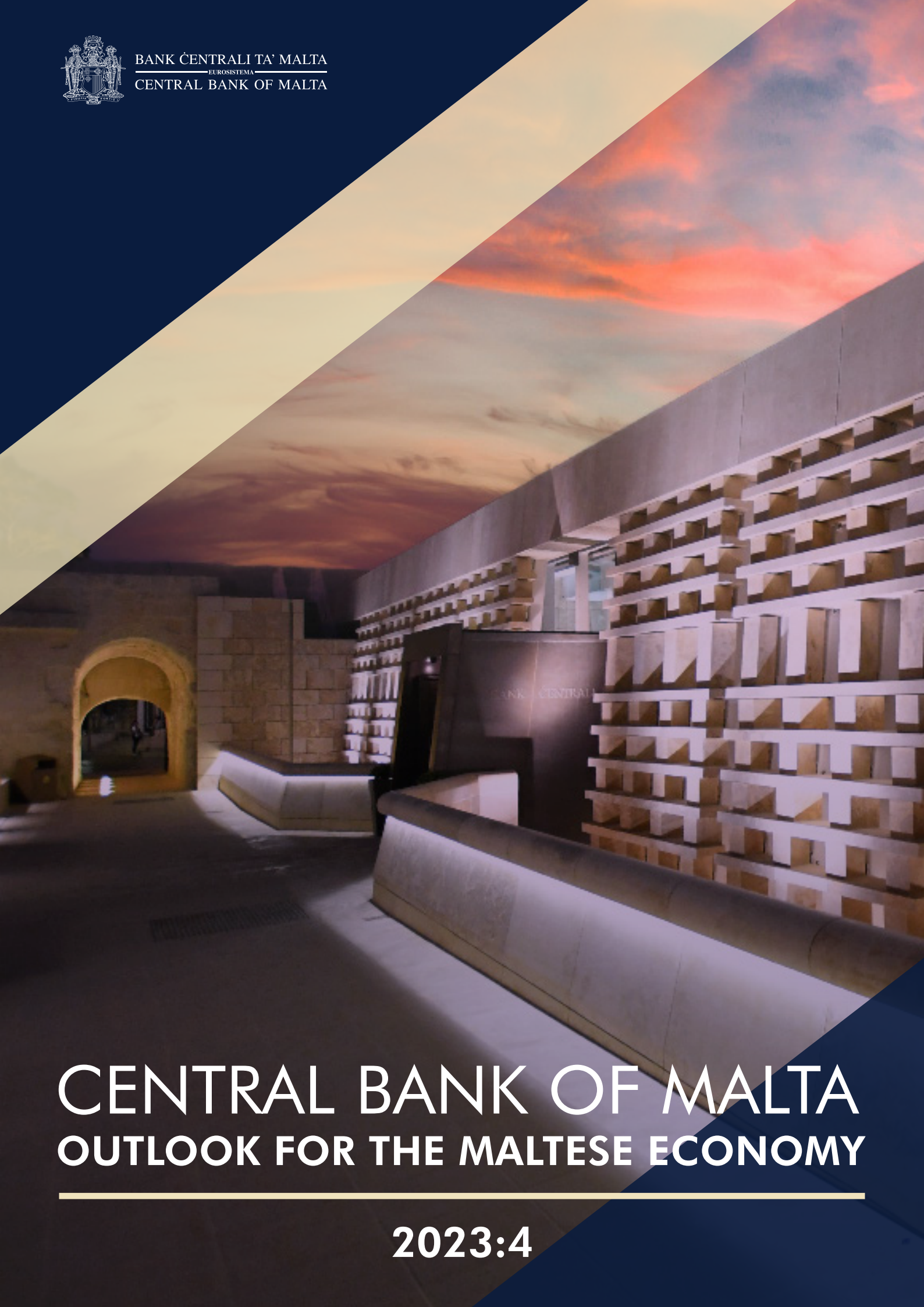




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CENTRAL BANK OF MALTA OUTLOOK FOR THE MALTESE ECONOMY

2023:4

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OUTLOOK FOR THE MALTESE ECONOMY 2023-2026

Overview^{1,2}

Incoming information suggests that economic activity in Malta remained resilient despite the weakness exhibited in key trading partners. In particular, the recovery in tourism remains faster than expected, while domestic demand has been generally robust. With regards to the latter, private consumption growth continues to grow very strongly despite high inflation.

Although price pressures remain elevated, inflation has started to moderate, and is expected to ease further throughout the projection horizon, though there are upside risks next year. At the same time, wage pressures have intensified further, though we expect these to be partly absorbed by lower profitability.

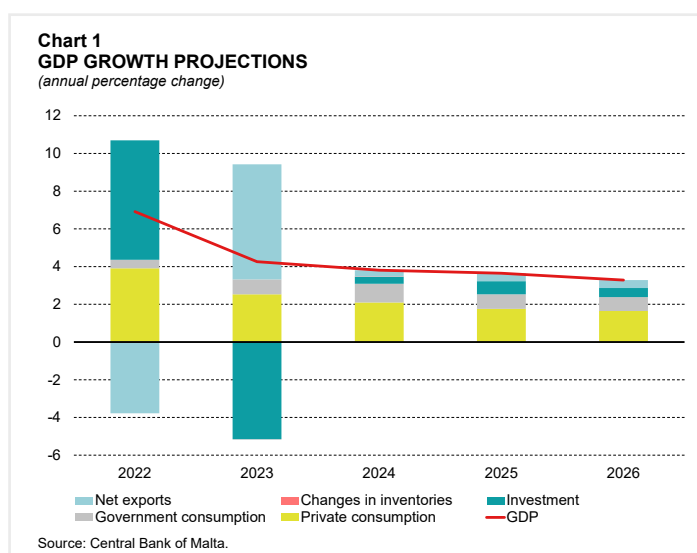
Given these factors, economic growth is expected to remain resilient, but generally slows down towards potential output growth by the end of the projection horizon. Moreover, international developments, and the lagged transmission of monetary policy tightening, are expected to contribute to a further moderation in growth in 2024 and 2025.

The projections outlined in this publication were finalised before the publication of the third quarter national accounts vintage by the National Statistics Office. That vintage introduced significant upward revisions to historical gross domestic product (GDP) data, which implies that GDP growth for 2023 included in this publication will be revised upwards accordingly in the forthcoming projection round. This is also likely to have positive carry-over effects for 2024.

Economic outlook

According to the Bank's latest forecasts, Malta's GDP growth is projected to moderate from 4.3% in 2023 to 3.8% in 2024, 3.6% in 2025, and 3.3% in 2026 (see Table 1). Compared to the Bank's August projections, GDP growth is being revised up in 2023, mainly on account of stronger than envisaged private consumption and investment. The upward GDP revision in 2024 reflects an upward revision in consumption and investment, as growth in exports was revised marginally downwards while that of imports was revised slightly upwards. GDP growth for 2025 remains broadly unchanged.

While in 2022, growth was driven by domestic demand, in 2023, net exports are expected to become the main contributor to GDP growth (see Chart 1). In 2023, domestic demand is



¹ The Bank's projections for the Maltese economy are based on information available up to 30 November 2023. However, the NSO's GDP release for the third quarter of 2023, published on 28 November 2023, has not been taken into account as complementary information relevant to the projections became available after the cut-off date for this exercise. Technical assumptions were transmitted by the ECB.

² See [Central Bank of Malta Outlook for the Maltese Economy 2023:2](#).

Table 1
PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES FOR MALTA⁽¹⁾

	2022 ⁽²⁾	2023	2024	2025	2026
Real economic activity (% change)					
GDP	6.9	4.3	3.8	3.6	3.3
Private consumption expenditure	9.5	6.0	4.8	4.0	3.7
Government consumption expenditure	2.3	4.3	5.4	4.1	3.9
Gross fixed capital formation	31.2	-20.4	1.9	3.7	2.6
Exports of goods and services	6.8	2.3	3.2	2.9	3.0
Imports of goods and services	10.1	-1.5	3.3	3.0	3.0
Contribution to real GDP growth (in percentage pts)					
Final domestic demand	10.6	-1.8	3.5	3.2	2.9
Net exports	-3.7	6.1	0.3	0.4	0.4
Changes in inventories	-0.1	0.0	0.0	0.0	0.0
Balance of payments (% of GDP)					
Goods and services balance	11.1	16.2	15.9	15.9	15.8
Current account balance	-3.0	2.2	2.1	2.1	2.0
Labour market (% change)⁽³⁾					
Total employment	6.2	4.0	2.6	2.5	2.4
Unemployment rate (% of labour supply)	2.9	2.8	2.9	2.9	3.0
Real disposable income⁽⁴⁾	2.9	2.1	3.5	3.7	3.4
Household saving ratio⁽⁴⁾	28.7	26.0	25.1	24.9	24.6
Prices and costs (% change)					
GDP Deflator	5.3	4.6	2.8	2.5	2.1
RPI	6.2	5.1	2.9	2.2	1.9
Overall HICP	6.1	5.6	3.0	2.3	2.0
HICP excluding energy	6.6	5.8	2.5	1.9	1.7
Compensation per employee	3.1	5.8	6.0	4.0	3.1
ULC	2.4	5.6	4.8	2.9	2.2
Business Cycle					
Potential output (% change)	7.0	6.0	4.1	3.7	3.1
Output gap (% of GDP)	2.2	0.4	0.1	0.1	0.3
Technical Assumptions					
EUR/USD exchange rate	1.05	1.08	1.08	1.08	1.08
Oil Price (USD per barrel)	103.7	84.0	80.1	76.5	73.6

Sources: NSO; Central Bank of Malta.

⁽¹⁾ Data on GDP were sourced from NSO *News Release 158/2023* published on 04 September 2023, while RPI and HICP data were sourced, respectively, from NSO *News Releases 186/2023* and *183/2023* (published on 24 October 2023 and 18 October 2023). The NSO *News Release NR214/2023* issued on 28 November 2023 was not taken into

⁽²⁾ Actual data. National accounts data is consistent with NSO *News Release 158/2023* published on 04 September 2023. The latest NSO *News Release NR214/2023* issued on 28 November 2023 was not incorporated.

⁽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.

⁽⁴⁾ Central Bank of Malta estimates.

expected to lower growth, as negative base effects related to extraordinary outlays in aircraft in 2022 are set to reduce private investment in 2023, offsetting positive contributions from government and private consumption. From 2024, domestic demand is expected to be the main driver

of growth, as private consumption growth continues to grow at a brisk pace and private investment begins to recover. Net exports are also projected to contribute positively for the rest of the forecast horizon, driven mainly by growth in services exports.

Private consumption growth is set to gradually slow down but remain robust, as consumers are expected to continue to draw on their past savings to sustain their consumption in a high-inflationary period. Throughout the projection horizon, growth in private consumption is set to moderate somewhat, but is set to outpace the Bank's estimate of real disposable income. The saving ratio is thus envisaged to retreat from recent peaks over the projection horizon, though remaining high from a historic perspective.

Growth in government consumption is set to pick up in 2023, and to peak at 5.4% by 2024. It is then set to moderate slightly to 4.1%, and 3.9% in 2025 and 2026, respectively. This profile is mainly driven by outlays on compensation of employees and intermediate consumption. The former reflects outlays on allowances, which are set to grow at strong rates particularly in 2023 and 2024. The profile of intermediate consumption is driven by outlays on contractual services and maintenance.

Investment is projected to decline this year, reflecting the aforementioned negative base effect in the aviation sector. Investment is then forecast to grow by 1.9% in 2024, 3.7% in 2025, and 2.6% in 2026.

When abstracting from the base effects related to the above-mentioned outlays in the aviation sector, private investment is set to grow slightly this year. Residential construction is set to decline this year, as sentiment in this sector continues to weaken, and labour shortages are judged to be binding. Similarly, non-dwelling private investment is expected to decline in 2023, due to the profile of equipment investment, and to grow at below historical rates in the following two years in view of the ongoing weakness in the non-residential construction sector.

After falling in 2022, government investment is set to increase in 2023. It is then set to decline once again by 5.4% in 2024. Thereafter, it is projected to rise by 4.9% in 2025 and to decline slightly by 0.5% in 2026. This profile is partly driven by the expected take up of EU funds, notably the full absorption of funds from the 2014-2020 financing framework by 2023, and the increased take up of RRF grants in 2023 and 2024. It also reflects the profile of domestically-funded investment, which is set to increase slightly, and to remain at elevated levels.

With regards to export growth, it is set to reach 3.2% in 2024, before easing marginally to just around 3% in the following two years and grow broadly in line with foreign demand.

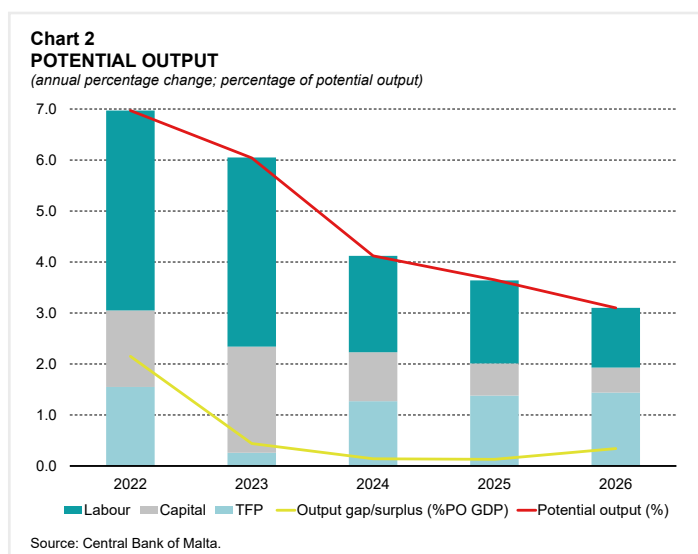
Similar to investment, imports are projected to decline this year reflecting the aforementioned base effect from the extraordinary outlays on aviation investment. Growth is then expected to turn positive in the following year.

The current account is expected to turn to a surplus this year, which follows a deficit registered in 2022. This primarily reflects base effects related to investment on the trade balance. The surplus on the current account is then projected to stand at 2.1% in 2024 and 2025, and 2.0% in 2026.

Potential output

Potential output is expected to moderate throughout the rest of the projection horizon to stand at 4.1% in 2024, 3.7% in 2025, and 3.1% in 2026. This mostly reflects decreasing contributions from capital and labour.

The economy is expected to be operating at slightly above potential throughout the projection horizon, with the output gap set to stand at 0.3% by 2026 (see Chart 2).



Labour market

Employment growth is set to moderate gradually to 2.4% by 2026, as GDP growth dampens.

The unemployment rate is forecast to stand at around 3.0% for the period 2024-2026. The unemployment gap is forecast to remain slightly negative until the end of the projection horizon, as the NAIRU is projected at around 3.1% in 2026.

In view of current high inflation, as well as tight labour market conditions, nominal wage growth is projected to be relatively strong from a historical perspective. Compensation per employee is thus projected to grow by 6.0% in 2024, 4.0% in 2025, and 3.1% in 2026. Indeed, real wage levels are expected to recover by 2024.

A persistently negative employment gap implies that labour market tightness will be a key factor driving the wage outlook. However, the gradual easing of labour market tightness should dampen upward pressure on wages by 2025 and 2026.

BOX 1: THE EFFECT OF A RISE IN MINIMUM WAGES ON AVERAGE WAGE GROWTH^{1,2}

The first National Minimum wage legislation in Malta was introduced on December 2, 1974, through the Conditions of Employment Act when a minimum wage of €23.29 per week was set. This wage tended to be increased in a discretionary manner till the cost-of-living adjustment (COLA) mechanism was introduced in 1990. Subsequently, Malta's National Minimum Wage started to rise annually in line with the COLA, at the start of the calendar year. However, in 2017 another social pact was agreed between social partners regarding the establishment of a low wage commission to advise Government every four years on whether there needs to be additional increases to the minimum wage. The pact also stipulated increases in the minimum wage above COLA in 2018 and 2019, and that a person on the minimum wage would get an automatic increase once they complete a full year on this wage, and another increase in the second year.³

In 2023 Malta's weekly National Minimum Wage stood at €192.73 for those aged more than 18 years, which amounted to 28% of the average weekly wage. As announced in Budget 2024, the national minimum wage is set to rise during the period 2024-2026. In 2024, the national minimum wage will increase by €8 over and above the COLA. The latter change integrates the automatic increases specified in the 2017 agreement for those who stay for more than a year on the minimum wage. The €8 will be granted to them immediately, an increase over and above COLA. In the following two years, the national minimum wage is set to rise by €3 over and above the COLA. Considering that the COLA for 2024 has been announced at €12.81, the weekly minimum wage for 2024 is set at €213.54.

This box aims at providing some preliminary quantification of the effects of the rise in Malta's minimum wage for 2024 on average compensation per employee and thus the effect of such a measure on the Bank's wage projections for 2024.

Estimated impact on wages in Malta

Neumark et al. (2000)⁴ show that apart from the direct impact on minimum wage earners, a change in the minimum wage also affects those workers whose wage is close to the minimum wage. Indeed, one of the recurring challenges in such literature is the estimation of the spillover effect from a minimum wage change to higher wage brackets.

In general, literature on spillover effects from minimum wage changes to average wages is mixed. For instance, Neumark et al. (2000) state that those earning higher than the minimum wage are only minimally affected by higher minimum wages in the United States. Also, Stewart (2010)⁵ finds no evidence of minimum wage spillover effects in the United Kingdom.

¹ This box was prepared by Abigail Marie Rapa, Principal Economist within the Economic Projections and Conjunctural Analysis Office.

² This analysis looks at the effects on the National Minimum Wage and does not take in consideration the marginal differences that exist between the national minimum wage and the sector and age-specific minimum wage rates foreseen in Maltese Law.

³ See [National Agreement on the Minimum Wage \(2017\)](#).

⁴ Neumark, D., Schweitzer, M., and Wascher, W. (2000). The effects of minimum wages throughout the wage distribution. *NBER Working Paper Series*, No. 7519.

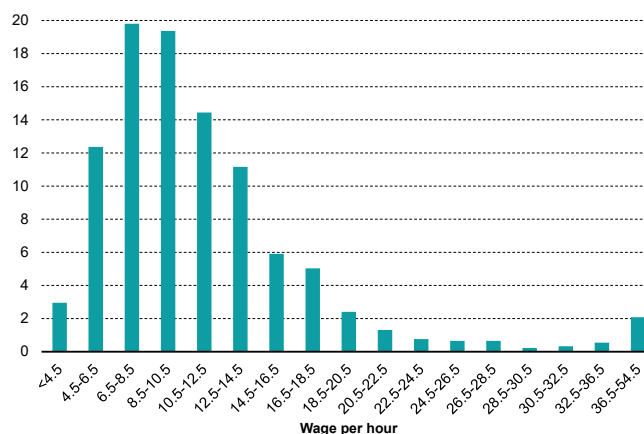
⁵ Stewart, M. B. (2010). Individual-level Wage Changes and Spillover Effects of Minimum Wage Increases. *University of Warwick*.

On the other hand, Neumark et al. (2004)⁶ find evidence of substantial spillover effects when they examine effects on individual wage changes directly at various points in the wage distribution.

For the purposes of this box, we estimate a range of impacts from minimum wages to average wages in view of the uncertainty exhibited in the literature.

As a first step, we have used Household Finance and Consumption Survey (HFCS) data to obtain a wage per hour distribution of the Maltese economy. The latest HFCS vintage holds individual-level data of compensation and average hours worked for 2020, which allows us to obtain information about the wage per hour distribution. According to these data, the proportion of those earning the minimum wage in 2020 (€4.48 per hour) stood at slightly below 3% of the total sampled employees (see Chart 1). Moreover, these data showed that around 40% of sampled employees earned between €6.50 and €10.50 per hour.

Chart 1
DISTRIBUTION OF COMPENSATION PER HOUR IN 2020
(percentage of employment)



Sources: HFCS; Central Bank of Malta calculations.

To obtain an estimate for 2023, we extrapolate the wage per hour distribution from 2020 by using COLA increases over the period 2020 to 2023 for the lowest wage bracket, and the average wage per hour growth (obtained from national accounts data) for the rest of the distribution.

To estimate the impact of the recent increase in minimum wages on wage growth in 2024, a baseline wage distribution for 2024 is assumed, whereby an individual receives at least the COLA increase announced in the Budget 2024. This implies that the first 11% of the distribution are assumed to receive an increase in their wage per hour of €0.32. The rest are assumed to receive an increase in their wage per hour consistent with the projected wage per hour growth rate embedded in this forecast publication.

In view of the uncertainty surrounding the expected spillover effects of the rise in minimum wages, a few scenarios were assumed to estimate a range of impacts on the growth in average wages.

To estimate the direct impact of the minimum wage increase, as a first scenario, we assume that only the minimum wage earners are affected by the proposed increase of €8 in their weekly wage over and above the COLA. As mentioned earlier, this will thus effect only

⁶ Neumark, D., Schweitzer, M., and Wascher, W. (2004). Minimum Wage Effects throughout the Wage Distribution. *The Journal of Human Resources*, No. 39, pp. 425-50.

slightly less than 3% of the employed population. According to our estimates, the effect of such a measure on the average wage per hour is 0.04 percentage point and is thus considered to be minimal.

To estimate the spillover effect on other wage brackets, we explore two methods. The first method derives from findings in Neumark et al. (2004). In this study, the elasticity of workers with wages between the minimum wage and 10% above the minimum with respect to the minimum is 0.8, which implies that those earning 10% above the minimum wage per hour would receive 80% of the increase in the minimum wage. This elasticity falls to about 0.4 for those with wages 10-30% above the minimum, and to about 0.25 for those with wages 30-50% above the minimum. Employees whose wage per hour is above 50% of the minimum wage are assumed not to benefit from the rise in the minimum wage. In such an instance, the effect on average wage growth is estimated to be around 0.11 percentage point.

As a third scenario, we account for stronger spillover effects by assuming that the impact from the rise in the minimum wage to other wage brackets depends on where the individual falls within the wage per hour distribution, rather than their relative hourly wage to the minimum wage. In such a scenario, the first 10% of the wage distribution receive the increase in the minimum wage in full. Those who fall in the 10-20% of the wage distribution are assumed to receive an increase of 80% of the minimum wage rise, the next 10% assumed to receive 60%, the following 10% are given 40%, while those falling in the 40-50% of the distribution are given 20% of the minimum wage increase. The rest of the distribution are assumed not to benefit from the minimum wage increase. In such a scenario, the average wage growth is estimated to be 0.69 percentage point higher than the baseline wage per hour.

Implications for the Bank's wage projections

Based on the above assumptions, the impact of minimum wages on average wage growth in 2024 is thus being estimated to fall within the range of 0.04 to 0.69 percentage point. In this projection we take the case of 0.11 percentage point as the most likely impact of the recent increase in the minimum wage on average wage growth in 2024. This is consistent with the methodology derived from estimates in Neumark et al. (2004).

Such estimates are very preliminary, and results may be reviewed as new information becomes available. Furthermore, it is rather challenging at this stage to fully take into account all indirect effects of the minimum wage increase to the rest of the wage distribution, and further analysis and scenarios might be warranted.

Prices

HICP rose sharply to 6.1% in 2022, from 0.7% in 2021. High inflationary pressures continued in the first half of 2023, but HICP inflation moderated somewhat in the second half of the year and is estimated to have fallen to 3.8% in November.

HICP inflation is expected to moderate to 5.6% in 2023, on the back of lower NEIG and services inflation (see Chart 3). Overall HICP inflation is set to stand at 3.0%, 2.3% and 2.0%, in the following three years.

HICP, excluding energy and food, is projected to grow by 4.9% in 2023, as compared to 5.8% in 2022. It is then projected to slow down further to 2.9% in 2024, 2.2% in 2025, and 2.0% in 2026.

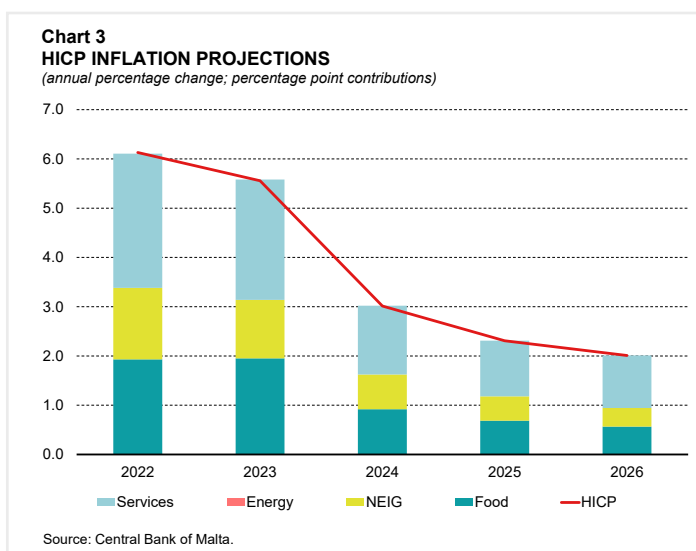
Compared to the Bank's previous forecast publication, overall HICP inflation was revised downwards by 0.3 percentage point in 2023 (reflecting lower than expected outturns in recent months), and by 0.1 percentage point in 2024.

Services inflation is expected to ease from 5.2% in 2023, to 3.1% in 2024, and to 2.6% and 2.4% in 2025 and 2026, respectively. Services inflation this year and in 2024 is expected to be driven by restaurants and housing services, which are assumed to remain affected by indirect spillovers from inflation of other subcomponents, as well as high wage pressures. The stronger rebound in tourism will also contribute to sustain prices of restaurant meals and other tourism-related services.

Food prices are projected to remain elevated in the near term, rising by 9.2% in 2023, partly reflecting persistently high imported inflation. Indeed, processed food inflation is expected to rise to 9.6%, from 8.2% in 2022. By contrast, unprocessed food inflation is set to ease to 8.0%, from 12.1% in the previous year. Food inflation is set to moderate gradually to 4.3% in 2024, 3.2% in 2025, and 2.6% in 2026, in line with expected developments in international commodity prices.

NEIG inflation is expected to fall from 5.3% in 2022, to 4.3% in 2023. This reflects abating international supply-chain disruptions, and hence a moderation in imported inflation. However, inflation rates for this component are expected to remain above historical outcomes in the projection horizon. NEIG inflation is expected to moderate over the rest of the projection horizon, standing at 1.4% in 2026.

Energy inflation is expected to have no effect on inflation over the NIPE horizon, reflecting the administered nature of this component and the Government's commitment to keep consumer prices for energy stable.



Public finance

The general government deficit-to-GDP ratio is set to decline below 5.0% of GDP in 2023, and to narrow further over the rest of the forecast horizon. By 2026, the deficit is forecast to reach 3.2%

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

	2022 ⁽¹⁾	2023	2024	2025	2026
Headline aggregates					
Total Revenue	34.2	34.6	34.2	34.3	34.4
Total Expenditure	39.9	39.2	38.3	37.9	37.6
General Government Balance	-5.7	-4.6	-4.1	-3.6	-3.2
of which: Primary Balance	-4.8	-3.4	-2.8	-2.3	-1.7
General Government Debt	52.3	52.8	55.1	55.9	56.7
Detailed Breakdown					
Current Revenue	33.0	33.2	33.2	33.2	33.2
Current taxes on income and wealth	13.1	12.9	13.0	13.1	13.2
Taxes on production and imports	10.4	10.8	10.8	10.8	10.8
Social contributions	5.8	5.7	5.7	5.6	5.6
Other current revenue ⁽²⁾	3.8	3.8	3.7	3.6	3.6
Current Expenditure	35.6	34.6	34.3	33.9	33.5
Compensation of employees	10.7	10.5	10.5	10.6	10.6
Social benefits	8.6	8.6	8.8	8.6	8.4
Intermediate consumption	7.8	8.0	8.0	8.0	8.0
Interest payments	1.0	1.2	1.3	1.4	1.5
Subsidies	4.8	3.9	3.0	2.7	2.4
Other current expenditure ⁽³⁾	2.8	2.5	2.7	2.7	2.7
Gross Savings	-2.6	-1.4	-1.1	-0.7	-0.3
Capital Revenue	1.1	1.4	1.0	1.1	1.2
Capital taxes	0.2	0.2	0.2	0.2	0.2
Other capital revenue ⁽⁴⁾	0.9	1.2	0.8	0.9	1.0
Capital Expenditure	4.2	4.6	4.0	4.0	4.0
Gross fixed capital formation	3.4	3.5	3.2	3.2	3.1
Capital transfers	0.8	1.1	0.8	0.8	0.9
Other capital expenditure ⁽⁵⁾	0.0	0.0	0.0	0.0	0.0
Capital Revenue net of Capital Expenditure	-3.1	-3.2	-3.0	-3.0	-2.8
Underlying budgetary outcome					
Cyclical Component	0.7	0.4	0.2	0.1	0.2
Temporary Government Measures	0.0	0.3	0.0	0.0	0.0
Structural Balance	-6.4	-5.3	-4.3	-3.7	-3.3

Sources: NSO; Central Bank of Malta.

⁽¹⁾ Actual data as per NSO *News Releases* 158/2023 (published on 28 August 2023) and 185/2023 (published on 23 October 2023).

⁽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.

of GDP (see Table 2). This improvement is driven by a declining share of expenditure in GDP, mainly due to the profile of inflation-mitigation measures.

Compared with the Bank's earlier projections, the projected deficit is now lower in 2023, but higher throughout the projection horizon. This partly reflects revised macro projections and their impact on tax revenue. It also reflects a revised profile for current expenditure, to take into account the latest targets presented in the 2024 Draft Budget Plan (see Box 2).

The share of current revenue in GDP is expected to remain constant throughout the forecast horizon. Tax revenue as a share in GDP is set to increase slightly, driven by the profile of taxes on income and wealth. Taxes on production and imports are set to retain a broadly stable ratio in GDP, while the ratio of social contributions is expected to decline over time. Non-tax current revenue is also set to increase by less than nominal GDP.

The share of capital revenue in GDP is set to peak in 2023, decline in 2024, and to increase slightly in the outer years of the forecast horizon. This is due to the expected profile of EU grants, which partly finance capital expenditure.

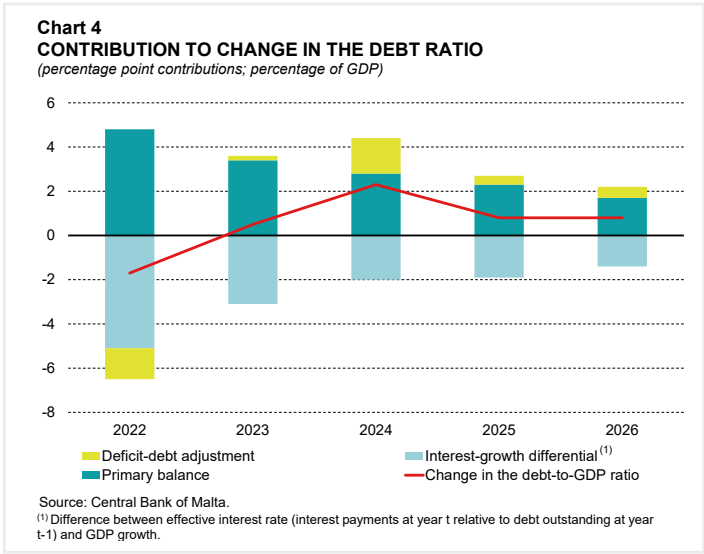
The share of current expenditure in GDP is forecast to decline throughout the forecast horizon, mainly due to projected lower subsidies. This reflects the profile of inflation-mitigation measures, which is set to decrease in line with forecast energy prices. It also reflects the end of restructuring assistance to Air Malta by end-2023. Growth in compensation of employees and intermediate consumption is set to remain buoyant, such that their share in GDP is expected to either increase slightly or remain stable over time. Meanwhile, spending on social benefits is set to grow by more than nominal GDP in 2024, driven by measures announced in the 2024 Budget. Outlays are then set to grow by less than nominal GDP in 2025 and 2026. The share of other current expenditure is first set to decline in 2023, due to a one-time refund from the EU. Its share in GDP is however set to increase over time, partly driven by the profile of interest payments.

The share of capital expenditure in GDP is projected to peak in 2023, before declining in 2024, and to remain constant thereafter. While remaining elevated in level terms from a historical perspective, the share of domestically funded investment in GDP is set to decline throughout the projection horizon. Meanwhile, the share of EU funded investment in GDP – which constitutes a smaller component – is set to decline in 2024, following the completion of projects financed by the 2014-2020 EU financing framework in 2023. This, however, is set to be partly offset by a pick-up in spending on projects financed through the Recovery and Resilience Facility. Capital transfers are set to follow a similar profile as investment.

The structural deficit is projected to narrow over the projection horizon, reaching 3.3% of GDP by 2026.³ This profile is driven by the above-mentioned inflation support measures, which are not treated as one-off outlays, and thus affect the underlying structural position.

³ The structural balance is defined as the cyclically-adjusted balance, net of temporary government measures.

The general government debt ratio is set to increase throughout the forecast horizon, reaching 56.7% by 2026. This is driven by the expected level of primary deficits, which offset the debt-decreasing impact of the interest growth differential (see Chart 4).⁴ Deficit-debt adjustments are set to exert a debt-increasing impact. This is particularly the case in 2024, due to the impact of an equity acquisition into a new airline following the closure of Air Malta.



⁴ Please note that if one adopts data on GDP published on 28 November 2023, the debt ratio would be lower than stated here.

BOX 2: THE IMPACT OF BUDGET 2024 TARGETS ON THE BANK'S FISCAL PROJECTIONS¹

This Box assesses the impact of Government fiscal targets as announced in the Budget 2024 and the 2024 Draft Budgetary Plan (DBP), on the Bank's latest projections.

With this Budget, Government reaffirmed its commitment to support economic growth and protect households and firms from high international commodity prices. Vulnerable and low-income persons also benefit from additional social measures. Although the Budget envisages lower deficits in each year in the medium term, it projects a slower pace of fiscal consolidation compared with previous government forecast exercises.

Budget 2024 measures

Inflation-mitigating support measures constitute the main form of measures included in the 2024 Budget. Apart from retaining the minimum level of excise duties on fuel imports allowed by EU law, these measures also include subsidies to retain fixed retail prices for electricity, fuel, and LPG gas. Other, smaller measures offer targeted support to farmers, fishermen and importers of wheat.

Newly-announced measures mainly reflect an increase in pensions and higher benefits for low-income beneficiaries, as well as more generous allowances to carers and parents with children. Government also extended the eligibility of the additional COLA mechanism previously offered to low-income households but now being made accessible to all those earning below median household equivalised income.

Existing measures supporting first time and second time property buyers, and purchases of vacant property or buildings in village cores will be renewed. A tax exemption scheme on employment income of pensioners, first introduced in 2022, will be extended. Tax refunds and other measures to address past anomalies will also be continued in 2024.

The Budget also refers to ongoing measures related to the facilitation of the green economy and digital transitions. These include schemes for installing renewable energy systems, installation of electric vehicle charging points, investment in green urban spaces and building renovations. Large-scale projects include new waste treatment facilities and investment in the storage of electricity in batteries. Many of these projects form part of the milestones listed in the Recovery and Resilience Plan, by means of which Government is eligible for grants from the EU's Recovery and Resilience Fund.

The Budget's Financial Estimates and the 2024 DBP also foresee support to Air Malta. As announced in a press conference in October, prior to its closure, the airline is set to finance legacy early retirement schemes to existing employees. In 2022 and 2023, the Airline also benefited from additional assistance by the Government. In 2024, a new airline will be set up, backed by a financial injection by the State. In line with the ESA methodology, this

¹ This box was prepared by John Farrugia, Manager within the Fiscal Affairs and Reports Office, and Kurt Sant, Senior Economist within the same office.

measure will not affect the level of the deficit but will instead be classified as part of general government debt.

As shown in Table 1, in marginal terms, the main budget measures are set to have a deficit-reducing impact. The impact is largest in 2023, at 1.9% of GDP, and mostly reflects the end of COVID-19 related support measures in 2022. The termination of such measures is set to boost government revenue by 0.4% of GDP whilst reducing expenditure by 1.0% of GDP. While some outlays on treatment and vaccinations were retained in 2023, their impact is very small.

The deficit-reducing impact of measures in 2024 amounts to around 0.3% of GDP. The impact of newly-announced measures, inclusive of COLA, is set to boost expenditure by around 0.5% of GDP. At the same time, Government expects outlays on inflation support measures to increase compared with 2023. However, the impact of these measures is expected to be offset by savings in expenditure made from the end of support measures to Air Malta, and higher revenue from improved efficiency and effectiveness of tax collection.

Table 1
IMPACT OF MAIN BUDGET MEASURES

(% of GDP)

	2023	2024
Revenue	0.42	0.18
Exemption of tax on employment income of pensioners	-0.03	-0.02
Schemes for property buyers in Malta & Gozo	0.03	0.07
Inflation support measures – minimum excise duty applicable on petroleum products	0.02	0.01
COVID measures – reduction in stamp duty and capital gains tax on property sales/purchases	0.41	0.00
Improved efficiency and effectiveness of tax collection	-0.01	0.12
Expenditure	-1.47	-0.10
Increase in pensions (including COLA)	0.27	0.31
Higher social benefits	0.07	0.22
Additional outlays on tax rebates to employees and schemes to address past anomalies	-0.01	-0.07
EUR1,000 grant to first-time buyers	0.02	0.01
Inflation support measures – commodity prices	-0.48	0.29
Inflation support measures – economic stimulus cheques; COLA mechanism for vulnerable persons	-0.27	0.02
COVID measures – support to employers and households and liquidity measures	-0.83	-0.01
COVID measures – health treatment, repatriation and safe reopening of schools	-0.18	-0.08
Support to Air Malta	-0.05	-0.79
Impact on balance⁽¹⁾	1.89	0.27

Sources: Budget Speeches; Draft Budget Plans; authors' estimate.

⁽¹⁾ A positive value indicates a lower deficit, and vice versa.

Revised Government targets

According to the 2024 DBP, the general government deficit-to-GDP ratio is set to decrease to 5.0% in 2023, from 5.7% in the previous year (see Table 2). It is then expected to decline to 4.5% in 2024, and to fall to 3.5% by 2026. Meanwhile, the debt ratio is set to increase from 52.3% of GDP in 2022 to just under 57.0% of GDP by 2026.

Compared with the targets set in last April's Stability Programme Update (SP), a slower pace of fiscal consolidation is expected throughout the projection horizon. As a result, the deficit is now expected to remain above 3.0% of GDP by 2026.

Apart from revisions to the profile in tax revenue, brought about by new macro projections, the latest forecasts embed faster growth in certain expenditure items. The DBP attributes some of the revisions to the introduction of new measures, the expected impact of new public sector collective agreements, and revisions to the expected cost of inflation support measures.

Compared with the SP targets, the projected growth in outlays on compensation of employees and social benefits is revised up in 2024 and 2025. On the other hand, growth in capital expenditure (investment and capital transfers) is mostly revised up in 2023 and 2026. Outlays on subsidies are set to decrease at a slower rate in 2023 and 2024, but to decline at faster rates thereafter. Meanwhile, outlays on intermediate consumption are projected to increase at a slower pace throughout the forecast horizon.

Owing to the higher deficits, the DBP envisages the debt-to-GDP ratio to increase at a faster pace from 2024 onwards. In contrast with the SP, the debt ratio is not expected to peak within the forecast horizon.

Table 2
GOVERNMENT REVENUE AND EXPENDITURE TARGETS
(% of GDP)

	Budget /Draft Budget Plan 2024					Stability Programme 2023 Update				
	2022	2023	2024	2025	2026	2022	2023	2024	2025	2026
General government balance	-5.7	-5.0	-4.5	-4.0	-3.5	-5.8	-5.0	-4.3	-3.6	-2.9
Revenue	34.2	35.0	34.0	33.5	33.3	35.1	35.7	34.2	34.0	33.7
Tax revenue	29.6	29.4	29.4	29.0	29.0	30.4	30.0	29.6	29.3	29.2
Other revenue	4.6	5.6	4.6	4.5	4.3	4.7	5.7	4.6	4.7	4.5
Expenditure	39.9	40.0	38.6	37.6	36.8	40.9	40.7	38.5	37.6	36.6
Compensation of employees	10.7	10.5	10.5	10.6	10.4	10.8	10.7	10.6	10.4	10.3
Intermediate consumption	7.8	8.1	7.7	7.4	7.2	8.1	8.5	8.2	8.0	7.8
Social payments	8.6	8.5	8.6	8.6	8.5	8.8	8.8	8.8	8.6	8.4
Interest payments	1.0	1.1	1.3	1.4	1.5	1.0	1.2	1.5	1.5	1.4
Subsidies	4.8	3.8	3.3	2.8	2.0	5.0	3.7	2.9	2.6	2.2
Gross fixed capital formation	3.4	4.5	3.8	4.2	4.7	3.3	3.8	3.1	3.1	3.2
Capital transfers	0.8	1.0	0.6	0.3	0.2	0.9	1.3	1.0	1.0	1.0
Other expenditure	2.8	2.5	2.8	2.3	2.3	3.0	2.7	2.4	2.4	2.3
General government debt	52.3	52.8	55.3	56.3	56.9	53.4	54.5	55.7	56.2	56.1

Sources: Budget Speech 2024; Draft Budget Plan 2024; Stability Programme Update 2023.

Impact on Bank's fiscal forecasts

Chart 1 decomposes the revisions in the Bank's deficit projection, compared with the August exercise. The impact of newly-announced and ongoing support measures is shown separately. The chart also shows revisions in the projected impact of underlying expenditure, such as wages, previously-enacted measures, and the profile of capital

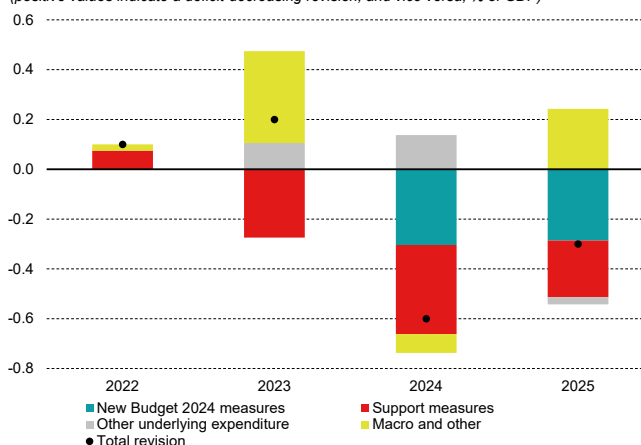
expenditure. Revisions in the macro outlook and its impact on the deficit ratio (including the impact of prices and the resulting COLA) are also displayed.

The Bank's forecasts do not take into account measures whose impact is currently unknown or hard to determine (for example, the impact of improved efficiency in tax collection).

Revisions to past data and in the recording of certain support measures led to a small improvement in the deficit ratio for 2022.

Overall, revisions to the impact of Budget and support measures are deficit-increasing throughout the forecast horizon. This impact is partly mitigated by a reassessment of the profile of underlying expenditure (particularly spending on capital transfers). The impact of macro revisions on the fiscal balance was deficit-reducing in 2023 and 2025 and marginally deficit-increasing in 2024.

Chart 1
REVISIONS COMPARED WITH THE PREVIOUS CBM FORECAST
(positive values indicate a deficit-decreasing revision, and vice versa; % of GDP)



Sources: Authors' estimate.

Risks

On balance, risks to economic activity are to the upside in 2023. This reflects the latest revisions to national accounts data for the first half of this year, and the outcome for the third quarter of 2023. This vintage is not included in the baseline and features much stronger economic activity than that incorporated in the current projections, with significant positive surprises for private consumption and net exports.

With regards to the rest of the projection horizon, risks are also tilted to the upside, though to a lesser extent. Indeed, the above-mentioned revisions to the national accounts data might imply a strong upward mechanical impact to annual GDP growth in 2024. Moreover, domestic demand might be stronger than anticipated especially if a faster normalisation of the saving ratio will lead to higher private consumption growth. On the other hand, the international economic environment may turn out to be weaker than anticipated, especially if financing conditions tighten more forcibly in response to the restrictive monetary policy than assumed in this projection round. Moreover, geopolitical risks could also lead to lower foreign demand.

Risks to inflation are slightly to the upside in 2024 but balanced in the rest of the projection horizon. Global inflationary pressures have started to ease considerably in recent months. However, international energy prices could rise more sharply than expected if geopolitical tensions escalate, which could have indirect effects on other commodities such as food. Furthermore, wage pressures could be stronger than envisaged in the baseline, which could delay the envisaged decline in inflation. Upside risks to inflation also stem from extreme weather events and geopolitical related disruptions to trade in key commodities. Some of these upside risks are gradually fading over the projection horizon. Other upside risks to headline inflation in the medium-term reflect the potential impact of Fit-for-55 measures. Moreover, a stronger pass-through from recent monetary tightening to financial and real economic conditions could ease inflationary pressures in the medium-term.

On the fiscal side, risks are on the upside (deficit-reducing) in 2023 due to the likelihood of stronger than expected growth in tax receipts. Risks are then set to tilt on the downside from 2024 (deficit-increasing). These mainly reflect the likelihood of higher-than-expected outlays on energy support measures, in the event that commodity prices are higher than envisaged. They also reflect the likelihood of additional increases in pensions and public wages. These risks are partly offset by the likelihood of a pick-up in the pace of fiscal consolidation in the outer years of the forecast horizon.