New Street in Regional Road,
Msida, Malta
T: +356 21312442
info@mfac.org.mt
www.mfac.org.mt

12 December 2024

Hon. Mr Clyde Caruana
Minister for Finance
30, Maison Demandols,
South Street,
Valletta. VLT 2000.

Honourable Minister,

ASSESSMENT OF THE MEDIUM-TERM FISCAL STRATEGY
FOR MALTA 2024 – 2027

The Malta Fiscal Advisory Council (MFAC) is required, under Article 15(2) of the Fiscal Responsibility Act, to endorse, as it considers appropriate, the macroeconomic and fiscal forecasts prepared by the Ministry for Finance (MFIN) as contained in the Medium-Term Fiscal Strategy for Malta 2024 – 2027. On 3 December 2024, the Ministry submitted provisional macroeconomic and fiscal forecasts to the Council, followed by a finalised version on 9 December 2024 (refer to Appendix 1). These projections extend the macroeconomic and budgetary forecasts outlined in the MFIN's Draft Budgetary Plan 2025 (DBP) for 2024 and 2025, further projecting estimates for 2026 and 2027. Notably, the historical data and forecasts for 2024 and 2025 remain consistent with those published in the DBP. The MFAC previously conducted a comprehensive assessment of, and endorsed, the macroeconomic and fiscal forecasts included in the DBP.[1] Consequently, while summarising the Council's conclusions regarding the 2024 and 2025 forecasts as articulated in its Assessment Report, this endorsement letter primarily emphasises the evaluation of the macroeconomic and budgetary forecasts for the years 2026 and 2027. The cut-off date for these macroeconomic and fiscal projections is 30 October 2024.

[1] The Council's Draft Budgetary Plan 2025 Assessment is available here.

The Council's assessment of the Medium-Term Fiscal Strategy for Malta 2024–2027, as with its evaluation of the DBP, is undertaken within a reformed European Union economic governance framework. Typically, this document is published following Malta's submission of the Update of the Stability Programme, at the end of April each year. However, 2024 represents a transitional period, as the new economic governance framework came into effect on 30 April 2024.

Given the transitional nature of this year, the MFIN released the Medium-Term Fiscal Strategy for Malta 2024 - 2027 following the publication of the Medium-Term Fiscal Structural Plan 2025 - 2028 (MTFSP) on 20 September 2024[2] and of the Draft Budgetary Plan 2025 on 15 October 2025.[3] The MTFSP limits the growth of the nationally financed net primary expenditure indicator for the next four years.[4] Furthermore, it takes into account Malta's current status under the Excessive Deficit Procedure. The Medium-Term Fiscal Strategy for Malta 2024 – 2027 was prepared in this context.

On 29 November 2024, the MFAC presented its assessment of the DBP to the Minister for Finance. The MFAC endorsed the government's macroeconomic and fiscal forecasts for 2024 and 2025, noting that they fall within its endorsable range and align with the assumptions in the official document.

The government's forecasts project an economic growth rate of 4.9% in 2024 and 4.3% in 2025. The fiscal deficit is expected to be lower than in 2023 but to remain above the 3% benchmark, reaching 4.0% of Gross Domestic Product (GDP) in 2024 and 3.5% in 2025. Public debt-to-GDP is expected to stay well below the 60% threshold, at 49.5% in 2024 and 50.1% in 2025.

These forecasts align with estimates from other independent institutions. The MFAC's risk outlook suggests positive risks for GDP growth in 2024 and 2025, with the upside risk being

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[2] The MTFSP 2025-2028 for Malta can be found here.

[3] The Draft Budgetary Plan 2025 for Malta can be found here.

[4] The nationally financed net primary expenditure indicator represents government expenditure net of interest expenditure, discretionary revenue measures, expenditure on Union programmes fully matched by revenue from Union funds, national expenditure on co-financing of programmes funded by the Union, as well as cyclical elements of unemployment benefit expenditure.

more pronounced for 2024. The MFAC also highlighted that government expenditure, especially for compensation of employees and gross fixed capital formation may be lower than anticipated in 2024, with potential spillover effects into 2025. At the same time, the Council also identified positive risks for government revenue, particularly from direct taxes. Combined with the upside risks to GDP, this could lead to a smaller fiscal deficit than projected and a lower debt ratio in 2024 and 2025. Since the forecasts for 2024 and 2025 remain unchanged from the DBP, the Council notes that its assessment of the DBP is equally applicable to the MTFS.

The forecasts presented in the MTFS show that the economy is projected to maintain a robust growth trajectory in both 2026 and 2027, with real GDP forecast to expand by 4.4% and 4.5%, respectively. An interplay of domestic and external factors will drive this sustained expansion. Domestic demand is anticipated to remain the principal growth component, contributing 3.0 pp to GDP growth in 2026 and 2.9 pp in 2027. However, this contribution is projected to moderate slightly compared to previous years. This moderation can be attributed, in part, to an anticipated easing in labour market conditions, which is expected to result in some improvements in productivity.

Countering this moderation in domestic demand, the contribution of net exports is projected to increase to 1.4 pp in 2026 and 1.7 pp in 2027. This surge in external demand is anticipated to be propelled by increased competitiveness of Maltese businesses within international markets and improved economic growth in Malta's main trading partners, which is expected to reach 1.3% in 2027. The MFAC shows concern that the growth composition is expected to remain predominantly domestic-led in 2026 and 2027 and reiterates its long-standing recommendation to transition from a reliance on domestic demand to export-led growth. An analysis of the individual GDP components reveals that real private consumption growth is projected to remain strong but moderate slightly to 4.1% and 3.8% in 2026 and 2027, respectively, mainly reflecting a gradual normalisation of spending patterns following the post-pandemic recovery. Government consumption in real terms is anticipated to contract marginally in 2026 (-0.4%) before rebounding to 1.1% growth in 2027. Constraining expenditure growth to these specified rates appears highly challenging, particularly when compared to this component's long-term average growth rate. Over the past 20 years, the annual average growth rate has been 4.7%, increasing to 6.9% when calculated over the last decade. The Council positively notes that investment is poised to remain a key driver of economic expansion, with gross fixed capital formation projected to grow by 6.5% and 5.2% over the forecast horizon.

As regards the labour market, while moderating slightly, employment growth is anticipated to remain strong at 3.9% in 2026 and 3.6% in 2027, while the unemployment rate is projected to remain stable at 3.0%. The Council notes that labour productivity is expected to register modest improvements, growing by 0.5% in 2026 and 0.9% in 2027, signifying incremental gains in efficiency. However, despite government's policy objective of increasing productivity, such improvements are rather muted and still result in deteriorating price competitiveness. Meanwhile, potential GDP growth is projected to slightly moderate to 4.6% in both 2026 and 2027. This trajectory produces a negative output gap of 0.7% in 2026 and further widens to 0.8% in 2027. Consistent with previous recommendations, the Council observes that the projected persistence of a negative and widening output gap in 2026 and 2027 appears to be at odds with labour market projections. In particular, the unemployment rate is expected to remain low, at approximately 3%, which suggests a potential misalignment between output gap estimates and labour market conditions.

On the fiscal front, the government is targeting a gradual reduction in the budget deficit, of 0.5 pp each year, reaching 3.0% of GDP in 2026. For 2027, the projected improvement is slightly less, at 0.4 pp. This improvement in the deficit ratio is driven by expected declines in the expenditure-to-GDP ratio, as revenue-to-GDP is forecast to remain relatively stable at 31.9%. As Malta continues to operate below its potential output, the structural balance is anticipated to fall below the 3% reference trajectory ahead of the headline balance. The forecasts point to a structural balance of 2.6% in 2026, declining further to 2.2% in 2027. If these projections materialise, Malta will exit the deficit-based Excessive Deficit Procedure within the timeframe of the MTFS.

Overall, the fiscal revenue components are forecast to increase at a similar pace to GDP over the 2026-2027 forecast period. The ratio of direct taxes to GDP is forecast to decline to 12.1% in 2025, reflecting the impact of the revision in income tax bands. Subsequently, it is expected to be relatively elastic and rise annually by 0.1 pp. This increase is offset by equivalent declines in indirect taxes to GDP ratio, while other revenue components are expected to maintain relatively constant ratios.

The Council positively notes that the plan to rescind the ratio of expenditure-to-GDP is not at the cost of planned reductions in investment. Indeed, public gross fixed capital formation is projected to continue increasing, up to 4.3% of GDP in 2027 from 3.9% in 2025. This is in line with one of the recommendations issued by the Council in its recent reports that restraining public expenditures should not involve curtailing productive investment. The only other expenditure component forecast to continue increasing relative to GDP is interest expenditure, up to 1.4%. As a result, the implicit interest rate on debt shall continue to increase to 3.1% by 2027. On the other hand, following the significantly large increments anticipated for compensation of employees, intermediate consumption and social payments in 2024, increments in these components are thereafter more muted. The projections indicate very low increments in intermediate consumption over the outer forecast years, which could be challenging to achieve, particularly when compared to past increments. Albeit to a lesser extent, this also applies to the forecast for social payments. With respect to subsidies, these are forecast to stabilise at 2.0% of GDP in 2026 and 2027, following consecutive declines since 2021.

Such developments in expenditures and other fiscal elements would imply compliance with the maximum average growth of 5.9% in the net nationally financed primary expenditure committed to in the Medium-Term Fiscal Structural Plan for 2025-2028. Indeed, the Fiscal Strategy suggests a net expenditure growth of 5.6%, 5.0% and 4.9%, respectively, between 2025 and 2027. The Council notes the widening margin between the targets for net expenditure growth presented in the MTFS and the ceiling committed to in the MTFSP, which allows some flexibility to adjust expenditures if faced with unexpected developments. At the same time, the Council underscores the potential challenges of achieving these targets, particularly when compared to historical expenditure patterns. In this context, the Council advises constant scrutiny of spending, particularly for those components where restraining expenditure growth has proven to be difficult in the past.

As regards debt developments, the plan expects that the debt ratio is maintained close to 50%, thus adhering to the 60% of GDP reference value, with a projected buffer of 10.8 percentage points by 2027. The positive risks to GDP and the possibility of better deficit ratios identified by the Council for 2024 and 2025 could have spillover effects on the rest of the forecast years, and the debt ratio could also turn out to be less than projected. The forecasts are nonetheless contingent on stock-flow adjustment values, which are closer to neutral in the projections, but these have been rather volatile than over the recent years.

Following the endorsement of the Draft Budgetary Plan's forecasts in its Assessment published on 2 December 2024, the Council also considers the macroeconomic and fiscal forecasts included in the Medium-Term Fiscal Strategy 2024 – 2027 to lie within its endorsable range, while acknowledging that forecasts for 2026 and 2027 are subject to greater uncertainty. The risks identified by the Council in its Assessment of the Draft Budgetary Plan 2025 apply also in the context of the Medium-Term Fiscal Strategy. The Council further notes that despite remaining above the 3% deficit ratio in 2024 and 2025, the Plan is to make a sustained structural effort, exceeding the minimum adjustment requirements, to rescind below this reference value by 2026. While the structural balance is projected to improve further in 2027, it is still expected to remain above the 1.5% deficit resilience safeguard.

The Council also notes that the projections suggest lower net expenditure growth for all forecast years than projected in the Medium-Term Fiscal Structural Plan. This is beneficial to create an element of fiscal buffer. However, the Council notes that achieving the targeted growth for certain expenditure components may prove to be challenging, particularly when juxtaposed against historical trends. The Council recommends that, as the net expenditure path becomes binding in 2025, routine and constant screening of fiscal spending is undertaken to ensure that the targets in the Strategy are adhered to. Any potential buffers from the macro side, inducing more fiscal revenue, should be directed to accelerate fiscal consolidation and not to increase expenditure as has been the occurrence over past years. Means to improve efficiency in public spending should be explored. Given the high economic growth environment, the normalisation of inflation, and robust forecasts for the labour market, it is important that government does not inflate expenditure beyond what is necessary through unnecessary expansionary policies. In terms of the government's debt ratio, the Council notes that this is projected to remain close to 50% over the four forecast years, remaining sufficiently below the 60% benchmark.

Particularly, given that this was a transitory year towards the new regulations, including changes in reporting requirements, the Council would like to express its gratitude for the ongoing collaboration and assistance with the Ministry's employees. Looking ahead, the Council looks forward to work with all the relevant stakeholders to review the Fiscal

Responsibility Act so as to align the national fiscal legislation to the new EU economic governance framework by the end of December 2025.

Yours sincerely,

Dr Moira Catania
Chairperson of the Malta Fiscal Advisory Council

Appendix Tables

Table 1: Macroeconomic variables 2022 – 2027 (%)

	Actual		Forecasts			
	2022	2023	2024	2025	2026	2027
Real GDP components						
Private final consumption expenditure*	10.9	11.2	4.4	4.6	4.1	3.8
General government final consumption expenditure	0.4	2.9	8.6	1.9	-0.4	1.1
Gross fixed capital formation	9.7	-18.2	4.5	5.5	6.5	5.2
Exports of goods and services	13.7	4.7	5.2	5.3	5.7	5.3
Imports of goods and services	18.5	-0.4	5.4	5.3	5.5	4.9
Real GDP	4.1	7.5	4.9	4.3	4.4	4.5
Contribution to real GDP growth						
Domestic demand (pp)	6.8	1.0	4.3	3.4	3.0	2.9
Inventories (pp)	-0.1	0.0	0.0	0.0	0.0	0.0
Net exports (pp)	-2.6	6.5	0.6	0.9	1.4	1.7
Nominal GDP components						
Private final consumption expenditure	16.8	18.0	7.6	6.9	6.6	6.3
General government final consumption expenditure	3.9	7.8	13.1	5.1	3.0	4.3
Gross fixed capital formation	15.7	-12.9	6.3	7.4	8.6	7.1
Exports of goods and services	18.6	8.1	8.0	7.6	8.1	7.4
Imports of goods and services	23.4	3.0	8.2	7.4	7.8	6.8
Nominal GDP	9.4	13.2	8.1	7.0	7.0	7.2
Labour market						
Employment (National Accounts definition -FTEs)	5.1	6.3	4.6	4.2	3.9	3.6
Unemployment rate (%) (LFS definition)	3.5	3.5	3.2	3.1	3.0	3.0
Nominal compensation per employee	3.8	1.7	4.4	4.2	3.9	3.8
Labour productivity (real GDP per person employed)	-0.9	1.1	0.3	0.1	0.5	0.9
Unit labour costs	4.8	0.5	4.0	4.1	3.4	2.9
Other macroeconomic variables						
Inflation rate (%) (based on the HICP)	6.1	5.6	2.5	2.1	2.2	2.0
Potential GDP	6.7	5.2	5.1	4.8	4.6	4.6
Output Gap	-2.1	0.1	-0.1	-0.5	-0.7	-0.8

Note: Figures for 2022 and 2023 are actual according to NR 159/2024, while figures from 2024 to 2027 are forecasts.
*Includes Non-Profit Institutions Serving Households (NPISH).
Source: MFIN and NSO

Table 2: Main fiscal developments (% of nominal GDP)

	Total Revenue	Total Expenditure	Fiscal Balance	Structural Balance (% of potential GDP)	Gross Debt
2022	32.5	37.8	-5.2	-4.3	49.4
2023	31.8	36.3	-4.5	-4.6	47.4
2024	32.8	36.9	-4.0	-4.0	49.5
2025	32.0	35.5	-3.5	-3.3	50.1
2026	31.9	34.9	-3.0	-2.6	50.0
2027	31.9	34.5	-2.6	-2.2	49.2

Source: MFIN and NSO

Table 3: Fiscal Developments (% of nominal GDP)

	Actual		Forecast			
	2022	2023	2024	2025	2026	2027
Total revenue	**32.5**	**31.8**	**32.8**	**32.0**	**31.9**	**31.9**
Taxes on production and imports	9.7	9.4	9.8	9.9	9.8	9.7
Current taxes on income and wealth	12.7	12.2	12.5	12.1	12.2	12.3
Social contributions	5.4	5.2	5.1	5.0	5.0	5.0
Other revenue*	4.6	5.0	5.4	5.0	4.9	4.9
Total expenditure	**37.8**	**36.3**	**36.9**	**35.5**	**34.9**	**34.5**
Compensation of employees	10.1	9.4	10.1	9.7	9.6	9.5
Intermediate consumption	7.1	7.1	7.4	7.6	7.2	6.9
Social payments	8.4	8.0	8.0	7.9	7.7	7.5
Gross fixed capital formation	3.2	3.5	4.2	3.9	4.1	4.3
Subsidies	4.6	3.6	2.5	2.1	2.0	2.0
Other expenditure**	4.3	4.7	4.5	4.2	4.3	4.3

Note: Figures for 2022 and 2023 are actual according to NR 195/2024, while figures from 2024 to 2027 are forecasts.
Source: MFIN and NSO