INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/33

# MALTA

January 2024

## 2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALTA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2023 Article IV consultation with Malta, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 17, 2024 consideration of the staff report that concluded the Article IV consultation with Malta.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 17, 2024, following discussions that ended on November 22, 2023, 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 December 18, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Malta.

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

Selected Issues

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

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**International Monetary Fund**
**Washington, D.C.**

# IMF Executive Board Concludes 2023 Article IV Consultation with Malta

**FOR IMMEDIATE RELEASE**

**Washington, DC** – **January 29, 2024:** On January 17, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Malta.

Malta has experienced an impressive recovery from the pandemic and demonstrated resilience to shocks resulting from Russia's invasion of Ukraine. With weaker growth in Europe and waning post-pandemic pent-up demand, staff expect growth to decelerate somewhat but continue to expand by 6¼ percent in 2023 and 5 percent in 2024, among the highest in Europe. Both headline and core inflation peaked a year ago and have since decelerated as global inflationary pressures have eased. Still, inflation is expected to remain persistent and above 2 percent until late 2025, in part reflecting tight labor markets and sustained demand pressures. The financial system has demonstrated resilience to successive shocks.

The challenge for the medium term is to ensure a robust policy framework to foster strong, socially- and environmentally-sustainable, and inclusive growth. Risks to the outlook are tilted to the downside in part due to spillover effects from a possible escalation of Russia's war in Ukraine or of the Israel-Gaza conflict, as well as a deeper-than-expected economic downturn in Europe. Domestically, wage and inflationary pressures could be higher and more persistent. On the upside, lower-than-expected commodity prices would help decelerate inflation, ease fiscal pressures, and boost growth.

**Executive Board Assessment[2]**

Executive Directors agreed with the thrust of the staff appraisal. They commended Malta's resilience to external shocks and strong post-pandemic recovery on the back of fiscal support, a persistent inflow of migrants, a strong recovery in tourism, and robust consumer demand. They expected continued solid growth over the medium term, albeit below pre-pandemic levels, with risks to the outlook tilted to the downside. Directors concurred that raising productivity growth and accelerating the green transition are crucial to ensure sustainable and inclusive growth over the longer term.

With Malta's economy above potential, and with tight labor markets, elevated inflationary pressures, and sizeable fiscal deficits, Directors stressed the need for accelerating fiscal consolidation to support disinflationary efforts and to rebuild fiscal buffers at a faster pace to bolster fiscal sustainability. They noted that energy subsidies place a substantial burden on

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

the budget, limit fiscal space for supporting productivity-enhancing reforms, and blunt incentives for energy savings and efficiency; they recommended that such subsidies be phased out while increasing targeted support for vulnerable households. Directors also called on the authorities to continue steps, supported by Fund TA, to modernize revenue administration, rationalize recurrent spending, enhance public investment efficiency, and strengthen oversight of public enterprises.

Given the EU's adoption of the minimum tax directive (Pillar II), Directors underscored the increasing urgency of developing a well-structured roadmap for phased implementation of the corporate income tax reform. They recommended that the roadmap also include personal income tax reform to make the adjustment more efficient and less distortionary.

Directors welcomed the resilience of Malta's financial system while noting that continued monitoring of potential pockets of vulnerabilities, especially in the real estate market, is needed. They encouraged the authorities to closely assess how inflation and macro-financial conditions affect vulnerable and leveraged borrowers, to remain vigilant in monitoring property price developments, and to continue efforts to strengthen cyber security. Directors welcomed progress made in improving the AML/CFT framework and called for continued efforts in this regard.

Directors encouraged the authorities to bolster structural reform efforts and boost productivity, given increasing capacity constraints. They noted that Malta's Recovery and Resilience Plan will deliver crucial reforms and investments in digitalization and green transition. However, more efforts are needed to enhance governance and anti-corruption frameworks, promote research and innovation, address skill gaps, accelerate decarbonization and climate resilience, boost investment in renewables, and strengthen education outcomes—overall and for immigrant students.

It is expected that the next Article IV Consultation with Malta will be held on the standard 12-month cycle.

**Malta: Selected Economic Indicators, 2019–24**
(Year on year change, unless otherwise indicated)

Per capita income (2022, euros): 33,496
Quota (as of November 30, 2023; millions of SDRs): 168.3

| | 2019 | 2020 | 2021 | 2022 | Projections 2023 | 2024 |
|---|---|---|---|---|---|---|
| **Real economy (constant prices)** | | | | | | |
| Real GDP | 7.1 | -8.1 | 12.6 | 8.2 | 6.2 | 5.1 |
| Domestic demand | 8.2 | -3.8 | 8.3 | 13.8 | -1.0 | 3.1 |
| HICP (period average) | 1.5 | 0.8 | 0.7 | 6.1 | 5.8 | 2.9 |
| Unemployment rate (percent) | 3.6 | 4.4 | 3.4 | 2.9 | 2.5 | 2.5 |
| **Public finance** | | | (Percent of GDP) | | | |
| Net lending/borrowing (overall balance) | 0.5 | -9.6 | -7.4 | -5.6 | -4.8 | -4.4 |
| Primary balance | 1.8 | -8.3 | -6.3 | -4.7 | -3.7 | -3.0 |
| Structural overall balance 1/ | -1.9 | -5.7 | -6.6 | -5.9 | -5.4 | -5.0 |
| General government debt | 40.0 | 52.2 | 53.9 | 51.6 | 52.2 | 54.5 |
| **Financial sector** | | | (Percent change year on year) | | | |
| Credit to the private sector 2/ | 6.8 | 6.6 | 6.5 | 9.1 | … | … |
| Credit to the private sector (percent of GDP) | 71.6 | 81.8 | 75.8 | 72.7 | … | … |
| **Interest rates** | | | (Percent) | | | |
| Interest rate for mortgages purposes | 3.0 | 3.0 | 2.8 | 2.7 | … | … |
| Ten-year government bond yield | 0.7 | 0.5 | 0.5 | 0.8 | … | … |
| **Balance of payments** | | | (Percent of GDP) | | | |
| Current account balance | 9.0 | 2.2 | 1.2 | -3.0 | 1.9 | 2.5 |
| Trade balance (Goods and services) | 21.2 | 16.8 | 14.2 | 11.0 | 15.8 | 16.5 |
| **Exchange rate** | | | | | | |
| Nominal effective rate (2010=100) | 100.5 | 101.6 | 103.0 | 103.2 | … | … |
| Real effective rate, CPI based (2010=100) | 103.6 | 104.7 | 103.6 | 100.9 | … | … |

Sources: Maltese authorities, Eurostat, and IMF staff projections.
1/ As a percentage of nominal potential GDP.
2/ Loans to corporate sector and households/individuals.

INTERNATIONAL MONETARY FUND

# MALTA

## STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

December 18, 2023

## KEY ISSUES

**Context.** Malta has experienced an impressive recovery from the pandemic and demonstrated resilience to shocks resulting from Russia's invasion of Ukraine. With weaker growth in Europe and waning post-pandemic pent-up demand, staff expect growth to decelerate somewhat but continue to expand by 6¼ percent in 2023 and 5 percent in 2024, among the highest in Europe. Persistent inflationary pressures are expected, while concern has risen about growing capacity constraints. The financial system has demonstrated resilience to successive shocks.

**Policy recommendations.** Key priorities include containing demand pressures by accelerating fiscal consolidation, exiting gradually from the current fixed energy price policy while protecting vulnerable groups, maintaining financial stability, and boosting structural reform efforts.

- **Fiscal policy.** To support disinflationary efforts in the short term and rebuild fiscal buffers at a faster pace, the authorities should accelerate fiscal consolidation plans. The authorities should also prepare an exit strategy from the current generous energy subsidy policy and implement it in a way that contains fiscal costs and risks and enhances incentives for energy conservation and transition while protecting vulnerable populations. In light of the EU's Minimum Tax Directive (Pillar II), the authorities should develop a well-structured roadmap for a phased implementation of the corporate income tax reform.

- **Financial sector.** The financial system remains sound, but given macroeconomic uncertainty, the authorities should maintain vigilance in monitoring risks. It is particularly important to ensure that banks continue to closely assess how developments in inflation and financial conditions affect the balance sheets of vulnerable and leveraged borrowers and update provisions for credit risks. The authorities' recent actions to tighten macroprudential policies are welcome. They should also maintain vigilance in monitoring financial sector risks in the areas of cyber security and money laundering/terrorist financing (ML/TF).

- **Structural reforms.** Boosting productivity will be imperative to achieve strong, socially-and environmentally-sustainable, and inclusive growth. Further efforts are needed in promoting innovation and digitalization, addressing domestic labor's skill gaps, strengthening the education system, and accelerating green transformation including the reform of energy prices. There is a need to refocus Malta's economic development strategy by taking account of capacity constraints, infrastructure needs, and immigrants' complementary role in filling domestic labor's skill shortages. The national planning strategy should be updated expeditiously. Further strengthening Malta's anti-corruption framework would help ensure continued investor confidence.

Approved By:
**Mark Horton (EUR) and Geremia Palomba (SPR)**

Discussions were held in Valletta during November 9–22, 2023. The team comprised Kotaro Ishi (head), Mahir Binici, Agnese Carella, and Luca Mazzone (all EUR). Yueshu Zhao (EUR) provided research assistance, and Eunmi Park (EUR) provided administrative assistance. Claudia Mastrapasqua (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 Edward Scicluna, Central Bank Deputy Governors Oliver Bonello and Alexander Demarco, Finance Minister Clyde Caruana, Permanent Secretary Paul Zahra, Malta Financial Services Authority CEO Kenneth Farrugia, and other senior officials, representatives of labor and business organizations, and financial institutions.

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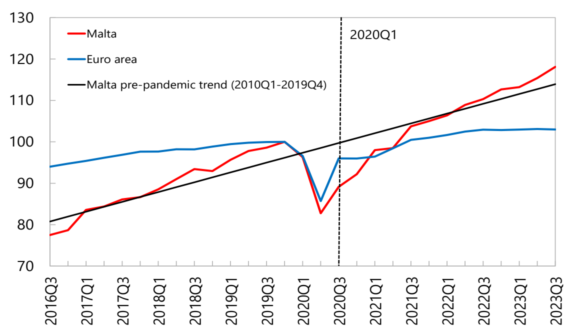
# CONTEXT

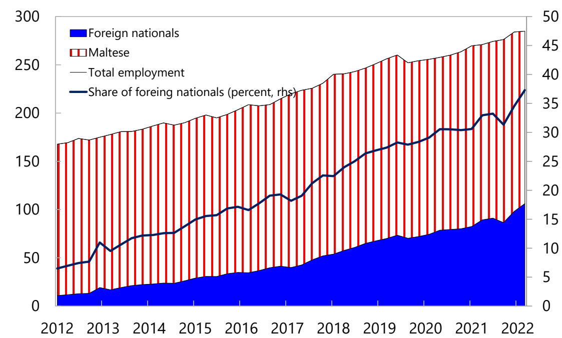
**1. Malta experienced an impressive recovery from the pandemic** (Table 1). Following a deep contraction in 2020, output growth rebounded by 12½ percent in 2021 and 8¼ percent in 2022, among the highest in Europe. As a result, the level of output has returned to and exceeded its pre-pandemic trajectory. The recovery was initially driven by fiscal support and a reopening rebound in the tourism sector. Subsequently, domestic private demand gained momentum, while the government's decision to freeze retail electricity and fuel prices in response to the global energy shock helped contain headline inflation despite a significant fiscal cost.[1] The recovery has also been supported by increased and large inflows of foreign workers, allowing rapid labor force growth despite the slow growth of the domestic working-age population, and more recently, limited pass-through from monetary policy interest rates to domestic retail lending rates.

**Real GDP**
(Index, 2019Q4=100)




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

**Employment by Nationality**
('000, unless otherwise indicated)




Sources: Eurostat.

**2. A key policy challenge lies in navigating the current highly uncertain global economy while setting the course for sustainable long-term growth.** As a small, open, island economy, Malta is particularly exposed to external shocks, including volatility in global food and energy prices and a deeper-than-expected economic downturn in Europe.[2] On the domestic front, wide-ranging energy subsidies have deteriorated public finance positions. Inflows of foreign workers have supported strong economic growth and helped contain wage pressures, but concern has risen about capacity constraints and skills shortages in the workforce.

**3. Political stability.** After general elections in March 2022, the Labor Party secured a third successive term in office and an outright parliamentary majority for 2022–27. 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).

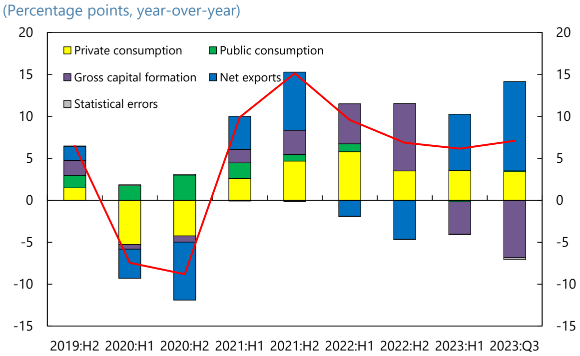
[1] Retail energy prices are administered by state-owned companies. Prior to the energy crisis in 2022, a long-term fixed price contract for LNG imports helped maintain stable retail energy prices at 2014 levels. In March 2022, the contract expired, resulting in a substantial increase in prices. In response, the government decided to freeze retail energy prices—including for fuels and electricity—by fully compensating energy company losses.

[2] Direct economic repercussions of Russia's war in Ukraine have been limited primarily due to Malta's negligible direct trade, energy, or financial linkages with Russia and Ukraine.

# RECENT DEVELOPMENTS—STILL ROBUST GROWTH

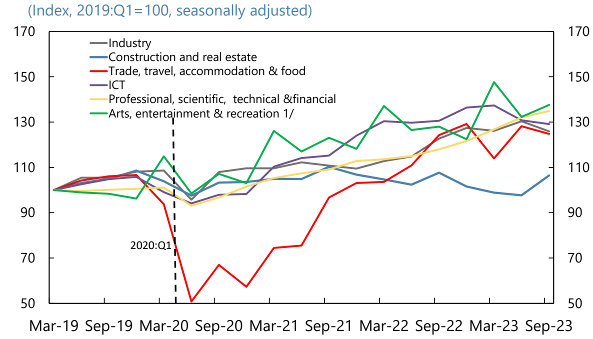
4. **The economy has continued to steadily expand** (Figure 1). Output growth remained strong at 6½ percent y/y for the first three quarters of 2023, compared to 8¼ percent in 2022. Net exports, driven by strong service exports, were the key driver. On domestic demand, private consumption growth remained buoyant despite reduced real disposable income, while gross capital formation—which grew by nearly 30 percent in 2022 mainly due to large aircraft investments—contracted. By sector, while the recovery in information and communications technology (ICT), trade and tourism services, and construction moderated, remote gaming and professional services continued to grow robustly.

**Contributions to Real GDP Growth - Expenditure Based**
(Percentage points, year-over-year)




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

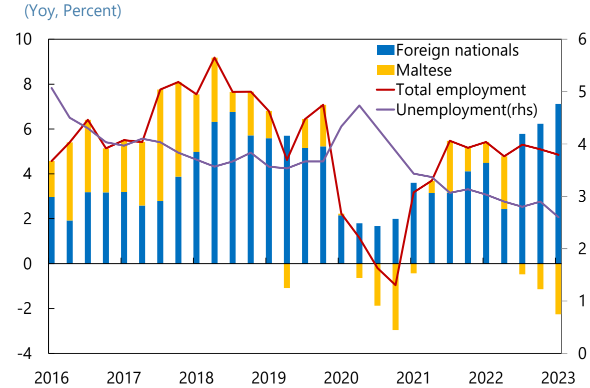
**Gross Value Added**
(Index, 2019:Q1=100, seasonally adjusted)




Sources: Haver Analytics, Eurostat, and IMF staff calculations.
1/ Includes remote gaming.

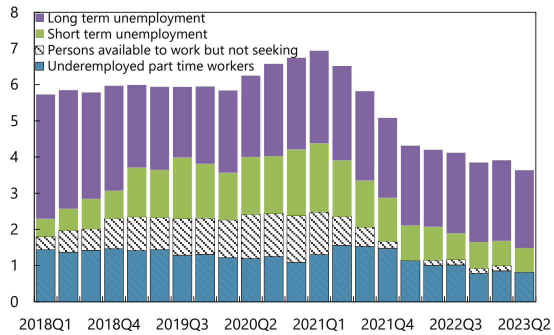
5. **Labor markets remain tight.** Employment continues to grow fast—by 5 percent y/y in 2023:Q2, with significant contributions from immigrant workers. The unemployment rate increased slightly but continues to hover near its historical lows (2.5 percent in October 2023). Broader labor market indicators, such as vacancy rates and the number of underemployed workers, point to a continued reduction in the underutilized labor force. Despite the tight labor market, wage pressures have remained relatively contained compared to past records, in part reflecting increased foreign worker inflows.

**Employment Growth by Maltese and Foreign Workers**
(Yoy, Percent)



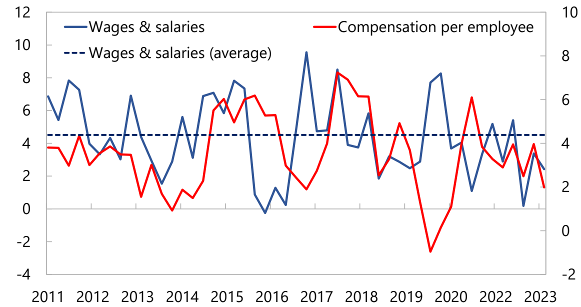

Sources: Haver Analytics, Eurostat and IMF staff calculations.

**Labor Market Slack**
(Percentage of labor force four-quarter moving average)




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

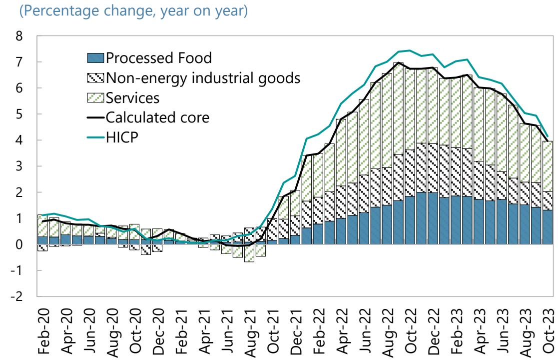
**Wages and Salaries Growth and Inflation 1/**
(Annual percent change)




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

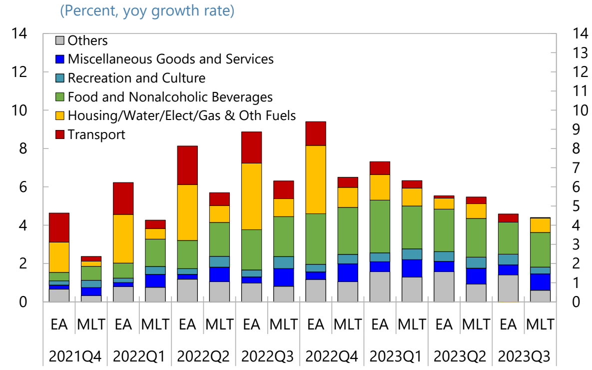
**6. Inflation pressures are easing.** Headline HICP inflation and core inflation (HICP excluding energy and processed food) fell to 4.2 percent y/y and 4.5 percent y/y in October 2023, respectively, down from over 7 percent a year ago, reflecting lower global inflation. The fixed energy price policy has helped contain headline inflation in Malta in comparison with the euro area over the past year—at its peak in 2022:Q4, headline inflation in Malta was 7½ percent, below 10 percent in the euro area. However, the negative difference in headline inflation between Malta and the euro area has recently faded as energy inflation in the euro area receded.

**Decomposition of Core HICP in Malta**
(Percentage change, year on year)




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

**Inflation Decomposition**
(Percent, yoy growth rate)




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

**7. Continuing energy subsidies and support for Air Malta weigh on the fiscal position** (Figure 2 and Table 2). The overall fiscal deficit in 2022 was 5.6 percent of GDP,[3] slightly above the budget forecast of 5.4 percent of GDP, as revenue collections were less buoyant to the strong output growth, while spending exceeded the budget forecast (in euro value terms) due to increased energy subsidies (Annex II), early retirement compensation for Air Malta employees, and the extension of the first home buyer scheme introduced during the pandemic period.[4] For the first nine months of 2023, revenue collections were strong, up 16 percent y/y, while the authorities contained spending in line with the budget forecast by withdrawing COVID-19 related fiscal measures and reducing Air Malta support and energy subsidies (due to lower market prices). Staff expect the fiscal deficit to narrow to 4¾ percent of GDP in 2023.

[3] The budget refers to the Update of Stability Program announced in April 2022 and April 2023.

[4] The scheme includes: (i) reduced stamp duty for first-time buyers and for property in Gozo; and (ii) cash grants for first-time buyers ranging from €10,000 to €30,000 spread over 10 years subject to specific conditions.

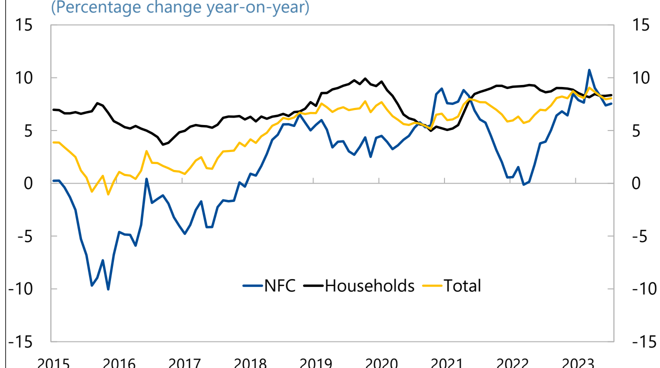
**Malta: Fiscal Estimates and Projections**
(Percent of GDP)

| | 2017-2019 Average | 2020 | 2021 | 2022 (*) USP | 2022 (*) Outturn | 2023 (*) USP | 2023 (*) Staff proj. |
|---|---|---|---|---|---|---|---|
| Revenue | 37.3 | 35.7 | 35.5 | 38.1 | 33.7 | 35.7 | 35.0 |
| Expenditure | 35.4 | 45.3 | 42.9 | 43.6 | 39.3 | 40.7 | 39.9 |
| Overall balance | 1.9 | -9.6 | -7.4 | -5.4 | -5.6 | -5.0 | -4.8 |
| Primary balance | 3.4 | -8.3 | -6.3 | -4.4 | -4.7 | -3.8 | -3.7 |
| Structural balance | 0.4 | -5.7 | -6.6 | -4.9 | -5.9 | -4.9 | -5.4 |
| Public debt | 43.7 | 52.2 | 53.9 | 58.6 | 51.6 | 54.5 | 52.2 |
| *Memorandum items:* | | | | | | | |
| *Discretionary measures* | | | | | | | |
| COVID-19 related fiscal measures | ... | 4.9 | 4.6 | 1.6 | 1.9 | 0.3 | 0.1 |
| Energy subsidies | ... | ... | ... | 1.4 | 2.6 | 1.7 | 1.4 |
| Air Malta restructuring | ... | ... | ... | | 0.9 | 0.5 | 0.5 |
| Total | ... | 4.9 | 4.6 | 3.0 | 5.4 | 2.5 | 2.0 |
| Nominal GDP growth | 10.7 | -6.6 | 14.8 | 7.5 | 13.9 | 8.6 | 10.2 |
| Real GDP growth | 8.5 | -8.1 | 12.6 | 4.4 | 8.2 | 4.1 | 6.2 |

Source: Maltese authorities and IMF staff calculations.
(*) Table presents numbers from the Update of Stability Programme announced in April 2022 and 2023, respectively.

**8. Bank credit continued to grow steadily along with the economic recovery.** Pass-through from European Central Bank (ECB) policy interest rates to Malta's retail interest rates has been relatively limited (especially for mortgages) due to ample liquidity in the banking system, with banks relying largely on domestic deposit funding. Bank interest rates on non-financial corporate (NFC) loans are on the rise but at a slower pace than in other euro area countries, while mortgage interest rates have remained broadly flat.[5] Against this backdrop, both household and NFC credit growth has remained robust.

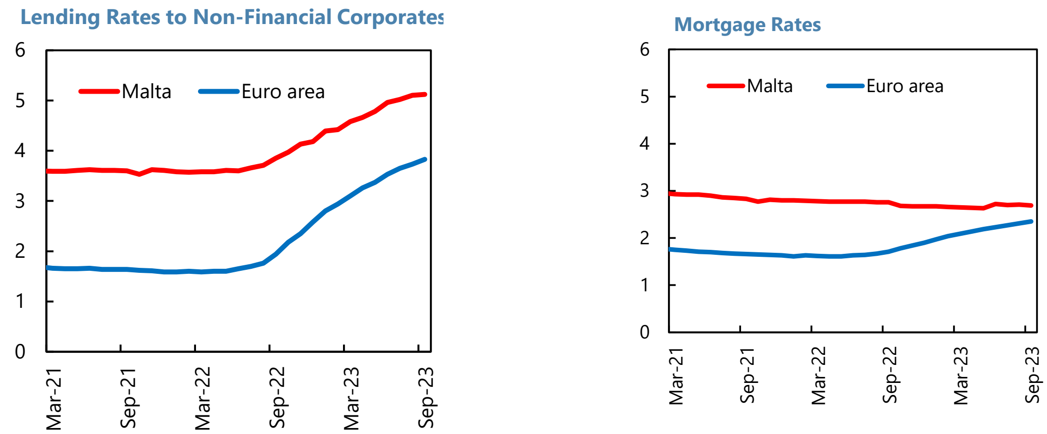
**Bank Credit Growth 1/**
(Percentage change year-on-year)




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

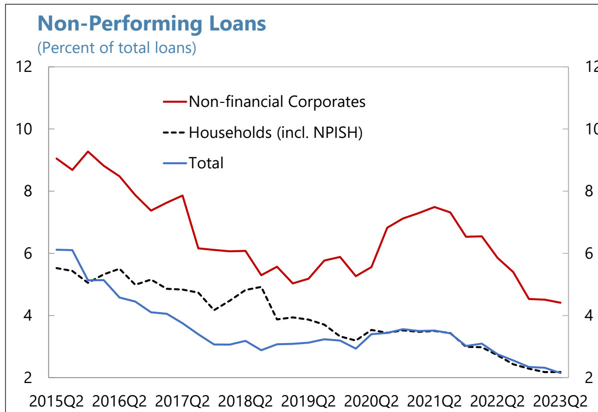
[5] See Selected Issues Paper.

**Bank Lending Rates** [1]
(Percent)




Sources: European Central Bank and Haver Analytics.
[1] Monetary financial institutions (MFIs)' harmonized interest rates on outstanding loans to nonfinancial corporates and to households & non-profit institutions serving households for house purchase.

9. **Banks and domestic insurance companies maintained adequate capital and liquidity buffers** (Figure 3 and Table 3). The quality of core bank credit portfolios has improved, with non-performing loans (NPLs) falling to a historic low of 2.6 percent in 2023:Q2. Higher interest rates on NFC loans and increased loan volumes boosted net interest income while impairment charges remained low. This resulted in increased bank profitability, with core banks' return on equity reaching 11 percent in 2023:Q2. Core banks are well-capitalized, with a common equity Tier 1 capital ratio of about 20 percent and a leverage ratio of 7 percent, both above the average of the European countries. They also maintain strong liquidity positions with a liquidity coverage ratio of nearly 400 percent.[6] Domestic insurance companies also maintained strong financial footing, with the solvency capital requirement coverage ratio at over 220 percent and the liquid asset ratio at almost 70 percent in June 2023.



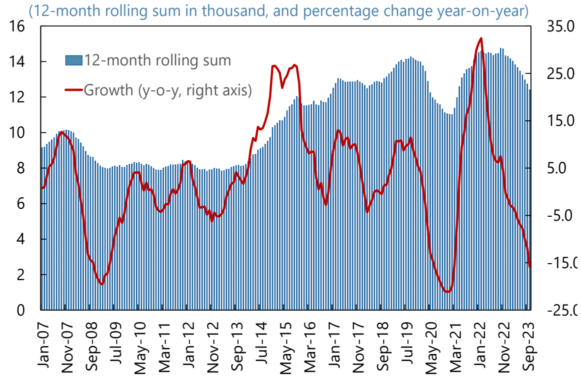

Source: FINREP, Haver Analytics, and IMF staff calculations.

10. **Following a sharp post-pandemic rebound, activity in the residential property market is moderating.** Real estate market indicators, including the number of real estate transactions and the gross value added of the real estate sector, suggest a moderation in the real estate market. Residential property prices have started decelerating to 4½ percent y/y in 2023:Q2, down from

[6] Core and non-core banks accounted for 66 percent and 8 percent of banking sector assets, respectively, in 2023:Q2. The remainder is accounted for by international banks, which have limited linkages with domestic economic and financial activities.

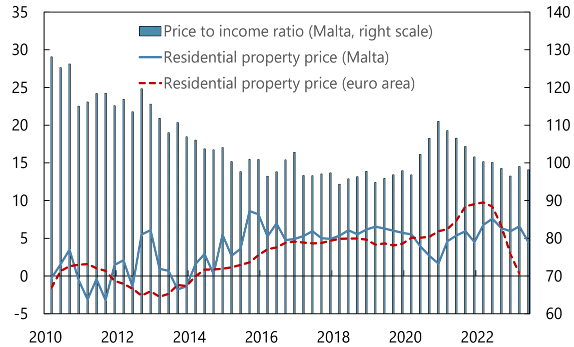
6¾ percent on average in 2022, with a decline in the price-to-income ratio. Staff estimate that house prices are broadly in line with fundamentals.

**Real Estate Transactions-Number of Final Deeds of Sale**
(12-month rolling sum in thousand, and percentage change year-on-year)




Sources: Malta National Statistics Office and IMF staff calculations.

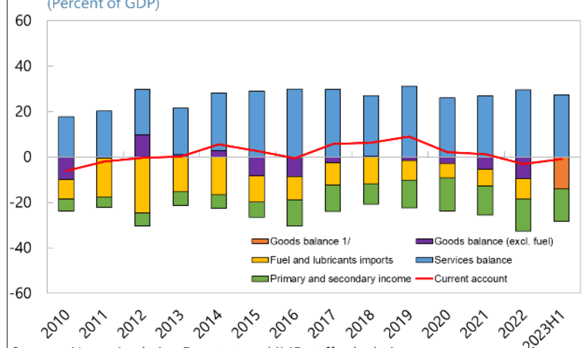
**Residential Property Price Growth**
(Percent, Year-on-year)




Source: Eurostat, the European Central Bank, and IMF staff calculations.

**11. The external current account balance position improved in 2023:H1** (Figure 4 and Table 4). It turned from a surplus of 1¼ percent of GDP in 2021 to a deficit of 3 percent in 2022. The goods deficit widened sharply due to higher energy prices and the import of aircraft equipment. This was partially offset by a widening surplus in services, reflecting continued strong export growth of tourism, remote gaming, and ICT services. For the first half of 2023, preliminary estimates suggest some improvement due to continued robust services exports. Malta's external position in 2023 is expected to be broadly in line with the level implied by medium-term fundamentals and desirable policies (Annex III).

**Current Account**
(Percent of GDP)

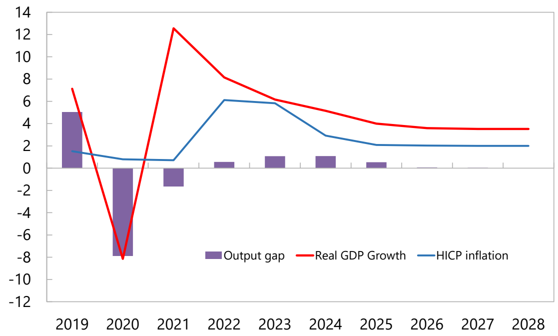



Sources: Haver Analytics, Eurostat, and IMF staff calculations.
1/ Goods balance incl. fuel only for 2023.

# OUTLOOK AND RISKS

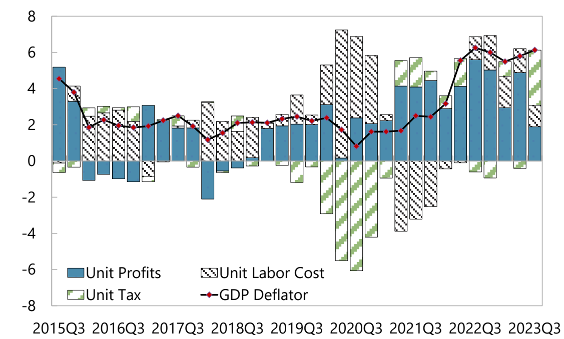
**12. Growth is expected to expand at a robust pace, while inflation will stay above 2 percent in the near term.** With weaker growth in Europe, waning post-pandemic pent-up demand, and, to a lesser extent, gradually rising costs of borrowing, output growth is projected to decelerate somewhat but continue to expand by 6¼ percent in 2023 and 5 percent in 2024, among the highest in Europe. The economy is expected to remain above its capacity, with a positive output gap (1 percent of potential GDP) in 2024. Despite the continuation of the fixed energy prices policy and moderating imported inflation, persistent inflationary pressures are expected, even though corporate profits could offer a buffer to absorb pressures. Inflation will remain persistent and above 2 percent until late 2025.

**GDP, Output Gap, and Inflation**
(Year over year growth and percentage points)




Sources: Haver Analytics and IMF staff calculations.

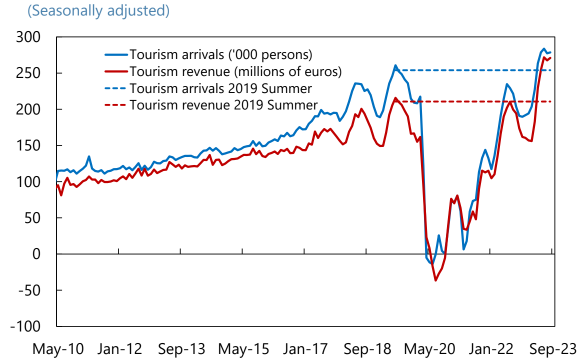
**GDP Deflator Growth**
(Percent y/y, Percentage points)




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

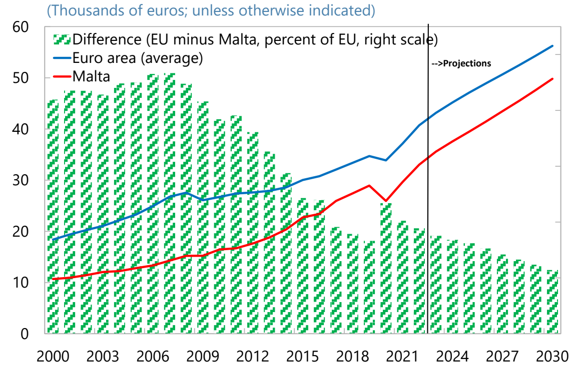
**13. The medium-term growth outlook is positive but less buoyant than in the past.** At 3½ percent, staff's estimate of Malta's medium-term potential growth is half of its pre-pandemic growth records (7 percent for the 2012–19 average). This reflects that medium-term global growth is expected to be lower than in the past two decades,[7] and the past booming sectors (e.g., gaming) will moderate. In addition, the growth of tourism arrivals will normalize until additional substantial capacity is built. Looming physical infrastructure bottlenecks and relatively weak labor productivity could also limit Malta's potential growth. Nonetheless, Malta's per capita income is expected to grow faster than the euro area average, narrowing the income gap from 19 percent in 2022 to 11 percent by 2030.

**Tourism Arrivals and Revenue**
(Seasonally adjusted)




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

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




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

**14. Risks to the outlook are tilted to the downside** (Annex IV).

- *The primary downside risks* include spillover effects from a possible escalation of Russia's war in Ukraine or of the Israel-Gaza conflict, with implications for global commodity prices as well as a deeper-than-expected economic downturn in Europe. Meanwhile, there is a risk of monetary policy miscalibration among major central banks, which could trigger a wage-price spiral, spilling over into financial markets. In addition, the war has escalated the specter of cyberattacks, threatening to disrupt economic and financial activities.

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[7] IMF October 2023 World Economic Outlook.

- *On the domestic front,* wages and inflationary pressures could be higher and more persistent, while money laundering/terrorist financing risks could materialize, adversely affecting correspondent banking relations and FDI inflows. Uncertainties surrounding the effects of the EU's Minimum Tax Directive (Pillar II) also remain a risk.
- *On the upside,* easing of global pressures on commodity prices would help decelerate inflation, ease fiscal pressures, and drive stronger-than-expected growth. The green transition presents opportunities to lower energy input costs, enhance energy security, and boost growth.

# POLICY DISCUSSIONS

*Key policy priorities include supporting disinflationary efforts by accelerating fiscal consolidation plans, exiting gradually from the current fixed energy price policy while protecting vulnerable groups, and maintaining financial stability. Boosting structural reform efforts is imperative to achieve strong, socially- and environmentally-sustainable, and inclusive growth.*

## A. Ensuring Fiscal Sustainability

**15. Fiscal deficits remain large.** The 2024 Budget envisages a small reduction in the overall deficit from 5 percent of GDP in 2023 to 4½ percent of GDP in 2024, with new discretionary spending measures, including to support pensioners and low-income earners, more than offset by the phasing out of costs related to Air Malta's restructuring and of remaining COVID-19-related support measures, and reduced capital spending (as several large projects were completed in the previous year). Energy subsidies will remain large at 1¾ percent of GDP, accounting for about 40 percent of the overall deficit. The structural balance will remain at a deficit of 4¼ percent of GDP in 2024, compared to a surplus of ½ percent of GDP before the pandemic (the 2017–19 average). Beyond 2024, the authorities plan to gradually reduce the overall deficit to 3 percent of GDP by 2027, assuming sustained strong growth and a substantial reduction in energy prices.[8] Despite the large deficits, financing risk appears to be limited with a strong domestic investor base, high appetite for government securities, and ample liquidity.

**Malta: Staff and Authorities' Fiscal Estimates and Projections**

(Percent of GDP)

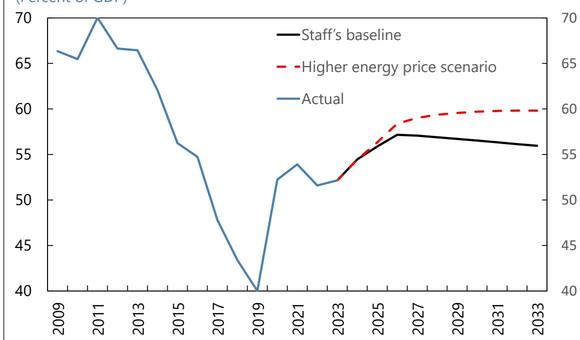
| | 2017-2019 Average | 2020 | 2021 | 2022 | 2023 Staff | 2023 DBP | 2024 Staff | 2024 DBP |
|---|---|---|---|---|---|---|---|---|
| Revenue | 37.3 | 35.7 | 35.5 | 33.7 | 35.0 | 35.0 | 34.0 | 34.0 |
| Expenditure | 35.4 | 45.3 | 42.9 | 39.3 | 39.9 | 40.0 | 38.5 | 38.5 |
| Overall balance | 1.9 | -9.6 | -7.4 | -5.6 | -4.8 | -5.0 | -4.4 | -4.5 |
| Primary balance | 3.4 | -8.3 | -6.3 | -4.7 | -3.7 | -3.8 | -3.0 | -3.2 |
| Structural balance | 0.4 | -5.7 | -6.6 | -5.9 | -5.4 | -4.8 | -5.0 | -4.3 |
| Primary structural balance | 2.0 | -4.5 | -5.5 | -5.0 | -4.3 | -3.7 | -3.6 | -3.0 |
| Public debt | 40.0 | 52.2 | 53.9 | 51.6 | 52.2 | 52.8 | 54.5 | 55.3 |

Source: Ministry of Finance, and IMF staff calculations.

[8] The EC is expected to deactivate the general escape clause of the Stability and Growth Pact in 2024. In that case, Malta will be subject to the Excessive Deficit Procedure as its deficits are above the threshold of 3 percent of GDP.

**16. The authorities remain committed to keeping the debt-to-GDP ratio below 60 percent (the EU's current debt ceiling), but the public debt trajectory is exposed to downside risks.** The IMF's sovereign risk and debt sustainability framework (SRDSF) suggests a low overall sovereign stress (Annex V). However, with sustained large deficits, public debt is projected to continue to rise from 52 percent of GDP in 2022 to about 57 percent in 2026 before stabilizing, compared with 40 percent of GDP in 2019. In addition, the debt trajectory is exposed to energy price shocks—as an illustration, should energy prices stay at currently high levels, public debt would continue to rise and reach 60 percent over time. Furthermore, contingent liabilities (about 7 percent of GDP), mostly related to government guarantees for state-owned enterprises (SOEs), add another layer of risk to debt sustainability.

**Public Debt: Baseline and Higher Energy Price Scenario**
(Percent of GDP)




Sources: Haver Analytics, and IMF staff calculations.

**17. Because of strong demand pressures, the authorities should consider accelerating the planned fiscal adjustment to support disinflationary efforts and rebuild fiscal buffers at a faster pace.** The economy is above its full potential, marked by a tight labor market, strong consumption, and elevated inflation. Accordingly, a tighter fiscal stance would help contain demand pressure. In addition, given that Malta is a small, open, island economy particularly exposed to external shocks and with growing spending pressures to address climate change and infrastructure needs, building larger fiscal buffers—above current levels—is essential to strengthen the economy's resilience. Consideration should be given to balancing the need for building fiscal buffers while protecting vulnerable groups. In staff's view, an additional adjustment totaling 1½ percent of GDP over 2024–25, aimed at reducing the deficit to 3 percent of GDP by 2026, would help narrow the positive output gap faster without putting an undue burden on the economy, given the current strong cyclical position.[9] Under these assumptions, public debt would be placed on a clear downward path, even if energy prices remain high at current levels.

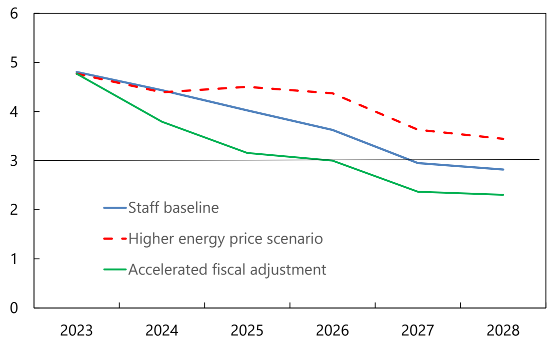
**Malta: Suggested Measures for an Accelerated Fiscal Adjustment**
(Percent of GDP)

| | Impact | | |
|---|---|---|---|
| | 2024 | 2025 | Total |
| Reducing energy subsidies by two-thirds | 0.4 | 0.6 | 1.0 |
| Strengthening revenue administration | 0.2 | 0.2 | 0.4 |
| Improving spending efficiency | … | … | … |
| Total | 0.6 | 0.8 | 1.4 |

Source: IMF staff calculations.

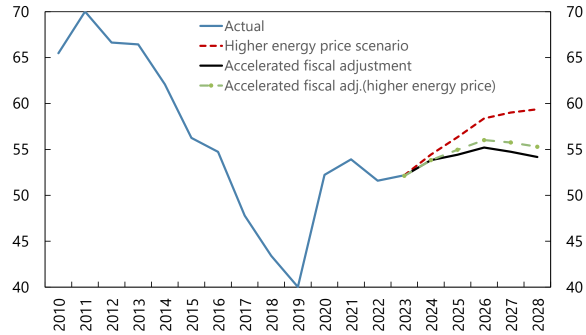
[9] Assuming a fiscal multiplier of 0.5 for spending and 0.1 for revenue administration, additional fiscal tightening of 1½ percent of GDP over the next two years would reduce GDP by around ½ percent, bringing the output gap closer to zero in 2025.

**Overall Deficit: Baseline and Alternative Scenarios**
(Percent of GDP)




Sources: IMF staff calculations.

**Public Debt: Baseline and Alternative Scenarios**
(Percent of GDP)

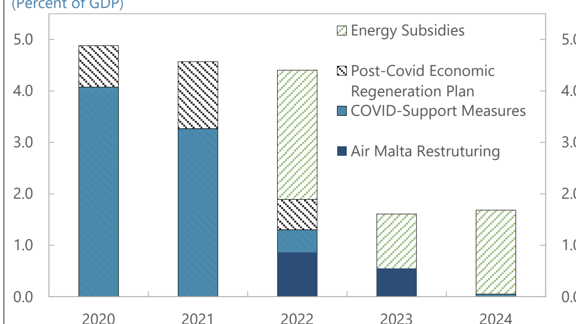



Sources: Haver Analytics, and IMF staff calculations.

**18. The fiscal adjustment should primarily focus on substantially rationalizing energy subsidies, while broader efforts encompassing both revenue and spending measures should be explored.** The current energy price policy distorts price signaling, disincentivizes energy savings and green investment, and impedes progress toward environmentally-sustainable economic growth (as retail energy prices are fixed). In addition, the sheer size of the subsidies limits fiscal space in reallocating resources to productivity-enhancing reforms while consolidating the fiscal position.

- *Rationalizing energy subsidies.* The ongoing energy price shock can no longer be viewed as temporary, putting a strain on fiscal policy for a prolonged period. Accordingly, in line with staff's recommendations in the 2022 Article IV Consultation, the authorities should prepare an exit strategy from the fixed price policy, with the aim of containing fiscal costs, strengthening market price mechanisms to enhance conservation while protecting low-income and to a lesser extent, middle-income households (Box 1). The strategy should be implemented predictably and in light of significant concerns about the impacts on consumers, gradually. While a gradual approach may ease pressures on households and firms, it would delay the benefits of exit and leave public finances vulnerable to further energy price increases.[10]

**COVID-19 Fiscal Support, Energy Subsidies, and Other Discreationary Measures**
(Percent of GDP)




Source: Ministry of Finance, and IMF staff calculations.

[10] Staff recommends a partial adjustment over the next two years (by cutting the subsidies by two-thirds). The inflationary impact is estimated at around 1 percent over the next two years. Note that the inflationary impact is highly sensitive to market prices.

**Box 1. Exit Options from the Fixed Retail Energy Price Policy**

- Begin with adjusting fuel prices to better reflect their import costs in line with pre-crisis practices.
- Allow a greater pass-through of prices with targeted cash transfers to low-income households and, to a lesser extent, middle-income households, and with temporary financial support for energy-intensive firms conditional on efforts to increase energy efficiency.
- Alternatively, for household consumers, make the electricity tariff structure more progressive to better reflect the level of electricity consumption by subsidizing a "minimum household consumption level" and below while applying cost-recovery pricing above this level.

- *Increasing expenditure efficiency.* Priorities include: (i) launching a spending review to assess the durability of the departmental budget cut measures and identify the scope for rationalizing recurrent spending; (ii) sustaining the ongoing efforts aimed at improving the efficiency of public investment, including green investment, drawing on the IMF public investment management assessment (PIMA) and Climate-PIMA; and (iii) strengthening public procurement by streamlining the vetting process, accelerating digitalization, and implementing a risk-based approach. [11]

- *Strengthening revenue administration.* The authorities have recently launched a comprehensive program to modernize the Office of the Commissioner for Revenue (now the Malta Tax and Customs Administration, MTCA), with the technical assistance of IMF, aimed at improving the efficiency and effectiveness of tax collection.[12] Reform priorities include: (i) strengthening the operational autonomy of the MTCA and its governance structure; (ii) developing strategies to mitigate compliance and enterprise risks; (iii) instituting a large taxpayer office; (iv) introducing an integrated tax administration IT system; and (v) advancing the merger of customs and tax administration (Annex VI). Continued IMF TA will be needed over the period of the transformation.

**19. Corporate income tax (CIT) reform is increasingly urgent.** The statutory tax rate for domestic enterprises is 35 percent (a flat rate). Malta, however, adopts a refund system, which allows shareholders of Maltese multinational enterprises (MNEs) to claim a refund of 6/7$^{th}$ of the tax paid in Malta, reducing the effective tax rate (ETR) to 5 percent. In light of the EU's adoption of the Minimum Tax Directive (Pillar II), Malta's tax advantage for large MNEs will be reduced over time. However, the authorities can turn this challenge into an opportunity to modernize the corporate tax system and make it more efficient and less distortionary. This, however, requires immediate action.

- Of utmost importance is developing a well-structured roadmap for a phased implementation of the CIT reform to provide both international and domestic investors with certainty. Given the interaction of personal income tax (PIT) and CIT, the roadmap should also include PIT reform.

[11] See OECD (2023), Public Procurement in Malta: Building Capacity and Managing Risks.

[12] See Malta Tax and Customs Administration (2023), 2023-2025 Strategic Plan for Tax and Customs Administration.

- The strategy should carefully calibrate the sequencing of needed reforms to mitigate distortion in investor incentives, as the adoption of the EU directive creates three distinct tax groups: (i) MNEs within the scope of Pillar II (subject to a 15 percent ETR); (ii) MNEs outside the scope of Pillar II (subject to a 5 percent ETR, the status quo); and (iii) domestic enterprises (subject to a 35 percent ETR).

- For in-scope MNEs, there is a case for Malta to introduce a Qualifying Domestic Minimum Top-up Tax to minimize foregone tax revenues that will otherwise be collected by other jurisdictions.

- To better align ETRs across different tax groups, consider phasing out the tax refund system over time, for example, by reducing the 6/7$^{th}$ to 5/7$^{th}$ in a first step to raise the ETR for out-of-scope MNEs. Meanwhile, the statutory tax rate should be decreased from 35 percent to reduce the burden on domestic enterprises.

- Review the cost-effectiveness of the current tax expenditure system and introduce Qualified Refundable Tax Credits aimed at addressing externalities, including R&D activity and green transition, but designing it carefully to minimize revenue risks.

**20. Contingent liabilities and long-term demographic trends should be closely monitored.**

- The stock of government guarantees for state-owned enterprises (SOEs) decreased from about 9 percent of GDP in 2020 to 7 percent of GDP in 2022. However, the ongoing restructuring of state-owned Air Malta could add to the government's contingent liabilities.[13] The government should draw on lessons learned and develop strategies to strengthen SOE governance and oversight with IMF technical assistance.[14]
- The EC 2021 Aging Report suggests that aging costs in Malta would remain broadly flat until 2040 at around 18 percent of GDP but accelerate to 26 percent by 2070.[15] The projection, however, is sensitive to immigration patterns and the number of retired migrants. Therefore, close monitoring of migration patterns is crucial from a fiscal sustainability perspective.

## B. Safeguarding Financial Stability

**21. The financial system appears resilient.** Continued monitoring of potential pockets of vulnerabilities, however, is needed given macroeconomic uncertainty and high inflation, and to a lesser extent, gradually rising interest rates (especially for corporate borrowers). Malta's financial system is relatively sizable and dominated by banks, with their total assets at around 2.4 times GDP.

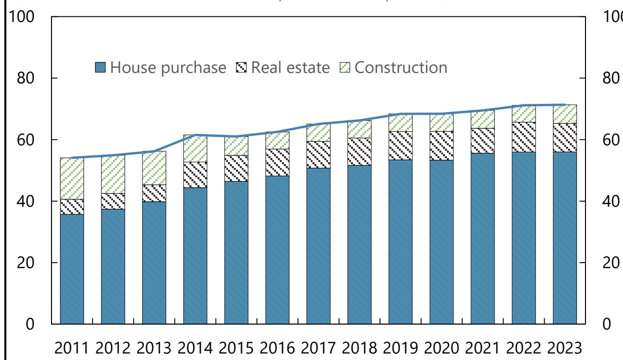
[13] The restructuring of Air Malta is anticipated to conclude in 2024. The government will invest €215 million (1.1 percent of GDP) in the new national airline.

[14] The IMF's "Malta Technical Assistance Report – Fiscal Transparency Evaluation (2018)" recommends strengthening the institutional framework for managing fiscal risks.

[15] European Commission, 2021, "The 2021 Aging Report."

- Due to the sustained growth of residential mortgages over the past years, mortgage loans now exceed half of resident bank loans, raising banks' concentration risk. If pass-through from ECB policy rates to bank lending rates accelerates and economic growth falters, households' debt service capacity could be tested, with variable-rate mortgages accounting for 80 percent of the total.[16] Nevertheless, credit risk is mitigated by strong labor markets, a moderate level of households' indebtedness (57 percent of GDP), and substantial household assets (above 200 percent of GDP).

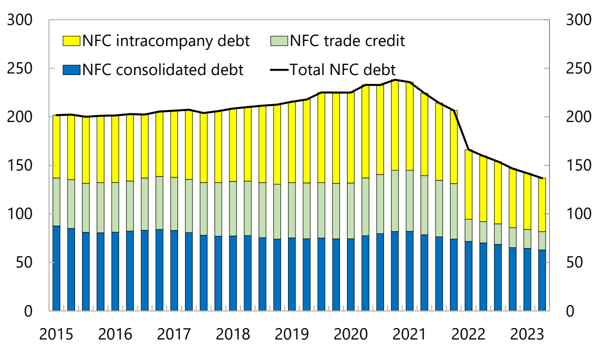
**Exposure to the Housing Market**
(Share of resident bank loans to the private sector, percent)




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

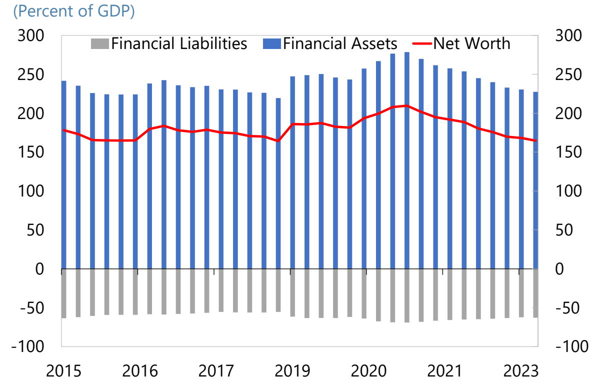
- NFC debt remains high at around 140 percent of GDP. However, consolidated debt, which excludes intracompany loans and trade credits, was significantly lower at about 63 percent of GDP. NFCs also maintain large financial asset holdings (230 percent of GDP), which strengthens their resilience to shocks. Nonetheless, the risks of rising cost pressures, increasing interest rates, despite limited pass-through from ECB policy rates thus far, and a weaker economic outlook are still prevalent.

**Nonfinancial Corporates Debt 1/**
(Percent of GDP)




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

**Households Debt**
(Percent of GDP)



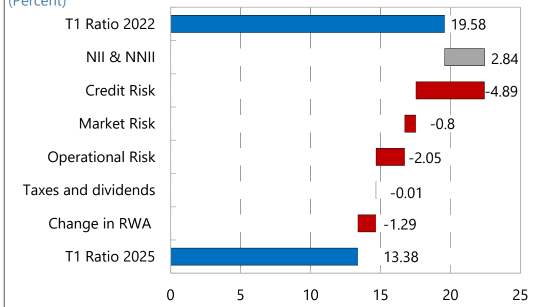

Sources: Central Bank of Malta, Haver Analytics, and IMF staff calculations.

[16] See Selected Issues Paper.

**22. The CBM's stress tests suggest that banks have sufficient capital and liquidity buffers to cope with severe but plausible stress scenarios.**[17] Despite increased insolvencies of households and NFCs under a stress scenario, all core banks would be able to absorb losses and meet capital requirements with ample buffers. On the liquidity front, all core banks and most non-core banks would be able to maintain the liquidity coverage ratio (LCR) above 100 percent even under a bank-run type deposit withdrawal scenario. However, some small non-core banks are challenged by liquidity shocks, falling below the 100 percent LCR, depending on the severity of the scenarios.

**Stress Test Results – Relative Contribution of the Impact on Core Domestic Banks' Tier 1 Capital Ratio 1/**

(Percent)




Source: Central Bank of Malta.

1/ Stress test results are based on an adverse scenario.

**23. Against this backdrop, the authorities should continue to be vigilant in monitoring risks.** Given heightened uncertainty, the authorities should ensure that banks continue to closely assess how developments in inflation and financial conditions affect the balance sheets of vulnerable borrowers and update provisions for credit risks. In addition, the authorities should remain vigilant in monitoring price developments in the residential and commercial real estate sectors. Furthermore, while pass-through from monetary policy to retail lending and deposit interest rates has been limited, its effects on bank financial performance have been varied, depending on bank size and business models. This warrants close monitoring. Increased allocation of resources towards cyber security is welcome, especially given the increasing threats of cyberattacks. This will help achieve compliance with the EU's Digital Operational Resilience Act (effective in 2025).

**24. Macroprudential policies have been tightened, but potential pockets of risks, especially in the real estate market, warrant continued monitoring.** The authorities introduced a sectoral systemic risk buffer (SSyRB) targeting residential mortgage exposures, initially set at 1 percent from end-September 2023 and increasing to 1.5 percent from end-March 2024. This will strengthen banks' resilience to a possible housing sector shock. Staff consider the current zero setting of the countercyclical capital buffer (CCyB) appropriate, given tightening financial conditions and limited signs of excessive credit. The borrower-based measures (BBMs), including loan-to-value, stressed debt-service-to-income, and maturity limits, have been largely unchanged since their introduction in 2019. As macro-financial conditions evolve, the effectiveness and appropriateness of these BBMs, especially the speed limits, should be reviewed.[18, 19]

[17] Stress tests are based mainly on the 2022 Financial Stability Report (FSR), updated with the Interim FSR 2023. The solvency stress tests under a stress scenario—equivalent to the adverse scenario of the European Banking Authority's 2023 EU-wide stress test—assume a cumulative 5.5 percent fall in GDP, a 7.8 percent increase in unemployment, and a 9.7 percent decline in house prices over a three-year period.

[18] "Speed limit" is defined as the restriction of the volume of new loans with the LTV ratio above 90 percent for Category I borrowers (mainly first-time borrowers) and 75 percent for Category II borrowers (mainly those purchasing secondary property). The speed limit is set at 10 percent for Category I borrowers and 20 percent for Category II borrowers.

[19] The implementation status of the 2019 FSAP recommendations is summarized in Annex VII.

## C. Sustaining AML/CFT and Governance Reform

**25. The authorities remain committed to further improving their AML/CFT framework.** The 2023 AML/CFT National Risk Assessment finds a decline in the residual risk across most sectors, including gaming and company service providers, due to more stringent mitigation measures. Resources for AML/CFT supervisors and regulators have been significantly bolstered, with a plan to further increase them, while collaboration mechanisms among supervisors and regulators have been enhanced. Malta has also joined the EU Beneficial Ownership Registers Interconnection System, which helped to further improve the identification and verification of beneficial ownership information, while the authorities have further enhanced training programs for the private sector and a risk-based approach. In light of the 2022 EU Court of Justice's ruling on public accessibility of beneficial ownership (BO) information, Malta has suspended general public access to the BO registry. Its implications for the robustness of the AML/CFT framework should be assessed, and if warranted, risk mitigation measures be developed.

**26. Progress has been made in strengthening Malta's anti-corruption framework, but further efforts are needed.** Over the past two years, the authorities have made progress in reforming the justice system and strengthening the independence of the judiciary[20] and adopted a National Anti-Fraud and Corruption Strategy.[21] Implementation of the 2021 Digital Justice Strategy is underway, which includes introducing digital tools to strengthen justice system efficiency, effectiveness, and accessibility. However, further efforts are needed, especially to: (i) reform the appointment process of the Chief Justice and enhance judicial accountability and efficiency; (ii) strengthen the capacity of the Permanent Commission Against Corruption; (iii) reduce the length of proceedings and investigation of high-level corruption cases; (iv) prevent the conflicts of interest and enhance the codes of ethics for public officials; and (v) strengthen the supervision and enforcement of the asset declaration system, including requiring the publication of Members of Parliament's asset declarations and covering the assets of the obliged person's spouses and children.

## D. Pursuing Structural Reforms

**27. Boosting productivity will be imperative to achieve high, sustainable, and inclusive growth.** The strong growth of the past decade has been driven more by increased labor inputs than by productivity growth (Annex VIII). Strong labor growth can be attributed to a sharp influx of foreign immigrants (European immigrants account for two-thirds of the total). As a result, population density increased by nearly 25 percent over the past decade. There are indications that the provision of physical infrastructure (e.g., roads) and public services (e.g., health) has not caught

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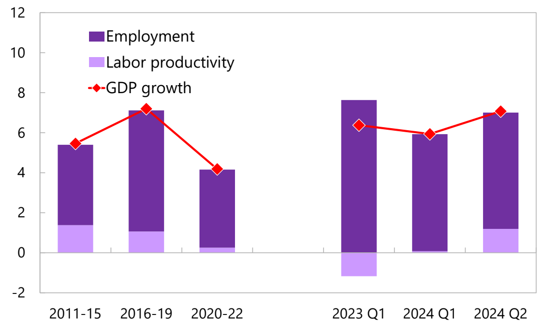
[20] Progress includes: (i) revamping the method of appointing and dismissing judges and magistrates; (ii) reforming the Judicial Appointments Committee with a greater representation of judiciary members to reduce political interference risk; (iii) requiring public calls when filling judiciary vacancies to enhance transparency in the appointment process; and (iv) transferring the prosecution function from the police to the Attorney General Office.

[21] National Anti-Fraud and Corruption Strategy.

up with population growth. Should this trend continue, capacity pressure threatens to reach a point where productivity and welfare are adversely affected. Accordingly, the authorities need to continue structural reform efforts to boost productivity across broad economic segments.

**GDP Growth Decomposition**
(Percentage points)




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

**Selected Capacity Pressure Indicators**

| | Malta | | EU |
|---|---|---|---|
| | 2012 1/ | 2022 2/ | 2022 2/ |
| Population density (Persons per km^2) | 1,329 | 1,657 | 109 |
| Number of cars per km road | 106 | 110 | 76 |
| Hospital beds per 000 inhabitants | 471 | 414 | 525 |
| *Memorandum items* | | | |
| 2013-2022 ave. y/y % | | | |
| Population | 2.2 | | 0.1 |
| Of which: foreigner: | 18.5 | | … |

Sources: Eurostat, Haver Analytics, and IMF staff calculations

1/ Some indicators are for 2013.
2/ Or latest available year.

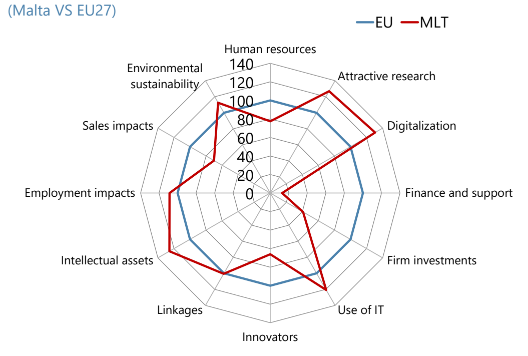
**28. Accelerating implementation of Malta's Recovery and Resilience Plan (RRP) will help deliver much-needed reforms and investments.** The RRP supports efforts to advance green and digital transition and enhance economic and social resilience in judiciary reform, governance, early school leaver problems, and healthcare. In July 2023, the plan was expanded to incorporate a new REPowerEU plan and additional green-transition investments. As of early October, €93 million out of a total of €328 million (1¾ percent of GDP, all grants) have been disbursed, with 19 out of 138 milestones and targets achieved.[22]

**29. Efforts to boost innovation should be stepped up.** Malta has relative strengths, including in digitalization, use of ICT, and intellectual assets. However, it is trailing EU peers in several other areas, including government support for business R&D, venture capital, product and business process innovation, and R&D expenditures. To address these shortcomings, the government adopted a new Smart Specialization Strategy for 2021–27, aiming to strengthen the effectiveness of channeling public funds into priority areas,[23] while the 2024 Budget includes measures to support venture capital and start-ups. Beyond these efforts, more could be considered to enhance innovation, including by reviewing the effectiveness and efficiency of current R&D financial incentives and easing administrative burdens, especially for SMEs to tap these financial incentives.

[22] These include the adoption of a strategy to reduce waste in the construction sector, reforms to boost industrial research, a national antifraud and corruption strategy, and the digitalization of the justice system.

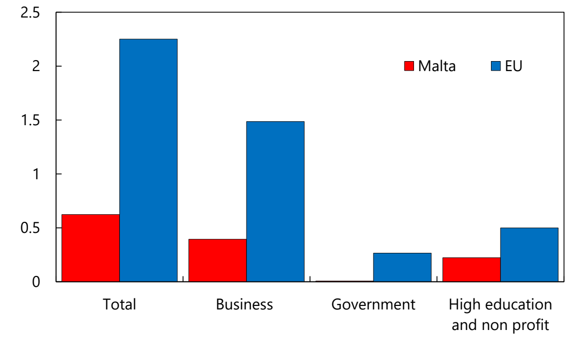
[23] These are health, climate change, manufacturing, marine and maritime, aviation, and digitalization.

**Innovation Performance Indicators 2023**
(Malta VS EU27)




Sources: European Innovation Scoreboard 2023.

**R&D Spending, 2021**
(Percent of GDP)




Sources: Euro Stat, Haver Analytics, and IMF staff calculations.

**30. Promoting R&D activity and innovation will require increasing the pool of skilled workers.** Chronic shortages of skilled workers (especially in financial services, ICT, and gaming), relatively weak education outcomes, and high turnover of foreign skilled labor are pressing challenges. Multifaced approaches are needed.

- *Upskilling and reskilling.* This is key to resource reallocation across sectors. In 2021, the government launched a comprehensive national employment policy, including upskilling. Progress should be closely monitored, with corrective actions where needed. The recently established National Skills Council should provide technical advice to policymakers.

- *Strengthening the education system.* Malta's tertiary education attainment has improved significantly, and early leavers from education and training have dropped over the past decade.[24] However, there remain long-standing weaknesses, including relatively weak school learning outcomes, a decrease in the number of new graduates in science and engineering (per population), and the low take-up rate of adult learning for the low-skilled. To address basic skills challenges, the authorities should continue efforts to ensure high teaching quality.[25]

- *Enhancing education outcomes for students with immigrant backgrounds.* These students lag in education performance, with large gaps in PISA scores and early leavers. The authorities should closely monitor the educational outcomes of students with immigrant backgrounds and address gaps in performance.

**31. Given looming capacity constraints and the desirability of ensuring productivity growth, there is a need to refocus Malta's economic development strategy.** In this light, the authorities should review: (i) gaps in the needed labor force and skills to achieve sustainable long-term growth; (ii) immigration policies to ensure there is the right supply of skills needed to meet demand; and (iii) needs in physical and social infrastructure, including housing, education, and health services. The review should also include policy options (e.g., tax incentives and regulations) to shift the focus of investment incentives away from labor-intensive projects toward higher value-

[24] EC Education and Training Monitor, 2022.

[25] EC 2023 Country Report - Malta.

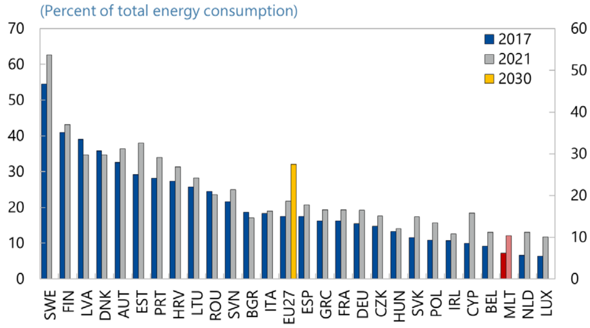
added and innovative projects. The existing national planning strategy, *Strategic Plan for Environment and Development* 2015, should be updated expeditiously to reflect capacity constraints and the latest demographic projections, and sectoral policies (e.g., tourism) should be aligned.

## Climate Policies

**32. Accelerating decarbonization and renewable investments will help strengthen Malta's resilience to energy shocks.** Malta is among the lowest greenhouse gas emitters per capita in the EU. It faces a challenge in meeting the 19 percent effort-sharing regulation reduction target by 2030, as emissions in effort-sharing sectors are expected to rise by about 50 percent.[26] There is also concern that electricity consumption (per capita) increased in the past two years in Malta, in part reflecting the fixed energy price policy. Construction of a second interconnector with Italy (to be completed by 2025) and large-scale offshore wind farms would help make progress in achieving key climate commitments, including on renewables, but more efforts are encouraged.

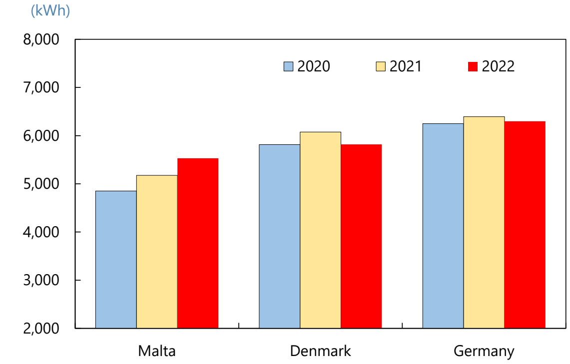
- Making steady progress in implementing the 2021 Low Carbon Development Strategy is critical, especially in the areas of transportation, waste management, and building.
- Allowing greater pass-through of market energy prices to consumers will enhance incentives for saving energy and investing in energy efficiency. In the medium term, consider raising excises on fuels in building and transport sectors, which would help prepare for the next EU Emissions Trading System (EU ETS II, effective in 2027) and the revision of the EU Energy Tax Directive (under proposal).[27]
- As a small island economy, climate change poses many threats, including to infrastructure, water sources, and coastal population.[28] The vulnerability risk assessment should be completed timely, and the adaptation plan updated. Furthermore, efforts should continue to better understand banks' exposure to both transition and physical risk from climate change.

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




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

**Electricity Consumption per Capita**
(kWh)




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

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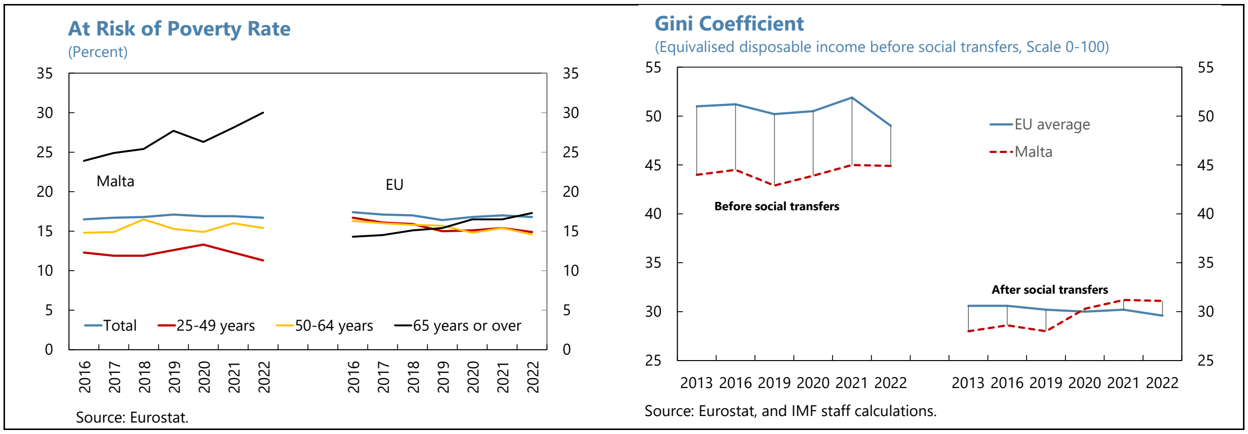
[26] EU Climate Action Progress Report Country Profile 2022 - Malta.

[27] EU ETS II and EU Energy Tax Directive.

[28] See Malta's 4th Biennial Report.

### Poverty and Inequality

**33. There are signs that income inequality and poverty risk have risen since the pandemic** (Figure 5). Income inequality increased to above the EU average (after social transfers) in 2022. Furthermore, although the overall share of people at risk of poverty has remained steady at around 17 percent, similar to the EU average, it has worsened for elderly populations. The authorities should closely monitor income inequality and poverty risk, with a specific focus on pensioners, and assess the effectiveness of the social protection system in preventing the widening of income inequality.




# AUTHORITIES' VIEWS

**34. The authorities broadly agreed with staff on the economic outlook.** They expected the economy to steadily expand in 2023 and 2024, albeit at a more moderate pace than in the past two years. They project inflation to remain persistently high, above 2 percent, until late 2025, while wage inflation would pick up somewhat. The authorities expected house prices to decelerate, broadly in line with their fundamental values. Risks to the outlook are balanced, with downsides from lower foreign demand arising possibly from increased tensions in Russia's war in Ukraine and the Israel-Gaza conflict and tighter financial conditions offset by stronger domestic demand. They viewed that the current account balance turned to a deficit in 2022 due to exceptionally large one-off equipment imports and would recover to a surplus in 2023.

**35. The authorities reiterated their commitment to keeping public debt below 60 percent of GDP.** The Ministry of Finance and Employment (MFE) assessed the fiscal stance in 2024 as appropriate and plans to reduce the overall deficit by 0.5 percentage points of GDP a year to reach 3 percent of GDP by 2027. The authorities stressed that the current fixed energy price policy is imperative to economic and social stability and that they will maintain this policy for the foreseeable future. They indicated that planned investments in renewable energy would help reduce energy prices and fiscal costs over the medium term. The MFE stressed that to create fiscal space for energy subsidies, they will continue to assess the scope for rationalizing expenditures. At the same time, they noted that the ongoing tax administration reform would help generate more tax revenues.

**36. The authorities indicated that they were still working on the strategy of implementing the EU's Directive on OECD Pillar II.** They indicated that the tax reform should be in accordance with the EU's Directive and EU state aid rules but stressed that the reform should be revenue-neutral whilst maintaining Malta's global competitiveness. The authorities indicated that they would keep a close eye on global tax developments and assess their position accordingly in 2024.

**37. The authorities stressed that the financial system remains robust.** They highlighted the banking sector's strength as evidenced by significant capital and liquidity buffers and improved asset quality and profitability. They stressed that the limited monetary policy transmission was largely attributed to ample liquidity in the system. While acknowledging its differential effects on bank profit margins, they stressed that all core banks were profitable. The authorities deem the current macroprudential policy stance appropriate. The recent increase in the sectoral systemic risk buffer should address potential exposure from the real estate market. The authorities also agreed that cyber security remains among the key risks.

**38. The authorities stressed their progress in strengthening the judiciary system and AML/CFT framework.** They indicated that capacity in the judiciary has been boosted, while a number of recommendations by the Venice Commission and GRECO have been taken. With concerted efforts among stakeholders and increased human and technological resources, Malta has developed a robust AML/CFT framework. They indicated that the 2023 AML/CFT National Risk Assessment found lower ML/TF risks in gaming and virtual financial asset operators, identified as high in the previous assessment.

**39. The authorities agreed that robust structural reforms will be needed to boost productivity and achieve high and sustainable growth.** They pointed to many initiatives underway to enhance research and development activity, innovation, venture capital, start-ups, and the reskilling and upskilling of the labor force. The authorities indicated that the updated National Education Strategy will give a clear direction in education reforms. At the same time, they agreed with the importance of closely monitoring education outcomes for students with non-EU backgrounds to achieve inclusive growth. They also agreed that there is a need to refocus Malta's economic development strategy by incorporating capacity constraints. To meet the climate goals, they agreed that timely implementation of the 2021 Low Carbon Development Strategy is imperative. They did not, however, agree with allowing greater pass-through of market energy prices to consumers, whilst stressing the importance of investments in renewable energy sources.

# STAFF APPRAISAL

**40. Malta's recovery from the pandemic was impressive, but strong output and employment growth has contributed to demand pressures and capacity constraints.** With weaker external demand and waning post-pandemic pent-up demand, GDP growth is expected to moderate but continue to expand at a solid pace in 2024. Risks to the outlook are tilted to the downside in part due to spillover effects from a possible escalation of Russia's war in Ukraine or of the Israel-Gaza conflict. Malta's external position in 2023 is expected to be broadly in line with the level implied by medium-term fundamentals and desirable policies. The challenge for the medium term is to ensure a robust policy framework to foster strong, socially- and environmentally-sustainable, and inclusive growth.

41. **The authorities should consider accelerating fiscal consolidation to support disinflationary efforts in the short term and rebuild fiscal buffers at a faster pace.** The economy is at its potential, marked by tight labor markets, strong demand, and elevated inflation, and therefore, a tighter fiscal stance will help contain demand pressure. In addition, the public debt trajectory is exposed to important downside risks because growth could underperform or energy prices could stay high. Malta is a small, open, island economy particularly exposed to external shocks, with growing spending pressures to address climate change and infrastructure needs. Accordingly, the authorities should consider accelerating fiscal consolidation to rebuild fiscal buffers at a faster pace.

42. **Energy subsidies should be substantially rationalized, while broader efforts encompassing both revenue and spending measures should continue.** The prevailing energy subsidy policy should be phased out as it places a substantial burden on the budget, limits fiscal space for productivity-enhancing reforms, and blunts incentives for energy savings and efficiency. Accordingly, the authorities should prepare and implement an exit strategy, if necessary, gradually, given significant concerns about economic and social impacts. The authorities should also continue modernizing revenue administration and explore the scope for rationalizing recurrent spending, enhancing the efficiency of public investments (particularly green), and strengthening public procurement.

43. **CIT reform is increasingly urgent given the EU's Directive on OECD Pillar II.** The authorities should develop a well-structured roadmap for a phased implementation of the CIT reform in consultation with stakeholders and announce it by late 2024. This should help provide both international and domestic taxpayers with certainty. Considering the interactions of CIT and PIT, the roadmap should also include the PIT reform.

44. **The financial system appears resilient, but continued monitoring of potential pockets of vulnerabilities is needed.** The authorities should ensure that banks continue to closely assess how inflation and macro-financial conditions affect vulnerable and leveraged borrowers and update provisions for credit risks accordingly. The authorities should also remain vigilant in monitoring price developments in the residential and commercial real estate sectors. In this context, they should continue to review the effectiveness and appropriateness of borrower-based measures. Furthermore, limited pass-through from monetary policy to retail lending and deposit interest rates requires close monitoring, considering its differential effects on bank financial performance depending on bank size and business model. Finally, efforts to strengthen cyber security should continue, given the growing threat of cyberattacks.

45. **Progress made in improving the AML/CFT framework is welcome.** Resources for AML/CFT supervisors and regulators have been boosted, while collaboration mechanisms, training programs for the private sector, and the risk-based approach have been enhanced. The 2023

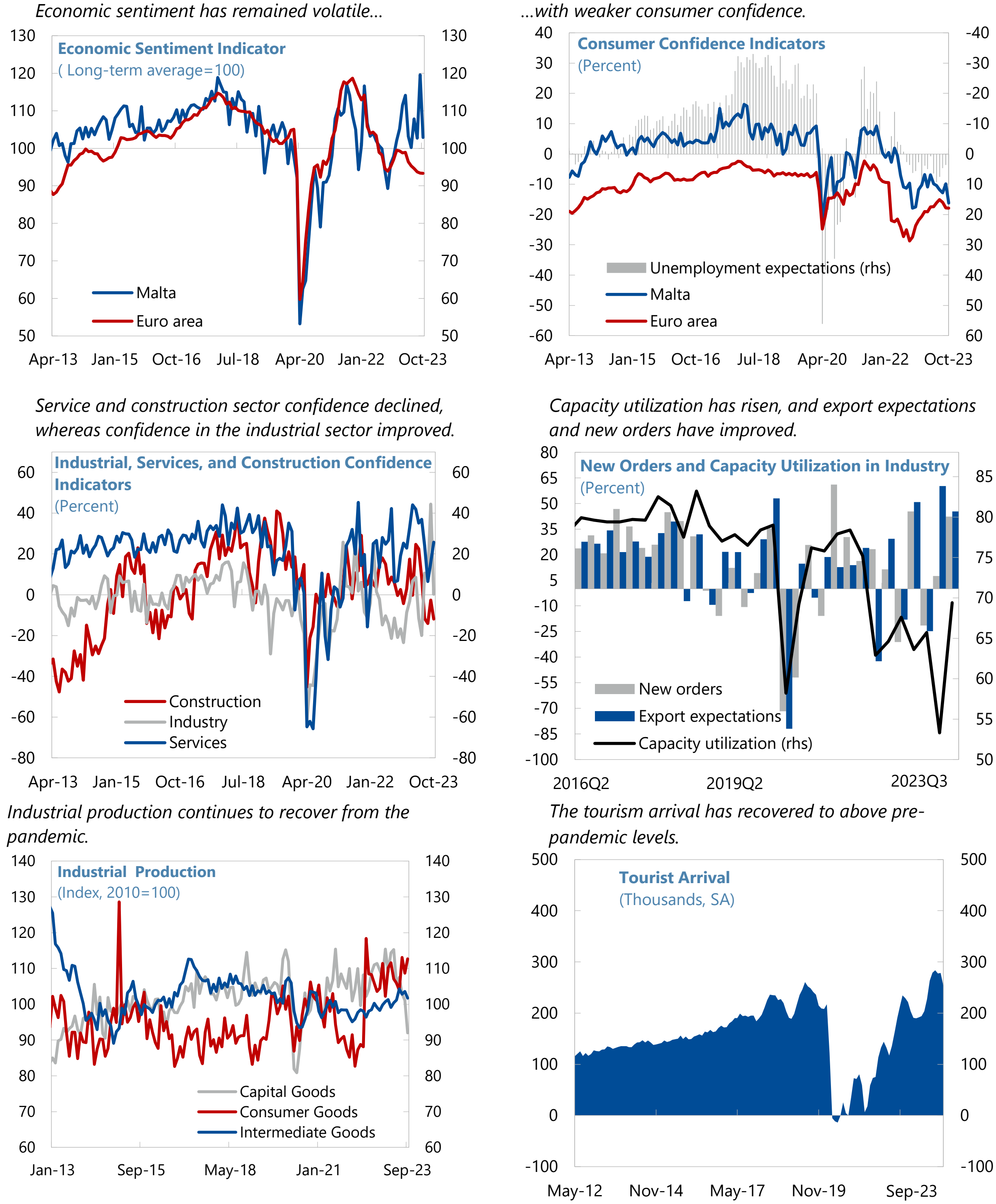
AML/CFT National Risk Assessment finds a decline in the residual risk across most sectors, including gaming and company service providers, due to more stringent mitigation measures. In light of the suspension of general public access to the beneficial ownership registry, the authorities should carefully assess its implications for the overall AML/CFT framework.

**46. The authorities should bolster their structural reform efforts to boost productivity, given increasing capacity constraints.** Malta's Recovery and Resilience Plan will deliver crucial reforms and investments in digitalization and green transition. However, more efforts are needed to promote research and innovation, address skill gaps, and strengthen education and immigrant student outcomes. There is a need to refocus Malta's economic development strategy, including assessing needs in physical and social infrastructure.

**47. Accelerating decarbonization and boosting investment in renewables will help strengthen Malta's resilience to energy shocks and its competitiveness.** It is imperative to make steady progress in implementing the 2021 Low Carbon Development Strategy and to allow greater pass-through of market energy prices to consumers to enhance energy saving and efficiency.

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

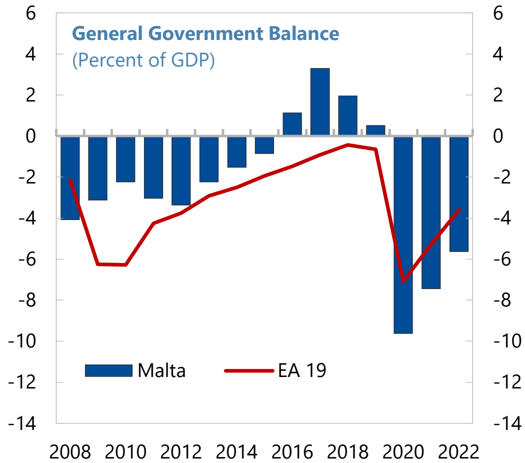
**Figure 1. Malta: Short-Term Indicators**



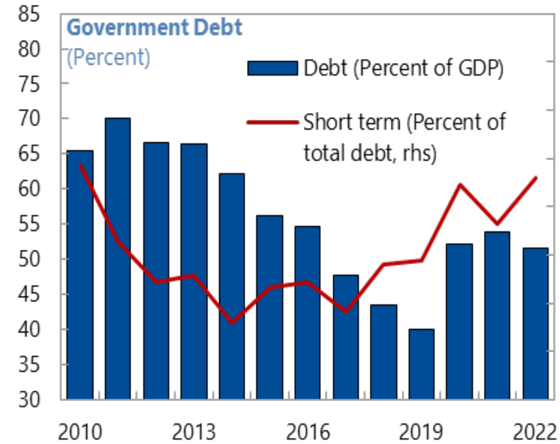

Sources: European Central Bank, Central Bank of Malta, European Commission, and IMF staff calculations.

## Figure 2. Malta: Fiscal Developments

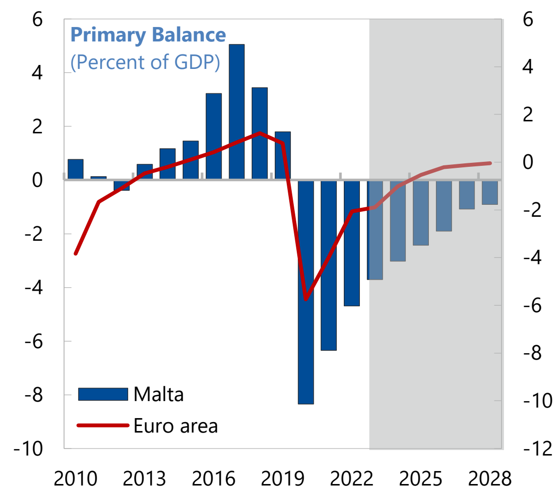
*The fiscal balance deteriorated with COVID-19 related expenditures, and more recently, energy subsidies…*



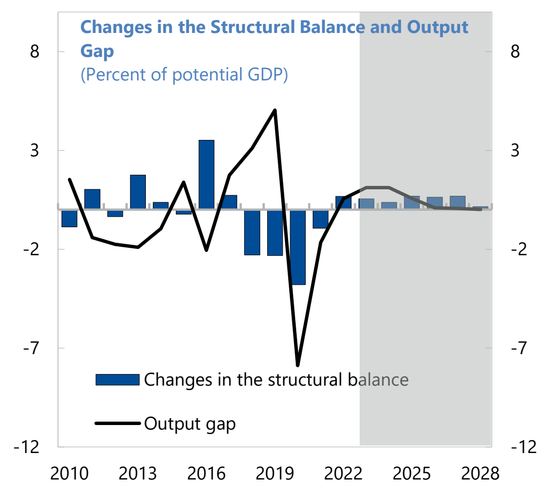

*…which led to a sharp rise in the public debt ratio.*



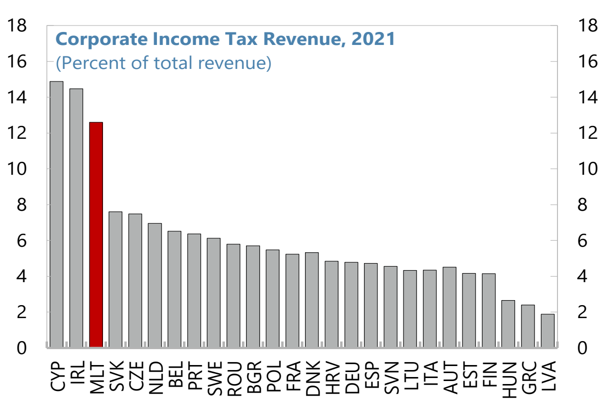

*The primary deficit will narrow gradually over the medium term…*



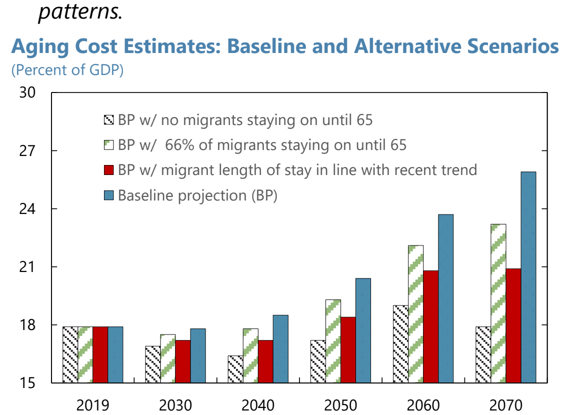

*…reflecting an improvement in the structural balance.*




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




*Age-related spending pressure will depend on migrant patterns.*

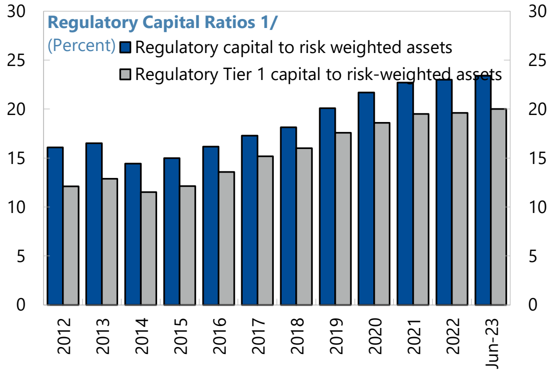



Source: Central Bank of Malta, European Commission, and IMF staff calculations.

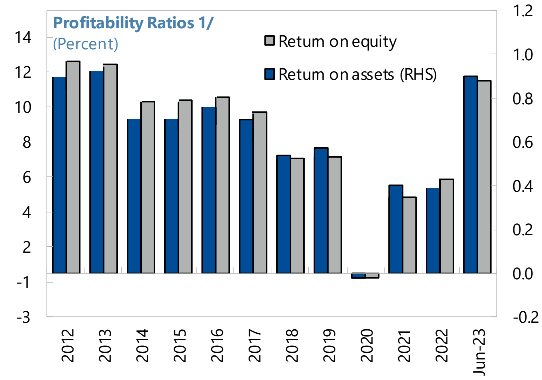
Sources: Eurostat, IMF *World Economic Outlook,* European Commission's "*The 2021 Ageing Report*", and IMF staff calculations.

## Figure 3. Malta: Financial Soundness Indicators

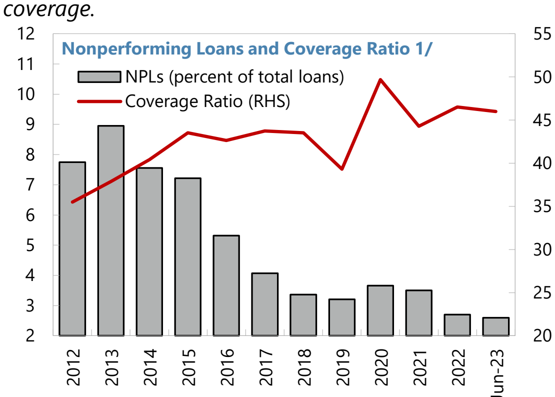
*The banking system is well capitalized…*



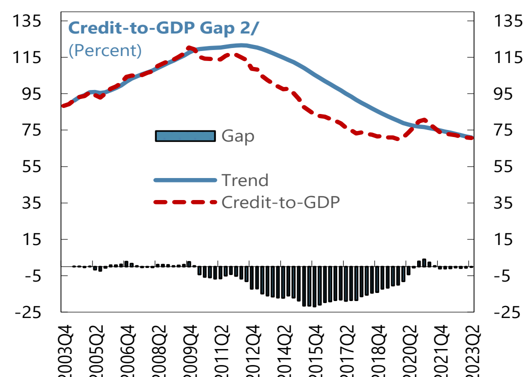

*…and bank profitability has improved.*



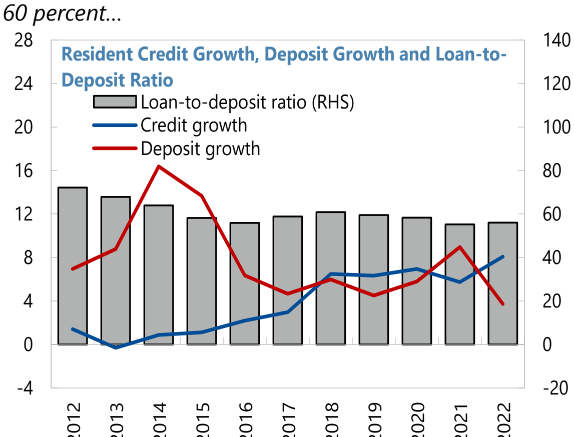

*NPL ratios are at historically low levels with adequate coverage.*



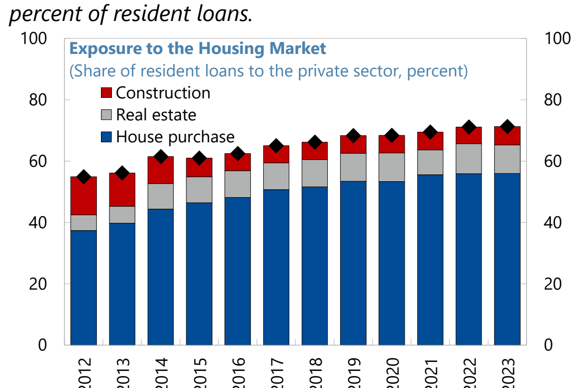

*Credit-to-GDP gaps are estimated to be small.*




*The loan-to-deposit ratio has stayed constant at around 60 percent…*




*…while bank exposures to the housing market exceed 70 percent of resident loans.*



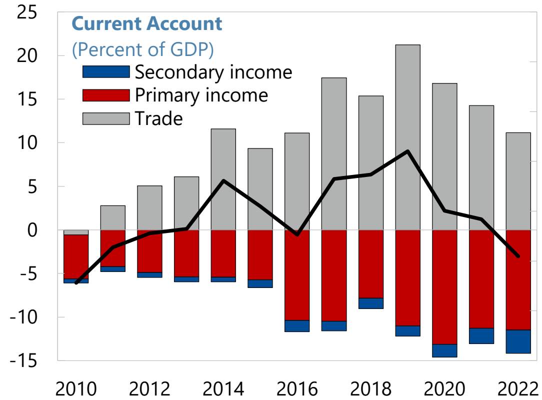

Sources: IMF *Financial Soundness Indicator,* Central Bank of Malta, Malta Financial Services Authority, and IMF staff calculations.

1/ Core domestic banks.

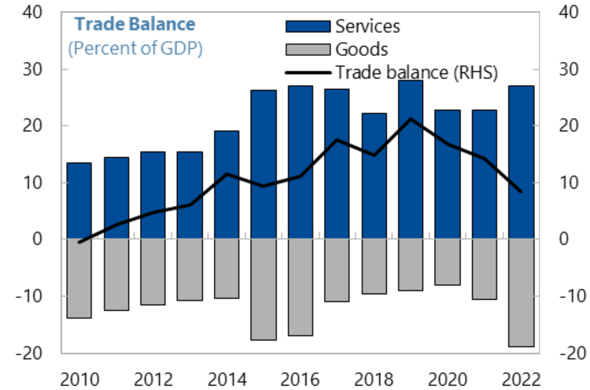
2/ The credit data encompass resident households and non-financial corporations. The credit-to-GDP gap is estimated by the BIS type gap measurement (a one-sided HP filter with a smoothing parameter of 400,000).

## Figure 4. Malta: External Sector

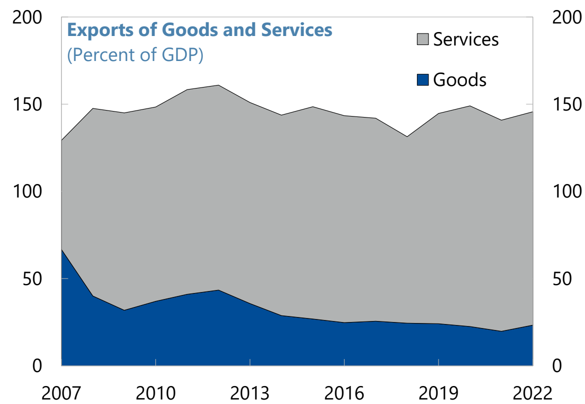
*The current account balance turned negative in 2022, with higher energy prices and increased imports.*



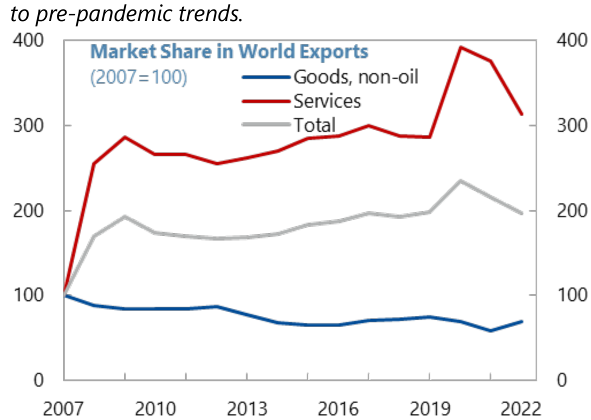

*The goods deficit widened, more than offsetting the increased services surplus.*



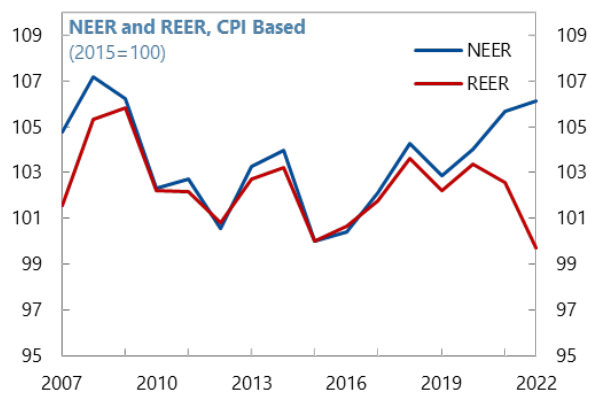

*Service exports continued to dominate total exports...*



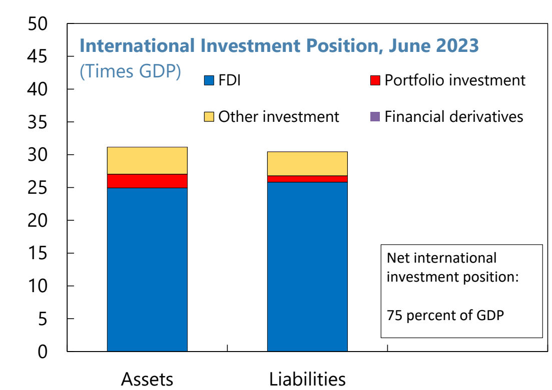

*...while market shares in both services and goods reverted to pre-pandemic trends.*




*The CPI-based REER depreciated slightly despite a nominal appreciation.*



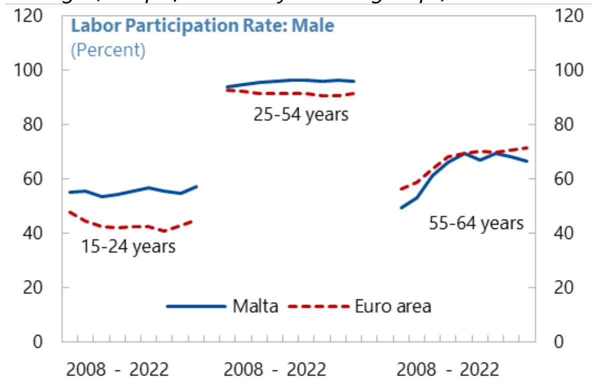

*Gross international assets and liabilities exceed 30 times GDP, with sizable foreign direct investment (FDI).*



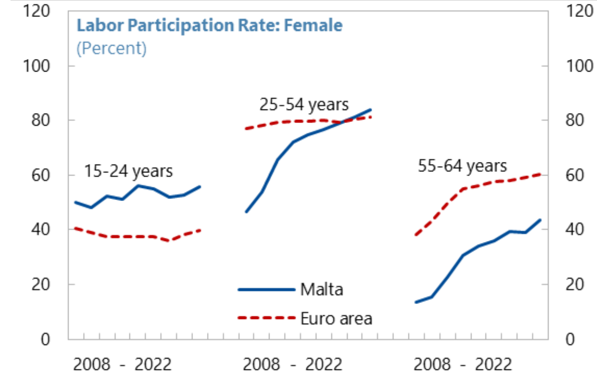

Sources: Haver Analytics, Eurostat, IMF World Economic Outlook, and IMF staff calculations.

## Figure 5. Malta: Labor Market and Income Inequality Developments

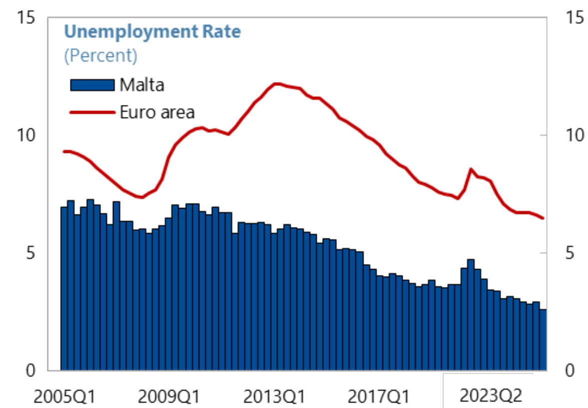
*The male participation rate is higher than the euro area average (except for 55-64-year-old groups).*



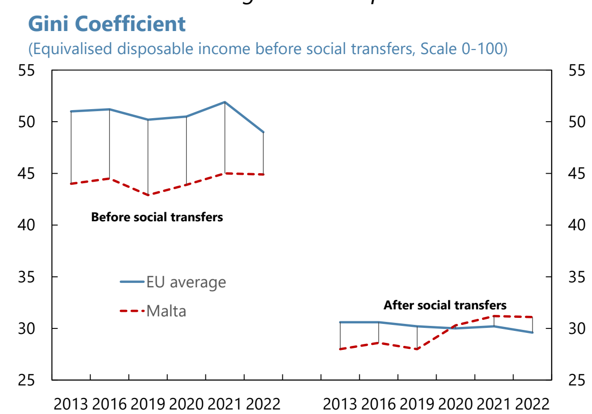

*The female participation rate (25-54 and 55-64 years old) has increased significantly over the past decade.*



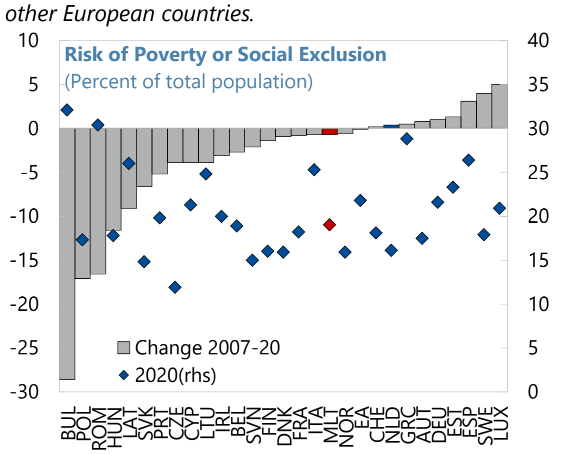

*The unemployment rate has declined to historically low levels.*



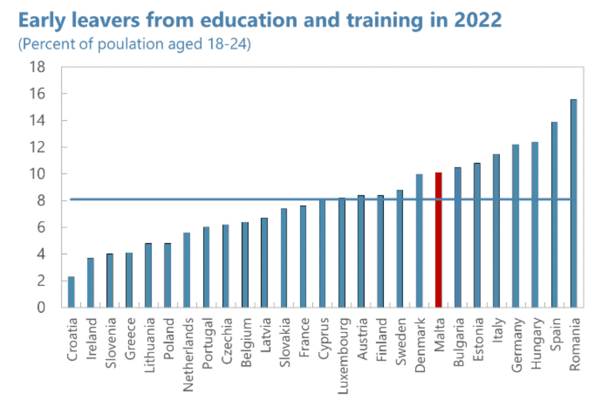

*Income inequality (after including social transfers) has exceeded the EU average since the pandemic.*




*The risk of poverty and social exclusion is comparable with other European countries.*




*The number of early school leavers is above the EU average.*




Sources: Eurostat and IMF staff calculations.

**Table 1. Malta: Selected Economic Indicators, 2020–28**

(Year on year change, unless otherwise indicated)

| | | | |
|---|---|---|---|
| Population (2022, millions): | 0.52 | Per capita income (2022, euros): | 33,496 |
| Quota (as of November 30, 2023; 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 | -8.1 | 12.6 | 8.2 | 6.2 | 5.1 | 4.0 | 3.6 | 3.5 | 3.5 |
| Domestic demand | -3.8 | 8.3 | 13.8 | -1.0 | 3.1 | 2.8 | 2.6 | 2.4 | 2.4 |
| Consumption | -4.1 | 7.6 | 8.3 | 6.7 | 3.1 | 2.9 | 2.6 | 2.4 | 2.4 |
| Private consumption | -10.7 | 8.1 | 10.8 | 7.8 | 3.2 | 3.1 | 2.8 | 2.5 | 2.5 |
| Public consumption | 14.9 | 6.5 | 2.4 | 4.0 | 3.0 | 2.5 | 2.2 | 2.2 | 2.2 |
| Fixed investment | -5.9 | 12.5 | 31.4 | -20.0 | 3.0 | 2.5 | 2.5 | 2.5 | 2.5 |
| Exports of goods and services | -1.8 | 7.7 | 7.1 | 5.6 | 4.0 | 2.9 | 2.5 | 2.3 | 2.3 |
| Imports of goods and services | 1.5 | 4.9 | 10.1 | 1.4 | 2.7 | 2.1 | 1.7 | 1.5 | 1.5 |
| Contribution to growth | | | | | | | | | |
| Foreign balance | -5.2 | 5.5 | -3.3 | 7.1 | 2.6 | 1.7 | 1.5 | 1.6 | 1.6 |
| Exports of goods and services | -3.0 | 13.5 | 12.0 | 9.4 | 6.6 | 4.7 | 4.0 | 3.7 | 3.7 |
| Imports of goods and services | -2.2 | -8.1 | -15.4 | -2.2 | -4.0 | -3.0 | -2.5 | -2.1 | -2.1 |
| Potential GDP growth | 4.7 | 5.4 | 5.8 | 5.6 | 5.1 | 4.6 | 4.1 | 3.5 | 3.4 |
| Output gap (% potential GDP) | -7.9 | -1.6 | 0.6 | 1.1 | 1.1 | 0.6 | 0.1 | 0.1 | 0.0 |
| **Prices and employment** | | | | | | | | | |
| HICP (period average) | 0.8 | 0.7 | 6.1 | 5.8 | 2.9 | 2.1 | 2.0 | 2.0 | 2.0 |
| GDP deflator | 1.7 | 2.0 | 5.3 | 3.7 | 2.5 | 2.1 | 2.1 | 2.0 | 1.9 |
| Unemployment rate (EU harmonized) | 4.4 | 3.4 | 2.9 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| Employment growth | 2.7 | 3.1 | 5.2 | 4.4 | 4.0 | 3.5 | 3.1 | 3.0 | 3.0 |
| **Savings and investment** (% GDP) | | | | | | | | | |
| Gross national savings | 24.0 | 22.6 | 23.0 | 21.8 | 22.1 | 21.9 | 21.7 | 21.5 | 21.2 |
| Gross capital formation | 21.8 | 21.4 | 25.9 | 19.9 | 19.5 | 19.2 | 19.0 | 18.8 | 18.6 |
| **Public finance** (% GDP) | | | | | | | | | |
| Net lending/borrowing (overall balance) | -9.6 | -7.4 | -5.6 | -4.8 | -4.4 | -4.0 | -3.6 | -2.9 | -2.8 |
| Structural overall balance (% potential GDP) | -5.7 | -6.6 | -5.9 | -5.4 | -5.0 | -4.3 | -3.7 | -3.0 | -2.8 |
| Revenue | 35.7 | 35.5 | 33.7 | 35.0 | 34.0 | 33.6 | 33.3 | 33.3 | 33.3 |
| Expenditure | 45.3 | 42.9 | 39.3 | 39.9 | 38.5 | 37.7 | 37.0 | 36.2 | 36.1 |
| General government debt | 52.2 | 53.9 | 51.6 | 52.2 | 54.5 | 55.9 | 57.2 | 57.1 | 56.9 |
| **Balance of payments** (% GDP) | | | | | | | | | |
| Current account balance | 2.2 | 1.2 | -3.0 | 1.9 | 2.5 | 2.7 | 2.7 | 2.7 | 2.6 |
| Trade balance (Goods and services) | 16.8 | 14.2 | 11.0 | 15.9 | 16.5 | 16.7 | 16.7 | 16.7 | 16.6 |
| Goods balance | -9.2 | -12.6 | -18.2 | -12.1 | -11.4 | -10.6 | -10.4 | -10.2 | -10.0 |
| Services balance | 25.9 | 26.8 | 29.2 | 28.0 | 27.9 | 27.3 | 27.1 | 26.8 | 26.6 |
| Primary income, net | -13.1 | -11.3 | -11.3 | -11.3 | -11.3 | -11.3 | -11.3 | -11.3 | -11.3 |
| Secondary income, net | -1.5 | -1.8 | -2.6 | -2.6 | -2.6 | -2.6 | -2.6 | -2.6 | -2.6 |
| Financial account, net | -2.0 | 4.2 | -0.4 | 2.6 | 3.2 | 3.4 | 3.4 | 3.3 | 3.3 |
| Of which: reserves ( - inflow; + outflow) | -0.3 | -0.3 | 0.6 | ... | ... | ... | ... | ... | ... |
| ***Memorandum items:*** | | | | | | | | | |
| Nominal GDP (millions of euros) | 13,352 | 15,327 | 17,450 | 19,227 | 20,731 | 22,014 | 23,283 | 24,589 | 25,937 |
| Nominal GDP growth | -6.6 | 14.8 | 13.9 | 10.2 | 7.8 | 6.2 | 5.8 | 5.6 | 5.5 |

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, 2020–28**
(Percent of GDP, unless otherwise indicated)

| | | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 |
| Revenue | 35.7 | 35.5 | 33.7 | 35.0 | 34.0 | 33.6 | 33.3 | 33.3 | 33.3 |
| Taxes | 23.3 | 23.8 | 23.3 | 24.0 | 23.8 | 23.7 | 23.5 | 23.5 | 23.5 |
| Indirect taxes | 10.4 | 10.2 | 10.3 | 10.5 | 10.5 | 10.4 | 10.4 | 10.4 | 10.4 |
| Direct taxes | 12.7 | 13.4 | 12.9 | 13.2 | 13.1 | 13.0 | 12.9 | 12.9 | 12.9 |
| Other taxes (capital taxes) | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Social contributions | 6.3 | 6.0 | 5.7 | 5.6 | 5.5 | 5.4 | 5.4 | 5.3 | 5.3 |
| Grants and capital revenue | 1.6 | 1.1 | 0.9 | 1.0 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| Other revenue | 4.5 | 4.5 | 3.8 | 4.6 | 3.9 | 3.8 | 3.7 | 3.7 | 3.7 |
| Expenditure | 45.3 | 42.9 | 39.3 | 39.9 | 38.5 | 37.7 | 37.0 | 36.2 | 36.1 |
| Expense | 41.0 | 39.0 | 36.0 | 35.4 | 34.6 | 33.5 | 32.3 | 31.9 | 31.9 |
| Compensation of employees | 11.9 | 11.6 | 10.5 | 10.5 | 10.4 | 10.5 | 10.4 | 10.3 | 10.3 |
| Use of goods and services | 8.9 | 8.6 | 7.7 | 8.1 | 7.7 | 7.3 | 7.2 | 7.1 | 7.1 |
| Interest | 1.3 | 1.1 | 0.9 | 1.1 | 1.4 | 1.6 | 1.7 | 1.9 | 1.9 |
| Subsidies | 5.1 | 4.6 | 4.8 | 3.8 | 3.3 | 2.8 | 2.0 | 1.9 | 1.8 |
| Social benefits | 10.1 | 9.1 | 8.5 | 8.5 | 8.5 | 8.5 | 8.5 | 8.4 | 8.4 |
| Other expense | 3.7 | 4.1 | 3.6 | 3.4 | 3.3 | 2.7 | 2.5 | 2.4 | 2.4 |
| Net acquisition of nonfinancial assets | 4.3 | 3.9 | 3.3 | 4.5 | 3.8 | 4.2 | 4.7 | 4.3 | 4.2 |
| Gross operating balance | -5.4 | -3.6 | -2.3 | -0.3 | -0.6 | 0.2 | 1.1 | 1.3 | 1.3 |
| Net lending/borrowing (overall balance | -9.6 | -7.4 | -5.6 | -4.8 | -4.4 | -4.0 | -3.6 | -2.9 | -2.8 |
| Memorandum items: | | | | | | | | | |
| Overall balance excl. one-offs | -9.7 | -7.4 | -5.6 | -4.8 | -4.4 | -4.0 | -3.6 | -2.9 | -2.8 |
| Structural balance 1/ | -5.7 | -6.6 | -5.9 | -5.4 | -5.0 | -4.3 | -3.7 | -3.0 | -2.8 |
| Cyclically adjusted primary balance | -4.4 | -5.5 | -5.0 | -4.3 | -3.6 | -2.7 | -2.0 | -1.1 | -0.9 |
| Structural primary balance 1/ | -4.4 | -5.5 | -5.0 | -4.3 | -3.6 | -2.7 | -2.0 | -1.1 | -0.9 |
| Primary balance | -8.3 | -6.3 | -4.7 | -3.7 | -3.0 | -2.4 | -1.9 | -1.1 | -0.9 |
| Public debt | 52.2 | 53.9 | 51.6 | 52.2 | 54.5 | 55.9 | 57.2 | 57.1 | 56.9 |
| Government guaranteed debt | 8.9 | 7.9 | 6.6 | 6.0 | 5.4 | 5.2 | 5.1 | 5.2 | 5.2 |
| Nominal GDP (millions of euros) | 13,352 | 15,327 | 17,450 | 19,227 | 20,731 | 22,014 | 23,283 | 24,589 | 25,937 |

Sources: Maltese authorities, and IMF staff projections.

1/ As a percentage of nominal potential GDP.

## Table 3. Malta: Financial Soundness Indicators, 2019–23[1]

(Percent, unless otherwise indicated)

| | Core Domestic Banks | | | | | Non-Core Domestic Banks | | | | | International Banks 2/ | | | | | Total Banks 2/ | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2022 | 2023Q2 | 2019 | 2020 | 2021 | 2022 | 2023Q2 | 2019 | 2020 | 2021 | 2022 | 2023Q2 | 2019 | 2020 | 2021 | 2022 | 2023Q2 |
| **Capital /3** | | | | | | | | | | | | | | | | | | | | |
| Regulatory capital to risk-weighted assets | 20.1 | 21.7 | 22.7 | 23.0 | 23.4 | 19.2 | 20.2 | 20.3 | 20.4 | 20.9 | 45.7 | 52.5 | 46.3 | 41.1 | 41.8 | 23.6 | 25.8 | 25.6 | 24.9 | 25.2 |
| Regulatory tier 1 capital to risk-weighted assets | 17.6 | 18.6 | 19.4 | 19.6 | 20.0 | 18.9 | 19.9 | 20.0 | 19.3 | 19.8 | 45.6 | 52.4 | 46.3 | 40.7 | 41.5 | 21.7 | 23.4 | 23.1 | 22.1 | 22.4 |
| Leverage ratio | 7.8 | 7.6 | 7.3 | 7.2 | 7.4 | 11.0 | 9.5 | 10.0 | 9.5 | 9.4 | 36.4 | 42.4 | 34.2 | 32.3 | 28.0 | 10.6 | 10.5 | 9.6 | 9.0 | 9.0 |
| Large exposures to total own funds | 75.9 | 69.6 | 67.7 | 83.3 | 86.5 | 140.7 | 175.8 | 173.4 | 184.7 | 124.3 | 88.5 | 83.3 | 67.9 | 75.6 | 68.2 | 85.7 | 81.8 | 76.4 | 91.6 | 86.7 |
| Risk-weighted assets to total assets | 46.2 | 42.9 | 39.1 | 38.0 | 38.3 | 61.1 | 49.0 | 50.9 | 50.5 | 49.2 | 84.5 | 82.8 | 74.9 | 10.8 | 60.3 | 50.9 | 46.6 | 43.0 | 41.5 | 41.1 |
| **Profitability** | | | | | | | | | | | | | | | | | | | | |
| Return on assets /4 | 0.6 | 0.0 | 0.4 | 0.4 | 0.8 | 1.3 | -1.5 | 0.2 | -0.4 | -0.2 | 1.1 | 2.2 | 1.5 | 2.6 | 3.0 | 0.8 | 0.6 | 0.7 | 0.9 | 1.2 |
| Return on equity /3,4 | 6.7 | -0.3 | 4.3 | 5.4 | 11.0 | 11.0 | -12.7 | 2.4 | -3.4 | -1.7 | 5.8 | 6.2 | 11.6 | 6.2 | 10.7 | 6.8 | 0.4 | 6.0 | 4.6 | 9.5 |
| Operational cost-to-income ratio | 66.3 | 68.1 | 75.2 | 82.3 | 56.3 | 47.0 | 95.8 | 82.2 | 81.0 | 76.7 | 39.9 | 35.1 | 47.2 | 45.1 | 49.5 | 53.9 | 51.7 | 61.8 | 63.1 | 54.1 |
| Interest margin to gross income | 63.7 | 73.2 | 72.1 | 71.8 | 77.3 | 31.5 | 48.9 | 40.9 | 54.0 | 67.0 | 56.1 | 64.8 | 55.9 | 50.0 | 44.0 | 58.0 | 67.8 | 62.4 | 59.7 | 61.0 |
| Non-interest expense to gross income | 67.8 | 70.0 | 77.0 | 83.2 | 56.9 | 47.1 | 97.5 | 83.4 | 81.3 | 76.4 | 39.9 | 35.2 | 47.3 | 45.1 | 49.5 | 54.7 | 52.7 | 62.7 | 63.5 | 54.4 |
| Personnel expenses to non-interest expenses | 43.8 | 45.8 | 41.2 | 36.4 | 47.9 | 50.2 | 48.3 | 48.5 | 47.3 | 47.1 | 65.5 | 61.6 | 57.3 | 56.7 | 56.2 | 34.6 | 34.2 | 30.3 | 27.4 | 31.0 |
| Non-interest income to gross income | 36.3 | 26.8 | 27.9 | 28.2 | 22.7 | 68.6 | 51.1 | 59.1 | 46.0 | 33.0 | 43.9 | 35.2 | 44.8 | 50.0 | 56.0 | 42.0 | 32.3 | 37.3 | 40.3 | 39.1 |
| Net impairment charges to gross income | 0.1 | 29.2 | -3.4 | -11.5 | -7.4 | 12.8 | 79.5 | 6.3 | 35.2 | 28.4 | 24.2 | 18.7 | 18.9 | 14.8 | 14.6 | 11.0 | 25.6 | 8.1 | 4.4 | 4.9 |
| **Asset quality** | | | | | | | | | | | | | | | | | | | | |
| Non-performing loans to total own funds /3 | 25.1 | 28.9 | 29.4 | 21.5 | 20.7 | 34.8 | 53.1 | 34.2 | 27.8 | 18.5 | 15.9 | 13.2 | 12.1 | 11.5 | 12.5 | 23.5 | 26.4 | 25.7 | 20.1 | 18.9 |
| Non-performing loans to total gross loans | 3.2 | 3.7 | 3.5 | 2.7 | 2.6 | 5.4 | 7.1 | 5.1 | 4.3 | 2.8 | 1.8 | 1.9 | 1.4 | 1.3 | 1.3 | 3.0 | 3.5 | 3.1 | 2.5 | 2.3 |
| Non-performing exposures to total gross exposures | 2.5 | 2.8 | 2.7 | 2.0 | 1.9 | 4.6 | 5.6 | 3.8 | 3.0 | 2.0 | 1.3 | 1.3 | 1.0 | 0.9 | 0.8 | 2.2 | 2.6 | 2.4 | 1.8 | 1.7 |
| Total coverage ratio /5 | 39.3 | 49.7 | 44.3 | 46.5 | 46.0 | 41.0 | 47.6 | 59.8 | 72.7 | 68.1 | 78.4 | 91.4 | 147.5 | 189.6 | 182.1 | 46.8 | 55.2 | 57.9 | 66.1 | 65.4 |
| Unsecured loans to total lending | 25.1 | 23.2 | 20.1 | 18.7 | 18.4 | 77.6 | 80.8 | 71.9 | 55.3 | 54.4 | 22.4 | 19.7 | 77.6 | 23.5 | 25.3 | 27.1 | 25.6 | 23.8 | 22.4 | 22.4 |
| Share of Stage 3 provisions to total provisions | 71.9 | 66.7 | 70.2 | 69.6 | 68.6 | 91.4 | 93.0 | 90.2 | 88.3 | 80.1 | 48.3 | 44.6 | 27.9 | 26.5 | 30.0 | 67.1 | 65.1 | 60.5 | 58.4 | 56.1 |
| Forbearance ratio to gross loans | 2.4 | 3.0 | 4.5 | 3.5 | 2.9 | 0.9 | 0.5 | 0.8 | 0.6 | 0.6 | 3.7 | 3.3 | 7.4 | 7.5 | 1.1 | 2.7 | 2.9 | 4.9 | 4.1 | 2.3 |
| **Liquidity** | | | | | | | | | | | | | | | | | | | | |
| Liquidity coverage ratio /3 | 343.7 | 328.2 | 359.9 | 380.0 | 394.8 | 374.7 | 325.4 | 356.8 | 316.0 | 344.6 | 303.0 | 686.6 | 2469.6 | 383.7 | 385.3 | 345.4 | 332.7 | 379.0 | 373.8 | 387.3 |
| Liquid assets to total assets /3 /6 | 31.0 | 33.3 | 35.6 | 36.3 | 35.8 | 36.2 | 40.3 | 33.2 | 30.8 | 34.2 | 12.7 | 11.8 | 27.3 | 26.9 | 35.4 | 29.9 | 32.3 | 34.7 | 35.1 | 35.6 |
| Customer loans to customer deposits | 59.5 | 58.4 | 55.2 | 56.0 | 58.0 | 46.6 | 46.5 | 52.2 | 54.4 | 49.4 | 376.6 | 462.3 | 267.0 | 231.1 | 185.2 | 79.3 | 75.4 | 67.5 | 67.2 | 66.5 |
| Counterbalancing capacity on net cash outflows | 139.0 | 169.9 | 189.3 | 251.0 | 263.2 | 245.4 | 238.1 | 300.8 | 240.7 | 256.1 | 116.1 | 326.3 | 601.9 | 58.6 | 63.7 | 149.5 | 180.2 | 204.0 | 239.8 | 246.8 |
| Net stable funding ratio /3 | | | 174.0 | 187.1 | 182.2 | | | 178.4 | 174.2 | 202.9 | | | 155.3 | 118.4 | 132.9 | | | 172.8 | 180.4 | 179.8 |
| **Balance sheet** | | | | | | | | | | | | | | | | | | | | |
| Assets to GDP | 172.9 | 192.8 | 181.6 | 165.2 | 158.4 | 20.6 | 22.8 | 22.1 | 19.9 | 19.5 | 121.4 | 86.7 | 74.7 | 58.7 | 62.0 | 309.1 | 302.3 | 278.5 | 243.8 | 240.0 |
| Domestic debt securities to total assets | 6.4 | 8.3 | 8.8 | 9.4 | 8.2 | 2.9 | 7.2 | 7.9 | 7.9 | 7.9 | 0.0 | 0.1 | 0.2 | 0.2 | 0.1 | 4.1 | 5.9 | 6.4 | 7.1 | 6.1 |
| Foreign debt securities to total assets | 15.4 | 13.8 | 12.4 | 16.5 | 17.2 | 10.7 | 12.2 | 15.9 | 18.0 | 16.5 | 26.4 | 25.2 | 24.0 | 29.8 | 32.3 | 18.7 | 16.9 | 15.8 | 19.8 | 21.0 |
| Customer loans to total assets | 48.0 | 48.2 | 45.4 | 47.2 | 48.4 | 33.1 | 33.2 | 34.5 | 38.2 | 36.6 | 43.4 | 43.9 | 36.9 | 41.6 | 34.3 | 45.4 | 45.8 | 42.3 | 45.1 | 43.8 |
| Interbank exposures to total assets | 6.2 | 5.3 | 4.9 | 4.9 | 4.4 | 14.7 | 9.7 | 9.4 | 7.2 | 6.5 | 13.5 | 12.3 | 17.8 | 10.0 | 14.9 | 9.2 | 7.6 | 8.7 | 6.3 | 7.3 |

Source: Central Bank of Malta.

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

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

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

4/ Based on profit after tax.

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

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

## Table 4. Malta: Balance of Payments, 2020–28
(Percent of GDP, unless otherwise indicated)

| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Projections | | | | | |
| Current account balance | 2.2 | 1.2 | -3.0 | 1.9 | 2.5 | 2.7 | 2.7 | 2.7 | 2.6 |
| Trade balance (Goods and services) | 16.8 | 14.2 | 11.0 | 15.9 | 16.5 | 16.7 | 16.7 | 16.7 | 16.6 |
| Goods balance | -9.2 | -12.6 | -18.2 | -12.1 | -11.4 | -10.6 | -10.4 | -10.2 | -10.0 |
| Exports | 22.6 | 19.8 | 23.3 | 23.2 | 23.0 | 23.1 | 22.7 | 22.4 | 22.1 |
| Imports | 31.8 | 32.4 | 41.6 | 35.3 | 34.4 | 33.7 | 33.2 | 32.6 | 32.0 |
| Services balance | 25.9 | 26.8 | 29.2 | 28.0 | 27.9 | 27.3 | 27.1 | 26.8 | 26.6 |
| Exports | 126.5 | 121.1 | 122.3 | 120.3 | 117.7 | 115.5 | 113.7 | 111.9 | 110.3 |
| Imports | 100.5 | 94.3 | 93.1 | 92.3 | 89.8 | 88.2 | 86.6 | 85.1 | 83.7 |
| Primary income, net | -13.1 | -11.3 | -11.3 | -11.3 | -11.3 | -11.3 | -11.3 | -11.3 | -11.3 |
| Secondary income, net | -1.5 | -1.8 | -2.6 | -2.6 | -2.6 | -2.6 | -2.6 | -2.6 | -2.6 |
| Private | -1.4 | -1.7 | -2.6 | -2.6 | -2.6 | -2.6 | -2.6 | -2.6 | -2.6 |
| 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 | 1.5 | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Financial account, net | -2.0 | 4.2 | -0.4 | 2.6 | 3.2 | 3.4 | 3.4 | 3.3 | 3.3 |
| Direct investment | -73.1 | -64.0 | 24.8 | 24.8 | 24.8 | 24.8 | 24.8 | 24.8 | 24.8 |
| Portfolio investment | 48.0 | 45.8 | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 |
| Assets | 50.3 | 48.3 | 11.7 | 11.7 | 11.7 | 11.7 | 11.7 | 11.7 | 11.7 |
| Liabilities | 2.3 | 2.4 | 7.9 | 7.9 | 7.9 | 7.9 | 7.9 | 7.9 | 7.9 |
| Other investment | 24.3 | 24.5 | -29.0 | -25.4 | -24.8 | -24.6 | -24.6 | -24.6 | -24.7 |
| Assets | 20.0 | 32.1 | -8.9 | -8.9 | -8.9 | -8.9 | -8.9 | -8.9 | -8.9 |
| Liabilities | -4.3 | 7.6 | 20.1 | 16.5 | 15.9 | 15.7 | 15.7 | 15.8 | 15.8 |
| Reserves ( - inflow; + outflow) | -0.3 | -0.3 | 0.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Errors and omissions | -4.9 | 2.0 | 1.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Memorandum items: | | | | | | | | | |
| Gross external debt (Percent of GDP) 1/ | 661.9 | 606.8 | 546.5 | 497.9 | 464.3 | 440.0 | 418.7 | 399.1 | 381.0 |
| Net external debt (Percent of GDP) 1/ | -162.8 | -136.8 | -113.2 | -113.6 | -114.3 | -115.0 | -115.7 | -116.5 | -117.3 |
| Services Export: Travel (Percent of GDP) | 2.6 | 3.9 | 7.8 | 8.1 | ... | ... | ... | ... | ... |
| Services Export: Non-Travel (Percent of GDP) | 123.9 | 117.2 | 114.5 | 112.2 | ... | ... | ... | ... | ... |

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

1/ The data revision that the National Statistics Office announced on June 13, 2023 is not reflected.

# Annex I. Implementation of IMF Recommendations

| 2022 Article IV Advice | Actions Since 2022 Article IV |
|---|---|
| **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. | Ongoing. |
| Consider introducing a sectoral systemic risk buffer to target systemic risks arising from mortgages. | Implemented. In March 2023, the authorities introduced a sectoral systemic capital buffer (SSyRB) targeting residential mortgage exposures, initially set at one percent from end-September 2023 and thereafter at 1.5 percent from end-March 2024. |
| Keep close monitoring of high AML/CFT-related risk sectors. | Ongoing. |
| **Fiscal Policy** | |
| Prepare an exit strategy from the current fixed energy price policy while protecting vulnerable groups. | Not implemented. |
| Tighten the fiscal stance in 2023 to lower inflationary pressure and improve public finances and take additional measures to mobilize revenues and enhance spending efficiency over the medium term. | Underway. The structural deficit is expected to narrow from 6 percent of GDP to 5½ percent of GDP in 2023. |
| 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. | Underway. In light of the EU's adoption of the Minimum Tax Directive (Pillar II), the authorities are exploring options to reform the CIT system by leveraging IMF technical assistance. |
| Improve public investment management framework and rationalize recurrent spending to achieve a credible medium-term consolidation. | Ongoing. The authorities have requested public investment management assessment TA from the IMF. |
| **Structural Reforms** | |
| Address the skills gap in the workforce and foster labor force participation. | Ongoing. |
| Promote digitalization and advance green investment and decarbonization. | Ongoing, including as a part of Malta's Recovery and Resilience Plan. |
| Complete the comprehensive insolvency reform plan. | Implemented. The new Insolvency Practitioners Act and Pre-Restructuring Act were enacted in December 2022. |

# Annex II. Energy and Other Support Measures in Response to Russia's War in Ukraine

| Measures | Details | Effective Period |
|---|---|---|
| Energy Support Measures | Measures aim at supporting companies and households by stabilizing the price of gas, petroleum, and electricity, which was at 2½ percent of GDP in 2022 and is projected at 1½ percent of GDP in 2023. | March 2022–in place |
| Subsidized Loans Scheme (SLS) | A scheme to support companies active in the importation, manufacturing, and wholesale trading/supply 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 direct subsidized loans. The size of the SLS is 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. The MDB provided three loans amounting to €14.2 million (as of end-March 2023). | May 2022–in place |
| Liquidity Support Guarantee Scheme–Measure A (LSGS-A) | 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 MDB provides a guarantee covering 90 percent of each new individual loan, capped at 50 percent of the portfolio. The size of the LSGS-A is up to €100 million. The last date for inclusion of loans is December 31, 2022, with a term of the loan of up to 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. The MDB issued a guarantee for one loan amounting to €24.5 million (as of end–March 2023). | May 2022–in place |
| Liquidity Support Guarantee Scheme–Measure B (LSGS-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 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

***Overall Assessment:*** *Malta's external position in 2023 is expected to be broadly in line with the level implied by medium-term fundamentals and desirable policies. The current account (CA) is expected to turn positive in 2023, reflecting lower energy and import prices and a decrease in imports and continue to gradually improve over the medium term. However, this assessment is subject to uncertainty, given possible revisions to historical external sector statistics.*

***Potential Policy Responses:*** *Malta's current account balance is expected to improve as external demand and net exports continue to recover from the pandemic crisis, alongside lower energy prices. The country's large positive NIIP significantly mitigates external vulnerabilities. Policies to maintain the external position in line with fundamentals include (i) advancing the fiscal consolidation to safeguard fiscal sustainability, (ii) exiting gradually from the current fixed energy price policy while protecting vulnerable groups, and (iii) boosting structural reform efforts to strengthen productivity and investment, including climate- and digital-related.*

## Foreign Assets and Liabilities: Position and Trajectory

**Background.** Malta has maintained large net asset positions over the past decade, with sizable gross assets and liabilities. The net international investment position is expected to remain flat at 77 percent of GDP in 2023 (78 percent of GDP in 2022). Gross assets and liabilities are sizable at around 32 and 31 times GDP, respectively.

**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. However, the majority of the liabilities are direct investments, and the sizable gross asset position mitigates risks.

| | | | | | |
|---|---|---|---|---|---|
| 2023 (% GDP) | NIIP: 77.1 | Gross Assets: 3,220 | Debt Assets: - | Gross Liab.: 3,143 | Debt Liab.: - |

## Current Account

**Background.** The CA balance turned from a surplus of 1¼ percent of GDP in 2021 to a deficit of 3 percent in 2022. The goods deficit widened sharply due to higher energy prices and the import of aircraft equipment. This was partially offset by a widening surplus in services, reflecting continued strong export growth of tourism, remote gaming, and information and communication technology services. For the first half of 2023, preliminary estimates suggest some improvement due to continued robust services exports, and the CA is expected to turn into a surplus of 1.9 percent of GDP in 2023. Over the medium term, the CA is expected to continue to improve as energy prices come down and external demand recovers.

**Assessment.** Taking into account cyclical contributions (-0.2 percent of GDP), the actual CA (1.9 percent of GDP) is adjusted to 2.1 percent of GDP. The tourism sector has recovered to above pre-pandemic levels. The EBA-lite CA model suggests a CA norm of -1.3 percent of GDP. The norm is adjusted by 2.4 percentage points to 1.1 percent by removing the negative contribution of the remittance variable in the EBA-lite model, as it is less relevant for Malta (a high-income country where remittances can have a positive impact on the CA). As a result, the CA gap is estimated at 1.0 percent of GDP, with an implied REER gap of -0.9 percent of GDP. Relative policy gaps contribute 1.9 percentage points to the CA gap (the contribution of domestic policy gaps is -1.6 percentage points of GDP).

| | | | | | | |
|---|---|---|---|---|---|---|
| 2023 (% GDP) | Actual CA: 1.9 | Adj. CA: 2.1 | CA Norm: -1.3 | Adj. Norm: 1.1 | CA gap: 1.0 | Policy Gap: 1.9 |

### Real Exchange Rate

**Background.** The CPI-based REER appreciated by 5.0 percent during the first three quarters of 2023, following a depreciation of 4.2 percent in 2022.

**Assessment.** The EBA-lite CA model indicates a REER undervaluation of about 0.9 percent for 2023.

| | | | |
|---|---|---|---|
| Actual REER: 4.0 | REER Norm: 4.6 | REER gap: -9.4 | Implied REER gap (from CA model): -0.9 |

### Capital and Financial Accounts: Flows and Policy Measures

**Background.** The capital account is expected to record a surplus of 0.7 percent of GDP in 2023, and the financial account balance is expected to turn into a surplus of 0.4 percent, with positive contribution from net FDI inflows more than offsetting net other investment outflows.

**Assessment.** As net external demand recovers, Malta's financial account balance is expected to return to pre-pandemic levels by 2027.

### FX Intervention and Reserves Level

**Background and Assessment.** The euro (free-floating) is a global reserve currency. Reserves held by the euro area are typically low relative to standard metrics.

# Annex IV. Risk Assessment Matrix[1]

| Source of risks | Relative Likelihood | Impact if realized | Policy response |
|---|---|---|---|
| **Global Risks** | | | |
| **Intensification of regional conflict(s).** Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, FDI and financial flows, and payment systems and lead to refugee flows. | High | **Medium.** The direct impact of the war would be limited. However, as a small, open island economy, Malta's growth and inflation would be adversely affected by a slowdown in the global economy and higher commodity prices. | Provide targeted fiscal and financial support measures. Maintain structural reform momentum to spur investment and promote higher productivity growth. |
| **Abrupt global slowdown or recession.** Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn. In Europe, intensifying fallout from the war in Ukraine, recurrent energy crises and supply disruptions, and monetary tightening exacerbate economic downturns and housing and commercial real estate market corrections. | Medium | **Medium.** As a small, open island economy, Malta is exposed to external shocks, including global economic downturns. Malta's export demand, including tourism, will weaken, affecting overall growth. | Same as above. |
| **Monetary policy miscalibration.** Amid high economic uncertainty and financial sector fragility, major central banks pause monetary policy tightening or pivot to loosen policy stance prematurely, de-anchoring inflation expectations, triggering a wage-price spiral and spillovers to financial markets. | Medium | **Medium.** Inflation expectations could be de-anchored, triggering a wage-price spiral. Tighter financial conditions would increase financing costs for households and businesses and lower growth. | Intensify monitoring of the financial sector and calibrate macroprudential policies to ensure financial stability. |
| **Cyber-attacks** on critical infrastructure, institutions, and financial systems. | Medium | **Medium.** Payment and financial systems are disrupted. | Following a cyber security contingency plan, take actions to assess damages and regain and restore IT functions. |
| **Malta's Specific Risks** | | | |
| **Realization of money laundering and terrorist financing risks**, for example, in activities benefitted from Malta's Citizenship by Investment program. | Medium | **Medium.** Pressure on correspondent banking relationships will rise, and Malta's attractiveness as a financial and business location may deteriorate. | Identify shortcomings in the AML/CFT framework and take swift remedial actions. |
| **A sharp correction in house prices.** A sharp decline in housing prices could affect financial stability with adverse effects on lending and growth. | Low | **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. |
| **Unsmooth transition in adopting the OECD Pillar 2.** A lack of a well-calibrated strategy could undermine investor's confidence. | Medium | **Medium.** Malta's attractiveness as a financial and business location may deteriorate, leading to reduced fiscal revenues, foreign investment, and slower economic growth. | Develop a well-structured roadmap for a phased implementation of the CIT reform and carefully calibrate their sequence. |

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10, "medium" a probability between 10 and 30, and "high" a probability between 30 and 50). 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. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

# Annex V. Sovereign Risk and Debt Sustainability Assessment

*Malta's overall risk of sovereign stress is low, with low risk of gross financing needs. Public debt is expected to continue to rise from 52 percent of GDP in 2022 to 57 percent of GDP in 2026 before stabilizing,* compared with 40 percent of GDP in 2019. *Debt sustainability could be affected significantly by a macroeconomic shock—as the debt fan chart suggests the moderate level of medium-term risk—and materialization of contingent liabilities. Given that Malta is a small, open island economy particularly exposed to external shocks, building larger fiscal buffers above current levels is essential to boost the economy's resilience, ensure debt sustainability, and maintain low risk of sovereign stress.*

1. **Malta's public debt ratio has risen sharply since the onset of the pandemic.** In the years leading up to the pandemic, gross public debt declined from 70 percent of GDP in 2011 to 40 percent in 2019, driven by primary surpluses and robust GDP growth. However, due to a sharp economic contraction and a significant fiscal response during the pandemic, the gross public debt to GDP ratio increased to 54 percent by 2021. In 2022, a narrowing of the primary deficit and robust economic growth contributed to a decrease in the debt ratio to 52 percent. Under the baseline scenario, public debt is projected to pick up again to 57 percent by 2026, given sizable primary deficits.

2. **Gross financing needs (GFNs) are projected to remain manageable despite a tightening of financing conditions.** GFNs were 12 percent of GDP in 2022, down from 14 percent in 2021, reflecting a smaller primary deficit. Over the medium term, GFNs are projected to decline gradually to 8 percent of GDP by 2028. More than 80 percent of the outstanding debt has a long-term maturity on a residual basis. The government has continued to be successful in auctioning long-term bonds, although financial conditions have tightened as the European Central Bank raised monetary policy interest rates.

3. **The public debt trajectory is exposed to downside risks, and contingent liabilities remain significant.** The debt fan chart suggests a moderate level of medium-term risk. The stock of government guarantees decreased from about 9 percent of GDP in 2020 to 7 percent of GDP in 2022. It is projected to remain at similar levels in 2023. Contingent liabilities related to public-private partnerships account for about 1 percent of GDP.

4. **In the long term, potential risks may arise from aging-related spending.** According to the EC 2021 Aging Report, aging costs in Malta are expected to remain relatively stable until 2040 at around 18 percent of GDP. Subsequently, the costs are projected to increase to 26 percent by 2070, primarily due to growth in pension and healthcare expenditures. However, the projections are sensitive to immigration patterns and the number of retired migrants. Assuming that migrants' length of stay aligns with recent trends, aging costs are estimated to increase to around 21 percent of GDP by 2070, up from 18 percent in 2019.

## Annex V. Figure 1. Malta: Risk of Sovereign Stress

| Horizon | Mechanical signal | Final assessment | Comments |
|---|---|---|---|
| **Overall** | … | Low | The overall risk of sovereign stress is low, reflecting a relatively low level of vulnerability in the near- and medium-term and a moderate level of vulnerability in the long-term horizon. |
| **Near term 1/** | | | |
| **Medium term** | Low | Low | Medium-term risks are assessed as low, consistent with the mechanical signal. However, the medium term risk index is near the "moderate risk" threshold. |
| Fanchart | Moderate | … | |
| GFN | Low | … | |
| Stress test | | … | |
| **Long term** | … | Moderate | Long-term risks are moderate over the extended period and could deteriorate going forward with aging-related expenditures on health and social security. However, the projection is sensitive to immigration patterns and the number of retired migrants. |
| **Sustainability assessment 2/** | Not required for surveillance countries | Not required for surveillance countries | |
| **Debt stabilization in the baseline** | | | Yes |

### DSA summary assessment

Commentary: Malta is at a low overall risk of sovereign stress. Most indicators have started to normalize as the recovery from the COVID-19 shock has been strong. However, debt is expected to rise marginally for several years before stabilizing. Medium-term risks as analyzed by the GFN Financeability Module are low. However, risk of sovereign stress could be affected significantly by materialization of contingent liabilities, and a real GDP growth shock. Effective implementation of fiscal adjustments is important to mitigate these risks and ensure manageable gross financing needs while facilitating a decline in debt levels. Over the longer run, Malta should continue with reforms to tackle risks arising from population aging in the long term.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

## Annex V. Figure 2. Malta: Debt Coverage and Disclosures

| | | | | | | Comments |
|---|---|---|---|---|---|---|
| **1. Debt coverage in the DSA: 1/** | CG | GG | NFPS | CPS | Other | |
| **1a. If central government, are non-central government entities insignificant?** | | | | | n.a. | |
| **2. Subsectors included in the chosen coverage in (1) above:** | | | | | | |

| CPS / NFPS / GG: expected / CG | | Subsectors captured in the baseline | Inclusion | Comments |
|---|---|---|---|---|
| CG | 1 | Budgetary central government | Yes | |
| CG | 2 | Extra budgetary funds (EBFs) | No | Not applicable |
| CG | 3 | Social security funds (SSFs) | Yes | |
| GG: expected | 4 | State governments | Yes | |
| GG: expected | 5 | Local governments | Yes | |
| NFPS | 6 | Public nonfinancial corporations | No | |
| CPS | 7 | Central bank | No | |
| CPS | 8 | Other public financial corporations | No | |

**3. Instrument coverage:**

| Currency & deposits | Loans | Debt securities | Oth acct. payable 2/ | IPSGSs 3/ |
|---|---|---|---|---|

**4. Accounting principles:**

| Basis of recording | | Valuation of debt stock | | |
|---|---|---|---|---|
| Non-cash basis 4/ | Cash basis | Nominal value 5/ | Face value 6/ | Market value 7/ |

**5. Debt consolidation across sectors:**

| Consolidated | Non-consolidated |
|---|---|

**Color code:** Chosen Coverage; Missing from recommended coverage; Not applicable

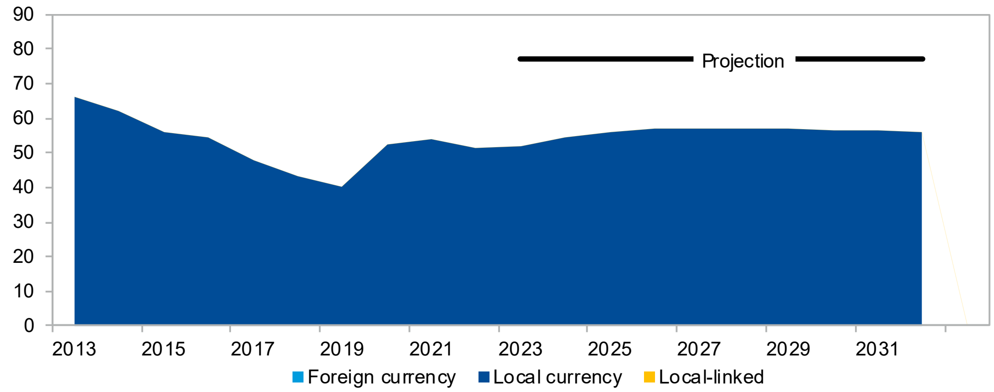
### Reporting on Intra-Government Debt Holdings

| Issuer \ Holder | | | Budget. central govt | Extra-budget. funds (EBFs) | Social security funds | State govt. | Local govt. | Nonfin. pub. corp. | Central bank | Oth. pub. fin corp | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| CG | 1 | Budget. central govt | | | | | | | | | 0 |
| CG | 2 | Extra-budget. funds | | | | | | | | | 0 |
| CG | 3 | Social security funds | | | | | | | | | 0 |
| GG: expected | 4 | State govt. | | | | | | | | | 0 |
| GG: expected | 5 | Local govt. | | | | | | | | | 0 |
| NFPS | 6 | Nonfin pub. corp. | | | | | | | | | 0 |
| CPS | 7 | Central bank | | | | | | | | | 0 |
| CPS | 8 | Oth. pub. fin. corp | | | | | | | | | 0 |
| | | Total | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor ow es to the creditor. It reflects the value of the instrument at creation and subsequent economic flow s (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they w ere acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

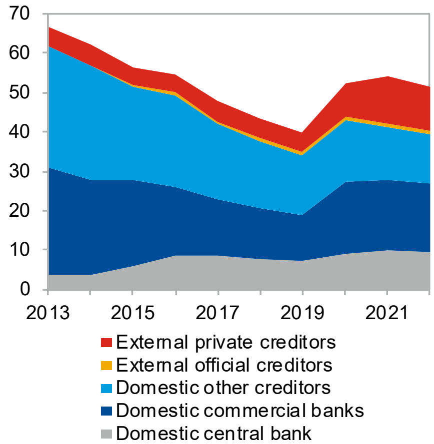
## Annex V. Figure 3. Malta: Public Debt Structure Indicators

**Debt by Currency (percent of GDP)**



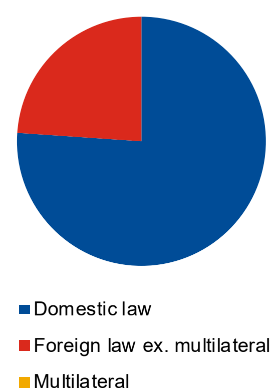

Note: The perimeter shown is general government.

**Public Debt by Holder (percent of GDP)**



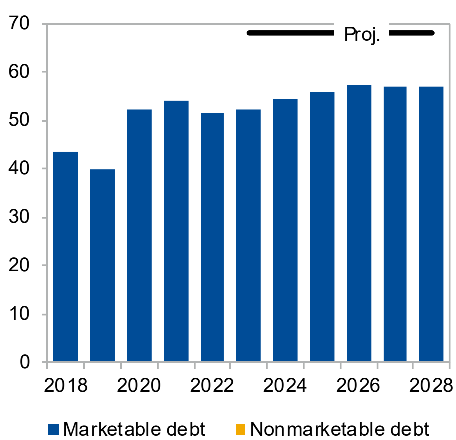

Note: The perimeter shown is general government.

**Public Debt by Governing Law, 2022 (percent)**



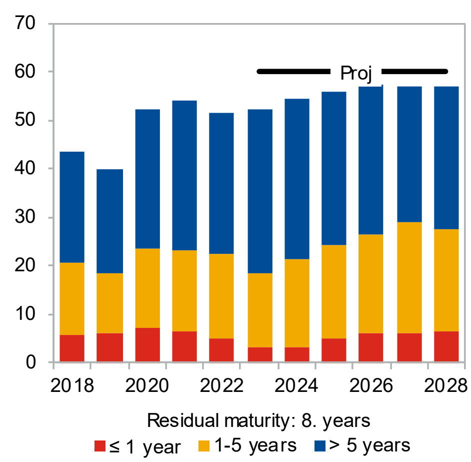

Note: The perimeter shown is general government.

**Debt by Instruments (percent of GDP)**




Note: The perimeter shown is general government.

**Public Debt by Maturity (percent of GDP)**




Note: The perimeter shown is general government.

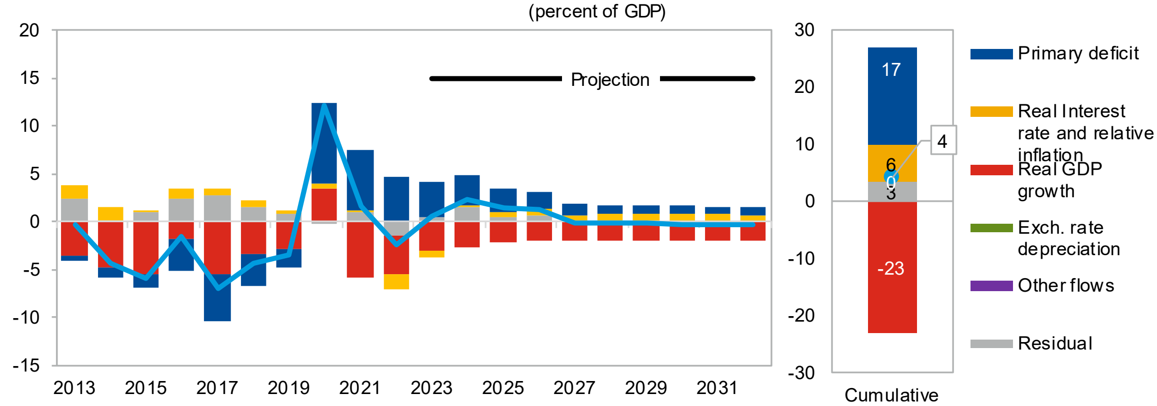
## Annex V. Figure 4. Malta: Baseline Scenario

**Percent of GDP unless indicated otherwise.**

| | Actual | Medium-term projection | | | | | | Extended projection | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 |
| Public debt | 51.6 | 52.2 | 54.5 | 55.9 | 57.2 | 57.1 | 56.9 | 56.8 | 56.6 | 56.4 | 56.0 |
| Change in public debt | -2.3 | 0.6 | 2.3 | 1.4 | 1.3 | -0.1 | -0.1 | -0.1 | -0.2 | -0.3 | -0.3 |
| Contribution of identified flows | -0.9 | 0.0 | 0.7 | 0.8 | 0.6 | -0.1 | -0.1 | -0.1 | -0.2 | -0.3 | -0.3 |
| Primary deficit | 4.7 | 3.7 | 3.0 | 2.4 | 1.9 | 1.1 | 0.9 | 0.9 | 0.8 | 0.8 | 0.8 |
| Noninterest revenues | 33.7 | 35.0 | 34.0 | 33.6 | 33.3 | 33.3 | 33.3 | 33.3 | 33.3 | 33.3 | 33.3 |
| Noninterest expenditures | 38.4 | 38.8 | 37.0 | 36.1 | 35.3 | 34.3 | 34.2 | 34.2 | 34.1 | 34.1 | 34.1 |
| Automatic debt dynamics | -5.6 | -3.7 | -2.4 | -1.6 | -1.3 | -1.2 | -1.1 | -1.0 | -1.0 | -1.1 | -1.1 |
| Real interest rate and relative inflation | -1.6 | -0.6 | 0.2 | 0.5 | 0.6 | 0.8 | 0.9 | 0.9 | 0.9 | 0.8 | 0.7 |
| Real interest rate | -1.6 | -0.6 | 0.2 | 0.5 | 0.6 | 0.8 | 0.9 | 0.9 | 0.9 | 0.8 | 0.7 |
| Relative inflation | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Real growth rate | -4.1 | -3.0 | -2.6 | -2.1 | -1.9 | -1.9 | -1.9 . | -1.9 | -1.9 | -1.9 | -1.9 |
| Real exchange rate | 0.0 | … | … | … | … | … | … . | … | … | … | … |
| Other identified flows | 0.0 | 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 | 0.0 |
| (minus) Interest Revenues | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other transactions | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Contribution of residual | -1.4 | 0.6 | 1.6 | 0.6 | 0.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Gross financing needs | 11.8 | 11.6 | 11.0 | 9.5 | 11.2 | 9.8 | 7.9 | 7.2 | 7.4 | 6.6 | 7.9 |
| of which: debt service | 7.1 | 7.9 | 8.0 | 7.1 | 9.3 | 8.7 | 7.0 | 6.3 | 6.5 | 5.8 | 7.1 |
| Local currency | 7.1 | 7.9 | 8.0 | 7.1 | 9.3 | 8.7 | 7.0 | 6.3 | 6.5 | 5.8 | 7.1 |
| Foreign currency | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Memo: | | | | | | | | | | | |
| Real GDP growth (percent) | 8.2 | 6.2 | 5.1 | 4.0 | 3.6 | 3.5 | 3.5 | 3.5 | 3.5 | 3.4 | 3.4 |
| Inflation (GDP deflator; percent) | 5.3 | 3.7 | 2.5 | 2.1 | 2.1 | 2.0 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 |
| Nominal GDP growth (percent) | 13.9 | 10.2 | 7.8 | 6.2 | 5.8 | 5.6 | 5.5 | 5.5 | 5.5 | 5.4 | 5.4 |
| Effective interest rate (percent) | 2.0 | 2.4 | 2.9 | 3.1 | 3.3 | 3.4 | 3.5 | 3.6 | 3.6 | 3.4 | 3.3 |

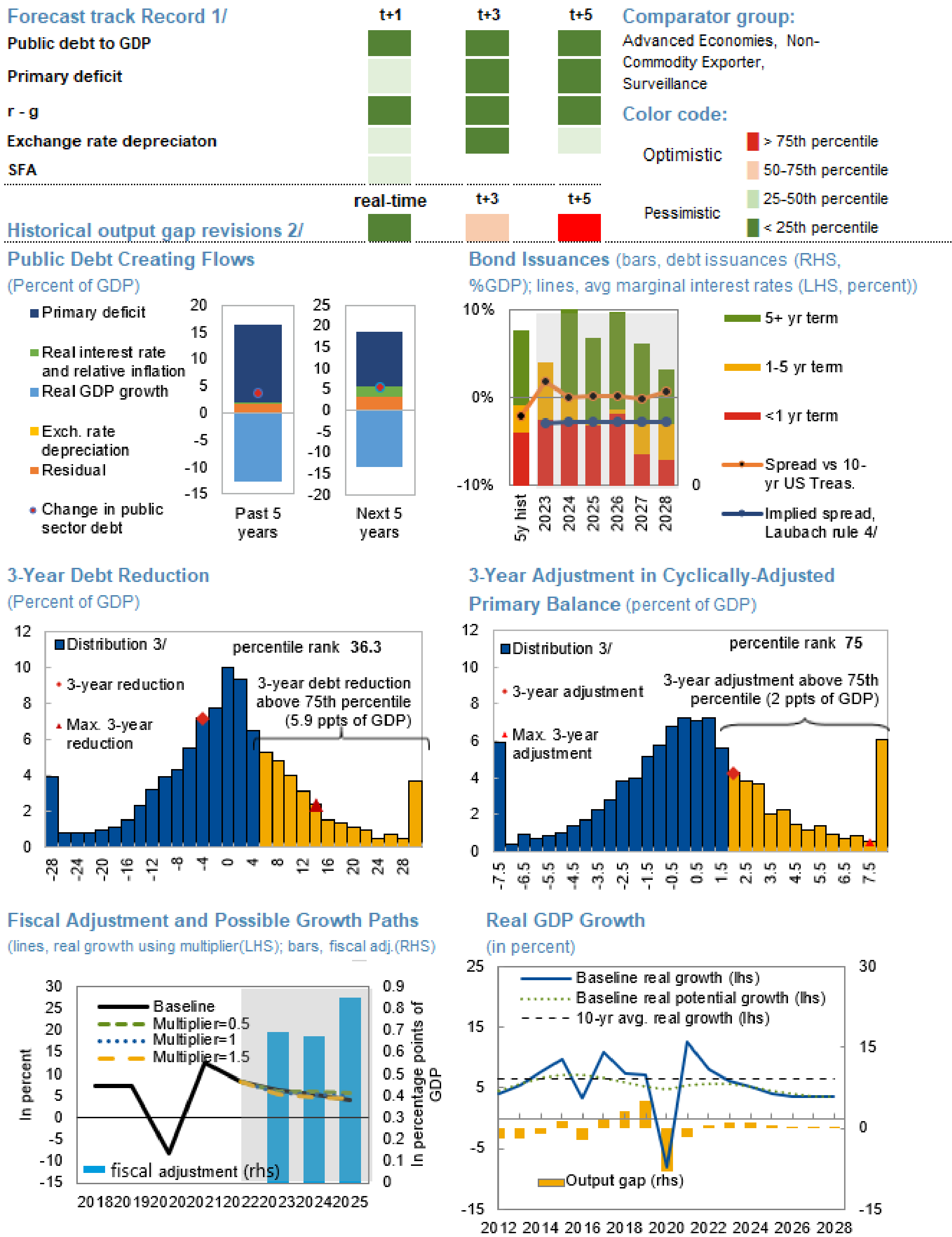
**Contribution to change in public debt**

(percent of GDP)




Staff commentary: Public debt will rise a bit but then stablize, reflecting expectations of a narrowing of primary deficits and stable economic conditions.

## Annex V. Figure 5. Malta: Realism of Baseline Assumptions




| |
|---|
| Commentary: The 3-year adjustment in cyclically-adjusted primary balance falls within the highest 75 th percentile. |

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

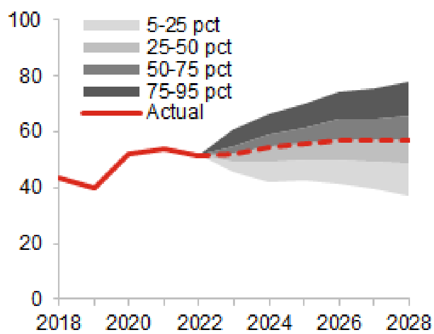
3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

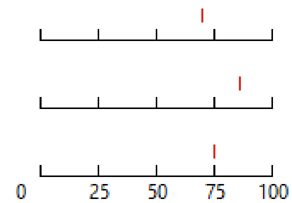
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

## Annex V. Figure 6. Malta: Medium-Term Risk Assessment

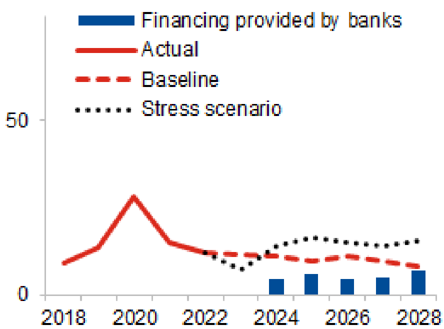
| | Value | Contrib [1/] | Percentile in peer group [2/] |
|---|---|---|---|
| **Debt fanchart module** | | | |
| Fanchart width *(percent of GDP)* | 40.4 | 0.6 | |
| Probability of debt non-stabilizaiton *(percent)* | 53.7 | 0.5 | |
| Terminal debt-to-GDP x institutions index | 21.0 | 0.5 | |
| **Debt fanchart index (DFI)** | | 1.5 | |
| **Risk signal:** [3/] | | Moderate | |
| **Gross financing needs (GFN) module** | | | |
| Average baseline GFN *(percent of GDP)* | 10.2 | 3.5 | |
| Banks' claims on the ge govt *(pct bank assets)* | 7.2 | 2.3 | |
| Chg. In banks' claims in stress *(pct banks' assets)* | 3.9 | 1.3 | |
| **GFN financeability index (GFI)** | | 7.1 | |
| **Risk signal:** [4/] | | Low | |

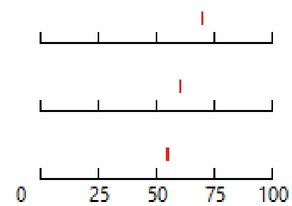
Final Fanchart (pct of GDP)



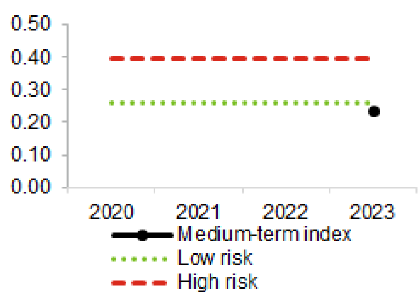

Gross Financing Needs (pct of GDP)




Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index (index number)




Medium-term risk analysis

| | Value | Norm. Value | Weight | Contribution |
|---|---|---|---|---|
| Debt fanchart index | 1.49 | 0.33 | 0.50 | 0.17 |
| GFN finaceability index | 7.10 | 0.14 | 0.50 | 0.07 |
| **Medium-term index** | | 0.2 | | |
| **Risk signal: 5/** | | Low | | |
| **Final assessment:** | | Low | | |

Prob. of missed crisis, 2023-2028, if stress not predicted: 9.1 pct.

Prob. of false alarms, 2023-2028, if stress predicted: 45.5 pct.

Medium-term risks are assessed as low, consistent with the mechanical signal. However, the medium term risk index is near the "moderate risk" threshold.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.

2/ The comparison group is advanced economies, non-commodity exporter, surveillance.

3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.

4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.

5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

## Annex V. Figure 7. Malta: Long-Term Risk Assessment

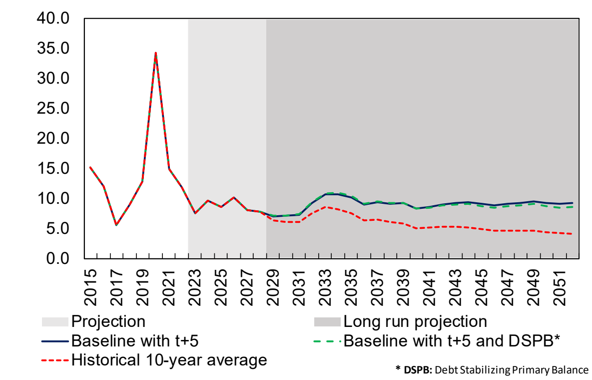
### Large Amortization Trigger

| Projection | Variable | Risk Indication |
|---|---|---|
| Medium-term extrapolation | GFN-to-GDP ratio<br>Amortization-to-GDP ratio<br>Amortization | |
| Medium-term extrapolation with debt stabilizing | GFN-to-GDP ratio<br>Amortization-to-GDP ratio<br>Amortization | |
| Historical average assumptions | GFN-to-GDP ratio<br>Amortization-to-GDP ratio<br>Amortization | |

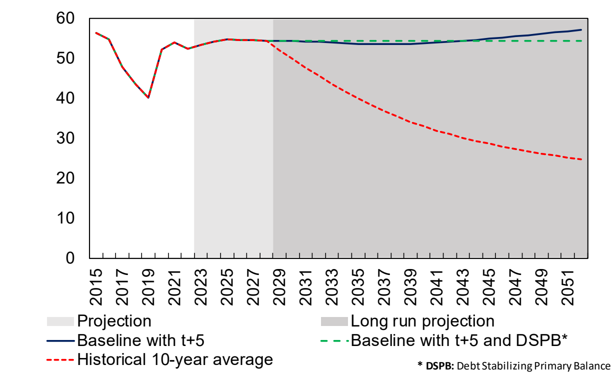
| Overall Risk Indication | |
|---|---|

### Alternative Baseline Long-Term Projections

**GFN-to-GDP Ratio**



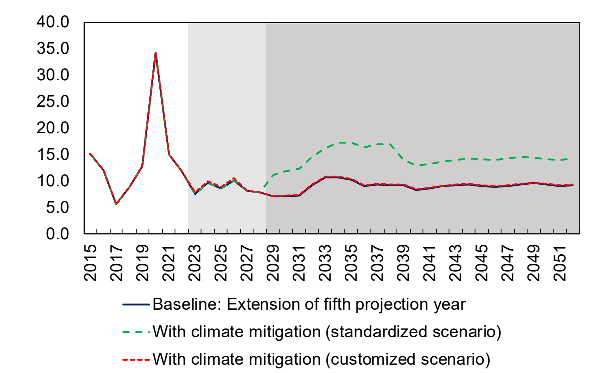

**Total Public Debt-to-GDP Ratio**



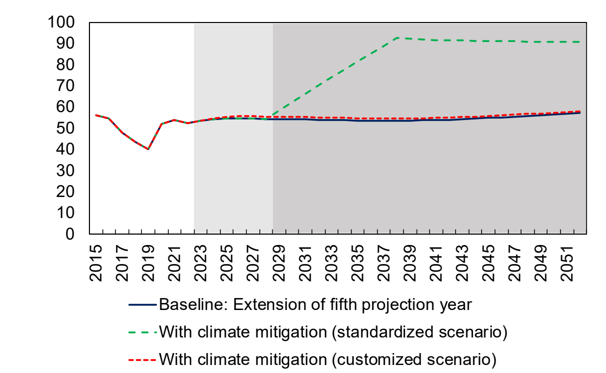

**Commentary:**

### Climate Change: Mitigation

**GFN-to-GDP ratio**




**Total Public Debt-to-GDP Ratio**




**Commentary:** The financing of climate mitigation efforts raises concerns about the long-term impact on Malta's debt. The staff estimates a substantial investment requirement of approximately 4 percent of GDP annually. However, a significant portion of these investment needs stems from the private sector. As a result, the actual increase in debt may not be as pronounced as assumed under the default scenario.

# Annex VI. IMF Fiscal Affairs Department Capacity Development

*Over the past year, the IMF's Fiscal Affairs Department (FAD) commissioned several technical assistance missions to help the authorities develop a revenue administration reform program and corporate income tax reform options.*

***Revenue Administration Reform***

1. **Increasing fiscal pressures have prompted the need for further reforms in revenue administration.** The government's decisive support to mitigate the fallout from the pandemic and its response to the global energy shock in 2022, which involved freezing retail energy prices, played an important role in supporting the recovery. However, Malta's fiscal position deteriorated significantly. Sustained fiscal pressures have pushed the Office of the Commissioner for Revenue (now the Malta Tax and Customs Administration, MTCA) to strengthen revenue administration and support the fiscal consolidation process by increasing tax revenue going forward. While some limited reform initiatives were underway, the intended reforms were not being implemented comprehensively, thus necessitating a comprehensive reform agenda for a transformational change.

2. **The authorities sought IMF FAD support in planning their reform agenda and developing a high-level implementation roadmap to enable the MTCA to pursue these reforms.** From November 2022 to November 2023, seven technical assistance (TA) missions were conducted in Malta to assist the authorities in preparing and delivering their reform agenda. After each mission, Fund staff and external experts provided the MTCA with a report summarizing the mission's main findings and recommendations.

3. **FAD identified several key areas requiring attention,** including: (i) enhancing institutional settings; (ii) managing risks to revenue (compliance risks) and risks to tax administration operations (enterprise risks) and developing strategies to mitigate them; (iii) improving some of MTCA's core functions; (iv) redeveloping an integrated tax administration information technology (IT) system; (v) implementing a large taxpayer office (LTO); and (vi) progressing with the merger of tax and customs administration.

4. **FAD's support served as a foundation for the development of the Delivering Transformation Strategic Plan 2023–25, which was launched in May 2023.** This strategic plan led to the merger of the Malta Tax and Customs Administration, resulting in a redesigned organizational structure that includes dedicated units for Large Taxpayers and Compliance Risk Management.

***Corporate Income Tax (CIT) Reform***

5. **The EU's commitment to implement the OECD tax reform agreement has come into effect.** On December 12, 2022, the EU adopted a directive aimed at establishing a global minimum level of taxation for multinational enterprise (MNE) groups and large-scale domestic groups in the EU with combined financial revenues exceeding €750 million annually and having either a parent

company or subsidiary situated in an EU Member State. As part of the OECD Inclusive Framework, Pillar II introduces a global minimum effective tax rate (ETR) of 15 percent on income generated in low-tax jurisdictions. EU member states are required to transpose this directive into their domestic law by December 31, 2023.

**6. Malta will need to implement the EU's directive, which is a challenge due to its unique corporate taxation regime.** Malta is home to a considerable number of MNEs, some of which fall within the scope of Pillar II, subject to a 15 percent ETR. Malta's refund system allows shareholders of MNEs to claim a refund of 6/7th of the tax paid in Malta, reducing the ETR from 35 percent (a flat rate) to 5 percent. With the adoption of the EU's directive, Malta's tax advantage for large MNEs could diminish over time. In light of these challenges, the authorities requested FAD assistance in developing a reform agenda to transform the challenges arising from these new CIT developments into an opportunity to modernize Malta's tax system.

**7. In late 2022 and early 2023, two TA missions were conducted with the primary objective of assessing CIT.** The missions addressed a range of issues, including some broader corporate tax issues unrelated to Pillar II, as well as those brought about by the need to respond to it. They aimed to: (i) identify trends deserving further analysis; (ii) analyze and assess the key features of the CIT scheme, outlining a comprehensive strategy to mitigate challenges and maximize benefits arising from Pillar II; (iii) provide additional analysis on MNEs that fall outside the scope of Pillar II; (iv) address the future of the tax refund system; (v) present considerations for an overarching strategy for reforms; and (vi) estimate the revenue implications of different packages of CIT reform.

**8. The TA missions recommended that the authorities seize the opportunity presented by the Pillar II agreement to modernize the tax system, making it more efficient and less distortionary.** The key recommendation was to develop a well-structured roadmap for the phased implementation of CIT reform, in consultation with all stakeholders, to provide both international and domestic investors with certainty. These recommendations include:[1]

- Introducing, at an early date, a Qualifying Domestic Minimum Top-up Tax (QDMTT) that aligns with EU and OECD guidance.

- Utilizing the revenue generated by the QDMTT to further tax reform initiatives, as outlined below, to stimulate economic activity and promote fairness.

- Keeping the option of introducing an income inclusion rule (IIR) and undertaxed profit rule (UTPR) before it becomes mandatory.

[1] Revenue impacts of the recommended reform strategy vary depending on new statutory tax rates, the size of refunds, and the size of the semi-elasticity of inward investment with respect to CIT rates, Assuming the new statutory tax rate of 25 percent (down from 35 percent), the refund rate of 5/7$^{th}$ (down from 6/7$^{th}$), and the semi elasticity of 4, the revenue impact is estimated at around 2¼ percent of GDP.

- Phasing out the tax refund system, with full removal by 2030, and gradually increasing ETRs for out-of-scope MNEs, bringing them closer to the ETRs faced by others, including domestic enterprises and entities belonging to in-scope MNE groups.

- Gradually reducing the statutory CIT rate from 35 percent to alleviate the burden on domestic enterprises and foster greater alignment in ETRs across various entities, making the CIT more neutral, efficient, less distortionary, and fairer.

- Undertaking a tax expenditure analysis and developing Qualified Refundable Tax Credits (QRTCs) that would be accessible to all companies and help address externalities, such as those related to Research and Development (R&D) and the green transition.

# Annex VII. Main FSAP Recommendations[1]

| Recommendations and Authority Responsible for Implementation[1] | Timing[2] | Authorities' Actions |
|---|---|---|
| ***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 the European Systemic Risk Board (ESRB) is ongoing on several projects, including macroprudential analysis, O-SII methodology results and Capital Requirements Regulation (CRR) provisions in relation to risk weights.<br><br>Both the CBM and the MFSA invested in improving the data management system and work closely on identifying risks and pockets of vulnerabilities.<br><br>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. A methodology has also been developed to assess credit risk within the financial sector investment portfolio. An internal Financial Stability Monitor report continues to be raised on an annual basis, highlighting emerging systemic risks across sectors. |
| ***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, the NSO started developing a database on commercial real estate indicators. The CBM and the MFSA have set up a technical working group in view of collaborating with respect to the development of a methodology to analyze further commercial real estate developments, in line with the ESRB Recommendation on vulnerabilities in the commercial real estate sector in the European Economic Area (ESRB/2022/9). 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 the latest developments in residential real estate property and rental markets. |
| 1/ The Central Bank of Malta (CBM); the Financial Intelligence Analysis Unit (FIAU); the Malta Financial Services Authority (MFSA); the National Statistics Office (NSO).<br><br>2/ I = Immediate (within 1 year); ST = Short Term (within 1–2 years); MT = Medium Term (within 3–5 years). | | |

[1] Please refer to the 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.

| Recommendations and Authority Responsible for Implementation[1] | Timing[2] | Authorities' Actions |
|---|---|---|
| Refine and introduce the planned borrower-based instruments to address a possible buildup of vulnerability in the housing and household sectors. (CBM) | I | CBM Directive No. 16 defines borrower-based macroprudential measures (effective on July 1, 2019, and revised in November 2021.) |
| ***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 the MFSA's recruitment independence.<br><br>The MFSA has raised and submitted a 5-year plan in relation to its budgetary resources. The government has committed to covering all annual MFSA budgetary shortfalls. The MFSA is currently considering the possible review of certain fees.<br><br>Regulatory Committee is in place, with meetings conducted on a weekly basis. An Enforcement Decisions Committee is in the process of being set up, pending developments of case law currently in front of Maltese courts of law. |
| Address the significant gap in supervisory and enforcement capacity by increasing staff and broadening skill sets. (MFSA) | I | The MFSA total headcount is currently 443, an increase of 45 percent since December 2018. The authority undertakes an annual Training Needs Analysis, which is reviewed by the Financial Supervisors Academy (FSA) to ensure training is aligned with its needs. The 2024 Annual Training Needs process is in train. |
| ***Banking Regulation and Supervision*** | | |
| Increase the number and risk orientation of onsite inspections of Less Significant Institutions (LSIs). Enhance supervision of third-country branches. (MFSA) | ST | The MFSA conducts a bi-annual Supervisory Review and Evaluation Process (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, FIAU, the 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 introducing a quality control function to further reduce subjectivity and ensuring consistency throughout the supervisory and enforcement process.<br><br>MFSA investigations and enforcement actions have continued to increase. The enforcement function has been strengthened following the recruitment of qualified and experienced officials in the field of financial investigations.<br><br>The authorities have also established a dedicated internal penalty model for calculating administrative penalties imposed on entities and individuals for breaches of regulatory requirements. |

| Recommendations and Authority Responsible for Implementation | Timing | Progress |
|---|---|---|
| ***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.<br><br>The MFSA also carries out focused onsite inspections of credit institutions, including banks that distribute insurance products through bancassurance, with a view to assess their adherence to the applicable conduct of business rules.<br><br>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. |
| ***AML/CFT*** | | |
| Improve the authorities' assessment and understanding of ML/TF risks and strengthen 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 proliferation financing. The NCC facilitates the involvement of both authorities and the private sector representative bodies.<br><br>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) TF; (iii) concealment of beneficial ownership; (iv) organized crime; (v) the shadow economy; (vi) corruption; and (vii) the laundering of the proceeds of tax crimes.<br><br>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. |

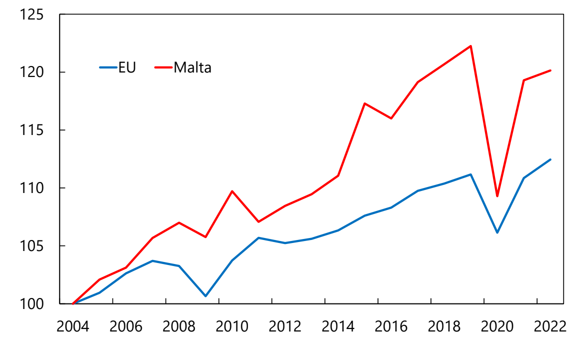
| Recommendations | Timing | Progress |
|---|---|---|
| Adopt a multi-prong strategy that includes: (i) ensuring that banks appropriately apply preventive measures; (ii) fully implementing a risk-based AML/CFT supervision; and (iii) applying timely, dissuasive, and proportionate sanctions and effective 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.<br><br>(i) The MFSA's Financial Crime Compliance function (FCC) reviews license applications and MLRO questionnaires and conducts interviews with proposed MLROs, to ensure, inter alia, that the relevant policies and procedures are in place.<br><br>(ii) Through the FCC function the MFSA carries out AML/CFT on-site examinations as agent of the FIAU. Programming of these examinations is based on the FIAU's CASPAR risk scoring model. The MFSA's own integrated risk scoring models for prudential supervision also include an AML/CFT component. FCC also participate directly in MFSA prudential and conduct related inspections as required.<br><br>(iii) Enforcement related to outcomes from FIAU-programmed inspections carried out by MFSA follows the standard FIAU enforcement process. FCC officials attend committees chaired by the FIAU to provide further feedback on these cases. Decisions are finally taken by the FIAU, following established methodologies.<br><br>Fitness and properness assessments at pre- and post-licensing stage are carried out by the MFSA's Due Diligence Function (DDF), on individual and corporate shareholders, members of the management body and key function holders.<br><br>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. on the first draft of the legislation for the Administrative Bank Insolvency regime is complete and discussions are ongoing. |
| 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 and this project remains at implementation stage. 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 | In the latter part of 2023, headcount allocated to Resolution function has been improved to 18 FTEs. |

# Annex VIII. A Closer Look at Labor Productivity Growth in Malta[1]

**1. Since joining the EU in 2004, Malta has achieved strong labor productivity growth.** The accumulated growth of real labor productivity in Malta was 20 percent between 2004 and 2022, compared to 12 percent in the EU. This reflected structural changes and reforms, including labor market reforms and improved access to credit for SMEs, as well as the restructuring of the energy sector and the introduction of low-cost airlines (Attard, 2020; Micallef, 2017; Rapa, 2017). An increase in foreign direct investment contributed to productivity growth by redirecting resources toward higher-value-added sectors, including finance, maritime, professional services, information technology, and gaming (Darmanin and Montebello, 2021).

**Labor Productivity**

(2004=100)

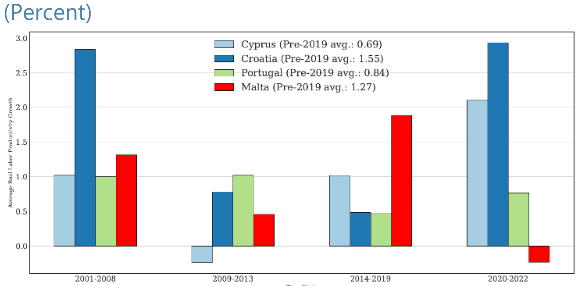



Sources: Euro Stat and IMF staff calculations.

**2. Prior to the pandemic, labor productivity growth in Malta was particularly strong.** Labor productivity growth averaged 1.9 percent per annum in Malta in 2014–19, much higher than that in Croatia, Cyprus, and Portugal, other smaller, tourism-dependent Mediterranean countries. By sector, the strong productivity growth in Malta was driven by manufacturing and trade, followed by professional services. On the other hand, transport, accommodation, and hospitality have been a drag on productivity.

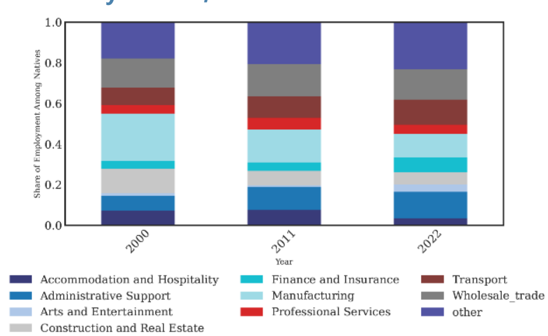
**Real Labor Productivity Growth, 2001–22**

(Percent)




Sources: Eurostat and IMF staff calculations.

**Sectoral Contributions to Cumulative Real Labor Productivity Growth, 2001–22**

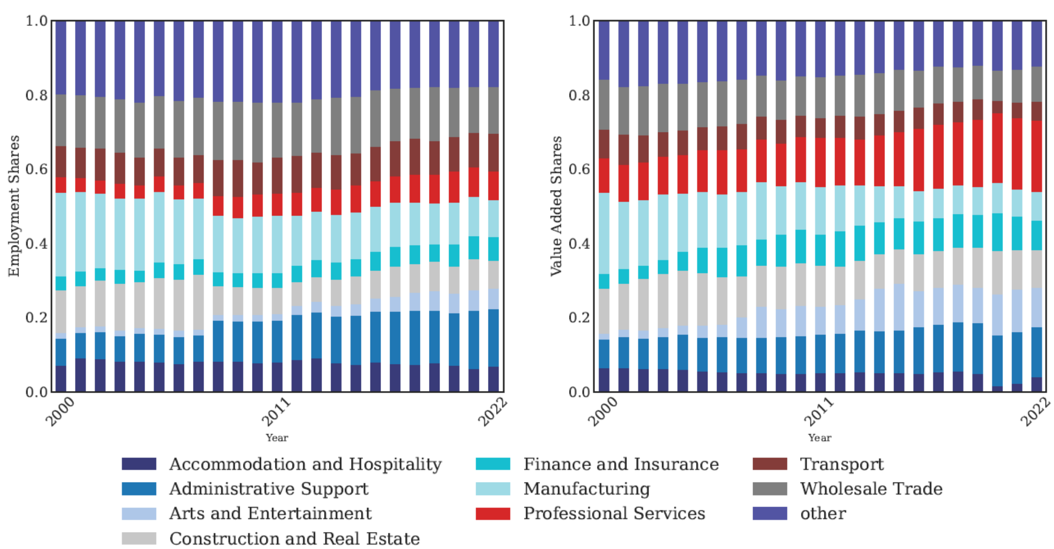



[1] Prepared by Agnese Carella and Luca Mazzone (both EUR). The GDP data in this annex are based on those published by the National Statistics Office on September 4, 2023.

**3. To shed additional light on sectoral contributions to labor productivity growth, including contributions of efficiency gains and reallocation effects, the *generalized exactly additive decomposition methodology* is employed** (Annex VIII Box 1). Building on Darmanin and Montebello (2021), aggregate labor productivity growth is decomposed into three terms: (i) within-sector productivity ("pure productivity"), (ii) resource reallocation effects ("reallocation"), and (iii) dynamic reallocation growth ("covariance").[2] The first term of the decomposition captures efficiency gains accrued to individual sectors and grows when output per employee grows, net of reallocation. The second term is driven by the reallocation of workers across sectors with different productivity levels and is positive when the employment share of more productive sectors grows. The third term characterizes the reallocation of workers across sectors with different productivity growth and is positive when workers are moving towards sectors that grow more.

**4. Data are from annual national accounts (Eurostat).** The sample period (2001–22) is split into four periods: 2001–07 (pre-global financial crisis, including Malta's EU accession in 2004), 2008–12 (global financial and the European sovereign debt crisis), 2013–19 (pre-pandemic crisis), and 2020–22 (pandemic and post-pandemic period).[3] Sectors are categorized using the NACE classification.[4] For comparisons, Croatia, Cyprus, and Portugal are added to the decomposition exercise as these countries are also small open economies with large tourism sectors.

**Employment and Value-Added Shares, 2001–22**




Sources: Eurostat and IMF staff calculations.

[2] Labor productivity growth is calculated as the ratio of chain-linked sectoral gross value added per person employed.

[3] We received the sectoral national account data published on November 11, 2023.

[4] "Administrative supports" includes social work; "construction" includes furnishing and real estate services; "manufacturing" includes textile and shoemaking, and "professional services" includes health services, information communication and other services.

**5. The decomposition results are summarized in Table 1.** Key findings are as follows.

- **Both pure productivity and reallocation effects increased strongly in Malta in 2014–19.** The growth of the within-sector pure productivity effect averaged 1.95 percent, and that of the reallocation effect averaged 0.02 percent, both of which were much higher than in Cyprus, Croatia, and Portugal. Indeed, employment grew fast in Malta in sectors with high value-added, namely professional services and finance. At the same time, the share of value-added in the most productive sectors increased more than their share of employment did, driving overall productivity growth.
- **However, the covariance term was negative (-0.09 percent) on average in 2014–19 in Malta,** whereas these effects were positive in Cyprus (0.01 percent) and Portugal (0.13 percent). This implies that, while there has been a positive reallocation towards more productive sectors in Malta, labor resources shifted increasingly toward sectors with stagnant or declining productivity growth, such as support services and the government.
- **During the last three years (2020–22), labor productivity in Malta declined.** Labor productivity growth fell by 0.31 percentage points on average in Malta, whereas labor productivity growth in Croatia, Cyprus, and Portugal strengthened, compared to the previous period. In Malta, all decomposition terms (pure productivity, reallocation, and covariance) were negative. In contrast, both reallocation and covariance effects gained positive contributions to overall labor productivity in Croatia, Cyprus, and Portugal. Arguably, generous subsidies that the Maltese government provided to mitigate shocks from the pandemic and energy crisis (e.g., wage compensation measures during the pandemic and energy subsidies to fix retail energy prices) could have weakened productive reallocation in the economy.

**6. Achieving strong, sustainable, and inclusive long-term growth will require further boosting productivity.** Malta has achieved strong growth since its entry into the EU, but the weaker productivity trends in recent years are of concern. While a strong influx of foreign workers should support Malta's headline growth, whether Malta can achieve higher levels of living standards would hinge importantly on productivity. Accordingly, the authorities need to continue structural reform efforts to boost productivity across broader economic sectors.

**7. Of additional importance is how Malta will leverage foreign talent.** Over the past decade, the share of foreign workers in the labor force increased more than five times to around 35 percent in 2022. In some sectors (e.g., accommodation and construction), foreign workers represent more than half of the total workforce (Figure 1). There has been a tendency for foreign workers (especially those from non-EU countries) to flow into low-productivity sectors (such as accommodation and construction). This helped the reallocation of native Maltese workers towards higher paying jobs, while the inflow of foreign workers in lower productivity sectors contained wage pressure in the overall economy.[5] However, it appears that there is scope to strengthen the policy framework to more effectively attract and integrate foreign workers into the Maltese economy so that not only high-skilled but also low- and medium-skill migrants could better contribute to

[5] See Peri and Sparber (2009).

aggregate productivity to the extent that their skills are complementary to those of natives. Complementarity supports higher productivity through greater specialization in tasks and occupations where each worker has a comparative advantage (see Foda and Sales, 2020).

### Annex VIII. Box 1. A Sectoral Decomposition Methodology

**We use the *generalized exactly additive decomposition (GEAD)* by Tang and Wang (2004) to estimate sectoral contributions to aggregate labor productivity growth**. Building on Darmanin and Montebello (2021), aggregate labor productivity growth is decomposed into three terms: (i) within-sector productivity ("pure productivity"), (ii) resource reallocation growth ("reallocation"), and (iii) dynamic reallocation effects ("covariance") as follows:

$$G_t = \sum \frac{Y_{i,t-1}}{Y_{t-1}} G_{i,t} + \frac{Z_{i,t-1}}{z_{t-1}} (p_{i,t} l_{i,t} - p_{i,t-1} l_{i,t-1}) + \frac{Z_{i,t-1}}{z_{t-1}} (p_{i,t} l_{i,t} - p_{i,t-1} l_{i,t-1}) G_{i,t}$$

where $G_t$ denotes aggregate labor productivity growth, $G_{i,t}$ labor productivity growth in sector $i$ (pure productivity effect), $l_{i,t}$ its employment share (static reallocation level effect), and $p_i$ its price level relative to the overall economy (dynamic reallocation growth). The relative importance of each component differs across countries, industries and over time.

- **The first term represents pure productivity growth, capturing sectoral efficiency gains as firms within a sector become more efficient at producing output for a given level of input.** This can reflect technological progress, improved internal processes, or training and upskilling of the workforce. Isolating pure productivity growth allows capturing the effect of productivity changes while abstracting from non-efficiency factors (i.e., changes in the relative size of a sector).

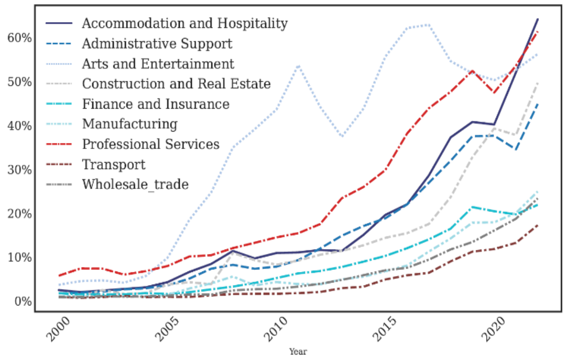
- **The second term is the clean reallocation effect, holding constant productivity growth.** It involves structural changes within the economy, resulting from the movement of labor towards productive sectors or shifts in the industry composition due to the entry and exit of firms, scaled by each sector's productivity level ($Zi$) relative to the aggregate (Z). The scaling implies an overall increase in aggregate labor productivity by favoring the above-average productivity sector.

- **The third term captures the dynamic reallocation growth effect, represented by the covariance term between real productivity growth and the reallocation effect.** This accounts for the economic impact of Baumol's cost disease, wherein resources shift towards sectors with stagnant or declining labor productivity growth.

## Annex VIII. Figure 1. Malta: Productivity Growth and Migration Flows

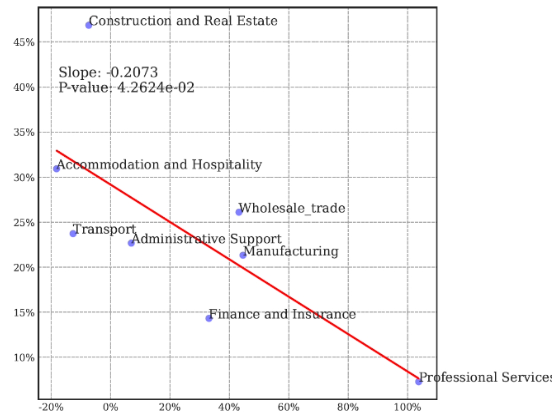
*Non-native workers now constitute more than half of the workforce in sectors like accommodation and construction.*

**Shares of Non-Native Workers in Each Economic Sector, 2001-22**



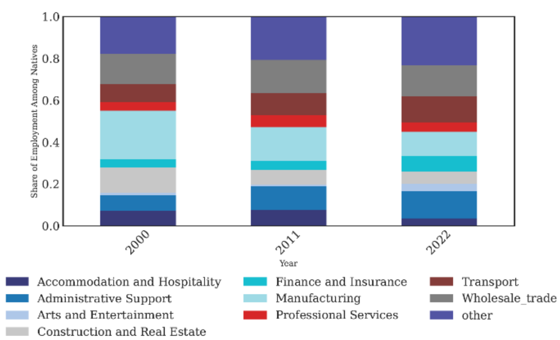

*High immigration has been observed in low-growth sectors…*

**Shares of Non-Native Workers Growth in Each Economic and Sectoral Real Labor Productivity Growth, 2001-22**



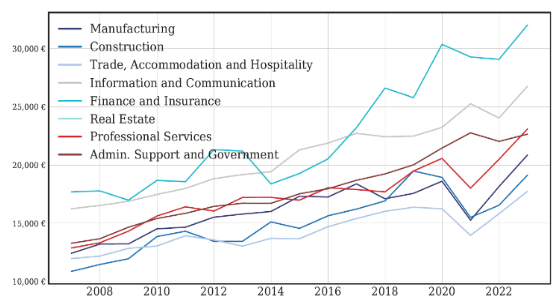

*…which has helped the reallocation of natives…*

**Employment Shares for Native Workers Only, 2001-22**




*…towards higher paying jobs*

**Yearly Wages by Sector, 2001-22**



## Annex VIII. Table 1. Malta: Sectoral Decomposition Results

(Percent)

| Country | Period | Pure Productivity | Reallocation | Covariance |
|---|---|---|---|---|
| Malta | 2001-2008 | 1.417618 | 0.045857 | -0.150975 |
| | 2009-2013 | 0.424022 | 0.01597 | 0.020008 |
| | 2014-2019 | 1.952742 | 0.02273 | -0.092138 |
| | 2020-2022 | -0.147408 | -0.092138 | -0.078149 |
| Cyprus | 2001-2008 | 1.010531 | 0.006217 | 0.008252 |
| | 2009-2013 | -0.253365 | 0.00358 | 0.009785 |
| | 2014-2019 | 1.00691 | 0.003492 | 0.006264 |
| | 2020-2022 | 1.578247 | 0.011257 | 0.510496 |
| Croatia | 2001-2008 | 2.784174 | 0.013231 | 0.040095 |
| | 2009-2013 | 0.918462 | -0.066692 | -0.071771 |
| | 2014-2019 | 0.508943 | 0.001872 | -0.027482 |
| | 2020-2022 | 2.355073 | 0.011856 | 0.566405 |
| Portugal | 2001-2008 | 0.99135 | 0.010699 | -0.002049 |
| | 2009-2013 | 0.996354 | 0.010161 | 0.013485 |
| | 2014-2019 | 0.423417 | -0.089503 | 0.132752 |
| | 2020-2022 | 0.492716 | 0.009818 | 0.264133 |

Sources: Eurostat and IMF Staff Calculations.

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INTERNATIONAL MONETARY FUND

# MALTA

## STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 18, 2023

Prepared By

European Department
(In consultation with other departments)

## CONTENTS

# FUND RELATIONS

(As of November 30, 2023)

**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 | 266.05 | 103.64 |

**Outstanding Purchases and Loans**
None

**Financial Arrangements**
None

**Overdue Obligations and Projected Payments 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 | | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | | 0.00 | 0.00 | 0.00 | 0.00 |

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 November 28–December 9, 2022, and the staff report (Country Report No. 23/78) was brought for the Executive Board's consideration. The Article IV Consultation with Malta was concluded on February 2, 2023.

**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 2022 | FAD | Revenue administration (*Commissioner for Revenue: Delivering Transformation)* |
| November/December 2022 | FAD | Corporate income tax (*Planning for the Future of the Corporate Income Tax)* |
| December 2022-February 2023 (virtual) | FAD | Revenue administration (*Commissioner for Revenue - Integration of Tax and Customs Organization Structure)* |
| March - April 2023 | FAD | Revenue administration (*Commissioner for Revenue - Taxpayer Compliance Risk Management (CRM) Framework)* |
| April 2023 | FAD | Revenue administration (*Commissioner for Revenue - Establishing a Large Taxpayer Office)* |
| April-May 2023 | FAD | Corporate income tax (*Facing up to the Challenges)* |
| June 2023 | FAD | Revenue administration (*Commissioner for Revenue - Structure of Customs within the Malta Tax and Customs Administration)* |

| | | |
|---|---|---|
| June-July 2023 | FAD | Revenue administration (*Malta Tax and Customs Administration - Procurement of Integrated Tax Information System)* |
| September 2023 | FAD | Revenue administration (*Malta Tax and Customs Administration - Establishing the Large Taxpayer Office and Developing a Compliance Risk Management Framework)* |

**Resident Representative**
None

# STATISTICAL ISSUES

(As of November 30, 2023)

| 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 three-month lag. Summary trade statistics are released monthly with about 40 days' lag. 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**

In July 2023, Malta adhered to the IMF's Special Data Dissemination Standard (SDDS) Plus, the highest tier of the IMF's Data Standards Initiatives. Malta has been an SDDS subscriber since 2009. Malta's SDDS Plus data, including an advance release calendar are also accessible through the IMF's Dissemination Standards Bulletin Board.

**Malta: Table of Common Indicators Required for Surveillance**
(As of November 30, 2023)

| | 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/] | Oct 2023 | Nov 2023 | M | M | M |
| Central Bank Balance Sheet | Oct 2023 | Nov 2023 | M | M | M |
| Consolidated Balance Sheet of the Banking System | Oct 2023 | Nov 2023 | M | M | M |
| Interest Rates [2/] | Current | Current | D | D | D |
| Consumer Price Index | Oct 2023 | Nov 2023 | M | M | M |
| Revenue, Expenditure, Balance, and Composition of Financing [3/] – General Government [4/] | 2023Q2 | Sep 2023 | Q | Q | Q |
| Revenue, Expenditure, Balance, and Composition of Financing [3/]– Central Government | 2023Q2 | Sep 2023 | Q | Q | Q |
| Stocks of General Government and General Government-Guaranteed Debt [5/] | 2023Q2 | Sep 2023 | Q | Q | Q |
| External Current Account Balance | 2023Q2 | Sep 2023 | Q | Q | Q |
| Exports and Imports of Goods and Services | 2023Q2 | Nov 2023 | Q | Q | Q |
| GDP/GNP | 2023Q2 | Nov 2023 | Q | Q | Q |
| Gross External Debt | 2023Q2 | Sep 2023 | Q | Q | Q |
| International Investment Position [6/] | 2023Q2 | Sep 2023 | 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 assets and liability positions vis-à-vis nonresidents.
7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

**Statement by Mr. Giammusso and Ms. Mastrapasqua on Malta**
**January 17, 2024**

*On behalf of the Maltese authorities, we thank the Mission Chief, Mr. Kotaro Ishi, and his team for the very fruitful discussions during the Article IV mission, by a longstanding tradition of constructive dialogue and interactions. Our authorities welcome staff's analytical work and their deep insights into significant macro-economic, financial and structural issues and overall agree with the thrust of the 2023 Article IV Report.*

## Macroeconomic outlook and risks

Malta is a small, open, island economy, which has weathered the negative effects of the COVID-19 pandemic well, and experienced a remarkable recovery sustained by fiscal support and past active labor market policies, and significant immigrant labor supply.

Our authorities broadly concur with staff's views of the economic outlook and related risks. They forecast the economy to steadily expand in 2023 and 2024, albeit at a slower pace than during the recovery after the COVID-19 pandemic. This scenario is consistent with an assumed slowdown in the global economy, as tight financial conditions are expected to continue weighing on global demand with a lag, while geopolitical tensions from Russia's war in Ukraine and the Gaza/Israel conflict pose further downside risks. The tourism sector is a possible upside factor, as economic indicators have recently suggested further strengthening.

While Malta has observed one of the lowest inflation rates in 2022 when compared to other European countries, domestic inflation is now converging towards the European average.

The Maltese authorities concur with staff's projections of inflation – and core inflation – to remain persistently above 2 percent until late 2025, mostly driven by services and food prices, and partly reflecting the lagged transmission of added costs across the economy. Firms were able to pass the increased costs to consumers, enabled by strong domestic demand which led to sustained pricing power. In spite of the tight labor market, wage pressures have remained relatively limited, partly reflecting increased inflows of foreign workers; at the same time, higher profits would act as a buffer against prospective wage increases. Albeit sticky, house prices are projected to decelerate and be in line with their fundamental values.

Our authorities note that while the 2022 current account turned negative, due to higher energy prices and one-off imports of aircraft equipment, the current account balance will recover in 2023 and continue to improve over the medium term, driven by external demand and net exports. To facilitate this positive outcome, they commit to stepping up their efforts to safeguard fiscal sustainability and advance structural reform to enhance productivity and promote investment, also drawing on the Fund's Public Investment Management Assessment (PIMA).

**Fiscal policy**

Our authorities consider the 2024 fiscal stance appropriate and reiterate their commitment to maintaining public debt below 60 percent of GDP, and reducing the overall deficit by 0.5 percentage points of GDP a year to reach the 3 percent target by 2027.

The finalization of the reform of the Malta Tax and Customs Administration with help from the Fund's Technical Assistance will allow improving the efficiency and effectiveness of revenue mobilization; the ongoing Corporate income tax reform will be in line with the EU's Directive on OECD Pillar II and EU state aid rules; however, our authorities underscore the importance of keeping the tax reform revenue-neutral to safeguard the Maltese enterprises' competitiveness.

Reprioritization of public expenditure will help reduce the overall deficit from 5 percent of GDP in 2023 to 4.5 percent of GDP in 2024; measures will include enhanced support to the most vulnerable, and the phase-out of costs related to Air Malta's restructuring and the extension of the first home buyer scheme introduced during the COVID-19 pandemic.

Although the energy subsidies weigh for about 40 percent of the overall deficit, the government energy policy has been instrumental in maintaining economic and social stability. At the same time, lower-than-expected commodity prices and sustained efforts in investing in renewable energy will help reduce fiscal costs over the medium term.

**Financial sector**

The financial system proved robust and resilient, with banks' considerable capital and liquidity buffers and enhanced asset quality and profitability. Limited monetary policy transmission is to be mainly ascribed to the large liquidity in the sector, with banks relying mostly on domestic deposits, and relatively high concentration in the banking system; households and NFCs credit growth has remained solid. Also, limited pass-through - especially if compared to other Euro Area countries or the euro area as a whole - can also be explained by the fact that NFC lending rates in Malta were already higher prior to the monetary policy tightening from the ECB. The authorities welcome staff's recommendation for close monitoring of the effect of the interest rate pass-through on the banks' individual financial performance.

They agree with staff that high global uncertainty calls for close monitoring of inflation and price dynamics in the real sector and general financial conditions, and commit to maintaining a sound macroprudential framework.

After a sharp rebound in 2022, activity in the residential property market is curbing; the recent introduction of a sectoral systemic capital buffer addressed to residential mortgage exposures will help reinforce the banking system's resilience to possible shocks in the residential real estate sector; our authorities will assess the need to review these measures alongside macro-financial developments. They will also closely monitor and mitigate possible cyber-security risks, in compliance with the EU's Digital Operational Resilience Act.

**Governance and the AML-CFT framework**

Following past recommendations from the IMF, the Venice Commission, and the GRECO committee, Malta has achieved remarkable progress in strengthening its judiciary system and the AML-CFT framework. The resources for AML-CFT supervisors and regulators have been increased to support the medium to long term reforms and technological investments will be further deployed. Effective collaboration and coordination mechanisms among regulatory and supervisory authorities, including on-site inspections and risk data sharing for prudential and AML purposes have been key to achieving these goals.

We highlight that in compliance with the 2022 ruling of the EU Court of Justice on public accessibility of beneficial ownership (BO) information, Malta has suspended public access to the BO registry; nevertheless, all competent authorities and reporting entities in the country have access to this information.

Malta is currently in the process of finalizing the National AML/CFT Risk Assessment; this process has benefited also from the involvement of several authorities and private-sector representative bodies.

**Structural reforms**

Robust structural reforms are instrumental to achieving long-term and sustainable growth.

The National Recovery and Resilience Plan under the Next Generation EU initiative is helping the country achieve important goals in terms of reforms, and digitalization and green transition investments. Other initiatives, including the Smart Specializations Strategy for 2021-27 and the National Employment Policy for 2021-30 are aimed at promoting R&D, addressing labor market mismatches, and improving learning and technical expertise. At the same time, our authorities concur on the need to closely monitor education outcomes for students with non-EU backgrounds for better inclusive growth and appreciate staff's advice to refocus the country's economic development strategy by incorporating capacity constraint projections in the labor market.

The Maltese authorities agree that a timely implementation of the 2021 Low Carbon Development Strategy is a fundamental milestone in meeting the country's climate goals. They commit to completing the climate vulnerability risk assessment and updating the country's climate change adaption plan. Key ingredient of this strategy – which will draw also on the IMF's Climate-PIMA – is investment in renewable energy.