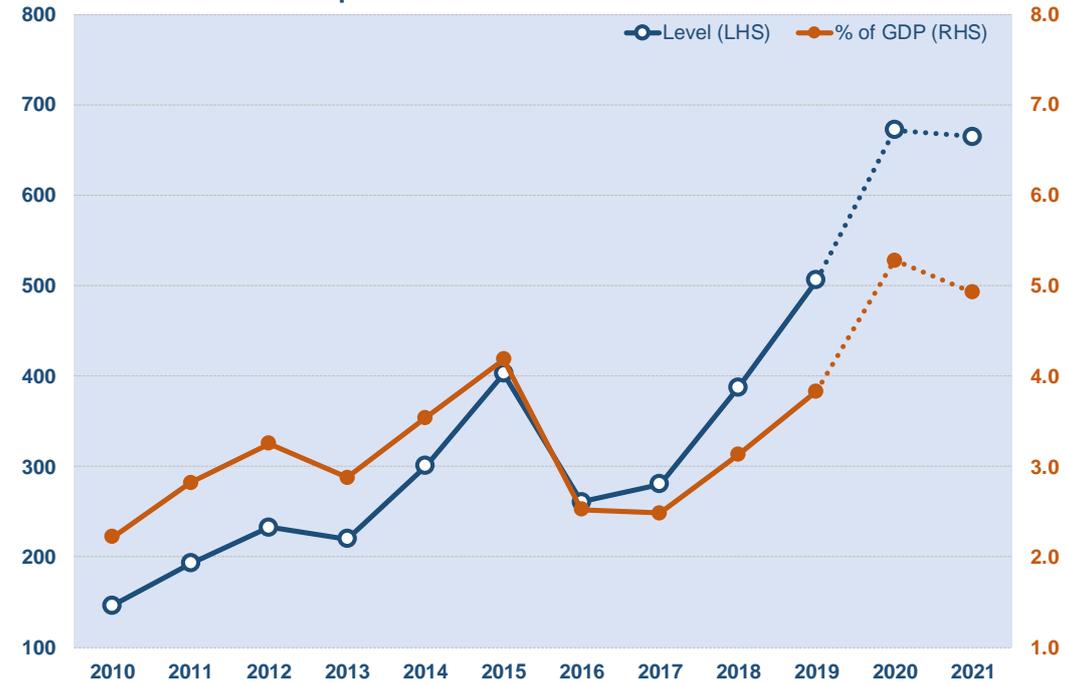
Nevertheless, over the forecast horizon, the ratio of public investment to GDP is expected to hover around 5.0%, which is rather ambitious when considering that in recent years it fluctuated between 2.0% and 4.0% of GDP. Capital expenditure over the forecast horizon is mainly related to roads, the environment, health and education. These include infrastructure expenditure financed both from the EU and local funds.

Table 5.11: Gross fixed capital formation

	Yearly growth rate (%)	Yearly absolute change (EUR millions)
2018	37.9	106.3
2019	30.7	119.0
2020	32.9	166.2
2021	- 1.1	- 7.6

Source: MFIN

Chart 5.11: Gross fixed capital formation

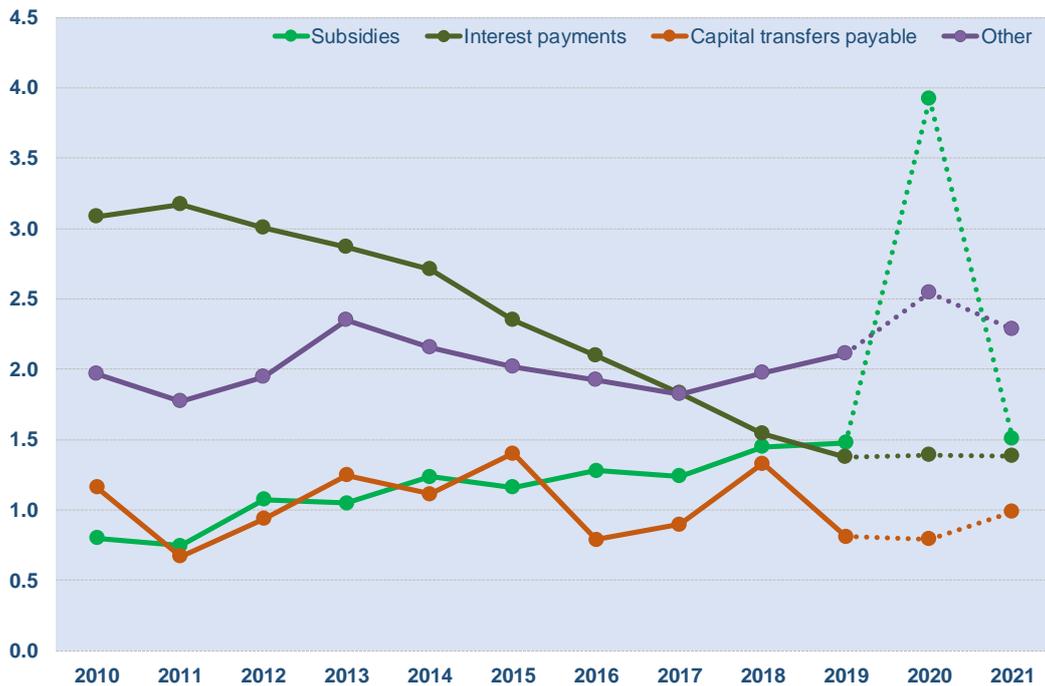


Source: MFIN

5.3.5 Subsidies and other expenditure components

Compensation of employees, intermediate consumption, social payments and gross fixed capital formation account for the bulk of total expenditure. Their combined share made up 84.7% of total expenditure in 2019. The remaining components consist of subsidies, interest payments, capital transfers payable and ‘other’ expenditure. Chart 5.12 shows the forecast profile for these respective categories, expressed as percentage of nominal GDP.

Chart 5.12: Other expenditure components (% of nominal GDP)



Source: MFIN

Subsidies have been rising marginally faster than GDP over the last decade. However, as at 2019 they still accounted for a small share of public spending, equivalent to 1.5% of GDP. The support measures implemented by the Government, primarily by financing the retention of workers in the case of those businesses which were impacted by the full or partial lockdown, are however expected to contribute to a strong spike in subsidies. Indeed, the allocation for subsidies for 2020 was raised by €304.6 million on a year earlier, to reach 3.9% of GDP. These open-ended subsidies are temporary, but their duration is assumed consistent with the macroeconomic scenario. The phasing out of these subsidies explains the lower allocation for 2021 which is comparable to the pre-pandemic levels, at 1.5% of GDP.

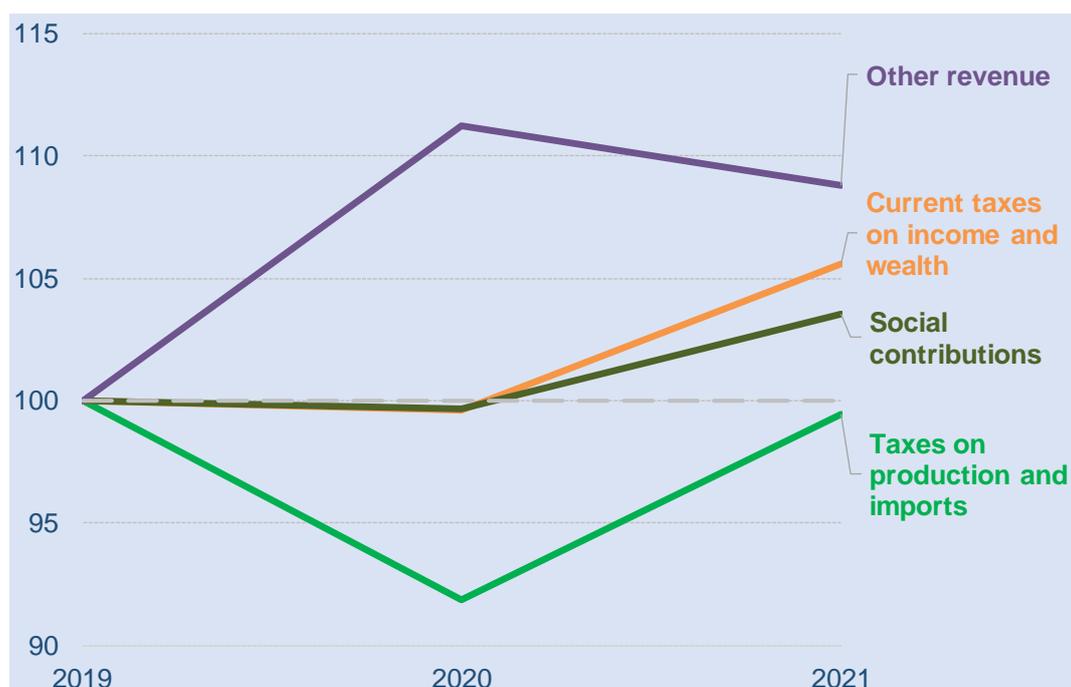
Spending on interest payments is expected to drop for the sixth year running, down by €4.3 million in 2020. However, in 2021 interest payments are expected to increase by €9.8 million. Overall, interest payments are expected to stabilise at 1.4% of GDP throughout the forecast horizon. The projected interest savings in 2020 reflects the further reduction in the implicit interest rate on public debt as it is rolled over at lower rates. This factor is expected to more than compensate for the additional costs created by the anticipated rise in the outstanding public debt. However, the latter is expected to create a much stronger upward effect in 2021, explaining the budgeted increase in interest payments, despite the lower weighted average cost of debt.

Likewise, capital transfers are forecast to remain low, equivalent to 0.8% of GDP in 2020 and 1.0% of GDP in 2021. On the other hand, 'other' expenditure is expected to fluctuate slightly, rising by €45.4 million in 2020 and dropping by €15.6 million in 2021, with the ratio to nominal GDP settling slightly above its historical pattern.

5.4 Fiscal risk outlook

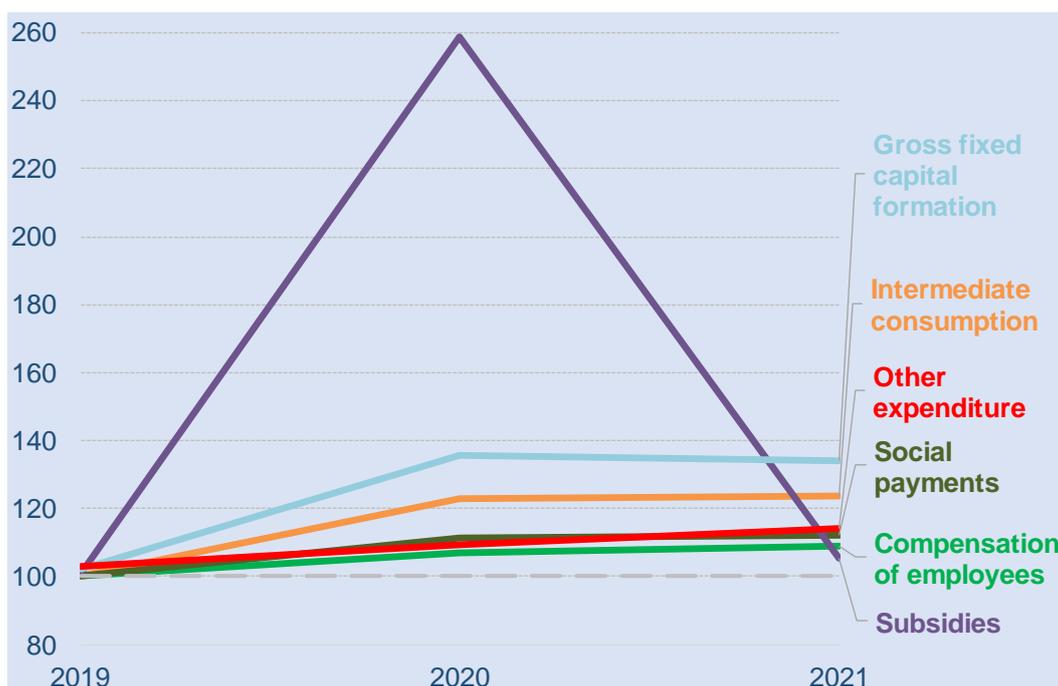
COVID-19 creates a significant impact on public finances as it affects various revenue streams negatively, while boosting public expenditure in a bid to mitigate its health and economic effects. Owing to the highly uncertain duration and severity of the COVID-19 effects, the possible impact on public finances can vary significantly. The MFAC's risk outlook thus focuses on the joint profile pattern for each revenue and expenditure component over the two forecast years, using 2019 as the base year, rather than for each year separately (see Chart 5.13 and Chart 5.14). The risk assessment for public finances takes the macroeconomic scenario as presented in the USP as given. The downside risk outlook vis-à-vis the profile for real GDP for the period 2020 and 2021 would amplify the downside risks to revenue and amplify the upside risks to expenditure. In turn this would worsen the outlook for the fiscal balance and public debt.

Chart 5.13: Revenue components (2019 = 100)



Source: MFIN

Chart 5.14: Expenditure components (2019 = 100)



Source: MFIN

Under the baseline scenario, current taxes on income and wealth and social contributions are both resilient in 2020 and resume growth in 2021. The measures implemented by the Government to provide income support and encourage job retention, together with the capping system in relation to social payments justify the optimistic view for social contributions in 2020. In turn, the expected recovery in employment in 2021 makes the increase in social contributions plausible. On the other hand, the profile for current taxes on income and wealth appears rather ambitious, given that COVID-19 is likely to affect personal taxable income, a factor whose impact is magnified by the progressivity in Malta's income tax system. In addition, the corporate tax performance may fall short of the target. Furthermore, since the corporate tax system in Malta allows for losses to be carried forward for tax purposes, any major losses incurred during 2020 may impinge on the recovery in direct taxes. Thus, whereas the risk outlook with respect to social contributions is neutral, that for direct taxes is on the downside.

The V-shaped pattern for taxes on production and imports appears plausible as it is consistent with the rest of the macroeconomic scenario, characterised by a recession and recovery the year after. Although the amplitude of such swing remains uncertain, the risk outlook vis-à-vis indirect taxes is neutral.

The scenario of an increase in other revenue in 2020 and the partial scaling back in 2021, because of the base effect, appears plausible. However, COVID-19 may make it more difficult to raise the IIP revenue in 2020. Other downside impacts could arise should dividends fall short of expectations. As a result, there is a downside risk outlook with respect to the other revenue sources.

There is more homogeneity in the forecast patterns on the expenditure side of the budget. In 2020, apart from subsidies, which are expected to shoot up temporarily, the rest of the expenditure components are expected to rise strongly, yet much less dramatically than subsidies. In 2021, subsidies are then expected to revert to their pre-pandemic level whereas the rest of the expenditure components are set to broadly stabilise at the previous year's level. These estimates assume a specific, yet prudent, expiry period for the temporary assistance measures in place. Although there remains the risk that the extension beyond the date assumed in the USP would put upward expenditure pressures (particularly on subsidies which account for the bulk of COVID-19 related assistance measures), such risk is deemed to be contained in view of the prudent buffers that were factored in. On the other hand, the degree of expenditure containment, particularly in the outer forecast year may prove challenging, as in certain cases the envisaged slower growth (net of COVID-19 effects) than recorded in recent years cannot be traced to specific measures.

Overall, the upside risks appear more pertinent in the case of compensation of employees. On the other hand, the rather elevated budget allocations for intermediate consumption, social payments, gross fixed capital formation, subsidies and 'other' expenditure suggest a neutral risk outlook in relation to these components over the forecast horizon.

The assessment carried out on the individual revenue and expenditure components suggests an overall downside risk outlook vis-à-vis the fiscal balance for the period 2020 and 2021 (see Table 5.12).⁴⁰ This reflects the joint impact of a downside risk on the revenue side and an upside risk on the expenditure side of the budget.

⁴⁰ A downside risk to the fiscal balance means that the fiscal balance could be worse than the target.

Table 5.12: Summary of risks to the fiscal balance

	2020 – 2021
REVENUE	⇓
Taxes on production and imports	⇔
Current taxes on income and wealth	⇓
Social contributions	⇔
Other revenue	⇓
EXPENDITURE	⇑
Compensation of employees	⇑
Intermediate consumption	⇔
Social payments	⇔
Gross fixed capital formation	⇔
Subsidies	⇔
Other expenditure	⇔
BALANCE	⇓

Note: ⇔ indicates neutral risks, ⇑ indicates upside risks and ⇓ indicates downside risks.

Source: MFAC

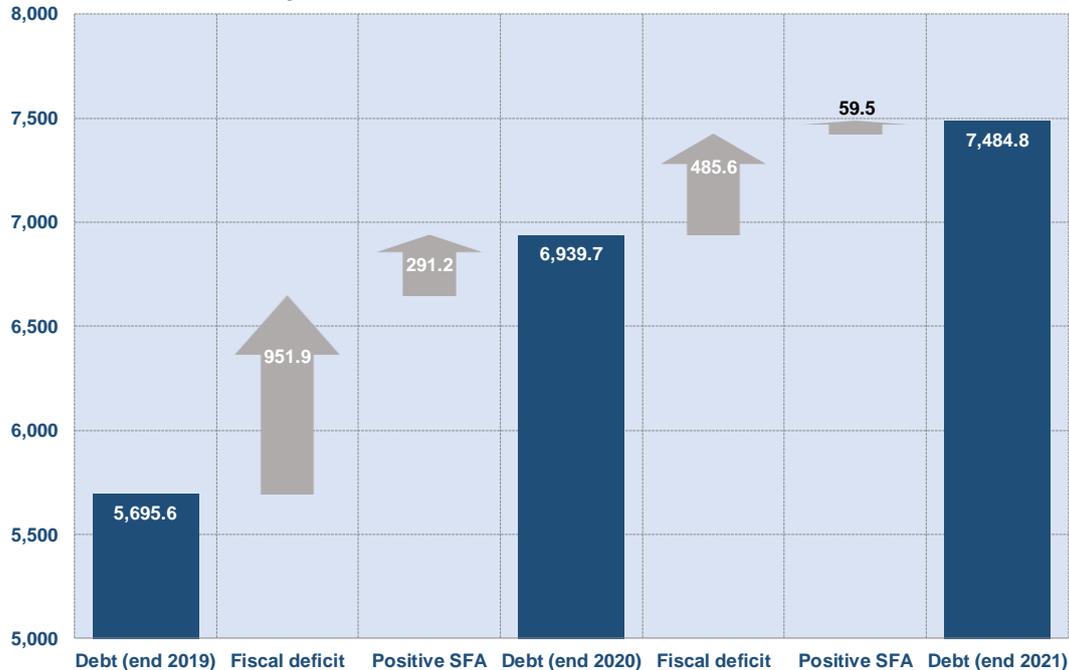
However, the downside risk to the fiscal balance is deemed to be contained in view of the fact that other reputable institutions producing fiscal forecasts, and which have factored in the impact of COVID-19 have produced a range of fiscal scenarios which are broadly similar and in cases less adverse than that presented by the MFIN (refer to Chapter 6 in this Report for further details).⁴¹

⁴¹ Refer to chapter 6 in this Report for the comparison with respect to the fiscal forecasts produced by the other institutions.

5.5 Assessment of the public debt projections

In 2020 the outstanding level of public debt is expected to rise by €1,244.1 million, from €5,695.6 million to €6,939.7 million (see Chart 5.15). The bulk of the increase reflects the financing of the projected fiscal deficit for 2020 which amounts to €951.9 million. This is compounded with the upward push created by the estimated positive Stock-Flow Adjustments (SFA) for the year.⁴² In 2021 public debt is expected to increase by a further €545.1 million to reach €7,484.8 million. Public debt is thus expected to accumulate at a slower pace, consistent with the lower fiscal deficit and smaller impact from SFA anticipated for the outer forecast year.

Chart 5.15: Drivers of public debt

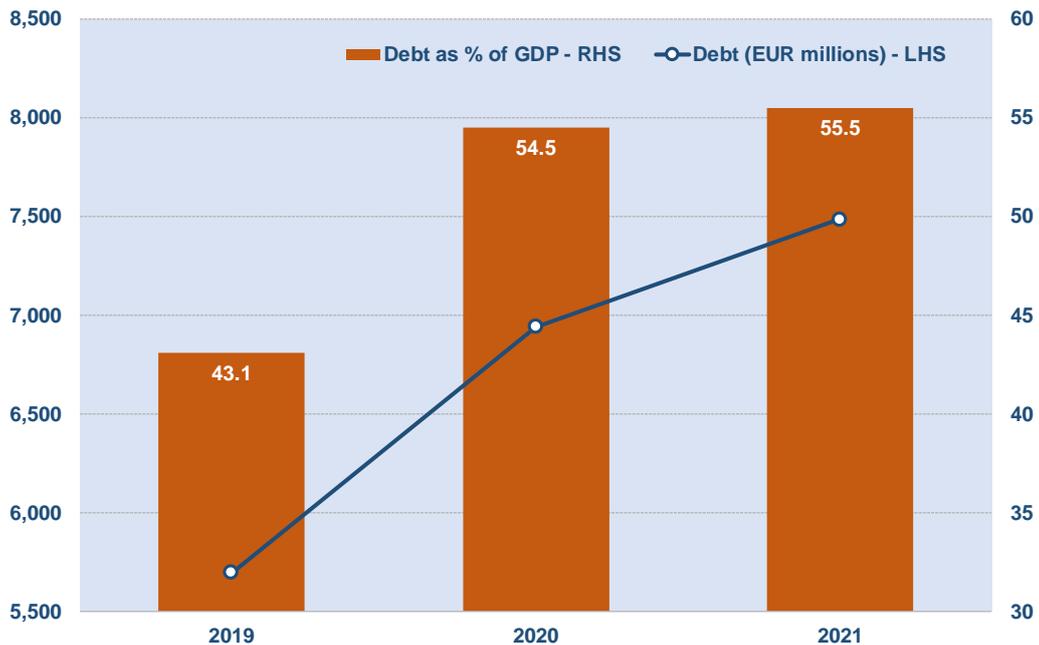


Source: MFIN

The steady declines recorded in the public-debt to GDP ratio, which lowered it from 68.4% in 2013 to 43.1% by 2019, are expected to be partially reversed because of COVID-19. Indeed, the debt ratio is expected to shoot up to 54.5% in 2020 and rise slightly more in 2021, to 55.5% (see Chart 5.16). The expected 3.6% contraction in nominal GDP (which serves as denominator) in 2020, magnifies the upside impact on the debt ratio in that year, while the forecast 5.9% expansion in 2021 moderates the projected increase in the debt ratio in the outer forecast year.

⁴² Stock-flow adjustment are termed 'positive' when they raise the stock of debt and 'negative' when they lower the stock of debt.

Chart 5.16: Public debt dynamics



Source: MFIN

The estimated SFA create a strong upward push on public debt in 2020, amounting to €291.2 million, which is equivalent to 2.3% of GDP (see Table 5.13). This upward push is repeated in 2021, albeit with a much lower intensity, amounting to €59.5 million, equivalent to 0.4% of GDP.

The largest adjustment for 2020 reflects the concession to defer certain tax payments to a later stage. Indeed, according to the ESA methodology these would still be imputed with revenues, even though the funds would not yet have been collected. In turn, this would contribute to a significant difference between cash and accrual recording of transactions, which are categorised as ESA adjustments. For 2021 the effect would be the opposite (hence the negative value for ESA adjustments) since delayed payments relating to the previous year would be collected, thereby resulting in higher cash receipts than measured on an accruals basis.

Another factor influencing the ESA adjustment relates to the IIP funds which are retained by the National Development and Social Fund (NDSF), which for statistical purposes is still considered part of general government.⁴³ This gives rise to the situation

⁴³ The allocation of funds between the Consolidated Fund and the NDSF was temporarily revised in 2020. Up to 2019, 30% was channeled to the Consolidated Fund and 70% was retained by the NDSF. Starting from 2020, 80% was channeled to the Consolidated Fund and 20% to the NDSF. As a result, the ESA adjustment due to the NDSF transactions is lower.

where some revenues (specifically forming part of market output) are not directly available to finance the fiscal deficit, hence requiring additional issuance of public debt. However, this factor applies only for 2020 since the expected proceeds from the IIP in 2021 are the same as a year earlier.

Table 5.13: Stock-flow adjustments (EUR millions)

	2020	2021
ESA adjustment	125.9	-31.5
ESA re-routed debt	72.0	50.0
Changes in Sinking Fund balances and MGS holdings*	41.8	32.4
Equity acquisitions	37.1	0.1
Euro currency issue	10.3	6.9
Other adjustments	4.1	1.6
Total stock-flow adjustment	291.2	59.5

Note: Includes the MGS consolidation adjustment.

Source: MFIN

Other factors expected to push up debt in 2020 are ESA re-routed debt which is estimated at €72.0 million and changes in sinking fund balances and MGS holdings, estimated at €41.8 million.^{44,45} Equity acquisitions and euro currency issue, which are estimated at €37.1 million and €10.3 million respectively, are also contributing to the increase in debt. Other minor transactions effecting the debt represent an increase of €4.1 million.

The much smaller total SFA in 2021 reflects the partial reversal of the ESA adjustment a year earlier, the non-repetition of the equity acquisition, and generalised lower adjustments across the other main components.

⁴⁴ ESA re-routed debt includes financial assistance from the European Financial Stability Facility (EFSF). Since the EFSF is acting on behalf of Malta (the guarantor), the lending is rerouted through the government accounts, thus increasing national gross debt.

⁴⁵ Sinking funds balances and Malta Government Stock (MGS) holdings includes designated funds for repayment of public debt at maturity.

The profile for public debt, characterised by a surge in 2020 and a further increase in 2021 is consistent with the macroeconomic and fiscal scenario, and the estimated SFA presented in the USP. However, the overall downside risk vis-à-vis the profile for real GDP for the period 2020 and 2021, compounded with the overall downside risk vis-à-vis the fiscal balance for the same period, places an upside risk for the debt profile throughout the forecast horizon. This upside risk can also be larger if SFA adjustments turn out larger than factored in the USP. Such scenario can happen in case the COVID-19 related concessions for delayed payments turn out larger than expected because of a longer-than-expected phasing out period.

Chapter 6

Comparison across different fiscal forecasts

6.1 Introduction

The plausibility of the fiscal forecasts contained in the USP 2020 – 2021 can be further assessed by examining the extent of similarity or divergence with the forecasts produced by other reputable institutions. In this respect, a comparison is carried out with respect to the previous vintage of official forecasts (DBP 2020), to assess the magnitude of the revisions brought about by COVID-19, and the forecasts which by the Report's cut-off date (22 May 2020) had already factored in the economic and fiscal impact of the pandemic. The latter include the fiscal forecasts produced by the COM, IMF and two credit rating agencies (Fitch and Moody's). The forecasts produced by other institutions, namely the CBM, and the remaining two major credit rating agencies (Standard and Poor's and DBRS) are not discussed in this Report since these did not yet include the impact of COVID-19 by the cut-off date.⁴⁶ As in the case of the macroeconomic forecasts, the main caveat remains that even the fiscal forecasts are not necessarily based on the same information sets and assumptions related to the possible health and economic effects of COVID-19. Nonetheless, the MFAC considered such comparisons as a valid benchmark against which one could compare the qualitative assessment carried out in Chapter 5.

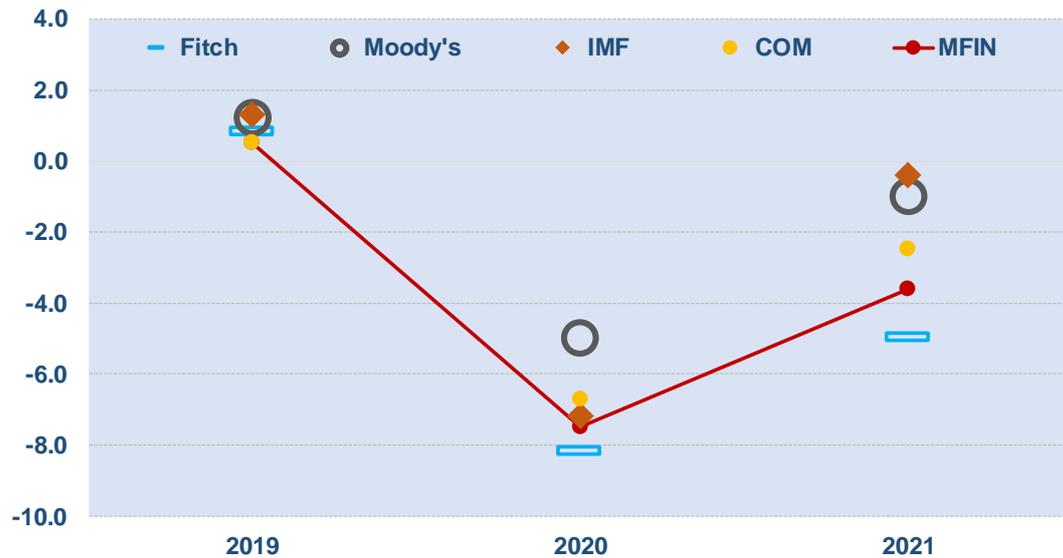
6.2 Fiscal balance

All institutions anticipate a similar trajectory for the fiscal balance over the forecast horizon, namely a large deterioration from a surplus to a deficit in 2020, and a partial reduction in the fiscal deficit in 2021 (see Chart 6.1). The fiscal forecasts presented in the USP fit within the range of projections by other institutions which are available. For 2020, the expected fiscal deficit ranges from 8.2% by Fitch, to 5.0% of GDP by

⁴⁶ The latest CBM forecasts (published on 21 April 2020) show a stable fiscal surplus for 2020 and 2021 at 1.3% of GDP. The CBM however stated that as a result of the containment measures imposed by the government, real GDP growth could fall and as a result would adversely affect the fiscal balance by around 0.8 pp. The latest available forecasts by Standard and Poor's (published on 13 March 2020) shows the fiscal surplus-to-GDP for Malta at 0.5% and 0.7% respectively in 2020 and 2021, while DBRS (published on January 2020) shows the fiscal surplus stable at 0.8% throughout the two forecast years.

Moody's, while for 2021 the range for the fiscal deficit is slightly higher, from 5.0% of GDP by Fitch, to 0.4% of GDP by the IMF. These fiscal scenarios are consistent with the macroeconomic outlook presented by the same institutions and discussed in Chapter 4 in this Report.

Chart 6.1: Fiscal balance estimates by institution (% of GDP)



Source: MFIN, COM, IMF, FITCH, MOODY'S

The USP targets a deficit of €951.9 million in 2020, veering significantly from the pre-pandemic €193.0 million surplus presented in the DBP (see Table 6.1). Indeed, the expected revenue and the planned expenditure were both revised significantly, with revenue lowered by €526.5 million and expenditure raised by €618.4 million.

The revision in total revenue was primarily driven by a €333.9 million downward re-assessment of taxes on production and imports. In turn, the projected intake from current taxes on income and wealth was reduced by €187.0 million, while the expected social contributions were lowered by €73.2 million. These reductions were slightly dampened by the upward revision in 'other revenue'.

In turn, the upward revision in expenditure was mostly related to higher subsidies and intermediate consumption, which were respectively raised by €303.9 million and €157.4 million. Gross fixed capital formation was also revised upwards by €98.4 million. On the other hand, compensation of employees was increased by just €16.7 million. These increases were partly mitigated by a €27.4 million cut in the budget for 'other expenditure'.

Table 6.1: Fiscal forecasts by the MFIN and COM (EUR millions)

	2020			2021	
	MFIN DBP	MFIN USP	COM SPR	MFIN USP	COM SPR
Total Revenue	5,523.6	4,997.1	5,040.0	5,237.9	5,290.0
Taxes on production & imports	1,804.9	1,471.0	1,544.0	1,592.1	1,653.0
Current taxes on income & wealth	2,007.0	1,820.0	1,871.0	1,928.6	1,949.0
Social contributions	870.6	797.4	808.0	828.4	843.0
Other *	841.1	908.7	817.0	888.8	845.0
Total expenditure	5,330.6	5,949.0	5,890.0	5,723.6	5,636.0
Compensation of employees	1,567.9	1,584.6	1,566.0	1,619.3	1,658.0
Intermediate consumption	1,055.4	1,212.8	1,212.0	1,220.8	1,137.0
Social payments	1,308.6	1,378.0	1,361.0	1,386.8	1,369.0
Gross fixed capital formation	573.8	672.2	598.0	664.5	604.0
Subsidies	195.7	499.6	531.0	203.7	217.0
Other **	629.2	601.8	622.0	628.5	651.0
Fiscal balance	193.0	-951.9	-850.0	-485.6	-346.0
Gross debt	5,690.7	6,939.7	6,419.0	7,484.8	6,900.0

* Include capital taxes, property income and 'other' revenue.

** Include interest payments, capital transfers payable and 'other' expenditure.

Source: MFIN, COM

The MFIN's forecasts are most comparable to those by the COM since these were prepared at approximately the same time and are based on similar information sets and external assumptions. For 2020, the revenue forecasts by the COM are slightly more optimistic than those by the MFIN. The COM's estimates for taxes on production and imports, current taxes on income and wealth and social contributions are respectively €73.0 million, €51.0 million and €10.6 million higher than the MFIN's. These are partially offset by the difference in 'other' revenue, for which the COM's forecast is €91.7 million lower than indicated in the USP. The latter can be ascribed to the different assumptions in relation to the absorption of EU funds and the proceeds from the IIP. These variations are broadly carried forward unto 2021, as all components exhibit the same improving outlook. In the COM's forecasts, tax revenues are consistently higher but lower in the case of 'other revenue'.

On the expenditure front, the COM's estimates are slightly lower than the MFIN's for both forecast years. Indeed, for 2020 the main difference relates to spending on gross fixed capital formation, where the COM's estimates are €74.2 million below that planned by the MFIN. This effect is partly muted by subsidies which in the COM's forecasts are €31.4 million higher than indicated in the USP. The differences between the other expenditure components are more contained in absolute terms. Turning to 2021, the highest expenditure variation between the two institutions is on intermediate consumption, as the COM's estimate is €83.8 million less than the MFIN's. On the other hand, both institutions assume similar spending on subsidies, sharing the view on the expiry of the temporary COVID-19 assistance. The COM's forecasts also indicate higher spending on compensation of employees but lower spending on gross fixed capital formation than envisaged in the USP.

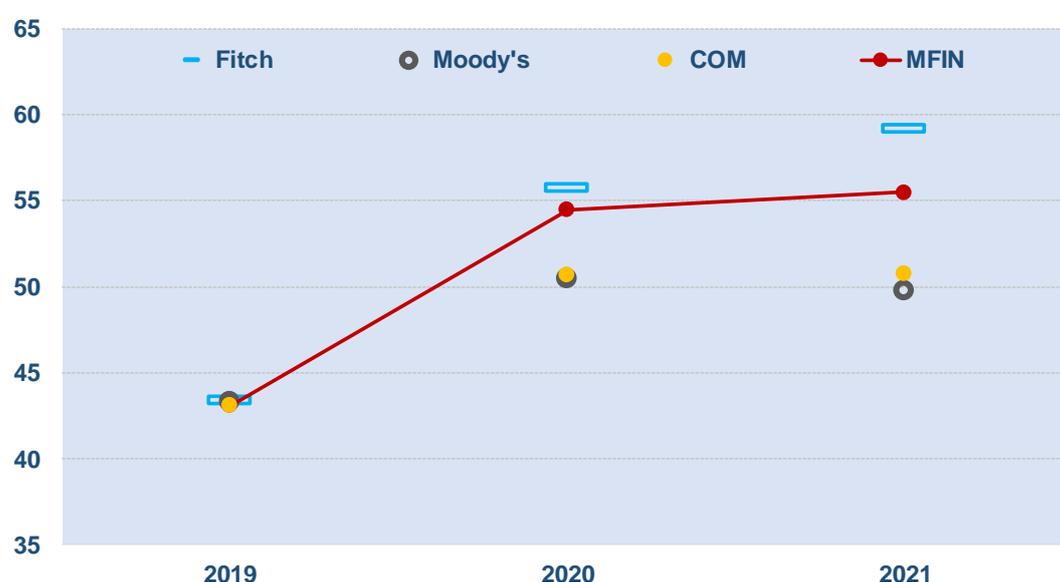
6.3 Public debt

The official debt target for 2020 was revised upwards by €1,249.0 million, to €6,939.7 million, compared to the DBP. This revision slightly exceeds the anticipated deterioration in the fiscal balance as a result of COVID-19, as even the upward impact of SFAs was reappraised. The COM's debt forecast pattern is similar. However, the COM's estimated debt for 2020 is €520.7 million below that indicated by MFIN. Around one-fifth of this discrepancy reflects the lower fiscal deficit expected by the COM compared to the MFIN and the rest is attributable to the different assumptions for the

value of SFA for the year. This level difference is carried unto 2021, so the debt forecast by the COM is again lower than indicated in the USP.

The upward trajectory in the debt-to-GDP ratio, with a spike in 2020 and a further increase in 2021 is shared by the MFIN, COM and the credit rating agencies which had factored the pandemic effects on Malta's public finances (see Chart 6.2).⁴⁷ Indeed, the MFIN's forecast trajectory for the public debt ratio fits within the range of available estimates. Even the more adverse outlook (by Fitch) still places Malta's public debt ratio below the 60.0% of GDP threshold in 2021.

Chart 6.2: Public debt estimates by institution (% of GDP)



Source: MFIN, COM, Fitch, Moody's

6.4 Assessment

The fiscal revisions carried out by MFIN in the USP largely reflect the economic impact of COVID-19. The lower revenue and the higher anticipated expenditure are consistent with the expected contraction in the overall tax base and the temporary support measures implemented. Despite the high level of uncertainty, the fact that the forecasts for the fiscal balance and the public debt produced by the MFIN fit within the range of estimates by the other institutions, supports the overall plausibility of the official fiscal forecasts.

⁴⁷ When considering the debt-to-GDP ratio, an additional source of discrepancy relates to the different forecasts for the value of nominal GDP, which acts as the denominator for this ratio.

Chapter 7

Conclusion

The scenario presented by the MFIN indicates that Malta's real GDP would fall by 5.4% in 2020 due to the temporary negative supply and demand shocks caused by COVID-19. The country is however expected to rebound by 3.9% in 2021 as these adverse shocks are anticipated to diminish in intensity. However, the unprecedented circumstances and the uncertain duration and severity of the health problems make the magnitude and span of the economic downturn highly conditional on the specific scenario considered. Nevertheless, the MFAC considers that the macroeconomic forecasts for 2020 and 2021 presented in the USP provide a plausible and internally consistent scenario which fits within its endorsable range. This while acknowledging that the outturn for important sectors such as tourism plays a critical role in shaping the overall outlook for the economy. This assessment is corroborated by the broad similarity between the macroeconomic projections presented in the USP and the forecasts of other institutions which embed the impact of COVID-19 on the Maltese economy.

Similarly, the MFAC considers the estimates of a fiscal deficit in 2020 and a further, yet smaller, fiscal deficit in 2021, as plausible and within its endorsable range. The consequent rise in the public debt trajectory during these two forecast years is thus also plausible. Still, the fiscal outturn is highly conditional on the period during which the COVID-19 mitigation measures remain in place, which in turn are conditional on the way in which the economy absorbs and reacts to the pandemic-induced demand and supply shocks. The fiscal targets contained in the USP are plausible, but their attainment may prove challenging. The official fiscal forecasts are corroborated by the broad similarity with the fiscal forecasts for Malta produced by other institutions which have factored the fiscal reactions to the pandemic. However, the main challenges stem from the possibility that the pandemic effects last longer than factored in the USP, or if further expansionary measures beyond what is specified in the USP are implemented, or if certain containment in expenditure growth is not carried out in the outer forecast year.

The Council takes note of the decision by the Government to invoke the escape clause in the FRA directly by stating this in the USP, and after the agreement was reached for

invoking this procedure vis-à-vis the SGP at the European level. This is the first time this procedure was adopted since the establishment of the SGP and the FRA.

The Council highlights the importance to target again strong public finances once the downside effects of the pandemic ease out. The fiscal space which was available pre-COVID-19, because of the stream of fiscal surpluses and the low level of public debt, made it possible to implement aggressive fiscal measures to mitigate the negative shock. Rebuilding fiscal space would be useful to counteract any future adverse shocks.

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