MALTA FISCAL ADVISORY COUNCIL

ASSESSMENT OF THE

HALF-YEARLY REPORT 2023

MALTA FISCAL ADVISORY COUNCIL

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10 October 2023

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

Dear Minister,

ASSESSMENT OF THE HALF-YEARLY REPORT 2023

The Malta Fiscal Advisory Council is hereby presenting its assessment of the Half-Yearly Report 2023, in terms of the Fiscal Responsibility Act. The cut-off date for this Assessment report is 8 August 2023.

The Malta Fiscal Advisory Council (MFAC) notes that for the purpose of the Half-Yearly Report, the Ministry retained the macroeconomic forecasts presented earlier in Spring. The Council agrees that since no major changes occurred, this approach, which was also adopted in previous years, is justified. Over the first six months of 2023, tourism exceeded expectations, the labour market kept performing buoyantly, whilst inflation remained high and could possibly turn out higher than forecasted. As in its assessment of the Update of Stability Programme, the MFAC still views that the possibility of upside risks outweighs those on the downside.

On the fiscal side, the estimates for the first half of the year, when compared to the yearly targets, indicate the possibility of expenditure savings. The Council advises that such savings should be directed towards further rescindment of the deficit. However, expenditure on productive investment should not be curtailed. Further steps should be taken to preserve nationally financed public investment and meet the targets, also with respect to the absorption of RRF grants and other EU funds. On the revenue side, the targets particularly for taxes on production and imports and social contributions seem on track. On the other hand, revenue from direct taxes and especially the ‘other revenue’ component should be monitored closely as their performance was more muted than expected during the first half of the year. The collection of revenue arrears exceeded the targeted collection rate, but total arrears have increased as well. The Council recommends that for future budgetary planning, the government may consider increasing the targeted collection rate of 10% as this is consistently being overachieved.

The Council encourages the government to aim for a medium-term sound fiscal position, which provides for more fiscal space, along with achieving sustainable growth. Thus, it is recommended that debt levels are maintained sufficiently below 60%, and the deficit ratio is reduced by a satisfactory margin towards the 3% benchmark, especially since the suspension of fiscal rules of the Stability and Growth Pact is to be terminated by the end of the year. In relation to the fixed-energy-price policy, an adequate exit strategy should be prepared, adopting a more targeted approach and enhancing incentives for energy savings.

In addition to its assessment, the Council would like to recommend that the Half-Yearly Report is made public earlier. Article 39(7) of the Fiscal Responsibility Act specifies that the Half-Yearly Report shall be tabled in Parliament by the end of July of each year. The Council notes that the Report was prepared by this deadline but, it was tabled after the summer parliamentary recess and made public in October. Whilst acknowledging the logistic reasons for this delay, the Council recommends a more timely publication, so as to improve the relevance of this Report and consequently also of the Council's assessment. Regarding the content of the Half-Yearly Report, the MFE should also explore how to address Article 39(8)(h) of the Fiscal Responsibility Act which prescribes that the Half-Yearly Report should contain "data on the absorption of European funds, indicating the approved program, the results achieved in the first six months and an updated forecast for the entire year" and Article 39(8)(i) which requires data on all outstanding creditors for the first six months of the year.

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

Yours sincerely,

Moira Catania

Dr Moira Catania
Chairperson of the Malta Fiscal Advisory Council

INTRODUCTION

1. **Article 13(3)(e) of the Fiscal Responsibility Act prescribes that the Malta Fiscal Advisory Council (MFAC) shall "*analyse and issue an opinion and any recommendations pursuant to the Government's publication of the half-yearly and the annual report on the execution of the budget*".** On 2 October 2023, the Half-Yearly Report 2023 (HYR) was tabled in Parliament. The HYR was prepared in July 2023 to provide an update on whether any significant developments have occurred since the latest forecast vintage in April and, if necessary, undertake corrective or fine-tuning measures in the current year's macroeconomic and/or fiscal forecasts. The HYR also provides estimates for the main fiscal variables for the first six months of the year, enabling a review of these developments when compared to the yearly targets. Additionally, the report provides an update on debt developments during the first half of the year, a stock of revenue arrears and the government's stance on fiscal rules.[1] This Report provides an assessment of the HYR, mainly reviewing the latest forecasts in contrast to the half-year developments.

2. **The forecasts for 2023 within the Half-Yearly Report remained unchanged from those published in the Update of Stability Programme 2023 – 2026 (USP).** Between the publication of the USP in May 2023 and the preparation of the HYR in July, the GDP NSO news release and the accounts for the NSO's general government news release for the first quarter of the year, along with additional monthly Consolidated Fund data, were issued. However, the Ministry for Finance and Employment (MFE) stated that, based on the developments following the Update of Stability Programme 2023 – 2026, it does not recommend a major revision to the macroeconomic and fiscal targets for 2023. Thereby, the forecasts presented in the USP are, in this assessment, regarded as the most recent yearly forecasts available in order to enable a comparison between half-yearly developments and annual targets.

3. **Despite global uncertainty and rising inflation, the Maltese economy registered another year of significant growth in 2022, while the fiscal deficit ratio remained high.** The Maltese economy expanded by 7.1% in real terms in 2022. In nominal terms, growth was 12.7%, as inflationary pressures were high, with consumer prices rising by 6.1%, whilst the GDP deflator recorded an increase of 5.3%. Whilst energy inflation in Malta was zero reflecting the impact of national energy subsidies, services contributed the most to the overall HICP rate, 2.5 percentage points (pp), followed by non-energy industrial goods and processed food, contributing 1.5 pp and 1.4 pp respectively. Growth stemmed from the domestic side of the economy, as net exports turned out negative on account of an extraordinary investment that boosted imports significantly in 2022. On the fiscal side, while the deficit was reduced to 5.8% of GDP, it remains well above the deficit benchmark of 3% and was the fourth highest in the EU. On the other hand, the debt-

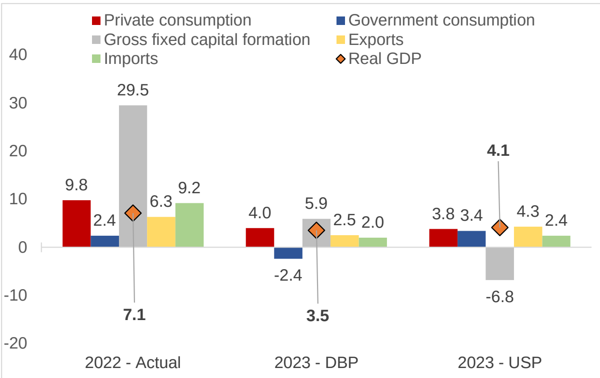
[1] The required content of the HYR is described in Article 39(8) of the Fiscal Responsibility Act of Malta, available here.

to-GDP ratio slid to 53.4%, extending further below the debt benchmark of 60% due to a stronger GDP effect which outweighed the increase in debt.

MACROECONOMIC DEVELOPMENTS

4. **Compared to the October 2022 forecast round, real GDP growth for 2023 is presently forecasted to be 0.6 pp higher, thus increasing by 4.1% over 2022. Growth in government consumption and exports have been revised upward, whilst investment growth was revised to negative.** An unforeseen one-off investment in machinery and equipment has completely dominated the landscape in 2022, leading to a growth of 29.5% in gross fixed capital formation, thus creating a large base effect for 2023. This shifted the forecast for investment growth for 2023 of 5.9% envisaged in the DBP, to -6.8% in the USP. Export growth is higher than forecasted in October, by 1.8 percentage points (pp), partly due to more buoyant tourist spending than projected earlier. Growth in private consumption expenditure remained similar, close to 4%, whilst that in government consumption turned positive, to 3.4%. These developments are reflected in an upward revision in import growth of 0.4 pp. Meanwhile, the inflation rate was revised upwards by 2.0 pp to 5.7%, whilst the unemployment rate and employment growth forecasts remained broadly similar, at 3.0% and 3.5%, respectively.[2]

Variations in real GDP components between the DBP and USP for 2023
(Percentage change)



Sources: NSO and MFE

5. **Expenditure developments reflect shifts in the forecasted contribution towards GDP growth, with external demand presently expected to be the main driver of growth.** Domestic demand is no longer set to be the main driver of GDP growth for 2023. Its contribution declined from 2.5 pp in the DBP to 0.6 pp in the USP, partly on account of the notable downward revision in investment. On the other hand, net exports are presently anticipated to contribute towards a much higher 3.5 pp to growth in 2023 when compared to 0.9 pp in the DBP. Such expectations are completely different from the ones experienced in 2022, when

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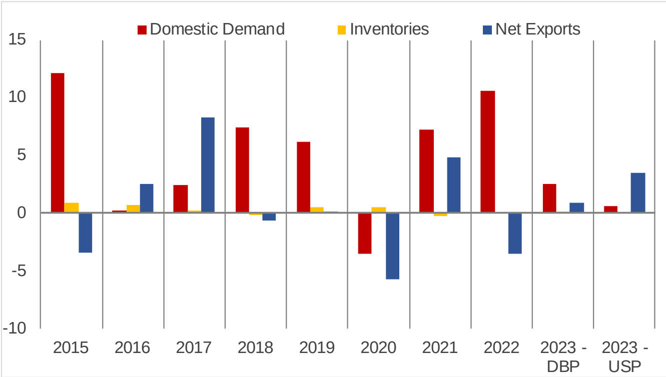
[2] For a more detailed assessment of the variances between the forecast within the DBP and the USP, please refer to Chapter 4 of the MFAC's Assessment of the USP 2023-2026, available here.

domestic demand contributed towards a significant 10.6 pp whilst net exports contributed negatively by 3.5 pp. If the forecast materialises, it would be the first time since 2017 that net exports are the main contributor to GDP growth.

Contributions to real GDP growth
(Percentage points)



Sources: MFE and MFAC staff calculations

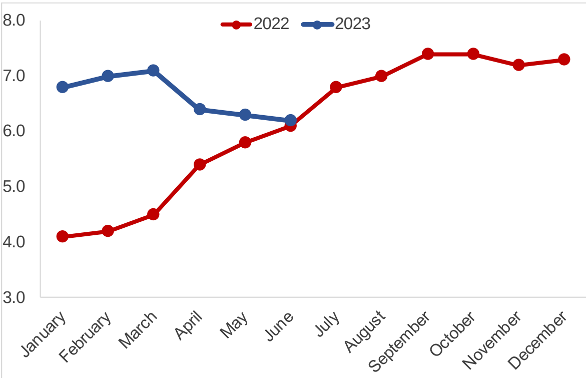
6. **Over the first half of the year, tourism exceeded the MFE's expectations.** The number of tourists visiting Malta between January and June of this year increased by 43.8% when compared to the first six months of 2022. The expenditure per capita also increased from an average of €777 to €804. This is augmented by an improved expenditure per tourist per night. Almost 1.3 million inbound tourists were registered during January – June 2023, a figure which represents 106% of the level recorded in 2019 (pre-pandemic highest ever tourist annual inflow) over the same period. At the time of the DBP, the MFE was projecting that tourist arrivals in 2023 would amount to only 85% of the 2019 level; in the USP, this was revised to exceed pre-pandemic levels. The developments during the first six months indicate that this projection will be surpassed and that 2023 should register the highest number of annual tourists on record, boosting the level of exports. This confirms the upside risk highlighted by the MFAC in its assessment of the DBP and the USP for expenditure emanating from tourism.

7. **The registered unemployment rate steadily declined below 3% over the first six months of 2023, whilst registered full-time employees consistently increased by close to 8.5% over the first three months.** The registered unemployment rate continued to gradually and consistently decline from 3.0% in January 2023 to 2.5% in June 2023. This rate is the lowest among EU countries, with the EU rate averaging 6.0% over the first six months of 2023. The MFE's USP unemployment rate forecast of 3.0% is based on Labour-Force Survey (LFS) data. The unemployment rate reported for the first quarter of 2023 by LFS was 2.9%. Employment growth was also high between January and March 2023, when compared to the MFE's estimate for the year (3.5%).

8. **Malta's annual inflation rate remained high, above 6 percent, whilst that of the Euro Area dipped below Malta's rate in recent months.** The government's energy subsidies have maintained Malta's energy inflation at zero. Despite this,

core inflation has remained persistent, particularly that of services and processed food. On the other hand, the average inflation rate in the Euro Area declined to 5.5% in June, with energy inflation turning negative due to a base effect when compared to 2022. For the forecasted inflationary rate of 5.7% to be realised, the average annual rate of change of inflation over the July – December period must decelerate to 4.8%. In June, the inflationary rate was still 1.4 pp higher than required to meet the yearly target, meaning that to compensate inflation would need to get considerably lower over the last few months of the year. Moreover, the inflationary developments during 2023 imply that the Cost-of Living-Allowance (COLA) for 2024, which is calculated on the Retail Price Index (RPI), will exceed the current allowance of €9.90 weekly.[3] The Council estimates that next year's COLA based on 2023 inflation is likely to be around €13.

Annual rate of change – Harmonised Index of Consumer Prices (HICP)
(Annual Percentage change)



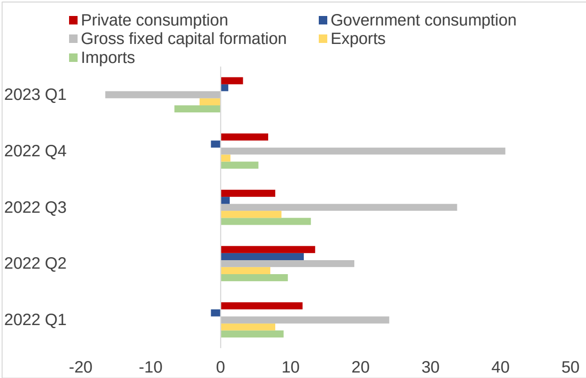
Sources: Eurostat and MFE

9. **The GDP for the first quarter of the year was published while the Half-Yearly report was being prepared, turning out below the projected rate for the year.** Nominal growth in the first quarter (Q1) of 2023 was 9.1%, but due to a still very high inflation, growth in real terms was 3.1%, when compared to the same quarter of 2022. Domestic demand contributed 2.2 pp negatively, underpinned by lower investment (-16.5%) which offset increases in private and government consumption expenditure of 3.2% and 1.1%, respectively. On the other hand, external demand contributed positively by 5.3 pp, reflecting a relatively larger drop in imports than that in exports.

[3] The COLA, announced each Budget, is worked on the RPI starting from October of the previous year until September of the current year.

Quarterly real GDP components (Q1 News Release)

(Year-on-year percentage change)



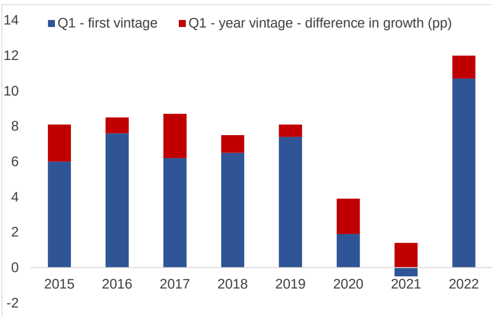
Sources: NSO

10. **This first quarterly GDP data for 2023 does not necessarily imply a downside risk for the annual growth forecast.** The first vintage of Q1 data is generally conservative and historically, it is consequently consistently revised upwards by a significant margin. This is based on an analysis conducted by the MFAC on the revisions in GDP statistics between 2015 and 2022.[4] This was performed by comparing the first vintage of data for Q1 usually released in May of year *t*, with the data for Q1 as revised in the GDP release for the whole of year *t*, usually released in February of year *t+1* (that is the fourth vintage). The comparison shows that from the first to the fourth vintage of Q1 data, over this eight-year period, nominal GDP was revised upwards, by an average of €106.0 million. Similarly, comparing the reported growth rates, nominal GDP growth was, on average, revised upwards by 1.5 pp, whilst real GDP growth was revised upwards by 1.4 pp by the fourth vintage. No negative revision resulted over this time span of eight years between the first issue of Q1 and the fourth. Thus, based on these historical revisions, one expects that 2023 Q1 data is likely to be revised upwards with subsequent vintages of data for the year.

Upward revisions in Q1 nominal GDP growth rates between the first GDP NSO release of Q1 and the end-of-year GDP NSO release[5]

Nominal terms

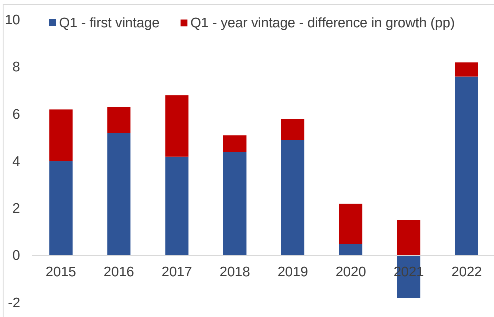
(Percentage change)



Source: NSO and MFAC staff calculations

Real terms

(Percentage change)



Sources: NSO and MFAC staff calculations

[4] This analysis complements the MFAC's Annual Report thematic chapter on evaluating the forecasting performance of GDP, available here.

[5] The top of the red column represents the Q1 growth rate reported in the end-of year NSO GDP release. This analysis does not consider changes adopted to the Q1 of the previous year (which would act as the base).

11. **In the HYR, the MFE stated that the macroeconomic forecasts presented in the USP 2023 – 2026 remain plausible, though, on balance, subject to downside risks in real terms, and upside risks in nominal terms. The MFAC reiterates its opinion, that risks are likely to be tilted towards the upside.** The MFAC's assessment of the USP's macroeconomic forecasts, published in June 2023, was that the forecast lies within the Council's plausible range. However, the MFAC had highlighted the possibility of upside risks for private consumption and a higher contribution from the external demand side, whereas investment was viewed as more negative than projected in the USP. The implication of such risks reflected the possibility that GDP for 2023 turns out better than projected by the MFE. In the HYR, the MFE does acknowledge upside risks to tourism numbers projected in April (which is consistent with the MFAC's assessment), which could outweigh possible negative developments in other export sectors due to deteriorating competitiveness. In nominal terms, the MFE views upside risks due to higher inflationary pressures, which outweigh the negative risks in volume terms. The MFAC maintains its USP assessment that both in nominal and real terms, the GDP turnout for the year is more likely to surpass the MFE's current forecast, despite the possibility of higher inflationary pressures.[6]

FISCAL ASSESSMENT

12. **The fiscal balance for 2023 was revised downwards to 5.0% from a rate of 5.5% of GDP projected in October. This was largely driven by a larger nominal GDP (denominator effect), and by higher fiscal revenue, as the total expenditure target remained practically the same in absolute terms.** The revisions in expenditure were compensatory. Compared to the DBP 2023, the Medium-Term Fiscal Strategy 2023 (MTFS) lowered the expenditure projected for subsidies (- €173.2 million), in part due to a lower estimated cost of energy subsidies, but this was almost completely offset by higher intermediate consumption (+ €141.5 million).[7] The latter reflected the impact of higher than expected inflation. The other expenditure components were not revised significantly individually, but on aggregate, led to an upward revision of €40.0 million. On the other hand, there were also upward revisions in revenue. Higher current taxes on income and wealth, social contributions, and revenue termed as 'other revenue' are projected. In total, these were increased by €127.9 million, mainly because of updates to the macroeconomic projections and thus higher tax bases, and for 'other revenue' because of more market output. On the other hand, taxes on production and imports were lowered (- €61.0 million). This reflects a downward revision in elasticity for this tax component, in view of the low elasticity experienced in 2022, when compared to historical averages.

[6] Refer to the MFAC's macroeconomic assessment of the Update of the Stability Programme 2023 – 2026, here.

[7] Within the subsidies category, an upward revision included additional restructuring costs related to the national airline.

Revisions in revenue and expenditure between the DBP 2023 and the MTFS 2023 - 2026[8]

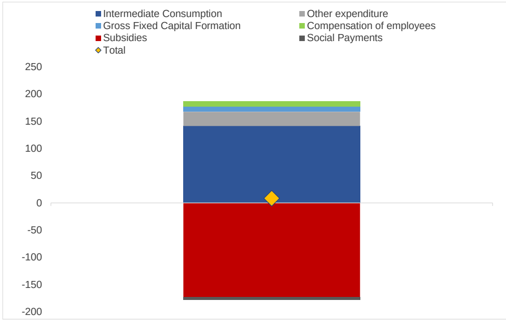
Revenue

(Millions)

Source: MFE and MFAC staff calculations

Expenditure

(Millions)



Sources: MFE and MFAC staff calculations

13. **The Consolidated Fund (cash-based) deficit in the first half of the year is notably lower than that registered during the first six months of 2022 and also the annual deficit target.** The cash-based deficit was recorded at €258.5 million over the first half of 2023, considerably lower than the €464.2 million imbalance recorded over January – June 2022. However, despite this low figure, the revised deficit estimate stated in the HYR was of €924.3 million in 2023, thus still relatively close to the €979.7 million figure presented in October 2022. This deficit figure thus implies that expenditure would need to surpass revenue by a significantly higher margin in the July – December period than was realised over the first six months of the year. Over the first six months of the year, revenue stood at 45.9% of the total budgetary estimate for the year, whilst the pace of expenditure was less, at 43.3% of the total. This revenue ratio is higher than that of 2022 by 2.0 pp (when comparing first six months divided by the actual for the year), whilst the expenditure ratio is 1.6 pp less than that recorded in 2022.[9]

    The MFE's revised estimates, thus compared to those in published in the Financial Estimates, are that recurrent expenditure is expected to turn out 0.42% of GDP less than expected in October, on account of significantly lower progress in the Programmes and Initiatives expenditure category, in part due to less than projected energy subsidies. The revision for capital expenditure was minimal, by 0.01% of GDP. This, albeit capital expenditure over January – June, was still 34.2% of the yearly estimate. Total revenue was also practically kept the same, only revised downwards by 0.01% of GDP. However, progress relating to revenue variables varied. The upward revisions in income tax and social security contributions offset most of the downward revision implemented for excise duties and Value Added Tax compared to the Budget.

14. **On an ESA (accrual-based) basis, compared to the yearly targets for revenue and expenditure, the first six-month progress is marginally less than in 2022. More change is needed over the second half of 2023 to achieve the targets when compared to the first half.** For the HYR, the MFE is required to present

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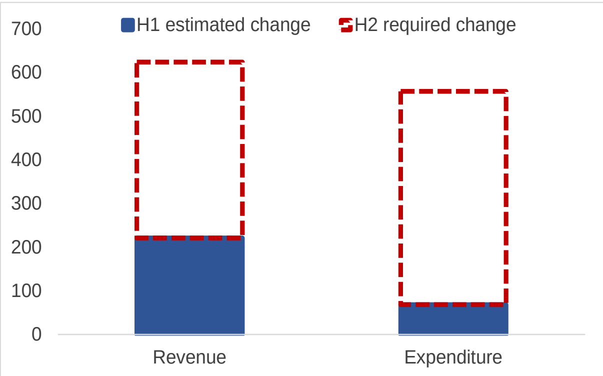
[8] The revisions refer to the reported figures in the MTFS minus the reported figures in the DBP.

[9] For Consolidated Fund purposes, the target for 2023 reflects the Budgetary Approved Estimates finalised in 2022. Cash based data is not included in the MTFS.

fiscal data for the first six months of the year on an ESA basis. Since the second quarter of general government accounts data would not yet be released by publication data, such data is partly estimated and is to be considered provisional. The estimated figures show that revenue and expenditure for the first half of the year have exceeded 2022 levels, but not by a relatively significant amount, particularly in terms of expenditure. Indeed, larger changes over 2022 are required over the year's second half to meet the end-of-year projections, both for revenue and more so for expenditure. The amount of revenue absorbed from the total 2023 target specified in the MTFS stands at 46.4% in H1, requiring a 53.6% ratio over the July – December period. Excluding 2020, the average revenue ratio over the first two quarters between 2018 and 2022 was 47.3%. The 2023 rate is thus close to the average. On the other hand, for expenditure, outlays in the first half of the year amounted to 44.9% of the annual target, which is lower than the average of 47.7% between 2018 and 2022 (excluding 2020). Thus, whilst acknowledging that expenditure is more discretionary in nature and certain outlays can be subject to volatile seasonal patterns (especially capital expenditure), the outturn in the first half of the year indicates possible expenditure savings.

Mid-year estimated and required performance to meet the 2023 target changes set in the MTFS when compared to actual 2022 data
(Millions)

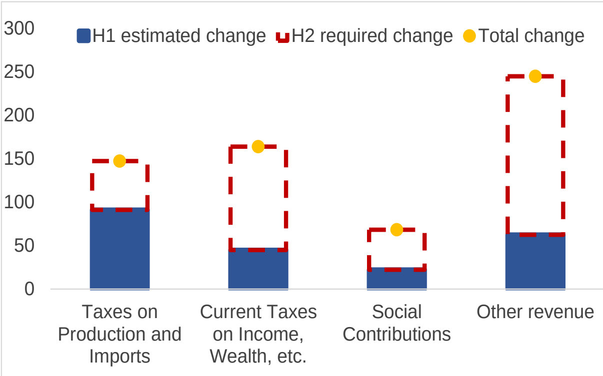


Source: MFE and MFAC staff calculations

15. **Estimates for the first half of the year indicate that revenue generated from taxes on production and imports stands closest to 50% of the respective targeted change for the whole of 2023, whilst the 'other revenue' component is farthest to 50% of the yearly projection.** The mid-year performance of indirect taxes was rather strong when compared to the annual target. Indeed, taxes on production and imports reached 48.9% of the yearly target by the first half of 2023, 1.1pp higher than in the previous year. All the other main revenue components (direct taxes, social contributions, and other revenue) registered a more muted performance during the first six months of the year. For current taxes on income and wealth, 45.5% of the annual target was estimated to have been accounted for by June 2022, 1.3 pp less than in 2022. For social contributions, the ratio to the yearly target was slightly higher, at 46.5%, but still 1.0 pp less than in 2022. For the 'other revenue' sources the ratio stood at 44.0%, therefore 5.3 pp less than in 2022. However, it is relevant to highlight that this revenue component exhibits more

volatile seasonal patterns. In particular, with the possibility that government concludes more projects related to EU funding over the rest of the year, more revenue could be registered over the second half of 2023.

Mid-year estimated and required revenue performance to meet the 2023 targets set in the MTFS
(EUR millions)



Source: MFE and MFAC staff calculations

16. **Half-yearly estimates indicate that there may be some savings from specific expenditure components when compared to the yearly target, although lower investment can be counterproductive.** Both compensation of employees and intermediate consumption have only increased marginally over the first six months of the year (€10.2 million and €41.9 million), when compared to the turnout of the same period of 2022. When juxtaposed with the target for the whole year, compensation of employees reached 47.3% over the first six months, less than the 50.2% ratio reached in 2022, and similarly, intermediate consumption's progress was estimated as 46.0%, 3.1 pp less than the ratio of 2022.[10] These developments suggest that there may be potential savings for these expenditure components. This is also the case for the 'other expenditure' component, with the first six months ratio standing at 38.4%, though in 2022, despite having been higher, the ratio was also low at 41.7%.

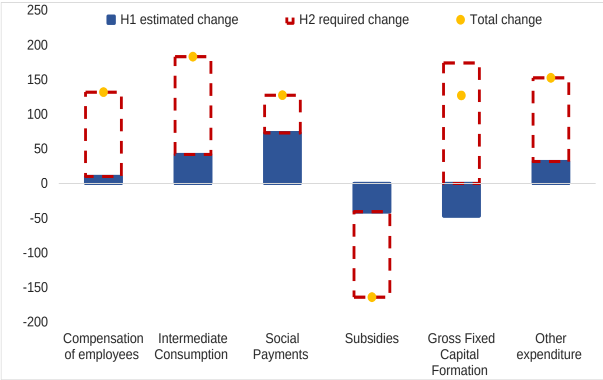
On the other hand, developments in social payments outlays during the first half of 2023 indicate that the budgetary estimate for this expenditure category is on point. Regarding subsidies, in 2022, only 37.9% of total subsidies were spent over the first half of the year, since energy subsidies were much more significant over the rest of the year.[11] Although for the current year, the ratio stands at 41.0%, the target for 2023 is €164.3 million lower than that of 2022. Since subsidies were higher in the second half of 2022, a larger reduction is anticipated for the second half of 2023, given the base effect, when compared to the first half. In terms of gross fixed capital formation, during the first half of 2023, total spending has only reached 30.8% of the 2023 MTFS projection. Although somewhat volatile as a component, effort should be made for productive public investment to be realised, especially

[10] A large part of intermediate consumption involves contracts that constitute mandatory spending, such as those in the health sector.

[11] The turnout for 2022 turned out lower than initially anticipated, with this revision carried forward for the estimates of 2023. For more details refer to Box C of the MFAC's Assessment of the Update of Stability Programme 2023 – 2026, available here.

that funded from EU programmes, particularly that to bolster the island's green and digital capacity. Full absorption of the targeted EU funded investment is particularly important during 2023 in view of the closure of the 2014-20 financial programmes.

Mid-year estimated and required expenditure performance to meet the 2023 targets set in the MTFS
(EUR millions)



Source: MFE and MFAC staff calculations

17. **The collection of revenue arrears exceeded the targets and outperformed the average collection recorded in recent years, but total arrears have increased as well.** Article 39(8)(k) of the FRA requires information about revenue arrears. This information is duly presented in the HYR (Table 6) wherein it is noted that the yearly target for revenue arrears collection was exceeded during the first half of the year. In 2023, €113.6 million have been collected over the first six months compared to the target of €51.7 million. This exceeds by a notable margin the average levels collected over the previous five years.[12] The bulk of these revenue arrears involve tax revenue falling under the responsibility of the MFE, with other Ministries having significantly lower arrears. The targets set in the Financial Estimates assume a 10% collection rate of total collectable arrears as of the end of 2021, thus in respect of data compiled for the prior year to the publication of the Estimates. However, this target appears conservative as in the past years, it has been exceeded by a very large margin.[13] The MFAC commends the heightened level of revenue arrears that is being collected in 2023 when compared to recent years and encourages the MFE to improve further its tax collection efforts. This is also in light of the NAO reports which indicates that collectable arrears increased from 4.7% of GDP in 2017 to 6.7% in 2021.[14]

18. **In absolute terms, total government debt was revised downwards since the 2023 Budget Estimate, but it is still expected to exceed the €10.0 billion mark by the end of the year.** The revised debt estimate implies an increase of more than one billion euro of government debt over 2022, thus an increase of 11.5%.

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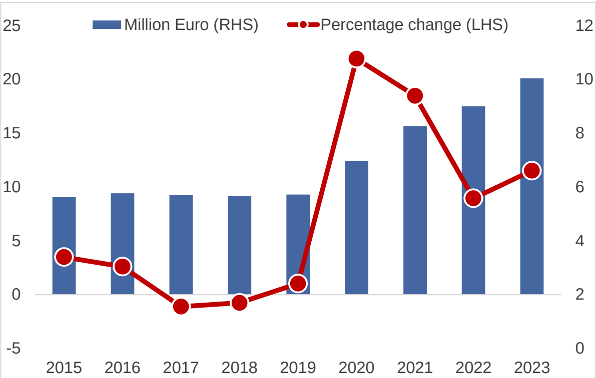
[12] Average revenue collection in the first half of the year as reported in consecutive HYR reports between 2018 and 2022 was €69.0 million.

[13] For example, the Half-Yearly Report for 2022 stated a target of €4 million for the first half of the year, whilst the actual amount collected was close to €150 million.

[14] The information presented in the Half-Yearly Report represents 'collectible' arrears. Collectable arrears stand around €1.0 billion in 2021, but total arrears are reported by the National Audit Office (NAO) to have been close to €6.4 billion in 2021. This information is available from the NAO and can be found here.

The half-yearly estimate is that debt should reach €9.165 billion by June, thus implying that most of the projected increase in debt would occur in the second part of the year. Should the current 2023 projection materialise, government debt would have increased by 75.5% since 2019, that is, over only four years. Despite such a large increase in a short period of time, the debt-to-GDP ratio is still anticipated to remain below the 60% benchmark, supported buoyantly by growth in real output, and over the past year, also by a high inflationary effect. The debt ratio is projected to increase from 53.4% of GDP in 2022 to 54.5% in 2023. Containing debt growth is particularly important in the context of recent developments whereby stronger monetary policy tightening is leading to higher borrowing costs. Meanwhile, the weighted-average-maturity of central government debt maintained the declining trend observed over the past years, falling to 7.8 years at end June 2023 when compared to 8.3 years in June of 2022.

Debt developments and 2023 forecast
(EUR millions and percentage change)



Source: Eurostat and MFE

COUNCIL'S APPRAISAL

19. **Although recent developments indicate that inflationary pressures could be higher than projected, the GDP targets remain plausible, and could even turn out higher than targeted.** The MFAC notes that in the HYR, the MFE presented the same macroeconomic forecasts for 2023 as published in the Update of Stability Programme 2023-2026. The MFAC acknowledges that in view of the limited additional information available between the publication of the USP and the preparation of the HYR, this approach, which has been consistently adopted in previous years, is justified. Furthermore, no major changes occurred which would suggest the necessity to significantly revise the macroeconomic forecasts.

Nonetheless, the Council maintains its assessment of the Update of Stability Programme that the GDP figure remains plausible. The Council maintains a more positive view of GDP growth than the MFE, in particular since tourism arrivals and expenditure exceeded the forecast. Overall, the MFAC's view on the forecasts published in the MTFS is still that the possibility of upside risks outweigh those on the downside. This contrasts with the MFE's view that in real terms, the downside risks outweigh the upside risks.

20. **Fiscal estimates over the first half of the year indicate the possibility of expenditure savings, which should be allocated towards the reduction of the deficit, and consequently debt levels.** The fiscal projections for 2023 within the HYR were unchanged from those in the Medium-Term Fiscal Strategy 2023 – 2026. The targeted change in revenue is achievable, particularly for taxes on production and imports and social contributions. For the other revenue components, the MFE should step up revenue collection efforts to ensure that the targets are reached. On the expenditure side, based on the MFE's estimates for the first half of the year, there is potential for savings in a number of expenditure components. However, expenditure on productive investment should not be curtailed. Moreover, nominal GDP growth is also contributing strongly to the deficit and debt ratios.

COUNCIL'S RECOMMENDATIONS

21. Following this Assessment of the Half-Yearly Report 2023, the Council hereby recommends the following[15]:

    a. Monitor closely those components where revenue generation over the first half of 2023 was slower than anticipated.

    b. Pursue further potential expenditure savings based on the developments noted over the first half of the year. However, expenditure savings should not occur from curtailing planned productive capital expenditure. Whilst acknowledging the inherent volatility of this component, the Council notes that estimated public investment over the first six months is still low when compared to the yearly target, and has also declined over the same period of 2022. Further steps should be taken to preserve nationally financed public investment and meet the targets, also with respect to the absorption of RRF grants and other EU funds, especially in view of the closure of the 2014-20 financial programmes.

    c. Continue achieving higher levels of collection of revenue arrears, but for future budgetary planning, the rate of 10% target collection can be plausibly revised upwards, as this is consistently being overachieved.

[15] These recommendations complement and are to be viewed in conjunction to those issued by the MFAC in the assessment of the Annual Report, available here.

d. Government should strive towards achieving a medium-term sound fiscal position combined with efforts to achieve sustainable growth. In relation to the fixed-energy-price policy, an adequate exit strategy should be prepared, adopting a more targeted approach and enhancing incentives for energy savings.

e. Article 39(7) of the Fiscal Responsibility Act specifies that the Half-Yearly Report shall be tabled in Parliament by the end of July of each year. The Council notes that the Report was prepared by this deadline, but it was tabled after the summer parliamentary recess and made public in October. Whilst acknowledging the logistic reasons for the delay which has become typical over the past years, this timing of the publication reduces the relevance of this report and consequently also of the Council's assessment. The Council thus recommends that the Half-Yearly Report should be made public earlier.

f. As regards the content of the Half-Yearly Report, the MFE should also explore how to address Article 39(8)(h) of the Fiscal Responsibility Act which prescribes that the Half-Yearly Report should contain "data on the absorption of European funds, indicating the approved program, the results achieved in the first six months and an updated forecast for the entire year" and Article 39(8)(i) which requires data on all outstanding creditors for the first six months of the year.