Executive Board Minutes 21/91-1

September 15, 2021–10:00 a.m.

Malta—2021 Article IV Consultation

Documents: SM/21/157 and Cor.1 and Sup.1 and SM/21/162

Staff: Ishi, EUR; Palomba, SPR

Length: 30 minutes

ISSUED: September 19, 2022
APPROVAL: September 26, 2022

CEDA OGADA
Secretary

TABLE OF CONTENTS[1]

[1] Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary "gray" or "buff" statements by Executive Directors and staff's responses to Directors' technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair's "sense of the meeting" or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF's Transparency Policy and Open Archives Policy.

THE ACTING CHAIR'S SUMMING UP

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

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

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

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

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

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

EXECUTIVE BOARD ATTENDANCE[1]

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
	O. Odonye (AE)
	K. Carvalho da Silveira (AF), Temporary
	I. Bustillo (AG), Temporary
	O. Parkyn (AP)
	R. Velloso (BR), Temporary
	Z. Zhang (CC)
	F. Lopez (CE), Temporary
	F. O'Brolchain (CO)
D. Palotai (EC)	
	C. Roman (FF)
	A. Rieck (GR)
	N. Thiruvenkadam (IN), Temporary
D. Fanizza (IT)	
	M. Kashima (JA)
	S. Belhaj (MD), Temporary
	F. Al-Kohlany (MI), Temporary
	L. Dresse (NE)
M. Poso (NO)	
	L. Palei (RU)
	F. Rawah (SA), Temporary
	F. Mochtar (ST)
	B. Piasecki (SZ), Temporary
	K. Nelson (UK), Temporary
	L. Sturm (US), Temporary

O. Vongthieres, Acting Secretary
V. Sola, Summing Up Officer
D. Alcantara, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
European Central Bank: R. Rueffer, S. Tordoir. European Department: K. Ishi, C. Mikami Baba, M. Pradhan, C. Tejada Grullon, Y. Wang. Legal Department: A. Aly, F. Fernando. Monetary and Capital Markets Department: U. Das, W. Oman. Strategy, Policy, and Review

[1] For countries in each constituency, please see the Constituency Codes in the annex.

Department: G. Palomba. Executive Director: A. Andrianarivelo (AF), R. Lim (ST), M. Mahmoud (MI), P. Moreno (CE). Alternate Executive Director: B. Alhomaly (SA), A. Alhosani (MI), H. Azal (EC), M. El Qorchi (MD), A. Guerra (CE), C. Just (EC), R. N'Sonde (AF), J. Romero (CE), F. Sylla (AF). Senior Advisors to Executive Directors: W. Abdelati (MI), H. Andrianometiana (AF), E. Cartagena (CE), M. Choueiri (MI), M. Gilliot (FF), O. Hendrick (AG), L. Marek (EC), J. Rojas (CE), S. Senich (US), A. Tolstikov (RU), M. Villeneuve (CO), L. Voinea (NE), M. Zhunusbekova (SZ). Advisors to Executive Directors: I. Allika (NO), P. Al-Riffai (MI), A. Arevalo Arroyo (CE), Bah, R. (AF), T. Cham (AE), D. Fadhel (MI), J. Gallardo Zavala (BR), M. Ghalanos (NE), D. Hamzah (MI), Z. Huang (CC), A. Korinthios (IT), T. Krahnke (GR), V. Lankester Campos (CE), M. Merhi (MI), P. Mooney (CO), R. Moral Betere (CE), E. Shimada (JA), L. Siliva (AP), Min H. Soe (ST), I. Valdes Fernandez (NO).

DISCUSSION RECORD[2]

The Acting Chair (Mr. Furusawa):

Welcome to the Board meeting on Malta, 2021 Article IV consultation. As usual, those seated at the virtual table, please leave cameras on. Seventeen gray statements have been issued by 20 Directors, and the ECB representative has issued a statement.

The fallout from the COVID-19 crisis has hit the Maltese economy hard, particularly in its large tourism sector. The authorities have taken swift action to support households, businesses, and the healthcare system by using fiscal buffers Malta accumulated prior to the pandemic.

As vaccination proceeds rapidly and containment measures ease, economic activity is strengthening. Consumer and business confidence have recovered to pre-COVID-19 levels, and the Maltese economy is expected to rebound this year. Nonetheless, the outlook is surrounded by a high degree of uncertainty because of the pandemic. Against this backdrop, the authorities face several challenges. These include how to gradually unwind the pandemic-related support measures and shift to policies to support productive and high-growth-potential activities, address deficiencies in the AML/CFT framework, and pursue the structural reforms to strengthen the economy's resilience and sustainability.

Mr. Fanizza:

I would like to express my personal and my authorities' thanks to Mr. Ishi and his team for quite constructive discussions and valuable policy advice. I also would like to thank all my colleagues for their comments and suggestions that I will convey to my Maltese authorities.

I would like to make a few points before the discussion starts. First, before the pandemic, Malta was clearly a success story, built on four pillars. The first one, a remarkable economic diversification strategy; the second, a dynamic and modern service sector; the third one, the openness of its economy, and an attractive business environment.

It should be noted that the strong continued performance of the new sectors, such remote gaming and information and communication technology,

[2] Edited for clarity.

allowed to cushion the impact of the pandemic that hit tourism hard. Over the ten years before the pandemic, public debt declined from 65 percent of GDP to 42 percent in 2019, a remarkable result by any metric. This shows the importance my authorities have attached to fiscal consolidation. At the onset of the pandemic, as Chair said, the authorities were in the enviable position to use fiscal space they had built over the years. Now, they are determined to rebuild it gradually when the recovery becomes well established.

Malta's solid economic foundations, together with an impressive vaccination rollout, augurs well for both the strength and the sustainability of the ongoing recovery, which is driven by continued strong performance of the new service sector and now by the rebound in tourism. I am convinced Malta's proactive approach will turn this crisis into an opportunity, as the country has already done after the global financial crisis.

Finally, my Maltese authorities underscore that debt reduction cannot take place without growth. Therefore, a successful implementation of the Recovery and Resilience Plan (RRP) will be essential for achieving fiscal consolidation. Let me stress that the supply-side policy package that we are talking about, the supply-side policy package that should have long-lasting effects, and I should say that I tend to agree with many of my colleagues who believe the staff may have understated these effects.

As the recovery becomes more established, the main support measures would be replaced by reforms and investment projects that should lift potential output and prepare the economy to seize the opportunities and face the challenges of the green and digital transition. It is reassuring that Malta has in a sense already started to do that. I like to think that Malta will provide us with a bit of a glimpse on the economy we will all live in in a not-too-distant future.

Mr. Poso:

I have issued a gray statement but would like to raise a few points for emphasis.

We broadly agree on the strong rebound projected by staff but also note that risks remain tilted to the downside. In this very open economy, the risks are mainly related to the global evolution of the pandemic, which despite Malta's very high vaccination rate, could hamper international tourism and result in scarring effects.

Malta's strong fiscal response helped containing the impact of the pandemic but also brought about a sharp increase in the deficit and debt ratios. Despite this, we believe that Malta still retains policy space and that policies should remain supportive in the near term, given the still-high level of uncertainty.

When the recovery strengthens, fiscal policy should aim at achieving medium-term fiscal positions while prioritizing investments, as Mr. Fanizza also said. At the same time, more attention could be given to improving the quality of tax revenue and public expenditure. We agree with staff that structural policies should aim at boosting potential growth and supporting the green and digital transformations of the economy, making use of the inflow of EU funds. However, investment should come hand in hand with long-needed enabling reforms to improve framework conditions. We also note that most of the structural priorities are adequately reflected in Malta's Recovery and Resilience Plan and underscore the importance of the upskilling and reskilling of the labor force in order to facilitate resource reallocation.

Finally, we concur that the financial sector remains sound, and macroprudential measures are adequate but that careful monitoring is warranted given the high degree of uncertainty. We also agree with staff that a prolonged inclusion of Malta on the FATF grey list could have negative implications but note that a swift implementation of the FATF action plan would limit these risks.

Mr. Palotai:

We issued a gray statement, so I will only make two very brief points here.

First, while digitalization is critical in enhancing Malta's economic potential, we underscore that more progress is needed to buttress the AML/CFT framework in line with MONEYVAL's recommendations. We note that the authorities made significant attempts to develop quick crypto asset regulation, but we are aware of risks which are inherently related to virtual financial assets, and they need to be brought firmly under control in order to benefit from technological advancements in this fast-developing field.

The second point I would like to make is that we really appreciate the Selected Issues Paper by staff on the corporate liquidity and solvency gaps in the context of the pandemic-related shock. It was very useful to read. Therefore, as Ms. Kashima, Mr. Mochtar, and Mr. Trabinski noted in their gray statements, we also see merit in strengthening the corporate insolvency framework, which should allow for a sound exit of firms to prevent and adverse financial impact on the banking sector going forward.

Ms. Rieck:

We have issued a comprehensive gray statement, and I also associate myself with the points raised by Mr. Poso just this morning, and I would just like to underscore one point and raise one additional question for staff.

First, we are, of course, a bit concerned by the FATF grey listing, but we are reassured that the authorities are aware of the urgency to tackle the matter, and we encourage a swift implementation.

Second, as laid out in the report, the lack of skilled workforce may prove to be a serious bottleneck for a successful recovery, and this dynamic may become even more pronounced in the near-term as COVID-related travel restrictions continue to discourage immigration of skilled labor, so we would like to learn more about staff's view on the potential effects of such shortages on wages and inflation.

Mr. O'Brolchain:

We have issued a gray statement, so I will keep my comments brief.

First, we note the progress made by the authorities in strengthening the AML/CFT framework since the adoption of the July 2019 MONEYVAL assessment report. As mentioned by Mr. Poso in his gray statement and in his oral remarks and by Ms. Rieck, a prolonged inclusion of Malta on the FATF grey list may have negative implications, but a timely implementation of the FATF action plan would limit the risk of not meeting the deadline.

Second, we commend the authorities for the successful vaccine rollout, which enabled the Maltese economy to reopen for the summer tourism season. We look forward to the launch of the Malta Tourism Strategy 2021-2030, as mentioned in the buff, which will enhance the country's attractiveness as a tourist destination and set the foundations for ambitious changes in the tourism sector.

Finally, as outlined in our gray statement, we welcome the authorities' policy initiatives which have led to an increase in female labor force participation in the Maltese economy.

Mr. Odonye:

The fallout from COVID-19 pandemic has severely impacted the economy, particularly the large tourism sector. We commend the swift response to the crisis, supported by prior solid macroeconomic fundamentals that underpins early rebound. We broadly agree with the staff appraisal which supports the authorities' continued near-term targeted policy support and enhanced economic sustainability in the medium-term and emphasize the following points.

First, ample fiscal buffers, resilient financial sector, and stable prices are significant preconditions to lift the recovery and sustain the robust momentum. As the recovery becomes rooted, we urge the authorities to pursue a targeted and well communicated gradual unwinding of the measures. Like many Directors, we encourage the authorities to intensive policy actions that strengthen public investment, reallocate resources to high growth sectors, boost tax revenue, and rebuild fiscal buffers to achieve a greener and more inclusive growth.

Second, we positively note that financial assistance has been received and encourage the authorities to take actions in the AML/CFT framework to address identified deficiencies to remove Malta from the FATF grey list. Effective AML/CFT and governance frameworks would help mitigate financial integrity risks and increase investor confidence.

Finally, we support more structural transformations that can address skills gap in the workforce, reform the corporate sector insolvency framework, and implement sustainable pension system. Such longer-term goals are conducive to the wider spectrum of the population. The authorities should concurrently leverage the country's lowest per capita emission levels and per capita energy consumption to promote green and digital transformation and invest in emerging technologies to achieve higher and sustainable growth.

Ms. Kashima:

As we issued a joint gray statement and broadly concur with staff's analysis, we would like to mention three points for emphasis.

First, as mentioned by Mr. Poso and others, we encourage the authorities to continue vigilant monitoring of the pandemic's impact on sectors. Although it may seem reasonable for now to start withdrawal from the intensive support, recovery of the tourism sector, which represents 16 percent of the economy, will highly depend on international travel demand and thus the path of the pandemic. The authorities should be flexible to re-expand or extend supportive measurements if considered necessary. We underscore the possible scarring on corporate balance sheets. We note staff's analysis, also mentioned by Mr. Palotai, that the crisis has eroded corporate liquidity and equity positions, and at least 11 percent of pre-COVID solvent firms are estimated to remain in financial distress. As the policy support diminishes, it is possible that more serious damage would be revealed than expected, especially among SMEs. We support staff's recommendation to consider additional measures to viable SMEs when needed, while so those measures should be thoughtfully designed to respect market-based reallocation and be well targeted by discerning the viable and the nonviable. We welcome staff's suggestion to partner with the private sector to build up the authorities' capability and to pursue sophistication of the insolvency framework.

Second, the authorities should take effective steps with a solid roadmap to exit from the FATF grey list. Enhancing transparency of AML/CFT framework is key to attract foreign investment, lower financial transformation costs, and smoothen correspondent banking relationships (CBRs). It is also highly important to monitor and appropriately regulate and manage AML/CFT risks associated with virtual financial assets and the Citizenship by Investment program.

Third, we stress the importance to take decisive measures to enhance productivity and to shift to a greener economy. We note the decline in labor productivity and underscore the need for efficient labor resource allocation, as well as upskilling and reskilling of workers. We commend the authorities for being Europe's digital frontrunners and encourage the authorities to further continue their efforts, as well as their response to climate change, through the utilization of EU funds.

The staff representative from the European Department (Mr. Ishi):

I want to address two questions which came up just now. The first one is virtual financial assets, and the second is foreign workers and wage pressures.

On virtual financial assets, I remember that at the concluding meeting, we had an extensive discussion on the AML/CFT and grey listing and associated issues, including gaming and the high-risk businesses. The Ministers and Governor emphasized that for fintech area, including the virtual financial assets, they do not have a good experience so far. It is a new product, so they want to be careful to proceed. That is the message I got from the Ministers and Governor in Malta.

Now, secondly, on questions of the wage pressures and foreign workers, this could be challenging. First, so far, wage pressures are very limited, and inflation is quite moderate. I would say it is low in Malta; but if we talk to the industry people or Chamber of Commerce or hotel representatives, especially in service or contact-intensive sectors like hotel, restaurants, or tourism services, many people left, and before the crisis they are highly dependent on foreign workers. So those people left, and they feel labor shortage. So far, they confirm that the economy overall is still, output gap is still so deep, so large, so far it is not where the wage pressure is coming.

That said, I want to emphasize this is a longstanding issue in Malta. Before the crisis when the GDP growth is up 5 or 6 percent and tourism boomed, they rely on foreign labor forces, but actually that kind of gives pressure on infrastructure in Malta, education system, healthcare, basic social services.

So, the authorities in the recent strategy report recognize it is kind of tradeoff and want to basically again look at how to basically upgrade the skilling and domestic labor forces; and in the context of the Next Generation EU national program or their own national program, they want to emphasize the importance of education and also training programs and especially for basically coordination between the government and industry and how to improve the labor force in Malta.

Mr. Fanizza:

I do not have final remarks. I would like only to thank my colleagues for their inputs that are valuable. I will refer to the authorities duly.

The Acting Chair (Mr. Furusawa) noted that Malta is an Article VIII member, and no decision is proposed.

The Acting Chair (Mr. Furusawa) adjourned the discussion

ANNEX

- Staff's Statement
- Gray Statements
- European Central Bank Statement
- Staff’s Responses to Executive Director’s Technical Questions
- Constituency Codes

BUFF/21/16

September 9, 2021

Statement by the Staff Representative on Malta
Executive Board Meeting
September 15, 2021

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

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

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

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

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

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

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BUFF/ED/21/120

September 10, 2021

Statement by Mr. Fanizza and Ms. Korinthios on Malta
Executive Board Meeting
September 15, 2021

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

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

Macroeconomic outlook and risks

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

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

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

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

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

The response to the pandemic and the way forward

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

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

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

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

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

Fiscal Policy

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

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

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

Financial Sector and AML/CFT framework

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

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

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

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

Structural reforms

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

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

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

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

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

Climate change policy

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

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

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

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

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GRAY/21/2596

September 13, 2021

Statement by Ms. Senich and Mr. Sturm on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for their informative reports and Mr. Fanizza and Ms. Korinthios for their helpful Buff statement. While Malta entered the crisis on relatively firm economic footing, the pandemic hit the tourism sector particularly hard, weakening economic activity more broadly and driving down private consumption and investment. We commend the authorities for their swift and decisive economic and health responses to the COVID-19 pandemic, including the rapid and effective vaccine campaign, which has now fully vaccinated 80 percent of the population. **We generally agree with staff's analysis and highlight a few areas below for emphasis.**

The fiscal stance should remain expansionary given the high level of uncertainty and the dependence of the economy on the tourism sector. We appreciate that Malta accumulated fiscal buffers prior to the crisis, having placed debt on a firmly declining path during the prior decade. While we note the 13 percentage point increase in public debt in 2020, we agree with staff that fiscal support should continue until the recovery has firmly taken hold. At that time, the authorities should gradually rebuild their fiscal buffers while retaining space for public investment. In addition, we strongly support staff's call to address fiscal vulnerabilities through steadfast progress on strengthening public debt management and increasing tax revenues as well as addressing contingent liabilities and undertaking pension reform.

The authorities should intensify their efforts to strengthen their AML/CFT framework. We strongly agree with staff that the money laundering and terrorist financing (ML/TF) risks associated with virtual financial assets (VFAs) and Malta's Citizenship by Investment (CBI) Program are of concern. In particular, we urge Malta to take decisive and comprehensive action to mitigate the potential vulnerabilities associated with the gaming sector, the country's CBI Program, and VFAs, including effectively implementing the FATF's standards concerning the regulation and supervision of virtual assets and virtual asset service providers.

The health of the banking system requires close monitoring. While we take note of the authorities' views on the health of the banking system, we agree with staff that the increased indebtedness of the corporate sector and rising risks in mortgage lending amid continued pandemic uncertainty warrant close monitoring. If pandemic stress necessitates further corporate sector support, the authorities should extend public support to viable companies transparently and with a clear exit strategy to minimize fiscal risks.

We encourage the authorities to take full advantage of the EU Recovery and Resilience Facility funds to make further strides in structural reforms, including digitalization and climate change. Digital intensive sectors are already supporting growth and further promotion of digitalization will be important to improve productivity. We encourage the authorities to advance efforts to improve capacity to absorb EU funds, and we welcome the planned review of infrastructure investment and management frameworks in this context. We also welcome the authorities' growth strategies and concur with staff's prioritization on advancing labor market reforms, notably upskilling and reskilling workers and reforming the corporate sector insolvency framework. We also urge the authorities to continue working with the Fund to improve their infrastructure investment and management framework.

GRAY/21/2598

September 13, 2021

Statement by Mr. Hendrick and Ms. Bustillo on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for the informative set of reports on the Maltese economy and Mr. Fanizza and Ms. Korinthios for their insightful Buff statement.

We welcome the authorities' swift and decisive response to mitigating the impact of the pandemic that was facilitated by sizable macro-financial buffers and a wage supplement scheme that protected employment. Driven by digital intensive sectors and a reopening of the tourism sector, the economy is expected to grow by 5¾ percent in 2021. Nonetheless, the outlook remains uncertain with a global resurgence of the pandemic and a tightening of financial conditions as primary external risks.

On fiscal policy, the authorities have started tapering support measures with a view to terminating them by the end of 2021. We concur with gradually unwinding government support as the recovery takes hold but note that targeted fiscal support to vulnerable sectors is critical. In particular, measures to address skills shortages can play an important role in the recovery and help raise the economy's potential growth rate. In this respect, we agree with the authorities that re-establishing growth is necessary for fiscal sustainability in the medium term. To this end, we highlight the importance of efficient management of growth-enhancing public investment and welcome the authorities' plan to launch a review of the infrastructure investment. Also, a review of the overall tax system, as highlighted by staff, would be helpful to enhance fiscal sustainability.

Continued monitoring of financial stability. The banking sector has remained resilient, but staff notes that asset quality could deteriorate as support measures are withdrawn or expire or the economic outlook deteriorates. In this respect, we welcome the authorities' commitment to remaining vigilant of banks' financial position. In particular, given the high exposure of the banking sector to mortgage loans, close monitoring of risks in housing markets is essential. We welcome the authorities' progress to collect real estate loan level data. With respect to the AML/CFT framework, we positively note the progress made in its strengthening and welcome the authorities' commitment, as highlighted in the Buff statement, to enhance its effectiveness. Close monitoring of potential risks of high-risk sectors such as remote gaming is necessary for financial integrity.

On structural reforms, notwithstanding Malta's strong economic growth prior to the pandemic that commendably halved the income gap with the European Union, further reforms are needed to enhance productivity and long-term growth prospects. In this regard, we welcome the Recovery and Resilience Plan (RRP)'s focus on energy efficiency, decarbonization, digitalization, education, and reform of the institutional framework. Moreover, we welcome the creation of a new ministry on research and innovation and ongoing initiatives to spur higher and sustained growth.

With these comments, we wish the people of Malta all the best in their future endeavors.

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GRAY/21/2602

September 13, 2021

Statement by Mr. Bevilaqua, Mr. Velloso, and Mr. Gallardo on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for the report and Mr. Fanizza and Ms. Korinthios for their helpful statement. We agree with the thrust of the staff appraisal and would like to offer the following comments.

The global pandemic hit hard the Maltese economy. Last year, the economic contraction was significant. Malta's tourism sector—the most important in the economy—was severely affected by the collapse of tourist arrivals. Other sectors, like remote gaming and ICT, grew strongly but not enough to offset the contraction of the tourism sector. At the beginning of the pandemic, the authorities introduced several containment measures that were instrumental in slowing the spread of the virus. However, containment measures were relaxed too soon, leading to a resurgence in infections and forcing the reintroduction of restrictive measures.

Support measures aimed at protecting lives and livelihoods during the pandemic were appropriate. We take positive note of the wage supplement scheme that has been instrumental in preventing large-scale layoffs and containing scarring. We also take positive note that social assistance measures to protect the most vulnerable were designed in a cost-effective manner. Looking ahead, the authorities should maintain well-targeted fiscal support in the near term, until the recovery is firmly established. Support should then be gradually reduced, and fiscal buffers rebuilt.

A review of the tax system is urgently needed. To address post-pandemic economic and social challenges, a revenue-enhancing tax reform should be strongly considered. This is also needed to improve the efficiency of the tax system and address the potential impact on Malta of the minimum corporate tax proposal made by the G-20.

The banking system should continue to be carefully monitored. Like other countries affected by the pandemic, the authorities introduced measures to support bank liquidity and credit flows. We take positive note that banks have maintained capital and liquidity ratios above the regulatory requirements. Nevertheless, the authorities should continue to carefully assess banks' financial positions, the quality of their risk management capabilities, and their level of provisions.

Finally, we strongly encourage the authorities to take the necessary actions to remove Malta from FATF's "gray list" as soon as feasible. Concern over Malta's AML/CFT framework related to transparency of beneficial ownership information and financial reporting on money laundering and tax evasion has recently led FATF to place Malta under increased monitoring. A prolonged placement in the "gray list" could adversely affect correspondent banking relationships, raising transaction costs, and adversely affecting the stability of the financial system.

With these remarks we wish the Maltese authorities success in their future endeavors.

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GRAY/21/2603

September 13, 2021

Statement by Mr. Palei and Mr. Tolstikov on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for the set of well-written papers and Mr. Fanizza and Ms. Korinthios for their helpful Buff statement. We note that the resilience of the Maltese economy has improved substantially in the period preceding the COVID-19 crisis. The economy was diversified, with ICT and the gaming sector becoming the new sources of growth, with public debt reduced, and banks' balance sheet strengthened. This has softened the impact of the COVID-19, although it still hit the economy hard, especially its tourism sector. The authorities' policy response was timely and strong, as policy buffers allowed implementation of the large-scale fiscal and financial sector measures to support economic activity and employment. We also commend the authorities for the successful vaccination program, which has achieved an impressive 80 percent immunization level, one of the highest in the world.

While the economy is recovering and GDP growth is expected to reach more than 5 percent in 2021, a large output gap remains, and fragilities accumulated during the crisis require careful attention. In this regard, we agree with staff that fiscal support should be withdrawn only gradually and be well-coordinated with the unwinding of financial sector policy support measures to avoid the potential cliff effect. Over the medium term, the rebuilding of the fiscal buffers should be underpinned by improved efficiency of public investment and strengthening tax revenue, including adjusting the tax system to global corporate taxation reforms. The authorities should also manage risks from contingent liabilities and continue the pension reform.

The pandemic impact on the banking sector was well contained, banks remain well-capitalized and NPL level is low. The support measures are gradually unwinding. At the same time, the supervisors should closely monitor banks' financial positions, taking into account possible risks to the financial sector from corporate insolvencies, mortgage lending and a high level of intercompany loans. Malta's placement on the FATF "grey list" requires additional attention to the remaining weaknesses in the AML/CFT framework. In this regard we welcome the authorities' commitment to develop an action plan to address these deficiencies. *To what extent is the progress in Malta dependent on the progress in the AML/CFT framework at the EU level and the euro area? What are the recent developments in this area?*

Looking beyond the immediate response to the economic fallout of the pandemic, the authorities need to advance structural reforms to boost Malta's potential growth, including the reforms aimed at improving education and training and addressing the skills gap. We welcome the authorities' efforts towards green and digital transformation, which will be key to achieving sustainable growth and addressing climate risks concerns.

With these remarks, we wish the authorities further success.

GRAY/21/2605

September 13, 2021

Statement by Mr. Trabinski and Mr. Piasecki on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We broadly concur with the thrust of the staff report. We welcome the Maltese authorities' sound macroeconomic and health policy response to the pandemic. The past decade was very successful with impressive economic growth and a narrowing of the income gap with its EU peers, but some structural challenges remain in place.

We acknowledge the efforts taken by the authorities to improve and strengthen the AML/CFT framework, but more decisive actions are still required. Exiting from the FATF's "Grey List" should remain the authorities' priority. *We would welcome Staff comments on the authorities' plan and the timeline for doing so.* We note with concern the rising pressures stemming from the potential loss in correspondent banking relationships (CBR). Malta's prolonged placement on FATF's "Grey List" could result in additional CBR pressures and have severe impact on transaction costs and investment inflows, which could ultimately negatively affect the economy. We call for a decisive and credible plan to enhance the effective implementation of the FATF standards.

We positively note the banking sector's resilience, although bank asset quality could deteriorate, and close monitoring is thus warranted. A sharp increase in corporate debt could pose significant risks once the support measures are withdrawn. Real estate and mortgage lending can be additional sources of risk. We therefore encourage the authorities to update the corporate solvency framework and closely monitor developments in the banking sector.

We note that public debt will pick up in 2023 rising to almost 70 percent of GDP. We tend to agree with staff that given the high level of uncertainty, fiscal support should remain in place for the time being but could be more targeted. However, some efforts could be taken to limit a further increase in public debt. We welcome the authorities' commitment to addressing long-standing fiscal vulnerabilities. Additional resources should be devoted to strengthening tax revenue administration by closing loopholes and digitalizing the tax system. We welcome the Fund’s engagement to improve the public investment management framework, as the efficient absorption of the EU funds remains a challenge.

On a separate note, we would welcome more coverage in the Staff’s report on Malta’s Recovery and Resilience Plan under the EU resources as it will likely remain country’s main engine of the green and digital transformation.

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GRAY/21/2607

September 13, 2021

Joint Statement by Ms. Kashima, Mr. Mochtar, Mr. Parkyn, Ms. Fukuda, Mr. Shimada, Mr. Soe, and Mr. Tui Siliva on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for the insightful report and Mr. Fanizza and Ms. Korinthios for the useful Buff statement.

The authorities' swift and bold response measures have supported the Maltese economy to rebound by more than 5 percent in 2021, after severely impacted by the COVID-19 shock in 2020. While we welcome this positive outlook, there are downside risks of a global resurgence of the pandemic. Thus, we underscore the need to vigilantly monitor the pandemic's impact on sectors of the economy. In addition, we share staff's view that the authorities need to rebuild fiscal buffers once the pandemic subdues. As we broadly concur with the points raised in the staff's appraisal, we will limit our comments to the following points:

While the economy has shown a positive development, withdrawal of supportive measures should be proceeded gradually. We note that the authorities have started to steer away from the intensive support measures, given that the various statistics are indicating recovery. We welcome that they plan the withdrawal of each policy in stages to avoid cliff-effects, but we encourage the authorities to continue close monitoring and to be flexible in modifying their plan as needed. We see merit to remain vigilant as future development of this crisis is still highly uncertain, and recovery of the large tourism sector is heavily dependent on the global trend of the crisis. Furthermore, unforeseen scarring, such as labor market disruptions or escalation of bankruptcies, may materialize with a lag. In this regard, the authorities should stay prepared to re-expand or extend the support if necessary. As for corporate sector support, we note staff analysis that at least 11 percent of pre-COVID solvent firms are estimated to remain in financial distress. Assessing business viability and prospects will be key to ensure necessary liquidity and solvency support are provided to viable firms, while facilitating market-based resource allocation and avoiding zombification.

We encourage the authorities to strengthen measures to enhance fiscal sustainability once the recovery becomes well-set. We share staff's analysis that Malta's medium-term debt outlook is resilient, and commend the authorities' commitment to tackle long-standing fiscal vulnerabilities. A comprehensive approach to increase overall tax policy efficiency should be deployed, and tax administration should be strengthened by identifying loopholes and utilizing digitalization. In addition, considering that the ongoing discussion on global minimum corporate tax would pose challenges to Malta's high reliance on corporate tax and its existing tax system, we strongly encourage the authorities to follow the global discussion closely and prepare for the possible transition to a new corporate tax framework. Furthermore, given there are sizable needs for public investment to accommodate the growing population, we see merit to pursue reforms as soon as possible. *In relation, given the important role of the EU Recovery and Resilience Facility for public investment going forward, could staff elaborate on capacity constraints to absorb EU funds and possible solutions?*

The remaining deficiencies in the AML/CFT framework should be swiftly addressed. In June 2021, the FATF put Malta on the "grey-list" because of the concerns on the effectiveness of the AML/CFT framework, which remains two years after the first identification by Moneyval. We welcome the past efforts by the authorities, but more has to be done in line with the FATF action plan. We support the staff's suggestion on the areas of focus—transparency on beneficial ownership information and financial intelligence related to money laundering and tax evasion. As lingering on the list for long would do harm to its financial integrity and reputation and could be a deterrent to calling in more foreign investment for long-term growth, we strongly encourage the authorities to further strive on this front.

As the recovery progresses, the authorities need to advance structural reforms to achieve sustainable growth. As we take cautious note of Malta's decreasing labor productivity, we encourage the authorities to strengthen labor policy priorities to address inefficiencies in labor markets and welcome the steps already taken to upskill and reskill workers. Furthermore, corporate insolvencies may increase as support measures are wound down, and thus urgent rollout of the corporate sector insolvency framework is warranted. We also encourage the authorities to utilize EU funds to enhance digital transformation and decarbonization, and welcome the ongoing work to update the medium-term national digital strategy and the recent publication of the Malta Low Carbon Development Strategy.

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GRAY/21/2608

September 13, 2021

Statement by Mr. Pösö on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank Staff for their clear and insightful report and selected issues paper in the context of Malta's Article IV consultation. We also thank Mr. Fanizza and Ms. Korinthios for their informative Buff statement. We commend the national and EU authorities' resolve to fight the health, social and economic consequences of the ongoing pandemic, both domestically and internationally.

Thanks to strong growth and prudent fiscal policies before the crisis, Malta made good use of its ample policy space to provide a strong policy response, which was critical in containing the economic and social impact of the pandemic. Despite a sharp increase in the deficit and public debt ratio, Malta still retains policy space in the short and medium term. Fiscal policy should remain supportive in the near-term given the still high level of uncertainty, also making use of the sizeable inflow of EU Funds. When the recovery firms up, policies should gradually achieve prudent medium-term fiscal objectives, while enhancing investment to boost potential growth and supporting the green and digital transformations of the economy. To this end, structural reforms and investments to improve framework conditions are crucial.

Macroeconomic developments

We broadly agree on the strong economic rebound projected by Staff, in a context of still very high uncertainty. As Staff, we expect Malta's very open economy to gain momentum in 2021 and maintain a robust growth rate thereafter, above the EU average. We note, however, that it is not clear how the impact of the Next Generation EU (NGEU) has been factored in on Staff's projections. We also assess risks to be tilted to the downside, reflecting primarily the possible global resurgence of the pandemic, which despite Malta's very high vaccination rate, could hamper international tourism, with possible scarring effects. While we broadly agree with Staff's strong long-term GDP growth projections, we find that the contribution of TFP to potential growth is somewhat pessimistic given the increasingly skilled labor force.

Fiscal Policies

We broadly agree that fiscal policies should remain supportive in the near term, and as the recovery is secured, policies should gradually rebuild fiscal buffers while preserving investment. Malta's strong fiscal response helped containing the economic and social impact of the pandemic, but also resulted in a sharp deterioration of public finances. Still, we believe that Malta retains policy space in the short and medium term. We agree with Staff that fiscal policy should remain supportive in the near term, making use of the sizeable resource impulse provided by the NGEU Funds while maintaining the level of nationally-financed investments. When the recovery strengthens, Malta should gradually achieve prudent medium-term fiscal objectives, while enhancing investment to boost potential growth. We share Staff's concerns about the negative effects on public debt sustainability stemming from contingent liabilities, including government guarantees, as well as high expected ageing and health care expenditure. In this regard, although pension spending is still relatively low, further adjustments to the pension system may be needed to address the projected high increase in pension outlays in the long term. Measures to increase labor market participation of older and low-skilled workers could also contribute to alleviating pressures on long-term fiscal sustainability. Malta could also reduce its reliance on volatile revenue sources, such as the investor citizenship program or international corporate tax optimization strategies, and find alternative ways to broaden the tax base.

Structural Policies

We agree with Staff that structural policies should aim at boosting potential growth, enhancing resilience, and supporting the green and digital transition, making use of the Next Generation EU Funds. While policy measures have helped to keep the labor market resilient, some further support may be needed for some sectors, especially tourism. Monitoring the financial situation of smaller firms may also be warranted to reduce the risk of scarring. Going forward, structural priorities should aim at boosting productivity growth and supporting the green and digital transformation of the economy, and in this regard, the Recovery and Resilience Plan is a unique opportunity. To facilitate resource reallocation, labor market policies should aim at addressing skills gaps, both through upskilling and reskilling of the labor force and by supporting cross-border mobility of professionals, whereas the insolvency framework should be improved to allow for an orderly reallocation of capital. We agree with Staff that other framework reforms are also needed in the areas of research and innovation, governance, justice, climate change, and digital transformation. The Maltese Recovery and Resiliency Plan covers most of these areas.

Financial Sector Policies

We agree with Staff that while the financial sector remains sound and macroprudential measures are adequate, careful monitoring is warranted given the high degree of uncertainty. The Maltese banking sector was well-capitalized at the onset of the crisis, which allowed it to face the crisis without compromising banks' intermediation capacity. The increase in NPLs has been limited and concentrated on NFCs, and banks appear well placed to handle a possible increase in distressed assets. Specific buffers for systemically important institutions are satisfactory and appropriate, and macroprudential borrower-based measures have so far been successful at preventing the potential build-up of vulnerabilities related to the real-estate market, but continued monitoring appears warranted. A prolonged inclusion of Malta on the FATF grey-list could have negative implications, but a swift implementation of the FATF action plan would limit the risk of not meeting the deadline.

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GRAY/21/2609

September 13, 2021

Statement by Mr. Buissé, Mr. Roman, and Ms. Gilliot on Malta (Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for their interesting set of documents as well as Mr. Fanizza and Ms. Korinthios for their helpful Buff statement. We broadly share the thrust of the report, including the macroeconomic outlook, risk assessment and policy recommendations. The swift and forceful response of the Maltese authorities to the Covid-19 pandemic, allowed for lesser economic and financial impact on households and firms as well as for a prompt and dynamic recovery. Strong fiscal position, low debt and a well-capitalized banking sector have likewise contributed to a faster rebound. We however agree with staff that given the high uncertainty over the course of the pandemic risks are titled to the downside. While we commend the authorities for their wide-ranging policy support to the economy, we emphasize going forward the need for a strengthening of the tax administration and for an overall review of the tax system, which would help rebuild fiscal buffers. In addition, we strongly encourage the authorities to expedite the implementation and enforcement of the AML-CFT framework, to exit from the FATF grey-list as soon as possible and preserve the country's attractiveness for foreign investment. We associate ourselves with Mr. Pösö's statement and would like to offer the following comments for consideration.

We fully endorse staff's recommendation to carefully calibrate the pace of the withdrawal of Covid-19-related support policies to pull the country back into a strong economic position, while gradually rebuilding fiscal buffers once the recovery is firmly on track. Given the unprecedented uncertainty over the evolution of the virus and the emergence of new variants, the pace of unwinding fiscal and financial support should be progressive. Fiscal stimulus should target productive activities and growth-enhancing areas while being ready to implement, if necessary, additional measures to support the most affected sectors. On a longer run, tax revenue needs be enhanced, and contingent liability risk must be carefully managed to ensure fiscal sustainability, even more when considering the potential surge in ageing-related expenditure for healthcare and pensions. The proposal for a global minimum corporate tax is a great opportunity to advance on a new corporate tax framework, encompassing actions for a more efficient tax administration.

Heightened efforts are needed to address the remaining shortcomings in the AML-CFT framework and exit as soon as possible from the FATF grey-list. Accordingly, we agree with staff that prolonged placement in the FATF grey-list could negatively impact correspondent banking relationships, raising transaction costs as well as affecting adversely foreign direct investment inflows. We thus urge the Maltese authorities to keep addressing financial integrity issues, monitoring closely the risks associated with virtual financial assets, gaming, and Malta's Citizenship by Investment (CBI) Program. *We'd be interested in staff's views on the potential impact on Malta's banking sector's stability and profitability in the event of a prolonged placement of the country in the FATF grey-list?*

We recognize the authorities' willingness to embrace a wide range of structural reforms rightly identified in the report in various key areas including labor market, tourism, digital transformation, climate change, infrastructure, insolvency regime, governance framework and justice. In this regard, we welcome their Recovery and Resilience Plan (RRP) to promote digitalization and climate change policies, which would contribute to rebalance Malta's current account and reduce its exposition to shocks to the tourism sector. Beyond these two areas, we would have seen merit in more analysis on the articulation between the RRP and the achievement of objectives in other key structural areas above mentioned. Related to solvency support to firms, we agree that the main goal should be to avoid excessive bankruptcies of viable firms going forward. This should allow for a market-based reallocation of resources and efficient exit strategies preserving the systemically important and/or innovative firms (as duly underscored in the *Selected Issues Paper)*. Deployment of quasi-equity instruments in partnership with the private sector would be an interesting way forward to do so, while maintaining corporates' investment capacity. Labor market reforms should be intensified to facilitate reallocation of resources. Focusing on upskilling and reskilling workers remains an efficient way to address the skills gap and reduce the risk of critical labor shortages due to reduced inflows of foreign workers. Finally, we found the developments on income inequality relatively limited. *Staff's assessment of the impact of the Covid-19 crisis on social and income inequality would be welcome.*

GRAY/21/2611

September 13, 2021

Statement by Ms. Rieck and Mr. Krahnke on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for the report and Mr. Fanizza and Ms. Korinthios for their helpful Buff statement. **We broadly agree with staff's assessments and recommendations.** We would like to associate ourselves with Mr. Pösö's statement and only add a few additional points, mainly for emphasis:

On fiscal policy, we agree that the fiscal measures may still be necessary to support the recovery from the effects of the pandemic. However, they should become more targeted once the recovery is on the way. In this context, we note that the expected deficit increase largely reflects a rise in "other expense" (page 31), and *would welcome if staff could elaborate somewhat on this spending item*. Furthermore, the relatively low overall tax intake and the high reliance on the corporate income tax suggest that there is room for improvement on the revenue side. We therefore agree with staff's recommendation that a holistic review of the tax system as well as an improved tax administration might be beneficial. Progress on this front could greatly facilitate the necessary rebuilding of fiscal space, in particular as we move forward on the global minimum corporate tax proposal.

We agree with staff that the high contingent liabilities, inter alia incurred during the pandemic, pose substantial fiscal risks. Consequently, the liability management might warrant some improvements. Building on the recent progress regarding the disclosure of financial statements, we encourage the authorities to strengthen the financial position of SOEs and further increase transparency. *In this context, could staff provide additional information on the size and impact of the planned capital injection for Air Malta and its effect on government finances?*

To promote sustainable growth the authorities are well-advised to improve the execution of public investment projects. With Malta having one of the lowest absorption rates for EU funds, infrastructure project management could be improved. Despite the relatively low access to financing under the EU Recovery and Resilience Facility, this could enable the authorities to revamp their infrastructure to become less carbon intensive and further promote the digital transformation without incurring extensive costs for the Maltese government. As also proposed by staff, having a pipeline of viable infrastructure projects ready would greatly improve spending execution and benefit the economic recovery. At the same time, it would need to be complemented with adequate institutional capacity for planning and implementation. We concur with staff that in particular the transportation sector and the generation of renewable energy lacks behind its European peers and can benefit from public investments.

Despite the weakening of the price dynamics on the housing market during the pandemic, the authorities need to carefully evaluate the effects of their real estate support measures and phase them out as planned, not to refuel a potential overheating of the market. Once household income and demand for tourism-related accommodation picks up again, housing prices might also pick up again. Therefore, continued close monitoring of the housing market is warranted. The authorities should stand ready to use and adapt the available macroprudential toolbox, if needed. Additionally, we welcome the authorities' recent efforts to increase housing affordability, but we also want to emphasize that further work is necessary to ease the pressure on the real estate market.

The addition to the FATF so-called "grey-list" in June 2021 is concerning and calls for immediate and decisive action to improve the effectiveness of the AML/CFT framework. As a country highly integrated into the global financial system, reliance on correspondence bank relationships is critical. We share staff's assessment that the concerns regarding financial integrity could weigh on foreign direct investments and thus adversely affect Malta's external position. We thus welcome that the authorities are aware of the urgency and urge them to implement the necessary measures swiftly.

GRAY/21/2612

September 13, 2021

Statement by Mr. Zhang and Mr. Huang on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for the insightful report and Mr. Fanizza and Ms. Korinthios for their helpful Buff statement. The pandemic has interrupted Malta's strong economic growth after the global financial crisis. Real GDP growth sharply dropped to -8.3 percent in 2020, due to the almost halted cross-border tourism and sluggish domestic economic activities. As every cloud has a silver lining, we are encouraged to see that some non-contact intensive sectors, such as information and communications technology (ICT), continued to grow strongly during the pandemic. With nearly 80 percent of the total population fully vaccinated, the recovery seems already underway. **While short-term supportive policies should continue to foster the recovery, more needs to be done to boost the potential growth over the medium term.** We broadly agree with the thrust of staff's appraisal and would like to limit ourselves to the following comments for emphasis.

Fiscal policy

An expansionary fiscal policy stance is appropriate in the near term. Pandemic-related support measures, as mostly scheduled to end by the end of this year, should be rolled back in a gradual way.
Given the rosy economic outlook and the already low take-up rate, we tend to agree with the authorities that no additional corporate support measures are needed going forward. Nevertheless, the authorities are encouraged to keep a close eye on the corporations, especially the tourism and contact-intensive ones, in case their balance sheets suddenly deteriorate.

Once the recovery is firmly underway, we agree with staff that fiscal buffers should be rebuilt to create policy rooms for envisaged infrastructure and aging-related spending. The authorities are encouraged to further improve the public investment management, including project appraisal and selection, to increase the investment efficiency. The ongoing international tax reform is expected to have a substantial impact on Malta's fiscal revenues and cross-border capital flows. We encourage in-depth analysis on this issue in future Article IV consultations.

Financial sector

The stress test reassured that the banking system remains broadly resilient, but as staff rightly pointed out, its asset quality could deteriorate. The authorities are encouraged to continue closely monitoring banks' financial positions and keeping prudent supervision standards. While enhancing data collection is essential to monitor the risks related to intercompany lending, more could be done to facilitate banks' credit provision and incentivize corporates to shift away from opaque intercompany lending.

As for the AML/CFT, we encourage the authorities to double their efforts to resolve the remaining deficiencies and get off the FATF's "grey list" as soon as possible. Appropriate supervision of the virtual financial assets and online gaming is also essential to prevent criminals from using them for money laundering purpose. Preserving the financial integrity and reputation is the key to secure Malta's success as a financial service hub.

Structural reform

We note that the potential growth is expected to moderate to around 3 percent over the medium term, nearly half of the average growth rate in 2014-2019. To reverse or at least slow down this declining trend, structural reforms are needed to boost productivity and new drivers of growth should be found. We take positive note that the authorities have made a tourism development strategy, rightly focusing on using new digital technology, making it greener and increasing its value-added. We look forward to its implementation. *As for the labor market, we take positive note that the female participation rate improved swiftly these years even during the pandemic. Could staff elaborate more on the reasons behind this and the experience from Malta for peer countries to learn from?*

With these remarks, we wish the authorities every success in their policy endeavors.

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GRAY/21/2613

September 13, 2021

Joint Statement by Mr. Alhomaly, Mr. Alhosani, Mr. Al-Kohlany, and Mr. Rawah on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank the staff for the comprehensive set of reports and Mr. Fanizza and Ms. Korinthios for their Buff statements. We are in broad agreement with the staff's appraisal and policy recommendations and would like to limit our comments to the following:

1- **Fiscal policy should remain supportive in the near term**. As the crisis abates, it will be important to return to a structural fiscal balance and to place debt on a firm downward trajectory to safeguard fiscal sustainability and rebuild buffers. Here, we welcome the authorities' commitment to fiscal sustainability and positively note the plan for fiscal consolidation once the recovery is fully established. To this end, we agree that the withdrawal of support measures should be gradual and well-managed in order to avoid disrupting the recovery. We take note of staff's view that the proposed global minimum corporate tax could impact Malta's fiscal revenues and we agree on the need to review the current tax system with a view to strengthening tax revenue and compliance. Improving the efficiency of public investment management is key to enhancing the utilization of the EU funds, and we encourage continuing strengthening contingent liabilities management together with pursuing tax and pension-related reforms.

2- **The banking sector proved resilient to the COVID-19 crisis, thanks to the authorities' recent support measures and good effort to build banks resilience post the global financial crisis**. Nonetheless, we encourage the authorities to remain vigilant to risks given the uncertainty around the pandemic's impact, especially on the corporate and housing sectors. We agree that improving data collection, monitoring and the full utilization of the credit registry system are important steps to better identify and address vulnerabilities from intercompany lending.

3- **We welcome Malta's commitment to enhancing its AML/CFT framework, addressing the remaining deficiencies identified in the Moneyval assessment report, and to exiting the FAFT grey list**. While progress has been made in addressing issues related to the gaming sector as noted in Mr. Fanizza's Buff, in addition to adopting new risk-based tools, strengthening enforcement and creating a new Asset Recovery Bureau, further efforts are needed to improve the accuracy of beneficial ownership information and to enhance investigations and prosecutions related to criminal tax and money laundering cases. While we note the divergence of views between staff and the authorities regarding the adversity of the inclusion of the country in the FATF grey list on correspondent banking relationships, continued monitoring is warranted to help avoid renewed pressures.

4- **Structural reforms are needed to support inclusive growth and competitiveness, including through boosting productivity**. We take note of staff's assessment that the shortage of skilled labor remains a bottleneck and the skill gaps with EU are projected to widen. Here, we encourage the authorities to adopt a holistic approach to address weaknesses in the labor market, including improving the education system as well as promoting technical and vocational training. We positively note that the gender gap in employment seems to have narrowed as the female participation rate and employment growth rate have improved.

With these remarks, we wish the authorities further success.

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GRAY/21/2617

September 13, 2021

Statement by Mr. Moreno and Mr. Lopez on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for their comprehensive set of reports, and Mr. Fanizza and Ms. Korinthios for their useful Buff statement. We broadly share staff's appraisal and associate ourselves with Mr. Pösö's statement. We would like to add the following comments for emphasis.

We commend the authorities for the decisive policy response to confront the social and economic effects of the pandemic. During the last decade, prudent fiscal policy and successful structural reforms have underpinned growth and help build fiscal buffers, allowing the rapid implementation of a diverse set of policy measures to support households' income and firms' liquidity during the crisis. These measures have mitigated the fallout of GDP and safeguarded financial stability. Going forward, we share staff's view on a rebound of the economic activity in 2021 and 2022, facilitated by the successful vaccination campaign. Nevertheless, uncertainty remains high and risks—mainly related to domestic and international pandemic developments—are tilted to the downside, especially given the large weight of the tourism sector on the economy.

Fiscal support should be maintained and gradually turn to a prudent mode when the recovery takes ground, while fiscal structural vulnerabilities should be tackled. Support measures should be maintained, although more calibrated and focused on vulnerable sectors and households. The gradual recovery of the economic activity should be aligned with the progressive withdrawal of support measures and a more active use of reallocation and training policies, solvency support to viable firms, and a revision of the social safety net to improve its efficiency and coverage. We praise the authorities for their commitment with fiscal consolidation in the medium-term and take note of staff's conclusion that public debt will recover a robust downward path after reaching its peak in 2023. At the same time, the recovery is a good opportunity to tackle long-standing fiscal challenges with the support of the Next Generation EU funds. Specifically, public investment should markedly increase to close infrastructure gaps, accompanied by a well-targeted reform of the tax system and a revision of the governance framework of the SOEs. Additionally, we encourage the authorities to continue working on the revision of the pension system to ensure its long-term sustainability.

The banking sector should be closely monitored to ensure an adequate management of credit-related risks, while concerning shortcomings in the AML/CFT framework should be addressed. Although, according to staff's solvency analysis, the capital position of banks seems to be robust, supervisory authorities should monitor interconnectedness risks through intercompany loans and continue requiring banks to carefully assess, classify and provision their credit portfolio, since corporate and personal bankruptcies could emerge after policy support is withdrawn. In addition, we are concerned over the remaining deficiencies in the AML/CFT framework, and we urge the authorities to continue their efforts to close the existing gaps and ensure its effective implementation.

On structural reforms, we share staff's recommendations to improve the labor market, to strengthen the insolvency framework and to progress the digital and green agendas. Labor markets policies should be focus on labor reallocation through ALMPs and addressing deficiencies related to skill gaps through upskilling, training programs and facilitating international labor mobility. At the same time, policies should be oriented to facilitate capital reallocation by improving the insolvency framework to ease procedures and increase their efficiency, including the provision of adequate physical and human resources in the judicial system to avoid bottlenecks. Additionally, the European recovery funds should be an opportunity to promote the digital transformation of the economy and to advance towards a green transition.

Close monitoring of the tourism sector developments is warranted to adequately assess scarring effects. The significance of the tourism sector in the economy provoked a sharp decline in GDP during the periods of higher incidence and more restraint containment measures, although the sector could recover quickly when these measures are relaxed in line with vaccination progress domestically and in the main importing markets. While the full recovery of the tourism sector will depend on many factors, including the easing of travel restrictions to foreign travelers and workers, the effect of the pandemic could be temporary and less scarring than previously projected. The authorities' strategy to modernize the sector and increase its value added will also help in this direction. Similar results could be observed in other tourism dependent countries, especially in those where strong domestic demand has partially prevented a major impact of the pandemic. Staff should carefully monitor these sectoral patterns to produce accurate medium-term projections and sound policy advice.

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GRAY/21/2619

September 13, 2021

Statement by Mr. O'Brolchain and Mr. Mooney on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for the comprehensive report and Mr Fanizza and Ms Korinthios for their helpful Buff statement. The large tourism sector in Malta has been severely negatively impacted by the COVID-19 crisis. However, thanks to years of prudent fiscal management and the authorities' swift actions to support households, businesses, and the healthcare system, the Maltese economy is expected to rebound by 5¾ percent in 2021. We broadly agree with staff's assessment and offer the following comments for emphasis.

We share staff's view that the authorities should carefully manage the unwinding of fiscal support measures to avoid cliff effects, while maintaining the flexibility to extend some measures if health risks reemerge. We welcome the authorities' ongoing review of the social protection scheme, with a view to improving the coverage of social safety nets in a cost-effective manner. We note the recent improvements to the accountability and governance framework of SOEs, and encourage the authorities to build on this progress by further developing the financial position of these entities.

We positively note that the Maltese banking sector was well-capitalized at the onset of the pandemic, which has contributed to ongoing resilience in the sector. We agree with staff that bank supervisors should continue to closely monitor banks' financial positions and risk management frameworks as the recovery takes hold. The authorities should remain vigilant in monitoring risks in the real estate market, and consider refining the borrower-based macroprudential measures if warranted. The AML/CFT framework has been significantly enhanced since Moneyval identified deficiencies in 2019, and we note that the authorities do not expect downside risks to emerge in the short term from the inclusion of the country in the FATF grey list.

We welcome the information contained in the Selected Issues Paper that incoming data in the tourism sector shows a strong recovery. This positive trend has been accompanied by a drop in COVID-19 infection rates and the fact that over 90 percent of adults have now been fully vaccinated. We positively note the low unemployment level, and we agree with staff that labor market reforms should prioritize upskilling and reskilling workers. In addition, we welcome the increase in the female employment rate during the pandemic. In terms of climate mitigation, the publication of the “Malta Low Carbon Development Strategy” is a positive development. In this regard, we welcome the authorities’ commitment to reduce greenhouse gas emissions under the EU Effort Sharing Regulation.

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GRAY/21/2620

September 13, 2021

Statement by Mr. Dresse and Mr. Voinea on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We would like to thank Mr. Ishi and his team for the insightful report and Mr. Fanizza and Ms. Korinthios for the informative Buff statement. We associate ourselves with Mr. Pösö's statement and would like to make the following points for emphasis:

We would like to commend Malta for its successful vaccination campaign; the high vaccination rates helped the economy gain momentum and allowed for the reopening of the very important tourism industry. This could contribute to a gradual return to a surplus current account post-pandemic.

Moreover, **we believe that the ambitious Recovery and Resilience Plan will be a catalyst for change** in key areas such as energy efficiency, carbon neutrality, digitalization, health sector resilience, education, and institutional framework, therefore promoting growth. *Could staff detail whether the RRP has been accounted for in the growth projections?* As it is crucial to ensure efficiency in public investment delivery, we welcome authorities' plans to leverage the IMF's PIMA framework.

We share the view that while expansionary fiscal policy is still needed in the short run, in the medium-term a gradual shift from emergency to recovery support is warranted. Fiscal buffers should be gradually rebuilt, and debt should reenter a downward trajectory in the medium-term. We agree with staff that, given the global consensus on corporate tax reform, the authorities should consider launching a holistic review of the overall tax system to improve the efficiency of the tax system, minimize distortions, administration and compliance costs while generating sufficient revenues to cover government spending. *In this vein, we would appreciate a more detailed analysis of the effective corporate tax rate (after refunds) and of the merits of the favorable tax treatment for the gaming industry. Staff's comments are welcome.*

On the financial sector, we note that the large banks appear to be well capitalized, and that the authorities have strengthened their capacity for risk analysis and supervision along the lines recommended by the 2019 FSAP. However, Malta's inclusion on the FATF's grey list could be detrimental to foreign investments and raise transaction costs if not properly addressed, especially in the areas of transparency on beneficial ownership information and financial intelligence related to money laundering and tax evasion. *Virtual financial assets and the real estate market through Malta's Citizenship by Investment Program are inherently associated with ML/FT risks and should be closely monitored. We would ask staff to pay more attention to these topics in future Art. IV consultations.*

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GRAY/21/2623

September 13, 2021

Statement by Mr. Palotai, Mr. Just, and Mr. Marek on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for the informative set of reports and Mr. Fanizza and Ms. Korinthios for their helpful Buff statement. While Malta was considerably hit by the COVID-19 pandemic and subsequent lockdowns, the economy has become more robust and living standards have improved since the global financial and eurozone debt crisis. We broadly share staff's appraisal and associate ourselves with the statement by Mr. Pösö. The authorities should gradually move toward fiscal consolidation once the pandemic-related support measures have been unwound and stay vigilant of potential financial stability risks. We also encourage them to remove bottlenecks to growth through well-targeted structural reforms going forward.

The authorities' fiscal trajectory prior to the pandemic was commendable, but it is critical to buttress revenues and keep contingent liabilities in check. We share staff's recommendations to enhance the efficiency of tax collection and improve accountability and governance of state-owned enterprises, in particular against the backdrop of vulnerabilities analysed in the staff DSA's government guarantee shock simulations. The tax revenue reforms should also be aligned with the authorities' climate policies and reflect the respective tax structure, as explained in Annex VII. Increasing pension system sustainability needs to be at the forefront of the authorities' medium-term reform plans owing to the projected long-term budgetary impacts. We therefore encourage further work on exploring various pension reform options and see merit in staff's engagement with the authorities on this matter, in particular regarding the related fiscal costs and distributional implications.

While the banking sector is well-capitalized and non-performing loans have been under control, supervisory vigilance is warranted. We positively note that the banking sector is more resilient than after the global financial crisis, as evidenced by robust capital buffers and solid credit loss absorption capacity. The supervisory and regulatory authorities should monitor developments in the real estate market amid persistent credit growth and asset overvaluations. *Staff's comments on the authorities' use of macroprudential tools in the context of rising real estate risks would be welcome.* The lack of granular information on intercompany loans between non-financial corporates and their risk management practices might also weigh on banks' balance sheets. The authorities should therefore keep the local credit registry system up to date to ensure that banks perform adequate loan provisioning.

Structural reforms need to be aimed at expanding the potential GDP. The authorities should increase in a fiscally prudent manner public expenditure in R&D, which has been significantly below the EU average. We also encourage them to move ahead with tourism sector modernization and advancements in digitalization to further boost the economy's growth potential. Increasing the relatively low absorption capacity of EU funding will be instrumental in putting the financing for the EU-supported Recovery and Resilience Plan to a productive use. To this end, leveraging the Fund's Public Investment Management Assessment Framework would be a step in the right direction. Further structural reforms should also include upskilling and reskilling of workers to avoid widening the current skills gap and keep up with the EU trend. *Against the backdrop of rising real estate overvaluation and credit growth, we would welcome staff's additional comments on the low sectoral productivity in the real estate as indicated in the staff report on p. 17.*

While we note the authorities' progress to address the AML/CFT shortcomings, Malta's placement on the FATF "grey list" is concerning. We therefore call on the authorities to step up their effort to eliminate the remaining deficiencies in the AML/CFT framework and improve its effectiveness. It is particularly important to ensure that beneficial ownership information is accurate and up to date, while close attention should be paid to addressing ML/FT risks located in business models with virtual financial assets and the gaming sector. *We would welcome more details from staff on the regulation of crypto assets in Malta.* Maintaining sound correspondent banking relationships is also critical to ensure that Malta continues to be an attractive financial and business location.

GRAY/21/2635

September 13, 2021

Statement by Mr. Andrianarivelo, Mr. N'Sonde, and Mr. Carvalho da Silveira on Malta (Preliminary)
Executive Board Meeting
September 15, 2021

We thank staff for the informative set of papers and Mr. Fanizza and Ms. Korinthios for their insightful Buff statement.

We are pleased to note that the Maltese economy is rebounding following the sharp contraction caused by the Covid-19 pandemic. Sound macroeconomic policies and buffers built over the years were helpful to enter this turbulent period on a strong economic footing. The authorities’ swift actions to curb the spread of the virus and provide strong support to the most affected households and businesses, notably through wage supplements and financial assistance, are noteworthy. We welcome the indication that real GDP growth is expected to bounce back from -7.8 percent in 2020 to 5.7 percent in 2021 and increase further to pre-Covid-19 levels in 2022. Given that risks to the outlook remain skewed to the downside, we agree that emphasis should be placed on balancing near-term support with making progress on key reforms to achieve fiscal sustainability, enhance the resilience and integrity of the financial system and boost growth potential. We concur with staff appraisal and will limit our comments to the following points.

We share the view that maintaining support measures remains essential in the near-term without losing sight of fiscal sustainability. Given the uncertainty surrounding the pandemic, the authorities should gradually phase out Covid-19 measures as the economy strengthens while remaining flexible to extend and/or target them to assist the most affected households and businesses. In this connection, we appreciate that the authorities are currently monitoring the deterioration of corporate balance sheets and reviewing the social protection scheme to improve the efficiency of its coverage. For the medium-term, we welcome the authorities’ commitment to fiscal sustainability guided by EU level fiscal rules and to putting the debt-to-GDP ratio on a downward path. To this end, we welcome their efforts to improve tax administration. Considering the discussions around global minimum corporate taxation, these efforts should be complemented by a comprehensive review of the overall tax system.

Furthermore, the authorities should remain steadfast in their efforts to enhance public financial management; improve governance of SOEs to contain contingent liabilities; and reform the pension system, in order to reduce the daunting fiscal vulnerabilities.

We urge the authorities to step up efforts to address risks to financial stability and integrity. As a financial center, being placed on the Financial Action Task Force (FATF) list of countries for increased monitoring is concerning for the Maltese economy, as it may lead to a loss of correspondent banking relationships, scare away foreign investors and thus hamper growth prospects. While progress on technical compliance is welcome, we call on the authorities to address the remaining deficiencies in the AML/CFT framework, particularly those pertaining to transparency of beneficial ownership information and financial intelligence related to money laundering and tax evasion, with a view to exit the FATF grey list as soon as possible. We appreciate the initial steps taken in this regard. With respect to the banking sector, we encourage the authorities to continue to proactively monitor banks' balance sheet, address potential risks in the real estate market and prepare to deploy further macro-prudential measures, as appropriate.

Tackling existing structural bottlenecks is necessary to support the recovery, enhance competitiveness, build resilience and foster higher long-term growth. We praise the authorities for the steps taken to implement policy actions in several fronts, notably to promote business investment, strengthen insolvency framework, reduce skills gap in the workforce and increase digitalization. Finally, we take note of their commitment to climate policies and are hopeful that the new Malta Tourism Strategy 2021-2030 will help bolster tourism and promote a more sustainable direction for the sector after the crisis.

With these remarks, we wish the authorities of Malta every success in their future endeavors.

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GRAY/21/2636

September 13, 2021

Statement by Mr. Bhalla and Mr. Natarajan on Malta
(Preliminary)
Executive Board Meeting
September 15, 2021

1. We thank the staff for the detailed report and Mr. Fanizza and Ms. Korinthios for the informative Buff. The streak of strong economic growth witnessed by the Maltese economy was interrupted by the COVID-19 pandemic. Strict containment measures were taken to mitigate the adverse health impact of recurrent waves of the pandemic. The economy suffered huge contraction particularly due to collapse in the tourism sector. Strong and swift fiscal measures by the authorities have helped to provide support to the households and businesses. An effective vaccination roll out is expected to catalyze the economic recovery. Promoting high growth activities and undertaking key structural reforms can help in sustaining the recovery and growth.

2. The economy is expected to rebound strongly by over 5 percent in 2021 after suffering severe contraction in 2020. Progress made in vaccination is expected to facilitate gradual revival of contact intensive sectors like tourism. Strong growth is expected from the digital intensive sectors like ICT and remote gaming. Improvement in business and confidence indicators point to the strong economic recovery. On the external sector front, the current account turned deficit due to fall in travel activities and decline in investment income.

3. Strong fiscal response to support households and firms through measures like wage supplement, financial assistance to businesses and social measures led to double digit fiscal deficit and about 11 percent increase in public debt. We concur that the fiscal policy should be appropriately expansionary in the near-term and gradually reduced as the recovery sustains. Long term fiscal measures include strengthening tax revenues and managing the risks from contingent liabilities. Can the staff provide an assessment of expenditure control or reduction measures that are feasible in the near-term?

4. The monetary and financial sector measures like loan moratoria and interest subsidies have helped to improve liquidity and credit flows. We recognize the criticality of safeguarding the financial stability particularly due to possible rise in corporate insolvencies, risks from mortgage lending in the housing sector and inter-company loans. We encourage the authorities to closely monitor the corporate sector as their resilience will be under

pressure when the support measures are wound up. The banking sector has remained stable but requires to be closely monitored in the context of corporate sector risks.

5. Sustainable growth can be maintained by advancing structural reforms. The rapidly changing business environment requires reorienting labor market policies by prioritizing upskilling and adult learning. We welcome the Malta Tourism Strategy 2021-2030 which provides future direction to the sector by incorporating digital technologies, enhancing greener tourism, and improving tourism infrastructure. We welcome the authorities' efforts for adoption of risk-based tools and institutional improvements in the AML/CFT framework. We encourage further intensification of efforts to resolve remaining deficiencies in the framework.

6. Finally, we wish the authorities the best in all their endeavors.

Statement by Rasmus Rueffer (ECB representative) and Sander Tordoir on Malta - Article IV Consultation 2021
(Preliminary)

IMF Executive Board Meeting

September 15, 2021

We thank Mr. Fanizza and Ms. Korinthios for their informative Buff statement and Staff for their report. We associate ourselves with the Statement of Mr. Pösö and would like to highlight the following issues:

We broadly agree with Staff's macroeconomic assessment and the real GDP growth projections for Malta, but expect somewhat slower economic growth in 2021 given the still very subdued tourism exports. Economic growth was strong in Malta before the pandemic. The government contained the economic fallout with adequate support measures, while the rapid rollout of the vaccine also supports the economy. Like Staff, we see the risks to economic growth as tilted to the downside, reflecting primarily the resurgence of the pandemic and the possible scarring effects of the crisis. While we broadly agree with Staff's long-term growth projections, Staff's medium-term TFP projections may not adequately account for the strong capital contribution to potential growth, the improving skill level of the population and the fact that labour shortages can be expected to support skilled immigration. At the same time, we agree that further measures are needed to boost productivity growth.

Malta's strong fiscal response to stem the pandemic was justified, although it led to a deterioration in public finances that is larger than in many other EU countries. The deficit rose to over 10% of GDP in 2020 and is forecast to remain among the highest in the euro area and above the 3% of GDP threshold over the projection horizon. We broadly agree with the debt path projection of Staff which see debt to remain below 70% of GDP butshare Staff's concerns about the negative effects on public debt sustainability stemming from contingent liabilities, including government guarantees, as well as high expected ageing and health care expenditure.

The implementation of an ambitious Recovery and Resilience Plan presents an important opportunity to address some of the structural challenges faced by Malta's public finances. For example, Malta could reduce its reliance on volatile revenue sources and find alternative ways to broaden the tax base. The sustainability of the healthcare and pension systems could be reinforced in view of expected gains in life expectancy.

As regards structural policies, the pandemic has the potential to exacerbate vulnerabilities in Malta, thereby increasing the risks of scarring effects, as pointed out by Staff. The policy measures implemented so far have helped to keep labour markets and capital formation strong, but, as the Staff report points out, some further measures may be needed to support vulnerable sectors, for example, tourism. Scarring effects may also stem from the estimated rise in the share of financially distressed firms, as shown in the related Selected Issues paper. Thus, the financial situation of smaller firms needs to be closely monitored.

In the aftermath of the COVID-19 pandemic, reforms aimed at boosting potential growth and enhancing resilience should be the main priority of policy. The fact that Malta was placed on the FATF grey-list, particularly if prolonged, may negatively affect FDI inflows and, through that, longer-term growth prospects. Structural reforms should focus on productivity growth, both through labour productivity and R&D, as well as tackling the weaknesses in institutional quality and supporting the digital and green transformation. In terms of labour market policies, we agree that upskilling and reskilling workers is key whilst noting that supporting cross-border mobility of professionals may also support skilled labour supply.

Against this backdrop, we agree with Staff's call for a suite of measures to boost productivity, manage skill gaps, reform the corporate insolvency framework, promote digitalisation, advance decarbonisation and improve governance. We also agree that the AML/CFT framework needs to be further strengthened.

As regards financial sector policies, we concur with Staff that the pandemic's impact on the financial sector in Malta was well contained and that banks have remained resilient. The Maltese banking sector was well-capitalised at the onset of the coronavirus pandemic, which allowed it to face the crisis without compromising banks' intermediation capacity. The CET1 ratio further increased steadily since then (from 15.7 in 2019q1 to 18.2 in 2021q1), while the NPL ratio increased very slightly (from 3.4 in 2019q1 to 3.7 in 2021q1). The support measures for the real estate market should expire in summer 2021 as planned.

We share the Staff's view that macroprudential measures in Malta are adequate and sufficient to address current risks but vigilance in risk monitoring is warranted given a high degree of uncertainty. Specific buffers for systemically important institutions are satisfactory and appropriate. The borrower-based measures from July 2019 (limits on the loan-to-value at origination, debt-service-to-income at origination and maturity) strengthened the resilience of lenders and borrowers against the potential build-up of vulnerabilities originating from the real estate market. We welcome the highlighted progress in extending the frequency and coverage of real estate loan data and the plan to improve the reporting lag and frequency of nonfinancial corporates' balance sheet data.

Malta

Responses to Technical Questions Posed by Executive Directors in Advance of EBM/21/91—September 15, 2021

COVID-19 impact, outlook, and risks

1. We note, however, that it is not clear how the impact of the Next Generation EU (NGEU) has been factored in on Staff's projections.

- Staff's macroeconomic framework assumes that investment projects under the Recovery and Resilience Facility would boost annual GDP growth by 0.1-0.3 percentage points of GDP per year. For this calculation, we assume a relatively small fiscal multiplier (0.4), given that Malta is a small open economy.

Assumed Macroeconomic Impact of EU Recovery and Resilience Facility

	2021	2022	2023	2024	2025
GDP growth (%)	5.7	6.0	5.0	4.5	3.7
RRF contribution (% points)	0.1	0.3	0.2	0.1	0.0
Growth excluding NGEU (% points)	5.6	5.7	4.8	4.4	3.7
Memorandum item:					
NGEU Grants (% of GDP)	0.3	0.8	0.6	0.3	0.1

Sources: Staff calculations.

2. Staff's assessment of the impact of the Covid-19 crisis on social and income inequality would be welcome

- The latest data for income inequality are for 2019, and updated data reflecting the COVID-19 impact on social and income inequality are not yet available. Available indicators, however, suggest that absolute poverty continued to decline in 2020. For example, the number of persons dependent on social assistance declined by 4 percent (y/y) in 2020, and the proportion of the population in severe material deprivation fell from 3.6 percent in 2019 to 3.3 percent in 2020.

- It appears that the potential negative impact from the crisis has been largely mitigated due to the authorities' swift and generous support measures, including the wage supplement, the temporary increase in unemployment benefits to persons who lost their job during the pandemic, and other social measures (e.g., support for working parents with school-aged children).

3. As for the labor market, we take positive note that the female participation rate improved swiftly these years even during the pandemic. Could staff elaborate more on the reasons behind this and the experience from Malta for peer countries to learn from?

- Since the late 2000s, the authorities have introduced a series of schemes to promote female labor participation, including income tax rebates for long-term unemployed women on re-entering work, free childcare, expanding the availability of before- and after-school care, and in-work benefits for low-income households with children.

- In addition, the authorities introduced a number of measures to improve basic skill attainment and reduce the number of early school leavers to strengthen the employability prospects of people joining the labor market.

- A study by the Central Bank of Malta concludes that around half of the increase in the female participation rate is attributable to reforms (Michallef, 2018)

4. **Against the backdrop of rising real estate overvaluation and credit growth, we would welcome staff's additional comments on the low sectoral productivity in the real estate as indicated in the staff report on p. 17.**

- Between 2015 and 2019, the GVA of the real estate sector grew by 28 percent, but employment growth in this sector more than doubled, resulting in a decline in productivity growth. Before the pandemic crisis, Malta experienced a property market boom, reflecting rising disposable incomes, the continued influx of foreign workers, higher use of online accommodation services by tourists, and portfolio rebalancing towards property investments. The boom in the sector appears to explain, in part, the strong growth of employment in this sector.

Fiscal Policy

5. **In relation, given the important role of the EU Recovery and Resilience Facility for public investment going forward, could staff elaborate on capacity constraints to absorb EU funds and possible solutions?**

- While Malta's public investment programs demonstrate high levels of financial commitment to the allocation of EU funds, actual payment claims and certified amounts tend to fall short, indicating challenges in funding allocation and project implementation. To reduce underspending, the authorities have been regularly requesting beneficiaries to update progress in achieving contracts and highlight implementation challenges. More generally, there appears room for improvements in project appraisal, project selection, and contracting and procurement. In addition, the authorities have requested a Public Investment Management Assessment (PIMA) by the Fund to help identify bottlenecks.

6. **We note that the expected deficit increase largely reflects a rise in "other expense" (page 31), and would welcome if staff could elaborate somewhat on this spending item.**

7. **In this context, could staff provide additional information on the size and impact of the planned capital injection for Air Malta and its effect on government finances?**

- The rise in "other expense" in 2021 and 2022 in staff's projections largely reflects planned financial assistance to the national airline, Air Malta. The authorities indicated that they had requested the European Commission to authorize state aid of about €290 million (2 percent of GDP) for Air Malta. However, discussions on the restructuring plans are still ongoing, with the support size yet to be determined.

8. In this vein, we would appreciate a more detailed analysis of the effective corporate tax rate (after refunds) and of the merits of the favorable tax treatment for the gaming industry. Staff's comments are welcome.

- All companies in Malta are subject to corporate taxes at the rate of 35 percent on their worldwide income and capital gains. Under the full imputation tax system in Malta, following the distribution of dividends, shareholders are entitled to a refund of part or of all the taxes paid by the company to eliminate any double taxation that might arise on the distribution of such dividends. Effectively, the tax rate can be lowered to 5 percent or less after refunds.

- Remote gaming companies are subject to the same tax rules, with the effective tax rate of 5 percent.

Financial sector policy

9. Staff's comments on the authorities' use of macroprudential tools in the context of rising real estate risks would be welcome

- In July 2019, the authorities introduced borrower-based macroprudential measures against the background of rising house prices and bank exposures to real estate. The share of loans granted to purchase secondary and buy-to-let properties dropped, and banks' lending standards have improved.

- In June 2020, some of the borrower-based measures were temporarily relaxed, and in July 2020, fiscal incentives for property transactions were introduced to address potential shocks on borrowers' income resulting from the pandemic. The temporary relaxation of the borrower-based measures has already lapsed, and phased tightening of a loan-to-value cap was implemented in July 2021.

AML/CFT

10. To what extent is the progress in Malta dependent on the progress in the AML/CFT framework at the EU level and the euro area? What are the recent developments in this area?

- The ongoing efforts to strengthen AML/CFT frameworks at the EU level, including discussions to consolidate AML/CFT supervision at the EU level, can provide additional support to Malta's overall efforts to enhance their national AML/CFT framework. In the 2019 FSAP, staff recommended that authorities support establishing an EU-level arrangement responsible for AML/CFT supervision. Recently, on July 20, 2021, the EC proposed a package of legislative proposals to strengthen the EU's AML/CFT framework, which will be discussed by the European Parliament and Council. The proposal includes: (i) a new EU AML Authority; (ii) a single EU rulebook for AML/CFT; (iii) full application of the EU AML/CFT rules to the crypto sector; and (iv) EU-wide limit of €10,000 on large cash payments.

- However, to exit the FATF's "grey list," Malta will be required to meet its specific action items as agreed with the FATF. Malta's progress in this context will be assessed individually by the FATF. The authorities will provide an update on their recent efforts at the upcoming October FATF Plenary meeting.

11. Exiting from the FATF's "Grey List" should remain the authorities' priority. We would welcome Staff comments on the authorities' plan and the timeline for doing so.

- The authorities have put together a detailed national action plan, in coordination with all relevant stakeholders, to meet the requirements of the FATF's action plan. These include, among others, (i) actions to clarify the roles and responsibilities of the Revenue Commissioners and Malta's Financial Intelligence Unit, (ii) measures to enhance coordination/cooperation between law enforcement and tax authorities, (iii) enhanced enforcement actions related to tax crimes, and (iv) more decisive enforcement actions and sanctioning of companies and gatekeeper who do not comply with their obligations to provide accurate and up-to-date beneficial ownership information.

- While timelines for each of the actions will vary and depend on progress to be made, the authorities emphasized that they would prioritize their efforts with respect to the FATF action plan, aiming to exit the "grey list" as soon as possible.

- With respect to the process, the FATF meets every four months ("FATF Plenary meeting"), during which grey-listed countries have the opportunity to provide the necessary documentation and information to demonstrate that all action items are met. If FATF members are convinced that there is indeed a likelihood that all issues have been addressed, then the Plenary can authorize an on-site visit to the grey-listed country to verify the information. Provided the on-site mission is a success, the country would be removed from the grey list at the subsequent FATF Plenary meeting.

12. We'd be interested in staff's views on the potential impact on Malta's banking sector's stability and profitability in the event of a prolonged placement of the country in the FATF grey-list?

- A prolonged placement on the FATF gray list can have important financial stability and economic implications. Grey-listing does not result in counter-measures but may signal heightened risks in transactions with the country, dissuading foreign investments (see Kida and Paetzold, 2021). Pressure on corresponding banking relationships could rise, increasing fragilities in the payment sector, for example, via higher concentration risks, higher cost of transactions, and lower bank profitability. Pressures on certain segments of the economy can also arise if banks adopt "de-risking" strategies and terminate or restrict business relationships with clients without evaluating their ML/FT risks individually. There can also be spillover effects on foreign banks which use Maltese banks as intermediary banks for processing payments.

13. Virtual financial assets and the real estate market through Malta's Citizenship by Investment Program are inherently associated with ML/FT risks and should be closely monitored. We would ask staff to pay more attention to these topics in future Art. IV consultations.

- Staff have been following ML/TF risks related to virtual financial assets and Malta's Citizenship by Investment Program, including its inter-connection with the real estate sector. These issues were covered during the 2019 Malta Financial Sector Assessment Program (see Malta FSAP Technical Note – AML/CFT, IMF Country Report No.19/345) and previous Article IV reports (2019 and 2020). Taking into account the ongoing financial integrity risks posed by such sectors/initiatives, staff will continue to pay attention to these topics in future Article IV consultations.

14. We would welcome more details from staff on the regulation of crypto assets in Malta

- Malta has established a framework for the licensing and regulation of virtual asset service providers through the enactment of the 2018 Virtual Financial Assets (VFA) Act (Cap. 590 of the Laws of Malta), which regulates persons using virtual assets or providing related services and introduces the concept of VFA agents who are responsible for introducing virtual asset business to Malta. VFA agents are subject to AML/CFT obligations and supervision by Malta's Financial Intelligence Unit.

- More recently, the authorities have also (i) taken additional measures, including to finalize a risk assessment in relation to VFAs, (ii) launched a risk-assessment mechanism for smart contracts, (iii) created a regulatory sandbox, and (iv) have published relevant sectoral guidance.

Constituency Codes

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