MFAC
MALTA FISCAL ADVISORY COUNCIL

Annual Report and Statement of Accounts

2024

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ANNUAL REPORT

AND

STATEMENT OF ACCOUNTS

2024

MFAC
MALTA FISCAL ADVISORY COUNCIL

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18 March 2025

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

Dear Minister,

LETTER OF TRANSMITTAL

In terms of article 58 of the Fiscal Responsibility Act, 2014 (Cap 534), I have the honour to transmit to you a copy of the Annual Report of the Malta Fiscal Advisory Council for the year 2024.

In terms of article 56 of the Fiscal Responsibility Act, I am also transmitting a copy of the audited accounts of the Council for the financial year ended 31 December 2024.

Yours sincerely,

Moira Catania

Moira Catania
Chairpersoncomposite

Vision

'To contribute to stronger fiscal governance in Malta and offer assurance about the quality of the official economic and fiscal projections, and about fiscal sustainability, through independent analysis and advice.'

Mission statement

The Malta Fiscal Advisory Council (MFAC) is an independent institution established under the Fiscal Responsibility Act (2014) which has the primary objective to contribute to sustainable public finances and sound economic policy making in Malta.

The MFAC seeks to carry out its statutory responsibilities by:

i. Assessing the plausibility of the Government's macroeconomic forecasts and fiscal projections and endorsing them as it considers appropriate;

ii. Assessing whether the fiscal stance is conducive to prudent economic and budgetary management;

iii. Assessing the extent to which the conduct of fiscal policy in Malta is consistent with the country's fiscal commitments as a member of the European Union;

iv. Assessing the extent to which the annual budgetary plan and medium-term fiscal plan comply with the Fiscal Responsibility Act and the Stability and Growth Pact;

v. Assessing the extent to which the fiscal and economic policy objectives proposed by the Government are being achieved;

vi. Determining whether exceptional circumstances, which would allow for a departure from the announced fiscal plans, exist or have ceased to exist;

vii. Issuing opinions and formulating recommendations in the areas of public finances and economic management;

viii. Advising the Government and the Public Accounts Committee concerning the maintenance of fiscal discipline; and

ix. Disseminating information and analysis to the public to increase awareness and understanding of economic and fiscal issues.

The Malta Fiscal Advisory Council

Chairperson

Dr Moira Catania

Council Member

Dr Stephanie Fabri

Council Member

Dr Stephanie Vella

Staff

Chief Economist

Mr Gilmour Camilleri

Senior Economist

Mr Christian Xuereb

Senior Economist

Mr Kurt Davison

Economist

Ms Kylie Spiteri

Administrator and Council Secretary

Ms Alison Bugeja Persiano

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List of Acronyms

AMECO	Annual Macro Economic Database of DG ECFIN
CBM	Central Bank of Malta
COM	European Commission
DBP	Draft Budgetary Plan
DG ECFIN	Directorate-General for Economic and Financial Affairs
DSA	Debt Sustainability Analysis
EDP	Excessive Deficit Procedure
EFM	European Fiscal Board
EU	European Union
EUCAM	European Union Commonly Agreed Methodology
EU NIFI	European Union Network of Independent Fiscal Institutions
GDP	Gross Domestic Product
HP	Hodrick-Prescott
IFIs	Independent Fiscal Institutions
IMF	International Monetary Fund
MFAC	Malta Fiscal Advisory Council
MFIN	Ministry for Finance
MTFS	Medium-Term Fiscal Strategy
MTFSP	Medium-Term Fiscal Structural Plan
NAWRU	Non-Accelerating Wage Rate of Unemployment
NSO	National Statistics Office
OECD	Organisation for Economic Co-operation and Development
OGWG	Output Gap Working Group
PAC	Public Accounts Committee
TFP	Total Factor Productivity
TSI	Technical Support Instrument
USP	Update of the Stability Programme

Chairperson's statement

I present with pleasure the tenth Annual Report of the Malta Fiscal Advisory Council (MFAC), which provides an overview of the activities undertaken during 2024. The Report also contains two thematic chapters. The first chapter discusses the topic of fiscal responsibility and expenditure control within the context of the new EU Fiscal Framework, with a particular focus on Malta. The enhanced Framework places greater emphasis on expenditure control and provides a more differentiated country-specific approach which takes into account potential output growth and debt sustainability. The second thematic chapter examines how various economic conditions and policy decisions can influence the EU Commonly Agreed Methodology (EUCAM), which the European Commission uses to estimate potential growth and output gap projections for Member States. By conducting this analysis, the MFAC aims to refine its approach to endorsing macroeconomic and fiscal projections. Notably, potential output and output gap projections derived from EUCAM also serve as inputs into the Commission's Debt Sustainability Analysis, further underscoring the significance of this assessment.

This statement reflects on macroeconomic and fiscal policy developments during the past year, outlining key challenges and priorities for the short- to medium-term. Uncertainty persisted throughout 2024, driven by geopolitical tensions across multiple regions and shifting global trade dynamics. An important development in terms of fiscal governance was the deactivation of the Stability and Growth Pact's general escape clause, which had been in force since 2020, and the adoption of the new EU Fiscal Framework in April 2024.

Despite the challenging environment, the EU economy began to show signs of recovery, recording real economic growth of 1.0%, mainly supported by a resilient labour market and a rebound in real wages. While energy prices remaining elevated, the disinflation process continued throughout the year.

Fiscal consolidation efforts also ensued in 2024. The European Commission expects the EU general government deficit to decline by 0.4 percentage points to 3.1% of GDP, thus remaining above the 3% threshold. Meanwhile, public debt is expected to edge up marginally by 2.6 percentage points, to 83.4% of GDP, therefore remaining well above the 60% threshold. In fact, during this year, the European Council initiated excessive deficit procedures against eight countries.

Notwithstanding the prevailing fragility of the international economic environment, the Maltese economy demonstrated remarkable resilience, exceeding expectations with a robust real economic growth rate of 6.0%. Notably, this outcome surpassed the projections of key institutions—including the Ministry for Finance, the European Commission, the Central Bank of Malta, and the International Monetary Fund—by approximately one percentage point compared to their forecasts issued during the autumn 2024 forecast round. The primary factors driving this growth include robust private and public consumption, supported by a favourable contribution from net exports. These patterns reflect the continued increase in tourist arrivals and strong immigration inflows. Furthermore, the labour market remained strong, with employment increasing by 5.1% coupled with an unemployment rate of 3.1%. Reflecting EU trends, inflation in Malta continued to decelerate (2.4%) though still driven by core inflation components.

The reactivation of fiscal rules at the beginning of the year, the adoption of the new EU Fiscal Framework, and the Council's decision on 26 July 2024 to launch an excessive deficit procedure against Malta and seven other Member States were the main activities that shaped the area of public finances in 2024. For last year, the Ministry for Finance targeted a deficit ratio of 4.0% for 2024, reaching the minimum structural adjustment of 0.5 percentage points of GDP required. In the forthcoming period, the Government is targeting to reduce the deficit ratio below the required 3% threshold by 2027. On the other hand, regarding the debt rule, Malta's government debt ratio remains well below the 60% of GDP ceiling, anticipated at 49.5% of GDP in 2024.

In September, Malta submitted its first Medium-Term Fiscal Structural Plan (MTFSP), a new reporting requirement introduced under the revised EU Fiscal Framework. The reformed framework places greater emphasis on the differentiated fiscal positions of individual Member States, allowing for a more tailored approach to fiscal rules while reinforcing national ownership of fiscal policies.

The revised framework shifts the focus towards expenditure control, specifically by setting limits on the growth in net nationally-financed primary expenditure. On 21 June 2024, the European Commission provided a reference trajectory for net expenditure growth. In line with this guidance, the Government of Malta opted to fully adhere to the Commission's reference expenditure growth limit of 5.9%, setting this as the target for the period spanning from 2025 to 2028. This decision was documented in Malta's MTFSP. It is worth noting that the Government of Malta has set a more ambitious growth trajectory in the Draft Budgetary Plan 2025 (published in October) and the Medium-Term Fiscal Strategy 2024-2027 (published in December) compared to the projections outlined in the Medium-Term Fiscal Structural Plan 2025-2028 (published in September).

Throughout its publications over the year, the Council identified several short- to medium-term economic and fiscal challenges and proposed recommendations to ensure economic and fiscal sustainability. Notably, sub-section 1.9 of Chapter 1 outlines these challenges and provides an overview of the recommended actions communicated by the Council in its periodic reports throughout the year.

Looking ahead, two major challenges warrant particular emphasis. The first concerns the drivers of Malta's economic growth. Rapid population growth, coupled with strong private consumption have boosted domestic demand, but at the same time, have placed significant strain on the country's infrastructure. In response, the Council calls for an export-led growth strategy, underpinned by enhanced competitiveness through improvements in labour productivity.

Achieving this objective necessitates a comprehensive economic vision that prioritises high-value added as opposed to high-volumes, low value-added economic activities. Sustained efforts are required to ensure that Malta maintains its ability to expand export market shares across diverse economic sectors. Key enablers in this regard include addressing skill gaps through targeted education and training, fostering innovation and research, and advancing the twin transition towards digitalisation and environmentally sustainable business practices. These measures are essential for enhancing organisational efficiency and strengthening labour productivity.

The second major challenge for Malta lies in ensuring the efficiency of public spending, in the context of the need to restrain expenditure growth in accordance with the trajectory outlined in the MTFSP. In the first thematic Chapter in this Report, the Council observed that the average annual growth rate of net nationally financed primary expenditure between 2013 and 2023 stood at 8.9% (7.5% when excluding the COVID-19 pandemic year). Given these historical trends, the expenditure growth limit and the government's more ambitious targets pose a challenge, particularly within the context of a growing economy and expanding population. Accordingly, continuous monitoring of expenditure developments is essential, whilst efforts should be made to improve public spending efficiency and to reallocate resources towards productive capital investment.

With regard to the Council's operations, it is encouraging to observe that, throughout its years of activity, the government's official macroeconomic and fiscal projections have consistently fallen within the endorsable range. Reliable economic forecasts, coupled with realistic fiscal targets, serve as essential foundations for effective policymaking.

Looking forward, the EU Council Directive 2024/1265 on requirements for national budgetary frameworks should be transposed into national legislation by the end of 2025. The Council considers that this presents a critical opportunity to update the Fiscal Responsibility Act (Cap. 534), taking into account the experience of implementing this legislation as well as economic and fiscal developments during the past ten years.

On behalf of the Council members, I wish to convey our profound appreciation for the unwavering support and collaboration extended by all stakeholders in facilitating the activities of the Malta Fiscal Advisory Council (MFAC). In particular, the constructive engagement with the Ministry for Finance, coupled with the timely and comprehensive provision of information by the Economic Policy Department, the Budget Affairs Division within the Ministry, and the National Statistics Office, have been instrumental in ensuring the seamless preparation of the MFAC's periodic reports. Furthermore, I extend my sincere gratitude to my esteemed colleagues on the Council and to the dedicated staff for their exemplary professionalism and commitment throughout the year. Their unwavering dedication and expertise have been pivotal in enabling the MFAC to discharge its mandate with both efficacy and efficiency.

Dr. Moira Catania

Chairperson

Chapter 1

Developments during 2024

Fiscal Responsibility and Expenditure Control: National Strategies within the EU Fiscal Framework, with a focus on Malta

The sensitivity of the EU commonly agreed methodology to estimating potential output and the output gap for Malta

Financial Statements

Developments during 2024

1.1 The Fiscal Council

The Council's composition remained unchanged from the previous year, with Dr Moira Catania serving as Chairperson and Dr Stephanie Vella and Dr Stephanie Fabri as Council Members. In 2024, the **Malta Fiscal Advisory Council** (MFAC) convened eleven meetings. These meetings addressed various administrative and operational matters, which involved decisions relating to the annual work programme, the Council's finances, operations, human resources, training programmes, and participation in official meetings and seminars. Thorough internal discussions and supplementary meetings were conducted to analyse macroeconomic trends and public finances, focusing on the relevant risks at the time. These discussions were a key input in shaping the Council's macro-fiscal evaluations, leading to the required endorsement of the government's official forecasts.

1.2 Relations with key stakeholders

Regular meetings were held with key domestic and international stakeholders. As in past years, regular dialogue was maintained with the **Ministry for Finance** (MFIN). Technical meetings were conducted to discuss and exchange views on the macroeconomic and fiscal forecasts, clarifying the assumptions and methodologies employed and addressing the surrounding risk factors. Meetings were also held on the national implications emanating from the new EU's Economic Governance Framework which was adopted in April 2024. Moreover, to keep adjourned on data-related revisions and changes in statistical recording methodologies, the MFAC also attended meetings and maintained regular communication with the **National Statistics Office** (NSO).

Apart from its independent assessment, the MFAC also assesses the plausibility of the government's official projections by comparing them with those of other reputable institutions. In this regard, the MFAC takes note of the various reports published by other forecasting bodies, such as the **Central Bank of Malta** (CBM). As part of their rating evaluations, a number of **credit rating agencies** also met with the Council in 2024 to discuss the above-mentioned issues. During such meetings, the MFAC discussed the contents of its published reports, which can serve as input for the rating assessments carried out by these agencies.

Furthermore, the MFAC held meetings with officials from the Directorate-General for Economic and Financial Affairs (DG ECFIN) within the **European Commission** in April and October. The Council also participated in the 2024 Article IV consultation mission of the **International Monetary Fund** (IMF). During these technical meetings, the Council exchanged its perspective and insights on recent macroeconomic and fiscal developments. It also discussed possible risk factors that could derail the Ministry's official short- and medium-term economic outlook, especially considering the elevated uncertainty during the period. This uncertainty includes the geopolitical tensions between Russia and Ukraine and between Israel and Palestine. Furthermore, during 2024, the escape clause in the EU's Stability and Growth Pact was deactivated whilst Malta was subjected to an Excessive Deficit Procedure (EDP) due to a deficit which exceeded the 3.0% of GDP threshold. Discussions with these key stakeholders were framed within the context of the newly reformed EU Economic and Governance Framework, which introduced additional complexities and challenges.

Throughout the year, the MFAC actively participated in initiatives coordinated by the **EU Network of Independent Fiscal Institutions** (EUNIFI), engaging in discussions on prevailing economic concerns and the Economic Governance Review. The MFAC staff was also actively involved in ad-hoc working groups with other **Independent Fiscal Institutions** (IFIs). Specifically, during 2024 these working groups addressed the importance of communication in an IFI's role, stipulating best practices among IFI's and their effectiveness, as well as the role of IFIs in assessing and endorsing macroeconomic and budgetary forecasts of their respective countries. Meetings were also regularly held with the Commission's DG Reform regarding the MFAC's participation in a joint project under the **Technical Support Instrument** (TSI).[1]

The Fiscal Responsibility Act prescribes that the Chairperson of the Fiscal Council shall appear before the **Public Accounts Committee** (PAC) of the House of Representatives whenever requested to provide evidence to that Committee regarding the activities concerning the Fiscal Council's operations. In 2024, the Public Accounts Committee did not make such requests to the Fiscal Council.

[1] More details on the TSI are provided in a subsequent section within this Chapter.

1.3 Other meetings, seminars and conferences

The MFAC participated in several meetings, seminars, and conferences that were organised by local and foreign organisations.

Most of the events that the Council attended were organised by the EUNIFI. Other events attended were organised by the European Commission and other national IFIs. The MFAC also attended events organised by local institutions.

Meetings and seminars attended by the MFAC during 2024

Event	Organiser
Various EU IFIs Network meetings	EUNIFI
The Future of Public Spending	OECD
Path for Public Finances 2024	Irish Fiscal Advisory Council
What public investment for the future?	DG ECFIN
Navigating the Future: Challenges and Opportunities of Longevity in Europe	DG ECFIN
Strengthening the Capacity of Independent Fiscal Institutions	EUNIFI
The role of independent advice on fiscal policy	European Fiscal Board
Meeting of the Economic and Financial Committee Alternates	Economic and Financial Committee
Malta’s Recovery and Resilience Plan; Competitiveness, Education, and Sustainable Mobility	European Commission Representation in Malta
Building our Future - Property Malta National Conference 2024	KPMG
ECFIN's 4th annual National Fiscal Frameworks Conference	DG ECFIN
EUROMOD Training	European Commission, Joint Research Centre (JRC-Seville)

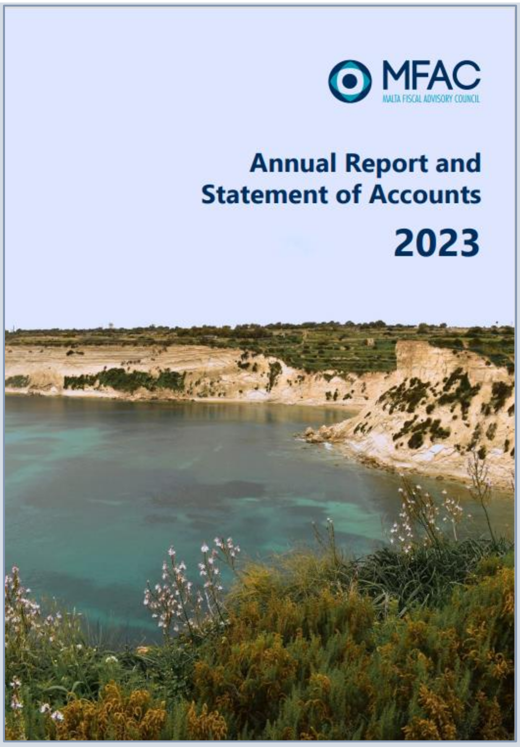
Annual Research Workshop 2024	Central Bank of Malta
Seminar on Disability Benefits and Reforms	Central Bank of Malta
The Local Start-up Ecosystem: A Policy Perspective	Malta Enterprise
Conference on Microsimulation modelling	University of Malta
'MALTA VISION 2050': Just Another Slogan?	Times of Malta

1.4 Publications and research

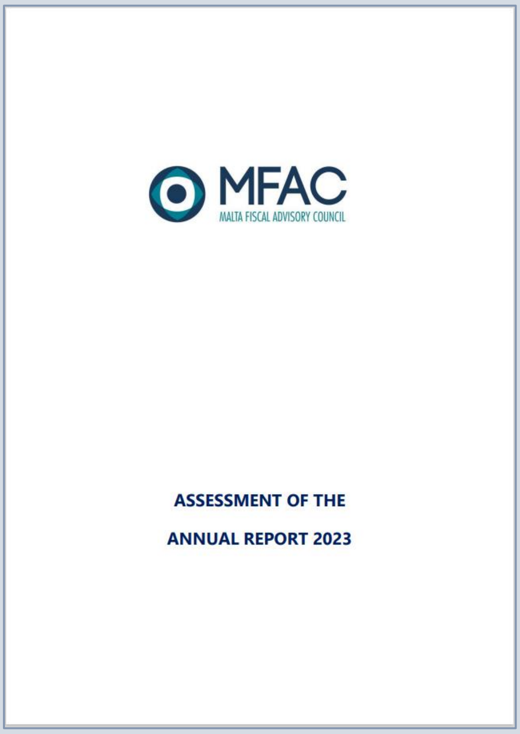
In 2024, the MFAC published **four reports**. The first publication of the year was the Annual Report and Statement of Accounts for 2023. The second report assessed the MFIN's Annual Report for 2023 while the third report assessed the Half-Yearly Report for 2024. The final report assessed the official forecasts presented in the Draft Budgetary Plan for 2025.

Apart from the four reports, the MFAC transmitted an official letter to the MFIN on 14 October 2024. This letter formally endorsed the macroeconomic forecasts included in the **Draft Budgetary Plan** (DBP) 2025. Unlike previous years, the **Update of the Stability Programme** (USP) was not issued in April. Instead, the MFIN published the Medium-Term Fiscal Strategy for Malta 2024–2027 in December. Subsequently, on 12 December 2024, the MFAC issued an endorsement letter endorsing the Medium-Term Fiscal Strategy. This Strategy extended the macroeconomic and budgetary forecasts outlined in the DBP 2025 to 2026 and 2027.

Reports published by the MFAC during 2024



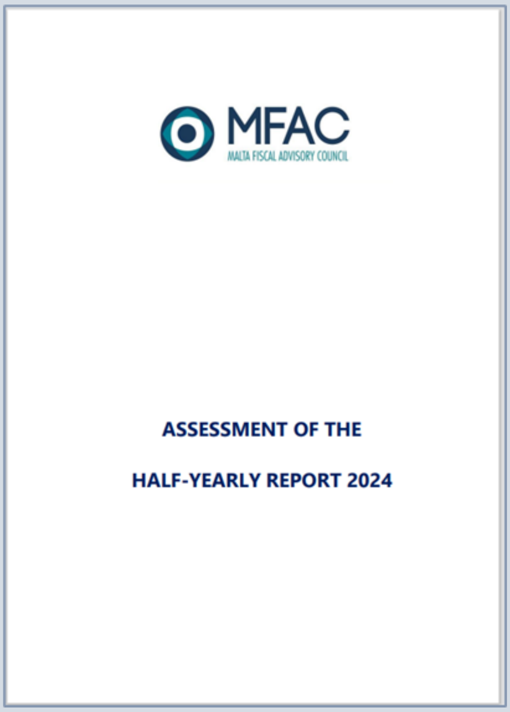
The ninth Annual Report covered the activities performed by the MFAC during 2023 and presented the organisation's financial statements for the year. The report also contained three thematic chapters. One of the thematic chapters evaluated the unemployment and output nexus by testing Okun's Law for Malta. The second chapter assessed Malta's labour productivity, unit labour costs and price developments while the third chapter presented the model used by the MFAC for forecasting primary fiscal revenue components.



In its assessment of the Ministry's Annual Report for 2023, the Council observed that economic growth surpassed the government's projections outlined in the USP and the DBP. This positive outcome was primarily driven by robust export performance, particularly in the services sector.

During 2023, government expenditure exhibited a higher-than-anticipated increase, exceeding the growth in revenue. Consequently, the actual deficit ratio reached 4.9%, exceeding the USP target of 4.6% but falling below the DBP 2023 target of 5.5%.

Given the termination of the EU's general escape clause at the end of 2023 and the subsequent reapplication of fiscal rules in 2024, the Council recommended that the fiscal policy should prioritise a gradual and sustainable path towards deficit reduction. The MFAC further recommended that priority be given to productive expenditure that fosters medium-to-long-term economic growth, while simultaneously ensuring efficiency and effectiveness in public spending.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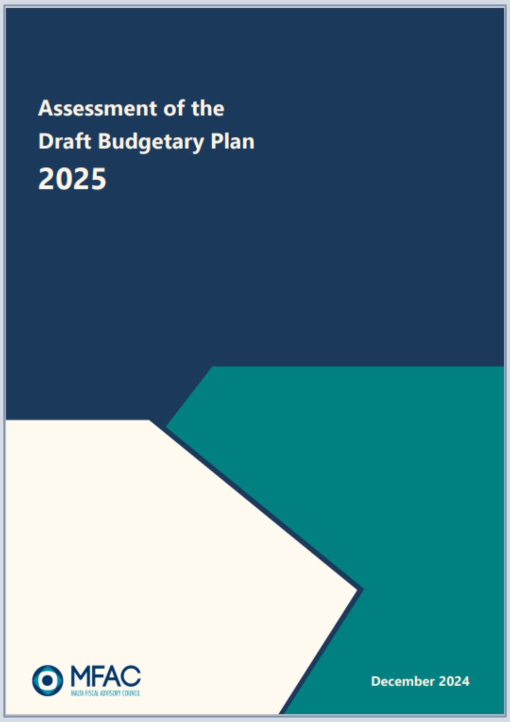
ASSESSMENT OF THE

HALF-YEARLY REPORT 2024

In this report, the Council noted that the macroeconomic forecasts for 2024 were retained from the previous round, specifically the DBP 2024, and these remained within its endorsable range.

The Council noted that fiscal estimates for the year's first half indicate that the outturn for both revenue and expenditure would exceed the projections outlined in the DBP 2024. This suggests a potential for a lower fiscal deficit, particularly given the stronger-than-expected economic performance, which could also lead to a lower debt ratio than that anticipated.

Considering the increased focus on limiting expenditure growth within the revised EU Economic Governance Framework and given Malta's current status under an EDP, the Council continues to strongly recommend that any revenue exceeding initial projections be utilised to accelerate fiscal consolidation efforts and build fiscal buffers.



The MFAC considered the macroeconomic and fiscal forecasts for 2024 and 2025 published in the DBP 2025 to lie within its endorsable range. The assessment identified upside risks to real GDP growth in both years, with these risks being more pronounced in 2024.

This upward risk in 2024 stems primarily from the stronger-than-projected economic performance observed in the year's first half, driven by robust growth in private consumption expenditure and exports. The Council also anticipates an upside risk for 2025, as domestic factors could contribute to stronger-than-expected economic growth.

The projected positive risk to real GDP in 2024 translates into the possibility of increased revenue from direct taxes. Combined with potential expenditure savings, these factors could lead to a smaller-than-projected fiscal deficit and a lower debt ratio in both 2024 and 2025. This is expected to keep the debt ratio below the 60% of GDP benchmark.

During the period under review, the MFAC continued to contribute to the **European Fiscal Monitor (EFM)** as part of the EUNIFI initiative. Two publications were issued in February and July.[2] The February edition underscored the resilience of the EU labour market while acknowledging the decline in energy prices from their 2023 peaks. However, the economic outlook faced significant headwinds from persistent geopolitical risks and the continued impact of rapid monetary policy tightening by central banks, which exerted downward pressure on growth. Furthermore, the rising burden of interest expenditures posed a significant challenge for Euro Area countries, particularly those with elevated public debt levels. This edition provides a comprehensive overview of the assessments conducted by national IFIs regarding the state of public finances in 2023. These assessments are based on the Budgetary Plans submitted by Member States in October 2023, which outlined their fiscal projections for 2024.

The second report indicated an anticipated economic rebound within the EU in 2024, coinciding with a continued deceleration of inflation. Nonetheless, the macroeconomic environment remains shrouded in geopolitical uncertainties, which have the potential to disrupt trade, destabilise financial markets, and negatively impact investment and growth prospects. Throughout these developments, national IFIs have played an important role in assessing the macroeconomic and fiscal outlooks of Member States.

At the start of the year, the MFAC published a **working paper** evaluating the MFIN's macroeconomic forecasting performance.[3] This evaluation encompassed forecasts for nominal and real GDP and its sub-components from 2004 to 2022, with assessments covering forecast accuracy, unbiasedness and efficiency.

Throughout the year, the MFAC staff also conducted additional internal thematic **research** on macroeconomic and public finance developments to enhance the institution's output quality. The most significant findings from this research were published as boxes within the reports issued throughout the year. These boxes covered various topics, including MFAC's suite of models approach for estimating potential

[2] The documents are available here.
[3] The working paper was concluded and published in the first week of January 2024. This can be accessed here.

output and the output gap, an updated version of MFAC's fiscal revenue forecasts, Malta's net expenditure path, and the country's compliance with fiscal rules.[4]

1.5 Public relations of the MFAC

During 2024, the MFAC issued several **press releases** which were made available in both English and Maltese. These press releases seek to inform the general public about the latest reports published by the MFAC and provide a non-technical summary of the Council's assessments.

Additionally, the MFAC continued to participate in public events organised by **institutional bodies** and interviews with the media on matters falling under its responsibility. Additionally, the Council's staff published articles in local newspapers on its research. The Council's Chief Economist and Chairperson were interviewed by the media on several occasions during this year. Additionally, the Council's Senior Economists delivered a speech and presentation at the Malta Stock Exchange, offering attendees an insightful exchange on the responsibilities and mandate of the Council alongside a comprehensive macroeconomic and fiscal analysis of the present state of the economy.

The MFAC's website was routinely updated to ensure easy access to its reports and press releases. It also featured the most recent Gross Domestic Product (GDP) and fiscal statistics released by the NSO.

1.6 Human resources

During 2024, the MFAC's staff included a Chief Economist, two Senior Economists, one Economist, and an Administrator who also serves as the Council's secretary.[5] Throughout the year, the Council remained dedicated to supporting professional growth among its staff, promoting active participation in macro-fiscal training programmes to strengthen their expertise.

[4] The boxes published during 2024 can be accessed from here.
[5] An economist resigned during the second half of 2024.

1.7 Social media

During 2024, the MFAC continued to expand its online presence to strengthen public engagement and outreach. All reports published by the Council were uploaded to its official website, which attracted over 3,000 visitors throughout the year, both from Malta and overseas. Additionally, the Council's reports received mentions in various media outlets, both in official gazettes and online news portals, including Times of Malta, The Independent, Newsbook, and TVM News, among others.

Social media platforms play a key role in aligning with the Council's mission to enhance public awareness and understanding of the Council's role, thereby ensuring that the MFAC's efforts in promoting fiscal responsibility resonate effectively with the public. The Facebook page allows the Council to tap into a broader demographic by informing the public of the Council's work and duties. At the same time, LinkedIn provides a professional platform to engage with industry peers. To further enhance accessibility, with every publication of the Council on its website, the MFAC posted non-technical summaries on its official pages on both LinkedIn and Facebook platforms.

1.8 Technical Support Instrument

Alongside seven other EU-independent fiscal institutions (Lithuania, Czech Republic, Greece, Belgium, Spain, Latvia, and Cyprus), the MFAC forms part of a multi-country project utilising EU funding for technical support under the Technical Support Instrument Programme (Regulation [EU] 2021/240). The technical support instrument aims to strengthen Member States' capacity in public management, particularly reinforcing independent oversight of Member States' public finances.

The MFAC, together with Lithuania and Greece, is actively participating in Pillar 1 of this project, being the "Development or upgrading of analytical tools for short- to medium-term macroeconomic and budgetary forecasting." Through collaboration with key experts in in the field, the Council is currently developing an integrated macroeconomic-fiscal model for short- to medium-term forecasting to improve its function to assess the forecasts produced by the MFIN.

Through this model the Council aims to:

a. Produce macroeconomic and fiscal projections
b. Allow for scenario analysis of different policies
c. Assess the impact of different external assumptions on macroeconomic and fiscal forecasts
d. Produce its own macroeconomic and risk scenarios and quantitatively assess the risk scenarios produced by the Ministry for Finance.

During 2024, the MFAC staff actively collaborated with the experts engaged for this project to develop a model tailored for Malta, participating in ongoing discussions and meetings to refine its design. They also engaged regularly with the project steering committee and contributed to discussions with other members involved in Pillar 1.

Since the project's inception, Cambridge Econometrics, one of the key experts entrusted with developing the model alongside MFAC staff, has played a pivotal role. Bi-weekly meetings were held to discuss progress and ensure alignment in the development of this project between both parties. In the last week of August, a team from Cambridge Econometrics visited Malta to deliver in-person training. This training focused on the model's functionality, technical aspects, and the construction of its individual components, equipping the MFAC team with the knowledge and skills required to advance the project effectively.

By the end of 2024, significant milestones had been achieved, including the selection of the model type and the completion of data assessment. Currently, the core model is being developed block by block, with the trade block nearing completion. The TSI project is expected to continue through 2026, with the aim of finalizing it by the end of the same year.

1.9 Recommendations made by the Council in 2024

As mentioned in section 1.4 of this Chapter, the MFAC published four reports in 2024 which evaluate the macroeconomic and fiscal developments as well as the projections produced by the MFIN. In these reports, the Council put forward a series of recommendations, which are summarised below:

Fiscal Council Recommendations during 2024

Recommendation	Publications
On the overall economic and fiscal policy	
a. The economy's growth should continue to be export-led, with less dependence on the domestic drivers of economic growth, especially private consumption. This requires further efforts to ensure a strong competitive position, through labour productivity increases, particularly by addressing skills gaps.	**Annual Report 2023**
b. To achieve export-led growth there is a significant need to improve competitiveness through labour productivity increases. Greater efforts are required to ensure Malta retains its capacity to expand export market shares across various economic sectors. Addressing skill gaps through education and training, fostering innovation and research, and advancing the twin transition towards digitalisation and environmentally sustainable business practices are critical enablers for improving organisational efficiency and labour productivity.	**Draft Budgetary Plan 2025**
c. Although a long-term economic vision has been announced, these efforts should be expedited and implemented within the framework of a comprehensive strategy with concrete policy measures. Furthermore, budgetary measures, both as regards taxation and on the expenditure side, should be dove-tailed to yield tangible policy outputs. Otherwise, Malta risks losing the competitive	**Draft Budgetary Plan 2025**

advantage it secured during the post-pandemic recovery period.	
d. It is recommended that firms channel excess profits into productive investment and towards enhancing labour productivity. This will not only enhance competitiveness, but also strengthen the country's capacity for sustainable economic growth.	**Annual Report 2023**
e. The Council encourages 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.	**Half-Yearly 2024**
On the composition of fiscal policy stance	
a. Government should avoid inflating government spending to ensure adherence with the benchmark fiscal expenditure path. Whilst means of expenditure restraint should be explored, productive capital expenditure that promotes medium to long-term growth should not be curtailed.	**Annual Report 2023; Half-Yearly 2024; Medium Term Fiscal Strategy**
b. Further steps should be taken to preserve nationally financed public investment and improve its efficiency and effectiveness whilst ensuring the effective absorption of RRF grants and other EU funds, particularly to foster the green and digital transitions.	**Annual Report 2023**

c. Fiscal consolidation should ensure that the required fiscal effort is achieved. The structural adjustment must be more than the 0.4pp of GDP recorded in 2023, given that in an EDP, a country must realise a minimum annual effort of 0.5pp. The Government should also consider targeting a larger effort than the minimum required, particularly whilst in a high economic growth environment, in order to build fiscal buffers.	**Annual Report 2023; Half-Yearly 2024; Draft Budgetary Plan 2025; Medium Term Fiscal Strategy**
d. There is an importance of prioritising expenditure policies that ensure the quality and sustainability of public finances. Public spending efficiency should be improved and reallocating resources towards productive capital investment.	**Draft Budgetary Plan 2025**
e. Maintain the buffer achieved below the 60.0% debt benchmark and monitor the various components contributing to changes in debt, particularly interest expenditure and the level of stock-flow adjustment. The latter exhibits considerable volatility and over the past years has turned out rather different than forecasted.	**Annual Report 2023**
On specific fiscal measures	
a. Prepare an adequate exit strategy in relation to the fixed-energy-price policy, adopting a more targeted approach and enhancing incentives for energy savings, with the over-arching objective of achieving a carbon-neutral economy and promoting the green transition.	**Annual Report 2023; Half-yearly 2024; Draft Budgetary Plan 2025**

Other recommendations	
a. Although GDP growth was significantly higher than the forecasts for 2023, government revenue was not as responsive. The elasticity of both direct and indirect taxes to GDP growth was at low levels when compared to the previous 10 years. The government ought to explore the reasons for such occurrences and take any necessary actions.	**Annual Report 2023**
b. Recent research by the MFAC showed that the persistent underestimation of economic growth by MFIN may be partly explained by the upward revisions carried out by the NSO. It is recommended that the MFIN takes into account such statistical tendencies in its forecasting process and address any forecast biases adhering to Council Directive 2011/85/EU – Article 4(6).	**Annual Report 2023**
c. 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.	**Half-Yearly Report 2024**

d. 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.	**Half-Yearly Report 2024**

Fiscal responsibility and expenditure control: national strategies within the EU fiscal framework, with a focus on Malta

2.1 Maximising Public Resources: The Importance of Efficient Government Spending

The efficient management of government expenditure is fundamental to sound public financial management. Governments are responsible for ensuring the optimal use of taxpayer resources, minimising waste and inefficiencies. This approach fosters fiscal sustainability, enabling governments to pursue balanced budgets and prevents the accumulation of excessive public debt. Additionally, a commitment to efficient public spending also enhances transparency and accountability, bolstering public trust in the stewardship of state resources. Consequently, it is important that every expenditure aligns with broader public policy objectives, such as economic stability, social equity, and long-term development, to uphold good governance principles and safeguard societal well-being.

Efficiency becomes particularly important in periods requiring expenditure restraint. In such contexts, by enhancing the efficiency of existing expenditures, governments could avoid having to reduce the provision of certain services.

The significance of expenditure efficiency has been further reinforced by the introduction of the new economic governance framework and the revised EU fiscal rules, which took effect on 30 April 2024. These regulations establish a binding multi-year net expenditure growth limit for each member state, underscoring the need for greater fiscal discipline and more careful management of public resources.[1]

2.2 The new economic governance framework – more focus on expenditure

The multi-year net expenditure limit is designed to maintain national budgets within sustainable parameters, thereby mitigating the risk of excessive debt accumulation. This limit is defined as the maximum permissible annual growth rate of nationally financed net primary expenditure. This metric is calculated by excluding specific expenditure components from general government spending, namely interest payments, one-off expenditures, EU-funded spending, nationally financed contributions to EU co-funded programmes, and temporary unemployment-related expenditures driven by the economic cycle. Furthermore, the indicator incorporates the

[1] More information on the new economic governance framework can be accessed here.

net impact of discretionary fiscal measures. For instance, revenue-enhancing measures, such as tax increases, create additional fiscal space for expenditure growth, whereas tax reductions correspondingly constrain the scope for increased spending.

2.3 Medium-Term Fiscal Structural Plans

Member States must outline their planned average net expenditure growth within a newly introduced country-specific reporting document, the *Medium-Term Fiscal Structural Plan (MTFSP)*.[2] Each plan covers a four-year period, which may be extended to seven years if the Member State commits to a predefined set of structural reforms and investments. Once approved by the European Commission and the Council of the EU, the agreed net expenditure trajectory remains binding for the duration of the Plan, except in cases where a newly elected government assumes office, in which case revisions are permissible but not obligatory.

The initial deadline for the first submission of MTFSPs was set for 20 September 2024. However, Member States were granted flexibility to submit their plans later, with most opting to align their submission with the *Draft Budgetary Plans (DBP)* in mid-October. Subsequently, on 26 November 2024, the European Commission (COM) issued country-specific assessments on the submitted plans as part of the European Semester Autumn Package.[3] By this date, the COM also proposed Council recommendations for the MTFSPs and endorsed 21 of the 22 submitted plans.

Regarding Malta's MTFSP, submitted on 20 September 2024, the COM recommended its adoption by the Council, as it complies with the requirements set out in *Regulation 2024/1263* on the effective coordination of economic policies and multilateral budgetary surveillance.[4] The COM concluded that Malta's Plan outlines a credible fiscal trajectory aimed at ensuring medium-term fiscal sustainability. Beyond adhering to the prescribed expenditure growth limits, the COM recommended that Malta prioritise the implementation of reforms and investments that address key structural challenges identified in the European Semester, particularly those outlined as country-

[2] More information on national MTFSP's, the submitted Plans and the COM's assessments, including that for Malta, can be found here.

[3] Some countries did not submit their MTFSP by 2024, due to various country-specific reasons.

[4] Regulation 2024/1263 can be accessed here.

specific recommendations.[5] Additionally, Malta was encouraged to align its fiscal and economic strategies with the broader policy priorities of the EU.

2.4 Country-specific expenditure growth limits [6]

Compared to the previous economic governance framework, the revised framework emphasises the differentiated fiscal positions of individual Member States, allowing for a more tailored approach to fiscal rules and reinforcing national ownership of fiscal policies.

This is reflected in the considerable variation in expenditure limits set across countries, ranging from 1.1% in France to 5.9% in Malta. An analysis of the MTFSPs submitted and assessed by the COM reveals that the simple average net expenditure growth across reporting countries is 3.9%, whilst the median is slightly higher at 4.4%.

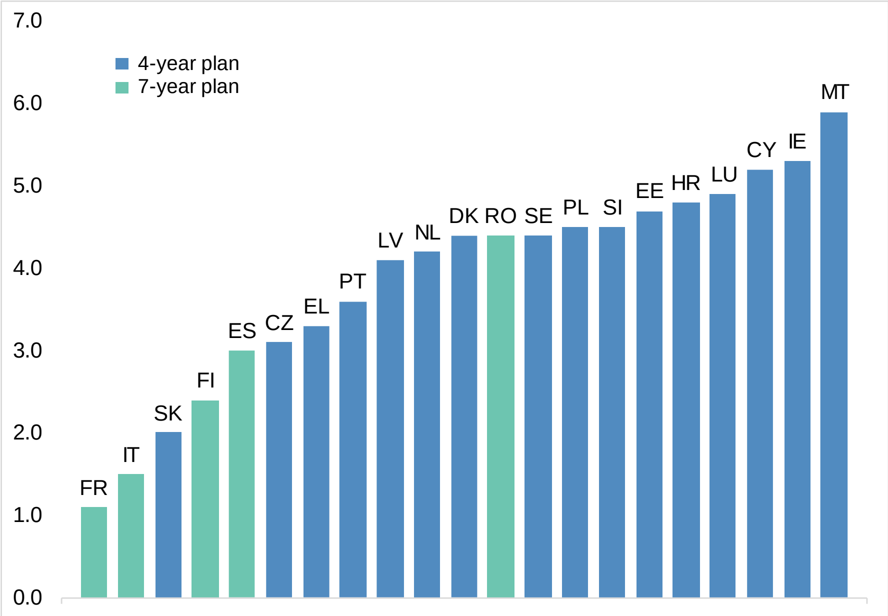
The COM provided reference trajectories for net expenditure growth on 21 June 2024. The Government of Malta eventually opted to fully adhere to the Commission's reference expenditure growth limit of 5.9%, setting this as the target for the fiscal adjustment period spanning from 2025 to 2028. This decision was documented in Malta's MTFSP. Malta was among only five Member States that chose to adopt the same average expenditure growth as that proposed by the COM.

[5] As a summary, the country-specific recommendations issued in June 2024 to Malta were to: timely submit the MTFSP and limit the growth in net expenditure in 2025 consistent with the reformed Stability and Growth Pact requirements; wind down the emergency energy support measures; address remaining aggressive tax planning risks, introduce a withholding tax on outbound payments or equivalent defensive measures, and amend rules on non-domiciled companies; continue with the implementation of the RRF and REPowerEU by August 2026 and focus on the agreed priorities; address low educational outcomes and the shortage and mismatch of skills; accelerate the deployment of renewable energy through large-scale projects as well as small-scale investments in direct energy production and consumption; address the traffic congestion problem. More details can be accessed here.

[6] The analysis in this section and the next section of the Chapter are based on information available in the "Communication from the Commission to the European Parliament, the Council and the European Central Bank 2025 European Semester: bringing the new economic governance framework to life", available here. Any developments beyond this date regarding changes or further submissions of MTFSPs/expenditure growth limits are not taken into consideration in this Chapter.

The average annual net expenditure growth submitted in the MTFSP by country[7,8]

(percentage)



Source: COM

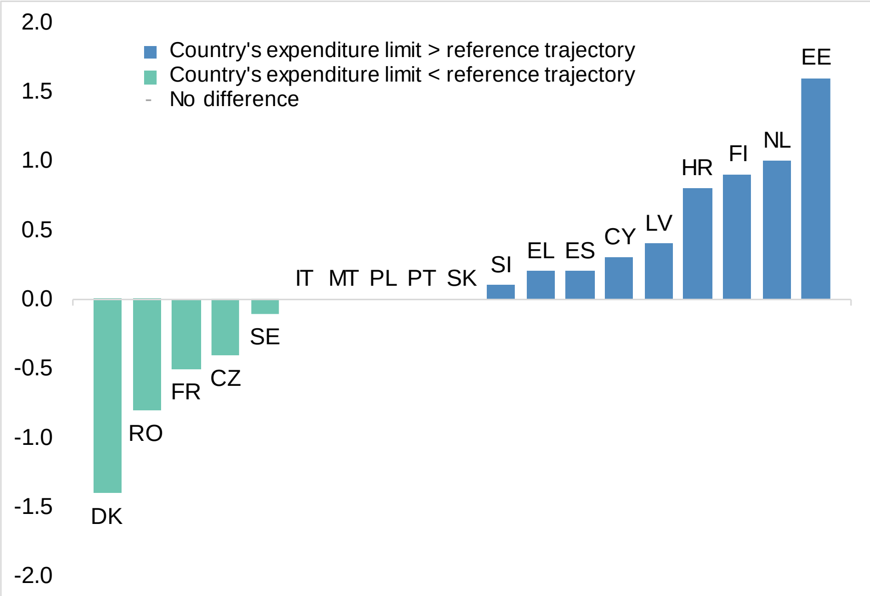
Indeed, Member States have the flexibility to adjust their expenditure limits compared to the trajectory recommended by the COM, provided they present sound economic justifications for any deviations. In this context, five Member States opted for a more restrictive net expenditure limit than that proposed by the COM, reflecting either a more cautious approach to spending growth or a strategic commitment to accelerated fiscal consolidation. Conversely, nine Member States submitted plans with higher expenditure limits, accentuating more on stimulating economic growth or addressing specific domestic fiscal challenges. This flexibility within the framework highlights the adaptability of the new framework, allowing Member States to balance fiscal prudence with national priorities while ensuring that their proposed expenditure trajectories remain consistent with long-term fiscal sustainability, particularly in terms of debt dynamics.

[7] Note: For the Netherlands, the Commission proposes to endorse the net expenditure path consistent with the technical information it transmitted in June, therefore a net expenditure growth that is 1.0 pp less than in the Plan. For the purpose of this Chapter, the submitted expenditure path by the countries was used.

[8] Country codes refer to: Czechia(CZ), Denmark(DK), Estonia(EE), Ireland(IE), Greece(EL), Spain(ES), France(FR), Croatia(HR), Italy(IT), Cyprus(CY), Latvia(LV), Luxembourg(LU), Malta(MT), Netherlands(NL), Poland(PL), Portugal(PT), Romania(RO), Slovenia(SI), Slovakia(SK), Finland(FI), Sweden(SE).

Difference between the net expenditure growth submitted in MTFSPs and the COM's prior guidance [9]

(percentage points)



Source: COM

Should expenditure savings materialise, they will be retained in a control account that monitors cumulative deviations, both upward and downward, from the agreed expenditure path. Potential savings may be utilised in the event of expenditure slippages.

Negative deviations from the path must not exceed 0.3 pp of GDP annually, or 0.6 pp cumulatively. Updates on the outturn of the net expenditure indicator, as well as any savings or deviations, are to be documented in the Annual Progress Reports, which must be published by 30 April of each year following the submission of the MTFSP.

2.5 Coherence with the deficit and debt rule, the deficit-resilience safeguard and the adjustment period

In addition to the new expenditure rule, the deficit and debt thresholds established in the Maastricht Treaty of 1992 remain in force. These rules mandate that Member States maintain budget deficits below 3% of GDP and public debt below 60% of GDP.

[9] Countries that did not receive a reference trajectory due to having a general government deficit below 3% of GDP and general government debt below 60% of GDP, and did not request such guidance, were excluded from this chart. These were Luxembourg and Ireland.

For countries exceeding these limits, the expenditure rule incorporates the necessary fiscal adjustments to facilitate compliance with these benchmarks. For Member States with a budget deficit exceeding 3% of GDP, the framework requires a minimum annual structural fiscal adjustment of at least 0.5% of GDP. If adhered to, the net expenditure trajectories endorsed by the COM should ensure that this adjustment target is also met.

Beyond the 3.0% of GDP threshold, the new framework also introduces a deficit resilience safeguard to ensure that fiscal adjustments continue until a common margin of 1.5% of GDP is reached. To meet this requirement, Member States must implement an annual improvement in the structural primary balance of 0.4 percentage points of GDP. However, the framework also provides flexibility by allowing an extension of the fiscal adjustment period by up to three additional years, bringing the total duration of the plan to seven years. In such cases, the required adjustment is distributed over a longer timeframe, lowering the annual improvement requirement to 0.25 percentage points of GDP.

Member States opting for this extension must commit to implement a defined set of structural reforms and investments, meeting specific eligibility criteria. In the first round of MTFSP submissions, five countries (Spain, France, Italy, Romania, and Finland) opted for the extended adjustment period.[10] This decision reflects a strategic preference for a longer timeframe to achieve the set fiscal targets while integrating the necessary investment and reform measures.

2.6 Potential output, the debt ratio and the expenditure growth limit

The limit on expenditure growth is determined by several factors, with the primary basis being the results derived from the COM's Debt Sustainability Analysis (DSA) methodology. The DSA provides a medium-term multilateral public debt projection framework, utilising common assumptions and methodologies, and considering a variety of alternative scenarios to account for potential economic developments. It evaluates the sustainability of public debt by forecasting the impact of various macroeconomic variables such as economic growth rates, interest rates, and inflation, on a country's debt trajectory. Additionally, the DSA incorporates a country's fiscal position, the outlook for primary balances, and the projected path of public debt,

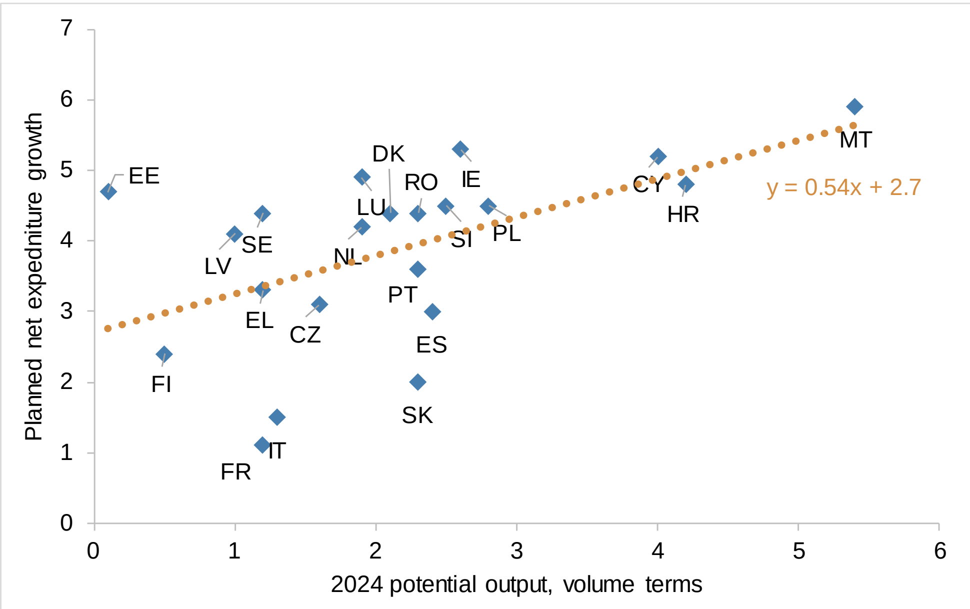
[10] As documented in the COMs assessment of 26 November 2024.

enabling a comprehensive assessment of whether a country's fiscal policies are aligned with long-term debt sustainability goals.

Two key variables in the DSA framework are a country's potential output and the debt-to-GDP ratio. In this section, the expenditure limits proposed in the Member States' MTFSPs, are compared with the COM's 2024 projection (Autumn forecast) of these two variables. Overall, the analysis of these relationships aligns with *a priori* expectations. As illustrated in the chart below, a positive correlation is evident between the planned expenditure growth limits and the level of potential output across countries. This suggests that countries with higher potential output are generally permitted to plan for higher expenditure growth, in consistency with forecasted economic conditions.[11]

The relationship between potential output (volume terms) and the average net expenditure growth submitted in the MTFSPs

(percentage change)



Source: COM

The relationship between debt levels and planned expenditure growth is evident in the cross-plot of debt-to-GDP ratios against the planned average net expenditure growth. As expected, the analysis reveals a negative correlation between the two. Countries with higher debt-to-GDP ratios are generally required to adopt a more restrictive net

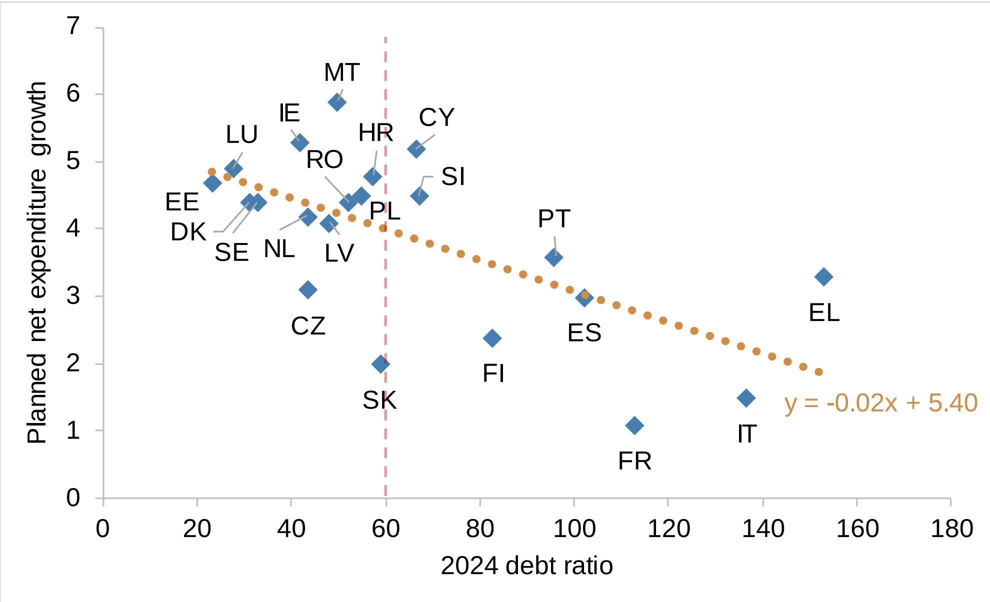
[11] Other factors influence the net expenditure growth path, which explains why there is still variances across the potential output and expenditure path combinations. This also applied to the relationship between the debt level and the planned expenditure growths.

expenditure path, reflecting the greater fiscal discipline required to reduce the elevated debt levels and move towards sustainability.

In contrast, most Member States with debt ratios below the 60% threshold have tended to set their average net expenditure growth between 4% and 5% of GDP. This underscores the importance of maintaining low public debt levels, as it provides greater fiscal flexibility, allowing governments more room to adjust fiscal policies in response to changing economic conditions and to finance required public investments.

The relationship between debt ratios and the average net expenditure growth submitted in the MTFSPs

(percentage)



Source: COM

In the case of Malta, the COM has recommended the highest expenditure limit (5.9%) among EU countries. This is primarily attributed to Malta's relatively large potential output growth and its debt position, which remains below the 60% benchmark. Concomitantly, these two factors allow for a higher expenditure growth path while still adhering to the fiscal constraints of the EU framework.

Another factor affecting the expenditure growth limits is the deficit ratio, specifically whether a country, given the macroeconomic and fiscal assumptions employed, would remain within the 3% limit or is brought below this value within the adjustment period, and is maintained as such over the medium term. Out of the countries considered in this section of the Chapter, in 2024, four were in a surplus position, ten had a deficit that is equal to or lower than 3% whilst seven had a deficit above 3%. As suggested from the table below, the average net expenditure does, on average, scale with each delineation of fiscal balance position. The better the balance, the better is the average net expenditure path planned, in general, across countries. In the case of Malta, although both the debt ratio and potential output outlook is favourable, the country is subject to a deficit-based Excessive Deficit Procedure, as its projected deficit for 2024 was of 4.0%. The required 0.5 pp annual deficit adjustment (in structural, net of interest terms) needs to be factored in the net expenditure path calculations, restricting how much the expenditure limit can be extended.

The expenditure limit vis-à-vis diverse fiscal balance position

2024 COM Autumn forecast	Number of countries	Cross-country average net expenditure limit
Fiscal balance in surplus	4	4.6
Fiscal deficit ≤ 3%	10	4.1
Fiscal deficit > 3%	7	3.1

Source: COM

2.7 Maintaining expenditure growth within the planned limit – Malta's case

Although Malta has the largest expenditure growth limit among EU countries, this does not imply that meeting this target will be without significant challenges. Following the submission of the MTFSP, another set of forecasts has been published, in December 2024, within the Medium-Term Fiscal Strategy (MTFS). In the MTFS, the Government targets a net expenditure growth of 5.6% for 2025, 0.3 percentage points below the annualised limit. For 2026 and 2027, the target net expenditure growth is set to decrease to 5.0% and 4.9%, respectively.

The MFAC has analysed the effort required for the Maltese Government to comply with the expenditure path outlined in the MTFSP. This analysis compares the MTFSP's expenditure path and the projected growth in net expenditure in the MTFS with actual expenditure growth over the past decade, providing context based on historical expenditure trends.

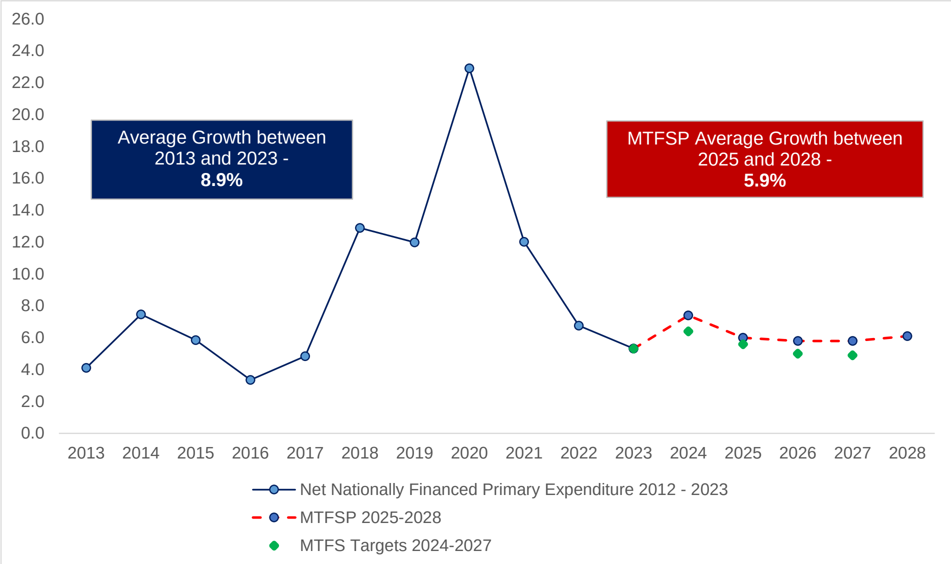
The Council acknowledges that direct comparisons may be limited due to several factors: a budget surplus was recorded between 2015 and 2019, which mitigated the need for expenditure limits; and fiscal rules were suspended between 2020 and 2023, further distinguishing the fiscal environment of that period from the current framework. Also, the target for net primary expenditure growth in the coming years may not align directly with the nominal growth in net nationally financed primary expenditure during the 2012-2023 period, owing to changes in the macroeconomic context, such as differing potential output. Nonetheless, the Council believes that past expenditure trajectories can still shed light on the degree of effort needed to maintain expenditure growth within the limits allowed by the new expenditure rule.

The average annual growth rate of net nationally financed primary expenditure from 2013 to 2023 was 8.9%. Excluding the impact of the COVID-19 pandemic year, this average declines to 7.5%. Consequently, the limit on expenditure growth and the more ambitious government targets represent a challenge, particularly when viewed against historical trends and the context of an expanding economy with a growing population. Given this, close scrutiny of expenditure developments throughout the year is essential, as the margin between the 2025 target of 5.6% set in the MTFS and the 5.9% ceiling set in the MTFSP leaves limited room for expenditure slippages.

Moreover, as mentioned previously, tax cuts are considered as ‘expenditure-increasing', thereby reducing the room for actual expenditure growth. For instance, as of January 2025, income tax brackets have been adjusted to increase disposable income. This constitutes a discretionary revenue measure which is considered as part of the allowable nominal growth in the net expenditure indicator. Preliminary calculations from the Ministry for Finance, included in the Budget for 2025, estimate that this measure will account for approximately 0.54% of GDP. This implies that keeping expenditure growth within the targeted limits could be even more challenging during the current year.

Net Nationally Financed Primary Expenditure

(y-o-y % change)



Source: Eurostat, AMECO, NSO, Author's Calculations

2.8 The Excessive Deficit Procedure and other fiscal requirements

The COM's 2024 European Semester Autumn Package, which included the assessment of the MTFSPs, also set out fiscal path recommendations for eight Member States subject to an Excessive Deficit Procedure (EDP). This includes Malta, whose budget deficit currently exceeds the 3% of GDP threshold.

According to the MTFS, the headline balance is projected to reach the 3.0% threshold by 2026. In structural terms, the fiscal balance is expected to decline below this threshold within the same timeframe, reaching 2.6% in 2026. Moreover, the latest MTFS projections also indicate that the minimum required annual structural improvement of at least 0.5 percentage points of GDP will be surpassed in both 2025 and 2026. In 2027, the structural adjustment is planned at 0.4 pp, but this would still adhere to the new EU fiscal rules since the adjustment requirement is reduced to 0.4 pp when the deficit is between 1.5% and 3.0% of GDP.

Moreover, given the prevailing high interest rate environment, the fiscal effort is currently being assessed in terms of the structural primary balance. Accordingly, the structural primary deficit is projected to decline by 0.7 pp in 2024, 0.8 pp in 2025, 0.7 pp in 2026 and 0.6 pp in 2027, thereby exceeding the 0.5 pp requirement in all the years.

Regarding the debt rule, Malta's obligations remain well within the 60% of GDP ceiling. The projections in the MTFS indicate that government debt will increase to 50.1% by 2025, before declining to 49.2% in 2027. While this represents a slight increase in the debt ratio, it still maintains a buffer of approximately 10 pp below the 60% threshold. Additionally, the MTFS updates the planned trajectory for net expenditure growth. As suggested previously, the government's latest forecasts adhere to the net expenditure path set in the MTFSP, with a buffer of around 1.0 pp to the 5.9% limit in the outer forecast years.

Fiscal Rules and Government Targets

MTFS 2024 – 2027 Projections	2024	2025	2026	2027
Headline deficit below 3% of GDP	4.0	3.5	3.0	2.6
Structural deficit below 3% of potential GDP	4.0	3.3	2.6	2.2
Structural primary balance adjustment ≥ 0.5 pp of GDP*	0.7	0.8	0.7	0.6
Structural balance adjustment ≥ 0.5 pp of GDP*	0.6	0.7	0.7	0.4
Net expenditure growth averaging ≤ 5.9%	6.4**	5.6	5.0	4.9
Debt ratio < 60% of GDP	49.5	50.1	50.0	49.2

Note: Green boxes mean adherence to the rules, whilst red means non-adherence to the fiscal rule.
* When the deficit falls below 3%, the minimum requirement is 0.4 pp until a common resilience margin of 1.5% of GDP is reached relative to this deficit reference value.
** Not binding in 2024, but the Council Recommendation of 14 July 2023 on the 2023 National Reform Programme of Malta recommended that the nominal increase in net nationally financed primary expenditure in 2024 is limited to 5.9%.
Source: MFIN

2.9 Conclusion

This chapter has provided an overview of the new EU economic governance framework and the progress made thus far, specifically addressing the initial submission of MTFSPs and their subsequent assessment by the COM, focusing more prominently on the case of Malta vis-à-vis other Member States. The MTFSPs illustrate a broad range of net expenditure growth limits across countries, reflecting each member state's varying fiscal strategies and economic conditions. These expenditure trajectories are generally aligned with projections for potential output, debt levels, and other macroeconomic and fiscal assumptions. Following the first round of MTFSPs, reflecting countries' efforts to develop four- or seven-year plans in the year the rules were adopted, now attention shifts to the implementation of the new framework.

Looking forward, the next important step for Member States is to enact the necessary laws, regulations, and administrative provisions to comply with the new EU fiscal

Directive by 31 December 2025. In this respect, the MFAC is committed to collaborating with all relevant stakeholders to review and, where necessary, propose amendments to the Fiscal Responsibility Act, ensuring that national fiscal legislation aligns with the revised EU economic governance framework by the established deadline. Lessons learnt from the implementation of the Fiscal Responsibility Act, since its adoption in 2014, will also be taken into account to ensure that the national fiscal framework is efficient and effective to promote fiscal sustainability in the local context.

In conclusion, the effective management of government expenditure growth within the framework aims to ensure the long-term sustainability of public finances. Compliance with fiscal rules, particularly within the context of an EDP, remains important to safeguard credibility to government's commitment to fiscal discipline. While Malta's fiscal position allows for a higher expenditure growth path, as recommended by the European Commission, it must remain vigilant in adhering to the established limits to avoid potential challenges in the future. The Council considers that targeting lower growth in expenditure than the limit is beneficial to create an element of fiscal buffer. Nonetheless, achieving these targets may prove challenging, particularly when juxtaposed against historical trends. **The MFAC thus recommends that continuous monitoring, particularly for certain expenditure line items, which are more susceptible to overspending, is undertaken to ensure that the expenditure rule is adhered to.** It is important to emphasise that the new EU expenditure rule implies that higher than projected revenues generated from better than expected economic growth cannot be allocated to additional expenditures beyond the limit set in the MTFSP. Instead, such revenues would make way for potential buffers used to accelerate fiscal consolidation. Finally, reaching better efficiency levels in public expenditure, limiting unnecessary spending and making the best use of government resources, particularly tax-payer money, is a critical aspect of good governance and fiscal responsibility.

Chapter 3

The sensitivity of the EU commonly agreed methodology to estimating potential output and the output gap for Malta

3.1 Introduction

Understanding a country's potential output, the maximum sustainable level of economic activity it can achieve, is vital for effective policymaking. In the European Union, potential output is estimated through the Commonly Agreed Methodology (EUCAM). Developed by the Output Gap Working Group (OGWG), EUCAM provides a standardised framework for assessing each Member State's productive capacity and the difference between actual and potential output (i.e., the output gap). Accurate estimates of potential output and the output gap are essential for guiding fiscal and monetary policies, ensuring economic stability and promoting sustainable growth across the EU.

One of the main tasks of the Malta Fiscal Advisory Council (MFAC), as an independent fiscal institution, is to scrutinise and endorse, as appropriate, the macroeconomic and fiscal forecasts prepared by the Ministry for Finance (MFIN). This includes critically assessing estimates of potential output and the output gap, a task that has become even more significant under the EU's updated Economic Governance Framework, which came into effect in April 2024. Indeed, potential output growth estimates underpin the expenditure growth trajectory which is the main fiscal indicator within the new framework. This framework aims to strengthen fiscal responsibility and foster sustainable growth while offering Member States greater flexibility in achieving these goals. Accurate and reliable forecasts of potential output and the output gap are essential for sound fiscal planning, informed budgetary decisions, and ensuring Malta's compliance with EU fiscal rules. To fulfil this mandate, the MFAC must have a thorough understanding of the methodology underpinning these estimates and rigorously assess their sensitivity to key economic inputs.

This chapter provides an in-depth analysis of the EUCAM for estimating potential output and the output gap. By systematically varying individual inputs within the EUCAM framework and observing their effects, the sensitivity analysis highlights the robustness of the model and the influence of specific variables on the resulting estimates. The chapter is structured as follows: Section 3.2 explores the theoretical framework and key features of EUCAM, Section 3.3 presents the sensitivity analysis, and Section 3.4 concludes with a summary of the key insights.

3.2 The EU Commonly Agreed Methodology

The EUCAM is based on the work of Havik et al. (2014) and was adopted by EU Member States through discussions in the OGWG, as a common model for policymakers to uniformly assess the cyclical position and productive capacity of EU economies. This methodology prioritises a structural approach over a purely statistical one, as the structural approach allows for a deeper analysis of the economic drivers of potential output and establishes a link between policy reforms and actual outcomes.[1] The structural approach employed by the EUCAM relies on the production function framework, which posits that potential output is fundamentally determined by the economy's available factor inputs, such as capital and labour, and their respective productivities. This framework allows for a direct assessment of how changes in these underlying factors influence potential output.

A key feature of the structural approach is its emphasis on the relationship between potential output and the Non-Accelerating Wage Rate of Unemployment (NAWRU), as the production function method relies on estimates of "normal" or equilibrium unemployment rates. Moreover, this approach integrates future growth prospects by explicitly incorporating anticipated developments in demographic, institutional, and technological trends.

The production function approach is also widely used by other reputable organizations, including the Central Bank of Malta (CBM), the International Monetary Fund (IMF), and individual Independent Fiscal Institutions (IFIs) across EU Member States.

The production function assumes that output (Y) is produced by labour (L), capital (K), and total factor productivity (TFP) in a Cobb-Douglas specification:

$$Y = L^{\alpha} K^{1-\alpha} * TFP$$

where TFP represents the degree of utilisation of factor inputs (U_L, U_K) and adjusted for their level of efficiency (E_L, E_K), such that:

$$TFP = (E_L^{\alpha} E_K^{1-\alpha})(U_L^{\alpha} U_K^{1-\alpha})$$

[1] A statistical approach to potential output estimation typically relies on statistical filtering techniques to decompose actual output into its trend (potential output) and cyclical components. These methods are primarily data-driven and require minimal assumptions about underlying economic relationships.

The output elasticities of labour and capital (α and 1-α, respectively) are estimated from the wage share, under the assumptions of constant returns to scale and perfect competition. These assumptions simplify economic interactions and provide a consistent framework for estimation. In the EUCAM framework, the output elasticity of labour (α) is set at 0.65, based on the average wage share across all EU countries. Consequently, the output elasticity of capital (1-α) is assumed at 0.35. While this standardisation across EU members ensures a uniform framework, it comes at the cost of potentially more accurate, country-specific elasticity estimates.

3.2.1 Capital

Defining the potential use of capital is relatively straightforward. The "maximum potential output contribution" of capital is determined by the full utilisation of the existing capital stock in the economy. The capital stock, which encompasses the total value of physical assets such as machinery, buildings, and infrastructure, serves as an indicator of overall productive capacity. Since the capital stock represents the existing productive capacity, and the interest is in the potential output based on that capacity, there is no need to smooth the capital series in the way one might smooth other economic time series to remove cyclical fluctuations.[2]

Whilst investment is generally volatile on an annual basis, the contribution of capital to economic growth remains relatively stable. This stability occurs because annual investments typically account for only a small proportion of the existing capital stock. To estimate the capital stock, the "perpetual inventory method" is used. This method accumulates past investments while accounting for depreciation.

Real capital stock (K) is measured by:

$$K_t = K_{t-1} + IQ_t - \frac{CFC_t}{defl_t}$$

Where K_{t-1} represents the existing capital stock in year t-1, IQ_t is the new real investment in year t, while (CFC_t / $defl_t$) is the consumption of fixed capital (i.e., depreciation) in real terms.

[2] Economic data like GDP or employment often fluctuate due to business cycles. Smoothing techniques are used to remove these short-term fluctuations and reveal the underlying trend. However, the capital stock itself doesn't fluctuate in the same way. It's a measure of the capacity to produce, which changes more slowly over time (through investment, depreciation, etc.).

3.2.2 Labour

Assessing the "normal" or potential utilisation of labour is slightly more complex. Potential labour (LP) is measured in terms of potential hours worked per employee ($hperehp_t$) multiplied by the potential number of employees ($emplp_t$):[3]

$$LP_t = hperehp_t * emplp_t$$

The trend in hours worked ($hperehp_t$) is calculated using the HP (Hodrick-Prescott) filter with λ set to 10 applied on a series extended with forecasts through an autoregressive process to mitigate end point bias. [4]

To estimate the employment trend ($emplp_t$), the process begins with the maximum possible labour input, defined as the total working-age ($popw_t$) which represents the upper limit of potential labour supply. This is then adjusted by the participation rate ($part_t$), and the employment rate ($1-lurharm_t/100$), where $lurharm_t$ is the harmonised rate of unemployment.

$$empl_t = popw_t * \left(\frac{part_t}{100}\right) * \left(\frac{1 - lurharm_t}{100}\right)$$

Thus,

$$emplp_t = popw_t * \left(\frac{parts_t}{100}\right) * \left(\frac{1 - nawru_t}{100}\right)$$

The participation rate ($parts_t$) (the percentage of the working-age population that is either employed or actively seeking work) is mechanically "detrended" using the HP (Hodrick-Prescott) filter, with λ set to 10:

$$parts_t = HP(part_t, T = 1, \ldots, t + 8, \lambda = 10)$$

[3] $empl_t$ represents the total number of employees, based on working population, the participation rate and the unemployment rate, whereas $emplp_t$ represents the potential number of employees based on the potential participation rate and the natural rate of unemployment.

[4] This analysis uses a smoothing parameter (lambda) of 10 instead of the standard 100 in the HP filter for both labour force participation and hours worked. This adjustment reflects recent trends: (1) Evidence suggests a plateauing of participation rates, rather than continued growth. A lambda of 10 better captures this stabilisation, while 100 would overestimate future participation. (2) The historical decline in hours worked per worker appears to be slowing. The lower lambda gives more weight to recent data, better reflecting this potential shift. This approach ensures the trend estimations align with current labour market dynamics.

The next step involves estimating trend unemployment, consistent with the NAWRU. The NAWRU represents the unemployment rate at which wage inflation remains stable, reflecting a balance between labour supply and demand. This estimate is further refined by incorporating a long-term anchor.[5] Finally, the NAWRU, combined with demographic factors, is used to project potential labour supply. This approach produces a potential employment series that remains relatively stable over time. While generally stable, the series does reflect gradual shifts due to demographic changes and evolving structural factors influencing the NAWRU, such as long-term trends in labour force participation.

3.2.3 Total Factor Productivity

In the production function approach, potential output is the level of output an economy can produce when its factor inputs are utilised at a "normal" level of efficiency. This "normal" efficiency represents a balanced state where the economy is operating without overheating or underutilising its resources.

The trend efficiency of factor inputs, particularly Total Factor Productivity (TFP), is estimated using a bivariate Kalman filter model. This model identifies the unobserved components of an economic series, such as the underlying trend in TFP. The Kalman filter leverages the relationship between the TFP cycle and the degree of capacity utilisation in the economy.

TFP is calculated by exponentiating the Solow residual (sr_t):

$$sr_t = logY_t - \alpha logL_t - (1 - \alpha)logK_t$$

The model incorporates a measurement equation that links fluctuations in capacity utilisation to the cyclical component and an idiosyncratic shock. Potential TFP is then derived by taking the exponential of the estimated trend component. This constitutes the last element in the EUCAM and together with potential labour and capital, is used to forecast potential GDP and calculate the output gap.

[5] The NAWRU is adjusted to include an anchor, S_t, which represents a long-term stable value that the NAWRU is expected to converge towards under a no-policy-change scenario. This anchor is derived from a panel regression on structural indicators of the labour market.

3.2.4 Strengths and limitations of the EUCAM

While the EUCAM offers several advantages, such as promoting consistency and enabling policy coordination across Member States, it also has limitations that must be acknowledged. A comprehensive understanding of both the strengths and weaknesses of the EUCAM is essential for its effective application and interpretation. To provide a clear and concise overview, the below table summarises the key features of the EUCAM, also highlighting its main strengths and weaknesses.

Summary of strengths and weaknesses of the EUCAM

Feature	Description	Implications	Source
Strengths			
Common Framework for Analysis and Surveillance	EUCAM provides a standardized methodology for estimating potential output and the output gap across EU Member States	- Promotes consistency and comparability. -Facilitates economic surveillance and policy coordination. - Aids in assessing fiscal sustainability.	European Commission (2023), Carnot & Konings (2016)
Enhances Understanding of Economic Dynamics	EUCAM explicitly models the relationships between key economic variables (labour, capital, TFP).	- Provides insights into the drivers of economic growth. - Informs structural reforms aimed at boosting long-term growth.	Havik et al. (2014), OECD (2018)
Facilitates Medium-Term Fiscal Planning	EUCAM supports the assessment of fiscal sustainability over the medium term by providing estimates of potential growth.	- Helps countries set realistic fiscal targets. - Aids in designing expenditure paths consistent with debt reduction objectives.	European Commission (2021), International Monetary Fund (2019)
Contributes to Counter-Cyclical Fiscal Policy	EUCAM helps policymakers identify whether an economy is operating above or below its potential.	- Informs the appropriate stance of fiscal policy (stimulus or restraint).	Borio (2014)
Undergoes Continuous	The EUCAM methodology is	- Ensures the methodology	Blondeau et al. (2021)

Development and Refinement	subject to ongoing review and refinement by the OGWG.	remains relevant and incorporates the latest economic research.	
Weaknesses			
Reliance on Unobservable Variables	EUCAM relies on estimating key variables (NAIRU, TFP) that are not directly observable.	- Introduces uncertainty and sensitivity to model specifications.	Staiger et al. (1997)
Challenges in Accurate Estimation	Estimating potential output and the output gap is inherently difficult, especially during economic uncertainty or structural change.	- Estimates can be impacted by economic shocks and structural shifts.	Orphanides & van NordenS (2002)
Limited Applicability to Diverse Economies	EUCAM's standardised approach may not be suitable for all economies, particularly those with unique characteristics like large informal sectors, structural rigidities, specific trade balances, or financial development. This may not accurately reflect country specificities and may require adjustments to incorporate relevant country-specific factors.	- May not accurately reflect country specificities. - May necessitate adaptation to better reflect country-specific circumstances.	European Commission (2019), Casey (2018)
Methodological Rigidity	The standardised nature of EUCAM can limit its ability to fully capture the specific characteristics of individual economies.	- May need to be adapted to better reflect country-specific circumstances.	Ódor and Jurašeková Kucserová (2014)
Pro-cyclicality	EUCAM estimates can be pro-cyclical, overestimating potential output during booms and underestimating it during recessions.	- Can lead to misguided fiscal policy recommendations.	Bordignon M. et al. (2013), Carnot & de Castro, 2015; Heimberger, 2020

Sensitivity to Cyclical Fluctuations	Potential output estimates may not be responsive enough to real-time economic developments.	- May result in lags in policy responses.	Ódor and Jurašeková Kucserová (2014)
Need for More Realistic Estimates	Relying solely on model-based estimations may not be sufficient.	- Consider using a range of estimates or incorporating expert judgment.	Casey E. (2018)

3.3 Sensitivity Analysis

This section conducts a sensitivity analysis of the EUCAM model for Malta to evaluate how changes in input variables affect estimates of potential output and the output gap.[6] The analysis uses the European Commission's Spring 2024 forecast as the baseline scenario.

Two methodologies are employed:

1. **Isolated Effects Analysis:** This method involves altering a single variable by +/- 1.0% to observe its immediate impact on potential output and the output gap for a specific year. By isolating the effect of a single change, this analysis provides insights into the sensitivity of the estimates to individual input variables.

2. **Cumulative Effects Analysis:** This approach similarly alters one variable by +/- 1.0%, but the adjustment is applied consistently across multiple years (2023 to 2025). This allows for the assessment of the cumulative impact of sustained changes in input variables, capturing their long-term influence on the EUCAM estimates.

By combining these two approaches, the analysis offers a comprehensive assessment and evaluation of the EUCAM's model responsiveness to both short-term fluctuations and sustained changes in key input variables.

[6] The model may be downloaded from here.

3.3.1 Isolated effects

To assess isolated effects, input variables for a specific year are individually adjusted by +/-1.0%, while all other years are held constant at baseline values. The resulting changes in potential output and the output gap estimates are recorded for the year in which the adjustment occurs (i.e., the same year the input variables are adjusted). The findings reveal that the impact of altering inputs in a given year extends beyond that year, with subsequent changes in output observed in subsequent years.

The analysis begins by examining isolated effects, showing that the output gap does not respond uniformly to +/-1.0% adjustments across several inputs, particularly real GDP, hours worked per employee, capital stock, working-age population, and employment.[7] This is because the output gap is calculated as the difference between actual GDP and potential output. When input variables are adjusted, actual GDP changes directly, while potential output, remains relatively stable. This leads to a larger change in the output gap.[8]

Potential output estimates generally exhibit a stable trajectory in response to changes in real GDP, hours worked per employee, and employment between 2023 and 2025, indicating that the economy's long-term productive capacity is relatively resilient to these short-term fluctuations. While some minor or temporary adjustments in potential output may occur, the overall trend remains stable. This is consistent with the production function approach, where potential output is determined by the full utilisation of inputs such as labour, capital, and technology. Potential output is unaffected by short-term cyclical or demand-side fluctuations in real GDP, since these fluctuations do not alter the economy's underlying productive capacity.

The production function approach used in the EUCAM to estimate potential output emphasises long-term structural factors. Labour inputs, including employment levels and hours worked, are derived from stable components such as the NAWRU and average hours worked, which reflect the equilibrium conditions of the labour market. To ensure that potential output represents the economy's sustainable productive

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[7] The full list of variables tested can be found in Appendix, Table A. The other variables did not show any material impact on the potential output and output gap estimates, so they were excluded from the study.

[8] It is important to note that a 1% increase or decrease in a variable will result in a different absolute change depending on the variable's initial size. In other words, the impact of a 1% adjustment varies with the magnitude of each variable. Table B in the appendix shows the respective magnitude changes for each variable within this study.

capacity, these inputs are smoothed using statistical techniques such as the Hodrick-Prescott filter, which removes short-term cyclical fluctuations. This approach aims to isolate structural trends from temporary economic variations. As a result, labour inputs in the potential output model remain unaffected by short-term changes in employment or hours worked due to business cycles.

For capital stock, the potential output analysis reveals a more complex pattern with lagged effects. An increase in capital stock typically boosts potential output in the year of the increase, as investments in infrastructure, machinery, and technology enhance the economy's productive capacity. However, this initial positive effect is followed by a decrease in potential output the following year before returning to baseline levels in the subsequent year. This suggests that while capital accumulation expands productive capacity, there may be short-term adjustments or inefficiencies as the economy integrates new resources. These adjustments could result from the time required for workers and firms to fully adapt to the new capital. These transitional dynamics may temporarily offset the initial gains in potential output, reflecting a period of adjustment before the economy stabilises and potential output returns to its expected trajectory.[9]

The analysis of the working-age population's effect on potential output in Malta reveals a dynamic similar to that observed for capital stock. In the baseline scenario for Malta, the working-age population is projected to increase steadily over the forecast horizon. An increase in the working-age population initially raises potential output, as the expanded labour supply contributes to higher production levels. However, this initial boost is followed by a reduction in potential output in the subsequent year, before returning to baseline levels. This cyclical effect may be due to the time it takes for the labour market to fully absorb the additional workers, especially if there are frictions in matching workers to appropriate jobs or if the economy experiences temporary mismatches in labour demand and supply. Moreover, while the initial increase in potential output reflects an increase in labour availability, the subsequent decrease may indicate challenges in sustaining this growth. These challenges could include a lag in job creation or the need for additional capital investment to fully utilise the larger workforce.[10]

[9] It's important to note that the observed temporary nature of capital stock impacts is a consequence of the isolated effects methodology employed in this analysis. By design, only the year in which the capital stock is adjusted experiences the direct impact, while subsequent years revert to the baseline capital stock level. Therefore, the observed dynamics reflect the economy's adjustment back to its previous capital stock trajectory, rather than the long-term effects of capital accumulation.

[10] Similar to the capital stock, the temporary effect of the working-age population on potential output is a result of the isolated effects methodology employed.

The significant impact of real GDP on the output gap is primarily due to the relative stability of potential output. Since potential output remains relatively constant, changes in real GDP directly translate into changes in the output gap. For example, a 1.0% increase in real GDP in 2023 leads to a 0.8% increase in the output gap, because potential output is not changing significantly. This pattern persists into 2024 and 2025, although the effects gradually diminish as the economy adjusts to the initial shock. The direct relationship between changes in real GDP and the output gap reflects the economy's responsiveness to shifts in aggregate demand. Increases in GDP push actual output above its potential, creating a positive output gap, while decreases pull it below potential, resulting in a negative gap.

As previously discussed, the stability in potential output for real GDP suggests that these short-term fluctuations do not significantly alter the economy’s long-term productive capacity. However, the impact on the output gap highlights the importance of managing cyclical economic factors to minimise deviations from potential output and maintain economic stability.

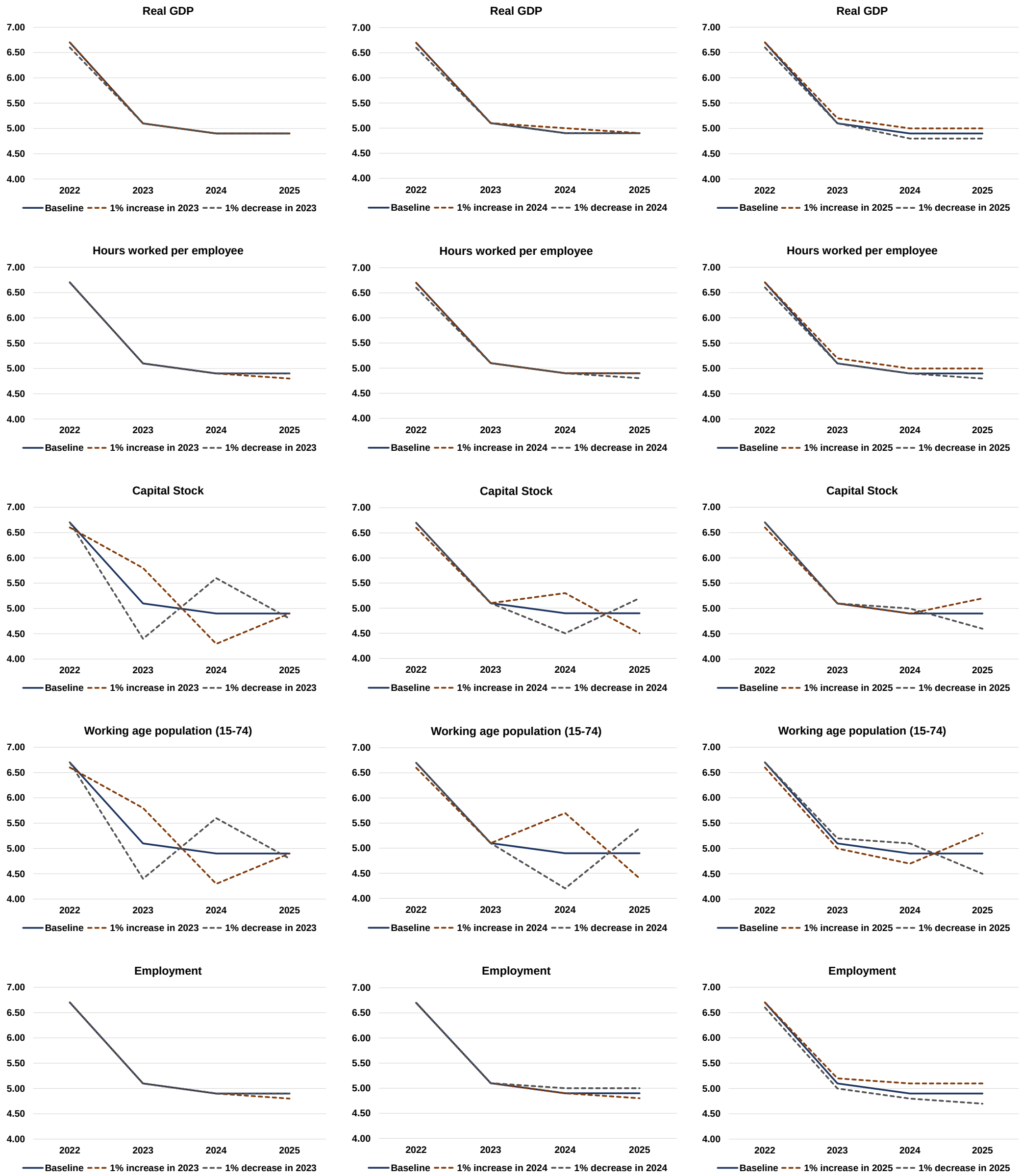
Meanwhile, changes in hours worked per employee have a subdued impact on the output gap. A 1.0% increase in hours worked in 2023 results in a slight 0.1% decrease in the output gap, while a 1.0% decrease has no notable effect. This pattern persists in subsequent years, reflecting the limited role that hours worked play in driving significant changes in the output gap.

Given the stability in potential output for hours worked, it is clear that fluctuations in labour input do not substantially affect the economy’s overall potential output level. This reinforces the understanding that factors other than simply increasing labour hours, such as productivity improvements, are more critical for long-term potential output growth.

Turning to the output gap, the relative stability of potential output for hours worked, combined with the observed fluctuations in actual hours worked (reflected in real GDP), means that changes in actual labour input will have a proportionally larger impact on the output gap. This highlights the importance of managing cyclical fluctuations in labour demand to minimise deviations from potential output, even if the impact on long-term potential output is limited.

Sensitivity analysis of potential output estimates – isolated effects

Change in 2023 | Change in 2024 | Change in 2025



Source: Author's Calculations

Sensitivity of potential output estimates – isolated effects

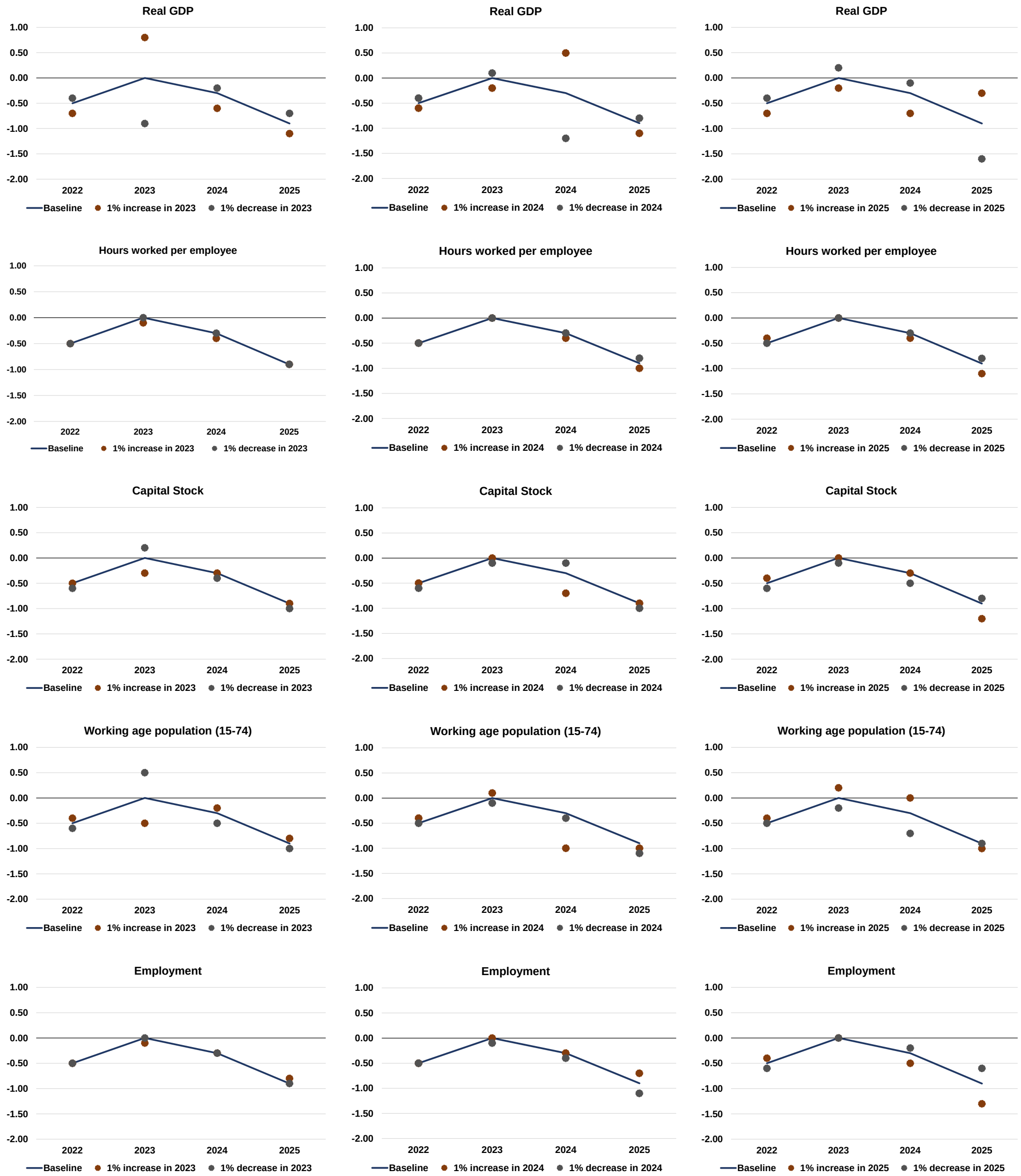
	2022	2023	2024	2025
+1.0% (-1.0%) change in 2023				
Real GDP	0.0 (-0.1)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)
Hours worked per employee	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	-0.1 (0.0)
Capital stock	-0.1 (0.0)	0.4 (0.3)	-0.4 (0.4)	0.0 (0.0)
Working age population	-0.1 (0.0)	0.7 (-0.7)	-0.6 (0.7)	0.0 (-0.1)
Employment	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	-0.1 (0.0)
+1.0% (-1.0%) change in 2024				
Real GDP	0.0 (-0.1)	0.0 (0.0)	0.1 (0.0)	0.0 (0.0)
Hours worked per employee	0.0 (-0.1)	0.0 (0.0)	0.0 (0.0)	0.0 (-0.1)
Capital stock	-0.1 (0.0)	0.0 (0.0)	0.4 (-0.4)	-0.4 (0.3)
Working age population	-0.1 (0.0)	0.0 (0.0)	0.8 (-0.7)	-0.5 (0.5)
Employment	0.0 (0.0)	0.0 (0.0)	0.0 (0.1)	-0.1 (0.1)
+1.0% (-1.0%) change in 2025				
Real GDP	0.0 (-0.1)	0.1 (0.0)	0.1 (-0.1)	0.1 (-0.1)
Hours worked per employee	0.0 (-0.1)	0.1 (0.0)	0.1 (0.0)	0.1 (-0.1)
Capital stock	-0.1 (0.0)	0.0 (0.0)	0.0 (0.1)	0.3 (-0.3)
Working age population	-0.1 (0.0)	-0.1 (0.1)	-0.2 (0.2)	0.4 (-0.4)
Employment	0.0 (-0.1)	0.1 (-0.1)	0.2 (-0.1)	0.2 (-0.2)

Source: Author's Calculations

The working-age population also has a strong influence on the level of potential output, and consequently, on the output gap, particularly in the initial year of change. In 2023, a 1.0% increase reduces the output gap by 0.5%, with similar effects observed in subsequent years. The relative stability of the growth rate of potential output related to the working-age population suggests that while demographic changes are important for long-run economic growth, the economy can adjust to these changes without significant shifts in its trend productive capacity. This stability helps mitigate the impact of demographic fluctuations on the output gap, underscoring the importance of policies that enhance labour force participation and productivity, which are crucial for sustaining long-term growth.

Sensitivity analysis of output gap estimates – isolated effects

Change in 2023 | Change in 2024 | Change in 2025



Source: Author's Calculations

Sensitivity of output gap estimates – isolated effects

	2022	2023	2024	2025
+1.0% (-1.0%) change in 2023				
Real GDP	-0.2 (0.1)	0.8 (-0.9)	-0.3 (0.1)	-0.2 (0.2)
Hours worked per employee	0.0 (0.0)	-0.1 (0.0)	-0.1 (0.0)	0.0 (0.0)
Capital stock	0.0 (-0.1)	-0.3 (0.2)	0.0 (-0.1)	0.0 (-0.1)
Working age population	0.1 (-0.1)	-0.5 (0.5)	0.1 (-0.2)	0.1 (-0.1)
Employment	0.0 (0.0)	-0.1 (0.0)	0.0 (0.0)	0.1 (0.0)
+1.0% (-1.0%) change in 2024				
Real GDP	-0.1 (0.1)	-0.2 (0.1)	0.8 (-0.9)	-0.2 (0.1)
Hours worked per employee	0.0 (0.0)	0.0 (0.0)	-0.1 (0.0)	-0.1 (0.1)
Capital stock	0.0 (-0.1)	0.0 (-0.1)	-0.4 (0.2)	0.0 (-0.1)
Working age population	0.1 (-0.1)	0.1 (-0.1)	-0.7 (0.6)	-0.1 (0.1)
Employment	0.0 (0.0)	0.0 (-0.1)	0.0 (-0.1)	0.2 (-0.2)
+1.0% (-1.0%) change in 2025				
Real GDP	-0.2 (0.1)	-0.2 (0.2)	-0.4 (0.2)	0.6 (-0.7)
Hours worked per employee	0.1 (0.0)	0.0 (0.0)	-0.1 (0.0)	-0.2 (0.1)
Capital stock	0.1 (-0.1)	0.0 (-0.1)	0.0 (-0.2)	-0.3 (0.1)
Working age population	0.1 (0.0)	0.2 (-0.2)	0.3 (-0.4)	-0.1 (0.0)
Employment	0.1 (-0.1)	0.0 (0.0)	-0.2 (0.1)	-0.4 (0.3)

Source: Author's Calculations

Changes in employment levels have a relatively modest impact on the output gap, with small decreases observed in response to increases in employment. This reflects that while employment is essential for maintaining economic output, other factors, such as capital intensity, play more significant roles in driving long-term economic performance. The stability in potential output associated with employment changes reinforces this view, suggesting that the economy's long-term growth trajectory is not highly sensitive to short-term employment fluctuations.

The results obtained from the sensitivity analysis, show that real GDP and the working-age population have a substantial and immediate impact on the output gap. Capital stock also plays a critical role, although its effects on the output gap are more gradual. Conversely, changes in hours worked per employee and employment levels exhibit more moderate impacts.

3.3.2 Cumulative effects

Building on the isolated effects analysis results, the cumulative effects analysis also focuses on the main variables that influence potential output and output gap estimates: real GDP, hours worked per employee, capital stock, working-age population and employment. This analysis examines the impact of sequential changes in each variable over multiple years (2023 to 2025). Indeed, increasing an input variable by 1% annually over this period leads to a cumulative effect on the output gap that differs significantly from a one-time +/- 1.0% change in a single year.

For a cumulative 1.0% increase in real GDP, the output gap initially decreases by 0.2% in 2023, followed by a 0.4% decrease in 2024, before rebounding with a significant 0.6% increase in 2025. In contrast, a cumulative 1.0% decrease in real GDP initially increases the output gap by 0.3% in 2023, with smaller fluctuations in the following years.

The initial negative impact of a real GDP increase on the output gap can be attributed to the fact that, in the short term, potential output may rise faster than actual output due to lagged responses in consumption and investment. However, as the economy adjusts, higher GDP growth typically leads to stronger demand and increased production levels, reducing the output gap over time. This delayed positive effect aligns with Keynesian economics, where changes in aggregate demand (such as those driven by GDP growth) take time to fully translate into changes in actual output.

Changes in hours worked per employee show relatively small and consistent effects on the output gap. A cumulative 1.0% increase in hours worked slightly raises the output gap by 0.1% in 2022, but this effect diminishes over time, resulting in a 0.2% decrease by 2025. On the other hand, a cumulative 1.0% decrease in hours worked has minimal impact, with a slight positive effect observed in 2025.

The limited impact of changes in hours worked can be attributed to the principle of diminishing marginal returns. As employees work more hours, the additional output produced per hour tends to decrease, meaning that even significant increases in hours worked may not lead to proportional increases in output. Furthermore, labour market rigidities and productivity constraints often limit the effectiveness of changes in working hours on overall economic output.

The cumulative 1.0% increase in capital stock results in negligible effects on the output gap in the initial years but leads to a 0.3% decrease by 2025. Conversely, a cumulative 1.0% decrease in capital stock initially has a minor impact but increases the output gap by 0.1% in 2025. This pattern reflects the delayed effects of capital investment on economic output.

In the short term, increases in capital stock expand potential output by enhancing production capacity and technological efficiency. However, if actual output does not keep pace with the increase in potential output, the output gap may initially widen. Over time, the output gap decreases as the economy adjusts and businesses begin utilising the additional capital more effectively. This aligns with the Solow-Swan growth model, which emphasises the role of capital accumulation in fostering long-term economic growth.

A cumulative 1.0% increase in the working-age population initially raises the output gap by 0.1% in 2022, with the effect peaking at 0.3% in 2024 before slightly decreasing in 2025. Conversely, a cumulative decrease leads to a more immediate negative impact, reducing the output gap by 0.3% in 2023, with the effect stabilising in subsequent years.

The significant influence of changes in the working-age population can be attributed to its direct impact on labour supply. An increase in the working-age population boosts the labour force, thereby enhancing the economy's capacity to produce goods and services. However, this increase also raises potential output, which may initially widen the output gap if demand does not increase correspondingly. Over time, as the economy adjusts, the expanded labour force contributes to higher actual output, reducing the output gap. On the other hand, a decrease in the working-age population constrains labour supply, reducing potential output and thus narrowing the output gap, assuming actual output remains steady.

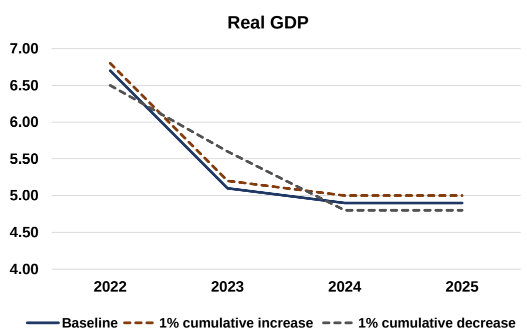
Employment changes exhibit moderate effects on the output gap. A cumulative 1.0% increase initially has no effect but leads to a 0.4% decrease in the output gap by 2025. Conversely, a cumulative decrease in employment has minimal impact, with a slight positive effect of 0.1% in 2025.

The delayed and moderate impact of employment changes on the output gap can be attributed to the fact that employment growth does not always translate directly into increased output. The quality and productivity of newly created jobs, as well as the level of underemployment, play critical roles in determining the overall impact on economic output. This observation aligns with Okun's Law, which suggests that changes in employment are associated with changes in output, but the relationship is not perfectly proportional due to variations in productivity levels and other structural factors in the labour market.

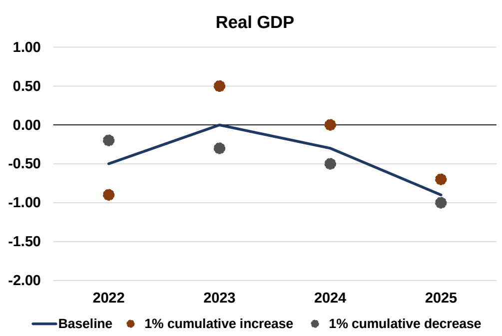
This analysis highlights that cumulative changes in real GDP and the working-age population are the most influential factors affecting the output gap, particularly over the long term. Capital stock also plays a significant role, albeit with a delayed effect, while changes in hours worked per employee and employment have more subdued and gradual impacts. These findings underscore the importance of managing real GDP growth and demographic trends to mitigate output gap fluctuations and support sustainable economic stability. Additionally, the delayed effects of capital stock and the modest influence of employment suggest that while immediate changes in the labour market can have some impact, long-term growth relies more heavily on capital accumulation and demographic factors.

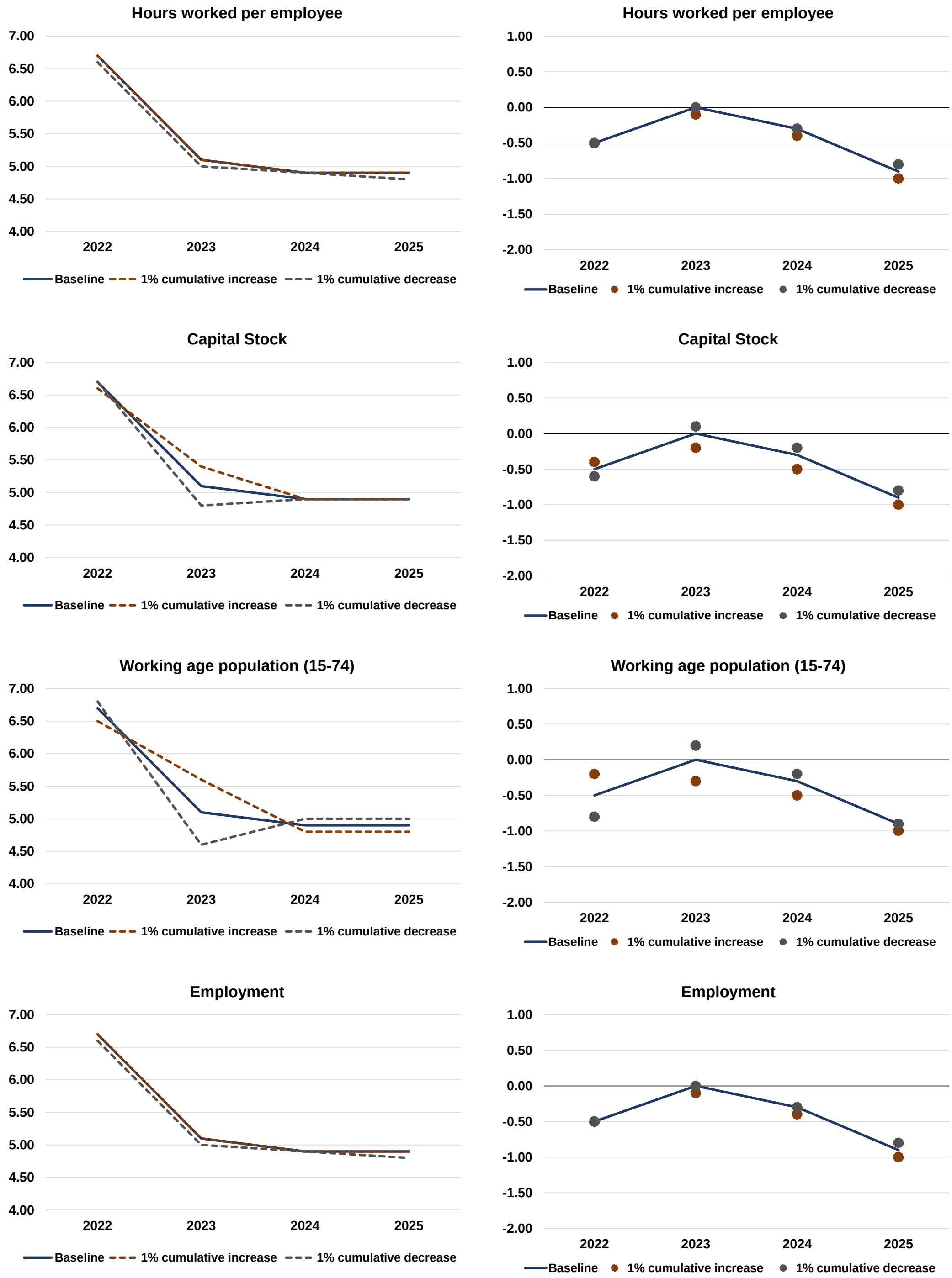
Sensitivity analysis of potential output and output gap estimates – cumulative effects

Potential Output



Output Gap





Source: Author's Calculations

Sensitivity of potential output estimates – cumulative effects

	2022	2023	2024	2025
+1.0% (-1.0%) cumulative change				
Real GDP	0.1 (-0.2)	0.1 (0.5)	0.1 (-0.1)	0.1 (-0.1)
Hours worked per employee	0.0 (-0.1)	0.0 (-0.1)	0.0 (0.0)	0.0 (-0.1)
Capital stock	-0.1 (0.0)	0.3 (-0.3)	0.0 (0.0)	0.0 (0.0)
Working age population	-0.2 (0.1)	0.5 (-0.5)	-0.1 (0.1)	-0.1 (0.1)
Employment	0.0 (-0.1)	0.0 (-0.1)	0.0 (0.0)	0.0 (-0.1)

Source: Author's Calculations

Sensitivity of output gap estimates – cumulative effects

	2022	2023	2024	2025
+1.0% (-1.0%) cumulative change				
Real GDP	-0.2 (0.3)	-0.2 (-0.3)	-0.4 (-0.2)	0.6 (-0.1)
Hours worked per employee	0.1 (0.0)	0.0 (0.0)	-0.1 (0.0)	-0.2 (0.1)
Capital stock	0.1 (-0.1)	0.0 (0.1)	0.0 (0.1)	-0.3 (0.1)
Working age population	0.1 (-0.3)	0.2 (0.2)	0.3 (0.1)	-0.1 (0.0)
Employment	0.1 (0.0)	0.0 (0.0)	-0.2 (0.0)	-0.4 (0.1)

Source: Author's Calculations

3.4 Conclusion

The sensitivity analysis conducted on the EUCAM model provides valuable insights into how changes in input variables affect the model's estimates of potential output and the output gap. By exploring both isolated and cumulative effects, we gain a deeper understanding of the model's responsiveness to fluctuations in key economic indicators.

The findings highlight the role of several factors in driving potential output growth. Capital stock emerges as a primary driver, with increases leading to a short-term boost in potential output. This aligns with economic theory, which emphasizes the role of capital accumulation in expanding an economy's productive capacity. Similarly, the working-age population also plays a pivotal role in driving potential output, with increases leading to an initial increase in potential output, although this effect is also temporary in the isolated effects analysis.

These changes in potential output, in turn, have significant implications for the output gap. For instance, changes in real GDP demonstrate a direct and substantial influence, with increases leading to a positive shift in the output gap, while decreases result in the opposite effect. This relationship underscores the critical role of GDP as a measure of an economy's overall output and its capacity to influence output gap estimates.

The working-age population also plays a crucial role, particularly in the initial years following a change. An increase in this population segment enhances the labour supply, which can initially widen the output gap if the economy does not immediately absorb the additional workers. However, over time, the economy adjusts, and the increased labour force contributes to higher actual output, thereby reducing the output gap.

Conversely, changes in hours worked per employee and employment levels exhibit more moderate impacts on the output gap. The relatively small effect of changes in hours worked per employee suggests that labour productivity may not increase proportionally with hours worked, and that structural factors such as fixed costs of labour and market rigidities limit the impact on overall economic output. Similarly, changes in employment levels affect the output gap in a less elastic manner compared to other variables.

Understanding the output gap is important in the context of the new EU economic governance framework, which came into effect in April 2024. This framework aims to strengthen fiscal responsibility and foster sustainable growth while offering Member States greater flexibility in achieving these goals. The significance of the output gap has grown under this new framework, as potential output growth estimates now underpin the expenditure growth trajectory, which constitutes the main fiscal indicator. Thus, accurate and reliable estimates of potential output and the output gap are essential for sound fiscal planning, informed budgetary decisions, and ensuring Malta's compliance with EU fiscal rules.

Overall, this analysis offers valuable insights into how different economic conditions and policy decisions can influence the EUCAM model's estimates of potential output and the output gap. By understanding the model's sensitivity to changes in key inputs, the MFAC will be better equipped to anticipate the effects of economic shocks and make more informed decisions during the endorsement process.

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Appendix

Table A: List of input variables

Name in data file	AMECO	Description
dgdpdef	PVGD	GDP def. % change
dlprod	RVGDE	Change in productivity
dpcegdp		log(Private consumption def/GDP def)
er	XNE	Exchange rate
gdpn	UVGD	Nominal GDP
gdpne	UVGD	Nominal GDP in euro
gdpq	OVGD	Real GDP
hpere	NLHA	Hours worked per employee
hwcdw	HWCDW	Nominal compensation per employee
iq	OIGT	Real gross fixed capital formation
kt	OKND	Capital stock
lur	ZUTN	Harmonised unemployment rate
nulc	PLCD	Nominal unit labour cost
pce dpce	PCPH	Private consumption expenditure deflator, % change
pgde	PVGD	GDP def. (euro)
popa1	NPAN1	Working age population
popt	NPTD	Total population
ppp	KNP	Purchasing power parity
sle	NECN	Employment, civilian
sle1	NETN	Employment, national
sled	NETD	Employment, domestic
winf	HWCDW	Wage inflation
ws	UWCD	Wage share

Extracted from the European Commission Discussion paper 148, 'Output Gap Estimation Using the European Union's Commonly Agreed Methodology: Vade Mecum & Manual for the EUCAM Software available here.

Table B: The value of a 1.0% change in input variables

Name in data file	Description	2023	2024	2025
dgdpdef	GDP deflator (% change)	0.01	0.01	0.01
dlprod	Change in productivity (GDP per person employed)	0.00	0.00	0.00
dpcegdp	log(Private consumption def/GDP def)	0.00	0.00	0.00
er	Exchange rate (wrt euro)	n/a	n/a	n/a
gdpn	Nominal GDP (EUR billions)	0.19	0.21	0.22
gdpq	Real GDP (EUR billions)	0.16	0.16	0.17
hpere	Hours worked per employee (average annual hours)	18.36	18.54	18.69
hwcdw	Nominal compensation per employee (EUR thousands)	0.30	0.31	0.32
iq	Real gross fixed capital formation (EUR billions)	0.03	0.03	0.03
kt	Capital stock (EUR billions)	0.27	0.27	0.28
lur	Harmonised unemployment rate (% of active population)	0.03	0.03	0.03
nulc	Nominal unit labour cost (index 2015=1)	0.01	0.01	0.01
pce dpce	Private consumption expenditure deflator (% change)	0.01	0.01	0.01
pgde	GDP deflator (% change)	0.01	0.01	0.01
popa1	Working age population (thousand persons aged 15-74)	4.29	4.39	4.49
popt	Total population (thousand persons)	5.48	5.63	5.77
ppp	Purchasing power parity (annual average)	n/a	n/a	n/a
sle	Employment, civilian (thousand persons)	3.01	3.14	3.26
sle1	Employment, national (thousand persons)	3.01	3.14	3.26
sled	Employment, domestic (thousand persons)	3.01	3.14	3.26
winf	Wage inflation (% change in nominal compensation per employee)	0.02	0.03	0.03
ws	Wage share (%)	-0.01	-0.01	-0.01

Source: Author's calculations

Financial Statements

For the year ended 31 December 2024

The Members of the Council present the annual report and the audited financial statements of the Malta Fiscal Advisory Council (the "Council") for the year ended 31 December 2024.

Principal Activity

The Malta Fiscal Advisory Council ("the Council") was established by the Minister for Finance with effect from 1 January 2015 in terms of the Fiscal Responsibility Act, 2014, Cap 534. The Council's aim is to review and assess the extent to which the fiscal and economic policy objectives proposed by the Government are being achieved and thus contribute to more transparency and clarity about the aims and effectiveness of economic policy. The Council is independent in the performance of its functions.

Performance Review

The Council received €300,000 in Government Subvention during the year ended 31 December 2024 (2023: €281,000) in terms of the Fiscal Responsibility Act and incurred €319,327 in expenditure (2023: €310,667). The Council registered a deficit of €18,618 for the year ended 31 December 2024 (2023: €29,667) as shown in the statement of comprehensive income on page xi.

Going concern

The Agency registered a deficit of €18,618 during the year under review, which has been financed by the accumulated surplus. Nonetheless, the council anticipates that current services will continue to be provided with full support from the Government of Malta. For this reason, the Council does not foresee a significant impact on its operational performance. Therefore, the financial statements have been prepared on the going concern basis which assumes that the Council will continue in operational existence for the foreseeable future and that adequate support will continue to be made available by the Government through the subventions to enable the Council to meet its commitments as and when they fall due.

Future Developments

The Council is not envisaging to change its principal activity.

Council Members

In accordance with the Fiscal Responsibility Act, the Council shall consist of the Chairperson and two other members.

The Committee constitutes of the following members which were appointed on 10th January 2023

Dr. Moira Catania – Chairperson
Dr. Stephanie Fabri – Council Member
Dr. Stephanie Vella – Council Member

Statement of Responsibilities of the Council

The Council members are required to prepare the financial statements for each financial year which give a true and fair view of the state of affairs of the Council at the end of the financial year and of the income and expenditure of the Council for that year.

Statement of Responsibilities of the Council (continued)

In preparing these financial statements, the Council members are required to: -

- Adopt the going concern basis, unless it is inappropriate to presume that the Council will continue in business;
- Select suitable accounting policies and apply them consistently from one accounting year to another;
- Make judgement and estimates that are reasonable and prudent;
- Account for income and charges relative to the accounting year on the accrual's basis; and
- Value separately the components of assets and liability items on a prudent basis.

The Council members are responsible for keeping proper accounting records which disclose with reasonable accuracy, at any time, the financial position of the Council and to enable them to ensure that the financial statements have been properly prepared. The Council members are also responsible for safeguarding the assets of the Council and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Disclosure of Information to the Auditors

So far as the Council Members are aware, all relevant information has been brought to the attention of the Council's Auditors.

Auditors

PKF Malta Limited, Registered Auditors, have intimated their willingness to continue in office.

Approved by the Council and signed on 27th February 2025 by:

Moira Catania

Dr. Moira Catania
Chairperson

Dr. Stephanie Fabri
Council Member

Dr. Stephanie Vella
Council Member

Registered Office:

Malta Fiscal Advisory Council,
Level -1
New Street in Regional Road
Msida
Malta

Malta Fiscal Advisory Council

Independent Auditor's Report

To the Council Members of the Malta Fiscal Advisory Council

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of the Malta Fiscal Advisory Council (the 'Council'), set out on pages vi to xviii, which comprise the statement of financial position as at 31 December 2024, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements (IFRS), including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Council as at 31 December 2024, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Council in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in accordance with the Accountancy Profession (Code of Ethics for Warrant Holders) Directive issued in terms of the Accountancy Profession Act (Cap. 281) in Malta, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

The Council is responsible for the other information. The other information comprises the Council Member's report and Schedule. Our opinion on the financial statements does not cover this information, including the Council Member's report. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

In addition, in light of the knowledge and understanding of the Council and its environment obtained in the course of the audit, we are required to report if we have identified material misstatements in the Council Member's report. We have nothing to report in this regard.

Responsibilities of the Council

The Council Members are responsible for the preparation of the financial statements that give a true and fair view in accordance with International Financial Reporting Standards(IFRS) as adopted by the EU, and for such internal control as the Council Members determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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Malta Fiscal Advisory Council
Independent Auditor's Report
To the Council Members of the Malta Fiscal Advisory Council

Auditors' Responsibilities for the Audit of the Financial Statements

In preparing the financial statements, the Council Members are responsible for assessing the Council's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Council Members either intends to liquidate the Council or to cease operations, or has no realistic alternative but to do so.

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Council Members.

- Conclude on the appropriateness of the Council Members' use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Council's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Council to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Malta Fiscal Advisory Council
Independent Auditor's Report
To the Council Members of the Malta Fiscal Advisory Council

Auditors' Responsibilities for the Audit of the Financial Statements

- We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

We communicate with the Council Members regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current year and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

Under the Fiscal Responsibility Act, 2014, Cap 534, we have nothing to report you with respect to the following matters:

- Proper accounting records have not been kept; or
- The Financial statements are not in agreement with the accounting records; or
- We have not obtained all the information and explanations which, to the best of our knowledge and belief, we require for the purpose of our audit;

The Director in charge of the audit resulting in this independent auditor's report is Ms. Donna Greaves for and on behalf of:

PKF Malta Limited
Registered Auditors
15, Level 3-4, Mannarino Road
Birkirkara, BKR 9080
Malta

27th February 2025

Malta Fiscal Advisory Council
Statement of Comprehensive Income
For the year ended 31 December 2024

	Notes	2024 EUR	2023 EUR
Income	3	**300,000**	281,000
Expenditure		**(319,327)**	(310,667)
Other Income		**709**	-
Deficit for the year	7	**(18,618)**	(29,667)

The notes to the financial statements on pages x to xviii form an integral part of these financial statements.

Malta Fiscal Advisory Council
Statement of Financial Position
As at 31 December 2024

	Notes	2024	2023
		EUR	EUR
ASSETS			
Non-Current Assets			
Intangible Assets	8	**-**	-
Plant and Equipment	9	**7,027**	8,210
		7,027	8,210
Current Assets			
Other Receivables		**575**	575
Cash and Cash Equivalents	10	**287,025**	277,680
Total Current Assets		**287,600**	278,255
TOTAL ASSETS		**294,627**	286,465
CAPITAL AND LIABILITIES			
Capital and Reserves			
Accumulated Surplus – Recurrent vote and operating activities	11	**245,576**	264,194
Current Liabilities			
Other Payables	12	**49,051**	22,271
TOTAL CAPITAL AND LIABILITIES		**294,627**	286,465

The notes to the financial statements on pages x to xviii form an integral part of these financial statements.

These financial statements were approved by the Malta Fiscal Advisory Council, authorised for issue on 27th February 2025 and signed on its behalf by:

Moira Catania

Dr. Moira Catania
Chairperson

Dr. Stephanie Fabri
Council Member

Dr. Stephanie Vella
Council Member

Malta Fiscal Advisory Council
Statement of Changes in Equity
For the year ended 31 December 2024

	Accumulated Surplus EUR
Balance as at 1st January 2023	293,861
Surplus for the year	(29,667)
Balance as at 31 December 2023	**264,194**
Deficit for the year	(18,618)
Balance as at 31 December 2024	**245,576**

The notes to the financial statements on pages x to xviii form an integral part of these financial statements.

Malta Fiscal Advisory Council
Statement of Cash Flows
For the year ended 31 December 2024

	Notes	2024 EUR	2023 EUR
Cash Flows from Operating Activities			
Deficit for the year		**(18,618)**	(29,667)
Adjustments for:			
Depreciation of Plant and Equipment	8	**1,992**	2,080
Operating deficit before working capital changes		**(16,625)**	(27,587)
Movement in other receivables		**-**	-
Movement in other payables	11	**26,780**	20,018
Net Cash flow (used in)/from Operating activities		**10,154**	(7,569)
Cash flows from Investing Activities			
Acquisition of Plant and Equipment	8	**(809)**	(618)
Net Cash used in Investing Activities		**(809)**	(618)
Movement in Cash and Cash Equivalents		**9,345**	(8,187)
Cash and Cash equivalents at start of the year		**277,680**	285,867
Cash and Cash equivalents at end of the year	9	**287,025**	277,680

The notes to the financial statements on pages x to xviii form an integral part of these financial statements.

1. Basis of Preparation

The principal accounting policies adopted in the preparation of these financial statements are set out below:

a) Statement of Compliance

The financial statements of the Malta Fiscal Advisory Council for the year ended 31 December 2024 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

b) Basis of Measurement

These financial statements have been prepared on the historical cost basis.

c) Functional and Presentation Currency

The financial statements are presented in Euro (€), which is the Council's functional currency.

d) Changes in accounting policies and disclosures

Standards, Interpretations and amendments to published standards as endorsed by the EU effective in the current year

In the current year, the Company has applied new and amended IFRS Standard issued by the International Accounting Standards Board (IASB) and adopted by the EU that are mandatorily effective in the EU for an accounting period that begins on or after 1 January 2024. The adoption of new and amended standards did not have a material impact on the Company's financial statements.

- Change in accounting policy (Amendments to IAS 1 and IFRS Practice Statement 2) – The amendments to IAS 1 and IFRS Practice Statement 2 Making Materiality Judgements provide guidance and examples to help entities apply materiality judgements to accounting policy disclosures.

Standards, interpretations and amendments to published standards as endorsed by the EU that are not yet effective

At the date of the authorization of these financial statements, certain new standards, amendments and interpretations to existing standards have been published by the IASB but are not yet effective and have not been adopted in the Company. Management anticipates that all the relevant pronouncements will be adopted in the Company's accounting policies upon their effective date. The Company is still assessing the effect of these changes on the financial statements. However, certain new standards and interpretations are not expected to have a material impact on the Company's financial statements.

- Amendments to IAS 7 Statement of Cash Flows and IFRS 7 Financial Instruments – Supplier Finance Arrangements.

Standards, interpretations amendments to published standards that are not yet endorsed by the EU

Certain amendments to accounting standards have been published that are not mandatorily for 31 December 2024 reporting periods and have not been early adopted by the Council.

d) Changes in accounting policies and disclosures (continued)

These amendments are not expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions. The Company intends to adopt these new and amended standards and interpretations, if applicable, when they become effective. The new and amended standards are as follows:

- Amendments to IAS 21 The Effects of Changes in Foreign Exchange Rates titled Lack of Exchangeability
- IFRS 18 Presentation and Disclosures in Financial Statements
- IFRS 19 Subsidiaries without Public Accountability: Disclosures

2. Significant Accounting Policies

a. Plant and Equipment

Recognition and Measurement

The cost of an item of plant and equipment is recognized as an asset when it is probable that the future economic benefits that are associated with the asset will flow to the Council and the cost can be measured reliably. Plant and equipment are initially measured at cost comprising the purchase price and any costs directly attributable to bringing the assets to a working condition for their intended use. Subsequent expenditure is capitalised as part of the cost of plant and equipment only if it enhances the economic benefits of an asset in excess of the previously assessed standard of performance, or it replaces or restores a component that has been separately depreciated over its useful life.

After initial recognition, plant and equipment may be carried under the cost model, that is at cost less any accumulated depreciation and any accumulated impairment losses, or under the revaluation model, that is at their fair value at the date of the revaluation less any accumulated depreciation and any accumulated impairment losses.

After initial recognition plant and equipment are carried under the cost model.

Depreciation

Depreciation commences when the depreciable assets are available for use and is charged to profit or loss so as to write off the cost amount, less any estimated residual value, over their estimated useful lives, using the straight-line method, on the following bases:

Fixtures and fittings	10% per annum
Computer and office equipment	25% per annum
Library books	10% per annum
Air conditioners	16.67% per annum

Depreciation method, useful life and residual value

The depreciation method applied, the residual value and the useful life of property, plant and equipment are reviewed on a regular basis and when necessary, revised with the effect of any changes in estimate being accounted for prospectively.

Derecognition

Property, plant and equipment are derecognized on disposal or when no future economic benefits are expected from their use or disposal. Gains or losses arising from derecognition represent the difference between the net disposal proceeds, if any, and the carrying amount, and are included in profit or loss in the period of derecognition.

2. Significant Accounting Policies (continued)

b. Financial Instruments

Financial assets and financial liabilities are recognised when the Council becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially recognised at their fair value plus directly attributable transaction costs.

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when the Council has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Financial assets are derecognised when the contractual rights to the cash flows from the financial assets expire or when the Council transfers the financial asset and the transfer qualifies for derecognition.

Classification

The Council classifies its financial assets in the following measurement categories;

- those to be measured subsequently at fair value (either through OCI or through profit or loss), and
- those to be measured at amortised cost.

The classification depends on the entity's business model for managing the financial assets and the contractual terms of the cash flows. The Council's financial assets are classified at amortised cost.

For assets measured at fair value, gains and losses will either be recorded in profit or loss or OCI. For investments in equity instruments that are not held-for-trading, this will depend on whether the Council has made an irrevocable election at the time of initial recognition to account for the equity investment at fair value through other comprehensive income (FVOCI). The Council reclassifies debt instruments when and only when its business model for managing those assets changes.

Recognition and derecognition

The Council recognises a financial asset in its statement of financial position when it becomes a party to the contractual provisions of the instrument.

Regular way purchases and sales of financial assets are recognised on settlement date, the date on which an asset is delivered to or by the Council. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all the risks and rewards of ownership or has not retained control of the asset.

Measurement

Subsequent measurement of debt instruments depends on the Council's business model for managing the asset and the cash flow characteristics of the asset. There are three measurement categories into which the Council classifies its debt instruments:

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. Interest income from these financial assets is included in finance income using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss and presented in other gains/(losses) together with foreign exchange gains and losses. Impairment losses are presented as separate line item in the statement of profit or loss.

2. Significant Accounting Policies (continued)

b. Financial Instruments (continued)

- FVOCI: Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in other gains/(losses). Interest income from these financial assets is included in finance income using the effective interest rate method. Foreign exchange gains and losses are presented in other gains/(losses) and impairment expenses are presented as separate line item in the statement of profit or loss.

- FVPL: Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL. A gain or loss on a debt investment that is subsequently measured at FVPL is recognised in profit or loss and presented net within other gains/(losses) in the period in which it arises. From 1 January 2018, the Council assesses on a forward-looking basis the expected credit loss associated with its debt instruments carried at amortised cost and FVOCI. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

Impairment

The Council assesses on a forward-looking basis the expected credit loss associated with its debt instruments carried at amortised cost and FVOCI. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

Assets carried at amortised costs

For financial assets carried at amortised costs, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The asset's carrying amount is reduced and the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the reversal of the previously recognised impairment loss is recognised in the profit or loss. Financial liabilities are derecognised when they are extinguished. This occurs when the obligation specified in the contract is discharged, cancelled or expires.

c. Other Receivables

Other receivables are classified with current assets and are stated at their nominal value. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired.

d. Other Payables

Other payables are classified with current liabilities and are stated at their nominal value.

2. Significant Accounting Policies (continued)

e. Impairment

Financial Assets

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

Financial Assets (continued)

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk circumstances. All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at cost and available-for-sale financial assets that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

Non-Financial Assets

The carrying amount of non-financial assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If such indication exists, then the asset's recoverable amount is estimated.

Non-Financial Assets (continued)

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

2. Significant Accounting Policies (continued)

f. Cash and Cash Equivalents

Cash comprises cash on hand and demand deposits. Cash equivalents are short-term investments that are held to meet short-term cash commitments rather than for investment or other purposes.

g. Provisions and contingent liabilities

A provision is recognised when, as a result of a past event, the Council has a present obligation that can be estimated reliably, and it is probable that the Council will be required to transfer economic benefits in settlement. Provisions are recognised as a liability in the balance sheet and as an expense in profit or loss or, when the provision relates to an item of property, plant and equipment, it is included as part of the cost of the underlying assets. A contingent liability is disclosed where the existence of the obligation will only be confirmed by future events or where the amount of the obligation cannot be measured with sufficient reliability.

h. Government subvention

Government grants are assistance by government, inter-governmental agencies and similar bodies whether local, national or international, in the form of cash or transfers of assets to the Council in return for past or future compliance with certain conditions relating to operating activities of the Council. Government grants are recognised when there is reasonable assurance that the Council will comply with the conditions attaching to them and the grants will be received.

Government grants are recognised in the income statement so as to match them with the expenditure towards which they are intended to contribute. Any grants relating to future periods are recognised as deferred income.

i. Going Concern

The financial statements have been prepared on the going concern basis, which assumes that the Government of Malta will continue to provide the subvention to the Council in accordance with Article 55 of the Fiscal Responsibility Act (Chapter 534 of the Laws of Malta) in the order to continue with the performance of its functions.

3. Income

Income represents the subvention voted to the Council by the Government of Malta and is analysed as follows:

	2024 EUR	2023 EUR
Government Subvention	**300,000**	281,000

The Government subvention as per Article 55 sub-articles (2), (4a) and (4b) of the Fiscal Responsibility Act amounts to not less than €250,000 annually and increases by the Index of Inflation as established and published by the National Statistics Office in each subsequent year.

4. Council Honoraria

	2024 EUR	2023 EUR
Honoraria	**42,000**	40,859
Number of Council Members	**3**	3

5. Taxation

The income of the council is exempt from the tax in pursuant to Article 12(2) of the Income Tax Act Cap. 123 of the Laws of Malta.

6. Salaries and Consultancy Fees

	2024 EUR	2023 EUR
Staff Gross Salaries and Social Security Contributions	**236,675**	234,717
Average Number of Employees	**6**	6

7. Deficit for the year

Auditors' Remuneration

Total remuneration paid to the auditors during the year amounted to:

	2024 EUR	2023 EUR
Audit Fees	**1,475**	1,239

8. Intangible Assets

The Council has Computer Software, amounting to €4,053, which was fully depreciated in 2019.

9. Plant and Equipment

	Fixtures & Fittings	Computer and Office Equipment	Library Books	Air Conditioner	Total
	EUR	EUR	EUR	EUR	EUR
Cost					
Opening Balance	9,190	13,488	1,091	1,130	24,899
Additions		809	-	-	809
As at 31 December 2024	9,190	14,297	1,091	1,130	25,708
Depreciation					
Opening balance	2,867	11,810	882	1,130	16,689
Charge for the year	919	964	109	-	1,992
As at 31 December 2024	3,786	12,774	991	1,130	18,681
Net Book Value					
As at 31 December 2023	6,323	1,678	209	-	8,210
As at 31 December 2024	**5,404**	**1,523**	**100**	**-**	**7,027**

10. Cash and Cash Equivalents

For the purpose of the cash flow statements, the year-end cash and cash equivalents comprise the following amounts:

	2024	2023
	EUR	EUR
Bank Balances	**287,026**	277,680

11. Accumulated Reserve – Recurrent Vote and operating activities

The recurrent vote and operating activities represent the accumulated surplus resulting from operations.

12. Other Payables

	2024	2023
	EUR	EUR
Other Payables	**8,710**	217
Accrued expenses	**40,341**	22,054
	49,051	22,271

13. Financial Instruments

Fair Values of Financial Assets and Financial Liabilities

At 31 December 2024 the carrying amounts of financial assets and financial liabilities classified with current assets and current liabilities respectively approximated their fair values due to the short-term maturities of these assets and liabilities.

Financial Risk Management

The exposures to risk and the way risks arise, together with the Council's objectives, policies and processes for managing and measuring these risks are disclosed in more detail below. The objectives, policies and processes for managing financial risks and the methods used to measure such risks are subject to continual improvement and development.

Liquidity Risk

The Council monitors and manages its risk to a shortage of funds by maintaining sufficient cash and by monitoring the availability of raising funds to meet commitments associated with financial instruments and by maintaining adequate banking facilities.

Capital Risk Management

The Council's objectives when managing capital is to safeguard its ability to continue as a going concern.

The capital structure of the Council consists of cash and cash equivalents as disclosed in note 10 and items presented within the accumulated reserve in the statement of financial position.

14. Related Parties

The Malta Fiscal Advisory Council is an independent fiscal institution and reports to Parliament on an annual basis. The Council Members are appointed by the Government of Malta. In terms of the Fiscal Responsibility Act, Council Members will not seek or receive instructions from public authorities or from any other institution or council.

Transactions with Council Members which occurred during the years ended 31 December 2024 and 2023 are disclosed in note 4.

15. Comparative Information

Certain comparative information has been reclassified to conform to the current's year disclosure for the purpose of fairer presentation.

The Schedules and Appendices on the pages that follow do not form part of the Financial Statements.

Malta Fiscal Advisory Council
Schedules to the Expenditure Account
For the year ended 31 December 2024

Expenditure

	2024	2023
	EUR	EUR
Accountancy fees	**590**	590
Advertising	**120**	-
Annual report	**492**	1,368
Audit fees	**1,475**	1,239
Bank charges	**456**	417
Cleaning	**1,350**	1,904
Depreciation	**1,992**	2,080
Licences	**70**	2,147
Gross salaries, bonuses and allowances	**220,785**	219,021
Council Honoraria	**42,000**	40,859
Social Security Contributions	**15,890**	15,696
Insurance	**1,264**	1,308
Hospitality	**-**	58
General expenses	**10,850**	1,743
MITA subscription	**4,846**	5,133
Postage, other printing and stationery	**1,533**	2,285
Staff welfare	**1,606**	1,263
Subscriptions	**686**	769
Telecommunication and internet costs	**5,617**	4,400
Travel and training costs	**6,324**	7,154
Payroll services	**428**	469
Website	**953**	764
Total Expenditure	**319,327**	310,667

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