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REPORT FROM THE COMMISSION

Malta

Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union

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1. INTRODUCTION

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Data notified by the Maltese authorities on 31 March 2020 and subsequently validated by Eurostat[1] show that the general government deficit in Malta reached 0.5% of GDP in 2019, while general government gross debt stood at 43.1% of GDP. According to the 2020 Stability Programme, Malta plans a deficit of 7.5% of GDP in 2020, while debt is planned at 54.5% of GDP.

The planned deficit for 2020 provides *prima facie* evidence of the existence of an excessive deficit as defined by the Stability and Growth Pact.

Against this background, the Commission has therefore prepared this report, which analyses Malta's compliance with the deficit criterion of the Treaty. Tthe debt criterion can be considered to be met as the debt ratio is below the Treaty reference value of 60% of GDP. It takes into account all relevant factors and gives due consideration to the major economic shock linked to the COVID-19 pandemic.

[1] https://ec.europa.eu/eurostat/documents/2995521/10294648/2-22042020-AP-EN.pdf/6c8f0ef4-6221-1094-fef7-a07764b0369f

Table 1. General government deficit and debt (% of GDP)

		2016	2017	2018	2019	2020 COM	2021 COM
Deficit criterion	General government balance	1.0	3.3	1.9	0.5	-6.7	-2.5
Debt criterion	General government gross debt	55.5	50.3	45.6	43.1	50.7	50.8

Note: Eurostat, Commission 2020 spring forecast

2. DEFICIT CRITERION

Based on the Stability Programme, Malta's general government deficit in 2020 is expected to reach 7.5% of GDP, above and not close to the Treaty reference value of 3% of GDP.

The planned excess over the Treaty reference value in 2020 is exceptional, as it results from a severe economic downturn. Taking into account the impact of the COVID-19 pandemic, the Commission 2020 spring forecast projects a contraction of real GDP in 2020 by 5.8%.

The planned excess over the Treaty reference value would be temporary, based on the Commission 2020 spring forecast, which projects the general government deficit to fall under 3% of GDP in 2021. However, those projections are surrounded by an exceptionally high degree of uncertainty.

In sum, the planned deficit for 2020 is above and not close to the 3%-of-GDP Treaty reference value. The planned excess is considered to be exceptional as defined by the Treaty and the Stability and Growth Pact, while the nature of the excess is currently considered temporary. Hence, the analysis suggests that *prima facie* the deficit criterion as defined by the Treaty and Regulation (EC) No 1467/97 is not fulfilled.

3. RELEVANT FACTORS

Article 126(3) of the Treaty provides that, if a Member State does not fulfil the requirements under one or both of those criteria, the Commission has to prepare a report. That report must also "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

Those factors are further clarified in Article 2(3) of Regulation (EC) No 1467/97, which also provides that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess compliance with the deficit and debt criteria and which the Member State has put forward to the Council and to the Commission" need to be given due consideration.

In the current situation, a key additional factor to take into consideration regarding 2020 is the economic impact of the COVID-19 pandemic, which has a very substantial impact on the budgetary situation and results in a highly uncertain outlook. The pandemic has also led to the activation of the general escape clause.

3.1. COVID-19 pandemic

The COVID-19 pandemic has led to a major economic shock that is having a significant negative impact throughout the European Union. The consequences for GDP growth will depend on the duration of both the pandemic and of the measures taken by national authorities and at European and global level to slow its spread, protect production capacities and support aggregate demand. Member States have already adopted or are adopting budgetary measures to increase the capacity of health systems and provide relief to those individuals and sectors that are particularly affected. Significant liquidity support measures and other guarantees have also been adopted. Subject to more detailed information, the competent statistical authorities are to examine whether those measures entail an immediate impact on the general government balance or not. Together with the fall in economic activity, those measures will contribute to substantially higher government deficit and debt positions.

3.2. Medium-term economic position

Malta's annual real GDP growth of 7.3% in 2018 and 4.4% in 2019 was driven by domestic demand underpinned by robust private consumption and investment. In 2020, Malta's economy will be severely affected by the COVID-19 pandemic. The Stability Programme assumes the GDP to fall by around 5½% in 2020 before recovering somewhat in 2021. According the Commission 2020 spring forecast GDP is expected to contract by around 5¾%. Private consumption is expected to fall due to the lockdown and closure of nonessential businesses. Investment is also set to fall despite continuation of some large-scale investment projects in health and infrastructure. The weak external environment is projected to translate into a substantial decline in services exports, reflecting also halted tourism. The plunge in imports will be lower reflecting mainly falling domestic demand. This is a mitigating factor in the assessment of Malta's compliance with the deficit criterion in 2020.

The economy is expected to rebound in 2021, as an easing of general restrictions is expected to re-stimulate domestic demand. Nevertheless, Malta is a small open economy and hence its economic outlook is highly sensitive to global uncertainties and performance of its trading partners. In the medium-term, Malta is expected to continue growing more strongly than the Union average. Potential growth in Malta is supported by increasing population, capital accumulation and productivity growth.

3.3. Medium-term budgetary position

Malta is subject to the preventive arm of the Stability and Growth Pact and in 2019 it was required to ensure ongoing compliance with its medium-term budgetary objective (a balanced budget in structural terms). Based on outturn data and the Commission 2020 spring forecast, both pillars point to some deviation. Specifically, the growth of net public expenditure exceeded the rate allowed under the expenditure benchmark pillar and the structural balance in 2019 worsened beyond the allowed structural deterioration. The overall assessment thus points to some deviation from the requirements of the Stability and Growth Pact in 2019.

The 2020 Stability Programme for Malta projects a major worsening of public finances from a surplus of 0.5% of GDP in 2019 to a deficit of 7.5% of GDP amid the COVID-19 pandemic. The fiscal package to tackle the negative impact of the pandemic is estimated to amount to 4.1% of GDP, focussing on wage supplements, special social benefits, and additional healthcare spending. Moreover, the government postponed tax payments and provided guarantees of some 2.8% of GDP, regarding which the statistical authorities are to examine whether there is an immediate budgetary impact at inception or not. The deficit also reflects an expected fall on the revenue side, reflecting mainly falling household consumption. In 2021, the deficit is projected to decline to 3.6% of GDP. That projection depends highly on the assumed modest economic recovery driven mainly by domestic demand, which is expected to support receipts both from direct taxes as consumption recovers and indirect taxes reflecting labour market improvements. Government expenditure is expected to decline as temporary policy support is unwound. In the medium term, the Stability Programme commits to returning the debt-to-GDP ratio to a declining path and to reverting to the medium-term budgetary objective of a balanced budget in structural terms.

4.4. Other factors put forward by the Member State

On 12 May 2020, the Malta authorities transmitted a letter with relevant factors in accordance with Article 2(3) of Regulation (EC) No 1467/97. The analysis presented in the previous sections already broadly covers the key factors put forward by the authorities. Additional factors not yet mentioned above are those related to strengthening of the fiscal framework, especially the institutionalisation of spending reviews.

4. CONCLUSIONS

According to the Stability Programme, Malta’s general government deficit in 2020 is planned to increase to 7.5% of GDP, above and not close to the 3% of GDP Treaty reference value. The planned excess over the reference value is considered to be exceptional and currently considered to be temporary.

In line with the Treaty and the Stability and Growth Pact, this report also examined relevant factors. Overall, since the planned deficit is well above 3% of GDP and taking into account all relevant factors, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.