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

Dear Minister,

**ASSESSMENT OF THE MACROECONOMIC FORECASTS
CONTAINED IN THE DRAFT BUDGETARY PLAN 2021**

The Malta Fiscal Advisory Council has an obligation under Article 13 of the Fiscal Responsibility Act to endorse, as it considers appropriate, the macroeconomic forecasts prepared by the Ministry for Finance and Financial Services on which the Draft Budgetary Plan is based. Accordingly, the Ministry forwarded to the Council the first estimates on 7 October 2020, and the final set of macroeconomic forecasts on 15 October 2020.

The Fiscal Council acknowledges the ongoing challenges in the preparation of macroeconomic forecasts, as the duration of the COVID-19 pandemic and the severity of its economic impact remains highly uncertain.

The Fiscal Council's assessment focused on an in-depth review of the assumptions employed by the Ministry and comparisons with the latest available forecasts prepared by independent institutions. An online meeting was also held with the Ministry's senior officials to discuss the drivers underpinning the updated official macroeconomic forecasts and the factors contributing to the revisions since the previous vintage produced in April 2020.

According to the Ministry's forecasts, real GDP is expected to decline by 7.4% in 2020. Partial recovery is then anticipated in 2021, as the economy is forecast to grow by 5.0% (see Appendix 1). In turn, nominal GDP is set to contract by 6.3% in 2020 and then expand by 6.4% in 2021.

The 2020 economic scenario is characterised by a strong negative contribution from net exports (-6.7pp) and further downward drag from domestic demand (-1.1pp). These effects are marginally dampened by additions to inventories (+0.4pp). On the other hand, the expected recovery in 2021 is primarily driven by domestic demand (+3.3pp) and supported by net exports (+1.7pp), whereas inventories are assumed not to exert any effect on growth.

In real terms, the strong expansion in government consumption (+18.7%) is expected to sustain domestic demand in 2020, compensating in part for the expected declines in private consumption (-6.0%) and investment (-6.3%). In 2021, the anticipated rebound in private consumption (+3.7%) and investment (+7.5%) is then expected to be partially dampened by the scaling back of the exceptional government consumption (-1.2%) from the previous year. In turn, exports are expected to swing significantly, with a 10.5% contraction in 2020 and a partial recovery amounting to 5.5% next year. These expenditure patterns are together estimated to lower imports by 6.4% in 2020 but raise them by 4.5% in 2021.

The low yearly inflation pattern is expected to persist throughout the two-year forecast horizon. On the other hand, employment, which had expanded significantly in 2019, is projected to decline slightly in 2020. However, job losses are expected to be more than reversed in 2021. As a result, the unemployment rate is set to follow a trajectory with a temporary rise and a subsequent drop, albeit remaining marginally above the pre-pandemic rate.

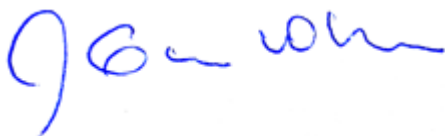
The Fiscal Council notes that the revised official real GDP growth forecast for 2020 is more cautious than had been presented in the Update of Stability Programme in April this year, and this base effect gives rise to an expected stronger pick-up in 2021. The Council also notes that the Ministry's outlook for real GDP growth for the two years fits within the range of forecasts produced by independent institutions which are available to date.

The Fiscal Council is satisfied with the background information and extensive clarifications provided by the Ministry, particularly to verify the internal consistency of the figures presented. At the same time, the Fiscal Council notes that in view of the exceptional circumstances, the macroeconomic outlook remains very sensitive to the assumptions employed. Any material departure from such assumptions could deviate the outcome, possibly significantly, from the outlook as presented in the official forecasts.

Based on the information available to the Malta Fiscal Advisory Council by the date of this letter, 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 macroeconomic forecasts for the period 2020 to 2021 prepared by the Ministry for Finance and Financial Services as part of the Draft Budgetary Plan 2021 to lie within its endorsable range.

A detailed assessment of the macroeconomic forecasts carried out by the Fiscal Council to support its endorsement decision will be published in the Council's forthcoming Report.

Yours sincerely,



John Cassar White
Chairman

Appendix 1: Main macroeconomic indicators

	2019	2020	2021
Real GDP components chain linked volumes, reference year 2015			
Private final consumption expenditure (including NPISH) (y-o-y %)	5.2	-6.0	3.7
General government final consumption expenditure (y-o-y %)	11.5	18.7	-1.2
Gross fixed capital formation (y-o-y %)	8.8	-6.3	7.5
Exports of goods and services (y-o-y %)	6.1	-10.5	5.5
Imports of goods and services (y-o-y %)	7.9	-6.4	4.5
Real GDP (y-o-y %)	4.9	-7.4	5.0
<i>Contribution to real GDP growth:</i>			
Domestic demand (pp)	6.3	-1.1	3.3
Inventories (pp)	0.0	0.4	0.0
Net exports (pp)	-1.4	-6.7	1.7
Nominal GDP (y-o-y %)	7.2	-6.3	6.4
Inflation rate (based on the HICP) (%)	1.5	0.9	1.3
Employment growth (National Accounts definition) (%)	6.5	-0.7	2.3
Unemployment rate (based on the LFS) (%)	3.4	4.8	4.0

Note: Figures for 2019 refer to the provisional values as published by the National Statistics Office on 28 August 2020 (News Release 142/2020), while figures for the period 2020 to 2021 represent the forecasts prepared by the Ministry for Finance and Financial Services.

Source: Ministry for Finance and Financial Services