

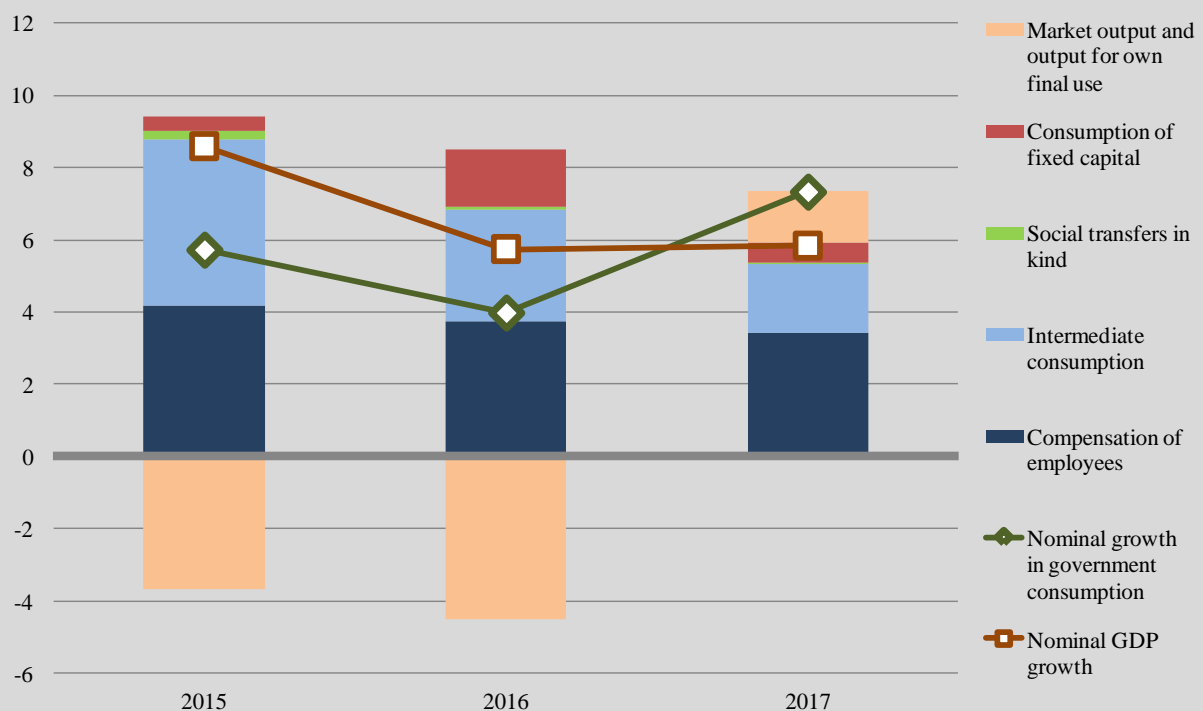
On the basis of the detailed assessment of the various budget components, Box 1 evaluates the plausibility of the 2016 and 2017 projections for real government consumption.⁴¹ Accordingly, the MFAC considers the forecast for real government consumption to be within its endorsable range both for 2016 and for 2017.

Box 1: Assessment of the projections for real government consumption

Real government consumption is expected to decelerate from 4.6% in 2015 to 2.8% in 2016 and then accelerate again to 5.9% in 2017. The forecast government consumption deflator is stable, at 1.1% in 2016 and 1.2% in 2017. These deflator rates are quite similar to the 1.0% reported in 2015.

Hence the volatility in the forecast for real government consumption is entirely driven by the volatility in the estimates for nominal government consumption, which in 2016 is expected to be below nominal GDP growth but above nominal GDP growth in 2017. In turn, the major impact is created by swings in the forecasts for market output, which is a sub-component of the ‘other revenues’ category (see Chart A).

Chart A: Components of nominal government consumption



Source: MFIN

⁴¹ Real government consumption is compiled by aggregating a number of expenditure items and netting the market output. The resulting nominal government consumption is then deflated using an appropriate deflator.

This is driven by the anticipated trajectory for revenues from the IIP, which in 2016 are expected to be higher than in 2015, while in 2017 they are expected to be less than in 2016. It is worth highlighting that notwithstanding that the revenue streams generated from the IIP have a depressing effect on the estimate of government consumption, the effect on GDP is however fully neutralised, since an equivalent amount is added to service exports.

In 2016, the downward push exerted by market output is expected to be more pronounced than in 2015. Further deceleration in nominal government consumption is due to the planned slower growth in compensation of employees and in intermediate consumption. Their slowdown effect is partly mitigated through higher consumption of fixed capital, in line with the elevated investment which was carried out in 2015.

Notwithstanding that compensation of employees, intermediate consumption and consumption of fixed capital are planned to exert a smaller contribution to growth in 2017, nominal growth in government consumption is set to pick up. This reflects the swing created by market output, whose contribution is anticipated to change from negative to positive, due to its anticipated decline in 2017 compared to 2016.

The assessment for real government consumption mirrors the conclusions for its various components. The dynamics in the deflator appear to be plausible and consistent with the low inflation scenario. With regard to the nominal components, the before-identified upside risks to compensation of employees for 2016 could exert a similar upside risk to government consumption, both in nominal and in real terms. Upside risks similarly exist for 2017, on account of the upside risks to compensation of employees and to intermediate consumption. On balance, however, these identified risks could be outweighed by the uncertainty characterising the revenues from IIP, whose potential volatility is much higher.

6. Assessment of the trajectory for the fiscal balance for 2016 and 2017

Risks to the revenue projections appear to be tilted to the upside for both 2016 and 2017. On the other hand, the MFAC considers the risks to the expenditure projections to be downside for 2016 but upside for 2017. Notwithstanding the risks to the baseline revenue and expenditure projections for 2016 and 2017, both sets of projections are deemed to be within the endorseable range of the MFAC. As a result, even the targets for the 2016 and 2017 fiscal deficit are within the endorsable range of the MFAC. On a net basis, there may be an upside risk to the fiscal balance both for 2016 and for 2017 (see Table 14).