INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/78

MALTA

2022 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

February 2023

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 2022 Article IV consultation with Malta, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis, following discussions that ended on December 9, 2022, 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 January 18.
- An **Informational Annex** prepared by the IMF staff.

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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PRESS RELEASE

PR23/33

IMF Executive Board Concludes 2022 Article IV Consultation with Malta

FOR IMMEDIATE RELEASE

Washington, DC –February 8, 2023: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Malta on February 2, 2023 and endorsed the staff appraisal without a meeting.

Malta's economy has recovered strongly following the worst recession in decades due to the COVID-19 pandemic. With the easing of pandemic containment measures, output grew by 11¾ percent in 2021. The economy has continued to expand for the first three quarters of 2022, driven by strong net exports and private consumption, and staff expect growth of 6½ percent in 2022. Inflation has picked up but has remained among the lowest in the euro area, reflecting the government's policy to freeze retail electricity and fuel prices for all consumers.

GDP growth is expected to slow to 3¼ percent in 2023 due to lower consumer purchasing power, dampening domestic demand and weakening external demand from Europe. Inflation is expected to gradually decline but remain elevated. Uncertainty is exceptionally high, and risks are tilted to the downside, including a deeper-than-expected recession in Europe, a possible de-anchoring of inflation expectations, and the realization of money laundering and terrorist financing risks. On the upside, lower-than-expected commodity prices would lead to stronger growth than forecast.

Executive Board Assessment[2]

In concluding the 2022 Article IV consultation with Malta, Executive Directors endorsed staff's appraisal, as follows:

Malta's economic recovery from the pandemic is remarkable, but the indirect impact of Russia's war in Ukraine weighs on the outlook. The strong economic recovery continued into 2022, driven by high net exports and consumption. GDP growth is, however, set to slow in 2023 as the confluence of global shocks weighs on the economy. Inflation is expected to gradually decline but remain elevated. Risks to the outlook are tilted to the downside, mainly because the growth slowdown in Europe could be deeper than expected.

The authorities should prepare an exit strategy from the fixed-energy-price policy while protecting vulnerable groups. The exit strategy should aim to contain fiscal costs and introduce market price mechanisms to enhance incentives for energy conservation and help

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[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] Management has determined it meets the established criteria as set out in Board Decision No. 15207 (12/74); (i) there are no acute or significant risks, or general policy issues requiring a Board discussion; (ii) policies or circumstances are unlikely to have significant regional or global impact in the near term; and (iii) the use of Fund resources is not under discussion or anticipated.

accelerate the green transition while protecting vulnerable groups. The authorities should explore reform options with the aim of gradually rolling them out ahead of winter 2023/24. Ultimately, accelerating the green transition is the best way to strengthen Malta's resilience to an energy shock.

The fiscal tightening planned for 2023 is appropriate, given the need to slow inflation and improve the public finances, but additional actions are needed to pursue consolidation over the medium term. While public debt is projected to remain just below 60 percent of GDP, it could be forced on an upward path if growth underperforms or contingent liabilities materialize. To protect against this risk, the authorities need additional measures to mobilize revenues and enhance spending efficiency over the medium term. In light of Pillar II of the global corporate tax reform, the authorities need to reform the taxation of multinational firms and consider broader reforms to the tax system and to revenue administration with the aim of simplifying and improving the efficiency of the tax system and reducing administration and compliance costs while protecting revenues. Efforts aimed at identifying the scope for rationalizing recurrent spending should continue, while further steps should be taken to improve the efficiency of public investment, including green investments. Long-term demographic trends should be closely monitored to properly plan pension-related reforms, and efforts should continue to promote voluntary occupational pensions and personal pensions.

The financial system remains sound, but emerging risks warrant continued vigilance and close monitoring of banks. The authorities should closely monitor banks' risk management to ensure that provisions are continuously updated as economic prospects change. Given the banking sector's large exposure to the housing market, the consideration of introducing a sectoral systemic capital risk buffer targeting mortgage loans is warranted. In addition, efforts to monitor cyber security risks and strengthen resilience against cyberattacks should continue.

The authorities should continue efforts to strengthen the effectiveness of the AML/CFT framework. The boosted resources for AML/CFT supervisors should remain in place to help the long-term sustainability of reforms. Notwithstanding the progress Malta has made, the authorities need to continue to demonstrate the effectiveness of supervisory outcomes, including through the effective implementation of sanctions. The implementation of the national AML/CFT strategy for 2021–2023, as well as the NRA exercise, is important to enhance coordination and supervision to mitigate existing and emerging risks. The close monitoring of high-risk sectors, especially virtual financial assets, gaming, and sectors associated with Malta's Citizenship by Investment program, should also continue.

Structural reforms are necessary to improve Malta's long-term growth and address climate challenges. Malta's Recovery and Resilience Plan will address part of its structural challenges, but more efforts will be needed, especially to address labor skill mismatches, increase STEM graduates, enhance vocational training, promote research and innovation, and advance the digital transformation of SMEs. Labor force participation should also be fostered through incentives for workers to delay retirement and flexible working solutions to address structural labor shortages. On climate change policy, concerted efforts involving all stakeholders should continue to implement the 2021 Low Carbon Development Strategy and seek decarbonization potential by exploiting various sources, including investing in renewable sources.

Malta: Selected Economic Indicators, 2018–2023
(Year-on-year percent change, unless otherwise indicated)

					Projections	
	2018	2019	2020	2021	2022	2023
Real economy (constant prices)	(Percent change year on year)					
Real GDP	6.2	7.0	-8.6	11.7	6.5	3.3
Domestic demand	8.8	8.1	-3.7	7.8	4.0	3.7
CPI (harmonized, average)	1.7	1.5	0.8	0.7	6.1	5.2
Unemployment rate (percent)	3.7	3.6	4.4	3.4	3.0	3.1
Public finance	(General government, percent of GDP)					
Overall balance	2.1	0.6	-9.6	-7.8	-5.4	-5.0
Primary balance	3.6	1.9	-8.3	-6.7	-4.3	-3.8
Structural balance 1/	1.4	0.3	-6.3	-7.4	-6.1	-5.5
Gross debt	43.7	40.3	53.0	55.2	56.6	58.5
Financial sector	(Percent change year on year)					
Credit to nonfinancial private sector 2/	7.0	6.8	6.6	6.5	...	...
Credit to the private sector (percent GDP)	74.0	72.2	83.0	77.6	...	...
Interest rates (year average)	(Percent)					
Interest rate for mortgage purposes	3.1	3.0	3.0	2.8	...	...
Ten-year government bond yield	1.4	0.7	0.5	0.5	...	...
Balance of payments	(Percent of GDP)					
Current account balance	6.4	4.9	-2.8	-4.5	-3.6	-3.5
Trade balance (goods and services)	15.6	13.9	7.9	4.2	5.1	5.3
Exchange rate						
Exchange rate regime	Joined EMU on January 1, 2008.					
Nominal effective rate (2010=100)	101.8	100.5	101.6	103.0	...	...
Real effective rate, CPI-based (2010=100)	104.9	103.6	104.7	103.7	...	...

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 2022 ARTICLE IV CONSULTATION

January 18, 2023

KEY ISSUES

Context. Malta's economy rebounded strongly from the pandemic. However, the indirect impact of Russia's war in Ukraine, including the anticipated slowdown in the European economy, high and volatile global energy prices, rising import costs, and weakened public finances following the pandemic are weighing on the outlook. The Maltese economy is expected to slow from 6¼ percent this year to 3¼ percent in 2023. The financial system has proved to be resilient to the pandemic with ample capital and liquidity buffers. In June 2022, the Financial Action Task Force (FATF) removed Malta from its grey list of anti-money laundering and combatting the financing terrorism (AML/CFT) framework.

Policy recommendations. The priority is to alleviate the economic impact of the global energy price shock efficiently and cost-effectively, continue fiscal consolidation while supporting the economic recovery, and maintain financial stability. Concerted efforts are required to pursue structural reforms, including green and digital transformation.

- **Energy and fiscal policy.** Prepare an exit strategy from the current fixed energy price policy while protecting vulnerable groups. Tighten the fiscal stance in 2023 to lower inflationary pressure and improve public finances. Reform the taxation of multinational firms and consider broader reforms to the tax system and revenue administration, aimed at improving the efficiency of the tax system and reducing administration costs. Improve public investment management framework and rationalize recurrent spending to achieve a credible medium-term consolidation.

- **Financial sector.** Remain vigilant in monitoring risks, particularly to ensure that banks update the assessment of expected losses as economic prospects evolve and provision accordingly. Consider introducing a sectoral systemic risk buffer to target systemic risks arising from mortgages. Keep close monitoring of high AML/CFT-related risk sectors.

- **Structural reforms.** The pandemic has highlighted the need to reinvigorate structural policies to boost productivity and make the economy more competitive and resilient. Address the skills gap in the workforce, complete the comprehensive insolvency reform plan, further promote digitalization, and advance green investment and decarbonization. In addition, strengthening governance would help sustain medium-term growth.

Approved By
Helge Berger (EUR) and Geremia Palomba (SPR)

Discussions were held in Valletta from November 28 to December 9, 2022. The team comprised Kotaro Ishi (head), Rafael Barbosa, Mahir Binici, and Farid Jimmy Boumediene (all EUR). Yueshu Zhao (EUR) provided research assistance, and Dilcia Noren (EUR) provided administrative assistance. Annalisa Korinthios (Advisor to the Executive Director) participated in the discussions, and Federico Giammusso (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 Paul Zahra, Malta Financial Services Authority Acting CEO Mizzi Buontempo, and other senior officials, representatives of labor and business organizations, and financial institutions.

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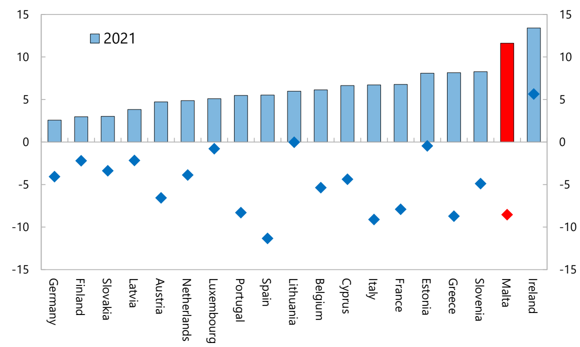
CONTEXT

1. The Maltese economy has rebounded strongly since the deep pandemic recession. Decisive government support mitigated the fallout from the pandemic, supporting households and corporates through the pandemic. With the easing of pandemic measures, real GDP grew by 11¾ percent in 2021, the second highest in the euro area, driven largely by remote gaming, information and communications technology (ICT), and professional services (Figure 1 and Table 1). As a result, output recovered to its pre-pandemic level by end-2021.

2020 and 2021 Real GDP Growth
(Percent)



Sources: Haver Analytics and Eurostat

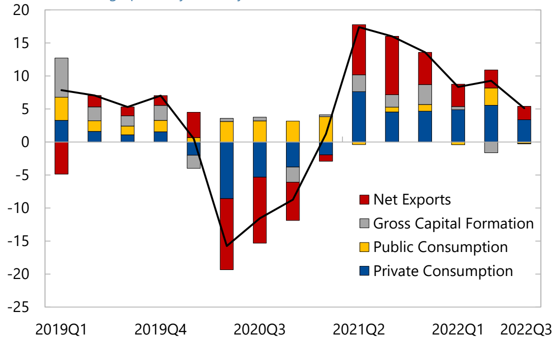
2. However, slowing global growth and rising inflation, amid structural labor shortages and infrastructure bottlenecks, pose significant challenges. The immediate economic spillover of Russia's war in Ukraine has been limited due to Malta's negligible direct trade, energy, and financial linkages with Russia and Ukraine. But as a small open island economy, Malta is exposed to the anticipated slowdown in European growth (Malta's main trading partners), rising import costs, and high and volatile energy prices at a time of weakened public finance positions following the pandemic. Fiscal space is further pressured by the decision to freeze retail energy prices.

3. Policy continuity seems likely. The Labor Party won a third successive term in a general election in March 2022, securing an outright parliamentary majority, which allows for policy continuity. Malta exited the FATF's grey list in June 2022, after a year, reflecting Malta's concerted efforts involving all stakeholders to address the deficiencies that the FATF identified. Progress in the structural reform agenda has been mixed, but Malta's policy direction has been broadly in line with past staff recommendations (Annex I).

RECENT DEVELOPMENTS—RECOVERY FROM THE PANDEMIC

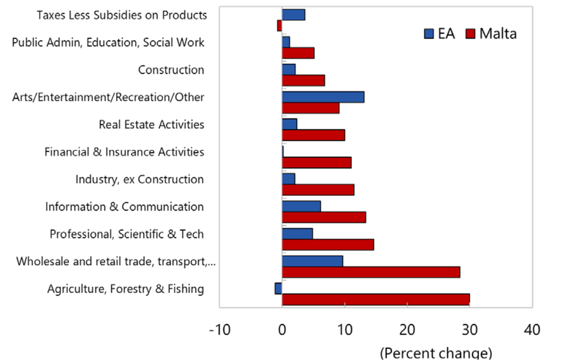
4. The strong economic recovery continued into 2022. For the first three quarters of 2022, output grew by 7½ percent (y/y), driven by strong net exports and private consumption. With all COVID-19-related restrictions lifted by July, tourist arrivals recovered to around 85 percent of 2019 levels in the summer, with positive spillovers to the rest of the economy. Private consumption was robust, supported by relatively contained inflation. More recently, however, economic sentiment indicators suggest some signs of moderation in economic activity (Figure 2).

Contributions to GDP Growth
(Percentage points; year-on-year)



Sources: Haver Analytics and IMF staff calculations.

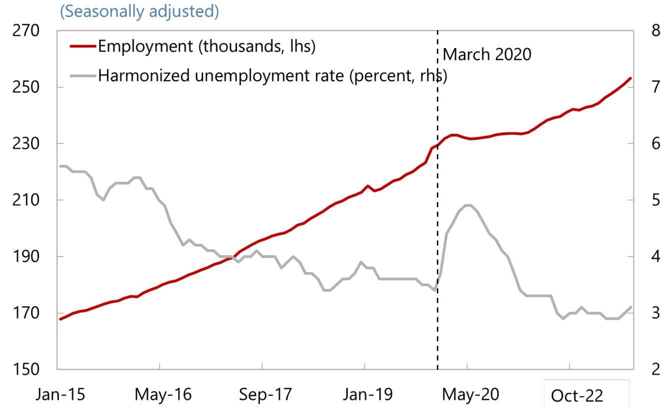
2022 Q1-Q3 Growth in Nominal Value Added by Sector



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

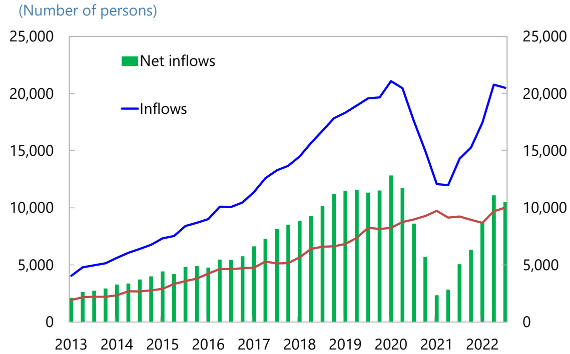
5. Labor markets have tightened. Employment growth remained robust (4.4 percent y/y in October), while the unemployment rate remained low at 3.1 percent. Due to strong labor demand, labor market indicators point to historically tight conditions. Net immigration inflows have yet to fully return to a pre-pandemic level, with inflows of foreign workers having fully recovered while outflows have increased. Despite the tightened labor market, however, wage pressures have remained contained relative to past records. In late October, the government announced the cost-of-living (COLA) adjustment of €9.9 per week (equivalent to 5 percent of the minimum wage) in 2023, the highest increase since its inception in 1990.[1]

Employment and Unemployment
(Seasonally adjusted)



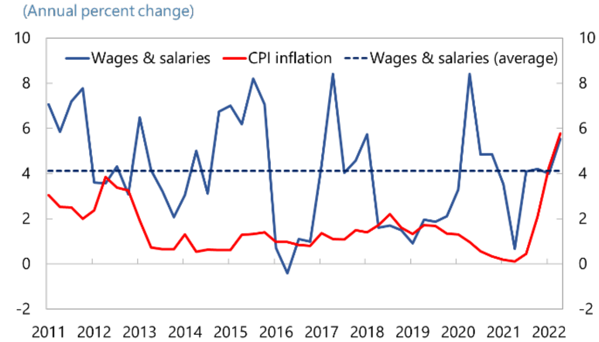
Sources: Statistical Offices of European Communities and Haver Analytics.

Foreign Workers Inflows and Outflows
(Number of persons)



Source: Malta Jobs Plus.

Wages and Salaries Growth and Inflation 1/
(Annual percent change)

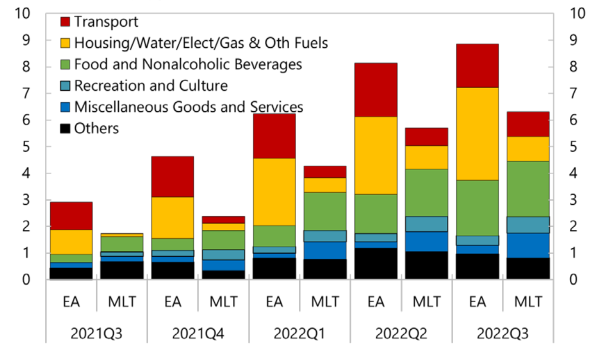


Sources: Eurostat and Haver Analytics.
1/ Data on wages and salaries in industry, construction and services sectors.

[1] The COLA is part of wages, adjusted yearly by the government.

6. Inflation has picked up. At 7.3 percent in December 2022, headline HICP inflation remains below the euro area average of 9.2 percent, as electricity and fuel prices have been administratively frozen (see below). In contrast, core inflation in October (HICP excluding energy and unprocessed food) was 7.6 percent y/y, higher than 6.4 percent y/y in the euro area, as Malta is a small open economy with the import-to-GDP-ratio exceeding 130 percent, and a large portion of core inflation is imported.

Inflation Decomposition
(Percent, qoq growth rate)



Sources: Haver Analytics and IMF Staff Calculations.

7. The fiscal performance surprised on the upside. The fiscal deficit in 2021 was 7.8 percent of GDP, significantly lower than the budget forecast (12 percent of GDP), due to lower-than-expected spending (Figure 3 and Table 2). In 2022, the budget included measures to mitigate the impact of higher energy and food prices, in addition to COVID-19-related support measures (amounting to 2½ and 1¾ percent of GDP, respectively, Annex II). For the first ten months of 2022, revenue collections remained robust, while the authorities had withdrawn the bulk of COVID-19 support measures, contributing to lower expenditure. Staff expect the fiscal deficit to further narrow to 5½ percent of GDP in 2022.

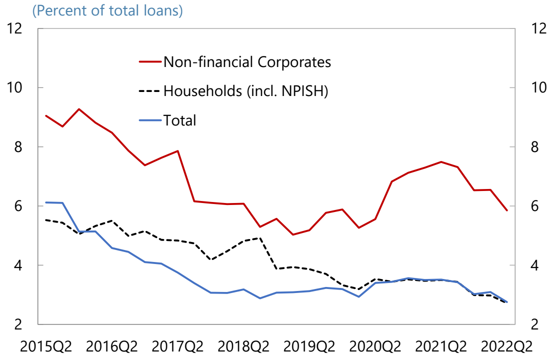
Malta: Fiscal Estimates and Projections
(Percent of GDP)

			2021 (*)		2022 (*)	
	2019	2020	USP	Outturn	USP	Staff proj.
Revenue	36.3	36.4	36.7	36.3	38.1	35.7
Expenditure	35.7	46.0	48.7	44.2	43.6	41.1
Overall balance	0.6	-9.6	-12.0	-7.8	-5.4	-5.4
Primary balance	1.9	-8.3	-10.8	-6.7	-4.4	-4.3
Structural balance	0.3	-6.3	-9.6	-7.4	-4.9	-6.1
Public debt	40.3	53.0	65.0	55.2	58.6	56.6
Memorandum items:						
COVID-19 related fiscal measures	...	5.0	5.3	4.7	1.6	1.9
Energy and food subsidies	...	...	...	...	1.4	2.3
Total	...	5.0	5.3	4.7	3.0	4.2

Source: Maltese authorities and IMF staff calculations.
(*) Table presents numbers from the Updated Stability Programme announced in April 2021 and 2022, respectively.

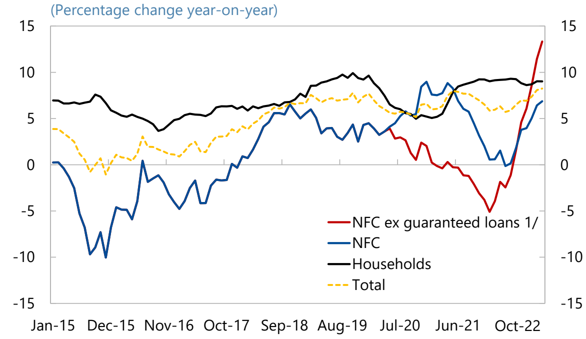
8. With ample capital and liquidity buffers and extensive government support for borrowers, banks have weathered the pandemic well. Nonperforming loans (NPLs) increased slightly to 3½ percent in early 2020 on account of higher NPLs in non-financial corporates (mainly accommodation and food services) but have since fallen to 3 percent (Figure 4 and Table 3). A relatively high share of loans previously under moratoria has turned non-performing (about 6 percent), contributing to about 11 percent of the stock of NPLs. The economic recovery improved the repayment outlook of borrowers and overall credit quality, resulting in a decrease in loan provisions and a recovery in bank profits. However, banks have recently increased provisions due to elevated economic uncertainty and higher cost pressures for non-financial corporates (NFCs). Resident credit growth has remained robust (8.2 percent y/y in October 2022): mortgage lending remained buoyant, in part reflecting COVID-19-related tax incentives, giving rise to a higher concentration of risk, while credit to NFCs recently picked up.

Non-Performing Loans
(Percent of total loans)



Source: FINREP and haver Analytics.

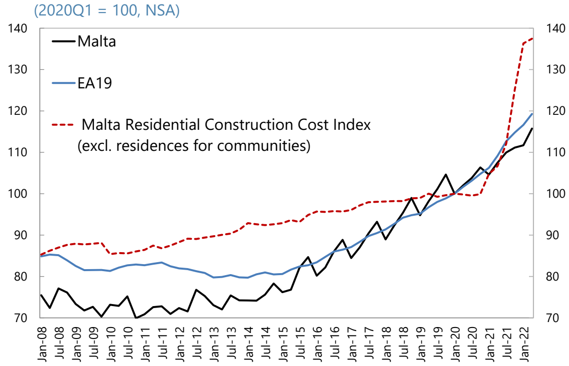
Bank Credit Growth
(Percentage change year-on-year)



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

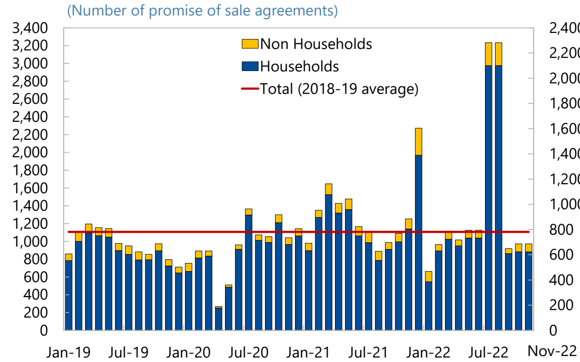
9. Residential property prices grew at a faster pace, while activity in the housing market has been broadly stable. House price growth accelerated to 7¼ percent y/y in the first half of 2022, up from 5.1 percent on average in 2021. Since the outbreak of the pandemic, residential property prices have risen fast by 11½ percent, below nominal GDP growth (14.4 percent), reflecting low mortgage rates, tax incentives, and, more recently, a sharp increase in construction costs. Staff estimates that house prices are broadly in line with fundamentals. Real estate transactions have remained broadly stable.

Residential Property Price Index
(2020Q1 = 100, NSA)



Source: Eurostat and European Central Bank.

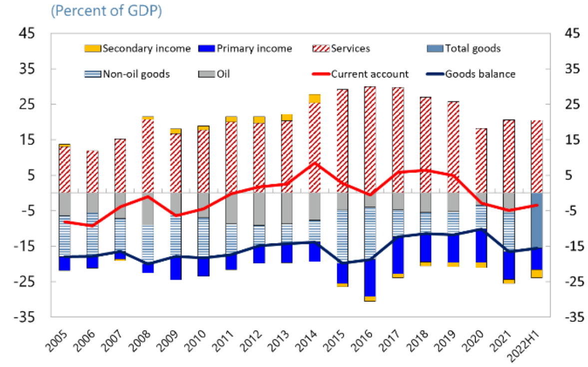
Real Estate Transactions
(Number of promise of sale agreements)



Sources: Malta National Statistics Office and IMF staff calculations.

10. The current account deficit widened due to a deterioration in the goods balance. The current account (CA) deficit was 5 percent of GDP in 2021, up from 3 percent of GDP in 2020 (Figure 5 and Table 4). The goods balance deteriorated, mainly reflecting equipment imports in the aviation sector, while the services surplus increased due to the partial recovery in the tourism sector and strong gaming sector exports. In the first half

Current Account
(Percent of GDP)



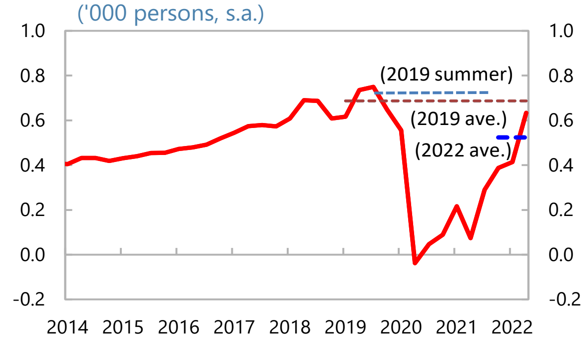
Sources: IMF BOP Statistics and IMF staff calculations.

of 2022, the CA deficit narrowed slightly, with the recovery in tourism exports partially offset by increased imports reflecting higher prices. Malta's external position in 2022 is expected to be broadly in line with the level implied by medium-term fundamentals and desirable policies (Annex III).

OUTLOOK AND RISKS

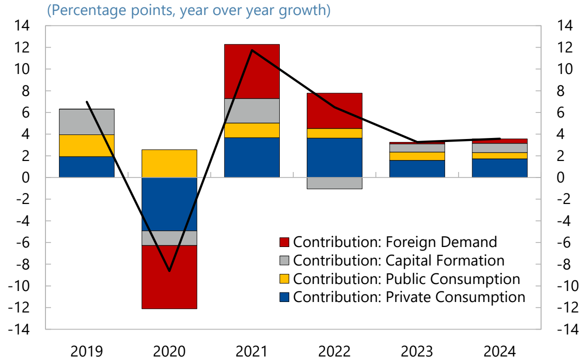
11. Malta's economic growth is expected to slow, reflecting weakening growth in its trading partners. GDP growth is set to slow from 6½ percent in 2022 to 3¼ percent in 2023 due to the weaker overall external demand from Europe, lower growth in real wages, and a tighter fiscal stance. Nonetheless, Malta will likely avoid a deep growth slowdown or recession mainly because (i) the tourism sector will continue to recover as its pent-up demand remains, and (ii) the gaming sector, which has grown fast reflecting technological developments in recent years, will prove to be recession resilient. Against this backdrop, inflation is expected to peak in the fourth quarter of 2022 before decreasing gradually to around 3¼ percent by the end of 2023, helped by assumed moderation in global inflation and the administratively fixed domestic energy prices. The relatively low inflation and the improvement in unit labor costs relative to euro area countries (reflecting Malta's faster recovery in labor productivity growth) should support Malta's external competitiveness.

Tourist Arrivals
('000 persons, s.a.)



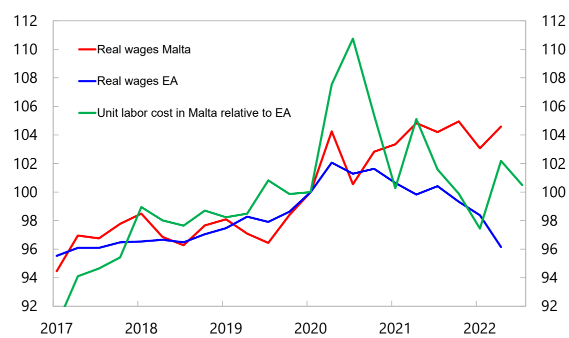
Source: Haver Analytics and IMF Staff calculations.
Note: Horizontal lines represent levels of arrivals for a given period.

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



Source: Havery Analytics and IMF staff calculations.

Real Wages, and Unit Labor Costs
(Index, 2020Q1=100)

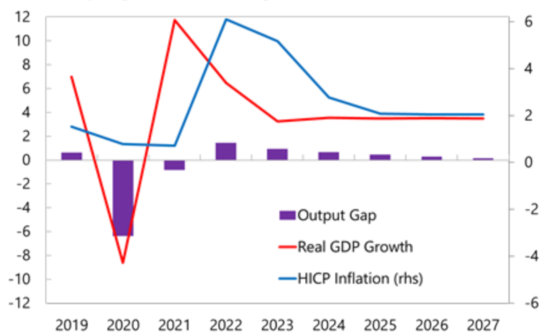


Sources: Haver Analytics and IMF staff calculations.

12. Supply bottlenecks could limit Malta's medium-term potential growth. Medium-term potential growth is estimated at 3½ percent of GDP, and the positive output gap in 2022 will mostly close by 2024 as growth slows down. With the strong growth rebound, Malta's long-standing structural challenges have reemerged, including labor shortages and infrastructure bottlenecks, while hours worked have also yet to recover to pre-pandemic levels. These challenges, together with a new challenge in achieving a climate-neutral economy, could constrain Malta's potential growth.

GDP, Output Gap, and Inflation

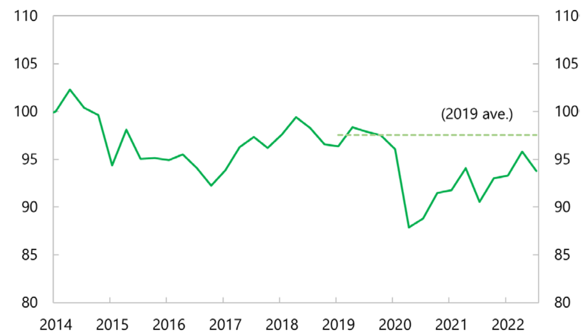
(Year over year growth and percentage points)



Sources: Haver Analytics and IMF staff calculations.

Hours Worked

(2014 Q1 = 100)



Sources: Haver Analytics and Eurostat

13. Uncertainty is significantly high, and risks to the outlook are tilted to the downside, mostly due to the volatile external environment (Annex IV).

- The primary downside risk is an abrupt global slowdown or recession. In Europe, a complete gas shutoff by Russia would result in acute gas shortages and further supply disruptions, which would trigger an EU recession. In addition, the war has increased cyber threats, which may disrupt economic and financial activities. A possible de-anchoring of inflation expectations could force the ECB to tighten monetary policy more than envisaged. The risk of local outbreaks of vaccine-resistant Covid-19 variants also remains.

- Domestically, higher wage pressure could risk higher and persistent inflation. Uncertainty regarding the remaining details of corporate income tax changes could adversely affect Malta's attractiveness as a financial and business location, reducing foreign direct investment (FDI) inflows and fiscal revenues. In addition, high ML/TF risks persist in sectors such as gaming and virtual asset providers and, if realized, could adversely affect correspondent banking relations (CBRs) and FDI inflows.

- On the upside, a sooner-than-expected easing of global commodity price pressures could lead to stronger growth than forecast. The effective and coordinated implementation (across European countries) of the Next Generation EU program could boost growth substantially, with an estimated impact of ½–1 percentage point of GDP (including spillover effects in the EU) by 2026.[2]

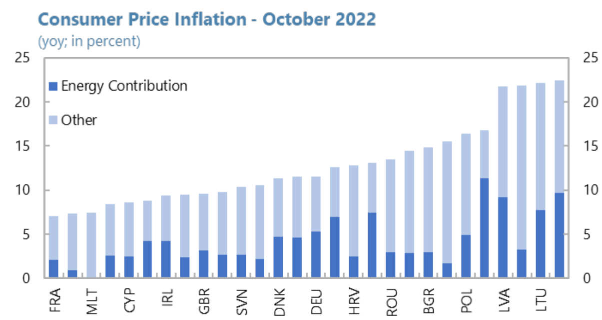
[2] Pfeiffer, P., J. Varga, and J. in't Veld, 2021, "Quantifying Spillovers of Next Generation EU Investment."

POLICY DISCUSSIONS

Key challenges are to alleviate the economic impact of the global energy price shock in an efficient and cost-effective way, continue fiscal consolidation while supporting the economic recovery, maintain financial stability in the wake of rising interest rates, and pursue vigorously structural reforms, including in the areas of green and digital transformation.

A. Tackling the Global Energy Price Shock

14. In response to the global energy price shock, the government has opted to freeze retail electricity and fuel prices. The retail energy prices in Malta are administered by state-owned energy companies, and a long-term fixed price contract for liquefied natural gas (LNG) imports helped maintain stable retail energy prices at 2014 levels for many years (Figure 6 and Annex V). In March 2022, however, the price contract expired, resulting in a substantial increase in import gas prices (under new contracts). Instead of passing increased energy prices on to consumers, the government decided to freeze retail energy prices by fully compensating the losses of the energy companies. The strategy has helped contain headline inflation (with inflation in Malta among the lowest in the EU) and mitigated the impact of the energy price shock on households and businesses.[3]

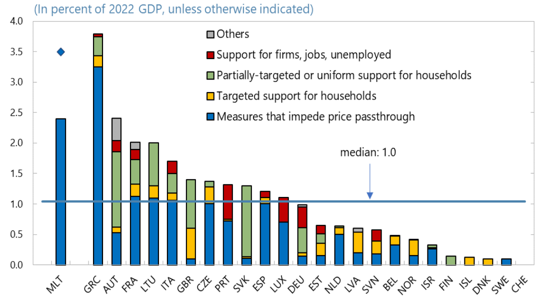


Sources: Haver Analytics and IMF staff calculations.

15. The authorities' approach, however, comes with significant fiscal costs, and blunts incentives to adjust energy demand and to invest in green energy. The energy sector subsidies are expected to increase from 2½ percent of GDP in 2022 to 3½ percent of GDP in 2023, one of the highest in the EU. To accommodate the increased spending, the government plans to rationalize departmental budgets. If energy prices rise further and the shock continues for a prolonged period, this approach could place a strain on fiscal policy. In addition, by fully suppressing the price increase, this approach does not help incentivize energy conservation and investment in energy-efficient products (e.g., electric vehicles) and renewable energies (e.g., photovoltaics panels). Finally, the policy is regressive as high-income individuals (typically consuming more energy than low-income individuals) benefit more.

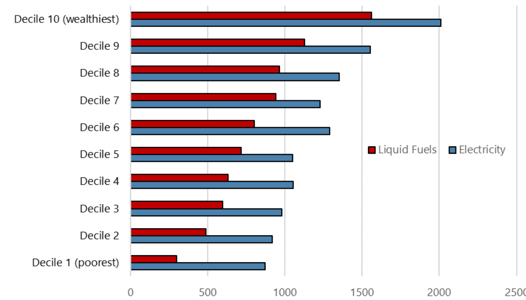
[3] The Central Bank of Malta's models suggest that a 10 percent increase in electricity and fuel prices would lead to close to a one percentage point increase in HICP inflation and about 0.2 percentage points decrease in GDP in the short term.

Fiscal Cost of Energy Support Measures
(In percent of 2022 GDP, unless otherwise indicated)



Source: IMF European Department Desk Survey.

Household Average Energy Expenditures by Consumption Decile
(Euros)



Source: Eurostat and IMF staff using Carbon Pricing Assessment Tool (CPAT).

16. The authorities need to prepare an exit strategy from the current fixed price policy in anticipation of a prolonged energy crisis while protecting vulnerable groups. The objective of the exit strategy should be to contain fiscal costs and introduce market price mechanisms to enhance incentives for energy conservation and facilitate a transition to net zero emissions while protecting low-income households and, to a lesser extent, middle-income households. Various options should be explored, taking into account Malta's institutional setting.

- Adjusting fuel prices to better reflect their import prices in line with pre-crisis practices would be a helpful first step.
- Regarding electricity for household consumers, allowing a greater passthrough of market prices to consumers with targeted cash transfers to low-income and, to a lesser extent, middle-income households would be the best option. However, currently, there is no framework to provide targeted cash transfers to individuals, not on social assistance programs. Alternatively, the tariff structure should be made more progressive to better reflect the level of electricity consumption and marginal cost, with the subsistence level of consumption priced at below marginal cost.
- For business electricity consumers, allowing a greater passthrough of market prices, with financial support for energy-intensive firms provided only on a temporary basis and conditional on efforts to increase energy efficiency.
- Introducing a peak demand electricity charge for both households and firms.

17. The authorities should start preparing exit options with the aim of gradually rolling them out ahead of winter 2023/24. Over time, options to provide targeted transfers to individuals, not on social assistance programs, should be developed, for example, in the form of lump sum transfers or tax credits. Ultimately, accelerating the green transition is the best way to strengthen Malta's resilience to an energy shock. Communicating the overall approach early and clearly will ease the transition.[4]

[4] For more detailed discussions, see Selected Issues Paper Chapter 1.

B. Ensuring Fiscal Sustainability

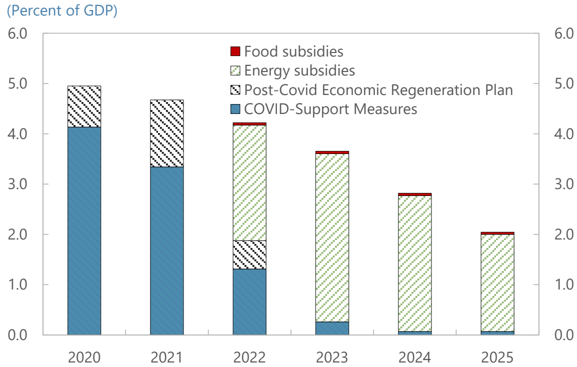
18. The fiscal tightening planned for 2023 is appropriate. Staff project a reduction in the overall deficit from 5½ percent of GDP in 2022 to 5 percent of GDP in 2023, underpinned by an improvement of the primary structural balance of about one percentage point. The expected size of the fiscal tightening is appropriate given the need to slow inflation and improve public finances. The increase in the energy and food subsidies (3½ percentage points of GDP) and various social spending measures for vulnerable households (½ percentage points of GDP) are expected to be more than offset by the expiration of several COVID-19-related support measures and the containment of compensation of employees and use of goods and services. If downside risk to the economic outlook materializes, however, automatic stabilizers should continue to be allowed to operate in full.

Malta: Staff and Authorities' Fiscal Estimates and Projections
(Percent of GDP)

		2022		2023	
	2021	Staff	2023 Budget	Staff	2023 Budget
Revenue	36.3	35.7	36.3	35.7	36.3
Expenditure	44.2	41.1	42.1	40.7	41.9
Overall balance	-7.8	-5.4	-5.8	-5.0	-5.5
Primary balance	-6.7	-4.3	-4.7	-3.8	-4.3
Structural balance	-7.4	-6.1	-5.9	-4.3	-5.3
Primary structural balance	-6.3	-5.0	-4.8	-4.3	-4.1
Public debt	55.2	56.6	57.0	58.5	59.1

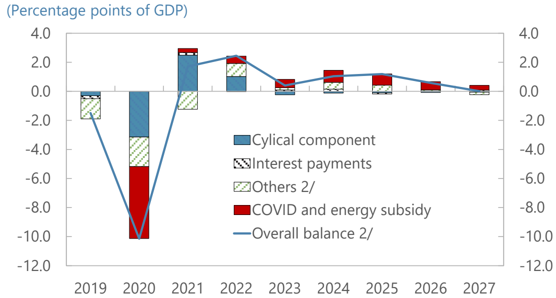
Source: Maltese authorities and IMF staff calculations.

COVID-19 Fiscal Support, Energy and Food Subsidies
(Percent of GDP)



Source: Ministry of Finance and IMF staff calculations.

Contribution to Change in Fiscal Balance 1/
(Percentage points of GDP)



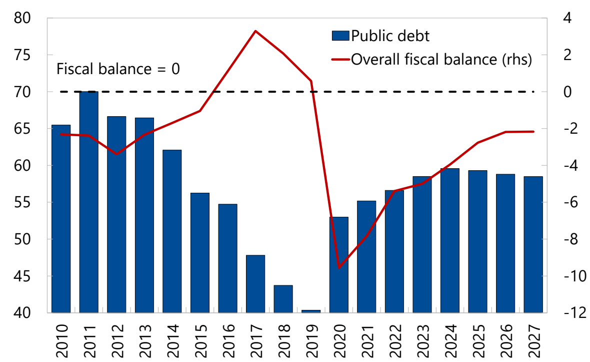
Source: Ministry of Finance and IMF staff calculations.
1/ Positive numbers indicate an improvement in the fiscal balance
2/ The overall balance excluding cyclical contribution, interest payments, and COVID and energy subsidy.

19. Fiscal buffers need to be rebuilt over the medium term. The fiscal buffers that were generated over the years prior to the pandemic enabled the authorities to take bold and swift actions to avert the fallout from the pandemic crisis. The authorities are committed to keeping the debt-to-GDP ratio to below 60 percent and reducing the deficit to below 3 percent of GDP by 2025, mainly by reducing energy subsides (as energy prices come down) and reining in the growth of compensation of employees.[5] While the structural balance will significantly improve, staff's projections suggest that it will remain in a deficit position through 2027, compared to a surplus position before the pandemic. Public debt is projected to hover just below 60 percent of GDP under

[5] Energy subsidies are projected to fall from 3½ percent of GDP in 2023 to 2 percent of GDP in 2025.

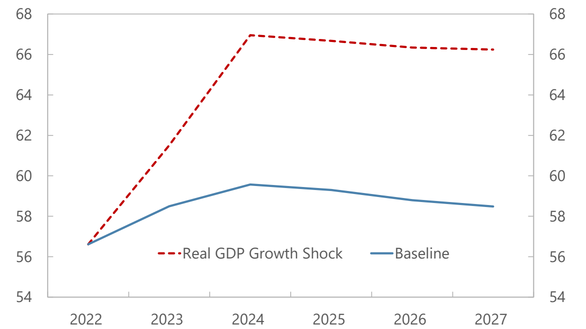
staff's baseline scenario and could be put on an upward path if growth underperforms, and contingent liability materializes (Annex VI). Accordingly, over the medium-term, the authorities need additional measures to mobilize revenues and enhance spending efficiency to keep public debt under 60 percent of GDP.

Public Debt and Fiscal Balance
(Percent of GDP)



Sources: Haver Analytics and IMF staff projections.

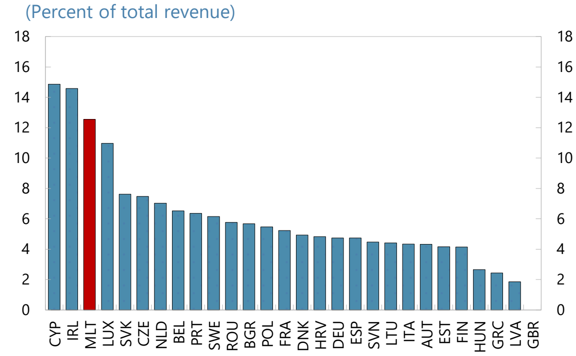
Public Debt: Baseline and Growth Shock Scenarios
(Percent of GDP)



Sources: IMF staff projections.

- ***Revenue.*** In line with Pillar II of the global agreement on corporate tax reform, the authorities need to reform the taxation of multinational firms. This also provides the authorities with a unique opportunity to modernize the tax system—covering both corporate and personal income taxes as they are closely integrated in Malta—and reform revenue administration with the aim of improving the efficiency of the tax system and reducing administration and compliance costs. IMF technical assistance can be usefully leveraged. Malta's revenue mobilization is relatively low compared to other euro area countries, with relatively high reliance on corporate income tax and large tax arrears. Accordingly, the reform should also aim to generate sufficient revenues to cover government spending. The authorities have recently launched a revenue administration transformation program 2023–2025, aiming to reorganize the Office of the Commissioner for Revenue and implement a digital business model. Additional reform needs include implementing a risk-based approach to manage compliance risk and establishing a large taxpayer office.

Corporate Income Tax Revenue, 2020
(Percent of total revenue)



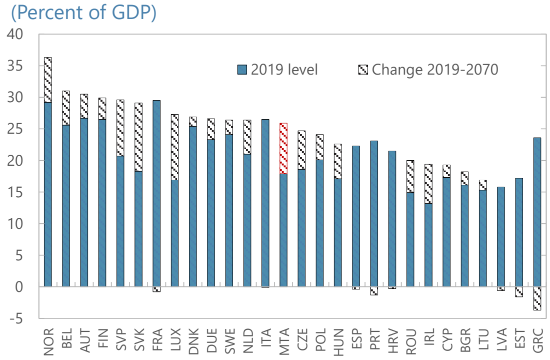
Sources: European Commission and IMF staff calculations.

- ***Expenditure.*** The authorities' intention to streamline current spending (including measures to contain the growth of the wage bill) and maintain a relatively high level of capital spending could help limit the impact of fiscal consolidation on growth. Spending review is a priority to assess the durability of the planned departmental budget cut measures and to identify the scope for rationalizing recurrent spending. IMF technical assistance is under preparation. The efficiency of social spending should also be reviewed: for example, Malta's spending on education is among the highest in the EU, but so is its number of early school leavers. In addition, the sizable contingency liabilities (around 7½ percent of GDP in 2022), especially pertaining to state-owned enterprises (SOEs, e.g., Air Malta and state-owned energy companies), remain of concern, and therefore, the authorities need to strengthen a framework to manage fiscal risks.

20. The impact of the global minimum corporate tax reform appears to be contained. Malta's statutory corporate income tax (CIT) rate is 35 percent (a flat rate). Malta, however, adopts a full imputation system, which allows shareholders of Maltese companies to deduct 6/7th of the tax paid in Malta, reducing the effective CIT rate to five percent, below the global minimum (15 percent). Because there are few large multinational companies (above 750 million euros in global sales) in Malta, the impact of a potential revenue loss appears to be relatively contained at ¾ percent of GDP (2¾ percent of total revenues). The details of the changes, however, have yet to be settled at the EU and OECD level, and there remains uncertainty about the full impact of the reform.

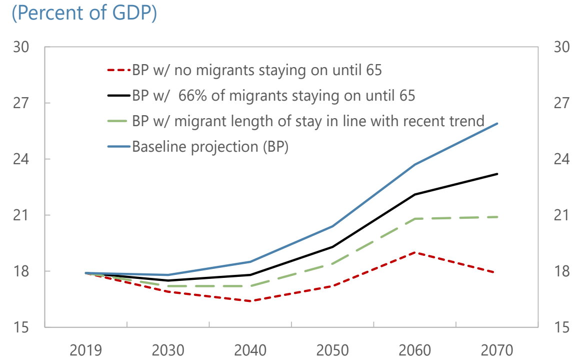
21. Long-term demographic trends should be closely monitored. The 2021 EC Aging Report identified Malta as one of the top five EU countries where the projected increase in pension spending is high. Aging costs in Malta are simulated to remain broadly flat until 2040 at around 18 percent of GDP but accelerate to 26 percent of GDP by 2070.[6] The projections, however, are highly sensitive to the assumption regarding the number of retired migrants.[7] Accordingly, close monitoring of the migration pattern is important, especially when the government considers raising an effective retirement age and other reforms. Meanwhile, efforts should continue to promote voluntary occupational pensions and personal pensions.[8]

Age-Related Spending, 2019–2070
(Percent of GDP)



Source: European Commission and IMF staff calculations.

Alternative Scenarios for Aging Cost Estimates
(Percent of GDP)



Source: Central Bank of Malta, European Commission, and IMF staff calculations.

6 European Commission (2021), "The 2021 Ageing Report: Economic & budgetary projections for the EU Member States (2019–2070)", Economic and Financial Affairs, Institutional Paper 148.

7 Central Bank of Malta, Quarterly Review, 2022, Vol. 55, No.3.

8 For reform options, see IMF Country report No. 20/98.

22. Further efforts to improve the efficiency of public investment should be a priority while supporting the green transition. Public investment has been scaled up since the onset of the pandemic and is projected to remain above 4 percent of GDP over the medium term. The increasing share of foreign funding would help the sustainability of investment: in particular, Malta's Recovery and Resilience Plan (2¼ percent of GDP) will support Malta's green transition and enhance its capacity through various reforms. The upcoming review of the infrastructure investment and management framework—which will be benefited from the IMF's Climate-Public Investment Management Assessment framework—should set the ground for stronger infrastructure governance and better public investment efficiency.

C. Safeguarding Financial Stability

23. The financial system remains sound, but risks are rising due to macroeconomic uncertainty and tightening financial conditions. The Tier 1 capital ratio of both core banks and non-core banks is at around 20 percent, the liquidity coverage ratio at around 360 percent (the highest in the EU banking system), and banks are primarily domestic deposit funded.[9] Bank loans are also highly collateralized. In addition, the direct linkages of the Maltese banking sector to Ukraine and Russia are small.[10] However, Malta's financial sector could be adversely affected by lower growth, higher inflation, and rising interest rates.

- The strong labor market has strengthened households' resilience to shocks, containing the risk of mortgage default. In addition, the household sector holds a large net asset position (148 percent of GDP) with a moderate level of liabilities (59 percent of GDP). Maltese banks have yet to raise mortgage rates in line with other European banks, in part reflecting their continued access to domestic deposits at low rates. However, as variable rate mortgages account for 80 percent of the total, households' debt service capacity would be tested immediately once interest rates start to rise. In addition, house prices could decline, which through wealth effects could impact private consumption and further lower growth.

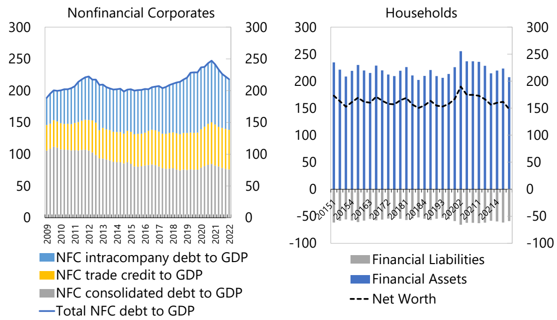
- The indebtedness of the nonfinancial corporate (NFC) sector has risen over the past several years, to around 218 percent of GDP (2022:Q2). On a consolidated basis excluding intracompany loans and trade credits, NFC debt was much lower at about 76 percent (2022:Q2). NFC's financial asset holdings are also sizable (150 percent), mitigating potential risks. The NFC sector, however, may face risks arising from the increased costs due to higher inflation and interest rates and weaker demand from Malta's main trading partners—all contributing to squeezing profits and

[9] Core (non-core) domestic banks accounted for 65 percent (8 percent) of banking sector assets, 70 percent (6 percent) of total loans and 86 percent (8 percent) of customer deposits in 2021. The remainder is accounted for by international banks which have limited linkages with domestic economic and financial activities.

[10] As of September 2022, Maltese banks' loans to Russia and Ukraine are €4 million (0.02 percent of GDP) and €2 million (0.01 percent of GDP), respectively. Deposits from Russia and Ukraine are €10 million (0.06 percent of GDP) and €2 million (0.01 percent of GDP), respectively.

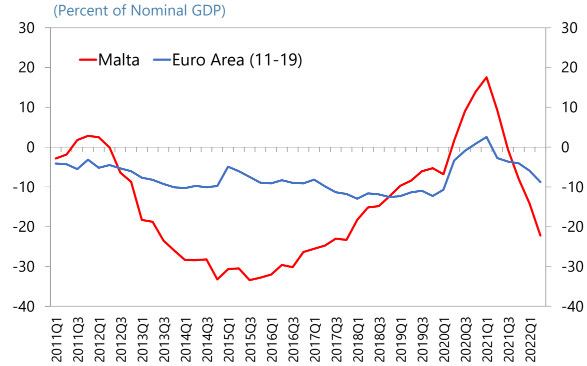
weakening debt service capacity. The reliance on intercompany loans (accounting for 42 percent of total corporate debt) could potentially propagate and amplify intragroup shocks.

Household and Nonfinancial Corporates Debts 1/
(Percent of Nominal GDP)



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

Credit-to-GDP Gap
(Percent of Nominal GDP)



Sources: Haver Analytics and European Central Bank.

24. Against this backdrop, the authorities should continue to be vigilant in monitoring risks. First, close supervision is warranted to monitor banks' risk management and to ensure that banks continuously update their assessment of and provisions for expected losses as economic prospects change. Second, the authorities should continue to closely monitor credit quality, especially given the increase in NPLs among loans that were previously under moratoria. Third, the banking sector's concentration of risk resulting from its large exposure to mortgage loans and the high proportion of variable rate loans warrant close monitoring of households' creditworthiness and housing market developments. Finally, supervisors should continue closely monitoring cyber security risks, given the increased risks of cyberattacks on critical infrastructure and institutions.

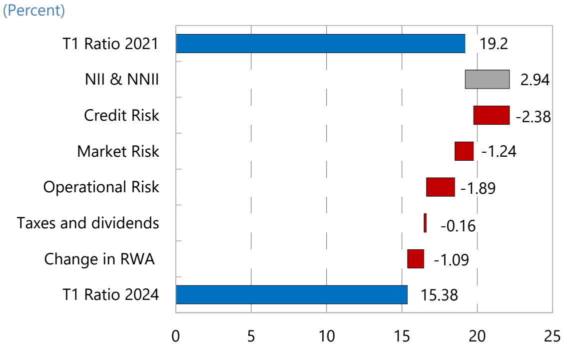
25. Macroprudential policy could be fine-tuned to address pockets of vulnerability. A set of borrower-based macroprudential measures, including loan-to-value and debt-service-to-income limits, are in place along the lines of the 2019 FSAP recommendations (Annex VII). The countercyclical capital buffer (CCyB) is currently set at zero, which is appropriate given the negative overall credit-to-GDP gap and weak NFC credit growth. The CBM's stress tests also suggest that the banking system is resilient to credit risks, including from mortgage exposures.[11] However, banks' large exposure to the housing market, following a prolonged period of strong mortgage credit growth, gives rise to concerns. In this context, the Central Bank of Malta (CBM)'s cost-benefit analysis of introducing a sectoral systemic risk buffer (SyRB) targeting mortgage loans is welcome.

[11] The CBM's analysis suggests that in an extreme adverse scenario, a 30 percent decline in house prices, paired with an 18 percent increase in NPLs, would lead to a decline in core banks' Tier 1 capital ratio only by about two percentage points, and banks' capital ratio would remain at above 16 percent.

26. Domestic life insurance companies are sizable but have ample buffers to withstand adverse shocks.[12] Insurance companies' profit more than doubled, with the solvency capital requirement up from 186.8 percent in 2020 to 218.1 percent in 2021. They invested half of their assets in collective investment undertakings and government bonds. The impact of rising inflation risk on insurers is uncertain, as they gain from higher long-term yields, with lower liability valuations, while the nominal value of claim payouts will increase. In addition, if capital market volatility intensifies, the equity and corporate bond portfolios (accounting for about 30 percent of assets) could be adversely affected. This calls for continued supervisory vigilance in monitoring risks in the insurance sector, including its interconnectedness with other financial institutions.

27. The CBM is developing a framework for stress testing climate risk. The CBM recently conducted a stress test that assessed the banking sector's resilience to transitional climate risk.[13] The scenario assumes (i) the introduction of a carbon tax; (ii) significantly lower or even negative GDP growth; (iii) a surge in oil prices;[14] and (iv) the introduction of additional 25 percentage-point risk-weight on NFCs in energy-intensive sectors. The results suggest that the banking sector is resilient to the shock, with the Tier 1 capital ratio falling to 15 percent, which is well above the minimum regulatory requirement of 6 percent. Building upon this stress testing framework, the authorities could usefully develop a framework that can assess the banking sector's resilience to physical climate risk. In addition, plans to introduce a module to model the second-round effects on NFCs would further improve the framework.

Stress Test Results – Relative Contribution of the Impact on Core Domestic Banks' Tier 1 Capital Ratio
(Percent)



Sources: Central Bank of Malta

D. Pursuing AML/CFT and Governance Reforms

28. The successful exit from the FATF's grey list reflected the authorities' high-level political commitment to AML/CFT reform. Over the past year, Malta has made demonstrated progress in (i) improving beneficial ownership information and applying appropriate sanctions for non-compliance by companies and gatekeepers, and (ii) enhancing the use of financial intelligence to pursue tax-based money laundering cases—key weaknesses highlighted by the FATF in

[12] In the non-bank financial sector, domestic life insurers are the largest, with their total assets amounting to 25 percent of GDP. Non-life insurers and investment funds are much smaller, amounting to 3½ percent of GDP and 13 percent of GDP, respectively.

[13] See CBM Financial Stability Report 2021. The scenarios are consistent with the Divergent Net Zero scenario of the Network of Central Banks and Supervisors for Greening the Financial System.

[14] Specifically, the scenario assumes that oil prices are US$71 per barrel higher than the baseline projection in the first year, US$112 in the second year, and US$157 in the third year. GDP growth is assumed to be 1.4 percent in 2022, -0.1 percent in 2023, and -1.8 percent in 2024.

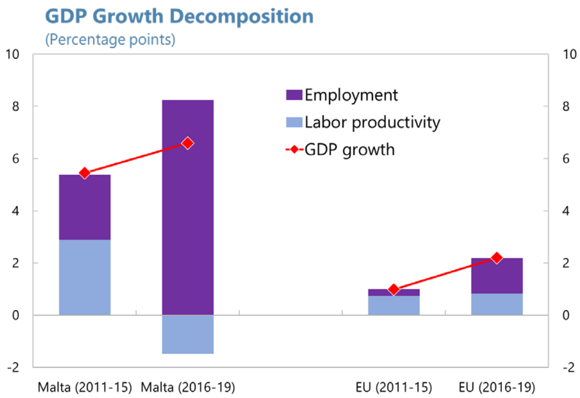
June 2021. Resources for AML/CFT supervisors have been boosted, which will help the long-term sustainability of reforms. The authorities have also adopted a new national AML/CFT strategy for 2021–2023, which enhances coordination and supervision to mitigate risks and protect the financial system's integrity and stability. The ongoing National Risk Assessment (NRA) exercise involves the cooperation between authorities and private sector representatives, aimed at developing policy recommendations based on identified threats and vulnerabilities in different sectors. In this regard, the close monitoring of high-risk sectors, especially virtual financial assets, gaming, and sectors associated with Malta's Citizenship by Investment program, should also continue. The authorities should also continue to ensure the effective implementation of supervisory sanctions.

29. Further strengthening of the governance framework is critical. Over the past two years, the authorities have made some progress in reforming the Maltese justice system in line with the recommendation from the Council of Europe's Venice Commission and the Group of States Against Corruption (GRECO).[15] The progress includes (i) a gradual transfer of the prosecuting functions from the police to the Attorney General's Office (AG) and (ii) the introduction of judicial reviews for non-prosecution by the AG. The adoption of the National Anti-Fraud and Corruption Strategy, allocating increased resources to investigative and prosecution bodies, has also been an important achievement. Malta also launched Digital Justice Strategy in December 2021 to strengthen the justice system's efficiency, effectiveness, and accessibility. However, further efforts are needed (i) to reform the appointment process of the Chief Justice; (ii) to enhance the efficiency and effectiveness of the operation of the AG and the Office of the State Advocate; (iii) to reduce the length of proceedings and investigation of high-level corruption cases; and (iv) to strengthen the asset declaration system.

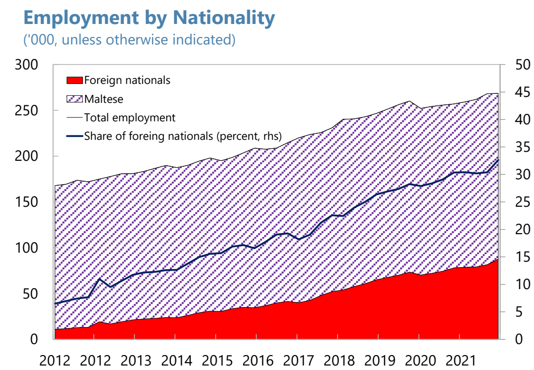
E. Re-Invigorating Structural Reforms

30. Boosting potential growth while achieving environmentally sustainable growth remains a key challenge. Prior to the pandemic, Malta's growth averaged 6½ percent in 2016–19, significantly higher than the EU average of 2¼ percent. The strong growth, however, was driven largely by labor inputs, with increased reliance on foreign immigrants (European immigrants account for two thirds of the total), while labor productivity growth was negative. Given land and human resource constraints, structural reforms should be advanced to boost productivity and potential growth. As a small state, Malta also faced several challenges in achieving a climate-neural economy and strengthening its resilience to climate risks.

[15] GRECO's Fifth Evaluation Round Compliance Report for Malta (September 2021) indicated that Malta had implemented 2 out of 23 recommendations satisfactorily, 12 recommendations partly implemented, and 9 not been implemented.



Sources: Eurostat, Haver Analytics and IMF staff calculations.



Sources: Eurostat.

31. Malta's Recovery and Resilience Plan (RRP) will address part of those structural policy challenges. Malta will receive €258.3 million (1¾ percent of GDP) in grants under the EU Recovery and Resilience Facility. The plan includes the measures to facilitate Malta's green transition, accelerate digital transition (primarily focusing on the public sector), increase the resilience and sustainability of the health sector, and address challenges in education, labor markets, pension systems, and the judiciary system. The implementation of the plan is underway, and Malta requested the first payment in December 2022 (Annex VIII).

32. More efforts, however, will be needed to address Malta's longer-term growth and climate challenges.

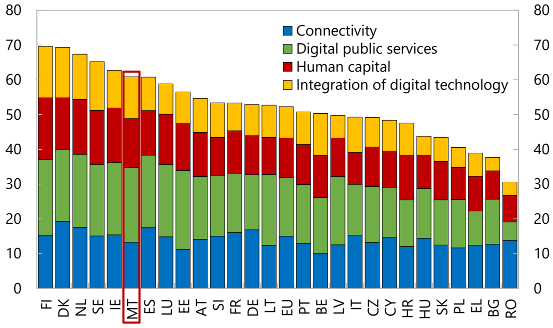
- ***Digital transformation and innovation.*** Malta's digital transformation is well placed in the EU's 2022 Digital Economy and Society Index (sixth out of 27 countries). However, there remain weak spots, including (i) the low number of STEM graduates, particularly for women;[16] (ii) the low digital intensity in small and medium-sized enterprises;[17] and (iii) weak technical skills and human resources.[18] To address these weaknesses, the government has adopted the Smart Specialization Strategy for 2021–27, aimed at channeling public and private investments in priority areas, including digital technologies, and promoting research and innovation. In this light, the collaboration between academia and the private sector should be enhanced. Given the increased cyber threats, strengthening cybersecurity solutions at the national and firm levels is critical.

[16] European Commission, 2022, "Women in Digital Scoreboard."

[17] European Commission, Malta 2022 Country Report.

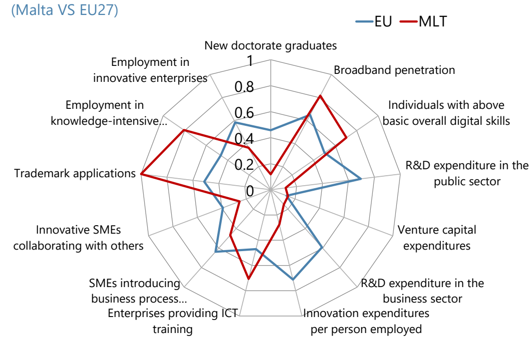
[18] Malta National Productivity Board, 2022, "National Productivity Report 2022."

Digital Economy and Social Index, 2022
(Percent out of maximum score)



Sources: DESI 2022, European Commission.

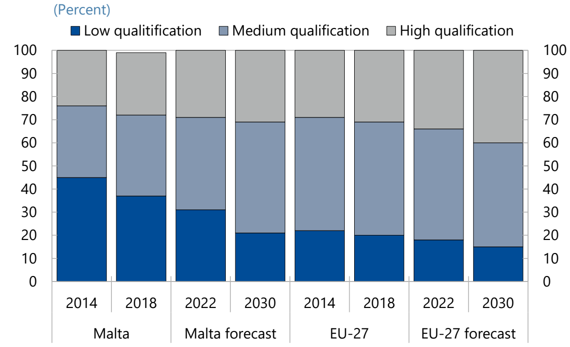
Innovation Performance Indicators 2021
(Malta VS EU27)



Sources: European Innovation Scoreboard 2021.

- ***Labor market policies.*** In October 2021, the government announced a new plan for employment, including policies to upskill the labor force, especially among young workers, create incentives for workers to delay retirement, and foster participation in the labor force through flexible working solutions. The plan also recognizes the need for Malta to keep attracting foreign workers, especially in the short term. The authorities should continue efforts in upskilling and reskilling workers, including by supporting industry-led training.

Labor Force Share by Level of Qualification, 2014-2030
(Percent)



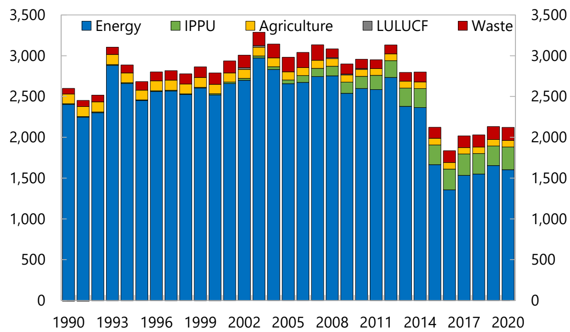
Source: Cedefop (2020 Skills Forecast).

- ***Corporate sector insolvency framework.*** New Insolvency Practitioners Act and Pre-Restructuring Act, in line with the European Directive on Restructuring and Second Chance, have been tabled in Parliament. The proposed legal reform aims at establishing an early warning system and improving the efficiency of the procedures related to restructuring, insolvency, and discharge of debt.

- ***Climate change and adaptation policy.*** Greenhouse gas (GHG) emissions have been significantly reduced over the past decade due to the shift from heavy fuel oil to natural gas in power generation. To reduce a carbon footprint and achieve the national target,[19] the authorities have identified abatement measures in the 2021 *Low Carbon Development Strategy*. The implementation of these measures, however, will be a challenge given Malta's low overall energy intensity, temperate winter climate, limited land area, and high population density (suggesting cost diseconomies in developing renewable energies). In this light, studies are underway to develop large-scale offshore windfarms, and the government is actively soliciting investors' interest. Collaboration with other countries can also be enhanced, for example, by offering Malta as a pilot case to test new carbon technologies and investing in renewables in Italy to increase the share of imports of renewable energies.

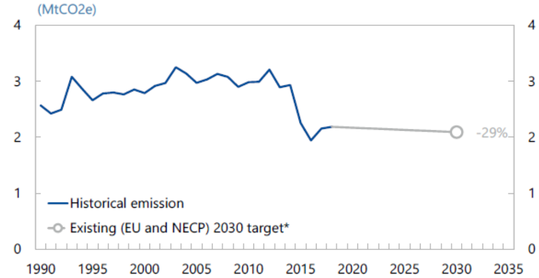
[19] A 19 percent reduction in net territorial non-Exchange Trade System GHG emission relative to 2005 by 2030.

Greenhouse Gas Emissions by Source Sectors
(Thousand Tonnes)



Sources: Eurostat.

GHG Emissions Projections and 2030 Target
(MtCO2e)

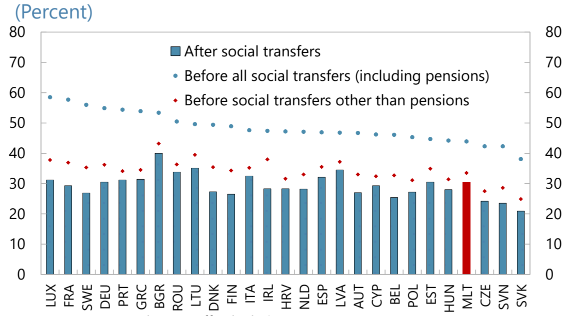


Sources: European Environment Agency; European Commission; and IMF Staff Calculations.
Note: * reflects the emission-weighted average of the 43-percent reduction target (compared to 2005) for energy (subject to ETS) and the emission reduction in other sectors by 19 percent, as per Malta's 2030 target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

33. A better-coordinated approach involving all stakeholders will be essential to strategize the sustainable development of the tourism sector. A number of hotel projects are in the pipeline, and if all projects are implemented, tourist arrivals will need to nearly double to keep their businesses profitable. This will pose significant risks to Malta's sustainable development prospects, as it will aggravate labor shortages, infrastructure bottlenecks, and social and environmental concerns. Accordingly, rather than focusing on volume, Malta will need to take a strategy to increase value-added in the tourism sector in an economically, environmentally, and socially cohesive way, as called for in the *Malta Tourism Strategy 2021–2030*.

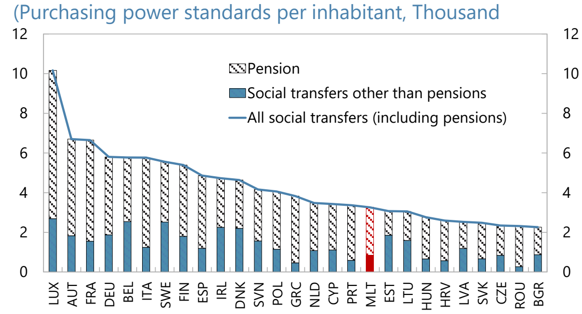
34. Poverty and income inequality risks may have risen over the past two years. The at-risk-of-poverty and social exclusion rate and income inequality indicators increased slightly by 0.4 and 0.3 percentage points in 2021, respectively (Figure 7). Due to higher inflation, these indicators may be worsening, particularly for low-income individuals and elders who receive a pension that falls below the poverty line. To mitigate poverty pressures, the 2023 Budget introduced additional measures to support these vulnerable groups. Given the risk of persistent inflation, the authorities should closely monitor its impact on poverty and inequality and evaluate the adequacy of the current tax and benefit system to prevent income inequality from widening.

Gini Coefficient for Equivalized Disposable Income per Inhabitant in 2020
(Percent)



Sources: Eurostat and IMF staff calculations.
Note: Ranked on the Gini coefficient: before all social transfers (including pensions).

Contribution of Social Transfers to Median Equivalised Disposable Income, 2020
(Purchasing power standards per inhabitant, Thousand



Source: Eurostat and IMF staff calculations.
Note: ranked on all social transfers.

AUTHORITIES' VIEWS

35. **The authorities broadly agreed with staff's assessment of the economic outlook and the main risks.** They expected output growth to slow in 2023 due to the deterioration in the international environment, while Malta's high dependence on imports adds inflationary pressures. They agreed that risks to the outlook were to the downside, though noting that the Maltese economy has consistently outperformed expectations due to gains in competitiveness and export market shares. They generally concurred with staff's external sector assessment, noting the high fiscal deficit would weigh on the current account balance whilst the sustained improvement in export competitiveness in various industries coupled with a strong tourism performance would improve the external position.

36. **The authorities stressed the importance they attach to continuing the fixed energy price policy.** In the context of limited alternative energy sources, they see the policy as contributing to the resilience of the economy by helping contain inflation, promoting price stability, increasing consumer confidence, avoiding rising inequality and poverty, and supporting growth. They emphasized that the situation remains uncertain, but plan to withdraw energy subsidies once the energy crisis has come to an end, which would significantly improve the fiscal position. They were seeking to increase the hedging coverage of liquefied natural gas imports to contain fiscal risks, while a progressive structure of household energy prices was already in place. They highlighted that part of the strategy to address the energy crisis includes investments in renewables and indicated that they were actively soliciting investors' interest in large-scale offshore windfarms, which would reduce the cost of electricity production.

37. **The authorities reiterated their commitment to medium-term fiscal consolidation**. They agreed that a moderate fiscal tightening in 2023 was appropriate, given the high inflation and deficits. The authorities aim to reduce the overall deficit to below 3 percent of GDP by 2025 while keeping debt below 60 percent of GDP. They were committed to strengthening revenue administration, improving operational efficiency, and reducing compliance costs. They supported the EU directive on the Pillar 2 model and were exploring options to make the tax system simpler. They agreed on the need to launch a spending review and further strengthen public investment management.

38. **There was agreement that the financial system remained sound, notwithstanding geopolitical risks and inflationary pressures.** The authorities highlighted the strength of the banking sector as evidenced by adequate capital and liquidity buffers, low NPL ratios, and high loan provisions, while agreeing on the need to keep monitoring developments. They emphasized their efforts to strengthen supervisory engagement and resources to address cyber risk, although they are not experiencing an increase in attacks.

39. **The authorities stressed the progress made on AML/CFT issues and reiterated their commitment to governance reform.** They assured their high-level political commitment to keep the reform momentum in the AML/CFT framework and the judicial system. They noted that the

National Risk Assessment exercise has improved information sharing between authorities and industry and agreed on the importance of continuing the monitoring of high-risk sectors. On governance reform, they stressed their continued efforts in addressing the recommendations from international organizations and, in particular, the measures implemented to address the recommendations of the Venice Commission.

40. The authorities agreed on the importance of structural reforms to boost productivity and achieve environmentally sustainable growth. They stressed that the implementation of Malta's Recovery and Resilience Plan was on track. They agreed that further efforts would be needed in the areas of labor markets, education, research and innovation, and the digital transformation of SMEs. They reiterated their commitment to environmentally and socially sustainable tourism sector developments. They noted that the implementation of the 2021 Low Carbon Development Strategy had been well underway, including the electrification of vehicles and the increased use of public transportation. They noted that the legislative amendments to strengthen the insolvency framework would become effective in early 2023.

41. The authorities noted that the 2023 Budget addressed the distributional impact of the high inflation. It included additional measures to support pensioners and lower income earners.

STAFF APPRAISAL

42. Malta's economic recovery from the pandemic is remarkable, but the indirect impact of Russia's war in Ukraine weighs on the outlook. The strong economic recovery continued into 2022, driven by high net exports and consumption. GDP growth is, however, set to slow in 2023 as the confluence of global shocks weighs on the economy. Inflation is expected to gradually decline but remain elevated. Risks to the outlook are tilted to the downside, mainly because the growth slowdown in Europe could be deeper than expected.

43. The authorities should prepare an exit strategy from the fixed-energy-price policy while protecting vulnerable groups. The exit strategy should aim to contain fiscal costs and introduce market price mechanisms to enhance incentives for energy conservation and help accelerate the green transition while protecting vulnerable groups. The authorities should explore reform options with the aim of gradually rolling them out ahead of winter 2023/24. Ultimately, accelerating the green transition is the best way to strengthen Malta's resilience to an energy shock.

44. The fiscal tightening planned for 2023 is appropriate, given the need to slow inflation and improve the public finances, but additional actions are needed to pursue consolidation over the medium term. While public debt is projected to remain just below 60 percent of GDP, it could be forced on an upward path if growth underperforms or contingent liabilities materialize. To protect against this risk, the authorities need additional measures to mobilize revenues and enhance spending efficiency over the medium term. In light of Pillar II of the global corporate tax reform, the authorities need to reform the taxation of multinational firms and consider broader reforms to the tax system and to revenue administration with the aim of simplifying and improving the efficiency of the tax system and reducing administration and compliance costs while protecting revenues. Efforts aimed at identifying the scope for rationalizing recurrent spending should continue, while further steps should be taken to improve the efficiency of public investment, including green investments. Long-term demographic trends should be closely monitored to properly plan pension-related reforms, and efforts should continue to promote voluntary occupational pensions and personal pensions.

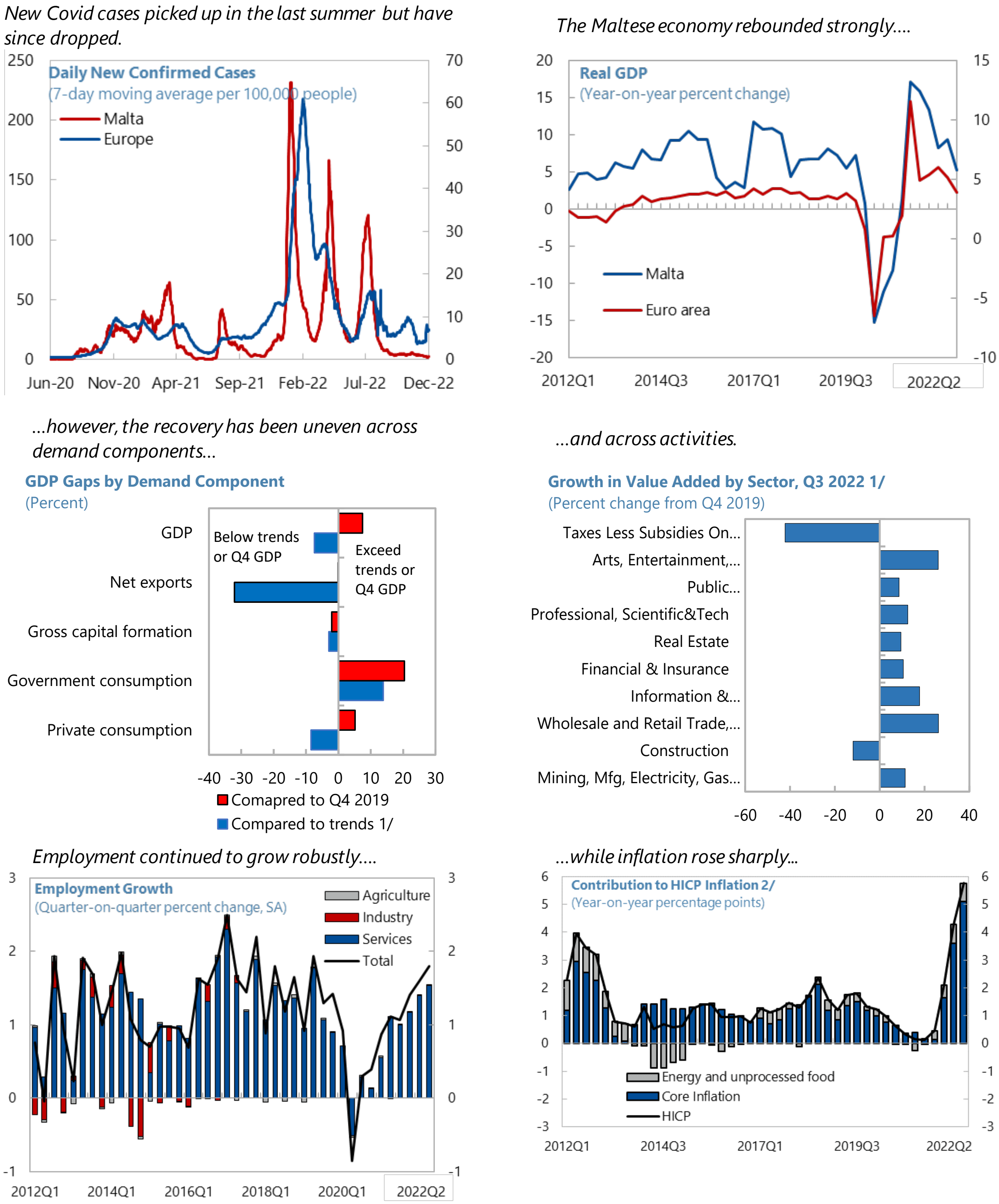
45. The financial system remains sound, but emerging risks warrant continued vigilance and close monitoring of banks. The authorities should closely monitor banks' risk management to ensure that provisions are continuously updated as economic prospects change. Given the banking sector's large exposure to the housing market, the consideration of introducing a sectoral systemic capital risk buffer targeting mortgage loans is warranted. In addition, efforts to monitor cyber security risks and strengthen resilience against cyberattacks should continue.

46. The authorities should continue efforts to strengthen the effectiveness of the AML/CFT framework. The boosted resources for AML/CFT supervisors should remain in place to help the long-term sustainability of reforms. Notwithstanding the progress Malta has made, the authorities need to continue to demonstrate the effectiveness of supervisory outcomes, including through the effective implementation of sanctions. The implementation of the national AML/CFT strategy for 2021–2023, as well as the NRA exercise, is important to enhance coordination and supervision to mitigate existing and emerging risks. The close monitoring of high-risk sectors, especially virtual financial assets, gaming, and sectors associated with Malta's Citizenship by Investment program, should also continue.

47. Structural reforms are necessary to improve Malta's long-term growth and address climate challenges. Malta's Recovery and Resilience Plan will address part of its structural challenges, but more efforts will be needed, especially to address labor skill mismatches, increase STEM graduates, enhance vocational training, promote research and innovation, and advance the digital transformation of SMEs. Labor force participation should also be fostered through incentives for workers to delay retirement and flexible working solutions to address structural labor shortages. On climate change policy, concerted efforts involving all stakeholders should continue to implement the 2021 Low Carbon Development Strategy and seek decarbonization potential by exploiting various sources, including investing in renewable sources.

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

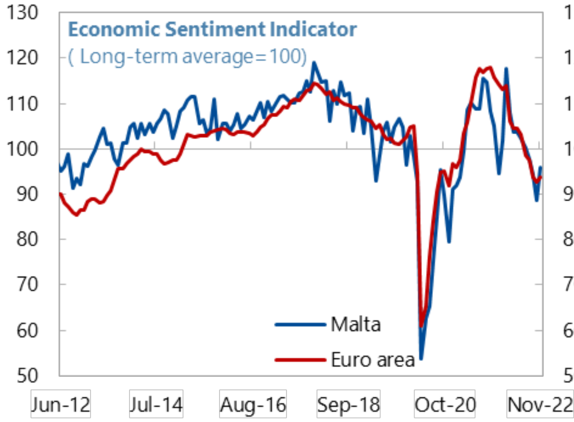
Figure 1. Malta: Recovery from the Pandemic Crisis



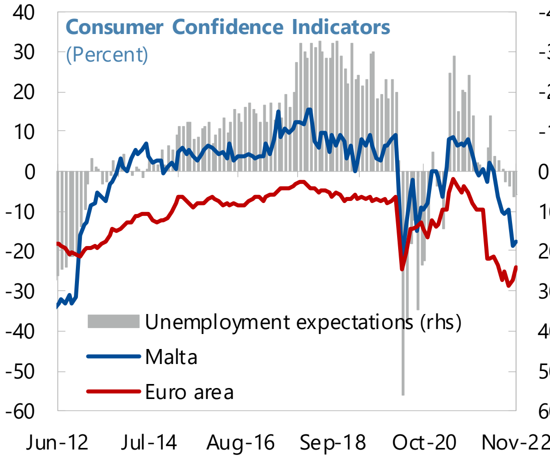
Sources: Malta Ministry of Health, NSO, Eurostat, Haver Analytics, Bloomberg Finance L.P., OWID, WEO, and staff calculations.
1/ The "Agriculture, Forestry, and Fishery" sector is excluded because the data are too volatile.
2/ HICP stands for Harmonized Index of Consumer Prices.

Figure 2. Malta: Short-Term Indicators

Economic sentiment weakens after a strong recovery…



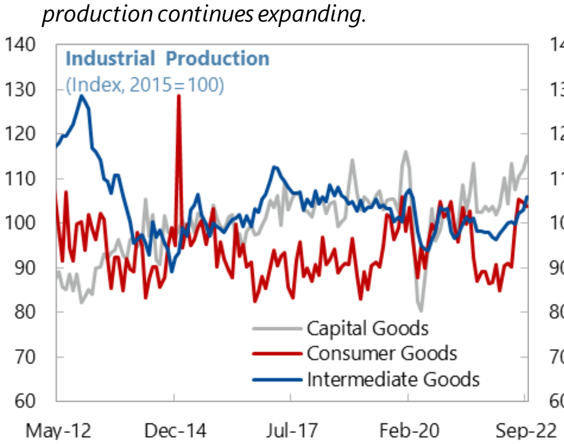
…with weakening consumer confidence…



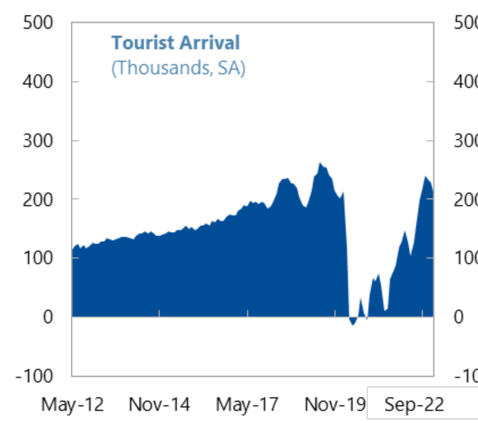
…and the business sector facing high uncertainty.

Capacity utilization and export expectations have decreased.

Consumer goods production has recovered to pre-pandemic levels, and capital and intermediate goods production continues expanding.



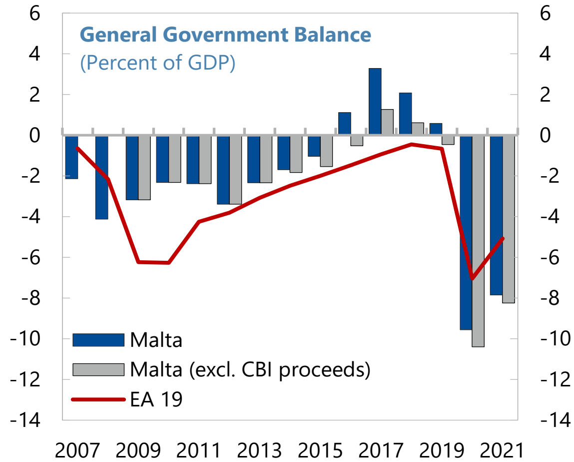
The tourism sector continues to recover from the pandemic shock.



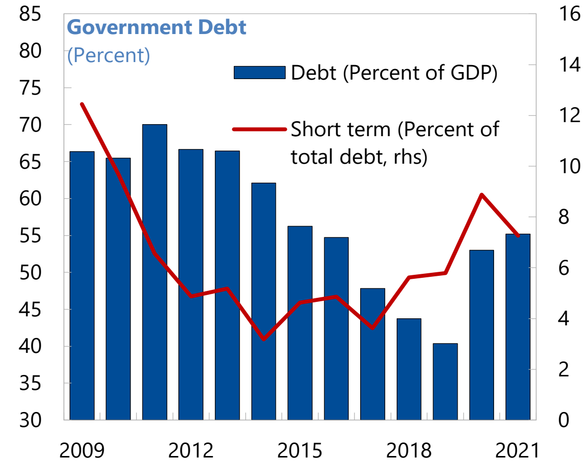
Sources: European Central Bank; Central Bank of Malta; European Commission; and IMF staff calculations.

Figure 3. Malta: Fiscal Developments

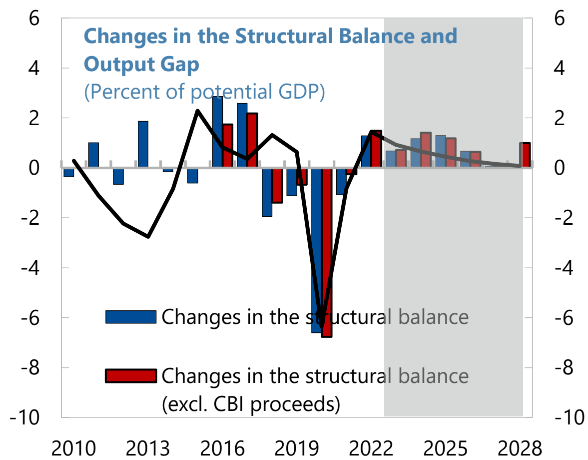
The fiscal balance deteriorated sharply reflecting COVID-19 related expenditures…



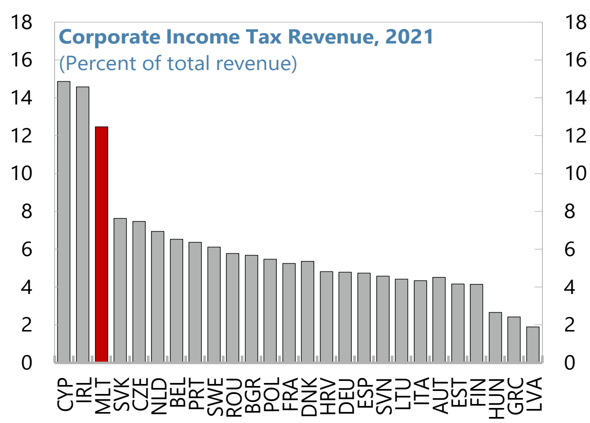
… which led to a sharp rise in the public debt ratio.



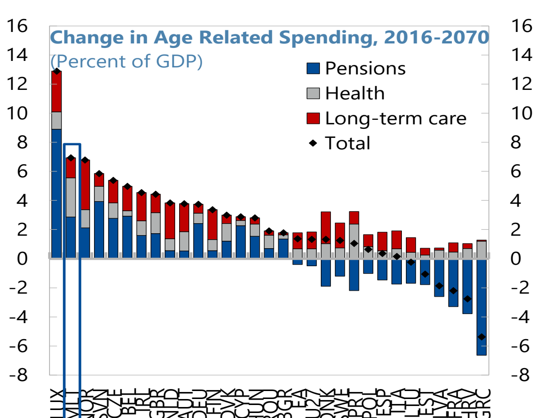
A gradual fiscal tightening is expected through the medium-term.



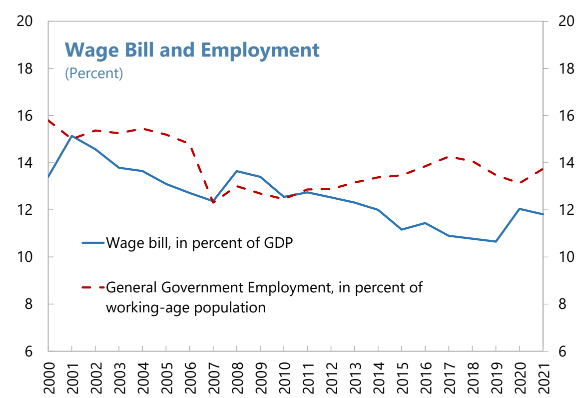
Malta's reliance on corporate income tax revenues remains well above the EU average



Over the long term, demographic trends may put significant pressure on age-related spending.



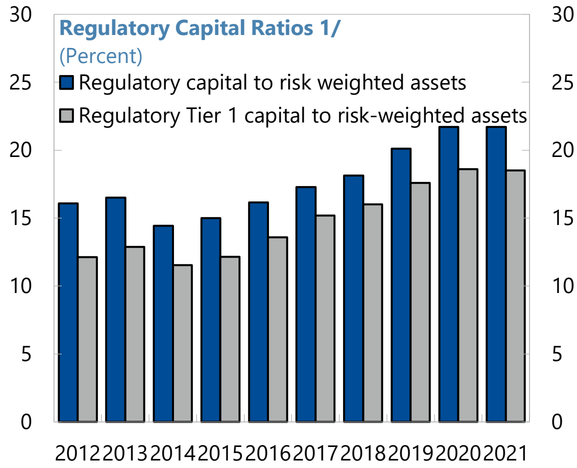
Wage spending and general government employment have increased since the pandemic.



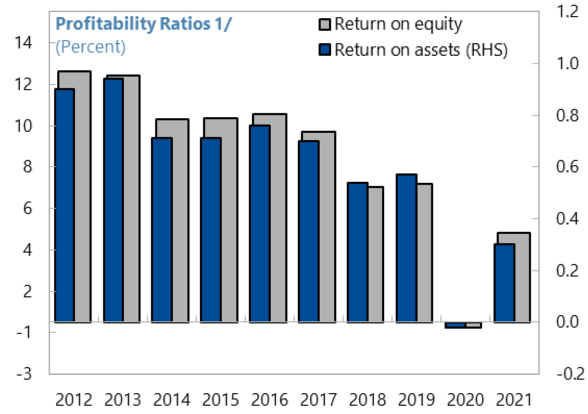
Sources: Eurostat; IMF *World Economic Outlook;* European Commission's "*The 2018 Ageing Report;*" and IMF staff calculations.

Figure 4. Malta: Financial Soundness Indicators

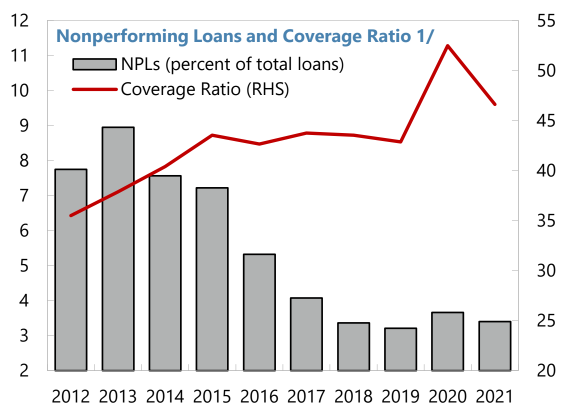
The banking system remains well capitalized...



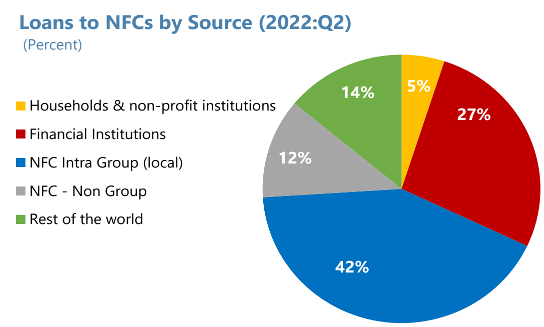
...but bank profitability fell.



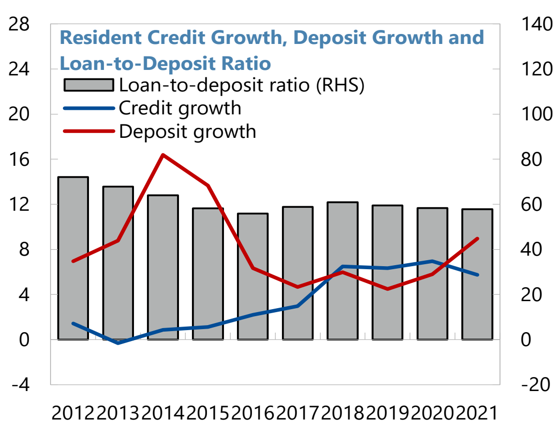
NPL ratios edged up but stayed at low levels with adequate coverage...



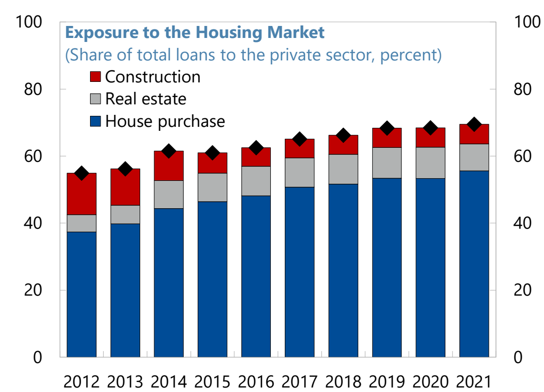
High NFC intracompany loans remains a source of uncertainty...



The loan-to-deposit ratio stayed constant at around 60 percent...



...while banks' exposure to the real estate market remained high.

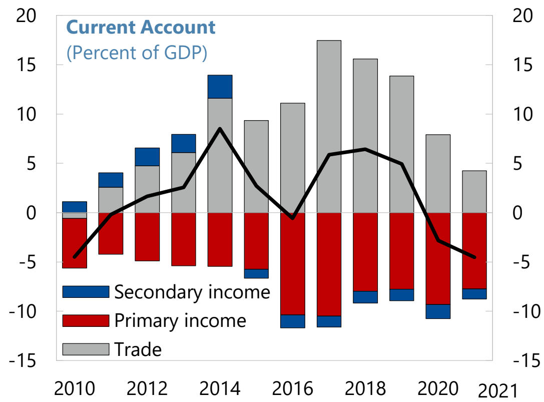


Sources: IMF *Financial Soundness Indicator;* Central Bank of Malta; Malta Financial Services Authority, and IMF staff.

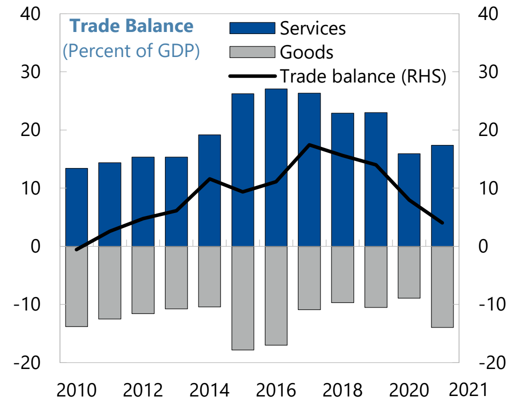
1/ Core domestic banks.

Figure 5. Malta: External Sector

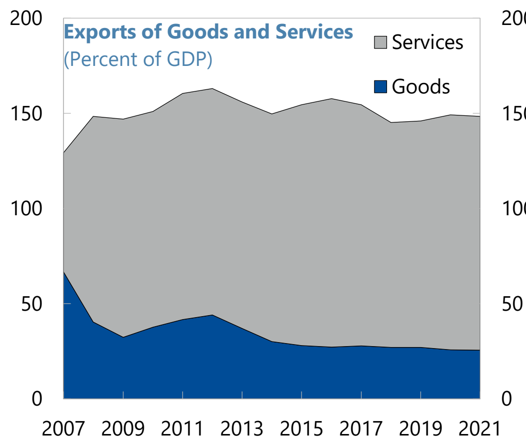
The current account balance remained negative in 2021, as external demand remained weak.



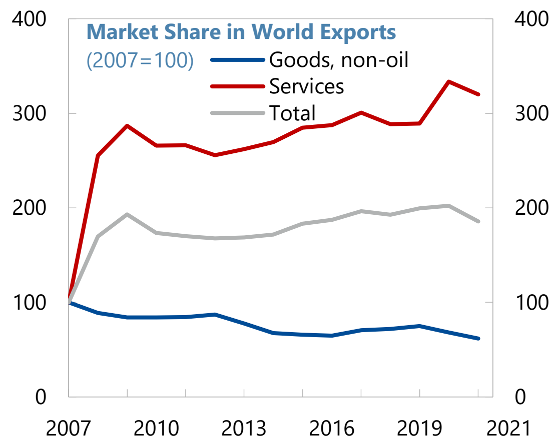
The goods trade deficit widened, more than offsetting a small recovery in services.



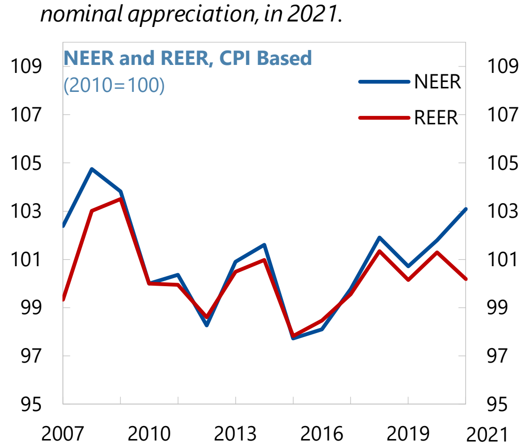
Service exports continued to dominate total exports…



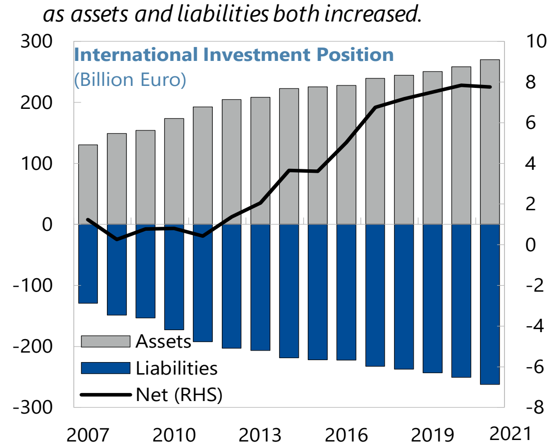
…while market shares in both services and goods decreased.



The CPI-based REER depreciated slightly, despite a nominal appreciation, in 2021.



Net international investment position remained stable as assets and liabilities both increased.

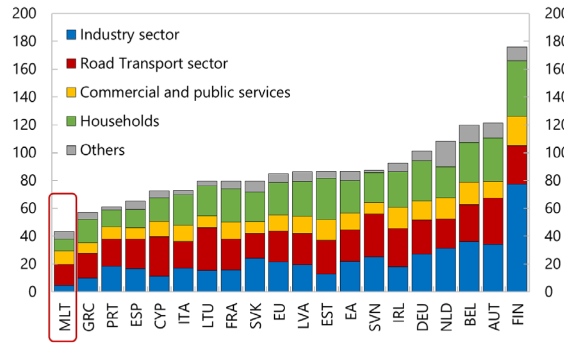


Sources: Haver Analytics; Eurostat; UNCTAD; IMF *World Economic Outlook*; and IMF staff.

Figure 6. Malta: Energy

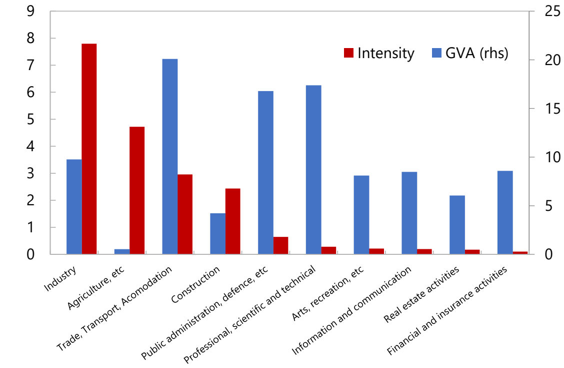
Malta has the lowest energy consumption per capita in the euro area…

Final Energy Consumption per capita by Sector
(Terajoule, 2020)



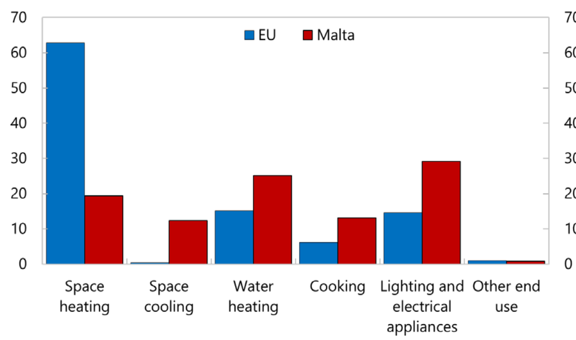
…due to its relatively small industry sector.

Energy Intensity and share of GVA by Sector, 2019
(Terajoules and percent)



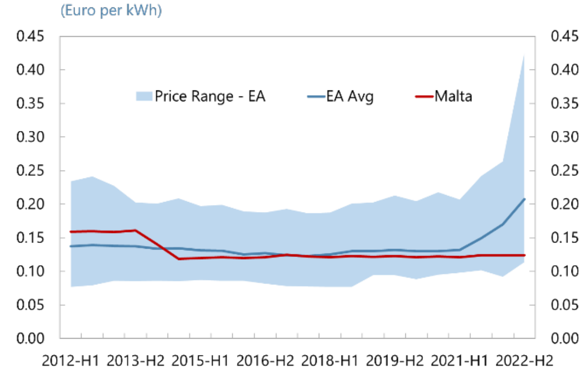
…and due to low needs of households for space heating compared to other European countries.

Share of Final Energy Consumption in the Residential Sector by Type of End-use, 2020
(Percent)



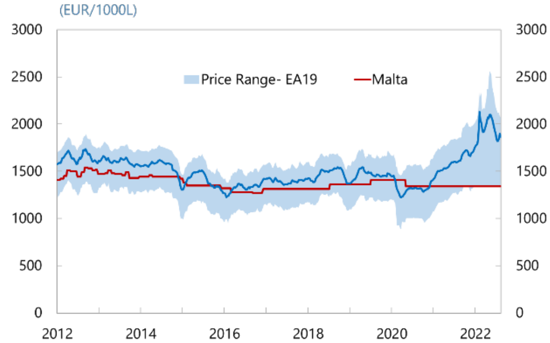
Due to Government intervention, household electricity prices are among the lowest in the euro area…

Electricity Prices for Household Consumers 1/
(Euro per kWh)



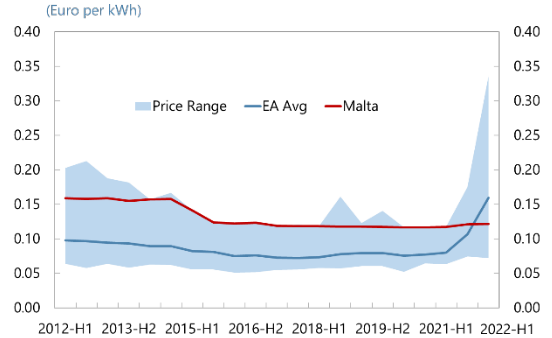
…and so are gasoline and diesel prices.

Gasoline Price 2/
(EUR/1000L)



Electricity prices for firms also remain stable, as euro area prices increase markedly.

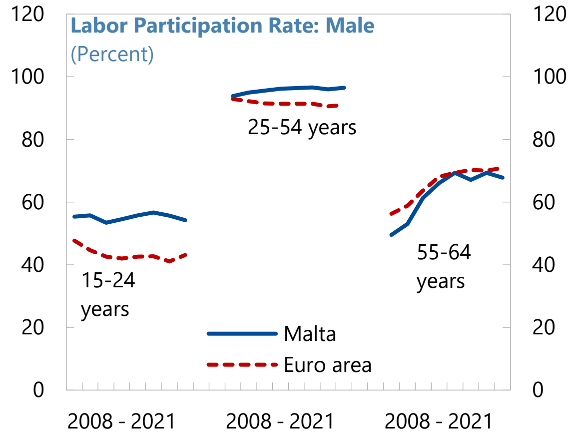
Electricity Prices for Non-household Consumers 3/
(Euro per kWh)



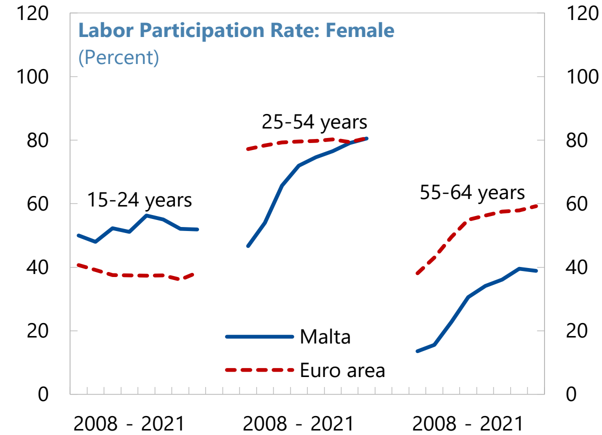
Sources: Central Bank of Malta; Eurostat; Haver Analytics; IMF World Economic Outlook; and IMF staff calculations.
1/ Price for consumption Band DC (2 500 kWh < Consumption < 5 000 kWh). Price does not include taxes.
2/ Price includes Taxes and Duties.
3/ Price for consumption Band ID (2 000 kWh < Consumption < 20 000 kWh). Price does not include taxes.

Figure 7. Malta: Labor Market and Income Inequality Developments

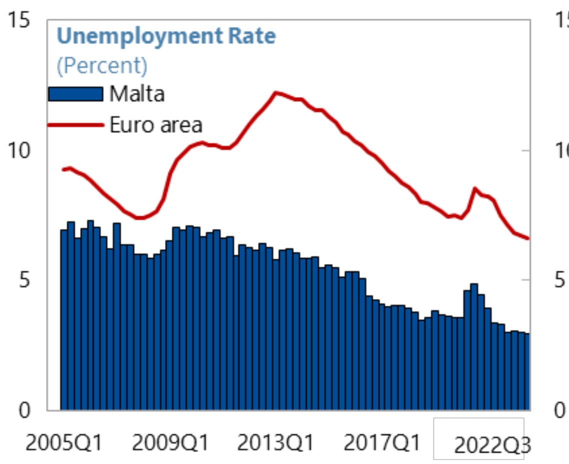
The male participation rate is higher than the euro area average (except for 55-64-year-old groups)...



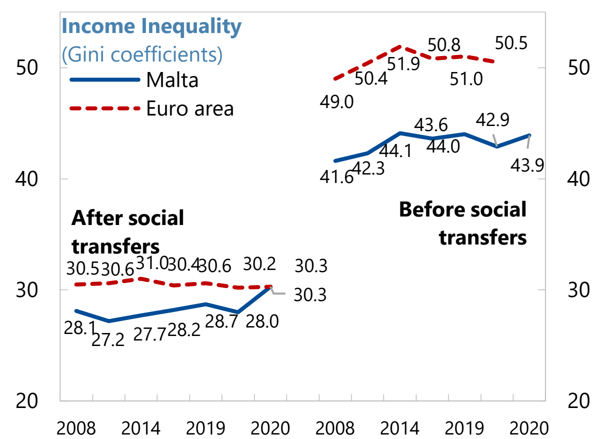
...while the female participation rate (25-54 years old) has increased significantly over the past decade.



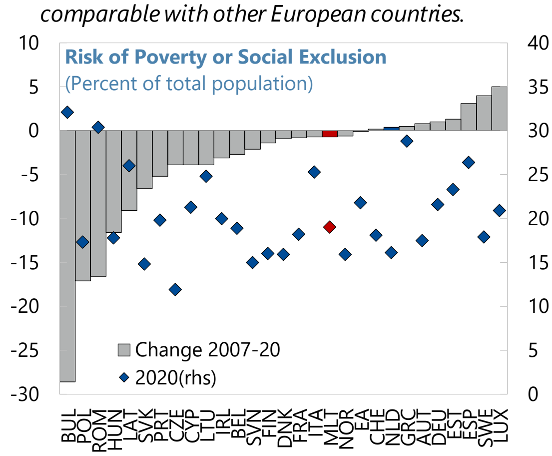
The unemployment rate has declined to historically low levels.



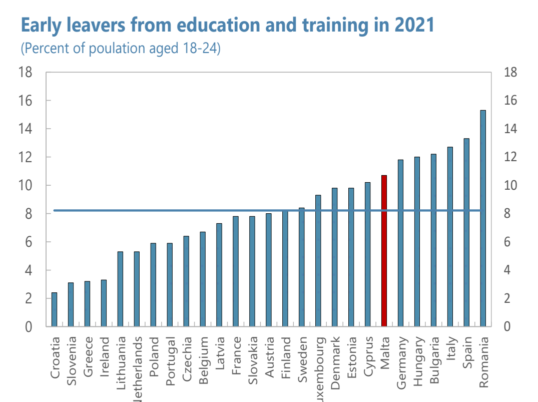
Income inequality remains below the euro area average...



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



The number of early school leavers is among the highest in the EU.



Sources: Eurostat and IMF staff.

Table 1. Malta: Selected Economic Indicators, 2020–2028

(Year on year percent change, unless otherwise indicated)

Population (2022, millions):	0.5	Per capita income (2021, euros):	29,031
Quota (as of Nov. 25, 2022; millions of SDRs):	168.3	At-risk-of-poverty rate (2020) 1/	16.9

			Projections						
	2020	2021	2022	2023	2024	2025	2026	2027	2028
National accounts									
Real GDP	-8.6	11.7	6.5	3.3	3.6	3.5	3.5	3.5	3.5
Domestic demand	-3.7	7.8	4.0	3.7	3.7	2.7	2.5	2.3	2.0
Consumption	-3.7	7.6	7.1	3.7	3.6	2.8	2.5	2.3	1.9
Private consumption	-10.5	8.0	8.2	3.5	3.8	3.0	2.6	2.3	1.8
Public consumption	15.7	6.5	4.5	4.0	3.0	2.2	2.2	2.2	2.2
Fixed investment	-6.5	10.6	-5.0	4.0	4.5	2.5	2.5	2.5	2.5
Exports of goods and services	-1.6	6.3	6.2	2.9	3.1	2.5	2.5	2.5	2.5
Imports of goods and services	2.0	3.8	4.7	3.1	3.1	1.9	1.8	1.7	1.5
Contribution to growth									
Foreign balance	-5.8	5.0	3.3	0.2	0.4	1.2	1.4	1.6	1.9
Exports of goods and services	-2.7	11.5	10.8	5.0	5.3	4.2	4.2	4.1	4.1
Imports of goods and services	-3.1	-6.5	-7.5	-4.8	-4.9	-3.0	-2.7	-2.6	-2.2
Potential GDP growth	-1.8	5.5	4.1	3.8	3.8	3.7	3.7	3.6	3.6
Output gap (% potential GDP)	-6.4	-0.8	1.4	0.9	0.7	0.4	0.3	0.2	0.1
Prices and employment									
HICP (period average)	0.8	0.7	6.1	5.2	2.8	2.1	2.0	2.0	2.0
GDP deflator	1.6	1.9	4.4	3.5	1.4	1.8	1.8	1.8	1.8
Unemployment rate (EU harmonized)	4.4	3.4	3.0	3.1	3.2	3.3	3.3	3.4	3.5
Employment growth	2.7	2.8	4.0	2.5	2.0	2.0	2.0	2.0	2.0
Savings and investment									
Gross national savings (% GDP)	19.1	16.8	15.1	15.2	15.4	16.4	17.6	18.3	19.2
Gross capital formation (% GDP)	21.9	21.4	18.8	18.7	19.0	18.9	18.8	18.7	18.6
Public finance									
Net lending/borrowing (overall balance)	-9.6	-7.8	-5.4	-5.0	-4.0	-2.8	-2.2	-2.2	-2.1
Structural overall balance (% potential GDP)	-6.3	-7.4	-6.1	-5.5	-4.3	-3.0	-2.3	-2.2	-2.1
Revenue	36.4	36.3	35.7	35.7	34.9	34.8	34.8	34.8	34.8
Expenditure	46.0	44.2	41.1	40.7	38.8	37.6	37.0	37.0	36.9
General government debt	53.0	55.2	56.6	58.5	59.6	59.3	58.8	58.5	57.9
Balance of payments									
Current account balance	-2.8	-4.5	-3.6	-3.5	-3.6	-2.4	-1.2	-0.4	0.6
Trade balance (Goods and services)	7.9	4.2	5.1	5.3	5.2	6.3	7.6	8.4	9.4
Goods balance	-10.1	-15.9	-13.7	-13.6	-13.8	-13.4	-12.9	-12.5	-12.1
Services balance	18.0	20.2	18.8	18.9	19.0	19.7	20.4	20.9	21.5
Primary income, net	-9.3	-7.7	-7.7	-7.7	-7.7	-7.7	-7.7	-7.7	-7.7
Secondary income, net	-1.4	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Financial account, net	-2.4	5.2	-2.9	-2.8	-2.9	-1.8	-0.6	0.2	1.2
Of which: reserves (- inflow; + outflow)	-0.3	-0.3	...	...	...	...	...	...	...
Memorandum items:									
Nominal GDP (millions of euros)	13,164	14,983	16,654	17,798	18,694	19,692	20,751	21,862	23,047
Nominal GDP growth	-7.2	13.8	11.2	6.9	5.0	5.3	5.4	5.4	5.4

Sources: Maltese authorities; Eurostat; and IMF staff projections.

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

Table 2. Malta: Fiscal Developments and Projections, 2020–2028
(Percent of GDP, unless otherwise indicated)

			Projections						
	2020	2021	2022	2023	2024	2025	2026	2027	2028
Revenue	36.4	36.3	35.7	35.7	34.9	34.8	34.8	34.8	34.8
Taxes	23.6	24.3	24.3	24.5	24.0	24.0	24.0	24.0	24.0
Indirect taxes	10.6	10.5	10.8	10.9	10.7	10.7	10.7	10.7	10.7
Direct taxes	12.8	13.5	13.2	13.3	13.1	13.1	13.1	13.1	13.1
Other taxes (capital taxes)	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social contributions	6.4	6.1	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Grants and capital revenue	1.9	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Other revenue	4.6	4.5	4.0	3.7	3.4	3.4	3.4	3.4	3.4
Expenditure	46.0	44.2	41.1	40.7	38.8	37.6	37.0	37.0	36.9
Expense	41.4	40.0	37.3	36.9	35.7	34.3	33.9	33.8	33.8
Compensation of employees	12.0	11.8	11.2	11.0	10.9	10.9	10.9	10.8	10.8
Use of goods and services	9.0	9.1	8.0	7.5	7.4	7.2	7.1	7.2	7.2
Interest	1.3	1.1	1.1	1.2	1.3	1.3	1.3	1.3	1.3
Subsidies	5.1	4.6	4.6	4.7	4.0	3.1	2.9	2.8	2.7
Social benefits	10.2	9.3	9.0	8.9	9.0	8.9	8.8	8.8	8.9
Other expense	3.7	4.1	3.5	3.6	2.9	2.9	2.9	2.9	2.9
Net acquisition of nonfinancial assets	4.6	4.1	3.8	3.8	3.2	3.3	3.1	3.1	3.1
Gross operating balance	-5.0	-3.7	-1.6	-1.2	-0.8	0.5	0.9	1.0	1.0
Net lending/borrowing (overall balance	-9.6	-7.8	-5.4	-5.0	-4.0	-2.8	-2.2	-2.2	-2.1
Memorandum items:									
Overall balance excl. one-offs	-9.6	-7.8	-5.4	-5.0	-4.0	-2.8	-2.2	-2.2	-2.1
Structural balance 1/	-6.3	-7.4	-6.1	-5.5	-4.3	-3.0	-2.3	-2.2	-2.1
Cyclically adjusted primary balance	-5.1	-6.3	-5.0	-4.3	-2.9	-1.7	-1.1	-0.9	-0.8
Structural primary balance 1/	-5.1	-6.3	-5.0	-4.3	-2.9	-1.7	-1.1	-0.9	-0.8
Primary balance	-8.3	-6.7	-4.3	-3.8	-2.6	-1.5	-0.9	-0.8	-0.8
One-offs	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public debt	53.0	55.2	56.6	58.5	59.6	59.3	58.8	58.5	57.9
Government guaranteed debt	8.9	8.0	7.7	6.5	5.6	4.0	3.8	3.6	3.4
Nominal GDP (millions of euros)	13,164	14,983	16,654	17,798	18,694	19,692	20,751	21,862	23,047

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

Table 3. Malta: Financial Soundness Indicators, 2019–2022 /1

(Percent, unless otherwise indicated)

	Core Domestic Banks				Non-Core Domestic Banks				International Banks 2/				Total Banks 2/			
	2019	2020	2021	June 2022	2019	2020	2021	June 2022	2019	2020	2021	June 2022	2019	2020	2021	June 2022
Capital /3																
Regulatory capital to risk-weighted assets	20.1	21.7	22.7	21.8	19.2	20.2	20.4	20.5	46.6	52.5	46.4	43.5	23.7	25.8	25.6	24.5
Regulatory tier 1 capital to risk-weighted assets	17.6	18.6	19.4	18.6	18.9	19.9	20.1	20.2	46.5	52.4	46.4	43.5	21.7	23.4	23.1	22.1
Leverage ratio	7.8	7.6	7.3	6.9	11.0	9.5	10.0	9.5	38.7	42.4	34.2	39.6	10.6	10.5	9.6	9.2
Large exposures to total own funds	75.9	69.6	66.8	75.5	140.7	175.8	173.6	212.8	84.3	83.3	68.2	62.6	84.3	81.8	76.9	86.0
Risk-weighted assets to total assets	46.2	42.9	39.1	38.3	61.1	49.0	50.6	50.5	88.3	82.8	74.8	85.4	51.1	46.6	43.0	42.7
Profitability																
Return on assets /4	0.6	0.0	0.3	0.2	1.3	-1.5	0.2	0.1	1.1	2.2	1.5	1.7	0.8	0.6	0.7	0.6
Return on equity /3,4	6.7	-0.3	4.3	2.3	11.0	-12.7	2.4	1.5	5.8	6.2	11.6	7.1	6.8	0.4	6.0	3.5
Operational cost-to-income ratio	66.3	68.1	75.3	90.3	47.0	95.8	82.2	81.5	39.9	35.1	47.2	50.1	53.9	51.7	61.8	70.1
Interest margin to gross income	63.7	73.2	72.3	70.0	31.5	48.9	40.9	43.0	56.1	64.8	56.4	53.8	58.0	67.7	62.7	60.6
Non-interest expense to gross income	67.8	70.0	77.0	91.6	47.1	97.5	83.3	82.2	39.9	35.2	47.3	50.1	54.7	52.7	62.7	70.7
Personnel expenses to non-interest expenses	43.8	45.8	41.2	34.2	50.2	48.3	48.5	48.8	13.5	12.7	10.8	10.2	34.6	34.2	30.3	26.8
Non-interest income to gross income	36.3	26.8	27.9	30.0	68.6	51.1	59.1	57.0	43.9	35.2	43.6	46.2	42.0	32.3	37.3	39.4
Net impairment charges to gross income	0.1	29.2	-3.4	-5.3	12.8	79.5	6.3	13.5	24.2	18.7	18.5	15.1	11.0	25.6	7.9	5.7
Asset quality																
Non-performing loans to total own funds /3	25.1	28.9	28.9	27.2	34.8	53.1	34.2	35.5	8.0	9.7	10.4	10.2	21.3	25.4	24.9	24.0
Non-performing loans to total gross loans	3.2	3.7	3.4	3.1	5.4	7.1	5.1	5.3	1.8	1.9	1.4	1.4	3.0	3.5	3.1	2.9
Non-performing exposures to total gross exposures	2.5	2.8	2.7	2.4	4.6	5.6	3.8	3.9	1.3	1.3	1.0	0.9	2.2	2.6	2.3	2.1
Total coverage ratio /5	42.9	52.5	46.6	52.4	41.0	47.6	59.8	64.6	78.5	91.4	147.5	150.4	49.2	57.2	59.9	65.4
Unsecured loans to total lending	25.1	23.2	20.1	19.1	77.6	80.8	71.9	71.0	22.4	19.7	21.5	22.5	27.1	25.6	23.8	23.5
Share of Stage 3 provisions to total provisions	71.9	66.7	69.2	67.4	91.4	93.0	90.2	89.5	48.3	44.6	27.9	31.9	67.0	65.2	59.8	60.9
Forbearance ratio to gross loans	2.4	3.0	4.4	4.2	0.9	0.5	0.8	0.7	3.8	3.3	7.4	8.0	2.7	2.9	4.9	4.9
Liquidity																
Liquidity coverage ratio /3	343.7	328.2	359.6	374.0	374.7	325.4	356.8	357.8	364.9	686.6	2469.6	1152.2	347.5	332.7	379.0	382.9
Liquid assets to total assets /3 /6	31.0	33.3	35.6	36.9	36.2	40.3	33.2	31.0	7.6	11.8	27.3	21.2	29.6	32.3	34.7	35.3
Customer loans to customer deposits	59.5	58.4	55.2	55.2	46.6	46.5	52.2	52.8	376.6	462.3	267.0	270.5	79.3	75.4	67.5	67.2
Counterbalancing capacity on net cash outflows	139.0	169.9	189.3	213.5	245.4	238.1	300.8	286.8	78.5	326.3	601.9	120.4	149.5	180.2	204.0	218.9
Net stable funding ratio /3			174.0	180.0			178.4	180.1			155.3	153.7			172.8	178.1
Balance sheet																
Assets to GDP	175.9	197.0	189.2	182.2	20.9	23.3	23.1	22.3	96.2	88.5	77.8	73.7	293.0	308.8	290.1	278.2
Domestic debt securities to total assets	6.4	8.3	8.8	9.4	2.9	7.2	7.9	7.3	0.0	0.1	0.2	0.1	4.1	5.9	6.4	6.8
Foreign debt securities to total assets	15.4	13.8	12.4	12.7	10.7	12.2	15.9	17.4	26.4	25.2	24.0	28.3	18.7	16.9	15.8	17.2
Customer loans to total assets	48.0	48.2	45.4	46.0	33.1	33.2	34.5	35.9	43.4	43.9	36.9	36.9	42.3	45.8	45.4	43.4
Interbank exposures to total assets	6.2	5.3	4.9	5.0	14.7	9.7	9.4	8.9	13.5	12.3	17.8	14.9	9.3	7.6	8.7	7.9

Source: Central Bank of Malta.

1/ Banks' total assets amounted to 278 percent of GDP (about €43 billion) at June 2022. About 26 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 66 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

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, 2020–2028

	2020	2021	2022	2023	2024	2025	2026	2027	2028
			Projections						
			(Percent of GDP)						
Current account balance	-2.8	-4.5	-3.6	-3.5	-3.6	-2.4	-1.2	-0.4	0.6
Trade balance (Goods and services)	7.9	4.2	5.1	5.3	5.2	6.3	7.6	8.4	9.4
Goods balance	-10.1	-15.9	-13.7	-13.6	-13.8	-13.4	-12.9	-12.5	-12.1
Exports	22.8	20.3	23.3	23.3	23.5	23.4	23.2	23.1	22.9
Imports	33.0	36.2	36.9	37.0	37.3	36.7	36.1	35.6	35.1
Services balance	18.0	20.2	18.8	18.9	19.0	19.7	20.4	20.9	21.5
Exports	107.1	104.5	102.0	102.1	103.0	102.4	101.8	101.2	100.5
Imports	89.0	84.4	83.2	83.2	84.0	82.7	81.3	80.3	79.0
Primary income, net	-9.3	-7.7	-7.7	-7.7	-7.7	-7.7	-7.7	-7.7	-7.7
Secondary income, net	-1.4	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Private	-1.4	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Public	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital account, net	0.6	1.0	0.7	0.7	0.6	0.6	0.6	0.6	0.6
Financial account, net	-2.4	5.2	-2.9	-2.8	-2.9	-1.8	-0.6	0.2	1.2
Direct investment	-74.1	-64.1	-82.2	-82.2	-82.2	-82.2	-82.2	-82.2	-82.2
Portfolio investment	48.7	46.9	44.0	44.0	44.0	44.0	44.0	44.0	44.0
Assets	51.0	49.4	43.4	43.4	43.4	43.4	43.4	43.4	43.4
Liabilities	2.3	2.5	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Other investment	24.4	24.6	37.3	37.4	37.2	38.3	39.6	40.4	41.4
Assets	19.5	31.7	31.7	31.7	31.7	31.7	31.7	31.7	31.7
Liabilities	-4.9	7.1	-5.6	-5.7	-5.6	-6.7	-7.9	-8.7	-9.7
Reserves (- inflow; + outflow)	-0.3	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-0.1	8.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Gross external debt (Percent of GDP)	671.4	620.7	554.8	515.7	487.4	460.2	435.5	413.0	392.4
Net external debt (Percent of GDP)	-165.1	-139.9	-139.0	-138.1	-137.1	-136.3	-136.0	-135.8	-136.0
Services Export: Travel (Percent of GDP)	2.6	4.0	8.2	8.7	...	...	...	...	...
Services Export: Non-Travel (Percent of GDP)	104.5	100.6	93.8	93.4	...	...	...	...	...

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

Annex I. Implementation of IMF Recommendations

2021 Article IV Advice	Actions Since 2021 Article IV
Financial Sector	
The authorities should expeditiously resolve the remaining deficiencies in the AML/CFT framework and enhance its effectiveness.	Over the past year, Malta has made demonstrated progress in (i) improving beneficial ownership information and applying appropriate sanctions for non-compliance by companies and gatekeepers and (ii) enhancing the use of financial intelligence to pursue tax-based money laundering cases—key weaknesses highlighted by the FATF in June 2021. In June 2022, the FATF removed Malta from its grey list of AML/CFT framework.
Continue to closely monitor banks' financial positions and risk management and ensure that banks update the assessment of expected losses.	Ongoing.
Enhancing data collection and monitoring are essential for intercompany lending.	Ongoing.
Fiscal Policy	
The pace of unwinding COVID-19 related support measures should balance the near-term need to support growth and long-term economic stability.	As the economy recovered strongly, the majority of the COVID-related support measures have been withdrawn.
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.	The authorities are planning to launch a spending review and public investment management assessment by leveraging IMF technical assistance.
Efforts to strengthen tax administration should continue, while a holistic review of the overall tax system would be useful.	The authorities supported an EU directive on the Pillar 2 model and are exploring options to make the tax system simpler by leveraging IMF technical assistance.
Manage risks from contingent liabilities and ensure the sustainability of the pension system.	Risks from contingent liabilities are being closely monitored. To support the sustainability of pension system, the 2023 budget includes a measure to encourage pensioners to remain in employment.
Structural Reforms	
Further advance labor market reforms, focusing on upskilling and reskilling workers, and leverage active labor market policies to facilitate resource reallocation.	Reforms are underway as a part of Malta's National Employment Policy 2021–2030.
Promote digital transformation and decarbonization.	Reforms are underway as a part of Malta's Recovery and Resilience Plan.
Ongoing work on the corporate insolvency framework should be completed by mid-next year.	The New Insolvency Practitioners Act and Pre-Restructuring Act have been tabled in the parliament.

Annex II. Selected COVID-19 Support Measures and Energy and Other Measures in Response to the War in Ukraine

Measures	Details	Effective Period
Wage Support		
Wage Supplement	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 and ended in May 2022.	March 2020–May 2022
Quarantine Leave	A one-off lump sum grant for employees on mandatory quarantine due to the possible contact with individuals at risk of infection.	March–May 2022
Liquidity Support		
Tax Deferral	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. Payments will have to start from June 2022 and end December 2024	March 2020–December 2021
Facilitating Teleworking	Support investment in telework equipment.	March–June 2020
Moratoria	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 applications before March 31, 2021, for new moratoria or the extension of the existing moratoria up to nine months in total.	March 2020–March 2021
Loan Guarantees	The MDB COVID-19 Guarantee Scheme (CGS) provided 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 last date for inclusion of loans under the scheme was extended a number of times from the original applicability period of December 2020. The final inclusion date was June 30, 2022. The CGS was further complemented by an interest rate subsidy to soften the terms of working capital loans extended by banks.	April 2020–30 June 2022
Interest Rate Subsidies	Subsidized interest rates on working capital loans for two years and up to a maximum of 2.5 percent. The MDB COVID-19 Guarantee Scheme (CGS) extension until 30, June 2022, was also applicable to the MDB's COVID-19 Interest Rate Subsidy Scheme.	April 2020–June 2022

Measures	Details	Effective Period
Social Support		
Social Measures	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 to employees who lost their jobs due to the COVID-19 crisis. Moreover, the medical benefits scheme and the disability benefit scheme were 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.	March 2020–June 2020
Real Estate Market Support		
Reduction in Property Tax Rate and Stamp Duty	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 2021 Budget extended or introduced more favorable terms on a number of existing schemes supporting the property market. In the 2023 Budget, fiscal incentives on the property market were announced, which include: reduced stamp duty for first-time buyers and for property situated in Gozo; cash grants for first-time buyers ranging from €10,000 to €30,000 spread over 10 years subject to specific conditions; refund of duty paid on the first €86,000 of the value of the replacement property for second-time buyers; exemption from income tax and duty on the first €750,000 for transfers of property situated in an urban conservation area and on a vacant property that has been transferred, subject to certain conditions; VAT scheme applicable to restoration of qualifying property.	July 2020–December 2023
Postponement and Relaxation of Certain Macroprudential Measures	The phasing-in of the lowering loan-to-value ratio to 75 percent from 85 percent previously for Category II borrowers was 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	July 2020–July 2021
Economic Recovery Support		
COVID-19 Business Assistance Program	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.	July 2020–in place
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.	September 2020 (Second scheme announced in June 2021)
Direct Business Support	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 were granted.	July 2020–in place

Measures	Details	Effective Period
Energy and Other Support Measures Related to the War in Ukraine		
Energy Support Measures	As communicated in the 2023 Budget, the measure aims at supporting companies and households by stabilizing the price of gas, petroleum, and electricity, which is projected to be about 2.3percent of GDP in 2022 and 3.3 percent of GDP in 2023.	March 2022–in place
Subsidized Loans Scheme	A scheme to support companies active in the importation, manufacturing, and wholesale of grains and other similar products in the context of Russia's invasion of Ukraine. Facilitated by the Malta Development Bank (MDB), the scheme provides urgent liquidity support in the form of a direct subsidized loan. A total loan portfolio of up to €30 million, backed by a government guarantee of 90 percent. The term of the loans shall be a maximum of two years. The loans shall be covered by a maximum interest rate subsidy of 2 percent, subject to a minimum interest payment by the borrower of 0.1 percent. The last date for inclusion of loans is December 31, 2022, with a maximum 2-year maturity.	May 2022–in place
Liquidity Support Guarantee Scheme–Measure A	The second emergency liquidity support measure by the Malta Development Bank (MDB) as part of a package of measures in response to the Ukraine crisis. The LSGS-A is a portfolio-capped guarantee scheme intermediated by partner credit institutions to provide working capital loans to undertakings affected by the Ukraine/Russia crisis. The Guarantee covers 90 percent of each new individual loan, capped at 50 percent of the portfolio. The last date for inclusion of loans is December 31, 2022, with a term of the loan of up to maximum 6 years. This scheme is covered by a maximum interest rate subsidy of 2.5 percent, subject to a minimum interest payment by the borrower of 0.1 percent, subject to maximum thresholds as set out by the EU Commission.	May 2022–in place
Liquidity Support Guarantee Scheme–Measure B	LSGS-B provides short-term liquidity support for importers of fuel and oil, which were impacted by the current crisis, to ensure the security of supply and more stable prices. The LSGS-B is an uncapped guarantee scheme intermediated by partner credit institutions to provide working capital loans to importers of fuel and oil affected by the Ukraine/Russia crisis. The Guarantee covers 80 percent of each new individual loan, and each loan under this scheme is covered by the guarantee rate of 80 percent, without a capping on the portfolio. The last date for inclusion of loans is December 31, 2022, with a term of the loan of up to maximum 6 years. This scheme is covered by a maximum interest rate subsidy of 2.5 percent, subject to a minimum interest payment by the borrower of 0.1 percent, subject to maximum thresholds as set out by the EU Commission.	May 2022–in place

Annex III. External Sector Assessment

<table>
<tr><td colspan="7">Overall Assessment: The external position of Malta in 2022 is expected to be broadly in line with fundamentals and desirable policies settings. 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 continue to recover from the pandemic crisis, and the fiscal balance strengthens. The recent energy crisis has, however, created new risks. The country's large positive NIIP significantly mitigates external vulnerabilities.</td></tr>
<tr><td rowspan="2">Foreign Assets and Liabilities</td><td colspan="6">Background: Malta has maintained large net asset positions over the past decade, with sizable gross assets and liabilities (close to 20 times GDP). The net international investment position is expected to deteriorate from 51.8 percent of GDP in 2021 to 38.2 percent of GDP in 2022, returning to levels similar to those in 2015. Gross assets are expected to increase from 18 times GDP in 2021 to 19.4 times GDP in 2022, primarily due to increases in FDI and portfolio investment assets (measured in percent of GDP). Meanwhile, gross liabilities are expected to also increase from 17.5 times GDP in 2020 to 19 times GDP in 2022, mostly related to an increase in FDI liabilities.</td></tr>
<tr><td colspan="6">Assessment: Malta's gross liabilities are sizable. The volatility of financial flows and investment returns could present some risk, especially in the current global context of high inflation and uncertainty of interest rates. But the majority of the liabilities are direct investment, and the large gross asset position mitigate risks.</td></tr>
<tr><td>2022 (% GDP)</td><td>NIIP: 38.2</td><td>Gross assets: 1,942</td><td>Gross liabilities: 1,904</td><td colspan="3"></td></tr>
<tr><td rowspan="2">Current Account</td><td colspan="6">Background: The current account (CA) is expected to be in a deficit of 3.6 percent of GDP in 2022, down from a deficit of 4.5 percent of GDP in 2021. This reflects the improvement in tourism, partially offset by higher import prices. Over the medium term, the CA is expected to return to positive territory by 2028, as the effects of the pandemic continue to recede, energy prices come down, and external demand recovers, though still below pre-pandemic levels (around 4.0 percent of GDP, on average).</td></tr>
<tr><td colspan="6">Assessment: Taking account the COVID-19 adjustor capturing the ongoing impact on tourism (0.9 percent of GDP), the cyclical contributions (0.8 percent of GDP) and the adjustment due to natural disasters and conflicts relative to the world average (0.5 percent of GDP), the actual CA (-3.6 percent of GDP) is adjusted to -1.4 percent of GDP. Although tourism is expected to remain 20 percent below 2019 levels in 2022, on average, no scarring in the tourism sector is expected in the medium run. The EBA-lite CA model suggests a CA norm of -3 percent of GDP. The norm is adjusted by 2.4 percentage points to -0.6 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 -0.8 percent of GDP, with an implied REER gap of 0.9 percent. Policy gaps contribute 1.6 percentage points to the gap, of which the domestic component of the gap was –1.0 percent of GDP.</td></tr>
<tr><td>2022 (% GDP)</td><td>Actual CA: -3.6</td><td>Adj. CA: -1.4</td><td>CA Norm: -3.0</td><td>Adj. Norm: -0.6</td><td>CA gap: -0.8</td><td>Policy Gap: 1.6</td></tr>
<tr><td rowspan="2">Real Exchange Rate</td><td colspan="6">Background: The CPI-based REER depreciated by 4.0 percent during the first three quarters of 2022, following a slight appreciation of 0.3 percent in 2021.</td></tr>
<tr><td colspan="6">Assessment: The EBA-lite CA model points to a small REER overvaluation of about 0.9 percent for 2022, broadly in line with fundamentals.</td></tr>
<tr><td>2022 (% GDP)</td><td>Actual REER: 4.5</td><td>REER Norm: 4.6</td><td>REER gap: -9.2</td><td colspan="3">Implied REER gap (from CA model): 0.9</td></tr>
<tr><td rowspan="2">Capital and Financial Accounts</td><td colspan="6">Background: The capital account is expected to record a surplus of 0.7 percent of GDP in 2022, while the financial account balance is expected to turn into a deficit of 2.9 percent in 2022, with contributions from higher net FDI outflows more than offsetting higher net other investment inflows.</td></tr>
<tr><td colspan="6">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="6">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 IV. Risk Assessment Matrix[1]

Source of risks	Relative Likelihood	Impact if Realized	Policy Response
Global Risks			
Intensifying spillovers from Russia's war in Ukraine. Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility, with Europe, LICs, and commodity-importing EMs among the worst hit.	**High** **ST/MT**	**Medium.** Higher uncertainty and a negative trade shock could lower private consumption and prevent the recovery in the tourism sector.	Stand ready with fiscal and financial support measures, if needed. Maintain structural reform momentum to spur investment and promote higher productivity growth (*).
De-anchoring of inflation expectations and stagflation. Supply shocks to food and energy prices sharply increase inflation, de-anchoring inflation expectations and triggering a wage-price spiral. Central banks tighten monetary policy more than envisaged leading to weaker global demand	**Medium:** **ST/MT**	**High/Medium.** Import prices will rise, feeling into domestic inflation. Domestic financial conditions will also tighten.	Tighten fiscal policy, and intensify financial supervision to identify most affected groups and pockets of vulnerability.
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown. In Europe, gas shutoff by Russia would result in acute gas shortages and further supply disruptions, which triggers an EU recession.	**High** **ST/MT**	**High/ Medium.** Malta's export demand, including tourism, will weaken, affecting its overall growth.	Same as (*) above.
Local Covid-19 outbreaks. Emergence of more contagious vaccine-resistant variants force new lockdowns or inhibit commerce.	**Medium:** **ST/MT**	**Medium.** Reinstatement of containment measures will undermine a recovery in the tourism sector.	Same as (*) above.
Cyber-attacks on critical infrastructure, institutions, and financial systems.	**Medium:** **ST/MT**	**Medium.** Payment and financial systems are disrupted.	Continue efforts to strengthen the cybersecurity framework.
Malta's Specific Risks			
Realization of money laundering and terrorist financing risks, for example, in high-risk sectors, such as gaming, virtual asset provides, and activities benefitted from Malta's Citizenship by Investment program.	**Medium** **ST/MT**	**Medium.** Pressure on correspondent banking relationships will rise, and Malta's attractiveness as a financial and business location may deteriorate.	Continue efforts to address remaining shortcomings in the AML/CFT framework, and continue monitoring of high-risk sectors.
Sharp correction in house prices. A sharp decline in housing prices could affect financial stability with adverse effects on lending and growth.	**Low ST/MT**	**Low.** Risks are largely mitigated by banks' strong capital and liquidity positions, households' high financial wealth, and strong labor markets.	Continue close monitoring of risks and readjust macro-prudential measures.
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 V. Malta's Energy Sector

Malta is a small island economy and largely disconnected from the European energy network. Maltese energy sector has some unique characteristics in the European context.

1. Malta overwhelmingly relies on imported liquefied natural gas (LNG) for energy production. Malta is not connected to gas pipelines in Europe. LNG provides the main source of electricity (80 percent of Malta's energy production), followed by other fossil fuels (12 percent), and renewable energy including solar and bioenergy (8 percent), which is one of the lowest shares in the euro area.

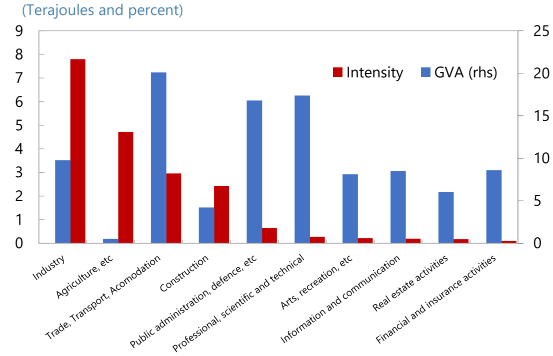
2. Interconnector with Italy is the only direct link to EU energy market. Local power generation (using LNG) provides 70 percent of total electricity consumption, and the remaining comes from renewable energy (10 percent) the interconnector with Sicily in Italy (20 percent). Electricity supplied through the interconnector is subject to daily spot price volatility which can be substantial. Interconnector prices shot up in the months following the war in Ukraine.

3. Maltese energy markets are not fully liberalized. ENEMALTA is the solo electricity company, and ENEMED is a petroleum product importer and distributer with a dominant market share. Both are state-owned enterprises.

4. The long-term LNG contract expired in March 2022. In 2015, Malta signed long-term contracts for LNG imports, which helped maintain stable retail energy prices. However, the first leg of the contract, establishing a fixed price, expired in March 2022, resulting in a substantial increase in costs. The importation of LNG is now indexed to the Brent oil price.

5. Malta's energy consumption per capita is the lowest in the EU. Household consumption is relatively low due to temperate climate and lower needs for space heating. The structure of the economy suggests low energy intensity, due to the relatively low weight of industry (that consumes 6 percent of total energy, compared to 35 percent in EU). More broadly, high intensity sectors (i.e., industry, agriculture, trade, transport and accommodation), jointly account for 80 percent of energy consumption but represent only 30 percent of Gross Value Added.

Energy Intensity and Share of GVA by Sector, 2019
(Terajoules and percent)



Source: Eurostat and IMF Staff calculations.

Annex VI. Debt Sustainability Analysis

Malta's public debt increased sizably due to a sharp growth contraction and fiscal response to the pandemic. Nevertheless, due to a strong post-pandemic recovery and a gradual fiscal tightening, public debt is projected to stabilize at below 60 percent of GDP by 2024 under the baseline scenario. Gross financing needs are projected to fall from 13 percent of GDP in 2022 to 7 percent of GDP by 2027. Risks to the baseline projections include the materialization of contingent liability and a real GDP growth shock. Malta's external debt sustainability remains robust to various shocks.

Public Debt Sustainability

1. **Malta's public debt ratio has risen sharply since the onset of the pandemic.** Prior to the pandemic, gross public debt declined from 70 percent of GDP in 2011 to 40.3 percent in 2019, reflecting primary fiscal surpluses and strong GDP growth. Due to a sharp growth contraction and a sizable fiscal response during the pandemic, the gross public debt to GDP ratio rose to 53 percent in 2020 and further to 55.2 percent in 2021 and is projected to rise to 56.6 percent of GDP in 2022. After reaching a peak level in 2020, the primary deficit started improving in 2021 with a strong economic recovery and the unwinding of a bulk of the COVID-19-related support measures and is projected to continue to shrink over the medium term. Public debt is projected to hover around 59 over the medium term.

2. **Gross financing needs (GFNs) are projected to decline while financing conditions are tightening.** GFNs were 15.3 percent of GDP in 2021 (unchanged from 2020), reflecting a primary deficit and rollover needs for short-term public debt. GFNs are projected to decline gradually and fall below 7 percent of GDP by 2027. More than 80 percent of the outstanding debt is long-term on a residual maturity basis. The government has continued to be successful in auctioning long-term bonds, although financial conditions have tightened as the European Central Bank started monetary policy normalization.

3. **Contingent liabilities remain significant.** The stock of government guarantees decreased from 8.9 percent of GDP in 2020 to 8 percent of GDP in 2021. It is projected to decline further in 2022. The liabilities of non-financial state-owned enterprises (SOEs) represented 19 percent of GDP in 2019 (latest official data). Contingent liabilities related to public-private partnerships account for about 1 percent of GDP.

4. **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 about 1 percentage points per year over 2023–24 (slightly lower than one standard deviation of growth over the past 10 years).[1] Debt would peak at 67 percent of GDP in 2024, about 7 percentage points higher than

[1] Excluding 2020-2021 as contraction and recovery were excessive due to COVID-19 shock.

in the baseline, but below the high-risk threshold of 85 percent. It would then decline to 66 percent of GDP in 2027.

- **Primary balance shock:** A cumulative reduction of 4.4 percent of GDP in the primary balance (equivalent to one standard deviation shock) in 2023–24, coupled with a 25-basis point increase in the interest rate, would raise the debt ratio by about 5 percentage points relative to the baseline over the medium term.

- **Interest rate shock:** A sustained increase of 237 basis points in spread throughout the projection period would increase the debt ratio by about 2 percentage points relative to the baseline over the medium term.

- **Real exchange rate shock:** A 13 percent real exchange rate depreciation with a pass-through to the inflation rate is assumed in 2023. 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 68 percent of GDP in 2024, 8 percentage points higher than the baseline and remain above 60 percent in the medium term.

5. 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 2023–24), lower inflation by 0.25 percentage points for every one percentage point reduction in growth, and higher interest rate spread 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 in the baseline, the shock would deteriorate the primary balance to minus 24 percent of GDP in 2023, largely reflecting the effect of bank assets. The debt ratio is projected to rise sharply to 85 percent of GDP in 2024 and remain around the same levels until the end of the projection horizon.

- **Government guarantee shock:** This scenario analyzes a contingent liability risk from SOEs and other government-guaranteed debt, assuming a one-time increase in expenditures equivalent to 50 percent of SOE liabilities. Additional shocks follow the same assumptions as for the financial contingent liability shock above, including slower growth, lower inflation, and higher interest rate spreads. With these shocks combined, the debt-to-GDP ratio would increase to 71 percent in 2024, about 11 percentage points higher than the baseline scenario.

External Debt Sustainability

6. 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 intracompany lending and liabilities of offshore financial institutions that have limited links to the domestic economy. Total net external debt was minus 140 percent of GDP at the end of 2021, and it is projected to decline marginally 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.

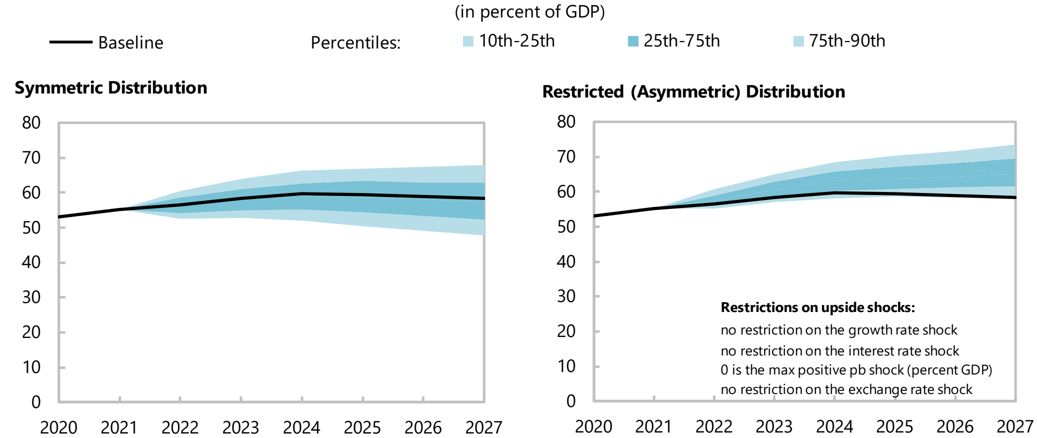
Annex Figure VI.1. Malta: Public Debt Sustainability Analysis—Risk Assessment

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

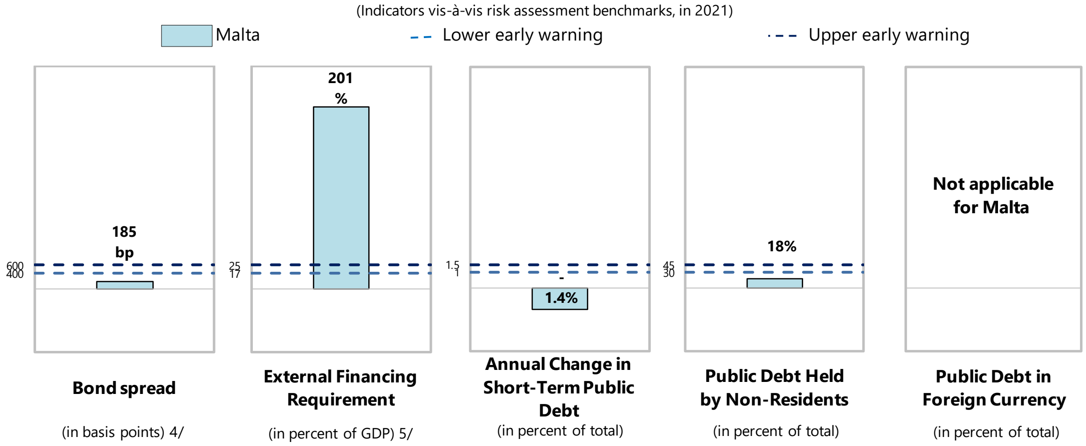
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2021)



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.

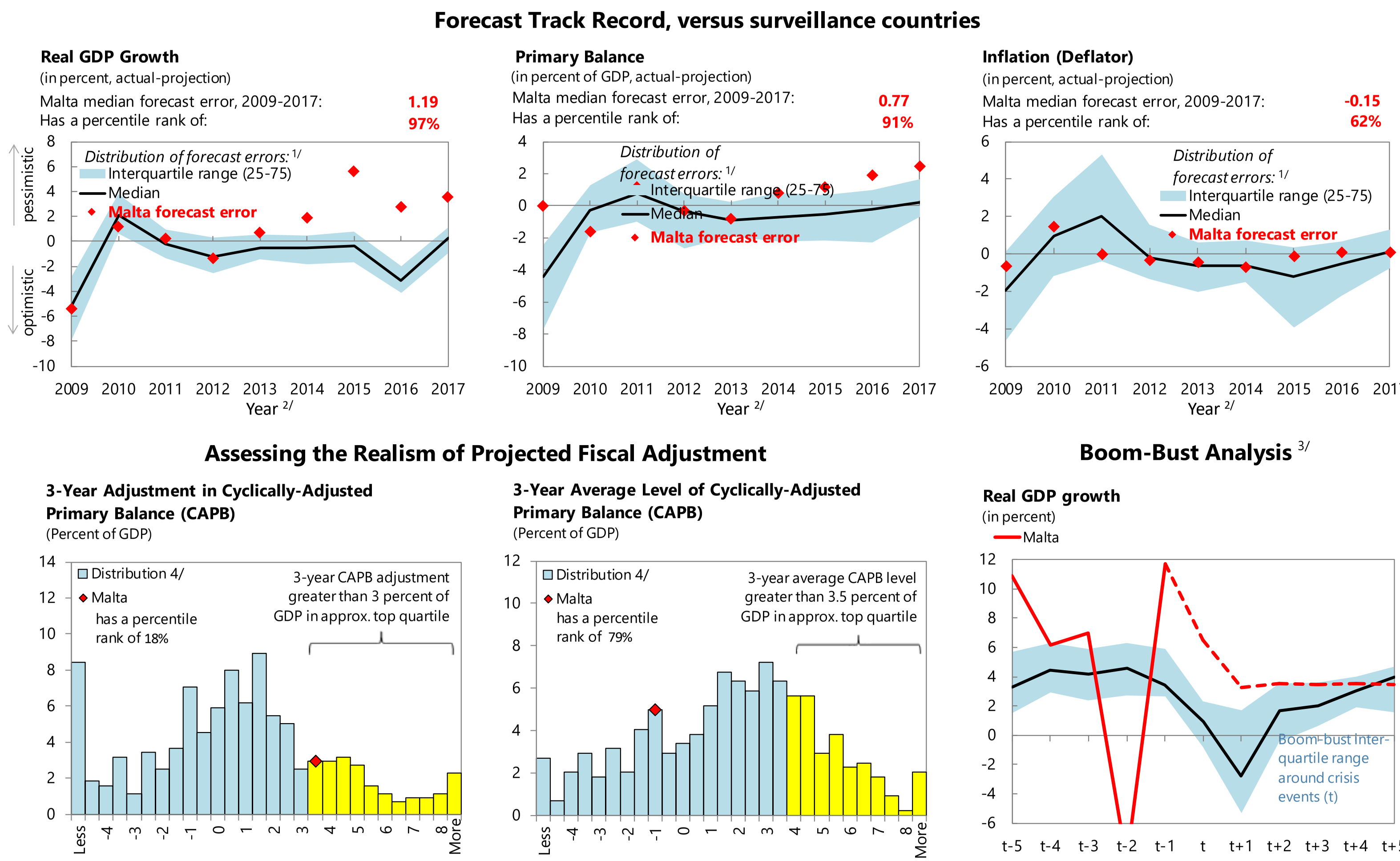
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, 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, 06-Sep-22 through 05-Dec-22.

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.

Annex Figure VI.2. Malta: Public Debt Sustainability Analysis—Realism of Baseline Assumptions



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, 2019-2021. For Malta, t corresponds to 2022; 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.

Annex Figure VI.3. Malta: Public Debt Sustainability Analysis—Baseline Scenario

(in percent of GDP unless otherwise indicated)

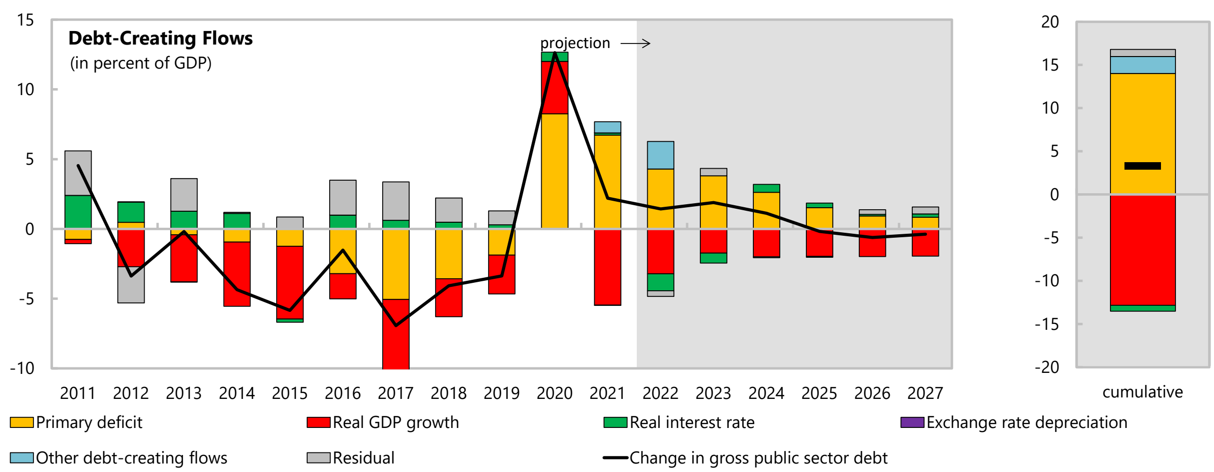
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2011-2019 [2/]	2020	2021	2022	2023	2024	2025	2026	2027
Nominal gross public debt	56.4	53.0	55.2	56.6	58.5	59.6	59.4	58.8	58.5
Public gross financing needs	14.7	15.3	15.3	12.9	12.6	10.6	9.5	6.3	6.7
Real GDP growth (in percent)	6.1	-8.6	11.7	6.5	3.3	3.6	3.5	3.5	3.5
Inflation (GDP deflator, in percent)	2.3	1.6	1.9	4.4	3.5	1.4	1.8	1.8	1.8
Nominal GDP growth (in percent)	8.5	-7.2	13.8	11.2	6.9	5.0	5.3	5.4	5.4
Effective interest rate (in percent) [4/]	4.1	3.0	2.4	2.2	2.3	2.5	2.5	2.0	2.3

As of December 05, 2022		
Sovereign Spreads		
EMBIG (bp) 3/		133
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							
	2011-2019	2020	2021	2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.8	12.6	2.2	1.4	1.9	1.1	-0.2	-0.6	-0.4	3.3	
Identified debt-creating flows	-4.1	12.7	2.2	1.8	1.4	1.2	-0.1	-0.9	-0.9	2.5	
Primary deficit	-1.8	8.3	6.7	4.3	3.8	2.6	1.5	0.9	0.8	14.0	-1.7
Primary (noninterest) revenue and grants	37.7	36.4	36.3	35.7	35.7	34.9	34.8	34.8	34.8	210.6	
Primary (noninterest) expenditure	35.9	44.7	43.0	40.0	39.5	37.5	36.3	35.7	35.6	224.6	
Automatic debt dynamics [5/]	-2.3	4.4	-5.3	-4.4	-2.4	-1.4	-1.6	-1.9	-1.7	-13.5	
Interest rate/growth differential [6/]	-2.3	4.4	-5.3	-4.4	-2.4	-1.4	-1.6	-1.9	-1.7	-13.5	
Of which: real interest rate	0.9	0.7	0.2	-1.2	-0.7	0.6	0.3	0.1	0.2	-0.7	
Of which: real GDP growth	-3.2	3.7	-5.5	-3.2	-1.7	-2.0	-2.0	-2.0	-1.9	-12.8	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.8	2.0	0.0	0.0	0.0	0.0	0.0	2.0	
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	0.8	2.0	0.0	0.0	0.0	0.0	0.0	2.0	
Residual, including asset changes [8/]	1.3	0.0	0.0	-0.4	0.5	-0.1	-0.1	0.3	0.5	0.8	



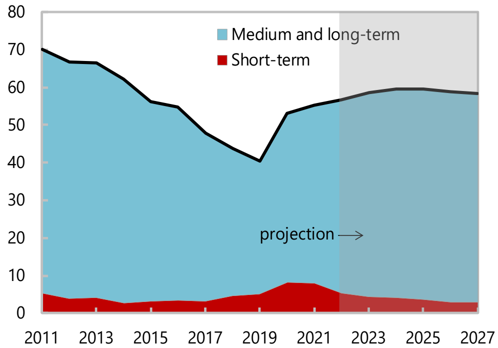
Source: IMF staff.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ Long-term bond spread over German bonds.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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.

Annex Figure VI.4. Malta: Public Debt Sustainability Analysis—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

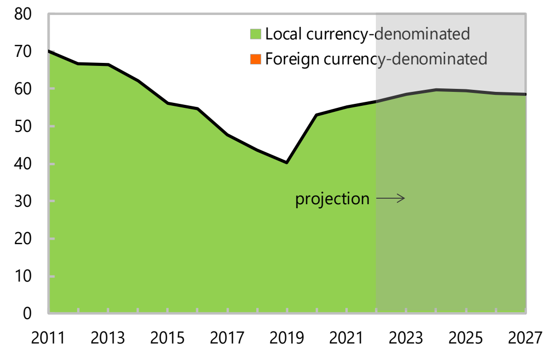
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

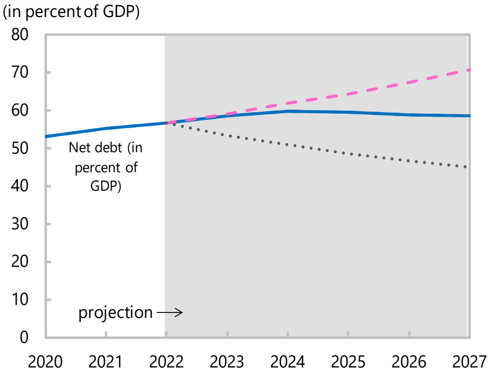


Alternative Scenarios

Baseline Historical Constant Primary Balance

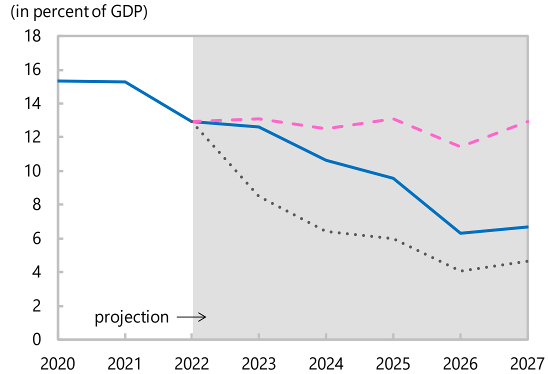
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

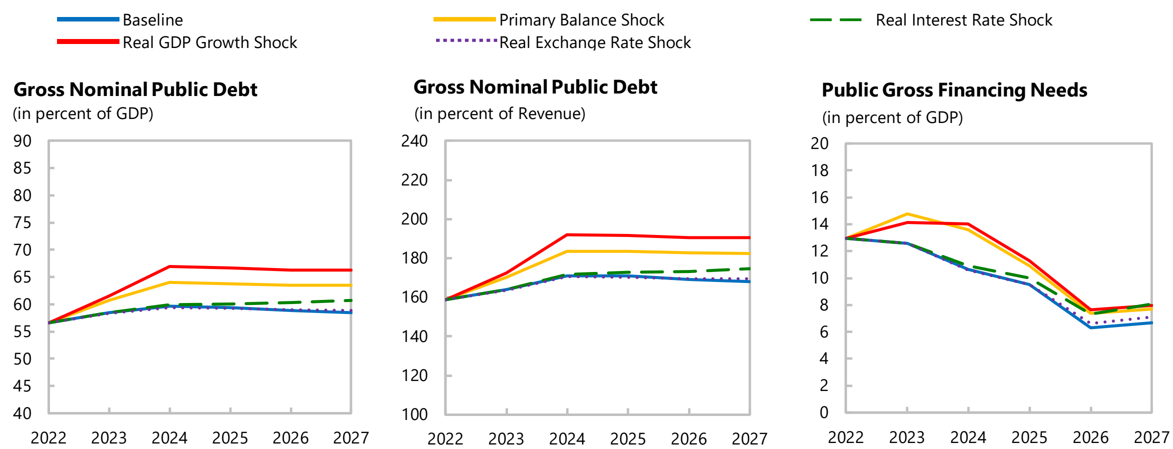
Baseline Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	6.5	3.3	3.6	3.5	3.5	3.5
Inflation	4.4	3.5	1.4	1.8	1.8	1.8
Primary Balance	-4.3	-3.8	-2.6	-1.5	-0.9	-0.8
Effective interest rate	2.2	2.3	2.5	2.5	2.0	2.3
Constant Primary Balance Scenario						
Real GDP growth	6.5	3.3	3.6	3.5	3.5	3.5
Inflation	4.4	3.5	1.4	1.8	1.8	1.8
Primary Balance	-4.3	-4.3	-4.3	-4.3	-4.3	-4.3
Effective interest rate	2.2	2.3	2.5	2.5	2.7	2.9

Historical Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	6.5	5.7	5.7	5.7	5.7	5.7
Inflation	4.4	3.5	1.4	1.8	1.8	1.8
Primary Balance	-4.3	0.1	0.1	0.1	0.1	0.1
Effective interest rate	2.2	2.3	2.7	2.7	2.9	3.2

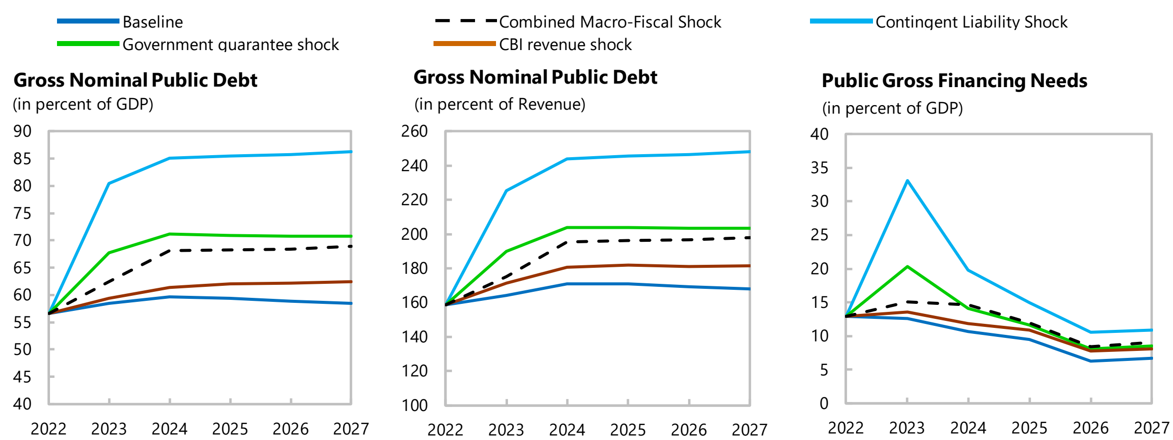
Source: IMF staff.

Annex Figure VI.5. Malta: Public Debt Sustainability Analysis—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	6.5	3.3	3.6	3.5	3.5	3.5
Inflation	4.4	3.5	1.4	1.8	1.8	1.8
Primary balance	-4.3	-6.0	-4.8	-1.5	-0.9	-0.8
Effective interest rate	2.2	2.3	2.6	2.7	2.9	3.1
Real Interest Rate Shock						
Real GDP growth 1/	6.5	3.3	3.6	3.5	3.5	3.5
Inflation	4.4	3.5	1.4	1.8	1.8	1.8
Primary balance	-4.3	-3.8	-2.6	-1.5	-0.9	-0.8
Effective interest rate	2.2	2.3	2.9	3.1	3.5	3.9
Combined Shock						
Real GDP growth	6.5	0.7	1.0	3.5	3.5	3.5
Inflation	4.4	2.9	0.8	1.8	1.8	1.8
Primary balance	-4.3	-6.0	-5.1	-1.5	-0.9	-0.8
Effective interest rate	2.2	2.3	3.0	3.3	3.7	4.0

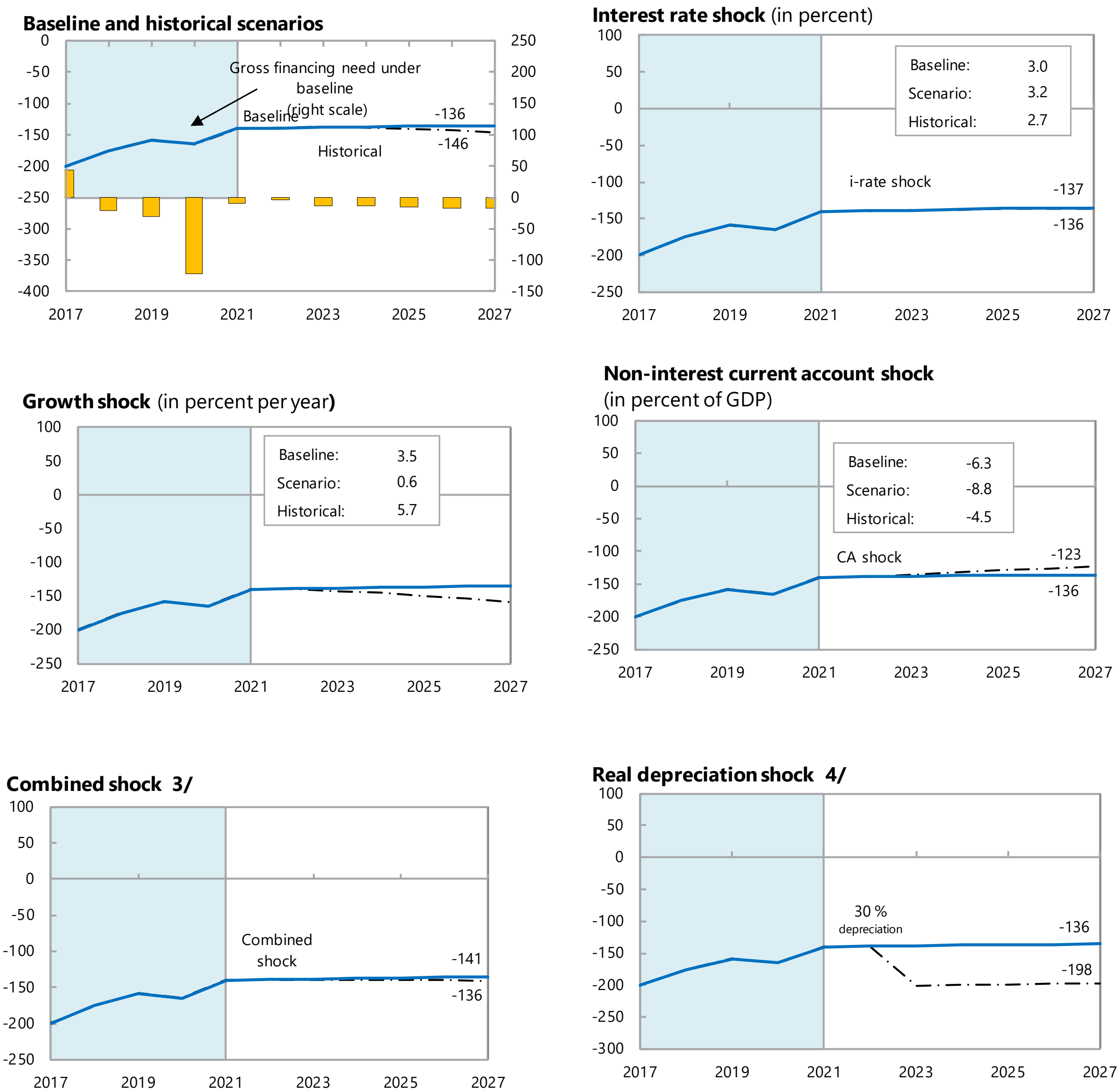
Real GDP Growth Shock	2022	2023	2024	2025	2026	2027
Real GDP growth 1/	6.5	0.7	1.0	3.5	3.5	3.5
Inflation	4.4	2.9	0.8	1.8	1.8	1.8
Primary balance	-4.3	-5.1	-5.1	-1.5	-0.9	-0.8
Effective interest rate	2.2	2.3	2.6	2.6	2.8	3.0
Real Exchange Rate Shock						
Real GDP growth	6.5	3.3	3.6	3.5	3.5	3.5
Inflation	4.4	3.9	1.4	1.8	1.8	1.8
Primary balance	-4.3	-3.8	-2.6	-1.5	-0.9	-0.8
Effective interest rate	2.2	2.3	2.5	2.5	2.6	2.9
Contingent Liability Shock						
Real GDP growth 1/	6.5	0.7	1.0	3.5	3.5	3.5
Inflation	4.4	2.9	0.8	1.8	1.8	1.8
Primary balance	-4.3	-23.9	-2.6	-1.5	-0.9	-0.8
Effective interest rate	2.2	2.5	4.4	4.0	4.2	4.3

Source: IMF staff.

1/ For calibration of real GDP growth shock, historical standard deviation excludes 2020 and 2021.

Annex Figure VI.6 Malta: External Debt Sustainability—Bound Tests 1/ 2/

(External debt in percent of GDP)



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.

Annex Table VI.1 Malta: External Debt Sustainability Framework, 2017–2027

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

	Actual 2017	2018	2019	2020	2021	10-Year Historical Average	10-Year Standard Deviation	Projections 2022	2023	2024	2025	2026	2027	Debt-stabilizing non-interest current account 6/
1 **Baseline: Net external debt**	-199.6	-175.3	-158.5	-165.1	-139.9			**-139.0**	**-138.1**	**-137.1**	**-136.3**	**-136.0**	**-135.8**	**-82.8**
2 Change in external debt	10.4	24.3	16.8	-6.6	25.2			0.9	0.9	1.0	0.7	0.4	0.1	
3 Identified external debt-creating flows (4+8+9)	-58.2	-59.4	-67.8	-81.5	-35.5			-69.1	-74.0	-73.6	-74.8	-76.0	-76.8	
4 Current account deficit, excluding interest payments	-1.6	-1.6	-0.4	8.0	9.0			7.5	7.5	7.6	6.5	5.2	4.4	
5 Deficit in balance of goods and services	-17.4	-15.6	-13.9	-7.9	-4.2			-5.1	-5.3	-5.2	-6.3	-7.6	-8.4	
6 Exports	142.0	133.0	130.9	129.9	124.8			125.3	125.5	126.5	125.8	125.0	124.3	
7 Imports	124.6	117.4	117.1	122.0	120.6			120.1	120.2	121.3	119.4	117.4	115.9	
8 Net non-debt creating capital inflows (negative)	-80.6	-76.7	-69.2	-75.4	-65.3			-81.9	-81.9	-81.9	-81.9	-81.9	-81.9	
9 Automatic debt dynamics 1/	24.0	19.0	1.8	-14.1	20.7			5.3	0.3	0.6	0.6	0.7	0.6	
10 Contribution from nominal interest rate	-4.3	-4.8	-4.5	-5.1	-4.5			-3.9	-4.0	-4.1	-4.0	-4.0	-4.0	
11 Contribution from real GDP growth	19.8	10.9	11.8	-14.4	16.4			9.2	4.4	4.7	4.6	4.7	4.6	
12 Contribution from price and exchange rate changes 2/	8.5	12.9	-5.5	5.5	8.8			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	68.6	83.7	84.6	74.9	60.7			70.0	74.9	74.6	75.6	76.4	77.0	
External debt-to-exports ratio (in percent)	-140.5	-131.8	-121.0	-127.1	-112.1			-111.0	-110.1	-108.4	-108.4	-108.8	-109.3	
Gross external financing need (in billions of US dollars) 4/	6.0	-3.2	-4.9	-18.2	-1.7			-0.5	-2.3	-2.6	-2.9	-3.3	-3.6	
in percent of GDP	44.5	-21.0	-31.1	-121.2	-9.4			-2.9	-12.9	-13.8	-14.9	-16.4	-17.4	
Scenario with key variables at their historical averages 5/								**-139.0**	**-137.5**	**-138.9**	**-140.0**	**-142.3**	**-146.1**	**-75.2**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	10.9	6.2	7.0	-8.6	11.7	5.7	5.7	6.5	3.3	3.6	3.5	3.5	3.5	
GDP deflator in US dollars (change in percent)	4.2	6.9	-3.0	3.6	5.6	0.8	6.3	-7.4	0.2	1.0	-0.2	-0.5	-1.1	
Nominal external interest rate (in percent)	2.3	2.7	2.7	3.1	3.2	2.7	0.4	2.7	3.0	3.1	3.0	3.0	3.0	
Growth of exports (US dollar terms, in percent)	14.4	6.3	2.1	-6.1	13.4	3.9	6.3	-1.0	3.6	5.5	2.7	2.3	1.7	
Growth of imports (US dollar terms, in percent)	8.8	7.0	3.4	-1.3	16.6	3.7	5.7	-1.8	3.5	5.6	1.8	1.2	1.0	
Current account balance, excluding interest payments	1.6	1.6	0.4	-8.0	-9.0	-4.5	5.1	-7.5	-7.5	-7.6	-6.5	-5.2	-4.4	
Net non-debt creating capital inflows	80.6	76.7	69.2	75.4	65.3	80.6	14.3	81.9	81.9	81.9	81.9	81.9	81.9	
B. Bound Tests														
B1. Nominal interest rate is at historical average plus one standard deviation								-139.0	-138.3	-137.5	-137.0	-136.9	-137.0	**-83.0**
B2. Real GDP growth is at historical average minus one standard deviations								-139.0	-142.2	-145.7	-149.6	-154.1	-159.0	**-99.9**
B3. Non-interest current account is at historical average minus one standard deviations								-139.0	-135.5	-132.0	-128.8	-125.9	-123.2	**-82.7**
B4. Combination of B1-B3 using 1/2 standard deviation shocks								-139.0	-139.0	-139.0	-139.3	-140.0	-141.0	**-90.9**
B5. One time 30 percent real depreciation in 2006								-139.0	-201.2	-199.7	-198.6	-198.1	-197.9	**-120.5**

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.

Annex VII. 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)	ST	The CBM enhanced its liquidity and solvency stress testing frameworks, including by assessing climate related risks, IFRS9's expected losses and household vulnerabilities. Co-operation between the CBM and ESRB is ongoing on several projects, including macroprudential analysis, O-SII methodology results and CRR provisions in relation to risk weights. Both the CBM and the MFSA invested in improving the data management system and work closely on identifying risks and pockets of vulnerabilities. The MFSA conducts stress tests for the insurance sector and investment fund liquidity. They also assess climate transition risk and have developed a composite indicator for Non-Bank Financial Intermediation.
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)	ST	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)	ST/MT	In 2021, the CBM started collecting comprehensive real estate data from all banks engaging in real estate lending on a quarterly basis. The database is now fully operational for authorized internal users. Concurrently, NSO started developing a database on commercial real estate indicators. The development of a risk dashboard for NBFIs is underway. MFSA continues to develop its systemic risk monitoring capacity. The Financial Stability function has developed an internal methodology to monitor latest developments in residential real estate property and rental markets.
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 defines borrower-based macro prudential measures that became effective on July 1st, 2019. Directive No.16 was revised in November 2021 (see overview of changes).
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	Legal amendments in 2019 allow MFSA's recruitment independence. A revision of supervisory fees based on a "cost recovery" model was presented to the Ministry of Finance in 2020 but was paused during the pandemic. The project has is now being revived and the government has

[1] Please refer to Malta Financial System Stability Assessment 2019 for the full set of FSAP recommendations. The description of authorities' actions in this table was based on inputs from the Maltese authorities.

[2] I = Immediate (within 1 year); ST = Short Term (within 1–2 years); MT = Medium Term (within 3–5 years).

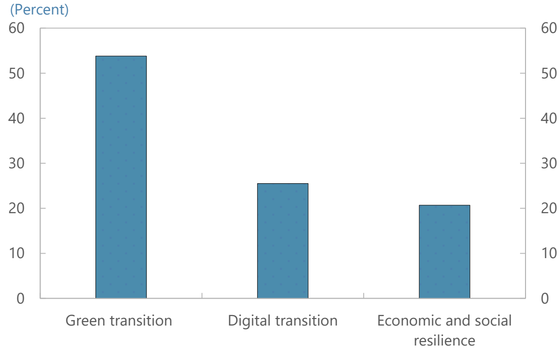
Recommendations	Timing	Progress
		indicated its commitment to continue funding the yearly shortfalls until the Authority becomes self-sustainable. The Authority is working to implement the new fees on 1 January 2024 subject to Government approval. Statutory amendments have been made allowing the MFSA to set up the Enforcement Decisions Committee that is on track for completion by 31 March 2023.
Address the significant gap in supervisory and enforcement capacity by increasing staff and broadening skill set. (MFSA)	I	The MFSA total headcount is currently 422 and is planned to reach 460 by 2023. Authority undertakes an annual Training Needs Analysis which is reviewed by the Financial Supervisors Academy (FSA) to ensure training is aligned to its 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. Minimum Engagement Level Meetings are conducted with banks to follow up on SREP actions and the MFSA aims to adopt a risk-based approach to these meetings going forward. It has also developed an onsite visit program covering higher risk areas. The MFSA conducts an annual review of third country branches 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 further increasing human resources, creating specialized supervisory teams, improving its risk-based supervision approach, improving the IT tools used for risk assessment purposes, and introduce a quality control function to further reduce subjectivity and ensuring consistency throughout the supervisory and enforcement process. MFSA investigations and enforcement actions have continued to increase. Enforcement actions increased by 46 percent in 2021. The authorities have also established a dedicated internal penalty model for calculating administrative penalties imposed on entities and individuals for breaches of regulatory requirements.
Insurance and Securities Regulation and Supervision		
Strengthen conduct supervision and enhance the sectoral risk-based supervision framework. (MFSA)	MT	Conduct Supervision is based on outcomes from the Risk-Based Supervision frameworks that apply to prudential supervision. An ongoing internal workstream aims to establish a dedicated Conduct Risk Model focusing on product design and distribution. The MFSA also carries out focused onsite inspections to credit institutions, including banks which distribute insurance products through bancassurance, with a view to assess their adherence to the applicable conduct of business rules. As part of its macro-prudential risk monitoring framework, the MFSA has developed and updated various risk analysis tools that strengthen the risk-based supervision carried out across sectors.

Recommendations	Timing	Progress
AML/CFT		
Improve the authorities' assessment and understanding of ML/TF risks and strengthen the national coordination. (National Coordination Committee)	I	A new National Risk Assessment (NRA), coordinated by the National Coordination Committee (NCC), was launched in 2021 and improves on the 2018 NRA in terms of identifying risks and vulnerabilities for ML, TF and PF. The NCC facilitates the involvement of both authorities and the private sector representative bodies Between 2018 and the undertaking of the process for a new NRA, Malta carried out a series of sector-specific risk assessments, including on (i) virtual financial assets; (ii) terrorism financing; (iii) concealment of beneficial ownership; (iv) organized crime; (v) the shadow economy; (vi) corruption and (vii) the laundering of the proceeds of tax crimes. The authorities have also issued sector specific AML/CFT guidance, communicated the results of strategic analyses carried out by the FIAU and increased outreach initiatives focusing on key risk areas.
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 bank have increased from 1 in 2017 to 161 in 2021.
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. A skeleton document with preliminary suggestions was drawn up at end 2021. Technical assistance and funding were requested from the European Commission. Work on drafting the legislation for the Administrative Bank Insolvency regime commenced in August 2022. Expected to be finalized in 14 to 16 months.
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. Significant progress has been made in relation to the necessary legislative changes to transfer this role to the Resolution function. In the meantime, the Resolution function is actively taking on cases to liquidate banks, working closely in conjunction with Banking Supervision.
Review the adequacy of the Resolution Unit's staffing and increase its resources accordingly (MFSA)	I	Staff resources in the Resolution Unit have been restored to 15 FTEs in the latter part of 2022.

Annex VIII. Malta's Recovery and Resilience Plan—Green Transition

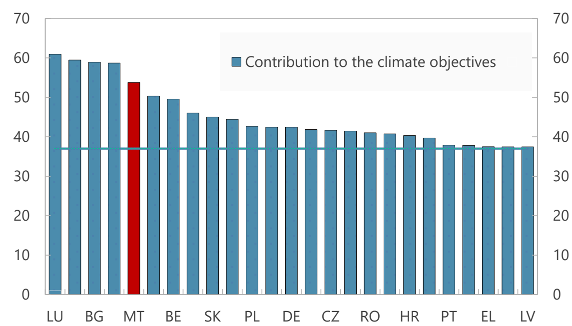
1. **Malta's recovery and resilience plan (RRP) aims to support its post-pandemic recovery and green and digital transition.** In European Union, following the unprecedented impact of the COVID-19 pandemic, the need to facilitate the economy for a strong recovery and prepare for the green and digital transition has come to the fore. Against this backdrop, on September 16, 2021, the European Commission initially approved Malta's RRP, which included 17 investment projects and 30 reforms, financed by €316.4 million (2.1 percent of GDP) in grants. About 54 percent of the RRP envelope is allocated to support climate objectives (among the highest in the EU). The remaining is allocated to digital transition (26 percent) and economic and social resilience (20 percent).

RRP Spending Composition
(Percent)



Sources: European Commission and IMF staff calculations.

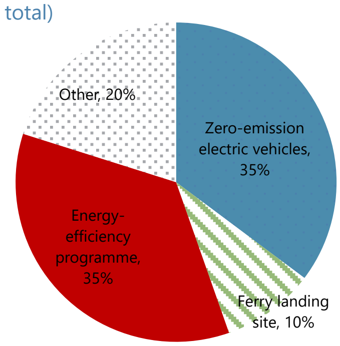
RRP's Estimated Expenditure Towards Climate Objectives
(Percent)



Source: European Commission and IMF staff calculations.

2. **The RRP supports the green transition by enhancing sustainable mobility, energy efficiency, and networks.** The transportation sector presents considerable mitigation potential, given its largest share in energy consumption. To this end, a large port ion of the RRP fund goes toward investment (€60 million) to promote zero-emission electric vehicles and to operate free public transportation. It also includes (i) the construction of a ferry landing site; (ii) a large-scale energy-efficiency program for public and private buildings; and (iii) measures to improve waste management, including construction and demolition waste.

Green Transition Measures
(Percent of total)



Sources: European Commission and IMF staff calculations.

3. **RRP supports the Malta's broader climate policy objectives, including the European goals, as well as the Sustainable Development Goals.** The government has identified 'higher priority' areas over 2020–2030, which include active transport, electrification, and expanding free public transport. RRP supports this strategy with identified qualitative indicators or milestones.

INTERNATIONAL MONETARY FUND

MALTA

January 18, 2023

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	European Department (In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of December 31, 2022)

Membership Status

Joined: September 11, 1968; Article VIII

General Resources Account	SDR Million	Percent Quota
Quota	168.30	100.00
Fund holdings of currency	123.68	73.49
Reserve Tranche Position	44.65	26.53

SDR Department	SDR Million	Percent Allocation
Net cumulative allocation	256.71	100.00
Holdings	249.98	97.38

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				
	2023	**2024**	**2025**	**2026**	**2027**
Principal					
Charges/Interest	0.20	0.20	0.20	0.20	0.20
Total	0.20	0.20	0.20	0.20	0.20

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

The currency of Malta is the euro.. The exchange rate arrangement of the euro area is free floating. Malta has been a member of the euro area since January 1, 2008 and has no separate legal tender. The euro, the common currency floats freely and independently against other currencies.

Malta maintains an exchange system that is free of multiple currency practices and 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 July 7–20, 2021, and the staff report (Country Report No.21/211) was brought for the Executive Board's consideration. The Article IV Consultation with Malta was concluded on September 15, 2021.

Technical Assistance

Date	Department	Subject
February 1999	MAE	Monetary operations and liquidity
		Forecasting
March 2001	STA	Money and banking statistics
October 2002–January 2003	MFD	FSAP missions (joint with the World Bank)
June 2005	STA	ROSC Data Module
November 2006	STA	Producer price index/SDDS preparations
April and December 2007	STA	Expert visits
April 2009	STA	SDDS subscription finalization
May 2013	STA	Balance of payments
March 2014	FAD	Strengthening public financial management
August 2021	FAD	Revenue administration
November/December 2022	FAD	Corporate income tax

Resident Representative

None

STATISTICAL ISSUES

(As of December 31, 2022)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for surveillance purposes. Malta publishes timely economic statistics and most macroeconomic statistics can 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 Statistics 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 consumer prices are released monthly within 30 days after the reference month. In addition to the national index, Malta also produces a harmonized index of consumer prices (HICP). The HICP differs from the national index by including expenditures of foreign visitors to Malta, which leads to a larger weight for restaurants and hotels. 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 mobile and internet banking, mobile money, gender disaggregated data, 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. They are currently reporting 14 core and 22 additional indicators including those for other financial corporations.

External sector statistics: Balance of Payments (BOP) and International Investment Position (IIP) statistics are released quarterly, with a lag of 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. ,Concepts and definitions used in BOP and IIP statistics follow *Balance of Payments Manual 6th Edition's* recommendations, therefore special purpose entities incorporated in Malta are treated as resident units. 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

A data ROSC was published in August 2006. Malta subscribes to the SDDS since December 2009 and publishes the data on its National Summary Data Page. The latest Annual Observance Report is available on the Dissemination Standards Bulletin Board. Malta is currently preparing for SDDS Plus adherence.

Malta: Table of Common Indicators Required for Surveillance (As of December 31, 2022)					
	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/]	Nov 2022	Dec 2022	M	M	M
Central Bank Balance Sheet	Nov 2022	Dec 2022	M	M	M
Consolidated Balance Sheet of the Banking System	Nov 2022	Dec 2022	M	M	M
Interest Rates [2/]	Current	Current	D	D	D
Consumer Price Index	Nov 2022	Dec 2022	M	M	M
Revenue, Expenditure, Balance and Composition of Financing [3/] – General Government [4/]	2022Q2	Oct 2022	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing [3/]– Central Government	2022Q2	Oct 2022	Q	Q	Q
Stocks of General Government and General Government-Guaranteed Debt [5/]	2022Q2	Oct 2022	Q	Q	Q
External Current Account Balance	2022Q2	Oct 2022	Q	Q	Q
Exports and Imports of Goods and Services	2022Q3	Nov 2022	Q	Q	Q
GDP/GNP	2022Q3	Nov 2022	Q	Q	Q
Gross External Debt	2022Q2	Oct 2022	Q	Q	Q
International Investment Position [6/]	2022Q2	Oct 2022	Q	Q	Q

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).