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CENTRAL BANK OF MALTA



# CENTRAL BANK OF MALTA OUTLOOK FOR THE MALTESE ECONOMY

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2022:3

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## OUTLOOK FOR THE MALTESE ECONOMY 2022-2024

### Overview<sup>1,2</sup>

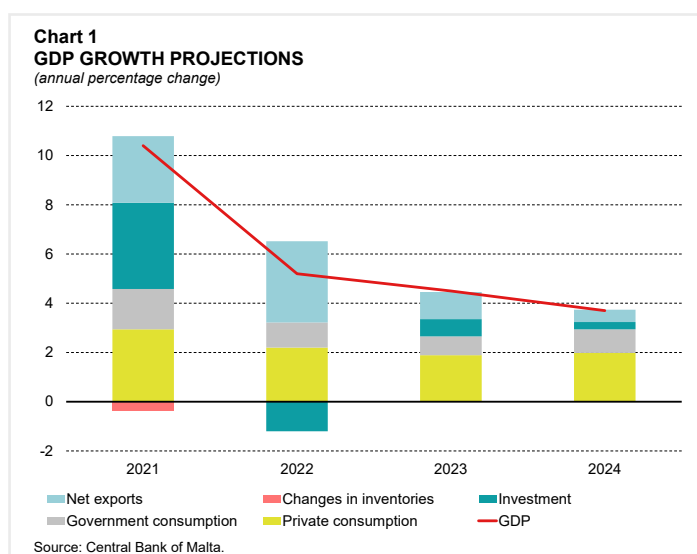
The international economic environment has remained weak and characterised by high uncertainty since the Central Bank of Malta's last set of projections in June. The Russian invasion of Ukraine continues to represent a major headwind to international economic growth and adds considerable upward inflationary pressures. Fiscal measures in Malta have somewhat cushioned the direct impact of high commodity prices, but indirect spill overs have increased. Moreover, supply-chain disruptions remain high and are expected to persist for longer than previously envisaged. Such disruptions tend to affect small open economies more-than-proportionally.

Since the previous set of projections, the assumed duration of the war in Ukraine and its repercussions have been extended. While international sanctions on Russia are envisaged to persist until 2024, with adverse consequences on world trade and demand, this exercise takes into account significant cuts in gas supplies to European countries. Thus, inflationary pressures are expected to take longer to dissipate. In addition, supply disruptions and the short-term costs of quickly reducing dependence on Russian fossil fuels are likely to have more direct and adverse consequences on economic activity of Malta's trade partners. This is expected to lead to weaker demand.

On the other hand, the easing of pandemic-related restrictions and the normalisation of travel rules has continued to support the recovery, unleashing pent-up demand in tourism activity and in the broader economy. Moreover, the strong Government support to limit the pass-through from high commodity prices to energy and food inflation will continue to support Malta's external competitiveness and domestic demand, and hence short-term economic growth.

### Economic outlook

Malta's gross domestic product (GDP) is projected to grow by 5.2% in 2022, 4.5% in 2023 and 3.7% in 2024. When compared to the previous projections, the Bank's latest forecast presents downward revisions of 0.2 percentage point in 2022, 0.4 percentage point in 2023, and 0.1 percentage point in 2024 (see Table 1). For 2022, the change reflects a lower contribution from domestic demand due to downward revisions in private and government consumption. The downward revision in private consumption reflects the upward revision in the inflation projections, which lowers growth in real disposable income. This was partially offset by a slight upward revision in gross fixed capital formation. The downward revision in GDP growth for both 2023 and 2024 primarily reflects a downward revision in private consumption due to higher inflation.



<sup>1</sup> The Bank's projections for the Maltese economy are based on information available up to 9 August 2022.

<sup>2</sup> See <https://www.centralbankmalta.org/site/Publications/Projections-2022-2.pdf>

**Table 1**  
**PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES FOR MALTA<sup>(1)</sup>**

	2021 <sup>(2)</sup>	2022	2023	2024
<b>Real economic activity (% change)</b>				
GDP	10.4	5.2	4.5	3.7
Private consumption expenditure	6.7	5.2	4.3	4.5
Government consumption expenditure	7.7	4.9	3.7	4.7
Gross fixed capital formation	17.0	-5.6	3.7	1.5
Exports of goods and services	8.0	5.7	3.3	3.2
Imports of goods and services	6.7	3.8	2.9	3.2
<b>Contribution to real GDP growth (in percentage pts)</b>				
Final domestic demand	7.7	1.9	3.4	3.2
Net exports	2.7	3.3	1.1	0.5
Changes in inventories	-0.4	0.0	0.0	0.0
<b>Balance of payments (% of GDP)</b>				
Goods and services balance	4.0	4.9	4.5	4.3
Current account balance	-4.9	-4.2	-3.9	-3.7
<b>Labour market (% change)<sup>(3)</sup></b>				
Total employment	2.8	3.5	2.8	2.1
Unemployment rate (% of labour supply)	3.5	3.1	3.1	3.2
<b>Real disposable income<sup>(4)</sup></b>	4.6	1.9	2.1	3.5
<b>Household saving ratio<sup>(4)</sup></b>	31.2	29.0	27.4	26.7
<b>Prices and costs (% change)</b>				
GDP Deflator	1.8	2.6	2.2	1.9
RPI	1.5	5.9	4.0	2.0
Overall HICP	0.7	5.9	3.8	2.1
HICP excluding energy	0.9	6.3	3.8	2.3
Compensation per employee	4.9	4.5	4.2	3.2
ULC	-2.3	2.8	2.5	1.6
<b>Business Cycle</b>				
Potential output (% change)	4.1	5.0	4.2	3.7
Output gap (% of GDP)	0.2	0.4	0.6	0.7
<b>Technical Assumptions</b>				
EUR/USD exchange rate	1.20	1.10	1.10	1.10
Oil Price (USD per barrel)	71.1	105.8	93.4	84.3

Sources: NSO; Central Bank of Malta.

<sup>(1)</sup> Data on GDP were sourced from NSO *News Release* 095/2022 published on 30 May 2022, while RPI and HICP data were sourced, respectively, from NSO *News Releases* 127/2022 and 124/2022 (published on 22 July 2022 and 19 July 2022).

<sup>(2)</sup> Actual data.

<sup>(3)</sup> 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.

<sup>(4)</sup> Central Bank of Malta estimates.

Net exports are expected to be the main driver of growth in 2022, reflecting the correction in import-intensive investment outlays from the exceptionally high levels reached in 2021 (see Chart 1). The contribution of domestic demand is expected to be positive but significantly lower compared to that of 2021, as growth in activity normalises following the strong rebound last year.

In the following years, domestic demand is expected to lead the expansion in economic activity, reflecting especially a foreseen strong contribution from private consumption. The contribution of

net exports is projected to diminish over the projection horizon, reflecting the gradual normalisation of tourism exports and growth in foreign demand more generally.

Private consumption growth is set to moderate somewhat in 2022, primarily due to the envisaged slowdown in real disposable income following higher inflation, as well as the impact on households of the higher uncertainty arising from the war. Despite the projected moderation, private consumption growth remains buoyant from a historical perspective, and is thus set to outpace the Bank's estimate of real disposable income growth over the forecast horizon. This implies that households are expected to absorb part of the increase in inflation by running down excess savings accumulated during the pandemic (see Box 1). Private consumption growth is set to moderate further in 2023. The saving ratio is envisaged to retreat from recent peaks, but it is still projected to remain above 2019 levels throughout the projection horizon.

Government consumption is set to rise by 4.9% in 2022, partly reflecting growth in compensation of employees and intermediate consumption. These two items are however projected to grow at a slower rate than in 2021, when there had been one-off outlays on allowances and large outlays on treatment and vaccination for COVID-19. Revenue from sales, which contributes negatively to government consumption growth, is forecast to decline this year. In 2023, growth in government consumption is set to moderate to 3.7% as COVID-related outlays decrease and sales revenue picks up. In 2024, government consumption is set to grow by 4.7%.

Investment is projected to decline by 5.6% this year due to a base effect from a large outlay in aviation investment in the private sector in 2021. Investment is set to grow by 3.7% in 2023 and 1.5% in 2024.

Equipment investment is expected to decrease in 2022 before returning to growth in the following two years, reflecting developments in the aviation sector. Conversely, investment in residential and non-residential construction is envisaged to pick up somewhat throughout the projection horizon but remain low from a historical perspective.

EU funds, in particular the Recovery and Resilience Funds (RRF), will provide a substantial boost to government investment in the projection horizon. Indeed, growth in government investment is foreseen to reflect increased outlays on EU-financed projects, especially in 2022 and 2023.

In 2022, export growth is set to normalise after the base effect of 2021, when exports recovered from the sharp drop due to the pandemic. Growth in goods exports is expected to remain low by historical standards, which reflects the impact of supply bottlenecks, the sharp rise in input costs, as well as lower foreign demand. On the other hand, services exports are expected to remain buoyant, reflecting the continued recovery in tourism exports as well as the resilience of the non-travel services sectors.

Services exports are projected to grow at a slower rate of 6.4% in 2022 following growth of 9.9% in 2021, on account of an envisaged moderation in non-travel services exports. The latter are however expected to remain robust despite the Russia-Ukraine war. Indeed, these exports have extended their recent strong performance into the first quarter of this year. With regard to tourism exports, these are also projected to grow markedly this year as containment measures related to travel have been removed. As a result, tourism exports in 2022 are being revised up in the projection to around 75% of 2019 levels, from the 66% projected in June. The upward revision

mainly reflects data releases for the first half of 2022, which show higher than expected tourism numbers.

Goods exports are more directly affected by the war, reflecting lower demand from trading partners, prolonged supply bottlenecks, as well as the effect of the steep increase in input and transportation costs on production. Exports of goods are expected to grow in 2022 by 1.2%, following two years of contraction. These are set to pick up but grow less rapidly than foreign demand in the following two years, in part reflecting the stronger impact of supply-chain disruptions on small-open economies.

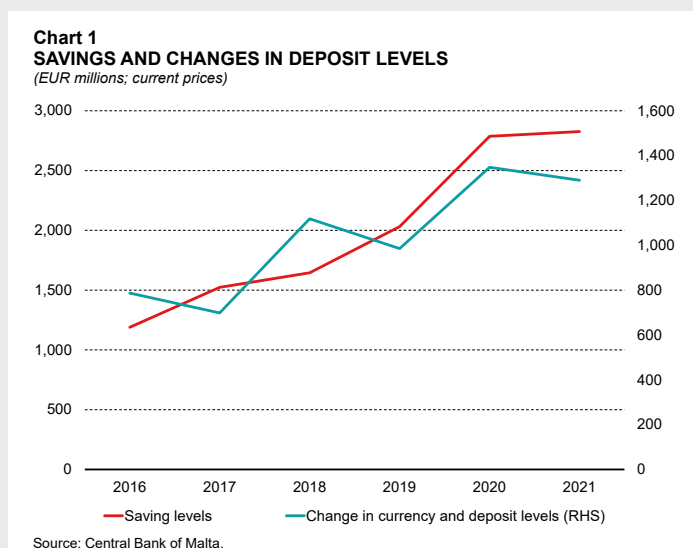
With regard to imports, these are expected to slow down sharply this year, due to the envisaged decline in import-intensive investment in transport equipment. In the following years, goods imports are projected to grow in line with final demand, while services imports are projected to grow in line with services exports.

The current account balance is to remain in deficit although this is expected to narrow over the projection horizon. This partly reflects the expectation that the terms of trade will remain negative due to the strong import price pressures, the inability of exporters to fully pass on the increase in costs to higher prices, and, an albeit declining fiscal deficit.

## BOX 1: PANDEMIC-RELATED EXCESS SAVINGS – HOW WILL THIS AFFECT PRIVATE CONSUMPTION IN THE COMING YEARS?<sup>1</sup>

In view of the strong income growth in the years preceding the pandemic, the Bank’s estimate of households’ saving levels had been trending upwards. However, these rose abruptly and to unprecedented levels during the COVID-19 pandemic in 2020 and 2021. Chart 1 shows that saving levels rose to close to €2.8 billion in both 2020 and 2021, while the stock of households’ currency and deposits rose by around €1.3 billion each year.<sup>2</sup>

This strong increase in saving levels was largely of an involuntary nature as the containment measures to limit the spread of the virus – such as the shut-down of non-essential services, as well as



<sup>1</sup> Prepared by Ian Borg, Manager within the Economic Projections and Conjunctural Analysis Office.

<sup>2</sup> Households’ currency and deposits and net financial wealth used in this box are sourced from financial accounts. See <https://www.centralbankmalta.org/financial-accounts>.

restrictions on travel and mass events – prevented households from consuming certain items, particularly services. As a result, private consumption declined by 10.2% in 2020 (see Chart 2).

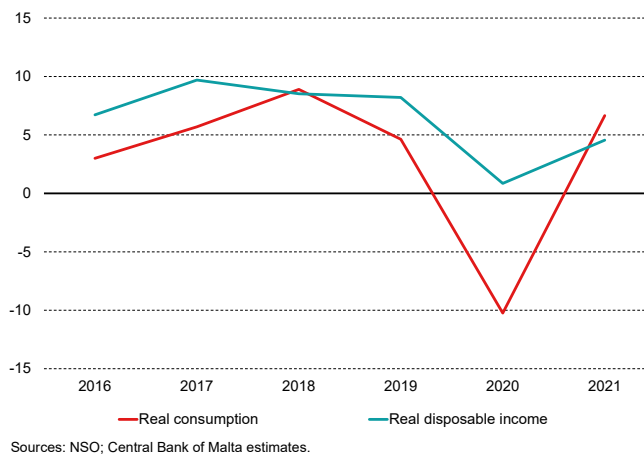
At the same time, the Maltese Government introduced several support measures – mainly in the form of the Wage Supplement Scheme – to limit layoffs and cushion household incomes.

Indeed, in 2020, pandemic-related measures amounted to around 5.0% of GDP, which impacted GDP growth positively by around 2.8 percentage points.<sup>3</sup> Consequently, despite the severe economic contraction in 2020 (of 8.3%), real disposable income still rose by 0.8%.

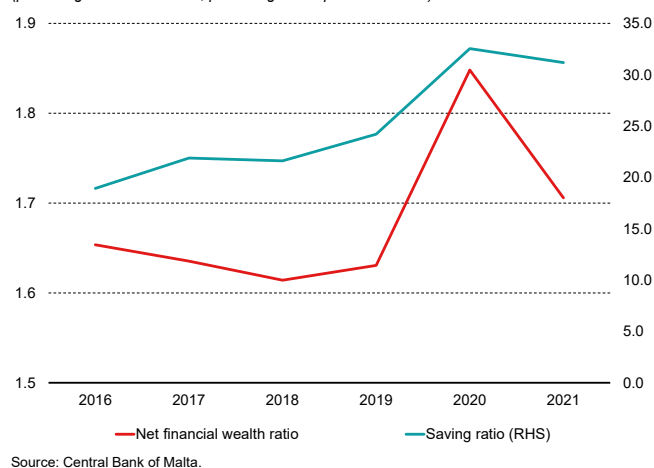
Although private consumption increased by 6.6% in 2021, its level was still around 4.5% below that prevailing in 2019, as containment measures were intermittently enhanced due to new variants of COVID-19. At the same time, real disposable income is estimated to have risen further by around 4.5% in 2021, thus providing further support to private consumption.

In view of these developments, the estimated saving ratio reached a historical high of 32.5% in 2020, easing to around 31.2% in 2021 (see Chart 3). Similarly, household net financial wealth as a percentage of nominal GDP rose to a historical high in 2020. Although it retreated somewhat in 2021 on the back of a recovery in nominal GDP, the ratio of household net financial wealth remained well above that in 2019.

**Chart 2**  
**PRIVATE CONSUMPTION AND DISPOSABLE INCOME**  
(annual percentage change)



**Chart 3**  
**NET FINANCIAL WEALTH AND SAVING RATIOS**  
(percentage of nominal GDP; percentage of disposable income)



<sup>3</sup> See Borg I. (2022) Box 2: The impact of COVID-19 Fiscal and Liquidity Measures on GDP, Central Bank of Malta *Outlook for the Maltese Economy 2022:2* <https://www.centralbankmalta.org/site/Publications/Projections-2022-2.pdf>

In forecast rounds that preceded the COVID-19 pandemic, the Bank had projected the saving ratio to decline somewhat over the period 2020-2022, following a period of relatively strong accumulation of savings.<sup>4</sup> Hence, the sharp increase in the saving ratio in 2020 and 2021 is mostly due to pandemic-related effects of forced savings due to the inability to consume, although it is also likely that this rise could also include some precautionary element due to the elevated uncertainty and loss in confidence that the pandemic had generated. In this box we estimate excess savings as the difference between real savings accumulated in 2020 and 2021 and a counterfactual level consistent with the saving ratio that prevailed in 2019.<sup>5</sup> By end 2021, pandemic excess savings stood at around 7.6% of disposable income.

### Forecast implications

Containment measures during 2022 have been eased further and by the end of June, almost all the measures that hinder consumption have been removed. Households entered this re-opening period with a large stock of savings, and in excess of that which they would have saved if the pandemic shock did not occur. These additional savings could provide huge support to private consumption growth in the forecast period, beyond that expected on the basis of the increase in income. There are however many aspects to consider.

Firstly, although private consumption growth could be somewhat buoyed by pent-up demand due to the re-opening of contact-intensive services, the full re-opening of travel routes and the restart of mass events, part of the consumption foregone during the pandemic cannot be recovered. For example: consumers are unlikely to increase their expenditure on leisure activities enough to offset the drop during the period in which these were shut down. There are also capacity restrictions, particularly in travel, which limit higher consumption. Similarly, the frequency at which certain personal care services are consumed will not necessarily exceed the rate at which they were availed of before 2020. Therefore, the de-accumulation of pandemic-related savings could be limited.

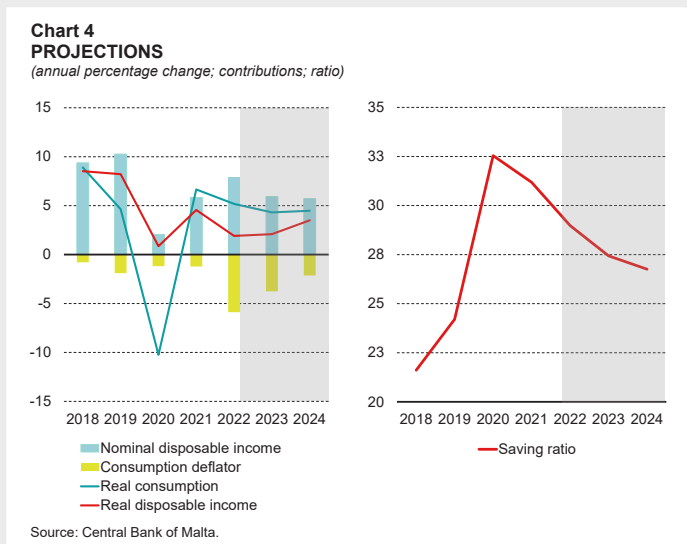
Secondly, uncertainty remains high and has increased further due to the sharp pick-up in inflation and the invasion of Ukraine. In such a context, consumers could find it challenging to properly assess their medium-term expected income. This could lead households to maintain or even increase the precautionary element of saving which would slow down the de-accumulation of savings and adversely affect the growth of private consumption.

Chart 4 shows the forecast of the growth in private consumption and real disposable income between 2022 and 2024. Growth in real disposable income is expected to slow down to 1.9% in 2022 from 4.6% in 2021. This deceleration is driven by a stronger negative contribution from inflation, which is expected to contribute negatively by 5.9% and offsets a modest pick-up in nominal income growth. Real disposable growth is set to pick up to 2.1% and 3.5% in 2023 and 2024 respectively as inflation is set to moderate from the peaks of 2022.

<sup>4</sup> See <https://www.centralbankmalta.org/file.aspx?f=92670>

<sup>5</sup> This is similar to the measure adopted in [https://www.ecb.europa.eu/pub/economic-bulletin/focus/2021/html/ecb\\_ebbox202105\\_01~f40b8968cd.en.html](https://www.ecb.europa.eu/pub/economic-bulletin/focus/2021/html/ecb_ebbox202105_01~f40b8968cd.en.html), except that instead of considering the counterfactual saving ratio as being equal to the average prior to 2020, we utilise the saving ratio for 2019. Such an assumption is made mainly because the saving ratio in Malta was trending upwards and hence the equilibrium saving ratio is probably higher than the historical average.

At the same time, private consumption growth is set to moderate to 5.2% in 2022 from 6.7% in 2021. It is then set to decelerate further to 4.3% in 2023 and pick-up slightly to 4.5% in 2024. As these growth rates exceed those projected for disposable income, the saving ratio is expected to decline somewhat throughout the projection horizon, as pandemic-related excess savings are run down. Nevertheless, given the high uncertainty related to the war in Ukraine, the saving ratio in 2024 is still expected to remain elevated and above that of 2019. This implies that around half of the excess savings accumulated during the pandemic will be retained by the end of the projection horizon.

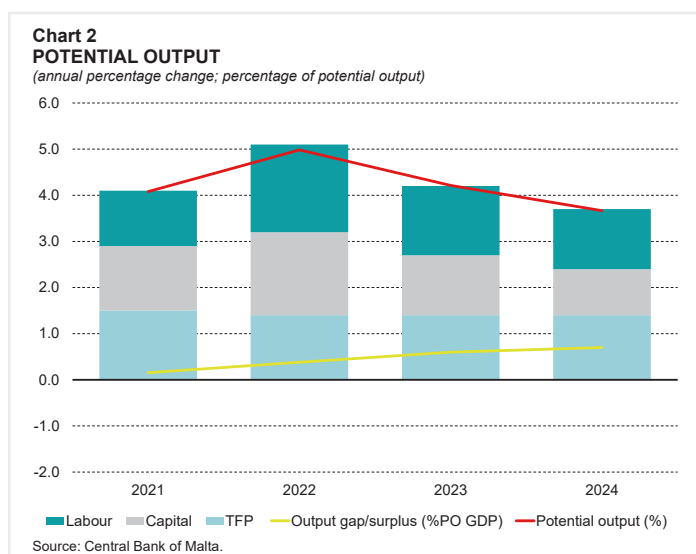


### Potential output

Potential output is expected to pick up further this year. It is projected to grow by 5.0% in 2022, up from 4.1% in 2021 (see Chart 2). This pick-up in potential output growth partly reflects a higher contribution from labour, following the removal of travel restrictions and the foreseen resultant improvement in net migration. Moreover, the contribution of the capital stock is also expected to recover this year due to the strong pick-up in investment in 2021. The contribution of total factor productivity is envisaged to fall marginally and remain stable thereafter.

Potential output growth is set to moderate to 4.2% and 3.7% in 2023 and 2024, reflecting lower contributions from both capital and labour.

The economy is expected to be operating slightly above potential this year, with the output gap standing at 0.4%. The output gap is expected to widen further to 0.6% and 0.7% in the following two years, primarily reflecting the sharp rebound in demand in sectors that were still subject to pandemic-related



restrictions in 2021. Although the output gap remains positive and is widening, it is below that estimated for the last three years before the pandemic.

### Labour market

Employment growth in 2022 is expected to reach 3.5%, from 2.8% in 2021. Employment growth in 2022 has been revised upwards due to stronger than expected outcomes during the first quarter of the year. It is then set to moderate to 2.1% by 2024. This year's pick-up reflects the continued strong demand for labour in the context of historically high labour shortages. That said, net migration flows are assumed to pick up sharply in 2022, and gradually alleviate some of the broad-based labour shortages. However, employment is set to grow more slowly than GDP during the whole projection horizon, as productivity is expected to improve from the lows experienced during the pandemic and a degree of tightness in the labour market is expected to persist.

Despite the assumed growth in net migration and hence labour supply, the unemployment rate is projected to decline to 3.1% this year, from 3.5% last year and is expected to hover within this range during the remainder of the outlook period. This is the lowest unemployment rate in history.

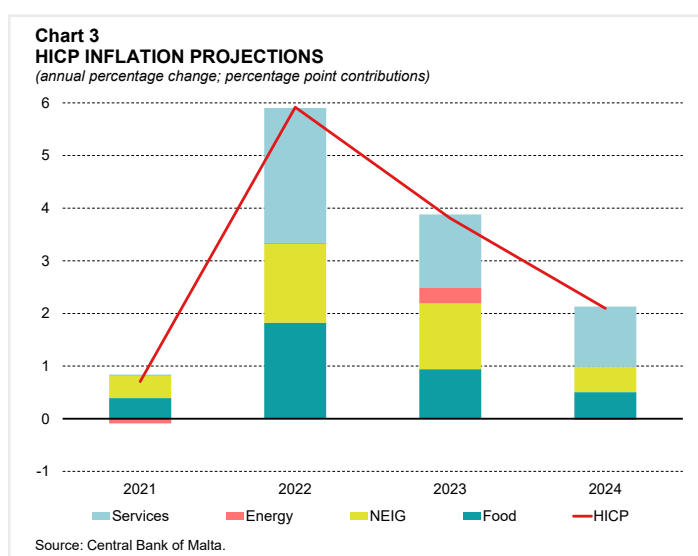
In view of the expected increase in inflation this year as well as tight labour market conditions, wage growth is projected to be relatively strong. Nevertheless, nominal wage growth is projected to remain below consumer price inflation this year due to some lag in the transmission from prices to wages. Compensation per employee is thus set to increase by 4.5% in 2022, down from 4.9% in 2021.

Over the projection horizon we expect labour market tightness to ease somewhat as net migration flows are projected to normalise as the global pandemic situation improves. This easing of labour market tightness should limit the upward pressure on nominal wages by 2024. Hence, growth in compensation per employee is projected to moderate to 3.2% by 2024.

### Prices

With regard to consumer prices, annual HICP inflation is projected to accelerate to 5.9% in 2022, from 0.7% in 2021. The sharp pick-up in inflation reflects a broad-based increase across all sub-components of HICP except for energy inflation. Services inflation is envisaged to be the main contributor to HICP inflation, but food inflation and non-energy industrial goods (NEIG) inflation are also projected to contribute strongly to annual HICP inflation this year (see Chart 3).

In 2022, the sharp pick-up in services inflation primarily reflects spill overs from high



inflation in other subcomponents such as food and NEIG (see Box 2). In addition, labour costs are envisaged to remain buoyant.

Food prices are projected to rise strongly in 2022, largely due to higher unprocessed food inflation, although processed food prices are also expected to increase sharply. This reflects the indirect impact of higher import prices for most commodities and the rise in freight costs.

NEIG inflation is similarly expected to increase strongly due to higher import price pressures both for intermediate inputs and for final consumer goods due to higher imported product prices and freight costs.

Despite the increase in international energy commodity prices, energy inflation is expected to remain low during the whole projection horizon, in light of announcements by the Government, which intends to keep stable energy prices until at least the end of this year. Energy prices are expected to pick up in 2023, before falling marginally in the outer year of the forecast horizon, reflecting the profile of the technical assumptions for international oil prices which shape the Bank's projections for transport fuels and gas. Electricity prices are assumed to remain fixed throughout the projection exercise.

Import price pressures are expected to gradually ease by the beginning of next year, although these are envisaged to remain high by historical standards. HICP inflation is expected to moderate to 3.8% in 2023, driven by lower contributions from all subcomponents except for energy inflation. Inflation is set to ease further in 2024, to 2.1%.

When compared with the Bank's June forecasts, overall HICP inflation has been revised up by 0.9 percentage point in 2022 and 2023 and by 0.3 percentage point in the outer year of the projection horizon. The upward revisions in 2022 and 2023 partly reflect stronger than projected inflation outcomes in recent months. In addition, they reflect stronger upward pressures from the rise in international commodity prices, high freight costs as well as higher prices incurred on imported consumer goods.

## **BOX 2: THE INDIRECT IMPACT OF HIGH FOOD INFLATION ON THE DEVELOPMENT AND OUTLOOK OF CATERING SERVICES PRICES<sup>1</sup>**

### **Introduction**

The recent acceleration in inflation has been primarily driven by high import price pressures. These external factors have both direct and indirect effects on the prices of the consumption basket. In particular, the recent surge in commodity prices has contributed to a sharp acceleration in food and other goods' prices.

However, due to links between the different subcomponents of HICP, such increases have also indirectly affected services prices.

This box focuses on the impact of the recent surge in food prices on recreation and personal care services, which provides some insights regarding the outlook for this category of the consumption basket.

<sup>1</sup> Prepared by Abigail Marie Rapa, a senior economist within the Economic Projections and Conjunctural Analysis Office.

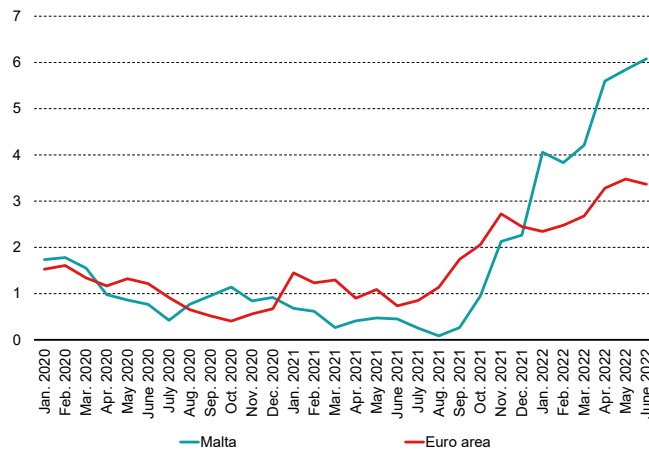
## Services prices

Services inflation in Malta reached an annual rate of 6.1% in June 2022, the second highest rate since the beginning of the HICP computation. Indeed, services inflation in Malta has exceeded that of the euro area from January 2022 onwards (see Chart 1). Furthermore, the gap between Malta's services inflation and that in the euro area average has widened between January and June, rising to 2.7 percentage points, notwithstanding that energy costs for service providers were stable, unlike those faced by their counterparts in the euro area.

In 2022, services account for 43.3% of Malta's consumption basket and are thus an important driver of Malta's headline HICP inflation. Indeed, alongside food, services price inflation has recently been one of the main contributors to the acceleration in overall HICP inflation (see Chart 2). The contribution of services prices shifted from a negative contribution of 0.4 percentage point in June 2021 to a positive 2.9 percentage points a year later. This increase was largely driven by recreation and personal care services.

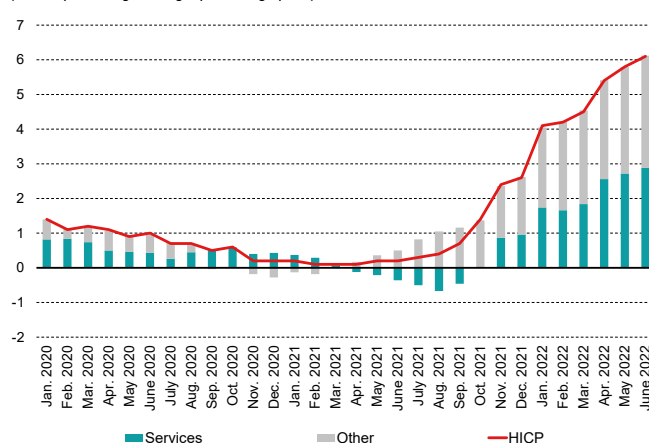
The growth in the prices of this sector accelerated from 3.3% in December 2021 to 5.2% in June. Its contribution to overall HICP growth has more than doubled from 0.6 percentage points in December to 1.4 percentage points in June (see Chart 3). Around three-fourths of this increase can be

**Chart 1**  
**SERVICES INFLATION**  
(annual percentage changes)



Source: Eurostat.

**Chart 2**  
**HICP INFLATION AND CONTRIBUTIONS**  
(annual percentage change, percentage point)



Source: SDW.

attributed to the restaurant and accommodation sub-sector.

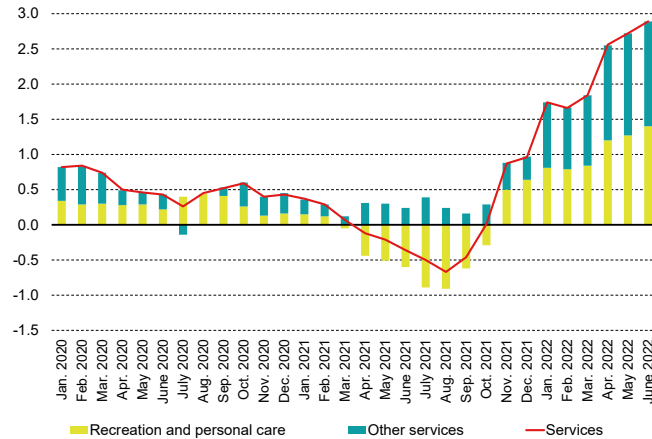
### Relationship between consumer food prices and consumer prices in the catering sector

Inflation in the catering sector reached 9.4% in June, the second highest rate in history (see Chart 4). Abstracting from the effects of labour costs and the resurgence in demand for catering services,

the rise in catering prices could be driven by food inflation since food is one of the main inputs of the sector.<sup>2</sup> Indeed, the latest input-output tables for Malta show that excluding indirect effects, output of the agriculture, fishing and manufacturing of food sectors, contribute up to 33% of total intermediate inputs to accommodation and food services activities sector.

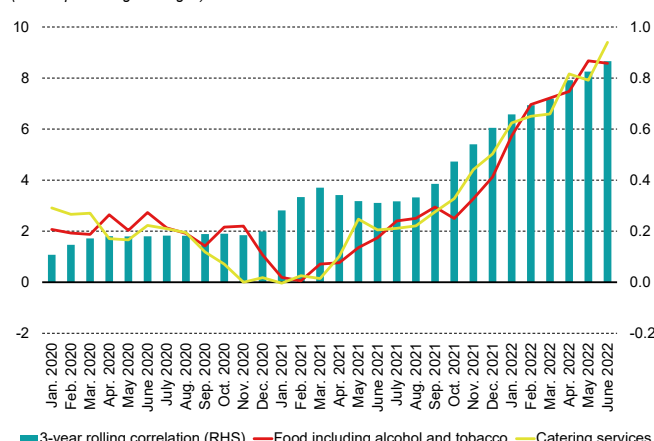
Chart 4 shows that there is a strong correlation between consumer food prices in the HICP and those for catering services. This relationship may reflect the fact that both consumers and catering service providers source food products from the same group of suppliers. This correlation has increased in recent months, rising to a high of 0.87 in June. Hence, the recent increase in the correlation between the two price indices may reflect an increased pass-through of wholesale food price inflation to both consumers and catering services. In turn, this increases the contribution of services to overall inflation.

**Chart 3**  
CONTRIBUTION OF SERVICES INFLATION AND MAIN COMPONENTS  
(percentage point)



Source: SDW.

**Chart 4**  
INFLATION IN FOOD AND CATERING SERVICES  
(annual percentage changes)



Sources: Eurostat; own calculations.

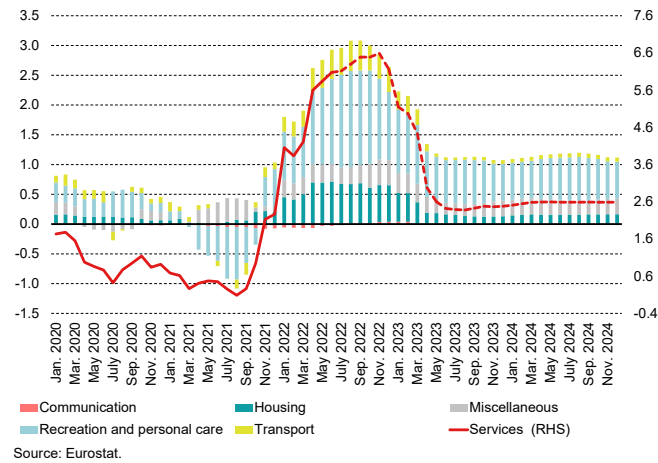
<sup>2</sup> See Rapa A. M. (2022) Box 1: Recent Developments and Forecasts of Food Prices in Malta, Central Bank of Malta *Outlook for the Maltese Economy 2022:2* <https://www.centralbankmalta.org/site/Publications/Projections-2022-2.pdf>

## Services price projections 2022-2024

Overall services inflation is forecast to reach a peak of 6.6% in November 2022, before falling gradually to 2.5% by the end of 2023 (see Chart 5). This is expected to stabilise at 2.6% throughout 2024. The slowdown in 2023 is driven by all subcomponents.

Recreation and personal care services are expected to remain the main driver of services inflation throughout the forecast horizon, contributing at their peak in November 2022 1.4 percentage points of the overall services inflation. In turn, the catering sector is one of the main contributors to the inflation of the recreation and personal care sector, whose projection follows a similar path to that of food inflation.

**Chart 5**  
**SERVICES INFLATION FORECAST AND ITS CONTRIBUTION TO HICP**  
(annual percentage change, percentage point)



Source: Eurostat.

## Public finance

The general government deficit-to-GDP ratio is set to narrow to 5.6% in 2022 from 7.9% in 2021 (see Table 2). It is projected to narrow further to 4.0% in 2023 and to 3.2% in 2024. This profile is driven by the unwinding of COVID-19 support measures in 2022, which more than offsets outlays on price mitigation measures.

The deficit ratio is projected to remain unchanged compared with the Bank's earlier projections.

In 2022, the share of current revenue in GDP is expected to be lower than that of 2021. It is then expected to increase gradually over the projection horizon. This is due to the profile of tax revenue, where inflows from indirect taxes, particularly VAT receipts, are set to grow at a stronger pace than nominal GDP. Revenue from current taxes on income and wealth and social contributions are meanwhile set to grow by less than nominal GDP in 2022, and in line with it in the following years. Meanwhile, the share of other current revenue in GDP is set to decline in 2022 and to stabilise thereafter.

The share of capital revenue in GDP is set to peak in 2023 before declining in 2024, due to the profile of EU grants, which part-finance capital expenditure.

The share of current expenditure in GDP is expected to gradually decline over the forecast horizon, mainly due to lower outlays on subsidies. This reflects the aforementioned decline in COVID-related spending and the gradual unwinding of price-mitigating measures. In 2022, compensation

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

	2021 <sup>(1)</sup>	2022	2023	2024
<b>Headline aggregates</b>				
Total Revenue	37.1	36.9	37.3	37.0
Total Expenditure	45.1	42.5	41.3	40.3
General Government Balance	-7.9	-5.6	-4.0	-3.2
of which: Primary Balance	-6.8	-4.4	-2.8	-2.0
General Government Debt	56.4	58.1	58.7	58.8
<b>Detailed breakdown</b>				
Current Revenue	35.5	35.0	35.3	35.4
Current taxes on income and wealth	13.8	13.3	13.3	13.3
Taxes on production and imports	10.7	11.4	11.7	11.9
Social contributions	6.2	6.1	6.1	6.0
Other current revenue <sup>(2)</sup>	4.8	4.2	4.1	4.2
Current Expenditure	39.7	37.3	36.2	35.6
Compensation of employees	12.1	11.9	11.9	11.9
Social benefits	9.6	9.5	9.5	9.5
Intermediate consumption	9.1	8.8	8.6	8.7
Interest payments	1.1	1.2	1.2	1.2
Subsidies	4.7	2.9	2.5	1.9
Other current expenditure <sup>(3)</sup>	3.1	2.9	2.6	2.4
Gross Savings	-4.2	-2.3	-1.0	-0.3
Capital Revenue	1.6	1.9	2.0	1.6
Capital taxes	0.2	0.2	0.2	0.2
Other capital revenue <sup>(4)</sup>	1.4	1.7	1.8	1.4
Capital Expenditure	5.3	5.3	5.1	4.6
Gross fixed capital formation	4.1	4.2	4.2	3.8
Capital transfers	1.1	1.1	0.9	0.8
Other capital expenditure <sup>(5)</sup>	0.1	0.0	0.0	0.0
Capital Revenue net of Capital Expenditure	-3.7	-3.4	-3.0	-3.0
<b>Underlying budgetary outcome</b>				
Cyclical Component	0.1	-0.1	0.4	0.4
Temporary Government Measures	-0.4	0.0	0.0	0.0
Structural Balance	-7.6	-5.5	-4.4	-3.6

Sources: NSO; Central Bank of Malta.

<sup>(1)</sup> Actual data as per NSO *News Releases* 114/2022 (published on 5 July 2022) and 95/2022 (published on 30 May 2022).

<sup>(2)</sup> Mainly includes revenue from dividends, rents and sales.

<sup>(3)</sup> Mainly includes spending on education and contributions to the EU budget.

<sup>(4)</sup> Mainly includes grants from EU Programmes.

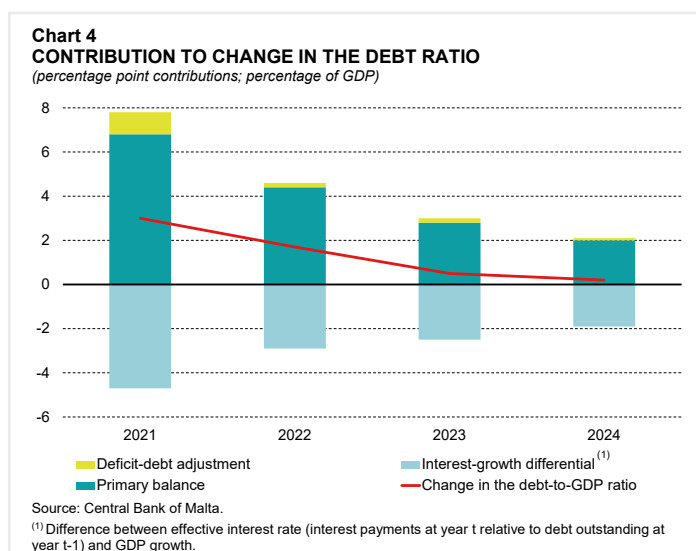
<sup>(5)</sup> Mainly reflects the value of changes in inventories and in the net acquisition of valuables and other assets.

of employees and intermediate consumption are set to increase at a slower pace than nominal GDP, as outlays in the health sector are set to grow less rapidly compared with the period immediately following the onset of COVID-19. Social benefits are also set to grow by less than nominal GDP, owing to the profile of pension payments. On the other hand, the share of interest payments in GDP is set to end its declining trend as it is expected to increase slightly in 2022. Almost all current expenditure categories are set to grow in line with nominal GDP in subsequent years. Outlays on subsidies are however, set to decline over time, due to the expected partial unwinding of price-mitigating measures.

The share of capital expenditure in GDP is projected to remain elevated throughout the forecast horizon, although it is set to decline over time. This profile reflects a declining share of domestically-funded projects and the completion of projects financed from the 2014-2020 EU financing framework. This is partly offset by the projected pick-up in spending on projects financed from grants by the RRF.

The structural deficit is projected to narrow over the projection horizon, reaching 3.6% of GDP by 2024, from 5.5% this year. This is due to the unwinding of support measures, as these are not treated as one-off outlays and thus affect the underlying structural position.

The general government debt-to-GDP ratio is projected to increase from 56.4% in 2021 to 58.1% in 2022. It is then projected to increase further in the outer years of the projection horizon, albeit at a slower pace, reaching 58.8% by 2024. The increase in the debt ratio is driven by the expected primary deficits, which are partly offset by the interest-growth differential (see Chart 4).



## Risks

Risks to economic activity are to the downside, especially for 2023, though uncertainty even during 2022 remains high. The main downside risks relate to the evolution of energy supply from Russia to Europe. This could lead to severe shortages of energy supplies going into the winter, which could in turn adversely affect production abroad and amplify supply bottlenecks, with an adverse impact on foreign demand. Moreover, if higher input and transport costs persist for a longer period, manufacturing activity could be weaker than anticipated in the baseline. The prolongation of supply bottlenecks might also lead to additional inflationary pressures than those already assumed, which can continue to adversely impact private consumption and corporate investment. Foreign demand could also be weaker than expected if monetary policy in advanced economies continues to tighten more forcibly than assumed in this projection round.

These downside risks are mitigated somewhat by domestic fiscal policy which is to some extent cushioning the impact of imported inflation. In addition, the savings ratio could fall faster than assumed in the baseline, stimulating higher consumption. Further to this, positive surprises in tourism could further boost net exports and GDP growth.

Risks to inflation are on the upside throughout the entire projection horizon. Indeed, further escalation in cuts in gas supplies could trigger a stronger than envisaged rise in commodity prices, which would put further upward pressures on the prices of imported goods and freight costs. In addition, the EU policy to sharply reduce dependence on Russian fossil fuels could also lead to

stronger than expected increases in import costs, particularly in the short-run. The risk of second-round effects from wages and mark-ups grows if high inflation persists for longer.

On the fiscal side, risks mainly relate to a larger deficit in 2022 and 2023. These mostly reflect the likelihood of additional Government support to mitigate rising commodity prices and the likelihood of state aid to Air Malta.