

the findings of the various CSRs will continue to be followed up by appropriate decisions, to ensure that non-productive expenditures are phased out, and that inefficiencies are addressed.

This should also help to ensure that nominal government consumption, which in 2015 expanded by 6.5%, grows at a slower pace between 2016 and 2019, by an average of 4.4% annually, though the rate is expected to be quite volatile throughout this period. In fact, from 4.0% in 2016, the growth rate is projected to spike to 7.4% in 2017, before decelerating to 2.5% and 3.5% in the following two years. Should these projections materialise, growth in nominal government consumption would thus be contained to below that in nominal GDP in all but one year. This is in line with what happened in 2015 and evidences the planned expenditure restraint which underpins the MTFS, with the rather ambitious target to scale the ratio of total government expenditure to GDP from 43.3% in 2015 to 38.3% by 2019. The MFAC acknowledges that the apparent volatility in the projected nominal growth dynamics for government consumption, and in particular the elevated growth rate for 2017, is influenced by the statistical methodologies (in particular the treatment of market output) rather than a departure from the fiscal consolidation momentum (see Box 1).

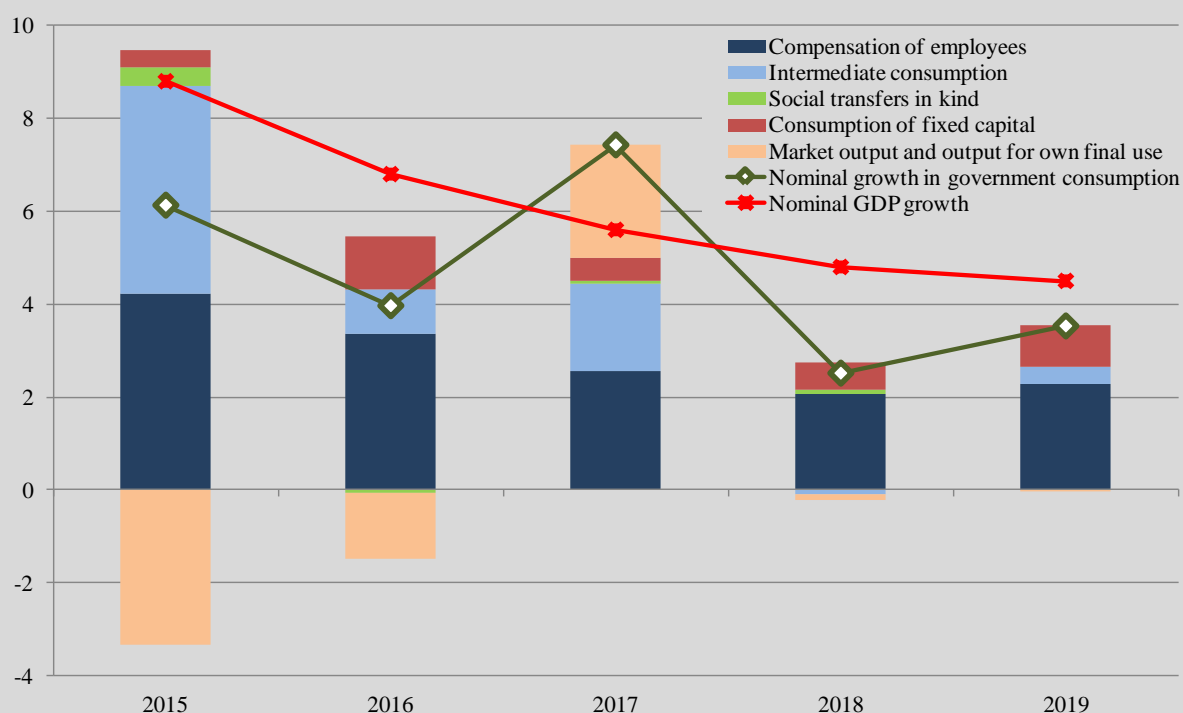
Box 1: Nominal government consumption growth

Nominal government consumption is driven by five different elements within the fiscal budget. The largest component is compensation of employees which in 2015 accounted for approximately two-thirds of the total government consumption. Intermediate consumption is another main component within this aggregate. The European System of National and Regional Accounts (ESA) methodology prescribes that market output, is netted out from the various expenditure items forming government consumption, as this represents a source of revenue for the Government,. Hence, statistically, an increase in market output lowers government consumption and vice versa.

Compensation of employees is expected to be the main driver of growth in nominal government consumption throughout the forecast horizon. Its contribution to growth is however expected to fall in the outer years (see Chart A). On the other hand, the contribution to growth from intermediate consumption is expected to fluctuate, particularly as this item is conditioned by opposing factors throughout the forecast horizon, such as efficiency gains and expenditure restraint in some areas, and one-off event-driven expenditures in other areas.

Developments in market output are the main factor explaining the instability in the forecast for nominal growth in government consumption, and in particular the spike anticipated for 2017. In 2015 higher market output was recorded and in 2016 this is projected to increase further (thereby reducing government consumption). On the other hand, it is expected to fall back in 2017 (which increases government consumption) and stabilise thereafter (which exerts a neutral effect on government consumption). The developments in market output mirror closely the assumed profile for the revenues derived from the IIP, which are expected to increase in 2016 compared to 2015 and then scale back in the outer forecast years.

Chart A: Contribution to growth in nominal government consumption (pp)



Source: MFIN

On the other hand, consumption of fixed capital (which reflects the decline in the value of fixed assets owned) and social transfers in kind (which reflects mostly the direct provision of pharmaceutical products, the provisions of free school transport and the running of homes for the elderly) are expected to exert only a small impact on the overall dynamics for nominal government consumption.

It is worth noting that owing to the general stability in the projected pattern for the government deflator, with its growth estimated at around 2% annually, the volatility in the nominal government consumption is mirrored into a similar pattern for real government consumption. Indeed, the MFIN's forecasts indicate that growth in real government consumption, which for 2016 is expected to be 2.2%, will similarly peak at 5.1% in 2017, and then decelerate to 0.1% and 1.1% respectively in the following two years. The stability in the deflator for government consumption is thus driving the similar pattern for growth in real government consumption.

The planned improvement in the fiscal balance relies only to a very limited extent on one-off and temporary effects, which in 2015 are estimated to have been 0.2pp lower than in 2014. In fact, the projected balance for general government changes only marginally when excluding one-off and temporary effects.¹¹ As can be seen from Chart 1, such effects are contained to around 0.1% of GDP annually throughout the period 2015 to 2019, and consist primarily of

¹¹ One-off measures are measures having only a transitory budgetary effect that does not lead to a sustained change in the budgetary position. For an overview of the classification principles for one off and temporary measures used for fiscal surveillance refer to 'Report on Public Finances in EMU – 2015', by the COM.