Medium-Term Fiscal Strategy for Malta:

Update of Stability Programme
2018 – 2021

Ministry for Finance
June 2018

Fiscal Responsibility Act, 2014

(Cap 534)

Statement of Fiscal Responsibility

by the Prime Minister and Minister for Finance

In accordance with the requirements of Article 15 (8) of the Fiscal Responsibility Act, 2014, we hereby attest to the reliability and completeness of information contained in this Medium-Term Fiscal Strategy and to compliance with the principles of fiscal responsibility.

Joseph Muscat	Edward Scicluna
Prime Minister	Minister for Finance

14 June 2018

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Introduction

This Programme constitutes the ninth update of Malta's Stability Programme, which was submitted in 2008. The first Update was submitted in December 2008. This Programme has been prepared in accordance with Council Regulation (EC) No. 1466/97 as amended by Council Regulation (EC) No. 1055/05 and Council Regulation (EC) No 1467/97 as amended by Council Regulation (EC) No. 1056/05.

This document is also in line with the new requirements of the Stability and Growth Pact, namely the amendments to Council Regulation (EC) No. 1466/97 by Council Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 and the amendments to Council Regulation (EC) No 1467/97 by Council Regulation (EU) No 1177/2011 of 8 November 2011. The programme also takes into account Council Directive 2011/85/EU of 8 November 2011 on the requirements for budgetary frameworks of the Member States.

The Stability Programme now also meets the reporting requirements under Article 15 of the Fiscal Responsibility Act and will thus constitute Malta's Medium-Term Fiscal Plan. It is the intention of the Government to lay this Plan on the table of the House of Representatives together with the fiscal risk assessment to be provided by the Malta Fiscal Advisory Council in line with Article 15(1) of the Fiscal Responsibility Act.

The document is in line with the Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes, endorsed by the ECOFIN Council on 24th January 2012. Nevertheless, it contains additional information as required by the Fiscal Responsibility Act.

The Ministry for Finance compiled this document, with an important contribution from the National Statistics Office as well as from other Ministries and entities across Government. It was prepared on the basis of policies proposed in the 2018 Budget and updated with the latest macroeconomic projections and more recent fiscal data.

The Programme includes seven chapters: Chapter 1 presents Government's Medium Term Fiscal Policy Strategy including the expenditure priorities and the public investment programme in order to fulfil the requirements of Article 15(7) of the Fiscal Responsibility Act; Chapter 2 presents the main macroeconomic projections for the medium-term as well as the potential impact of a selection of structural reform measures; Chapter 3 outlines the overall fiscal policy strategy and updated budgetary plans for the current year, followed by a presentation of the medium-term fiscal projections and debt developments as well as the budgetary implications of major structural reforms featuring in the National Reform Programme; Chapter 4 contains an analysis of forecast uncertainty and the balance of risk surrounding macroeconomic projections and an evaluation of the risks to the achievement of fiscal targets conditional on alternative plausible macroeconomic conditions; Chapter 5 reviews the long-term sustainability of public finances; Chapter 6 analyses the quality of public finances, and finally Chapter 7 reviews the institutional features of public finances.

The macroeconomic forecasts underlying this Programme have been submitted to the Fiscal Advisory Council for its endorsement. The Council concluded that "Based on the information made available to the MFAC and on the assessment undertaken by the MFAC, the projected increases in the headline GDP figure for the forecast period 2018 to 2021 are within the MFAC's endorsable range." The fiscal projections underlying this Programme have also been submitted to the Council for its evaluation and endorsement in line with the requirements of the Fiscal Responsibility Act. This exercise concluded that the planned stream of fiscal surpluses in the region of 1.0 per cent of GDP for the period 2018 to 2020, and slightly higher, at 1.6 per cent of GDP, in 2021, are "within its endorsable range. Likewise, the anticipated steady decline in the debt-to-GDP ratio, from 50.8 per cent in 2017 to 35.6 per cent by 2021, is deemed to be plausible".

1. Medium-Term Fiscal Policy Strategy

The year 2017 saw a further over-achievement of fiscal targets resulting in a surplus of 3.9 per cent of GDP and a structural balance of 3.6 per cent of GDP. This indicates that Malta remains well within its Medium Term Budgetary Objective (MTO) of a balanced budget in structural terms. Whilst the International Investor Programme (IIP) partly contributed to this positive outcome, the budget balance net of IIP would still have reached a surplus of 1.4 per cent of GDP, supported by the strong economic momentum. Also notable is the decline in the debt ratio, which in 2017 has declined to almost 50 per cent of GDP. The projections underlying this Programme suggest that the surplus position can be maintained over the forecast horizon and that the results are sustainable. Whilst macroeconomic risks have shifted primarily on the downside for the immediate short term, mainly as a result of rising uncertainty associated with international trade policy issues, under the worst possible cyclical scenarios contemplated, the budget balance would remain in surplus for the period under review.

In the context of the requirements of the Fiscal Responsibility Act, this Programme is being submitted to the Malta Fiscal Advisory Council for its endorsement thus elevating it to the status of Malta's Medium Term Fiscal Plan. The Medium Term Fiscal Policy Strategy includes the expenditure priorities and the public investment programme highlighted in this chapter in order to fulfil the requirements of Article 15(7) of the Act. In the process of its assessment, the Malta Fiscal Advisory Council will carry out a fiscal risk assessment. Once this is completed, the report of the Malta Fiscal Advisory Council will be considered by Government and will then be submitted to Parliament in conjunction with the Stability Programme.

1.1 Economic Situation and Risks to the Outlook

Economic conditions supporting the fiscal performance in 2017 remained strong, underlined in particular by a strong labour market performance that continued to sustain a relatively strong rate of growth in household consumption in the context of relatively weak external demand conditions resulting from the appreciation of the Euro in 2017. Economic performance manifested itself in a strong growth in sectoral gross value added, marked predominantly by exceptionally strong growth in services, including tourism, remote gaming, financial services and other business services coupled by a strong growth in manufacturing, principally in electronics. Furthermore, the import content of domestic production is also diminishing, consistent with a stronger element of domestic production and value added in gross turnover. As a result, economic growth reached 6.6 per cent in real terms and 9.0 per cent in nominal terms. From the income side, economic growth is supported by strong growth in profits of 10.5 per cent whilst compensation of employees rose by 6.8 per cent.

The composition of growth can be considered as tax rich, considering the solid growth in household consumption and incomes. Nevertheless, lower than anticipated consumer inflation mitigated some of the positive influence of macroeconomic conditions. Indeed, when one considers the actual macroeconomic developments in nominal terms against what was projected last Autumn, nominal growth in household spending was lower than anticipated even though real growth in household spending was practically on target. The effect this could have had on indirect tax revenue was however offset by a stronger than anticipated growth in tourism spending such that the projected indirect tax base was 0.9 percentage points above the Autumn forecasts. From the income side, corporate profits were practically in line with the Autumn projection and the main variance was evident in compensation of employees which turned out 0.7 percentage points above the Autumn targets for 2017.

The strong economic performance being registered by the Maltese economy is the result of Government's prudent approach towards fiscal consolidation combined with an ambitious structural reform agenda. The growth in economic activity is supported by the strengthening of potential growth and a strong investment activity. Potential growth continued to strengthen and the average growth between 2013 and 2017 is estimated at around 5.7 per cent. The improvement in the structural conditions were marked by a substantial rise in the investment-to-GDP ratio which climbed to 23.6 per cent of GDP in 2015 and 22.1 per cent of GDP in 2016, before settling at its long-term average of just above 19 per cent of GDP in 2017. The labour market however remained the strongest element contributing to potential growth, in line with patterns observed since 2013. It is also notable that in 2017, the contribution of total factor productivity strengthened to the extent that it now exceeds capital in its contribution to potential growth.

These developments will continue to support the strong pace of potential growth albeit some moderation is expected over the forecast period. It is also interesting to note that the substantial increase in the investment-to-GDP ratio was achieved at a time when the economy was registering successive surpluses in the current account of the balance of payments. This suggests that the overall savings ratio in the economy was increasingly financing the rise in investment activity. The improvement in the current account is also underlined by the gradual improvement in the fiscal position. In particular, it is worth noting that Government has been registering a primary surplus (budget balance excluding interest payments) and a current surplus (budget balance excluding investment) since 2013 and in 2016 has actually reached a surplus in the overall budget after more than three decades in deficit. This increase in public savings has also contributed to the correction of the twin deficits suggesting that the Maltese economy is not suffering any major imbalances as also confirmed by the European Commission.

Output gap estimates suggest notably positive cyclical conditions particularly in 2014 and 2015, with estimates indicating that output will remain around 1.0 per cent above potential in 2018. Nevertheless, the low inflationary pressures, relatively moderate wage growth and the stabilisation of debt-to-income ratios suggest that this pace of economic activity can be sustained without major imbalances. The macroeconomic forecasts underlying this Programme suggest a moderation in economic activity and a gradual correction in the positive output gap expected over the next three years. This is in part due to the prudent forecasts surrounding this three-year plan, in line with past practices. Nevertheless, Government is of the view that Malta will continue to experience a positive economic situation over the forecast period, and register a growth of 6.1 per cent in 2018. Growth is expected to moderate to 5.3 per cent in 2019 and trend downwards to a growth of 4.6 per cent by 2021.

Like all forecasting exercises, this largely positive macroeconomic outlook is subject to a measure of uncertainty. The baseline scenario underpinning this Programme has been subjected to a series of exogenous shocks producing alternative growth scenarios. Based on these scenarios and an evaluation of past forecast accuracy, the risks surrounding macroeconomic forecasts have been quantified. Based on the established methodology, this risk assessment suggests exposure to both upside and downside risks though the risk profile is balanced on the downside for short term, due primarily to the uncertainty related to US trade policy. The balance of risk turns on the upside at the end of the forecast period. The alternative macroeconomic scenarios have also been used to gauge the fiscal response to the materialisation of such risks. It is encouraging to note that under the worst case macroeconomic scenarios contemplated, the budget balance remains in surplus. In addition, when one takes into account the balance of risk of the macroeconomic forecasts and the fiscal forecast error variances, the probability of an excessive deficit appears to be fairly remote.

1.2 Fiscal Performance and Stance

Over the last five years, Government managed to turn a deficit of 3.5 per cent of GDP in 2012 to a surplus of 1.0 per cent of GDP in 2016. In 2017 the surplus rose further, reaching 3.9 per cent of GDP. The gradual but consistent reduction in the deficit positively impacted the debt ratio which fell below the 60 per cent target to 50.8 per cent of GDP in 2017. The fiscal strategy presented in this Programme will reduce the debt burden even further to 36 per cent of GDP by 2021. Government considers fiscal developments over the last four years as an important achievement, particularly the recovery of the necessary fiscal space to allow fiscal policy to act in a countercyclical manner. The achievement of the MTO is also an important step in the safeguard of long-term sustainability of public finances. The budget surplus also allows more room for manoeuvre to address other structural challenges such as infrastructural bottlenecks and further investments in human capital and technology, thus further strengthening potential growth and supporting the process of convergence to higher living standards. In this context, it is opportune to note that in 2016, GDP per capita in Purchasing Power Standards had already reached 94 per cent of the EU average, up from 84 per cent in 2010. At the same time Government is conscious of persistent challenges in the external environment which support the need for continued prudence in the fiscal targets and the creation of additional buffers.

Whilst recognising the minimum binding constraint of maintaining a fiscal position within the MTO, the medium term fiscal strategy portrayed in this Programme is one that essentially aims to maintain a rising surplus net of IIP and achieve a permanent structural surplus net of IIP. The budget balance is targeted to reach 1.1 per cent of GDP in 2018 and to remain at 0.9 per cent of GDP in both 2019 and 2020 before rising further to 1.6 per cent of GDP in 2021. Such targets are themselves based on prudent fiscal assumptions which create an extra buffer in these projections. The targets presented in this Programme are consistent with the allocation of around 3.0 per cent of GDP towards public investment programmes in 2018 which rises to around 3.4 per cent of GDP by 2021. These investments do not include additional investment devoted to the improvement of human capital to meet the challenges in the education sector, which are generally classified elsewhere in the ESA categorisation.

1.2.1 Government's Expenditure Priorities

Government is committed to implement its work programme on the basis of the Electoral Manifesto. It is also committed to make the best use of EU funds from the 2014-2020 Programming period. The short-term expenditure priorities also include major commitments related to Valletta 2018, European Capital of Culture events.

Whilst consolidating earlier achievements, the 2018 budget focused primarily on addressing infrastructural bottlenecks to growth, particularly in transport, social housing and waste management. In the context of the increasing financial sophistication of the economy, the fight against tax evasion and money laundering is a pertinent priority of this Government. Health, education and social protection continue to be a priority in line with Government's commitment to improve the standard of living of the Maltese population, including the most vulnerable individuals and families whilst at the same time ensuring equality of opportunities for everyone willing to further their education or to contribute directly in the labour market.

Notwithstanding these expenditure priorities, Government is constantly striving to ensure that expenditure leads to high quality outcomes. This year's Programme continues to focus on the quality of public spending. Indeed, ensuring that expenditure growth does not exceed the economy's growth potential remains an intermediate target in this Programme. As outlined in this Programme, gains in public sector productivity can play a role in enhancing the quality of public expenditure. Furthermore, the spending review process has shown that incremental benefits are possible not just in terms of expenditure savings but more importantly may yield public sector outcomes and productivity.

Government remains committed to continue with the pension reform process. In particular, important steps were adopted in the Budget for 2016 through measures intended to strengthen the sustainability of pensions, particularly through the lengthening of the contribution period and the introduction of incentives to defer retirement. Measures were also adopted to strengthen adequacy of contributory pensions, particularly through increases to minimum pensions. It is noteworthy that Government is required by legislation to lay on the Table of the House a report reviewing the state of public pensions together with recommendations with a view of achieving further adequacy, sustainability and social solidarity in such manner that a stable proportion is kept between the contribution periods by not later than end-2020. Furthermore, following the market launch of voluntary third pillar pension products in 2015, Government has announced in the Budget for 2017 the introduction of fiscal incentives for employers that opt to introduce occupational pensions on a voluntary basis.

The conduct of comprehensive reforms in the public health system to ensure the delivery of a cost-effective and efficient service has been high on the political agenda over the past few years. This has been mainly driven by strategic investments to underpin the revision of existing processes, whilst shifting the focus of care away from hospital and towards the primary health care setting. The review of existing processes is also highlighting which areas are best suited for structural expansion in capacity with a view to maximising return on investment. Progress has also been registered with respect to strengthening health promotion and disease prevention. These developments reflect the adoption of a new National Health Systems Strategy covering 2014-2020 focusing on three pillars: Improving Governance; Health Promotion and Disease Prevention; and Strengthening of Primary Care. Government is also actively seeking the involvement of the private sector in the health sector. This should improve efficiency while easing pressures on public finances.

1.2.2 Public Investment Programme

Malta's Partnership Agreement presents the overarching strategy and identifies the priorities in the allocation of EU funds. In this regard, the Partnership Agreement has identified three funding priorities which are considered as the main overarching objectives for the 2014-2020 programming period, namely:

1. Fostering competitiveness through innovation and the creation of a business-friendly environment;
2. Sustaining an environmentally-friendly and resource efficient economy; and
3. Creating opportunities through investment in human capital and improving health and well-being.

The main overarching objectives will be addressed through two Operational Programmes and their respective priority axis. The Priority Axes of the first Operational Programme are the following:

1. Investing in research, technological development and innovation;
2. Consolidating investment within the ICT sector;
3. Enhancing Malta's competitiveness through investment in SMEs;
4. Shifting towards a low-carbon economy;
5. Protecting our environment - investing in natural and cultural assets;
6. Sustainable Urban Development;
7. Shifting towards a more low-carbon transport sector;
8. Investing towards a more socially-inclusive society;
9. Developing our future through education, training and lifelong learning;
10. Investing in a more environmentally-friendly society;
11. Investing in TEN-T infrastructure; and
12. Technical assistance.

The second Operational Programme targets employment, education, social inclusion and health and is aimed at achieving inclusive growth. The priority axes of the second Programme are:

1. Investing in the employability and adaptability of human capital;
2. Towards a more inclusive society;
3. Investing in people through education, training and lifelong learning;
4. Building the institutional administrative capacity; and
5. Technical assistance.

These objectives and priority axis in general also apply to the national funds earmarked for capital investment. In addition to the co-financing part of EU-funded projects, local funds are mostly targeted to road, education and health infrastructure, waste management and environmental management.

1.3 Structural Reforms

The strong economic performance registered in recent years is reflective of the policy reform programme implemented by the Government. Indeed, Government continues to monitor and address the challenges outlined in the Country Report with respect to taxation, quality of public finances and long-term fiscal sustainability, labour market, education and skills and social aspects, the business environment and competitiveness. The 2018 National Reform Programme and this Update of the Stability Programme outline Government's strategy and policy measures intended to address challenges in the structural and fiscal policy domains.

Of particular relevance, also in view of the recent analysis provided by the Country Report, Government is leaving no stone unturned in the strengthening of the fiscal and regulatory infrastructure, including measures combatting money laundering, tax fraud and tax avoidance. The strengthening of the institutional framework is deemed essential in order to safeguard Malta's reputation as a responsible financial centre with adequate safeguards to address potential misuse of Malta's financial system. Measures include the transposition of the fourth Anti-Money Laundering Directive. Government has also engaged an international consultancy firm to carry out a national risk assessment of the financial institutions to combat money laundering and fight tax evasion. A strategic plan has been drawn in order to strengthen these institutions based on this risk-assessment and a National Coordinating Committee has been set up. An independent review of the local anti-money laundering regime, will be carried out by the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) during 2018. In addition, Malta has invited the IMF and the World Bank to conduct a Financial Sector Assessment Programme by the end of 2018 and preparations are underway to initiate this assessment. At the request of the Maltese Government, a Fiscal Transparency Evaluation (FTE) exercise is currently being carried out in conjunction with the IMF's Fiscal Affairs Department.

In addressing its policy objectives, Government is implementing a number of policies aimed at improving the supply-side of the economy while raising the country's potential output. In addition, the Government is attentive at ensuring responsible environmental management and safeguarding social cohesion. As part of its work programme, Government has through the budgetary process stimulated work effort through measures intended to make work pay whilst ensuring that the social security system positively incentivises work effort and discourages dependency. These measures have been complimented by initiatives intended to improve the distribution of income especially the incomes of households defined as being at the risk of poverty and indeed ensuring that economic prosperity reaches all groups in society.

Going forward, the Government is sustaining its investment in enhancing human capital and enhancing the business environment through improved access to finance, whilst maintaining momentum in infrastructural investment in the economy. At the same time, it remains committed towards a prudent fiscal policy oriented towards the long-term sustainability of public finances and reducing further the public debt ratio. Moreover, the Government will seek to harness long-term sustainability risks by sustaining its improvement in the fiscal position as well as through careful reforms to age-sensitive components of public expenditure.

2. Economic Outlook

2.1 Economic Conditions for 2017

In 2017, the Maltese economy recorded a real growth rate of 6.6 per cent, equivalent to 9.0 per cent in nominal terms. This growth figure was 4.2 percentage points higher than the EU average of 2.4 per cent, which means that Malta remained among the top performers in the European economy. Underpinning this positive performance was consistent growth in household consumption, supported by buoyant labour market conditions, subdued inflation and moderate increases in compensation of employees. Whilst export activity moderated in real terms, export prices picked up reflecting stronger external demand conditions particularly in the European economy. Meanwhile, the decline in investment flows, the increasing service orientation of the economy and consequently the trend decline in import content of production led to a negative growth in imports. As a result, net exports contributed to 5.9 percentage points to growth whilst domestic demand contributed only marginally. Furthermore, changes in inventories contributed positively by 0.6 percentage points.

The analysis of the output side confirms that Gross Value Added (GVA) at basic prices increased by 8.8 per cent in 2017. This robust growth is primarily attributed to growth in the services sector that contributed 7.9 percentage points to growth in GVA. The industry sector contributed for the rest of the growth in GVA. The services sector maintained its strong share in GVA at 88.7 per cent, while the industry sector increased its share by 0.1 percentage points from 2016 to reach 10.2 per cent of GVA in 2017. Delving deeper into the individual sectors, the highest growth was recorded in the Professional, Scientific and Technical Activities, Administrative Support Services sector, which grew by 21.7 per cent over the year. The Arts, Entertainment and Recreation sector sustained its strong performance, growing by 9.4 per cent. The Manufacturing Sector recorded a 9.0 per cent increase over the previous year, followed by growth of 8.3 per cent recorded in the Construction sector.

On the income side in 2017, compensation of employees increased by 6.8 per cent in nominal terms to reach €4,574.1 million. Gross operating surplus and mixed income growth remained strong at 10.5 per cent, reaching €5,242.5 million. Meanwhile, subsidies on production and imports experienced a mild increase of 0.7 per cent, while revenue from taxation on production and imports rose by 9.9 per cent or €129.2 million.

During 2017, the global economy continued to expand, albeit at a moderate and uneven pace. According to the IMF's most recent Economic Outlook, the global economy expanded by 3.7 per cent in 2017, 0.5 percentage points higher than the growth estimated in 2016. Global GDP is expected to grow by 3.9 per cent in both 2018 and 2019. These growth figures are higher when compared to the previous year's forecasts, reflecting increased global growth momentum.

Nevertheless, global and EU capital flows continued to be subdued in 2016 and 2017 with the EU expected to continue to register a net outflow of capital after registering a current account surplus last year. This in part reflects the growing disparities in the monetary policy stance of the Euro Area on one hand and the US on the other hand, with the most pronounced movements in net flows being recorded in portfolio investments, which were marked by a decline in non-resident purchase of bonds in the EU. Meanwhile, global FDI flows have largely stabilized in the last two years following the significant increase registered in 2015. Nevertheless, they are not expected to exceed pre-crisis levels over the forecast horizon. Balance of payment flows in Malta continued to be characterized by a growing current account surplus and a net outflow of funds primarily reflecting net acquisitions of portfolio investment assets by domestic residents, in line with trends observed in the EU. However, unlike in the EU, FDI inflows increased more strongly in Malta whilst outflows declined, potentially reflecting the strong and more established pace of economic expansion in Malta.

Downside risks have increased in a synchronized fashion. As growth in the Euro Area continues to pick up, the eventual normalization of monetary policy may shock financial markets and affect investment decisions. Eurozone activity may also be hampered by further appreciation of the Euro vis-à-vis main currencies. Moreover, the risks of a global trade war will undoubtedly act as a drag on the positive global growth momentum. Also, according to the European Commission (EC), the overheating of major economies like the US and China set forth a great global concern. In sum, despite the optimistic global economic outlook, the actual outcome in the short and medium term remains surrounded by uncertainty which may negatively impact consumer confidence and investment decisions.

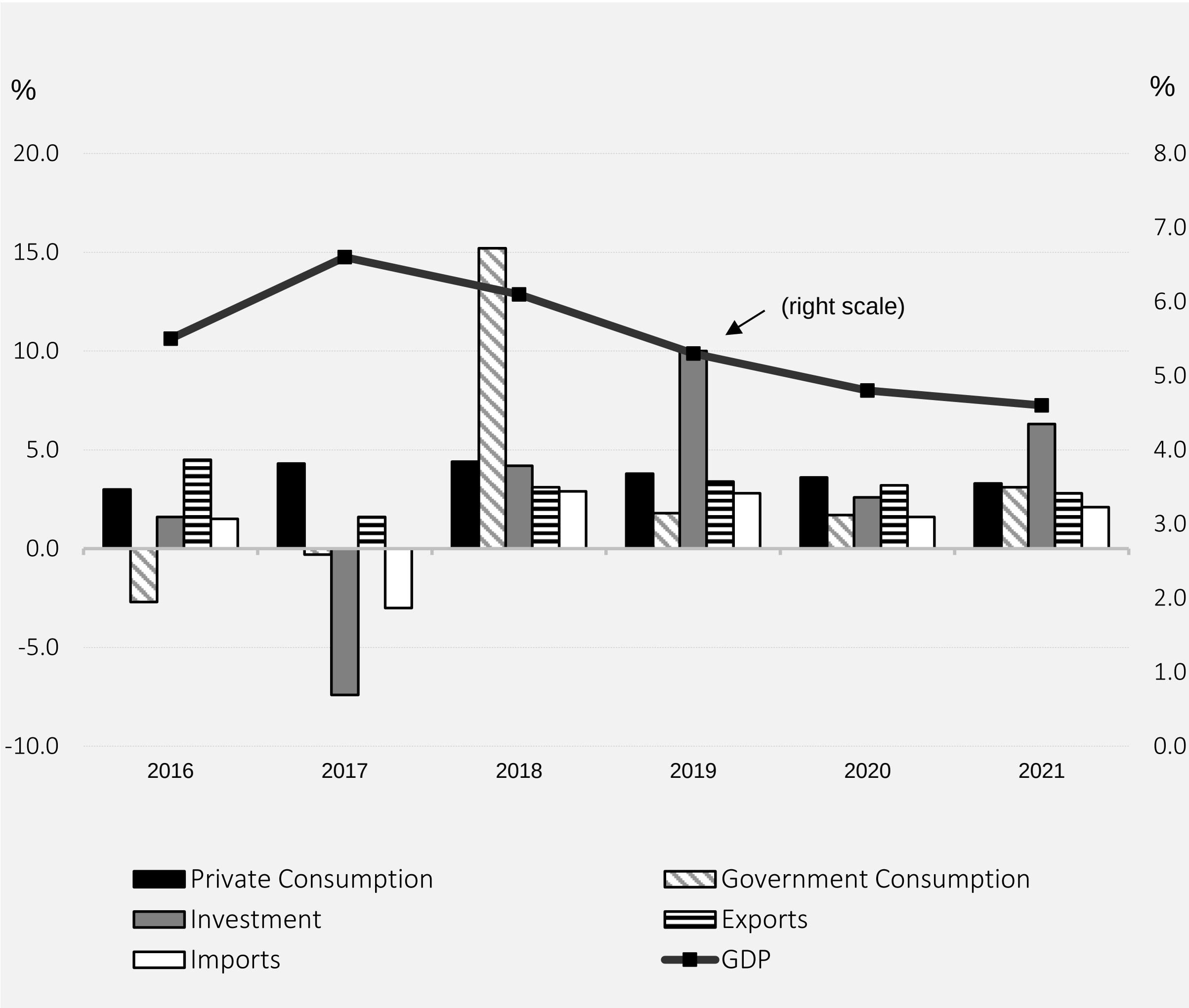
2.2 The Medium-Term Scenario

Over the forecast horizon, the Maltese economy is expected to continue growing at a strong pace, though at a slower rate than that recorded in 2017, with real GDP growth forecasted at 6.1 per cent and 5.3 per cent for 2018 and 2019, respectively. Economic growth in 2018 is expected be mainly driven by domestic demand, which is projected to contribute 5.4 percentage points to growth, underpinned by robust growth in private and public consumption, as well as investment. At the same time, external developments will also contribute 0.8 percentage points to growth. In 2019, a pick-up in investment will underpin domestic demand and drive economic growth by 4.2 percentage points, while the contribution of net exports will remain modest at 1.1 percentage points. In 2020 and 2021, economic growth is foreseen to be more balanced and reach 4.8 per cent and 4.6 per cent, respectively.

The contribution of domestic demand is projected to be more contained over the outer years, at an average of 2.9 percentage points. This reflects a gradual deceleration in private consumption following a pick-up in inflation and a moderation of employment growth, as well as lower investment growth attributed to a base effect from 2019. Over the outer years, net exports are expected to contribute by an average of 1.8 percentage points to economic growth.

Chart 2.1 illustrates the projected growth rate of GDP, together with a detailed breakdown of the various expenditure aggregates. Table 2.1 presents the main macroeconomic indicators for the years 2016-2021. The figures for 2016 and 2017 have been published by the NSO, whilst figures for 2018 onwards are forecasts. The macroeconomic forecasts take into account the latest available data and are being provided in Table 1a, 1b, 1c and 1d of the Statistical Appendix.

Chart 2.1: ***GDP Growth Rate***



Main Macroeconomic Indicators

Table 2.1

	2016	2017	2018f	2019f	2020f	2021f
GDP growth at current market prices (%)	7.1	9.0	8.3	7.5	6.7	6.6
GDP growth at Chain Linked Volumes by period (Reference year 2010) (%)[(1)]	5.5	6.6	6.1	5.3	4.8	4.6
Expenditure Components of GDP at Current Market Prices by period (%)						
Private final consumption expenditure[(2)]	3.4	4.5	6.1	5.6	5.4	5.3
General government final consumption expenditure	-1.1	1.5	17.4	4.3	3.5	5.1
: net of Individual Investor Programme (IIP) proceeds	6.7	7.5	5.5	3.7	3.9	4.8
Gross fixed capital formation	3.0	-5.2	6.4	12.4	4.7	8.3
Exports of goods and services	5.8	5.2	5.3	5.2	4.9	4.6
: net of Individual Investor Programme (IIP) proceeds	4.8	4.4	6.7	5.2	4.8	4.6
Imports of goods and services	2.2	-0.1	5.0	4.4	3.2	3.7
Expenditure Components of GDP at Chain Linked Volumes by period (Reference year 2010) (%)						
Private final consumption expenditure[(2)]	3.0	4.3	4.4	3.8	3.6	3.3
General government final consumption expenditure	-2.7	-0.3	15.2	1.8	1.7	3.1
Gross fixed capital formation	1.6	-7.4	4.2	10.0	2.6	6.3
Exports of goods and services	4.5	1.6	3.1	3.4	3.2	2.8
Imports of goods and services	1.5	-3.0	2.9	2.8	1.6	2.1
Inflation rate (%)	0.9	1.3	1.6	1.8	1.9	2.0
Employment growth (National Accounts Definition) (%)	4.0	5.4	3.8	3.5	3.2	3.1
Unemployment rate (Harmonised definition, Eurostat) (%)	4.7	4.0	3.8	3.9	4.0	4.0
Compensation per employee (% change)	2.9	1.3	3.2	3.2	3.1	3.0
Labour productivity (% change)	1.4	1.1	2.1	1.7	1.6	1.4
Nominal Unit Labour Cost (% change)	1.5	0.2	1.2	1.5	1.5	1.6
Real Unit Labour Costs (% change)	0.6	-1.1	-0.4	-0.3	-0.4	-0.4

[(1)] Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. This non-additivity, similar to that in other countries' national accounts, is due to mathematical reasons and reflects the fact that chain-linked volumes are calculated by separately extrapolating both totals and their sub-components.

[(2)]Includes NPISH final consumption expenditure.

2.2.1 Assumptions for Projections

The macroeconomic forecasts presented in this Stability Programme are based on the following assumptions:

- Growth of Malta's main trading partners is expected to increase by 2.1 per cent in 2018 and then moderate gradually over the forecast horizon to 1.8 per cent in 2019, 1.5 per cent in 2020 and 1.4 per cent in 2021.
- World prices are projected to increase by 2.1 per cent in 2018 and 1.7 per cent in 2019, before growing by an average of 1.7 per cent over the outer years.
- Oil prices are assumed to increase to $64.30 per barrel in 2018, then decline marginally to $62.80 and stabilise at this level until 2021.
- The Dollar/Euro exchange rate is expected to appreciate from a yearly average of 1.1476 Dollars per Euro in 2017 to 1.2260 Dollars per Euro in 2018 and 1.2320 Dollars per Euro in 2019, before stabilising at 1.2380 Dollars per Euro in the outer years.
- The Sterling/Euro exchange rate is expected to depreciate from a yearly average of 0.8760 Pounds per Euro in 2017 to 0.8466 Pounds per Euro in 2018. In 2019, a slight appreciation over the previous year to 0.8473 Pounds per Euro is projected, after which the Euro will further depreciate to 0.8375 Pounds per Euro in 2020 and 2021.
- Following the potential normalisation of the monetary strategy the European Central Bank (ECB) short term interest rates are projected to rise by 2.0 basis points in the fourth quarter of 2018 up to mid-2019, and eventually rise further by 1.5 basis points for the remaining forecast period. Long run interest rates are assumed to remain stable during the forecast period at 1.2 per cent.
- Changes in inventory are assumed not to contribute to GDP growth.

These assumptions are outlined in Table 8 of the Statistical Appendix.

2.2.2 Risks to Outlook

The medium-term outlook for the global economy is one of steady growth. Nevertheless, there are a number of factors that could boost or restrain growth prospects. These risk factors will be explored in more detail in Chapter 4. Nevertheless, it is worth highlighting that the balance of risks shows downside risks for 2018, 2019 and 2020 and upside risks for 2021.

2.2.3 Private Final Consumption Expenditure

After registering robust growth in 2017, private consumption is expected to remain strong and contribute significantly to economic growth over the forecast horizon, on the back of buoyant labour market developments and coupled with moderate appreciation in wages. Indeed, private consumption is projected to grow by 4.4 per cent in 2018 and at a slower pace of 3.8 per cent in 2019. Over the outer years, private consumption is expected to grow by 3.6 per cent in 2020 and 3.3 per cent in 2021. The historically declining trend of real private consumption expenditure as a percentage of GDP is anticipated to continue over the forecast horizon, reaching 45.8 per cent by 2021 from the 48.4 per cent recorded in 2017.

2.2.4 General Government Final Consumption Expenditure

Following a decline of 0.3 per cent in 2017, public consumption is foreseen to increase by 15.2 per cent in 2018 and 1.8 by per cent in 2019 with the former rate reflecting a relative slowdown and a base effect in receipts from the Individual Investor Programme (IIP). Over 2020 and 2021, public consumption is projected to grow by an average of 2.4 per cent. This implies that the share of public consumption in real GDP over the forecast horizon will average at 16.3 per cent.

Over the forecast horizon, nominal government consumption net of IIP is expected to grow by 5.5 per cent in 2018, and 3.7 per cent in 2019, before increasing to 3.9 per cent and 4.8 per cent in 2020 and 2021, respectively.

2.2.5 Gross Fixed Capital Formation

Following the considerable spike in gross fixed capital formation of 58.2 per cent in 2015 and further investment growth of 1.6 per cent in 2016, GFCF decreased by 7.4 per cent in 2017. The inherently volatile nature of gross fixed capital formation makes it relatively challenging to forecast. Hence, it is worth noting that when forecasting investment, economists within the Ministry for Finance take a relatively prudent approach, factoring in only those projects which have a strong political commitment or a high probability of realization, while assuming a relatively high import content. In 2018, gross fixed capital formation is projected to increase by 4.2 per cent and will pick up strongly in 2019, as several projects in the health, technology and telecommunications sectors are foreseen to commence. In fact, investment in 2019 is expected to increase by 10.0 per cent.

In the medium term, investment is foreseen to retain its strength and grow by 2.6 per cent and 6.3 per cent in 2020 and 2021, respectively, mainly driven by government investment, the increased absorption of EU funds from the 2014-2020 program, strong private investment and positive economic sentiment. Following the high investment-to-GDP ratio attained in 2015 and 2016, the ratio is expected to remain above the pre-crisis average of 19.6 per cent. Over the forecast period, the investment-to-GDP ratio is expected to exhibit an upward trend and average at 20.3 per cent of GDP.

2.2.6 External Balance of Goods and Services

In 2016 and 2017, net exports were the dominant driver of GDP growth, contributing 4.3 percentage points and 5.9 percentage points, respectively. Delving deeper into the net exports figure over recent years, one may observe a general increase in the external balance supported by marked increases in services exports and a decline in goods imports.

The growth in Malta's main trading partners combined with increased positive economic sentiment and improved competitiveness of Malta's services exports are projected to result in an increase in exports of 3.1 per cent in 2018. This growth figure is further supported by the projected IIP proceeds which are expected to accumulate in 2018. That said, nominal exports net of IIP are expected to increase by 6.7 per cent for the year. In 2019 and 2020, real exports are then projected to grow by 3.2 per cent, before decelerating to 2.8 per cent in 2021, following the gradual moderation of world GDP growth.

Following a drop of 3.0 per cent in 2017, imports are projected to increase by 2.9 per cent in 2018 and grow further by 2.8 per cent in 2019. In 2020, imports are forecasted to grow more moderately at 1.6 per cent before picking up once again in 2021, where they are expected to grow by 2.1 per cent. It is worth mentioning that investment activity in Malta tends to be highly import-intensive, and thus, year-on-year movements in investment are offset by imports of capital goods thus minimizing the impact of volatile investment flows on GDP in the short term. Furthermore, over recent years the import intensity of exports has been showing signs of a steady decline consistent with the strong increase in gross value added in the services sector. The external balance as a percentage of GDP is expected to increase from 17.2 per cent in 2017 to an average of 18.2 per cent over the forecast horizon.

2.2.7 Productivity and Employment Growth

Employment fared well in 2017, registering 5.4 per cent growth according to the National Accounts definition. This reflected strong labour demand conditions and the strong pace of economic activity, supported by a considerable increase in employment of migrants, and improved business prospects in Malta. Employment growth was further supported by several structural reforms that the Government has initiated, including free child care services, the opening of schools earlier and providing after school child care services, the maternity leave reform, promotion of flexible working arrangements, in-work benefits and the tapering of benefits, lower taxes on labour and tax incentives.

Employment growth is expected to remain strong, while moderating somewhat in the outer years of the forecast horizon to edge closer to the long run average. Employment growth is expected to grow by 3.8 per cent in 2018 and 3.5 per cent in 2019. In 2020 and 2021, employment growth is forecasted to increase by 3.2 per cent and 3.1 per cent, respectively. Such growth is expected to be mainly supported by the increasing female participation rate as well as the inflow of foreign workers.

In reflection of the above, the unemployment rate is projected to decrease to a historical low of 3.8 per cent in 2018. The unemployment rate is projected to increase marginally to 3.9 per cent in 2019 and 4.0 per cent in the outer years.

Further tightening of the labour market has put upward pressures on wages, resulting in an increase in income per head of 1.3 per cent in 2017. Indeed, compensation of employees increased by 6.8 per cent in 2017 and it is anticipated that the growth momentum will be maintained in 2018, where compensation of employees is forecasted to increase by 7.1 per cent. The growth rate is expected to slow slightly in 2019 to 6.8 per cent. In 2019 and 2020, compensation of employees is expected to increase at marginally slower pace of 6.3 per cent and 6.2 per cent, respectively. Concomitantly, over the forecast period, growth in compensation per employee is projected to grow by 3.2 per cent in 2018 and 2019, before decelerating slightly to 3.0 per cent by 2021. This scenario is consistent with the further tightening expected in the labour market. Real labour productivity in 2017 increased by 1.1 per cent. This growth momentum is expected to be maintained in 2018, where labour productivity is expected to grow by 2.1 per cent. Over the medium-term, real labour productivity is expected to retain a positive but more moderate trajectory in line with the moderation of economic activity. Nominal unit labour costs increased marginally by 0.2 per cent in 2017 and are projected to gradually increase over the forecast horizon. On the same lines, real unit labour costs are projected to decline by an average of 0.4 per cent per annum over the forecast horizon as the GDP deflator exceeds the rise in nominal unit labour costs.

2.2.8 Inflation

In 2017, the inflation rate (which is measured as the twelve-month moving average of the Harmonized Index for Consumer Prices (HICP)) increased by 1.3 per cent. This was mainly driven by increases in the price of foods (both processed and unprocessed) and moderate growth in services prices. Energy prices also reported increases after three successive years of negative growth. The inflation rate is expected to increase to 1.6 per cent and 1.8 per cent in 2018 and 2019, respectively. While the effect of rising oil prices will contribute to higher inflation in 2018, inflation is expected to be driven mainly by services prices as well as processed and unprocessed food prices. Inflation is projected to increase by 1.9 in 2020, before reaching 2.0 per cent in 2021.

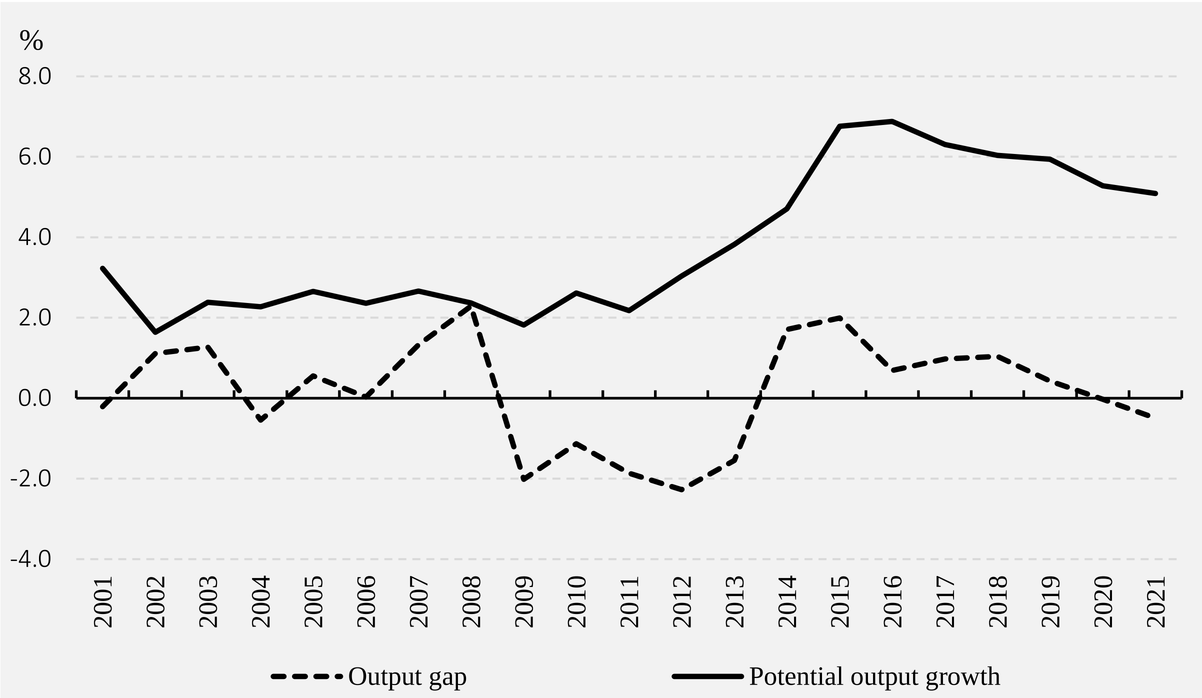
2.2.9 Comparison with the Commission's Winter Forecast

The winter forecasts published by the EC project a growth rate for Malta of 5.6 per cent and 4.5 per cent in 2018 and 2019, respectively. For 2018, this is 0.5 percentage points below this forecast's expectations, while for 2019, this is 0.8 percentage points lower. Both the EC's forecast and the MFIN's forecast agree that domestic demand will be the key driver of Malta's growth over both 2018 and 2019. In terms of components, a similar outlook to the MFIN's forecast is foreseen by the EC for private consumption and investment, while in 2019, the contribution of net exports is projected to be modest due to the increase in imports following the pick-up in investment growth. It is to be noted that the EC's Winter Forecast does not use the latest statistical data and that EC forecasts are currently in the process of being revised.

2.3 Potential Output and Output Gap

The estimation of potential output and the output gap within this Update of the Stability Programme is based on the commonly-agreed Production Function method. The main differences between the EC's and MFIN's estimation pertain to differences in the macroeconomic forecasts. Developments in the potential output and output gap are presented in Chart 2.2.

Chart 2.2: ***Malta's Potential Output Growth and Output Gap Estimates***



Between 2002 and 2009, potential output growth averaged 2.4 per cent, rising to 4.3 per cent in the following seven-year period. In 2017, the rate of growth of potential output stood at 6.3 per cent and is expected to average around the 5.7 per cent level over the forecast period. The labour market contribution is expected to be the main contributor to potential GDP growth reflecting a higher participation rate and the growth in migrant labour supply. Concomitantly, growth is underpinned by capital accumulation as a result of higher investment and also from Total Factor Productivity. Potential growth is expected to stand at 5.1 per cent in 2021.

The output gap is indicative of the cyclical developments prevailing in the Maltese economy. With the exception of the year 2004, the period 2002-2008 has been a period where the Maltese economy operated above its potential level. The output gap turned negative between 2009 and 2013 following the international recession and the subsequent contraction of the domestic economy in 2009. The output gap turned positive as from 2014 and was estimated at 1.0 per cent in 2017. The output gap is expected to remain positive over the forecast horizon, closing down in 2020 and turning slightly negative in 2021.

3. Fiscal Outlook and the Medium-Term Fiscal Strategy

During the last five years, the Government managed to successfully consolidate public finances, turning a deficit of 3.5 per cent of GDP in 2012 to a surplus of 3.9 per cent of GDP in 2017. The gradual but consistent improvement in the budget balance positively impacted the Government debt ratio which fell below the 60.0 per cent target to 50.8 per cent of GDP in 2017. These developments were primarily supported by a strong and sustainable rate of economic growth and growing primary surpluses.

Over the coming years, Government shall continue to contain current expenditure, both to build fiscal buffers to absorb any unexpected shocks, as well as to address long-term fiscal sustainability challenges posed by an ageing population.

As explained in further detail in Chapter 6, given the positive budgetary developments, the quality and the efficacy of the public finances have become an even greater priority. Whilst gains in public sector productivity can play a major role in enhancing the quality of public expenditure, the spending review process has shown that incremental benefits are possible not just in terms of expenditure savings but more importantly in producing better public sector outcomes.

As documented in Malta's 2018 National Reform Programme, the Government will continue to address structural challenges including infrastructural bottlenecks and further investments in human capital and technology, thus further strengthening potential growth and supporting the process of convergence to higher living standards. The Budget for 2018 builds on the achievements of the previous four Budgets, while also outlining new initiatives on infrastructure and other social investments. Over the medium-term, the level of investment in Malta's infrastructure will continue to increase to reshape and redefine road networks, and reduce the infrastructural bottlenecks to further economic growth. Public investment initiatives are also planned in health care, which will provide new health services for both Malta and Gozo, while investment in waste management, in water storage and in energy, will create a more effective use of these essential resources. Lastly, the Maltese Government is committed to higher investment in social housing and creating pathways towards affordable housing.

Over the forecast period, the rate of growth of potential output has been revised upwards. The output gap is expected to be more positive during the period 2018 to 2020 though closing gradually by 2020 and then to turn slightly negative in 2021, in reflection of prudent growth estimates rather than an indication of negative economic conditions. In the context of buoyant economic growth and a starting position where the Medium-Term Objective (MTO) was over-achieved already in 2016 (a target originally meant to be achieved in 2019), the fiscal situation transcends the normal fiscal rules of the

Stability and Growth Pact (SGP) and the Fiscal Responsibility Act (FRA). Nevertheless, over the medium-term, the Maltese Government is committed to ensure compliance with the MTO, net of the International Investment Programme (IIP) receipts and expenditure. In addition, ensuring that expenditure growth does not exceed the economy's growth potential remains an intermediate target in this Programme.

Further improvements in the underlying debt dynamics are expected to be attained through an improvement in the primary surplus, positive growth prospects, sustained investor confidence, and an efficient and effective debt management system. In this respect, the debt-to-GDP ratio is expected to remain below the 60 per cent threshold, and decline further, until the end of the forecast horizon.

In line with the practice of the previous three Updates of the Stability Programme, the Government's medium-term budget framework as outlined in this Programme constitutes Malta's national medium-term fiscal plan as required by Article 4(1) of the European Union (EU) Regulation No 473/2013 on common provision for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the Euro Area.

3.1 Fiscal Developments in 2017

In 2017, the general Government improved its surplus by another 2.9 percentage points over 2016 and recorded a surplus of 3.9 per cent of GDP. This surpassed the surplus target of 0.5 per cent of GDP contemplated in the 2017 Update of the Stability Programme which was later revised to 0.8 per cent in the 2018 Budget. Whilst the buoyant IIP contributed positively to the fiscal outcome in 2017, it is noted that the budget balance net of IIP would have recorded a strong surplus of 1.4 per cent.

3.1.1 General Government Revenue in 2017

In 2017, the general Government revenue-to-GDP ratio increased by 2.4 percentage points to 40.5 per cent of GDP, as the ratio to GDP of 'other revenue' increased by 1.7 percentage points reflecting increases in market output from contributions from the IIP and a strong tax-revenue performance.

Higher tax revenues were recorded in 2017, such that the tax revenue ratio increased by 0.7 percentage points, from 26.3 per cent of GDP in 2016 to 27.0 per cent of GDP in 2017. Indeed, tax revenue buoyancy was positive in 2017 as economic growth composition was significantly influenced by tax-rich components, in particular corporate profits, a strong labour market performance and record tourism earnings. As a consequence, the ratio to GDP of current taxes on income and wealth increased by 0.5 percentage points, mainly underpinned by higher revenue from income tax paid by companies. It is nevertheless worth noting that growth in corporate income tax revenue was marked by a one-off increase of €41 million resulting from new administrative provisions on the operation of the international companies' departmental account at the Central Bank of Malta, as recommended by Eurostat. If this one-off impact is (which will not be repeated as long as the balance at the Central Bank is maintained stable) is excluded, growth in corporate tax revenue would have been consistent with past tax revenue elasticity trends. Similarly, revenue from taxes on production and imports registered a slight increase of 0.2 percentage points of GDP, mainly due to the positive performance from VAT underlined by strong domestic demand conditions, tourism earnings and construction activity. Meanwhile social security contributions remained relatively stable at 6.3 per cent of GDP in 2017 reflecting strong labour market conditions and migration trends.

Meanwhile, in 2017 a decline of 0.1 percentage points of GDP was registered in the ratio of property income.

3.1.2 General Government Expenditure in 2017

In 2017, the ratio of general Government expenditure to GDP declined by 0.6 percentage points to 36.5 per cent. This included a decline in the ratio of compensation of employees by 0.2 percentage points of GDP as growth in wages and salaries was contained relative to GDP growth.

Social payments declined by 0.5 percentage points to 10.2 per cent of GDP. This development is supported by the in-depth Comprehensive Spending Review at the Department for Social Security through which several measures were introduced aiming at making work pay and encouraging the reduction of dependency on the benefit system, as well as on account of the further strengthening of labour market conditions.

Against the background of the ensuing low interest rate environment and the Treasury's debt management strategy, expenditure on interest payments declined in both absolute and relative terms in 2017. Furthermore, in spite of higher capital expenditure, developments failed to keep up with GDP growth. In particular, a 0.1 percentage point of GDP increase in capital transfers was more than offset by the 0.3 percentage point of GDP decline in gross fixed capital formation in 2017.

Meanwhile, intermediate consumption increased by 0.6 percentage points to 6.8 per cent of GDP in 2017. This was mainly due to health-related expenditure including the health concession agreements, which increased to 0.3 per cent of GDP, and expenditure on medicines and surgical materials, the new provisions for cancer treatments and long-term care beds and increased outlays on residential care in private homes. It also reflected the one-off expenditure in respect of Malta's responsibility for the Presidency of the Council of the EU. Nevertheless, as documented in the 2018 National Reform Programme and in Chapter 6 of this Update, the comprehensive reviews of Government spending in health care and social security are contributing to the achievement of improved efficiency in public spending, reduction of waste and value for money.

3.2 Fiscal Outlook in 2018

During the current fiscal year, developments in the revenue and expenditure ratios to GDP are expected to result in a general Government surplus of 1.1 per cent of GDP, or 0.5 per cent of GDP net of IIP revenue and expenditure. This constitutes a 0.6 percentage point improvement in the targeted balance, as compared to a surplus of 0.5 per cent of GDP targeted in the 2018 Budget and is also expected to remain within the Medium-Term Budgetary Objective of a balanced budget in structural terms. It is nevertheless worth noting that the 2018 general Government balance includes €63.5 million or 0.5 per cent of GDP primarily for the capitalization of Malta Air Travel Ltd (MAT Ltd) for the purchase of Air Malta's landing slots, whilst the 2017 balance includes the 0.4 per cent of GDP one-time administrative measure affecting revenue from corporate tax.

In terms and for the purposes of Article 31 of the Fiscal Responsibility Act, a 'Contingency Reserve' account was established within general Government (outside the Consolidated Fund). In 2018, the annual contribution to the 'Contingency Reserve' account is expected to amount to €11.6 million. No activity may take place within this account unless duly authorised by the Permanent Secretary at the Ministry for Finance, following a proposal from the Ministry for Finance and with the approval of the Prime Minister.

Table 3.1 presents the main fiscal projections, while Table 3.2 presents the measures supporting the fiscal developments envisaged over the medium-term.

Main Fiscal Projections

(percent of GDP)

Table 3.1

	2016	2017	2018	2019	2020	2021
Revenue	**38.1**	**40.5**	**38.7**	**38.0**	**37.6**	**37.4**
Components of revenue						
Taxes on production and imports	12.5	12.7	12.3	11.9	11.7	11.6
Current taxes on income and wealth	13.6	14.1	14.5	14.6	14.6	14.7
Capital taxes	0.2	0.2	0.2	0.2	0.2	0.2
Social contributions	6.3	6.3	6.3	6.2	6.1	6.0
Property income	0.9	0.8	0.9	0.8	0.8	0.7
Other revenue	4.7	6.4	4.5	4.4	4.2	4.3
Expenditure	**37.1**	**36.5**	**37.6**	**37.1**	**36.7**	**35.8**
Components of expenditure						
Compensation of employees	11.6	11.4	11.4	11.1	10.8	10.6
Intermediate consumption	6.2	6.8	6.7	6.7	6.5	6.4
Social payments in cash and in kind	10.7	10.2	10.0	9.7	9.4	9.1
Interest expenditure	2.1	1.9	1.6	1.4	1.3	1.2
Subsidies	1.3	1.2	1.2	1.2	1.2	1.1
Gross fixed capital formation	2.5	2.2	3.0	3.3	3.5	3.4
Capital Transfers Payable	0.8	0.9	1.7	1.4	1.3	1.3
Other expenditure	2.0	1.8	2.0	2.3	2.7	2.8
General Government Balance	**1.0**	**3.9**	**1.1**	**0.9**	**0.9**	**1.6**
Primary Balance	**3.1**	**5.8**	**2.7**	**2.4**	**2.2**	**2.8**

Discretionary Factors Underpinning Fiscal Consolidation

(Euro millions)

Table 3.2

	2016	2017	2018	2019	2020	2021
Main Measures Impacting on Revenue						
Fiscal consolidation measures	13.47	9.71	0.89	-14.98	0.00	0.00
Revision in excise duty on fuel	8.26	0.42	0.00	0.00	0.00	0.00
Revision in excise duty on cement	1.74	0.00	0.00	0.00	0.00	0.00
Revision in excise duty on cigarettes and tobacco	6.94	5.14	0.00	0.00	0.00	0.00
Fee on caging of blue fin tuna	-0.10	0.00	0.00	0.02	0.00	0.00
Estimated loss of revenue from the phasing out of Eco-Contribution	-6.90	-0.63	-0.50	0.00	0.00	0.00
Excise duty on plastic	3.03	0.82	0.00	0.00	0.00	0.00
Excise duty on chewing gum	0.50	0.10	0.00	0.00	0.00	0.00
Estimated increase in VAT from 2017 Budget measures	0.00	1.69	0.00	0.00	0.00	0.00
Excise duty on non-alcoholic beverages	0.00	0.20	0.00	0.00	0.00	0.00
Excise duty on toiletries and washing preparations	0.00	0.80	0.36	0.00	0.00	0.00
Excise duty on construction components and other fixtures	0.00	1.16	1.04	0.00	0.00	0.00
Impact from VAT directive on electronic commerce	0.00	0.00	0.00	-15.00	0.00	0.00
Growth enhancing measures	-13.00	1.75	-30.50	5.60	0.00	0.00
Adjustment in Income Tax Rates	-11.30	-3.50	-4.50	0.00	0.00	0.00
Duty on Documents - first/second time buyers, Gozo, persons with disability	-0.50	0.25	-5.30	5.80	0.00	0.00
Efficiency in revenue collection	-1.20	0.00	0.00	0.00	0.00	0.00
Concessions on Stamp Duty for business inheritance	0.00	5.00	-5.00	0.00	0.00	0.00
VAT reduction for SMEs	0.00	0.00	-1.50	0.00	0.00	0.00
Income tax credit to Master's and PhD graduates	0.00	0.00	-3.60	-0.20	0.00	0.00
Reduction in Income Tax - annual tax rebate	0.00	0.00	-10.60	0.00	0.00	0.00
Measures promoting a sustainable environment	0.25	3.25	0.00	0.00	0.00	0.00
Environmental Contribution	0.25	3.25	0.00	0.00	0.00	0.00
Social cohesion measures	3.20	0.00	0.00	0.00	0.00	0.00
Pension reform initiatives	3.20	0.00	0.00	0.00	0.00	0.00
Other measures	121.35	113.74	-175.28	-17.00	11.00	12.00
International Investor Programme	121.35	113.74	-175.28	-17.00	11.00	12.00
Total	125.26	128.45	-204.88	-26.38	11.00	12.00

Discretionary Factors Underpinning Fiscal Consolidation

(Euro millions)

Table 3.2

Main Measures Impacting on Expenditure						
Social cohesion measures	**9.68**	**-7.71**	**-2.78**	**2.89**	**0.00**	**0.00**
Assistance to the Elderly	0.12	-0.12	0.00	0.00	0.00	0.00
Free Child Care Centres	0.15	-0.80	0.00	0.00	0.00	0.00
Pension reform initiatives	0.92	0.98	11.20	0.00	0.00	0.00
Tapering of Social Benefits	3.36	3.63	4.31	3.75	0.00	0.00
Youth Guarantee	1.15	0.03	0.04	0.03	0.00	0.00
Extended in-work benefit scheme	-0.94	-1.00	-0.20	0.00	0.00	0.00
Conditional Children's Allowance	7.84	0.00	0.00	0.00	0.00	0.00
Pensions	-7.60	-2.40	-0.20	-0.20	0.00	0.00
One-Time Additional Bonus	7.18	0.00	0.00	0.00	0.00	0.00
Single Means Test	-1.50	-0.10	0.00	0.00	0.00	0.00
Live-in Carers Fund	-1.00	-0.40	0.00	0.00	0.00	0.00
Social fund for students in difficulty	0.00	-1.00	0.00	0.00	0.00	0.00
Disability allowance	0.00	-1.00	0.00	0.00	0.00	0.00
Supplementary allowance	0.00	-3.23	0.00	0.00	0.00	0.00
Rent subsidy	0.00	-2.30	0.00	0.00	0.00	0.00
Adoption grant	0.00	0.00	-0.40	0.00	0.00	0.00
Disability allowance	0.00	0.00	-0.50	0.00	0.00	0.00
Increase in foster care allowance	0.00	0.00	-0.25	0.00	0.00	0.00
Reckoning contributions after retirement	0.00	0.00	-0.45	0.00	0.00	0.00
€2 increase in pensions	0.00	0.00	-8.50	0.00	0.00	0.00
Exam fees	0.00	0.00	-0.60	-0.70	0.00	0.00
Housing Regeneration Works	0.00	0.00	-2.20	0.00	0.00	0.00
Housing Authority schemes (social housing)	0.00	0.00	-3.02	0.00	0.00	0.00
Extension of Community Work Scheme	0.00	0.00	-2.00	0.00	0.00	0.00
Measures promoting a sustainable environment	**0.08**	**-5.00**	**0.10**	**0.00**	**0.00**	**0.00**
Scrappage Scheme	0.48	0.00	0.20	0.00	0.00	0.00
Hotel Energy Efficiency Scheme	-0.40	-0.60	0.20	0.00	0.00	0.00
Tourism Environmental Trust	0.00	-3.50	0.00	0.00	0.00	0.00
Tal-linja card to 18 year olds	0.00	-0.90	0.00	0.00	0.00	0.00
Grant for electric vehicles, bicycles & motorcycles, wheelchair accessible vehicles	0.00	0.00	-0.30	0.00	0.00	0.00
Other measures	**28.58**	**-9.53**	**-9.22**	**0.00**	**-58.00**	**0.00**
Equity acquisition in Airmalta plc	31.00	12.00	0.00	0.00	0.00	0.00

Discretionary Factors Underpinning Fiscal Consolidation

(Euro millions)

Table 3.2

Ex-Gratia Payment on Car Registration Tax	-1.87	-0.45	-0.35	0.00	5.00	0.00
Compensation payments	-4.75	-4.84	-0.91	0.00	0.00	0.00
Expropriation Compensation	-4.50	0.00	0.00	0.00	0.00	0.00
IIP expenditure	0.00	0.00	-35.00	0.00	-63.00	0.00
2016 SP Expenditure Consolidation Measures	15.00	0.00	0.00	0.00	0.00	0.00
EU Presidency	-6.30	-16.24	27.04	0.00	0.00	0.00
Total	**38.34**	**-22.24**	**-11.90**	**2.89**	**-58.00**	**0.00**

Note: The impact is recorded in incremental terms - as opposed to levels - compared to the previous year's baseline projection. Simple permanent measures are recorded as having an effect of +/- X in the year(s) they are introduced and zero otherwise (the overall impact on the level of revenues or expenditures does not cancel out). If the impact of a measure varies over time, only the incremental impact is recorded in the Table. By their nature, one-off measures are recorded as having an effect of +/- X in the year of the first budgetary impact and -/+ X in the following year, i.e. the overall impact on the level of revenues or expenditures in two consecutive years is zero. The total figure is the total Impact on the budget balance, as a revenue increasing measure is listed as positive, while an expenditure decreasing measure is also positive. The contrary applies for negative figures, such that a revenue decreasing measure is negative and an expenditure increasing measure is also negative.

Note: The impact of the measures is reported on accruals basis. The impact is recorded in incremental terms, as compared to the previous year's baseline projection. It also includes lagged incremental effects of previous budget measures. A positive represents an improvement in the general Government balance.

3.2.1 General Government Revenue in 2018

Consistent with the better than expected outturn in 2017 and revised macroeconomic forecasts, revenue projections have been updated accordingly. Total revenue is nevertheless expected to decline by 1.8 percentage points of GDP, from 40.5 per cent of GDP in 2017 to 38.7 per cent of GDP in 2018, primarily reflecting developments in the 'other' revenue category. Indeed, revenue from Malta's citizenship programme is expected to decline to €110.0 million in 2018, as the number of successful main applicants is assumed to moderate.

Meanwhile, tax revenue is expected to broadly follow economic developments in 2018, as the fiscal impact of discretionary revenue measures (other than contributions from the IIP) is expected to be relatively marginal. These mainly include a tax rebate to persons in employment earning less than €60,000 a year and to Master's and PhD graduates, as well as extended incentives for first time home buyers and similar new incentives to assist households who sell their first home to buy another home to better reflect the needs of their family. Incentives are also being introduced to enable persons with disabilities to become homeowners.

At unchanged policies, tax revenues are expected to grow at 8.1 per cent, with an implied elasticity of tax revenue to GDP estimated at 1.0. This is supported by historical developments in elasticity estimates for revenue components relative to their respective tax base and includes the lagged effects on income tax revenue from strong increases in corporate profits registered in previous years. Indeed, a lower revenue ratio for taxes on production and imports is offset by a higher ratio for current taxes on income, as capital taxes and social contributions are expected to remain relatively stable.

3.2.2 General Government Expenditure in 2018

The ratio of general Government expenditure to GDP is expected to increase by 1.1 percentage points, from 36.5 per cent in 2017 to 37.6 per cent in 2018. The increase in the expenditure-to-GDP ratio is mainly set to come from higher capital expenditure. Increases in capital expenditure will be devoted to roads, the environment, health and education and include higher infrastructure expenditure financed from both the EU and local funds. As already indicated in this Chapter, higher capital transfers in 2018 include the transfer of Air Malta's landing slots to Malta Air Travel Ltd (MAT Ltd). In addition, Government has included an allowance of €35 million in expenditure in 2018 for projects financed from the National Development and Social Fund, of which the absolute majority are expected to finance projects of a capital nature.

A lower ratio for social payments as a share of GDP, alongside lower expenditure on interest expenditure, are expected to in part offset these developments. Against the background of historically low interest rates and a decline in the stock of debt, interest expenditure is expected to decline by 0.3 percentage points of GDP. Moreover, the growth in social benefits expenditure is expected to be weaker than GDP growth. A lower ratio for social payments is expected in spite of a number of 2018 Budget measures addressing the adequacy of pensions, including disability pensions, and other vulnerable groups. Indeed, the negative fiscal impact of these measures will be for the most offset by the expenditure-reducing effect of measures legislated in previous Budgets, in particular the tapering of social benefits, and the further extension of the retirement age in 2018 by virtue of the 2006 pension reform initiatives.

Meanwhile, expenditure on subsidies and on compensation of employees as a share of GDP are expected to remain relatively unchanged. Developments in the latter reflect moderate increases in civil service salaries, including the agreed 8-year collective agreement signed last year, as well as the planned recruitment as envisaged in the Ministries and Departments' Business and Financial Plans, including HR Plans, within the parameters of the approved budgetary estimates. Allowances were made to other collective agreements currently being negotiated or agreements which were concluded after the Autumn round of fiscal projections presented in the 2018 Budget.

3.3 Medium-Term Fiscal Strategy

Malta's medium-term fiscal strategy envisaged for the 2019-2021 period reflects the macroeconomic projections contained in this Programme. Over the medium-term, the robust performance of the Maltese economy is expected to be sustained, though growth is expected to moderate compared to rates recorded in recent years. The rate of growth of potential output is also expected to moderate over the medium-term, and the output gap is expected to remain positive though closing gradually by 2020 and to turn slightly negative in 2021.

Inflation is expected to revert to its long-term average. Employment growth is expected to remain strong, while moderating somewhat in the outer years of the forecast horizon to edge closer to the long run average, with unemployment forecasted to remain below the historical average. No major external imbalances are foreseen and the contribution from external demand is projected to remain positive with a higher contribution to GDP growth in the outer years of the forecast horizon.

3.3.1 Structural Budget Balance and the Medium-Term Budgetary Objective

Over the medium-term, the Maltese Government is committed to continue to ensure compliance with the Medium-Term Objective (MTO), net of IIP receipts and expenditure. In addition, ensuring that expenditure growth does not exceed the economy's growth potential remains an intermediate target in this Programme. Based on the outlined macroeconomic projections and estimates of the business cycle generated using the commonly agreed methodology, and expected developments in one-off and other temporary measures over the medium-term, the outlined trajectory is translated into a structural balance of 0.6 per cent of potential GDP in 2018 (or a structural budget balance net of IIP revenue and expenditure), increasing gradually to 1.8 per cent of potential GDP by 2021.

An analysis of the developments in the general Government balance is presented in Table 3.3, while further details on the cyclical developments over the medium-term are illustrated in Table 3.4 and Chart 3.1.

The primary surplus is expected to increase gradually to 2.8 per cent of GDP by 2021 while the ratio to GDP of interest payments is expected to follow a downward trajectory. The general Government balance is expected to increase to 1.6 per cent of GDP over the medium-term forecast horizon. Given a projected average annual growth rate of nominal GDP higher than 7.0 per cent and a widening primary surplus, targets are consistent with a further reduction in the debt-to-GDP ratio over the medium-term, which is expected to decline significantly below the 60 per cent of GDP reference value.

Analysis of the Developments in the General Government Balance

(percentage points of GDP)

Table 3.3

	2016	2017	2018	2019	2020	2021
Change in Revenue Ratio	**-0.94**	**2.37**	**-1.78**	**-0.66**	**-0.43**	**-0.20**
Discretionary factors underpinning fiscal consolidation	1.14	0.95	-1.96	-0.30	0.01	0.01
Tax revenue buoyancy	0.61	0.71	0.31	-0.33	-0.25	-0.18
Other revenue	-2.69	0.71	-0.12	-0.03	-0.19	-0.04
Change in Expenditure Ratio	**3.03**	**0.57**	**-1.05**	**0.49**	**0.43**	**0.86**
Discretionary factors underpinning fiscal consolidation	0.43	-0.17	-0.06	0.06	-0.39	0.06
Change in Gross Fixed Capital Formation	1.72	0.26	-0.50	-0.36	0.12	0.09
Other expenditure	0.88	0.48	-0.50	0.79	0.70	0.72
Change in the General Government Balance	**2.09**	**2.94**	**-2.83**	**-0.17**	**-0.01**	**0.66**

Note: Positive represents an improvement in the general Government balance

Cyclical Developments

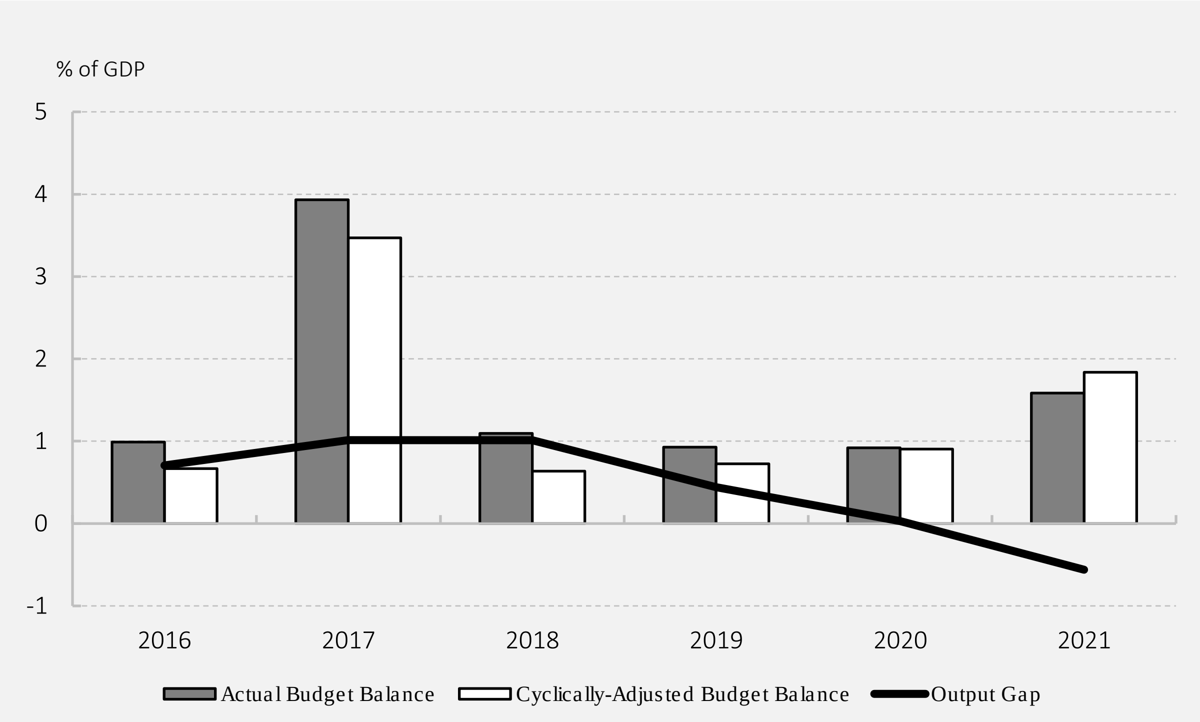
(percentage points of GDP)

Table 3.4

	2016	2017	2018	2019	2020	2021
General Government Balance	1.0	3.9	1.1	0.9	0.9	1.6
One-off and other temporary measures[(1)]	0.0	-0.2	0.1	0.1	0.1	0.0
General Government Balance net of One-offs	1.0	4.1	1.0	0.9	0.9	1.5
Output Gap Estimates	0.7	1.0	1.0	0.4	0.0	-0.6
Cyclically-Adjusted Budget Balance	0.7	3.5	0.6	0.7	0.9	1.8
Structural Balance	0.7	3.6	0.6	0.7	0.9	1.8
Structural Adjustment	2.8	2.9	-3.0	0.1	0.2	0.9

[(1)] A plus sign means deficit-reducing one-off measures

Chart 3.1: ***Actual and Cyclically-Adjusted Budget Balances***



3.3.2 Revenue forecasts.

Against the background of plausible medium-term macroeconomic forecasts and elasticity assumptions, as well as relatively more moderate contributions from the citizenship scheme, the total revenue ratio is expected to decline to 37.4 per cent of GDP by 2021.

Tax receipts are expected to decline by 0.9 of a percentage point of GDP to 32.4 per cent of GDP by the end of the Programme period. Such developments are partly driven by a slower growth in the indirect tax base than nominal GDP, as a result of which revenue from taxes on production and imports is expected to follow a declining trend to 11.6 per cent of GDP in 2021. Meanwhile, in spite of a slower wage growth compared to GDP growth, this is expected to only partly dampen the strong growth in gross operating surplus. As a consequence, the ratio to GDP of current taxes on income and wealth is expected to increase gradually over the forecast period to 14.7 per cent of GDP. Meanwhile, social security contributions are expected to decline marginally to 6.0 per cent of GDP by the end of the forecast period reflecting a slower growth in wages than GDP, as well as the capping of the weekly rate of contributions payable by employed persons as per the Social Security Act (Cap 318).

Proceeds from 'other revenue', are set to decline from 6.4 per cent of GDP in 2017 to 4.3 per cent of GDP in 2021 as contributions from the IIP moderate.

3.3.3 Expenditure Targets

As outlined, over the medium-term, growth in the corrected expenditure aggregate net of discretionary revenue measures is targeted to be lower than the economy's growth potential. Nevertheless, it is worth noting that in 2018, the expenditure aggregate is adversely affected by the significant decline in proceeds from the citizenship scheme, such that growth in the corrected expenditure aggregate is expected to deviate temporarily from the allowed nominal growth in benchmark expenditure. Indeed, the general Government expenditure ratio is set to increase to 37.6 per cent of GDP in 2018 and to subsequently decline to 35.8 per cent of GDP by 2021.

While the ratio of current expenditure-to-GDP is expected to decline over the medium-term to 31.1 per cent, capital expenditure is forecasted to increase from 3.2 per cent of GDP in 2017 to an average of 4.7 per cent of GDP between 2018 and 2021. Indeed, by means of the planned capital programme, the Maltese Government will give precedence to the national infrastructure needs over the forecast horizon, aligned with national economic and social priorities, and consistent with Government's objectives for sustainable economic growth.

Social benefits and social transfers in kind are set to continue on the declining trend relative to GDP recorded in recent years and are expected to decline to 9.1 per cent of GDP by the end of the forecast horizon. Such development reflects savings in social benefits stemming from implemented measures which are aimed to encourage and reward work effort as well as discourage dependency on the social security system.

Expenditure on compensation of employees is expected to decline by 0.8 of a percentage point of GDP to 10.6 per cent in 2021, as the growth in the average public sector compensation is expected to lag nominal GDP growth over the medium-term.

Expenditure on interest payments both in level terms but particularly as a share of GDP, is expected to follow a declining trend over the medium-term to 1.2 per cent of GDP in 2021.

Meanwhile, a lower ratio of intermediate consumption to GDP, which is set to decline to 6.4 per cent of GDP during the period under review, is expected to be offset by a marginally higher ratio of 'other' expenditure. Developments in 'other' expenditure are mainly explained by changes in other current transfers payable, which includes an element of unallocated expenditure items between 2019 and 2021. It is worth noting that developments in this component of expenditure are also influenced by expected outlays from the National Development and Social Fund.

3.4 Debt levels and developments

Government debt has declined below the 60 per cent Treaty requirements in 2015 and reached a debt-to-GDP ratio of 50.8 per cent in 2017. This is expected to decrease further to 35.6 per cent of GDP in 2021. The projected decrease in the debt-to-GDP ratio is expected to result from primary surpluses and the snowball effect which will mitigate the debt increasing Stock Flow Adjustments (SFA).

Meanwhile, the Government's debt strategy remains that of ensuring that the financing needs of the public sector are met at the lowest possible costs, while simultaneously minimising medium and long-term interest rate risk. The Government's reliance on short-term funding remains marginal, in line with the dynamics exhibited in recent years. During 2017, short-term debt accounted for 3.1 per cent of total Government debt and is expected to continue increasing to 4.5 per cent in 2020. Short-term debt funding will then marginally decrease to 4.3 per cent of total Government debt in 2021.

Moreover, the share of maturing stocks in total Government debt is expected to increase from a level of 6.6 per cent in 2017 to 7.0 per cent in 2018. Furthermore, the proportion of maturing stocks in total Government debt is projected to remain on an upward trajectory, with the ratio reaching 8.7 per cent in 2021.

3.4.1 Projected Debt developments

Developments in the debt ratio for the Programme period and the contributors to developments in the debt-to-GDP ratio are presented in Table 3.5 and Statistical Appendix Table 4. In this regard, the positive primary surpluses targeted in the coming years are expected to decrease the debt-to-GDP ratio throughout the forecast horizon. Furthermore, the contractionary impacts of the primary balance and the 'snowball effect' will more than offset the expansionary impact of the SFA on the debt-to-GDP ratio foreseen thorough the forecast horizon.

The Dynamics of Government Debt[(1)]

Table 3.5

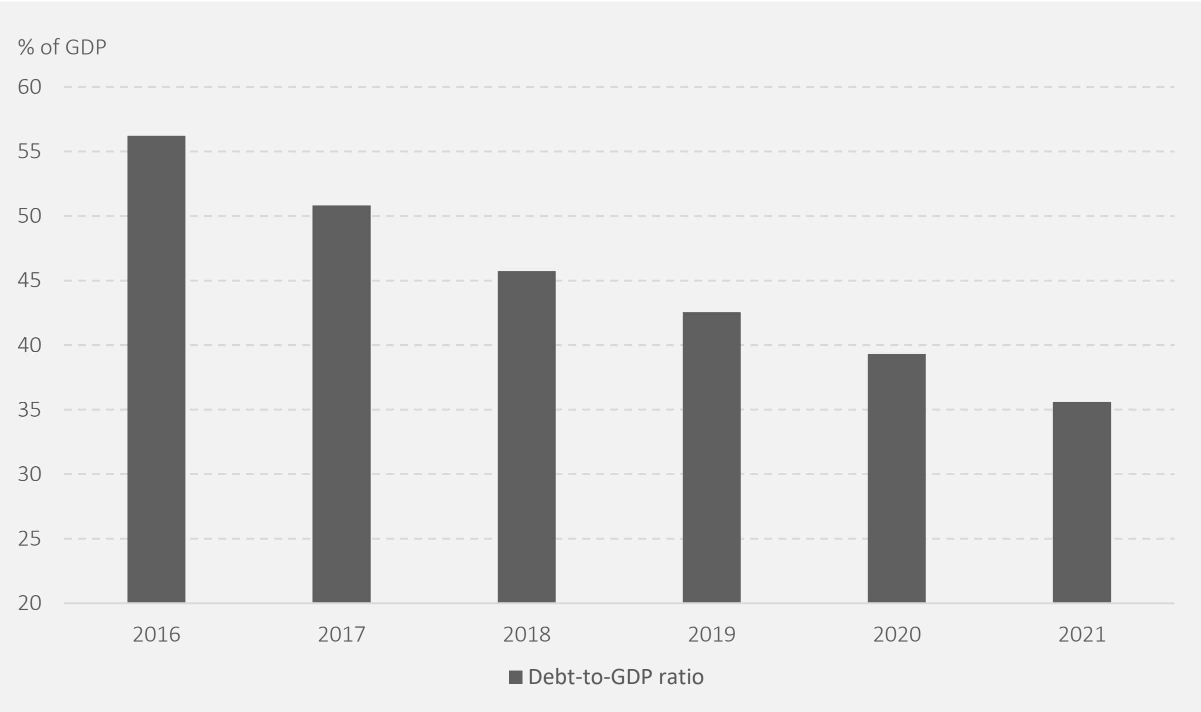
Percentages of GDP	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Gross debt	56.2	50.8	45.8	42.5	39.3	35.6
Change in gross debt ratio	-4.4	-5.4	-5.1	-3.2	-3.2	-3.7
Contributions to changes in gross debt						
Primary balance	-3.1	-5.8	-2.7	-2.4	-2.2	-2.8
Snowball Effect	-3.3	-2.8	-2.3	-1.7	-1.4	-1.3
Interest expenditure	2.1	1.9	1.6	1.4	1.3	1.2
Real GDP growth	-4.7	-3.5	-2.9	-2.3	-1.9	-1.7
Inflation Effect	-0.8	-1.2	-1.0	-0.9	-0.7	-0.7
Stock-flow adjustment	2.0	3.2	-0.1	0.9	0.3	0.3
p.m. implicit interest rate on debt	3.9	3.6	3.4	3.4	3.3	3.2

[(1)] *Developments in the debt- to-GDP ratio depend on:* $\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} \cdot \frac{i_t - y_t}{1+y_t}\right) + \frac{SFA_t}{Y_t}$

where t denotes a time subscript, D, PD, Y and SFA are the government debt, primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth.

Developments in the gross Government debt are illustrated in Chart 3.2. After declining below the 60 per cent Treaty requirement in 2015 and to 56.2 per cent of GDP in 2016, the ratio declined further by 5.4 percentage points to 50.8 per cent in 2017. The debt ratio is expected to continue to fall by 5.1 percentage points in 2018 and 3.2 percentage points in 2019, and then continue a declining path to reach 35.6 per cent of GDP in 2021. Over the medium-term horizon, the projected reduction in the gross debt ratio is mainly driven by the primary surplus and the nominal growth trajectory. Both components are expected to mitigate the upward pressure that the interest expenditure and the stock flow transactions are expected to have on the debt-to-GDP ratio. The expansionary contribution of interest expenditure on the debt ratio is expected to moderate throughout the forecast horizon, from 1.9 per cent of GDP in 2017 to 1.2 per cent of GDP in 2021.

Chart 3.2: ***Debt-to-GDP ratio***



In 2017, the SFA have resulted in a 3.2 percentage point increase in the debt-to-GDP ratio. This was mainly underpinned by the adjustments made to the deficit in ESA10 which mainly relate to IIP revenue and equity acquisition mainly related to the BOV and the development Bank. In 2018, stock flow transactions are expected to have a positive impact on the debt ratio while over the medium-term, stock flow transactions are expected to have a marginal impact on the debt ratio. Meanwhile, the projected IIP revenue will continue to underpin the positive stock-flow adjustments throughout the forecast period. Further details on the SFA can be found in Annex Table 10.

3.4.2 Comparison with the April 2017 Update of the Stability Programme

As illustrated in the Statistical Appendix Table 6, the ratios of general Government debt-to-GDP presented in this Programme are expected to be lower than those presented in the previous Stability Update. The expected improvement is largely attributable to a more favourable macroeconomic and fiscal outlook and a more beneficial 'snowball effect'. Lower interest expenditure than that projected in the previous Update has also contributed towards this improvement in the debt ratio.

For 2017, the debt-to-GDP ratio was revised downwards by 5.1 percentage points to 50.8 per cent of GDP. This revision reflects a more buoyant macroeconomic environment than that expected in the earlier update and a stronger than anticipated fiscal position. The debt-to-GDP ratios for 2018 and 2019 were revised downwards by 6.7 and 7.5 percentage points, respectively, in light of the positive developments in the 2017 debt-to-GDP ratio.

In the 2017 Update, the debt-to-GDP ratio was expected to follow a downward path from a level of 55.9 per cent in 2017 to a level of 47.6 per cent in 2020. On the other hand, in this Update of the Stability Programme, the debt-to-GDP ratio is estimated to decline to a level of 39.3 per cent by 2020.

4. Sensitivity Analysis

Ensuring the accuracy of macroeconomic forecasts in an economy is very important, especially for a small and open economy like Malta. Since macroeconomic forecasts are the foundation of Government economic policy making, formulation and analysis and decision-making process, the assessment of past forecasting performance is important to improve the accuracy of forecasts and as a means of assessing credibility of the forecasting exercise. While the Maltese economy has proved to be very resilient to the international economic crisis, GDP forecast errors are relatively higher for Malta than those observed for larger and less open economies within the EU[1].

In recognition of the risks surrounding macroeconomic forecasts, this chapter provides an assessment of forecast uncertainty and the balance of risk surrounding the macroeconomic forecasts in this Programme. The analysis is in line with the requirements of Council Directive 2011/85/EU of the European Union on the requirements for budgetary frameworks of the Member States.

4.1 The Accuracy of Past Forecasting Performance

The updated analysis as completed by the Economic Policy Department (EPD) in the Ministry for Finance (MFIN), shows a tendency to underestimate GDP growth and hence a downward bias in the GDP growth projections. However, this is a result of significant statistical revisions persistently in the upward direction in the national accounts data. While the one-year ahead forecasts display a root-mean squared error (RMSE) of 2.8, it is notable that the sample size employed is rather small and the earliest forecast available is that of 2004. The small sample size, the recession of 2009, the subsequent recovery and the statistical revisions play an undue influence on this evaluation and limit comparability with the forecast accuracy displayed by other economies.[2] It is noteworthy that when compared to the latest analysis undertaken by economists in MFIN, the RMSE has widened even further primarily attributed to the relatively large forecast errors in 2014 and 2015. This is also influenced by the result of significant data revisions in the national accounts data.

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[1] Camilleri, G., and Vella, K. (2015). "Interpolating Forecast Errors for Assessing Uncertainty in Macroeconomic Forecasts: An Analysis for Malta." EPD Working Paper Series, No. 1/2015, Mach 2015. http://mfin.gov.mt/en/epd/Documents/Working_Papers/Working_Paper_Full.pdf

[2] Kindly note that the analysis on past forecast errors has been updated and is different than to what is outlined in Camilleri and Vella, (2015). The updated analysis features the latest Updates of the Stability Programme as part of the sample data. However, the methodology remains unchanged.

The evaluation of the risk and uncertainty of the current macroeconomic projections underlying this Programme is based on an ex ante analysis of past forecast errors which determine the level of uncertainty. Ex post, a number of alternative but plausible economic scenarios generated with the forecasting model used by the Economic Policy Department are also simulated to determine the balance of risks surrounding the baseline projections.

4.2 The Balance of Risks

To determine the balance of risks surrounding macroeconomic forecasts, twelve alternative model-based growth projections were carried out. These represent scenarios that are considered to be plausible alternatives to the baseline projections. While economic judgement influences the choice of these scenarios, this judgement is also underpinned by the constant monitoring of economic conditions prevailing at the time and also informed by the various meetings with economic stakeholders carried out in the early stages of the forecasting exercise.

4.2.1 Model-Based Scenario

The first scenario is a standard scenario involving the removal of any form of economic judgement underlying the baseline forecast thus generating a purely model-based forecast. Nevertheless, the forecasts generated are still conditional on a number of exogenous assumptions such as world prices, international economic conditions, interest rates and exchange rates. This scenario is underlined by a weaker GDP growth in 2018 and stronger growth in the outer years. Consequently, the budget balance deteriorates marginally in 2018 and 2019 but remains in surplus before improving significantly in the outer years.

4.2.2 Global Economic Growth

In view of the prevailing uncertainty in the global economy, two scenarios yielding plausible outcomes are modelled. In the first scenario, it is assumed that global growth continues its recovery path while in the alternative scenario, global growth is assumed to be weaker than expected.

4.2.3.1 Improved global economic growth

This scenario assumes that growth in Malta's key trading partners will be stronger than expected. The relatively higher than expected economic growth for Germany, UK, Italy, France and the US is based on the Consensus Forecasts March 2018 issue, assuming the most optimistic plausible growth figure for each trading partner for the forecast horizon period 2018-2021. The outcome of this scenario yields a 0.2 percentage point increase in Malta's GDP in 2018, followed by significant upward revisions in real GDP growth of 0.4, 0.7 and 1.2 percentage points in 2019, 2020 and 2021, respectively. The budget balance would improve in the outer years by 0.2 percentage points in 2020 and by 0.4 percentage points in 2021, respectively.

4.2.3.2 Weaker global economic growth

This scenario is modelled on weaker than anticipated growth for Malta's key trading partners. Using a similar procedure as outlined in the preceding section, this scenario is based on worst-case real GDP growth projections for Malta's main trading partners based on the March 2018 Consensus Forecasts publication. Results indicate a growth rate of 5.9 per cent in 2018, 0.2 percentage points less than the baseline scenario. In 2019, growth declines to 4.9 per cent, 0.5 percentage points lower than the baseline. Moreover in this scenario, Malta's real GDP growth for the outer years would be lower relative to the baseline, reflecting weaker export growth which is more pronounced than the decline in imports. In fact, growth in 2020 and 2021 would decline to 4.2 per cent and 4.1 per cent, respectively. This negatively affects the budget balance, with most of the impact reflected in the outer years. In fact, the budget balance remains unaffected in 2018 and 2019 but then declines marginally by 0.1 and 0.2 percentage points in 2020 and 2021, respectively.

4.2.4 Alternative Models Scenario

The EPD within the Ministry for Finance is responsible for the preparation of macroeconomic forecasts for the Government of Malta through the use of its Short-term Quarterly Econometric Forecasting Model for Malta (STEMM). Such macroeconomic forecasts serve as vital inputs to various Government policy decisions, including budgetary projections.

The sole reliance on one structural time-series econometric model could pose problems of statistical confidence and is often discouraged for more than one reason. As part of a research effort, EPD has developed seven alternative forecasting models ranging from model-free statistical forecast (Random Walk and Holt-Winters Seasonal Smoothing Method), model-based univariate forecasts (2 ARIMA models) and model-based multivariate forecasts (2 VAR models and one VECM model). These models help EPD benchmark the results inferred from STEMM and can be used to generate alternative growth forecasts.

On average, these models suggest higher GDP growth for 2018 but lower growth in 2019. Concomitantly, the budget balance is expected to improve in 2018 but marginally worsen in 2019 relative to the baseline scenario.

4.2.5 Alternative Growth, Exchange Rates and World Prices Scenario

As outlined above, GDP growth assumptions for Malta's main trading partners and the exchange rates are based on the March 2018 Consensus Forecasts issue. World prices are also an exogenous variable in the macroeconomic projections, proxied by the producer prices index weighted by the share of international trade of Malta's main trading partners. The baseline assumptions of how world prices are expected to develop over the forecast horizon are also based on the Consensus Forecast March 2018 issue.

4.2.5.1 Consensus Forecasts April 2018

To obtain an alternative view, a scenario incorporating assumptions for real GDP growth, exchange rates and world prices based on the latest Consensus Forecast April 2018 issue (available only after the cut-off date of the baseline forecasts) is simulated. In this case, GDP growth decreases by 0.2 percentage points to 5.9 per cent in 2018, followed by a 0.2 percentage points decline in 2019 GDP growth. Alternatively, GDP growth increases by 0.1 percentage points in 2020 and by 0.8 percentage points in 2021. The budget balance only changes in 2021, improving by 0.3 percentage points.

4.2.5.2 Higher World Prices

This scenario assumes that growth in world prices weighted by Malta's key trading partners is stronger than expected. The relatively higher than expected producer prices for Germany, UK, Italy, France and the US is based on the Consensus Forecasts March 2018 issue, assuming the most optimistic plausible growth figure for each trading partner for the forecast horizon period 2018-2021. The outcome of this scenario leaves Malta's GDP in 2018 intact, followed by downward revisions in real GDP of 0.3 and 0.1 percentage points in 2019 and 2020, respectively. The budget balance improves by 0.1 percentage points in 2018 and 2019, respectively, and improves further by 0.2 percentage points in 2020 and by 0.5 percentage points in 2021.

4.2.5.3 Lower World Prices

This scenario is modelled based on weaker than anticipated growth in world prices weighted by Malta's key trading partners. Using a similar procedure as outlined in the preceding section, this scenario is based on worst-case producer prices projections for Malta's main trading partners based on the March 2018 Consensus Forecasts publication. Results indicate no change for 2018 and a growth rate of 5.6 per cent in 2019. Moreover, Malta's real GDP growth for the outer years is expected to be marginally higher relative to the baseline. This performance positively affects the budget balance, with most of the impact reflected in the outer years.

4.2.6 Stronger Medium-Term Private Investment Scenario

The baseline projections expect strong growth in investment in 2018-2019, attributed to a number of one-off projects, primarily those attributed to the health sector. Nevertheless, there are a number of major projects which have a strong probability of being implemented in the outer year of the forecast period but are yet to be included in the baseline projections. Among these are large scale construction projects. This scenario increases investment in 2020 by around 2.4 percentage points while 2021 decreases by 2.3 percentage points attributed to a base effect. This results in a marginal increase in GDP growth in 2020 as a significant share of the project is assumed to be imported.

4.2.7 Weaker Investment Scenario

This scenario assumes a weaker investment profile relative to the baseline scenario. It assumes a lower rate of realisation of one-off projects relative to the baseline forecast. Investment in this scenario increases to 2.3 per cent in 2018, 11.9 per cent in 2019, 2.9 per cent in 2020 and 6.0 per cent in 2021. Concomitantly, GDP growth decreases by 0.2 percentage points in 2018, increases by 0.2 percentage points in 2019, remains unchanged in 2020 and decreases by 0.1 percentage points in 2021.

4.2.8 US Trade Shock Scenario

Another plausible scenario simulates the possible impact of the US protectionist measures on the Maltese economy. Although on announcement of the tariffs, US exports should have become more competitive, the US dollar should also have appreciated in response. Nevertheless, so far, this has not been the case and it appears that the uncertainty surrounding US policies has kept the US Dollar low against other currencies, namely the Euro. This scenario assumes the worst-case real GDP growth projections for Malta's main European trading partners and the higher end growth for the US from the Consensus Forecasts March 2018 edition, coupled with a permanent depreciation of the US Dollar by 7.5 per cent in 2018. Results show that Malta's GDP growth declines by 0.5 percentage points to 5.6 per cent in 2018 and by 0.9 percentage points in 2019 to 4.4 per cent. The budget balance is projected to decline by 0.1 percentage point in 2019 and by 0.3 percentage points in the outer years.

4.2.9 Interest Rate Scenario

This scenario assumes that the European Central Bank (ECB) will opt for a more aggressive tightening of the monetary policy over the forecast horizon. Interest rates are assumed to increase marginally by the end of 2018, and increase further to 3.5 basis points from 2019, before reaching 5.0 basis points by 2021. Moreover, the spread between long-term and short-term interest rates is assumed to remain fixed at the 2017 average. Since the rise in interest rate is also a reflection of economic stability, real GDP for 2018 is initially projected to increase by 0.1 percentage point in 2018 attributed to an increase in financial services. In the medium-term the rise in interest rates will lower domestic demand growth, particularly investment such that in 2019, growth will decline by 0.3 percentage points. The effect on the budget balance will be a 0.1 percentage point increase in 2019.

4.3 Uncertainty and the Balance of Risk Underlying the Macroeconomic Projections

The uncertainty surrounding the macroeconomic projections is based on the past forecast error variance of GDP. This is equal to 2.4 for the current year forecast, 3.3 for the one-year ahead forecast, and 3.7 for the two-year ahead and the three year-ahead forecast, respectively. The balance of risk is based on the Pearson skewness indicator of the model generating alternative forecasts for GDP documented above. On balance, the indicator shows downside risks for 2018, 2019 and 2020 and upside risks for 2021. Chart 4.1 depicts a representation of the uncertainty and the balance of risk surrounding the macroeconomic forecasts presented in this Programme.

Chart 4.1: ***Fan Chart with GDP Growth Forecasts***

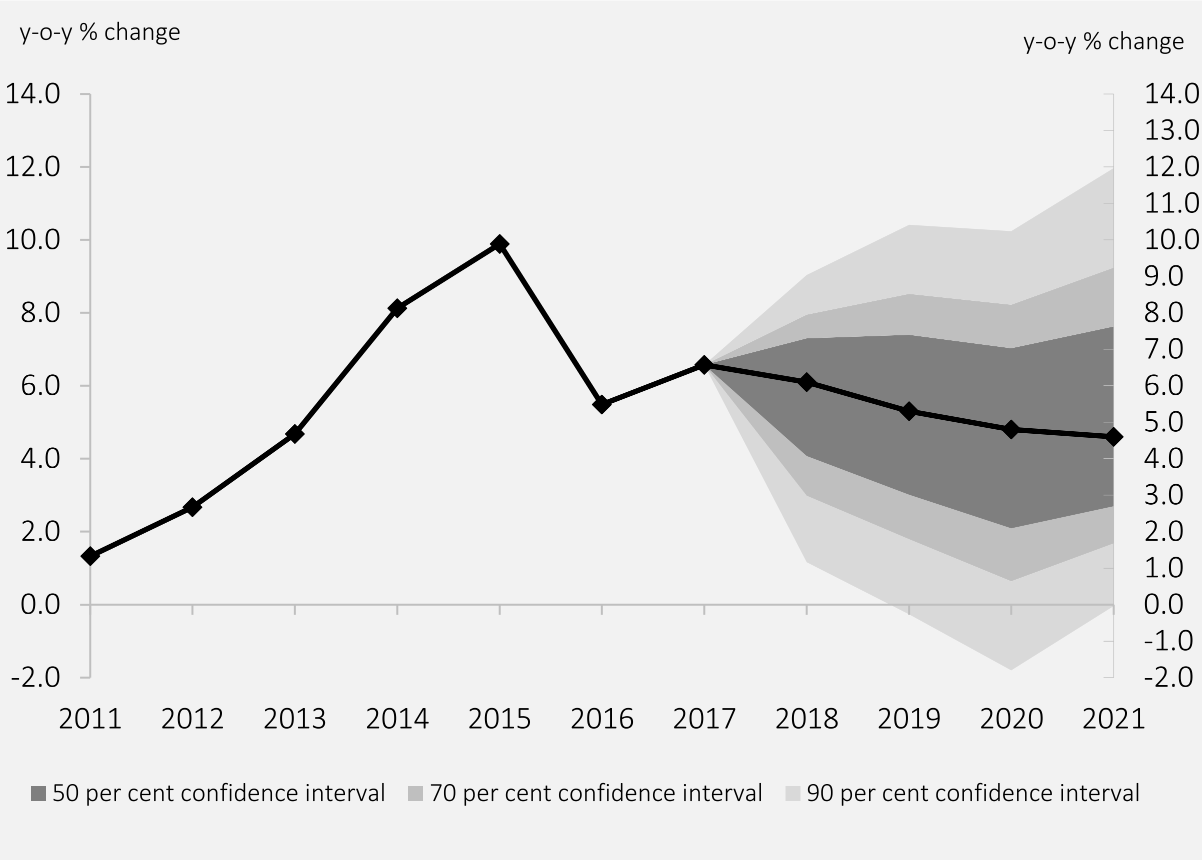
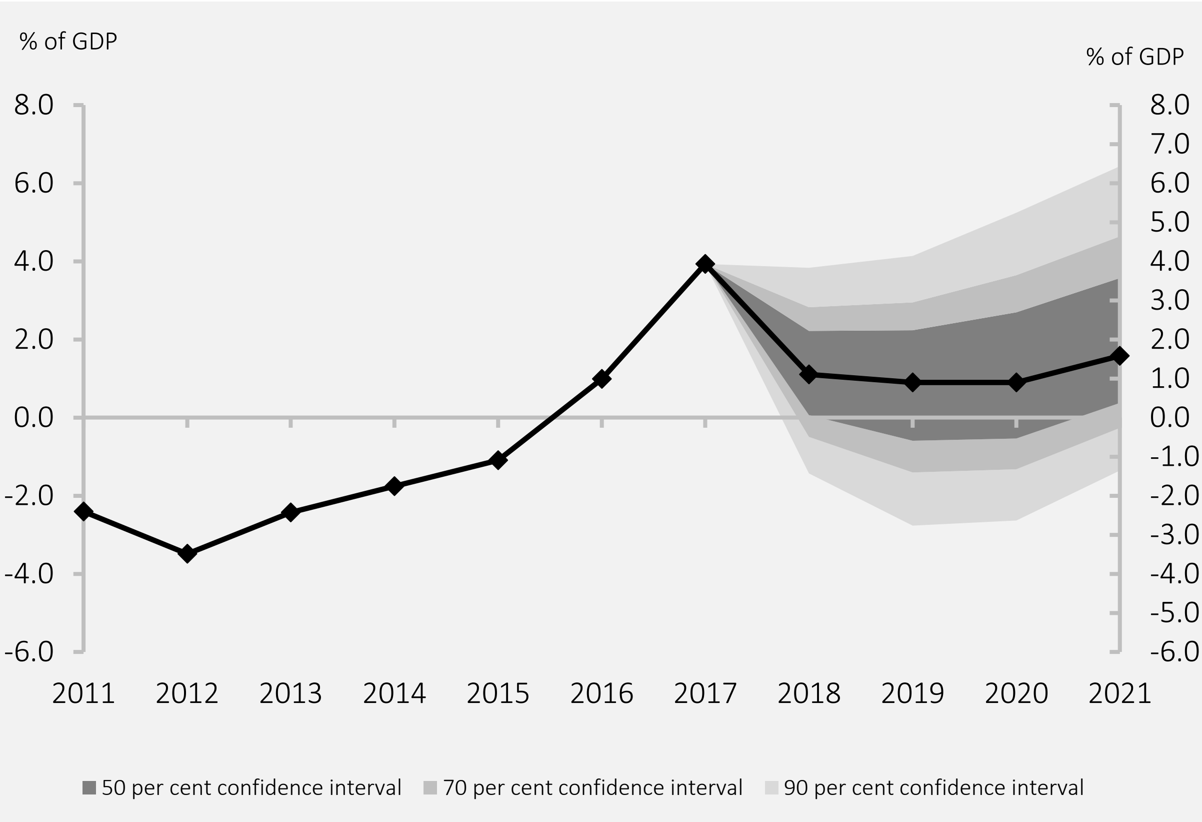


Chart 4.2: ***Fan Chart with Budgetary Targets***



4.4 Risks to Fiscal targets

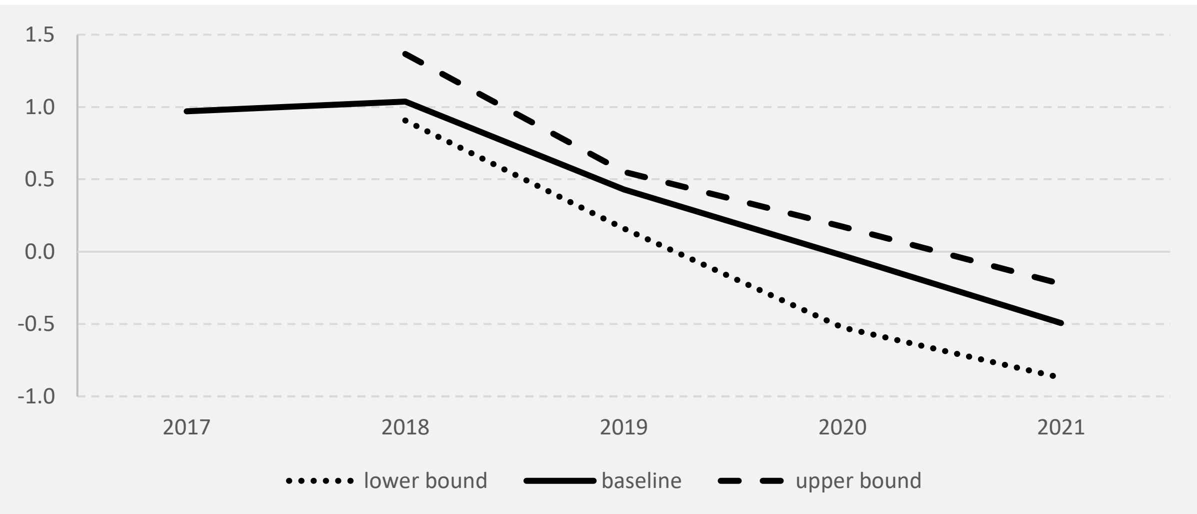
The alternative macroeconomic scenarios documented above, can influence the attainment of the deficit targets thus underpinning alternative fiscal conditions. Chart 4.2 illustrates the range of possible budget balance outcomes conditional upon the realisation of these alternative scenarios. This year the evaluation of fiscal risk conditional on macroeconomic risks also incorporates the variance resulting from the past forecast error of fiscal projections, based on a methodology similar to that used for deriving the macroeconomic risk assessment. As a result, the risk assessment is presented in the form of a probabilistic fan-chart rather than point estimates. The balance of risk is upside for 2018, marginally downside for 2019 and once again upside for the outer periods covered by the Programme. Looking at point estimates, under the worst possible cyclical scenarios contemplated, the budget balance would remain in surplus for the period under review.

4.5 Alternative Output Gap projections and risks to Structural Fiscal Targets

This assessment has been extended to cover risks to the output gap projections and hence the structural commitments presented in this Programme. Alternative output gap projections consistent with all the above economic scenarios have thus been carried out.

Compared to the baseline scenario, as shown in Chart 4.3, alternative output gap projections range from 0.9 in 2018 up to -0.9 in 2021 under the lower-bound and from 1.4 in 2018 down to -0.2 in 2021 under the upper-bound scenario.

Chart 4.3: ***Output gap: Risk assessment***



5. Sustainability of Public Finances

This Chapter seeks to assess Malta's long-term sustainability of public finances for the period 2016-2070. This assessment is based on the new public expenditure projection results produced by the Ageing Working Group (AWG) for the 2018 Ageing Report, reflecting a new set of population projections (ESSPOP2016) carried out by EUROSTAT. The AWG has produced new long-term projections ahead of the finalisation of the 2018 Ageing Report, which the ECOFIN mandated the Economic Policy Committee (EPC) to be endorsed and published by autumn 2018 at the latest.

The analysis of this Chapter includes pensions, health, long-term care, unemployment and education expenditure projections. These long-term projections provide an indication of the timing and scale of economic changes that would result from an ageing population in a 'no-policy change' scenario. The projections are helpful in highlighting the immediate and future policy challenges for Governments as a result of the expected strains caused by the demographic changes ahead.

5.1 Long-Term Budgetary Projection Results for Malta

This section provides an analysis of the long-term sustainability of public finances for Malta for the period 2016-2070 based on commonly agreed assumptions for the European Union (EU) Member States. The modelling work for pension projections assumes a 'no policy change' scenario and reflects as strictly as possible the pension rules, both current as well as those applying in future in reflection of legislated reforms. The model also assumes full wage indexation for non-contributory age (minimum) pensions, even though the current legislation in Malta adjusts age pension with the Cost of Living Adjustment (COLA). The projections for pension expenditure exclude the impact of linking the contributory period to life expectancy, in light of the fact that the AWG methodology is based on current legislation.

The model used in projecting pension expenditure was the World Bank's Pension Reform Options Simulation Toolkit (PROST 15), being the same model used in the projection of pension expenditure for the previous AWG budgetary projections exercise. Staff from the Economic Policy Department within the Ministry for Finance (MFIN) used PROST 15 to model the development of the current pension system and analyse various options for pension reform. The pension projections baseline was prepared by the World Bank with the assistance of expertise from the MFIN and the Ministry for the Family, Children's Rights and Social Solidarity (MFCS). The results obtained were subject to a process of internal review by pension experts within Government and subsequently endorsed by the EPC following a peer review at the AWG. Statistical Appendix Table 7 shows the expenditure components of the long-term budgetary projections as a percentage of Gross Domestic Product (GDP) for the period 2013-2070 and the assumptions used.

5.1.1 Demographic Projections

Population projections as published by EUROSTAT were used as a primary input in the long-term age-related expenditure projections used by the European Commission in the assessment of the sustainability of public finances. As shown in Table 5.1, population projections (ESSPOP 2016) indicate that total population in Malta is projected to rise from 436,658 in 2016 to around 521,000 in 2070, and such projections are higher than the population projections presented for the 2015 Ageing Report.

Eurostat Population Projections

Table 5.1

	2016	2020	2030	2040	2050	2060	2070*
2015 Ageing Report							
Total population	429,874	439,341	456,792	462,995	468,528	476,383	:
Old-age dependency ratio (65+ yrs/15-64 yrs)	29.4	33.2	40.5	40.8	45.0	50.9	:
2018 Ageing Report							
Total population	436,658	454,686	489,917	506,385	513,362	519,458	520,761
Old-age dependency ratio (65+ yrs/15-64 yrs)	29.1	33.0	40.4	41.4	46.0	53.9	55.8

** Population projections used for the 2015 Ageing Report are up to 2060.*

Source: EUROSTAT

5.1.2 Assumptions Applied

In projecting pensions, the demographic assumptions reflect ESSPOP 2016 projections by Eurostat, while the macroeconomic assumptions reflect the commonly agreed methodology in the EPC. The assumptions used include the real GDP growth rate, labour productivity (growth rate per hour), inflation rate, labour participation rate by age and gender, unemployment rate by age and gender, population (ESSPOP 2016), fertility rate by age, mortality rate by age and gender, and net migration by age and gender. A number of variables included in the assumptions as provided by the AWG, were not incorporated in the PROST workings for the pension projections, primarily due to the fact that such variables are not required as PROST inputs.

Life expectancy at birth for men is assumed to rise by 6.8 years over 2016 to reach 86.8 years in 2070, whilst in the case of women it is expected to reach 90.6 years, an increase of 6.3 years over 2016. This implies that despite some convergence, female life expectancy is projected to remain almost 4 years higher than that of males. Meanwhile, life expectancy at 65 years for males and females is projected to increase by 4.6 and 4.7 years, respectively, over the whole period. Another important variable in the evolution of the demography is net migration, where such inflows are projected to decline from 3,478 in 2016 to 1,015 in 2070. Net migration as a percentage of the population is projected to decrease from 0.8 per cent in 2016 to around 0.2 per cent in 2070.

With respect to macroeconomic assumptions, the labour force projections show a substantial rise in the overall participation rates, particularly for women and older workers. Potential GDP as well as average growth over the whole period is much higher than in the previous round of projections. In the new round of projections, the average potential GDP growth is 2.3 per cent whereas in the 2015 Ageing Report it hovered around 1.7 per cent. Potential GDP growth is projected to decline from 6.1 per cent in 2016 to 1.1 per cent in 2055 and thereby increasing to 1.6 per cent by the end of 2070.

5.1.3 Demographic Developments

Population projections (ESSPOP 2016) indicate that total population in Malta is projected to rise from 436,658 in 2016 to 520,761 in 2070. As shown in Table 5.2, the age structure of the population is expected to change significantly. While the share of the very young people (aged 0-14 years) in the total population is projected to hover around the 14.5 per cent share, the share of the people aged 65+ is projected to increase from 19.3 per cent to 30.6 per cent.

Total Population, by Selected Age Groups

Table 5.2

Age	2016	2020	2030	2040	2050	2070	2070
0-14 yrs	62,250	66,318	74,399	72,405	72,964	76,474	75,761
15-64 yrs	289,920	292,091	295,862	306,922	301,572	287,780	285,676
65+ yrs	84,488	96,277	119,657	127,059	138,827	155,204	159,325
Total	436,658	454,686	489,917	506,385	513,362	519,458	520,761
Share (%)							
0-14 yrs	14.5	14.9	15.4	14.6	14.9	14.9	14.9
15-64 yrs	68.0	63.9	60.2	60.7	58.7	58.7	58.7
65+ yrs	17.5	21.2	24.4	24.8	26.4	26.4	26.4
Ratio (%)							
Youth dependency ratio (0-14 yrs/15-64 yrs)	21.5	22.7	25.1	23.6	24.2	26.6	26.5
Old-age dependency ratio (65+ yrs/15-64 yrs)	29.1	33.0	40.4	41.4	46.0	53.9	55.8
Total dependency ratio	50.6	55.7	65.6	65.0	70.2	80.5	82.3
Ageing of the Aged Ratio (80+ yrs/65+ yrs)	18.9	20.6	28.2	35.5	33.7	33.7	39.6
Support ratio (15-64 yrs/65+ yrs)	343.2	303.4	247.3	241.6	217.2	185.4	179.3

Note: Figures may not add up due to the rounding

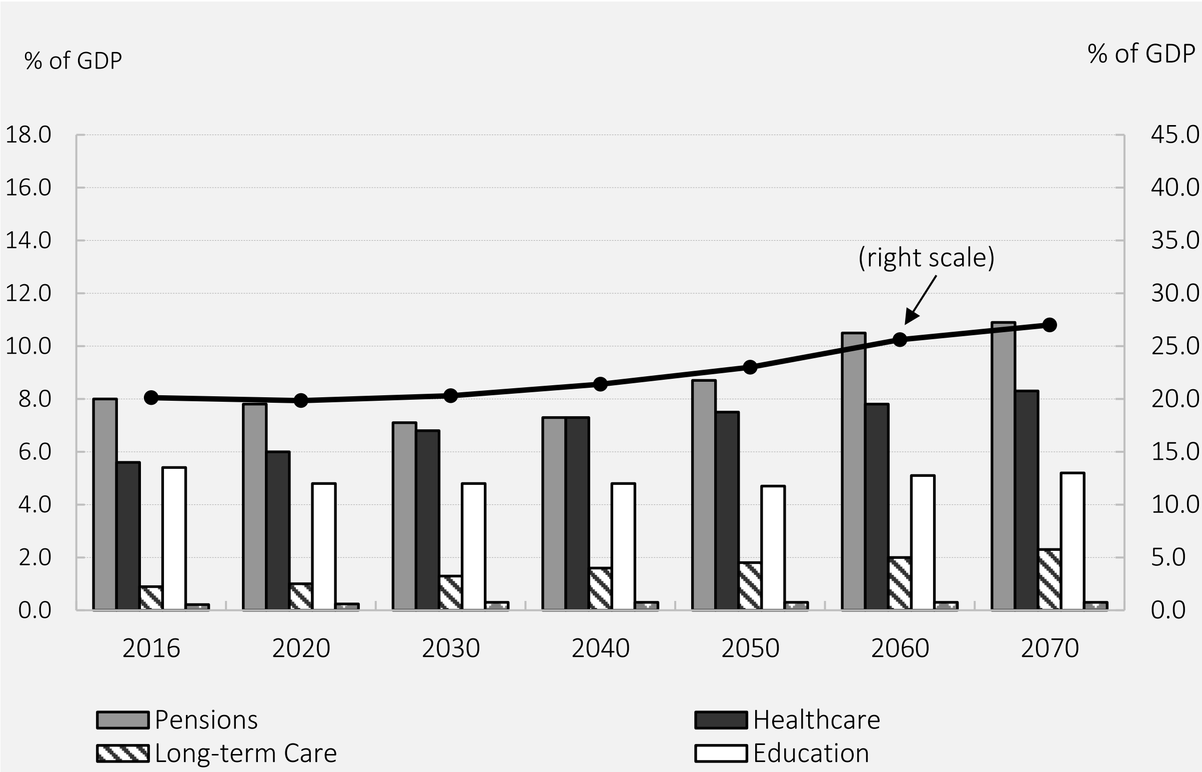
Source: EUROPOP2013, Eurostat

From an economic perspective, the most important change in demography concerns the working-age population (aged 15-64 years), which reflects the share of the population that will bear the financial ‘burden’ of the elderly. From a share of 66.4 per cent in 2016, this ratio is projected to subsequently fall to 54.9 per cent by 2070. The dynamics of the ageing process could be better appreciated by analysing the developments in the dependency ratios, which relate the number of individuals that are likely to be “dependent” on the support of others for their daily living – youths and the elderly – to the number of those individuals who can provide such support. Key indicators of age dependency presented in Table 5.2 are the old-age-dependency ratio (for persons aged 65 years and more calculated relative to the number of individuals aged 15-64 years) and the ageing of the aged ratio (80+ age bracket as a percentage of the 65+ age bracket). The old-age dependency ratio (65+ year bracket as a percentage of the 15-64 age bracket) is projected to increase consistently from 29.1 per cent in 2016 to 55.8 per cent in 2070, an increase of 26.7 percentage points. Meanwhile, the ageing of the aged ratio, is projected to increase from 18.9 per cent in 2016 to 35.5 per cent in 2040, decline to 33.7 per cent by 2050 and increase to 39.6 per cent by 2070. The youth dependency ratio is expected to increase from 21.5 per cent in 2016 to 25.1 per cent in 2030, drop to 23.6 per cent in 2040 and subsequently increase to 26.5 per cent by 2070. Thus, by 2070, the total dependency ratio, which is the combined burden of these two components of the economically active population, will amount to 82.3 per cent. As a result of these demographic developments, the support ratio (persons in the 15-64 years bracket as a proportion of persons aged 65+) is expected to decline from 3.4 per cent in 2016 to 1.8 per cent in 2070. This means that while in 2016 there were more than 3 persons of working-age for every person that reached pension age, by 2070 this ratio is projected to decrease to around 2 persons of working-age for every person of pensionable age.

5.1.4 Age-Related Public Expenditure

Age-related spending including pensions, health care, long-term care, education and unemployment benefits is foreseen to increase by 6.9 per cent of GDP over the period 2016-2070, as opposed to an increase of 6.6 per cent over the period 2016-2060, outlined in the 2015 Ageing Report. Chart 5.1 shows the age-related public expenditure as a share of GDP for this projection period and Table 5.3 shows the revenue from contributions and number of contributors.

Chart 5.1: ***Age-related Public Expenditure Projections***



Public expenditure on pensions is presently the most important age-related government expenditure item, and is expected to remain so for the foreseeable future. The pension projection exercise covers contributory and non-contributory old-age pension paid under the social security scheme. The coverage of pension schemes includes also the expenditure on non-contributory old-age pension together with the share paid on the contributory and non-contributory bonus payment. At present, voluntary private pensions play a rather minor role as regards pension provision for old-aged persons, even if their importance is expected to rise in future. Over the projection period, pension expenditure is projected to decrease from 8.0 per cent of GDP in 2016 to 7.1 per cent in 2030, and thereby increasing to 10.9 per cent in 2070. Over the period 2016-2070, pension expenditure as a percentage of GDP is projected to increase by 2.9 per cent of GDP. Taking into consideration the entire projection horizon, this increase is entirely driven by the developments in the dependency ratio. However, a decomposition of the projected pension expenditure that allows a better understanding of the underlying drivers, indicates that this increase is counteracted by the employment effect, followed by the labour market intensity effect, which describes the effects of labour market behaviour on pension expenditure. These two effects lower the ratio of pension expenditure to GDP, which is explained by the fact that in Pay as You Go (PAYG) systems, a higher employment rate helps increasing the sustainability of pension systems by allowing for a larger contribution base, and therefore, as the employment rate increases, the ratio of pension expenditure to GDP falls.

The expected increase in pension expenditure over the entire period is primarily attributable to an increase in expenditure on old-age pensions (earnings-related) that increases from 5.0 per cent of GDP in 2016 to 9.3 per cent in 2070. However, up to 2030, expenditure on old age pensions is expected to remain constrained due to higher pension age and indexation of the maximum pensionable income with the COLA. Thereafter, the increase in old-age pension expenditure is driven by the ageing process, in reflection of the projected demographic developments. At the same time, one notes that the parametric changes introduced in the pension reform – more dynamic indexation of the ceiling on pensionable income, the statutory changes to indexation for old-age pensions, crediting of contributions and the introduction of the guaranteed national minimum pension for persons retiring from 2027 onwards – also contribute to raise expenditure. On the other hand, the increase in the pension age, the increase in the contribution period for full pension eligibility, the changes to the benefit formula, and the incentives to defer retirement, contribute to lower the projected increase in pension expenditure. The incentives to defer retirement enable potential pensioners to postpone their retirement by up to 4 years. At the same time, the lengthening of the contributory period translates into a lower accrual rate because of longer required length of service to qualify for the full pension benefit rate.

Expenditure on disability pensions and old-age (non-contributory) pensions are projected to stay relatively constant at 0.2 per cent and 0.3 per cent of GDP while expenditure on survivors' pensions is projected to decrease from 1.4 per cent of GDP to 0.9 per cent of GDP by 2070. This decline reflects faster average economic growth, particularly in the first half of the projection period, which has an accumulating effect on the denominator of the ratio. Furthermore, it is expected that in the future more women will have an old-age pension in their own right in reflection of the stronger labour market participation modelled in the projection, leading to less reliance on survivorship pensions.

Expenditure on 'other pensions' is projected to decrease from 1.5 per cent of GDP to 0.4 per cent of GDP over the whole period. The decreasing contributions of other pensions (including 'top-ups' and Treasury pensions) reflect a combination of factors. The 'top-up' pension covers benefits currently payable to persons in receipt of service pensions which includes former servicemen in receipt of overseas pensions. This expenditure category is projected to decrease in importance over time in line with the life expectancy of the recipients of this pension category. Similarly, expenditure on the Treasury Pension is projected to decrease in importance over time given that it has been closed to new Government of Malta employees since 1979.

With regards to Table 5.3, it is to be noted that in Malta, contributions are payable by all gainfully occupied persons between the age of 16 and their pension age. The scheme allows for several types of contributions to extend coverage to all types of persons in employment. Employed persons pay Class One contributions, while the self-occupied pay Class Two contributions. Class One contributions imply that any person employed under a contract of service in Malta is in insurable employment and subject to the payment of these contributions. For each person, a tripartite contribution is payable: the employed person, the employer and the State pay 10 per cent each of the basic salary of the employee; with the contribution capped to the Maximum Pensionable Income. The rate of Class Two contributions is equally shared by the State and self-occupied persons, whereby the self-occupied pay 15 per cent and the State pays 7.5 per cent of their annual income that is subject to the same ceiling that applies for employees. Revenue from contributions is expected to decrease from 8.1 per cent to 6.3 per cent over the projection period, while the number of contributors is expected to increase from around 195,000 in 2016 reaching around 236,000 in 2040 and thereafter decreasing to around 221,000 in 2070.

Revenue from contributions and number of contributors

Table 5.3

	2016	2020	2030	2040	2050	2060	2070
Revenue from pension contributions (% of GDP)	8.1	7.0	6.9	6.7	6.6	6.5	6.3
Number of contributors (in 1000s)	195	205	224	236	234	224	221

Source: European Commission Services

Compared with the projections in the 2015 Ageing Report, expenditure on public pensions according to the baseline scenario is foreseen to rise less rapidly over the entire projection horizon. Over the period 2016-2030, public pension expenditure is expected to decline by 1.0 pp. of GDP. During the 2030-2060 period, the pension expenditure to GDP increases by 3.4 percentage points of GDP, while over the last remaining years expenditure rises further by 0.4 percentage points of GDP.

Another important contributor to the increase in age-related spending is healthcare. Projections indicate that Malta is now expected to record an increase of 2.7 percentage points of GDP in health care expenditure and for the long-term care, expenditure is expected to increase by 1.4 percentage points of GDP during the period 2016-2070. These results reflect an ageing society and an increase in life-expectancy at birth over the projection period. The Government is aware of the challenges posed by these demographic developments on healthcare and hence is implementing a holistic strategy to ensure the long-term sustainability of the health sector.

Public spending on unemployment benefits as a share of GDP is projected to remain rather stable rising marginally by 0.1 percentage points relative to the baseline to reach 0.3 per cent of GDP in 2030 and remain unchanged thereafter in reflection of the projected trajectory for the unemployment rate. Additionally, education spending as a percentage of GDP is projected to decrease by 0.2 percentage points during the projection period to reach 5.2 per cent of GDP in 2070 in reflection of developments in the structure of the population.

5.2 Focus on Pension Reforms

The pension projections presented for the 2018 Ageing Report take into account the legislated pension reforms, including measures to be phased in gradually. This section briefly outlines the main pension parameters of the contributory old-age pension also known as the two-thirds pension scheme. Pension reform in Malta is an ongoing process. The Government is sustaining its efforts to ensure adequate and sustainable pensions for current and future pensioners, as addressed in the ongoing pension reform process. The aim is to improve the current system primarily by strengthening further the first pillar and through the introduction of incentives pertaining to third pillar pensions and voluntary occupational pensions.

In December 2006, the House of Representatives adopted a series of parametric reforms (Act No. XIX of 2006). The reforms were aimed at enhancing the sustainability of the pension system whilst improving the adequacy of the pension enjoyed by retirees in the future. The Government has implemented measures to address the sustainability of pensions. The pension age has been increasing gradually from 61 to reach 65 years by 2027. The contributory period was also lengthened from 30 to 41 years.

Incentives to defer early retirement and lengthening working career were also introduced. The scheme is open to workers in the private sector, who would have paid 35 years of social security contributions and are eligible to retire at 61 years of age. Those who continue working until 62 years will receive an increase of 5.0 per cent in their pension. The scale increases every year, whereby, a person who works until 63 years would receive an increase of 10.5 per cent. A person deferring retirement by 4 years and 5 years, to retire at 64 and 65, would receive an increase of 16.5 per cent and 23.0 per cent respectively. In addition, another amendment was effected to Article 64A whereby persons born on or after 1/1/1969, who wish to access the early exit option, require 35 years of paid contributions with a maximum of 6 years of credits. Both measures are intended to lengthen careers and deter early retirement.

The two measures, that is, the incentives to encourage later retirement and the linking of the contributory period to the period spent in retirement, are expected to contribute to the strengthening of the long-term sustainability of public finances.

At the same time, the adequacy element was also safeguarded through the increase in the minimum pensions, better credits for child rearing and family growth (which is designed to address gaps in the contributory periods particularly of women, arising due to family responsibilities and as a policy instrument contributing positively toward fertility increases) and the introduction of credits for human capital development and lifelong learning, alongside other measures. Furthermore, Government has also improved the adequacy of contributory minimum pensions and survivorship pensions.

Periodic reviews, within intervals not exceeding 5 years, are to be carried out (the next review is expected in 2020) with the outcome of the exercise reported to the House of Representatives. The Social Security Act requires the report to put forward recommendations with a view to achieve further adequacy, sustainability and social solidarity in such a manner that a stable proportion is kept between the contribution periods and the period of time that the pension will be paid. In this regard, a Pensions Strategy Group has been set up and is tasked with the preparation of the studies necessary for the submission of the report as mandated by the Social Security Act.

The Government has also focused on diversifying retirement income and reducing dependency on state pensions. Personal private pension schemes were launched in 2015 and tax benefits for such products were introduced. Accordingly, there are now a number of providers offering personal pension plans. Savers undertaking these plans can receive tax rebates on their savings for retirement. In 2017, the Government also implemented a measure intended to incentivise the take-up of voluntary occupational pensions. The Voluntary Occupational Pension Scheme Rules provide tax credits to both employees and employers (including self-occupied persons). Furthermore, in an effort to further diversify income in retirement and improve its adequacy, an Equity Release Working Group, tasked to come up with proposals on the introduction of Equity Release products in Malta, was set up.

6. Quality of Public Finances

The Maltese Government is of the view that the framework for better quality public finances should be based on strong links that connect resources, budgeting, monitoring and intervention with clear expectations for delivering detailed outcomes.

6.1 Improving the Structure and Efficiency of Revenue Streams

The Government is committed to ensuring a sustainable revenue stream arising from taxation that is supportive to the attainment of its fiscal targets as outlined in this Stability Programme. In recent years, the reforms have focused on shifting the tax burden away from labour, widening the tax bases, and tackling environmental concerns. In addition, the reforms have also aimed at making the tax system more transparent while combatting tax evasion and avoidance.

In view of the mitigating effects high income taxation may have on economic growth and employment, the Budget for 2018, built on previous efforts to shift the tax burden away from labour, and granted a tax rebate to persons in employment earning less than €60,000 a year, to the benefit of around 200,000 persons in employment.

Meanwhile, the Government has also started to deal with issues of housing supply by targeting vacant properties and extending the stamp duty reduction from 5.0 per cent to 2.5 per cent on vacant property within an Urban Conservation Area (UCA). This aims to address the issue of idle resources and incentivise owners to restore properties, making them available on the rental market within the context of an ever-increasing demand for rental units.

In order to further simplify the tax system and support small and medium enterprises (SMEs), the Budget for 2018 included an increase in the threshold below which SMEs will have the option not to charge output VAT by increasing the present threshold from €14,000 to €20,000. The concept of VAT grouping is also being introduced, which means that legal independent entities having fixed establishments in Malta and which have financial, economic and organisational ties between them, can register as a single taxable person for VAT purposes. Moreover, the Government will continue its work on preparing Tax Consolidation regulations that permit groups of companies to calculate their taxable income on a group basis.

6.1.1 Combating Tax Evasion, Fraud and Money Laundering

In line with European and international standards, the Government has introduced a number of measures in the area of taxation to combat money laundering, tax evasion and fraud. A Joint Enforcement Task Force (JETF) has been launched with the aim of continuing the fight against unjust competition in commerce and tax evasion. The Tax Compliance and Investigations Directorate will be actively participating in combined efforts to help identify potential fraudulent networks carrying out carousel fraud. Moreover, further resources will be allocated towards the fight against tax evasion and improved tax compliance across all economic sectors in terms of pre-registration, post-registration and control visits, translating into immediate follow-up action on any tax leakage. Further to the fight against tax evasion and unjust competition in relation to the remit of the Customs Department, heavier fines were introduced by both the Court and out-of-Court settlements. These should also serve as a deterrent against the evasion of excise duty.

In December 2017, the fourth Anti-Money Laundering Directive was transposed in national law, and now incorporates the latest Financial Action Task Force Recommendations in the field of anti-money laundering and counter-terrorist financing. The Government has also engaged an international consultancy firm to carry out a national risk assessment of the financial institutions to combat money laundering and fight tax evasion. A strategic plan has been devised in order to strengthen these institutions based on this risk-assessment. To oversee the implementation of this plan, a National Coordinating Committee, with its own permanent secretariat, has been set up. In addition, Malta has invited the International Monetary Fund (IMF) and the World Bank to conduct a Financial Sector Assessment Programme by the end of 2018 and preparations are underway to initiate this assessment.

At the request of the Maltese Government, a Fiscal Transparency Evaluation (FTE) exercise is currently being carried out in conjunction with the IMF's Fiscal Affairs Department. In line with Government's objective for effective fiscal management and accountability, this evaluation shall assist the Maltese Government to obtain a more in-depth assessment of public finances that substantiate economic decisions, including of the costs and benefits of policy changes and potential risks to public finances.

6.2 Ministries' Business and Financial Plans, including HR Plans

Whilst the Ministry for Finance (MFIN) remains responsible for high level business planning, Ministries and Departments have similar responsibilities for lower level business planning. Towards this end, Directive Number 10, which came into effect in February 2016, sought to improve planning and financial management within the public service. The Directive entails the obligation of preparing Business and Human Resources Plans for a period of three years, renewable every year.

In this regard, in 2017, the Ministry for Finance issued circular MFIN 1/17 to request the submission of the Ministries' 2018–2020 Business and Financial Plans. MFIN assessed the plans received by each Ministry/Department/Entity in order to compile the three-year fiscal projections. Along the budgetary process, two rounds of bilateral meetings were held with each line Ministry, one at Permanent Secretarial level and the second at Ministerial level. The business and financial plans were discussed in detail, clarifications were sought and the fiscal forecasts were consolidated to compute the estimates of revenue and expenditure in the 2018 Financial Estimates presented to Parliament in October 2017 and subsequently approved in December of the same year.

6.3 Monitoring and Assessing Public Finances

6.3.1 The Comprehensive Spending Reviews

The Comprehensive Spending Reviews establish the baselines of performance and spending, and assist the Ministry for Finance in reallocating resources according to the Government's priorities. Indeed, the Comprehensive Spending Reviews are a core element of the Maltese Government's strategy to ensure the achievement of a more efficient and effective approach to public spending, improving on the policy process while also ensuring that public spending is reflective of changing priorities and changing social needs. The review processes seek to phase out unnecessary expenditure, reduce waste and inefficiencies and ensure a better match between public programmes and policy outcomes. The expansion of the scope of the ongoing spending review exercise will help to strengthen existing institutions and their technical capacities.

Following the review at the Department for Social Security in 2014, several measures were introduced aiming at making work pay and encouraging the reduction of dependency on the benefit system. It is estimated that some 3,300 claimants have left the benefit system as they found employment and took advantage of the tapering of benefits and In Work Benefit. Meanwhile, social security spending has declined from 12.6 per cent of GDP in 2014 to 10.2 per cent of GDP in 2018., Following the 2015 review at Mater Dei Hospital, in 2017 the Comprehensive Spending Review programme focused on the Ministry for Health. This included the Ministry for Health itself, Primary Care Services, Pharmacy of Your Choice (POYC) and the Contracts Procurement Services Unit. The panel focused on issues of procurement for medicines, contractual obligations including clerical support services, care workers, hospital cleaning services and security services. The Comprehensive Spending Reviews at Primary Care and POYC were completed in July 2017. The main recommendation at POYC was to review the processes that would increase the efficiency in the distribution of medicines to patients entitled to free prescription drugs. It was recommended to improve the connectivity with Mater Dei and open an outreach office at the hospital to reduce potential waste and the risks of duplication of prescription for patients in receipt of repeat prescription drugs. The review of Primary Care concluded that there is the capacity to increase the functions at primary care (including cardiology clinics and physiotherapy) and allow for patients to visit primary care rather than the hospital outpatients' clinics. This would reduce waiting lists for appointments at outpatient clinics at Mater Dei as well as reduce the costs given that a visit to primary care costs less than a visit to outpatient clinics at Mater Dei. In the meantime, the process of decentralisation continues at Mater Dei Hospital.

In 2018, following the review at the Management Efficiency Unit (MEU) which was completed in January, the Spending Review exercise shall focus on the Malta College for Arts, Science and Technology (MCAST). The Review at MCAST started in early April 2018 and is due for completion in June 2018. A team has also been set up to evaluate and monitor progress on the Spending Review's recommendations for Health and Education

Meanwhile, a new directorate has been set up within the Budget Affairs Division of the Ministry for Finance, tasked with Public Sector Performance and Evaluation and in particular the Comprehensive Spending Reviews, value for money assessments, standard costing, cost-benefit analysis, base-line costs; performance indicators, and programme evaluation capabilities. A director has been appointed and the institution structuring is underway, where a number of officers are expected to be recruited during 2018 with a view to start introducing the spending review function during this current year.

6.4 Delivering Outcomes

An effective performance measurement system requires information on inputs (monetary and other resources), on outputs delivered and enabling actions achieved, as well as direct measures of outcomes.

6.4.1 Public Sector Productivity

Now that medium-term budgetary objectives have been reached, Malta is looking more towards the quality of public finances. This section delves into how the various functions of government are using the resources at their disposal to deliver public services in an efficient manner. This aims to ensure more effective spending through the comprehensive spending review as well as through improvements made in the efficiency and effectiveness of the tax system.

6.4.1.1 Measuring Public Sector Productivity in Malta

This section quantitatively evaluates the productivity growth in Malta's public sector. It is beyond the scope of the study to produce statistical estimates supplementing input-based estimates in the national accounts. However, the various measures of public sector outputs are useful indicators of productivity and are consequently considered an important input in collective bargaining or simply as an assessment of key performance indicators in the public sector.

Assessing public sector productivity is challenging, since in such studies, it is the outcomes which are of interest, and not just of the output itself. In order to calculate the growth in public sector productivity, this study will be using the same methodology applied in last year's Programme. The system takes into account outputs and inputs related to the provision of healthcare, education, social care, public order and safety, defence and other public services. This is achieved by weighting indices of outputs and outcomes per unit of inputs to compute an overall figure for productivity growth within the public sector.

6.4.1.2 Public Sector Inputs

Similarly, to last year's exercise, production inputs considered will be limited to labour inputs. Labour figures are based on estimates provided by the National Statistics Office (NSO) and have been segregated according to the Classification of the Functions of the Government (COFOG).

A comparative analysis of employment by COFOG within the Euro Area was not possible, so a comparison of expenditure as a share of Gross Domestic Product was performed. Results for the Maltese economy were found to be relatively similar to those in the Euro Area. As highlighted in Chart 6.1, the biggest gap is observed in Social Protection where other Euro Area countries spend more relative to Malta. The same applies to Health but this gap is considerably smaller in comparison to the one in Social Protection. On the other hand, the share of expenditure on education in Malta remains higher than that observed in the Euro Area.

In relative terms, the composition of employment has remained somewhat the same. Chart 6.2 shows how Education and Health constitute the two largest employment shares in the public sector, comprising 29.0 per cent and 21.0 per cent of government employees, respectively. Together, the two categories make up half of the government employees. These are followed by Economic Affairs which amounts to 13.0 per cent. Social Protection makes up 10.0 per cent of public employment, whilst General Public Services and Public Order and Safety, constitute 9.0 per cent of total employment each. In terms of expenditure, the categories ranked the same as in previous publications of this Programme.

Chart 6.1: ***Composition of General Government Expenditure in 2016 by COFOG***

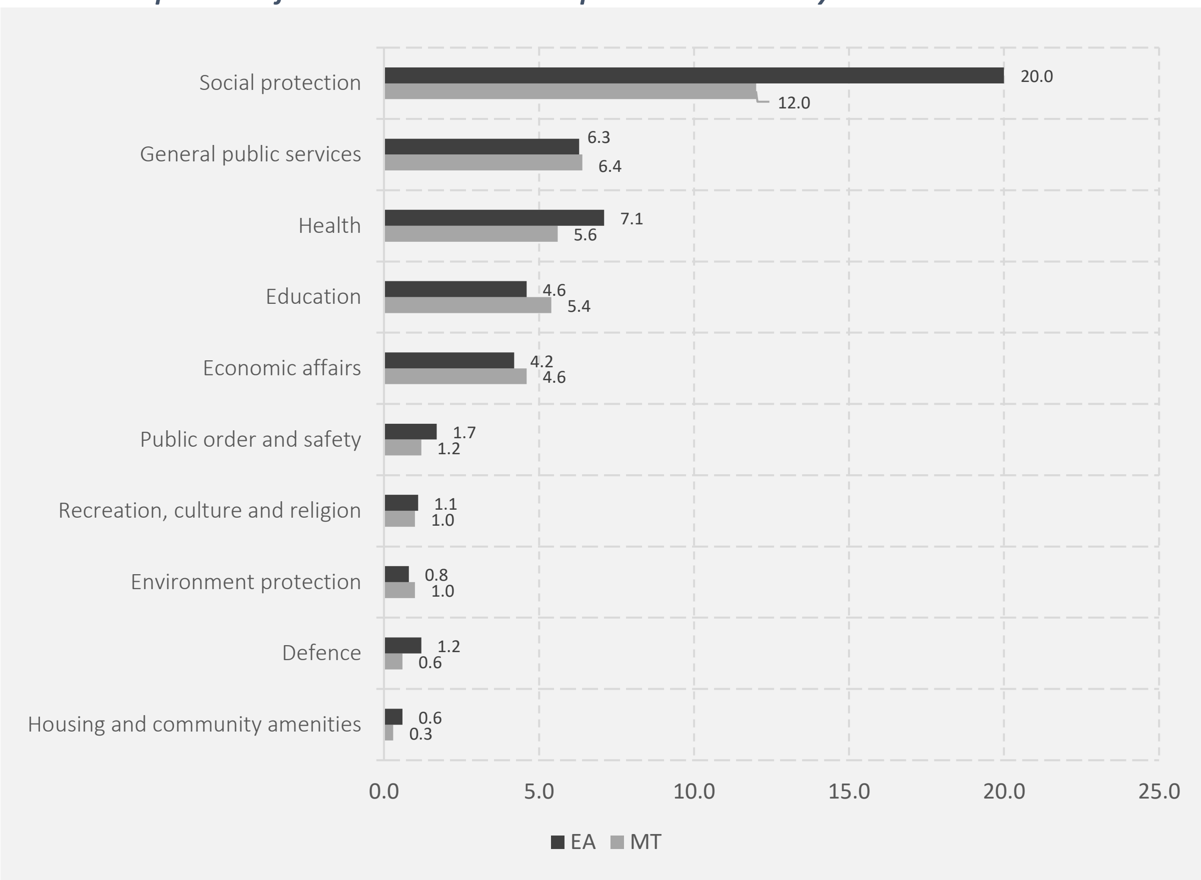


Chart 6.2: ***Composition of Public Sector Employment in 2016 by COFOG***

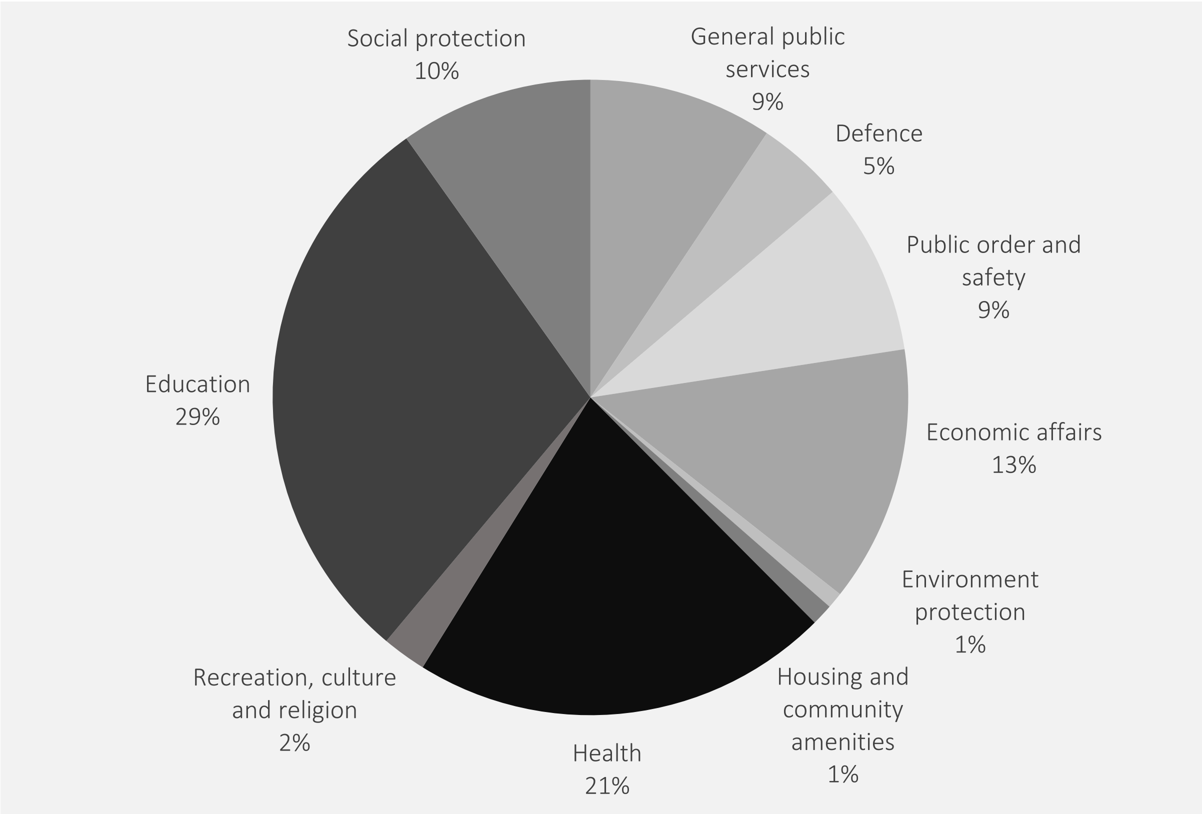
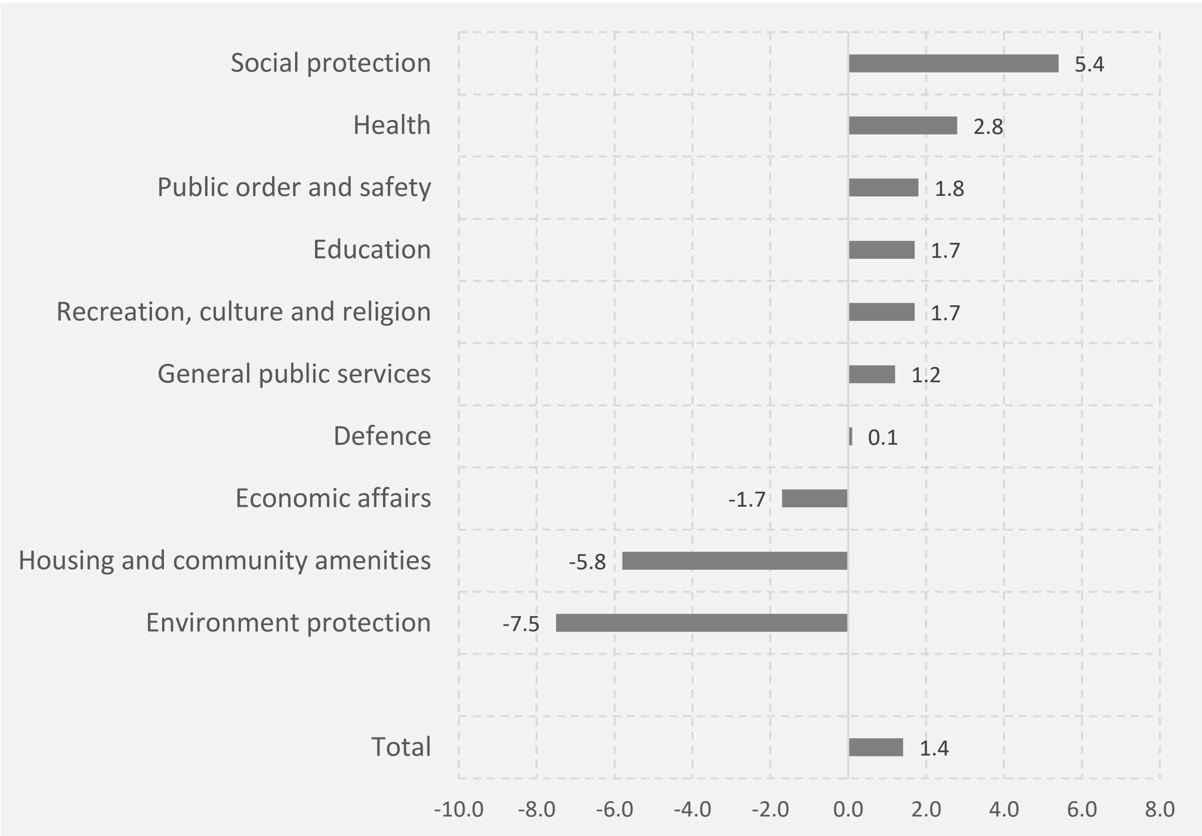


Chart 6.3: ***Average Annual Growth in Public Sector Employment by COFOG (2005-2016)***



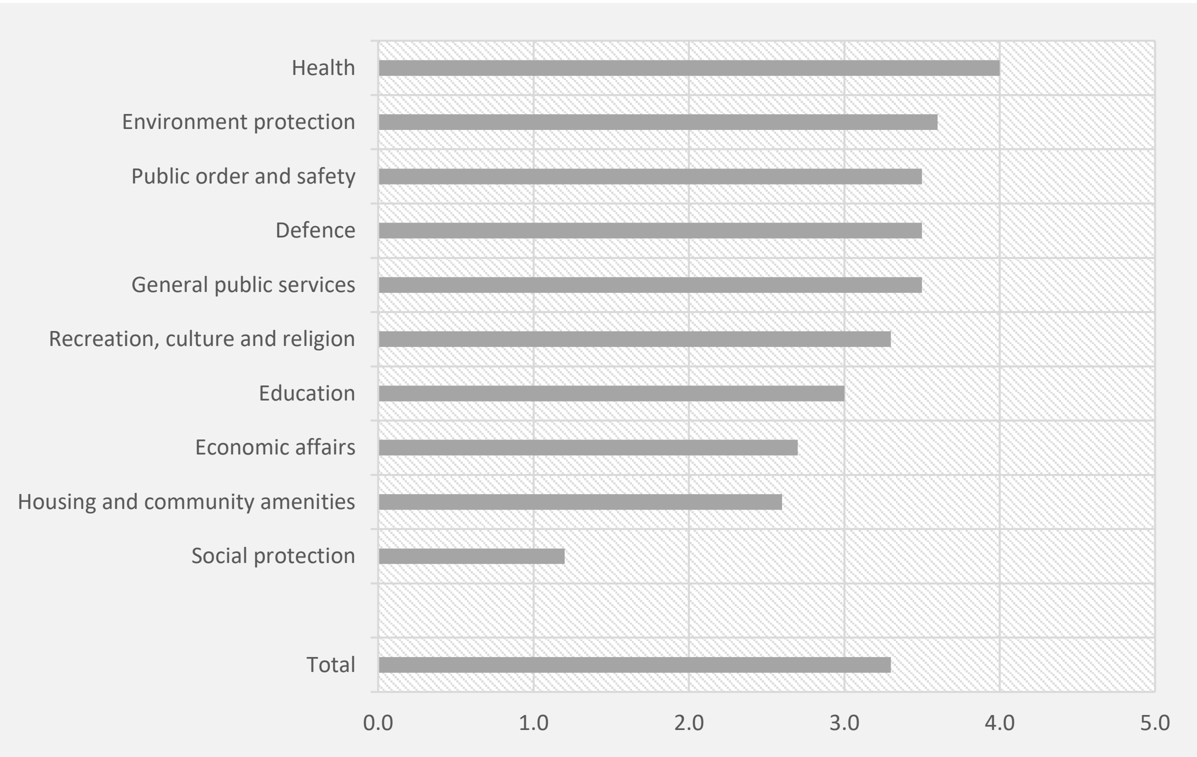
Employment growth between 2005 and 2016 averaged at 1.4 per cent per annum. The largest growth was recorded in Social Protection and Health. Chart 6.3 outlines that major declines were recorded in the Environment Protection and Housing Community Amenities categories, however this was mainly underpinned by the reclassification of employees to other COFOG categories. Nonetheless, employment growth has increased at an average annual growth rate of 2.0 per cent since 2010.

6.4.1.3 Public Sector Outputs

A measure of output was constructed for each of the COFOG categories. This was based on a number of indicators which cover a mix of both volume and quality. The methodology and indicators used for this study were documented in last year's Programme. Most of the selected indicators, particularly for Health and Social Protection, were only available from 2005, so the index captures productivity gains in the last decade.

As indicated in the Chart 6.4, an increase in output levels across all COFOG configurations was registered during this period. The highest increase was recorded in the Health sector (4.0 per cent), and the lowest output was registered in the Social Protection category (1.2 per cent). Taking the entire public sector into account, the average annual growth in public sector output since 2005 was of 3.3 per cent.

Chart 6.4: ***Average Annual Growth in Public Sector Output by COFOG since 2005***

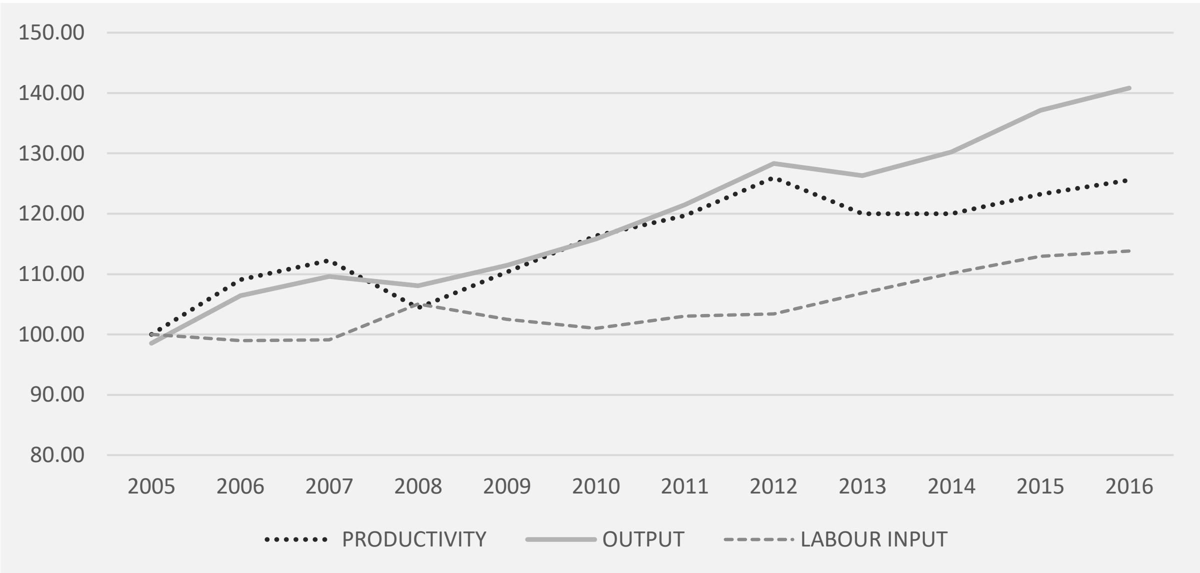


6.4.1.4 Public Sector Productivity

The Ministry for Finance (MFIN) estimates indicate that real public sector labour productivity has increased by an annual average of 2.1 per cent per annum since 2005. Whilst growth in real public sector productivity has slowed down since 2010, this is mostly attributable to the decline in productivity in 2013, when despite the rise in employment, output declined. After stabilising in 2014, as shown in Chart 6.5, productivity embarked on an upward path in the last two years under review.

The nominal value of public sector labour productivity can be estimated using real public-sector labour productivity together with a measure of any price changes related to public service provision. In the absence of a specific deflator from the output side, the GDP deflator was used as a measure of prices. This indicator is useful when comparing wage increases in the public sector. The nominal value of productivity in the public sector was thus estimated to have increased by an annual average of 4.2 per cent per annum since 2005.

Chart 6.5: ***PUBLIC SECTOR PRODUCTIVITY***



6.4.2 Public Service Renewal

During the past four years, a programme of constant renewal was implemented in the Public Service, aiming at delivering a more efficient service which satisfies the needs of both the public and civil servants. Several measures have been introduced since 2013, including five '*servizz.gov*' community hubs to enable easier access to services for citizens, a more concise Public Service Management Code (PSMC), efforts to reduce bureaucracy within the Public Service while safeguarding accountability, as well as reforms in the fields of public procurement and simplification of financial regulations.

Measures taken during 2017 to improve quality of service included the launch of the first 21 mobile apps for government services and the set up of the website '*servizz.gov.mt*' where about 800 services, and their related forms, may be accessed online. The website '*publicservice.gov.mt*' was also launched to disseminate information and news about the Public Service.

In 2017, the first 12 Key Performance Indicators (KPIs) for the Public Service were launched, with the intention of clearly specifying the targets which need to be reached within a specific timeframe. The KPIs launched in 2017 follow the pilot project introduced in 2016 for the business sector, through which the time needed to set up a new business was reduced drastically.

A mystery shopper for government departments was also introduced, in order to identify shortcomings in service delivery and remedy the situation accordingly.

The first collective agreement of its kind for Public Service employees was signed in 2017. This is the fifth agreement for the Public Service but the first one covering an eight-year period. The aim is to ensure more stability while allowing the administration to continue implementing the necessary changes, investing in people and offering a good quality service.

7. Institutional Features of Public Finances

Following the significant strengthening of Malta's institutional fiscal framework with the enactment of the Fiscal Responsibility Act (FRA) on 8th August 2014, a number of additional changes were legislated in 2018 to ensure full consistency with the Directive on Budgetary Frameworks. Furthermore, the European Commission has also evaluated Malta's transposition of the Fiscal Compact and concluded that the Fiscal Responsibility Act transposes in full the requirements of the Fiscal Compact. Other notable developments in the fiscal framework include the enactment of the Government Borrowing and Management of Public Debt Act and the submission and publication of the Government's official reply to the past Malta Fiscal Advisory Council (MFAC) recommendations which is meant to enhance transparency and accountability.

The Government is also strengthening the spending review process by providing a proper institutional framework and thus consolidating the ongoing work. A new directorate tasked with Public Sector Performance and Evaluation within the Budget Affairs Division of the Ministry for Finance (MFIN), has now been established. A director has been appointed, while a number of officers are expected to be recruited during 2018 with a view to start introducing the spending review function during this current year. In addition, at the request of the Maltese Government, during 2018 the IMF will undertake a Fiscal Transparency Evaluation (FTE) of Malta's public finances. In line with Government's objective for effective fiscal management and accountability, this evaluation shall assist the Maltese Government to obtain a more in-depth assessment of public finances that substantiate economic decisions, including the costs and benefits of policy changes and potential risks to public finances.

7.1 Legislative Developments

The year 2017 marked an important milestone in the legislation regarding public finances, with the passing of new legislation in July entitled Government Borrowing and Management of Public Debt Act, 2017 (Act No XXII – CAP 575). All the provisions of the Act came into force as from 1 September 2017, with the exception of certain articles. This Act, which is based on international best practices of debt management, consolidated and rationalised different pieces of legislation related to Government borrowing, such as the Malta Treasury Bills Act, 1952, the Local Loans (Registered Stock and Securities) Ordinance, 1959, and the Development Loan Acts of 1971 and 1972 and brought the management of public debt consistent with international sound practice in debt management. This legislation also introduced new features that were not covered by the previous legal framework. The aim of the Act is to contribute to a stronger governance system, as well as more transparency and prudency in terms of the management of Government debt, its cash position and liquidity and the reserve funds.

This legislation also introduced new features that were not covered by the previous legal framework, moving forward from a sixty-year old legislation focused entirely on domestic debt issuance to more comprehensive legislation comprising, but not limited to (i) different issuance methods of debt (ii) prudent administration of central government debt (iii) cash and liquidity management, and (iv) reserve funds. The aim of the Act was to contribute to a stronger governance system through, amongst other things, enhanced transparency and accountability. Moreover, it gives more flexibility for government to raise funds including the possibility to borrow funds from the international capital markets if the need arises.

Following a request for clarification in relation to the transposition in Maltese legislation of Council Directive 2011/85/EU on requirements of budgetary frameworks of the Member States (EU PILOT 8827/16/ECFI), and the subsequent exchange of views with the European Commission and various discussions, including with the MFAC, changes to the Act were legislated by the House of Representatives on 29th March 2018. These changes ensure the full transposition of the Directive, whilst taking the opportunity to clarify some aspects of the Act on the basis of the operational experience accumulated since its entry into effect.

The main amendments transposing the Directive may be summarised as follows:

1. Clearly specifying that the sensitivity analysis includes clear reference to the interest rate scenario and that the FRA requires explicitly that such analysis is not just contained in the Medium-Term Fiscal Policy Statement but also in the Annual Budget. This amendment is reflected in Article 15(6)a, ix and new Article 16(2)g. In practice these requirements were already being fulfilled prior to the legislative change.

2. A new function to carry out an independent ex-post assessment of macroeconomic and fiscal projections has been entrusted to the Malta Fiscal Advisory Council by virtue of the revised Article 13(3)e.

3. Revised Article 15(6)e contemplates that the fiscal risk assessment is to be carried out on the basis of the Malta Fiscal Advisory Council's independent ex-post assessment contemplated by the new Article 13(3)e and the Article 13(3)a reports by the MFAC, which call for the independent assessment of official forecasts. In practice, the MFAC's fiscal risk assessment of

the fiscal projections presented in the Stability Programme were already being incorporated in the Medium-Term Fiscal Plan submitted by Government to Parliament. Thus, in effect this good practice has now been entrenched through the changes in the Act.

4. The sensitivity analysis required by the Directive are also submitted to the scrutiny of the House during the annual budget with a view to enhance the awareness of the macroeconomic risks surrounding fiscal targets. This amendment is reflected in Article 16(2)g.

5. Amendments in line with Article 4(6) of the Directive aimed to ensure that
    a. the evaluation of macroeconomic forecasts including an evaluation of forecast accuracy and biases (referred to in Article 15(4)h of the FRA) shall now similarly be conducted in terms of fiscal forecasts;
    b. the FRA now makes it clear that both evaluations are to be made on "objective criteria" and
    c. the FRA now stipulates that "necessary action will be taken and made public" in case significant bias is detected affecting macroeconomic forecasts.

These amendments are being reflected in Article 15(6)e, Article 13(3)e, Article 15(4)h, Article 15(6)a, Article 16(2)g and Article 15(6)f, respectively.

7.2 Ministries' Business and Financial Plans, including HR Plans

In terms of the Fiscal Responsibility Act, Ministries, Departments and Government Entities are required to prepare their three-year business and financial plans which are based on the (most recently announced) medium-term fiscal strategy. In this regard, in 2017, the Ministry for Finance issued circular MF1/ 2017 (entitled 2018 - 2020 Business and Financial Plans).

The Ministry for Finance assessed the plans received by each Ministry/Department/Entity so as to compile the three-year fiscal projections. Along the budgetary process, two rounds of bilateral meetings were held with each line Ministry, one at Permanent Secretary level and another at Ministerial level. These meetings were held to discuss the plans in detail, seek clarifications and consolidate the fiscal forecasts, including proposals for budget measures which were put forward by the line Ministries. This was done to arrive at the estimates of revenue and expenditure in the 2018 Financial Estimates which were presented to Parliament in October 2017 and subsequently approved in December of the same year.

Following the issue of Directive 10, which aims at enabling the streamlining of procedures and processes for the formulation of business plans and human resource function, Ministries and Departments were required to provide a revised version of the HR Plans for 2018, based on the budget allocations provided for in the 2018 Financial Estimates. This was done to ensure that recruitment occurring during 2018 was within the parameters of the approved budgetary estimates.

7.3 The Malta Fiscal Advisory Council

The Malta Fiscal Advisory Council (MFAC) is an independent fiscal institution (IFI) which was established on 1st January 2015 in terms of the Fiscal Responsibility Act (FRA), 2014. The MFAC is composed of a chairman and two executive members, and at present, is supported by three economists and an administrator. In 2017, the MFAC held twelve formal Council Meetings to discuss various administrative and operational issues. These meetings mainly focused on the annual work programme, financial control, human resources, the planning of official travel and training programmes. Extensive discussions were also held on the assessment of macroeconomic forecasts, the fiscal policy thrust and public finance conditions, as part of the endorsement process, as well as on the Council's recommendations to the Ministry for Finance regarding fiscal policy issues.

In line with the objective of increasing transparency, providing information on fiscal policy and providing a means for the exchange of views across stakeholders, the Council, in collaboration with the European Commission Representation in Malta, held a conference on 23 October 2017, which focused on 'The Role of Fiscal Policy for Sustainable Economic Growth'. The Seminar provided the opportunity to discuss key issues relating to the conduct of fiscal policy and how these affect economic growth and sustainability. This was the first conference that the MFAC hosted since the start of its operation in 2015.

In 2017, the MFAC issued its Annual Report and Statement of Accounts for 2016. The MFAC then issued three reports on the assessment of the Medium-Term Fiscal Strategy of the Maltese Government for 2017-2020. These reports were related to the endorsement of the macroeconomic forecasts, the endorsement of the fiscal forecasts, and an overall assessment in terms of compliance with fiscal rules. The same modus operandi was used for the assessment of the Draft Budgetary Plan for 2018. Two further reports were issued during the year, which assessed the Ministry for Finance's Annual Report for 2016 and the Half-Yearly Report for 2017. Throughout the year the MFAC continued to make recommendations in the area of public finances and monitor the progress in implementation. The full set of recommendations made to date, and the extent of progress, were reported in the MFAC's 2017 Annual Report, which was published in March 2018.

Throughout 2017, the channels of communication between the Ministry for Finance and the MFAC have been strengthened, particularly through a calendar of regular dialogue meetings and exchange of correspondence. The Ministry has also forwarded its first official response to the recommendations made by the MFAC, which response is now published in the MFAC's most recent Annual Report.

On 30 January 2017, the MFAC was convocated to a meeting of the Public Accounts Committee, in terms of Article 57 of the FRA, for a discussion on the Council's overall assessment of the Draft Budgetary Plan (DBP) for 2017 and the relative report published by the Council on 28 December 2016.

The Council issued eight press releases during the year. The MFAC also featured several times in local newspapers, following the publication of its press releases. The Chairman and the Chief Economist also participated in TV and radio interviews and discussions during the year, with the objective of enhancing public awareness regarding relevant fiscal policy issues and information.

In order to ensure high quality standards in its deliverables, the MFAC continued to develop further its links with other international fiscal institutions and counterparts abroad. These included, participation in the regular meetings of the Network of EU IFIs coordinated by the European Commission, the Informal Network of EU IFIs, as well as the OECD Network of Parliamentary Budget Officials and IFIs (as observer). The MFAC maintained its active participation in the meetings and working groups of the Network of European Union Independent Fiscal Institutions, including the Working Group on the Output Gap and the Working Group on the Medium-Term Budgetary Framework.

Statistical Appendix

Macroeconomic Prospects

Table 1a

Percentages unless otherwise indicated	ESA Code	Level 2016[1]	Percentage change over previous period 2016	2017	2018[2]	2019	2020	2021
1. Real GDP	B.1g	9,007.9	5.5	6.6	6.1	5.3	4.8	4.6
2. Nominal GDP	B.1g	10,191.7	7.1	9.0	8.3	7.5	6.7	6.6
Components of real GDP								
3. Private consumption expenditure[3]	P.3	4,453.4	3.0	4.3	4.4	3.8	3.6	3.3
4. Government consumption expenditure	P.3	1,505.0	-2.7	-0.3	15.2	1.8	1.7	3.1
5. Gross fixed capital formation	P.51	2,090.0	1.6	-7.4	4.2	10.0	2.6	6.3
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53		0.8	1.2	1.2	1.1	1.1	1.0
7. Exports of goods and services	P.6	12,376.7	4.5	1.6	3.1	3.4	3.2	2.8
8. Imports of goods and services	P.7	11,536.0	1.5	-3.0	2.9	2.8	1.6	2.1
Contribution to real GDP growth[4]								
9. Final domestic demand		8,048.4	1.4	0.1	5.4	4.2	2.5	3.3
10. Change in inventories and net acquisition of valuables	P.52+P.53		-0.1	0.6	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	840.7	4.3	5.9	0.8	1.1	2.3	1.2

[1] € million

[2] Forecasts from 2018 onwards

[3] Includes NPISH final consumption expenditure

[4] Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. This non-additivity, similar to that in other countries' national accounts, is due to mathematical reasons and reflects the fact that chain-linked volumes are calculated by separately extrapolating both totals and their sub-components.

Price Developments

Table 1b

Percentages unless otherwise indicated	ESA Code	Level 2016[1]	Percentage change over previous period 2016	2017	2018[2]	2019	2020	2021
1. GDP deflator[3]		113.1	1.5	2.3	2.2	2.2	1.9	2.0
2. Private consumption deflator		107.6	0.4	0.2	1.7	1.8	1.8	1.9
3. HICP (Average 2010=100)		109.9	0.9	1.3	1.6	1.8	1.9	2.0
4. Public consumption deflator		111.0	1.7	1.7	1.9	1.8	1.8	1.9
5. Investment deflator		119.8	1.4	2.4	2.2	2.2	2.1	1.9
6. Export price deflator (goods and services)		113.6	1.2	3.6	2.2	1.9	1.6	1.7
7. Import price deflator (goods and services)		111.9	0.7	2.9	2.1	1.7	1.6	1.6

(1) Index (base 2010 unless otherwise indicated)

(2) Forecasts from 2018 onwards

(3) Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. Indeed, summing up the deflators of the components of GDP would not add up to the actual GDP deflator observed for the year. For this reason, the GDP deflator quoted in this table for 2014 and 2015 reflects the actual difference between nominal and real GDP growth rates for the year.

Labour Market Developments

Table 1c

Percentages unless otherwise indicated	ESA Code	Level 2016(	Percentage change over previous period 2016	2017	2018[1]	2019	2020	2021
1. Employment, persons (National Accounts Definition, Domestic Concept)		203,823	4.0	5.4	3.8	3.5	3.2	3.1
2. Employment, hours worked (National Accounts Definition, Domestic Concept) ('000s)		411,689	7.1	4.2	3.8	3.5	3.2	3.1
3. Unemployment rate (Harmonised definition, 1000 persons)		9,000	4.7	4.0	3.8	3.9	4.0	4.0
4. Labour Productivity, persons (Real GDP per person employed)		44,195	1.4	1.1	2.1	1.7	1.6	1.4
5. Labour Productivity, hours worked (Real GDP per hour worked)		21.9	-1.5	2.3	2.1	1.7	1.6	1.4
6. Compensation of employees (€ million)	D1	4,283.8	7.1	6.8	7.1	6.8	6.3	6.2
7. Compensation per employee (€)		21,017	2.9	1.3	3.2	3.2	3.1	3.0

[1] Forecasts from 2018 onwards

Sectoral Balances

Table 1d

Percentages of GDP	ESA Code	2016	2017	2018	2019	2020	2021
1. Net lending/ borrowing		7.4	13.0	13.6	16.2	17.0	19.0
vis-à-vis the rest of the world	B.9						
of which:							
Balance on goods and services		11.8	17.6	17.1	17.4	18.9	19.4
Balance of primary incomes and transfers		-4.8	-5.0	-3.5	-1.4	-2.1	-0.5
Capital account		0.4	0.4	0.1	0.2	0.2	0.2
2. Net lending/ borrowing of the private sector	B.9	5.7	7.9	11.6	14.3	15.2	16.6
3. Net lending/ borrowing of general Government	EDP B.9	1.0	3.9	1.1	0.9	0.9	1.6
4. Statistical discrepancy		0.7	1.1	1.0	0.9	0.9	0.8

General Government Budgetary Prospects

Table 2a

Percentages of GDP		ESA code	2016(*)	2017(*)	2016	2017	2018	2019	2020	2021
Net Lending (EDP B9) by sub-sector										
1.	General Government	S13	101.0	436.6	1.0	3.9	1.1	0.9	0.9	1.6
2.	Central Government	S1311	96.6	432.0	0.9	3.9	1.1	0.9	0.9	1.6
3.	State Government	S1312	-	-	-	-	-	-	-	-
4.	Local Government	S1313	4.3	4.6	0.0	0.0	0.0	0.0	0.0	0.0
5.	Social security funds	S1314	-	-	-	-	-	-	-	-
General Government										
6.	Total revenue	TR	3,882.0	4,494.6	38.1	40.5	38.7	38.0	37.6	37.4
7.	Total expenditure	TE	3,781.0	4,057.9	37.1	36.5	37.6	37.1	36.7	35.8
8.	Net lending / borrowing	B9	101.0	436.6	1.0	3.9	1.1	0.9	0.9	1.6
9.	Interest expenditure	D41	217.9	206.7	2.1	1.9	1.6	1.4	1.3	1.2
10.	Primary balance(1)		318.8	643.3	3.1	5.8	2.7	2.4	2.2	2.8
11.	One-off and other temporary measures(2)		-3.0	-17.3	0.0	-0.2	0.1	0.1	0.1	0.0
Selected Components of Revenue										
12.	Total Taxes (12=12a+12b+12c)		2,675.9	2,997.2	26.3	27.0	27.0	26.7	26.5	26.4
12a.	Taxes on production and imports	D2	1,276.1	1,408.1	12.5	12.7	12.3	11.9	11.7	11.6
12b.	Current Taxes on Income, Wealth, etc.	D5	1,383.9	1,569.8	13.6	14.1	14.5	14.6	14.6	14.7
12c.	Capital Taxes	D91	15.9	19.3	0.2	0.2	0.2	0.2	0.2	0.2
13.	Social Contributions	D61	639.3	702.9	6.3	6.3	6.3	6.2	6.1	6.0
14.	Property Income	D4	90.1	85.2	0.9	0.8	0.9	0.8	0.8	0.7
15.	Other(3)		476.7	709.2	4.7	6.4	4.5	4.4	4.2	4.3
16=6.	Total Revenue	TR	3,882.0	4,494.6	38.1	40.5	38.7	38.0	37.6	37.4
p.m.:	Tax Burden (D2+D5+D6111+D6131+D91-D995)(4)		3,331.0	3,720.4	32.7	33.5	33.5	33.1	32.8	32.6
Selected Components of Expenditure										
17.	Compensation of employees + intermediate consumption	D1+P2	1,811.3	2,025.1	17.8	18.2	18.1	17.8	17.3	16.9
17a.	Compensation of employees	D1	1,179.4	1,271.1	11.6	11.4	11.4	11.1	10.8	10.6
17b.	Intermediate consumption	P2	631.9	754.0	6.2	6.8	6.7	6.7	6.5	6.4
18.	Social payments (18=18a+18b)		1,086.0	1,138.4	10.7	10.2	10.0	9.7	9.4	9.1
	of which Unemployment benefits (5)		30.6	27.3	0.3	0.2	0.2	0.2	0.2	0.2
18a.	Social transfers in kind supplied via market producers	D632	64.8	74.7	0.6	0.7	0.7	0.8	0.7	0.7
18b.	Social transfers other than in kind	D62	1,021.2	1,063.7	10.0	9.6	9.4	8.9	8.6	8.4
19=9.	Interest expenditure	D41	217.9	206.7	2.1	1.9	1.6	1.4	1.3	1.2
20.	Subsidies	D3	132.0	132.2	1.3	1.2	1.2	1.2	1.2	1.1
21.	Gross fixed capital formation	P51G	255.2	249.0	2.5	2.2	3.0	3.3	3.5	3.4
22.	Capital transfers	D9	78.7	103.5	0.8	0.9	1.7	1.4	1.3	1.3
23.	Other(6)		199.9	203.1	2.0	1.8	2.0	2.3	2.7	2.8
24=7.	Total Expenditure	TE	3,781.0	4,057.9	37.1	36.5	37.6	37.1	36.7	35.8
p.m.:	Government consumption (nominal)	P3	1,671.0	1,696.1	16.4	15.3	17.1	17.1	16.8	16.5

(*) € million

(1) The primary balance is calculated as (B9, item 8) plus (D41, item 9)

(2) A plus sign means deficit-reducing one-off measures

(3) P10 + D39rec + D7rec + D9N (ie D9 other than D91rec)

(4) Including those collected by the EU and including an adjustment for uncollected taxes and social contributions D995), if appropriate

(5) Includes social benefits other than social transfers in kind (D62) and social transfers in kind via market producers (D632) related to unemployment benefits

(6) D29pay + D4Npay (ie D4 other than D41pay) + D5pay + D7pay + P5M + NP + D8

No policy change projections

Table 2b

Percentages of GDP		2017(1)	2017	2018	2019	2020	2021
1.	Total revenue at unchanged policies	4,494.6	40.5	40.4	39.8	39.2	38.8
2.	Total expenditure at unchanged policies	4,057.9	36.5	37.7	37.2	37.2	36.3

(1) € million

Amounts to be excluded from the expenditure benchmark

Table 2c

Percentages of GDP		2016[1]	2017[1]	2016	2017	2018	2019	2020	2021
1.	Expenditure on EU programmes fully matched by EU funds revenue	39.4	69.5	0.4	0.6	1.1	1.2	1.1	1.2
1a.	*of which* Investment fully matched by EU funds revenue[2]	18.5	49.5	0.2	0.4	0.6	0.7	0.7	0.7
2.	Cyclical unemployment benefit expenditure[3]	-0.8	-2.7	0.0	0.0	0.0	0.0	0.0	0.0
3.	Effect of discretionary revenue measures	125.3	128.5	1.2	1.2	-1.7	-0.2	0.1	0.1
4.	Revenue increases mandated by law	-	-	-	-	-	-	-	-

[1] € million

[2] Based on an estimate of Gross Fixed Capital Formation financed from EU funds

[3] The cyclical unemployment benefit expenditure is estimated based on the difference between the unemployment rate and NAWRU. Data for the total unemployment benefit expenditure is defined in COFOG under the code 10.5

General Government Expenditure by Function

Table 3

	Percentages of GDP	COFOG Code	2016	2021
1.	General public services	1	6.2	5.6
2.	Defence	2	0.6	0.6
3.	Public order and safety	3	1.1	1.1
4.	Economic affairs	4	4.5	4.9
5.	Environmental protection	5	1.0	1.4
6.	Housing and community amenities	6	0.3	0.3
7.	Health	7	5.5	5.2
8.	Recreation, culture and religion	8	1.0	1.0
9.	Education	9	5.2	5.2
10.	Social protection	10	11.7	10.3
11.	Total Expenditure	TE	37.1	35.8

General Government Debt Developments

Table 4

Percentages of GDP	ESA Code	2016	2017	2018	2019	2020	2021
1. Gross debt		56.2	50.8	45.8	42.5	39.3	35.6
2. Change in gross debt ratio		-4.4	-5.4	-5.1	-3.2	-3.2	-3.7
Contributions to changes in gross debt							
3. Primary balance		-3.1	-5.8	-2.7	-2.4	-2.2	-2.8
4. Interest expenditure	EDP D.41	2.1	1.9	1.6	1.4	1.3	1.2
5. Stock-flow adjustment		2.0	3.2	-0.1	0.9	0.3	0.3
p.m. implicit interest rate on debt(1)		3.9	3.6	3.4	3.4	3.3	3.2

(1) Proxied by interest expenditure divided by the debt level of the previous year.

Cyclical Developments

Table 5

Percentages of GDP	ESA Code	2016	2017	2018	2019	2020	2021
1. Real GDP growth (%)		5.5	6.6	6.1	5.3	4.8	4.6
2. General Government balance	EDP B.9	1.0	3.9	1.1	0.9	0.9	1.6
3. Interest expenditure	EDP D.41	2.1	1.9	1.6	1.4	1.3	1.2
4. One-off and other temporary measures(1)		0.0	-0.2	0.1	0.1	0.1	0.0
of which							
One-offs on the revenue side: general Government		0.1	0.1	0.1	0.1	0.1	0.0
One-offs on the expenditure side: general Government		-0.1	-0.2	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		6.9	6.3	6.0	5.9	5.2	5.0
contributions:							
- labour (hours)		3.2	3.1	2.8	2.6	2.1	1.8
- capital		2.1	1.5	1.5	1.7	1.6	1.7
- total factor productivity		1.6	1.6	1.6	1.5	1.5	1.5
6. Output Gap		0.7	1.0	1.0	0.4	0.0	-0.6
7. Cyclical Budgetary Component		0.3	0.5	0.5	0.2	0.0	-0.3
8. Cyclically-Adjusted Balance (2-7)		0.7	3.5	0.6	0.7	0.9	1.8
9. Cyclically-Adjusted Primary Balance (8+3)		2.8	5.3	2.2	2.2	2.2	3.0
10. Structural Balance (8-4)		0.7	3.6	0.6	0.7	0.9	1.8

(1) A plus sign means deficit-reducing one-off measures

Divergence from the April 2017 Stability Programme

Table 6

Percentages of GDP	ESA Code	2016	2017	2018	2019	2020	2021
Real GDP growth							
Previous update		5.0	4.3	3.7	3.5	3.4	…
Current update		5.5	6.6	6.1	5.3	4.8	4.6
Difference		0.5	2.3	2.4	1.8	1.4	-
General Government net lending	EDP B.9						
Previous update		1.0	0.5	0.5	0.5	0.5	…
Current update		1.0	3.9	1.1	0.9	0.9	1.6
Difference		0.0	3.4	0.6	0.4	0.5	-
General Government gross debt							
Previous update		58.3	55.9	52.5	50.0	47.6	…
Current update		56.2	50.8	45.8	42.5	39.3	35.6
Difference		-2.1	-5.1	-6.7	-7.5	-8.3	-

Long-term Sustainability of Public Finances

Table 7

Percentages of GDP	2016	2020	2030	2040	2050	2060	2070
Total expenditure	20.1	19.8	20.3	21.4	23.0	25.6	27.0
Of which: age-related expenditures							
Pension expenditure	8.0	7.8	7.1	7.3	8.7	10.5	10.9
Social security pension	8.0	7.8	7.1	7.3	8.7	10.5	10.9
Old-age and early pensions	5.0	5.1	5.0	5.6	7.0	8.8	9.3
Other pensions (disability, survivors)	3.0	2.7	2.1	1.7	1.7	1.7	1.6
Occupational pensions (if in general government)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Health care	5.6	5.6	5.6	5.6	5.6	5.6	5.6
Long-term care (this was earlier included in the health care)	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Education expenditure	5.4	5.4	5.4	5.4	5.4	5.4	5.4
Other age-related expenditures	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Interest expenditure	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Total revenue							
Of which: property income	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Of which: from pensions contributions (or social contributions if appropriate)	8.1	7.0	6.9	6.7	6.6	6.5	6.3
Pension reserve fund assets	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Of which: consolidated public pension fund assets (assets other than government liabilities)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Systemic pension reforms18							
Social contributions diverted to mandatory private scheme	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Pension expenditure paid by mandatory private scheme	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Assumptions							
Labour productivity growth	2.5	2.6	2.4	1.8	1.6	1.6	1.5
Real GDP growth	5.0	4.1	3.2	2.0	1.2	1.2	1.6
Participation rate males (aged 20-64)	86.8	87.0	90.4	89.4	89.1	89.4	89.7
Participation rates females (aged 20-64)	58.3	63.8	75.2	78.7	79.3	79.5	80.2
Total participation rates (aged 20-64)	72.9	75.7	83.0	84.2	84.3	84.6	85.0
Unemployment rate (aged 20-64)	3.8	4.2	5.1	5.1	5.1	5.0	5.0
Population aged 65+ over total population	19.3	21.2	24.4	25.1	27.0	29.9	30.6

Basic Assumptions

Table 8

	2016	2017	2018(f)	2019(f)	2020(f)	2021(f)
Short-term interest rate (annual average)	0.00	0.00	0.00	0.19	0.35	0.35
Long-term interest rate (annual average)	0.90	1.30	1.20	1.20	1.20	1.20
USD/EUR exchange rate (average)	1.1047	1.1476	1.2260	1.2320	1.2380	1.2380
GBP/EUR exchange rate (average)	0.8338	0.8760	0.8466	0.8473	0.8375	0.8375
Malta's main trading partners growth	1.4	2.0	2.1	1.8	1.5	1.4
Oil prices, (Brent, USD/barrel)	43.5	54.2	64.3	62.8	62.8	62.8
World prices weighted by main trading partners (y-o-y % change)	-2.0	2.8	2.1	1.7	1.6	1.7

Basic Fiscal Assumptions

Table 8b

	ESA Code	2016	2017	2018(f)	2019(f)	2020(f)	2021(f)
Implied Elasticity with respect to respective Tax Base							
Taxes on Production and Imports	D2	6.1	0.9	0.8	0.6	0.8	0.9
of which Value Added Taxes	D212	5.5	1.4	1.2	0.8	1.1	1.3
Current Taxes on Income, Wealth, etc. [Personal]	D5	2.0	1.4	1.6	1.2	1.1	1.2
Current Taxes on Income, Wealth, etc. [Corporate]	D5	1.0	1.6	0.9	0.8	0.8	0.9
Net social contributions	D61	1.0	1.5	1.1	0.9	0.7	0.7
General Government Adjustments (€ millions)		**92.1**	**254.0**	**11.9**	**52.3**	**-11.6**	**-3.6**
Other accounts payable and receivable		-31.9	35.2	24.9	23.9	23.9	23.9
Treasury Clearance Fund & Good Causes Fund		-24.4	37.2	20.0	9.4	0.0	0.0
Air Malta Adjustment		-12.0	0.0	0.0	0.0	0.0	0.0
Social and Investment Fund - IIP - Revenue		120.1	199.7	77.0	65.0	73.0	81.0
Social and Investment Fund - IIP - Expenditure		0.0	0.0	-35.0	-35.0	-98.0	-98.0
Others		40.3	-18.1	-75.0	-11.0	-10.5	-10.5
Social Security Benefits							
COLA (€)		1.75	1.75	1.75	2.91	3.49	3.49
Contributory Benefits (€ millions)		712.2	749.7	782.4	806.6	844.1	878.6
Number of CB Beneficiaries (persons)		114,018	116,384	118,594	120,381	122,329	123,739
Non-Contributory Benefits (€ millions)		188.5	189.1	199.9	202.9	206.6	206.6
Number of NCB Beneficiaries (persons)		110,261	110,172	110,614	111,084	111,821	110,556

Contingent liabilities

Table 9 % of GDP

	2016	2017	2018	2019	2020	2021
Public guarantees	13.7	9.6	8.9	8.3	7.8	7.3

Note: The data for Contingent liabilities for 2016 to 20167 is actual, while data for 2018 to 2021 is an estimate

Stock Flow Adjustment Statement

Table 10

Millions of Euros	2017	2018	2019	2020	2021
General Government deficit (-) / surplus (+) (ESA10)	**-436.6**	**-132.0**	**-119.0**	**-127.0**	**-233.0**
ESA Adjustments	254.0	11.9	52.3	-11.6	-3.6
Contribution to Sinking Fund (Local)	3.3	-88.4	0.0	0.0	0.0
Contribution to Sinking Fund (Foreign)	1.7	0.1	0.1	0.1	0.1
Contribution to Special MGS Sinking Fund	50.0	50.0	50.0	50.0	50.0
Equity Acquisition	71.4	63.5	2.6	2.6	2.6
EFSF/ESM Credit Line Facility	0.0	4.5	4.5	4.5	4.5
Courts and other deposits	-24.7				
Stock Premium paid to Church	1.1	0.7	1.4	0.0	0.3
Repayment of Loans to Government	0.0	0.0	0.0	0.0	0.0
Sale of Assets	-0.9	-0.9	-0.9	-0.9	-0.9
Sale of Non-Financial Assets	-	-			
EBUs	3.7	0.0	0.0	0.0	0.0
Currency	5.4	18.5	12.8	14.7	16.9
Movement in Bank Account	26.6	-	-	-	-
Other Statistical Discrepancies	-	-	-	-	-
Increase/(Decrease)in cash balance	-46.1	-7.9	-0.2	-0.1	-0.2
Increase/(Decrease) in Non-Consolidated Debt	**-91.2**	**-80.0**	**3.6**	**-67.7**	**-163.3**
MGS Consolidation	9.8	-60.2	-9.2	-11.6	-19.9
Increase/(Decrease) in Consolidated Debt	**-81.4**	**-140.2**	**-5.6**	**-79.3**	**-183.2**
SFA	**355.2**	**-8.2**	**113.4**	**47.7**	**49.8**

Appendix I – Fiscal Risk Assessment

The following section contains an overview of the fiscal risks identified by the Malta Fiscal Advisory Council (MFAC).

Malta's medium term fiscal strategy envisaged for the 2019-2021 period hinges on the macroeconomic projections contained in this Plan. These macroeconomic projections were assessed by the MFAC and were considered to be within their endorsable range. In particular, the MFAC noted that these projections are fairly in line with the views for the Maltese economy expressed by other institutions particularly the CBM, the EC and the IMF. Moreover, 'the Fiscal Council views the balance of risks to GDP growth for the period 2018 to 2021 as broadly neutral, with the possible downside risks associated to the external sector likely to be compensated for by possible upside risks related to domestic demand'.

The MFAC considers the revenue forecasts as generally prudent. At the same time, the possibility of upside risks in relation to revenue may possibly be more than countered by upside risks to expenditure forecasts, in particular for the period 2019 to 2021. Indeed, the Council considers the revenue forecasts as 'generally prudent with the possibility of upside risks in relation to taxes on production and imports over the period 2018 to 2021', since in the opinion of the Council, the Ministry's projections for this item of revenue appear to be rather cautious. On the other hand, the Council identifies possible downside risks to expenditure projections in 2018, but upside risks for the period 2019 to 2021. In particular, in terms of expenditure, whilst the MFAC identified downside risks to expenditure on gross fixed capital formation and 'other' expenditure in 2018, over the period 2019 to 2021 the Council considers that there could be upside risks to expenditure associated with spending on compensation of employees and intermediate consumption, which could however be partially mitigated by similar downside risks relating to the 'other expenditure' category, should no recourse to the contingency reserve be made.

Overall, the MFAC considers that the upside risks to total revenue and the concurrent downside risks to total expenditure allow for the possibility of a larger fiscal surplus in 2018. For the period 2019 to 2021, the Council is of the opinion that upside risks to total expenditure may more than offset the upside risks to total revenues, such that the fiscal surplus could be less than planned during these years. Nevertheless, the MFAC considers the planned stream of fiscal surpluses within its endorsable range, such that the anticipated steady decline in the debt-to-GDP ratio is deemed to be plausible.

The Government takes note of the opinion of the MFAC and is continuously monitoring the situation to ensure appropriate action is taken if deemed necessary.