# Assessment of the Macroeconomic Forecasts within the Draft Budgetary Plan 2026

17 November, 2025

**Assessment Report**

**No. 04/2025**


Malta Fiscal Advisory Council
New Street in Regional Road, Msida, Malta
Phone: +356 21312442 | Website: www.mfac.org.mt

The Malta Fiscal Advisory Council is an independent institution established under the Fiscal Responsibility Act (2014), which aims to contribute to stronger fiscal governance in Malta and offer assurance about the quality of the official economic and fiscal projections and fiscal sustainability through independent analysis and advice.

This assessment of the macroeconomic projections is undertaken in terms of Article 13, point 3(a), which states that the Fiscal Council shall "*endorse, as it considers appropriate, the macroeconomic and fiscal forecasts prepared by the Ministry for Finance and provide an assessment of the official forecasts"*.

**This Report was prepared based on the information available until 30 October 2025.**

MALTA FISCAL ADVISORY COUNCIL

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

15 October 2025

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

Honourable Minister,

## ASSESSMENT OF THE MACROECONOMIC FORECASTS CONTAINED IN THE DRAFT BUDGETARY PLAN 2026

In accordance with Article 13 of the Fiscal Responsibility Act (Cap. 534 of the Laws of Malta), the Malta Fiscal Advisory Council (MFAC) must endorse, as it considers appropriate, the macroeconomic forecasts prepared by the Ministry for Finance (hereinafter referred to as "Ministry") as part of the Draft Budgetary Plan. Accordingly, the Ministry forwarded to the Council the first draft projections of the high-level macroeconomic indicators on 08 October 2025. Further information was sent over the following days, and the finalised figures were received on 13 October 2025 (see Appendix 1). These forecasts updated the macroeconomic outlook published by the Ministry and endorsed by the Council on 29 April 2025 as part of Malta's Annual Progress Report for 2025 (APR25). The cut-off date for these macroeconomic projections is 01 October 2025.

Despite the heightened uncertainty, the Council notes that since the publication of the APR25, the global economy surprised on the upside during the first months of 2025. Economic activity proved resilient across several major economies, supported by stronger-than-expected trade and investment in the early part of the year. Following the unprecedented wave of tariff announcements in April, a series of trade agreements between the United States (US) and its major trading partners contributed to stabilising global sentiment. While trade restrictions remain elevated by historical standards, these agreements have reduced the immediate risk of a broader escalation in trade tensions. Consequently, the global trade policy uncertainty index declined sharply from the peak reached earlier in the year.

This easing of uncertainty, combined with the front-loading of imports to the US in anticipation of prospective trade restrictions, provided a temporary boost to global trade and industrial activity. Economic activity in the euro area grew by 1.3% in the first half of 2025, performing better than earlier expectations. However, part of this strength reflects temporary trade distortions, which are expected to unwind by the end of the year, leading to a moderation in growth among Malta's main trading partners. Indeed, according to the ECB's macroeconomic projections for the euro area, which were published in September, euro area GDP is projected to expand by 1.2% in 2025 and by 1.0% in 2026, while global growth (excluding the euro area) is expected to slow from 3.6% in 2024 to 3.3% in 2025 and to 3.1% in 2026.

The Council examined the plausibility of the external assumptions underpinning the updated macroeconomic projections prepared by the Ministry. In this context, discussions were held with Ministry officials to discuss the main factors shaping the revised outlook and the key changes compared to the previous forecast round. The Council also evaluated the projections against recent market developments and statistical data, while benchmarking them with forecasts published by other established institutions to ensure their overall consistency and plausibility.

The Ministry's macroeconomic projections point to a moderation in economic activity in Malta, which is consistent with data for the first half of the year. Real GDP growth is expected to ease from 6.8% in 2024 to 4.1% in both 2025 and 2026. In both years, domestic demand is anticipated to remain the primary driver of growth. Net exports are expected to contribute negatively in 2025, before recovering in 2026. The projections underlying the DBP are broadly consistent with those of the European Commission, published in May, where real GDP was projected to increase by 4.1% in 2025 and 4.0% in 2026. Nevertheless, the European Commission's projections preceded the release of the latest statistical information, which revealed a significant slowdown in the first months of the year.

Private consumption growth, which has been a major driver of recent expansions in economic activity, is expected to ease from 6.2% in 2024 to 3.7% in 2025 and 3.8% in 2026. Data for the first half of the year point to a sharp slowdown. However, private consumption should remain underpinned by a robust labour market, with real wages expected to continue growing as inflation stabilises. Coupled with the widening of the income tax bands introduced at the beginning of this year, this should sustain purchasing power. Consumer sentiment has also improved, supported by diminishing uncertainty.

Government final consumption expenditure is projected to increase by 6.6% in 2025 in real terms. This means that government consumption is expected to pick-up from a growth of 5.9% in the first half of the year. It is important to note that this comes on the back of a significant increase in the previous year, where government consumption increased by 14.4% in the second half of 2024. For 2026, government consumption is expected to increase by 4.6%. Moreover, gross fixed capital formation is expected to increase by 10.8% in 2025, representing a sizable upward revision of 8.3 percentage points when compared to the forecasts outlined in the APR25 published in April. In turn, investment is then expected to contract by 0.9% in 2026, reflecting the large base effect from the previous year.

Malta's limited direct exposure to the US market, coupled with its strong reliance on services, which tend to be less price sensitive compared to the goods market, has contributed to the resilience of the external sector during the first half of the year. The strong performance is expected to continue over the near term, with exports expected to increase by 4.7% in 2025, before easing slightly to 4.5% in 2026. In both years, exports are mainly led by services, including strong performances in business services and tourism. Imports are set to rise by 6.2% in 2025, before moderating to 3.5% in 2026, in line with the trajectory for investment, which tends to be relatively import-intensive in Malta.

Headline inflation is expected to stabilise, with an annual projection of 2.4% in 2025, in line with the average annual rate during the first eight months of the year. In 2026, inflation is anticipated to decline slightly to 2.2%, with price pressures in services projected to remain relatively elevated. Meanwhile, labour market conditions are set to remain tight, with the unemployment rate expected to remain unchanged at 2.8% throughout the forecast horizon. The tight labour market is anticipated to exert upward pressure on wages, with compensation of employees increasing by 11.2% in 2025, partly attributed to new collective agreements in the public sector, and 8.5% in 2026. As productivity gains are expected to remain muted, this is projected to translate into an increase in real unit labour costs, estimated at 4.1% in 2025 and 1.4% in 2026.

**Based on the information available to the MFAC by the date of this letter, and after considering the inherent risks and uncertainty surrounding these macroeconomic projections, the Council considers that the macroeconomic growth forecasts for 2025 and 2026 prepared by the Ministry as part of the Draft Budgetary Plan 2026 lie within its endorsable range. However, based on the available data for the first half of the year, the Council considers that the balance of risks for 2025 is tilted to the downside. On the other hand, the Council assesses the risks to GDP growth in 2026 to be broadly neutral. Moreover, for both years, the Council has differing views regarding the composition of the underlying growth drivers.**

According to its evaluation, the Council assesses the potential of a downside risk to GDP growth in 2025. With an annual projected growth of 4.1%, the Ministry expects growth to accelerate in the second half of the year to 5.0%, up from 3.1% in the first half. While soft indicators available by the cut-off date of this assessment suggest that economic activity remains resilient, the projected rebound may prove difficult to sustain, especially for private consumption and investment. Moreover, the Council also identifies a downside risk for export growth, which is perhaps less material than the previous components.

Indeed, private consumption is expected to accelerate from 2.8% in the first half of the year, to 4.6% in the second half. The expansion in private consumption is partly the result of a strong projection for compensation per employees, which is expected to increase by 6.9% in 2025. The Council believes that the projected growth in compensation per employee is on the high side, particularly given the one-off payments in the educational sector during the final months of 2024. On this basis, although economic fundamentals are expected to remain strong over the remaining quarters, household purchasing power may prove weaker than that envisaged in the forecasts, potentially dampening domestic demand and posing downside risks to the growth forecast for 2025.

The projected increase in wage growth, coupled with no growth in labour productivity, is leading to a significant growth in nominal unit labour costs of 6.9% or 4.1% in real terms. This expected increase in unit labour costs poses risks to cost competitiveness, particularly in sectors exposed to international competition, thus leading to downside risks to net exports. The Council also notes that, compared to foreign European counterparts, Malta's increases in unit labour costs will significantly outpace EU average projections, posing risks to Malta's ability to continue gaining export market shares, especially in the majority sectors, which are price takers.

Furthermore, investment activity is projected to strengthen markedly in 2025. While total gross fixed capital formation contracted by 0.1% in real terms during the first half of the year, it is expected to recover sharply by 21.4% in the second half. This increase is largely driven by public capital spending. Such a pick-up in public investment activity may prove difficult to achieve given historical implementation patterns. Whilst the Council considers that the ambitious public investment targets constitute a downside risk, the impact on GDP growth is largely mitigated as investment activity in Malta is relatively import-intensive.

For 2026, the Council identifies upside risks to investment growth, reflecting a correction from the anticipated lower investment levels observed in 2025 due to base effects. Conversely, the Council notes that private consumption expenditure may be lower than anticipated by the Ministry, as a moderation in real disposable income growth is expected. In the Council's assessment, these opposing forces are expected to broadly offset one another.

The Council further notes that the figures for public consumption expenditure have been revised upwards relative to the APR25 forecasts. The implications of these revisions in relation to compliance with the net primary expenditure path will be examined when the complete fiscal data is made available and will be published in the Council's forthcoming assessment of the fiscal forecasts report.

The Council also identifies a downside risk to the GDP deflator growth projected for 2025 and 2026. The Ministry anticipates the GDP deflator to increase by 2.8% in both years. For 2025, this projection implies an acceleration of the GDP deflator to 3.2% in the second half of the year. This downside risk is attributed to a lower-than-expected increase in private and public consumption deflators relative to the Ministry's projections. For 2026, the Council likewise notes a downside risk to the GDP deflator forecast, albeit less pronounced than in 2025, reflecting the moderate acceleration in global prices assumed in the exogenous assumptions.

Moreover, the Council favourably notes that, in line with its recommendations prescribed in past assessment reports, the potential growth estimates for 2024 and 2025 have been revised upwards to reflect a more coherent picture of the state of the Maltese economy. However, the Council notes that the significant widening in the output gap in 2026 is not consistent with expected developments in the labour market and inflation.

On a procedural level, the Council notes the tight timeframes under which this assessment was undertaken. Moving forward, it recommends a timelier submission of the forecasts to the Council.

Lastly, the Council wishes to express its sincere appreciation for the continued collaboration and support extended by the Ministry's staff.

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

Yours sincerely,

Moira Catania

**Dr Moira Catania**

**Chairperson of the Malta Fiscal Advisory Council**

# INTRODUCTION

1. **Each year, Member States within the Euro Area (EA) are required to submit a Draft Budgetary Plan (DBP) to the European Commission (COM).** The COM evaluates these plans to ensure effective coordination of fiscal and economic policies across the EA and to verify compliance with the European Union's (EU) economic governance framework, as established under the Stability and Growth Pact (SGP).[1] The MFIN submitted the DBP 2026 for Malta to the COM on 15 October 2025.

2. **Pursuant to Article 16(3) of the Fiscal Responsibility Act (FRA), "The Draft Budgetary Plan shall be submitted to the Fiscal Council for endorsement and shall thereafter be made public".** On 15 October 2025, the Chairperson of the Malta Fiscal Advisory Council (MFAC) formally notified the Minister for Finance that the macroeconomic projections for 2025 and 2026, prepared by the Ministry for Finance (MFIN) as part of Malta's DBP 2026, fall within the range deemed endorsable by the Council. In its assessment, the Council considers that the balance of risks to GDP growth in 2025 is tilted to the downside, while for 2026, risks are broadly balanced. Nonetheless, in both years, the Council noted that it holds differing views from MFIN regarding the composition of the underlying growth drivers.[2]

3. **In this Report, the MFAC is presenting its assessment and endorsement of the official macroeconomic projections within the DBP for the years 2025 and 2026. The Council's analysis is guided by the principle of employing realistic macroeconomic forecasts in the formulation of fiscal policy,** in line with the provisions of European legislation, most notably the Stability and Growth Pact and the revised Council Directive 2011/85/EU of 8 November 2011, which sets out requirements for Member States' budgetary frameworks. These forecasts updated the macroeconomic outlook for 2025 published by the MFIN and endorsed by the Council on 29 April 2025 as part of Malta's Annual Progress Report for 2025 (APR25). The cut-off date for these macroeconomic projections is 01 October 2025, while the Report has a cut-off date of 30 October 2025.

4. **The Council notes that the compliance of government expenditure forecasts with the net primary expenditure path will be examined and published in the Council's forthcoming assessment of the fiscal forecasts report.**

[1] The DBP for 2026 submitted by each country can be found here.

[2] The endorsement letter relating to the macroeconomic projections presented in the DBP 2026 is included in this Report prior to this section. The letter has also been published online on the MFAC's website.

5. **The methodology employed by the MFIN to produce macroeconomic projections remains broadly consistent with that adopted in previous forecasting rounds.** The MFIN primarily utilises the Short-Term Quarterly Econometric Forecasting Model for Malta (STEMM) as the core framework for generating its macroeconomic projections.[3] The model's equations are regularly reviewed and updated to ensure they accurately reflect the latest macroeconomic developments and evolving structural relationships within the Maltese economy and the external sector.

   The model incorporates exogenous assumptions regarding the international environment, drawing primarily on projections from Consensus Economics and the European Central Bank (ECB).[4] Furthermore, the forecasting process integrates expert judgement, supported by ad hoc data and consultations with key stakeholders. This element is particularly valuable when assessing volatile components, such as gross fixed capital formation and sector-specific dynamics, notably in tourism.

## MACROECONOMIC SCENARIO UNDERLYING THE DRAFT BUDGETARY PLAN 2026

6. **Global economic activity held up in the first half of 2025, underpinned by front-loaded trade and investment ahead of prospective tariffs, as well as by easing global financial conditions.** In April, the United States (US) announced a series of tariffs targeting multiple trading partners. Initially, these measures were widely expected to dampen global growth by disrupting long-established trade flows and increasing uncertainty for households and businesses. Subsequent trade negotiations, including agreements with the EU, as well as temporary pauses, however, reduced effective tariff rates. While tariffs remain elevated relative to historical norms, and well above 2024 levels, these developments alleviated market concerns and limited the immediate drag on economic activity. As a result, data for the first half of 2025 indicate better than expected global economic growth.

   Much of this resilience, however, reflects temporary factors, notably the accumulation of inventories in anticipation of higher tariffs. This front-loaded

[3] For further information regarding the methodology adopted in STEMM, refer to the paper published by the Economic Policy Department on 'STEMM: Short-Term Quarterly Econometric Forecasting Model for Malta' in July 2019, available here.

[4] The September 2025 edition of 'Consensus Forecasts' served as the primary source of assumptions regarding the euro exchange rate vis-à-vis the US dollar and the pound sterling, as well as global price trends, oil prices, and the real and nominal GDP growth of Malta's main trading partners. These assumptions were further supplemented by information from other institutional sources, including the ECB for exchange rate and interest rate developments, the COM for Malta's main trading partners' GDP projections, and the US Energy Information Administration for oil price forecasts.

production is starting to unwind, exerting a moderating effect on global economic activity. EA real GDP growth eased slightly from 1.4% in the first quarter to 1.3% in the second quarter, while Germany's economy contracted by 0.1% in the second quarter. Similarly, other advanced economies are showing early signs of moderation, with labour demand weakening in the US and business investment remaining subdued in China.

Against this backdrop, external demand is projected to decelerate in the latter half of 2025. According to the IMF's World Economic Outlook (October 2025), global growth is expected to reach 3.2% in 2025 and 3.1% in 2026, supported by easing financial conditions, stable inflation, and a weaker US dollar. In 2026, European growth is also set to be supported by a sizable fiscal expansion in Germany, generating positive spillovers across European economies. In this context, EA real GDP is expected to increase by 1.2% in 2025 and 1.1% in 2026. Among Malta's main trading partners, economic activity in Germany, France, and Italy is anticipated to strengthen in 2026.

Global inflation has broadly stabilised, creating conditions for further monetary easing and a gradual loosening of financial conditions. Nonetheless, renewed protectionist measures and expansionary fiscal policies in some advanced economies, most notably in Germany and the US, may generate upward price pressures and delay the pace of monetary policy interest rate reductions.

7. **Compared to the APR25 projections, the main revisions to the technical assumptions underlying the MFIN forecasts for 2025 are higher external demand, lower industrial prices and a stronger euro.** Growth in Malta's main trading partners is assumed to remain 0.8% in 2025, unchanged from 2024, before accelerating to 1.4% in 2026. Short-term interest rates are projected to decline to 2.2% in 2025 and further to 1.8% in 2026, while long-term rates are expected to remain stable at 3.4% in 2025, rising slightly to 3.5% in 2026. These assumptions imply a steepening of the yield curve over the forecast horizon.

   The euro is anticipated to appreciate against the US dollar in 2025 and 2026, while the euro-sterling exchange rate is also expected to strengthen in 2025 and remain elevated in 2026. Assumptions for oil prices remain broadly unchanged from the previous forecast round, with Brent crude oil prices projected at $69.0 per barrel in 2025 and $66.1 per barrel in 2026 (see **Table 1** for the macroeconomic forecasts underlying the DBP26).

## Table 1: Macroeconomic Forecasts underlying Malta's Draft Budgetary Plan 2026

| | Actual | Forecast | |
|---|---|---|---|
| | 2024 | 2025 | 2026 |
| **Real economic activity (% change)** | | | |
| Private final consumption expenditure* | 6.2 | 3.7 | 3.8 |
| Public consumption expenditure | 9.2 | 6.6 | 4.6 |
| Investment | 3.6 | 10.8 | -0.9 |
| Exports of goods and services | 6.2 | 4.7 | 4.5 |
| Imports of goods and services | 5.3 | 6.2 | 3.5 |
| GDP | 6.8 | 4.1 | 4.1 |
| **Contribution to real GDP growth (in pp)** | | | |
| Final domestic demand | 5.0 | 4.8 | 2.4 |
| Inventories | -0.2 | 0.0 | 0.0 |
| Net exports | 2.0 | -0.7 | 1.8 |
| **Labour market** | | | |
| Total employment (% change) | 5.0 | 4.0 | 3.8 |
| Unemployment rate (% of labour supply) | 3.1 | 2.8 | 2.8 |
| **Prices and costs (% change)** | | | |
| GDP deflator | 3.3 | 2.8 | 2.8 |
| HICP | 2.4 | 2.4 | 2.2 |
| Nominal compensation per employee | 7.0 | 6.9 | 4.6 |
| Labour productivity (real GDP per person employed) | 1.7 | 0.0 | 0.4 |
| Real Unit labour costs | 1.9 | 4.1 | 1.4 |
| **Business cycle** | | | |
| Potential GDP (% change) | 6.7 | 5.1 | 4.9 |
| Output Gap (as a % of potential GDP) | 0.7 | -0.3 | -1.2 |
| **Exogenous assumptions** | | | |
| Weighted WGDP by trading activity (% change) | 0.8 | 0.8 | 1.4 |
| Oil prices (Brent, USD per barrel) | 80.5 | 69.0 | 66.1 |
| EUR/USD exchange rate (annual average) | 1.0360 | 1.1730 | 1.1910 |
| EUR/STG exchange rate (annual average) | 0.8275 | 0.8612 | 0.8662 |

*Note: GDP Data for 2024 are based on statistics published by the National Statistics Office on August 28, 2025 (News Release 155/2025), while figures for 2025 and 2026 represent the macroeconomic forecasts prepared by the Ministry for Finance. The exogenous assumptions are based on the Consensus Forecast of September 2025. The potential output growth and output gap estimates for 2024 are derived from estimates by the Ministry for Finance using the EU-CAM methodology.*

**Includes Non-Profit Institutions Serving Households (NPISH).*

**Source: Ministry for Finance & NSO**

8. **Malta's economy continued to expand at a solid pace in 2024, although signs of moderation emerged in the first half of 2025.** Real GDP growth stood at 6.8% in 2024 to 3.1% in the first half of 2025, reflecting a loss of momentum in both external and domestic demand (for an evaluation of the Council's risk assessment of the macroeconomic projections submitted in the DBP 2025 for 2024, see **Box 1** in this Report). During the first half of the year, real private consumption increased by 2.8%. Government consumption increased by 5.9%, while gross fixed capital formation contracted by 0.1%, led by lower private investment in metal products, machinery and transport equipment. Moreover, imports increased by 5.7%, outpacing exports, which increased by 5.2% in real terms.

9. **The deceleration in economic activity in the first half of the year was primarily driven by a weaker contribution from both external demand and private consumption**. The contribution of net exports to real GDP growth declined markedly, to 0.5 percentage points (pp), compared with a positive contribution of 3.4 pp recorded in the corresponding period of 2024. Similarly, private consumption growth moderated, contributing 1.3 pp to growth, down from 3.5 pp in the first half of 2024.

10. **On the external front, the services sector continued to serve as a key pillar of resilience for the Maltese economy, offsetting the contraction in industrial activity.** Goods exports declined by 11.4% in real terms during the first half of the year, reflecting subdued demand in downstream global industries and heightened trade uncertainty. In contrast, services exports remained resilient, rising by 8.1% in the first half of 2025, following annual growth of 6.4% in the previous year. Growth in services was underpinned by strong performances in transport and business services, as well as a buoyant tourism sector.

11. **Indeed, the tourism sector continued to expand. In 2024, total expenditure by international visitors increased by 23.1% compared to 2023. This positive momentum extended into the early months of 2025, especially during traditionally off-peak months.** Between January and August 2025, the number of tourists visiting Malta reached 2.7 million, representing a 12.0% increase over the same period in 2024. This rise in arrivals was accompanied by an 18.2% increase in total tourism expenditure. Average per capita spending rose from €905.8 to €956.1, reflecting higher expenditure per tourist per night (up from €141.7 to €151.7), while the average length of stay declined slightly from 6.4 to 6.3 nights.

12. **The disinflationary process observed throughout 2024 persisted, although signs of renewed price pressures emerged in some services**

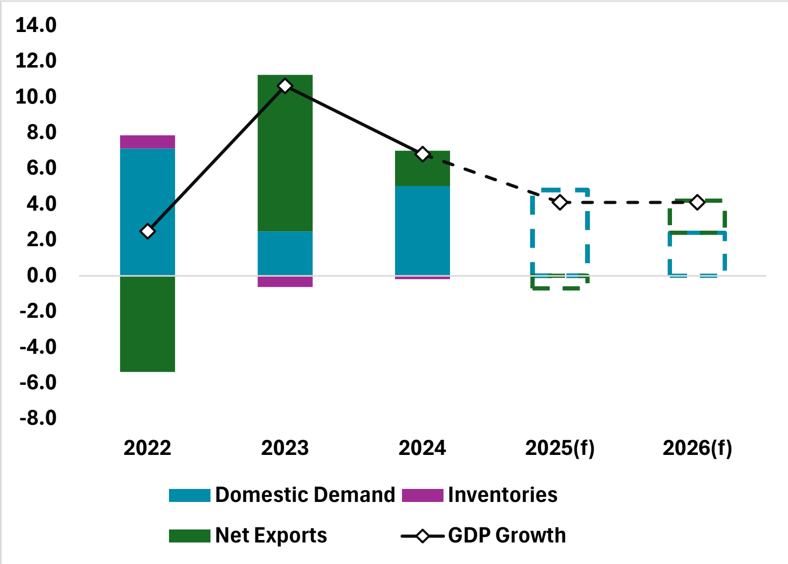
**from the second quarter of 2025.** Headline inflation moderated to 2.4% in 2024, down from 5.6% in 2023, as supply conditions normalised, leading to lower inflation across most non-energy products. Over the same period, nominal compensation per employee increased by 7.0%, significantly outpacing inflation. This resulted in a complete recovery in households' purchasing power after the inflationary shock in the previous two years. However, the pace of disinflation slowed in 2025, as price pressures increased in tourism-related services. Consequently, the average inflation rate during the first nine months of 2025 remained steady at 2.4%. During this period, the largest contribution to inflation came from services, particularly those related to recreation and personal care, followed closely by transport-related services. Processed food constituted the second largest contributor, while non-energy industrial goods also exerted an upward influence on price developments.

## MACROECONOMIC ASSESSMENT

13. **Real GDP growth is projected to moderate to 4.1% in 2025, following a strong expansion of 6.8% in 2024. Domestic demand is expected to remain the main driver of growth, while net exports are anticipated to contribute negatively. In 2026, real GDP is also expected to grow by 4.1%, supported mainly by domestic demand, albeit to a lesser extent than in the previous year, while net exports are projected to recover and contribute positively to growth** (see **Chart 1**). The DBP26 indicates a somewhat stronger economic outlook for 2025 compared to earlier projections. The real GDP growth forecast for 2025 has been revised upwards by 0.1 pp relative to the APR25 projections. Furthermore, reflecting a stronger-than-expected outcome in 2024, the nominal GDP level in 2025 is now projected to be approximately 3.3% higher than estimated in last year's DBP, equivalent to roughly €777 million in additional output.

For 2025, the MFIN expects domestic demand to be primarily led by investment. Gross fixed capital formation is projected to rise by 10.8%, largely reflecting higher public investment in the latter part of the year, as well as extraordinary outlays on transport equipment in the private sector. The second-largest contributor, private consumption, is anticipated to moderate to 3.7%, following a strong 6.2% increase in 2024. Meanwhile, government final consumption expenditure is projected to grow by 6.6%, after a robust 9.2% expansion recorded in the previous year. On the external side, exports of goods and services are projected to expand by 4.7%, largely supported by continued strength in the services sector. Imports are expected to increase by 6.2%, reflecting the elevated import intensity of investment and a stronger euro.

**Chart 1: Real GDP growth and contributions to growth (%, pp)**




*Source: NSO, MFIN*

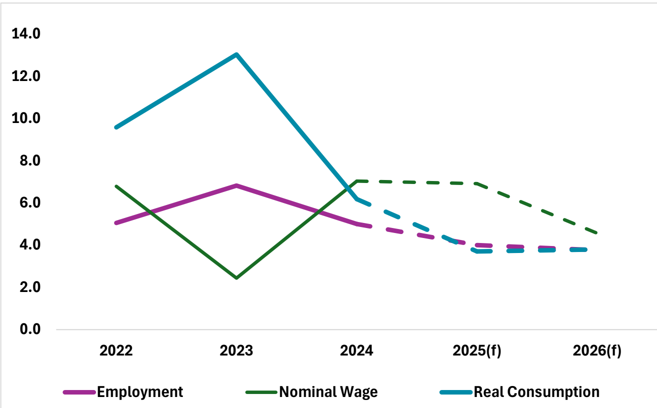
For 2026, real GDP is expected to expand by 4.1%, with domestic demand remaining the primary driver, contributing 2.4 pp to growth. In contrast to 2025, net exports are expected to make a positive contribution, adding 1.8 pp to overall economic growth. Within domestic demand, private consumption expenditure is expected to re-emerge as the main growth component, increasing by 3.8%. This increase is supported by strong labour market fundamentals, with an employment growth of 3.8% and a persistently low unemployment rate. Household purchasing power is also set to strengthen further, as average wages are expected to increase by 4.6% amid easing inflation. Public consumption expenditure is projected to decelerate to 4.6%, following strong growth in the previous two years. By contrast, investment is expected to decline slightly by 0.9%, reflecting a base effect from the significant capital spending expected in the latter part of 2025. Exports are projected to increase by 4.5%, reflecting improved external conditions, while import growth is expected to moderate to 3.5%, down from 6.2% in 2025, in line with the investment profile (for a comparison of the projections by the MFIN with those of the other institutions, refer to **Box 2** in the Report).

14. **Private consumption, a key driver of recent economic expansions, is expected to increase by 3.7% in 2025 and 3.8% in 2026.** This reflects a marked moderation compared with the strong growth observed since the pandemic, during which real consumption rose at an average annual rate of 10.0%. In fact, this moderation started in the second half of 2024 and persisted in the first half of 2025, whereby real consumption increased by

2.8%. The MFIN's projection of 3.7% implies a marked acceleration in private consumption during the latter part of 2025.

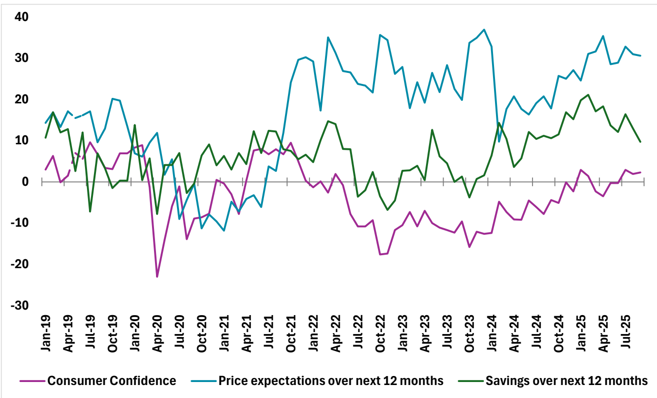
The projected increase in private consumption is expected to be underpinned by a robust labour market and easing price pressures. Real household income is anticipated to increase significantly, driven by stronger wage growth alongside stable inflation (see **Chart 2**). Moreover, improvements in consumer confidence are expected to further bolster private consumption in 2025 (see **Chart 3**). Private consumption in 2026 is also expected to be underpinned by strong employment and wage growth.

**Chart 2: Employment, Wages and Real Consumption (% annual change)**




*Source: NSO, MFIN*

**Chart 3: Consumer Confidence Indicators (balance)**




*Source: NSO, MFIN*

**Risk Assessment**

Signs of moderation in private consumption growth emerged towards the end of 2024, with this moderating trend persisting into early 2025. The slowdown in consumption mainly reflects slower growth in services expenditure, which had been the main driver of household spending in recent years. Although spending on semi-durable and non-durable goods gained momentum, it was insufficient to offset the slower pace of services growth, which account for over 60% of total household consumption.[5] In particular, expenditure in the Restaurants and hotels category, which had increased by 16.6% in 2024, moderated to 12.7% in the first half of 2025, while expenditure on Insurance and financial services contracted significantly in real terms.[6]

The MFIN's projection for private consumption is predicated on a strong acceleration in wage growth during the latter part of 2025, alongside an improvement in consumer sentiment. However, the Council considers that the assumption for compensation of employees is optimistic, with downside risks to both the forecast for wages, and to a lesser extent employment (see paragraph 19). Should labour market conditions evolve less favourably than projected, real disposable income would increase more moderately, thereby constraining the anticipated rebound in household spending.

Moreover, while consumer confidence has improved in recent months, it remains relatively subdued. Consumer sentiment remained in negative territory throughout the second quarter of 2025 and continues to lie below its long-term average. This persistent caution likely reflects the lingering effects of the high inflation experienced between 2022 and 2023, which eroded household purchasing power. Since 2021, real wages have increased by only 2.1%, based on the data for the first half of the year. These legacy effects of past inflation continue to weigh on consumer sentiment, as reflected by higher consumer expectations of price increases and an increase in savings intentions over the first nine months of 2025 compared with the previous year.

[5] Consumption expenditure by durability and purpose is defined by the domestic concept, which includes consumption expenditures of both residents and non-residents in Malta.

[6] The decline in consumption of Insurance and financial services partly reflects the method used to estimate implicit charges for value of services provided by financial intermediaries, known as Financial Intermediation Services Indirectly Measured (FISIM). This measure is based on the difference between the interest rate paid by households and the reference rate. The recent reduction in ECB policy rates narrowed this spread, thereby lowering the implicit value of financial services and reducing consumption in statistical terms. Consequently, this statistical effect is expected to continue dampening consumption throughout the remainder of 2025 and into 2026, although its impact is likely to moderate towards the end of the projection period. More information on FISIM can be obtained here.

Based on the above considerations, the Council opines that private consumption could underperform in 2025, potentially generating negative carry-over effects into 2026.

For 2026, the MFIN projects a slight strengthening in private consumption growth relative to 2025. Although both employment and compensation per employee are expected to moderate, household spending is anticipated to remain supported by further gains in real wages, underpinned by continued easing in inflation. Moreover, announced budgetary measures, including reductions in income tax, are expected to provide an additional boost to disposable income. Taking these factors into consideration, the Council assesses the risks to the private consumption outlook for 2026 to be broadly balanced.

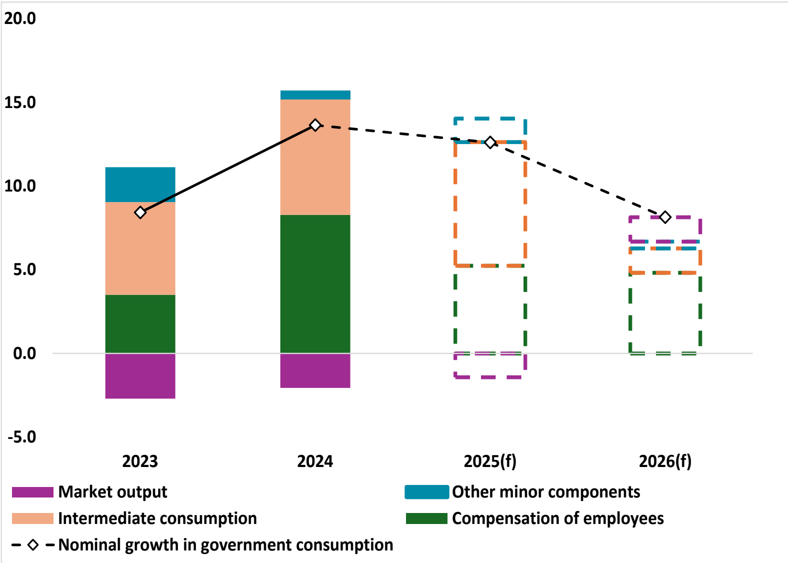
The Council's assessment of the balance of risks for 2026 surrounding private consumption differs from that presented in the endorsement letter submitted to the Minister on 15 October 2025. This revision primarily reflects new information arising from the fiscal measures announced in the Budget, particularly those related to income taxation, which were not available to the Council at the time of the endorsement. The incorporation of these measures into the macroeconomic context has led the Council to reassess its judgement regarding the private consumption outlook.

15. **The strong growth in government consumption expenditure observed in 2024 is projected to persist in 2025, albeit at a more moderate pace. The main driver of this growth is expected to shift from compensation of employees to intermediate consumption. In 2026, growth is anticipated to moderate further, with growth in all components decelerating, particularly intermediate consumption.** In real terms, the MFIN is forecasting government consumption to increase by 6.6% in 2025, compared to 9.2% in 2024. This deceleration largely reflects a higher deflator, which is projected to rise to 5.6% from 4.1% in the previous year. Consequently, in nominal terms, the slowdown is less pronounced, with growth expected to decline from 13.6% in 2024 to 12.6% in 2025. Of this increase, intermediate consumption is estimated to account for 7.4 pp, while compensation of employees is projected to contribute 5.3 pp. The remaining components, including market output, are expected to offset one another, resulting in a negligible net impact on overall consumption growth.[7]

[7] Market output is deducted from the calculation of government consumption expenditure, meaning that an increase results in a negative contribution towards government consumption growth (which is the case for the forecast for 2025), whilst a decrease boosts government consumption (as forecasted for 2026).

For 2026, the MFIN is projecting government consumption to increase by 8.4% in nominal terms or 4.6% in real terms.[8] The composition of growth is expected to shift significantly, driven by a smaller contribution from intermediate consumption. Compared to previous years, the forecasted increase in this component is relatively subdued. Meanwhile, the contributions from market output and other components are anticipated to turn positive, while growth in compensation of employees is expected to remain broadly in line with that observed in 2025 (see **Chart 4**).[9]

**Chart 4: Breakdown of nominal government consumption growth (%, pp)**




*Source: NSO, MFIN*

**Risk Assessment**

The Council assesses that there is a downside risk to the projection for government final consumption expenditure in 2025. This risk primarily relates to forecasts of both compensation of employees and intermediate consumption. Government compensation of employees reached €1,167.8 million during the first half of the year, representing an increase of €152.0 million compared with the same period a year earlier. For the second half of the year, the MFIN is projecting a further increase of €52.9 million, despite the high base effects arising from the education sector collective agreement

[8] The macroeconomic forecast for government expenditure growth shows a nominal increase of 8.4%. On the other hand, in the fiscal forecasts, the government consumption expenditure component computed by aggregating the fiscal components results in an increase of 8.1%. In absolute terms this inconsistency translates to a €13.2 million difference.

[9] A more detailed analysis of fiscal expenditure and revenue components will be included in the fiscal assessment of the DBP26, which will be published in the coming weeks.

adjustments that were paid in the latter half of 2024, including arrears backdated to 2023. The Council, however, holds a divergent view on the expected growth path for compensation of employees in the second half of the year, and considers the MFIN's projections to be optimistic.

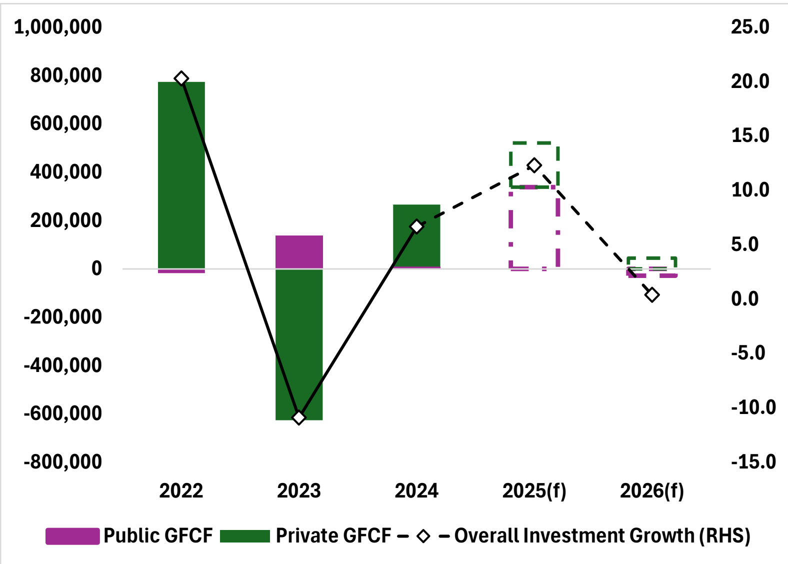
Intermediate consumption is currently expected to grow faster than initially projected in the APR25. The latest forecast of 16.8% nominal growth aligns closely with the 17.5% increase recorded during the first half of the year. This upward revision partly reflects a higher projection for government investment, a portion of which is attributed to intermediate consumption. However, the Council identifies a downside risk in public investment, which would in turn lead to a downside risk in this component.

In addition, the projection for market output is assessed to carry an upside risk, since the strong increase of €98.6 million recorded during the first half of the year substantially exceeds the €55.7 million growth anticipated for the full year. Since market output is deducted from government consumption expenditure, this further reinforces the likelihood of an overall downside risk to government consumption expenditure.

For 2026, the Council assesses that the overall risk to the MFIN projection for government final consumption expenditure is tilted to the upside. This assessment primarily reflects the conservative growth assumption for intermediate consumption, which is projected to increase by only 3.2% in nominal terms, compared to an average annual increase of 11.3% over the past three years. Given the contractual and recurrent nature of many intermediate consumption commitments, where costs tend to rise annually, the forecast may underestimate actual expenditure pressures. The MFIN projection also assumes a decline in market output in 2026, effectively reverting to the level observed in 2024. This forecast contrasts with the historical trend since 2015, during which market output consistently registered growth, except in 2020, when the contraction was attributable to the COVID-19 pandemic. With respect to compensation of employees, the nominal increase projected for 2026 is broadly unchanged from that in 2025. This is notable given that 2025 includes the carryover effects of the collective agreement for the education sector, which boosted expenditure during the first quarters of this year, as well as the full-year implementation of the new public service collective agreement. Consequently, the Council identifies a downside risk to compensation of employees component for 2026. Nevertheless, when considering the combined risks across components, the potential upside risk to total government consumption expenditure, driven primarily by intermediate consumption, is assessed to outweigh the downside risk associated with compensation of employees.

**16. Investment activity is projected to accelerate in 2025, with an expected growth rate of 10.8%, driven by higher public investment as well as private investment, albeit to a lower extent. For 2026, investment levels are anticipated to decline marginally by 0.9%, mainly reflecting a base effect stemming from the substantial expansion recorded in the preceding year.** In 2025, nominal private investment is projected to expand moderately by 5.2%, whilst public investment is expected to increase by 45.7%. The projected developments in public investment reflect anticipated increases in capital expenditure both by the central government and Extra Budgetary Units (EBUs). In contrast, in 2026, public investment growth is forecasted to decline by 2.6%, while private investment is expected to expand marginally by 1.2% (see **Chart 5**). Forecasts for gross fixed capital formation also account for projects funded through the Recovery and Resilience Facility (RRF), projected to contribute 0.1% of GDP in both 2025 and 2026.

**Chart 5: Public and private sector investment in nominal terms (EUR Thousands, %)**




*Source: NSO, MFIN*

Amongst the GDP expenditure components, gross fixed capital formation has displayed the greatest degree of volatility over the past years. This component has experienced substantial fluctuations, characterised by periods of exceptionally strong growth followed by phases of contraction, including in the pre-pandemic period. Such inherent volatility increases the forecasting uncertainty associated with this component.

**Risk Assessment**

The Council observes that while total gross fixed capital formation declined marginally by 0.1% in real terms during the first half of the year, it is expected to rebound sharply by 21.4% in the second half. This recovery is anticipated to be driven primarily by public capital expenditure.

During the first half of 2025, in nominal terms, public investment increased by €14.3 million (4.7%), while private investment rose by €18.5 million (1.0%). To achieve the levels projected by the MFIN for the whole year, public investment would need to increase by €324.2 million (74.0%), and private investment by €164.6 million (9.5%), relative to the corresponding period of the previous year. This implies that approximately 70.7% of the projected annual public investment would need to be realised in the second half of the year.

The Council notes that achieving such a pronounced acceleration in public investment may be challenging, given historical implementation patterns. Consequently, the Council considers that the public investment targets present a downside risk to the forecast. Nonetheless, the potential impact on GDP growth is expected to be partly mitigated by the high import content of investment activity in Malta, which limits the direct domestic value-added effect.

For 2026, the Council identifies upside risks to projected investment growth. The Council considers it likely that government projects not implemented this year will be deferred to the following year, thereby maintaining the planned level of public investment by year-end. Such postponements, however, would imply stronger-than-anticipated investment growth in the subsequent year.

17. **Exports are projected to remain resilient, increasing by 4.7% in 2025 and 4.5% in 2026, primarily underpinned by a strong services sector, as goods exports are set to remain subdued.** In the first half of this year, real exports grew by 5.2%. This performance stands out against the backdrop of sluggish global demand, as Maltese exports expanded at a faster pace than economic activity in Malta's main trading partners, estimated at 1.2%. Looking ahead, the MFIN anticipates that foreign demand will moderate towards the end of 2025, as the temporary boost from trade front-loading dissipates. Consequently, world GDP growth is expected to ease to around 0.8% annually in 2025.

    For 2025, the MFIN has revised its export growth projection downwards by 0.6 pp relative to last year's projections. This revision reflects a downward adjustment in world GDP forecasts, as well as the prevailing uncertainty in the goods market stemming from trade restrictions. At the same time, Malta's reliance on the services sector, which accounts for 85.4% of total real exports, makes the economy relatively less exposed to shifts in global trade.

During the first half of the year, real goods exports declined by 11.4%. The contraction was primarily driven by lower exports of machinery and transport equipment, including semiconductors, which are affected by the downturn in the global automotive sector. Meanwhile, real services exports remained robust, increasing by 8.1%, driven by strong growth in transport and business services, as well as sustained momentum in the tourism sector. The MFIN expects some moderation in services exports over the last months of 2025, consistent with the anticipated easing in foreign demand.

External demand is expected to strengthen towards the end of the forecast horizon, accelerating from 0.8% in 2025, to 1.4% in 2026. The projected stronger growth in Malta's main trading partners reflects the impact of the announced fiscal expansion in Germany, and the resulting positive spillovers across Europe. Consequently, goods exports are projected to recover slightly in 2026, while services exports are set to remain resilient, supported by continued strength in remote gaming and business services.

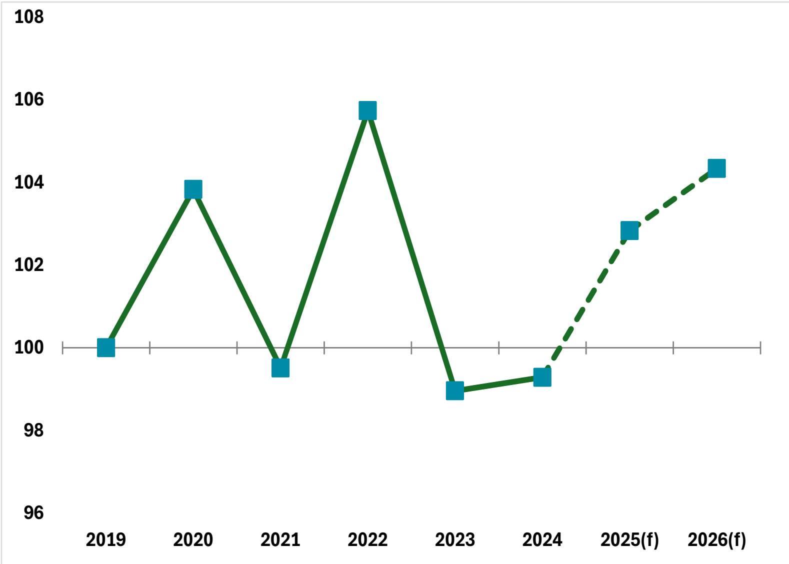
**Risk Assessment**

The projections indicate a moderation in export growth, declining from 5.2% in the first half of the year to 4.3% in the second half. Nonetheless, the Council assesses the risks to export growth projections for 2025 to be marginally downside.

For 2026, risks to the export outlook are broadly balanced. A persistently high level of global uncertainty, coupled with the potential renewal of trade restrictions, could constrain the anticipated recovery in goods exports and, in turn, weigh on services exports through weaker external demand. These downside risks, however, are counterbalanced by the likelihood that tourism exports will exceed current projections, as has been consistently observed since the pandemic. The positive outlook is further supported by the ongoing expansion in air connectivity, which could stimulate additional inflows, particularly during off-peak periods.

The Council notes that real unit labour costs are projected to increase by 4.1% in 2025 and 1.4% in 2026, reflecting strong wage growth amid weak productivity gains. By comparison, the COM forecasts that real unit labour costs in the EU will rise by only 0.4% in 2025 and decline by 0.1% in 2026 (see **Chart 6**). These dynamics could erode part of Malta's competitiveness gains accumulated since the pandemic, thereby limiting the economy's capacity to expand market shares. The assumed appreciation of the euro against both the US dollar and the British pound further amplifies the competitiveness challenge.

**Chart 6: Relative Unit Labour Costs, Malta vs EU (Index, 2019 = 100)**

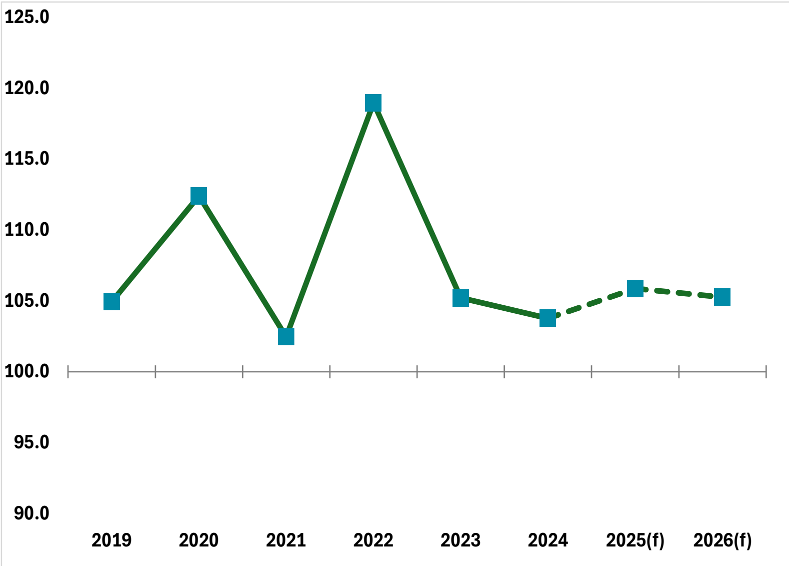



***Source: Eurostat, MFIN, European Commission Spring Forecast***

*Note: The chart shows the index of real unit labour costs in Malta relative to the EU average. An increase in the index indicates a rise in Malta's real unit labour costs compared with the EU, implying a deterioration in cost competitiveness.*

18. **Imports are projected to increase by 6.2% in 2025, followed by a more moderate rise of 3.5% in 2026.** This trajectory broadly reflects the anticipated path of investment activity, which in Malta is generally highly import-intensive. Meanwhile, the assumed appreciation of the euro against both the US dollar and the British pound is expected to provide some support to import growth over the forecast horizon. Indeed, the import-to-GDP ratio is projected to increase in 2025 and remain relatively stable in 2026 (see Chart 7). While imports of certain goods are expected to contract in 2025, services imports are projected to drive most of the overall import growth throughout the forecast horizon.

**Chart 7: Ratio of Real Imports to GDP (%)**




*Source: NSO, MFIN*

**Risk Assessment**

Considering the balance of risks associated with the expenditure components influencing imports, the Council identifies a downside risk to import growth in 2025. The Council is of the view that investment may turn out to be lower than projected by MFIN, which, in turn, would lead to lower imports of capital goods. This may be further exacerbated by subdued imports of industrial goods, given persistently weak manufacturing activity. Furthermore, downside risks to private and public consumption expenditures may also lead to weaker consumer goods imports.

For 2026, the Council identifies an upside risk to investment activity. In addition, the assumed appreciation of the euro is expected to provide further support to imports, particularly amid a recovery in manufacturing activity. The projected robust performance in exports of digital services and remote gaming is also anticipated to stimulate imports of business services, which have been the primary driver of aggregate imports over recent quarters.

Moreover, the Council assesses an upside risk to the intermediate consumption component of government final consumption expenditure, which would, in turn, lead to higher imports than projected by the MFIN. On this basis, the Council concludes that the overall risk to import growth in 2026 is tilted to the upside.

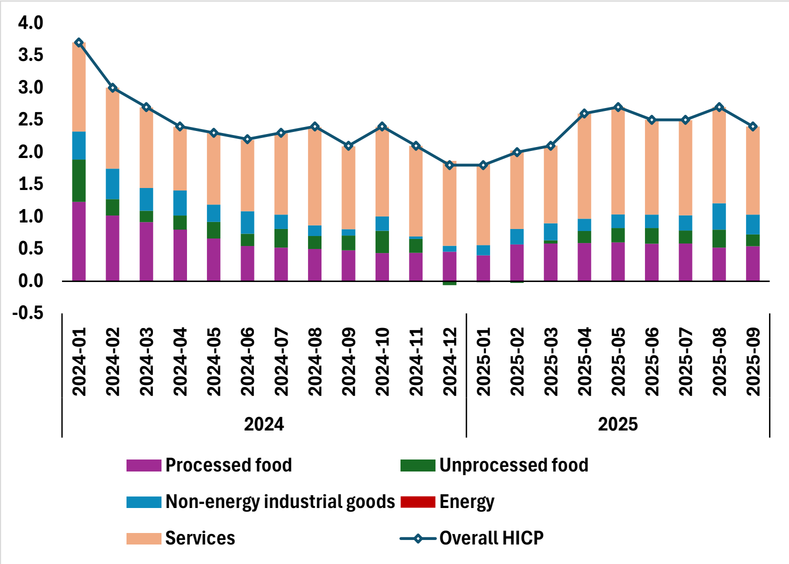
19. **Inflation is projected to remain broadly stable at 2.4% in 2025, before easing to 2.2% in 2026, thereby moving closer to the ECB's price stability target of 2.0%, albeit remaining slightly higher than the EA average.** Within the EA, the COM's Spring Forecast similarly anticipates a moderation in inflation this year. By 2026, inflation across the EA is expected to decline marginally below the 2.0% target.

    At the global level, cost pressures have continued to abate. Freight rates, which had temporarily increased at the beginning of 2025 due to the front-loading of trade flows, have since fallen by more than half. The Global Supply Chain Pressure Index remains close to its long-term average, indicating broadly normalised global supply conditions. Energy commodity prices have continued to stabilise at lower levels, with Brent crude oil trading below USD 70.0 per barrel, reflecting weaker global demand expectations and increased production. Gas prices have also stabilised, albeit remaining approximately twice their pre-pandemic levels. Meanwhile, food prices have exhibited renewed volatility, with the FAO Food Price Index, which tracks a basket of internationally traded food commodities, increasing by an average of 5.9% over the past 12 months, partially attributable to adverse weather events affecting production.

    In Malta, recent data point to a mild uptick in inflationary pressures. Following a rate of 1.8% in December 2024, headline inflation averaged 2.4% over the first nine months of 2025, with temporary peaks of 2.7% recorded in May and August. Inflation dynamics have been predominantly driven by services, where price growth has remained above 3.0% since April 2025, higher than historical standards, though still below the EA average. Price pressures in services are attributable to services related to recreation and personal care, with prices in restaurants and catering services exerting the strongest upward influence. Transport inflation has also made a significant contribution, with inflation averaging 8.0% during the first nine months of 2025, compared to 5.5% in the same period of the previous year. This acceleration primarily reflects an increase of 26.9% in international flight costs, driven by robust demand-side factors, including strong inbound and outbound tourism activity, as well as higher costs incurred by airlines from the supply-side.

    Processed food inflation was the second largest contributor to headline inflation during the first nine months of 2025, averaging 3.3%. This represents a moderation from the 4.5% average recorded in the previous year. Unprocessed food inflation also eased to 3.0% between January and September, down from 5.5% a year earlier, although prices for certain food products have firmed in recent months. Inflation in non-energy industrial goods remained stable at 0.9%, mainly driven by non-durable goods. Energy inflation remained unchanged at 0.0%, reflecting the continued government subsidies that kept energy prices fixed (see **Chart 8**).

**Chart 8: HICP Inflation and its contributors**
**(% annual change, pp)**




*Source: Eurostat, MFAC*

**Risk Assessment**

The Council anticipates that inflation will remain somewhat above historical norms during the final months of 2025, reflecting both underlying domestic cost pressures and the lagged effects of past increases in global commodity prices, which are now feeding into higher retail good prices. Accordingly, the Council expects inflation to remain close to 2.4% over the remainder of the year and therefore assesses the inflation outlook for 2025 as neutral.

Looking ahead to 2026, the Council concurs with the MFIN that inflation is expected to gradually converge towards its long-term average, although certain risks remain. Inflation in air transport is set to remain elevated till the second quarter of the year, before easing in the latter part of the year, consistent with trends in global energy prices and a moderation in tourism activity. Meanwhile, tight labour market conditions, coupled with fiscal measures supporting domestic demand could prolong price pressures in some services. However, these risks are mitigated by the expected disinflation in food and non-energy industrial goods. The COM's Business and Consumer Survey indicates some moderation in the forward-looking selling price expectations of food manufacturers, following a pronounced surge in the first half of the year. With regards to non-energy industrial goods, competitive pressures in the European consumer goods market and a stronger euro are expected to dampen imported inflation. Therefore, overall, the Council views the balance of risks to inflation in 2026 as neutral, with domestic factors expected to sustain moderate price pressures in services.

20. **The labour market is expected to remain tight in the short-term, characterised by historically low unemployment rates, although employment growth is projected to moderate.** In 2024, the Maltese economy added 15,515 jobs (National Accounts definition), equivalent to a 5.0% annual increase, with broad-based sectoral increases. Job creation was particularly strong within the services sector, notably in the wholesale and retail trade sector[10], reflecting robust tourism activity. This sector has been the main driving force of employment since the pandemic, together with the professional and administrative services sector. Driven by higher activity rates and population growth, the labour force continued to expand, but at a slightly slower pace relative to employment. Consequently, the unemployment rate declined from 3.5% in 2023 to 3.1% in 2024.

    The labour market remained robust during the first half of 2025, with employment growth reaching 4.3%, supported by broad-based gains across all the main economic sectors. Over the forecast horizon, employment growth is expected to moderate slightly, with MFIN projecting an annual growth rate of 4.0% in 2025 and 3.8% in 2026. Labour supply conditions are expected to remain favourable to address labour demand. Meanwhile, the unemployment rate is expected to edge down further to 2.8% in both 2025 and 2026.

**Risk Assessment**

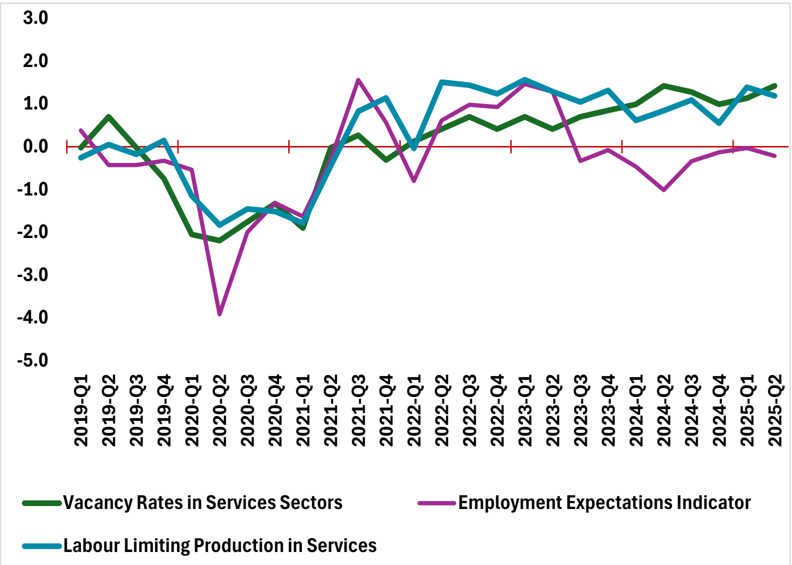
The Council concurs that the labour market is expected to remain tight, underpinned by sustained job creation and unemployment rates that remain well below EU averages and historically low. Recent indicators suggest some moderation in labour demand. It is relevant to note that since the pandemic, the wholesale and retail trade sector has generated approximately 17,000 jobs, accounting for over one-fourth of the total employment growth in the economy. Recent data, however, indicate a stabilisation in vacancy rates within this sector. In particular, vacancies in accommodation and food service activities have declined slightly to 3.3% in the first half of 2025, down from 3.6% a year earlier.

[10] In this assessment report, the 'Wholesale and retail trade sector' includes wholesale and retail trade, transportation, accommodation and food service activities.

The Council also notes that the expansion of the labour supply has slowed, increasing by 3.6% in the first half of 2025, compared with 5.9% a year earlier. The implementation of the Labour Migration Policy, including measures introduced in August and October 2025, aimed at improving workforce retention and regulating inflows of third-country nationals, may further constrain labour supply growth to a greater extent than assumed by the MFIN.

Taking these factors into account, the Council identifies some downside risks to the employment growth projections for both 2025 and 2026. While labour demand is expected to remain strong, and employment is still anticipated to increase over the forecast horizon, hiring is anticipated to cool slightly. This assessment is supported by a normalisation in the COM's Employment Expectations Indicator, which reflects managers' hiring intentions and currently stands below its long-term average over the past decade (see **Chart 9**). Meanwhile, the unemployment rate may turn out slightly higher than the projected 2.8% in 2025, given that it averaged 3.0% during the first nine months of the year.

**Chart 9: Labour Market Indicators**
**(z-score)**




***Source: Eurostat, MFAC***

*Note: Z-score computed from 2015 onwards.*

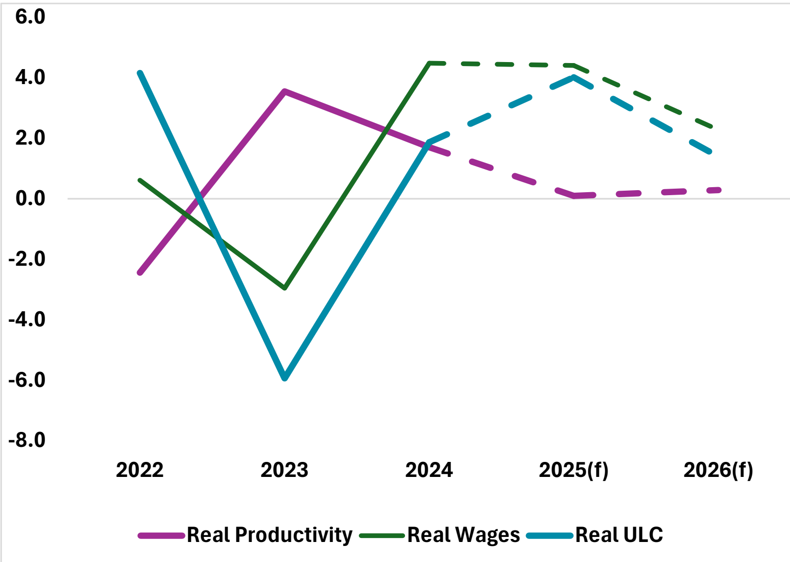
21. **Real labour productivity is projected to stagnate in 2025, before recovering marginally by 0.4% in 2026. Meanwhile, average compensation per employee is projected to increase by 6.9% in 2025 and 4.6% in 2026, resulting in a sustained rise in real unit labour costs over the forecast horizon.** During the first half of 2025, productivity declined by 1.1% as

employment growth (4.3%) outpaced real GDP growth (3.1%). According to the MFIN, this trend is expected to reverse in the second half of 2025, bringing productivity in line with 2024 levels, followed by a modest recovery of 0.4% in 2026.

Compensation per employee increased by 5.2% year-on-year in the first half of 2025, with average wages increasing by 3.9% in the private sector and 8.9% in the public sector, the latter reflecting the implementation of new collective agreements. Despite this divergence, real public sector wages remain below pre-inflation shock levels, whereas private sector wages have increased by 3.9% since 2021 in real terms, reflecting a faster adjustment to past inflation.

Over the forecast horizon, wage growth is expected to pick-up in the second half of 2025, resulting in an annual increase of 6.9%, before moderating to 4.6% in 2026. The combination of weak productivity gains and rising compensation per employee is projected to increase real unit labour costs by 4.1% in 2025 and 1.4% in 2026, continuing the upward trend following an increase of 1.9% in 2024 (see **Chart 10**).

**Chart 10: Competitiveness Indicators**
**(% annual change)**




***Source: NSO, MFIN***

*Note: Real wages are calculated using the HICP deflator, whereas unit labour costs are deflated by the GDP deflator to ensure consistency with national accounts data.*

**Risk Assessment**

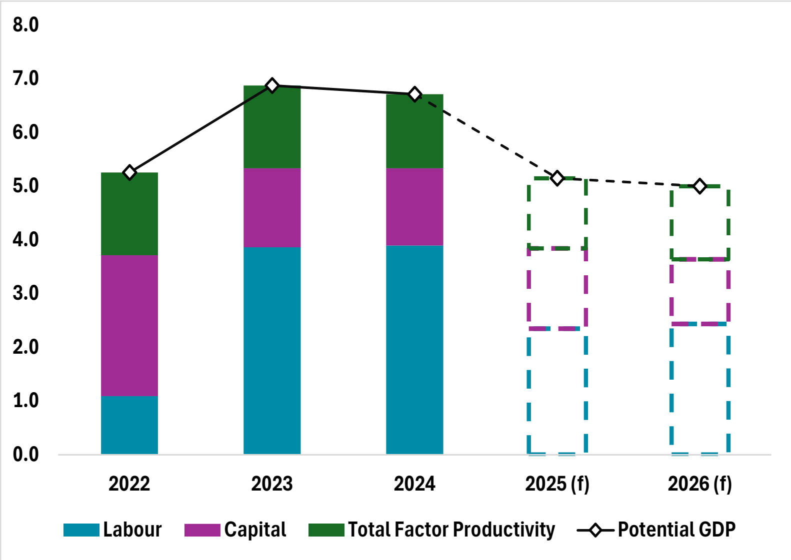
The Council identifies upside risks to labour productivity projections for both 2025 and 2026, as it expects labour inputs to be somewhat lower than envisaged by the MFIN. Given that the downside risk to employment is more pronounced than that for real GDP in 2025, labour productivity per employed person could exceed current projections, with upside risks increasing further in 2026.

Conversely, the Council sees downside risks to wage growth, with compensation per employee anticipated to increase at a slower pace than projected for 2025. The Council expects a gradual slowdown in the second half of the year, rather than the acceleration assumed by the MFIN. This assessment partly reflects base effects from the sharp increase in wages recorded in the fourth quarter of 2024, when public sector wages rose by 28.5% due to one-off payments under the education sectoral agreement, which are not expected to recur in 2025. Accordingly, the Council considers that there is a significant downside risk relative to MFIN assumptions. For 2026, with labour market tightness expected to ease and inflation projected to remain stable, the Council considers the expected wage growth of around 4.6%, close to the long-term average, to be broadly plausible.

The Council notes that although its assessment points to higher productivity and moderate nominal wage growth, leading to downside risks for unit labour costs over the forecast horizon relative to MFIN's projections, the outlook in terms of Malta's ability to continue gaining export market shares is still unfavourable, especially when juxtaposed with similar projections for Malta's main trading partners.

22. **The MFIN is anticipating a widening negative output gap over the forecast horizon, as potential output growth is expected to outpace real GDP growth. Using the EU's commonly agreed methodology, potential output growth was estimated at 6.7% in 2024, and is projected to moderate to 5.1% in 2025 and 4.9% in 2026. This trajectory resulted in a positive output gap of 0.7% in 2024, followed by a marginally negative output gap of 0.3% in 2025, widening further to -1.2% in 2026.** In 2024, the labour component was the primary driver of potential output growth, contributing 3.9 pp, with investment and total factor productivity each contributing an additional 1.4 pp. Looking ahead to 2025 and 2026, labour is expected to remain the main contributor to potential output growth, though to a lesser extent, adding 2.3 pp in 2025 and 2.4 pp in 2026. The contribution of the Total Factor Productivity is projected to remain broadly stable, at 1.3 pp in 2025 and 1.4 pp in 2026 (see **Chart 11**).

**Chart 11: Potential Output and its contributors**
**(% annual change, pp.)**



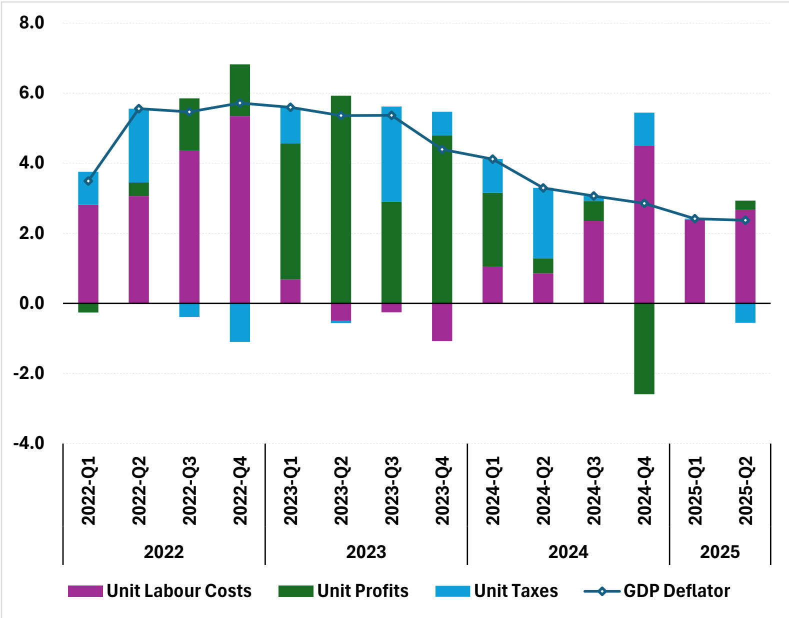

*Source: MFIN*

**Risk Assessment**

The Council favourably notes that, in line with its previous recommendations, recent historical potential output growth estimates have been revised upwards, providing a more coherent representation of the Maltese economy and its underlying capacity. However, the Council observes that the significant widening of the negative output gap projected for 2026 appears inconsistent with expected labour market and inflation developments. In the short term, the labour market is expected to remain tight, while inflation is projected to remain above the 2.0% price stability target.

23. **The GDP deflator continued to stabilise in the first months of 2025, decelerating from 3.3% in 2024 to 2.4% in the first half of the year, the lowest growth since the first half of 2021. From the income side, the GDP deflator was almost entirely driven by higher unit labour costs, which contributed 2.5 pp to the GDP deflator.** After a negative contribution in 2023, unit labour costs have become the main driver of the deflator, reflecting strong wage growth. On the other hand, unit profits contributed modestly to the GDP deflator in the first half of the year, following a temporary surge in profit margins during the post-pandemic recovery, amidst strong demand and supply constraints in some sectors.

**Chart 12: GDP Deflator Decomposition**
**(% annual change, pp.)**




*Source: NSO, MFAC*

From the expenditure side, the private consumption and government consumption deflators contributed most to the GDP deflator during the first half of the year, both accounting for more than one-third of the increase. This trend is expected to continue, with the private consumption deflator increasing by 2.6% in 2025 and 2.5% in 2026, higher than the projection for HICP inflation. The government consumption deflator is expected to increase from 4.1% in 2024, to 5.6% in 2025, before moderating to 3.7% in 2026. Meanwhile, the investment deflator is expected to stabilise at 1.3% throughout the forecast horizon. The export deflator is expected to increase by 2.3% in 2025 and 2.6% in 2026, while the import deflator is anticipated to increase by 2.5% in 2025, before moderating to 2.3% in 2026. Consequently, the terms of trade is set to turn negative in 2025, with an improvement in 2026.

**Risk Assessment**

The Council assesses marginally downside risk to the GDP deflator in both 2025 and 2026. From the income side, slower-than-projected growth in compensation of employees is likely to exert downward pressure on the deflator. A stronger rebound in labour productivity would also have a disinflationary effect.

From the expenditure side, the main downside risk in 2025 emanates from the private consumption deflator. During the first half of the year, it averaged

2.2%, implying that the MFIN's annual projection of 2.6% requires an acceleration to 2.9% in the second half. In the first two quarters, the private consumption deflator picked up from 2.1% in the first quarter to 2.6% in the second quarter. Higher prices in restaurants, accommodation and food products mainly drove this acceleration. However, HICP data for the third quarter shows a decline in inflation rates across these components, suggesting that the private consumption deflator is more likely to stabilise over the second half of the year. Moreover, the projected acceleration in the private consumption deflator appears inconsistent with the anticipated stabilisation in HICP inflation, although it is acknowledged that the two indicators need not necessarily evolve in tandem.

The government deflator is expected to accelerate from 5.2% in the first half of the year to 6.0% in the second half. While price pressures in some government consumption components are expected to persist, the Council notes that the base effect from the one-off payments in public sector wages in 2024 is set to weigh down on implicit prices for government consumption late in 2025. In 2026, the deflator of government consumption is expected to moderate to 3.7%, which is still above the ten-year average of 2.2%. In this context, the Council considers marginal downside risks to the government consumption deflator in 2025 and 2026.

Meanwhile, the deceleration in the investment deflator is considered to be plausible. This is backed by a moderation in producer prices for capital goods, which continued to ease in the third quarter of the year. Moreover, the assumed stronger euro should also lead to downward pressures on imports of capital goods throughout the forecast horizon. Finally, the Council broadly concurs with an improvement in the terms of trade in 2026, which is in line with the exogenous assumption of an appreciation of the exchange rate.

24. **Based on alternative model forecasts and the Pearson skewness indicator[11], the MFIN considers downside risks to the baseline forecasts for real GDP in 2025. Meanwhile, risks are considered balanced for 2026.** The DBP presents a range of potential real GDP growth and fiscal balance outcomes based on alternative scenarios, including both more optimistic and pessimistic developments relative to the baseline. The scenarios considered by the MFIN included: (i) different rates for global economic growth; (ii) different interest rate scenarios; (iii) stronger and weaker domestic household consumption; (iv) a stronger euro against both the US Dollar and British pound; (v) pronounced EA uncertainty; and (vi) lower investment.

[11] The Pearson's Coefficient of Skewness is a measure of asymmetry of a distribution. Negative values for the skewness indicate that the distribution of model outputs is skewed to the left (hence a downside risk), while positive values indicate that the distribution is skewed to the right (upside risk).

Furthermore, the alternative model forecasts for real GDP growth range from 2.9% to 3.7% in 2025 and from 1.3% to 4.6% in 2026, indicating a negative skew for both 2025 and 2026. The historical forecast error variance of GDP for the Autumn forecast round implies a standard deviation of 3.6 for the current-year forecast and 5.4 for the one-year ahead forecast.

25. **Within this context, the Council published a working paper last year evaluating the macroeconomic forecasting performance of the MFIN.** The findings indicated that the MFIN's one-year-ahead forecasts have exhibited a persistent downward bias. This bias may be partially influenced by statistical revisions, which have predominantly been upward in the national accounts data. While the Council acknowledges the importance of maintaining a prudent approach, particularly given that these forecasts form the basis for fiscal projections, it nonetheless encourages the MFIN to take the necessary corrective measures to address these biases and improve the reliability of its projections.

## COUNCIL'S RISK ASSESSMENT

26. **In this Assessment Report, the MFAC has undertaken a comprehensive evaluation of the macroeconomic projections for 2025 and 2026 as submitted by the MFIN in the DBP 2026. These projections have been formulated within an environment of heightened global trade policy uncertainty, marked by geopolitical tensions, including armed conflicts.** In its latest projections, the MFIN has identified these global developments as potential risks to Malta's growth economic outlook in the short-term.

27. **Based on the information available to the MFAC by the cut-off date of this Report, and after considering the inherent risks embedded within the baseline projections, the prevailing uncertainty surrounding the macroeconomic forecasts, and the range of available forecasts for the Maltese economy, the Council considers that the macroeconomic growth forecasts for 2025 and 2026 prepared by the Ministry as part of the DBP 2026 lie within its endorsable range. Nonetheless, the Council considers that the balance of risks for 2025 is tilted to the downside. On the other hand, the Council assesses the risks to GDP growth in 2026 to be broadly neutral. Moreover, for both years, the Council has differing views regarding the composition of the underlying growth drivers.** These autumn projections represent a slight upward revision to the real GDP growth forecast for 2025 relative to the spring projections submitted by the MFIN in the APR25. Malta's growth performance is anticipated to remain among the most robust within the EA. Furthermore, the growth outlook presented by the MFIN

remains broadly aligned with the projections issued by other key institutions engaged in macroeconomic forecasting for Malta.

28. **According to its evaluation, the Council assesses the potential of a downside risk to GDP growth in 2025.** With an annual projected growth of 4.1%, the Ministry expects growth to accelerate in the second half of the year to 5.0%, up from 3.1% in the first half. While recent indicators point to continued economic resilience, the projected rebound may prove difficult to sustain, particularly in private consumption and investment.

    Indeed, private consumption is expected to accelerate from 2.8% in the first half of the year, to 4.6% in the second half. The expansion in private consumption is partly the result of a strong projection for compensation per employees, which is expected to increase by 6.9% in 2025. The Council believes that the projected growth in compensation per employee is on the high side, particularly given the one-off payments in the educational sector during the final months of 2024. On this basis, although economic fundamentals are expected to remain strong over the remaining quarters, household purchasing power may prove weaker than that envisaged in the forecasts, potentially dampening domestic demand and posing some downside risks to the growth forecast for 2025.

    At the same time, unit labour costs are set to rise markedly by 6.9% in nominal and 4.1% in real terms amid stagnant productivity, posing risks to cost competitiveness, particularly in export-oriented sectors. The Council notes that its assessment points to higher productivity and moderate nominal wage growth, leading to downside risks for unit labour costs over the forecast horizon relative to MFIN's projections. Compared with the EU average, Malta's faster increase in unit labour costs could undermine export performance and limit further gains in market share.

    Furthermore, the sharp recovery in investment activity anticipated for the second half of 2025 is heavily dependent on the realisation of public capital expenditure, which may face implementation challenges based on historical patterns. Nonetheless, any shortfall in public investment is likely to have a mitigated impact on overall growth, given the high import content of such projects.

    Finally, government consumption expenditure could also turn out lower than projected by the MFIN, primarily due to potential downside risks in compensation of employees and intermediate consumption, and an upside risk in market output.

The overall impact on GDP growth stemming from the identified downside risks across all demand components is expected to be partly offset by a moderation in import growth projections.

29. **For 2026, the Council identifies upside risks to both public consumption and gross fixed capital formation growth. However, these upside risks are not expected to exert a material impact on real GDP growth, as much of the potential increase is likely to be offset by higher import growth. Consequently, the Council assesses broadly neutral risks for the GDP growth projections submitted by the MFIN in the DBP 2026.** The identified upside risks to gross fixed capital formation primarily reflect an anticipated correction from the lower investment levels in 2025. At the same time, the Council notes that government consumption expenditure could also turn out higher than anticipated by the MFIN, particularly due to higher intermediate consumption expenditure, which is projected to increase by only 3.2% in nominal terms, significantly below the average annual increase of 11.3% recorded over the past three years.

## COUNCIL'S RECOMMENDATIONS

30. **Following this Assessment of the macroeconomic forecasts presented in the DBP 2026, the Council hereby recommends the following:**

**Recommendation No. 1: Changing the Composition of Economic Growth**

Economic growth has remained predominantly driven by domestic demand, notably private and government consumption, since the pandemic, with forecasts indicating that this pattern will persist in the short term. While this has supported near-term resilience, the reliance on domestic demand as growth engine risks leading to pressures on infrastructure and fiscal sustainability, while offering limited productivity gains. The Council would like to again reiterate that the need to transition from a reliance on domestic demand to export-led growth remains a pressing priority. This will require support for innovation and export diversification, while also supporting the upgrading of existing competitive sectors. Greater efforts are required to ensure Malta retains its capacity to expand export market shares across various economic sectors.

**Recommendation No. 2: Addressing Long-term Structural Economic Challenges**

The Council acknowledges positively the initiatives announced to address Malta's structural economic challenges and encourages the swift and coordinated implementation of these measures within a comprehensive strategic framework. Addressing skill mismatches through education and training, fostering innovation and research, and advancing the twin transition towards digitalisation and environmental sustainability remain key to enhancing productivity and long-term competitiveness.

Fiscal policy should continue to act as a strategic enabler, facilitating productive investment and reforms that strengthen the economy's capacity to generate sustained, innovation-driven, and environmentally responsible growth.

## BOX 1: EVALUATION OF THE COUNCIL'S RISK ASSESSMENT OF THE MACROECONOMIC PROJECTIONS SUBMITTED IN THE DBP 2025 FOR 2024

The table below presents an analysis of the Council's risk assessment of the macroeconomic projections submitted by the Ministry for Finance in the Draft Budgetary Plan 2025, as presented in its Assessment Report.

| | Actual 2024 | DBP 2025 Forecast for 2024 | MFAC's Risk Assessment |
|---|---|---|---|
| **Real economic activity (% change)** | | | |
| Private consumption | 6.2 | 4.4 | Upside Risk |
| Public consumption | 9.2 | 8.6 | Downside Risk |
| Investment | 3.6 | 4.5 | Neutral Risk |
| Exports of goods and services | 6.2 | 5.2 | Upside Risk |
| Imports of goods and services | 5.3 | 5.4 | Upside Risk |
| **GDP** | 6.8 | 4.9 | Upside Risk |
| | | | |
| **Labour market** | | | |
| Employment (% change) | 5.0 | 4.6 | Upside Risk |
| Unemployment Rate (% of labour supply) | 3.1 | 3.2 | Neutral Risk |
| | | | |
| **Prices and costs (% change)** | | | |
| HICP | 2.4 | 2.5 | Neutral Risk |
| Labour productivity | 1.7 | 0.3 | Upside Risk |
| Nominal Unit labour costs | 5.2 | 4.0 | Downside Risk |

*Note: The GDP growth rate for 2024 is derived from official statistics published by the National Statistics Office on 28 August 2025 (News Release 155/2025). The Council's risk assessment is visually represented using a colour-coded system: green indicates that the Council's risk appraisal aligned with the actual outturn for 2024, whereas red signifies that the appraisal was inaccurate.*

**Source: Ministry for Finance, MFAC & NSO**

For most variables, the Council's risk assessments of the macroeconomic projections presented by the Ministry for Finance in the DBP 2025 were well substantiated when compared with the latest outturn data for 2024. The Council accurately anticipated the direction of risks, both upside and downside, in the Ministry's forecasts for private final consumption, exports, real GDP growth, inflation, employment growth, unemployment, and labour productivity. The subsequent developments in these indicators evolved broadly in line with the Council's expectations.

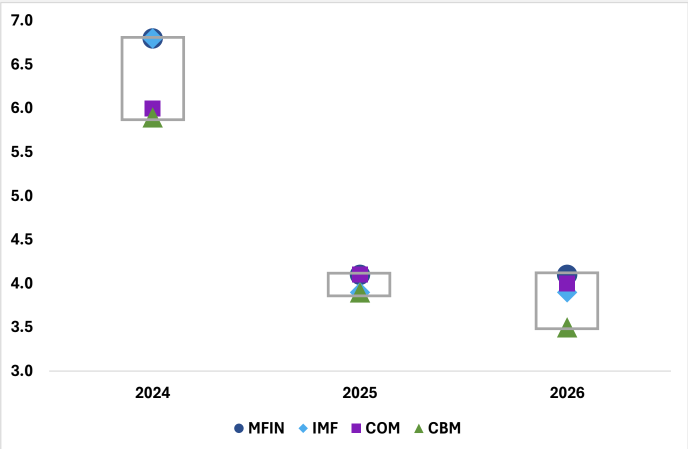
However, the Council's assessments did not fully materialise in the cases of public consumption expenditure, gross fixed capital formation, and imports. Public consumption expenditure exceeded expectations, as the Government's actual outlays surpassed the expenditure levels outlined in the Medium-Term Fiscal Structural Plan submitted in mid-September 2024, one month prior to the submission of the DBP 2025. Conversely, investment outcomes were lower than projected in the DBP 2025, primarily reflecting an overestimation of public gross fixed capital formation in the Government's forecasts. In addition, the collective agreements concluded at the end of last year resulted in higher-than-expected increases in compensation per employee, contributing to a stronger outturn in nominal unit labour costs.

## BOX 2: A COMPARISON OF THE MFIN'S MACROECONOMIC FORECASTS WITH OTHER INSTITUTIONS

As part of its assessment, the MFAC also conducts a comparative evaluation with the macroeconomic forecasts issued by other reputable institutions, including the European Commission (COM), the International Monetary Fund (IMF), and the Central Bank of Malta (CBM). The most pertinent forecasts for this analysis are those published by the COM in May 2025, the CBM in August 2025, and the IMF in October 2025.

For 2025, the COM projects the same real GDP growth rate as the MFIN, at 4.1%, while both the IMF and the CBM forecast slightly lower growth of 3.9%. Looking ahead to 2026, the MFIN projects the most optimistic outlook, projecting growth of 4.1%, followed closely by the COM at 4.0%. The IMF and CBM again foresee more moderate growth, at 3.9% and 3.5%, respectively.

**Real GDP growth forecast by MFIN and other institutions (%)**




*Source: MFIN, COM, IMF & CBM*

For 2025, both the MFIN and the IMF project an inflation rate of 2.4%, slightly above the CBM's forecast of 2.3% and the COM's projection of 2.2%. In 2026, MFIN again presents the highest forecast at 2.2%, followed closely by the COM and CBM at 2.1%, while the IMF anticipates a slightly lower rate of 2.0%. Overall, the dispersion across institutional forecasts remains minimal, with the difference between the highest and lowest projections amounting to only 0.2 pp over both forecast years.

**Inflation growth forecast by MFIN and other institutions (%)**


*Source: MFIN, COM, IMF & CBM*

The IMF, CBM, and COM all project a slower pace of employment growth compared to the MFIN's forecast of 4.0% for 2025. The IMF anticipates a more pronounced deceleration, with employment growth expected to ease to 2.2%, while the COM and CBM foresee more moderate increases of 3.1% and 3.0%, respectively. For 2026, the MFIN's projection continues to stand above those of the other institutions, indicating a comparatively more optimistic labour market outlook.[12]

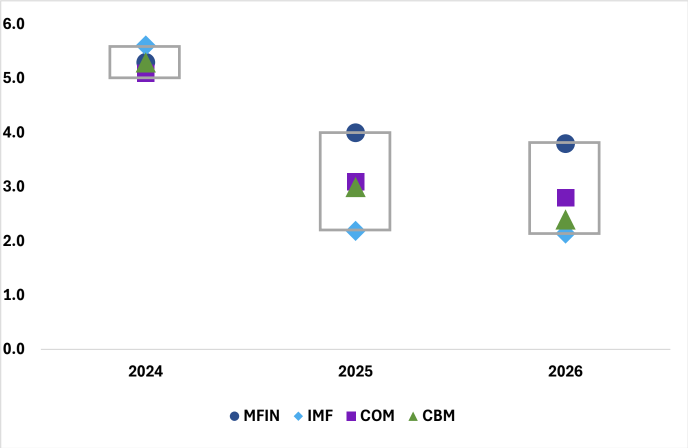
Meanwhile, the MFIN projects an unemployment rate of 2.8% for both 2025 and 2026. The CBM also forecasts 2.8% in 2025 but expects a slight decline to 2.7% in 2026. In contrast, the IMF anticipates a lower rate of 2.5% for both years, while the COM expects a higher rate of 3.1% in 2025 and 2026.

Similar to the MFIN projections, the COM also expects a negative output gap for 2025 and 2026. The COM projects a slightly larger negative gap than the MFIN in 2025, while the MFIN forecasts a more negative gap than the COM in 2026. In contrast, the IMF and CBM project a positive output gap for both years. Specifically, in 2025, the IMF and CBM both expect an output gap of 0.8% of potential GDP, whereas the MFIN and COM forecast -0.3% and -0.5%, respectively. For 2026, the IMF and CBM anticipate a

[12] The MFIN measures employment in terms of full-time equivalents, whereas the CBM reports employment based on headcount figures. The COM adopts the Labour Force Survey definition, while the IMF defines employment as the number of persons aged 15 years and over engaged in paid work or self-employment during a specified reference period.

narrowing of the output gap to 0.5% and 0.2%, respectively, while the MFIN and COM expect a widening to -1.2% and -1.0%, respectively.

**Employment rate forecast by MFIN and other institutions (%)**



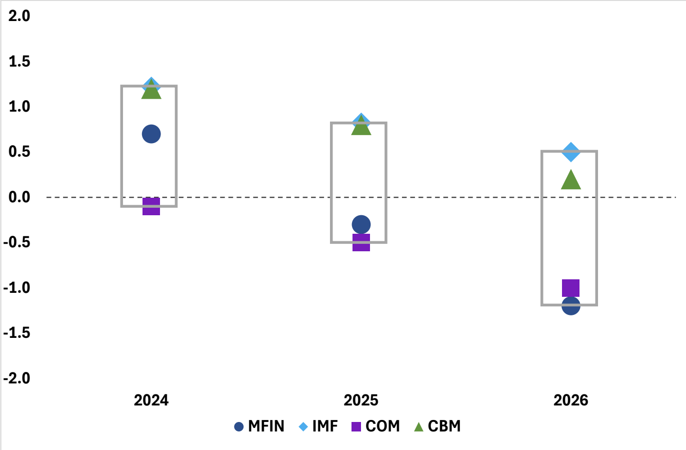

*Source: MFIN, COM, IMF & CBM*

**Unemployment growth forecast by MFIN and other institutions (%)**


*Source: MFIN, COM, IMF & CBM*

Overall, the forecasts provided by the various institutions for real GDP growth, inflation, and unemployment exhibit broadly similar trajectories and are closely aligned. In contrast, projections for the output gap differ markedly across institutions, with some anticipating a positive gap, unlike the negative gap projected by the MFIN. Moreover, the MFIN's forecast for employment growth is considerably higher than that of other institutions, reinforcing the Council's view of downside risks to employment growth for 2025 and 2026. Nonetheless, most of the MFIN's macroeconomic forecasts fall within the range projected by other institutions, further supporting the Council's endorsement.

Output gap forecast by MFIN and other institutions
(%)




*Source: MFIN, COM, IMF & CBM*