BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

Economic Projections

2020 - 2022

2020:1

Outlook for the Maltese economy

Economic projections

2020-2022

The Bank's latest economic projections were produced on the basis of information available until 28 February 2020, prior to the first case of COVID-19 in Malta.

At that point in time, the Central Bank of Malta expected economic growth over the coming years to moderate but remain strong. Growth was primarily expected to be supported by all components of domestic demand. Compared with the Bank's previous projections, published in December 2019, Gross Domestic Product (GDP) growth was revised downwards in 2020. Similarly, the pace of job creation was expected to ease but remain strong from a historical perspective. Meanwhile, annual inflation, based on the Harmonised Index of Consumer Prices (HICP), was projected to pick up, reflecting faster increases in services prices and non-energy industrial goods.

The government balance was expected to remain in surplus over the coming years, such that the debt-to-GDP ratio was projected to decline to 36.1% by 2022.

The COVID-19 global health crisis, however, has meanwhile prompted a powerful and ongoing economic shock. In this regard, the Central Bank of Malta has made some preliminary estimates of the impact of the containment measures imposed by the Maltese government until 15 March 2020. At that juncture, the Bank estimated that containment measures imposed until that date would lower GDP growth by around 3.5 percentage points, when compared with the baseline projections. In addition, as a result of lower GDP growth, the fiscal balance would be adversely affected by around 0.8 percentage points.

The fluidity of this situation and its unknown duration mean that these estimates are characterised by a high degree of uncertainty. Thus, the Bank is continuously updating its outlook as new information becomes available.

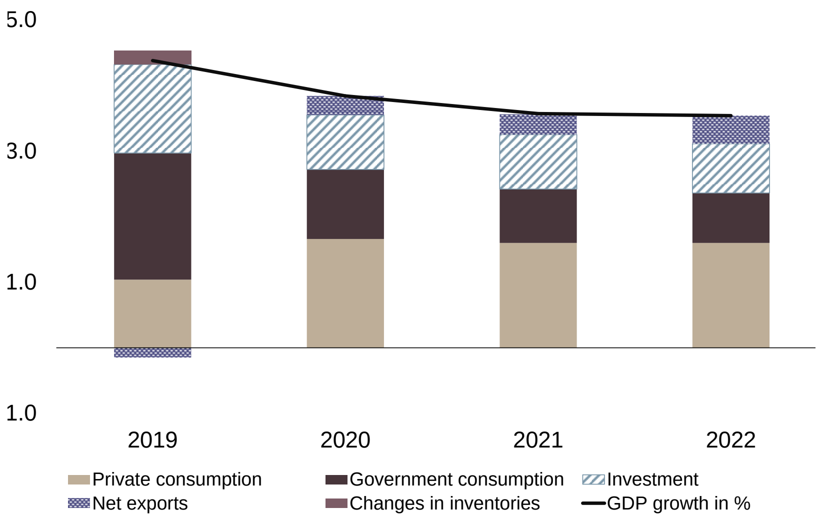
1 Economic outlook

The Bank's latest economic projections were based on information available until 28 February 2020. This was prior to the first case of COVID-19 in Malta. Hence, the baseline projections do not include the containment measures introduced by the Maltese authorities to limit the spread of COVID-19. However, this publication includes a box that quantifies the impact these containment measures might have in 2020 (see Box 1). Box 2 summarises monetary and fiscal measures taken by European institutions, to alleviate the economic impact of COVID-19.

Baseline projections

Economic activity in Malta was expected to remain robust but moderate over the projection horizon. GDP growth was projected to ease from 4.4% in 2019 to 3.8% in 2020, and further to 3.6% in 2021 and 3.5% in 2022 (see Table 1).[1] Compared with the Bank's previous projections, published in December 2019, GDP growth was revised downwards in 2020 due to lower private consumption and export growth.

Chart 1: GDP growth over the projection horizon
(percentage point contributions; annual percentage change)



Source: Central Bank of Malta

Domestic demand was expected to be the main driver of economic growth over the projection horizon reflecting positive contributions from all components (see Chart 1). Although net exports were also set to contribute to GDP growth over the next three years, their contribution was assessed to be much lower than that of domestic demand. The supply-side of the economy was also foreseen to be supportive of growth. The positive output gap was seen to gradually close and turn marginally negative by 2022.

Private consumption growth was set to grow significantly during the projection horizon, reflecting the

[1] The Bank's outlook for the Maltese economy is based on information available up to 28 February 2020 and is conditional on the technical assumptions reported in the March 2020 ECB staff projections.

Table 1: Projections for the main macroeconomic aggregates for Malta[1]

	2019[2]	2020	2021	2022
Real economic activity (% change)				
GDP	4.4	3.8	3.6	3.5
Private consumption expenditure	2.4	3.9	3.8	3.8
Government consumption expenditure	12.0	6.1	4.6	4.3
Gross fixed capital formation	7.2	4.2	4.2	3.7
Exports of goods and services	1.7	1.5	1.8	2.0
Imports of goods and services	2.5	1.5	1.8	1.9
Contribution to real GDP growth (in percentage pts)				
Final domestic demand	4.3	3.5	3.2	3.1
Net exports	-0.15	0.3	0.3	0.4
Changes in inventories	0.2	0.0	0.0	0.0
Real disposable household income[3]	5.7	3.9	3.3	2.5
Household saving ratio[3]	20.9	20.9	20.5	19.6
Balance of payments (% of GDP)				
Goods and services balance	20.9	20.5	20.2	20.0
Current account balance	9.9	9.3	9.0	8.8
Labour market (% change)[4]				
Total employment	5.0	4.0	2.9	2.5
Unemployment rate (% of labour supply)	3.4	3.5	3.7	3.8
Prices and costs (% change)				
GDP deflator	1.9	2.0	2.1	2.1
RPI	1.6	1.5	1.7	1.8
Overall HICP	1.5	1.6	1.8	1.9
HICP excluding energy	1.5	1.7	1.9	2.1
Compensation per employee	2.3	2.8	3.1	3.5
ULC	2.2	2.7	2.4	2.5
Business cycle				
Potential output (% change)	5.6	3.7	3.0	2.5
Output gap (% of GDP)	1.0	0.5	0.1	-0.0
Technical assumptions				
EUR/USD exchange rate	1.12	1.09	1.09	1.09
Oil price (USD per barrel)	64.0	56.4	55.6	55.4

[1] Data on GDP were sourced from NSO News Release 034/2020 published on 28 February 2020, while HICP and RPI data were sourced, respectively, from NSO News Release 028/2020 and 031/2020 (released on 21 and 26 February 2019).
[2] Actual data.
[3] Central Bank of Malta estimates.
[4] Employment data are consistent with the national accounts. The unemployment rate is based on the number of unemployed and employed as reported in the Labour Force Survey.

expectation of persistent favourable labour market conditions. With regards to developments in public consumption, details can be found in section 2.

Investment growth was expected to decelerate over the projection horizon, mirroring the projected easing of economic activity, and an expected moderation in growth of residential investment. Nevertheless, the timing of large-scale outlays on infrastructural projects were expected to continue conditioning the path of investment.

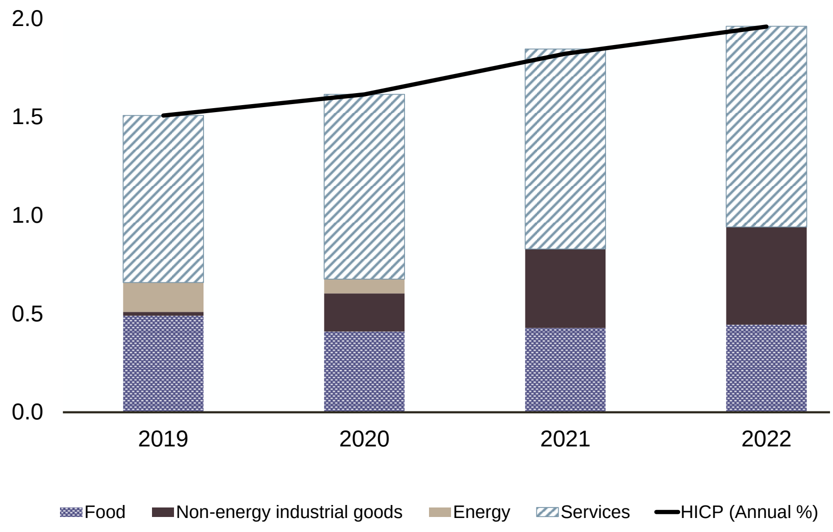
The cut-off date for technical assumptions regarding the international environment was 18 February 2020, prior to the spread of COVID-19 outside China, the reaction of financial markets, and fiscal measures. Nevertheless, exports were set to decelerate in 2020, in view of continued muted developments in the international economic environment. These were then projected to pick-up somewhat in the following years, in line with expected developments in foreign demand.

Mainly mirroring the investment and export projections, import growth was set to decelerate in 2020. It was then projected to pick up in the following years, reflecting the foreseen acceleration in export growth. In addition, the trade surplus was expected to narrow over the projection horizon, in line with an expected rise in outflows in the primary income account.

As economic activity was projected to moderate over the projection horizon, the pace of job creation was foreseen to slow down, while remaining well above the historical average. Consequently, the LFS unemployment rate was expected to edge up marginally from record lows, ending the projection horizon at 3.8%. As regards wage growth, this was projected to pick-up due to the expected rise in consumer price inflation and elevated labour market tightness.

With regards to consumer prices, HICP inflation in Malta was set to rise slightly to 1.6% in 2020, from 1.5% in 2019. Thereafter, consumer price inflation was expected to accelerate gradually, reaching 1.9% in 2022 (see Chart 2). The pick-up in HICP inflation over 2020 to 2022 was largely driven by expected movements in HICP excluding energy. This was mainly underpinned by faster growth in services prices, reflecting some intensification of demand and wage pressures. NEIG inflation was also set to pick up, mirroring a recovery in imported inflation. Food inflation was projected to remain robust over the projection horizon.

Chart 2: HICP inflation over the projection horizon
(percentage point contributions; annual percentage change)



Source: Central Bank of Malta

2 Public finance

The general government surplus was set to settle at 1.3% of GDP in the projection horizon (see Table 2). Compared with the Bank's earlier projections, the surplus profile was revised down marginally throughout the projection horizon, mainly due to stronger than expected current spending growth in 2019.

Overall, the ratio of gross savings in GDP was set to decline in 2020, before levelling off and improving slightly in the outer years of the forecast horizon. This was partly due to a forecast decline in the share of current revenue items in GDP - driven by low growth in taxes on production and imports. The share of current revenue was then set to increase in the following years, due to the profile of current taxes on income and wealth and sales by government entities.

The share of current spending items in GDP was expected to increase in 2020, before levelling off in the outer years of the forecast horizon. This was driven by the profile of compensation of employees and intermediate consumption, reflecting cost pressures in health care and in education. On the other hand, social payments and interest payments were set to act as a drag on government expenditure growth in the outer years of the forecast horizon. Respectively, this is due to the increase in the statutory retirement age in 2022, and lower financing needs in the context of a low interest rate environment.

On average, the share of current spending items in GDP throughout the forecast horizon was expected to be in line with the 2018 level. However, the profile of individual spending items varies considerably. Outlays on compensation of employees, subsides and 'other' current expenditure were set to grow

Table 2: Projections for main fiscal items (% of GDP) [1]

	2019	2020	2021	2022
Headline Aggregates				
Total revenue	38.4	38.9	38.9	38.9
Total expenditure	37.0	37.6	37.6	37.6
General Government Balance	1.4	1.3	1.3	1.3
of which: Primary Balance	2.7	2.5	2.4	2.4
General Government Debt	42.9	40.4	38.1	36.1
Detailed Breakdown				
Current Revenue	36.9	37.0	37.1	37.2
Current taxes on income and wealth	13.7	13.8	13.9	14.1
Taxes on production and imports	12.1	12.0	12.0	12.0
Social contributions	6.1	6.0	6.0	5.9
Other current revenue[2]	5.0	5.1	5.1	5.2
Current Expenditure	32.8	33.1	33.2	33.1
Compensation of Employees	11.2	11.3	11.5	11.6
Social benefits	9.5	9.5	9.4	9.3
Intermediate Consumption	7.3	7.6	7.7	7.7
Interest payments	1.3	1.2	1.1	1.0
Subsidies	1.3	1.3	1.3	1.3
Other current expenditure[3]	2.1	2.1	2.1	2.1
Gross savings	4.5	4.3	4.6	4.8
Capital Revenue	2.1	2.0	2.0	2.0
Capital taxes	0.2	0.2	0.2	0.2
Other capital revenue[4]	1.3	1.7	1.7	1.5
Capital Expenditure	4.2	4.5	4.5	4.5
Investment	3.6	3.9	3.9	3.9
Capital transfers	0.7	0.7	0.7	0.7
Other capital expenditure[5]	-0.1	-0.1	-0.1	-0.1
Capital Revenue Net of Capital Expenditure	-2.7	-2.6	-2.6	-2.8
Underlying Budgetary Position				
Cyclical component	0.6	0.3	0.1	0.0
Temporary government measures	0.0	0.0	0.0	0.0
Structural balance	0.8	0.9	1.2	1.3

[1] CBM calculations based on NSO News Release 04/2020 (published on 13 January 2020) and News Release 34/2020 (published on 28 February 2020).
[2] Mainly includes revenue from dividends, rents and sales.
[3] Mainly includes spending on education and contributions to the EU budget.
[4] Mainly includes grants from EU Programmes.
[5] Mainly reflects the value of changes in inventories and in the net acquisition of valuables and other assets.

broadly in line with nominal GDP. Meanwhile, the share of intermediate consumption in GDP was set to increase, driven by higher health-related costs. On the other hand, the ratio of interest payments in GDP was expected to decrease, reflecting lower financing needs as well as the prevailing low interest rate environment.

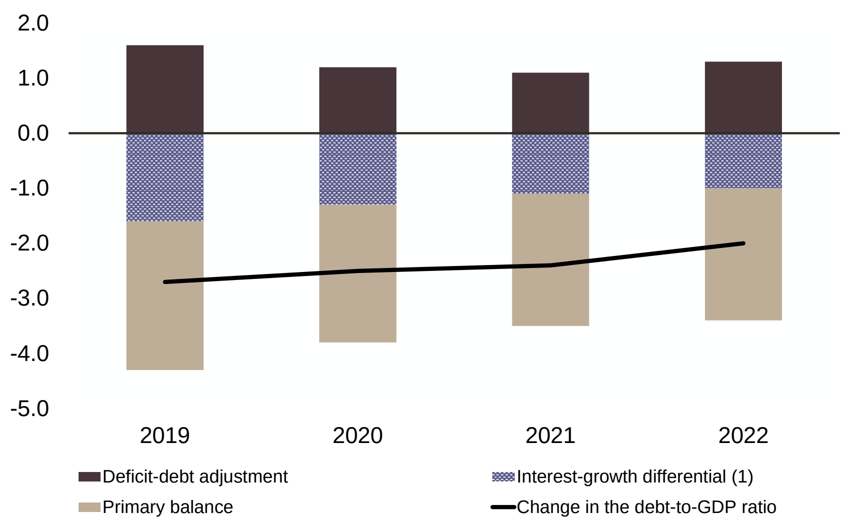
The shortfall in the balance between capital revenue and capital expenditure was expected to decline until 2021 and to rise again in 2022. Outlays in the profile of EU-financed expenditure were expected to peak in 2021, as work on large scale infrastructural projects, financed by the 2014-2020 funding framework, is eventually completed. At the same time, spending on domestically-funded projects was expected to remain elevated, and to increase in the outer years of the forecast horizon.

Overall, social payments were expected to increase more slowly than GDP, owing to favourable labour market developments, the retention of measures aimed at reducing dependence on social assistance and an increase in the statutory retirement age in 2022. However, outlays were set to increase broadly in line with GDP in 2020, reflecting the impact of higher pensions and other benefits as announced in the latest Budget.

The structural balance (i.e. the balance corrected for temporary government measures and the economic cycle) was set to improve to 1.3% of GDP by 2022, in line with the expected closure of the positive output gap.

The general government debt-to-GDP ratio was forecast to decline to 36.1% by 2022, driven by high primary balances and a favourable interest-growth differential (see Chart 3).

Chart 3: Contribution to change in the debt ratio
(percentage point contributions; percentage of GDP)



Source: Central Bank of Malta

Box 1: Estimating the impact of recent containment measures in 2020

COVID-19 has caused a public health emergency throughout the world. In response to these events, governments have put in place a number of containment measures to stem the spread of the virus. The economic impact is likely to be substantial, though mainly concentrated in 2020. The OECD has estimated that the outbreak could lead to world GDP growth being between 0.5 percentage point and 1.5 percentage points lower in 2020 than previously projected. The ECB staff projections released on 12 March foresee an impact of between 0.8 and 1.4 percentage points on euro area GDP growth in 2020.

The situation is unprecedented and fluid and hence it is very challenging to quantify the economic impact at this juncture, given the high uncertainty concerning the duration of this pandemic. The Bank has built a scenario which attempts to cater for the impact of COVID-19 on the Maltese economy. It is based on external developments, the announcements made by the Maltese Government up to 15 March and a number of assumptions.

In particular, the scenario assumes a severe drop in tourist expenditure due to the travel ban and extension of quarantine to all visitors to Malta, shocks related to possible supply-chain disruptions, lower employment hours, and a drop in confidence due to the environment of acute uncertainty. Moreover, the oil price is lower compared with that assumed in the baseline, reflecting developments in the international price of oil between 28 February and 15 March. Due to disruptions, a portion of government investment projects is assumed to be delayed.

GDP growth is estimated to be around 3.5 percentage points lower in 2020, when compared with the baseline projection shown in Table 1. The sectors that are expected to bear the largest drops are the accommodation and food service sector, travel agency-related services, sports and other recreational activities, the transport sector and firms involved in the production of food products. However, almost all other sectors are expected to experience a negative impact due to COVID-19.

The government balance is expected to remain in surplus, but is expected be around 0.8 percentage points lower than that projected in the baseline, as a result of the assumed lower economic activity.

The Bank will continue to monitor the situation and will update its assessment as new information becomes available. The impact of COVID-19 reported depends on the duration of this pandemic. Measures addressing the financial sector and any fiscal support the Maltese Government may offer to the private sector in Malta should mitigate the negative economic impact of COVID-19.

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[i]Prepared by Ian Borg, a principal economist within the Economic Analysis Department at the Central Bank of Malta; and Noel Rapa, a principal research economist within the Research Department at the Central Bank of Malta.

Box 2: COVID-19: A review of fiscal and monetary measures taken at EU level [i]

The COVID-19 pandemic has unquestionably presented various public health and economic challenges to all EU Member States and globally. The timing and composition of fiscal and monetary policies is important in mitigating the negative shocks caused by such an event. Monetary policy, in conjunction with government guarantees, can provide additional liquidity and more accommodative financing conditions to businesses hit with a sharp slowdown, and in some sectors sudden stop in demand. At the same time, additional fiscal measures help to cushion the impact of the COVID-19 outbreak on vulnerable social groups and businesses. To this end, the European Commission - backed by the Council of the European Union and the European Parliament - and the European Central Bank (ECB) are taking several measures to mitigate the socio-economic impact caused by COVID-19.

The first COVID-19 related monetary measures were announced on 12 March 2020, while the European Commission proposed fiscal measures a day later. As the COVID-19 crisis deepened, both the Commission and the ECB intensified their actions and enacted additional policies in the following days. Within a month, the scale of ECB programmes rose drastically, while the Commission approved State Aid packages and proposed additional relaxation of SGP rules. The next sections provide further detail on the monetary and fiscal measures announced in this period.

Monetary Measures

In its first set of monetary policy decisions, the ECB provided additional liquidity to banks to ensure they can extend support to businesses, particularly small and medium-sized enterprises, which may not have ready access to funding from capital markets or sufficient cash reserves. In particular, the ECB confirmed its previous forward guidance on interest rates, and also announced that it will conduct additional longer-term refinancing operations (LTROs) until the next targeted longer-term refinancing operations (TLTRO III) planned for June 2020. Furthermore, it announced more favourable financing conditions on TLTRO III and requested a review of the collateral requirements affecting these operations.

In addition to the existing asset purchase programme (APP), the ECB also announced temporary net asset purchases of €120 billion until the end of 2020, aiming to provide favourable financing conditions and to reinforce the accommodative impact of its policy rates.

On 15 March, the ECB announced measures to enhance the provision of US dollar liquidity. In collaboration with the Bank of Canada, the Bank of England, the Bank of Japan, the Federal Reserve and the Swiss National Bank, the ECB will offer weekly US dollar operations with 84-day maturity in addition to existing 1-week operations. Furthermore, the price of US dollar operations was reduced to the US dollar overnight index swap rate plus 25 basis points.

In the days that followed, the ECB acted more aggressively in response to concerns that its policies may not be enough to support firms during the crisis. Crucially, on 18 March, it announced a €750 billion Pandemic Emergency Purchase Programme (PEPP) targeting both private and public sector securities. Furthermore, the range of eligible assets under the corporate sector purchase programme (CSPP) was expanded to include non-financial commercial paper. As from 23 March, the frequency of US dollar operations issued jointly by central banks will increase from weekly to daily.

Fiscal Measures

On 13 March, the European Commission announced its commitment to use all the instruments at its disposal to counter the consequences of the pandemic. In particular, it aims to ensure the necessary supplies to European health systems, to avoid permanent harm from loss of income and/or jobs, to support firms and to ensure that financial sector liquidity is maintained. To this end, it proposed to apply the full flexibility provided for in the EU fiscal framework so that Member States can implement the required measures to contain the coronavirus outbreak and mitigate its negative socio-economic effects.

Furthermore, the Commission proposed the deployment of existing EU resources, mainly to bring immediate relief to hard-hit SMEs. In fact, €1 billion is to be redirected from the EU budget as a guarantee to the European Investment Fund, in order to incentivise banks to provide liquidity to SMEs. In addition, it proposed that €179 million from the European Globalisation Adjustment Fund and the €800 million EU Solidarity Fund are utilised to support newly unemployed individuals and national health systems.

These recommendations were subsequently welcomed by the Eurogroup, who also highlighted other initiatives by the European Investment Bank such as increasing bank credit guarantees to SMEs. Overall, by 16 March, the scale of EU-wide fiscal measures amounted to around 1% of GDP, with a commitment of the provision of liquidity facilities amounting to at least 10% of GDP (consisting of public guarantee schemes and deferred tax payments).

Other policies announced since then enable Member States to devote more resources towards addressing the crisis. On 19 March the Commission adopted a temporary legal framework enabling State aid. This framework is similar to that adopted in 2008 in wake of the global financial crisis.

On 23 March EU ministers of finance endorsed a Commission proposal to activate the general escape clause of the Stability and Growth Pact, in which adherence to fiscal targets is suspended in view of a 'severe economic downturn in the euro area or the Union as a whole'. Meanwhile, on 2 April the Commission proposed providing loans up to 100 billion for Member States to preserve employment.

Conclusion

On several occasions, policy makers vowed to take all measures necessary to mitigate the adverse economic impact of COVID-19, reduce uncertainty and ensure the public's trust in EU institutions. Actions taken by the ECB so far appear to have had the desired effect: ten-year government bond yields partly backed down from a spike in mid-March, while stock markets recovered slightly. On the fiscal front, EU ministers are discussing ways to offer additional support to countries, possibly through credit lines supported by the European Stability Mechanism. Ultimately, the effectiveness of all these measures will be gauged by the ability of national health systems to cope with demands for better treatment, and the speed with which Member States' economies recover from this crisis.

[i] Box prepared by Juergen Attard, a senior economist, and Kurt Sant, an economist, both at the Economic Analysis Department.