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Delegations will find attached document C(2017) 8023 final.



EUROPEAN
COMMISSION

Brussels, 22.11.2017
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COMMISSION OPINION

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on the Draft Budgetary Plan of Malta

{SWD(2017) 523 final}

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.
2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING MALTA

3. On the basis of the Draft Budgetary Plan for 2018 submitted on 16 October 2017 by Malta, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
4. Malta is subject to the preventive arm of the Pact and should preserve a sound fiscal position which ensures compliance with the medium term budgetary objective (MTO) of 0% of GDP.
5. The Draft Budgetary Plan's macroeconomic scenario appears favourable for 2017 and 2018, albeit with some differences in terms of the main drivers of growth compared to the Commission 2017 autumn forecast. The macroeconomic scenario underlying the DBP forecasts real GDP growth in 2017 to pick up to 5.9%, from 5.5% in 2016. More dynamic economic activity in 2017 reflects stronger household consumption and a lower import content of domestic demand, which more than offset the contraction in investment and a slowdown in exports. Real GDP growth is forecast to moderate somewhat to 5.6% in 2018 as a recovery in imports offsets the projected rebound in investment. This scenario is a significant upward revision of the projections underpinning the 2017 Stability Programme, which projected a more moderate economic expansion, in particular due to lower private consumption growth and stronger imports. The Commission 2017 autumn forecast projects real GDP growth at 5.6% in 2017 and 4.9% in 2018, below the Draft Budgetary Plan's projections, in particular for 2018. Inflation is expected to rise to 1.3% in 2017 and to 1.5% in 2018 according to the Draft Budgetary Plan. That inflation path, which is in line with the Commission 2017 autumn forecast, has been revised down compared to the projections in the latest Stability Programme. Volatility in Malta's main export markets could pose a risk to the Draft Budgetary Plan's underlying macroeconomic scenario.
6. Malta complies with the requirement of Regulation EU No 473/2013 that the draft budget must be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been endorsed by the Malta Fiscal Advisory Council. In its endorsement of the

forecasts the Malta Fiscal Advisory Council flagged that the macroeconomic scenario is generally plausible, highlighting that the balance of risks appears neutral, since possible downside risks are offset by the level of prudence in the projections, given also the strong potential output estimates.

7. The headline balance projections for 2017 included in the Draft Budgetary Plan constitute an improvement compared to the targets set in the 2017 Stability Programme. The Draft Budgetary Plan projects a surplus for 2017 at 0.8% of GDP, against a surplus of 0.5% of GDP targeted in the 2017 Stability Programme. Part of the difference is explained by the higher proceeds related to the Individual Investor Programme, which is expected to reach 1.9% of GDP in the Draft Budgetary Plan against an estimate of 1.0% of GDP in the 2017 Stability Programme. In addition, the stronger-than-expected growth is expected to contribute to a more buoyant projection for current taxes. At the same time, current expenditure is expected to be more dynamic compared to the 2017 Stability Programme. For 2018, the Draft Budgetary Plan targets a reduction of the surplus to 0.5% of GDP, unchanged compared to the target set in the 2017 Stability Programme. However, in nominal terms, both revenue and expenditure have been revised upwards for 2018 following an upward revision in the expected proceeds related to the Individual Investor Programme and the additional measures included in the 2018 budget, which have an expansionary impact. In structural terms¹, the government plans imply a decrease in the surplus in both years, which is expected to reach 0.6% and 0.2% of GDP respectively in 2017 and 2018. Based on the Commission forecast, the trend in the structural balance is the same, but with a higher base of 0.1 percentage point of GDP in 2017. In the Draft Budgetary Plan, the general government gross debt ratio is expected to decrease to 54.9% in 2017 and to decrease further by 4.2 percentage points of GDP in 2018, reaching 50.8% of GDP.

Against the background of falling interest expenditure, the projected deterioration in the structural balance in 2017-18 (0.2 percentage point and 0.4 percentage point, respectively) is accompanied by a more pronounced deterioration in the structural primary balance (0.5 percentage point and 0.6 percentage point, respectively).

8. The government's 2018 budget includes measures which are estimated to have a net decreasing impact on the headline balance of 0.3% of GDP. On the revenue side, the measures are expected to decrease the headline surplus by 0.2% of GDP. Those include, among other measures, the exemption and reduction of duty on documents for, respectively, the first time buyers and the second time buyers, several measures on VAT, a one-time income tax refund for employees earning less than €60,000 per annum, an increase in the pension income tax not subject to tax, and a tax credit for persons who want to sit for a postgraduate course. On the expenditure side, altogether, the measures are estimated to decrease the surplus by nearly 0.1% of GDP. The budget includes an increase in pensions by EUR 2 per week, several social measures and some measures on the property market. In addition, the Draft Budgetary Plan projects expenditure financed with the National Development Social Fund for 0.3% of GDP split between public investments (¾) and other current expenditure (¼).
9. The Commission 2017 autumn forecast projects the 2017 government surplus at 0.9% of GDP, which is 0.1 percentage point higher than the authorities' target. The

¹ Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

Commission projects lower nationally financed public investment (mainly the projects financed with the Individual Investor Programme revenue) which is partly offset by lower total current revenue and a more dynamic growth of current expenditure. The Commission 2017 autumn forecast projects the 2018 general government balance at 0.5% of GDP, in line with the authorities' target. However, there are some differences in the composition. Higher current taxes, mainly income taxes following also a higher base in 2017, and lower spending for investment from national funds are expected to be offset by higher current expenditure (mainly compensation of employees). According to the Commission forecast, the debt ratio is projected to decrease to 54.9% in 2017, in line with the authorities' target, and to decrease further to 51.6% of GDP in 2018. The difference compared to the authorities' target of 50.8% of GDP in 2018 is mainly explained by the higher stock-flow adjustment in the Commission forecast, which is in line with past values. The Commission also forecasts a slightly lower primary surplus and a lower impact of inflation on the debt-to-GDP ratio in 2018. Risks related to the fiscal targets seem balanced. Current expenditure could be higher due to implementation risks in view of possible slippages in the budgetary execution. On the other hand, given that a precise estimate of the expected revenue from the Individual Investor Programme has so far proven difficult to obtain, upside risk to the revenue projections exist. Moreover, compared to other Member States, the government guarantees provided by central government on debt of non-government units remains high in Malta. After having reached 15.8% of GDP in 2014, they decreased to 15.1% of GDP in 2015 and further to 14.1% of GDP in 2016.

10. According to the information provided in the Draft Budgetary Plan, in 2017, the (recalculated) structural balance is expected at 0.6% of GDP, thus above the MTO. This is in line with the Commission forecast. Therefore, the assessment of the (recalculated) Draft Budgetary Plan points to compliance with the provisions of the SGP in 2017, which is also confirmed by the Commission 2017 autumn forecast.

In 2018, according to the Draft Budgetary Plan, the (recalculated) structural balance is set to deteriorate by 0.4 percentage point, due mainly to the impact of the 2018 budget measures, and to reach a surplus of 0.2% of GDP, thus remaining above the MTO. This points to compliance in 2018 based on the Draft Budgetary Plan. In the Commission forecast for 2018, the structural balance is set to deteriorate by 0.5 percentage point, and to reach a surplus of 0.1% of GDP, thus remaining above the MTO at face value. The structural balance points to compliance while the nominal growth rate of government expenditure net of discretionary revenue measures of 10.4% (in nominal terms) is projected to exceed the applicable expenditure benchmark rate (gap of 0.6% of GDP) leading to a risk of significant deviation. An overall assessment suggests that the structural balance is positively impacted by revenue windfalls by 0.2% of GDP, by the decrease in interest outlays and the lower public investment compared to the average. The expenditure benchmark is thus considered to appropriately reflect the underlying fiscal effort of Malta. The overall assessment points to a risk of some deviation in 2018 based on the Commission forecast. At the same time, expenditure developments should be monitored carefully in the short and the medium term, especially in light of possible future risks to the robustness of revenues.

11. The total discretionary fiscal effort between 2011 and 2017 amounts to 2.5% of GDP. The increase in primary expenditure by 0.8% of GDP is more than compensated by adjustment on the revenue side (expected to be higher at 3.3% of

GDP). Since 2014, the Maltese authorities have launched multiple expenditure review processes, which so far have concerned three areas of public expenditure: social, health and education. Each review ended with the publication of a report which included recommendations, some of them have been already implemented and others are being implemented. The Draft Budgetary Plan reports on the latest developments with regards to the recommendation in the area of spending review, with the authorities envisaging that reviews will be undertaken at the Management Efficiency Unit and the Malta College for the Arts, Sciences and Technology. The authorities are also planning to institutionalise the spending review function under a directorate within the Ministry for Finance. These initiatives seem promising and should contribute towards increased effectiveness in public spending, provided those are properly implemented.

12. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Malta, which is currently under the preventive arm, is broadly compliant with the provisions of the Stability and Growth Pact. While at face value the structural balance is expected to remain in surplus in 2018, according to the Commission forecast there appear to be risks concerning the dynamics of public expenditure. The Commission invites the authorities to stand ready to take further measures within the national budgetary process to ensure that the 2018 budget will be compliant with the SGP.

The Commission is also of the opinion that Malta has made some progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 11 July 2017² in the context of the 2017 European Semester and invites the authorities to make further progress. A comprehensive assessment of progress made with the implementation of the country-specific recommendations will be made in the 2018 Country Reports and in the context of the country-specific recommendations to be proposed by the Commission in May 2018.

Done at Brussels, 22.11.2017

For the Commission
Pierre MOSCOVICI
Member of the Commission

² OJ C 261, 9.8.2017.