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CENTRAL BANK OF MALTA
OUTLOOK FOR THE MALTESE ECONOMY

2021:2

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OUTLOOK FOR THE MALTESE ECONOMY 2021-2023

Overview

Since the Central Bank of Malta's (Bank) previous projections, which were published in February 2021, the pandemic situation has evolved considerably. Following a sharp increase in active cases during the first two months of the year, a number of containment measures were re-introduced in March and April, such as school closures and the shutdown of non-essential shops and services. These measures were then gradually eased following a subsequent decline in active cases.

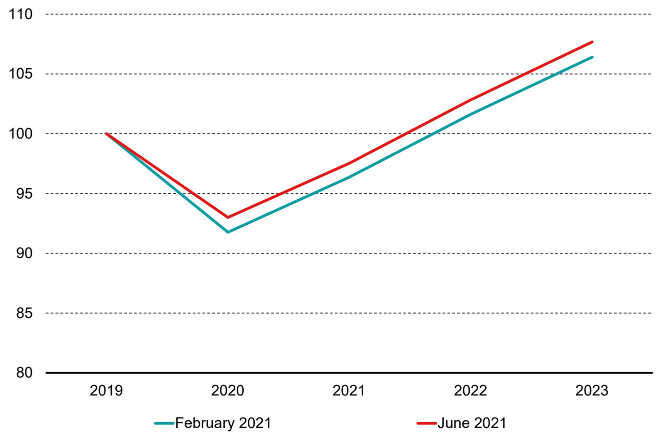
At the same time, the pace of vaccination has been remarkable, with more than 70% of the adult population receiving at least one jab of the vaccine – which was better than envisaged in February. Indeed, while herd immunity was initially expected to be attained towards the end of summer, this was achieved a month ahead of its start. In addition, fiscal support to the private sector was extended.

Hence, we estimate that the downward impact on activity emanating from higher stringency during the first half of this year will be compensated by the enhanced fiscal response and the impact on confidence of the rapid pace of vaccination.

Economic outlook[1]

The level of gross domestic product (GDP) in 2021 is expected to recover somewhat from last year's contraction but is to remain below the 2019 level (see Chart 1). It should then reach and exceed 2019 levels in 2022. Although the profile for GDP growth over the projection horizon remains broadly unchanged from the previous projections published in February 2021, the level of GDP is being revised up throughout the projection horizon, as the contraction in GDP in 2020 was smaller than that projected in February.

Chart 1
REAL GDP LEVEL
(index, 2019=100)



Sources: NSO; Central Bank of Malta estimates.

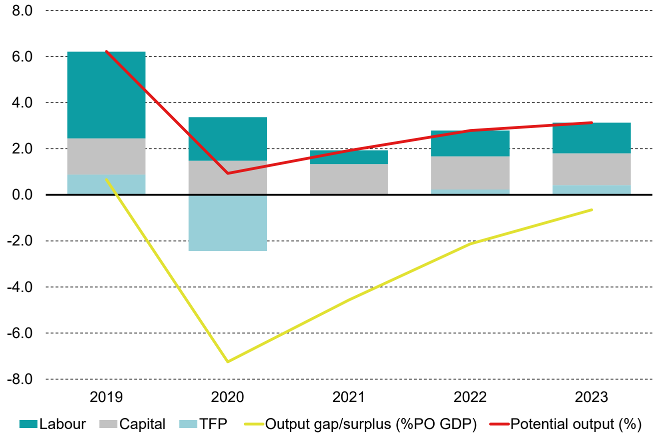
Containment measures and uncertainty are expected to have negatively affected the supply-side of the economy (see Chart 2). In particular, the Maltese economy attracted a smaller net inflow of foreign workers in 2020, average hours worked dropped, investment

[1] The Bank's projections for the Maltese economy are based on information available up to 26 May 2021 and are conditional on the technical assumptions used in the June 2021 Eurosystem staff projections. The Bank's projections were prepared by the Bank and peer reviewed by Eurosystem forecasters. This outlook does not incorporate the latest release of national accounts for the first quarter of 2021, which was published on 28 May 2021.

was postponed and capacity utilisation declined. As a result, potential output growth is estimated to have slowed down from 6.2% in 2019 to 0.9% in 2020.

Potential output growth is expected to pick up to 1.9% in 2021, reflecting an improvement in capacity utilisation, as well as a recovery in investment. It is projected to increase further in 2022 and 2023, mainly reflecting a recovery in productivity and a return of net migration flows more similar to those seen in the pre-pandemic period. Despite the projected recovery in GDP, the economy is expected to continue operating below its potential. Indeed, while the output gap is expected to narrow over the projection horizon, it remains negative throughout, partly reflecting the expectation that the tourism sector will continue to operate below capacity for an extended period.

Chart 2
POTENTIAL OUTPUT
(annual percentage change; percentage of potential output)

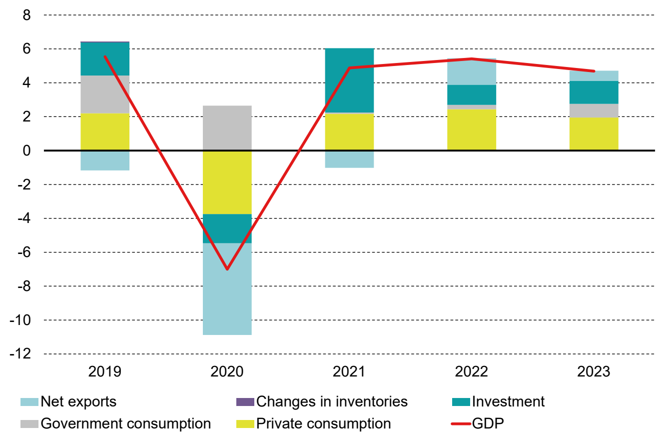


Source: Central Bank of Malta.

GDP is set to grow by 4.9% in 2021, 5.4% in 2022, and 4.7% in 2023 (see Table 1). Compared to the Bank's earlier projections, GDP growth is being revised marginally downwards by 0.1 percentage points in 2021 and 2022. These marginal revisions to economic activity are attributed to a weaker first half due to higher containment measures, which we expect to be broadly offset by a stronger second half due to the very strong pace of vaccination, as well as the enhanced fiscal response.

In 2021, all domestic demand components are projected to grow significantly as the economy gradually recovers from the 2020 contraction (see Chart 3). Overall, domestic demand is expected to be the main driver of growth, though the recovery in all demand components will be partially absorbed by an increase in imports. Net exports are expected to exert a smaller negative impact on GDP growth in 2021, as foreign demand starts to recover, with a positive contribution thereafter. However, the outlook for the tourism sector remains cautious.

Chart 3
GDP GROWTH PROJECTIONS
(annual percentage change)



Source: Central Bank of Malta.

Looking at the expenditure components in more detail, private consumption is expected to bounce back this year, following

Table 1
PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES FOR MALTA[1]

	2020[2]	2021	2022	2023
Real economic activity (% change)				
GDP	-7.0	4.9	5.4	4.7
Private consumption expenditure	-7.6	4.3	5.9	4.5
Government consumption expenditure	16.2	5.8	0.0	3.2
Gross fixed capital formation	-4.5	10.8	6.7	5.4
Exports of goods and services	-7.8	5.7	5.5	3.6
Imports of goods and services	-4.1	6.6	5.0	3.3
Contribution to real GDP growth (in percentage pts)				
Final domestic demand	-1.7	5.6	4.2	4.0
Net exports	-5.9	-0.7	1.2	0.7
Changes in inventories	0.6	0.0	0.0	0.0
Real Disposable Income[3]	1.7	2.2	2.3	3.2
Household Saving Ratio[3]	28.2	26.8	24.1	23.2
Balance of payments (% of GDP)				
Goods and services balance	7.0	6.2	7.1	7.6
Current account balance	-4.0	-2.9	-0.7	0.3
Labour market (% change)[4]				
Total employment	2.6	0.9	2.1	2.9
Unemployment rate (% of labour supply)	4.3	4.2	4.2	4.2
Prices and costs (% change)				
GDP Deflator	1.5	1.6	1.9	1.9
RPI	0.6	0.6	1.2	1.4
Overall HICP	0.8	0.3	1.3	1.6
HICP excl. energy	0.9	0.4	1.4	1.7
Compensation per employee	0.1	1.6	2.8	3.1
ULC	10.4	-2.3	-0.4	1.3
Business Cycle				
Potential Output (% change)	0.9	1.9	2.8	3.1
Output gap (% of GDP)	-7.3	-4.6	-2.1	-0.7
Technical Assumptions				
EUR/USD exchange rate	1.14	1.21	1.21	1.21
Oil Price (USD per barrel)	42.3	65.8	64.6	61.9

Sources: NSO; Central Bank of Malta.

[1] Data on GDP were sourced from NSO *News Release* 040/2021 published on 1 March 2021, while HICP and RPI data were sourced, respectively, from NSO *News Releases* 090/2021 and 074/2021 (released on 19 May 2021 and 23 April 2021).

[2] Actual data as per NSO *News Releases* 040/2021, 090/2021 and 074/2021.

[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.

the sharp contraction in 2020. However, the recent shutdown of non-essential services as well as continued limitations to international travel will continue to weigh on consumption, which is thus expected to remain below pre-pandemic levels. Private consumption is expected to pick up primarily in the second half of 2021 buoyed by the phasing out of containment measures, receding uncertainty due to vaccination, as well as a boost from the newly-announced voucher scheme. Private consumption is then set to mount a more meaningful recovery in 2022, as the factors weighing down on consumption this year will become less relevant going forward. Moreover, as a result of the pandemic, households have accumulated a high stock of savings. Hence, we expect some pent-up demand to spur private consumption growth during 2022 and 2023 as the saving ratio recedes from recent peaks.

Due to the pandemic, private sector firms' investment plans were mostly postponed last year. As uncertainty begins to recede and the economy begins to recover in 2021, investment is expected to bounce back. Furthermore, the EU Budget as well as Next Generation EU (NGEU) funds will provide a substantial boost to government investment during the next three years.

Exports are set to recover somewhat this year from the sharp decline in 2020, but levels will remain relatively low due to the partial recovery in foreign demand and tourism. The recovery in exports is expected to continue in 2022 and 2023, as travel disruptions ease and travellers respond favourably to the high vaccination rate in Malta, although travel exports are not expected to reach 2019 levels until the end of the projection horizon.

With regards to imports, these are set to increase in 2021, reflecting higher domestic demand as well as positive developments in goods exports. Imports are then set to grow further over the rest of the projection horizon, reflecting the expected recovery in final demand.

The trade surplus is set to narrow this year, which reflects the projected negative net export contribution. In 2022 and 2023, the trade surplus is set to rise once again due to the envisaged positive contributions from net exports. As a result, the current account is projected to be in deficit until 2022, and return to a small surplus in 2023.

Labour market

Notwithstanding the contraction in economic activity, the labour market displayed resilience during 2020. In particular, fiscal support measures allowed most firms to retain staff. Firms instead opted to reduce the number of hours worked. Given these developments in 2020, firms are expected to respond to an improvement in business conditions in 2021 by gradually returning to normal working hours. This implies that there will be less need for further recruitment this year. Hence, employment growth is set to decelerate to 0.9% in 2021. Employment is set to grow more rapidly in 2022 and 2023, but more slowly than GDP, as firms seek to regain some of the productivity losses experienced during the pandemic.

The unemployment rate is projected to decline marginally to 4.2% this year, from 4.3% last year. It is then expected to remain stable throughout the rest of the projection horizon.

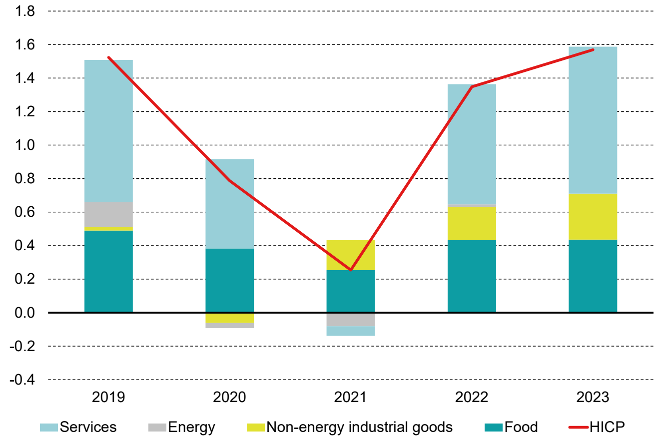
As regards wages, compensation per employee is expected to rise from 0.1% in 2020 to 1.6% in 2021. This reflects some growth in private sector compensation per employee following the contraction in 2020. Moreover, public sector compensation per employee is expected to rise at a faster rate in 2021. Wage growth for the whole economy is envisaged to pick up further in 2022 and 2023, reflecting the gradual recovery of demand.

Prices

With regard to consumer prices, annual inflation based on the Harmonised Index of Consumer Prices (HICP) is projected to decelerate in 2021, largely reflecting technical factors, mostly related to the computation of the index (see Box 1). In particular, households' consumption basket changed considerably in 2020 as a result of the pandemic, which brought about a large change in the weights of certain subcomponents of the index in 2021.

In 2021, HICP inflation is projected to stand at 0.3%, down from 0.8% in 2020. Thereafter, inflation is expected to pick up, reaching 1.3% in 2022 and 1.6% in 2023 (see Chart 4).

Chart 4
HICP INFLATION PROJECTIONS
(annual percentage change; percentage point contributions)



Source: Central Bank of Malta.

Services inflation is expected to fall to 0.5% in 2021, driven primarily by changes in weights of several subcomponents. Moreover, energy inflation is expected to turn more negative, reflecting the cuts to gas and fuel prices in April and June 2020, respectively. These are expected to offset the lagged impact of the recent increase in oil prices. In addition, food inflation is projected to decelerate in 2021, due to lower processed and unprocessed food inflation, reflecting weaker than expected outcomes for the first quarter of 2021 and the European Central Bank's technical assumptions. By contrast, NEIG inflation is expected to turn mildly positive reflecting increases in transport costs and import prices.

HICP inflation is expected to pick up in the medium term though still remaining moderate, reflecting the expected partial recovery in tourism following a successful vaccination drive in 2021.

When compared with the Bank's previous forecasts published in March 2021, overall HICP inflation has been revised up in 2021 and marginally down in subsequent years.

BOX 1: THE IMPLICATIONS OF THE 2021 HICP WEIGHTS ON INFLATION FORECASTS[1]

The HICP measures price changes of consumer goods and services over time bought by households. It is based on a fixed basket of goods and services whose weights are reviewed and updated annually to reflect consumption patterns over the previous 12 months. The review of weights is thus fundamental in ensuring that the HICP remains relevant as a statistical measure of consumer price changes. These weights are derived using the 'national accounts' concept of the consumption basket.

[1] This box was prepared by Rafael Fearne, an economist within the Economic Analysis Department.

Normally, consumption patterns vary only marginally from one year to the next, as households typically change consumption patterns only gradually over time. Hence, annual changes to HICP are typically interpreted simply as increases and declines in prices. Nevertheless, when consumption patterns change more abruptly, the interpretation of changes in the index could become more complex. A strong decline in the weight of a particular subcomponent is likely to exert downward pressures on the contribution of that component to overall inflation. If one subcomponent receives a lower weight, other subcomponents will receive higher weights, and thus exert upward pressures to overall inflation. Nevertheless, in this context, downward and upward pressures might not cancel out due to diverse initial price levels and differences in the inflation path of the various sub-components.

The COVID-19 pandemic dramatically shifted household consumption patterns in 2020. Following the shutdown of non-essential services, increased recourse to teleworking as well as travel restrictions (given that the HICP includes also consumption expenditure of tourists), households increased their consumption of items that can be regarded as essentials, such as food, housing, water and electricity, health, and education. Conversely, the consumption of items such as clothing and footwear, transport, recreation and culture, as well as restaurants and hotels declined sharply.

Given these substantial changes in consumption patterns, the weights of individual HICP components were also affected significantly (see Table 1). For example, the weight of the item Food and Non-Alcoholic Beverages rose from 16.1% to 18.1% between 2020 and 2021. Moreover, over this period the weight of Housing, Water, Electricity, Gas and Other Fuels rose from 8.5% to 10.2%. This partly reflects the fact that persons were forced to stay at home because of the containment measures and hence consumed more household-related items, but also reflect sharper declines in expenditure in other consumption categories. For example, due to restrictions on travel and mass events, the weight of Recreation and Culture declined from 10.3% to 7.8%, while that for Restaurants and Hotels dropped

Table 1
HICP WEIGHTS MAIN COMPONENTS (% of total)

	2020	2021
Food and non-alcoholic beverages	16.1	18.1
Alcoholic beverages, tobacco	3.6	4.0
Clothing and footwear	4.9	4.3
Housing, water, electricity, gas and other fuels	8.5	10.2
Furnishings, household equipment and routine household maintenance	7.8	8.8
Health	4.1	4.8
Transport services	13.7	12.4
Communications	3.3	3.9
Recreation and culture	10.3	7.8
Education	2.3	2.7
Restaurants and hotels	17.8	14.5
Miscellaneous goods and services	7.7	8.5
Total	**100.0**	**100.0**

Source: Eurostat.

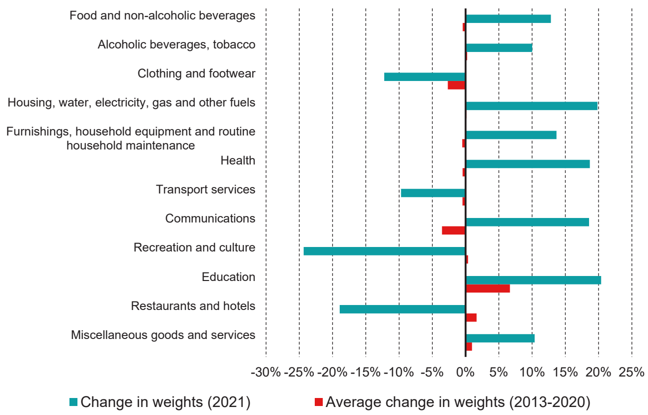
from 17.8% in 2020 to 14.4% in 2021, as both inbound and outbound tourism declined. These significant drops also automatically impact in the opposite direction the share of other components in the HICP.

Chart 1 shows the percentage change in the weights in 2021 compared to the average percentage change over the 2013-2020 period. Historically, changes on average do not exceed 5% (except in education). Conversely, in 2021, absolute changes of over 5% were registered in all main sub-components.

In this context, this box shows that for similar price changes in the sub-components of HICP, overall monthly inflation in 2021 will be affected markedly by these abrupt changes to the weights. To isolate the impact of the new weights, two monthly HICP forecasts for 2021 were prepared. One features the 2020 weights while the other incorporates the new 2021 weights. In both instances, the annual rates of change for the various HICP sub-components are consistent with the current projection round and the technical assumptions and equations used in both forecasts were identical, meaning the difference between the two results can be attributed solely to the differing weights.

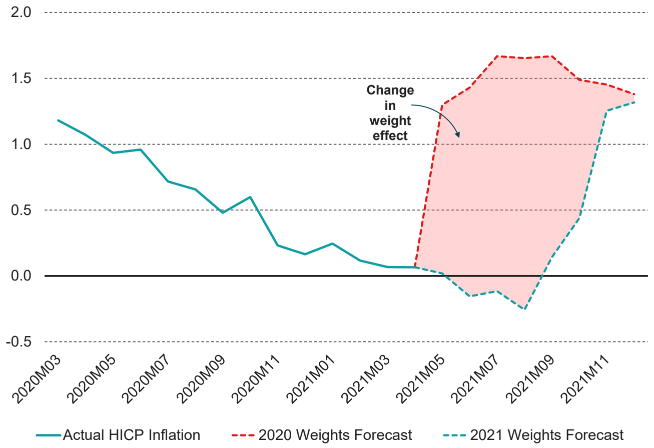
The impact of the new weights on overall inflation projections is shown by the shaded part in Chart 2. When using 2021 weights, overall HICP inflation is expected to trend downwards until August and recover thereafter. Indeed, overall HICP

CHART 1
2021 CHANGE IN HICP WEIGHTS COMPARED TO HISTORICAL AVERAGE
(per cent)



Source: Eurostat.

CHART 2
IMPACT OF THE CHANGE IN WEIGHTS
(percentage points)



Sources: Eurostat; own calculations.

inflation is projected to register negative growth rates from June to August and to return to positive levels in September 2021. Conversely, a counterfactual forecast prepared with 2020 weights – using the same path for HICP subcomponents – would predict a strong rebound in inflation from May and reach 1.7% in the third quarter of 2021. The difference between the two forecasts is also evident when comparing the average annual rates for 2021. The baseline forecast (which uses 2021 weights) predicts an average rate of 0.3%, while the counterfactual forecast projects a much higher rate for 2021 at 1.2% (assuming 2020 weights throughout 2021 and not just from May to December).

Therefore, the change in weights is set to exert a downward impact on headline HICP inflation throughout 2021. Further analysis shows that the main item contributing to the downward pressure on inflation in 2021 is Recreation and Culture Services inflation. This subcomponent has been a strong positive contributor in recent years. However, due to the chain-linking methodology used in the HICP, its contribution to overall HICP inflation is expected to be significantly negative in 2021.[2] Despite the projected increase in Recreation and Culture Services prices when compared with December 2020, the weight of this component fell by 23.9% from the previous year. As a result, the subcomponent's contribution is expected to be significantly negative throughout the second and third quarters of 2021.

Conversely, certain sub-components whose weight has increased significantly – namely non-durable goods and processed food – have exerted upward pressure on headline inflation. Nevertheless, this effect is smaller when compared to the strong downward impact of Recreational and Culture Services on 2021 HICP inflation.

Looking ahead, changes in HICP weights are likely to play a key role in the calculation of HICP inflation in the years to come. Just as the heavily pandemic-influenced consumption trends of 2020 are being reflected in 2021 weights and inflation rates, further changes could arise in the following years. Consumption patterns for 2021 are likely to be different from those in 2020 as the vaccination drive reaches its conclusion and the remaining containment measures are further relaxed. If that is the case, one can expect to see significant fluctuations in the 2022 HICP weights.

[2] The HICP is a chain-linked price index based on a Laspeyres-type formula, with expenditure weights updated every December, making it possible to portray the market and consumption patterns more accurately as opposed to a fixed-weight approach. Given that weights are updated in December, the impact of changes in weights also depends on relative price levels of a particular month to December of the previous year.

Public finance

In 2021, the general government deficit is set to reach 9.9% of GDP (see Table 2). It is then projected to narrow substantially over the forecast horizon, as COVID-19 measures unwind and macroeconomic conditions improve. By 2023, the deficit is forecast to narrow to 4.2% of GDP.

In 2020, the deficit turned out to be larger than previously projected by the Bank, mainly due to higher than expected capital expenditure and lower than expected non-tax revenue, though current expenditure was also on the high side. Compared with the Bank's earlier projections, a larger deficit is being projected throughout the forecast horizon, especially in 2021. This reflects the

Table 2
PROJECTIONS FOR MAIN FISCAL ITEMS (% of GDP)[(1)]

	2020[(2)]	2021	2022	2023
Headline aggregates				
Total revenue	36.5	36.6	36.9	36.8
Total expenditure	46.6	46.5	41.9	41.0
General Government balance	-10.1	-9.9	-5.0	-4.2
of which: Primary balance	-8.8	-8.7	-3.7	-2.9
General Government debt	54.3	62.2	63.4	64.0
Detailed breakdown				
Current revenue	35.0	34.1	34.5	34.6
Current taxes on income and wealth	13.2	12.7	12.5	12.5
Taxes on production and imports	10.7	10.7	11.6	11.8
Social contributions	6.6	6.3	6.1	5.9
Other current revenue[(3)]	4.5	4.4	4.4	4.3
Current expenditure	41.0	40.3	36.0	35.4
Compensation of employees	12.2	12.4	12.3	12.2
Social benefits	10.5	10.4	9.9	9.7
Intermediate consumption	9.5	9.5	8.7	8.4
Interest payments	1.3	1.2	1.3	1.3
Subsidies	5.0	4.3	1.2	1.1
Other current expenditure[(4)]	2.4	2.6	2.6	2.7
Gross savings	-6.0	-6.2	-1.5	-0.8
Capital revenue	1.5	2.4	2.4	2.2
Capital taxes	0.2	0.2	0.2	0.2
Other capital revenue[(5)]	1.3	2.3	2.3	2.0
Capital expenditure	5.7	6.1	5.9	5.6
Gross fixed capital formation	4.5	5.0	5.0	4.7
Capital transfers	1.1	1.2	1.0	1.0
Other capital expenditure[(6)]	0.1	-0.1	-0.1	-0.1
Capital revenue net of capital expenditure	-4.1	-3.7	-3.5	-3.4
Underlying budgetary outcome				
Cyclical component	-3.0	-2.2	-1.4	-0.6
Temporary Government measures	0.0	0.0	0.0	0.0
Structural balance	-7.1	-7.7	-3.6	-3.7

Sources: NSO; Central Bank of Malta.

[(1)] Central Bank of Malta calculations based on NSO *News Release* 40/2021 (published on 1 March 2021) and *News Release* 70/2021 (published on 20 April 2021).

[(2)] Actual data as per NSO *News Releases* 40/2021 and 70/2021.

[(3)] Mainly includes revenue from dividends, rents and sales.

[(4)] Mainly includes spending on education and contributions to the EU budget.

[(5)] Mainly includes grants from EU Programmes.

[(6)] Mainly reflects the value of changes in inventories and in the net acquisition of valuables and other assets.

extension and introduction of new COVID support measures (see Box 2) and revised government targets as outlined in the 2021-2024 Update of the Stability Programme.

The share of current revenue in GDP is set to decline in 2021 as the recovery in tax revenue is expected to be weaker than that in nominal GDP. Current revenue is set to grow at a stronger pace than GDP in 2022 and retain a similar rate of growth in 2023, mainly due to the profile of indirect tax receipts.

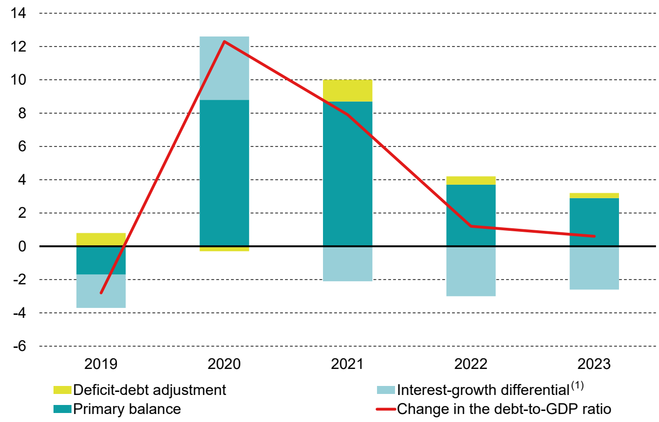
Meanwhile, the share of current expenditure in GDP is expected to decline over the forecast horizon. This reflects the gradual unwinding of COVID-related outlays on support measures, treatment and vaccination. Most of these measures are set to expire by end-2021. This affects the profile of subsidies and, to a lesser extent, intermediate consumption, social benefits and compensation of employees. At the same time, the share of interest payments in GDP is expected to increase due to rising financing needs.

Capital expenditure is expected to outpace GDP in 2021 and to grow by less than GDP thereafter. Overall, spending on domestically-funded projects is expected to remain elevated throughout the forecast horizon, owing mostly to investment in health, transport and the environment. At the same time, outlays on EU-financed projects are set to increase sharply in 2021, as works on projects which were delayed in the previous year due to the pandemic come to completion. EU-funded capital expenditure is set to increase again in 2022, due to the take up of NGEU grants.[2]

The structural deficit is estimated to widen to 7.7% in 2021. It is then projected to narrow to 3.7% by 2023, as COVID-related measures are unwound (the latter are not treated as one-off measures and thus affect the underlying structural position). It should be noted that owing to significant uncertainty surrounding the value of the budgetary semi-elasticity and the output gap in times of crisis, structural balance estimates should be treated with caution.

The general government debt-to-GDP ratio is projected to increase to 64.0% in 2023, mainly driven by the estimated primary deficit and deficit-debt adjustments (see Chart 5). At the same time, unlike in 2020, the interest-growth differential is set to exert a debt-reducing impact throughout the forecast horizon.

Chart 5
CONTRIBUTION TO CHANGE IN THE DEBT RATIO
(percentage point contributions; percentage of GDP)



Source: Central Bank of Malta.
(1) Difference between effective interest rate (interest payments at year t relative to debt outstanding at year t-1) and GDP growth.

BOX 2: THE IMPACT OF COVID-19 FISCAL AND LIQUIDITY MEASURES ON GDP[1]

During the pandemic, the Maltese Government introduced several support measures to cushion the negative economic shock caused by the COVID-19 virus. This box presents an updated estimate of the impact of these measures on the fiscal balance and on GDP.

[1] This box was prepared by John Farrugia, Juergen Attard, and Ian Borg, principal economist, senior economist, and manager, respectively, all within the Economic Analysis Department.

[2] In line with the Stability Programme Update, the Bank's projections assume that the Government will only use the grant element of the NGEU.

In line with the analysis in previous forecast publications, these measures are classified into the following categories: economic support; social measures; liquidity assistance; and spending on health (treatment, testing and vaccination).

Since the Bank's February 2021 projection round, several economic support measures were extended. In particular, the Wage Supplement scheme was extended until end-2021. Following the shutdown of non-essential firms in March and April 2021, supplements were no longer determined according to firms' loss in turnover. Instead, firms which were obliged to close again were offered the maximum possible wage supplement. The support scheme to bars and clubs was also extended. Extensions to liquidity measures affect the tax deferral scheme, which was originally open until August 2020 but is now available until December 2021, while firms need to start repayments from May 2022. Moreover, moratoria on interest and capital repayments in terms of the COVID Guarantee Scheme (CGS) loans was extended from a maximum of 12 to 18 months, and the scheme itself was extended from June to September 2021. The refund of certain commercial rent and electricity bills was also reoffered in 2021. Finally, social measures offered to working parents of young or vulnerable children were extended to cover the period in which schools were closed in March and April 2021.

Other new measures were introduced since February. These include new economic support measures offering additional assistance to the tourism sector, such as the waiver of tourism licence fees for 2021, schemes related to 'Free Individual Travel', vouchers to tourists in sport and diving industries, and rebates for digital marketing services for accommodation establishments. Additionally, a one-time grant was given to business who were not set to open by 10 May 2021. Another measure which was introduced and is not directly linked to the recovery in the tourism sector reflects schemes aimed at restarting the local arts sector.

Budgetary impact

The Bank estimates that in 2020, measures and health-related costs associated with the pandemic amounted to 5.0% of GDP (see Table 1). In 2021, the impact of COVID-related measures on government finances is expected to be smaller, but still substantial. Expenditure on economic support measures is expected to reach 2.9% of GDP. This largely

Table 1
FISCAL MEASURES AFFECTING THE BUDGET BALANCE
Per cent of GDP

Classification	ESA classification	2020	2021
Economic support measures	Subsidies, indirect taxes	3.6	2.9
Social measures	Social benefits other than in kind	0.1	0.0
Liquidity support measures	Subsidies	0.0	0.3
Health related measures	Intermediate consumption, social benefits in kind, compensation of employees	1.3	0.7
Total		**5.0**	**3.9**

Source: Central Bank of Malta.

consists of the extended Wage Supplement Scheme until the end of the year. An expenditure of 0.3% of GDP is allocated towards liquidity support to firms in the form of interest rate subsidies on State-backed loans, subsidised rent and electricity, and other grant schemes. Spending on health-related measures, which considers costs related to the purchase and distribution of the COVID-19 vaccine, is expected to amount to 0.7% of GDP. Social measures to assist vulnerable sectors in society are expected to amount to less than 0.1% of GDP.

The moratorium on CGS loan repayments and the tax deferral scheme do not directly affect the budget balance. Their impact on firms' economic activity and hence GDP growth is outlined below.

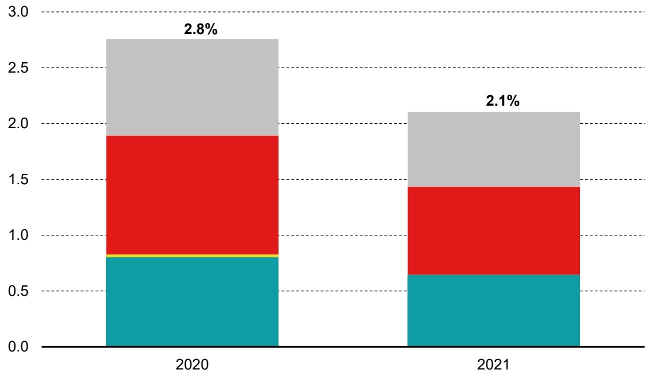
Estimated impact on GDP

Chart 1 updates the estimated impact of fiscal and liquidity measures on GDP for 2020 and 2021. It also includes a re-assessment of the impact of other liquidity measures that do not affect the budget balance. This includes: a further disbursement of loans under the Malta Development Bank (MDB) CGS scheme; a gradual decline of loans subject to the moratorium in terms of Central Bank of Malta Directive 18; and the extension of the tax deferral scheme to the end of this year.

Chart 1 shows that fiscal and liquidity measures are estimated to have impacted GDP growth positively by around 2.8 percentage points in 2020. Health-related measures are the largest category, followed by liquidity measures and economic and support measures. In 2021, the impact of COVID-19 fiscal and liquidity measures on GDP is estimated to remain strong, with these measures estimated to boost GDP growth by 2.1 percentage points. Similar to 2020, health-related measures will continue to have the largest impact on GDP, followed by economic support measures and liquidity measures.

Government is in the process of compiling the Recovery and Resilience Plan (RRP), which will outline how Malta intends to use the €316 million grants allocated from the Recovery and Resilience Facility (RRF). At the time of the cut-off date of this box, the RRP was not yet completed and hence it was not possible at this stage to quantify the indirect impact of RRF grants on economic growth.

Chart 1
ESTIMATED IMPACT ON GDP
(annual percentage change; contributions)



Source: Central Bank of Malta.

Revisions to February projections

In line with the extension and introduction of new measures, the impact of COVID support on the deficit has been revised upwards with respect to the February projections. At the time, these measures were set to contribute 2.3% of GDP to the 2021 deficit. As shown above, this impact was revised up by 1.6 percentage points, mainly due to the extension of the Wage Supplement Scheme.

These extensions – which were made partly in response to the shutdown of non-essential services, as well as to boost the tourism sector during the summer season – are estimated to boost GDP by an additional 0.8 percentage point when compared to the February 2021 projections.

Risks

Risks to economic activity are judged to be broadly balanced in 2021 and slightly on the upside during the rest of the projection horizon. In view of the substantial pick up in the vaccination rate both in Malta and more lately abroad, uncertainty regarding the evolution of the pandemic has receded considerably, though it remains significant due to the possibility of new variants that may be more resistant to the vaccine. In this context, the pandemic remains a downside risk to economic activity in 2021, as another pick up in infection rates would necessitate the re-introduction of containment measures which would disrupt again economic activity. In addition, this projection does not yet take into account possible scarring effects from the pandemic as bankruptcies have generally been low. However, there might be some long-term implications in certain strongly affected sectors, which might have some adverse medium-term effects.

On the other hand, this projection round assumes only a cautious pick up in tourism demand and private consumption. With regards to the former, Malta could experience a surge in tourism if it is highly successful in marketing itself as a safe country due to its high vaccination rate and the vaccination pace of source markets gathers further momentum. This also depends on restoring connectivity and the ability of Malta's tourism sector to increase its market share in the coming months. Moreover, this projection round assumes that the saving ratio will remain above its historical average until 2023. A faster decline in the saving ratio – also spurred by pent-up demand – could lead to faster than expected growth in economic activity, especially in 2022 and 2023.

With regards to prices, risks are assessed to be on the upside, for 2021 and 2022, as private consumption could pick up more strongly than assumed due to pent-up demand. In addition, recent increases in transport costs could transmit to domestic consumer prices at a faster rate than assumed in this projection round. Risks are seen as balanced in 2023.

On the fiscal side, risks are deemed to be mainly deficit increasing. The largest risks relate to 2021 and 2022 and reflect the need to provide State aid to the national airline. Other deficit-increasing risks relate to the possibility that some government guarantees on working capital loans extended by the MDB are called in during the outer years of the projection horizon. On the other hand, expenditure on economic support in 2021 could be lower than expected if the economic recovery proceeds faster than expected.