Assessment of the Annual Report 2021 and Half-Yearly Report 2022

MFAC
MALTA FISCAL ADVISORY COUNCIL

November 2022

MFAC

MALTA FISCAL ADVISORY COUNCIL

Assessment of the Annual Report 2021 and Half-Yearly Report 2022

MFAC
MALTA FISCAL ADVISORY COUNCIL

New Street in Regional Road,
Msida, Malta
T: +356 2247 9200
Fax: +356 2247 9219
info@mfac.org.mt
www.mfac.org.mt

04 November 2022

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,

OVERALL ASSESSMENT OF THE ANNUAL REPORT AND HALF-YEARLY REPORT PUBLISHED BY THE MINISTRY FOR FINANCE AND EMPLOYMENT

In terms of the Fiscal Responsibility Act, the Malta Fiscal Advisory Council is hereby presenting its assessment of the Annual Report and the Half-Yearly Report, which were published by the Ministry for Finance and Employment in 2022.

The Council notes that since the publication of Malta's Update of the Stability Programme in April of this year, the international economic environment has remained weak and characterised by high uncertainty. The geopolitical conflict between Russia and Ukraine, the growing risks of stagflation, the soaring debt levels, the supply-chain disruptions ensuing from the Covid-19 pandemic, global warming and climate change, and social instability represent a major headwind to global economic growth; it is no surprise that the International Monetary Fund described the above scenario as a '*perfect long storm'.*

Despite the global economic turmoil, Malta recovered strongly from the contraction experienced during the pandemic year and even surpassed the growth targets set in the Draft Budgetary Plan for 2021 and the 2019 pre-pandemic levels. This growth momentum was maintained during the first months of this year as the economy grew by 7.6 per cent in real terms compared to the same period last year on the back of growth from both the domestic and external sides of the economy.

The activation of the general escape clause of the Stability and Growth Pact has enabled countries to temporarily depart from the adjustment path towards their medium-term budgetary objective and to take all the necessary measures to address the Covid-19 pandemic effectively, sustain the economy and support economic recovery.

The Council acknowledges that the strong Government support to sustain domestic demand and preserve Malta's external competitiveness by combatting the pandemic and limiting the pass-through from high commodity prices to energy and food inflation is critical for a small and highly open economy such as Malta to remain afloat and competitive.

The stronger-than-anticipated economic growth in 2021 translated into higher government revenue than projected in October 2020. However, this was more than offset by higher-than-projected expenditure resulting from the extension of Covid-19 measures to combat the second wave of the global virus in the first half of 2021. This translated into a more significant fiscal deficit but a lower public debt as a share of GDP than anticipated in the Draft Budgetary Plan for 2021, as the more substantial economic growth outweighed the fiscal gap deviations in 2021.

The Council notes that the official macroeconomic forecasts and fiscal projections for 2022 specified in the Half-Yearly Report remained the same as published in the Update of Stability Programme in April 2022. The Programme envisaged 4.4% real GDP growth for 2022, a fiscal deficit of 5.4% of GDP and a public debt-to-GDP ratio of 58.6%. The Council had considered these forecasts within its endorsable range in its previous Report. The limited official statistics which became available since the publication of the forecast endorsement remain compatible with the macroeconomic and fiscal scenario as presented by the Government.

As highlighted in its Assessment of the Update of the Stability Programme 2022-25, the MFAC reiterates the caveat that given the elevated uncertainty in the global economy, the macroeconomic and fiscal outlook remains highly sensitive to the assumptions employed. The MFAC would also like to stress that when economic conditions allow, fiscal policies should again be aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability.

Finally, the Council would like to thank the Ministry for Finance and Employment staff for their collaboration and support in preparing this Report.

Yours Sincerely,

John Cassar White
Chairman
Malta Fiscal Advisory Council

Table of contents

List of tables

List of charts

Abbreviations

COM	European Commission
COVID-19	Coronavirus disease 2019
DBP	Draft Budgetary Plan
EBU	Extra Budgetary Units
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
LFS	Labour Force Survey
MFAC	Malta Fiscal Advisory Council
MFE	Ministry for Finance and Employment
MTFS	Medium-Term Fiscal Strategy
NPISH	Non-Profit Institutions Serving Households
NSO	National Statistics Office
pp	percentage point
RRF	Recovery and Resilience Facility
USP	Update of Stability Programme
VAT	Value Added Tax

Executive Summary

The latest Annual and Half-Yearly reports published by the Ministry for Finance and Employment, respectively, focus on an ex-post assessment of the deviations between the actual and forecast macroeconomic and fiscal developments in 2021 and present the macroeconomic and fiscal outlook for 2022.

According to NSO News Release 095/2022, nominal GDP growth is estimated to have recovered well from the contraction experienced a year earlier, registering a growth rate of 12.4% in 2021. This growth forecast well exceeded the rate of growth projected by the Ministry for Finance and Employment in the USP 2021-2024 (5.9%) and in the Draft Budgetary Plan 2021 (6.4%). This growth momentum was maintained during the first quarter of this year as the economy grew by 10.7% in nominal terms compared to the same period last year, on the back of a positive contribution from both the domestic and the external sides of the economy. The growth registered in the first quarter outperforms the projection for this year by the Ministry for Finance and Employment in the Draft Budgetary Plan 2022 (+8.6%) published in October 2021, and the Update of the Stability Programme (+7.5%) published in April 2022.

The stronger-than-anticipated economic growth in 2021 translated into higher government revenue than projected in October 2020. However, this was more than offset by higher-than-projected expenditure resulting from the extension of Covid-19 measures to combat the second wave of the global virus in the first half of 2021. This translated into a larger fiscal deficit, but a lower public debt as a share of GDP than anticipated in the Draft Budgetary Plan for 2021, as the stronger economic growth outweighed the fiscal gap deviations in 2021. In fact, the general government fiscal deficit amounted to €1,166.3 million on an ESA basis, €373.8 million more than projected in the Draft Budgetary Plan for 2021. The underestimation of the deficit projections was mainly related to the assumption that the COVID-19 pandemic would fade away sooner in 2021, with less recourse to significant expenditure on measures implemented to address the pandemic. However, the fiscal impact remained elevated, as other variants of COVID-19 emerged throughout the year, and more expenditure was needed. The additional support was made possible through the activation of the general escape clause of the Stability and Growth Pact, which has enabled countries to temporarily depart from the adjustment path towards their medium-term budgetary

objective and take all the necessary measures to effectively address the Covid-19 pandemic, sustain the economy and support economic recovery.

The Half-Yearly Report restated the macroeconomic and fiscal outlook for 2022, which had been indicated in April 2022 as part of the Update of the Stability Programme. The Council notes that the Government decided not to update the macroeconomic and fiscal projections before the next forecast round (October 2022). The real GDP growth estimate for 2022 was reconfirmed at 4.4%, while the targets for the fiscal balance and the public debt ratios remained at 5.4% and 58.6%, respectively. The Council considers that the macroeconomic and fiscal forecasts for 2022, as of July 2022, continue to lie within its endorsable range, and the risk assessment presented in its previous Report remains valid.

Chapter 1
Introduction

Each year, the Ministry for Finance and Employment (MFE) publishes an Annual Report and a Half-Yearly Report, adhering to the Fiscal Responsibility Act (FRA) requirements. These reports aim to enhance economic and fiscal transparency in Malta by providing an *ex-post* assessment of the deviations between the actual and forecast macroeconomic and fiscal developments in 2021 and the outturn during the first half of the current year. The FRA prescribes that the Malta Fiscal Advisory Council (MFAC) publishes an assessment of both reports.

The latest Annual Report published in June 2022 presents and compares actual macroeconomic data for 2021 to the forecasts prepared by the MFE during the previous year. The Annual Report also provides information on the execution of the fiscal budget and compares the outcome with the set targets. Given that the Draft Budgetary Plan (DBP) for 2021 and the 2020 Medium-Term Fiscal Strategy (MTFS) were published within a span of 3 months, incorporating the same projections, only one set of forecasts based on the European System of National and Regional Accounts (ESA) is compared to the actual data in the Annual Report.[1] The ex-post assessment is intended as a means to evaluate the quality of the official forecasts, possibly detecting any forecast bias which might occur repeatedly over the years. Given that in 2021, the world economy was still heavily affected by the pandemic and its aftermath, any deviations from the actual outturn need to be analysed and interpreted within this context.

On the other hand, the Half-Yearly Report provides a comparison and an update of the macroeconomic and fiscal forecast vintages published in October 2021 and April 2022. The Half-Yearly Report was prepared in July 2022 to provide an update on whether any significant developments have occurred since the latest forecast vintage and, if necessary, undertake corrective or fine-tuning measures in the macroeconomic and/or fiscal forecasts for the current year. In this year's report, the MFE concluded that the projections in Malta's Update of the Stability Programme (USP) 2022-2025 published in April 2022 remain plausible, and therefore, no revisions were necessary. However,

[1] In previous years, the MTFS used to be published following the publication of the Update of Stability Programme (USP), and thus close to mid-year. In this case, the actual data in the Annual Report was usually compared to two sets of forecasts (the MTFS and the DBP).

the MFE highlighted that the current situation of rising prices and geopolitical tension warrants regular monitoring of the situation. The Half-Yearly report states that although plausible, there could be upside risks to the macroeconomic forecasts published in April 2022. The report also includes provisional fiscal ESA revenue and expenditure estimates for the first half of the year, enabling an assessment of whether revenue and expenditure developments are harmonious with the yearly targets.

The structure of this report is as follows: chapter 2 evaluates the macroeconomic developments and the forecasting performance in relation to 2021 and analyses how distant the forecast produced in Malta's USP 2022-2025 for 2022 is from actual data for the first quarter of the same year. Chapter 3 is similar to the previous chapter, but it focuses on the fiscal developments for 2021 and the first half of 2022. Finally, chapter 4 concludes with an overall assessment.

Chapter 2

Macroeconomic developments in 2021 and updates for 2022

The MFE's Annual Report evaluates the accuracy of the 2021 forecast growth rates for the GDP components and other macroeconomic variables included in the USP 2021-2024 (published in April 2021) and the DBP 2021 (published in October 2020).[2] These forecasts are compared with the official statistics published by NSO, mainly contained in the national accounts released in May 2022 (News Release 095/2022).[3] The MFE's Annual Report focuses on developments in nominal terms since these serve as the main input to prepare the official fiscal forecasts.

In 2021, the economic outcome is estimated to have recovered well from the contraction experienced a year earlier, registering a nominal growth rate of 12.4%. This growth outturn is more or less double the growth rate projected by the MFE in the USP 2021-2024 (5.9%) and in the Draft Budgetary Plan 2021 (6.4%).

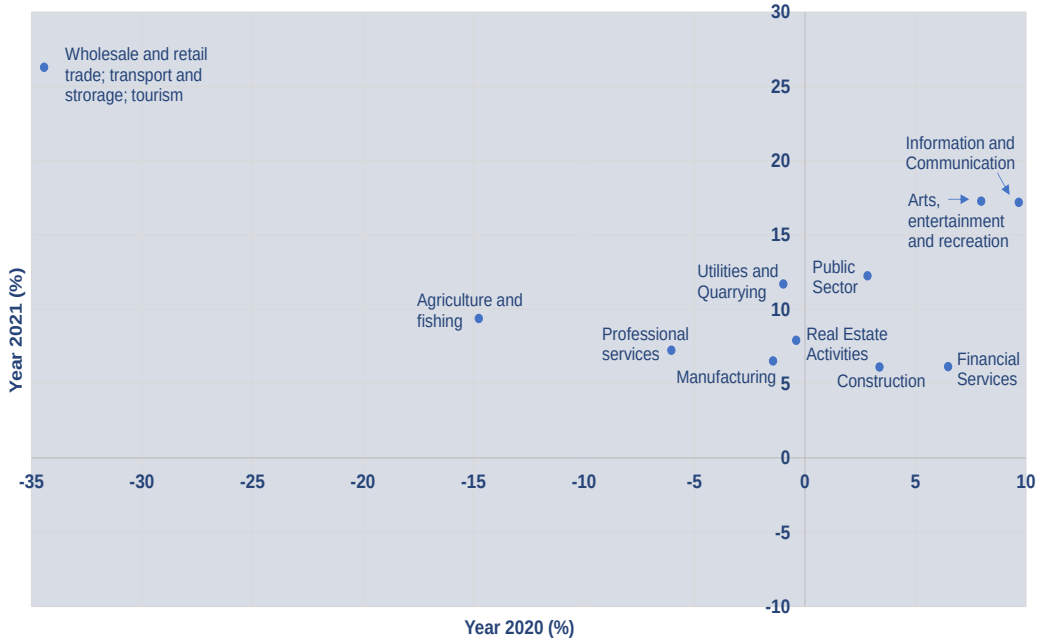
From the output side, growth was broad-based, with the services sector being the largest contributor to economic growth (see Chart 2.1). More than half of the economic sectors featured registered negative growth in 2020 but recovered strongly in 2021. Wholesale and retail trade, transportation and storage and accommodation and food services activities sector registered the worst during the pandemic year (-34.4%) but recorded the strongest recovery the following year (26.3%), contributing to around one-third of the growth in value added experienced by the Maltese economy in 2021. Growth in 2021 was mainly on the back of double-digit growth rates in wholesale and retail trade and increases in the tourism activities sector, the latter on the back of higher tourist numbers and double expenditure figures following the pandemic of 2020 in which inbound tourism fell by 76.1%, and tourism expenditure fell by 79.5%. The sector comprising public administration, health and education recorded higher growth in 2021 (12.3%) compared to 2020 (2.8%) and contributed to around 2.2 percentage points of the growth in value added. The information and communication sector and the arts,

[2] The Annual Report 2021 is available here.
[3] This News Release provided the latest official GDP statistics at the time the Annual Report was prepared. GDP statistics remain provisional for many years, which means that the "actual" data for the year may change across vintages because of revisions.

entertainment and recreation sector recorded strong growth in 2020 and even stronger growth in 2021, both increasing by more than 17.0%.

From the domestic side, domestic demand was the main driver of economic growth, contributing 9.9 percentage points to GDP growth. Meanwhile, net exports contributed 2.8 percentage points to economic growth while the inventories component accounted for the residual growth.

Chart 2.1: Gross Value Added Growth (%) - 2020 and 2021

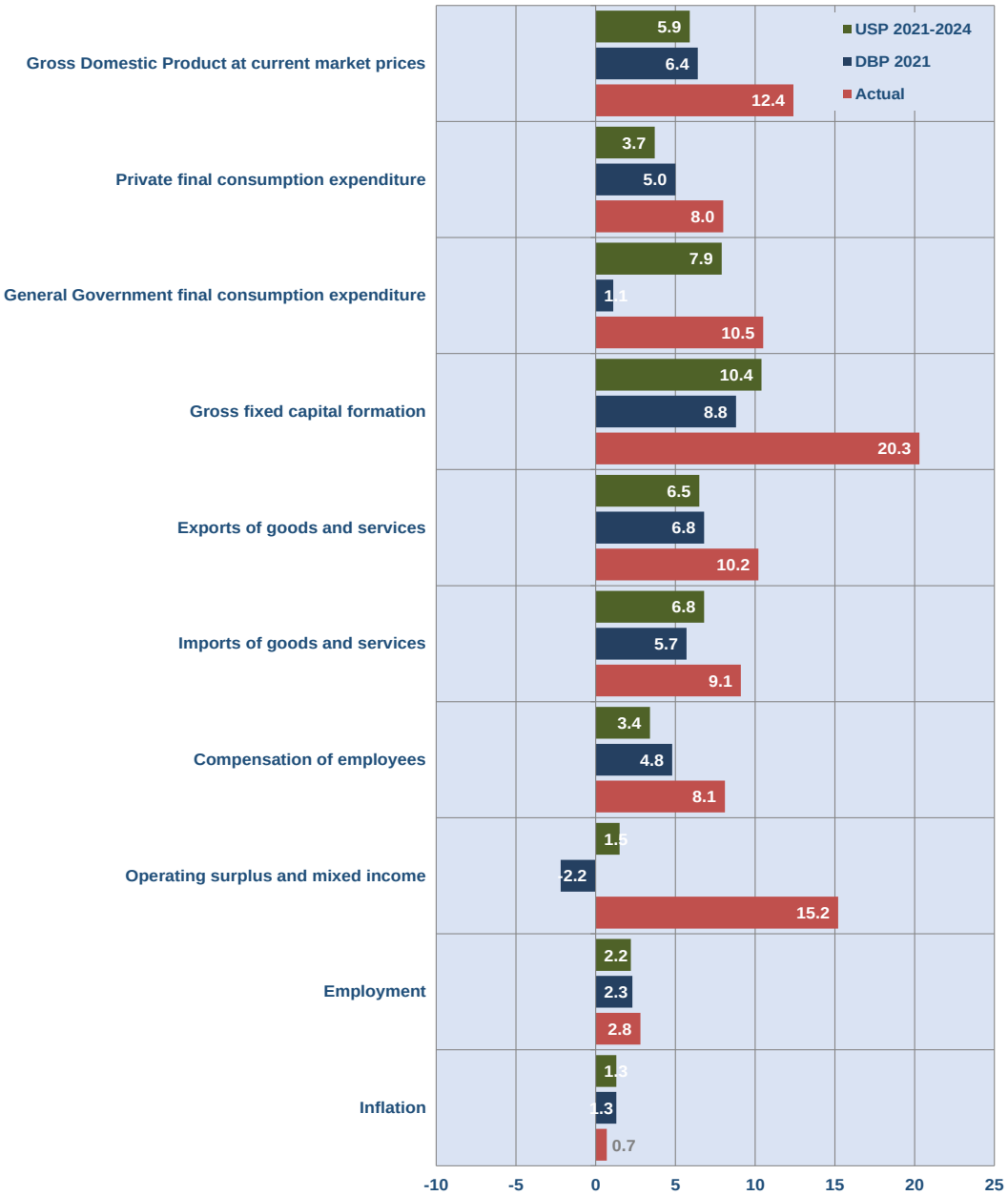


Source: NSO

At an expenditure component level, increases were broad-based (see Chart 2.2). Private consumption expenditure increased by 8.0% after contracting by 9.2% a year earlier. Such growth is on the back of a buoyant labour market, a subdued inflation rate and strong increases in compensation per employee growth. Nominal gross fixed capital formation experienced a similar trajectory, contracting by 6.7% during the pandemic year after a number of planned private sector projects were postponed because of the pandemic. However, in 2021, total investment increased by 20.3%, primarily driven by private investment in transport equipment and, to a much lesser extent, by investments in metal products and machinery. The MFAC notes that the growth trajectory of these two components surpassed the projections put forward by MFE in the 2021 DBP and the USP 2021-2024.

Following a contraction of 3.1%, nominal exports increased by 10.2% in 2021, in contrast with the 6.8% and the 6.5% growth forecasts indicated in the DBP and the USP, respectively. This growth was mainly on the back of the growth experienced by Malta's main trading partners and a depreciation in the Euro relative to the US dollar and the British Pound compared to 2020. Although tourism turned out weaker than expected in the DBP, however, other sectors which proved to be resilient during the pandemic year, such as information and communication and remote gaming, offset the lower growth in tourism.

Chart 2.2: Nominal macroeconomic developments in 2021 (% change over 2020)



Source: MFE

The only GDP component which recorded a lower growth rate than that in 2020 was government consumption. In fact, general government consumption expenditure increased by 10.5% in 2021, 7.7 percentage points less than the growth rate in 2020. Nonetheless, the growth rate observed in 2021 is still higher than that projected by the MFE in the DBP and the USP.

The stronger-than-anticipated recovery in 2021, particularly the higher growth in domestic and external demand, led nominal imports to perform stronger than anticipated in the DBP and the USP. Imports increased by 9.1% compared with a projected growth rate of 5.7% in the DBP and 6.8% in the USP.

From the income side, compensation of employees and gross operating surplus and mixed incomes also turned out stronger than anticipated. In 2021, the former increased by 8.1%, mainly attributed to stronger employment growth and higher compensation per employee, while the latter increased by 15.2%. The DBP projected a growth rate of 4.8% in the compensation of employees, while the USP expected 3.4% growth. On the other hand, gross operating surplus and mixed incomes was projected to increase by 1.5% in the USP and to decline by 2.2% in the DBP. On the contrary, the inflation rate turned out lower than expected at 0.7% compared to 1.3% projected in the USP and in the DBP.

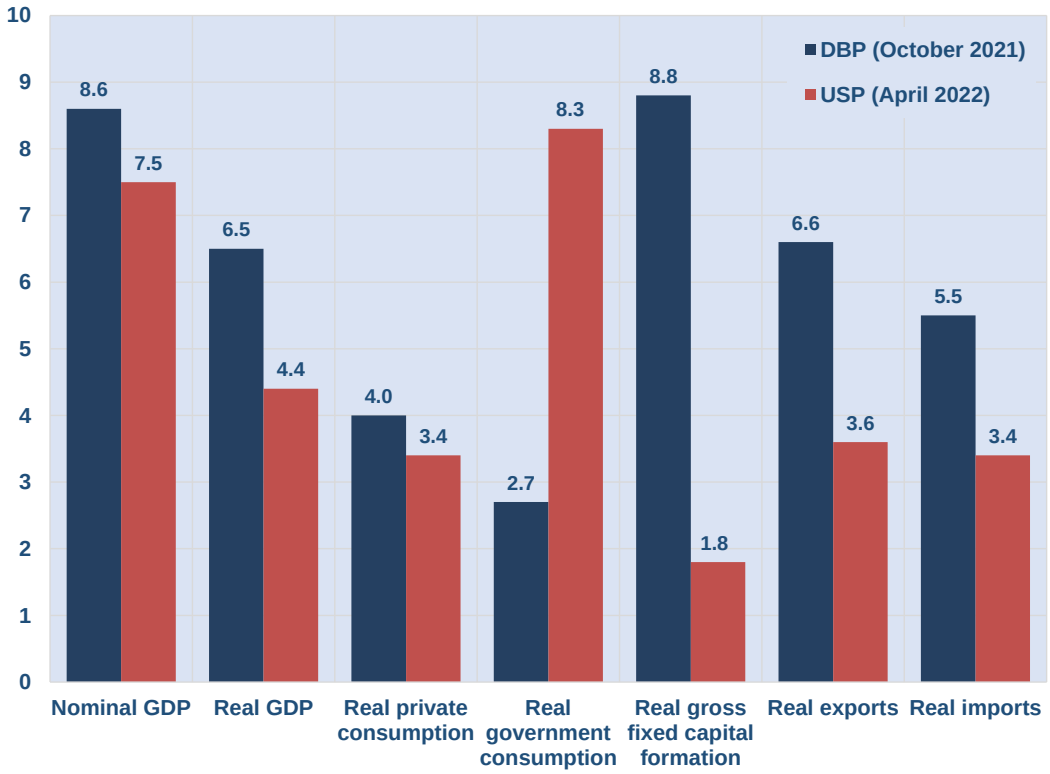
Turning to 2022, the Half-Yearly report reconfirmed the macroeconomic forecasts presented in the USP 2022 – 2025.[4] This approach is identical to that adopted in previous years. Between the submission of the USP and the preparation of the Half-Yearly Report, the actual GDP statistics for the first quarter of 2022 become available. However, the informativeness of the first quarter statistics in relation to the annual outturn is normally considered by MFE to be somewhat limited, owing to the fluctuations in the quarterly patterns, as well as the revisions which are regularly carried out by NSO. The macroeconomic forecasts published in the USP 2022 – 2025, which have been analysed and endorsed by the MFAC, thus serve as Malta's latest official macroeconomic forecasts to date.[5]

The USP had revised the 2022 nominal and real GDP growth forecasts downwards when compared to the DBP 2021. This downward revision was mainly due to the

[4] The Half-Yearly Report for 2022 is available on the MFE's website here.
[5] The MFAC's assessment, which was published in July 2022, is available here.

emergence of the Russia-Ukraine conflict and the supply-chain disruptions which ensued. Nominal GDP growth was lowered by 1.1 pp, while real GDP was revised down by 2.1 pp between the two forecast vintages (see Chart 2.3).

Chart 2.3: Forecast growth in GDP and its components for 2022 (y-o-y % change)



Source: MFE

Domestic demand was still expected to be the main driver of economic growth in 2022 in the USP, though to a lesser extent than in the DBP. This is owed to a downward revision in private final consumption expenditure and in gross fixed capital formation. On the contrary, these downward revisions were partly offset by the upward revisions in general government final consumption expenditure when comparing the DBP to the USP.

Similarly, the outlook for net exports was also revised downwards between the two forecast vintages. In the USP, the external side of the economy is expected to be revised downwards to 0.8 pp from 2.1 pp in the DBP. This is driven by downward revisions in both exports and imports, though the revisions in the former were more pronounced when compared to the latter. These revisions were in light of the Russia-Ukraine invasion representing a major headwind to economic growth, adding considerably upward inflationary pressures and the resurgence of the Omicron variant

in Autumn, slowing down even further global economic recovery, which further exacerbated supply-chain disruptions and shortages of key vital inputs. The contribution from the inventories component remained the same between both vintages.

Table 2.1: Other macroeconomic forecasts for 2022 (%)

	DBP (October 2021)	USP (April 2022)	Difference (pp)
Inflation rate	1.7	3.5	1.8
Employment growth	2.2	2.4	0.2
Unemployment rate	4.0	3.4	-0.6
Potential GDP growth	3.6	3.8	0.2
Output gap	- 2.5	- 1.2	1.3

Source: MFE

Potential GDP growth for 2022 was increased slightly, from 3.6% to 3.8%, consistent with higher employment growth and a lower unemployment rate (see Table 2.1). In fact, employment growth was increased by 0.2 pp while the unemployment rate was revised downwards by 0.6 pp. Due to the concurrent upward revision in potential GDP growth and the expected lower real GDP growth, in 2022, the Maltese economy is expected to retain a negative output gap, though less pronounced than in the Autumn forecast exercise.

Chapter 3

Fiscal outturn in 2021 and half-yearly developments in 2022

This section assesses the fiscal developments presented in the Annual Report for 2021 and in the Half-Yearly Report 2022 published by the MFE. The forecasts produced in the DBP 2021 / MTFS 2020 are compared with the outturn in 2021.[6] The required developments in each revenue and expenditure component to attain the targets set in the Update of Stability Programme 2022 – 2025 are evaluated vis-à-vis estimates for the first half of 2022.[7]

3.1 Fiscal outturn in 2021

In 2021, the general government fiscal deficit on an ESA basis amounted to €1,166.3 million (see Table 3.1).[8] The outturn was a lower deficit than that recorded in the Consolidated Fund, as the latter's balance was a deficit of €1,242.3 million.[9] The deficit turnout is larger than forecasted and published in the DBP 2021 and the MTFS issued in 2020. In terms of the ESA balance, the variance was €373.8 million, whilst the Consolidated Fund's balance turned out €485.7 million worse than the approved estimates which were announced in the Budget of October 2020 for 2021.

The underestimation of the deficit projections was mainly related to the assumption that the COVID-19 pandemic would fade away sooner in 2021, with less recourse to significantly high expenditure and measures to address the pandemic. However, the fiscal impact remained elevated, as other variants of COVID-19 emerged throughout the year and more health expenditure (i.e., intermediate consumption) was needed. Despite such difficulties, the economy recovered more quickly than expected, which led to higher fiscal revenue. Indeed, the €247.1 million more revenue than projected in

[6] Data sourced from the Annual Report 2021 is available here.
[7] The estimates are sourced from the Half-Yearly Report for 2022, available here.
[8] Actual data quoted in this section is sourced from the Annual Report 2021. There are some variations in the figures quoted in the Annual Report to those reported in NSO News Release NR 067/2022.
[9] The Consolidated Fund is based on cash transactions (which are not usually revised). ESA fiscal data is compiled on an accruals basis (subject to revisions), and has a wider coverage since the activities of Extra-Budgetary Units (EBUs) are also included. The latter is the method generally used to assess the government's fiscal stance and is the method on which this section shall mainly focus. The source for actual Consolidated Fund data is NSO News Release 053/2022 - Government Finance Data: January-December 2021.

the DBP 2021 / MTFS 2020, offset more than one-third of the variation in expenditure, with the latter having been underestimated by €620.9 million.

Table 3.1: Main developments in 2021 on an ESA basis (EUR millions)[10]

	DBP 2021 / MTFS 2020	Actual 2021	Variation
Revenue	**5,201.5**	**5,448.6**	**247.1**
Taxes on production and imports	1,663.3	1,575.7	-87.6
Current taxes on income and wealth	1,857.5	2,029.8	172.3
Social contributions	819.4	914.9	95.5
Market output and output for own final use	434.2	548.2	114.0
Other revenue	427.1	379.9	-47.2
Expenditure	**5,994.0**	**6,614.9**	**620.9**
Compensation of employees	1,667.7	1,769.6	101.9
Intermediate consumption	1,220.8	1,359.3	138.5
Social payments	1,387.6	1,389.5	1.9
Subsidies	405.4	685.7	280.3
Gross fixed capital formation	676.5	607.4	-69.1
Other expenditure	636.0	803.5	167.5
General government balance	**-792.5**	**-1,166.3**	**-373.8**

Source: MFE

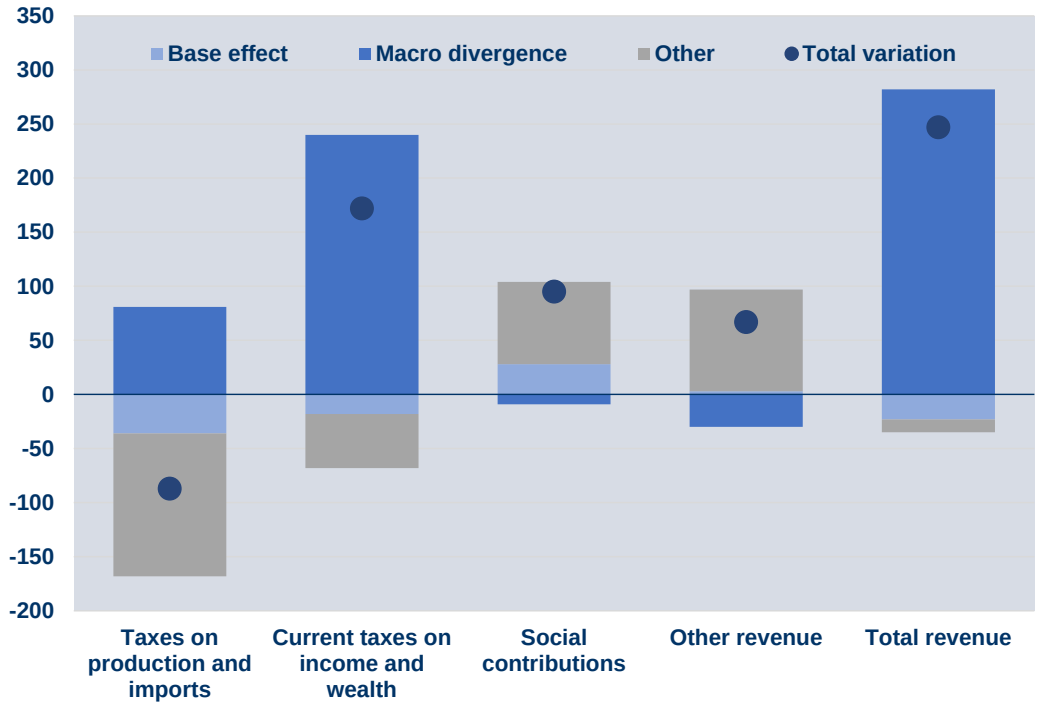
Although indirect tax revenue turned out less than projected, this was outpaced by the strong growth in current taxes on income and wealth. As outlined in Chapter 2 of this Report, the growth in total compensation of employees was 3.3 pp more than what was forecasted, whilst profits increased by more than 15.0% from the level in the

[10] Actual data is sourced from the Annual Report 2021. There is a marginal variation in the figures quoted in the Annual Report to those reported in NSO News Release NR 067/2022.

previous year, whilst the projections were that these would again decline in 2021. This gave rise to a more significant revenue stream from income tax, contributing largely to the total variation in current taxes on income and wealth of €172.3 million. Indeed, on a cash basis, the outcome for income tax turned out nearly €300 million more than the approved estimate. Concomitantly, according to the MFE, the variation in current taxes on income and wealth was entirely due to updated macroeconomic projections with other revisions and divergences due to the outturn of the previous year offsetting this to a certain extent (see Chart 3.1).[11] On the other hand, taxes on production and imports were boosted by a positive contribution from an updated macroeconomic forecast, mainly as private consumption turned out higher than expected, but 'other revisions' have completely offset this upward push.

Social security contributions also turned out higher than expected, by €95.5 million. 'Market output and output for own final use' was also under-estimated, but the 'other revenue' component compensated partially as these were over-estimated.

Chart 3.1: Source of revenue forecast error compared to the DBP (EUR millions)[12]



Source: MFE

[11] These represent the variances as recorded by the MFE.
[12] The variations quoted in this chart are those produced and shown by the MFE in the Annual Report. Note that figures might not add up due to rounding.

The overshoot in public spending was due to a higher outlay among all expenditure components, except for gross fixed capital formation. The largest variation was in terms of the unplanned higher subsidies (+€280.3 million). The extension of the wage supplement scheme, and more subsidies aimed at supporting the energy sector resulted in higher spending relating to this component. Expenditure on intermediate consumption also exceeded the budgeted amounts in view of the unanticipated costs associated with healthcare, particularly those relating to COVID-19 treatment and detection, and more spending than envisaged was exercised by Extra-Budgetary units (EBUs). The increase in 'other expenditure' was mainly due to higher accrued EU Own resources, whilst compensation of employees resulted larger because of higher personal emoluments both in central government and in EBUs.

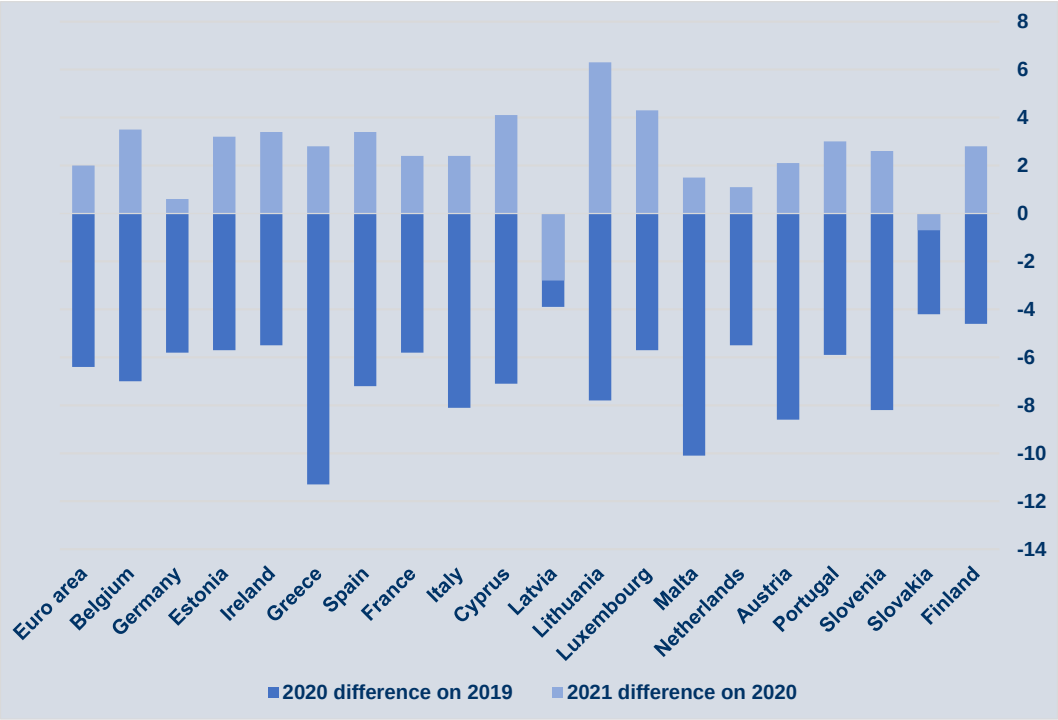
The European Commission's activation of the general escape clause in 2020 allowed Member States to temporarily depart from the adjustment path towards their medium-term objective, with the fiscal rules being lifted. This clause was carried on to 2021, and the recommendation was for countries to remain supportive of their fiscal policies, supporting economic activity against the background of considerable uncertainty. This was indeed the stance taken by the Government of Malta.

When comparing the fiscal developments of Malta to other euro area countries, the negative change in the fiscal balance in 2020, primarily caused by the pandemic, was one of the largest (see Chart 3.2). Countries in which tourism plays a key role in their economy (mostly the Mediterranean countries), were impacted more than the rest, as the sectors linked to tourism activities required a higher degree of fiscal support.

When assessing the change in the fiscal balance in 2021, almost all countries improved their fiscal position. However, despite that Malta had one of the highest fiscal deficits in 2020, the positive change in the fiscal balance (year-on-year) in 2021 was still one of the lowest among euro area countries, with the government of Malta continuing to aid heavily the economy through more COVID-19 expenditure.

The recovery in the fiscal balance in 2021, across all euro area countries, was entirely due to more revenues and not aided by declines in expenditure (see Chart 3.3). Malta's stance in 2021 was thus in line with the rest of the countries within the euro area. Still, Malta had one of the highest growths in expenditure, relatively, among these countries. Counteracting this, the country experienced one of the highest percentage increments in fiscal revenue in 2021.

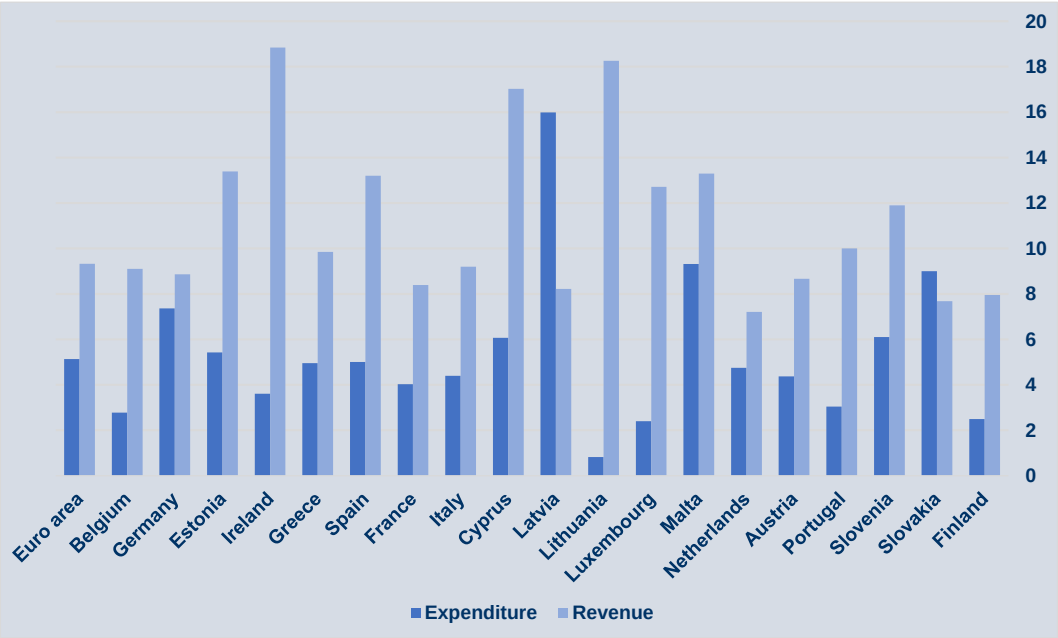
Chart 3.2: Year-on-year change in the general government fiscal balance to GDP ratio – euro area (percentage points)



Note: This chart is a clustered column chart. In the case where two columns overlap, the change for that year is still measured from the horizontal axis until the end of the column. The change represents the ratio in year 't', minus the ratio in year 't-1'.

Source: Eurostat

Chart 3.3: Revenue and expenditure growth in 2021 across euro area countries (%)

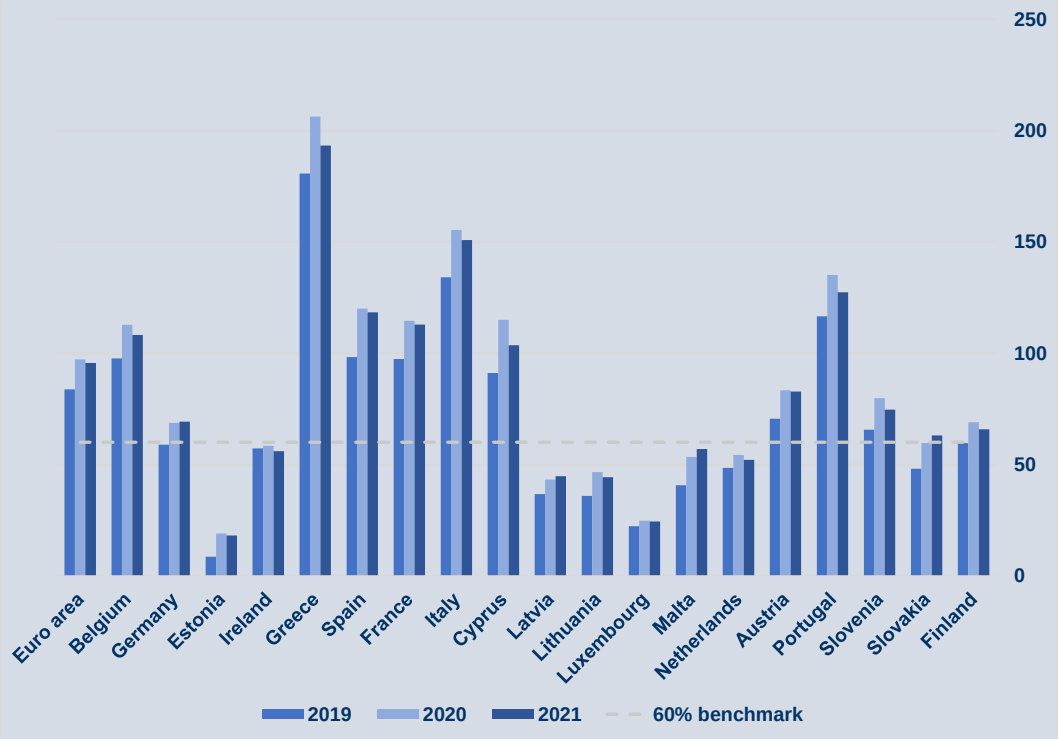


Source: Eurostat

In respect of the general government debt-to-GDP ratio, the outturn was marginally better than projected in the DBP 2021 / MTFS 2020. Indeed, the public debt ratio was estimated at 58.6% at the time, whilst this turned out as 56.4%. The higher variation in the fiscal deficit was more than offset by a better-than-projected growth in GDP.

Malta's debt position did not exceed the 60% benchmark in either 2020 or 2021, despite the significant increase in the country's debt ratio since 2019 (see Chart 3.4). Compared to the euro area, the country's debt is significantly lower as the euro area average stands close to 100.0% of GDP in 2021. However, in 2021, most countries improved their debt ratio when compared to 2020, though by a marginal extent, whilst in the case of Malta, the ratio has marginally worsened. Despite the very high nominal GDP, the contribution to the change in the debt ratio from the primary balance, interest expenditure and stock-flow adjustments was larger.

Chart 3.4: Debt-to-GDP ratio across euro area countries (% of GDP)

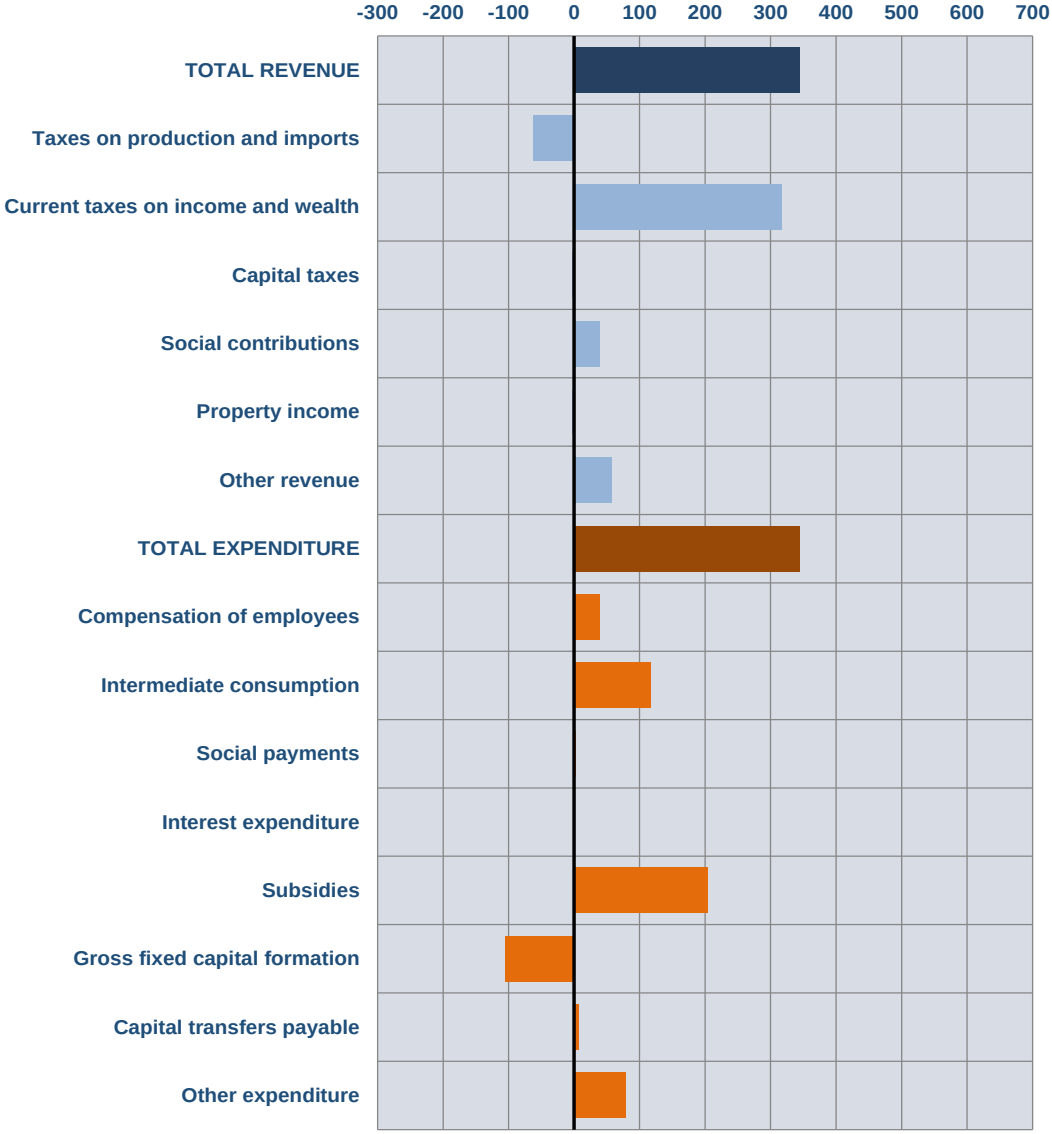


Source: Eurostat

3.2 2022 Half-Yearly Developments

The Half-Yearly Report provides an update on the changes between the most recent ESA fiscal forecast (USP 2022 – 2025), and the forecasts published in October 2021

Chart 3.5: Revisions between DBP and USP fiscal forecasts



Source: MFE

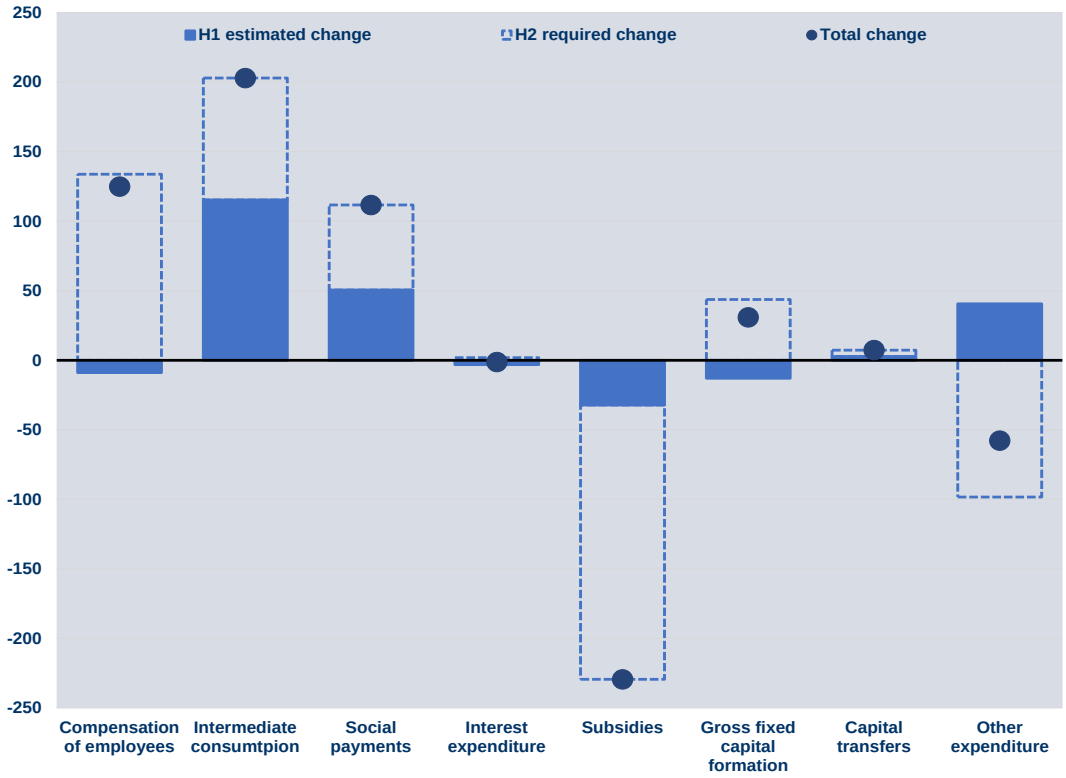
within the DBP 2022 (see Chart 3.5). The revisions in total revenue and total expenditure were of the same magnitude, both around €344.0 million more in the USP than in the DBP. The same fiscal balance estimate for 2022 was thus maintained at around €850.0 million.[13] The main contributor to higher revenue was current taxes on income and wealth, given the better developments in compensation of employees and gross operating surplus. In terms of expenditure, subsidies relating to a prolonged extension of the wage subsidy than anticipated and the introduction of energy-related measures, and higher intermediate consumption, mainly relating to health-relating expenditure, were the main updates pushing total expenditure up from the previous

[13] In the DBP, the fiscal balance was €850.7 million.

forecast round. The only two variables that were revised downwards were taxes on production and imports (revenue), due to the anticipation of more subdued economic developments, and public gross fixed capital formation (expenditure), reduced due to lower investment in part financed from foreign funds and also from national funds.[14]

The Ministry's Half-Yearly Report provides provisional half-yearly estimates of the government's fiscal position.[15] Such information is useful in assessing the required revenue and expenditure (for each component) needed for the other six months (July – December) to meet the targets set in the USP.

Chart 3.6: Mid-year estimated and required expenditure performance to meet the targets set in the USP 2022-2025 (EUR millions)



Source: MFE

The estimated total expenditure between January and June of 2022 reached 48.2% of the amount targeted for the year, thus close to half the projection. However, at a component level, expenditure was uneven (see Chart 3.6). The magnitude of the actual changes estimated over the first half of 2022 and those required during the second half

[14] The full MFAC assessment of the USP 2022 - 2025 fiscal projections is available on the MFAC's website here.
[15] The data for the second quarter of 2022 was partly estimated by the MFE and is to be considered provisional.

of 2022 (to be consistent with the overall yearly change) are somewhat different for the various expenditure components.

It should be noted that indeed in some cases, it might be challenging to achieve the planned yearly spending, however, other discrepancies between the first and second six months of the year might be due to the different timing of when certain expenditure is carried out. This is more relevant for expenditure, given the much more discretionary element than revenue.[16] Such occurrences are trend-like behaviour rather than a one-off incidence.

In the case of compensation of employees, there was a marginal decline during the first six months of the year of around 1.0% compared to the same period in 2021. This suggests that all of the estimated increase in the compensation of employees in 2022 has to be recorded in the second half of the year. Given the additional €133.7 million required in the second half of 2022 when compared to the same period in 2021, it could be a challenge to exert such expenditure, which might make room for some cost savings. Expenditure on gross fixed capital formation also declined over the first six months, which is contrary to the expected increase anticipated for the year. The required change to achieve the revised target is an increase of €43.7 million. The lower investment than last year resulted due to lower expenditure on projects in part financed from EU funds and also from domestically financed capital expenditure.

Intermediate consumption and social payments are on track and in line with their estimates for the year. Indeed, the estimated change over the first half of the year for these two components is close to half of the total required for the year.

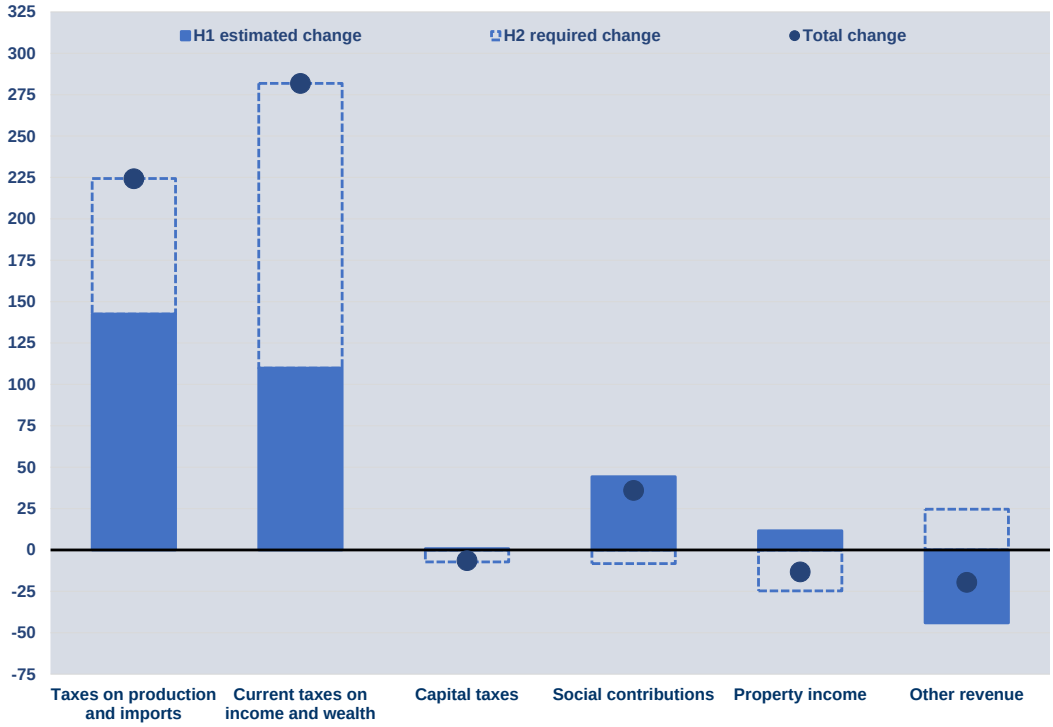
With respect to subsidies, the larger effort required in the second half of the year than in the first is justified because the wage subsidy was still in place until May 2022, and thus its termination thereon would result in a larger reduction of expenditure on subsidies over the rest of the year, when compared to 2021.[17]

[16] Revenue is more dependent on macroeconomic developments.
[17] At the time of the USP, the estimated cost of Malta Enterprise Schemes in 2022 was listed as €72 million, a drop of €296.2 million from the estimated expenditure in 2021. The introduction of the energy-related measures in part offset some of this wage subsidy termination. At the time of the USP, the estimated cost of energy-related measures for 2022 was around half the estimates produced.

Interest expenditure and capital transfers varied only slightly compared to the annual target, as these are smaller and more stable components of expenditure. Expenditure listed as 'other' turned out higher than the previous year over the first six months, meaning a significant reduction must be performed over the rest of the year to achieve the targeted reduction.

The total revenue for the first half of 2022 represented around 47.0% of the total amount targeted for the year (in the USP). However, the absolute change required between July and December of 2022 compared to that in 2021 (€238.3 million) is lower than that estimated over the first six months (€264.8 million).

Chart 3.7: Mid-year estimated and required revenue performance to meet the targets set in the USP 2022-2025 (EUR millions)



Source: MFE

The €503.1 million total change needed for the year in total revenue is mostly on account of higher taxes on production and imports and current taxes on income and wealth (see Chart 3.7). With respect to taxes on production and imports, the mid-year performance was rather strong when compared to the annual target. This was also the case for the same assessment carried out last year. The change between January and June of 2022 when compared to 2021, was of €142.5 million, thus for the target to be reached, €81.9 million more in indirect taxes is needed over the next six months when

compared to the same months in 2021. On the other hand, the progress on current taxes on income and wealth is slower, with a larger change needed during the second half of the year. The required change is €172.0 million between July and December of 2022 over the same period of 2021, as the change in the first six months was of €109.8 million. 46.5% of the annual target for current taxes on income and wealth was estimated to have been accounted for by June 2022.

For social contributions, capital taxes, and property income, the required change over the second half of the year to reach the annual target is negative. This means that over the first six months of the year, the change in the revenue from these sources of income had exceeded the total change targeted for the whole year. For the 'other revenue', the assumed reduction for the year was exceeded, thus a positive change of €24.6 million in the second half of the year would be needed to compensate for the larger decline.

Chapter 4
Conclusion

The Maltese economy is currently weathering a weak international environment characterised by elevated uncertainties. The supply-chain disruptions and the increase in international energy prices resulting from the global pandemic, the Russia-Ukraine war, and the surrounding energy politics have dragged down the envisaged global economic recovery, with many international forecasters revising their growth projections downwards.

Despite the global economic turmoil, Malta has recovered strongly from the contraction experienced during the pandemic year and even managed to surpass the growth targets set in the Draft Budgetary Plan for 2021 and the 2019 pre-pandemic levels. The stronger-than-anticipated economic growth in 2021 translated into higher government revenue than projected in October 2020. However, this was more than offset by higher-than-projected expenditure resulting from the extension of Covid-19 measures to combat the second wave of the global virus in the first half of 2021. This translated into a larger fiscal deficit, but a lower public debt as a share of GDP than anticipated in the Draft Budgetary Plan for 2021, as the stronger economic growth outweighed the fiscal gap deviations in 2021.

The MFAC acknowledges that 2021 was an exceptional year, and the forecast deviations for government expenditure were primarily the result of extraordinary circumstances, which required additional government support than what was envisaged back in Autumn 2020. The activation of the general escape clause of the Stability and Growth Pact has enabled countries to temporarily depart from the adjustment path towards their medium-term budgetary objective and to take all the necessary measures to address the Covid-19 pandemic effectively, sustain the economy and support economic recovery.

Good quality macroeconomic and fiscal forecasts are a prerequisite for sound policymaking, and it is important that the MFE continues to allocate adequate resources and time for their production, as well as for their ex-post assessment. The MFE needs to continue monitoring closely the ongoing developments on an international scale and evaluate the extent to which the current shocks are cyclical,

structural, or hybrid in nature. This information is invaluable for the next round of macroeconomic and fiscal projections in October.

The MFAC notes that in the Half-Yearly Report, the MFE presented the same macroeconomic forecasts for 2022 as published in the USP in April 2022. The MFAC acknowledges that the amount of additional information available between the publication of the USP and the Half-Yearly Report justifies this approach, which has been consistently adopted in previous years. Maintaining the current bi-annual macroeconomic forecast rounds, in April and October each year, appears the most feasible, also in view of resource constraints. Similarly, the fiscal projections presented in the Half-Yearly Report reproduce those included in the USP. However, the MFE remarked that the prevailing uncertainty at the current juncture warrants continuous monitoring of the situation.

As communicated in the Assessment of the Update of the Stability Programme 2022 – 2025, the MFAC considers that the macroeconomic and fiscal projections for 2022 continue to lie within its endorsable range and the risk assessment presented in its previous Report to remain valid. The risk assessment carried out by the Council had suggested a broadly positive risk outlook vis-à-vis the profile for real GDP growth over the forecast horizon. For 2022, the MFAC had considered that the fiscal balance and public debt could possibly be lower than expected by the MFE in the baseline scenario.

The Council takes note that given the activation of the general escape clause by the European Council, it is possible for the Government to take all the initiatives deemed necessary to mitigate the adverse effects of the pandemic and the conflict between Russia and Ukraine, the subsequent effects of supply chain disruptions and increased global prices, and to stimulate the economic recovery. At the same time, the Council reminds that when economic conditions allow, fiscal policies should again be aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability.

The MFAC invites the MFE to remain vigilant to ensure that the fiscal deficit and debt targets for the year are, to the extent possible, not exceeded. Close attention is warranted, particularly in those cases where the revenue and expenditure performance required during the second half of 2021 appears more challenging to attain when considering the estimated performance recorded during the first half of the year.

Malta Fiscal Advisory Council
Level –1, New Street in Regional Road, Msida
Tel: +356 22479200 Fax: +356 22479219
Email: info@mfac.org.mt www.mfac.org.mt