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The Hon Mr Clyde Caruana B.Com. (Hons) Economics, M.A. Economics
Minister for Finance and Employment
Maison Demandols,
South Street,
Valletta. VLT 2000

Dear Minister,

**ASSESSMENT OF THE MACROECONOMIC FORECASTS
CONTAINED IN THE DRAFT BUDGETARY PLAN 2022**

The Malta Fiscal Advisory Council (MFAC) 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 Employment as part of the Draft Budgetary Plan. The Ministry forwarded to the Fiscal Council the provisional macroeconomic forecasts on 28 September 2021, whereas the final forecasts were submitted on 8 October 2021 (see Appendix 1). These macroeconomic forecasts update the official outlook, which was endorsed by the Fiscal Council in April 2021, as part of the Update of Stability Programme.

The Fiscal Council reviewed the plausibility of the assumptions used by the Ministry in the October 2021 forecast round. Discussions were held with the Ministry's senior officials to examine in detail the drivers underpinning the updated macroeconomic outlook, as well as the factors contributing to the revisions from the previous forecast vintage. The macroeconomic forecasts were further examined in the light of the information available and compared to the forecasts prepared by independent institutions.

Real GDP is forecast to grow by 4.8% in 2021, partially reversing the 8.3% contraction experienced in 2020. In 2022, economic growth is then expected to accelerate, to 6.5%, thereby lifting real GDP above its pre-pandemic level. During these two years, nominal GDP growth is forecast at 7.0% and 8.6%.

Domestic demand is anticipated to be the main driver of real GDP growth throughout the forecast horizon. Net exports are expected to dampen growth slightly in 2021, but in 2022 they are envisaged to reinforce growth. The official economic outlook also embeds the assumption that in 2021 inventories contribute positively to growth, whereas in 2022 they exert no material impact on growth.

The baseline shows that in 2021 all the expenditure components making up real GDP are expected to grow on a year earlier. The fastest growth relates to government consumption, which is anticipated to expand by 9.6%. On the other hand, the recovery in private consumption and investment is expected to be partial in 2021, as the growth rate is respectively forecast at 4.3% and 5.0%. Similarly, the estimated rebound in exports in 2021, at 5.2%, is insufficient to compensate fully for the decline caused by the pandemic in 2020, conditioned by the gradual pick-up in tourism activity. The expected trajectory for domestic demand and exports is estimated to raise imports by 5.9% in 2021.

In 2022, investment is forecasted to grow fastest, by 8.8%. Meanwhile, even the growth rate in exports is expected to accelerate, to 6.6%. On the other hand, the forecast trajectory for private consumption indicates a generally stable growth rate of 4.0% in 2022. In turn, according to the fiscal plans, government consumption growth is set to decelerate to 2.7% in 2022. These expenditure components are together expected to raise imports by 5.5% in the outer forecast year.

Employment is expected to continue registering stable growth, which is however slower than in pre-pandemic years, of slightly more than 2.0% per annum. Meanwhile, the unemployment rate is expected to remain low, hovering around 4.0%. In turn, the yearly inflation measured by the HICP is expected to remain low, at 0.5% in 2021. The upward price pressures are then anticipated to lift the inflation rate to 1.7% in 2022.

The Fiscal Council notes that compared to the previous vintage the official real GDP growth forecast for 2021 has been raised, while that for 2022 was maintained broadly similar. The updated outlook adequately factors the macroeconomic information available to date and the fiscal plans for this period. In its assessment, the Council also acknowledges the uncertainty involved in estimating the pace of economic recovery from the unprecedented downturn caused by the COVID-19 pandemic in 2020.

The Council is satisfied with the background information and extensive clarifications provided by the Ministry, which were required to assess and verify the internal consistency of the forecasts. The Council reiterates the caveat that in view of the exceptional circumstances, the macroeconomic outlook remains very sensitive to the assumptions employed. In particular, the outlook is conditional on the ongoing resilience of Malta's labour market, and that key sectors in the Maltese economy, such as tourism, remote gaming, and financial services, perform in line with current expectations.

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 2021 and 2022 prepared by the Ministry for Finance and Employment as part of the Draft Budgetary Plan 2022 to lie within its endorsable range.

A detailed assessment of the macroeconomic forecasts carried out by the MFAC 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

	2020	2021	2022
Real GDP components chain linked volumes, reference year 2015			
Private final consumption expenditure (including NPISH) (y-o-y %)	-10.0	4.3	4.0
General government final consumption expenditure (y-o-y %)	15.1	9.6	2.7
Gross fixed capital formation (y-o-y %)	-6.5	5.0	8.8
Exports of goods and services (y-o-y %)	-6.3	5.2	6.6
Imports of goods and services (y-o-y %)	-2.7	5.9	5.5
Real GDP (y-o-y %)	-8.3	4.8	6.5
Domestic demand (pp)	-3.4	5.1	4.4
Inventories (pp)	0.6	0.3	0.0
Net exports (pp)	-5.5	-0.5	2.0
Nominal GDP (y-o-y %)	-7.1	7.0	8.6
Inflation rate (based on the HICP) (%)	0.8	0.5	1.7
Employment growth (National Accounts definition) (%)	2.7	2.3	2.2
Unemployment rate (based on the LFS) (%)	4.3	3.8	4.0

Note: The 2020 growth rates for the GDP components are based on the provisional values as published by the National Statistics Office on 27 August 2021 (News Release 156/2021). The figures for 2021 and 2022 represent the forecasts prepared by the Ministry for Finance and Employment. Figures may not add up due to rounding.

Source: Ministry for Finance and Employment