IMF Country Report No. 21/211

MALTA

September 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALTA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with Malta, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 15, 2021, consideration of the staff report that concluded the Article IV consultation with Malta.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 15, 2021, following discussions that ended on July 20, 2021, with the officials of Malta on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 25, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Malta.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2021 Article IV Consultation with Malta

FOR IMMEDIATE RELEASE

Washington, DC – September 17, 2021: On September 15, 2021, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Malta.

The COVID-19 pandemic has hit the Maltese economy hard. Tourist arrivals fell sharply, and contact-intensive services were severely affected due to domestic mobility restrictions. As a result, real GDP contracted by 7¾ percent in 2020, the worst recession in decades. Nonetheless, the authorities' swift and bold policy response helped mitigate the impact, preventing large-scale layoffs, bankruptcies, and credit disintermediation.

As vaccination proceeds and containment measures ease, economic activity is strengthening. Consumer and business confidence have recovered to pre-COVID-19 levels, and signs of labor markets tightening are emerging. Staff expect the economy to grow by around 5¾ percent in 2021 and 6 percent in 2022, assuming further progress in global vaccination, an unleashing of pent-up demand for contact-intensive services, and a gradual recovery in international tourist arrivals. Uncertainty is still very high, with risks to the outlook tilted to the downside, including from a global resurgence of the COVID-19 pandemic and a prolonged placement in the Financial Action Task Force (FATF) grey-list. On the upside, recovery from the pandemic could be faster than expected due to swift global vaccination boosting confidence and economic activity.

Executive Board Assessment[2]

Executive Directors commended the authorities for the swift and bold response to the COVID-19 pandemic. Directors noted that growth is expected to gain momentum in the coming months, although uncertainty remains high and downside risks cloud the outlook. They concurred that targeted, coordinated policy support should continue until the recovery firmly takes hold, balancing near-term growth with long-term stability while pursuing structural reforms to strengthen the economy's resilience.

Directors agreed that the pace of unwinding fiscal support should be managed carefully and flexibly. Once the recovery is fully entrenched, efforts should focus on rebuilding buffers gradually and fostering infrastructure investment and economic transformation. Directors encouraged strengthening tax administration, managing contingent liabilities, and ensuring pension system sustainability. They recommended a holistic review of the overall tax system, taking into consideration the global minimum corporate tax proposal. They noted that the

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

planned review of the infrastructure investment and management framework is critical to boosting Malta's capacity to absorb EU funds.

Directors noted that the banking system has proved resilient, but stressed the importance of safeguarding financial stability. They encouraged the authorities to closely monitor banks' financial positions and risk management, continuously analyze vulnerabilities from the corporate and real estate sectors, and enhance data collection.

While noting recent progress in strengthening the AML/CFT framework, Directors called for urgent action to address the remaining deficiencies in the AML/CFT framework and exit the FATF's grey list. They recommended prioritizing the areas of transparency on beneficial ownership information and financial intelligence related to money laundering and tax evasion. Directors also advised the authorities to continuously assess high-risk activities and their impact on correspondent banking relationships.

Directors underscored the importance of advancing structural reforms to foster higher and sustainable growth. They encouraged the authorities to further advance labor market reforms and leverage active labor market policies to facilitate resource reallocation. Completing the corporate insolvency framework reform remains an important priority. Further efforts are also needed to promote stronger and more sustainable tourism, and support digital transformation and decarbonization. Directors welcomed the authorities' commitment to reducing greenhouse gas emissions in line with EU targets.

Malta: Selected Economic Indicators, 2017–2022

(Year-on-year percent change, unless otherwise indicated)

					Projections	
	2017	2018	2019	2020	2021	2022
Real economy (constant prices)			(Percent change year on year)			
Real GDP	8.6	5.2	5.5	-7.8	5.7	6.0
Domestic demand	2.0	8.0	7.4	-2.5	5.3	3.2
CPI (harmonized, average)	1.3	1.7	1.5	0.8	0.7	1.8
Unemployment rate (percent)	4.0	3.7	3.6	4.3	3.6	3.5
Public finance			(General government, percent of GDP)			
Overall balance	3.2	1.9	0.4	-10.2	-11.8	-6.5
Primary balance	5.0	3.4	1.7	-8.9	-10.4	-5.2
Structural balance 1/	3.2	1.2	0.1	-7.3	-9.4	-5.3
Gross debt	48.5	44.8	42.0	54.8	64.6	66.9
Financial sector			(Percent change year on year)			
Credit to nonfinancial private sector 2/	3.5	6.7	7.4	6.6	...	...
Credit to the private sector (percent GDP)	76.5	76.1	75.4	86.0	...	...
Interest rates (year average)			(Percent)			
Interest rate for mortgage purposes	3.1	3.1	3.0	3.0	...	...
Ten-year government bond yield	1.3	1.4	0.7	0.5	...	...
Balance of payments			(Percent of GDP)			
Current account balance	5.7	6.3	5.7	-3.6	-2.5	-0.3
Trade balance (goods and services)	17.5	15.6	15.2	7.6	7.8	10.0
Exchange rate						
Exchange rate regime	Joined EMU on January 1, 2008.					
Nominal effective rate (2010=100)	99.8	101.9	100.7	101.8	...	...
Real effective rate, CPI-based (2010=100)	99.6	101.4	100.2	101.3	...	...

Sources: National Statistical Office of Malta; Central Bank of Malta; European Central Bank; Eurostat; European Commission; and IMF staff calculations.

1/ As a percentage of Nominal Potential GDP.

2/ Loans to nonfinancial corporate sector and household/individuals.

INTERNATIONAL MONETARY FUND

MALTA

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

August 25, 2021

KEY ISSUES

Context. The fallout from the COVID-19 crisis has hit the Maltese economy hard, particularly its large tourism sector. Using fiscal buffers accumulated prior to the pandemic, the authorities have taken swift actions to support households, businesses, and the healthcare system. With the rapid rollout of COVID-19 vaccine, the economy has reopened for the summer tourism season. While the outlook is surrounded by a high degree of uncertainty, the Maltese economy is expected to rebound by 5¾ percent this year, up from -7¾ percent in 2020. The financial system has remained stable. In late June 2021, the Financial Action Task Force (FATF) put Malta under increased monitoring due to concerns about effectiveness of its anti-money laundering and combatting the financing of terrorism (AML/CFT) framework.

Policy recommendations. Continue to support the economic recovery while gradually unwinding COVID-19 crisis measures and shifting to policies targeted at facilitating resource reallocation to productive and high-growth potential activities. Other key challenges include addressing deficiencies in the AML/CFT framework and pursuing structural reforms to strengthen the economy's resilience and sustainability.

- **Fiscal policy.** Maintain an expansionary stance in the near term. As the economy opens more widely, fiscal measures should become more targeted to support investments and economic transformation. Once the recovery is on firm ground, fiscal buffers should be gradually rebuilt. Strengthen public investment management and address long-standing fiscal vulnerabilities arising from relatively low tax revenues, increased contingent liabilities, and long-term pension sustainability.

- **Financial sector.** Remain vigilant in monitoring risks, in particular to ensure that banks update the assessment of expected losses as economic prospects evolve and provision accordingly. Mitigate financial integrity risks by enhancing the effectiveness of AML/CFT and governance frameworks.

- **Structural reforms.** Reinvigorate structural reforms to boost productivity and make the economy more competitive and resilient. Address the skills gap in the workforce, reform the corporate sector insolvency framework, further promote digitalization, and advance decarbonization. Maintain the momentum of governance reforms to sustain foreign investment.

Approved By
Mahmood Pradhan (EUR) and Geremia Palomba (SPR)

Mission team: The team comprised Kotaro Ishi (head), Chikako Baba, William Oman, Michelle Tejada, Yifei Wang (all EUR), and Francisca Fernando (LEG). Jenny Lee (EUR) provided research assistance, and Dilcia Noren (EUR) provided administrative assistance. Mahmood Pradhan participated in the concluding meeting. Annalisa Korinthios (Advisor to the Executive Director) participated in the discussions, and Domenico Fanizza (Executive Director) attended the concluding meeting.

The team met with Central Bank of Malta Governor Scicluna, Central Bank Deputy Governors Bonello and Demarco, Finance Minister Caruana, Permanent Secretary Camilleri, Malta Financial Services Authority Chairman Mamo, and other senior officials, representatives of labor and business organizations, and financial institutions.

Virtual mission dates: July 7–20, 2021.

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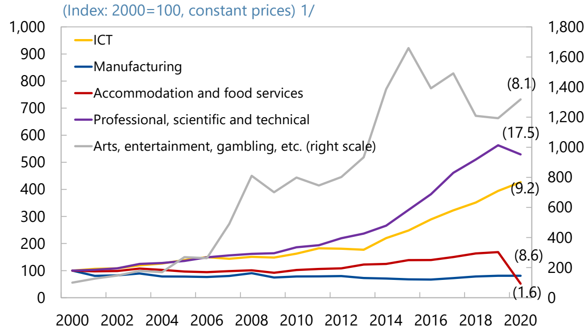
CONTEXT

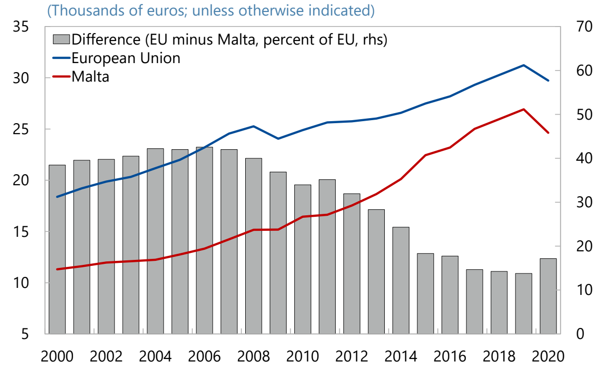
1. Malta entered the pandemic crisis on a relatively firm economic footing. Malta's economy boomed in the years prior to the pandemic, with GDP growth averaging 6¾ percent in 2014–2019, significantly higher than the EU average of 2 percent. The authorities pursued a pro-growth strategy, including labor market and power sector reforms and digitalization. The service sector, in particular information and communications technology (ICT), professional and scientific activities, and remote gaming, thrived as key growth engines. Malta's per capita income grew faster than the EU average, halving the income gap from 40 percent a decade ago to 14 percent in 2019. Progress in advancing the structural reform agenda has been mixed, but Malta's policy direction has been broadly in line with past staff recommendations (Annex I).

Gross Value Added
(Index: 2000=100, constant prices) 1/



1/ Nominal values are deflated by GDP deflator. Parentheses indicate the percentage share of total gross value added.
Sources: Eurostat, Haver Analytics, and IMF staff calculations.

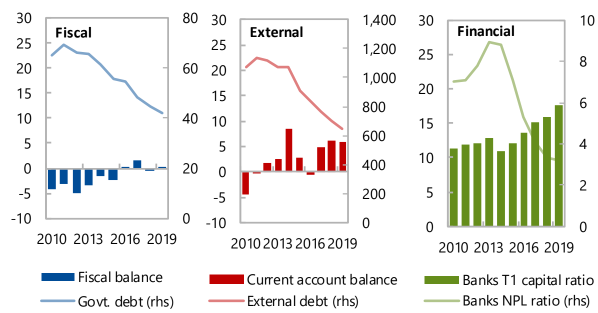
GDP Per Capita
(Thousands of euros; unless otherwise indicated)



Sources: Eurostat, Haver Analytics, and IMF staff calculations.

2. Sizable macro-financial buffers were built after the global financial crisis (GFC). Public debt fell from over 65 percent of GDP in the early 2010s to 42 percent of GDP in 2019, while external debt nearly halved, supported by broadly sustained current account surpluses. Banks' balance sheets were also strengthened, with higher capital ratios and lower nonperforming loan (NPL) ratios.

Fiscal, External, and Financial indicators
(Percent of GDP; unless otherwise indicated)



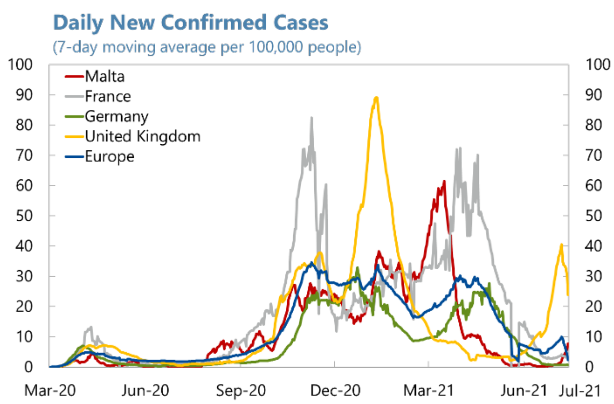
Sources: National Statistics of Malta, Haver Analytics, and IMF staff calculations.

3. On June 25, 2021, the Financial Action Task Force (FATF) put Malta under increased monitoring ("grey-list"). The FATF acknowledged that since the adoption of the July 2019 Moneyval assessment report, the authorities had made progress in addressing deficiencies in the AML/CFT framework. It, however, put Malta under increased monitoring due to remaining concerns over some aspects of the effectiveness of Malta's AML/CFT framework, especially in the areas of transparency on beneficial ownership information and financial intelligence related to money laundering and tax evasion.[1]

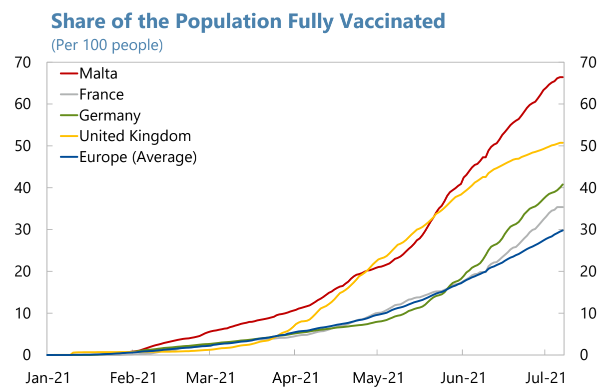
[1] Moneyval—the Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism—is the FATF's regional body in Europe.

COVID-19 IMPACT AND POLICY RESPONSE

4. COVID-19 surged in several waves (Figure 1). At the onset of the pandemic in Spring 2020, strict containment measures helped control the initial outbreak. In Summer 2020, the authorities relaxed containment measures and reopened the borders. COVID-19 cases started picking up and surged after the new year holiday season. The authorities significantly tightened containment measures in early March 2021 and accelerated the rollout of vaccination. By late April, daily COVID cases had dropped to a low single-digits, and the authorities began easing containment measures. They also relaxed entry conditions for tourists on June 1. Increased tourism arrivals, however, led to a rise in COVID cases, and the authorities tightened entry requirements for unvaccinated tourists in mid-July. At end-July, nearly 70 percent of the population were fully immunized.



Sources: Bloomberg Finance L.P., IMF World Economic Outlook, and IMF staff calculations.



Sources: Bloomberg Finance L.P., OWID, IMF World Economic Outlook, and IMF staff calculations.

5. The COVID-19 pandemic hit the Maltese economy hard, interrupting strong post-GFC growth (Figures 2–3). The tourism sector, representing almost 16 percent of the economy, collapsed—tourist arrivals fell sharply to around 25 percent of pre-pandemic levels in 2020. Domestic economic activities also slumped, as restrictions on movement and activities, as well as weak consumer and business sentiment, dampened private consumption and investment. Some sectors, such as remote gaming and ICT, continued to grow strongly, but not enough to offset the losses in contact-intensive sectors. As a result, the economy entered a deep recession, with real GDP contracting by 7¾ percent in 2020 (Table 1). With weak demand, inflation decelerated from 1½ percent before the pandemic to near zero at end-2020.

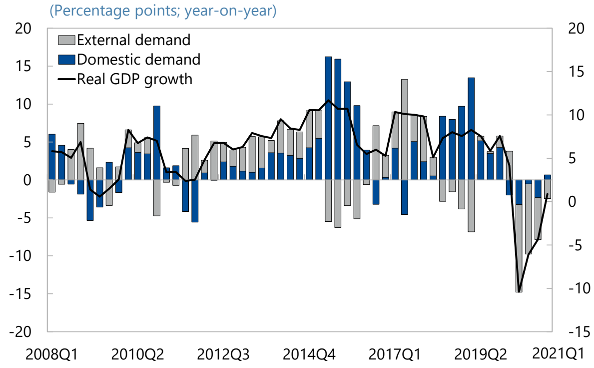
Size of the Tourism Sector
(2019)

	Malta	EU average
Tourism arrivals ('000)	2,023	37,259
Percent of population	409.9	225.3
Tourism sector		
Total travel exports (% GDP)	12.5	2.7
Employment (% total)	21.3	11.6
GDP Contribution (% total)	15.9	9.9

Sources: Eurostat, World Travel and Tourism Council, Haver Analytics, and IMF staff calculations.

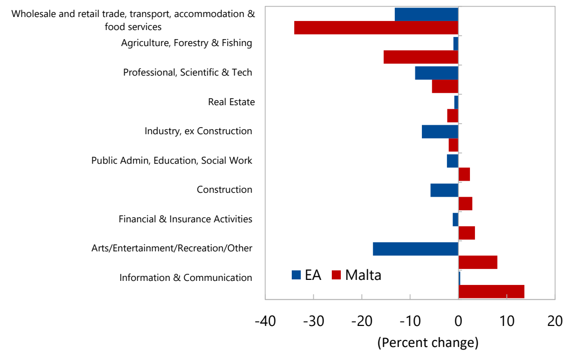
Contributions to GDP Growth

(Percentage points; year-on-year)



Sources: Haver Analytics and IMF staff calculations.

2020 Growth in Value Added by Sector



Sources: Eurostat, Haver Analytics, and IMF staff calculations.

6. **More recently, economic activity has been strengthening.** Output grew by 1.9 percent (q/q) in Q1 2021, driven by remote gaming, ICT, public administration, and wholesale and retail trade activities. Consumer and business confidence indicators have recovered to pre-COVID-19 levels.

7. **The authorities' fiscal response to mitigate the fallout from the COVID-19 crisis was swift and decisive** (Annex II). Sizable fiscal measures were announced in March 2020 to support firms and households through the wage supplement scheme, the tax deferral scheme, financial assistance to businesses, and social measures. Additional measures were subsequently announced in June and October 2020 to lower business costs and stimulate domestic demand. Altogether, COVID-19 related measures amounted to 5.1 percent of GDP in 2020, more than half of which were spent on the wage supplement scheme. As a result, the fiscal balance deteriorated from a surplus of 0.4 percent of GDP in 2019 to a deficit of 10.2 percent of GDP in 2020 (Figure 4 and Table 2). Public debt rose sharply, from 42 percent of GDP in 2019 to 55 percent of GDP in 2020.

Fiscal Support

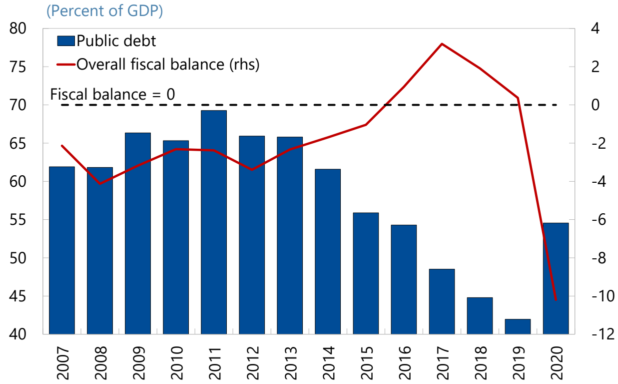
(In percent of GDP)

	2020	2021	2022
Above the line measures 1/ 2/			
Wage supplement scheme	2.9	2.1	0.0
Short-term social measures	0.1	0.0	0.0
Grant to business	0.0	1.3	1.0
Medical supplies	0.6	0.4	0.0
Other spending	0.9	0.3	0.0
Revenue measures	0.5	0.4	0.0
Total	**5.1**	**4.5**	**1.0**
Financial support			
Tax deferrals	1.6		
Government guarantees 3/	2.3		
Total fiscal support	**14.4**		

Sources: Ministry of Finance and IMF staff estimates.
1/ Implemented for 2020, and approved for 2021 and 2022.
2/ Excludes commitment for infrastructure spending of no less than €400 million over 8 years.
3/ Disbursed amount. Guarantee Fund of €350 million (2.7%GDP) was allocated for loans up to €780 million (6.1%GDP).

Public Debt and Fiscal Balance

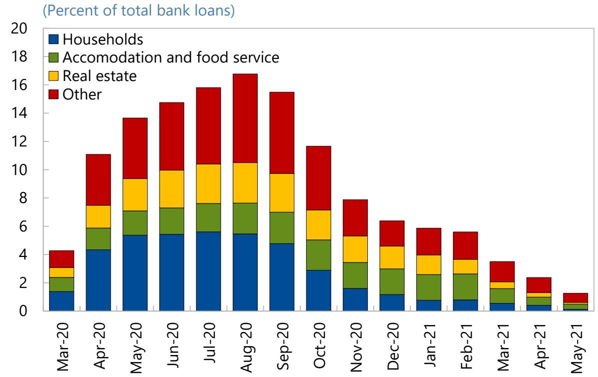
(Percent of GDP)



Sources: Haver Analytics and IMF staff projections.

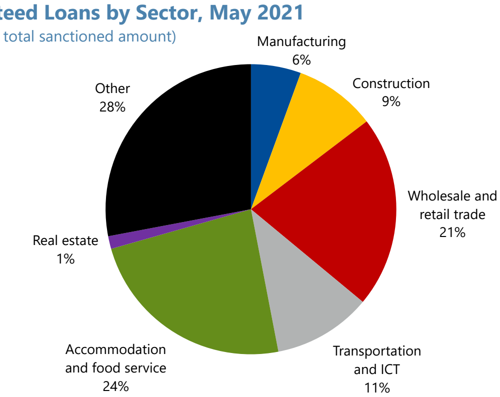
8. The authorities also introduced several financial sector measures to support liquidity and credit flows. These include: (i) loan moratoria on repayments on capital and interest; (ii) a loan guarantee scheme through the Malta Development Bank; (iii) interest subsidies; (iv) restrictions on dividend distribution; and (v) real estate support measures. The take-up of the loan moratoria had dropped to 1¼ percent of total loans (equivalent to 1 percent of GDP) by May 2021, from a peak of 17 percent in August 2020, as liquidity needs abated. By May 2021, the guarantee scheme had approved €451 million (3¼ percent of GDP) of new working capital loans, a quarter of which were granted to the accommodation and foodservice sector.

Loans Subject to Moratoria
(Percent of total bank loans)



Sources: Central Bank of Malta, Haver Analytics, and IMF staff calculations.

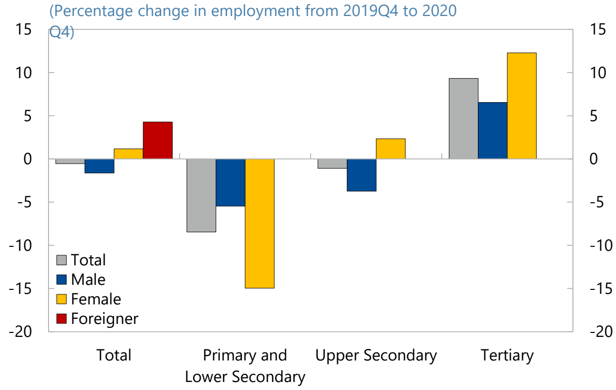
Guaranteed Loans by Sector, May 2021
(Percent of total sanctioned amount)



Sources: Central Bank of Malta and IMF staff calculations.

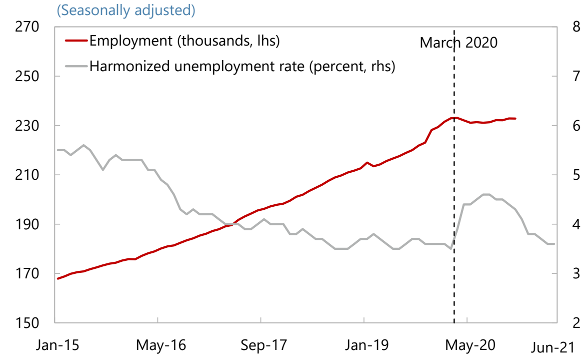
9. Labor markets have proved resilient to the pandemic shock. Employment dropped, and unemployment rose immediately after the COVID-19 outbreak. Following the relaxation of containment measures, however, employment resumed growing with strong job creation among females and highly educated workers. Unemployment also fell to around 3½ percent by June 2021. The generous wage supplement scheme contributed to preventing large-scale layoffs. With the reopening of the tourism sector, signs of labor markets tightening have emerged, partly reflecting reduced inflows of foreign workers.

Growth in Employment
(Percentage change in employment from 2019Q4 to 2020 Q4)



Sources: Eurostat and IMF staff calculations.

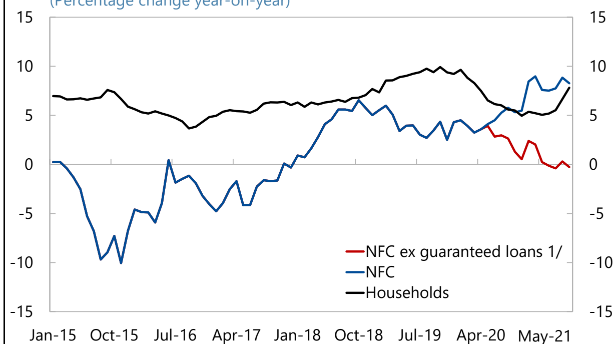
Employment and Unemployment
(Seasonally adjusted)



Sources: Statisitcal Offices of European Communities and Haver Analytics.

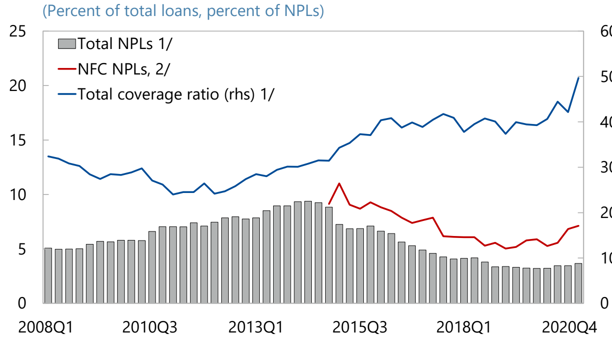
10. Banks have so far remained resilient. Core domestic banks maintained their capital and liquidity ratios well above the regulatory requirements (Figure 5 and Table 3), in part supported by the temporary restriction on dividend payouts and interest subsidies. Bank credit continued to grow (8 percent y/y in May 2021), reinforced by the loan guarantee scheme—if guaranteed loans are excluded, corporate credit remained flat. Corporate NPLs rose only modestly, by 1¼ percentage points to 7 percent in 2020, while mortgage NPLs remain low at 3½ percent. Provisioning needs pose challenges to banks that have been struggling with eroding profitability in the low-interest environment. The authorities have strengthened their capacity for risk analysis and supervision along the lines recommended by the 2019 FSAP (Annex III).

Bank Credit Growth
(Percentage change year-on-year)



1/ Loans to resident NFCs by all banks.
Sources: Haver Analytics, Central Bank of Malta and IMF staff calculations.

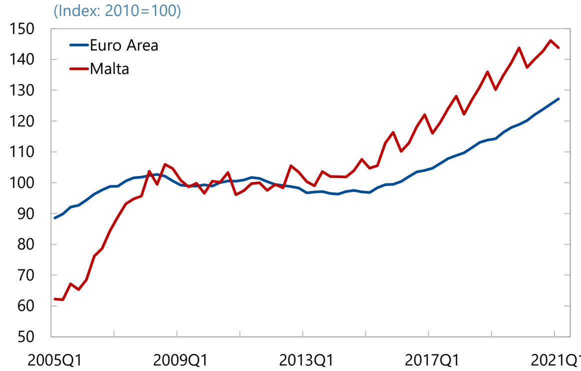
Non-Performing Loans and Coverage Ratio
(Percent of total loans, percent of NPLs)



Source: Central Bank of Malta and ECB.
1/ Core domestic banks.
2/ All banks. The reporting framework is FINREP since 2014Q4.

11. The housing market has moderated. After several years of rapid growth, house price growth slowed to 3½ percent in 2020, reflecting a mix of opposing factors. Downward pressures come from lower household income growth and weaker prospects for tourism rentals, whereas the low-interest rate environment and the reduction of the property tax rate and stamp duty helped sustain property demand.

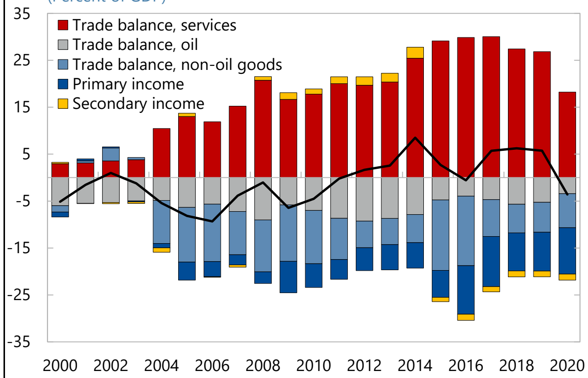
House Prices
(Index: 2010=100)



Sources: Eurostat, Haver Analytics, and IMF staff calculations.
Note: House prices refer to transaction prices and are non-seasonally adjusted.

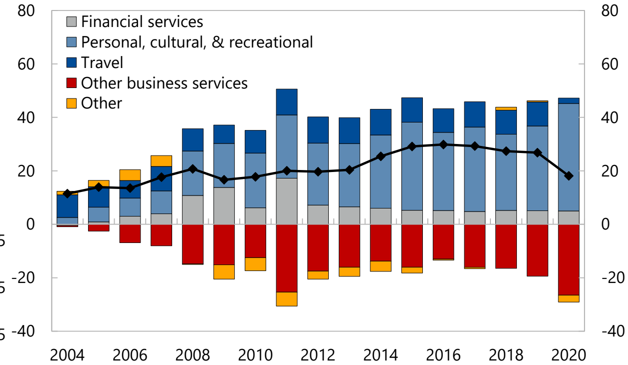
12. The current account deteriorated sharply (Figure 6 and Table 4). The current account balance turned into a deficit of 3½ percent of GDP in 2020, down from a surplus of 5¾ percent in 2019. The sharp deterioration in the current account balance was driven mostly by a large fall in net travel receipts, and to a lesser extent a decrease in investment income inflows, partially offset by reduced goods imports. While the capital account was broadly unchanged at ½ percent of GDP in 2020, the financial account recorded a net borrowing position (2½ percent of GDP) for the first time in seven years. The External Balance Assessment suggests that Malta's external position was weaker than medium-term fundamentals in 2020 (see Annex IV).

Current Account Components
(Percent of GDP)



Sources: IMF BOP Statistics and IMF staff calculations.

Services Trade Balance by Sector
(Percent of GDP)

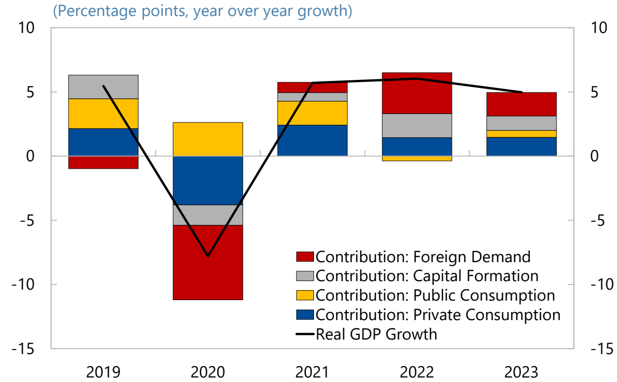


Sources: IMF BOP Statistics and IMF staff calculations

OUTLOOK AND RISKS

13. Growth is expected to gain momentum during the second half of 2021 and into 2022. Staff's baseline scenario assumes further progress in global vaccination and an unleashing of pent-up demand for contact-intensive services. International tourist arrivals are assumed to recover only gradually, given lingering virus fears, taking a couple of years to return to their 2019 level. Meanwhile, digital intensive sectors, including remote gaming and ICT sectors, will continue to drive growth. Staff expect growth to recover from -7¾ percent in 2020 to 5¾ percent in 2021 and further to 6 percent in 2022.[2] Although GDP is projected to reach its 2019 level by the end of 2022, a large negative output gap remains (-2½ percent of GDP in 2022), with inflationary pressures largely muted.

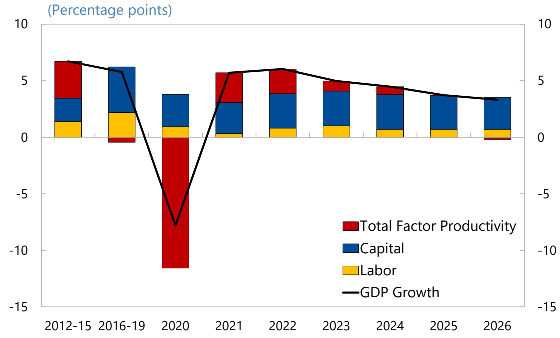
GDP and Contributions
(Percentage points, year over year growth)



Source: IMF staff calculations.

14. Over the medium term, growth will gradually moderate to a sustainable pace. Growth is projected to gradually decelerate to its potential rate of 3¼ percent by 2026, as growth in Malta's trading partners moderates and productivity growth slows to its pre-pandemic average over time (after a strong rebound in 2021–2022). Furthermore, the growth of Malta's working-age population is expected to moderate, contributing to the decline in potential growth. Because the growth trajectory is projected to fall

GDP Growth Decomposition
(Percentage points)



Sources: WEO and IMF staff calculations.

[2] See Selected Issues Paper Chapter 1.

short of pre-crisis trends, the pandemic crisis will potentially leave a permanent loss of 4½ percent of GDP in 2026 (the end of staff's forecast horizon).

15. Risks to the outlook are tilted to the downside (Annex V).

- The primary downside risk is a global resurgence of the pandemic, possibly due to the vaccine-resistant variants. This could require costly containment efforts and prompt persistent behavioral changes, rendering many activities unviable and impeding the recovery of export demand (in particular, tourism). Furthermore, a rise in US yields could lead to an increase in global risk premia, putting strains on financial institutions, leveraged firms, and vulnerable households. Cyber-attacks also remain a risk.

- Owning to the unprecedented policy response, damage to labor markets and capital formation has thus far been relatively limited. Still, the extent of long-term scarring to the economy is highly uncertain (Annex VI). COVID-related support measures mask the full impact of the crisis on corporate balance sheets. Possible scarring in the tourism sector is of concern, as the pandemic crisis could affect the pattern of tourism demand. In addition, should travel restrictions be in place for an extended period, businesses could face critical labor shortages due to reduced inflows of foreign workers.

- Malta is also subject to risks stemming from its own vulnerabilities. A prolonged placement in the FATF grey-list could adversely affect correspondent banking relationships (CBR) and foreign direct investment (FDI) inflows. Changes in global corporate taxation could also adversely affect Malta's attractiveness as a financial and business location, reducing FDI inflows and fiscal revenues.

- On the upside, recovery from the pandemic could be faster than expected due to the swift global vaccination boosting confidence and economic activity.

POLICY DISCUSSIONS: SUPPORTING STRONG AND SUSTAINABLE RECOVERY AND STRENGTHENING POTENTIAL GROWTH

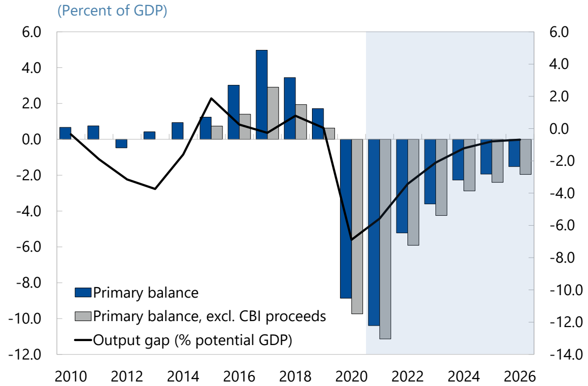
Key challenges are to gradually unwind pandemic-related support measures and shift to policies targeted at facilitating resource reallocation to productive and high-growth potential activities. Other key challenges include addressing deficiencies in the AML/CFT framework and pursuing structural reforms to strengthen the economy's resilience and sustainability.

A. Shifting Policies to Support Strong Recovery

16. Both fiscal and financial policies should remain flexible and coordinated. Most of the COVID-19 related support measures are set to expire by the end of 2021. Given a high degree of uncertainty, however, unwinding of the support measures will need to be carefully managed and well-coordinated between fiscal and financial sector policies to avoid "cliff effects" that could derail the recovery. If health risks reemerge and the recovery falters, some measures may need to be extended, refocusing on sectors and people that are still significantly affected by the pandemic.

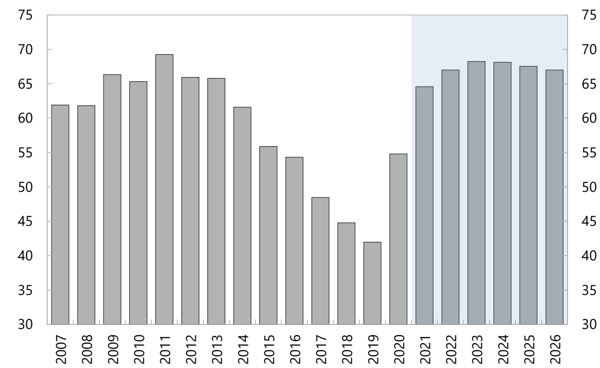
17. Fiscal policy remains appropriately expansionary in the near term. The primary deficit is expected to further widen from 9 percent of GDP in 2020 to 10½ percent of GDP in 2021, with public debt projected to rise to 65 percent of GDP. The authorities maintain COVID-related temporary fiscal measures sizable at 4½ percent of GDP in 2021. These include various incentives and subsidies to support labor markets, real estate markets, and businesses, and the planned financial aid to the national airline, Air Malta. In addition, large public investment continues, rising from 4½ percent of GDP in 2020 to 5 percent of GDP in 2021.

Primary Balance and Output Gap
(Percent of GDP)



Source: IMF staff calculations.

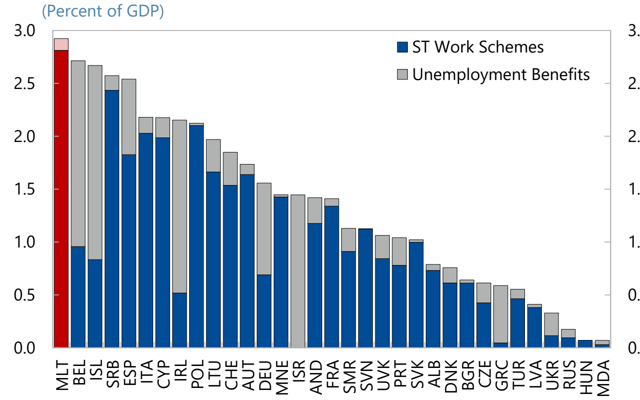
Public Debt
(Percent of GDP)



Sources: Haver Analytics and IMF staff projections.

18. As the economic outlook remains highly uncertain, fiscal support should continue and be only gradually reduced as the recovery takes hold. Malta's employment support measures are costly compared to similar measures in other EU countries. In August 2021, the authorities started tapering the wage supplement scheme by adjusting its size, while maintaining support for hardest-hit firms in full through the end of 2021. Given signs of labor market tightening and an economic recovery, this is a step in the right direction. The tax deferral scheme could also expire at end-2021, as planned. If downside risks materialize, however, the authorities should consider continuing to provide support to contact intensive sectors beyond year end. The use of existing active labor market policies (e.g., employment support schemes) would help facilitate labor reallocation to expanding sectors and firms, but labor market reforms should be further advanced, focusing on upskilling and reskilling workers (see ¶31 for further discussion). To protect the vulnerable, the authorities are currently reviewing the social protection scheme, with a view to improving the coverage of social safety nets in a cost-effective way by enhancing means testing and increasing the progressivity of net transfers.

COVID-19 Employment Measures, 2020
(Percent of GDP)

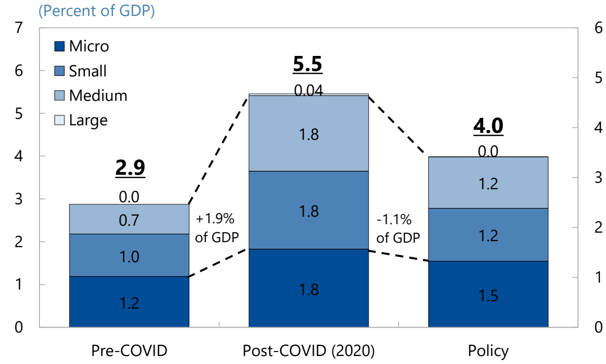


Sources: 2021 Spring REO, IMF World Economic Outlook, and IMF staff calculations.

19. The exit from financial sector support will also be gradual. New applications for guaranteed loans will be closed at end-September 2021, and the loan moratorium scheme will end by end-2021. The authorities have recently modified the guaranteed loan scheme to cover new loans to service debt payments, with the aim of mitigating the potential cliff-effect of ending the loan moratorium scheme. The maturity of the guaranteed loans averaged about 5½ years at origin, and thus their runoff will proceed gradually.

20. The pandemic's impact on the corporate sector should continue to be carefully monitored. While support measures have prevented large-scale bankruptcies, the pandemic may have caused lasting damage to firms' equity positions, which could undermine their capacity to invest and take risks for a strong post-pandemic recovery. It is important to assess the extent of the deterioration of corporate sector balance sheets and consider whether additional measures to support firms are needed, including investment tax credits, subsidized loans, as well as solvency support to viable small and medium-sized enterprises. Public support should be provided transparently, consistent with overall policy goals, and time-bound with a clear exit strategy to minimize fiscal risks. The authorities should also continue to partner with commercial banks to exploit their expertise in assessing business viability and prospects.[3]

Estimates of Equity Gap by Firms' Size
(Percent of GDP)



Sources: Orbis and IMF staff calculations.
Note: Excluding Air Malta and outliers.

B. Ensuring Long-Term Fiscal Sustainability

21. Once the recovery is on firm ground, fiscal buffers should be rebuilt. Under the baseline scenario that assumes the expiration of most of the COVID-related fiscal measures by the end of 2021 and the rationalization of spending, staff expect the primary deficit to narrow to 5¼ percent of GDP in 2022 and further to 1½ percent of GDP by 2026. Public debt is projected to peak in 2023 at 68 percent of GDP and thereafter start falling. Excluding proceeds from the citizenship program, the structural deficit is expected to be reduced from 10 percent in 2021 to 3¼ percent of potential GDP by 2026. The authorities remain committed to returning eventually to a structural fiscal balance and reducing the debt-to-GDP ratio to below 60 percent and plan to conduct a comprehensive review of COVID-19 related spending once the pandemic ends. Staff's debt sustainability analysis suggests that Malta's medium-term debt trajectory is resilient to most standard adverse macroeconomic shocks (Appendix I).

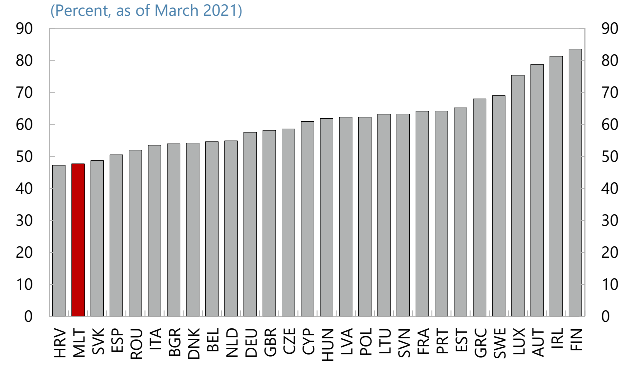
[3] See Selected Issues Paper Chapter 2.

Malta: Fiscal Estimates and Projections (Percent of GDP)								
			Staff Projections					
	2019	2020	2021	2022	2023	2024	2025	2026
Revenue	37.2	36.8	36.6	36.2	35.9	35.7	35.6	35.6
Expenditure	36.8	47.0	48.4	42.7	40.7	39.2	38.7	38.3
Overall balance	0.4	-10.2	-11.8	-6.5	-4.8	-3.5	-3.2	-2.8
Primary balance	1.7	-8.9	-10.4	-5.2	-3.6	-2.3	-1.9	-1.5
Structural balance	0.1	-7.3	-9.4	-5.3	-4.2	-3.3	-3.1	-2.8
Structural balance, excl. CBI proceeds	-1.0	-8.1	-10.1	-5.9	-4.9	-3.9	-3.6	-3.2
Public debt	42.0	54.8	64.6	66.9	68.1	67.9	67.3	66.7

Source: IMF staff calculations.

22. Efficient management of public investment will remain the priority. Malta doubled public investment to 4½ of GDP in 2020 during the past decade. Due to the rapid population growth, however, Malta's public infrastructure continues to face strains—in particular, air and road, and water and electricity supply—, and the authorities envisage a high level of public investment (at around 4–4½ percent of GDP) over the medium term. The authorities, however, face a challenge in boosting their capacity to absorb EU funds. To ensure efficiency in public investment delivery, it is important to regularly update a pipeline of well-defined infrastructure projects, with guidelines adopted for project appraisal and selection as recommended by the 2018 Fiscal Transparency Evaluation. The authorities are planning to launch a review of the infrastructure investment and management framework by leveraging the IMF's Public Investment Management Assessment framework.

EU Funds Absorption
(Percent, as of March 2021)



Sources: European Commission and IMF staff calculations.
Note: European Structural and Investment Funds 2014-2020.

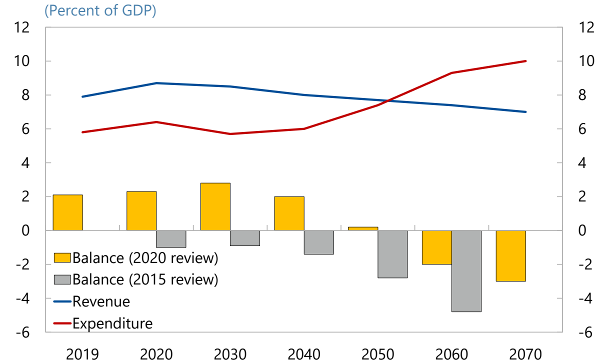
23. Long-standing fiscal vulnerabilities need to be tackled to ensure fiscal sustainability.

- **Strengthen tax revenue.** Risks to fiscal revenues include collecting COVID-related deferred taxes (amounting to about 1½ percent of GDP in 2020), relatively low tax revenues, and high reliance on corporate income tax. Tax revenues could face headwinds from the proposed global minimum corporate tax, while the impact depends on detailed calibration that is yet to be agreed. In light of a growing global consensus on tax reform, the authorities should consider launching a holistic review of the overall tax system to improve the efficiency of the tax system, minimize distortions and administration and compliance costs while generating sufficient revenues to cover government spending. Furthermore, building on their past efforts, the authorities need to further strengthen tax administration by identifying loopholes, exploiting digitalization, and completing the institutional reorganization.

- **Manage risks from contingent liabilities.** The size of contingent liabilities increased by two percentage points of GDP, reflecting government loan guarantees and support to financially weak state-owned enterprises (SOEs). Part of the contingent liability risk would materialize with the capital injection to Air Malta. To help improve the accountability and governance of SOEs, the authorities started disclosing financial statements of SOEs in 2020. Building on this progress, strategies to strengthen the financial footing of SOEs need to be developed.

- **Continue pension reform.** The 2020 pension review found improvements in pension adequacy and its long-term balance, in part reflecting a rise in contributions from female labor and migrants and delayed retirements. However, a sharp rise in age-related spending is projected from 2040, and the pension system will turn to deficits by 2050. Promoting voluntary occupational pensions and personal pensions and increasing the effective retirement age will help improve the long-run sustainability of the pension system. The authorities are also encouraged to complete public consultation on pension reforms and explore various reform options.[4]

Pension System: Projected Budget Impact
(Percent of GDP)



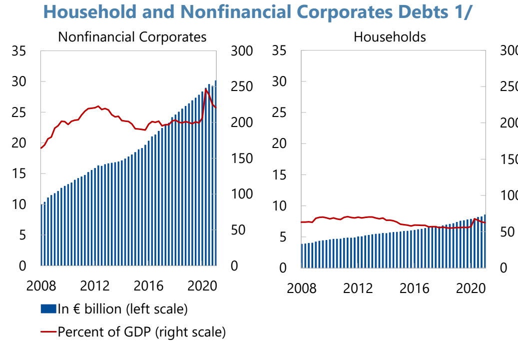
Source: Malta's Pensions Strategy Group.

C. Safeguarding Financial Stability

24. Bank asset quality could deteriorate.

- **Possible rise in corporate insolvencies.** COVID-19 support measures, as well as the temporary suspension of insolvency filings, have prevented a rise in corporate insolvencies. Corporates, however, became more indebted, and their resilience will be tested when support measures are withdrawn, or the economic recovery falters.

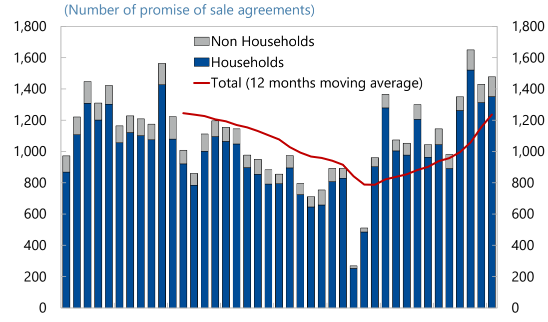
Household and Nonfinancial Corporates Debts 1/



Sources: Central Bank of Malta, Haver Analytics, and IMF staff calculations.
1/ Nonfinancial corporate debts are on an unconsolidated basis.

- **Risks from mortgage lending.** After a brief pause in early 2020, real estate transactions resumed and grew strongly. Staff's valuation analysis suggests that house prices were overvalued by about 5½ percent at end-2020. Continued vigilance for a possible market adjustment is warranted, given the concentration of mortgages in banks' loan portfolios.

Real Estate Transactions
(Number of promise of sale agreements)

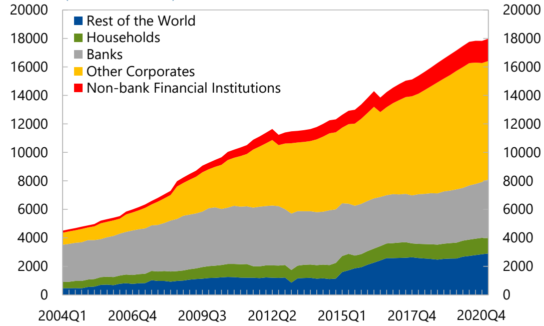


Sources: Malta National Statistics Office and IMF staff calculations.

[4] For reform options, see IMF Country report No. 20/98.

- **Potential interconnectedness risks through intercompany loans.** While its total amount decreased marginally, domestic intercompany lending remained high, representing almost 50 percent of total loans to non-financial corporates (NFCs). It offers diversified funding sources for NFCs and in part reflects financing optimization within business groups. However, the absence of granular information on intercompany loans and their risk management practices, as well as possible intragroup propagation of vulnerabilities, is of concern.

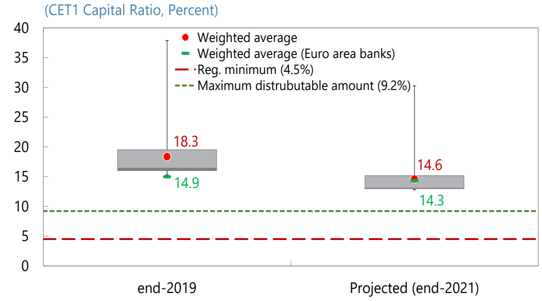
Loans to NFCs
(Millions of euros)



Source: ECB.

25. Core domestic banks are expected to be able to absorb the shocks. Banks' exposures to the tourism and contact-intensive sectors are relatively limited at about 10 percent of total bank loans. Staff's analysis (covering nine banks) suggests that under the baseline macroeconomic scenario considering COVID-related support measures, banks' aggregate CET1 ratio would decline by 3¾ percentage points from 18.3 percent to 14.6 percent, well above regulatory requirements.

Maltese Banks—Solvency Stress Test
(CET1 Capital Ratio, Percent)



Sources: EBA, ECB, ESRB, FitchConnect, S&P Market Intelligence, and IMF staff estimates.
Note: The analysis updates Aiyar et al. (2021) COVID-19: How Will European Banks Fare? IMF European Department. CET1 indicates common equity Tier 1, and maximum distributable amount is weighted averages. The grey shaded area of the boxplots shows the inter-quartile range (25th to 75th percentile), with whiskers at the 5th and 95th percentile of the distribution.

26. The authorities should remain vigilant in monitoring risks. During the pandemic, bank supervisors have kept prudential standards, requiring banks to assess their borrowers' creditworthiness in a forward-looking manner, reclassify loans, and record provisions. Bank supervisors should continue closely monitoring banks' financial positions and risk management and ensure that banks continuously update the assessment and provision for expected losses as the economic prospects change. Enhanced data collection and monitoring are essential in analyzing vulnerabilities from intercompany lending, and to this end, the authorities should fully utilize the credit registry system (established in 2016). Given the significance of mortgage loans in banks' portfolios, the authorities should continue vigilance in monitoring risks in housing markets and efforts in improving the data quality. The real estate market support measures should expire in Summer 2021 as planned, while the authorities could consider refining the borrower-based macroprudential measures if warranted.

D. Pursuing AML/CFT Reform

27. Progress has been made in addressing a number of shortcomings in the AML/CFT framework, but challenges continue, and in June 2021, the FATF put Malta under increased monitoring ("grey list"). In July 2019, Moneyval identified significant deficiencies with Malta's AML/CFT framework. The authorities have since stepped up efforts to improve their understanding of money laundering and terrorist financing (ML/TF) risks, enhanced AML/CFT supervision (including through the adoption of new risk-based tools), issued sector-specific AML/CFT guidance, implemented institutional changes to improve enforcement of ML/TF cases, and created a new Asset Recovery Bureau. In late April 2021, Moneyval recognized Malta's progress in technical compliance with the FATF Standards. However, due to remaining concerns over the effectiveness in implementing some aspects of the AML/CFT framework, in June 2021, the FATF put Malta on the "grey-list."

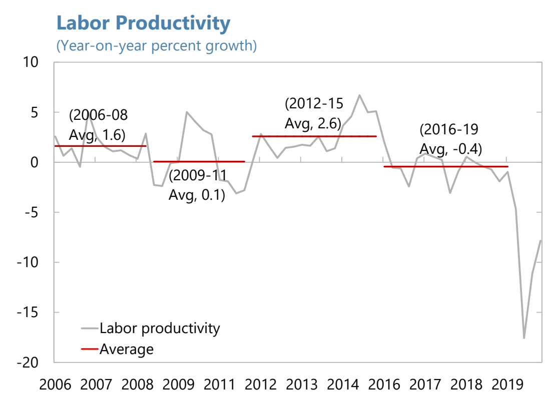
28. The authorities should intensify efforts to expeditiously resolve the remaining deficiencies and further enhance the effectiveness of the AML/CFT framework. The key areas that the authorities should focus on are: (i) ensuring the availability of accurate and up to date beneficial ownership information and applying appropriate sanctions for non-compliance by companies and gatekeepers; (ii) enhancing the use of financial intelligence to support tax and money laundering cases; and (ii) increasing the focus of the Financial Intelligence Unit's analysis on criminal tax offenses. It is also important to ensure that ongoing AML/CFT reforms are sustainable in the long term.

29. The authorities should continue to monitor correspondent banking relationship (CBR) pressures and address financial integrity and reputational risks, in particular those posed by high risk sectors and activities. Some Maltese financial institutions have been under US$ CBR pressures in recent years. A prolonged placement on the FATF's grey-list could result in further CBR pressures, raising transaction costs and adversely affecting the economy. Given the inherent ML/TF risks associated with virtual financial assets (VFAs), gaming and Malta's Citizenship by Investment (CBI) Program—which can also contribute to CBR pressures—, the authorities should continuously assess the risks of these sectors and programs and adopt enhanced transparency and mitigation measures. This includes maintaining close supervision of the gaming and VFA sectors and designating third-party agents supporting the CBI Program as reporting entities under Malta's AML/CFT framework.[5]

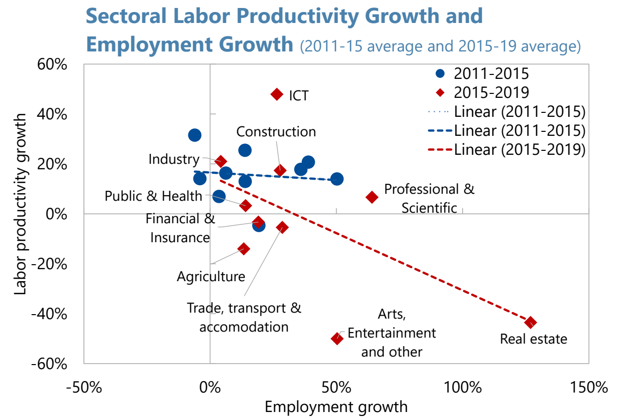
E. Advancing Structural Reforms for Higher and Sustainable Growth

30. As the economic recovery progresses, policy priorities should refocus on boosting potential growth. Before the pandemic crisis, Malta's labor productivity growth had slowed and turned slightly negative. Staff's sectoral analysis points to some inefficiency in labor resource allocation as employment grew faster in sectors with negative productivity growth (e.g., real estate and arts and entertainment). Reinvigorating structural reforms to raise Malta's productivity growth and improve the efficiency of resource allocations is critical to achieving strong, sustainable, and inclusive growth. In this light, the authorities have recently published several strategic papers to solicit nationwide efforts to identify and implement growth strategies.

[5] The CBI program has recently been revamped and renamed the Maltese Citizenship by Naturalization for Exceptional Services by Direct Investment.



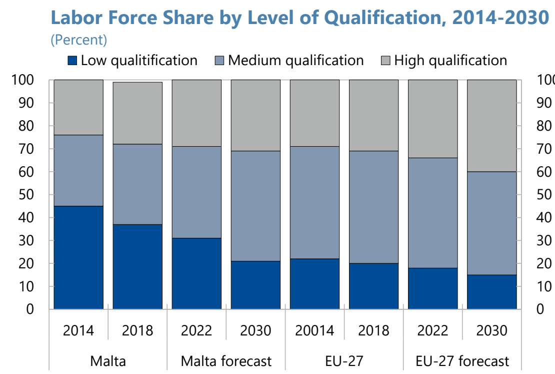
Sources: Eurostat and Haver Analytics.



Sources: Eurostat and IMF staff calculations.

31. Immediate policy priorities include addressing weak spots in the labor market and strengthening the corporate insolvency regime.

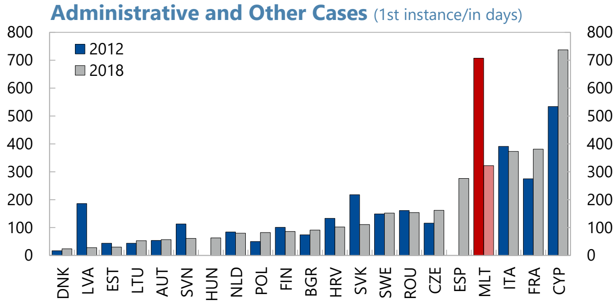
- ***Labor market policies.*** The authorities implemented several measures over the past decade to improve educational achievement, raise student retention rates, and increase participation in lifelong and adult learning. Some progress has been made (Figure 7). However, the efforts to increase the supply of skilled workers have failed to keep pace with the increased demand for these skilled workers. In fact, surveys show the availability of skilled workers as a bottleneck, and skill gaps with other European economies are projected to widen. Labor market reforms should prioritize upskilling and reskilling workers.



Source: Cedefop (2020 Skills Forecast).

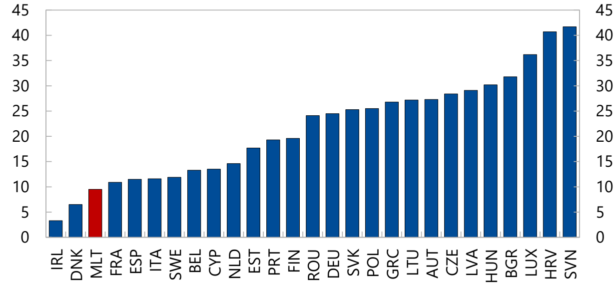
- ***Corporate sector insolvency framework.*** In anticipation of an increase in corporate insolvencies, the insolvency framework needs to be urgently strengthened to address existing shortcomings, including a lengthy liquidation process, low recovery rates, weak creditor rights, and an inefficient judicial system. The authorities have already initiated a comprehensive insolvency reform plan in line with the European Directive on Restructuring and Second Chance, including (i) establishing an early warning system; (ii) introducing new preventive restructuring procedures; (iii) revamping insolvency laws; and (iv) modifying the liquidation procedure. This should be completed by mid-next year as planned. Furthermore, the efficiency of the judicial system needs to be further strengthened.

Estimated Time Needed to Resolve Civil, Commercial, Administrative and Other Cases (1st instance/in days)



Source: EU Justics Scoreboard 2020.
Note: Under the CEPEJ methodology, this category includes all civil and commercial litigious and non-litigious cases, non-litigious land and business registry cases, other registry cases, other non-litigious cases, administrative law cases and other non-criminal cases. Methodology changes in SVK. Pending cases include all instances in CZE and, until 2016, in SVK. LVA: the sharp decrease is due to court system reform, and error checks and data clean-ups in the Court information system.

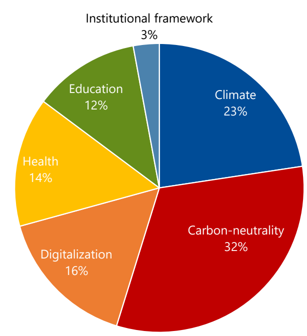
Number of Judges, 2018
(Per 100,000 inhabitants)



Source: EU Justice Scoreboard 2020.
Note: This category consists of judges working full-time, under the CEPEJ methodology. It does not include the Rechtspfleger/court clerks that exist in some Member States. AUT: Data on administrative justice is introduced for 2016 cycle for the first time. GRC: the total number of professional judges includes different categories over the years shown above, which partly explains their variation. Since 2016, data on number of professional judges includes all the ranks for criminal and political justice as well as administrative judges. ITA: The regional audit commissions, local tax commissions and military courts are not taken into consideration. LTU: numbers have been revised following an improved methodology.

32. Given the economic significance of the tourism sector, the authorities should take strong and coordinated policy actions to reboot the sector on a stronger and more sustainable footing. Tourist arrivals are expected to increase, but the return to business as usual appears to be highly unlikely due to travelers' increased concern about safety, hygiene, health, and environmental sustainability. In June 2021, the government published *Malta Tourism Strategy 2021-2030* to guide the direction of tourism sector reforms, which includes strategies to utilize new digital technologies, enhance a greener tourism system, improve tourism infrastructure, strengthen Malta's attractiveness as a tourist destination, and increase value-added in the tourism sector. The next step is to operationalize the strategies and move to take action.

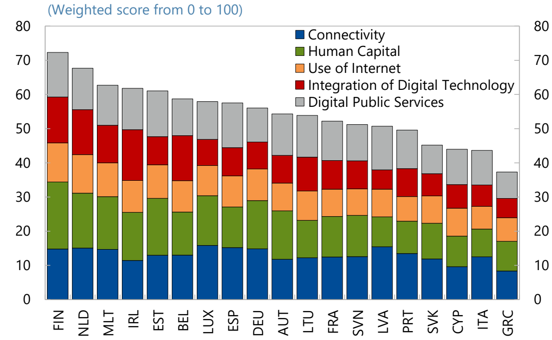
Recovery and Resilience Plan



Sources: Bank of Malta and IMF staff calculations.

33. Promoting digital transformation and decarbonization will be key to achieving higher and sustainable growth. EU funds will support investment in these areas. Under the EU Recovery and Resilience Facility, Malta has access to €345 million (2½ percent of GDP) in grants, 70 percent of which will be allocated to digital and environmental programs.

Digital Economy and Society Index, 2020
(Weighted score from 0 to 100)

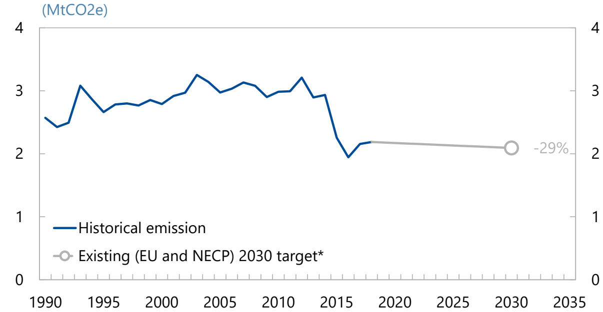


Source: DESI 2020, European Commission.

- ***Digital transformation and innovation.*** Over the past decade, the authorities have placed significant emphasis on digitization and technology adoption. As a result, Malta ranked fifth out of the 27 EU Member States in the Digital Economy and Society Index. Given ongoing rapid technological progress, however, efforts should continue. In this light, the ongoing work to update the medium-term national digital strategy provides a good opportunity to take stock of Malta's past experience and keep Malta among the digital frontrunners of Europe. In addition, given that Malta is still trailing EU peers in research and development (R&D) investment, there is room to boost public spending in R&D and develop the innovation ecosystem.[6]

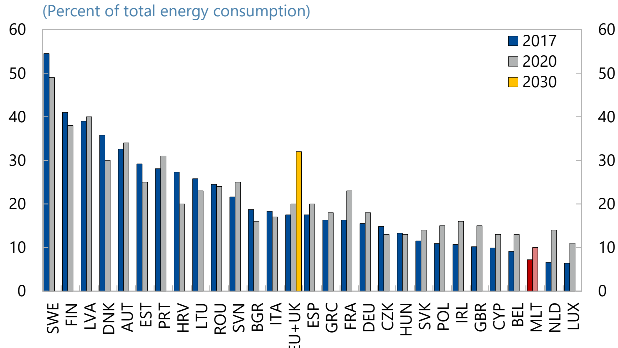
- ***Climate change policy.*** Due to temperate climate conditions and a lack of energy-intensive industries, per capita energy consumption in Malta is the second lowest in the EU. The authorities are committed to reducing greenhouse gas emissions under the EU Effort Sharing Regulation by 19 percent (compared to 2005 levels) by 2030, while the share of renewable energy in final energy consumption is expected to rise from 8 percent to 11.5 percent by 2030. In June 2021, the authorities published a public consultation document, the *Malta Low Carbon Development Strategy*, which elaborates on potential decarbonization and adaptation measures. The authorities should move fast to adopt a cost-effective emission reduction strategy and make further efforts to foster renewable energies, improve energy efficiency, and promote a modal shift in the transport sector (Annex VII).

GHG Emissions Projections and 2030 Target
(MtCO2e)



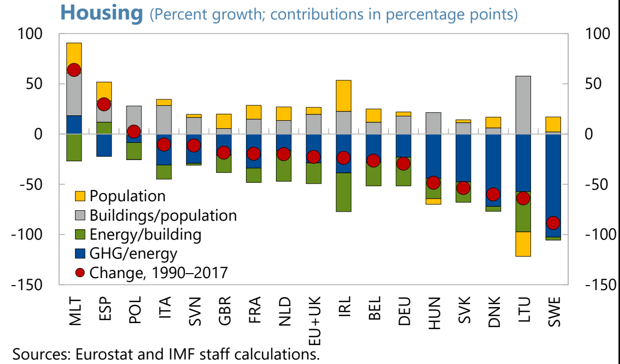
Sources: European Environment Agency; European Commission; and IMF Staff Calculations.
Note: * reflects the emission-weighted average of the 43-percent reduction target (compared to 2005) for energy (subject to ETS) and the emission reduction in other sectors by 19 percent, as per Malta's 2030 target under the EU Effort Sharing Regulation.

Share of Renewables in Final Energy Consumption
(Percent of total energy consumption)



Source: Eurostat.
Note: Country list uses International Organization for Standardization (ISO) country codes.

Decomposition of GHG Emissions in Residential Housing (Percent growth; contributions in percentage points)



Sources: Eurostat and IMF staff calculations.
Note: Country list uses International Organization for Standardization (ISO) country codes. GHG=greenhouse gas.

34. Further strengthening of the governance framework is critical to attract investors and ensure the long-term sustainability of Malta's growth potential. The authorities have been implementing the recommendations of the Council of Europe's Venice Commission and the Group of States Against Corruption and introduced a comprehensive legislative package, including concerning the appointment processes of various government and judicial officials. Additional measures, however, are required to fully meet the recommendations, including enhancing the capacity of the Office of the Attorney General and the efficiency of the judiciary system.

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[6] Malta's expenditure is 0.6 percent of GDP in 2019, below the EU average of 2.2 percent of GDP. For more discussion, see [IMF Country Report No. 20/98](#).

AUTHORITIES' VIEWS

35. The authorities agreed that the economic outlook had improved. They highlighted strong recovery in gaming, ICT, and professional services and expected the tourism sector to gradually rebound. The authorities viewed risks surrounding the near-term forecast were broadly balanced, with demand supported by high private savings and limited impacts from grey-listing by the FATF. They concurred with staff's external balance assessment, noting that the current account balance would return to a more balanced position once fiscal balances improve.

36. The authorities agreed that the near-term priorities were placed on the recovery from the pandemic while gradually reducing government support. They viewed the ongoing economic recovery strong enough to start tapering key support measures and terminate them by the end of 2021. They agreed that some corporates, especially in tourism and contact-intensive sectors, had been hit hard by the pandemic crisis and would carefully monitor and assess the extent of deterioration of their balance sheets. They did not foresee the need for additional corporate support measures, stressing that the take-up of support measures had already decreased and business investment prospects were robust. However, they recognized the need to address labor and skill shortages which could impact competitiveness and the pace of recovery.

37. The authorities remained committed to fiscal sustainability. They stressed that re-establishing strong growth would be necessary to ensure fiscal sustainability in the medium term. They intended to embark on fiscal consolidation efforts once economic conditions allow, guided by EU level fiscal rules. The authorities were closely following discussions about the global minimum corporate tax but pointed out difficulties in assessing the impact until the detailed rules were agreed internationally. They also noted that transition to a new corporate tax framework would require time for preparation but highlighted their continued efforts in strengthening tax administration. They acknowledged challenges in raising EU fund absorption and stressed their efforts to work out solutions with the beneficiaries to improve absorption.

38. The authorities stressed that the pandemic's impact on the financial sector was well contained. They highlighted the strength of the banks' loan books as evidenced by low NPL ratios, a rapid decrease in the usage of moratoria, high provisions, and high capital levels to withstand an extremely adverse scenario. They also considered that past overvaluations in house prices had been corrected. Nevertheless, they were committed to closely monitoring banks' financial position, in particular asset quality and provisioning levels, as well as risk management, given high uncertainty. They highlighted progress in extending the frequency and coverage of real estate loan data and their plan to improve the reporting lag and frequency of nonfinancial corporates' balance sheet data.

39. The authorities underscored their commitment to urgently address Malta's remaining AML/CFT deficiencies to get off the grey list. They will redouble efforts and thoroughly implement the action plan with the FATF. As an immediate priority, they will put in place a detailed and domestically coordinated implementation plan to improve the accuracy of beneficial ownership information, strengthen the supervision of gatekeepers, and enhance investigations and prosecutions related to criminal tax and money laundering cases. The authorities also indicated that taking this opportunity would make the AML/CFT framework robust and sustainable over the long term.

40. The authorities agreed on the need to pursue structural reforms to drive a strong recovery and bolster resilience and competitiveness. They published strategic papers, calling for policy actions in several areas, including health, social cohesion and equity, business investment, education, labor markets, and the environment. They noted that the size of the EU Recovery and Resilience Facility for Malta was relatively modest but would help their efforts to promote digitalization and climate change policies. The authorities agreed that the pattern of tourism could change, stressing the importance of improving value-added in the tourism sector. To strengthen the governance framework, the authorities pointed to several actions and reforms implemented. They also highlighted several measures taken to improve the efficiency of the judicial system but acknowledged the need for closer coordination among all relevant institutions.

41. The authorities emphasized their commitment to reducing greenhouse gas emissions in line with EU targets. They, however, stressed the ambitious nature of the target and the challenges in meeting the targets. Given that Malta is a small island economy with limited economies of scale, decarbonization would be less cost-effective than in most other EU member states. Nevertheless, the authorities stressed that the government would continue efforts to meet its climate neutrality targets.

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42. The COVID-19 pandemic has taken a heavy toll on the Maltese economy, but sizable macro-financial buffers and the authorities' bold response helped mitigate the impact. Pre-crisis, growth was much higher than the EU average, with strong fiscal positions, low debt, and well-capitalized banks. With tourism arrivals dropped sharply, the Maltese economy entered the deepest recession in decades last year. More recently, supported by the authorities' swift and bold actions, the economy is rebounding, and with the reopening of the economy for the summer tourism season, growth is projected to gain momentum in coming months. Risks to the outlook, however, are tilted to the downside, mainly because the global COVID-19 crisis is not over.

43. The pace of unwinding COVID-19 related support measures should balance the near-term need to support growth and long-term economic stability. As economic growth gains momentum, the authorities have appropriately begun to taper support measures. Given high uncertainty, however, they need to carefully manage its pace and coordinate between fiscal and financial sector policies. If the recovery falters, some support measures may need to be extended in a targeted manner. It is important to closely monitor and assess the pandemic's impact on the corporate sector and consider whether additional measures to support the corporate sector are needed.

44. Once the recovery is firmly entrenched, fiscal buffers should be gradually rebuilt. The fiscal consolidation strategy should utilize the planned comprehensive review of COVID-related spending, while retaining space for public investment to underpin growth and address infrastructure gaps. Efforts to strengthen tax administration should continue, with the aim of identifying loopholes and exploiting digitalization. In light of the global minimum corporate tax proposal, a holistic review of the overall tax system would be useful. The authorities should continue efforts to strengthen the management of contingent liabilities and ensure the sustainability of the pension system.

45. Banks have remained resilient, but vigilance in risk monitoring is warranted given a high degree of uncertainty. Bank supervisors should continue to closely monitor banks' financial positions and risk management and ensure that banks update the assessment of expected losses as economic prospects evolve and provision accordingly. Enhanced data collection and monitoring are essential for intercompany lending. The support measures for the real estate market should expire in summer 2021 as planned.

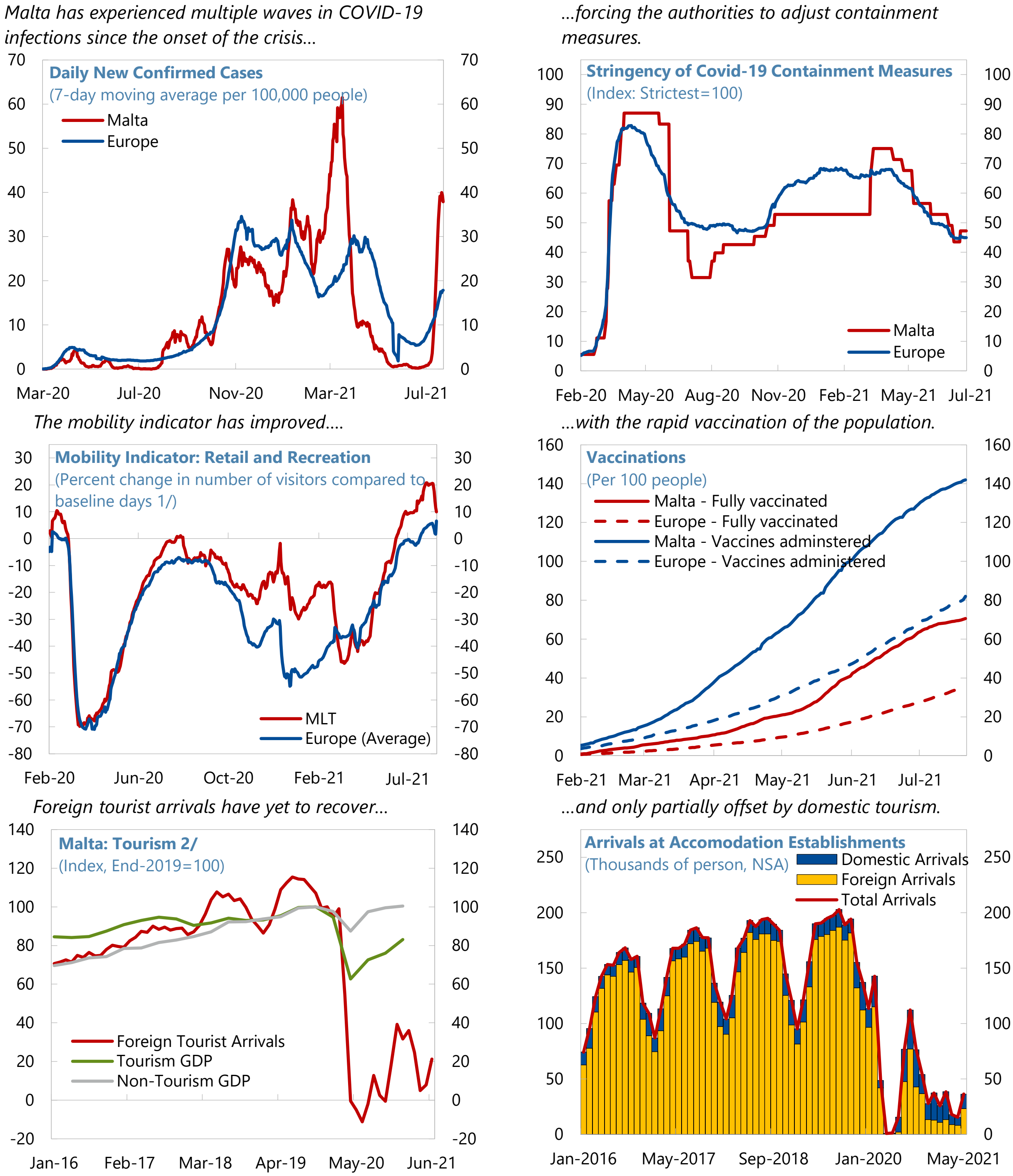
46. The authorities should expeditiously resolve the remaining deficiencies in the AML/CFT framework and enhance its effectiveness. The authorities need to intensify efforts to demonstrate effectiveness in line with the FATF action plan, especially in the areas of transparency on beneficial ownership information and financial intelligence related to money laundering and tax evasion. The authorities should also continue efforts to mitigate financial integrity and reputational risks in high-risk activities (e.g., virtual financial assets, gaming, and citizenship by investment program), while maintaining close monitoring of CBR pressures.

47. Advancing structural reforms is key to higher and sustainable growth. The authorities need to further advance labor market reforms, focusing on upskilling and reskilling workers, and leverage active labor market policies to facilitate resource reallocation. To facilitate corporate sector restructuring, ongoing work on the corporate insolvency framework should be completed by mid-next year. Given its economic significance, the authorities should move to take actions to make the tourism sector stronger and more sustainable. EU funds, including the EU Recovery and Resilience Facility, will support investment in digital transformation and decarbonization, while the governance framework should be further strengthened, including by enhancing the efficiency of the judiciary system.

48. Staff welcomes the authorities' commitment to reducing greenhouse emissions in line with EU targets. The authorities are encouraged to seek decarbonization potential by exploiting various sources, including investing in renewable sources, upgrading energy efficiency, and modernizing the transport sector.

49. It is recommended that the next Article IV consultation be held in the standard 12-month cycle.

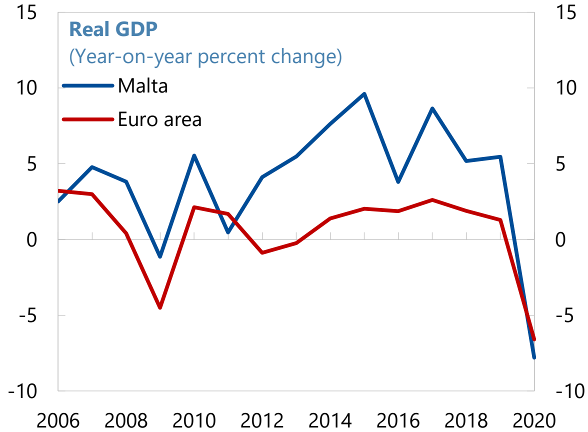
Figure 1. Malta: COVID-19 and Tourism Developments



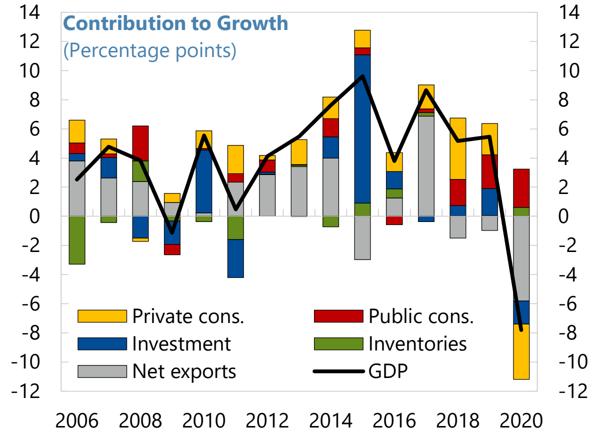
Sources: Malta Ministry of Health, NSO, Eurostat, Bloomberg Finance L.P., OWID, WEO, and staff calculations.
1/ Baseline days are median value for the 5-week period from Jan 3 to Feb 6, 2020).
2/ Tourism GDP is calculated as value added in transportation, trade, accommodation, and entertainment sectors; non-tourism GDP is value added in the other sectors.

Figure 2. Malta: Economic Impact of the Global Pandemic Crisis

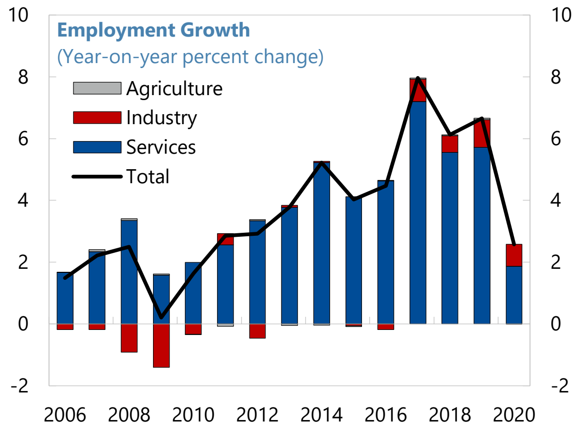
Following the strong pre-pandemic growth, Malta experienced a deep recession in 2020…



…with external demand and private consumption weighing most heavily on growth.

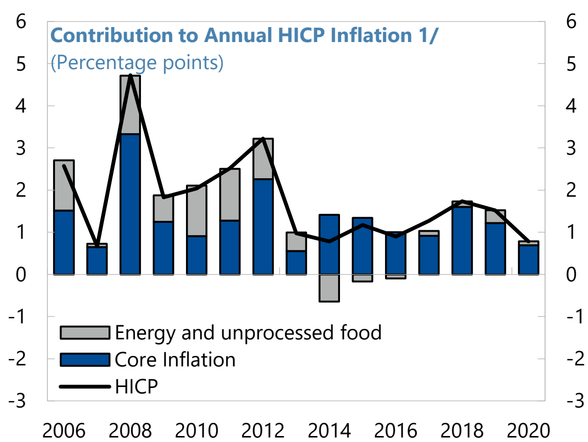


Employment continued to grow moderately…

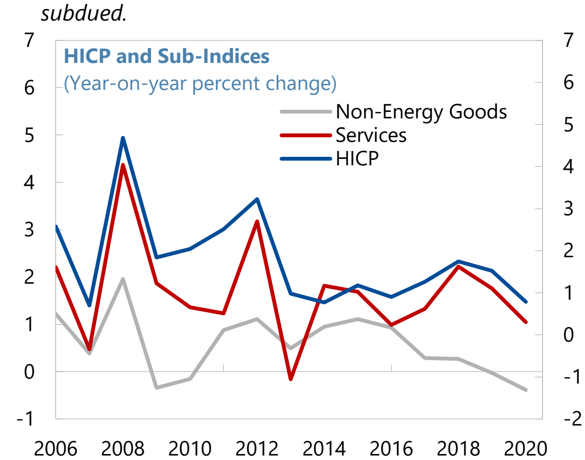


…while wage growth in the private sector picked up slightly.

Headline and core inflation moderated…

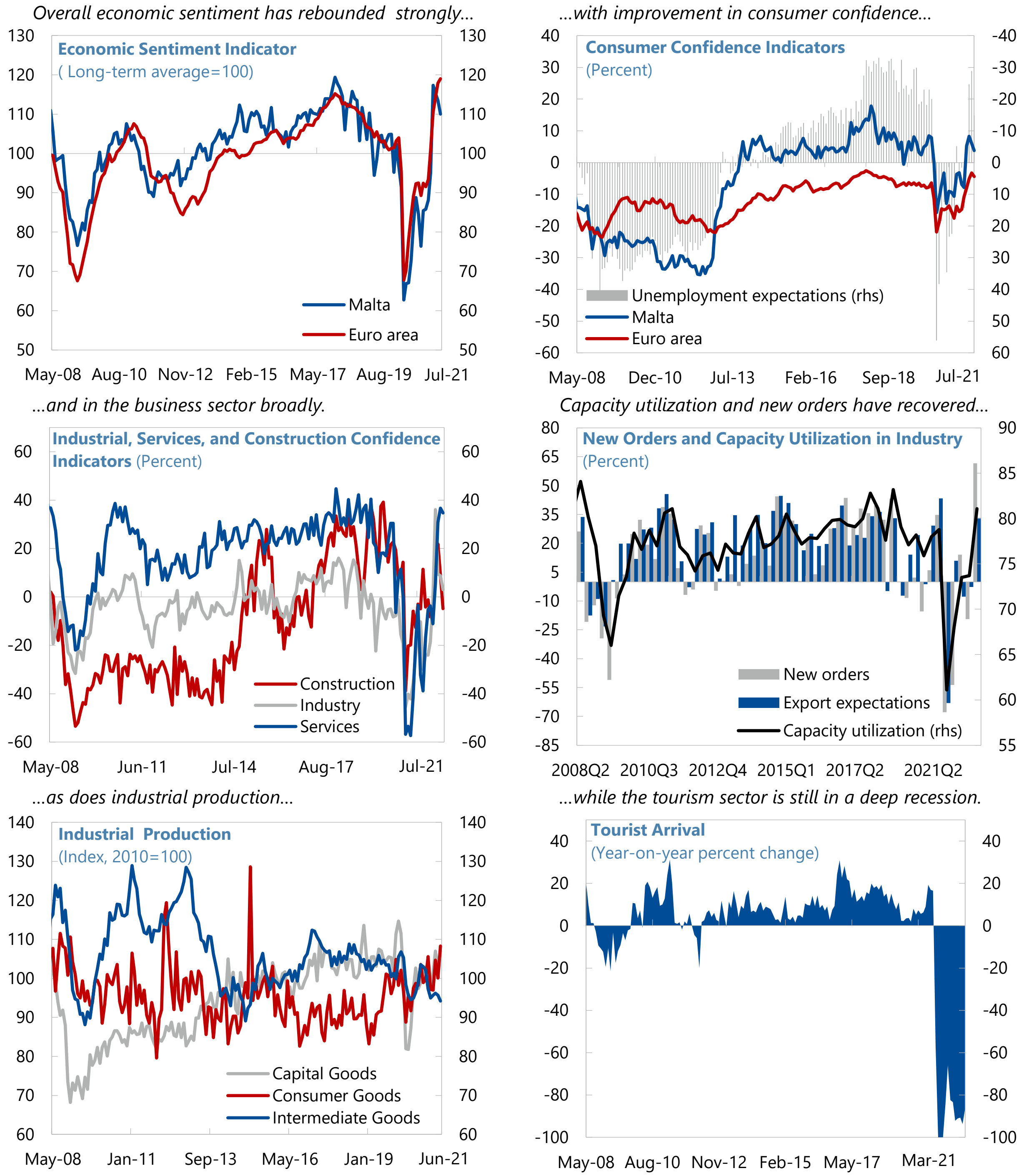


…as non-energy goods price inflation remained subdued.



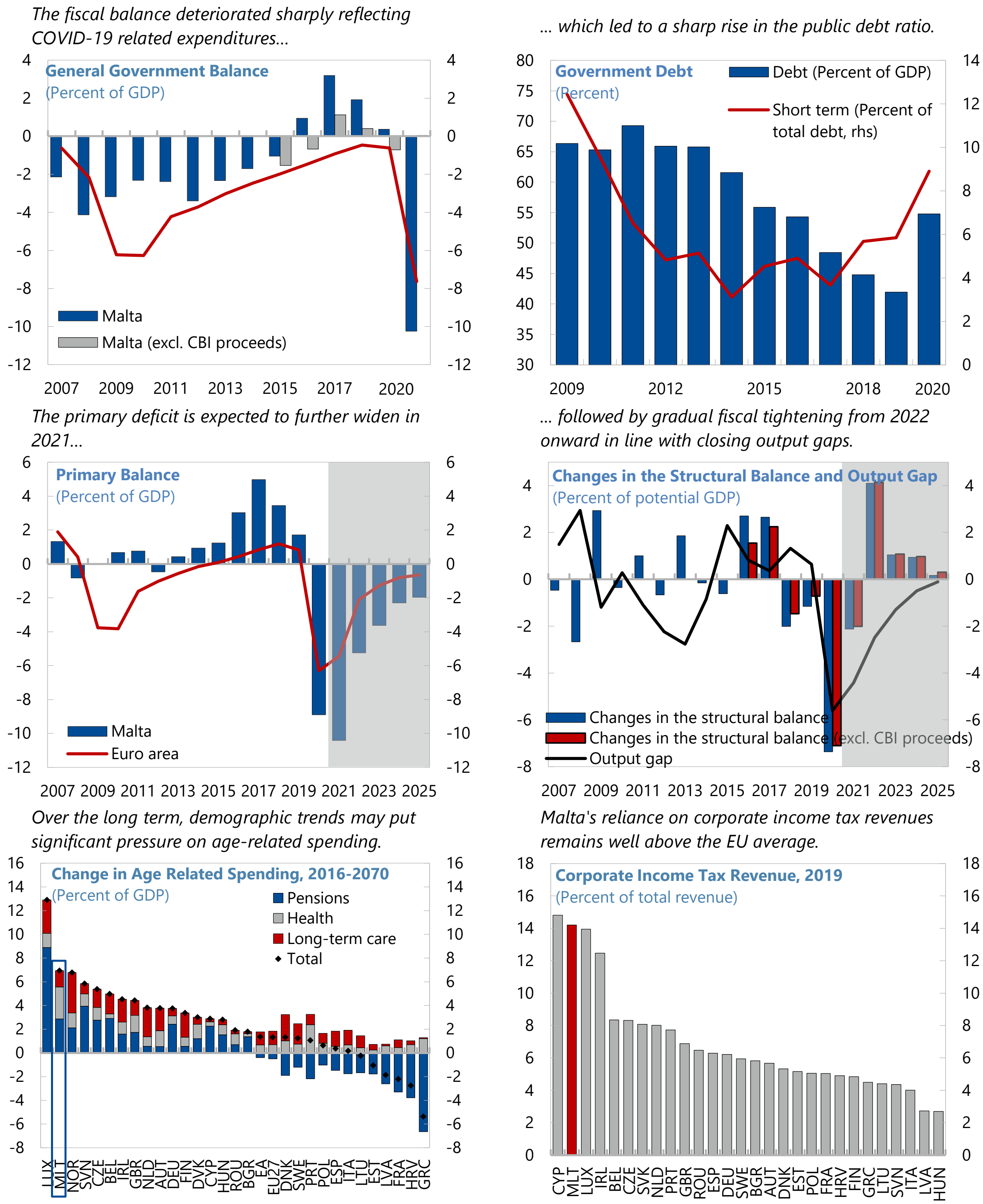
Sources: Central Bank of Malta; Eurostat; IMF World Economic Outlook; and IMF staff calculations.
1/ HICP stands for Harmonized Index of Consumer Prices.

Figure 3. Malta: Short-Term Indicators



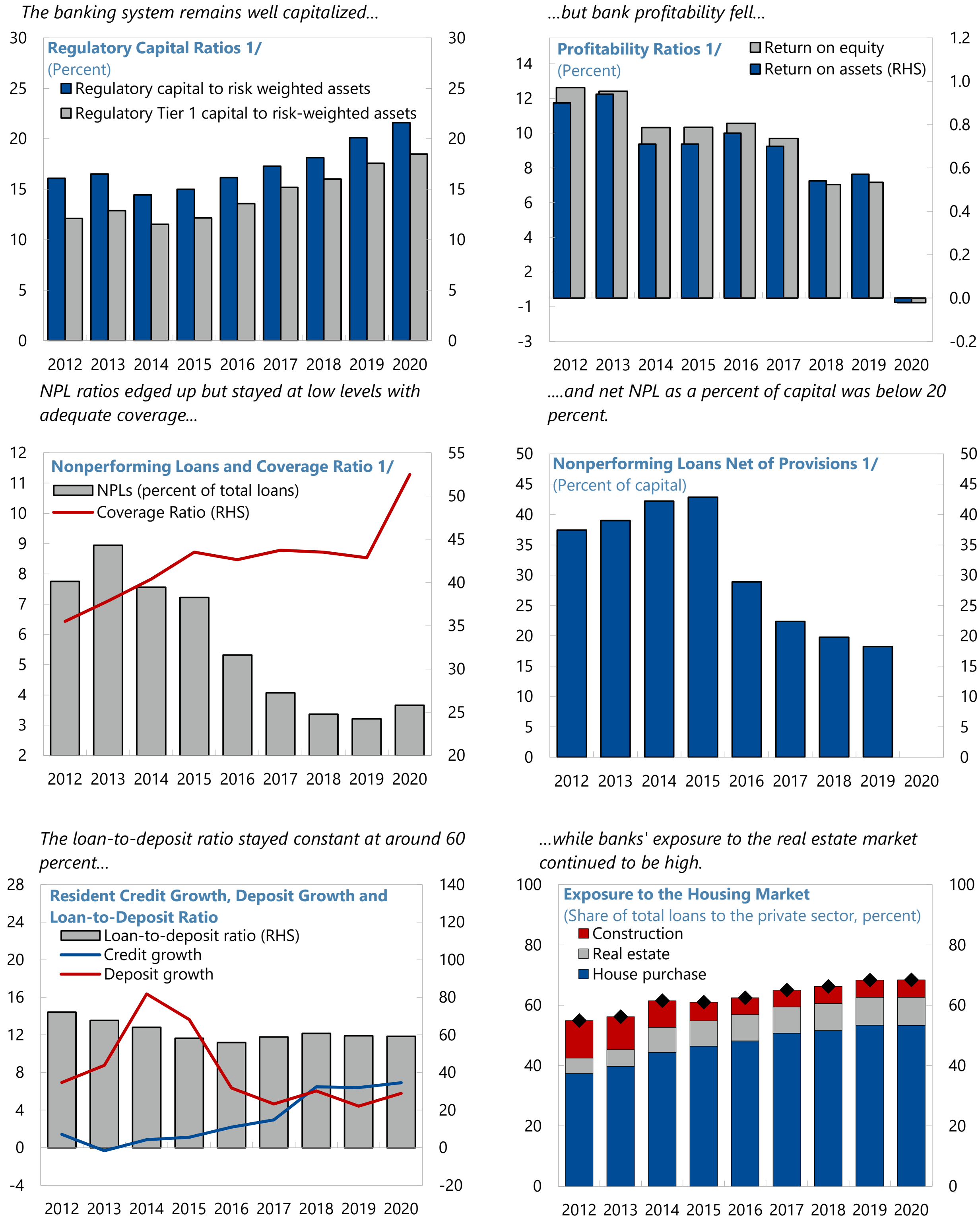
Sources: European Central Bank; Central Bank of Malta; European Commission; and IMF staff calculations.

Figure 4. Malta: Fiscal Developments



Sources: Eurostat; IMF *World Economic Outlook;* European Commission's "*The 2018 Ageing Report;*" and IMF staff calculations.

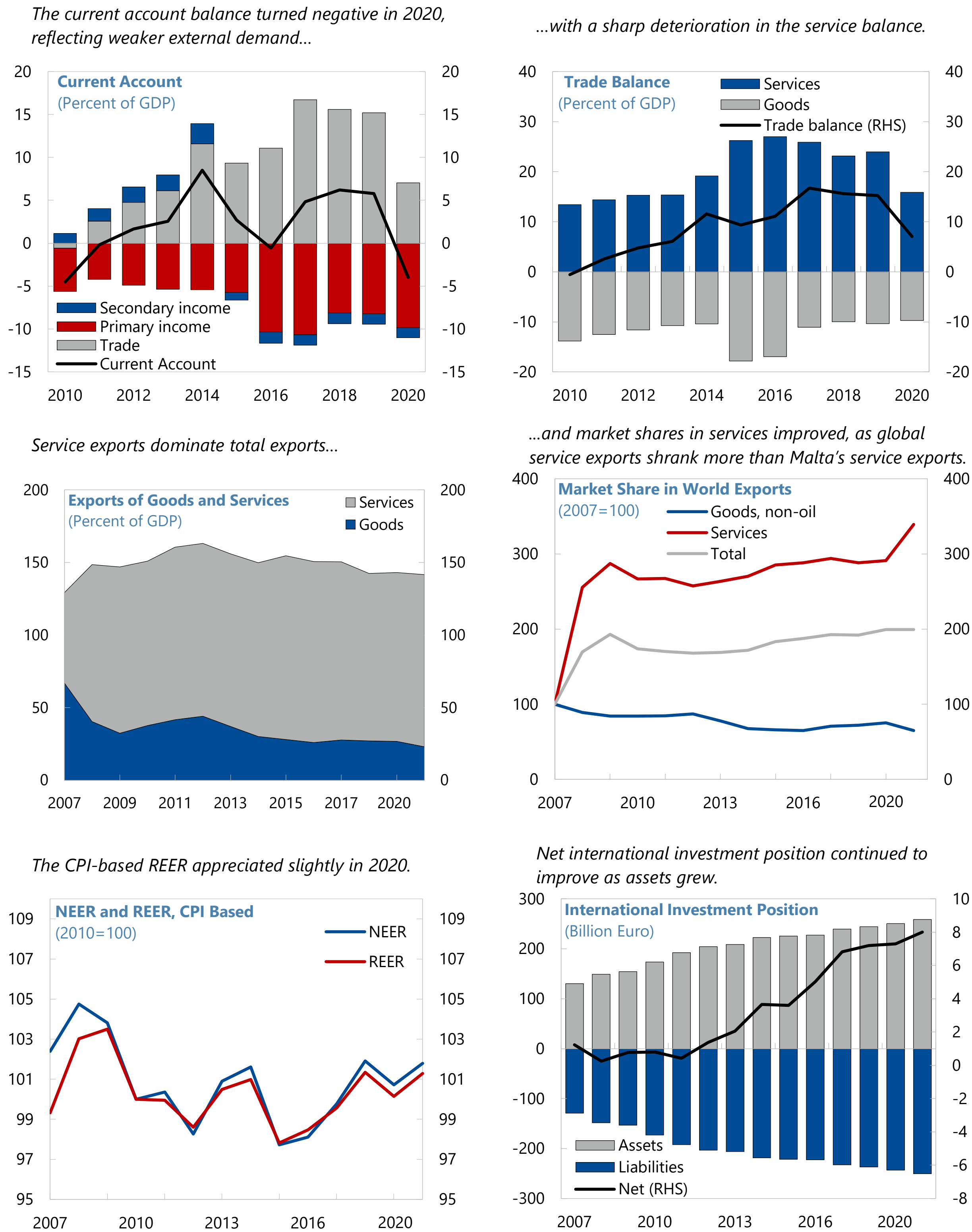
Figure 5. Malta: Financial Soundness Indicators



Sources: IMF *Financial Soundness Indicator;* Central Bank of Malta; Malta Financial Services Authority, and IMF staff.

1/ Core domestic banks.

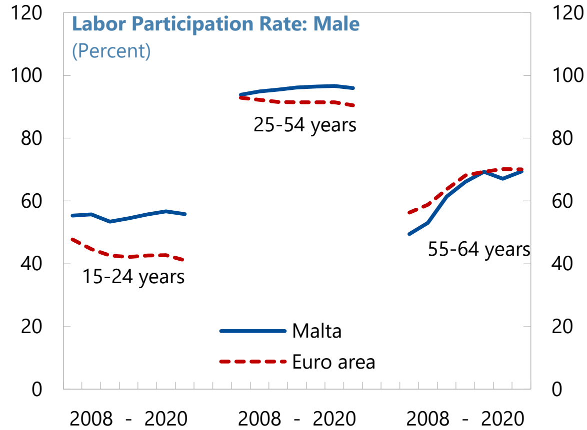
Figure 6. Malta: External Sector



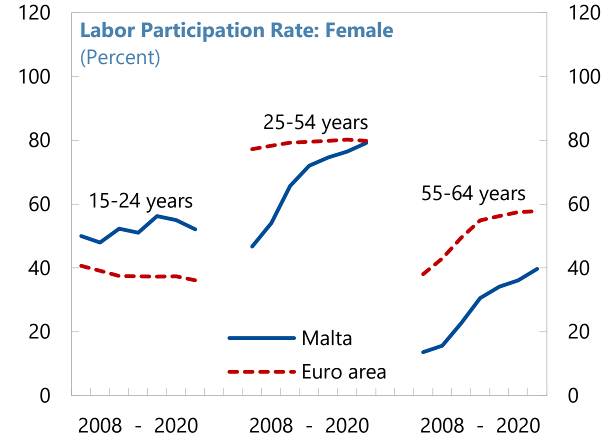
Sources: Haver Analytics; Eurostat; UNCTAD; IMF *World Economic Outlook*; and IMF staff.

Figure 7. Malta: Labor Market and Income Inequality Developments

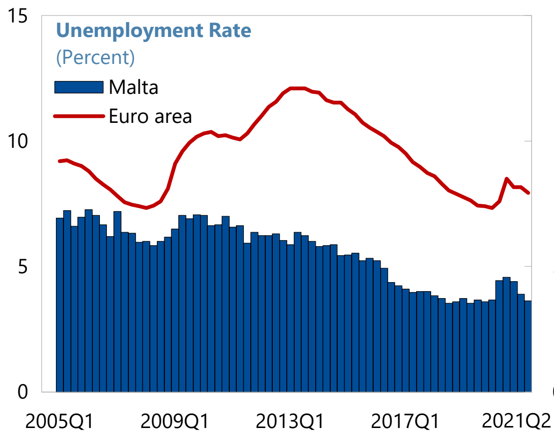
Labor participation imporved across all age groups.



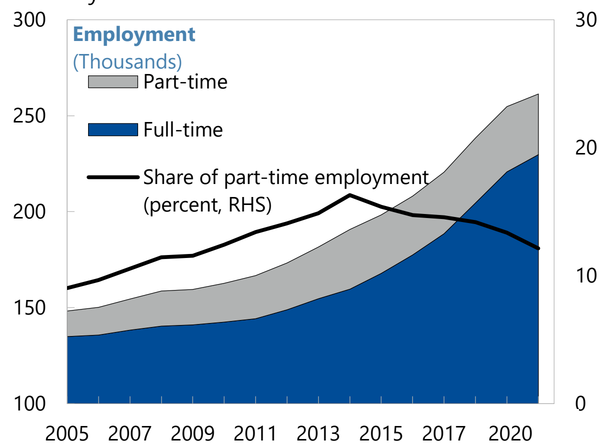
The female partipation rate, especially in prime age, improved fast even amidst the pandemic.



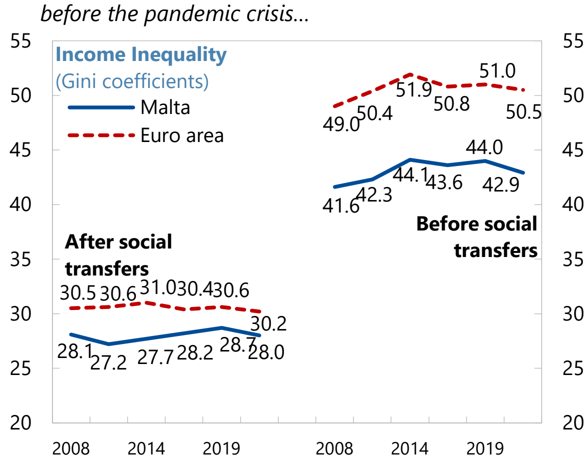
Unemployment increased in mid-2020 but has since fallen...



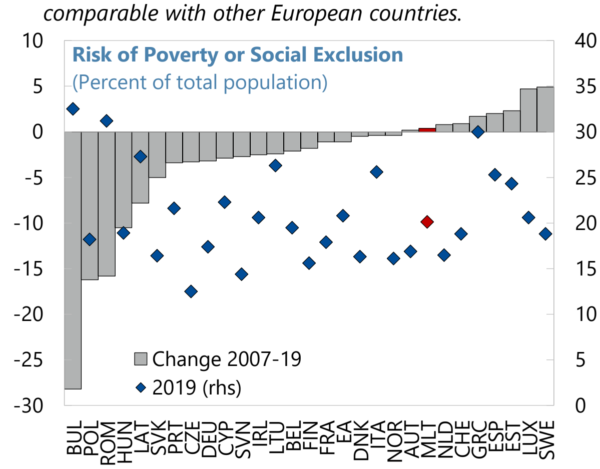
...reflecting relatively strong job creation, especially full-time jobs.



Income inequality was lower than euro area peers before the pandemic crisis...



...while the risk of poverty and social exclusion was comparable with other European countries.



Sources: Eurostat and IMF staff.

Table 1. Malta: Selected Economic Indicators, 2019–2026

(Year on year percent change, unless otherwise indicated)

Population (millions):	0.5	Per capita income (2020, euros):	24,684
Quota (as of Sep. 30, 2020; millions of SDRs):	168.3	At-risk-of-poverty rate (2019) 1/	17.1

			Projections					
	2019	2020	2021	2022	2023	2024	2025	2026
National accounts								
Real GDP	5.5	-7.8	5.7	6.0	5.0	4.5	3.7	3.3
Domestic demand	7.4	-2.5	5.3	3.2	3.5	3.1	2.8	2.6
Consumption	7.0	-1.8	6.2	1.5	3.0	2.6	2.7	2.6
Private consumption	4.5	-8.0	5.1	3.1	3.2	2.9	2.8	2.8
Public consumption	14.7	15.2	8.6	-1.7	2.6	1.8	2.5	2.2
Fixed investment	8.5	-7.1	3.0	8.5	5.0	4.6	3.2	2.5
Exports of goods and services	7.0	-7.0	5.1	5.8	2.9	2.8	2.4	2.3
Imports of goods and services	8.5	-3.3	4.8	3.8	1.8	1.7	1.7	1.7
Contribution to growth				(Percent)				
Domestic demand	6.4	-2.0	4.9	2.8	3.1	2.7	2.5	2.2
Consumption	4.5	-1.2	4.3	1.1	2.0	1.7	1.7	1.7
Private consumption	2.1	-3.8	2.4	1.4	1.5	1.3	1.2	1.2
Public consumption	2.3	2.6	1.9	-0.4	0.5	0.4	0.5	0.4
Fixed investment	1.8	-1.6	0.7	1.9	1.1	1.0	0.7	0.6
Inventory accumulation	0.1	0.8	0.0	-0.1	0.0	0.0	0.0	0.0
Foreign balance	-1.0	-5.8	0.8	3.2	1.8	1.8	1.3	1.1
Exports of goods and services	10.0	-10.2	7.5	8.4	4.3	4.0	3.4	3.2
Imports of goods and services	-11.0	4.4	-6.7	-5.2	-2.4	-2.2	-2.1	-2.1
Potential GDP growth	6.2	-1.7	4.4	3.9	3.7	3.6	3.3	3.2
Output gap (% potential GDP)	0.6	-5.6	-4.4	-2.5	-1.3	-0.5	-0.1	0.0
Prices and employment								
HICP (period average)	1.5	0.8	0.7	1.8	2.0	2.0	2.0	2.0
GDP deflator	2.3	1.4	1.3	1.7	1.6	1.9	2.1	2.1
Unemployment rate (EU harmonized)	3.6	4.3	3.6	3.5	3.5	3.5	3.5	3.5
Employment growth	7.6	2.7	0.9	2.3	2.9	2.0	2.0	2.0
Savings and investment				(Percent of GDP)				
Gross national savings	27.8	19.2	19.8	22.4	23.3	24.4	25.0	25.5
Gross capital formation	22.0	22.8	22.3	22.7	22.7	22.6	22.4	22.1
Public finance				(Percent of GDP)				
Net lending/borrowing (overall balance)	0.4	-10.2	-11.8	-6.5	-4.8	-3.5	-3.2	-2.8
Structural overall balance (% potential GDP)	0.1	-7.3	-9.4	-5.3	-4.2	-3.3	-3.1	-2.8
Revenue	37.2	36.8	36.6	36.2	35.9	35.7	35.6	35.6
Expenditure	36.8	47.0	48.4	42.7	40.7	39.2	38.7	38.3
General government debt	42.0	54.8	64.6	66.9	68.1	67.9	67.3	66.7
Balance of payments				(Percent of GDP)				
Current account balance	5.7	-3.6	-2.5	-0.3	0.7	1.8	2.6	3.3
Trade balance (Goods and services)	15.2	7.6	7.8	10.0	10.9	12.1	12.9	13.6
Goods balance	-11.7	-10.7	-15.1	-12.6	-12.0	-11.3	-10.8	-10.4
Services balance	26.9	18.2	22.9	22.6	22.9	23.4	23.7	24.0
Primary income, net	-8.3	-9.9	-9.0	-9.0	-9.0	-9.0	-9.0	-9.0
Secondary income, net	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Financial account, net	1.2	-2.5	-1.7	0.4	1.4	2.4	3.3	4.0
Memorandum items:								
Nominal GDP (millions of euros)	13,590	12,701	13,605	14,672	15,650	16,660	17,635	18,594
Nominal GDP growth	7.9	-6.5	7.1	7.8	6.7	6.5	5.9	5.4

Sources: Maltese authorities; and IMF staff projections.

1/ Share of population with an equivalised disposable income (including social transfers) below the threshold of 60 percent of the national median equivalised disposable income after social transfers.

Table 2. Malta: Fiscal Developments and Projections, 2020–2026
(Percent of GDP, unless otherwise indicated)

		Projections					
	2020	2021	2022	2023	2024	2025	2026
Revenue	36.8	36.6	36.2	35.9	35.7	35.6	35.6
Taxes	24.3	24.0	24.2	24.4	24.6	24.6	24.6
Indirect taxes	10.8	10.7	10.8	10.9	11.0	11.0	11.0
Direct taxes	13.3	13.1	13.3	13.3	13.4	13.4	13.4
Other taxes (capital taxes)	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social contributions	6.6	6.4	6.3	6.2	6.1	6.1	6.1
Grants and Capital revenue	1.4	1.8	1.5	1.4	1.4	1.4	1.4
Other revenue	4.5	4.4	4.2	3.9	3.6	3.5	3.5
Expenditure	47.0	48.4	42.7	40.7	39.2	38.7	38.3
Expense	42.4	43.3	38.1	36.3	35.2	34.8	34.4
Compensation of Employees	12.3	12.5	12.1	11.8	11.6	11.6	11.5
Use of goods and services	9.6	9.9	8.8	8.5	8.1	7.9	7.8
Interest	1.3	1.4	1.2	1.2	1.2	1.2	1.2
Subsidies	5.1	4.3	1.6	1.5	1.4	1.3	1.3
Social benefits	10.6	10.4	9.9	9.7	9.5	9.4	9.3
Other expense	3.5	4.9	4.5	3.6	3.4	3.3	3.2
Net acquisition of nonfinancial assets	4.6	5.0	4.6	4.4	4.0	4.0	4.0
Gross Operating Balance	-5.6	-6.8	-1.9	-0.4	0.6	0.8	1.2
Net lending/borrowing (overall balance)	-10.2	-11.8	-6.5	-4.8	-3.5	-3.2	-2.8
Memorandum items:							
Overall balance excl. one-offs	-10.2	-11.8	-6.5	-4.9	-3.5	-3.2	-2.8
Overall balance excl. CBI proceeds	-11.1	-12.5	-7.1	-5.4	-4.1	-3.6	-3.2
Cyclically adjusted overall balance	-7.3	-9.4	-5.2	-4.2	-3.2	-3.1	-2.8
Structural balance 1/	-7.3	-9.4	-5.3	-4.2	-3.3	-3.1	-2.8
Structural balance excl. CBI proceeds 1/	-8.1	-10.1	-5.9	-4.9	-3.9	-3.6	-3.2
Cyclically adjusted primary balance	-6.0	-8.0	-4.0	-3.0	-2.0	-1.9	-1.5
Structural primary balance 1/	-6.0	-8.1	-4.1	-3.0	-2.1	-1.9	-1.5
Structural primary balance excl. CBI proceeds 1/	-6.8	-8.8	-4.7	-3.7	-2.7	-2.3	-1.9
Primary balance	-8.9	-10.4	-5.2	-3.6	-2.3	-1.9	-1.5
One-offs	0.0	0.0	0.1	0.1	0.1	0.0	0.0
Public debt	54.8	64.6	66.9	68.1	67.9	67.3	66.7
Government guaranteed debt	9.2	9.7	8.5	7.3	6.0	5.7	5.4
Nominal GDP (millions of euros)	12,701	13,605	14,672	15,650	16,660	17,635	18,594

Sources: Maltese authorities; and IMF staff projections.
1/ As a percentage of Nominal Potential GDP.

Table 3. Malta: Financial Soundness Indicators, 2017–2020 1/

(Percent, unless otherwise indicated)

	Core Domestic Banks				Non-Core Domestic Banks				International Banks 2/				Total Banks 2/			
	2017	2018	2019	2020	2017	2018	2019	2020	2017	2018	2019	2020	2017	2018	2019	2020
Capital /3																
Regulatory capital to risk-weighted assets	17.3	18.1	20.1	21.6	17.4	17.9	19.2	20.2	47.7	52.1	47.3	52.8	21.7	22.6	23.7	25.7
Regulatory Tier 1 capital to risk-weighted assets	15.2	16.0	17.6	18.5	14.1	17.7	18.9	19.9	45.0	49.5	47.2	52.8	19.4	20.7	21.8	23.3
Leverage Ratio	7.0	7.3	7.8	7.6	7.7	10.8	11.0	9.5	26.3	35.1	38.8	41.9	9.4	10.2	10.7	10.4
Large exposures to total own funds	88.4	92.8	87.8	81.2	264.7	200.6	140.7	175.8	119.6	79.1	84.3	87.9	111.1	98.0	91.8	90.5
Risk-weighted assets to total assets	50.1	48.5	46.2	42.9	59.6	63.9	61.1	49.0	77.9	80.3	87.1	81.2	53.6	52.7	51.0	46.5
Profitability																
Return on assets /4	0.7	0.5	0.6	0.0	0.3	0.2	1.3	-1.4	1.5	1.4	1.1	2.2	1.0	0.9	0.8	0.6
Return on equity /3,4	9.2	6.5	6.7	-0.3	2.9	1.5	11.0	-12.6	4.9	5.1	6.3	6.2	7.3	5.7	6.8	0.4
Operational cost-to-income ratio	57.1	62.8	66.3	68.2	77.1	62.2	47.0	95.5	27.8	30.5	39.9	35.1	43.2	47.7	53.9	51.8
Interest margin to gross income	70.8	62.3	63.7	73.2	31.1	37.7	31.5	47.9	78.8	79.6	56.1	64.7	73.3	69.3	58.0	67.7
Non-interest expense to gross income	58.8	64.3	67.8	70.2	78.3	62.1	47.1	97.3	28.1	32.1	39.9	35.1	44.0	48.9	54.7	52.7
Personnel expenses to non-interest expenses	48.1	37.9	43.8	45.6	45.6	49.7	50.2	48.3	16.2	14.1	14.2	12.7	37.6	31.2	35.3	34.2
Non-interest income to gross income	29.2	37.7	36.3	26.8	68.9	62.3	68.6	52.1	21.2	20.4	43.9	35.3	26.7	30.7	42.0	32.3
Net impairment charges to gross income	0.8	9.0	0.1	28.8	1.1	29.0	12.8	79.0	15.3	21.1	26.2	18.1	8.1	15.7	11.0	25.1
Asset Quality																
Non-performing loans to total own funds /3	31.2	27.8	25.1	29.0	15.1	26.4	34.8	53.1	13.8	13.4	8.1	9.8	24.5	23.2	21.4	25.6
Non-performing loans to total gross loans	3.8	3.4	3.2	3.7	2.2	4.2	5.4	7.1	1.5	2.5	1.8	1.9	2.8	3.1	3.0	3.5
Non-performing exposures to total gross exposures	2.8	2.6	2.5	2.8	1.8	3.6	4.6	5.6	0.9	1.6	1.3	1.3	1.9	2.3	2.2	2.6
Coverage ratio /5	43.7	43.5	42.9	52.5	65.9	56.1	41.0	47.7	57.5	61.8	78.5	91.4	45.2	49.6	49.2	57.2
Unsecured loans to total lending	27.7	28.6	26.3	23.3	67.2	73.5	77.6	80.8	16.2	17.2	22.5	19.7	25.0	26.8	27.9	25.6
Share of Stage 3 provisions to total provisions	85.1	71.7	71.9	66.7	86.2	91.5	91.4	93.0	84.0	59.5	48.7	44.6	84.9	69.4	67.1	65.2
Forbearance ratio to gross loans	3.2	2.5	2.4	3.0	2.5	1.5	0.9	0.5	2.4	2.0	3.8	3.3	2.8	2.3	2.7	3.3
Liquidity																
Liquidity Coverage Ratio /3	276.0	417.6	343.7	328.3	265.2	422.3	374.7	325.4	278.1	573.0	364.9	685.1	275.3	420.7	347.5	332.8
Liquid assets to total assets /3 /6	30.5	27.8	31.0	33.3	28.6	32.0	36.2	40.3	20.6	7.0	7.6	11.7	29.2	26.4	29.6	32.3
Liquid assets to short-term liabilities /3 /6	43.5	36.0	39.1	39.9	37.6	38.9	45.1	50.0	43.5	24.1	15.1	24.1	43.0	35.9	38.5	40.1
Customer loans to customer deposits	58.9	60.9	59.5	58.4	47.2	50.5	46.6	46.5	111.6	208.7	376.6	462.4	70.4	79.0	79.3	75.4
Counterbalancing Capacity on net cash outflows		187.7	139.0	109.0		248.2	237.8	328.1		87.9	121.9	328.1		192.7	149.5	137.5
Balance Sheet																
Assets to GDP	196.0	191.4	181.8	202.7	18.9	21.5	21.6	24.0	194.6	136.3	99.4	91.1	409.4	349.2	302.9	317.8
Domestic debt securities to total assets	7.0	6.5	6.4	8.3	3.2	2.0	2.9	7.2	0.2	0.1	0.0	0.1	3.6	3.7	4.1	5.9
Foreign debt securities to total assets	16.8	15.8	15.4	13.8	11.9	14.1	10.7	12.2	42.7	29.7	26.1	25.2	28.9	21.2	18.6	16.9
Customer loans to total assets	46.7	48.5	48.0	48.2	32.2	34.8	33.1	33.3	29.0	37.6	43.4	43.9	37.6	43.4	45.4	45.8
Interbank exposures to total assets	8.0	7.8	6.2	5.3	20.2	21.6	13.4	8.8	12.4	10.2	9.9	11.3	10.7	9.6	7.9	7.3

Source: Central Bank of Malta.

1/ Banks' total assets amounted to 467 percent of GDP (about €46 billion) at 2016. About 48 percent of these assets are owned by international banks, which have limited or no linkages to the domestic economy. Core domestic banks, which account for 47 percent of the banking sector's total assets, are tightly linked to domestic activity as they rely mainly on domestic deposits and provide the bulk of lending to residents. The remainder of the assets are held by non-core domestic banks, which maintain small exposure to residents.

2/ Satabank plc is excluded from 2018 figures onwards following the MFSA's decision to appoint a competent person in October 2018 in terms of Article 29(1)(c) and (d) of the Banking Act. It's license was withdrawn on 30 June 2020.

3/ Data for International Banks excludes the branches of foreign banks.

4/ Based on profit after tax.

5/ For the core domestic banks the ratio includes 'Reserve for General Banking Risks' as per the revised Banking Rule 09/2019.

6/ The liquid assets to total assets and liquid assets to short-term liabilities figures from 2017 are based on COREP returns.

Table 4. Malta: Balance of Payments, 2019–2026

	2019	2020	2021	2022	2023	2024	2025	2026
			Projections					
			(Millions of euros)					
Current account balance	779	-457	-339	-45	105	301	466	622
Trade balance (Goods and services)	2,065	960	1,057	1,460	1,711	2,010	2,275	2,530
Goods balance	-1,584	-1,356	-2,052	-1,853	-1,874	-1,887	-1,907	-1,932
Exports	3,468	2,938	3,128	3,600	3,754	3,917	4,076	4,235
Imports	5,052	4,295	5,181	5,453	5,629	5,805	5,983	6,167
Services balance	3,649	2,317	3,110	3,313	3,585	3,897	4,182	4,461
Exports	15,170	14,018	14,924	15,748	16,421	17,134	17,826	18,524
Imports	11,521	11,701	11,814	12,435	12,836	13,237	13,644	14,063
Current income, net	-1,122	-1,254	-1,221	-1,316	-1,404	-1,495	-1,582	-1,668
Current transfers, net	-165	-164	-175	-189	-202	-215	-227	-240
Private	-161	-159	-171	-184	-196	-209	-221	-233
Public	-5	-4	-5	-5	-5	-6	-6	-6
Capital account, net	107	81	102	110	111	106	113	119
Financial account, net	163	-315	-237	64	216	407	578	740
Direct investment	-9,707	-9,743	-10,884	-12,198	-13,011	-13,851	-14,661	-15,459
Portfolio investment	4,723	6,412	6,680	6,488	6,921	7,367	7,798	8,223
Other investment	5,464	3,178	4,108	5,926	6,468	7,063	7,623	8,169
Reserves (- inflow; + outflow)	-109	-30	0	0	0	0	0	0
Errors and omissions	-723	62	0	0	0	0	0	0
			(Percent of GDP)					
Current account balance	5.7	-3.6	-2.5	-0.3	0.7	1.8	2.6	3.3
Trade balance (Goods and services)	15.2	7.6	7.8	10.0	10.9	12.1	12.9	13.6
Goods balance	-11.7	-10.7	-15.1	-12.6	-12.0	-11.3	-10.8	-10.4
Exports	25.5	23.1	23.0	24.5	24.0	23.5	23.1	22.8
Imports	37.2	33.8	38.1	37.2	36.0	34.8	33.9	33.2
Services balance	26.9	18.2	22.9	22.6	22.9	23.4	23.7	24.0
Exports	111.6	110.4	109.7	107.3	104.9	102.8	101.1	99.6
Imports	84.8	92.1	86.8	84.8	82.0	79.5	77.4	75.6
Primary income, net	-8.3	-9.9	-9.0	-9.0	-9.0	-9.0	-9.0	-9.0
Secondary income, net	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Private	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Public	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital account, net	0.8	0.6	0.7	0.7	0.7	0.6	0.6	0.6
Financial account, net	1.2	-2.5	-1.7	0.4	1.4	2.4	3.3	4.0
Direct investment	-71.4	-76.7	-80.0	-83.1	-83.1	-83.1	-83.1	-83.1
Portfolio investment	34.8	50.5	49.1	44.2	44.2	44.2	44.2	44.2
Assets	37.4	52.9	48.3	43.8	43.8	43.8	43.8	43.8
Liabilities	2.6	2.4	-0.8	-0.5	-0.5	-0.5	-0.5	-0.5
Other investment	40.2	25.0	30.2	40.4	41.3	42.4	43.2	43.9
Assets	17.9	19.8	19.8	19.8	19.8	19.8	19.8	19.8
Liabilities	-22.3	-5.2	-10.4	-20.5	-21.5	-22.6	-23.4	-24.1
Reserves (- inflow; + outflow)	-0.8	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-5.3	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Gross external debt (Percent of GDP)	644.7	697.3	648.5	601.0	564.1	531.7	505.0	482.3
Net external debt (Percent of GDP)	-164.7	-169.6	-168.9	-168.8	-169.0	-169.6	-170.5	-171.7

Sources: National Statistics Office of Malta; and IMF staff projections.

Annex I. Implementation of IMF Recommendations

2020 Article IV Advice	Actions Since 2020 Article IV
Financial Sector	
Immediately tackle shortcomings in the implementation of AML/CFT framework	See the *AML/CFT* section in Annex III.
Guarantee long-term financial and operational independence of the financial supervisor and increase supervisory capacity	See the *Financial Sector Supervisory Resources and Independence section* in Annex III.
Address limitations in the crisis management framework	See the *Safety Nets and Crisis Management* section in Annex III.
Strengthen the understanding of financial risks outside of the banking sector and close remaining data gaps	See the *Macroprudential Policy* section in Annex III.
Fiscal Policy	
Address long-term spending pressures related to pensions and healthcare	The 2020 Strategic Pension Review is ongoing, assessing the adequacy, sustainability, and solidarity of the pension system. The review finds that the principles in the 2015 review remain valid, including a need for a strong active employment policy and third pillar pensions. In addition, policy initiatives are underway to improve workforce planning and services in the healthcare sector.
Address infrastructure needs and upgrade public investment efficiency	Public investment rose in 2020. The government is also committed to additional infrastructure projects and raising the utilization of EU finds.
Ensure sustainability of tax revenues	The government prioritized fiscal stimulus to counter the pandemic impacts. However, work has started to increase tax compliance and widen the tax base.
Structural Reforms	
Improve housing affordability	House prices moderated. Rent housing benefit will be provided to pensioners and social welfare beneficiaries facing higher rents due to the Rent Reform bill. In addition, financial assistance will be provided to prospective homeowners and tenants according to the beneficiaries' age, income, and family needs.
Foster innovation through stronger public investment in human capital and research and development (R&D)	The authorities have launched a new stock-taking exercise to review the progress in labor market reforms, in consultation with key stake holders. Limited progress in boosting R&D spending.
Improve the governance framework to sustain attractiveness for foreign investment	The authorities have continued efforts to address shortcomings in their AML/CFT framework. Following the recommendations of the Council of Europe's Venice Commission and the Group of States Against Corruption, they have introduced a comprehensive legislative package, including with respect to the appointment process of various government and judicial officials.

Annex II. Selected COVID-19 Support Measures

Measures	Details	Announced expiration date
Wage Support		
Wage supplement (March 2020–in place)	The Wage Supplement scheme provided eligible employees with a basic wage to address the disruption caused by the COVID-19 pandemic. To simplify the administration of the scheme, funds were forwarded to the employer, who in turn would forward such funds to employees. Extended multiple times to end-2021.	December 2021
Quarantine leave (March–June 2020)	A one-off lump sum grant for employees on mandatory quarantine due to the possible contact with individuals at risk of infection.	
Liquidity Support		
Tax deferral (March 2020–in place)	A deferral to enterprises, including self-employed individuals, to pay provisional tax, VAT and national insurance contribution on salaries. The payments were originally due in May 2020. The scheme was extended in March 2021 to December 2021 and to include all taxes, and the settlement of provisional taxes, social security contributions of self-employed persons and VAT. Eligible taxes may be settled from May 2022 with no interest or penalties charged.	December 2021
Facilitating teleworking (March–June 2020)	Support investment in telework equipment.	
Moratoria (March 2020–in place)	Banks were directed to offer a moratorium on repayments on capital and interest for borrowers who have been negatively affected by COVID-19. After the original application deadline passed in September 2020, the scheme was reactivated in January 2021, allowing application before March 31, 2021 for new moratoria or to extend the existing moratoria up to nine months in total.	December 2021 (application by March 2021)
Loan guarantees (April 2020–in place)	The MDB COVID-19 Guarantee Scheme (CGS) provides guarantees to commercial banks in order to enhance access to bank financing for the working capital requirements of businesses in Malta facing a sudden acute liquidity shortage as a result of the COVID-19 outbreak. In March 2021, the definition of working capital was widened to include the financial costs related to servicing of bank loans of businesses. The scheme was extended from June 2021 (original) to September 2021.	September 2021
Interest rate subsidies	Subsidized interest rates on working capital loans for two years and up to a maximum 2.5 percent.	
Social Support		
Social measures (March 2020–June 2020)	A number of measures were introduced for individuals who were made redundant or who were unable to work. The parental benefit targeted working parents in the private sector, who could not go to work or carry out their functions through teleworking arrangements and were required to stay at home to take care of their school-aged children. The additional unemployment benefit scheme catered for employees who lost their jobs due to the COVID-19 crisis. Moreover, the medical benefit scheme and the disability benefit scheme were	

Measures	Details	Announced expiration date
	granted to working disabled and vulnerable people who could not carry out their work functions due to being ordered to stay home for medical reasons.	
Real Estate Market Support		
Reduction in Property Tax Rate and Stamp Duty (July 2020–in place)	The stamp-duty on the transfer of residential property was reduced, in addition to the reduction in the tax rate associated with sales of property and the extension and wider coverage of the first-time buyer scheme. Furthermore, the Budget 2021 extended or introduced more favorable terms on a number of existing schemes supporting the property market.	August 2021
Postponement and Relaxation of Certain Macroprudential Measures (July 2020– July 2021)	The phasing-in of lowering loan-to-value ratio to 75 percent from 85 percent previously for Category II borrowers is postponed by one year to July 1, 2021. The temporary relaxation of the stressed debt service-to-income limits was in effect for six months until December 1, 2020	
Economic Recovery Support		
COVID-19 Business Assistance Program (July 2020–in place)	Utility bills and commercial rents for businesses affected by the pandemic were subsidized, fuel prices were reduced, and commercial licenses were refunded. Contributions to support businesses to invest were granted.	
Stimulating Domestic Demand	In order to stimulate domestic expenditure, the government granted a €100 voucher to residents aged 16 and over to be spent locally at hotels, licensed accommodations, restaurants, bars, or diving schools and at retail outlets that were required to be closed during the pandemic. Other measures included tax refunds and a more generous in-work benefit scheme for low-income households.	
Direct Business Support (July 2020–in place)	The government introduced schemes which directly supported business operations related to logistics, digital promotion, underwriting facilities, participation in international fairs, and an export credit guarantee scheme for the establishment of new export markets. In addition, assistance to nursing homes and an allocation to non-governmental organizations was granted.	

Annex III. Main FSAP Recommendations[1]

Recommendations	Timing[2]	Progress
Risk Analysis		
Strengthen the risk analysis by incorporating new dimensions in liquidity stress testing, conducting regular sensitivity analysis on selected vulnerabilities, and enhancing data management (CBM, MFSA)	NT	The CBM enhanced the stress testing frameworks by considering new scenarios and dimensions in its liquidity and solvency stress test frameworks, and incorporating sensitivity analyses in the macro stress testing frameworks. Its stress test methodologies are frequently reviewed and modified, including to assess the banks' capacity to withstand COVID-19 shocks. The CBM has also revamped its credit risk model to implement IFRS9's expected loss approach, and developed a framework to assess household vulnerabilities. The Financial Stability Reports include analyses on new dimensions such as concentration and cross-border exposures. Both the CBM and the MFSA invested in improving the data management system.
Macroprudential Policy		
Consider providing the CBM with powers to recommend actions to be taken by a public authority or public institution, with a "comply or explain" mechanism, and to issue warnings and opinions. Amend the MFSA Act to add a financial stability objective (Government, MFSA)	NT	A financial stability objective has been added to the MFSA Act. The authorities note that the Joint Financial Stability Board, chaired by CBM governor, has recommendation powers.
Close remaining data gaps, and enhance analytical tools (CBM, NSO, MFSA)	NT/MT	In 2021, CBM initiated a process to collect a comprehensive real estate data from all banks engaging in real estate lending on a quarterly basis. Concurrently, NSO started developing a database on commercial real estate indicators. CBM published its risk analysis on the non-bank financial institutions (NBFIs) in the Financial Stability Report, highlighting their risk profile. Further work to develop risk assessment tools is underway, including developing risk dashboard for NBFIs. MFSA is finalizing its work to create NBFI composite indicators in mid-2021. The CBM and the NSO are exploring the possibility of surveying intercompany loans on a quarterly basis.
Refine and introduce the planned borrower-based instruments to address possible buildup of vulnerability in the housing and household sectors. (CBM)	I	CBM Directive No. 16 defining borrower-based macro prudential measures became effective on July 1st, 2019. Some of the measures were temporarily relaxed in June 2020 to address potential shocks on borrowers' income resulting from the pandemic. Further refinements should be considered in due course.

[1] Please refer to Malta Financial System Stability Assessment 2019 for the full set of FSAP recommendations.
[2] I = Immediate (within 1 year); ST = Short Term (within 1–2 years); MT = Medium Term (within 3–5 years).

Recommendations	Timing	Progress
Financial Sector Supervisory Resources and Independence		
Ensure stable funding for the MFSA, grant it full autonomy over its recruitment and maintain a dedicated statutory committee on supervisory issues. (MFSA, Government)	I	The revision of supervisory fees based on a “cost recovery” model was presented to the Ministry of Finance in 2020. Legal amendments in 2019 allow MFSA’s recruitment independence. The Regulatory Committee has been functioning well.
Address the significant gap in supervisory and enforcement capacity by increasing staff and broadening the skill set. (MFSA)	I	The MFSA expanded to 430 staff members in 2020, moving towards the goal of 450 by 2021. It conducted skills mapping exercise in 2020 to analyze training needs.
Banking Regulation and Supervision		
Increase the number and risk orientation of onsite inspections of LSIs. Enhance supervision of third country branches. (MFSA)	ST	The MFSA conducts a bi-annual SREP model, using thematic and deep dive assessments in its first round in 2020. It also developed an onsite visit program covering higher risk areas. The MFSA visits third country branches annually, and plans to enhance the relationship with their home regulators.
Take timely supervisory actions (including for ML/TF) and increase the use of monetary fines. Ensure supervisory action is not delayed through judicial appeal, including by amending the law, if needed. (MFSA, FAIU, Government)	ST	The FIAU has taken multiple initiatives to support timely actions, including by increasing human resources, improving its risk-based supervision approach, introducing IT tools to expedite the risk assessment process, and adopting compliance monitoring tools to reduce subjectivity in deciding administrative measure and penalty. The average time taken to issue supervisory reports following the examination has decreased to 2 months in 2020 from 12 months in 2017. The use of monetary fines has increased from 7 administrative penalties in 2017 to 161 in 2021. Legal amendments in February 2020 allowed the FIAU to give notice of administrative penalties even if they may still be appealed or are subject to appeal and set a time limit of 9 months for the appeal to be heard. The MFSA plans to finalize a review of legislative framework for imposing monetary penalties in 2021.
Insurance and Securities Regulation and Supervision		
Strengthen conduct supervision and enhance the sectoral risk-based supervision framework. (MFSA)	MT	The MFSA continues to conduct onsite inspections and offsite reviews in 2020-21, including thematic inspections on investment products to selected banks. Visits to selected banks are ongoing in 2021 to assess adherence to conduct of business rules.

Recommendations	Timing	Progress
AML/CFT		
Improve the authorities' assessment and understanding of ML/TF risks and strengthen the national coordination. (National Coordination Committee)	I	The authorities have stepped up efforts to improve their risk understanding, including by carrying out sectoral risk assessments and introducing new risk-based tools for AML/CT supervision. To monitor sectoral risks on a continuous basis, the FIAU has introduced Risk Evaluation Questionnaires which must be submitted on an annual basis by each subject person. Authorities have also issued sector specific AML/CFT guidance. Coordination among relevant authorities remains strong, with active participation in the NCC work.
Adopt a multi-prong strategy that includes: (i) ensuring that banks appropriately apply preventive measures; (ii) fully implementing a risk-based AML/CFT supervision; and (iii) applying timely, dissuasive, and proportionate sanctions and effective fit-and-proper tests. (MFSA, FIAU, ROC, Government)	I	The MFSA set up a financial crime compliance function to conduct AML/CFT inspections, and Prudential and Conduct Supervisory Functions integrated AML/CFT elements in their supervisory work. The FIAU's supervisory process for banks was revised involving sector specific risk evaluation questionnaires and dedicated teams. Administrative penalties on banks have increased from 1 in 2017 to 161 in 2021, and 6 remediation directives have been issued since 2019.
Support establishing an EU-level arrangement responsible for AML/CFT supervision. (Government)	MT	Malta is supporting the EU-level initiative of a harmonized higher-level AML regulation and supervision.
Safety Nets and Crisis Management		
Adopt an administrative bank insolvency regime with explicit powers to transfer assets/liabilities. Clarify the creditor hierarchy. (Government)	I	MFSA initiated advance research on possible models to improve the bank insolvency framework with the aim of presenting proposals to the government in 2021.
Shift responsibility for decisions on bank insolvency and liquidation, post-license revocation, from the MFSA's supervisory function to its resolution function (MFSA)	I	The MFSA's board decided in April 2021 to shift responsibility from the supervisory function to the resolution function and set up a transition team. Legal amendments are under discussion.
Review the adequacy of the Resolution Unit's staffing and increase its resources accordingly (MFSA)	I	Staff resources in the Resolution Unit have increased since 2019, and the adequacy will be reviewed again in 2021.

Annex IV. External Sector Assessment

<table>
<tr><td colspan="13">Overall Assessment: The external position of Malta in 2020 was weaker than the level implied bymedium term fundamentals and desirable policies. However, this assessment is subject to uncertainty given measurement challenges associated with identifying ultimate ownership of profits and savings between domestic and foreign investors or firms.
Policy Responses: Malta’s current account balance is expected to improve as external demand and net exports recover from the pandemic crisis, and the fiscal balance strengthens. The country’s large positive NIIP significantly mitigates external vulnerabilities.</td></tr>
<tr><td rowspan="2">Foreign Assets and Liabilities</td><td colspan="12">Background: Malta has maintained large net asset positions over the past decade, with sizable gross assets and liabilities (22-23 times GDP). Although the current account position turned negative, the net international investment position strengthened from 54 percent of GDP in 2019 to 63 percent of GDP in 2020 (in part reflecting net revaluation gains). Gross assets increased from 18.5 times GDP in 2019 to 20.4 times GDP in 2020, due to a strong increase in equity investment aboard, while gross liabilities increased from 17.9 times GDP in 2019 to 19.7 times GDP in 2020 (of which over 80 percent are direct investment liabilities).</td></tr>
<tr><td colspan="12">Assessment: Malta’s gross liabilities are sizable. The volatility of financial flows and investment returns could present some risk. But the majority of the liabilities are direct investment, and the large gross asset position mitigate risks.</td></tr>
<tr><td>2020 (% GDP)</td><td colspan="2">NIIP: 63</td><td colspan="3">Gross asses: 2,036</td><td colspan="3">Gross liabilities: 1,974</td><td colspan="4"></td></tr>
<tr><td rowspan="2">Current Account</td><td colspan="12">Background: The current account (CA) position turned into a deficit of 3.6 percent of GDP in 2020, for the first time since 2016. The sharp deterioration in the current account balance was driven mostly by a large fall in net travel receipts, and to a lesser extent, lower investment income inflows, partially offset by reduced goods imports. Over the medium term, the CA is expected to improve gradually as the pandemic recedes and external demand recovers.</td></tr>
<tr><td colspan="12">Assessment: Taking account of cyclical contributions (-0.8 percent of GDP) and COVID-19 related temporary shocks to the tourism and oil sectors (3 percent of GDP), the actual CA (-3.6 percent of GDP) is adjusted to -1.4 percent of GDP. The EBA-lite CA model suggests a CA norm of -2.1 percent of GDP. The norm is adjusted by 3 percentage points to 0.9 percent by removing the negative contribution of the remittance variable to the norm in the EBA-lite model (as the remittance variable is less relevant for Malta, a high-income country where the contribution of remittances to the CA could be positive). As a result, the CA gap is estimated at -2.3 percent of GDP, with an implied REER gap of 2.0 percent. Policy gaps contribute 0.9 percentage points to the gap, of which the domestic component of the gap was – 2.4 percent of GDP (largely reflecting a higher than desirable fiscal deficit level).</td></tr>
<tr><td>2020 (% GDP)</td><td colspan="2">Actual CA: -3.6</td><td colspan="2">Adj. CA: -1.4</td><td colspan="2">CA Norm: -2.1</td><td colspan="2">Adj. Norm: 0.9</td><td colspan="2">CA gap: -2.3</td><td colspan="2">Policy Gap: 0.9</td></tr>
<tr><td rowspan="2">Real Exchange Rate</td><td colspan="12">Background: The ULC-based REER appreciated by 2.8 percent and the CPI-based REER appreciated by 6.6 percent in 2020.</td></tr>
<tr><td colspan="12">Assessment: The EBA-lite REER model points to a modest REER overvaluation of about 2 percent, similar to the implied REER gap in the CA model.</td></tr>
<tr><td>2020 (% GDP)</td><td colspan="3">Actual REER: 4.5</td><td colspan="3">REER Norm: 4.5</td><td colspan="3">REER gap: 2.1</td><td colspan="3">Implied REER gap (from CA model): 2.0</td></tr>
<tr><td rowspan="2">Capital and Financial Accounts</td><td colspan="12">Background: The capital account recorded a small surplus of 0.6 percent of GDP, while the financial account balance turned into a deficit of 2 percent of GDP in 2020, with increased net FDI inflows and reduced net other investment outflows more than offsetting higher net portfolio investment outflows.</td></tr>
<tr><td colspan="12">Assessment: As net external demand recovers, Malta’s financial account balance is expected to return to a surplus position over the medium term.</td></tr>
<tr><td>FX intervention and reserves</td><td colspan="12">Background and Assessment: The euro is a global reserve currency. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</td></tr>
</table>

Annex V. Risk Assessment Matrix[1]

Source of risks	Relative Likelihood	Impact if Realized	Policy Response
Global Risks			
Global resurgence of the Covid-19 pandemic. Local outbreaks lead to a global resurgence of the pandemic (possibly due to vaccine-resistant variants), which requires costly containment efforts and prompts persistent behavioral changes rendering many activities unviable.	Medium **ST**	**High,** Protracted containment measures and a slower reactivation of the tourism sector would delay the recovery and produce greater scarring effects.	Continue fiscal and financial support measures. Maintain structural reform momentum to spur investment and promote higher productivity growth.
Disorderly transformations. Covid-19 triggers structural transformations, but the reallocation of resources is impeded by labor market rigidities, debt overhangs, and inadequate bankruptcy resolution frameworks. This, coupled with a withdrawal of Covid-19-related policy support, undermines growth prospects. Adjustments in global value chains and reshoring shift production activities across countries.	Medium **ST/MT**	**Medium/Low.** Malta's labor market and corporates have thus far been relatively reliant to the pandemic shock, However, the long-term impact of the crisis on the economy is uncertain, and Malta's potential growth would be adversely affected.	Pursue structural reforms, particularly in education, labor market, business climate, infrastructure, and insolvency framework, while safeguarding long-term fiscal sustainability and improving the quality of public finances.
De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia. The Fed reacts by signaling a need to tighten earlier than expected. The resulting repositioning by market participants leads to a front-loaded tightening of financial conditions and higher risk premia.	Medium: **ST/MT**	**Medium/Low.** Malta would be relatively insulated given the public and private sector's high reliance on domestic financing. However, it is still vulnerable to weaker external demand, lower FDI inflows, and potential indirect financial contagion.	Continue close financial supervision.
Cyber-attacks on critical infrastructure, institutions, and financial systems.	Medium: **ST/MT**	**Medium.** Wide-spread cyber-attacks could disrupt payment and financial systems and remote work arrangements.	Continue efforts to strengthen the cybersecurity framework.
Malta's Specific Risks			
Prolonged grey listing and incomplete AML/CFT reform. Slow progress in effectively implementing and enforcing the AML/CFT framework could damage the country's attractiveness for foreign investment.	Medium **ST/MT**	**High/Medium.** Pressure on correspondent banking relationships will continue, and Malta's attractiveness as a financial and business location may deteriorate.	Intensify efforts to address remaining shortcomings in the AML/CFT framework and exit from the grey-list as early as possible.
Sharp correction in housing prices. A sharp decline in housing prices could affect financial stability with adverse effects on lending and growth.	Medium/Low **ST, MT**	**Medium/Low.** Bank and household balance sheets will weaken, leading to widespread distress through an adverse feedback loop of decreased lending and investment affecting financial stability and growth.	Continue close monitoring or risks and readjust macro-prudential measures, as necessary. Risks are largely mitigated by banks' strong capital and liquidity positions, households' high financial wealth, and low default rates.
Possible changes in international corporate and personal taxation. International reforms could reduce Malta's attractiveness as a low tax jurisdiction.	Medium **ST/MT**	**Medium.** Malta's attractiveness as a financial and business location may deteriorate, weakening fiscal revenues and foreign investment.	Strengthen spending efficiency and revenue administration. Conduct a holistic review of the overall tax system.

[1]The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex VI. Measuring Scarring

A deep recession, like the COVID-19 pandemic crisis, could leave scarring (persistent damage) to the economy. Scarring could be driven by various supply and demand factors. Supply-side factors include permanent loss in physical and human capital accumulation and productivity, while demand factors include loss in external demand (including tourism service exports). A deterioration in the balance sheets of the government, households, and corporates could also aggravate scarring, weakening consumption and investment.

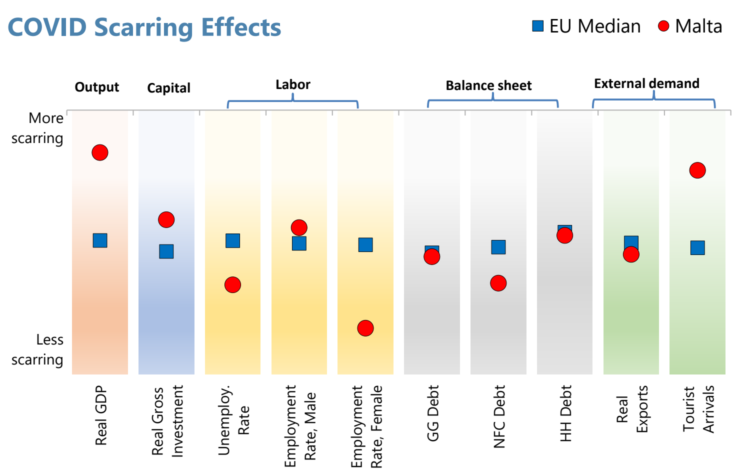
The chart below illustrates potential scarring for Malta in comparison with other EU economies. The scorecard is based on z-scores, which are calculated on key macroeconomic indicators for 27 EU economies. The loss in GDP in Malta was much larger than in many other EU countries, while labor markets have been relatively intact. There remains uncertainty about long-term scaring in the tourism sector.

- *Physical capital.* The loss in physical capital investment in Malta is broadly comparable with the EU median.

- *Labor markets* have been relatively intact. The unemployment rate is currently at 3.7 percent in Malta, only 0.6 percentage points higher than that at end-2019. In contrast, the unemployment rate remains much higher in the EU, at 7 percent on average, about 1.2 percentage point higher than the pre-crisis level. The male employment rate fell by about 1 percentage point in Malta, similar to other EU countries. The female employment rate in Malta, however, increased by 1 percentage points in Malta, compared to decreases in many other European countries.

- *Balance sheets.* Government debt increased by 20 percentage points of GDP, although it is expected to remain at around 65 percent of GDP in 2021. Although growth in corporate and household debt in Malta is lower than in other countries, the full impact of the crisis on corporate and household balance sheets have yet to be seen, as they have been protected by government support measures. Damages to their balance sheets could result in debt overhang problem.

COVID Scarring Effects



Sources: Eurostat, Haver Analytics, IMF International Financial Statistics, IMF World Economic Outlook, and IMF staff calculations.
Note: Variables are normalized such that the scales extend between maximum exposure to scarring effects on the top and minimum scarring on the bottom.

- *Tourism demand shock.* Malta is highly dependent on tourism income. It is highly uncertain how the pandemic crisis would affect the pattern of tourism demand.

Data descriptions

Real GDP: Percent change between the January 2020 WEO forecast and latest projection of the 2021 real GDP (as a percent of 2019 real GDP).

Real gross capital formation: Percent change between the January 2020 WEO forecast and latest projection of the 2021 real gross capital formation (as a percent of 2019 real gross capital formation).

Unemployment rate: Difference between latest (mostly 2021:M5) and 2019:M12 unemployment rate.

Employment rate: Difference between latest (mostly 2021:Q1) and 2019:Q4 employment rate.

General government debt: Difference between 60 percent and latest projection of the 2021 general government debt (as percent of fiscal year GDP).

Nonfinancial corporate sector debt: Difference between 2021:Q1 and 2019:Q4 NFC debt (as percent of GDP).

Household debt: Difference between 2021:Q1 and 2019:Q4 household debt (as percent of GDP).

Real exports: Percent change between the January 2020 WEO forecast and latest projection of the 2021 real exports of goods & services (as a percent of 2019 real exports of goods & services).

Tourist Arrivals: Difference between latest (mostly 2021:M5) and 2019:M12 annualized seasonally adjusted monthly tourist arrivals (as percent of population).

Annex VII. Climate Change Mitigation Policy

Malta contributes to the EU's Nationally Determined Contribution and is bound by EU targets. Malta adopted the Climate Action Act (which enshrines international requirements into national law) in 2015 and the Climate Emergency Resolution (which provides nationally binding legal obligations for coherent and coordinated governance to deal with climate change policies) in 2019. The EU has set the target of reducing greenhouse gas emissions by at least 55 percent (compared to 1990 levels) by 2030 and achieving climate neutrality by 2050. Each EU member state is required to meet targets set under the Effort Sharing Regulation, which relates to emissions not covered by the EU Emissions Trading System (ETS). For Malta, the target is a 19 percent reduction (compared to 2005 levels) in non-ETS emissions by 2030. Over the past several years, the authorities have published strategic papers to lay out their plans, including the *Low Carbon Development Vision* (2017), the *National Energy and Climate Plan* (NECP, 2019), the *Waste Management Plan* (2021), and the *Long Term Renovation Strategy* (2021).

With a view to spurring both immediate and longer-term action, the authorities published the *Low Carbon Development Strategy* (LCDS) in June 2021. It proposes a set of measures to achieve carbon neutrality by 2050, as well as adaptation policies. The LCDS uses marginal abatement cost curve modeling to identify the most cost-effective climate measures. It focuses on energy, transport, buildings, industry, waste, water, and agriculture, and emphasizes challenges in finding a broad range of options to decarbonize the Maltese economy, including due to its island country nature and small market size, its service-based economy and relative lack of carbon-intensive industry, and absence of natural gas and district heating and cooling networks.

There are merits to designing a decarbonization strategy from a long-term perspective. There is an economic case for investing upfront in those sectors that have long-term emission reduction potential but are more difficult and expensive to decarbonize, such as power and transport.[1] The rationale is twofold. First, it takes time to decarbonize these sectors, and thus investment should start earlier to avoid rushed and much costlier decarbonization in the future. Second, early investment in relatively costly emission reduction options could help encourage technological innovation and lower the cost of certain key technologies. This could be the case, for instance, of offshore wind—a technology that has potential in Malta according to the LCDS. Likewise, in the transport sector, early investments could help accelerate a modal shift.

Options to strengthen climate policies include a review of environmental taxes. There are several environmental taxes, including in the transport sector (electric vehicle exemption from registration taxes and road circulation fees, registration tax based on a "polluter pays" principle, cash grants for cleaner corporate vehicle fleets, and scrappage grants for inefficient vehicles) and

[1] For a discussion of the economics of starting with the most expensive options, see Vogt-Schilb, A., G. Meunier, and S. Hallegatte (2018), "When Starting with the Most Expensive Option Makes Sense: Optimal Timing, Cost and Sectoral Allocation of Abatement Investment," *Journal of Environmental Economics and Management*, 88 (March), 210–33. For a discussion of the difficulties of decarbonizing the transport sector and policy options to do so, see Arregui and others, 2020, "Sectoral Policies for Climate Change Mitigation in the EU," IMF Departmental Paper No. 20/14.

residential housing (corporate tax credits for high-efficiency combined heat and power units). The EU's "Fit for 55" package would provide an opportunity for Malta to review its environmental taxes.

Several sources of decarbonization could also be exploited. In addition to efforts to increase the contribution of energy efficiency through investment, decarbonization could focus in particular on two of the main emitting sectors:

- **Power** (34 percent of greenhouse gas emissions in Malta). Malta has a relatively high level of greenhouse gas emission intensity of power generation and one of the lowest shares of renewables in final energy production and consumption in the EU (Arregui and others, 2020).[2] Malta's target for renewables as a share of energy consumption (11.5 percent by 2025) remains lower than many EU countries' targets. While feed-in tariffs and subsidies provide support to renewables, other policies could be useful, including auctions/tenders, quotas, feebates, and investment grants.

- **Transport** (30 percent of emissions). Malta has a low rate of zero and low emission vehicle adoption, and one of the highest levels of life-cycle CO_2 emissions for electric vehicles in the EU (Arregui and others, 2020). The authorities expect to announce that they will phase out the use of combustion engine vehicles, in line with the EU's "Fit for 55" package. This will be an important policy signal to raise long-term investment in low-carbon transport. Policies to promote a modal shift to walking and cycling could also be embedded in urban mobility design.

[2] See Arregui and others, 2020, "Sectoral Policies for Climate Change Mitigation in the EU," IMF Departmental Paper No. 20/14.

Appendix I. Debt Sustainability Analysis

Malta's public debt increased sizably due to a sharp growth contraction and fiscal response to the pandemic. Nevertheless, due to the low debt level prior to the pandemic, public debt is projected to stabilize at around 68 percent of GDP by 2023 and be on a downward path in the medium term under the baseline scenario. Gross financing needs are projected to fall from 20 percent of GDP in 2021 to 7 percent of GDP by 2026. Risks to the baseline projections include materialization of contingent liability and a slower than expected recovery. Malta's external debt sustainability remains robust to various shocks.

Public Debt Sustainability

Malta's public debt ratio rose sharply since the onset of the pandemic. Prior to the pandemic, gross public debt declined from 69 percent of GDP in 2011 to 42 percent in 2019, reflecting primary fiscal surpluses and strong nominal GDP growth. Due to a sharp growth contraction and fiscal response during the pandemic, the gross public debt to GDP ratio rose to 54¾ percent in 2020 and is projected to rise further to 64½ percent of GDP in 2021. Under the baseline scenario, primary deficits are projected to shrink from 2022 with economic recovery and the unwinding of COVID fiscal measures. Public debt is projected to start declining in 2024 after peaking at 68 percent of GDP in 2023.

Gross financing needs (GFNs) have risen sizably, while financing conditions remain favorable. GFNs approach to the benchmark of 20 percent of GDP in 2021, reflecting a primary deficit and rollover needs for short-term public debt that rose by more than three percentage points of GDP in 2020. Thereafter, GFNs continue to fall to 7 percent of GDP by 2026 but remain higher than the projections in the last Article IV consultation. More than 80 percent of the outstanding debt is long-term on a residual maturity basis, and the government has continued to be successful in auctioning long-term bonds. Financing risks are mitigated by the ECB's accommodative monetary policy and the Pandemic Emergency Purchase Program and the usage of medium- and long-term loans under the EU's SURE instrument.

Contingent liabilities remain significant. The stock of government guarantees increased to 9 percent of GDP due to the COVID guarantee schemes. In addition, liabilities of non-financial state-owned enterprises (SOEs) represented 19 percent of GDP in 2019 (latest official data). Other contingent liabilities related to public-private partnerships account for about 1 percent of GDP.

Debt sustainability is resilient to most standard adverse macroeconomic shocks but more sensitive to low growth.

- **Growth shock:** This scenario envisages a reduction of real GDP growth by 5 percentage points per year over 2022–23 (equivalent to one standard deviation of growth over the past 10 years) and a 1.2 percentage-point drop in inflation relative to the baseline projection. Nominal interest rate increase by 65 and 127 basis points in 2022 and 2023, respectively, reflecting higher risk premiums. Debt would peak at 84 percent of GDP in 2023, about 16 percentage points higher than in the baseline and close to the high-risk threshold of 85 percent. It would then decline to 81 percent of GDP in 2026.

- **Primary balance shock:** A cumulative reduction of 4.4 percent of GDP in the primary balance (equivalent to one standard deviation shock) in 2022–23, coupled with a 25 basis point increase in the interest rate, would raise the debt ratio by about 4 percentage points relative to the baseline over the medium term.

- **Interest rate shock:** A sustained increase of 337 basis points in spread throughout the projection period would increase the debt ratio by about 3 percentage points relative to the baseline over the medium term, and the debt ratio is projected to remain in an upward trajectory.

- **Real exchange rate shock:** A 13 percent real exchange rate depreciation with pass-through to the inflation rate is assumed in 2022. Given that public debt is almost entirely denominated in local currency, this scenario makes negligibly small impacts on the debt ratio.

- **Combined macro-fiscal shocks:** This scenario combines the four above-mentioned shocks. The debt ratio would rise to 85½ percent of GDP in 2024, 17 percentage points higher than the baseline, and remain on an upward trajectory in the medium term.

Debt sustainability could be materially affected by some sources of fiscal vulnerability, especially contingent liabilities.

- **Financial contingent liability shock:** The scenario analyzes the impact of a one-time increase in non-interest expenditures equivalent to 10 percent of the size of the banking sector's assets, coupled with slower real GDP growth (a one standard deviation reduction in the growth rate over 2022–23), inflation decreasing by 0.25 percentage points for every one percentage point reduction in growth, and interest rate spread rising by 0.25 basis points for every one percent of GDP deterioration in the primary balance. While the revenue-to-GDP ratio is assumed to remain the same as the baseline, the shock would deteriorate the primary balance to minus 29 percent of GDP in 2022, largely reflecting the effect of bank assets. The debt ratio is projected to rise sharply to 102 percent of GDP in 2023. It would then decline to 101 percent of GDP at the end of the projection horizon.

- **Government guarantee shock:** This scenario analyzes a contingent liability risk from SOEs and other government guaranteed debt, by assuming a one-time increase in expenditures equivalent of 50 percent of SOE liabilities. Additional shocks follow the same assumptions as for financial contingent liability shock above, including slower growth, higher inflation, and higher interest rate spreads. With these shocks combined, the debt-to-GDP ratio would increase to 84 percent in 2023, about 16 percentage points higher than the baseline scenario. The debt ratio would then resume a declining trend afterwards, reaching 82 percent of GDP at the end of the projection period.

- **CBI proceed shock:** The sustainability of the debt without proceeds from the citizenship-by-investment program is analyzed by completely excluding such proceeds from non-interest revenues and assuming modest increases in interest rate spreads. The debt ratio is projected to increase to 70 percent of GDP at the end of the projection horizon, 3 percentage points higher compared to the baseline.

External Debt Sustainability

Malta's external position is expected to remain robust, with large holdings of external assets. Malta has maintained large net asset positions over the past decade, with sizable gross assets and liabilities (22–23 times GDP). External debt primarily represents stable intercompany lending and liabilities of offshore financial institutions that have limited links to the domestic economy. Total net external debt was minus 168 percent of GDP at the end of 2020. It is projected to stay broadly stable at around minus 165 percent of GDP over the medium-term, supported by an improvement in the current account balance (excluding interest payments) offset by a decline in net FDI inflows and a slower increase in gross assets. Standard tests suggest that Malta's external position would be robust to most adverse shocks.

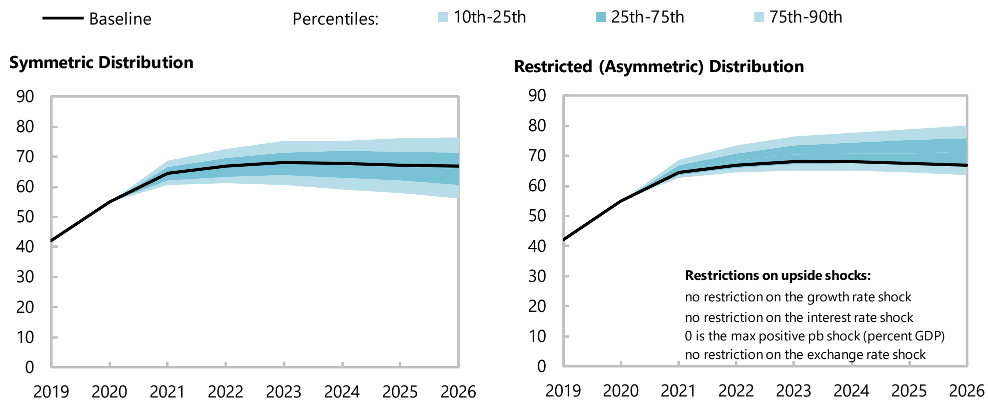
Appendix Figure I.1. Malta: Public DSA—Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

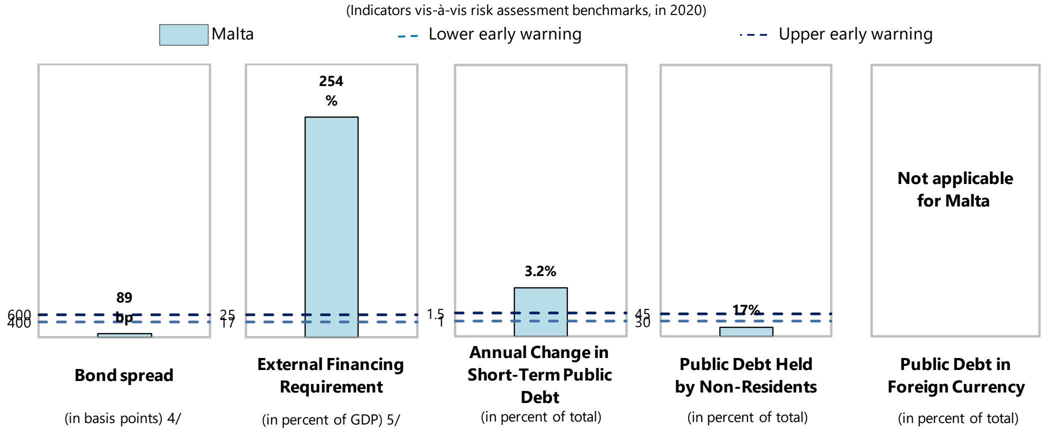
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

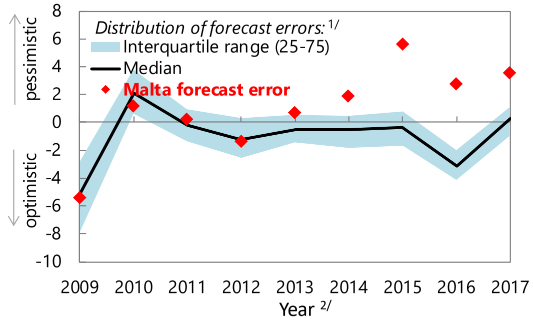
4/ Long-term bond spread over German bonds, an average over the last 3 months, 13-Feb-21 through 14-May-21.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

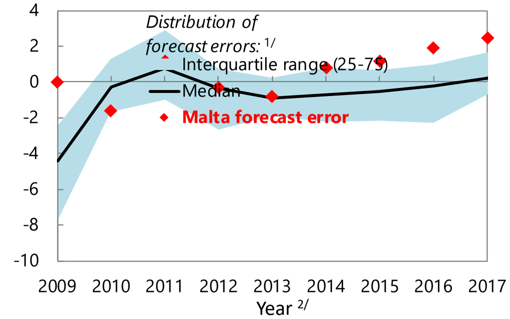
Appendix Figure I.2. Malta: Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

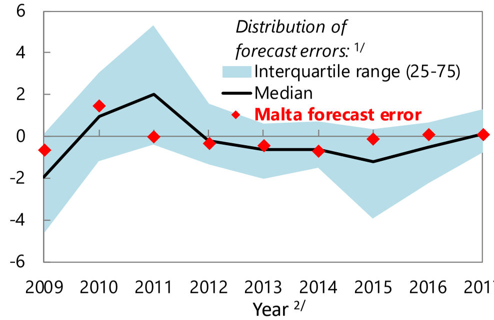
Real GDP Growth
(in percent, actual-projection)
Malta median forecast error, 2009-2017: **1.19**
Has a percentile rank of: **97%**



Primary Balance
(in percent of GDP, actual-projection)
Malta median forecast error, 2009-2017: **0.77**
Has a percentile rank of: **91%**

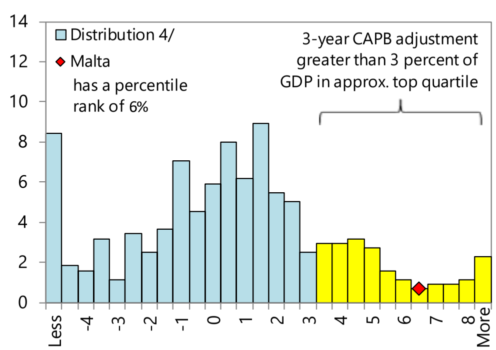


Inflation (Deflator)
(in percent, actual-projection)
Malta median forecast error, 2009-2017: **-0.15**
Has a percentile rank of: **62%**

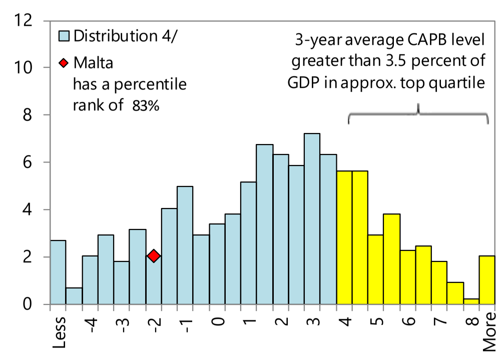


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

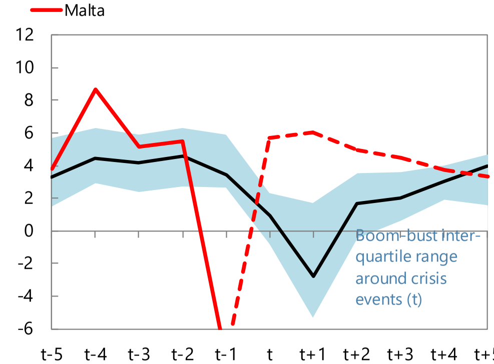


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



Source : IMF Staff.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Malta has had a positive output gap for 3 consecutive years, 2018-2020. For Malta, t corresponds to 2021; for the distribution, t corresponds to the first year of the crisis.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Appendix Figure I.3. Malta: Public DSA—Baseline Scenario

(in percent of GDP unless otherwise indicated)

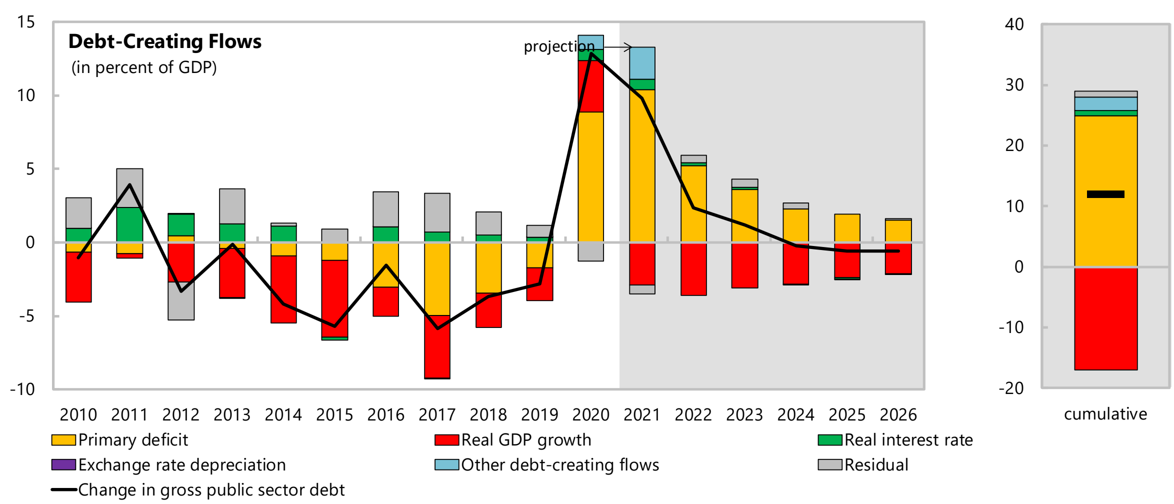
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	59.0	42.0	54.8	64.6	66.9	68.1	67.9	67.3	66.7
Public gross financing needs	16.3	5.0	16.2	20.0	15.1	12.4	10.7	10.1	7.1
Real GDP growth (in percent)	5.6	5.5	-7.8	5.7	6.0	5.0	4.5	3.7	3.3
Inflation (GDP deflator, in percent)	2.4	2.3	1.4	1.3	1.7	1.6	1.9	2.1	2.1
Nominal GDP growth (in percent)	8.1	7.9	-6.5	7.1	7.8	6.7	6.5	5.9	5.4
Effective interest rate (in percent) [4/]	4.3	3.2	3.0	2.8	2.1	2.0	1.9	2.0	2.0

As of May 14, 2021		
Sovereign Spreads		
EMBIG (bp) 3/		72
5Y CDS (bp)		N/A
Ratings	Foreign	Local
Moody's	A2	A2
S&Ps	A-	A-
Fitch	A+	A+

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.4	-2.8	12.8	9.8	2.3	1.2	-0.2	-0.6	-0.6	12.0	
Identified debt-creating flows	-3.7	-3.6	14.1	10.4	1.8	0.6	-0.6	-0.6	-0.7	10.9	
Primary deficit	-1.7	-1.7	8.9	10.4	5.2	3.6	2.3	1.9	1.5	24.9	-2.2
Primary (noninterest) revenue and grants	37.8	37.2	36.8	36.6	36.2	35.9	35.7	35.6	35.6	215.6	
Primary (noninterest) expenditure	36.2	35.5	45.7	47.0	41.5	39.5	38.0	37.5	37.1	240.5	
Automatic debt dynamics [5/]	-2.1	-1.9	4.3	-2.2	-3.4	-3.0	-2.9	-2.5	-2.2	-16.2	
Interest rate/growth differential [6/]	-2.1	-1.9	4.3	-2.2	-3.4	-3.0	-2.9	-2.5	-2.2	-16.2	
Of which: real interest rate	1.0	0.3	0.8	0.7	0.2	0.2	0.0	-0.1	-0.1	0.8	
Of which: real GDP growth	-3.1	-2.3	3.5	-2.9	-3.6	-3.1	-2.9	-2.4	-2.1	-17.0	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.9	2.2	0.0	0.0	0.0	0.0	0.0	2.2	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
ESM and euro area loans	0.0	0.0	0.9	2.2	0.0	0.0	0.0	0.0	0.0	2.2	
Residual, including asset changes [8/]	1.4	0.8	-1.3	-0.6	0.5	0.6	0.4	0.0	0.1	1.0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

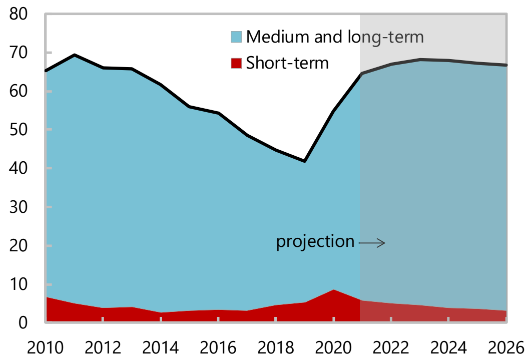
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Appendix Figure I.4. Malta: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

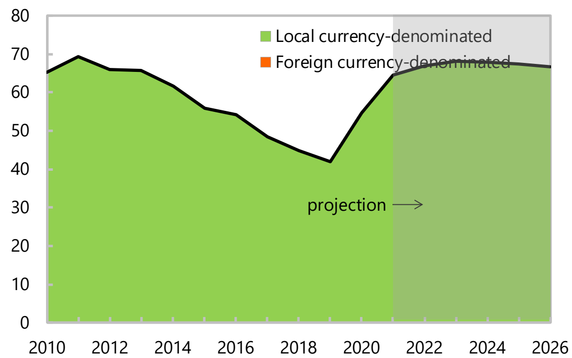
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

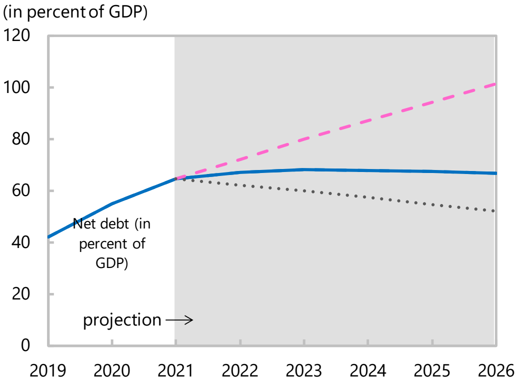


Alternative Scenarios

Baseline　Historical　Constant Primary Balance

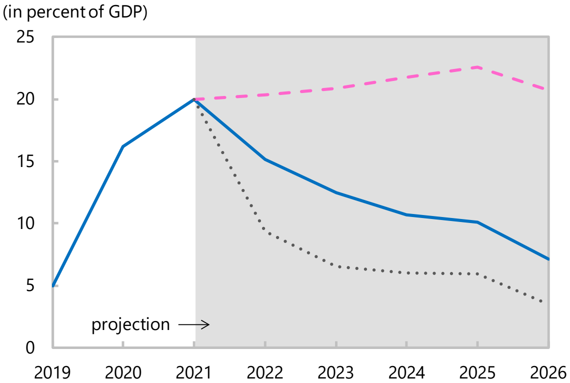
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

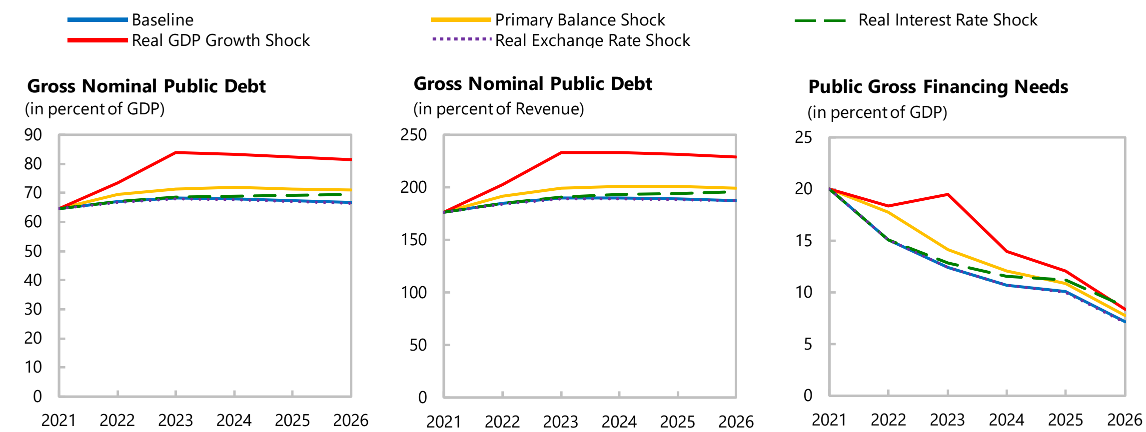
Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	5.7	6.0	5.0	4.5	3.7	3.3
Inflation	1.3	1.7	1.6	1.9	2.1	2.1
Primary Balance	-10.4	-5.2	-3.6	-2.3	-1.9	-1.5
Effective interest rate	2.8	2.1	2.0	1.9	2.0	2.0
Constant Primary Balance Scenario						
Real GDP growth	5.7	6.0	5.0	4.5	3.7	3.3
Inflation	1.3	1.7	1.6	1.9	2.1	2.1
Primary Balance	-10.4	-10.4	-10.4	-10.4	-10.4	-10.4
Effective interest rate	2.8	2.1	1.9	1.8	1.8	1.8

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	5.7	4.3	4.3	4.3	4.3	4.3
Inflation	1.3	1.7	1.6	1.9	2.1	2.1
Primary Balance	-10.4	0.7	0.7	0.7	0.7	0.7
Effective interest rate	2.8	2.1	2.3	2.3	2.5	2.6

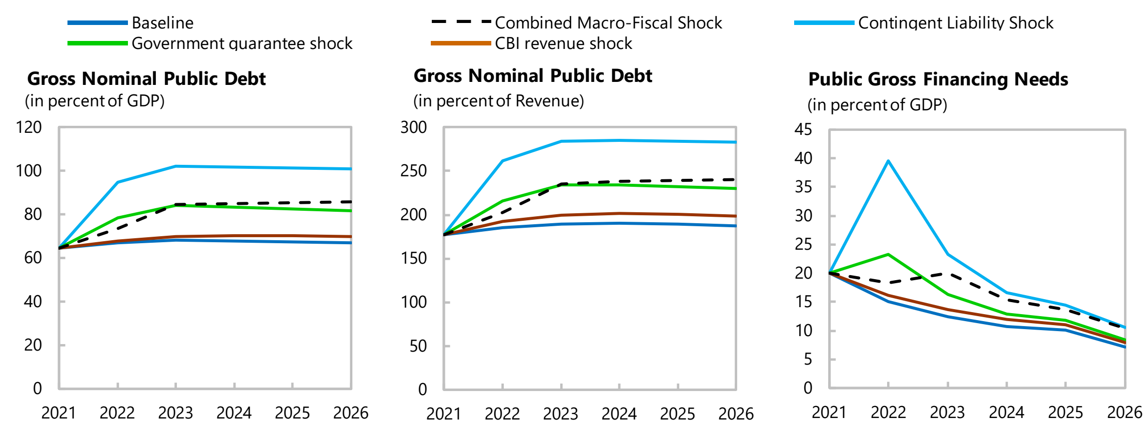
Source: IMF staff.

Appendix Figure I.5. Malta: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

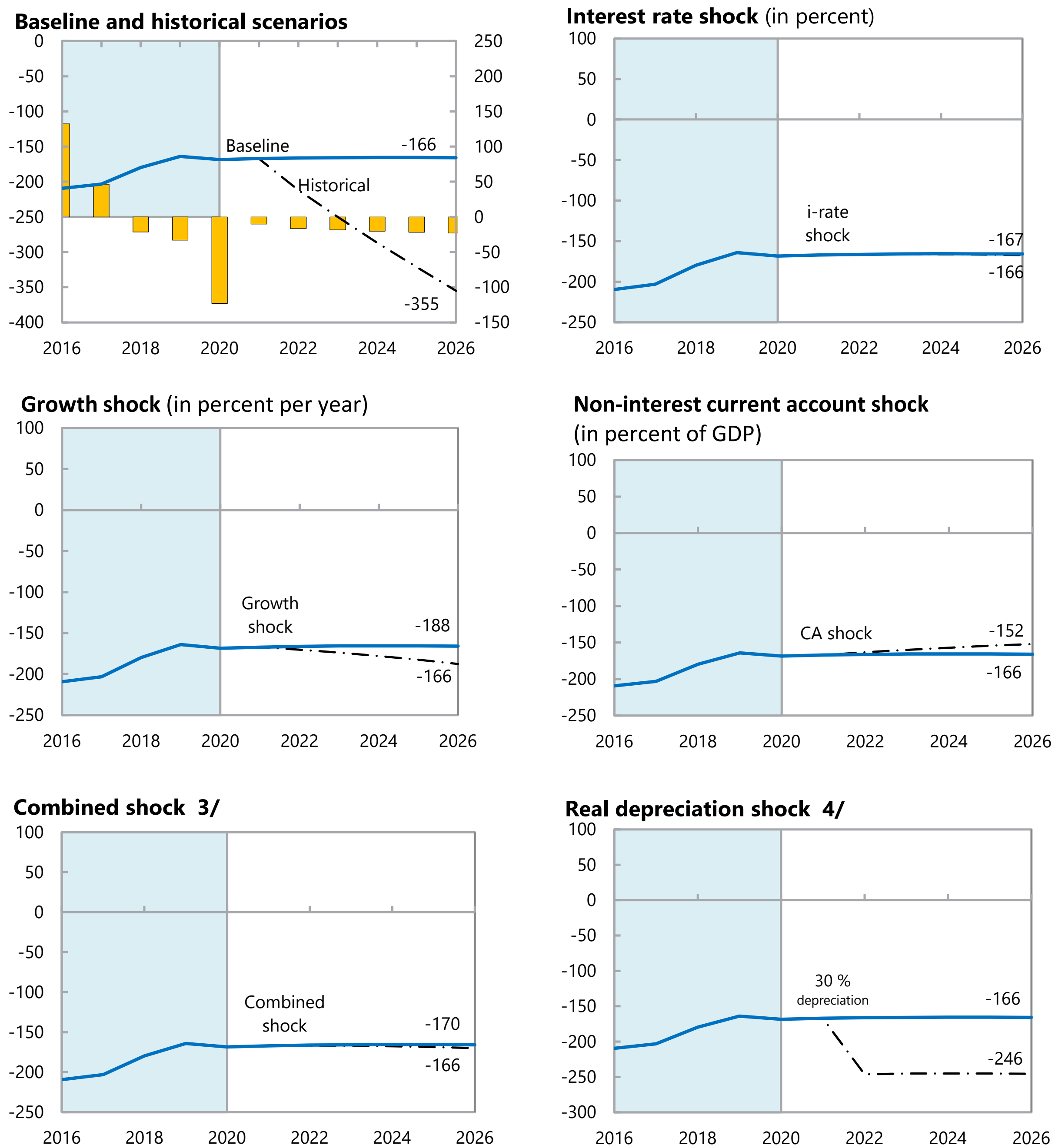
(in percent)

	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	5.7	6.0	5.0	4.5	3.7	3.3
Inflation	1.3	1.7	1.6	1.9	2.1	2.1
Primary balance	-10.4	-7.8	-4.4	-2.9	-2.1	-1.7
Effective interest rate	2.8	2.1	2.1	2.0	2.1	2.1
Real Interest Rate Shock						
Real GDP growth	5.7	6.0	5.0	4.5	3.7	3.3
Inflation	1.3	1.7	1.6	1.9	2.1	2.1
Primary balance	-10.4	-5.2	-3.6	-2.3	-1.9	-1.5
Effective interest rate	2.8	2.1	2.6	2.9	3.3	3.6
Combined Shock						
Real GDP growth	5.7	1.1	0.0	4.5	3.7	3.3
Inflation	1.3	0.5	0.4	1.9	2.1	2.1
Primary balance	-10.4	-7.8	-8.7	-2.9	-2.1	-1.7
Effective interest rate	2.8	2.1	2.7	3.0	3.4	3.7

	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock						
Real GDP growth	5.7	1.1	0.0	4.5	3.7	3.3
Inflation	1.3	0.5	0.4	1.9	2.1	2.1
Primary balance	-10.4	-7.8	-8.7	-2.3	-1.9	-1.5
Effective interest rate	2.8	2.1	2.1	2.2	2.2	2.2
Real Exchange Rate Shock						
Real GDP growth	5.7	6.0	5.0	4.5	3.7	3.3
Inflation	1.3	2.1	1.6	1.9	2.1	2.1
Primary balance	-10.4	-5.2	-3.6	-2.3	-1.9	-1.5
Effective interest rate	2.8	2.1	2.0	1.9	2.0	2.0
Contingent Liability Shock						
Real GDP growth	5.7	1.1	0.0	4.5	3.7	3.3
Inflation	1.3	0.5	0.4	1.9	2.1	2.1
Primary balance	-10.4	-28.9	-3.6	-2.3	-1.9	-1.5
Effective interest rate	2.8	2.3	3.8	3.3	3.3	3.2

Source: IMF staff.

Appendix Figure I.6 Malta: External Debt Sustainability: Bound Tests 1/ 2/



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

Appendix Table I.1 Malta: External Debt Sustainability Framework, 2016–2026

(Net external debt, in percent of GDP unless otherwise indicaged)

	Actual							Projections						
	2016	2017	2018	2019	2020			2021	2022	2023	2024	2025	2026	Debt-stabilizing non-interest current account 6/
1 **Baseline: Net external debt**	-209.4	-203.2	-179.8	-164.1	-168.4			**-167.1**	**-166.3**	**-165.7**	**-165.5**	**-165.6**	**-165.9**	**-8.2**
2 Change in external debt	18.9	6.2	23.4	15.8	-4.3			1.3	0.8	0.6	0.2	-0.1	-0.3	
3 Identified external debt-creating flows (4+8+9)	-30.6	27.4	6.0	-20.8	-20.3			-2.9	-0.6	-4.0	-5.5	-6.8	-7.5	
4 Current account deficit, excluding interest payments	5.5	-0.5	-1.3	-1.1	9.2			9.9	7.6	6.7	5.5	4.7	4.0	
5 Deficit in balance of goods and services	-11.1	-16.7	-15.6	-15.2	-6.3			-5.9	-8.1	-9.1	-10.2	-11.1	-11.8	
6 Exports	143.1	141.8	135.9	136.5	130.1			129.7	128.2	125.5	123.2	121.1	119.4	
7 Imports	132.0	125.0	120.3	121.3	123.8			123.7	120.1	116.4	112.9	110.0	107.5	
8 Net non-debt creating capital inflows (negative)	-43.0	8.2	-10.4	-19.1	-17.8			-14.6	-13.9	-13.5	-13.2	-12.4	-11.8	
9 Automatic debt dynamics 1/	6.9	19.7	17.7	-0.6	-11.7			1.8	5.6	2.9	2.1	1.0	0.3	
10 Contribution from nominal interest rate	-5.0	-4.4	-4.9	-4.7	-5.2			-4.9	-4.8	-4.8	-4.8	-4.8	-4.9	
11 Contribution from real GDP growth	8.8	15.1	9.4	9.7	-11.9			6.7	10.4	7.7	7.0	5.8	5.2	
12 Contribution from price and exchange rate changes 2/	3.0	9.0	13.3	-5.6	5.4			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	49.5	-21.2	17.4	36.5	16.0			4.2	1.4	4.5	5.8	6.7	7.2	
External debt-to-exports ratio (in percent)	-146.4	-143.4	-132.3	-120.2	-129.5			-128.9	-129.7	-132.0	-134.4	-136.7	-139.0	
Gross external financing need (in billions of US dollars) 4/	15.5	6.1	-3.2	-5.0	-18.0			-1.7	-3.0	-3.6	-4.2	-4.8	-5.3	
in percent of GDP	132.4	46.5	-21.4	-32.9	-123.2	10-Year	10-Year	-10.2	-16.6	-18.6	-20.3	-21.8	-23.0	
Scenario with key variables at their historical averages 5/								**-167.1**	**-211.8**	**-250.2**	**-286.7**	**-321.5**	**-355.0**	**-42.1**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	4.1	8.1	5.2	5.5	-7.0	4.3	4.7	4.5	6.8	5.0	4.5	3.7	3.3	
GDP deflator in US dollars (change in percent)	1.3	4.5	7.0	-3.0	3.4	0.9	6.3	8.4	2.8	1.7	1.9	2.0	2.0	
Nominal external interest rate (in percent)	2.3	2.3	2.7	2.7	3.1	2.7	0.4	3.3	3.1	3.1	3.1	3.1	3.1	
Growth of exports (US dollar terms, in percent)	1.6	12.0	7.9	2.8	-8.4	3.7	6.5	12.9	8.6	4.5	4.5	4.0	3.9	
Growth of imports (US dollar terms, in percent)	0.0	7.0	8.3	3.2	-1.8	3.1	4.5	13.2	6.6	3.5	3.3	3.1	3.0	
Current account balance, excluding interest payments	-5.5	0.5	1.3	1.1	-9.2	-5.2	5.9	-9.9	-7.6	-6.7	-5.5	-4.7	-4.0	
Net non-debt creating capital inflows	43.0	-8.2	10.4	19.1	17.8	50.7	42.8	14.6	13.9	13.5	13.2	12.4	11.8	
B. Bound Tests														
B1. Nominal interest rate is at historical average plus one standard deviation								-167.1	-166.6	-166.3	-166.3	-166.6	-167.2	**-8.4**
B2. Real GDP growth is at historical average minus one standard deviations								-167.1	-170.2	-173.8	-178.0	-182.6	-187.7	**-13.4**
B3. Non-interest current account is at historical average minus one standard deviations								-167.1	-163.4	-160.0	-157.0	-154.4	-152.0	**-8.5**
B4. Combination of B1-B3 using 1/2 standard deviation shocks								-167.1	-166.9	-167.1	-167.7	-168.7	-170.0	**-10.8**
B5. One time 30 percent real depreciation in 2006								-167.1	-246.2	-245.4	-245.0	-245.1	-245.6	**-12.1**

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

INTERNATIONAL MONETARY FUND

MALTA

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

August 27, 2021

Prepared By | European Department (In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of July 31, 2021)

Membership Status

Joined: September 11, 1968; Article VIII

General Resources Account	SDR Million	Percent Quota
Quota	168.30	100.00
Fund holdings of currency	127.68	75.86
Reserve Tranche Position	40.65	24.16

SDR Department	SDR Million	Percent Allocation
Net cumulative allocation	95.40	100.00
Holdings	87.51	91.73

Outstanding Purchases and Loans
None

Financial Arrangements
None

Projected Obligations to Fund [1/]
(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2021	2022	2023	2024	2025
Principal					
Charges/Interest	0.00	0.01	0.01	0.01	0.01
Total	0.00	0.01	0.01	0.01	0.01

1/ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Rate Arrangement
Member of the euro area since January 1, 2008. Malta maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions with the exception of restrictions notified to the Fund in accordance with decision No. 144-(52/51).

Article IV Consultation

Malta is on the standard 12-month consultation cycle. The previous consultation discussions took place during February 5–14, 2020, and the staff report (Country Report No.20/98) was brought for the Executive Board's consideration. The Article IV Consultation with Malta was concluded on April 9, 2020.

Technical Assistance

Date	Department	Subject
September 2018-January 2019	MCM	FSAP missions
September 2018	FAD	Fiscal Transparency
April 2015	FAD	Revenue Administration
November 2014	FAD	Revenue Administration
March 2014	FAD	Strengthening Public Financial Management
May 2013	STA	Balance of Payments
April 2009	STA	SDDS subscription finalization
November 2006	STA	Producer price index/SDDS preparations
April and December 2007		Expert visits
June 2005	STA	ROSC Data Module
October 2002–January 2003	MFD	FSAP missions (joint with World Bank)
March 2001	STA	Money and banking statistics
February 1999	MAE	Monetary operations and liquidity Forecasting

Resident Representative

None

STATISTICAL ISSUES

(As of August 26 ,2021)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for surveillance purposes. Significant progress in improving macroeconomic statistics has been made in close cooperation with the European Central Bank (ECB) and Eurostat while upgrading statistical systems to meet the euro area standards. Most macroeconomic statistics can now be accessed through Eurostat and Haver Analytics.
National Accounts: In September 2014, Malta, together with all other EU Member States, introduced the European System of Accounts 2010. In August 2020, the National Statists Office (NSO) made a benchmark revision and several methodological changes to improve the accuracy and richness of national accounts data and to harmonize the data with that of other countries. The NSO releases quarterly national accounts data in current and constant prices with a lag of about two months, annual nonfinancial sectoral accounts in current prices with a lag of about 10 months, and a monthly index of industrial production with a lag of about one month. National accounts data have been subject to substantial revisions, often affecting several years, in part due to large statistical discrepancies (captured under changes in inventory stocks) and revisions of deflators. Annual financial balance sheets and transactions by sectors are published on the Eurostat website, while data on household savings are not available.
Price Statistics: Data on retail and consumer prices are released monthly, usually with a short lag. A harmonized index of consumer prices has been published since May 2004. Malta also publishes a quarterly residential property price index and a monthly industrial producer price index (PPI) with base year 2015. The PPI does not currently cover services activities.
Government finance statistics: Fiscal statistics meet requirements, with quarterly accrual-based data on general government operations compiled in accordance with the *ESA2010* methodology and disseminated with a one-quarter lag. The general government comprises data from the consolidated fund of government adjusted to include other accounts of government, the accruals elements, and the financial performance of the Extra Budgetary Units and of the Local Councils. The NSO also publishes monthly statistics on the cash operations of the central government with a lag of one month, for which the authorities plan to utilize the targeted timeliness flexibility option in light of additional time required for the final month of the fiscal year.
Monetary and Financial Statistics: Monetary statistics are timely and of good quality. Since the entry into the euro area in January 2008, monetary data for IMF statistical publications on central

bank and other depository corporations balance sheets have been obtained through a gateway arrangement with the ECB. Malta reports data on several series and indicators of the Financial Access Survey (FAS), including gender disaggregated data on the use of financial services and the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).	
Financial Sector Surveillance: Malta has reported Financial Soundness Indicators since 2005 along with metadata.	
External sector statistics: Balance of Payments (BOP) and International Investment Position (IIP) statistics are released quarterly, with a lag of about three months. Summary trade statistics are released monthly with a lag of about 40 days. The CBM publishes the external debt statistics templates in line with requirements of the Special Data Dissemination Standard (SDDS), including both gross and net external debt. Malta reports quarterly external debt statistics to the Quarterly External Debt Statistics (QEDS) database. In line with the European regulation, Malta has transitioned to *BPM6*. Coordinated Portfolio Investment Survey (CPIS) and Coordinated Direct Investment Survey (CDIS) data are reported to the IMF Statistics Department for publication.	
II. Data Standards and Quality	
The country has subscribed to the SDDS since December 1, 2009, with the metadata posted on the IMF's Dissemination Standards Bulletin Board.	A data ROSC was published in August 2006.

Malta: Table of Common Indicators Required for Surveillance

(As of August 26, 2021)

	Date of latest observation	Date received	Frequency of Data[7/]	Frequency of Reporting[7/]	Frequency of Publication[7/]
Exchange Rates	Current	Current	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities [1/]	May 2021	Jun 2021	M	M	M
Central Bank Balance Sheet	Jul 2021	Aug 2021	M	M	M
Consolidated Balance Sheet of the Banking System	May 2021	Jun 2021	M	M	M
Interest Rates [2/]	Jul 2021	Aug 2021	M	M	M
Consumer Price Index	Jul 2021	Aug 2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing [3/] – General Government [4/]	2021Q1	Aug 2021	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing [3/]– Central Government	2021Q1	Aug 2021	Q	Q	Q
Stocks of General Government and General Government-Guaranteed Debt [5/]	2021Q1	Aug 2021	Q	Q	Q
External Current Account Balance	2021Q1	Aug 2021	Q	Q	Q
Exports and Imports of Goods and Services	2021Q1	Aug 2021	Q	Q	Q
GDP/GNP	2021Q1	Aug 2021	Q	Q	Q
Gross External Debt	2021Q1	Aug 2021	Q	Q	Q
International Investment Position [6/]	2021Q1	Aug 2021	Q	Q	A

1/ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
2/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
3/ Foreign, domestic bank, and domestic nonbank financing.
4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
5/ Including currency and maturity composition.
6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.
7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by the Staff Representative on Malta
September 15, 2021

This statement provides information on the use of the new SDR allocation and the latest economic developments and the COVID-19 situation since the staff report was issued to the Executive Board on August 25, 2021. The thrust of the staff appraisal remains unchanged.

1. **Following the 2021 general SDR allocation, gross international reserves are expected to increase by SDR 161 million (1.4 percent of GDP) by end-2021.** The authorities have clarified that they intend to save the new SDR allocation as international reserves. The financial account balance in the balance of payments is unchanged compared to the staff report.

2. **On August 27, the authorities released GDP data for 2021:Q2, in line with staff's projections, and revised national accounts data for 2017–2020.**

- GDP growth fell slightly by 0.5 percent (q/q) in 2021:Q2. The second quarter outcome is in line with staff projections and thus would not affect staff's annual GDP growth projection for 2021.

- Malta's National Statistics Office revised historical national accounts data for 2017–2020 by incorporating the Structural Business Statistics survey results. The growth of real GDP was revised upward to 5.7 percent (from 5.5 percent in the staff report) in 2019 and downward to -8.3 percent (from -7.8 percent) in 2020. The level of nominal GDP was revised upward by 2–3½ percent for 2017–2020. Staff's next publication of Malta's macroeconomic framework will reflect the revised national accounts data.

3. New COVID-19 cases fell from the recent peak, with further progress in vaccine rollout. As of September 8, daily new COVID-19 cases stood at 10 (7-day moving average per 100,000 people), down from the recent peak of 40 in mid-July. The authorities have further advanced vaccination, with 80 percent of the total population and 91 percent of the adult population fully immunized as of September 7.

Statement by Domenico Fanizza, Executive Director for Malta, and Annalisa Korinthios, Advisor to Executive Director
September 15, 2021

On behalf of the Maltese authorities, we thank Mr. Ishi and his team for the very constructive discussions during the Article IV mission, in line with a long tradition of good interactions.

The authorities highly appreciate staff's analytical work and contributions to relevant policy discussions and overall agree with the thrust of the 2021 Article IV Report.

Macroeconomic outlook and risks

The authorities broadly agree with staff on both the outlook and risks; although, they do see risks broadly balanced, but, if anything, somewhat tilted to the upside.

Prior to the pandemic, Malta was one of the fastest growing economies in Europe, with a GDP growth significantly above the EU average. Malta faced the pandemic with strong fundamentals because of its well-designed economic diversification strategy that limited the impact of the pandemic thanks to the continued strong performance of sectors, such as remote gaming and ICT. These sectors, together with a rebound in tourism, are now driving a strong recovery. Based on the latest indicators of economic activity, the Central Bank of Malta projects growth at 5.1 percent in 2021, following an 8.3 percent drop last year.

The authorities agree that a global resurgence of the pandemic constitutes the main downside risk to the outlook, but they see reasons for cautious optimism, given trends in the rollout of vaccines in the European Union.

Thanks to an aggressive vaccination strategy, 90 percent of the population above 12 (80 percent of the total population) was fully vaccinated as of September 6th – one of the world's highest vaccination rates.

The authorities agree that labor shortages may affect the pace of the recovery, but they underscore that the current difficulties in attracting foreign workers are likely to be temporary, because they reflect worldwide travel restrictions and low vaccination rates among home countries.

The response to the pandemic and the way forward

The authorities' strong and timely response to the Covid-19 crisis was key to mitigate its impact. The immediate priorities were to save lives and livelihoods, limit the pandemic's immediate social and economic impact, while also developing plans to make the post-pandemic recovery sustainable and transformative.

With regards to the fiscal response, government stimulus measures (including the 2020 Budget measures) amounted to 5.8 percent of GDP in 2020. As the economic recovery becomes more established, the extent of support is expected to gradually go down, with the main support measures being tapered off during H2 2021.

The authorities value Fund's advice to closely monitor the pandemic's impact on the corporate sector; they, however, note that the policy response has been effective in supporting firms' liquidity and equity positions, but do not see, so far, the need for additional corporate support measures. Nevertheless, they stand ready to provide further measures, if needed.

In July 2021, the authorities have submitted their Recovery and Resilience Plan (RRP) to the EU. They believe the RRP constitutes an opportunity to implement ambitious reforms and address key challenges. The main priorities include: (a) addressing climate neutrality through enhanced energy efficiency, clean energy, and a circular economy; (b) addressing carbon neutrality by decarbonizing transport; (c) fostering a digital, smart, and resilient economy; (d) strengthening the resilience of the health system; (e) enhancing quality education and fostering socio-economic sustainability; and (f) strengthening the institutional framework.

Although the rate absorption of EU funds has been improving during the last decade, the authorities are aware that challenges persist and are committed to make further improvements. The authorities also agree that the EU funds can help boost public spending in research and development; in this regard, they emphasize that the Government has recently set up a new Ministry that is dedicated to both promote research and innovation and coordinate the policy strategy for the post-Covid years.

Fiscal Policy

The crisis has hit the economy hard, especially tourism-related sectors, but the authorities' resolute fiscal response against the pandemic succeeded to support households, businesses, and the healthcare system. As a result, they managed to avoid a deeper economic contraction. In fact, Malta has used its large policy buffers – built thanks to years of prudent fiscal management and strong growth.

The Maltese authorities agree with staff's recommendations to keep the current expansionary fiscal stance in the near term and to carefully prepare the gradual unwinding of support measures, given the still high degree of uncertainty. They remain committed to fiscal sustainability and intend to resume their fiscal consolidation efforts once the recovery is fully established. The size of the consolidation objectives will need to consider the path of the pandemic, the possible need for additional targeted support, and likely changes in the EU fiscal rules.

With regards to the discussions about the global minimum corporate tax, the authorities would like to point out that Malta does not have a classical corporate tax; thus, any change would require major efforts to tailor the proposed minimum tax to Malta's peculiar taxation on corporate income. The authorities will continue, however, to follow the ongoing discussions at the international level. They appreciate staff's suggestions on how to improve the design of the overall tax system and, going forward, remain fully committed to further strengthen tax revenue and tax compliance.

Financial Sector and AML/CFT framework

The financial sector has so far weathered the Covid-19 crisis well, benefiting from both the pre-crisis efforts to build resilience and the several measures introduced by the authorities in response to the pandemic.

The banking sector has proven stable and sound, mainly because banks entered the pandemic with healthy capital levels and, as the report underscores, have remained resilient. There has not been, so far, a significant raise in NPLs, and the rapid decrease in the usage of moratoria confirms the strength of the banking system. Nevertheless, the authorities will continue monitoring developments and possible risks from the financial sector and will evaluate the need for additional actions to ensure financial stability.

The authorities wish to stress the significant progress made in strengthening the anti-money laundering and combatting the financing of terrorism (AML/CFT) framework since the adoption of the July 2019 Moneyval assessment report. This progress has been well highlighted by both the staff report and Moneyval.

Despite these efforts, some concerns about the effectiveness of the AML/CFT framework led the FATF to place Malta under increased monitoring. In this respect, the authorities wish to stress that they are fully committed to further enhancing the AML/CFT framework and to closely monitor high-risk sectors. In particular, with regard to the gaming sector, the authorities are working to maintain the impetus engendered on AML supervision, which was clearly recognized by Moneyval's fifth round mutual evaluation report in 2019. This, by ensuring that higher-risk gaming entities remain subject to periodic supervision in line with the high compliance standards of AML/CFT regulations. With the aim of ensuring a quick exit from the FATF grey list, they have started working on an action plan to address the action points set for Malta by the FATF. The authorities do not see, however, downside risks potentially affecting correspondent banking relationships (CBR) and foreign direct investment (FDI) inflows emerging from the inclusion of the country in the FATF grey list in the short term.

Structural reforms

My Maltese authorities broadly agree with staff's assessment on the need to advance structural reforms to raise Malta's productivity growth, which is why they have recently published several strategic papers with the aim at identifying possible growth strategies. The authorities also appreciate that staff recognize that Malta's policy direction has been broadly in line with past staff recommendations.

Although the extent to which long-term scarring may happen is hard to decipher, adverse effects on the labor market have been relatively limited, thanks both to the resilience of the labor market itself, and to support measures and schemes – in particular the Wage Supplement Scheme – promptly introduced by the Government with the aim at supporting employment during the pandemic. According to the latest estimates, the unemployment rate is currently at 3.3 percent, somewhat lower than at end-2019. It is also worth noting that female labor participation in the Maltese economy has recently increased, because of several initiatives, working arrangements, and tax incentives.

Nevertheless, the authorities are already working to address weaknesses in the labor market, building on a series of reforms unrolled over the past years to address the skills gap. These included reducing the early-school leaving, the Framework for the Education Strategy for Malta 2014-2024, the life-long learning strategy, closer collaboration between higher education institutions and industry in traditional academic programmes and vocational education and training (VET), adult learning, and giving higher priority to mathematics, information, and communication technology (ICT) and science subjects.

The authorities are also committed to supporting a green and digital transformation, which will be key to achieving higher and sustainable growth. With that in mind, they are updating the National Digital Strategy, whose objective is to continue to drive forward digital technologies to enhance the way public services are delivered, by continuing to invest in emerging technologies. The new strategy will also identify how policy can be used to drive positive change across all segments of society and reduce the digital divide.

The successful vaccination rollout has enabled the Maltese economy to reopen for the summer tourism season. Although it is too early to assess the pandemic's impact on socio and economic behaviors of travelers, the authorities are aware that the pandemic crisis could affect the pattern of tourism demand. Having said that, they emphasize that Malta's tourism industry is not static and is constantly adapting to a changing reality. Moreover, they are confident that the Malta Tourism Strategy 2021-2030, which is expected to be launched in the coming weeks, will help strengthen the country's attractiveness as a tourist destination and lay the ground for ambitious changes in the tourism sector.

Climate change policy

Malta's per-capita emissions levels and per-capita energy consumption are among the lowest in the EU because of climatic conditions, deliberate investments in cleaner power generation, and lack of energy intensive industries.

Nevertheless, the authorities are fully committed to reducing greenhouse gas emissions under the EU Effort Sharing Regulation by 19 percent (compared to 2005 levels) by 2030. The Government has recently launched for public consultation a Low Carbon Development Strategy (LCDS) which includes measures to reduce emissions in the next 30 years to move towards climate-neutrality.

In developing the low carbon development strategy, the authorities have been concentrating on those measures that are more cost-effective and resulting in best reduction of emissions, considering that Malta is an island. The authorities are working to make the public transport more efficient, in line with staff's advice, and have launched a draft national strategy for building charging stations for electric cars.

Although the authorities appreciate staff's advice on the need to invest in renewable sources, they note that, as Malta is a very small country, land space for renewable energy is extremely scarce. This is the reason why the authorities are also exploring the use of offshore technology.