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Hon. Mr Clyde Caruana  
Minister for Finance  
30, Maison Demandols,  
South Street,  
Valletta. VLT 1102.

Honourable Minister,

**ASSESSMENT OF THE MACROECONOMIC FORECASTS CONTAINED  
IN THE DRAFT BUDGETARY PLAN 2025**

Under Article 13 of the Fiscal Responsibility Act (Cap. 534 of the Laws of Malta), the Malta Fiscal Advisory Council (MFAC) must endorse, as it considers appropriate, the macroeconomic forecasts prepared by the Ministry for Finance as part of the Draft Budgetary Plan. The Ministry submitted the initial draft of the macroeconomic forecasts to the Council on 3 October 2024, followed by the finalised figures on 10 October 2024 (see Appendix 1). These forecasts constitute an update to the macroeconomic outlook previously published by the Ministry and endorsed by the Council on 15 October 2023 in the Draft Budgetary Plan of the preceding year. The cut-off date for these macroeconomic projections is 1 October 2024.

The Council notes that since the publication of Malta's Draft Budgetary Plan 2024, the global economic landscape has remained weak, with countries experiencing mixed economic performances. Emerging markets and developing economies registered moderate growth rates during 2023 and the first half of 2024, though relatively low compared to historical trends. Indeed, according to the World Economic Outlook published by the IMF in July of this year, real GDP for this group of countries has increased by 4.4% in 2023 and is forecasted to increase by 4.3% in 2024 and 2025. On the other hand, the growth registered by advanced economies in 2023 has been lower. However, on a more positive note, they seemed to have weathered the possibility of a renewed global recession, remaining relatively resilient in the face of several headwinds to global economic

growth. Indeed, in its World Economic Outlook, the IMF noted that real GDP growth registered by advanced economies in 2023 stood at 1.7% and is forecasted to remain hovering around the same rates for 2024 and 2025. Indeed, if one takes a closer look at Malta's long-standing European trading partners, Germany fell into a recession (-0.2%), the United Kingdom registered feeble economic growth (0.1%), while Italy and France registered a growth rate of 0.9% and 1.1%, respectively.

Monetary policy tightening to address price hikes, particularly in the energy, food, and services components, mounting geopolitical tensions amid two ongoing wars leading to renewed supply bottlenecks, volatility in financial markets, climate change risks, and pronounced global declines in the manufacturing sector constitute the major short-term headwinds to international growth. Indeed, prospects for economic growth registered by Malta's main trading partners remain fragile in 2024, expecting the same growth as in 2023 before slightly recovering in 2025.

Inflation in advanced economies is projected to maintain its downward trajectory; however, renewed political tensions may impede this progress. Nevertheless, baseline forecasts continue to anticipate that inflation will return to the 2.0% target. Achieving this may come at the cost of extended monetary policy tightening as central banks seek to offset recent increases in labour and transportation costs, which could, in turn, influence the pace of the much-anticipated global economic recovery.

In the latest forecast round, the Council reviewed the plausibility of the exogenous assumptions employed by the Ministry for Finance. Discussions were held with the Ministry's officials to examine the drivers underpinning the updated macroeconomic outlook and the factors contributing to the revisions from the previous forecast vintage. The macroeconomic forecasts were further assessed by considering the available market information and statistical data and comparing them to those prepared by independent institutions.

The economic performance registered by the Maltese economy seems to defy the global economic environment. Indeed, compared to its European peers, Malta had the highest economic growth rate in 2023 (7.5%), significantly outpacing EU average growth (0.4%). The latest projections by the European Commission expect Malta to continue leading the EU in economic growth in 2024 and 2025. In fact, according to the latest forecasts of the European Commission, the EU economy is expected to expand by 1.0% and 1.6% in 2024

and 2025, respectively, in comparison to 4.6% and 4.3% for Malta. The latest projections by the Ministry for Finance are even more positive regarding economic growth in 2024 than those of the European Commission. Indeed, following the first-half growth rate of 6.0%, the Ministry expects real GDP to grow by 4.9% in 2024. Growth in 2024 is expected to be primarily driven by the domestic side of the economy (4.3 pp.) and, to a lesser extent, by external demand (0.6 pp.).

Private consumption expenditure is expected to increase by 4.4%, driven by increases in compensation per employee and strong labour market developments, and population growth. Government final consumption expenditure growth is projected to pick-up considerably in the last months of the year, with an expected strong annual increase of 8.6%, compared to 2.9% registered a year earlier. Gross fixed capital formation is expected to increase by 4.5%, following a marked decline of 18.2% experienced in 2023. On the other hand, exports of goods and services are projected to increase by 5.2% during the year, mainly driven by the services sector. Imports are expected to increase by 5.4%, reflecting domestic and external developments.

Headline inflation is expected to continue its downward trend, with an annual projection of 2.5%, following a first-half average of 2.7%. This is primarily driven by inflation in food and services. Core inflation is forecasted at 2.3%. The moderation in economic growth, combined with strong labour market performance, has resulted in marginal increases in labour productivity per person employed, estimated at 0.3%. Furthermore, the tight labour market, coupled with slow improvements in productivity, is contributing to a 4.0% rise in unit labour costs. Meanwhile, the Ministry expects that relative to the previous three years, a higher share of income will be shifted towards compensation of employees as opposed to profits as increases in the former (9.2%) outpaces increases in the latter (4.3%).

The expected growth profile for 2025 is similar to that anticipated by the Ministry for 2024. The Ministry expects some further slowdown in growth, with the Maltese economy expected to expand by 4.3% in 2025 (the same growth rate as forecasted in the Draft Budgetary Plan submitted in the previous year). Growth is again expected to be primarily driven by domestic demand (3.4 pp.) and, to a lesser extent, by external demand (0.9 pp.).

Private consumption expenditure is expected to be the main driving force behind the contribution of domestic demand, increasing by 4.6%. Such an increase is on the back of an expected employment growth of 4.2%, an unemployment rate which remains hovering

at low levels, an increase in compensation per employee of 4.2%, and a further decrease in the inflation rate, which is expected to be closer to the 2.0% mark. Gross fixed capital formation is expected to increase by 5.5%, while public consumption expenditure is expected to increase by a much more modest growth of 1.9%. Exports are projected to increase by 5.3%, again driven by the services sector. The other services sector, the other business services sector, and remote gaming are expected to contribute heavily to the increase in exports. Imports are projected to increase by 5.3%, reflecting the developments in the domestic and external side of the economy.

**Based on the information available to the Malta Fiscal Advisory Council by the date of this letter, and after considering the inherent risks and uncertainty surrounding these macroeconomic projections, the Council considers that the macroeconomic forecasts for 2024 and 2025 prepared by the Ministry for Finance as part of the Draft Budgetary Plan 2025 lie within its endorsable range. Nonetheless, according to its assessment and views, the Council considers that the balance of risks for both 2024 and 2025 is upside, though the upside risk is more pronounced in 2024 than it is for 2025.**

According to its assessment, the upside risk for 2024 is primarily due to developments in the first half of the year, whereby economic growth stands higher (6.0%) than the overall projection for the year (4.9%). This implies that the Ministry's forecasts refer to relatively weak growth in the second half of the year (3.8%). The notable slowdown in the second half of the year is not concomitant with the soft indicators data available by the cut-off date of this assessment. In turn, this is leading to a forecast for the labour productivity per person employed for 2024, which is not congruent with the increases experienced in the first half of the year. In fact, whilst during the first six months, labour productivity per person employed increased by 1.2%, the projected growth for the year is only 0.3%, implying negative growth in productivity over the second half of the year.

Furthermore, the Council is concerned with the growth composition for 2024 and 2025. Although exports are expected to increase by around 5% in both years, GDP growth primarily emanates from domestic demand increases, mainly from private consumption expenditure. The Council would like to emphasise the importance of export-led growth and the need to improve competitiveness through labour productivity increases for sustainable medium-term economic growth. It also notes the expected strong growth in government consumption in 2024. The Council would like to reiterate the importance of restraining

public expenditure growth, particularly in the context of the new EU economic governance framework and since Malta is subject to an excessive deficit procedure.

Moreover, the Council notes the upside revision undertaken for potential output growth for 2024 (5.1%) relative to that projected in the Draft Budgetary Plan of the previous year (4.4%). Notwithstanding this, the Council opines that the relatively prudent macroeconomic forecasts are leading to a negative output gap in 2024 (-0.1), which widens further in 2025 (-0.5). The Council has different opinions on the output gap for the short term, especially when viewed within the context of core inflation projections.

Finally, the Council would like to express its gratitude for the ongoing collaboration and assistance with the Ministry's employees.

The Council's forthcoming report will include a detailed assessment of the macroeconomic forecasts carried out by the MFAC to support the endorsement decision.

Yours sincerely,



**Dr Moira Catania**  
**Chairperson of the Malta Fiscal Advisory Council**

**Appendix 1: Main macroeconomic indicators**

|  | 2023        | 2024       | 2025       |
|--|-------------|------------|------------|
| <b>Real GDP components chain-linked volumes, reference year 2020</b> |             |            |            |
| Private final consumption expenditure (including NPISH) (y-o-y %)    | 11.2        | 4.4        | 4.6        |
| General government final consumption expenditure (y-o-y %)           | 2.9         | 8.6        | 1.9        |
| Gross fixed capital formation (y-o-y %)                              | -18.2       | 4.5        | 5.5        |
| Exports of goods and services (y-o-y %)                              | 4.7         | 5.2        | 5.3        |
| Imports of goods and services (y-o-y %)                              | -0.4        | 5.4        | 5.3        |
| <b>Real GDP (y-o-y %)</b>  | <b>7.5</b>  | <b>4.9</b> | <b>4.3</b> |
| <i>Contribution to real GDP growth:</i>                              |             |            |            |
| Domestic demand (pp.)  | 1.0         | 4.3        | 3.4        |
| Inventories (pp.)  | 0.0         | 0.0        | 0.0        |
| Net exports (pp.)  | 6.5         | 0.6        | 0.9        |
|  |             |            |            |
| <b>Nominal GDP (y-o-y %)</b>   | <b>13.2</b> | <b>8.1</b> | <b>7.0</b> |
| Inflation rate (based on the HICP) (%)                               | 5.6         | 2.5        | 2.1        |
| Employment growth (FTEs) (%)   | 6.3         | 4.6        | 4.2        |
| Unemployment rate (based on the LFS) (%)                             | 3.5         | 3.2        | 3.1        |

*Note: GDP growth rates for 2023 are based on statistics published by the National Statistics Office on 28 August 2024 (News Release 159/2024), while figures for 2024 and 2025 represent the forecasts prepared by the Ministry for Finance.*

**Source: Ministry for Finance**