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EUROSISTEMA  
CENTRAL BANK OF MALTA

# ASSESSING THE FISCAL AND MACROECONOMIC IMPACT OF GOVERNMENT SUPPORT MEASURES FOLLOWING THE US–IRAN CONFLICT

## BOX 1: ASSESSING THE FISCAL AND MACROECONOMIC IMPACT OF GOVERNMENT SUPPORT MEASURES FOLLOWING THE US–IRAN CONFLICT<sup>1</sup>

### Introduction

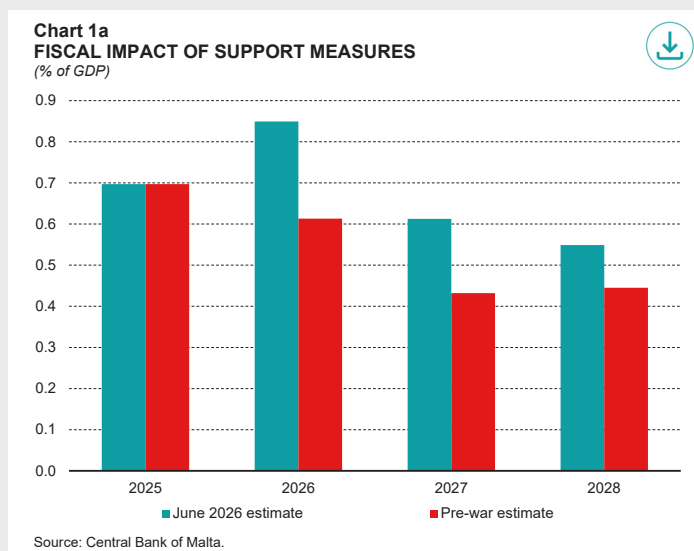
The escalation of geopolitical tensions between the United States and Iran has led to renewed pressures in international energy markets, resulting in higher oil, gas and wholesale electricity prices. Given Malta's policy of shielding households and firms from fluctuations in international energy prices 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



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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 subsidies 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).<sup>2</sup> 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.

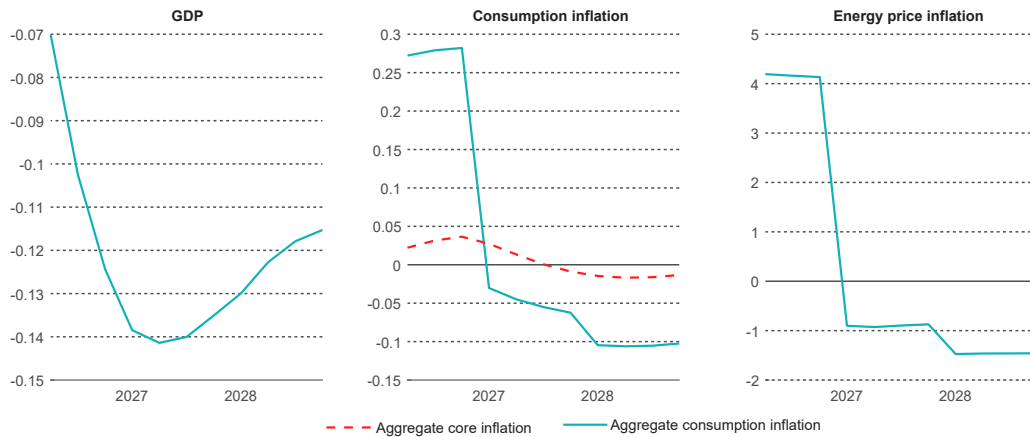
The simulation design rests on the estimated government outlays, normalised as percent of GDP, that are meant to cover for the increase in energy prices brought about by the Iran war under the baseline projection scenario. In this respect, the model is run with its energy price subsidy system turned 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

<sup>2</sup> 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.