ASSESSMENT OF THE

HALF-YEARLY REPORT 2024

MALTA FISCAL ADVISORY COUNCIL

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8 October 2024

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

Dear Minister,

ASSESSMENT OF THE HALF-YEARLY REPORT 2024

The Malta Fiscal Advisory Council (MFAC) is hereby presenting its assessment of the Half-Yearly Report 2024, in terms of the Fiscal Responsibility Act. The cut-off date for this Assessment report is 31 July 2024.

Based on estimated developments, the MFAC notes that the Ministry for Finance did not, in its Half-Yearly Report, revise the latest macroeconomic and fiscal forecasts, but retained those computed in October 2023 as the benchmark forecasts. Indeed, this year, the comparison is limited to that with the forecasts presented in October at the time of the Budget, given that the Update of the Stability Programme was not published because of the transitory period to the new EU fiscal rules.

The Council notes that the Maltese economy has continued to expand steadily, outperforming the Government's latest projections for economic growth. Net exports, driven by strong service exports, was the key driver for economic growth in 2023 and remained so in the first three months of 2024. From a domestic demand perspective, the Council expects private consumption expenditure to turn out stronger than anticipated in the DBP for 2024, largely on the back of a stronger labour market, waning inflationary pressures and stronger-than-expected compensation per employee. The Council assesses that the upside risk from private consumption expenditure will likely offset the downside risk on government consumption expenditure and gross fixed capital formation, leading to an unchanged domestic demand contribution relative to

that anticipated in the DBP. As regards the external sector, the Council has noticed that recent soft indicators may lead to a stronger contribution from external demand than anticipated by the Government in the DBP. Thus, overall, the Council appraises an upside risk for economic growth in 2024, primarily driven by external demand.

While Malta's economic growth continues to surprise on the upside, the challenge for the medium-term to foster sustainable and inclusive growth becomes even more critical. The Council recommends the Government to expedite structural reform efforts and promote productive investment, particularly in the areas of digitalisation and green transition, research and innovation, physical and social infrastructure, addressing skills gaps and shortages in the workforce and improving education outcomes.

On the fiscal side, the deficit for the year's first half stood close to €250 million relative to €919.7 million projected in the Budget for 2024. Indeed, the mid-year tax revenue outturn has been relatively robust compared to the annual goals. While some savings seem to have materialised from certain expenditure components over the first six months, total expenditure still increased almost one-for-one to the substantial increase in revenue when juxtaposed against the same comparable period last year. The situation in terms of fiscal balance is similar to last year's, when the deficit in the first half of the year was well below the annual target, but then government spending was boosted significantly over the year's second half. However, due to the new EU regulations, it is imperative that expenditure growth limits are respected, and any higher-than-anticipated revenue flows should be directed to build further fiscal buffers. The Council recommends that whilst means of restraining expenditure growth should be explored, productive capital expenditure that promotes medium to long-term growth should not be curtailed. With respect to the general government debt, this ratio is planned to remain at prudent levels over the medium term, below the 60% of GDP reference value, and it could even materialise as lower than projected.

The Council would like to reiterate its recommendation to prepare an adequate exit strategy in relation to the fixed-energy-price policy, adopting a more targeted approach and enhancing incentives for energy savings. The Council opines that the prevailing energy subsidy policy weighs substantially on public finances, involves risks to the deficit and expenditure trajectory and does not include incentives for energy savings and efficiency. The Council considers that the strong performance of the Maltese

economy, well above the EU average, and the stabilisation of international oil and gas prices, provide the appropriate context, for a gradual revision to this subsidy so that it is more targeted and coherent with the over-arching objective of achieving a carbon-neutral economy and promoting the green transition.

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 few years, this timing of the publication reduces the relevance of this report and, consequently, the Council's assessment. The Council thus recommends that the Half-Yearly Report should be made public earlier. As regards the content of the Half-Yearly Report, the MFIN 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 for the ongoing fruitful collaboration and assistance.

Yours sincerely,

Dr Moira Catania
Chairperson of the Malta Fiscal Advisory Council

INTRODUCTION

1. **Article 13(3)(e) of the Fiscal Responsibility Act mandates the Malta Fiscal Advisory Council (MFAC) to "*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 7 October 2024, the Half-Yearly Report 2024 (HYR) was tabled in Parliament. The HYR, which was prepared in July 2024, provides an update on whether any significant developments have occurred since the Draft Budgetary Plan (DBP) 2024 and, if necessary, the government will undertake corrective or fine-tuning measures in the current year's macroeconomic and fiscal forecasts.[1] The HYR report also provides estimates for the main fiscal variables, an update on debt developments, a stock of revenue arrears and the government's stance on fiscal rules for the first half of the year, enabling a review of these developments compared to the yearly targets.

2. **The forecasts for 2024 presented in the HYR remained consistent from those published in the DBP 2024.** Between the publication of the DBP in October 2023 and the preparation of the HYR in July 2024, multiple data releases concerning GDP and general government finances on an ESA basis, as well as monthly Consolidated Fund data from the National Statistics Office (NSO), were published. However, any data released after the cut-off date for the DBP 2024 was not reflected in the forecasts included in the HYR, which remained unchanged from the Autumn 2023 vintage. It is also noteworthy that the projections included in the DBP 2024 were based on the actual data for the first half of 2023, with the entire year of 2023 being a forecast. Since then, the data for the first half of 2023 has undergone significant upward revisions.

3. **Despite rising inflation, the Maltese economy exceeded expectations in 2023, achieving another year of substantial, albeit more moderate growth compared to recent years, while the fiscal deficit remained elevated.** The Maltese economy registered a 5.7% growth in real terms, significantly outpacing the average growth rate of 0.4% in the European Union (EU) and Euro Area (EA). Growth in Malta's real GDP in 2023 emanated from the external economy, contributing 7.3 pp, while domestic demand acted as a drag to economic growth (-1.5 pp). In nominal terms, the economy expanded by 11.3%, reflecting persistent inflationary pressures, which remained elevated at 5.6%. From a fiscal perspective, although the deficit was reduced to 4.9% of GDP, it continues to exceed the 3.0% deficit threshold level. Conversely, the debt-to-GDP ratio decreased to 50.4%, falling

[1] As per the note published on the MFAC'S website on 6 May 2024, reflecting the transitory period following the adoption of the new EU economic governance framework on 30 April 2024, the government did not submit the annual update of the Stability Programme to the European Commission. For this reason, the Half-Yearly Report compares actual data to the forecasts published in the DBP 2024 (the latest official forecast vintage).

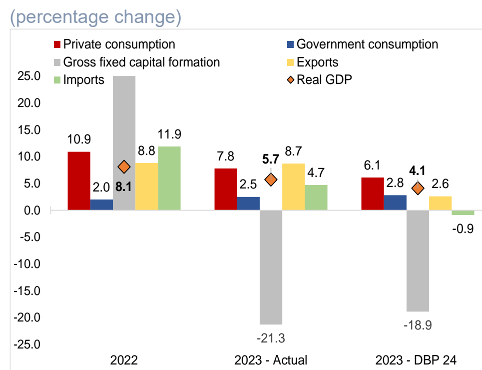
further below the 60.0% debt benchmark. This decline is primarily attributed to the robust GDP growth, which more than offset the rise in debt.

MACROECONOMIC DEVELOPMENTS

4. **Actual real GDP growth for 2023 moderated to 5.7%, from a growth of 8.1% registered in the previous year, but was still 1.6 percentage points (pp) higher than the DBP 2024 projections.** External demand was the primary driver of economic growth (7.3 pp), while domestic demand acted as a drag on the economy (-1.5 pp) due to negative growth in gross fixed capital formation. Actual data shows better-than-anticipated growth in private consumption, exports, and imports, while government consumption and investment growth turned out lower than expected in the DBP 2024 forecasts. In the case of investment growth, the unforeseen one-off investment in transport equipment that occurred in 2022 had created a significant base effect, which resulted in a large negative growth in 2023.

Variations in real GDP components between the DBP 2024 and actual data

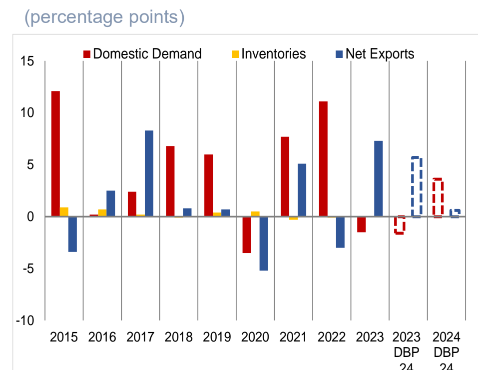
(percentage change)



Sources: NSO and MFIN

Contributions to real GDP growth

(percentage points)



Sources: MFIN and MFAC staff calculations

5. **According to the DBP 2024 projections, in 2024, domestic demand is anticipated to regain prominence (3.6 pp) in contributing to economic growth. External demand is also expected to contribute positively, although to a lesser extent than domestic demand (0.6 pp).** This indicates that, similar to the period from 2018 to 2022, domestic demand is expected to be the economy's primary driver again in 2024. However, the GDP data for the first quarter of 2024 shows a real GDP growth rate of 4.6%, of which external demand continues to propel the economy, contributing 3.5 pp, driven by strong export growth. Domestic demand also positively impacted real GDP, contributing 1.1 pp, primarily due to private consumption (1.6 pp) supported by declining inflation rates, which more than offset the negative contributions from government consumption (-0.3

pp) and investment (-0.2 pp). The growth in the first quarter implies a growth rate of 4.1% in real GDP for the rest of the year, which is considered plausible for the achievement of the Ministry for Finance (MFIN) forecasted growth for the year.

6. **Private consumption in the first quarter of 2024 grew by 3.7% in real terms, supported by robust labour market developments and declining inflation.** Compared to the same quarter last year, which saw an 8.3% growth, the expansion of this component has slowed, indicating that consumption is normalizing after a period of sharp increases driven by temporary factors resulting from the pandemic. The implied growth over the rest of the year is 4.8%, given the MFIN's forecast of 4.5% growth for this component in the DBP 2024. However, ongoing disinflationary trends, coupled with a robust labour market, may result in this component's growth to be even stronger in 2024 than anticipated in the DBP 2024.

7. **Both government consumption (-1.7%) and gross fixed capital formation (-0.9%) registered negative growth in the first quarter of 2024.** The contraction in government consumption during the first quarter of 2024 is driven by lower-than-expected growth in compensation of employees and intermediate consumption. This, coupled with the required growth of 4.3% in this component for the rest of the year, may signal a potential downside risk to the forecast outlined in the HYR. The decline in investment during 2024 Q1 is primarily attributed to a reduction in housing construction activity and transport equipment investment. Since the 2023 data turned out worse than initially forecasted, the resulting larger base effect suggests that, based on Q1 figures, which result in an implied growth of 7.6% for the remaining quarters, investment growth could present a potential downside risk.

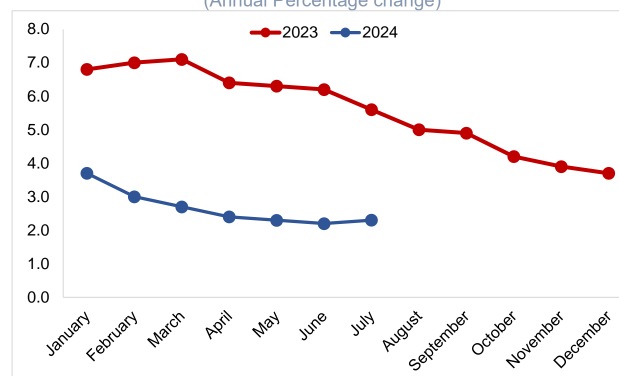
8. **Exports of goods and services grew by 3.6% in the first quarter of 2024, while imports of goods and services increased by only 1.8%, reflecting the performance of domestic demand**. Export growth in Q1 aligns closely with the DBP 2024's annual forecast of 3.9%, implying a required growth of 4.0% for the remaining quarters. This suggests a neutral risk for this component. However, with imports projected to grow by 3.9% for the year, an implied growth of 4.6% is needed for the rest of the year. The Council opines that this growth may materialize, as private consumption expenditure, the largest component of domestic demand, is projected to perform better than anticipated in the DBP 2024.

9. **In the first half of the year, tourism significantly outperformed MFIN's expectations.** The number of tourists visiting Malta from January to June 2024 increased by 23.4% compared to the same period in 2023, reaching approximately 1.6 million. Total tourist expenditure also grew by 24.5%,

surpassing expectations. Additionally, expenditure per capita slightly rose from an average of €804 to €812, driven by higher spending per tourist per night (from an €127.3 to €137.0), while the average length of stay per tourist declined from 6.3 to 5.9 nights per stay. The data for the first six months indicates that the 2024 projections will likely be exceeded, further boosting export levels and growth rates. The Council had noted a downside risk for export growth in 2024 in the DBP, based on concerns regarding key service sectors reaching market saturation, the introduction of global tax harmonization for multinationals, and challenges in gaining additional export market shares. However, in view of the upward revisions in tourism data, coupled with strong positive performance in high-value-added industries, the Council has revised its opinion to an upside risk for export growth.

10. **Malta's annual inflation rate has been gradually decreasing, averaging 2.7% over the first half of the year.** Core inflation components have been the primary driver of inflation during this period, contributing on average 2.4 pp. Within core inflation, services had the largest impact (1.2 pp), followed by processed foods, including alcohol and tobacco (0.8 pp), and non-energy industrial goods (0.3 pp). Non-core inflation, contributing 0.3 pp, was solely due to unprocessed foods, as government fixed prices on energy policy has kept energy inflation at zero. The DBP 2024's projected inflation rate for 2024 stood at 3.7%. To be achieved, the average annual rate of inflation from July to December would need to be close to 5.0%. However, given data up to June, inflation is on a downward trend, which indicates that, barring any unforeseen events, the annual inflation rate is likely to be considerably lower than projected.

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



Sources: Eurostat & MFIN

11. **A tight labour market persisted in the early months of 2024, marked by widespread increases in sectoral employment.** Year-on-year employment growth for 2024 Q1, based on the national accounts definition (FTEs), reached 5.8%, significantly exceeding the MFIN's annual projection of 4.4%. This increase was largely driven by employment growth

in the wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities sectors, contributing 2.3 pp to the overall growth. Additionally, the professional, scientific and technical activities; administrative and support service activities sector saw employment growth of 8.9% and 7,8%, contributing 1.4 pp to total employment growth. The unemployment rate forecasted at 2.7% stood at 3.0% for Q1 2024, remaining among the lowest in the EU and closely in line with the MFIN's forecast.

Macroeconomic performance and forecasts: key indicators for 2023-2024

	2023 (Actual)	2023 (Forecast DBP 2024)	2024 (Forecast DBP 2024)	2024 Q1 (Actual)	2024 (Q2-Q4 Implied)
Nominal GDP	11.3	9.7	7.4	7.8	7.3
Real GDP	5.7	4.1	4.2	4.6	4.1
Real GDP components					
Private Final Consumption Expenditure	7.8	6.1	4.5	3.7	4.8
General Government Final Consumption Expenditure	2.5	2.8	2.8	-1.7	4.3
Gross Fixed Capital Formation	-21.3	-18.9	5.5	-0.9	7.6
Exports of Goods and Services	8.7	2.6	3.9	3.6	4.0
Imports of Goods and Services	4.7	-0.9	3.9	1.8	4.6
Contributions to real GDP growth					
Domestic demand	-1.5	-1.6	3.6	1.1	4.4
Inventories	0.0	0.0	0.0	0.0	0.0
Net Exports	7.3	5.7	0.6	3.5	-0.4
Other macroeconomic variables					
Inflation Rate	5.6	5.7	3.7	3.1	3.9
Employment Growth (National Accounts)	6.7	4.7	4.4	5.8	3.9
Unemployment rate (LFS)	3.1	2.7	2.7	3.0	2.6
Nominal compensation of employees	9.5	9.0	8.9	9.6	8.7

Source: MFIN, NSO & MFAC Calculations

FISCAL ASSESSMENT

12. **The Consolidated Fund (cash-based) deficit for the first half of 2024 is significantly lower than that registered during the first six months of 2023 and the Budget Estimate for 2024.** The cash-based deficit was recorded at €89.8 million over the first half of the year, significantly lower than the €258.6 million registered between January and June of 2023. This deficit is also considerably lower than the Budgetary Estimates presented in October 2023, which indicated a deficit for 2024 of €992.0 million. This implies that in the second half of the year, expenditure would need to exceed revenue by more than €900 million, in cash terms, for the projected annual deficit to materialise. It is noteworthy that a similar situation had occurred in 2023, with the deficit increasing by a further €547.2 million over the last six months of the year, to €805.7 million. In particular, large increases in investment outlays were concentrated towards the end of the year.

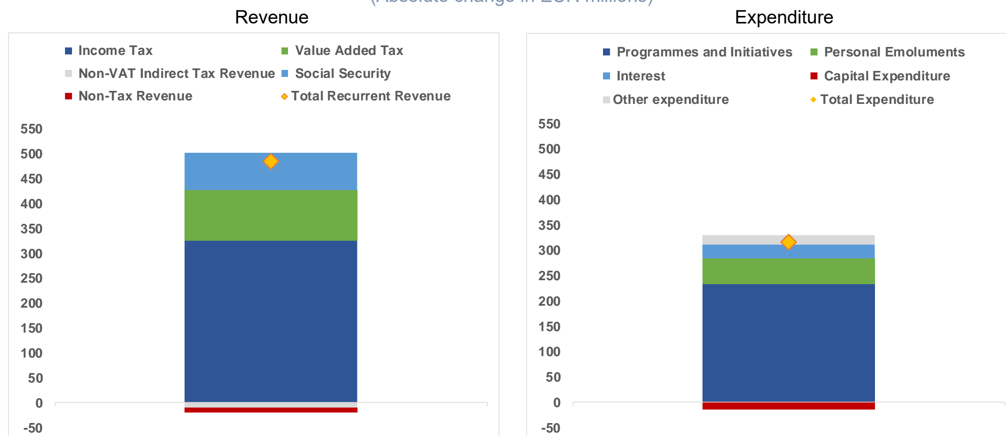
    Over the first half of 2024, on a cash basis, revenue accounted for 50.4% of the annual estimate, while expenditure reached 45.1% of the total. Compared to 2023, the ratio for revenue was 4.9pp higher, but this was partially offset by a higher ratio for expenditure (by 1.1 pp compared to 2023).

    Between January and June 2024, recurrent revenue totalled €3,404.7 million, marking a 16.6% increase (€484.0 million) compared to the previous year. The most significant gains were in Income Tax (€325.6 million), Value Added Tax (€102.4 million), and Social Security (€75.1 million). On the other hand, the rest of the revenue components, when aggregated, contributed around €19.0 million less than in the previous year. When comparing the half-year turnout to the full-year projection, both VAT and direct taxes performed better than last year. In particular, by June, direct taxes stood at 50.9% of the 2024 estimate, compared to 43.2% in 2023, while the VAT ratio stood at 49.5% compared to 48.1% in 2023, thus indicating that the attainment of the annual target is well on track.

    By June 2024, total expenditure reached €3,494.5 million, a 9.9% increase (€315.2 million) over the same six months of 2023. Recurrent expenditure rose to €3,067.4 million, largely due to a €232.7 million increase in programmes and initiatives, of which most were on social protection and general public services. Indeed, 46.6% of the allocated projected expenditure on programmes and initiatives were reached by the first six months of the year, which exceeds last year’s actual ratio of 45.5%. Additional expenditure of €51.2 million on personal emoluments has

materialised. Despite this increase, mid-year personal emoluments represented 45.0% of the yearly allocation, compared to an actual 45.9% in 2023. Contributions to Government Entities and operational and maintenance expenses increased by €19.4 million in total. Interest payments on public debt amounted to €126.9 million, reflecting a €26.9 million increase from the previous year. Interest expenditure stood at 46.7% of the approved target for the year which is the same level as in 2023, thus with progress in line with projections. Government capital spending for the first half of 2024 was €300.2 million, only one-third of the allocated estimate for the year. Such low cash expenditure on investment during the first six months also occurred in 2023. However, in 2023 a late recourse to funds from the EU's 2014-2020 Multi-Annual Financial Framework was expected. This year, around 80% of capital spending is projected to be nationally funded, compared to around 77% in 2023. Of the €721.9 million nationally funded capital expenditure, only 30.9% have been spent during the first six months, a ratio similar to that of last year.

Comparison of Revenue and Expenditure components between 2024H1 and 2023H1
(Absolute change in EUR millions)



Sources: NSO

13. **On an ESA (accrual-based) basis, the 2024 January-June estimated deficit stands close to that recorded in the first half of 2023, at €242.8 million, but is well below the annual deficit of €919.7 million projected in the Budget for 2024. For this deficit target to be realized, government spending would need to follow an ascending profile, compared to revenue, over the second half of the year, similar to the outcome during 2023.**[2] The preliminary ESA fiscal data indicates that during the first half of 2024, revenue has exceeded the level recorded in

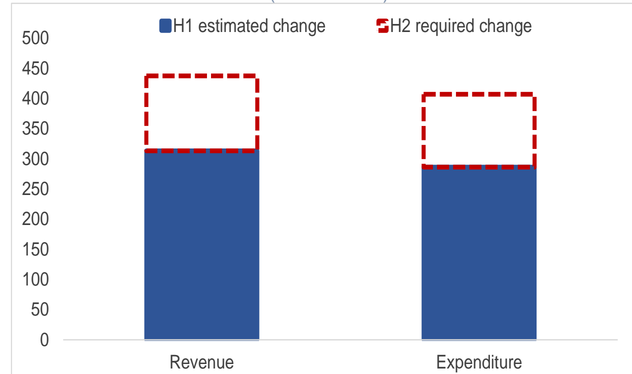
[2] As in previous years, the ESA fiscal data for the first half of 2024 was partially estimated by the MFIN, as the official figures for the second quarter of the year are published by NSO after the end of July. These estimates should be considered provisional and subject to future revisions.

2023 over the same period, by €313.3 million. This indicates a growth rate of 10.0%, which exceeds the annual estimate of 6.8% based on the Budget forecast, when compared to actual figures for 2023. However, expenditure also grew strongly (+ €286.2 million) during the first six months of the year, implying a growth rate of 8.4%, which is higher than the estimated annual increase of 5.5%. These developments contrast with the Council's recommendation that higher than projected revenue should be directed to build fiscal buffers.

In terms of the overall fiscal balance, the provisional estimates for the first half show a larger deficit than that computed on a cash-basis. In fact, the mid-year deficit of €242.8 million stands at close to the mid-year deficit of last year, which was €269.8 million.[3]

Mid-year estimated and required performance to meet the 2024 target changes set in the DBP 2024 when compared to actual 2023 data

(EUR Millions)



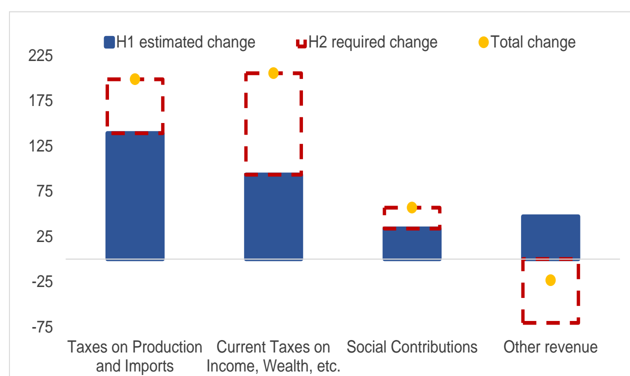
Sources: MFIN and MFAC staff calculations

14. **Mid-year tax revenue performance has been relatively robust compared to the annual goals. Estimates for the first half of the year indicate that growth was experienced across all the three largest revenue sources.** In particular, taxes on production registered the strongest growth (15.3%). Revenue from this component is well on track as the targeted annual growth rate for 2024 is 10.3%. Similarly, the growth of 6.6% in social contributions during the first six months compares well to the 5.7% growth projected in the DBP. Indeed, the 2024 half-year to full-year ratios for these tax revenue components were higher than the corresponding 2023 ratios. On the other hand, the similar ratio for current taxes on income and wealth was marginally lower, by 0.5pp, as growth

[3] The HYR disaggregates the transition between the Consolidated Fund to ESA in the January to June period, with the deficit increasing mostly because of other accounts receivable and payable (-€123.8 million, compared to -€201.9 million in 2023), time-adjusted cash transactions (-€58.0 million compared to +€174.4 million in 2023) and quarterly adjustments (-€49.9 million compared to -€44.9 million in 2023), whilst the positive balance of Extra-Budgetary units (+€63.8 million compared to +€68.6 million in 2023) was the main component offsetting the increase in the deficit.

during the first half of the year was slightly lower than the annual projection (7.5%, compared to an 8.5% yearly growth). As for the "other revenue" sources, the half-yearly outturn accounted for 49.5% of the yearly projection and has increased when compared to 2023. However, it is important to note that last year, this component experienced significant backloading, as the government concluded several EU-funded projects in the second half of 2023. Therefore, during the second half of 2024, a decline in "other revenue' sources is expected.

Mid-year estimated and required revenue performance to meet the 2024 target changes set in the DBP 2024
(EUR Millions)



Sources: MFIN and MFAC staff calculations

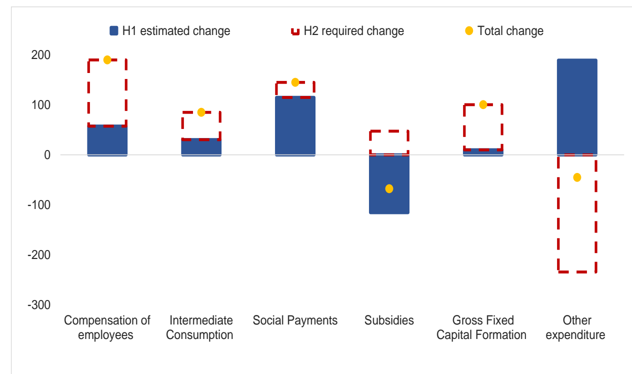
15. **During the first half of 2024, expenditure accounted for 47.1% of the amount budgeted in the DBP. At component level, performance was rather uneven. Half-year estimates suggest potential savings in some expenditure components compared to the yearly target, while other components may have been underestimated.** The outturn for compensation of employees and intermediate consumption during the first six months of the year suggest possible savings. Indeed, the half-year growth of 6.0% in compensation of employees is low compared to an implied 9.7% growth rate for the whole year. When measured against the full-year target, compensation of employees reached 47.6% by mid-year, which is 1.7pp lower than the ratio achieved in 2023. Similarly, intermediate consumption reached 46.4% of its target, 0.6pp lower than in 2023. Its growth in the first half of 4.2% is slightly lower than the implied growth of 5.6% for the year.

    In terms of subsidies, the six-month ratio stood at only 29.9% when compared to the DBP 2024 estimate. Subsidies were projected to decline by €67.8 million compared to the level in 2023, but the decrease during the first half of the year already amounted to €115 million. This indicates that potential savings could be considerable. Such savings are mainly due to lower costs associated with energy support measures following international energy market price stabilisation.

Meanwhile, for gross fixed capital formation, total spending only reached 35.4% of the 2024 projection by June, even less than the low mid-year turnout of 39.2% in 2023. Whilst recognising that outlays on this component are somewhat volatile, it is imperative to ensure that productive public investment is prioritised and realised.

In contrast, during the first half of the year, social payments already amounted to 55.2% of the budgeted estimate, which is 2.2pp higher than the level achieved by June 2023. In 2024, capital transfers, which constitute a large part of 'other expenditure' are projected to be around half of the amount in 2023. 58.1% of the Budgeted amount was however utilised by mid-2024 and therefore a decline is expected over the second half of the year.

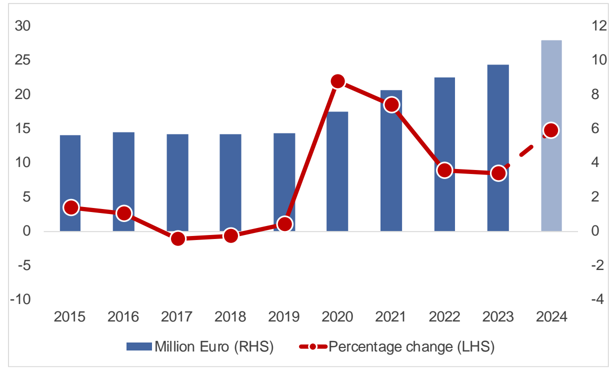
Mid-year estimated and required expenditure performance to meet the 2024 target changes set in the DBP 2024
(EUR Millions)



Sources: MFIN and MFAC staff calculations

16. **In the DBP, general government debt was projected to exceed €10.0 billion by 2023. However, debt turned out lower than envisaged, which suggests that a lower debt figure than the €11.2 billion Budget estimate for 2024 could be realised. As a ratio to GDP, debt is still projected to remain below the reference value of 60%.** In 2023, the end-of-year debt figure stood at €9,767.8 million. This better-than projected outcome resulted mainly because of higher than envisaged stock-flow adjustments. The lower debt level in 2023 together with the fact that the estimated deficit for the first six months is considerably lower than the annual projection suggests that the projections for the debt level in 2024 are overestimated. However, stock-flow adjustments have been volatile over the past years and therefore this component adds an element of uncertainty to the annual outturn. Similarly, the debt-to-GDP ratio for 2024 is also expected to be lower than projected. This reflects the base effect from 2023, where compared to a forecast of 53.1%, the ratio was reduced to 50.4%, due to both a lower debt level and a stronger GDP growth. Expectations regarding GDP growth as well as deficit performance further suggest a lower than projected debt ratio for 2024.

Debt developments and 2024 DBP forecast
(percentage change and EUR millions)



Sources: Eurostat and MFIN

17. **The FRA requires that the HYR also reports the extent of consistency with EU and local fiscal commitments. The Government plans to limit expenditure growth in line with the new EU fiscal regulations, which is important given that Malta is now subject to an Excessive Deficit Procedure.** The new EU fiscal regulations, which entered into force as from 30 April 2024, are aimed at achieving debt sustainability and maintaining fiscal balances at prudent levels, by capping the growth in the government's nationally financed net primary expenditure. The Maltese Government plans to limit the growth in net expenditure to a level that is consistent with the requirements and consequently reducing the general government structural deficit by 0.5pp of GDP annually. The goal is to approach the 3.0% of GDP Treaty reference value within the next four years. The deficit is at a relatively low level, compared to the annual projection. However, this was also the case last year, with expenditure then increasing significantly over the second half of the year. With respect to the general government debt, this ratio is planned to remain at prudent levels over the medium term, below the 60% of GDP reference value, and it could even materialise to be lower than projected.

COUNCIL'S APPRAISAL

18. **The Maltese economy has continued to expand steadily, outperforming the Government's latest projections for economic growth.** Output growth remained strong, though moderating from 2021 to 2022. Net exports, driven by strong service exports, were the key driver for economic growth in 2023 and the first three months of 2024. This performance was reflected in a robust labour market, with employment

growth at 5.8% in the first quarter of 2024, 1.4 percentage points higher than Government's forecast for the whole year, whilst the unemployment rate continues to hover near historic lows. In this tight labour market, inflows of foreign workers have alleviated labour shortages as well as some wage pressures. Meanwhile, the inflation rate continued to decelerate during the first months of 2024 and will most likely turn out to be lower than projected by the Government. Core inflation components continued to be the primary driver of inflation, particularly the services and processed food components.

19. **Overall, the Council appraises an upside risk for economic growth in 2024, primarily driven by external demand.** From a domestic demand perspective, the Council expects private consumption expenditure to turn out stronger than anticipated in the DBP, largely on the back of a stronger labour market, waning inflationary pressures and stronger-than-expected compensation per employee. The Council assesses that the upside risk from private consumption expenditure will likely offset the downside risk on government consumption expenditure and gross fixed capital formation, leading to an unchanged domestic demand contribution relative to that anticipated in the DBP. Regarding external demand, the Council has noticed that recent soft indicators may lead to a stronger contribution from external demand than anticipated by the Government in the DBP.

20. **On the fiscal side, the Council noticed that during the first six months of this year, revenue and expenditure turned out to be stronger than expected in the Budget Estimate for 2024. A possibly lower fiscal deficit coupled with the stronger-than-expected economic performance is expected to lead to a lower debt ratio than that anticipated by the Ministry in the Budget Estimate for 2024.** On an accruals-based basis, the deficit for the year's first half stood close to €250 million relative to €919.7 million projected in the Budget for 2024. Indeed, the mid-year tax revenue outturn has been relatively robust compared to the annual goals. While some savings seem to have materialised from certain expenditure components over the first six months, total expenditure still increased almost one-for-one to the substantial increase in revenue when juxtaposed against the same comparable period last year. The situation in terms of fiscal balance is similar to last year's, when the deficit in the first half of the year was well below the annual target, but then government spending was boosted significantly over the year's second half. However, in 2024, the new EU regulations have started to apply, setting limits on expenditure growth. Regarding the debt rule, currently there is a buffer of around 10 percentage points to the 60% debt-to-GDP benchmark and it is expected that this will continue to be respected.

21. **The new EU Economic Governance Framework calls for a shift in the government's budgetary process with more emphasis on controlling public expenditure growth. Malta's listing under an Excessive Deficit Procedure (EDP) also necessitates a more careful spending approach.** As highlighted previously, the new fiscal rules which have been implemented as part of the revised EU Economic Governance Framework, involve the setting of a net primary expenditure growth path. This means that higher-than-anticipated revenue flows should be directed to build fiscal buffers rather than spent. However, the Council notes that in previous years, as well as during the first half of this year, whilst actual revenue generated was higher than targeted, expenditure increased as well. Furthermore, in July, the Ecofin Council placed Malta, alongside six other countries, under an EDP. The deficit-based EDP is initiated when a Member State's fiscal deficit exceeds 3% of its GDP in the preceding year and is projected to remain above this threshold in the current year. Following Malta's placing under an EDP, the European Commission is expected to propose recommendations to correct the excessive deficit situation around November, in the context of the European Semester Autumn package.

COUNCIL'S RECOMMENDATIONS

22. Following the recommendations already put forward by the Council in the Assessment of the Annual Report 2023[4],on the basis of this Assessment of the Half-Yearly Report 2024, the Council hereby puts forward these recommendations:

a. The strong economic growth experienced in recent years has exerted demand pressures and exacerbated capacity constraints. While Malta's economic growth continues to surprise on the upside, the challenge for the medium-term to foster sustainable and inclusive growth becomes even more critical. **The Council recommends Government to expedite structural reform efforts and promote productive investment, particularly in the areas of digitalisation and green transition, research and innovation, physical and social infrastructure, addressing skills gaps and shortages in the workforce and improving education outcomes.**

b. **The Council would like to reiterate its recommendation to prepare an adequate exit strategy in relation to the fixed-energy-price policy, adopting a more targeted approach and enhancing incentives for energy savings.** The Council opines that the prevailing energy subsidy

[4] The Report is available here.

policy weighs substantially on public finances, involves risks to the deficit and expenditure trajectory and does not include incentives for energy savings and efficiency. The Council considers that the strong performance of the Maltese economy, well above the EU average, and the stabilisation of international oil and gas prices, provide the appropriate context, for a gradual revision to this subsidy so that it is more targeted and coherent with the over-arching objective of achieving a carbon-neutral economy and promoting the green transition.

c. The fiscal performance recorded in the first half of this year is better than expected, with the accruals-based deficit at around €240 million, considerably lower than the projected deficit of close to €920 million for the year. This was due to a higher-than-anticipated fiscal revenue on the back of stronger-than-expected economic growth. However, whilst there were some savings in specific expenditure components, the Council notes that, overall expenditure also increased strongly, matching almost one-for-one the unexpected revenue increases. **Given the increased focus on limiting expenditure growth in the revised EU economic governance framework and also in the context of Malta being subject to the EDP, the Council continues to strongly recommend that higher-than-projected revenue should be directed to accelerate fiscal consolidation and build fiscal buffers. The Council also recommends that whilst means of restraining expenditure growth should be explored, productive capital expenditure that promotes medium to long-term growth should not be curtailed.**

d. 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 few years, this timing of the publication reduces the relevance of this report and, consequently, the Council's assessment.** The Council thus recommends that the Half-Yearly Report should be made public earlier.

e. As regards the content of the Half-Yearly Report, the MFIN 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.**