BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

ECONOMIC PROJECTIONS

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BOX 3: ECONOMIC PROJECTIONS

Economic outlook

The Bank's latest economic projections were finalised on 7 February 2023 and thus pre-date the latest release of the national accounts on 28 February 2023. According to these projections, Malta's GDP growth is projected to moderate from almost 7% 2022, to 3.7% in 2023, and to ease slightly further to 3.6% and 3.5% in 2024 and 2025, respectively (see Table 1).

Private consumption growth is projected to moderate to 4.9% in 2023, as growth normalises following the strong recovery last year. However, inflation is also expected to have an adverse impact on household income, which in turn impacts consumption. Private consumption is set to moderate further in the following years but should still outpace the Bank's estimate of real disposable income growth. The saving ratio is thus envisaged to retreat from recent peaks over the projection horizon, as some households may seek to smoothen consumption during a period of high inflation.

With regards to investment, this is projected to grow by 1.7% in 2023, fall by 0.3% in 2024, and grow by 2.5% in 2025. The growth in 2023 partly reflects the profile of construction activity, which is expected to pick-up gradually from the decline in 2022. Moreover, government investment is also expected to increase this year. The latter is then set to decline strongly in 2024 (by 14.4%), and by a further 1.1% in 2025. This profile is partly driven by the expected take up of EU funds, notably the full

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

	2022[2]	2023	2024	2025
Real economic activity (% change)				
GDP	6.9	3.7	3.6	3.5
Private consumption expenditure	10.1	4.9	4.8	4.1
Government consumption expenditure	2.4	4.3	3.8	3.7
GFCF	30.4	1.7	-0.3	2.5
Exports of goods and services	6.4	2.8	3.2	3.0
Imports of goods and services	9.7	2.9	3.1	3.1
Contribution to real GDP growth (in percentage pts)				
Final domestic demand	10.9	3.3	2.8	3.0
Net exports	-4.0	0.4	0.8	0.5
Changes in inventories	-0.1	0.0	0.0	0.0
Labour market (% change)[2]				
Total employment	6.0	3.3	2.0	2.0
Unemployment rate (% of labour supply)	3.0	3.0	3.2	3.2
Prices and costs (% change)				
Overall HICP	6.1	4.4	2.3	2.2
Public Finances(% of GDP)[3]				
General government balance	-5.2	-4.9	-3.8	-2.9
General government debt	54.8	56.8	57.9	57.9

[1] Data on GDP were sourced from NSO *News Release* 036/2023 published on 28 February 2023, while HICP was sourced from *News Release* 008/2023 published on 18 January 2023. Inflation projections presented here differ from those published by the Bank in February 2023, due to new information available after the cut-off date for that exercise.
[2] Data on the number of employed are consistent with national accounts data. The unemployment rate is based on the number of unemployed and employed as reported in the LFS.
[3] Central Bank of Malta projections.

absorption of funds from the 2014-2020 financing framework by 2023, and the take up of Recovery and Resilience Facility grants in 2023 and 2024. It also reflects a shift from domestically-funded projects to EU-funded investment over this period.

Net exports are expected to decelerate in 2023. In view of the envisaged weakness in the international economic environment, export growth is set to moderate to 2.8% in 2023, and expand at around 3.0% in the following two years. With regard to imports, growth is set to moderate to 2.9% in 2023 due to a lower rise in overall demand, and to pick up marginally to 3.1% over the remainder of the forecast horizon.

The labour market is expected to remain robust, but to slow down from 2023. Employment growth is set to moderate to 3.3% in 2023, which partly reflects the envisaged slowdown in economic activity towards potential growth. Over the rest of the projection horizon, employment is set to expand by 2.0%. The unemployment rate is expected to stand at 3.0% in 2023, and to remain at a relatively low level of 3.2% in 2024 and 2025.

Annual HICP inflation is projected to moderate to 4.4% in 2023, as international supply bottlenecks are expected to ease further. However, lingering indirect effects from recent increases in input costs are set to keep inflation high from a historical perspective. The fall in inflation in 2023 reflects a broad-based decrease across all sub-components of HICP, except for energy inflation, which remained unchanged in 2022 as a result of government support measures. Services is envisaged to be the main contributor to HICP inflation, but NEIG and processed food are also projected to contribute somewhat to annual HICP inflation in 2023. Services inflation is expected to ease from 6.0% in 2022, to 4.0% in 2023, and to 2.9% in 2024 and 2025. This moderation is expected to be primarily driven by weaker spillovers from other subcomponents, such as food, where inflation is also expected to moderate over the projection horizon. Food prices are projected to rise by 5.9% in 2023, down from 9.1% in 2022. Indeed, both processed and unprocessed food inflation are expected to decrease in 2023, although the largest decline is expected to be in unprocessed food inflation, which is projected to fall to 4.4%, from 12.1% in 2022. This reflects the indirect impact of lower import prices for most commodities and falling international freight costs. Food inflation is set to moderate to 2.2% by 2025, in line with expected developments in international commodity prices. NEIG inflation is expected to remain rather persistent and decline only slightly from 5.3% in 2022 to 4.6% in 2023. This reflects the lagged pass-through from high import price pressures to goods inflation. As import prices are expected to ease slightly this year, NEIG inflation is projected to moderate over the rest of the projection horizon, standing at 1.4% in 2025.

Despite the decline in international energy commodity prices, these remain elevated. Nevertheless, domestic energy prices are expected to remain unchanged during the whole projection horizon, in line with the Government's commitment of keeping energy prices stable. HICP inflation is set to ease steadily in the following years. Thus, overall HICP is set to stand at 2.3% and 2.2% in 2024 and 2025.

The headline budget balance is expected to remain in deficit throughout the forecast horizon but should narrow over time, driven by resilient economic activity and the profile of price mitigation measures. It is set to decline to 4.9% of GDP in 2023 and to continue declining over the rest of the forecast horizon, reaching 2.9% of GDP by 2025. Meanwhile, the general government debt-to-GDP ratio is projected to rise to 56.8% in 2023, but is set to stabilise at just under 58.0% by the end of the projection horizon.

On balance, risks to economic activity are slightly tilted to the downside for 2023, and more balanced thereafter. The main downside risks relate to the possibility of stronger than envisaged weakness in the international economic environment, which could lead to lower exports. Foreign demand may also be weaker than expected, especially if monetary policy in advanced economies tightens by more than assumed in this projection exercise. Some of these downside risks could be mitigated in the short term by stronger than expected wage growth, which could offer additional support to household consumption.

Risks to inflation are considered as balanced for the entire projection horizon. Indeed, while upward price pressures to salaries in Malta, and an incomplete lagged pass-through of past increases in energy costs in the euro area could increase commodity prices further, the re-opening of China could be seen as a partial reversal of the supply shock. Also, a stronger pass-through of the recent appreciation of the euro, monetary tightening as well as lower international energy and transport costs could result in lower inflationary pressures.

On the fiscal side, risks are on the downside (deficit-increasing) from 2023 onwards. These mainly reflect the likelihood of additional State Aid to the national airline, though possible weaker economic growth in 2023 would also have an impact. These risks may be partly offset by the profile of outlays on price mitigation measures, which could be less than projected should oil and gas prices stabilise at lower levels.