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OUTLOOK FOR THE MALTESE ECONOMY

2026:2

Address
Pjazza Kastilja
Valletta VLT 1060
Malta

Telephone
(+356) 2550 0000

Fax
(+356) 2550 2500

Website
www.centralbankmalta.org

Contact
https://www.centralbankmalta.org/contact-us

The Bank's projections for the Maltese economy are based on information available up to 21 May 2026. Figures in tables may not add up due to rounding.

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OUTLOOK FOR THE MALTESE ECONOMY 2026-2028

Overview[1,2]

Over the past year, economic growth in Malta normalised from the very high levels recorded in recent years, though it exceeded somewhat the Bank's previous expectations. Short-term indicators also continue to signal robust activity during the first few months of 2026. The Bank's Business Conditions Index indicates developments that are consistent with the long-run historical average and sentiment remained high during the first months of the year. This contrasts sharply with weak developments in the global economy.

The conflict in the Middle East continues to generate a high level of uncertainty for the global outlook, including the euro area, as the situation remains volatile with ambiguity on its duration and intensity. The energy price shock emanating from the war is expected to weigh on global economic sentiment and exert both direct and indirect inflationary pressures in the euro area alongside lower foreign demand. Some of these effects are expected to transmit locally. However, the economic momentum in the Maltese economy is expected to show some degree of resilience in 2026, with a delayed small impact on GDP and prices envisaged to materialise later in the year and into 2027.

Going forward, and in the absence of severe and more prolonged disruptions arising from the Middle East conflict, GDP growth is expected to pick-up slightly again by 2028, though inflation should remain slightly above 2%.

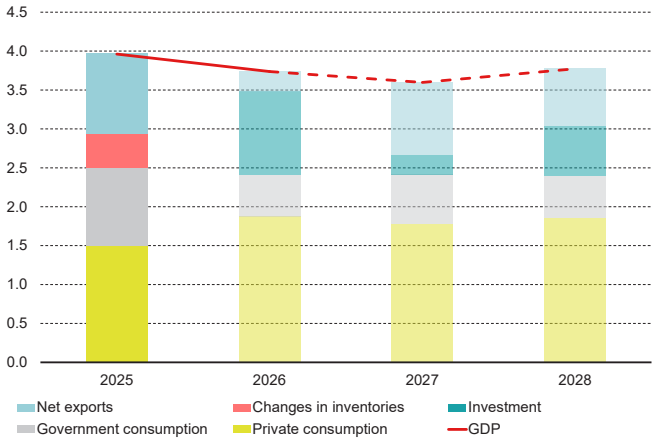
Economic outlook

The Bank projects Malta's real GDP growth to moderate from 4.0% in 2025 to 3.7% in 2026 (see Table 1). Slightly weaker growth is projected in 2027 at 3.6% as the domestic impact of the conflict in the Middle East is expected to unfold during this year. However, growth is expected to pick-up again to 3.8% in 2028.

Compared to the Bank's previous projections, the outlook for GDP growth has been revised down by 0.1 percentage points in 2027 and up by 0.1 percentage points in 2028. The downward revision is primarily due to a revised profile of government consumption and investment and slightly lower growth in private consumption because of higher imported inflation due to the war. These factors are envisaged to recede by 2028.

Over the projection horizon, domestic demand is expected to remain the main driver of growth (see Chart 1). The latter is expected to be led by private

Chart 1
GDP GROWTH PROJECTIONS
(annual percentage change; percentage point contributions)



Source: Central Bank of Malta.

[1] The Bank's projections for the Maltese economy are based on information available up to 21 May 2026.
[2] See Central Bank of Malta: Outlook for the Maltese Economy 2026:1.

Table 1

PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES FOR MALTA[1]

	2025[2]	2026	2027	2028
Real economic activity (% change)				
GDP	4.0	3.7	3.6	3.8
Private consumption expenditure	3.3	4.2	4.0	4.1
Government consumption expenditure	5.9	3.1	3.6	3.0
Gross fixed capital formation	-0.1	6.0	1.4	3.6
Exports of goods and services	4.5	4.3	3.5	3.5
Imports of goods and services	4.4	4.8	3.2	3.4
Contribution to real GDP growth (in percentage pts)				
Final domestic demand	2.9	3.5	2.7	3.0
Net exports	1.0	0.3	0.9	0.7
Changes in inventories	0.4	0.0	0.0	0.0
Balance of payments (% of GDP)				
Goods and services balance	19.5	18.9	19.0	19.0
Current account balance	8.6	8.1	8.3	8.3
Labour market (% change)[3]				
Total employment	3.9	2.7	2.5	2.3
Unemployment rate (% of labour supply)	3.1	2.8	2.9	2.9
Real disposable income	3.7	4.9	4.3	3.9
Household saving ratio	20.2	20.7	21.0	20.8
Prices and costs (% change)				
GDP deflator	2.2	2.5	2.4	2.3
Overall HICP	2.4	2.5	2.5	2.2
HICP excluding food and energy	2.4	2.4	2.4	2.1
Compensation per employee	4.2	4.4	4.5	3.9
ULC	4.1	3.4	3.5	2.5
Business cycle				
Potential output (% change)	5.1	4.3	3.9	3.5
Output gap (% of GDP)	0.9	0.4	0.1	0.4
Technical assumptions				
EUR/USD exchange rate	1.10	1.20	1.20	1.20
Oil price (USD per barrel)	69.1	96.9	82.2	77.1

Sources: NSO; Central Bank of Malta.

[1] Data on GDP were sourced from NSO *News Release 033/2026* published on 26 February 2026, while HICP data was sourced from NSO *News Release* 090/2026 published on 20 May 2026.

[2] Actual data.

[3] 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.

consumption, which is projected to continue to grow at a brisk pace. Net exports are also projected to contribute positively to GDP growth over the forecast horizon, driven by trade in services. However, such contribution is set to be smaller than that of domestic demand.

Private consumption growth is expected to pick up in 2026 and set to stay close to 4% in the following years. Over the projection horizon, growth in private consumption is expected to be

supported by the revision in the income tax brackets for parents, which in turn will boost disposable income. The household savings rate is also expected to increase, as some of the income tax savings are assumed to be saved.

Real government consumption growth is projected to ease in the coming years. This mostly reflects slower growth in intermediate consumption, which in 2025 was affected by exceptional outlays. While moderating, however, growth in this component is expected to keep pace with or exceed nominal GDP. In part this reflects strong growth in employee compensation, whose profile is in line with ongoing collective agreements covering most of the general government sector.

Growth in overall investment is projected to pick up in 2026, following a marginal decline in the previous year. This reflects an envisaged acceleration in private investment in part due to Budget 2026 incentives targeting investment. In addition, government investment is projected to increase strongly in 2026, driven by EU-financed outlays. These reflect Recovery and Resilience Facility (RRF)-financed projects, as well as other large-scale initiatives, notably the second electricity interconnector. Growth is then expected to moderate in 2027 as government investment is envisaged to decline strongly that year, with the assumed completion of all projects financed through the RRF by 2026. Despite this decline, overall investment is expected to increase in 2027, supported by growth in capital outlays by the private sector. Overall gross fixed capital formation (GFCF) is expected to grow further in 2028, mainly driven by private investment.

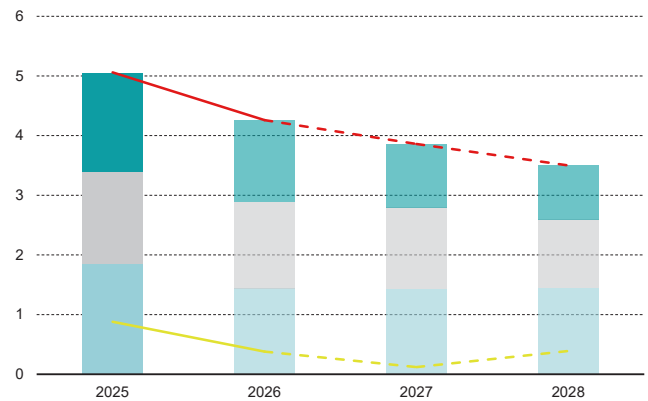
Export growth is set to moderate over the projection horizon. This reflects the expected easing of foreign demand and slower growth in services exports. In part this reflects slower, though still strong, growth in tourism exports. Nevertheless, overall export growth is set to remain above growth in external demand throughout the forecast horizon, driven by services exports. Meanwhile, growth in goods exports is expected to resume this year following the strong decline in 2025, though it is expected to be weaker than that of foreign demand, including in subsequent years of the projection horizon.

Imports are expected to increase at a faster pace in 2026 mainly due to goods imports which are set to recover from the fall in 2025. Growth in services imports is expected to remain strong in 2026. Going forward into next year, the dynamics of imports are partly affected by those in government investment, which are set to decline markedly in 2027.

Potential output

Potential output growth is estimated at 5.1% in 2025 and is expected to slow down to 4.3% in 2026 and further to 3.5% by 2028. This reflects declines in the contributions of all components of potential output (see Chart 2).

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



Source: Central Bank of Malta.

The contribution from capital is expected to decrease slightly in the outer years of the projection horizon reflecting the projected developments in investment. The labour contribution is also envisaged to decline due to expected lower growth in net migration flows, along with a slower increase in the participation rate. The contribution from total factor productivity is projected to ease gradually towards its long-run average before increasing marginally at the end of the forecast horizon.

The output gap is expected to remain slightly positive at 0.4% by 2028 due to the support from domestic demand led by expansionary fiscal measures over the next three years.

Labour market

Labour market performance remains strong and demand for labour is envisaged to stay high. However, employment growth is expected to slow, in line with the envisaged moderation in economic growth over most of the projection horizon. Following growth of 3.9% in 2025, employment is projected to grow by 2.7% in 2026 before easing gradually to 2.3% by 2028. At the same time, growth in the labour force is projected to moderate in view of the expected easing in migration flows.

The unemployment rate is forecast to edge down marginally from 3.1% in 2025 to around 2.9% over the projection horizon. The unemployment gap is expected to remain negative, as the NAIRU is projected at around 3.1% in 2028.

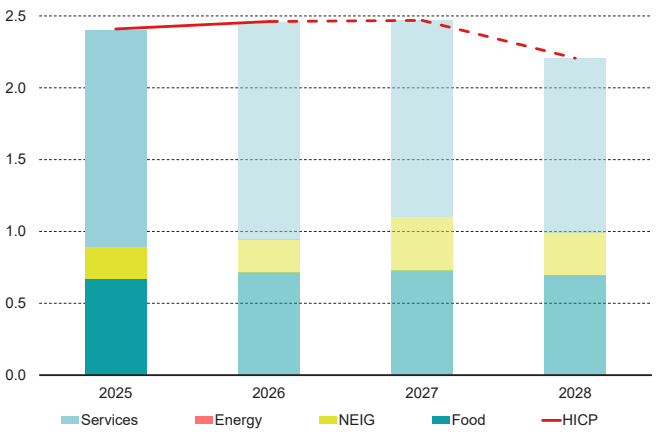
A persistently negative unemployment gap implies that labour market tightness remains a key factor in driving wage developments. In addition, higher inflation due to the impact from the war in the Middle East could put some upward pressures on nominal wages. Thus, compensation per employee is expected to grow by 4.4% and 4.5% in 2026 and 2027, respectively, before edging down to 3.9% in 2028.

Prices[3]

In 2025, HICP inflation averaged 2.4%, unchanged from the previous year. While the contribution of services inflation increased, this was offset by a lower contribution from food inflation. Data for the first four months of 2026 show an average inflation rate of 2.4%, but with a slight pick-up in April. Indeed, annual HICP inflation edged up to 2.5% in April from 2.3% in March.

HICP inflation is projected to be impacted by the war in the Middle East, notwithstanding the Government's commitment to maintain stable energy prices. This is expected to reflect primarily higher imported inflation, particularly in goods and food components. It is thus projected to increase to 2.5% in 2026 and is set to remain at 2.5% in 2027 (see Chart 3). The increase in overall inflation in 2025 is mainly

Chart 3
HICP INFLATION PROJECTIONS
(annual percentage change; percentage point contributions)



Source: Central Bank of Malta.

[3] Data in this section is based on the HICP index compiled according to the new European Classification of Individual Consumption according to Purpose version 2 (ECOICOP2). There may be minor discrepancies compared with the previous ECOICOP1 version in certain subcomponents.

due to stronger food inflation, though services inflation is envisaged to remain persistent. In 2027, we expect a pick-up in NEIG and processed food inflation arising from the gradual pass-through from higher import prices. The latter would offset a mildly lower contribution from services inflation. Overall inflation is then expected to ease to 2.2% in 2028, driven primarily by lower services and NEIG inflation. As a result, HICP excluding energy and food inflation is projected to stand at 2.4% in 2026 and 2027 and 2.1% in 2028.

Compared to the Bank's previous forecast publication, overall HICP inflation has been revised up by 0.2 percentage points in 2026 and 2028 and 0.4 percentage points in 2027. This considers the expected impact of the conflict in the Middle East, as well as the envisaged persistence in services inflation due to higher transport inflation. The impact is expected to be gradual and limited to the pass-through from trading partners, as well as the impact of the recent surge in jet fuel prices on air transport.

Services inflation remains above its historical average. Overall services inflation is expected to be impacted by higher transport services inflation in 2026 due to a surge in jet fuel prices. In addition, services inflation is expected to remain high due to strong domestic demand and tourism. It is expected to average 3.3% in 2026 before easing to 2.7% by 2028.

NEIG inflation converged back towards its historical mean by the end of 2025, after having peaked at 1.5% in August 2025. Data for the first four months of 2026 point to a slight deceleration, averaging at 0.6%. Going forward, NEIG inflation is expected to remain unchanged at its historical mean of 0.9% in 2026 while it is expected to peak at 1.4% in 2027 due to spillovers from higher inflation in Malta's main trading partners resulting from the ongoing war in the Middle East. NEIG inflation is then projected to decelerate, falling to 1.1% in 2028, but slightly above its long run average.

Unprocessed food inflation continues to exhibit high volatility and growth rates varied significantly over 2025. It is set to average at 5.5% this year and then fall gradually to 3.6% by 2028. At the same time, processed food inflation is expected to rise gradually over the projection horizon, in part due to developments in international commodity prices and spillovers from higher inflation in Malta's main trading partners.

Despite the surge in the international energy commodity prices, particularly oil, the Government has maintained its commitment to keep all energy prices stable such that energy prices are projected to remain unchanged at current levels throughout the forecast horizon.

Public finance

The general government deficit-to-GDP ratio is projected to continue to decline over the forecast horizon, albeit in a more gradual manner. It is set to narrow to 1.9% in 2026, 1.7% in 2027 and to 1.6% by 2028 (see Table 2). This improvement in public finances comes about as the expenditure-to-GDP ratio is expected to drop at a faster rate than the revenue-to-GDP ratio. Compared with the Bank's previous projections, the deficit-to-GDP ratio has been revised down throughout the forecast horizon, reflecting the more favourable-than-expected outturn recorded in 2025.

The ratio of current revenue to GDP is expected to decrease in 2026 and then to decline marginally throughout the remaining forecast period. This mostly reflects the profile of direct taxes, due to the impact of the widening of income tax bands for parents announced in the 2026 Budget,

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

	2025[1]	2026	2027	2028
Headline aggregates				
Total revenue	34.8	35.1	34.4	34.2
Total expenditure	37.0	37.0	36.1	35.9
General government balance	-2.2	-1.9	-1.7	-1.6
of which: primary balance	-1.0	-0.6	-0.3	-0.3
General government debt	46.4	46.0	45.1	44.1
Detailed breakdown				
Current revenue	34.0	33.7	33.6	33.5
Current taxes on income and wealth	15.1	14.6	14.6	14.5
Taxes on production and imports	9.6	9.8	9.8	9.8
Social contributions	5.1	5.1	5.1	5.0
Other current revenue[2]	4.1	4.2	4.2	4.2
Current expenditure	32.1	32.6	32.4	32.2
Compensation of employees	9.8	9.9	10.0	10.0
Social benefits	8.1	8.2	8.1	8.1
Intermediate consumption	8.3	8.4	8.4	8.3
Interest payments	1.2	1.3	1.4	1.3
Subsidies	2.1	2.2	1.9	1.8
Other current expenditure[3]	2.7	2.7	2.6	2.6
Gross savings	1.8	1.1	1.2	1.3
Capital revenue	0.9	1.4	0.8	0.7
Capital taxes	0.2	0.2	0.2	0.2
Other capital revenue[4]	0.7	1.2	0.6	0.5
Capital expenditure	4.9	4.4	3.7	3.7
Gross fixed capital formation	3.1	3.5	3.0	2.9
Capital transfers	1.7	0.9	0.6	0.7
Other capital expenditure[5]	0.1	0.0	0.0	0.0
Capital revenue net of capital expenditure	-4.0	-3.0	-2.9	-3.0
Underlying budgetary outcome				
Cyclical component	0.5	0.3	0.1	0.2
Temporary government measures	-0.3	0.0	0.0	0.0
Structural balance	-2.5	-2.2	-1.8	-1.8

Sources: NSO; Central Bank of Malta.

[1] Actual data as per NSO *News Releases* 033/2026 (published on 26 February 2026) and 066/2026 (published on 22 April 2026).

[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.

as well as the termination of the Individual Investor Programme in 2025. Meanwhile, the share of taxes on production and imports is projected to increase slightly from its 2025 level and

subsequently grow in line with nominal GDP, supported by VAT receipts. Social contributions are forecast to increase in line with, or marginally below, nominal GDP over the forecast horizon.

The ratio of non-tax current revenue to GDP is expected to remain unchanged over the projection horizon and supported by inflows from sales, which are set to grow in line with GDP.

By contrast, capital revenue as a share of GDP is projected to rise sharply in 2026 before dropping in 2027, reflecting the profile of EU-funded investment.

The general government expenditure-to-GDP ratio is forecast to remain unchanged in 2026 but to decline steadily throughout the remaining forecast period. This primarily reflects the projected profile of capital expenditure, followed by that of subsidies.

Compensation of employees is expected to grow at a faster pace than nominal GDP during most of the forecast horizon, whose profile is in line with ongoing collective agreements covering most of the general government sector. The two other largest forms of current expenditure – intermediate consumption and social benefits – are meanwhile set to grow by more than GDP in 2026, respectively driven by operational expenditure across various government entities and by the increase in benefits announced in the 2026 Budget. In 2027 and 2028 these items are then expected to grow at or slightly below GDP.

Interest payments are projected to rise at a pace slightly exceeding nominal GDP growth in 2026 and in 2027, mainly reflecting higher financing costs associated with maturing long-term debt. Other current transfers are projected to increase broadly in line with nominal GDP over the forecast horizon.

Meanwhile, the share of subsidies in GDP is expected to rise in 2026, reflecting higher projected outlays on energy support measures linked to the rise in international energy prices (see Box 1). Outlays are then set to decline from 2027 onwards, to a level below the 2025 share in GDP.

Capital expenditure as a share of GDP is projected to decline over the projection horizon. Government investment is set to grow by substantially more than GDP in 2026, due to the implementation of RRF-financed projects and other large-scale EU-funded initiatives, notably the second electricity interconnector. Outlays are set to decline in 2027 once these projects are completed. Investment is then set to grow by less than GDP in 2028. Meanwhile, the share of capital transfers in GDP is set to decline in 2026 mainly due to a base effect, stemming from a one-off payment arising from a Court judgement in 2025. The profile of capital transfers in 2027 and 2028 is then forecast to mirror that of government investment.

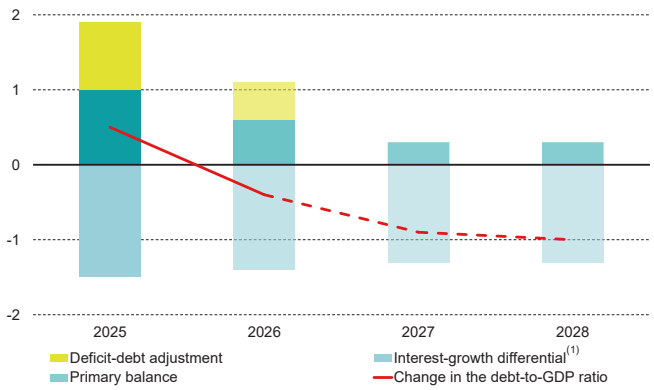
The structural budget deficit is projected to narrow from 2.5% of GDP in 2025 to 1.8% by 2028.[4] This largest year-on-year improvement is set to take place in 2027, driven by the forecast profile of inflation-mitigation measures, which are not treated as temporary in the structural balance framework and therefore influence the estimated structural position.

Under the EU fiscal framework, Member States are monitored using the net nationally financed primary expenditure indicator.[5] The calculation of this indicator can vary between institutions due

[4] The structural balance is defined as the cyclically-adjusted balance, net of temporary government measures.
[5] For more information on the net expenditure indicator, refer to Box 2 published in the *Outlook for the Maltese Economy 2025:3*.

to methodological differences.[6] The Bank forecasts net expenditure growth to average 6.1% between 2026 and 2028, which was revised upwards when compared to the February projections. For the period 2026 and 2027 the Bank forecasts are slightly below the Commission's latest assessment.[7]

Chart 4
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.

The general government debt-to-GDP ratio is expected to decline steadily from the 46.4% recorded in 2025 to 46.0% in 2026, and eventually to 44.1% by 2028. This is driven by a favourable interest-growth differential, although the latter is gradually declining over time (see Chart 4).

6 For instance, owing to the absence of publicly available data, the estimated impact of EU co-financed capital expenditure (i.e. the share of EU-funded outlays borne by the Maltese Government) is computed differently. Such differences include the assumed timing of payment of co-financed expenditure. Given the expected surge in EU-funded capital expenditure in 2026, this component (which is netted out of the net expenditure indicator) is set to exert a greater than usual weight in the calculation.
7 The European Commission's 2026 Spring Semester Package can be found here.

BOX 1: ASSESSING THE FISCAL AND MACROECONOMIC IMPACT OF GOVERNMENT SUPPORT MEASURES FOLLOWING THE US–IRAN CONFLICT[1]

Introduction

The escalation of geopolitical tensions between the United States and Iran has led to renewed pressures in international energy markets, resulting in higher oil, gas and wholesale electricity prices. Given Malta's policy of shielding households and firms from fluctuations in international energy prices through fixed retail energy tariffs, these developments mainly have a direct effect on public finances with the effects on the wider economy arising indirectly via global economic conditions and imported inflation.

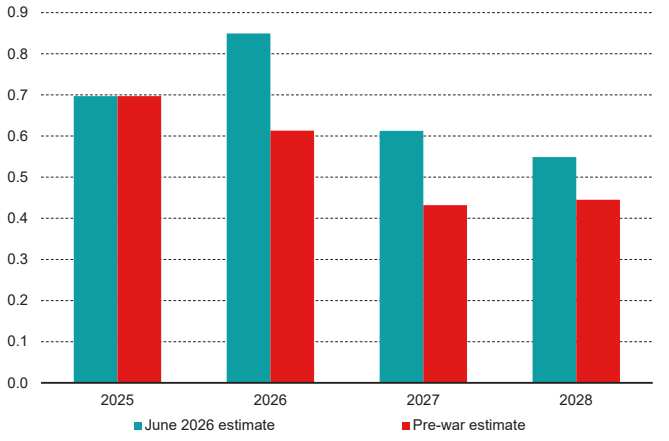
This box assesses the fiscal impact of maintaining existing energy support measures in the face of higher international energy prices and quantifies the extent to which these measures mitigate the macroeconomic consequences of the shock. The analysis compares the Bank's latest projections with estimates prepared prior to the conflict and uses a structural macroeconomic model to evaluate the stabilising role of energy subsidies.

Fiscal impact

Chart 1a illustrates the projected fiscal impact of the increase in the cost of energy support measures, which are classified as subsidies, following the war in Iran. Based on the technical assumptions used for the February 2026 projections exercise (i.e. prior to the start of the war), the Bank estimated the level of these subsidies to decline from 0.7% of GDP in 2025 to 0.6% in 2026, and further to 0.4% of GDP in 2027 and in 2028. The latest projections expect outlays to amount to 0.8% of GDP in 2026, representing a 0.2 percentage point upward revision from the pre-war estimate. In 2027 and 2028, subsidies were revised up by 0.2% and 0.1% of GDP, respectively compared with the pre-war average.

Unsurprisingly, the most marked revision to the profile of subsidies affects the fiscal impact for 2026. While the pre-war estimates expected outlays to decline, the Bank now expects subsidies to increase from their 2025

Chart 1a
FISCAL IMPACT OF SUPPORT MEASURES
(% of GDP)



Source: Central Bank of Malta.

[1] Prepared by Jessica Pace, Senior Economist within the Economic Analysis Department of the Central Bank of Malta, and Noel Rapa, Head of the Economic Research Department.

level. This is mostly due to an upward revision in the projected level of assistance to retain fixed electricity prices.

That said, the revised impact is relatively muted, compared with the pre-war estimates. Overall, subsidy expenditure is expected to remain well below the peak recorded in 2022, when energy support measures amounted to 1.9% of GDP. This reflects, in part, the existence of hedging agreements secured prior to the onset of the conflict, which temporarily cushion the impact of higher international energy prices on the cost of energy support measures. It also reflects the level increase in GDP during this period (i.e. the denominator effect).

Macroeconomic impact

We estimate the macroeconomic impact of the increases in energy subsides that exclusively arise from the Iran war by simulating an international energy price shock in a fully structural New Keynesian model with a detailed energy block (MEDSEA-NRG).[2] The model is tailored to Malta's economic structure.

The energy block is sufficiently detailed to allow for a distinction between fuel (petrol and diesel) and electrical energy. The latter is further decomposed in renewable and brown electricity which can either be produced locally through LNG-fuelled power stations or imported directly at international wholesale prices through the Malta-Sicily interconnector. Furthermore, the model allows for a retail energy price subsidy system that can shield economic agents from international oil, gas and electricity price fluctuations.

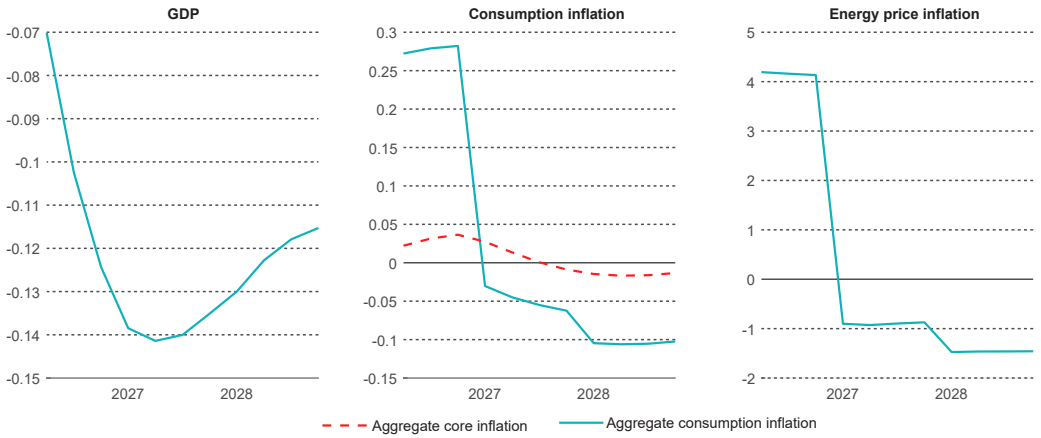
The simulation design rests on the estimated government outlays, normalised as percent of GDP, that are meant to cover for the increase in energy prices brought about by the Iran war under the baseline projection scenario. In this respect, the model is run with its energy price subsidy system turned on. Moreover, shocks to oil, gas and wholesale international electricity prices are calibrated such that the overall subsidies, in percent of GDP, match the increase in government subsidies arising from the Middle East conflict. This simulates the actual scenario whereby Government commits itself to shield economic agents from all energy price shocks. The same model is then re-run with the same series of shocks, but with the subsidy system turned off, simulating a hypothetical scenario whereby Government subsidy payouts are capped to those prevailing before the Iran war. The difference between the two scenarios therefore captures the hypothetical macroeconomic effects emanating from the war in Iran.

Results shown in Chart 1b show the output loss and extra inflation that would have ensued had the Government retained the same spending on energy subsidies (as a share of GDP) following the Iran war.

In such a case, energy inflation would be 4 percentage points higher in 2026 in annualised terms, mirroring the assumed trajectory of international energy prices assumed in

[2] See Rapa (2024), The effects of increases in carbon prices in Malta: A study using MEDSEA-NRG, CBM *Working Paper* 03/24, for a detailed discussion of the model and Rapa (2025), Energy Subsidies in Malta: Estimating the effects of current policies and hypothetical exit strategies, CBM *Discussion Paper* 04/25, for details on the simulation of energy price subsidies.

Chart 1b
MACROECONOMIC IMPACT OF SUPPORT MEASURES
(% deviation from baseline GDP levels, percentage point deviations from baseline inflation)



Source: Author's estimates.
Note: Charts show deviations of macroeconomic variables pertaining to a hypothetical no Government intervention strategy, compared to a strategy based on full subsidisation (baseline scenario). Both scenarios are characterised by the same series of foreign energy price shocks and differ only in the subsidy policy. All results show deviations in % from the levels with the exception of results for inflation measures which are in terms of percentage point deviations.

the baseline. In 2026, the increase in energy prices would result in an increase in headline HICP inflation of around 0.3 percentage points in year-on-year terms. Higher energy prices would in turn increase the marginal costs of production, which would lead to further increases in non-energy inflation. The latter would peak by end of 2026.

Higher inflation would produce negative income effects that would in turn put downward pressure on private consumption. In addition, Malta would experience some loss to external competitiveness, which would lead to lower exports compared to the baseline. Downward pressures on aggregate demand would in turn amplify negative income effects that would further dampen private consumption and investment.

This exercise suggests that, under the assumptions underlying the baseline projections and assuming Government intervention to stabilise energy prices is capped at pre-war levels, the Iran war would reduce output by around 0.1% relative to baseline projected levels for 2026. The impact would peak at 0.14% in 2027 before easing to around 0.12% below baseline by the end of the projection horizon.

In terms of the fiscal impacts of the Government support measures, model estimates indicate that under the baseline assumptions underpinning the current projections round, the Iran war is likely to raise the public debt-to-GDP ratio by around 0.4 percentage points by 2028. Overall, however, consistent with the fact that the increase in the energy subsidy is relatively modest, mainly as a result of past hedging agreements, the direct impact of the war in Iran on local energy prices, abstracting from the shielding effects of government intervention, would be relatively limited.

Conclusion

The US–Iran conflict is expected to increase the fiscal cost of Malta's energy support measures, primarily through higher expenditure required to maintain fixed domestic energy tariffs. However, the increase remains modest relative to the levels observed during the 2022 energy crisis, reflecting the protection by pre-existing hedging arrangements and the increased level of GDP since then.

Model simulations suggest that, in the absence of such additional government support, higher international energy prices would lead to higher inflation and a modest reduction in economic activity. By shielding households and firms from these price increases, the energy support framework helps contain the adverse macroeconomic effects of the shock, albeit at the cost of higher fiscal outlays.

Risks

Risks to economic growth are tilted to the downside. These risks largely emanate from the uncertainty surrounding the duration and intensity of the conflict in the Middle East which may lead to a weaker external environment and a more subdued trajectory of foreign demand. Disruptions to transport through the Strait of Hormuz has also raised concerns on fuel shortages which may negatively impact tourism, aviation and the shipping industry. Conversely, in the case of tourism, upside risks could arise from the possible redirection of tourists towards central and western Mediterranean from other competing destinations in the Middle East. On the other hand, the current situation of labour shortages could lead to even higher demand for labour and wages, which would in turn lead to higher growth in private consumption.

Risks to inflation are tilted to the upside over the projection horizon. Upside risks to inflation primarily reflect the risk of a more prolonged Middle East conflict and stronger disruptions to energy markets than embedded in the technical assumptions. Although the Government has committed to maintain its fixed energy price policy, higher-than-envisaged global energy prices could generate stronger imported inflation, with potential further amplification via second round effects from wages and profits. Inflation could also be higher than expected if supply disruptions were to spread to non-energy markets, although alternative supplies from other regions could mitigate this effect.

Moreover, services inflation could prove to be more persistent than envisaged in the baseline in part due to higher wage pressures. Conversely, downside risks could arise if a more prolonged scenario of disruptions to energy markets would lead to lower global growth, which could put some downward pressure on inflation. In addition, production disruptions, particularly if the current jet fuel shortage were to have a substantial impact on tourism, could put downward pressure on certain subcomponents of services inflation.

On the fiscal side, risks are assessed to be tilted to the downside (deficit-increasing). These predominantly stem from the possibility of slippages in current expenditure, notably higher-than-expected spending on energy support measures should commodity prices exceed assumptions. These risks are partly mitigated by the likelihood of higher-than-forecast increases in tax revenue, brought about by additional improvements in tax administration.

BOX 2: PROJECTIONS UNDER ALTERNATIVE SCENARIOS OF THE MIDDLE EAST CONFLICT[1]

Introduction

After hostilities began on 28 February 2026, the United States and Israel carried out coordinated air and missile strikes on military targets in Iran, substantially intensifying the conflict and heightening regional instability as neighbouring states to Iran were also subjected to military attacks. Fears over disruptions to global energy supplies rose as Iran restricted shipping through the Strait of Hormuz which serves as one of the world's most critical maritime chokepoints, with a fifth of global petroleum shipments passing through its narrow waters, making any closure, restriction, or highly risky to navigate such waters highly consequential for international trade and energy security.

The conflict led to higher market volatility and uncertainty whereby oil prices increased sharply, with global natural gas prices also increasing due to risks to Gulf LNG exports. As a result, the conflict has contributed to higher energy costs and increased uncertainty for the global economic outlook.

The Maltese economy is traditionally highly susceptible to disruptions in global energy markets, given its near-total dependence on imports for its energy needs. Nevertheless, the Government expressed clearly its intention to continue protecting households and businesses from the immediate and direct inflationary effects of an energy price shock. Consequently, as shown in Box 1, the primary impact domestically is on public finances, which are expected to absorb increases in wholesale electricity and fuel prices.

These energy disruptions also create a very significant negative supply shock on the global economy. As a highly open economy, Malta remains particularly exposed to economic performance of its main trading partners. As energy prices abroad increase, these would reduce demand from Malta's trading partners, which is reflected through weaker foreign demand. This would weigh on Malta's exports and thus on GDP.

At the same time, developments in foreign prices have a direct bearing on Malta's import prices and export competitiveness. In particular, higher production costs abroad are likely to contribute to imported inflation and raises cost pressures for domestic firms.

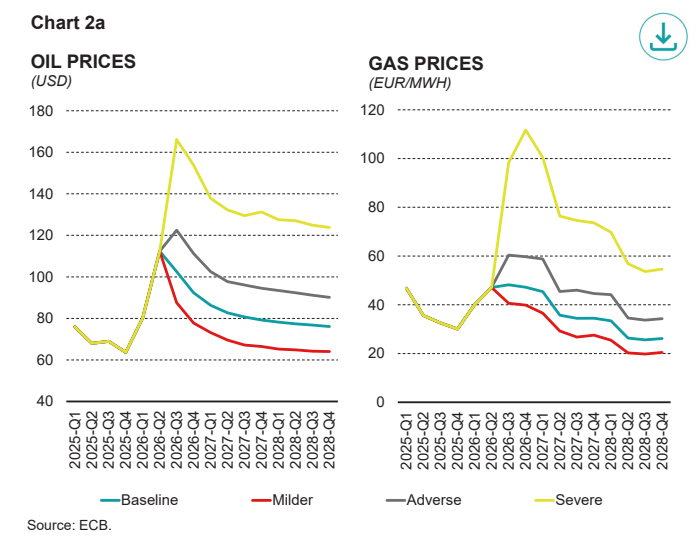
Given the high uncertainty surrounding the impact of the ongoing Middle East conflict on energy prices, and the propagation to the macroeconomy, this Box includes three scenarios to assess how the baseline economic activity, inflation, and fiscal projections could change in such scenarios.

Scenarios – Narrative, Assumptions and Key Transmission Channels

This box includes three scenarios; a milder, an adverse and a severe scenario. The scenarios differ with respect to the commodity price paths, the level of uncertainty and financial market volatility. Given the war's impact on the fertiliser market, we also incorporate upside

[1] Prepared by Lynn Cumbo, Senior Economist, Jessica Pace, Senior Economist and Abigail Marie Rapa, Principal Economist within the Economic Analysis Department of the Central Bank of Malta.

risks to food prices into the adverse and severe scenarios. The scenarios in this box are in line with those published by the ECB in the June 2026 Eurosystem staff macroeconomic projections for the euro area.[2]



The milder scenario simulates a relatively faster resolution of the conflict such that commodity prices would be lower than assumed in the baseline projections (see Charts 2a). In this scenario both oil and gas prices are assumed to follow the 25th percentile of the market implied probability distributions from the third quarter of 2026, implying that both prices are assumed to return to the pre-war levels by the end of 2026.

In the adverse and severe scenarios, both oil and gas prices follow the 75th and 95th percentiles of the probability distributions, respectively. In both scenarios commodity prices are assumed to peak in the third quarter of 2026, except for the price of gas in the severe scenario, which is assumed to peak in the following quarter. Oil prices are assumed to reach USD 122 and USD 166 per barrel in the adverse and severe scenarios, respectively. This is higher than the baseline peak price of USD 112 to be reached in the second quarter of 2026. Similarly, at the peak, the price of gas is assumed to stand at around €60 and €111 per MWH in the adverse and severe scenarios, respectively. The latter is significantly higher than the price of €48 per MWH assumed in the baseline projection. In addition to the above energy shock, in the adverse and severe scenarios we also include shocks to international food prices to account for the impact of fertiliser prices.

Given the high uncertainty surrounding the impact of the ongoing Middle East conflict on energy prices, and the propagation to the macroeconomy, apart from the above shocks we also take into account some uncertainty impacts. The assumed uncertainty path is broadly consistent with historical episodes of comparable tensions, including during the war between Russia and Ukraine.

Since the Government is committed to keeping energy prices fixed for both local consumers and businesses, the direct impact of the increase in oil and gas prices will be absorbed by public finances. Hence, the impact of the war on international oil and gas prices is reflected through Malta's GDP and HICP only indirectly through the foreign demand and foreign price channels.

[2] See Eurosystem staff macroeconomic projections for the euro area, June 2026.

The calibrations of the scenarios through the foreign demand and foreign price channels are derived from ECB model-based results of the impact of the war. Changes in the demand for Maltese exports from the euro area are based on the estimated fall in the euro area real GDP, while the drop in foreign demand from the rest of the world is proxied by the fall in foreign demand faced by the euro area. Changes in the euro area consumer prices are taken from the expected impacts of the war on the euro area HICP while the price increases in the rest of the world are proxied by the projected increases in the euro area competitors' export prices.

Beyond the effects on foreign demand and import prices, additional shocks are judgmentally incorporated to capture potential non-linear outcomes. These have been calibrated using a BVAR and a two-country DSGE models.

Fiscal impact of support measures

Chart 2b shows the estimated fiscal cost of energy support measures across scenarios. These measures consist of subsidies aimed at maintaining fixed retail electricity, fuel pump and LNG gas prices. While such measures were in place before the start of the conflict, their impact is expected to vary in each scenario, in line with the projected level of oil and gas prices.

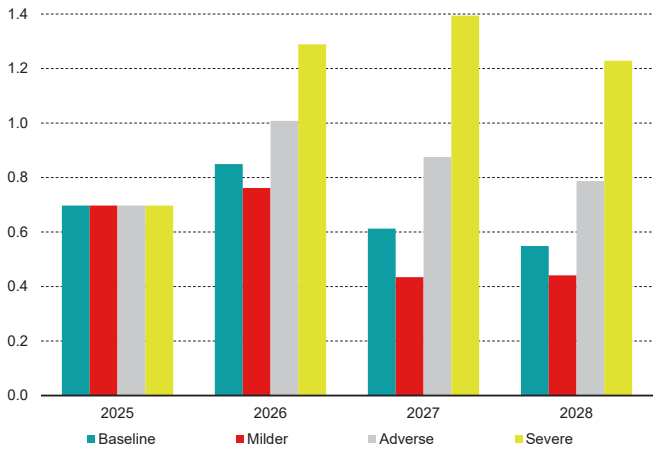
Under the baseline projections, support measures are forecast to amount to 0.8% of GDP in 2026, up from 0.7% on 2025. Outlays are then expected to decline gradually to 0.6% of GDP in 2027 and 0.5% in 2028 (see Box 1).

In the milder scenario, the fiscal cost of support measures in 2026 is projected to be somewhat lower than under the baseline scenario, with outlays declining more rapidly thereafter. By 2028 outlays are set to amount to 0.4% of GDP.

Outlays are expected to remain higher than in 2025 throughout the projection horizon in the adverse scenario. In 2026 spending is set to amount to 1.0% of GDP, which is 0.2 percentage points higher than in the baseline. While the share of outlays in GDP is set to gradually decline in 2027 and 2028, it remains around 0.3 percentage points higher than the baseline.

The fiscal impact in the severe scenario is significantly higher compared with the other scenarios.

Chart 2b
FISCAL IMPACT ACROSS SCENARIOS



Source: Central Bank of Malta.

Outlays are set to amount to 1.3% of GDP in 2026, and to peak at 1.4% of GDP in 2027, equivalent to 0.4 percentage points and 0.8 percentage points above the baseline scenario, respectively. Although expenditure is expected to moderate slightly in 2028, it would still amount to 1.2% of GDP, remaining 0.7 percentage points above the baseline projection.

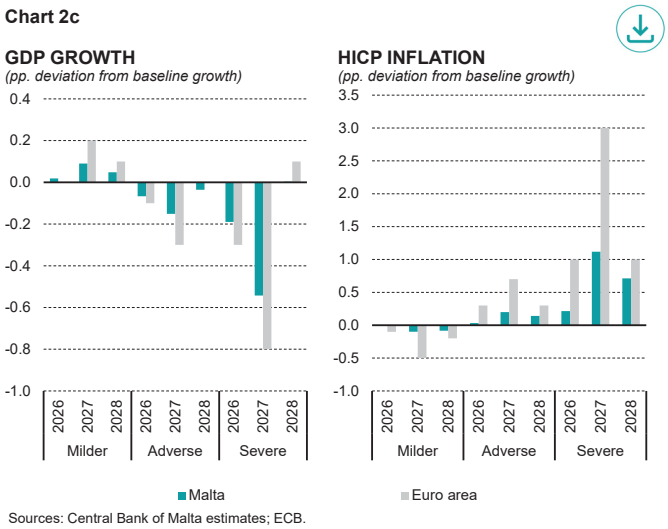
Macroeconomic impact

Given the nature of the milder scenario, that of a faster resolution than the baseline, results imply minor upside risks to economic growth and downside risks to inflation and the fiscal impact, especially for 2027. Simulation results suggest that GDP growth would be 0.1 percentage points higher than the baseline projections in 2027 and largely unaffected in 2026 and 2028 (see Chart 2c). As the conflict resolves rapidly and energy prices normalize quickly, the indirect effects on the prices of Maltese goods arising from higher foreign prices in 2026 are therefore limited and simulation results point to a 0.1 percentage point lower inflation in 2027 and 2028.

In the adverse scenario, the impact on GDP growth and inflation is somewhat limited. The main effect on economic activity stems from weaker external demand, which would reduce GDP growth by 0.1 percentage points in 2026 and 0.2 percentage points in 2027. This mainly reflects lower export growth. The impact on GDP growth is nil by 2028. At the same time, HICP inflation is estimated to be 0.2 percentage points higher in 2027 and 0.1 percentage points in 2028, as lagged indirect spillovers from higher international inflation feed through to higher prices for imported goods and food in Malta. These effects offset the weaker domestic price pressures associated with the slowdown in economic activity driven by lower foreign demand.

In the severe scenario, impacts would be relatively larger and longer lasting. Similar to the adverse scenario, the main effect on economic growth stems from weaker external demand, which is estimated to reduce GDP growth by 0.2 and 0.5 percentage points in 2026 and 2027, respectively. The impact on GDP growth is estimated to be nil by 2028. At the same time, HICP inflation is estimated to be 0.2 percentage points higher in 2026, and 1.1 and 0.5 percentage points higher in 2027 and 2028. These largely reflect the indirect spillovers from higher international inflation, which could feed through to higher prices for imported goods and food in Malta.

Chart 2c



Sources: Central Bank of Malta estimates; ECB.

Comparing the simulation results for Malta with the June 2026 Eurosystem projections for the euro area, we note that the impact of the war on economic growth and inflation in Malta is much smaller. This is due to the cushioning of energy prices by the Government of Malta as well as a lower share of energy intensive industries in the economy.

In the milder scenario, GDP growth would stand at 3.7% in both 2026 and 2027, increasing to 3.8% in the outer year (see Table 2a). With regards to the adverse scenario, GDP growth would be expected to stand lower than the baseline in the first two years at 3.6% and 3.4% and unchanged in the outer year at 3.8%. Similarly, in the severe scenario GDP growth is expected to stand at 3.5% in 2026, 3.1% in 2027 and recovers to 3.8% in 2028.

With regards to inflation, in the milder scenario, overall HICP inflation is estimated to stand at 2.5% in 2026, unchanged from the baseline, and at 2.4% and 2.1% in the following two years. Inflation in the adverse scenario is also equivalent to the baseline in 2026 but is then estimated at 2.6% and 2.3% in 2027 and 2028, respectively, marginally higher than the 2.5% and 2.2% projected in the baseline. As for the, severe scenario, HICP inflation is estimated at 2.6% in 2026, 3.4% in 2027 and 2.7% in 2028, which implies that in such a scenario inflation would be substantially higher and more persistent when compared with the baseline.

Table 2a
KEY MACROECONOMIC VARIABLES UNDER THE BASELINE AND ALTERNATIVE SCENARIOS

	Baseline			Milder			Adverse			Severe		
	2026	2027	2028	2026	2027	2028	2026	2027	2028	2026	2027	2028
GDP Growth	3.7	3.6	3.8	3.7	3.7	3.8	3.6	3.4	3.8	3.5	3.1	3.8
HICP inflation	2.5	2.5	2.2	2.5	2.4	2.1	2.5	2.6	2.3	2.6	3.4	2.7

Source: Central Bank of Malta.