6. GOVERNMENT FINANCE

In the first three quarters of 2023, the general government deficit declined significantly when compared to that recorded in the corresponding period of 2022. When measured on a four-quarter moving sum basis, the deficit-to-GDP ratio narrowed from 5.6% as at end-2022 to 3.4% in the third quarter of 2023.

Meanwhile, general government debt as a share of GDP declined, from 51.6% at end-2022 to 49.6% as at end-September 2023. The general government net financial worth also improved. Meanwhile, the cyclically-adjusted deficit narrowed in the four quarters up to September 2023.

Quarterly developments

General government deficit narrows significantly

In the first three quarters of 2023, the general government registered a deficit of €295.9 million, €337.2 million lower when compared to the deficit recorded in the corresponding period of 2022 (see Table 6.1). This was due to government revenue increasing much more significantly than government expenditure. As a result, the primary deficit more than halved, narrowing from €512.5 million in the first three quarters of 2022 to €151.4 million in the corresponding period of 2023.

Table 6.1
REVENUE, EXPENDITURE AND DEBT
EUR millions

						Q1 - Q3		Change Q1-Q3	
	2018	2019	2020	2021	2022	2022	2023	Amount	%
Revenue	**4,947.3**	**5,173.2**	**4,763.2**	**5,437.9**	**5,884.1**	**4,268.3**	**4,780.2**	**512.0**	**12.0**
Taxes on production and imports	1,569.3	1,615.1	1,393.4	1,568.4	1,789.4	1,324.1	1,431.6	107.4	8.1
Current taxes on income and wealth	1,676.7	1,855.8	1,700.7	2,052.7	2,249.1	1,626.5	1,842.0	215.5	13.2
Social contributions	764.8	800.1	838.2	914.8	990.6	725.4	765.9	40.5	5.6
Capital and current transfers receivable	287.2	277.6	291.6	270.3	275.5	185.3	186.9	1.7	0.9
Other[(1)]	649.2	624.6	539.4	631.7	579.5	406.9	553.8	146.9	36.1
Expenditure	**4,692.5**	**5,099.9**	**6,047.8**	**6,578.6**	**6,866.2**	**4,901.4**	**5,076.1**	**174.7**	**3.6**
Compensation of employees	1,395.9	1,510.5	1,589.2	1,772.5	1,834.5	1,374.9	1,448.8	73.9	5.4
Intermediate consumption	830.4	968.4	1,189.7	1,311.0	1,341.0	960.3	1,062.7	102.4	10.7
Social benefits	1,181.0	1,244.9	1,342.6	1,389.1	1,486.7	1,100.6	1,206.8	106.2	9.6
Subsidies	179.0	195.1	684.4	707.4	834.8	567.1	465.0	-102.1	-18.0
Interest	194.0	183.6	170.9	168.0	164.2	120.7	144.5	23.9	19.8
Other current transfers payable	266.3	291.8	304.1	445.4	463.3	276.5	240.0	-36.6	-13.2
GFCF	441.9	543.6	555.9	585.4	589.3	410.8	385.0	-25.8	-6.3
Capital transfers payable	207.5	151.4	191.3	178.6	138.2	79.7	106.9	27.2	34.2
Other[(2)]	-3.4	10.7	19.6	21.2	14.4	10.8	16.3	5.5	-
Primary balance	**448.8**	**256.9**	**-1,113.6**	**-972.7**	**-818.0**	**-512.5**	**-151.4**	**361.1**	**-**
General government balance	**254.8**	**73.3**	**-1,284.6**	**-1,140.7**	**-982.2**	**-633.1**	**-295.9**	**337.2**	**-**
General government debt	**5,662.1**	**5,720.3**	**6,974.7**	**8,263.9**	**9,000.5**	**8,695.0**	**9,409.8**		

Source: NSO.

[(1)] "Other" revenue includes market output as well as income derived from property and investments.

[(2)] "Other" expenditure principally reflects changes in the value of inventories and in the net acquisition of valuables and other assets.

Higher tax receipts underpin revenue growth

During the period under review, general government revenue increased by €512.0 million, or 12.0% in annual terms. This was largely due to higher inflows from current taxes on income and wealth, which increased by €215.5 million. This reflects higher income tax receipts paid by both companies and households. Furthermore, receipts from production and imports increased by €107.4 million, due to higher VAT receipts and, to a lower extent, higher inflows from stamp duty. Furthermore, social contributions went up by €40.5 million, reflecting favourable labour market conditions.

Non-tax revenue also increased during the period under review. This was mostly driven by a €146.9 million rise in the 'other' component of government revenue, reflecting an increase in income from sales.

Current outlays support expenditure growth

During the period under review, growth in government expenditure was relatively muted, as spending on energy price support measures was offset by the termination of COVID-related support measures. Overall, government expenditure increased by €174.7 million, or 3.6% when compared to the corresponding period a year earlier, with recurrent expenditure contributing the most to the increase.

Outlays on social benefits increased by €106.2 million, mainly due to higher outlays on retirement pensions and contributory bonuses. Similarly, intermediate consumption grew by €102.4 million, partly on the back of higher expenditure within the public administration sector. Moreover, spending on compensation of employees increased by €73.9 million, driven by higher wages in the public administration and, to a lower extent, in the education sector. Interest payments increased by €23.9 million, reflecting higher financing requirements in recent years, coupled with an increase in the cost of borrowing. Moreover, the 'other' component of government expenditure increased by €5.5 million.

On the other hand, spending on subsidies fell by €102.1 million, due to the aforementioned base effect from pandemic related assistance, and the timing of spending on energy support measures. Other current transfers payable declined by €36.6 million in the period under review, reflecting a one-time refund from the European Union.

Meanwhile, capital expenditure rose slightly in the period under consideration. This is due to a €27.2 million increase in capital transfers, which offset a €25.8 million decrease in GFCF. The latter mainly reflects a decline in spending on locally financed projects.

Debt increases in level terms

In September 2023, the stock of general government debt stood at €9,409.8 million, an increase of €409.3 million from its level as at end-2022. The stock of long-term debt securities (composed of MGS) increased by €820.4 million, as new MGS issues outweighed the value of redeemed securities. Moreover, in level terms, the share of long-term securities in total government debt increased by 5.4 percentage points, to 81.6%. On the other hand, the stock of short-term securities outstanding (composed of Treasury bills) decreased by €394.4 million, and their share in total debt broadly halved to 4.3%.

Meanwhile, the stock of loans outstanding increased slightly by €1.8 million. Notwithstanding this increase, the share of long-term loans in total debt fell by 0.4 percentage point, to 9.2%. Furthermore, the level of currency and deposits outstanding declined by €18.5 million, bringing down their share in total debt by 0.4 percentage point to 4.8%. This reflects a lower level of outstanding 62+ Malta Government Savings Bonds, which are classified as deposits according to European System of Accounts (ESA) methodology.

Headline and cyclically-adjusted developments

Headline deficit and debt ratios decline

When measured on a four-quarter moving sum basis, the general government deficit-to-GDP ratio declined from 5.6% at end-2022, to 3.4% in the third quarter of 2023.

During this period, the ratio of total revenue in GDP remained broadly unchanged (see Chart 6.1). On the other hand, the ratio of total expenditure in GDP declined by 2.3 percentage points, with this drop being mostly due to a lower share of current expenditure. Since 2021, the decline in the share of current outlays in GDP has been the primary force behind the improvement in the fiscal balance.

Meanwhile, the government debt-to-GDP ratio fell by 2.0 percentage points when compared to December 2022, reaching 49.6% of GDP (see Chart 6.2). As GDP growth remained strong, the interest-growth differential exerted a debt-decreasing effect in the period reviewed. The impact of sustained primary deficits and debt-increasing deficit-debt transactions was relatively muted.

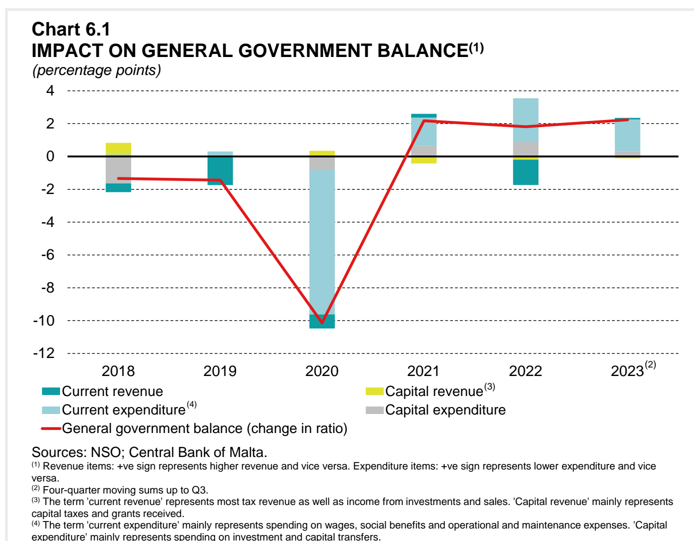
Net financial worth improves

The market value of financial assets as at end-September 2023 stood at €5,485.5 million, an increase of €578.3 million when compared with December 2022.[1] This was mainly due to higher government deposits held at banks. The share of financial assets in GDP rose by 0.8 percentage point to 28.9%, as at end-September 2023 (see Chart 6.3).

Meanwhile, the market value of financial liabilities increased by €799.9 million, ending the third quarter of 2023 at €11,136.1 million. This is mainly due to a strong increase in accounts payable and in the value of debt securities. Despite this substantial increase, the share of financial liabilities in GDP declined by 0.6 percentage point, to 58.7%.

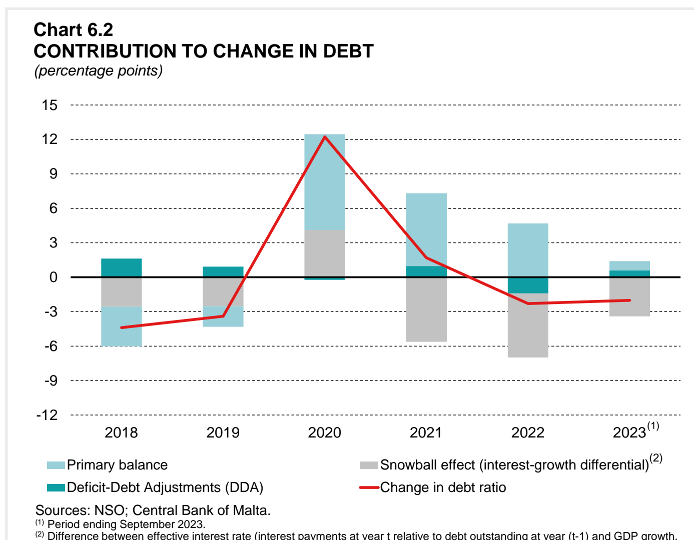
The resulting net financial worth of general government as a share of GDP improved by 1.3 percentage

Chart 6.1
IMPACT ON GENERAL GOVERNMENT BALANCE(1)
(percentage points)



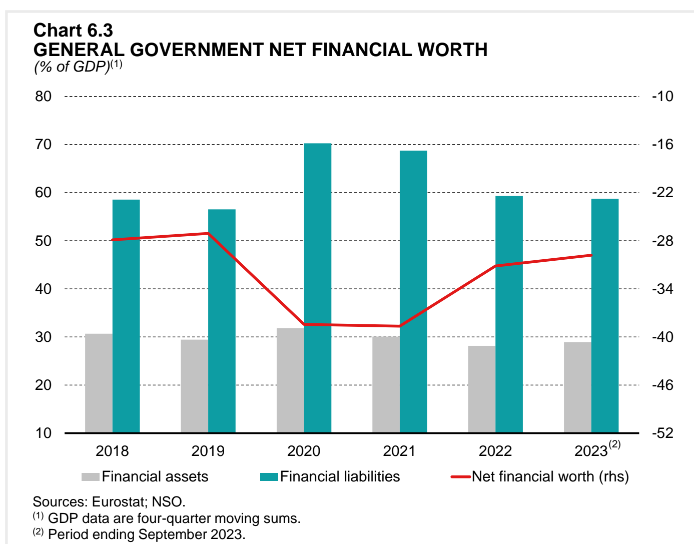
Sources: NSO; Central Bank of Malta.
(1) Revenue items: +ve sign represents higher revenue and vice versa. Expenditure items: +ve sign represents lower expenditure and vice versa.
(2) Four-quarter moving sums up to Q3.
(3) The term 'current revenue' represents most tax revenue as well as income from investments and sales. 'Capital revenue' mainly represents capital taxes and grants received.
(4) The term 'current expenditure' mainly represents spending on wages, social benefits and operational and maintenance expenses. 'Capital expenditure' mainly represents spending on investment and capital transfers.

Chart 6.2
CONTRIBUTION TO CHANGE IN DEBT
(percentage points)



Sources: NSO; Central Bank of Malta.
(1) Period ending September 2023.
(2) Difference between effective interest rate (interest payments at year t relative to debt outstanding at year (t-1) and GDP growth.

Chart 6.3
GENERAL GOVERNMENT NET FINANCIAL WORTH
(% of GDP)(1)



Sources: Eurostat; NSO.
(1) GDP data are four-quarter moving sums.
(2) Period ending September 2023.

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[1] According to the ESA 2010 methodology the stock of financial assets and liabilities are measured at market value. For further details see https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Net_financial_worth&stable=1

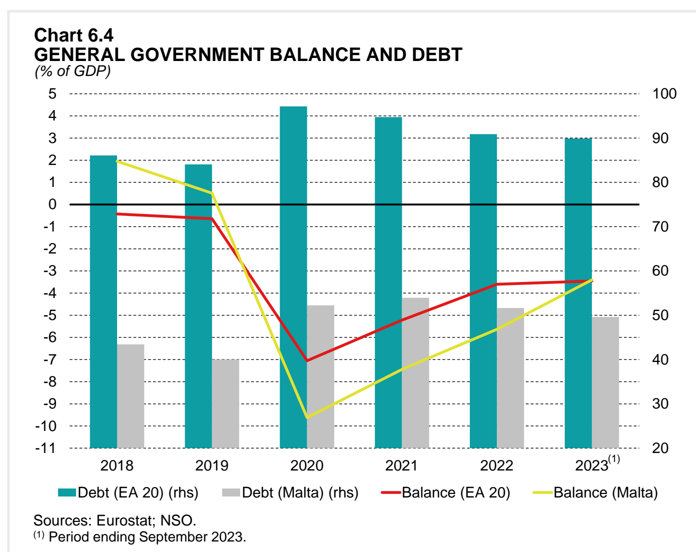
points and closed the third quarter of the year at -29.8%, from -31.1% as at end 2022. Consequently, the net financial worth of the Maltese Government continued to compare favourably with the euro area average. The latter stood at -54.9% of GDP in September 2023, compared with -56.3% registered in December 2022.

Maltese public finances improve at a faster pace than the euro area average

In September, the euro area general government deficit stood at 3.5% of GDP when measured on a four-quarter moving sum basis, slightly narrower than the deficit recorded in 2022 (see Chart 6.4). Moreover, over the same period, the euro area debt ratio decreased from 90.9% to 89.9% of GDP.

In the period under review, there has been a greater improvement in the Maltese general government deficit ratio than the euro area average. Moreover, the headline balance is now broadly in line with the euro area average, while the Maltese government debt-to-GDP ratio remained well below the corresponding ratio for the euro area.

Chart 6.4
GENERAL GOVERNMENT BALANCE AND DEBT
(% of GDP)



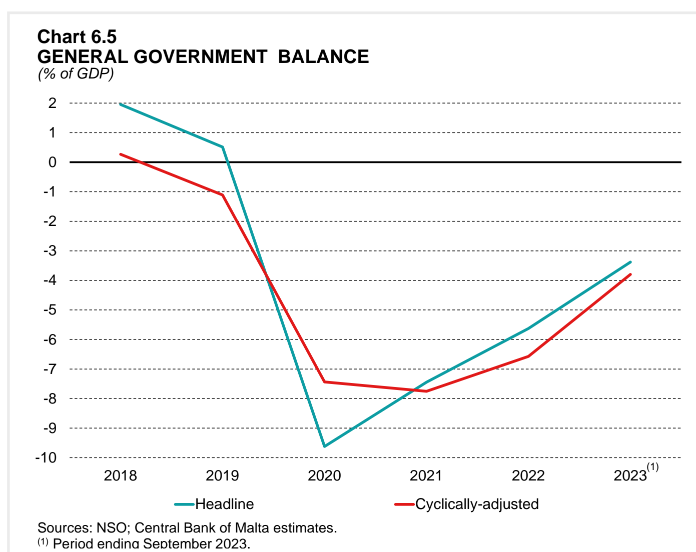
Sources: Eurostat; NSO.
(1) Period ending September 2023.

Cyclically-adjusted balance improves[2]

On a four-quarter moving sum basis, the cyclically-adjusted deficit stood at 3.8% of GDP in September 2023, 2.8 percentage points lower than the deficit posted at the end of 2022 (see Chart 6.5). This improvement is mostly in line with the change in the headline balance during the same period.

The improvement in the cyclically-adjusted balance since December 2022 mainly reflects a fall of 3.0 percentage points in the share of cyclically-adjusted expenditure in GDP (see Table 6.2). This reflects the abovementioned declines in subsidies, and in current transfers, which form part of 'other expenditure' in the table. At the same time, the share of compensation of employees and social benefits fell by 0.7 and 0.3 percentage points, respectively.

Chart 6.5
GENERAL GOVERNMENT BALANCE
(% of GDP)



Sources: NSO; Central Bank of Malta estimates.
(1) Period ending September 2023.

The share of cyclically-adjusted revenue fell by 0.3 percentage point. This was mainly due to a 0.3

[2] The cyclically-adjusted balance is corrected for the impact of the economic cycle on government tax revenue and unemployment assistance. This methodology is in line with the approach used by the European Commission but is based on own estimates for fiscal items' elasticities and the output gap. For an overview of the method used by the Commission, see Mourre, G., C. Astarita, and S. Princen (2014): "Adjusting the budget balance for the business cycle: the EU methodology," *European Economy – Economic Papers* 536, (DG ECFIN), European Commission.

Table 6.2
YEAR-ON-YEAR CHANGES IN CYCLICALLY-ADJUSTED FISCAL COMPONENTS
Percentage points of GDP

	2018	2019	2020	2021	2022	2023[1]
Revenue	**0.1**	**-1.8**	**-1.3**	**0.8**	**-2.1**	**-0.3**
Current taxes on income and wealth	-0.3	0.1	1.2	-0.4	-0.7	0.2
Taxes on production and imports	0.3	-0.7	-0.9	-0.2	0.0	-0.3
Social contributions	-0.1	-0.3	0.3	0.2	-0.5	-0.3
Other[2]	0.2	-0.9	-2.0	1.1	-0.9	0.1
Expenditure	**1.6**	**-0.4**	**5.0**	**1.1**	**-3.2**	**-3.0**
Compensation of employees	-0.2	-0.2	0.2	0.5	-1.0	-0.7
Intermediate consumption	0.4	0.4	1.3	0.3	-0.8	-0.2
Social benefits	-0.5	-0.4	0.0	0.0	-0.4	-0.3
Interest payments	-0.3	-0.2	-0.1	-0.1	-0.2	0.0
GFCF	1.0	0.4	-0.1	0.0	-0.4	-0.5
Other[3]	1.1	-0.5	3.7	0.5	-0.4	-1.4
Primary balance	**-1.7**	**-1.6**	**-6.5**	**-0.4**	**1.0**	**2.8**
General government balance	**-1.4**	**-1.4**	**-6.3**	**-0.3**	**1.2**	**2.8**

Sources: NSO; Central Bank of Malta estimates.

[1] Four-quarter period up to September 2023.

[2] Includes market output, income derived from property and investments and current and capital transfers received.

[3] Mainly includes subsidies, current and capital transfers.

percentage point fall in both the share of indirect tax and social contribution revenue in GDP. These declines offset a 0.2 percentage increase in the share of direct taxes. At the same time, the share of 'other revenue' rose marginally, mainly due to the above-mentioned rise in sales.

BOX 4: THE SUSTAINABILITY OF MALTESE GOVERNMENT DEBT[1]

This box assesses the sustainability of Maltese general government debt over different time horizons and evaluates risks stemming from macro-financial linkages. It updates previous debt sustainability analyses published by the Bank.[2,3] The term 'sustainability' used in this analysis is in line with the IMF's definition that 'sovereign debt is sustainable if the country is able to finance its policy objectives and service the resulting debt, without resorting to unduly large adjustments, which could otherwise compromise its stability'.

Main messages

The main messages can be summed up as follows:

- According to a heatmap of relevant indicators, in 2022 risks related to the structure and financing of debt, and risks related to contingent liabilities, are considered to be medium to moderate.
- This box presents two scenarios which serve as a preliminary assessment of the impact of the EU fiscal framework reform. The debt ratio is not expected to embark on an explosive path, even in the event of adverse shocks. However, depending on the pace of fiscal consolidation, the expected decline in the debt-to-GDP ratio could be insufficient to comply with the revised rules.
- There exist risks which could not be quantified and incorporated in the scenario analysis. In the immediate term, these mainly reflect the Government's commitment to maintain stability in energy prices to consumers. Medium to long-term risks reflect the reform in the international corporate tax framework and the introduction of new EU-wide revenue raising measures. While these risks may be substantial, the resulting changing structure of the Maltese economy, including those as a result of reforms implemented in the context of the national Recovery and Resilience Plan, may bring both positive and adverse impacts on debt sustainability.

Scenario analyses

The scenarios in this Box serve as a preliminary assessment of the impact of the EU fiscal framework reform. In December 2023, the Council of the EU agreed on a set of reforms to the Stability and Growth Pact, which affect both the preventive arm and the Excessive Deficit Procedure (EDP).[4] The Council then reached a provisional political agreement on the preventive arm with European Parliament negotiators in February 2024.[5] The new rules, which will be applied from 2025, need to be approved in a formal vote in both the Council and the EU Parliament before being adopted.

Under the proposed framework, which provides for greater differentiation across countries based on their fiscal positions, the European Commission will set a "technical trajectory" for Member States with government debt-to-GDP ratios above 60% and/or deficit-to-GDP ratios higher than 3%. This trajectory seeks to ensure that sufficient fiscal adjustment is carried out over an agreed period. The trajectory is agreed with Member States on the basis of multi-year national plans, which will cover a period of four years, extendible by a further maximum of three years if underpinned by credible commitments to investment and reforms. Although fiscal adjustment is expressed in terms of the

[1] Prepared by John Farrugia, Manager Fiscal Issues and Reports Office within the Economic Analysis Department of the Central Bank of Malta. The views expressed are those of the author and do not necessarily reflect the views of the Central Bank of Malta. Any errors are the author's own.

[2] For further details on government debt dynamics and fiscal sustainability, see Farrugia, J. and Grech, O., "The Sustainability of Maltese Government Debt Revisited", in Grech, A.G., and Zerafa, S. (eds.), *Challenges and Opportunities of Sustainable Economic Growth: the Case of Malta,* Central Bank of Malta*, 2017.*

[3] This study uses the national accounts vintage up to the fourth quarter of 2023, published in February 2024 and the general government data vintage up to the third quarter of 2023, published in January 2024. The cut-off date for projections is 6 February 2024.

[4] See https://www.consilium.europa.eu/en/press/press-releases/2023/12/21/economic-governance-review-council-agrees-on-reform-of-fiscal-rules.

[5] See https://www.consilium.europa.eu/en/press/press-releases/2024/02/10/economic-governance-review-council-and-parliament-strike-deal-on-reform-of-fiscal-rules

structural primary balance (SPB), it will be monitored via growth in a defined measure of nationally-funded government expenditure.

The new rules require countries to adhere to minimum annual changes in the SPB, depending on their deficit and debt level (see section at the end of the box). However, the pace of annual fiscal adjustment needs to ensure that the debt-to-GDP ratio is on a plausibly declining path or stays at prudent levels even after accounting for adverse scenarios.

The below scenarios explore the profile of the Maltese general government debt if different fiscal adjustment paths are targeted. Given that the new fiscal rules have not yet been formally adopted, and since Member States had not yet submitted national plans when this exercise was conducted, the forecast consolidation paths in this box are based on a number of assumptions.

Up until 2026, assumptions for GDP growth, inflation and Government's borrowing costs in both scenarios are in line with the Bank's latest forecast exercise.[6] Thereafter, a series of common assumptions govern the path of macro variables, prices and interest rates. Shocks to the scenarios are in line with those proposed under the new fiscal rules (see section at the end of this box).

Scenario 1 – Baseline Scenario

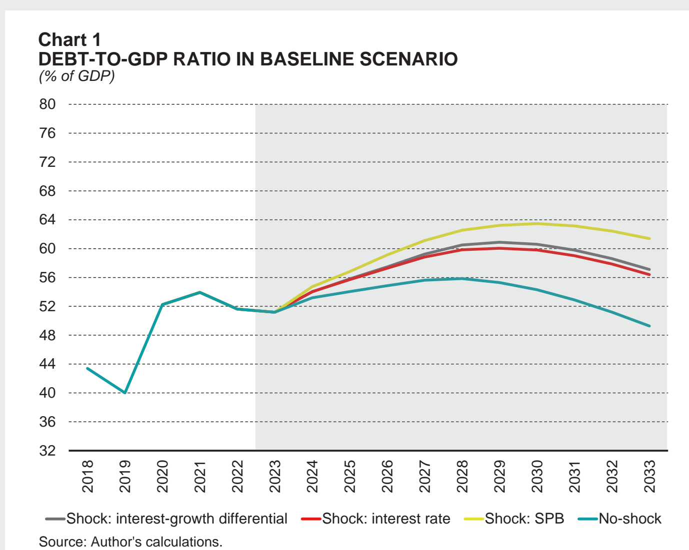
In this scenario, the SPB path between 2024 and 2026 is in line with the Bank's latest projections. On average, the annual rate of adjustment amounts to 0.7% of GDP – more than the minimum rate of adjustment required by the newly proposed fiscal rules. Thereafter, the mandated minimum annual change in the SPB is pursued. In this scenario, Government reaches a structural deficit ratio of 1.5% (the safety margin included in the preventive arm's deficit safeguard) by 2030. However, it continues to target fiscal consolidation even in subsequent years, such that the structural balance is only slightly in deficit by 2033.

On the basis of these assumptions, and excluding the impact of any shocks, the general government debt is expected to peak at just under 56.0% in 2028 before declining to around 50.0% of GDP by 2033 (see Chart 1).

In this scenario, the debt-to-GDP ratio remains on a downward path even when shocks are applied.

Owing to the different magnitude of shocks, a less favourable interest-growth differential and higher interest rates have a broadly similar effect on the debt ratio. Between 2028 and 2030, the debt ratio is set to be around 60% of GDP as a result of these shocks. However, by 2033 debt is expected to decline to around 57% of GDP.

Chart 1
DEBT-TO-GDP RATIO IN BASELINE SCENARIO
(% of GDP)



Source: Author's calculations.

[6] This exercise is available here: https://www.centralbankmalta.org/economic-projections

A shock to the SPB exerts the largest impact on the debt profile. Although the debt-to-GDP ratio is expected to decline from around 2030 onwards, it is still expected to remain above 60% by 2033.

According to this scenario, if no shocks occur, the debt-to-GDP ratio declines to below 2023 levels by the end of the projection horizon. On the basis of the mechanical shocks applied to this scenario, the debt ratio remains above 2023 levels. Moreover, the year in which the debt ratio reaches its peak is pushed back from 2028 in a no-shock scenario, to 2030 in the event of a SPB shock. A more aggressive fiscal consolidation path than that assumed in the no-shock path, aimed at bringing the debt ratio to a lower peak earlier on in the projection horizon, would be necessary to ensure that public finances are less susceptible to adverse economic developments.

Scenario 2 – Alternative Scenario

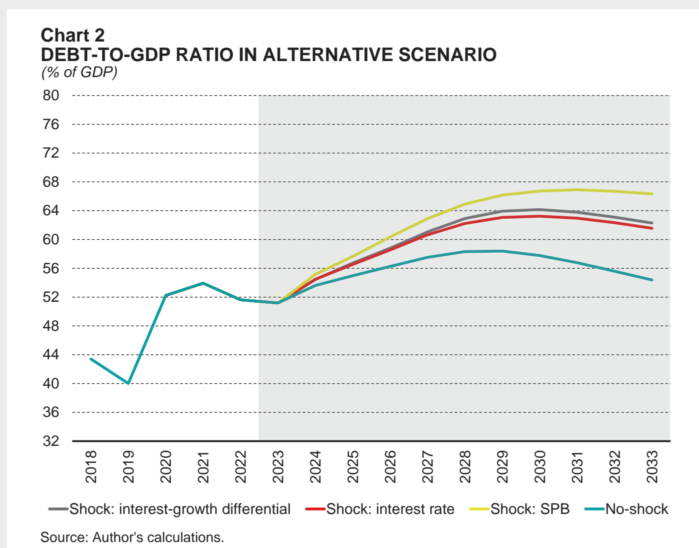
In this scenario, it is assumed that fiscal consolidation is not pursued as aggressively as in the baseline scenario. Between 2024 and 2026, the mandated minimum annual change in the SPB is pursued – which is smaller than the adjustment forecast in the latest CBM projections. Thereafter, the required minimum pace of consolidation is carried out, such that a structural deficit of 1.5% of GDP is posted by 2033. The SPB is slightly in surplus by the end of the projection horizon.

Excluding the impact of any shocks, general government debt is set to peak in 2029 at around 58% before decreasing to just below 55.0% of GDP by 2033 (see Chart 2).

Shocks to the interest-growth differential and to interest rates are set to push the debt ratio above 60%. However, debt is still forecast to decline to around 62.0% of GDP by 2033, from a peak of around 64.0% in 2030. A shock to the SPB is set to push the debt-to-GDP ratio to around 66% from 2029 onwards. Although the debt profile is still expected to decline over time, the year-on-year decrease in the ratio is very small.

This scenario highlights the importance of frontloaded fiscal consolidation and continuous adherence to the targets. Despite ensuring the minimum required rate of fiscal adjustment, the debt ratio in this scenario may not be brought on a strong downward path in the event of unexpected shocks. Thus, even though the debt ratio is not expected to embark on an explosive path, government debt under this adverse scenario may not comply with the EU's proposed new fiscal rules.

Chart 2
DEBT-TO-GDP RATIO IN ALTERNATIVE SCENARIO
(% of GDP)



Source: Author's calculations.

Heat map of indicators

This section assesses a number of indicators which, according to the literature, are highly relevant for debt sustainability in the short and long term. The thresholds used to grade these indicators are mainly sourced from the European Commission's *Debt Sustainability Monitor* series. The threat that each indicator poses to the

debt ratio is colour coded – red indicates a high threat, yellow indicates a medium threat and green signals a low threat to sustainability. The heat map is presented in Table 1.

This is a backward-looking analysis using information up to 2022. At the time this exercise was completed, data at end-2023 was not available for most indicators.

Risks surrounding the structure of debt and availability of liquidity are considered to be relatively low. Although the share of short-term debt in total debt is considered to be a medium threat, it declined from around 16% in 2020 to around 14% by end-2022.[7] Short-term debt also includes holdings of Malta Government Retail Savings Bonds, which are classified as deposits in the ESA methodology.

Risks related to gross financing needs have decreased compared with 2020, as the general government deficit declined. Consequently, they are now considered as low risk. However, net financing needs after accounting for government deposits remain substantial and continue to be classified as medium risk.

From a macro-financial perspective, the main risks to debt sustainability stem from the elevated share of non-performing loans in the total loans extended by the core domestic banks, when compared with the applicable threshold. This metric has however improved significantly over time and is currently at historic lows.[8]

Table 1
HEAT MAP

	2018	2019	2020	2021	2022
Structure of debt					
Share of short-term debt					
Change in share of short-term debt (y-o-y)					
Share of foreign currency denominated debt					
Share of debt with variable interest rate in GDP					
Share of debt held by non-residents					
Liquidity risks					
Gross financing needs (% of GDP)					
Net financing needs (% of GDP)					
Ten year government bond spread over German Bund					
Macro-financial risks					
Private sector debt (% of GDP)					
Private credit flow (% of GDP)					
Net international investment position (% of GDP)					
Share of non-performing loans to gross loans: core banks					
Change in share of non-performing loans (core banks) (y-o-y)					
Bank loans-to-deposits ratio (core banks)					
Change in nominal house prices (y-o-y)					
Competitiveness risks (High/Low risk)					
ULCs (% change over three years)					
Real effective exchange rate (% change over three years)					
Current account balance (three yr average as % of GDP)					
Export market shares (% change over five yrs)					
Implicit/ contingent risks					
Commission Ageing Report: 2019-2070 ageing costs (pp of GDP)					
General government guarantees (% of GDP)					

Sources: Author's calculations; Eurostat.

[7] The medium and high-risk thresholds applied in this study respectively have a value of 8.2% and 16%.
[8] The high-risk threshold applied in this study has a value of 2.3%. This metric amounted to 2.5% by end-2023.

Implicit liabilities in the form of ageing costs (pensions, healthcare and long-term care) as a share in GDP form another significant risk to sustainability. According to the Commission's 2021 *Ageing Report* projections, at 8.0 points, Malta is set to have the fourth highest increase in age-related spending in the euro area between 2019 and 2070. However, ageing costs are set to remain below the euro area average by 2070.

Government-guaranteed debt as a share of GDP continued to decline in 2022. At 6.6% of GDP, this ratio stood lower than the euro area average, and is more than half the peak ratios observed in 2012 and 2014. Consequently, the risk of guarantees being called is considered as medium, bordering on low. However, there still remain substantial pandemic-related guarantees outstanding. These form the fourth largest source of guarantees after those in the energy and logistics sectors.[9]

Non-quantifiable risks

This section outlines other debt sustainability risks which are likely to materialise but cannot be quantified at present.

In the short-to-medium term, sustainability risks reflect the Government's commitment to retain stable energy prices to consumers. If commodity prices remain at a higher level than estimated, Government will require higher subsidies than planned. This will also directly impact the Commission's assessment of the pace of fiscal consolidation. Both the Commission (in its assessment of the 2024 Draft Budgetary Plan) and the IMF (in its 2023 Article IV consultation) called for the Maltese Government to embark on a plan to gradually scale back the size and scope of energy support measures.

Medium-to-long term sustainability risks reflect the impact of a reform in the international corporate tax framework, as agreed by members of the Organization for Economic Co-operation and Development (OECD)/G20 Inclusive Framework. The reforms affect large multinational companies and seek the partial re-allocation of taxing rights from their home countries to markets where they also earn turnover. The reforms also introduce a 15% global minimum effective corporate tax rate. In December 2022, the Council of the EU reached unanimously an agreement to implement the EU Minimum Tax Directive (Directive 2022/2523). Member States were required to transpose the rules into domestic law by 31 December 2023. However, Member States in which no more than 12 ultimate parent entities of multinational enterprise groups are located, are allowed to apply a derogation for up to end-2029. The Maltese Government is eligible to apply this derogation. The impact of these proposals on government finances is thus hard to quantify at this stage.

Other medium-to-long terms risks reflect the impact of new EU-wide revenue raising measures, which Member States in principle agreed to introduce in order to repay financing of the Next Generation EU rescue package. These include the extension of the EU Emissions Trading System as from 2024, the introduction of a carbon border adjustment mechanism, and an own resource requirement from the above mentioned international corporate taxation framework.[10] Such measures have the potential to significantly affect the Maltese economy and public debt sustainability. On the one hand, the introduction of new taxation systems may disrupt existing industries and negatively affect inflows from corporate taxes. On the other hand, the shift towards new industries may boost competitiveness and productivity, leading to increased investment. The long-run impact of structural reforms being implemented as part of the national Recovery and Resilience Plan – which ought to reduce sustainability risks – is also difficult to gauge.

[9] See National Audit Office Malta (2023). "Annual Audit Report: Public Accounts 2022" for further details.

[10] See https://ec.europa.eu/commission/presscorner/detail/en/ip_21_7025.

Assumptions and technical information

Numerical targets proposed in the reform of the Stability and Growth Pact

Member States under the preventive arm of the fiscal rules will be subject to two safeguards. Under the debt sustainability safeguard, countries with debt ratios higher than 90% of GDP are required to bring down their debt ratio by a minimum annual average of 1 percentage point of GDP over the national plan's horizon. The minimum annual average of debt reduction for countries with ratios of between 60% and 90% is 0.5 percentage point of GDP. Under the deficit resilience safeguard, countries need to bring their structural deficit down to 1.5% of GDP to ensure a safety margin to the 3% of GDP Treaty-based threshold. To this end, the annual change in the SPB will be 0.4 percentage point of GDP for a four-year adjustment plan, and 0.25 percentage point for a seven-year plan.

Countries which breach the 3% deficit ratio threshold and enter into an EDP are required to make a minimum annual adjustment of 0.5 percentage point of GDP in the SPB for the transitional period 2025-2027, and in terms of the structural balance thereafter.

Scenario analyses: common assumptions (from 2027 onwards)

Potential output growth is determined exogenously in this framework. Real GDP growth is set to grow in line with the forecast SPB and potential output growth. The growth is therefore determined by the fiscal multiplier – i.e. the degree to which fiscal policy affects economic growth – and the output gap, which eventually closes. For further details, refer to the 2018 *Annual Report* Box.

Inflation, which in this box is measured by growth in the GDP deflator, is assumed to revert to around 2.0%, in line with the ECB's target for inflation over the medium term. Meanwhile, the level of the deficit-debt adjustment is assumed to revert to its long-run average. No temporary fiscal measures are assumed to take place.

Government debt is forecasted on the basis of different types of maturity. The share of each category of debt is assumed to revert to its long-run average. Interest payment projections are based on separate interest rate estimates applied to each maturity category.

The forecast path of interest rates is based on ECB assumptions for the EURIBOR (used to determine interest payments on short-term debt) and the ten-year yield on Malta Government Bonds (used to determine interest payments on rolled-over, long-term debt).[11] Interest rates on non-maturing debt are based on the maturity profile of outstanding MGS.

The forecast path for the main determinants of debt is shown in Table 2.

Table 2
SCENARIO ASSUMPTIONS: MAIN DETERMINANTS OF DEBT
Per cent; averages over simulation period

	Baseline scenario				Alternative scenario			
	2024-2033 average	Shock: interest growth differential	Shock: interest rate	Shock: SPB	2024-2033 average	Shock: interest growth differential	Shock: interest rate	Shock: SPB
Real GDP growth rate	3.5	3.0	3.5	3.5	3.5	3.0	3.5	3.5
Inflation (GDP deflator growth rate)	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Implicit interest rate	3.0	3.4	3.8	3.1	3.1	3.5	3.9	3.2
Deficit-debt adjustments (% of GDP)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
SPB (% of GDP)	-0.6	-0.7	-0.7	-1.6	-1.2	-1.2	-1.2	-2.2
Memo: SPB in 2033 (% of GDP)	*1.1*	*1.2*	*1.2*	*0.1*	*0.2*	*0.4*	*0.4*	*-0.8*

Source: Author's calculations.

[11] The euro area interest rate projections were sourced from the ECB's technical assumptions.

Scenario analyses: shocks (applied from 2024 onwards)

Shocks are assumed to be permanent in nature, and to target three main determinants of the debt-to-GDP path. Shocks to the interest-growth differential assume a 0.5 percentage point lower GDP growth path and 0.5 percentage point higher interest rate path. The interest rate shock scenario assumes a 1.0 percentage point higher path of interest rates. The SPB scenario assumes a 1.0 percentage point lower SPB path.

For shocks which impose an increase in interest rates, a gradual increase in the interest rate on non-maturing debt is being assumed, such that the full impact of the shock is felt by the end of the forecast horizon. The impact of the shock to interest rates applied to maturing and new debt is felt immediately.