LAPSE OF TIME

SM/20/76

March 25, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Malta—Staff Report for the 2020 Article IV Consultation**

Board Action:	Executive Directors' **consideration** on a lapse of time basis as envisaged under with the framework for handling Board meetings during the period of extended remote working.
Deadline to Request Board meeting:	**Monday, April 6, 2020** **12:00 (noon)**
Proposed Decision Deemed Approved:	Wednesday, April 8, 2020
Provisional Board Meeting Date: (if requested)	Wednesday, April 8, 2020
Proposed Decision:	Page 24
Publication:	Yes* Press Release will be based on the staff appraisal if there is no request for a Board discussion, as attached.
Questions:	Mr. Natal, EUR (ext. 35983) Mr. Salas, EUR (ext. 35549) Mr. Foda, EUR (ext. 34359) Ms. Shi, EUR (ext. 37438) Ms. Fernando, LEG (ext. 38658)

***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**

Document Transmittal in the Absence of an Objection and in accordance with Board policy:	Forthwith—European Central Bank Thursday, March 26, 2020—European Commission After Board Consideration—European Investment Bank, Food and Agriculture Organization, United Nations Development Programme, World Trade Organization

MALTA

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

March 24, 2020

KEY ISSUES

The Staff Report was prepared by a staff team of the IMF for the Executive Board's consideration on April 6, 2020. The staff report reflects discussions with the Maltese authorities in February 2020 and is based on the information available as of February 28, 2020. It focuses on Malta's near and medium-term challenges and policy priorities and was prepared before COVID-19 became a global pandemic and resulted in unprecedented strains in global trade, commodity and financial markets. It, therefore, does not reflect the implications of these developments and related policy priorities. The outbreak has greatly amplified uncertainty and downside risks around the outlook. Staff is closely monitoring the situation and will continue to work on assessing its impact and the related policy response in Malta and globally.

Context. Rapid rebalancing of the economy towards high value-added services, such as tourism, finance and remote gaming has allowed Malta to close its income-per-capita gap with the EU average. Prudent fiscal policy and timely structural reforms have helped boost employment and build fiscal buffers while promoting social inclusion. However, rapid growth has put pressure on infrastructure, housing and the environment, while significant deficiencies in Malta's anti-money laundering/countering the financing of terrorism (AML/CFT) framework threaten to damage the country's attractiveness for foreign investment and potentially its financial stability.

Policy recommendations. Policies should focus on sustaining economic achievements and addressing the most immediate threats to financial integrity while sustaining inclusive growth.

- **Financial sector.** Immediately tackle shortcomings in the implementation of the AML/CFT framework, guarantee the long-term operational and financial independence of the supervisor while enhancing its capacity, address limitations in the crisis management framework and—given the rising prominence of inter-company lending in the context of highly leveraged firms—further strengthen the understanding of financial risks outside of the banking sector and close remaining data gaps.

- **Fiscal policy.** Maintain gradual consolidation to ensure a balanced structural budget excluding proceeds from the Individual Investor Program (IIP). Continue addressing infrastructure needs while upgrading public investment efficiency. Improve fiscal risk analysis and management. Address long-term spending pressures related to pensions and healthcare. Ensure sustainability of tax revenues which are heavily reliant on corporate income tax proceeds.

- **Structural reforms.** Ensure and sustain inclusive growth by further encouraging labor market participation of female and elderly workers, closing skill gaps, and improving housing affordability. Foster innovation through stronger public investment in human capital and research and development (R&D). Sustain attractiveness for foreign investment by improving the governance framework.

Approved By
Mahmood Pradhan (EUR) and Rupa Duttagupta (SPR)

Discussions were held in Valletta during February 5–14, 2020. The team comprised Messrs. Jean-Marc Natal (head), Karim Foda, Jorge Salas, Ms. Yu Shi (all EUR), and Ms. Francisca Fernando (LEG). Mmes. Jai-Ryung (Jenny), Lee, Marta Burova, Tamari Mitaishvili and Dilcia Noren (all EUR) assisted from headquarters. Ms. Laura Cerami (Advisor to the Executive Director) participated in the discussions and Mr. Domenico Fanizza (Executive Director) attended the concluding meeting. The team met with Finance Minister Scicluna, Permanent Secretary Camilleri, Central Bank of Malta Governor Vella, Central Bank Deputy Governors Bonello, and Demarco, Malta Financial Services Authority CEO Cuschieri, and other senior officials, members of the Parliament, representatives of labor and business organizations, and financial institutions.

CONTENTS

TABLES

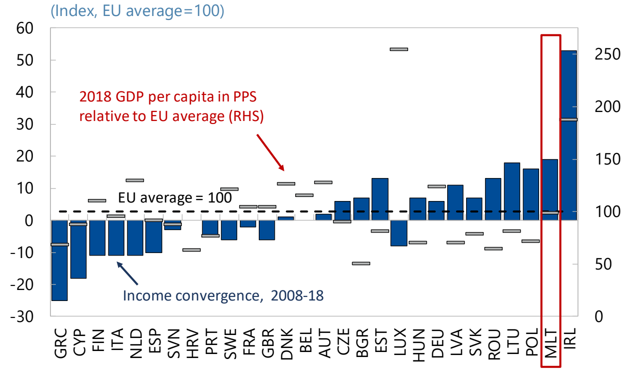
ANNEXES

APPENDIX

CONTEXT AND KEY POLICY ISSUES

1. **Malta has sustained several years of strong economic performance.** Its average real GDP growth was above 7 percent in 2013–18, underpinned by continued structural rebalancing toward services (remote gaming, professional and scientific activities, tourism-related). Robust inflows of foreign workers have accompanied these rapid economic gains, and by 2018 Malta had nearly closed its per-capita income gap with the EU average. Meanwhile, unemployment and inflation remain low, the public-debt ratio is on a declining path, and the current account surplus is sizable.

Income Convergence: GDP per Capita in PPS, 2008-18
(Index, EU average=100)



Sources: Eurostat and IMF staff calculations.
Note: PPS = purchasing power standards.

2. **Nevertheless, the economy faces pressing challenges which demand more determined actions.** Since key sectors are exposed to considerable ML/TF risks (e.g., finance, remote gaming), addressing weaknesses in Malta's AML/CFT framework and strengthening its effectiveness is urgent, as confirmed by the recent report by Moneyval.[1] Ensuring that the business climate remains healthy, including by improving governance, is also critical to encourage private investment. Filling infrastructure gaps, improving public investment efficiency as well as addressing labor shortages and housing affordability will help mitigate bottlenecks associated with high growth and promote social inclusion. Finally, tackling fiscal risks associated with contingent liabilities and long-term age-related spending pressures would put the fiscal position on a stronger footing—considering also that public finances have greatly benefited from large proceeds from the IIP[2] and corporate income tax, making Malta vulnerable to potential changes in taxation regimes.

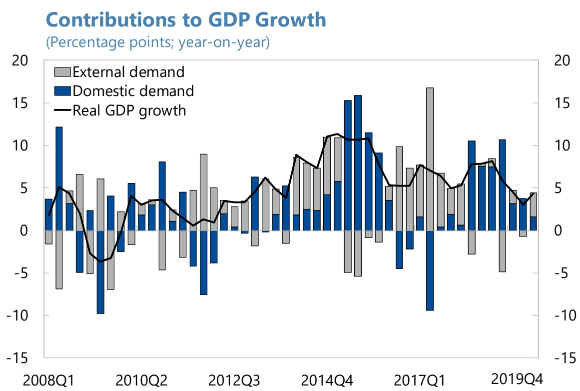
3. **Recent political events call for a faster implementation of governance reforms.** A new leader of the ruling Labor Party came to power after the previous prime minister stepped down in January. While the thrust of economic policies is not expected to change, urgent efforts are needed to improve the governance framework in light of the recent period of political turmoil.

[1] Moneyval is the Financial Action Task Force (FATF) - Style Regional Body (FSRB), the Council of Europe's Committee of Experts on the Evaluation of AML Measures and the Financing of Terrorism.

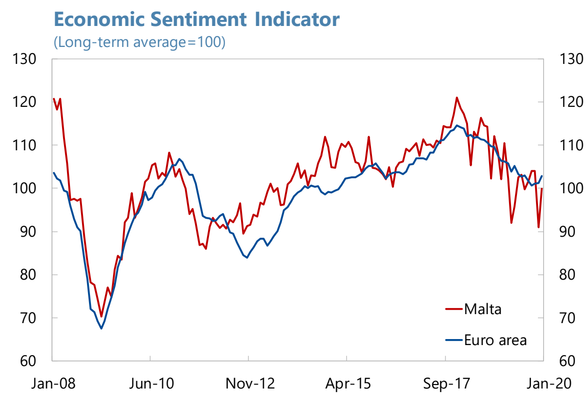
[2] The Maltese citizenship-by-investment program.

RECENT DEVELOPMENTS

4. The Maltese economy grew at a strong but slower pace in 2019. After surging to 7.3 percent in 2018, real GDP slowed to 4.4 percent in 2019. Domestic demand remained the main driver of growth, as weaker private consumption was partly offset by a one-off pick-up in business investment and strong increase in public consumption.

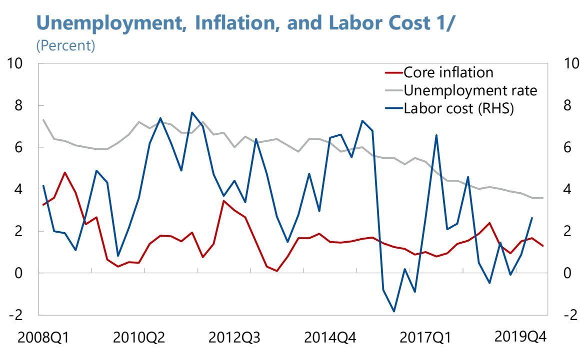


Sources: Haver Analytics and IMF staff calculations.

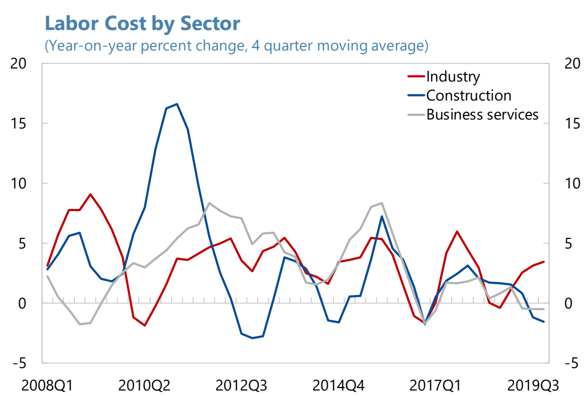


Sources: European Commission and Haver Analytics.

5. Inflation remained broadly stable despite record low unemployment. Headline and core inflation have slightly eased after exceeding 2 percent around late-2018. Strong employment creation in services has helped reduce the unemployment rate to 3.4 percent in the fourth quarter of 2019 (Figure 6) while further increases in labor force participation and inflows of foreign workers—who now account for nearly one quarter of total employment—have helped contain wage pressures (see Selected Issues Paper).

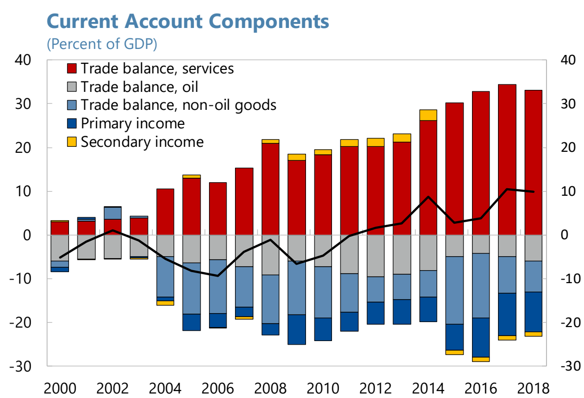


Source: Haver Analytics.
1/ Year-on-year percent change for core inflation and labor cost. Percent of labor force for unemployment rate. Labor costs include wages and salaries, employer social contributions plus taxes less subsidies received.

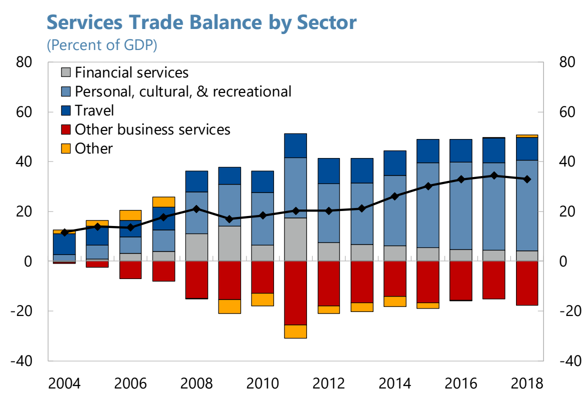


Source: Haver Analytics.

6. Strong services exports underlie the current account surplus. After surging to 10.5 percent of GDP in 2017, the current account surplus held broadly steady in 2018, partly due to a deceleration in tourist arrivals most notably from the U.K. (Figure 2). Preliminary estimates suggest some narrowing of the current account surplus to 8.4 percent in 2019, largely due to slower export growth reflecting weaker external demand. Relying on IMF methodology and judgment, staff assesses that Malta's external position was moderately stronger than medium-term fundamentals in 2019 (see Annex III).

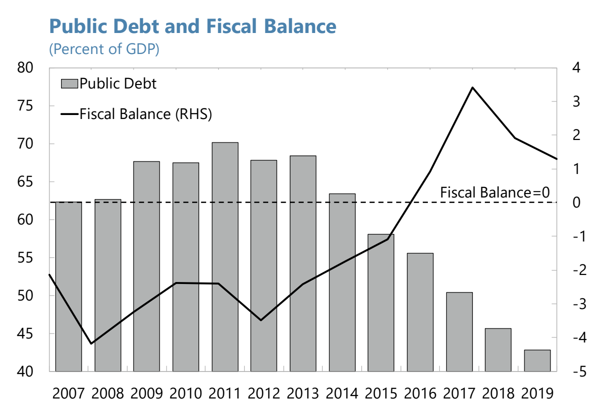


Sources: IMF BOP Statistics and IMF staff calculations.



Sources: IMF BOP Statistics and IMF staff calculations

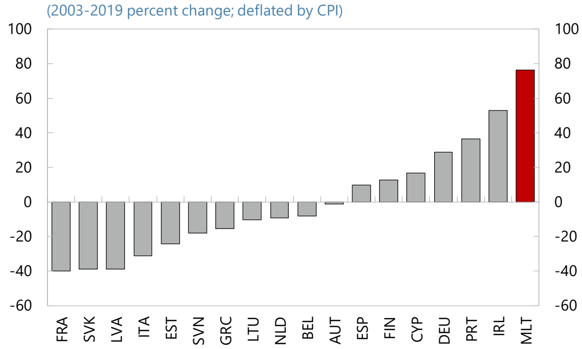
7. The fiscal balance is set to remain in surplus in 2019, for the fourth consecutive year, but is expected to decline further and reach 1.3 percent of GDP, moderately above the authorities' projection (2019 Stability Program Update)—the difference being partly explained by higher consumption-related tax revenue. Staff's estimates also include higher outlays in public investment than in 2018 (in line with past Fund advice). The structural balance is estimated to be around 1 percent of GDP, exceeding the medium-term objective of a balanced budget in structural terms (Figure 3). Excluding IIP proceeds, a slight structural deficit is expected for 2019.



Sources: Eurostat and IMF staff calculations.

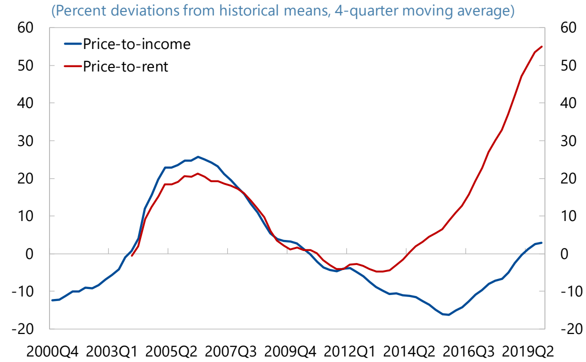
8. Banks' exposure to the housing sector increased further. Against the backdrop of rapidly rising house prices and rents, banks increasingly focus on mortgage lending. Following a short-lived pickup, credit to nonfinancial corporates (NFCs) slowed again in 2019, reflecting firms' increasing reliance on inter-company lending and cross-border loans. NPLs have declined further in 2019:H1 but legacy NPLs in the construction and manufacturing sectors remain high.

Monthly Rent of 2-bedroom Flats 1/
(2003-2019 percent change; deflated by CPI)



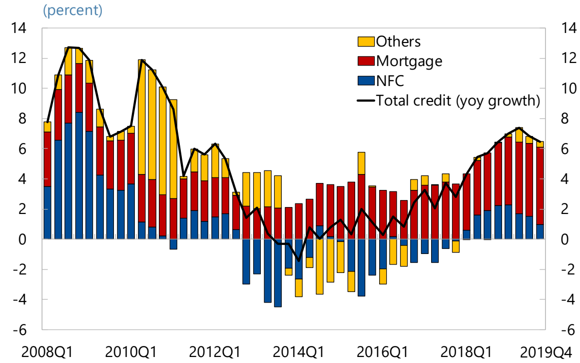
Sources: EC Estate Agency Rent Surveys and Haver Analytics.
1/ Data refer to selected cities.

Price-to-Income and Price-to-Rent Ratios
(Percent deviations from historical means, 4-quarter moving average)



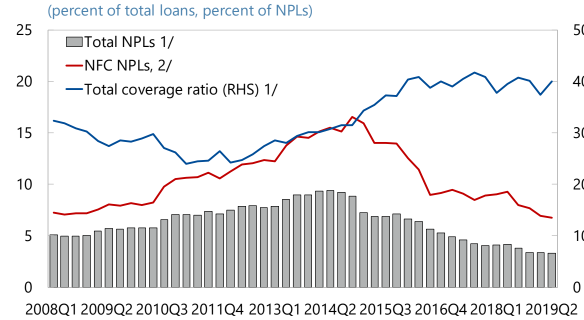
Sources: Global Property Guide, IFS, and IMF staff.

Contributions to Domestic Economy Credit Growth
(percent)



Sources: Central Bank of Malta and IMF staff calculations.

Non-Performing Loans and Coverage Ratio
(percent of total loans, percent of NPLs)

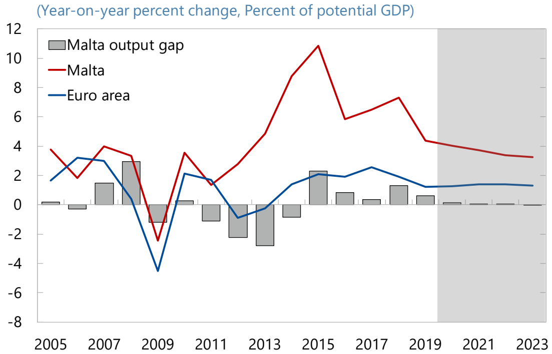


Source: Central Bank of Malta and ECB.
1/ Core domestic banks.
2/ All domestic banks. The reporting framework is FINREP since 2014Q4.

OUTLOOK AND RISKS

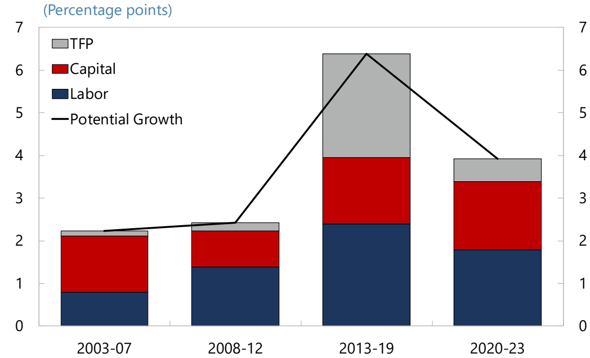
9. **Growth is projected to steadily moderate throughout the forecast horizon,** from 4.4 percent in 2019 to 4.0 percent in 2020, reflecting weaker domestic demand. The Coronavirus outbreak is expected to temporarily dampen foreign demand, particularly in the tourism sector, and delay the export recovery from the 2018 dip. Over the medium run, inflation is expected to hover around 2 percent as the output gap closes from above and unemployment rate approaches its long-term equilibrium. Growth is projected to gradually converge to its potential rate of slightly above 3 percent as the most dynamic sectors reach steady-state and total factor productivity and population growth—temporarily boosted by efficiency gains in the energy sector and large inflows of highly educated foreign workers—slows down to its long-term average pace.

Real GDP and Output Gap
(Year-on-year percent change, Percent of potential GDP)



Sources: WEO and IMF staff calculations.

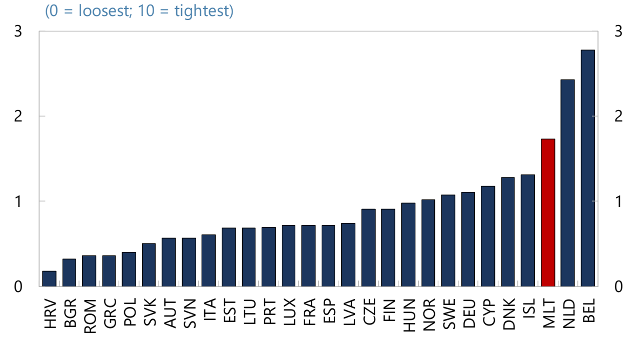
Malta: Contributions to Potential GDP Growth
(Percentage points)



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

10. Risks to the outlook are skewed to the downside. Prolonged weak growth in advanced economies, rising protectionism, a limited deal Brexit, possible changes in international corporate and personal taxation could delay private investment and reduce exports and FDI flows to Malta. While preliminary estimates of the effects from the Coronavirus epidemic are reflected in the baseline, the situation remains highly uncertain. A generalized, sharper and longer-lasting shock could significantly affect foreign demand and consumption beyond the short term. Pressures on correspondent banking relationships (CBRs) could build up further (see Box 1) and the business environment may be impacted if Malta does not effectively tackle shortcomings in its AML/CFT framework. Furthermore, a sharp correction in house prices could trigger adverse macro-financial spillovers, while slow progress in addressing structural deficiencies may limit potential growth, including by hurting competitiveness and deterring foreign workers. On the upside, Malta could attract more firms from the U.K. seeking to serve the EU market. (Annex IV).

Synthetic Index of Integration with the U.K. 1/
(0 = loosest; 10 = tightest)



Sources: IMF staff calculations.
1/ Ireland, with a value of close to 10, is off the scale. The index is composed of indicators on trade in domestic value-added, participation in supply chains, openness in services trade, cross-border banking positions, and migration.

Authorities' Views

11. The authorities broadly shared staff's assessment of the external position, outlook and risks. They acknowledged the challenges associated with measuring the current account in Malta—due to the presence of multinationals and captive financial institutions and money lenders . The authorities shared staff's view that the outlook is subject to risks and plan to continue to invest in infrastructure and in new technologies to diversify the economy and support future growth. They are also committed to continue monitoring financial risks regardless of the core banks' comfortable capital and liquidity positions and the gradual decline of credit risk as banks diversify away from construction towards mortgage lending.

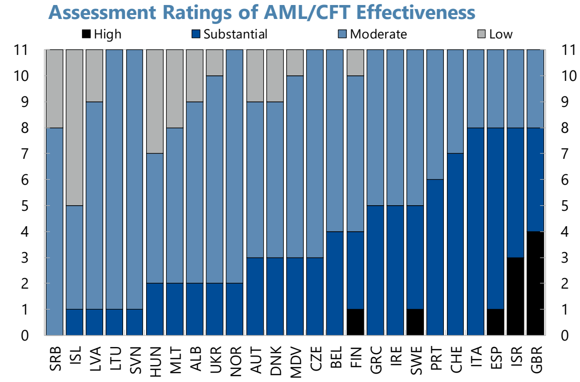
POLICY AGENDA

A. Financial Sector: Speeding Up Reforms to Safeguard Financial Stability

Tackling Financial Integrity Risks

12. **Deficiencies in Malta's AML/CFT framework must be urgently addressed.** A July 2019 report by Moneyval noted significant deficiencies in Malta's AML/CFT framework, particularly with respect to the effectiveness of supervision, investigation, prosecution and confiscation.[3] Failure to address these shortcomings can expose the financial system to further financial integrity and reputational risks—potentially threatening financial stability—and may result in Malta being identified by the FATF as a country with strategic AML/CFT deficiencies by early 2021 (also known as the FATF's grey list).[4]

Assessment Ratings of AML/CFT Effectiveness



Sources: FATF; Consolidated Assessment Ratings, November 18, 2019.

13. **Steps are being taken to tackle some of these issues.** The National Coordinating Committee for AML/CFT (NCC)[5] is coordinating the efforts of all relevant stakeholders to implement the authorities' detailed action plan that covers the range of deficiencies identified in the Moneyval assessment. As part of key measures, the Financial Intelligence Analysis Unit (FIAU), in coordination with the Malta Financial Services Authority (MFSA), have developed a risk-based automated tool to identify institutional risk and introduced a new supervisory strategy and methodology to enhance the frequency and depth of compliance reviews. In addition, they are recruiting new staff for supervision and both agencies have improved their collaboration on supervision of financial institutions through a new financial crimes compliance function created within the MFSA. An Asset Recovery Bureau has been set up to strengthen confiscation processes. The understanding of risk has been further improved by conducting sectoral risk assessments of legal entities, virtual financial assets (VFAs)[6] and non-governmental organizations. Furthermore, the MFSA has licensed several VFA agents to assist VFA issuers and service providers during their registration process and beyond,[7] and the Fifth EU AML directive should soon be transposed into national law.

[3] Malta received "low" ratings for supervision, ML investigations and prosecutions and confiscations. It received "moderate" ratings for understanding of risks and related policy and coordination, preventive measures, legal persons and arrangements, financial intelligence, as well as for TF investigation and prosecution, TF preventive measures and financial sanctions.

[4] See also Malta 2019 FSAP which identified shortcomings with the authorities' assessment and understanding of risk, banks' application of preventive measures and fit and proper requirements.

[5] The NCC is made up of the representatives of the Central Bank of Malta, Ministry of Finance, Ministry for Justice, Culture and Government, Malta Financial Services Authority, the Financial Intelligence Analysis Unit, Commissioner of Revenue, Malta Gaming Authority, Malta Police Force, Office of the Attorney-General and the Asset Recovery Bureau.

[6] Malta uses the term VFA to capture virtual assets (as defined by FATF).

[7] However, no licenses for VFA service providers have been granted yet.

14. Concerns over financial integrity risks may help explain ongoing pressures on CBRs (see Box1). There has been a decrease in the volume of payment flows since 2012 and there are reports of continued pressures on CBRs and related pressures on other sectors of the economy. While no macroeconomic effects have been identified yet, difficulties in making and receiving international payments cannot be ruled out in the future. Since this could severely affect Malta's attractiveness as a financial center and destination for foreign investment, the authorities should closely monitor ongoing pressures on CBRs and urgently address concerns over financial integrity risks by prioritizing efforts to demonstrate the effectiveness of the AML/CFT framework, ensuring that alternative solutions are sustainable, and engaging with correspondent banks and their regulators.

15. While the authorities are working towards implementing the detailed action plan, progress is unequal and efforts should be focused on improving and demonstrating the effectiveness of Malta's AML/CFT regime in key areas:

- *Continue to build understanding of risks.* Incoming and outgoing flows should be closely monitored, particularly those associated with non-residents clients, and higher-risk sectors such as remote gaming, VFAs and source of funds for the IIP. The authorities should continue to build on their recent sectoral risk assessments.

- *Strengthen AML/CFT supervision for banks and other higher-risk sectors***.** Authorities should increase the frequency and the intrusiveness of supervisory inspections of banks by building on their enhanced supervisory tools and processes and provide timely feedback. They should ensure that banks are applying appropriate customer due diligence measures. Supervision of higher risk sectors such as remote gaming and VFAs must be strengthened in line with the recently conducted sector-specific risks assessments. Timely actions to impose dissuasive and proportionate sanctions for AML/CFT breaches should be taken and authorities should continue to explore regional options for strengthening AML/CFT supervision.

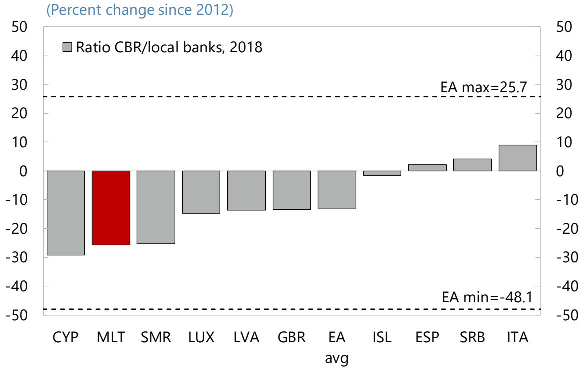
- *Enhance use of preventive measures.* Given the risks stemming from the significant cross-border linkages of Malta's financial sector, authorities should ensure that banks implement appropriate customer due diligence measures, especially for non-resident clients, and verify beneficial ownership information of companies, including information available in the Malta Business Registry. Moreover, the MFSA should continue to enhance its implementation of licensing controls (i.e., fit and proper tests).

- *Enhance AML/CFT enforcement actions.* Authorities should prioritize carrying out ML investigations, prosecutions and related confiscations in line with Malta's risk profile, including for investigations of high-level and complex ML cases.

Box 1. Pressures on CBRs and AML/CFT Considerations

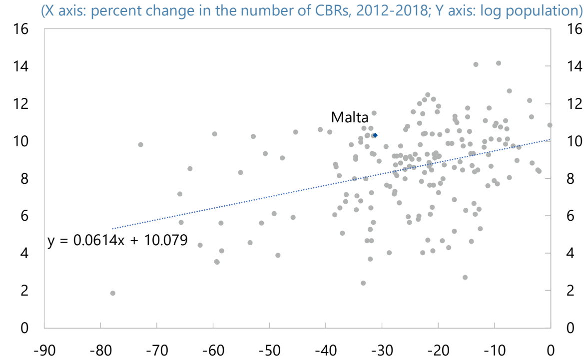
The number of active CBRs and volume of payment flows have declined in recent years. This follows a global trend for countries of similar size, but the loss per bank tends to be larger in Malta which may indicate concentration risk.[1] The volume of payment flows has also dropped by 10 percent between 2012 and 2017, which is unlike most countries where volume has continued to increase despite a decline in CBRs.[2]

Number of Active Correspondents
(Percent change since 2012)



Sources: CPMI (2018); FSB (2017); and IMF staff calculations.

Change in CBRs and Country Size
(X axis: percent change in the number of CBRs, 2012-2018; Y axis: log population)



Sources: CPMI (2019); IFS; and IMF staff calculation.

Pressures on CBRs intensified in 2019. In late 2019 one global bank announced its complete withdrawal from offering correspondent banking services to Maltese banks, while one of Malta's core domestic banks may lose its direct CBR for US dollar transactions by March 2020. Pressures continue to intensify with some banks reporting difficulties in finding alternative CBRs.

Risk perceptions related to shortcomings in Malta's AML/CFT framework may magnify existing pressures on CBRs. Decisions to terminate CBRs often relate to the correspondent bank's lack of confidence in the respondent bank's capacity to effectively manage risk. While ML/TF scandals across Europe may have influenced correspondent banks' own risk appetite and related business decisions, risk perceptions may have been compounded in Malta by the presence of higher-risk sectors and programs, such as remote gaming, VFAs, and the IIP. Identified deficiencies in banks' AML/CFT processes leading to the revocation of their licenses by the ECB in recent years and broader concerns related to Malta's jurisdictional risk may have also played a role.

Pressures on CBRs can adversely affect the economy. CBR losses can result in increased fragilities in the payment sector, e.g. via higher concentration risks and higher cost of transactions. Pressures on certain segments of the economy can also arise as some Maltese banks have adopted "de-risking" strategies and terminated accounts with clients who do not have a substantive link to the Maltese economy. There can also be spillover effects on foreign banks which use Maltese banks as intermediary banks for processing payments.

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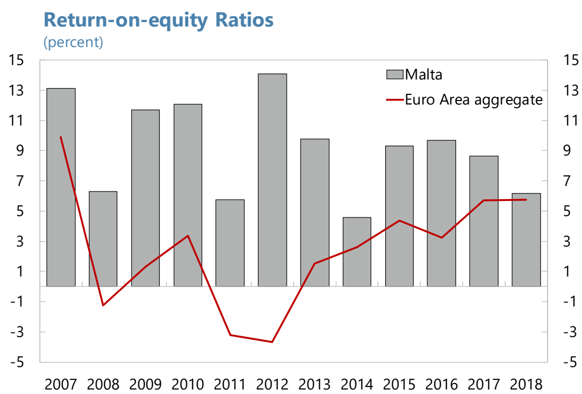
[1] See CPMI 2019. Correspondent Banking Chart pack. BIS, 2019.

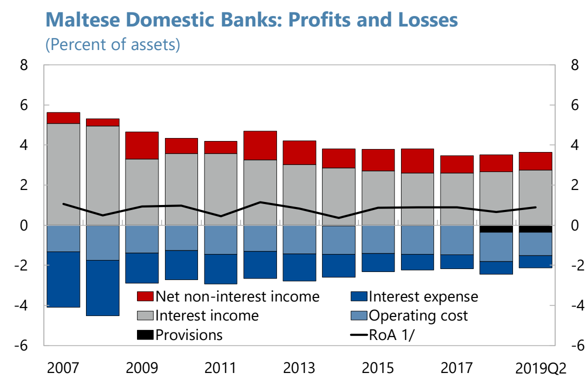
[2] See FSB 2018. Correspondent Banking Data Report—Update. FSB. 2019.

Upgrading Risk Analysis and Supervision

16. Improving the efficiency of the corporate insolvency process is key to safeguarding profitability in the banking sector. Liquidity and capitalization of core domestic banks remained at healthy levels in 2019:H1, with the loan-to-deposit ratio hovering around 60 percent and key regulatory capital and liquidity ratios rising further (Figure 4). However, bank profitability has dropped from its peak level in 2012, reflecting the low-interest environment and shrinking corporate loan portfolio, higher regulatory compliance costs and, in the past two years, higher loan-loss provisioning and further write-offs of legacy NPLs. Going forward, legacy NPLs reduction plans may have to be accelerated—as profitability may be further challenged by increasing competition from non-banks and the growing corporate bonds market—which will require further reforms of the corporate insolvency process.



Sources: European Banking Authority and IMF Staff Calculations



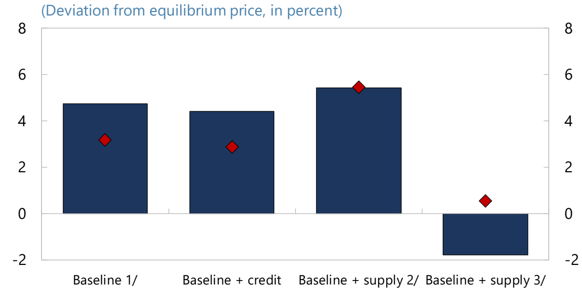
Sources: European Central Bank and IMF staff.
1/ RoA is based on a four-quarter moving average.

17. Continuing efforts to enhance supervisory capacity and improve the regulatory framework are warranted. While significant progress has been made to increase supervisory capacity along the lines recommended by the 2019 FSAP, further actions are needed to ensure adequate and stable recruitment of qualified staff. Moreover, important gaps in the crisis management framework persist. (see Annex II).

- *The authorities should take prompt actions to improve the crisis management framework.* Greater clarity regarding the bank insolvency regime—which should be led by the resolution arm of the MFSA—and explicit powers to transfer assets or liabilities in liquidation should be provided.
- *Long-term financial and operational independence of the MFSA should be guaranteed and its resources further increased.* The MFSA's new business plan—which envisages a reform of the supervisory fee structure—should be implemented as it provides room for steady capacity increase and grants the supervisor full financial independence by 2024. This is all the more urgent because the effective implementation of the new regulations regarding the licensing of VFA companies and supervision of high-risk sectors will demand significant resources and appropriate expertise.

18. Further refinements of the newly introduced macroprudential instruments should be considered in due time. Standard house price valuation analysis suggest housing was only slightly over-valued at the end of 2018. But this assessment could underestimate the underlying gap in real time since some of the fundamental drivers of prices, e.g. population growth, may be partly procyclical in Malta. Given rapidly rising house prices and the increasing exposure of banks to property-related credit, the authorities—in line with staff's recommendation, appropriately introduced a set of borrower-based macroprudential measures in July 2019 (see text table). Still, to avoid excessive risk concentration in the most speculative part of the market, there is scope for these measures to be refined when more data become available to assess their initial effects. Such refinements include, lowering the speed limits for loans against secondary and buy-to-let properties (category II) should be lowered to eventually match speed limits on loans for the purchase of primary residential property (category I), which should be defined in terms of the total value of new loans, not in terms of the number of new loans. The authorities should also continue to closely monitor developments on the housing market and stand ready to further tighten LTV/DSTI limits should current housing market trends continue unabated and result in the buildup of systemic vulnerabilities.

House Price Valuation, 2018Q4
(Deviation from equilibrium price, in percent)



Source: IMF staff calculations.
1/ The baseline model estimates house prices as a function of traditional demand factors (population, income) useing data from the Global Property Guide Price Index.
2/ Model uses advertised prices of the residential property from CBM.
3/ Model uses actual market transaction prices from NSO.

Malta: Borrower-Based Macroprudential Measures

	LTV-O 2/	DSTI-O 2/	Maturity
Category I Borrowers 1/	90 percent LTV-O cap with a "*speed limit*" of 10 percent on the volume of loans, for loans with a market value in excess of €175,000.	A stressed DSTI-O of 40 percent for loans with a market value in excess of €175,000 with a shock to interest rates of 150 bps.	A maturity term of 40 years or the official retirement age, whichever occurs first.
Category II Borrowers 1/	**1st year:** 85 percent LTV-O cap with a "*speed limit*" of 20 percent on the volume of loans.	A stressed DSTI-O of 40 percent with a shock to interest rates of 150 bps .	A maturity term of 25 years or the official retirement age, whichever occurs first.
	2nd + year: 75 percent LTV-O cap with a "*speed limit*" of 20 percent on the volume of loans.		

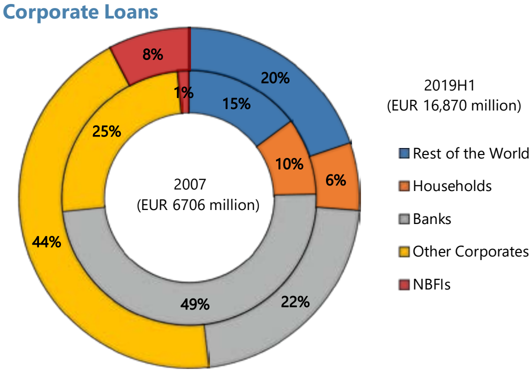
Source: CBM

1/ Category I comprises borrowers purchasing their primary residential property and Category II comprises borrowers purchasing their second or additional residential property or buy-to-let properties.

2/ LTV-O refers to the Loan-to-Value-at-Origination ratios. DSTI-O refers to the Debt-Service-to-Income-at-Origination ratios.

19. NFCs increasingly rely on non-bank finance, posing additional challenges to supervision and banks' risk management. Inter-company lending has been gradually displacing bank lending as the main source of corporate financing. While this trend offers welcome funding diversification to Maltese firms, it also raises new questions about macro-financial risk developing within the corporate sector. The question is particularly relevant in Malta where NFCs' leverage is high and two sectors, i.e. construction and manufacturing, could become possible sources of contagion to the rest of the economy through inter-company linkages (see Annex V). To assess and monitor these potential vulnerabilities, a deeper understanding of the flow of funds between companies and of their risk-management practices is required—in particular within business groups where the bulk of inter-company lending takes place. Information on inter-sectoral exposure, credit conditions, maturity, concentration and costs would help identify potential financial risks and contagion before they emerge. At the same time, it is important to continue incentivizing equity financing and to avoid over-concentration of banks' exposure to large indebted and interconnected corporates.

Corporate Loans



Sources: ECB and IMF staff calculations.

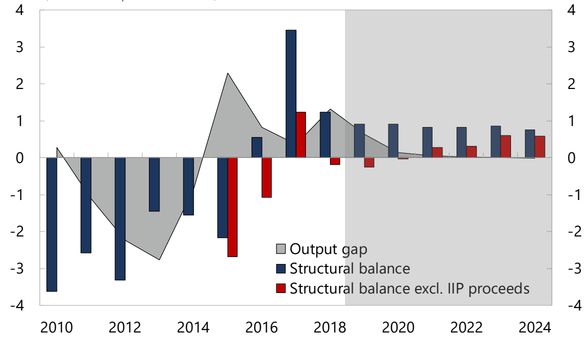
Authorities' Views

20. The authorities remain committed to safeguard financial stability and integrity. The authorities recognize the need to rapidly address the drivers of pressures on CBRs such as AML/CFT-related concerns. They are taking a number of steps to address deficiencies identified in the Moneyval report by implementing a detailed action plan and recognize the need to demonstrate the effective implementation of AML/CFT controls, taking into account high risk sectors. MFSA's new business plan is expected to help it achieve funding and operational independence in the medium term. Regarding financial risks, the authorities acknowledged the rapid increases in house prices and mortgage credit, but they consider it as mainly driven by fundamental factors. They stand ready to tighten macroprudential instruments in the future if necessary. They indicated that a working group is being set up to analyze progress in improving the bank insolvency framework. The authorities are also conducting analytical work to address remaining gaps in the deposit compensation scheme, the emergency liquidity assistance framework and crisis management planning. They agreed that further efforts to step up the monitoring of potential risks developing outside of the banking sector is warranted. Continued enhancement of data collection with regards to intercompany and NBFI lending would be a useful way forward in this regard.

B. Fiscal Policy: Enhancing Management and Addressing Risks

21. Given the presence of material fiscal risks, gradual structural adjustment will allow building further buffers while still supporting inclusion. The 2019 Stability Program Update envisaged further reduction in the public debt ratio by maintaining a headline fiscal surplus at around 1 percent of GDP over the next few years (similar to staff's forecast) together with a medium-term strategy to achieve a gradual structural adjustment. Excluding IIP proceeds, which are volatile and difficult to predict, staff projects the structural balance to be neutral in the near term, and to improve by a cumulative 0.7 percent of potential GDP over 2019–2024. Maintaining a gradual consolidation path net of IIP is warranted because of fiscal vulnerabilities from contingent liabilities, age-related pressures and heavy reliance on corporate income tax revenues. While enhanced public investment should continue to address infrastructure gaps, current expenditure growth needs to remain contained. Support for the most vulnerable is appropriate but should be well targeted and subject to regular cost-benefit analysis.

Structural Balance and Output Gap
(Percent of potential GDP)



Source: IMF staff calculations.

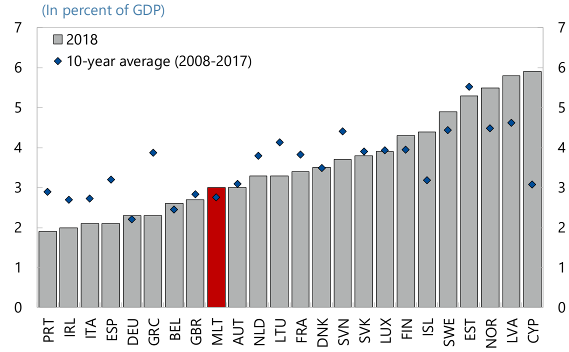
Malta: Fiscal Estimates and Projections
(Percent of GDP)

		Staff Projections				
	2019 Est.	2020	2021	2022	2023	2024
Revenue	38.7	38.1	37.6	37.3	37.1	37.0
Expenditure	37.5	37.0	36.8	36.5	36.2	36.2
Overall balance	1.3	1.1	0.8	0.8	0.9	0.8
Structural balance	0.9	0.9	0.8	0.8	0.9	0.8
Structural balance, excl. IIP proceeds	-0.2	-0.1	0.0	0.1	0.4	0.4
Public debt	42.8	39.8	36.9	33.7	30.9	27.7

Source: IMF staff calculations.

22. **Further efforts to enhance the efficiency of public investment are needed as volume increases.** Renewed focus on public investment started to materialize in 2018, in line with staff's advice. Partly driven by improved absorption of EU funds, the 2019 public investment-to-GDP ratio is estimated to be around 4 percent of GDP, well above its recent average. The bulk of this expenditure is aimed at road infrastructure, waste and natural resource management, health and education. While public investment is set to gradually decline, it is expected to remain relatively high over the medium term as several projects reach completion. Continued efforts are needed to boost the efficiency of public investment (see IMF Country Report No. 18/20). As recommended by the IMF's 2018 Fiscal Transparency Evaluation (FTE), this can be done by adopting general guidelines for project appraisal and selection and applying and disclosing cost-benefit analysis to all major projects. Additionally, the framework for public-private partnerships (PPPs), which Malta has barely used so far but might use more intensely in the future, can be strengthened considering the broad lack of policies and guidelines on PPPs and that there is no legal limit to the accumulated stock of PPPs. Addressing any weaknesses in the public procurement system would also enhance public investment management.

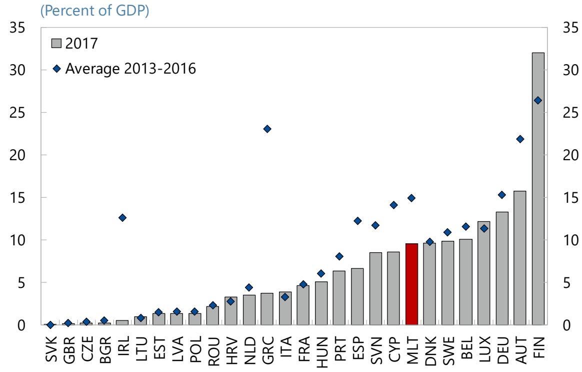
Public Investment
(In percent of GDP)



Sources: Eurostat and IMF staff calculations.

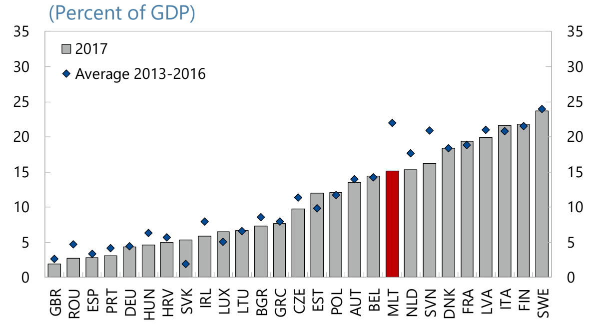
23. Improving fiscal risk analysis and management is needed to reduce contingent liabilities. Though declining, the stock of government guarantees remained relatively high at almost 10 percent of GDP in 2017, while total liabilities of nonfinancial public corporations stood at 15 percent of GDP. Thus, contingent liabilities related to government guarantees and public corporations remain material, with potential impact on debt sustainability (Annex VI). To better analyze and manage these risks, the new legal framework for managing guarantees, which would require limits on guarantees and an assessment of risks surrounding them, should be implemented. Plans to release statements on public corporations' financial performance need to be completed, and sound strategies to put financially vulnerable public corporations on a stronger footing should also be adopted. Moreover, Malta still lacks a common framework for exercising ownership functions and monitoring performance of public corporations.

Government Guarantees
(Percent of GDP)



Sources: Eurostat.

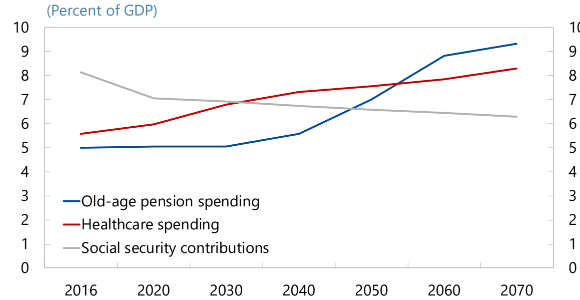
Total Liabilities of Nonfinancial Public Corporations
(Percent of GDP)



Sources: Eurostat.
Note: Due to lack of 2017 data, 2016 data is used instead for Germany, Austria and France. The 2013-16 average excludes 2015 for the United Kingdom (missing data).

24. Long-term age-related spending is projected to increase significantly and faster than in most EU countries. Demographic trends could put the pension system under pressure as fewer contributors fund an increasing number of pensioners, particularly after 2030. Recent measures have attempted to strengthen the sustainability and adequacy of the pension system by incentivizing longer work lives and encouraging voluntary saving. But the impact of some of these initiatives, especially on voluntary savings, has been limited so far. The next periodic review, expected by December 2020, should address the pension system's long-term challenges. Reform options could include: reassessment of the contributory period, automatic indexation of the statutory retirement age to changes in life expectancy, use of penalties and enhanced incentives to further increase the effective retirement age, and automatic enrollment in supplementary saving plans with the ability to opt out (see IMF Country Report No. 16/21). To help improve the efficiency of healthcare spending, ongoing work to monitor the implementation of recent spending reviews' recommendations should be advanced.

Age-Related Spending and Social Security Contributions: 2016-70
(Percent of GDP)

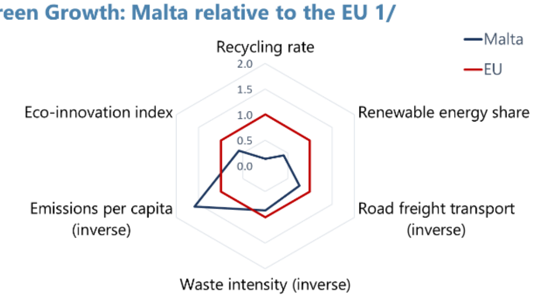


Source: European Comission, *The 2018 Ageing Report*.
Note: Recent upward revisions to Malta's population statistics for 2016 would likely yield lower projected age-related spending.

25. Higher, and more sustainable tax revenues would be necessary to put public finances on a stronger footing. Malta's tax revenues as a share of GDP are below the EU average and they disproportionately rely on corporate income tax (CIT) revenues, making them vulnerable to potential changes in international corporate taxation[8] Measures implemented in recent years to broaden the tax base, simplify the tax system, and address tax evasion and avoidance are useful steps toward strengthening tax revenues. Ongoing efforts to enhance revenue institutions, including by completing the consolidation of revenue departments and further increasing the use of e-services, should continue. As recommended in the IMF's FTE, it is also important to report estimated foregone revenues from tax expenditures and to set budgetary targets to better control them. Other options to diversify beyond CIT proceeds include introducing a recurrent tax on immovable property, which most EU countries have in place, and removing exemptions to the property-transaction tax.

26. More investment is needed to upgrade environmental outcomes, in particular regarding waste management and the production of renewable energy. In comparison to the EU, Malta has performed relatively well in terms of greenhouse gas emissions (GHG), but lags in other areas including waste management, renewable energy, multi-modal freight transport, and innovative approaches to improve sustainability. The authorities have taken steps to address sustainability concerns, including schemes to promote energy efficiency in buildings. However, national 2020 targets are likely to be missed and improvement in other critical areas including road congestion remains limited (see EC Country Report 2019).

Green Growth: Malta relative to the EU 1/



Source: Eurostat, European Commission
1/ Values are relative to EU levels. Greater than EU levels denotes better performance. Recycling rate is percent of total waste that is recycled; Eco-innovation index is composed of indicators on inputs to environmental innovation, activites, outputs, resource efficiency, and socio-economic outcomes; Emissions per capita is based on GHG emissions; Waste intensity is total waste (kg) divided by GDP; Road freight transport is the share of freight transport in total inland freight transport; Renewable energy share is share of energy consumption from renewable sources.

Authorities' Views

27. The authorities emphasized that fiscal policy remains prudent and that further upgrading public investment efficiency is a priority. They reiterated the medium-term objective of a balanced budget in structural terms and the intermediate target that expenditure growth should not exceed the economy's potential growth. The authorities stressed that higher public investment should contribute to social development, including by upgrading environmental outcomes. In their view, good public investment management has helped enhance transport infrastructure, but they see scope for broader efficiency gains. The authorities highlighted that fiscal risk has diminished thanks to the decline in contingent liabilities. They have plans to enhance Airmalta's revenues and to publish financial-performance statements of public corporations. The authorities underscored efforts to reform the revenue administration (including through the use of

[8] For example, the introduction of formula apportionment at the international level could imply large corporate-tax-revenue losses for Malta. See De Mooij, R., L. Liu and D. Prihardini, 2019, "An Assessment of Global Formula Apportionment", IMF Working Paper 19/213.

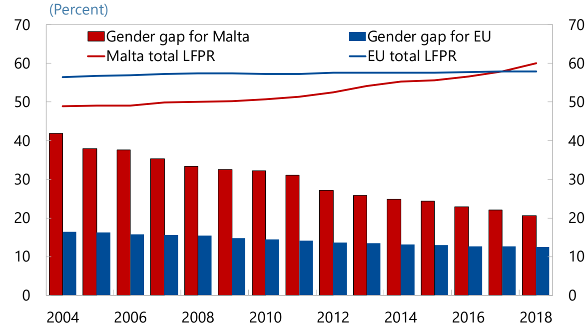
IT applications) and to continue the process to institutionalize Comprehensive Spending Reviews. They acknowledged that while international taxation changes could affect many countries, the nature and impact of such reforms remain uncertain.

C. Growth-Enhancing Structural Reforms and Policies for Greater Inclusion

28. Continued efforts to enhance the labor force and boost productivity will support inclusive growth and competitiveness. Priorities include:

- *Sustained commitment to increase labor force participation rates, particularly among females and the elderly.* Ongoing measures, including free childcare, in-work benefits, the tapering of benefits for those entering employment, along with the promotion of flexible working arrangements, have helped sustain rapid increases in female labor force participation (see Figure 6).[9] Similarly, recent initiative to help finance maternity leave in the private sector, and further measures to encourage later retirement, including lifelong learning and increased pension benefits for delayed retirement may help bridge remaining gaps with the EU.

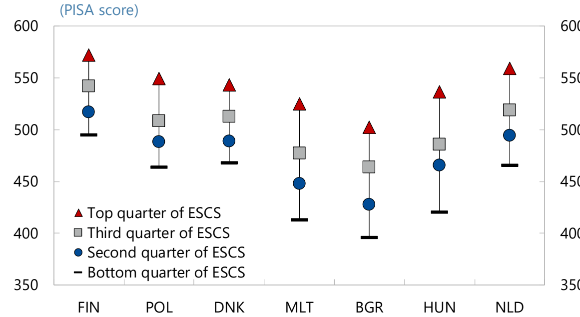
Labor Force Participation (LFPR) and Gender Gap 1/
(Percent)



Source: Eurostat.
1/ Gender gap defined as the gap in participation rate between men and women. Total LFPR refers to aggregate LFPR for all men and women 15 years or older.

- *Upskilling and reskilling workers to meet labor market needs and upgrade potential growth.* Survey evidence persistently shows that the availability of skilled staff or experienced managers remain the most pressing problem that Maltese firms face.[10] Although Malta invests a higher share of its GDP in education than the EU average, its students, particularly those in socio-economically disadvantaged schools, perform well below the EU average in international assessments. Recent initiatives to update the learning curriculum and broaden it to include apprenticeship and vocational training have the potential to improve educational outcomes and further reduce early school leaving over time. Similarly, recent on-the-job training schemes by Malta Enterprise Association, Jobsplus and others should be monitored to identify and expand the most promising initiatives.

Student Performance in Science by Schools' Socio-economic Status 1/
(PISA score)



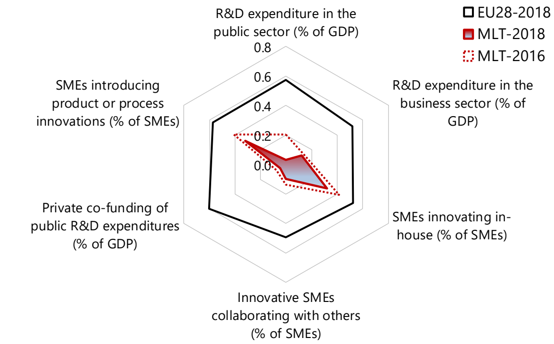
Sources: OECD and European Comission.
1/ ESCS refers to the PISA index of Economic, Social, and Cultural Status.

[9] See 2019 Selected Issues Paper "Promoting Inclusive Growth in Malta" for more analysis on the macroeconomic impacts of inclusive labor market policies.

[10] Survey on the Access to Finance of Enterprises (SAFE), European Central Bank.

- *Greater investment in innovation to drive productivity growth.* At 0.55 percent of GDP, total R&D expenditure is well below the government's target of 2 percent of GDP, which can partly be explained by the prevalence of SMEs and the decline in public spending on R&D in recent years. Recent partnerships between the Malta Development Bank (MDB) and commercial banks, the National Strategy for Artificial Intelligence, and the recently launched Start-Up Malta Foundation all aim to support innovations and entrepreneurship, though continuous monitoring and evaluation of those programs, including their risk management and governance, is needed to ensure that resources are allocated effectively.

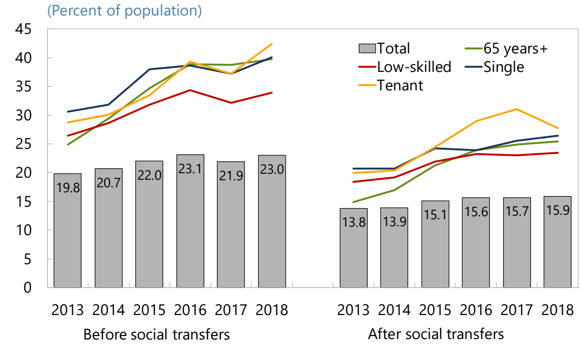
Innovation Activities, 2016-2018 /1



Source: European Innovation Scoreboard 2019 Database.
1/ Based on normalized scores. A score of one reflects the best performer.

- *Improve access to affordable housing.* Poverty risk has been increasing over the last few years, particularly among the elderly, low-skilled, and female single earners, who do not own their home. This has prompted the government to introduce a housing benefit for low income tenants and expand the remit of the Malta Housing Authority to include the regulation of the private rental market. To sustainably address affordability transfers should be complemented by policies to expand the supply of affordable and social housing—planned construction of new units as well as conversion of dilapidated housing into social housing should be prioritized.

At Risk of Poverty Rate /1
(Percent of population)



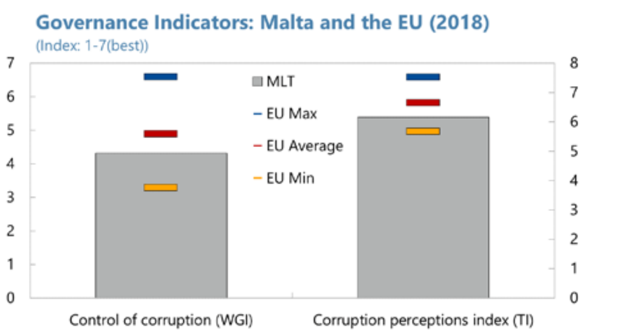
Source: Eurostat.
1/ Defined as 60 percent of the median equivalized income and for age class 18 years or over.

29. **Addressing shortcomings in governance would help safeguard Malta's business climate and its attractiveness for foreign investment.** Relative to EU peers, Malta underperforms in governance indicators related to perceptions and control of corruption, and such indicators appear to have deteriorated in recent years. Survey evidence (Eurobarometer) indicates that private investment would benefit from enhancing the fight against corruption, and previous staff analysis found that tackling inefficiencies in the judicial system would help support potential growth (IMF Country Report No. 16/21). Against this backdrop, and in addition to addressing deficiencies in the AML/CFT framework, efforts should be stepped up in several areas:

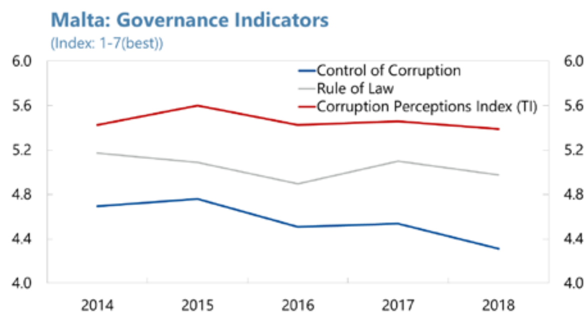
- *Fight against corruption***.** As recommended by the Council of Europe's Venice Commission, legislation has been completed to separate the Attorney General's prosecutorial and advisory roles. Other recommended actions by the Group of States Against Corruption (GRECO) and the Venice Commission, including to strengthen the anti-corruption framework and the capacity of the Maltese Police Force, and ensure independence of the judiciary, should continue to be pursued.

- *Judicial efficiency*. To reduce inefficiencies in the judicial system, the use of ICT technologies has increased. These include "E-Justice" initiatives to reduce bureaucracy and delays in civil courts. Continued efforts should aim to further reduce the length of proceedings for administrative and commercial cases as well as for insolvency procedures.

- *IIP risk mitigation*. In general, residence and citizenship schemes are subject to reputational and ML risks if due-diligence procedures are not sufficiently rigorous. In the context of the revision of the parameters of Malta's IIP scheme, deficiencies identified by Moneyval and the FSAP should be addressed.



Sources: World Governance Indicators (WGI) and Transparency International (TI).
Note: These indicators do not reflect IMF assessments of levels of corruption. Use of these indicators should be considered carefully as they are derived from perceptions-based data. Point estimates are shown. The 90 percent confidence interval for the WGI indicator is +/- 0.4 and for the TI indicator it is +/- 0.08.



Sources: World Governance Indicators (WGI) and Transparency International (TI).
Note: These indicators do not reflect IMF assessments of levels of corruption. Use of these indicators should be considered carefully as they are derived from perceptions-based data. Point estimates are shown. The 90 percent confidence interval for the Control of Corruption and Rule of Law indicators are +/- 0.4 each in 2018, and for the Corruption Perceptions Index it is +/- 0.08 in 2018.

Authorities' Views

30. The authorities highlighted progress in efforts to address structural challenges. Further drops in skills gaps, labor shortages and early school leaving rates are expected as recent government initiatives aimed at increasing the provision of professional training, improving school curriculums and fostering vocational training and apprenticeship should bear fruit. As part of the ongoing review of the pension system, the authorities will reassess projections of age-related spending and aim to further incentivize longer working lives. The authorities acknowledged the recent deterioration of some governance indicators but feel they are making progress in several areas. Among recent initiatives, they emphasized measures to improve the administrative autonomy of the Courts by setting up a new Court Services Agency to modernize judicial services offered to citizens, to separate the advisory and prosecutorial roles of the Attorney General and to appoint a State Advocate to be the primary consultant of the Government in relation to legal opinions. A new process for appointing the police commissioner—which would be more independent from the Prime Minister—is currently being reviewed by Parliament. The IIP program is also being reviewed with the aim to enhance due diligence and improve the communication strategy.

STAFF APPRAISAL

31. The Maltese economy has continued to overperform European peers. Prudent fiscal policy and timely structural reforms have helped boost employment and build fiscal buffers while promoting social inclusion. Growth remained strong in 2019, even though it weakened from 2018. Domestic demand is expected to remain the main engine of growth as the economy gradually reaches cruising speed and the large current account surplus declines. The risks to the outlook are skewed to the downside and a lot will depend on how pervasive and long-lasting disruptions related to the Coronavirus epidemic will be.

32. Continued efforts are needed to mitigate financial integrity and stability risks. As pressures on CBRs intensify, it is critically important to continue to address deficiencies identified with the AML/CFT system. The focus should be on improving and demonstrating effectiveness of the AML/CFT framework. In particular, the understanding of risks and the monitoring and supervision of banks and other high-risk sectors and programs—such as remote gaming, VFAs, and the IIP—should continue to be strengthened. It is also key to enhance AML/CFT enforcement actions, including through timely and adequate sanctions in case of breaches.

33. Supervisory capacity should be further enhanced and remaining deficiencies in the crisis management framework addressed. The operational and financial independence of the financial supervisor should be assured. Despite commendable progress, the MFSA remains under strain due to the large number of financial institutions under supervision, the evolving regulatory environment, and challenges associated with new and complex products. The legal framework for bank insolvency should also be updated and streamlined. An administrative regime for the orderly closure and liquidation of a failing bank should be introduced to avoid that supervisory actions are unduly delayed through judicial appeal.

34. Further improving the analysis of potential risks developing outside of the banking sector will help uphold financial stability. Inter-company lending is gradually displacing bank lending as the main source of corporate funding, posing new challenges to supervision. A better understanding of the flow of funds between corporates and of their risk-management practices could help identify potential financial risks and contagion channels to the financial system. In the meanwhile, it is important to avoid over-exposure to large, indebted and interconnected corporates and to monitor developments on the housing market, standing ready to tighten the recently introduced borrower-based macroprudential measures in due course.

35. Prudent fiscal policy needs to be maintained. Maintaining gradual consolidation excluding the proceeds from the IIP is warranted due to fiscal vulnerabilities from contingent liabilities, age-related spending pressures, and heavy reliance on corporate income tax revenues Current-expenditure also needs to be kept in check to ensure enough space within the budget limits for necessary public investment in transport, health, education, the environment and additional expenses targeted at improving social inclusion.

36. Further enhancing public investment management and reducing fiscal risk should be key priorities. As public investment rises, enhancing its management is critical. Efforts should focus on adopting general guidelines for project appraisal and selection, implementing cost-benefit analysis for major projects and addressing weaknesses in the public procurement system. Continued efforts are also needed to further reduce fiscal risks. The new legal framework for managing government guarantees should be implemented, ongoing work to release statements on financial performance of public corporations should be completed, and sound strategies to put financially vulnerable public corporations on a stronger footing need to be adopted. To address long-term age-related spending pressures, measures that increase the effective retirement age and further encourage enrollment in voluntary savings schemes should be prioritized, while the institutionalization of the CSRs should be completed. Finally, to diminish Malta's potential vulnerability to international taxation regime changes, options to strengthen and diversify revenues outside of CIT should be explored.

37. Pursuing structural reforms will help sustain Malta's growth performance while promoting social inclusion. The focus should continue to be on encouraging female and elderly participation in the labor market, upskilling the labor force and stimulating innovation. Moreover, to safeguard the business climate, remaining governance shortcomings should be addressed without delay, including by stepping up the fight against corruption and by increasing the efficiency of the judicial system while ensuring its independence. Improving access to affordable housing remains a key priority in support of greater inclusion.

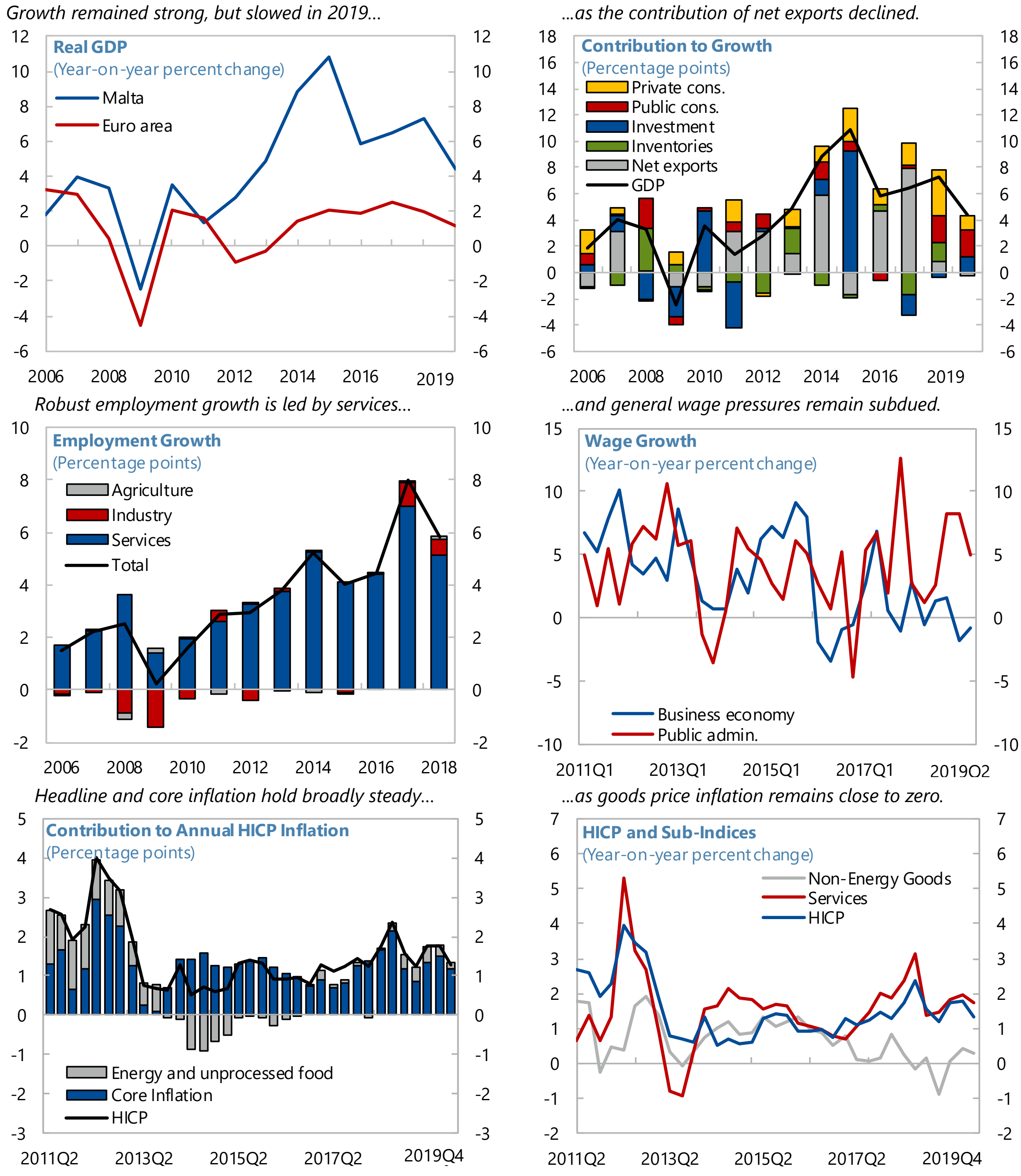
38. It is recommended that the next Article IV consultation be held in the usual 12-month cycle.

Proposed Decision

The Executive Board endorses the thrust of the staff appraisal in the report for the 2020 Article IV consultation with Malta (SM/20/76, 3/25/20).

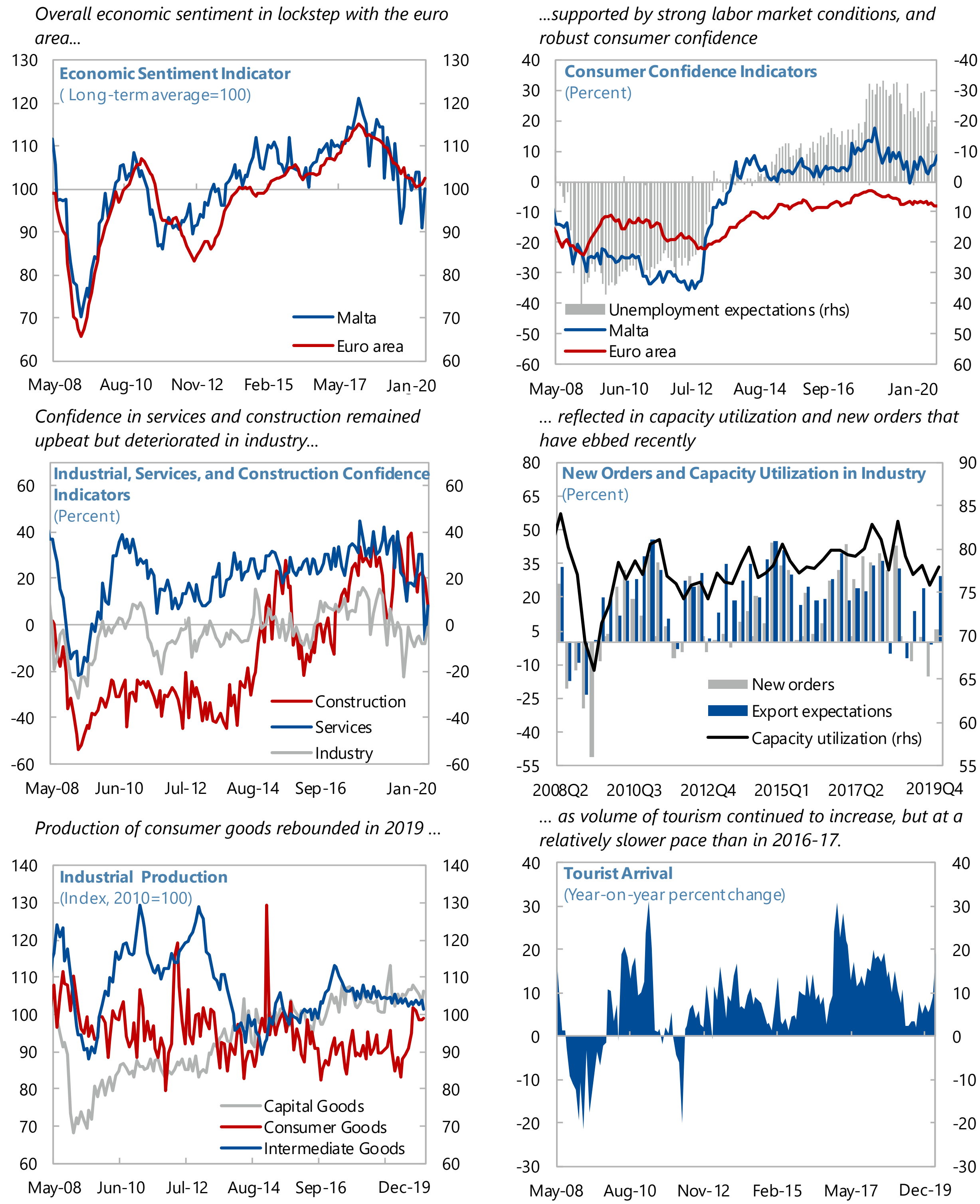
It is expected that the next Article IV consultation with Malta will take place on the standard 12-month cycle.

Figure 1. Malta: Economic Indicators



Sources: Central Bank of Malta; Eurostat; IMF *World Economic Outlook*; and IMF staff calculations.

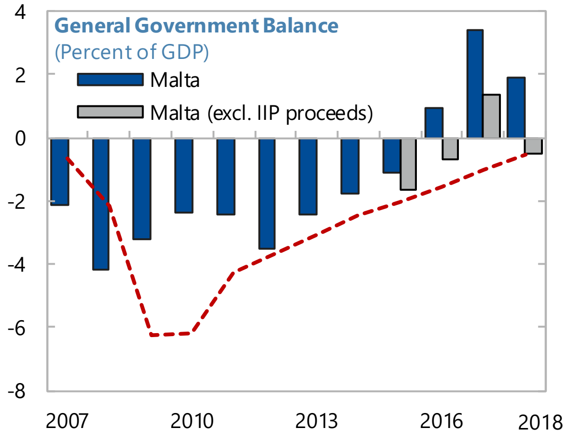
Figure 2. Malta: Short-Term Indicators



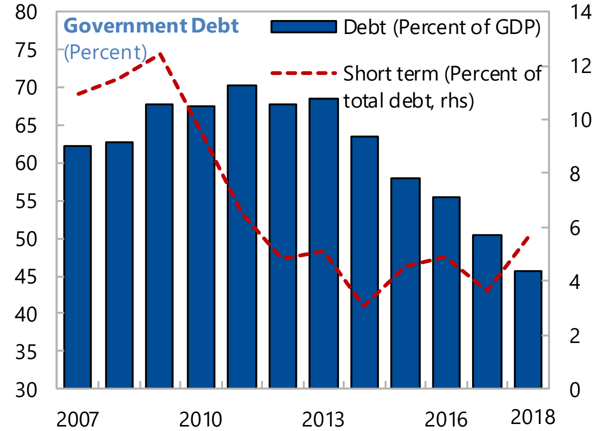
Sources: European Central Bank; Central Bank of Malta; European Commission; and IMF staff calculations.

Figure 3. Malta: Fiscal Developments

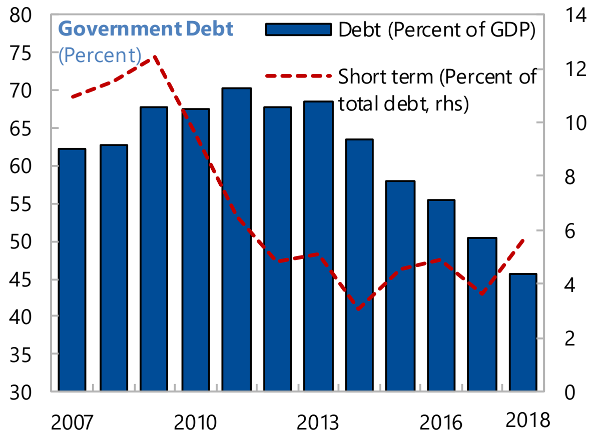
In recent years, IIP proceeds have helped to achieve headline fiscal surpluses...



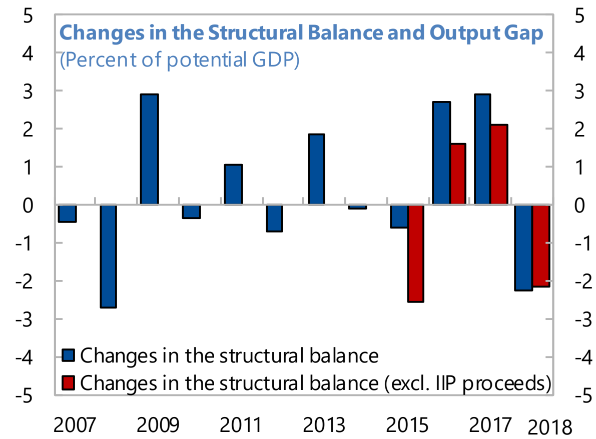
... which, along with high GDP growth, have led to a declining public debt ratio.



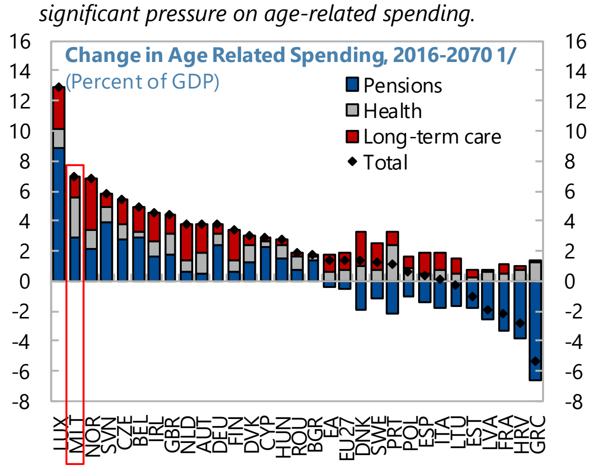
The primary balance continued to record a surplus in 2018 ...



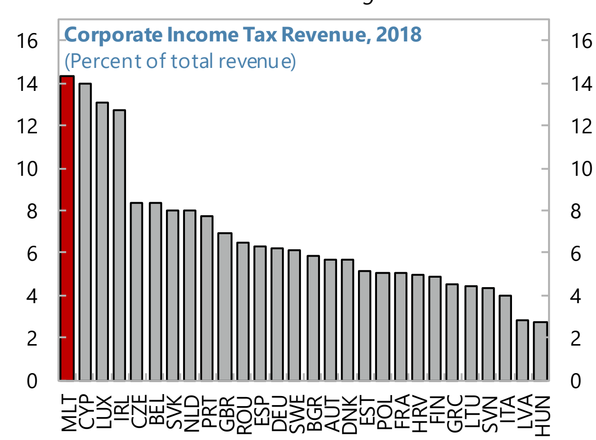
... whereas in that year the structural balance showed a deterioration.



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



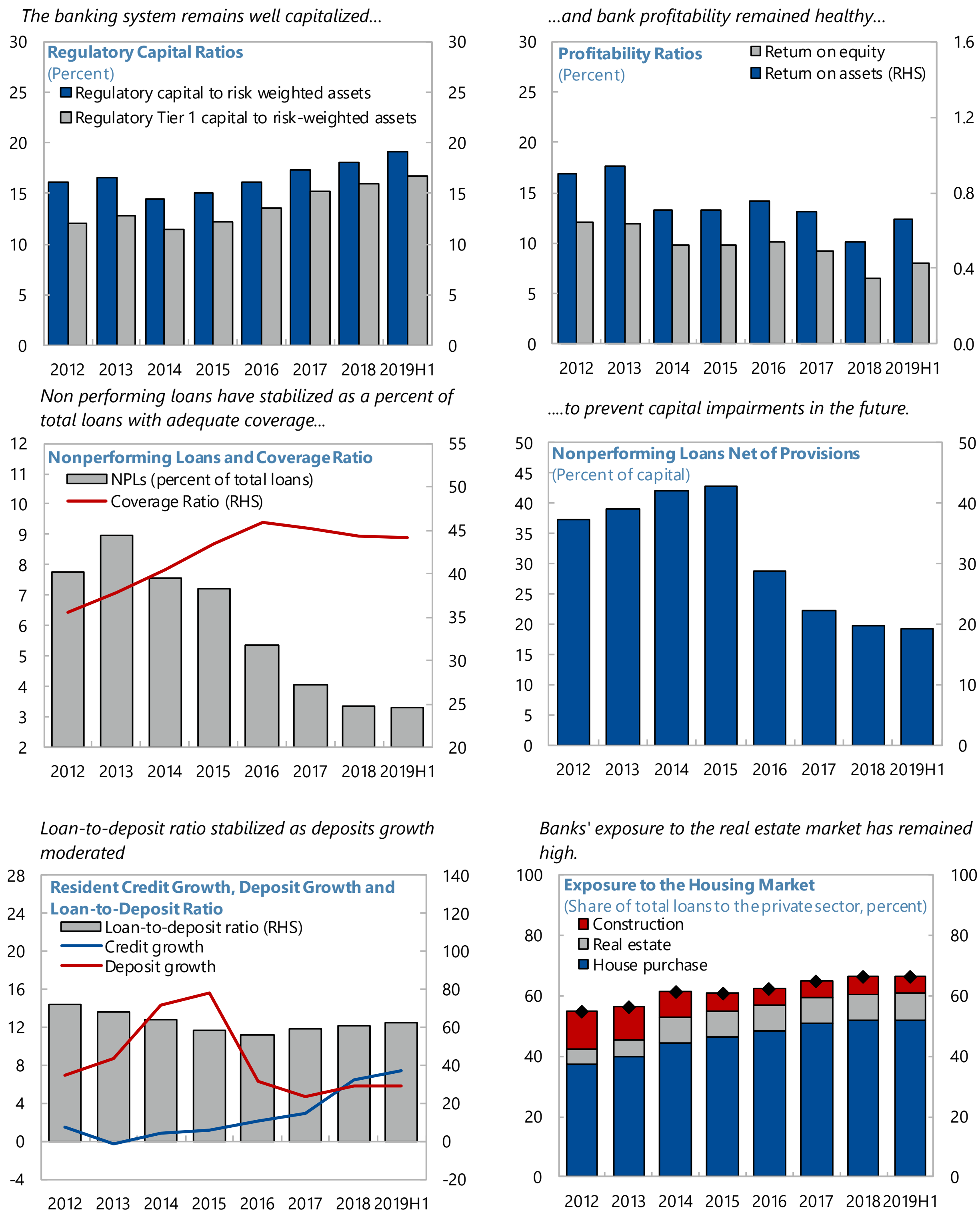
Malta's reliance on corporate income tax revenues remains well above the EU average.



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

1/ Recent upward revisions to Malta's population statistics for 2016 would likely yield lower projected age-related spending.

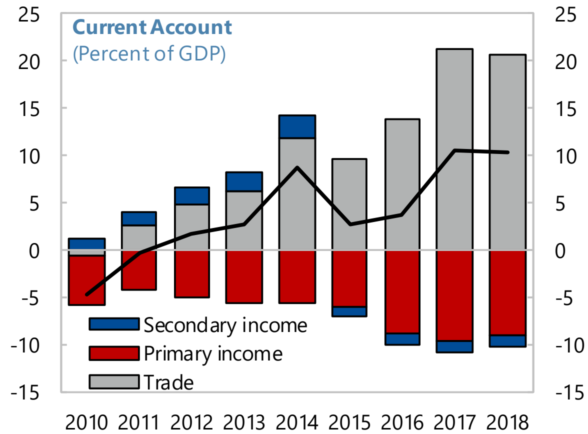
Figure 4. Malta: Financial Soundness Indicators



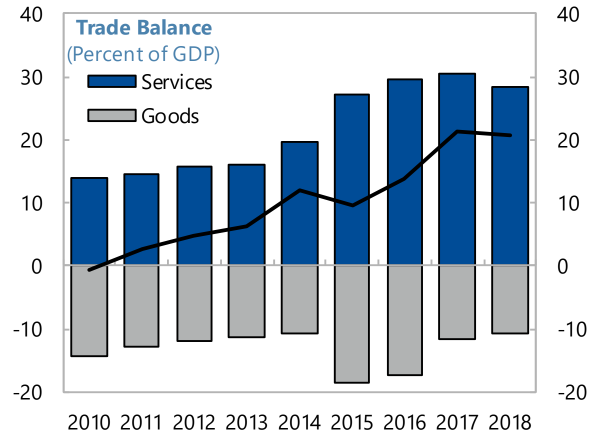
Sources: IMF *Financial Soundness Indicator;* Central Bank of Malta; Malta Financial Services Authority, and IMF staff.

Figure 5. Malta: External Sector

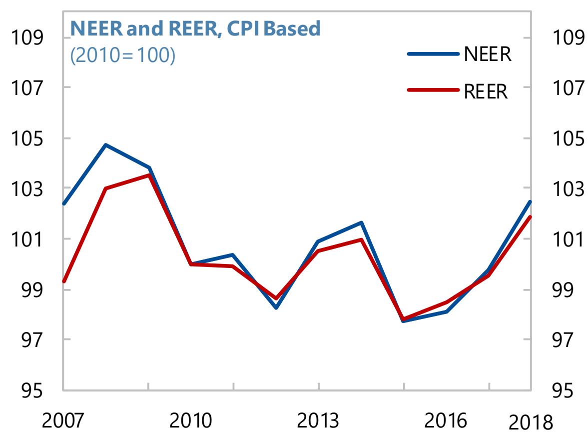
The current account surplus held broadly steady in 2018…



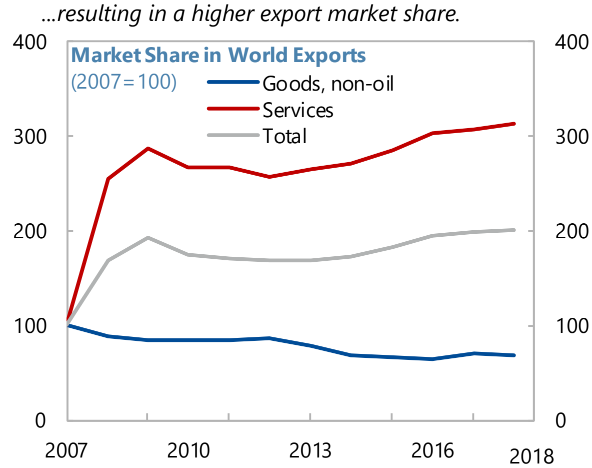
…as services surplus and goods deficit were little changed.



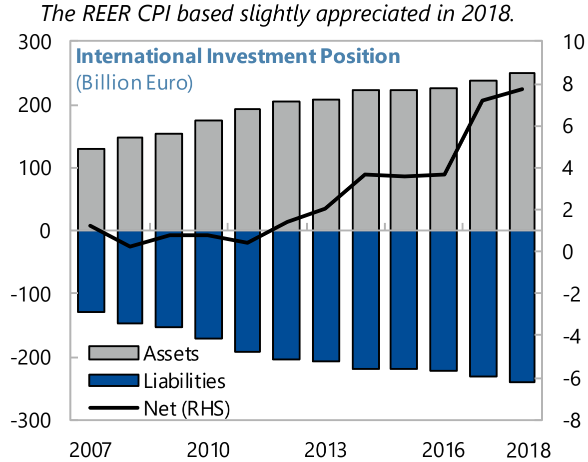
The share of services rose considerably in recent years…



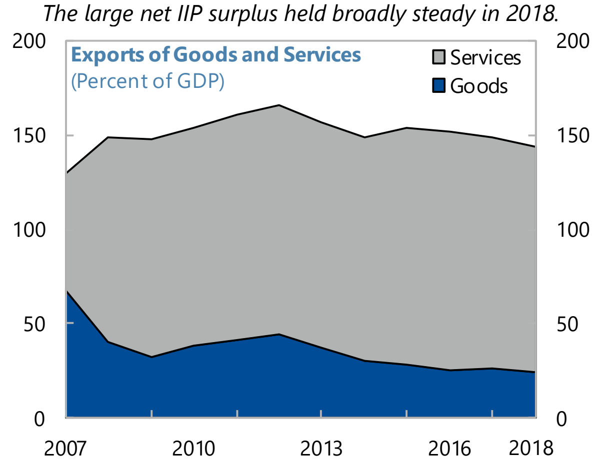
…resulting in a higher export market share.



The REER CPI based slightly appreciated in 2018.



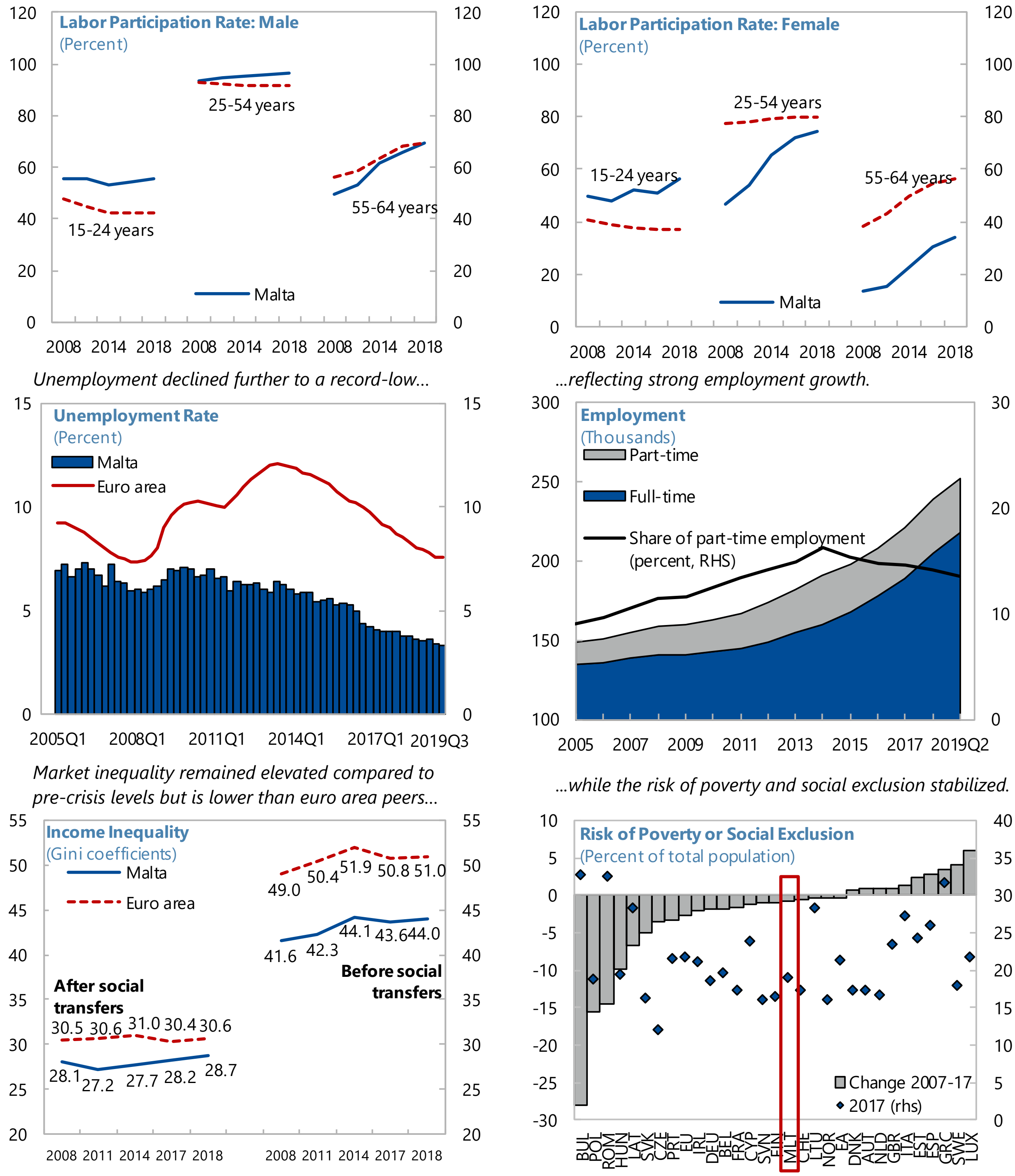
The large net IIP surplus held broadly steady in 2018.



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

Figure 6. Malta: Labor Market and Income Inequality Developments

Female labor force participation remained below euro area averages among middle-aged and older cohorts.



Sources: Eurostat and IMF staff.

Table 1. Malta: Selected Economic Indicators, 2016–2025

(Year on year percent change, unless otherwise indicated)

Population (millions):	0.5	Per capita income (2018, euros):	25,996
Quota (as of Oct. 31, 2018; millions of SDRs):	168.3	At-risk-of-poverty rate 1/	16.8

					Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
	(Year on year percent change)									
Real GDP	5.8	6.5	7.3	4.4	4.0	3.7	3.4	3.3	3.2	3.2
Domestic demand	1.2	-1.5	8.2	5.6	5.0	3.6	3.0	2.8	2.7	2.7
Consumption	1.0	3.0	8.9	4.9	4.8	3.7	3.2	3.0	2.9	2.9
Private consumption	2.4	3.4	7.6	2.4	4.1	3.6	3.3	3.0	2.8	2.8
Public consumption	-3.0	1.8	12.7	12.0	6.6	4.0	3.0	3.0	3.0	3.0
Fixed investment	-0.3	-6.9	-2.1	7.2	7.0	3.3	2.5	2.1	2.0	2.0
Exports of goods and services	4.5	4.8	3.5	1.7	1.8	2.2	2.2	2.2	2.2	2.2
Imports of goods and services	1.6	-0.5	3.4	2.1	2.0	1.9	1.8	1.7	1.7	1.7
Contribution to growth	(Percent)									
Domestic demand	1.1	-1.5	6.5	4.3	4.1	3.0	2.5	2.3	2.2	2.2
Foreign balance	4.7	7.9	0.8	-0.2	0.2	0.7	0.9	1.0	1.0	1.0
Potential GDP growth	7.4	7.0	6.3	5.1	4.6	3.8	3.4	3.3	3.2	3.2
Output gap (% potential GDP)	0.8	0.4	1.3	0.6	0.1	0.1	0.0	0.0	0.0	0.0
HICP (period average)	0.9	1.3	1.7	1.5	1.6	1.7	1.9	2.0	2.0	2.0
GDP deflator	1.5	2.5	2.1	2.3	2.4	2.1	2.2	2.2	2.1	2.1
Unemployment rate EU stand.	4.7	4.0	3.7	3.5	3.7	4.0	4.4	4.5	4.6	4.6
Employment growth	3.2	14.0	7.5	5.0	3.9	2.8	2.3	2.1	2.0	2.0
Gross national savings (percent of GDP)	27.7	29.8	29.5	28.4	27.6	27.2	26.9	26.6	26.2	26.1
Gross capital formation (percent of GDP)	23.9	19.2	19.1	20.0	20.3	20.3	20.2	20.0	19.9	19.8
Public finance	(Percent of GDP)									
Net lending/borrowing (overall balance)	0.9	3.4	1.9	1.3	1.1	0.8	0.8	0.9	0.8	0.8
Structural overall balance (% potential GDP)	0.5	3.5	1.2	0.9	0.9	0.8	0.8	0.9	0.8	0.8
General government debt	55.5	50.4	45.6	42.8	39.8	36.9	33.7	30.9	27.7	26.0
Balance of payments	(Percent of GDP)									
Current account balance	3.8	10.5	10.4	8.4	7.3	6.9	6.7	6.5	6.3	6.3
Trade balance (Goods and services)	13.8	21.3	20.7	19.8	19.4	19.6	20.0	20.5	20.9	21.2
Exports of goods and services	152.0	149.7	144.1	139.8	136.2	134.0	132.1	130.4	128.7	127.1
Imports of goods and services	138.2	128.4	123.4	119.9	116.8	114.4	112.1	109.9	107.9	105.9
Goods balance	-19.0	-13.2	-12.7	-15.1	-16.1	-15.4	-15.0	-14.8	-14.4	-14.0
Services balance	32.8	34.5	33.4	34.9	35.5	35.0	35.1	35.3	35.2	35.2
Primary income, net	-8.9	-9.5	-9.0	-10.1	-10.9	-11.5	-12.1	-12.7	-13.3	-13.7
Secondary income, net	-1.1	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Financial account, net	7.8	11.0	4.5	9.4	8.2	7.8	7.6	7.5	7.2	7.2
Financial sector										
Credit to the private sector (% GDP)	84.4	79.4	77.5	77.6	...	...	...	...	...	...
Credit growth, private sector	3.7	2.7	6.9	7.0	...	...	...	...	...	...
Memorandum item:										
Nominal GDP (millions of euros)	10338.9	11284.4	12366.3	13208.5	14067.8	14899.6	15741.3	16619.3	17506.7	18438.2
Nominal GDP growth	7.4	9.1	9.6	6.8	6.5	5.9	5.6	5.6	5.3	5.3

Sources: Maltese authorities; and IMF staff projections.

1/ Share of population with an equivalised disposable income (including social transfers) below the threshold of 60 percent of the national median equivalised disposable income after social transfers. Data is as of 2017.

Table 2. Malta: Fiscal Developments and Projections, 2016–2025
(Percent of GDP, unless otherwise indicated)

					Projections					
	2016	2017	2018	2019 (est.)	2020	2021	2022	2023	2024	2025
Revenue	37.5	39.3	38.5	38.7	38.1	37.6	37.3	37.1	37.0	36.9
Taxes	25.7	26.5	26.2	26.4	26.4	26.4	26.4	26.4	26.4	26.4
Indirect taxes	12.2	12.4	12.7	12.7	12.7	12.7	12.7	12.7	12.7	12.7
Direct taxes	13.4	13.9	13.3	13.5	13.5	13.5	13.5	13.5	13.5	13.6
Other taxes (capital taxes)	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social contributions	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2
Grants and Capital revenue	0.5	0.7	1.0	1.8	1.4	1.2	1.2	0.9	0.9	0.9
Other revenue	5.1	5.9	5.1	4.4	4.1	3.8	3.6	3.6	3.4	3.4
Expenditure	36.5	35.9	36.6	37.5	37.0	36.8	36.5	36.2	36.2	36.2
Expense	34.1	33.6	33.7	33.6	33.5	33.2	33.0	32.9	32.9	32.9
Compensation of Employees	11.4	11.2	11.1	11.2	11.2	11.2	11.2	11.2	11.2	11.2
Use of goods and services	6.1	6.4	6.6	6.9	6.9	6.9	6.9	6.9	6.9	6.9
Interest	2.1	1.8	1.5	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Subsidies	1.3	1.2	1.4	1.3	1.4	1.3	1.3	1.2	1.2	1.2
Social benefits	10.5	10.0	9.5	9.6	9.6	9.4	9.3	9.3	9.3	9.3
Other expense	2.7	2.8	3.6	3.3	3.3	3.3	3.1	3.1	3.1	3.1
Net acquisition of nonfinancial assets	2.5	2.3	2.9	3.9	3.5	3.5	3.5	3.3	3.3	3.3
Gross Operating Balance	3.4	5.7	4.8	5.2	4.6	4.4	4.3	4.1	4.0	4.0
Net lending/borrowing (overall balance)	0.9	3.4	1.9	1.3	1.1	0.8	0.8	0.9	0.8	0.8
Memorandum items:										
Overall balance excl. one-offs	0.9	3.6	1.8	1.2	1.0	0.8	0.8	0.9	0.8	0.8
Overall balance excl. IIP proceeds	-0.7	1.3	0.4	0.2	0.1	0.0	0.1	0.4	0.4	0.4
Cyclically adjusted overall balance	0.5	3.3	1.3	1.0	1.0	0.8	0.8	0.9	0.8	0.8
Structural balance 1/	0.5	3.5	1.2	0.9	0.9	0.8	0.8	0.9	0.8	0.8
Structural balance excl. IIP proceeds 1/	-1.1	1.3	-0.3	-0.2	-0.1	0.0	0.1	0.4	0.4	0.4
Cyclically adjusted primary balance	2.7	5.1	2.9	2.3	2.3	2.0	2.0	2.0	1.9	1.9
Structural primary balance 1/	2.7	5.3	2.8	2.2	2.2	2.0	2.0	2.0	1.9	1.9
Structural primary balance excl. IIP proceeds 1/	1.0	3.1	1.2	1.1	1.2	1.2	1.2	1.6	1.6	1.6
Primary balance	3.0	5.2	3.4	2.6	2.3	2.1	2.0	2.0	1.9	1.9
One-offs	0.0	-0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Public debt	55.5	50.4	45.6	42.8	39.8	36.9	33.7	30.9	27.7	26.0
Government guaranteed debt	13.5	9.5	8.7	8.2	7.6	7.1	6.8	6.5	6.1	5.8
Nominal GDP (millions of euros)	10,339	11,284	12,366	13,208	14,068	14,900	15,741	16,619	17,507	18,438

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

Table 3. Malta: Balance of Payments, 2016–2025

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Projections						
	(Millions of euros)									
Current account balance	394	1,188	1,289	1,114	1,023	1,021	1,049	1,087	1,104	1,155
Trade balance (Goods and services)	1,429	2,404	2,560	2,617	2,729	2,924	3,151	3,406	3,652	3,912
Goods balance	-1,967	-1,494	-1,575	-1,992	-2,259	-2,296	-2,368	-2,454	-2,513	-2,574
Exports	2,583	3,011	3,097	2,953	2,898	3,020	3,146	3,277	3,409	3,546
Imports	4,550	4,504	4,672	4,944	5,157	5,315	5,514	5,731	5,922	6,120
Services balance	3,396	3,897	4,135	4,609	4,987	5,220	5,518	5,860	6,166	6,486
Exports	13,133	13,884	14,718	15,508	16,263	16,947	17,655	18,391	19,129	19,897
Imports	9,737	9,987	10,583	10,899	11,276	11,727	12,137	12,531	12,964	13,411
Current income, net	-920	-1,075	-1,117	-1,338	-1,529	-1,717	-1,905	-2,111	-2,329	-2,526
Current transfers, net	-115	-141	-155	-165	-176	-187	-197	-208	-219	-231
Private	-115	-141	-155	-165	-176	-187	-197	-208	-219	-231
Public	0	0	0	0	0	0	0	0	0	0
Capital account, net	32	74	115	123	131	139	147	155	163	172
Financial account, net	806	1,242	559	1,237	1,154	1,160	1,196	1,242	1,268	1,327
Direct investment	-8,622	-9,438	-9,709	-11,271	-12,004	-12,714	-13,432	-14,182	-14,939	-15,734
Portfolio investment	4,757	6,722	2,960	5,957	6,345	6,720	7,100	7,496	7,896	8,316
Other investment	4,588	3,919	6,959	6,531	6,793	7,132	7,505	7,903	8,284	8,717
Reserves (- inflow; + outflow)	88	146	168	0	0	0	0	0	0	0
Errors and omissions	379	-19	-845	0	0	0	0	0	0	0
	(Percent of GDP)									
Current account balance	3.8	10.5	10.4	8.4	7.3	6.9	6.7	6.5	6.3	6.3
Trade balance (Goods and services)	13.8	21.3	20.7	19.8	19.4	19.6	20.0	20.5	20.9	21.2
Goods balance	-19.0	-13.2	-12.7	-15.1	-16.1	-15.4	-15.0	-14.8	-14.4	-14.0
Exports	25.0	26.7	25.0	22.4	20.6	20.3	20.0	19.7	19.5	19.2
Imports	44.0	39.9	37.8	37.4	36.7	35.7	35.0	34.5	33.8	33.2
Services balance	32.8	34.5	33.4	34.9	35.5	35.0	35.1	35.3	35.2	35.2
Exports	127.0	123.0	119.0	117.4	115.6	113.7	112.2	110.7	109.3	107.9
Imports	94.2	88.5	85.6	82.5	80.2	78.7	77.1	75.4	74.0	72.7
Primary income, net	-8.9	-9.5	-9.0	-10.1	-10.9	-11.5	-12.1	-12.7	-13.3	-13.7
Secondary income, net	-1.1	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Private	-1.1	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Public	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital account, net	0.3	0.7	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Financial account, net	7.8	11.0	4.5	9.4	8.2	7.8	7.6	7.5	7.2	7.2
Direct investment	-83.4	-83.6	-78.5	-85.3	-85.3	-85.3	-85.3	-85.3	-85.3	-85.3
Portfolio investment	46.0	59.6	23.9	45.1	45.1	45.1	45.1	45.1	45.1	45.1
Assets	46.5	60.5	26.0	44.3	44.3	44.3	44.3	44.3	44.3	44.3
Liabilities	0.5	1.0	2.0	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Other investment	44.4	34.7	56.3	49.4	48.3	47.9	47.7	47.6	47.3	47.3
Assets	-0.6	69.7	25.7	25.7	25.7	25.7	25.7	25.7	25.7	25.7
Liabilities	-45.0	35.0	-30.5	-23.7	-22.6	-22.1	-21.9	-21.8	-21.6	-21.5
Reserves (- inflow; + outflow)	0.9	1.3	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	3.7	-0.2	-6.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Gross external debt (Percent of GDP)	854.5	817.3	740.9	702.1	666.5	636.2	608.8	583.2	559.9	537.9
Net external debt (Percent of GDP)	-214.2	-207.9	-179.3	-181.5	-183.5	-185.5	-187.6	-189.7	-191.9	-194.1

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

Table 4. Malta: Financial Soundness Indicators, 2014–2019:H1 1/

(Percent, unless otherwise indicated)

	Core Domestic Banks						Non-Core Domestic Banks					International Banks					Total Banks				
	2014	2015	2016	2017	2018	2019H1	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
Core FSIs																					
Regulatory capital to risk weighted assets	14.4	15.0	16.2	17.3	17.3	18.4	17.4	22.1	15.5	16.7	16.9	69.2	56.3	49.2	47.9	52.5	25.7	21.8	21.2	21.7	21.9
Regulatory Tier 1 capital to risk-weighted assets	11.5	12.2	13.6	15.2	15.2	16.2	17.1	18.6	12.3	13.3	16.6	69.1	56.2	46.7	45.3	49.9	23.6	19.2	18.5	19.4	20.0
Non-performing loans net of provisions to capital	42.2	42.8	28.9	22.4	20.6	16.8	7.7	7.9	12.0	6.9	12.0	2.2	3.8	8.2	6.9	11.8	18.3	24.3	20.1	16.3	17.1
Non-performing loans to total gross loans	7.6	7.2	5.4	4.1	3.4	3.3	4.4	4.0	4.0	2.3	3.6	0.7	1.2	1.7	1.5	2.2	6.0	4.7	4.1	3.0	3.0
Sectoral distribution of resident loans to total loans																					
Agriculture	0.2	0.2	0.2	0.2	0.1		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Fishing	0.1	0.1	0.1	0.4	0.2		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.2	0.1
Mining and quarrying	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Manufacturing	2.7	2.8	2.6	2.6	2.5	1.7	0.6	0.6	0.3	0.4	0.3	0.0	0.0	0.0	0.0	0.0	1.7	1.7	1.6	1.6	1.5
Electricity, gas, Steam and Air Conditioning Supply	2.9	2.2	2.3	1.6	1.4	1.5	5.1	0.0	0.0	0.0	0.9	0.0	0.0	0.0	0.0	0.0	2.0	1.3	1.4	0.9	0.9
Water Supply; Sewerage waste management and remediation activities	0.6	0.5	0.5	0.4	0.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.3	0.3	0.3	0.2
Construction	7.3	5.2	4.9	4.5	4.4	2.8	0.0	0.0	0.0	2.5	3.3	0.0	0.0	0.0	0.0	0.0	4.4	3.2	3.0	2.7	2.8
Wholesale and retail trade; Repair of motor vehicles and motor cycles	8.3	8.2	7.8	6.9	6.3	3.8	0.7	1.1	0.4	2.2	5.2	0.0	0.0	0.0	0.0	0.0	5.0	5.0	4.8	4.1	4.0
Transportation and storage	2.8	2.8	2.3	2.3	1.7	1.0	0.8	0.0	0.0	0.0	0.0	0.1	0.2	0.2	0.2	0.2	1.8	1.8	1.5	1.4	1.1
Accomodation and food service activities	3.8	4.1	3.5	2.8	3.0	2.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.3	2.5	2.1	1.6	1.8
Information and communication	0.9	0.8	0.7	0.5	0.5	0.5	0.1	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.6	0.5	0.4	0.3	0.3
Financial and insurance activities	4.8	5.9	6.8	6.3	6.1	27.5	0.7	0.9	2.6	3.7	1.9	0.0	0.0	1.3	0.1	0.0	2.9	3.6	4.7	3.8	3.8
Real estate activities [includes inputed rents of owner-occupied dwellings]	6.6	6.7	7.3	7.0	6.9	4.4	3.6	3.5	4.2	4.4	4.8	0.0	0.5	0.0	0.0	0.0	4.2	4.4	4.7	4.2	4.4
Professional, scientific and technical activities	0.9	1.1	1.3	1.4	1.7	0.7	0.0	0.0	0.0	0.9	0.8	0.0	0.0	0.0	0.0	0.0	0.5	0.7	0.8	0.9	1.1
Administrative and support service activities	1.4	1.2	1.0	0.8	0.7	0.7	0.1	0.1	0.7	1.1	0.8	0.0	0.0	0.0	0.0	0.0	0.8	0.7	0.7	0.5	0.4
Public administration and defence; Compulsory social security	1.5	1.6	1.1	1.3	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.9	1.0	0.7	0.8	0.7
Education	0.4	0.4	0.3	0.3	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.3	0.2	0.2	0.2
Human health and social work activities	0.7	0.7	0.7	0.7	0.8	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.4	0.4	0.4	0.5
Arts, entertainment and recreation	0.5	0.5	0.4	0.3	0.3	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.2	0.2	0.2
Other Services activities	0.3	0.3	0.2	0.2	0.2	0.3	0.0	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.1	0.1	0.1
Households and individuals (excl. Sole Proprietors)	43.6	46.2	48.3	47.5	46.9	34.1	0.1	0.1	0.1	2.6	3.5	0.0	0.0	0.0	0.0	0.0	26.2	27.8	29.6	27.7	28.2
Mortgages	36.9	39.8	42.3	42.4	42.3		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	22.1	23.9	25.9	24.6	25.2
Activities of extraterritorial organisations and bodies	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-resident	9.6	8.4	7.8	12.2	14.6	17.7	87.8	93.6	91.6	82.1	78.3	99.9	99.3	98.5	99.7	99.7	45.1	44.3	42.6	48.2	47.8
Return on assets	0.7	0.7	0.8	0.7	0.5	1.0	-1.3	0.2	0.3	0.3	0.4	0.9	1.0	1.0	1.5	1.4	0.7	0.9	0.8	1.0	0.9
Return on equity	9.8	9.8	10.1	9.2	6.2	11.9	-6.4	1.4	3.4	2.9	3.6	2.4	3.4	3.7	4.9	4.3	3.6	5.9	6.7	7.3	5.4
Interest margin to gross income	64.8	64.5	62.3	70.8	62.3	62.7	46.3	43.5	31.2	31.1	29.8	201.9	137.8	92.6	78.8	79.7	115.1	93.0	73.0	73.3	69.0
Non-interest expenses to gross income	51.2	54.2	52.2	58.8	64.2	59.4	56.1	73.4	66.5	78.3	61.5	11.9	24.8	31.9	28.1	32.1	36.8	43.3	44.7	44.0	48.9
Non-interest income to gross income	35.2	35.5	37.8	29.2	37.7	37.3	53.7	56.5	68.8	68.9	70.2	-101.9	-37.8	7.4	21.2	20.3	-15.1	7.0	27.0	26.7	31.0
Liquid assets to total assets	28.3	31.8	36.5	29.4	27.6	29.3	31.7	36.3	33.5	28.6	32.0	19.7	22.7	30.1	20.6	18.7	27.3	31.2	35.6	16.6	27.2
Liquid assets to short-term liabilities	50.4	50.2	55.8	43.5	36.5	38.7	77.9	63.3	67.8	37.4	39.0	84.7	83.6	96.3	43.7	63.3	53.9	52.6	58.7	43.0	37.7
Other FSIs																					
Total Coverage ratio (total provisions to NPLs as per BR/09)	40.4	43.5	45.9	45.2	44.8		77.1	65.2	53.9	65.9	62.5	40.5	50.4	54.8	51.9	67.2	37.5	40.0	48.0	47.4	51.9
Liquidity Coverage Ratio		165.1	164.4	259.6	318.2			100.2	194.9	263.9	421.3		188.3	357.6	279.4	396.7		159.7	173.9	198.2	209.8
Domestic debt securities to total assets	9.6	9.3	7.9	7.0	6.5		4.6	7.7	4.9	3.2	2.0	0.0	0.2	0.1	0.2	0.1	3.9	4.5	4.0	3.6	3.7
Foreign debt securities to total assets	23.3	21.8	20.6	16.8	15.8		19.5	12.5	15.0	11.9	14.1	52.4	50.4	46.9	42.7	29.7	39.9	36.0	32.8	28.9	21.2
Unsecured loans to total lending	29.0	27.4	25.4	27.7	28.6		65.2	70.9	65.4	67.2	73.4	48.4	30.7	26.7	16.2	17.3	37.7	30.8	28.2	25.0	26.9
Assets to total capital and reserves	14.1	13.7	13.3	12.0	12.1		8.4	8.4	12.1	11.5	8.8	1.7	2.0	2.9	3.4	2.9	6.4	8.0	9.6	9.3	8.9
Large exposure to total own funds	103.4	96.5	110.9	88.4	100.1		339.9	157.6	268.6	274.9	215.2	45.3	129.9	128.8	119.2	93.4	88.9	115.8	130.1	111.1	107.7
Gross asset position in financial derivatives to total own funds	1.1	1.3	1.7	0.9	0.7		0.8	0.3	0.6	0.3	0.0	15.7	67.2	103.0	131.2	169.9	8.9	25.9	37.8	42.7	54.7
Gross liability position in financial derivatives to total own funds	4.5	2.0	2.0	1.0	1.0		2.2	0.3	3.6	0.3	0.9	10.4	15.9	69.2	80.2	104.8	10.4	15.3	22.6	26.4	34.1
Personnel expenses to non-interest expenses	50.8	51.2	48.8	48.1	38.0		45.0	42.5	49.7	45.6	49.8	27.4	23.2	19.9	16.2	14.1	47.4	44.0	40.5	37.6	31.3
Customer loans to customer deposits	64.0	58.2	56.0	58.9	60.9		75.7	60.7	46.5	47.1	50.6	93.1	104.1	108.1	111.6	189.5	71.8	67.9	65.7	70.4	78.0
Net open position in equities to total own funds	14.4	15.4	14.0	13.1	11.4		45.0	81.8	146.8	138.8	108.8	0.3	2.7	1.5	3.4	4.7	9.0	18.1	36.0	18.6	17.5
Loan-to-value																					
Residential	73.9	77.8	75.1	73.5	72.7																
Commercial	64.5	56.9	67.5	65.1	56.7																

Source: Central Bank of Malta.

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

Annex I. Implementation of IMF Recommendations

2019 Article IV Advice	Actions since 2019 Article IV
Fiscal Policy	
Continue building fiscal buffers, strengthening revenue collection and broadening the tax base.	The medium-term fiscal strategy envisages gradual structural adjustment. VAT grouping and tax consolidation regulations for company groups were introduced. Revenue administration reforms continue. Two EU Directives on Anti-Tax Avoidance are being transposed into national laws.
Improve fiscal risk analysis and management; reduce long-term fiscal risks.	Revisions to fiscal reports are underway; for instance, the latest Stability Program Update included details on changes relative to previous year's forecast and the NSO published general government pension entitlements.
Shift the balance of expenditure towards infrastructure and improve public investment management.	Public investment rose in 2018–19 partly due to improved absorption of EU funds. Multi-year projections of capital expenditure were introduced in the 2020 Financial Estimates.
Financial Sector and Housing Market	
Remedy deficiencies in the implementation of the AML/CFT framework.	See the *AML/CFT* section in Annex II.
Guarantee long-term financial and operational independence of the financial supervisor and increase supervisory capacity.	See the Financial Sector Supervisory Resources and Independence section in Annex II.
Enhance monitoring of the non-bank financial sector.	See the *Macroprudential Policy* section in Annex II.
Consider refining the new borrower-based macroprudential measures.	See the *Macroprudential Policy* section in Annex II.
Address affordability issues for vulnerable households.	Housing benefit for tenants were extended and expanded to middle-income individuals and households. Stamp duties for first time home buyers, other residential buyers and those inheriting homes for residence were reduced. Interest-free loans to cover down-payments for homebuyers under 40 years old were introduced. Plans for social housing were expanded.
Structural Reforms	
Further increase female and elderly participation in the labor force; address skills gap problem.	Facilitation in setting up a maternity leave fund for private sector employment. Extension of voluntary occupation pension schemes to incentivize delayed retirement. Introduction of applied and vocational learning subjects in secondary school. Offering of occupational licenses for specialized jobs are underway.
Foster innovation, including by improving SME's access to financing.	The Maltese Development Bank has partnered with commercial banks to provide SME financing. A National Strategy for Artificial Intelligence was published. The Ministry of Education has launched the Start-Up Malta Foundation to assist start-ups and entrepreneurs.

Annex II. Main FSAP Recommendations[1]

Recommendations	Timing	Progress
Risk Analysis		
Strengthen the risk analysis by incorporating new dimensions in liquidity stress testing, conducting regular sensitivity analysis on selected vulnerabilities, and enhancing data management (CBM, MFSA)	NT	**In progress.** The CBM enhanced stress testing frameworks by considering severe adverse scenarios and sensitivity analyses in the Macro Stress Testing framework and including in complementary liquidity measures. Both the CBM and the MFSA invested in improving the data management system. However, new dimensions such as asset concentration and cross-border exposures need to be considered to strengthen the banking sector risk management.
Macroprudential Policy		
Consider providing the CBM with powers to recommend actions to be taken by a public authority or public institution, with a "comply or explain" mechanism, and to issue warnings and opinions. Amend the MFSA Act to add a financial stability objective (Government, MFSA)	NT	**In progress.** A financial stability objective has been added to the MFSA Act (article 3, Act VIII of 2019). The CBM powers are still being assessed by the government.
Close remaining data gaps, and enhance analytical tools (CBM, NSO, MFSA)	NT/MT	**In progress.** Efforts have been taken to improve data quality of NBFIs, loans, and commercial and residential real estate. Further efforts to collect granular data on inter-company loans and cross-border lending are needed.
Refine and introduce the planned borrower-based instruments to address possible buildup of vulnerability in the housing and household sectors. (CBM)	I	**In progress.** CBM Directive No. 16 defining borrower-based macro prudential measures became effective on July 1st, 2019. Further refinements should be considered when concerns about possible market disruptions dissipate.
Financial Sector Supervisory Resources and Independence		
Ensure stable funding for the MFSA, grant it full autonomy over its recruitment and maintain a dedicated statutory committee on supervisory issues. (MFSA, Government)	I	**In progress.** Two amendments (Amendments to Directive 7 and Art. 11 of the MSFA Act) and a new Act XXVI in 2019 allow MFSA's recruitment independence and separation of enforcement decisions from the Chief Officer. A Regulatory Committee was established to discuss regulatory and supervisory issues. The MFSA has finalized its business plan but it remains to be implemented.
Address the significant gap in supervisory and enforcement capacity by increasing staff and broadening the skill set. (MFSA)	I	**In progress.** The MFSA has hired additional 80 staff members in 2019, moving towards the goal of 450 by 2022. Competitive packages and training should be provided to recruit and retain skilled experts, including IT, credit risk experts, supervisors, statisticians, etc..

[1] Please refer to Malta Financial System Stability Assessment 2019 for the full set of FSAP recommendations.

Recommendations	Timing	Progress
Banking Regulation and Supervision		
Increase the number and risk orientation of onsite inspections of LSIs. Enhance supervision of third country branches. (MFSA)	ST	**In progress.** The MFSA carried out two on-site inspections to Turkish credit institutions in 2019, but more are needed for adequate supervision of third-country branches as well as high priority LSIs. In addition, the authorities should address the gaps between the related-parties framework and the Basel Core Principles.
Take timely supervisory actions (including for ML/TF) and increase the use of monetary fines. Ensure supervisory action is not delayed through judicial appeal, including by amending the law, if needed. (MFSA, FAIU, Government)	ST	**In progress.** The FIAU has taken various initiatives including by increasing human resources, separation of functions, and improving its risk-based supervision approach together with enhanced collaboration with the MFSA. In Feb 2020, the FIAU acquired the legal power to publish notification of administrative sanctions that have been issued, even if these are still undergoing judicial review. The judicial system should be improved in a timely manner to ensure greater effectiveness of the sanctions policy.
Insurance and Securities Regulation and Supervision		
Strengthen conduct supervision and enhance the sectoral risk-based supervision framework. (MFSA)	MT	**In progress.** The MFSA's financial stability function has been conducting more comprehensive analysis of the insurance and funds sectors. On conduct supervision, the MFSA is planning to carry out more on-site inspections in 2020 and to launch off-site thematic reviews.
AML/CFT		
Improve the authorities' assessment and understanding of ML/TF risks and strengthen the national coordination. (National Coordination Committee)	I	**In progress.** Sector specific risk assessments (legal entities, VFAs, voluntary organizations) and a thematic risk assessment on TF have been completed, and the NCC has started working on targeted action plans to mitigate identified risks. The FIAU acquired new tools for and is dedicating further resources to improve its overall risk understanding. Authorities should make sure to continue to focus on risks related to higher-risk sectors and programs, including banking, remote gaming, VFAs, the IIP, and connected sectors, as well as foreign and cross-border flows.
Adopt a multi-prong strategy that includes: (i) ensuring that banks appropriately apply preventive measures; (ii) fully implementing a risk-based AML/CFT supervision; and (iii) applying timely, dissuasive, and proportionate sanctions and effective fit-and-proper tests. (MFSA, FIAU, ROC, Government)	I	**In progress.** The MFSA recently set up the coordination function—Financial Crime Compliance function, enhanced risk-ranking model, and updated single shareholder/risk appetite policy. The FIAU has increased supervisory inspections of credit institutions and adopted a new methodology which aims to ensure that all credit institutions will be subject to an on-site examination within a four-year supervisory cycle. The FIAU and the MFSA in

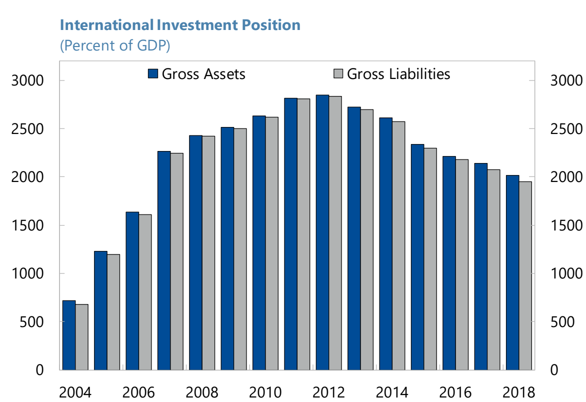
		collaboration have also increased training and outreach for banks and other subject persons and issued related guidance documents. In terms of the beneficial ownership transparency, ROC is empowered by law to verify the beneficial ownership information and can refuse registration if violations are identified. However, more efforts should be made to ensure proper and timely verification and robust sanctions if needed.
Support establishing an EU-level arrangement responsible for AML/CFT supervision. (Government)	MT	**In progress.** Malta is supporting the EU-level initiative of a harmonized higher-level AML regulation and supervision.
Safety Nets and Crisis Management		
Adopt an administrative bank insolvency regime with explicit powers to transfer assets/liabilities. Clarify the creditor hierarchy. (Government)	I	**In progress.** Malta is following the EU level initiative on a harmonized insolvency law applicable to credit institutions. However, the authorities should react more promptly as this process could take considerable period of time.
Shift responsibility for decisions on bank insolvency and liquidation, post-license revocation, from the MFSA's supervisory function to its resolution function (MFSA)	I	**Not done.** The recommendation is currently under discussion.
Review the adequacy of the Resolution Unit's staffing and increase its resources accordingly (MFSA)	I	**Not done**. Increasing staff in the Resolution Unit of MFSA is under consideration.

Annex III. External Sector Assessment

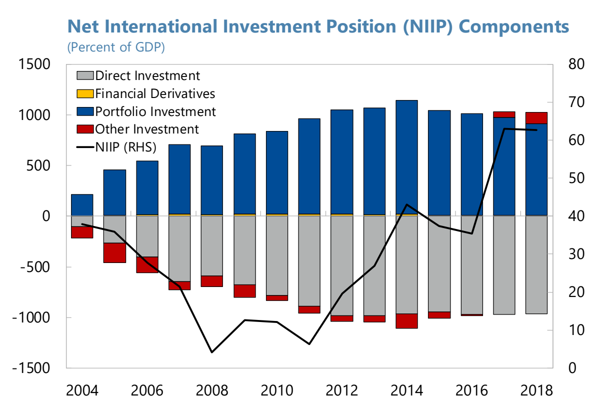
The external position of Malta in 2019 was moderately stronger than fundamentals and desirable policy settings, though this assessment is subject to high uncertainty. While the recorded current account surplus was sizable, staff's judgment takes into account that Malta is a small financial center, hosts many captive financial institutions and money lenders and other multinationals, compounding measurement issues related to the current account and introducing significant uncertainty to normative conclusions regarding the external position.

Foreign Asset and Liability Position

1. **Malta's external position is strongly influenced by the ownership structures of internationally-oriented firms and captive financial institutions and money lenders.** Its net international investment position (NIIP) remained steady at 63 percent of GDP at end-2018 after almost doubling from 2016 to 2017 Gross assets and liabilities are very large, with particularly sizable positions in portfolio investment assets (over 900 percent of GDP) and direct investment liabilities (around 1600 percent of GDP) which are mostly in the form of equity. The NIIP is expected to remain highly positive over the medium term, in line with projected current account surpluses. However, uncertainty related to the ownership structure of assets and liabilities between domestic and foreign investors generates uncertainty as to the measure of primary income flows, and therefore of the current account balance. A better understanding of ultimate ownership of captive financial institutions and money lenders, as well as other multinational firms, would help improve the measurement of associated income flows.



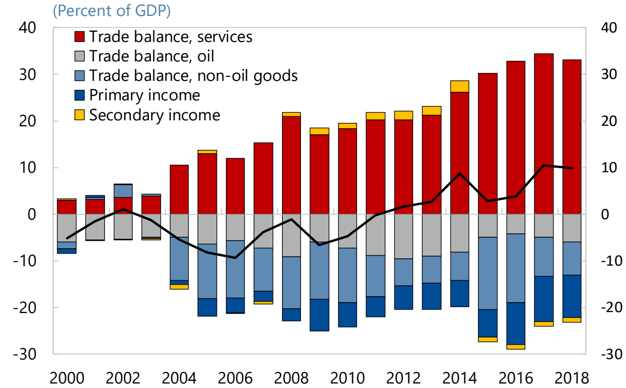
Sources: Haver Analytics, Eurostat, and IMF staff calculations.



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

2. The current account (CA) surplus remained broadly unchanged from 10.5 percent of GDP in 2017 to 10.4 percent of GDP in 2018. Preliminary estimates suggest some narrowing of the current account surplus to 8.4 percent in 2019, largely due to slower export growth reflecting weaker external demand. Strong net exports of services, which continue to largely reflect proceeds of remote gaming and tourism, account for the bulk of the CA improvement in recent years. The CA has recorded sustained surpluses since 2012, averaging close to 6 percent of GDP over 2013–18. Continued surpluses, though gradually declining, are expected over the medium term.

Current Account Components
(Percent of GDP)



Sources: IMF BOP Statistics and IMF staff calculations.

3. The EBA-lite CA model points to a large CA gap of 8.4 percent in 2019, a norm of nearly 0 percent, and a policy gap of 1.8 percent. Compared to last year, the contribution of the policy gap increased due primarily to public health expenditures, moving more in line with its desirable level and no longer offsetting a positive gap in fiscal policy. Moreover, staff considers that the large unexplained residual of 6.9 percent of GDP could be at least partially explained by a number of idiosyncratic factors, including Malta's role as a small financial center, proceeds from the government's Individual Investor Program, and the role of savings for remittances. These factors suggest a downward adjustment of 3.5 percentage points to the CA balance and an upward adjustment of 3 percentage points to the CA norm:[1]

Malta: Results Based on IMF's EBA-Lite Methodology, 2019

Current account approach 1/		*REER approach*	
Actual CA (percent of GDP)	4.9	Ln(REER), actual	4.5
Cyclically-adjusted CA	5.1	Ln(REER), norm	4.5
Cyclically-adjusted CA norm	2.5	REER gap (percent)	-1.2
Multilaterally consistent cyc.-adj. norm	3.1	Policy gap (percent)	-2.4
CA gap	2.0	Residual (percent)	1.5
Policy gap	1.8		
Residual	0.9		
Implied REER gap (percent)	-2.1		

Source: IMF staff calculations.

1/ The "actual CA" includes an adjustment of around -3.5 percent of GDP for 'measurement issues and temporary factors. The "CA norm" includes an adjustment of about +3 percent of GDP for the likely different impact of remittances in a high-income country. See text for details.

- As a small financial center, joint biases due to retained earnings and inflation distortions can overstate the CA balance. Previous IMF staff analysis estimates that this bias can be about 3 percent of GDP for a financial center. This estimate is used to adjust Malta's CA balance down by 3 percentage points.

- The CA balance reflects the revenues from the government's Individual Investor Program (IIP). The authorities estimate that annual IIP export receipts amounted to roughly 1 percent of GDP over 2015–2017. To reflect the uncertainty around the

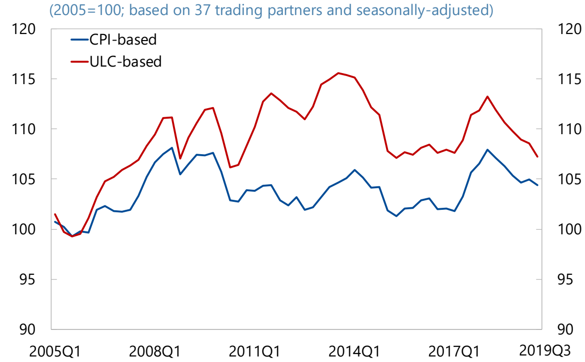
[1] See the 2019 Article IV Consultation, Annex IV (IMF Country Report No. 19/68) for further details.

duration and parameters of this program, staff makes a partial downward adjustment of 0.5 percentage points to the CA balance.

- An explanatory variable proxying for remittance inflows in the EBA-lite CA model contributes a negative contribution to the norm of minus 3 percent of GDP. This variable is less relevant for Malta, a high-income country where the contribution of remittances to the CA could be positive and associated with higher savings and CA balances. This adjustment adds 3 percentage points to the CA norm.

4. The ULC-based REER and the CPI-based REER remained broadly stable in 2019. The EBA-lite REER model points to a modest REER undervaluation of about 1 percent, similar to the implied undervaluation estimated by the CA model.

Malta: Real Effective Exchange Rate
(2005=100; based on 37 trading partners and seasonally-adjusted)

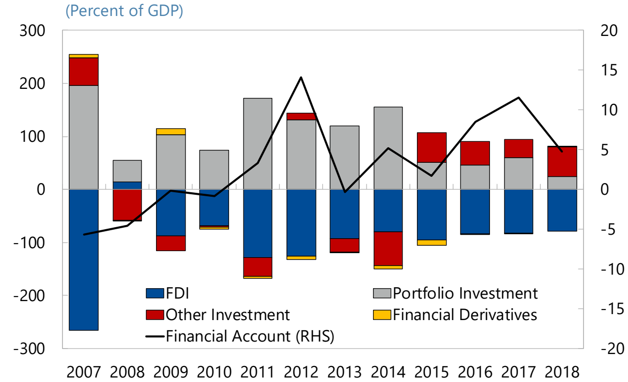


Sources: Haver Analytics, Eurostat, and IMF staff calculations.

5. To summarize the external assessment, the CA gap is estimated at about 2.0 percent of GDP, with an implied undervaluation of 2.1 percent, and an undervaluation of 1.2 percent estimated by the REER model. Staff assess that the external position in 2019 was moderately stronger than fundamentals and desirable policy settings. However, this assessment is subject to considerable uncertainty given Malta's idiosyncratic factors and measurement challenges associated with identifying ultimate ownership of profits and savings between domestic and foreign investors or firms.

6. Gross and net financial flows tend to be large relative to GDP. These flows are strongly influenced by the ownership structures and cross-border transactions of the several internationally-oriented firms that Malta hosts, including many captive financial institutions and money lenders Net FDI inflows and net portfolio investment outflows are particularly sizable. In recent years, the sum of net outflows accounted for by portfolio investment and other investment has exceeded the amount of net FDI inflows.

Financial Account Components
(Percent of GDP)



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

Annex IV. Risk Assessment Matrix

Source of Risks *Global Risks*	Relative Likelihood and Time Horizon[1]	Impact if Realized
Weaker-than-expected global growth. Weak foreign demand or an unanticipated Brexit outcome can delay investment, reduce private consumption and strain banks.	**High** **(ST, MT)**	**Medium** As a small and very open economy, Malta can be vulnerable to changes in foreign demand. Weaker external demand, accompanied by lower FDI inflows, would have adverse effects on domestic growth prospects. However, domestic demand is becoming a key driver of growth and large-scale infrastructure projects as well as healthy household balance sheets may mitigate adverse spillovers.
Policy response: Allow automatic stabilizers to operate in the short run if growth disappoints. Improve infrastructure quality and maintain structural reform momentum to remove supply-side bottlenecks, spur investment, and promote higher productivity growth. Continue diversifying trade activities. Fiscal policy could be used to mitigate the impact on vulnerable groups.		
Sharp rise in risk premia that exposes financial vulnerabilities. An abrupt reassessment of market fundamentals triggers widespread risk-off events that expose vulnerabilities building up in a period of low interest rates and a search for yield.	**Medium** **(ST, MT)**	**Medium/Low** Malta should be relatively insulated from direct international financial market contagion given the public and private sector's high reliance on domestic financing. However, it is still vulnerable to weaker external demand, lower FDI inflows and potential indirect financial contagion through cross-sectoral interlinkages. Loss of market confidence could lead to asset price declines, valuation losses and higher funding costs.
Policy response: Continue to reduce fiscal and financial vulnerabilities to ensure stability, and further diversify trade activities. Continue close financial supervision and further improve banks' asset quality to increase the banking system's loss absorption capacity, and further enhance crisis management framework. The authorities should stand ready to provide liquidity support to solvent financial institutions if needed. Remove remaining structural impediments to growth.		
Coronavirus outbreak causes widespread disruptions and global spillovers through tourism and confidence effects on investment.	**Medium** **(ST)**	**Medium** Tourism is an important sector for the Maltese economy in terms of both gross value-added and employment. A shock to this sector, as well as shocks to trade and investment, would hurt output and employment in Malta.
Policy response: Allow automatic stabilizers to operate in the short run if growth disappoints. Improve infrastructure quality and maintain structural reform momentum to remove supply-side bottlenecks, spur investment, and promote higher productivity growth. Continue diversifying trade activities. Fiscal policy could be used to mitigate the impact on vulnerable groups.		
Rising protectionism and retreat from multilateralism. In the near term, escalating and unpredictable protectionist actions imperil the global trade system, and additional new actions or the threat thereof reduce growth. In the medium term, protracted tensions lead to further fragmentation with adverse effects on investment, growth, and stability.	**High** **(ST, MT)**	**Medium** As a small open economy, Malta is vulnerable to external shocks through trade linkages. In the short term, escalating trade tensions, including an unanticipated Brexit outcomes, and the threat of new trade actions could reduce growth both directly and through adverse confidence effects and financial market volatility. Direct financial spillovers should be limited given the relatively high reliance of government and core domestic banks on domestic funding. Possible increases in the relocation of firms that service the EU from the UK to Malta may also support FDI inflows over the medium term.
Policy response: Participate in a coordinated policy response at the European level. Allow automatic stabilizers to operate. Maintain structural reform momentum and improve infrastructure to remove impediments to growth. Continue diversifying trade activities. Fiscal policy could be used to mitigate the impact on vulnerable groups.		

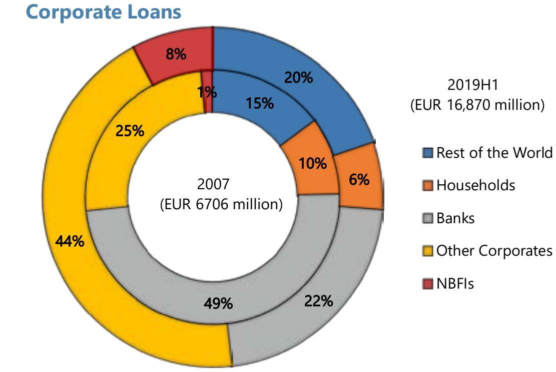
Source of Risks *Domestic Risks*	Relative Likelihood and Time Horizon[1]	Impact if Realized
Slow progress in addressing structural weaknesses. The persistence of structural bottlenecks in infrastructure and the labor market could deter investment and harm growth.	Medium **(MT)**	**Medium/Low** While the positive impact of recent structural reforms is likely to persist over the medium term, delayed implementation of the planned initiatives, including on infrastructure and labor market, would negatively affect competitiveness and long-term growth, and increase long-term fiscal risks.
Policy response: Sustain and monitor the implementation of structural reforms, particularly in education, labor market and infrastructure, while safeguarding long-term fiscal sustainability and improving the quality of public finances.		
Slow progress in effectively implementing and enforcing the AML/CFT framework could damage the country's attractiveness for foreign investment and potentially threaten financial stability.	Medium **(ST, MT)**	**High /Medium** Failure to timely address the shortcomings identified in the Moneyval September 2019 report would result in grey-listing by the FATF, placing greater pressure on correspondent banking relationships (CBRs). Malta has already lost key CBRs as a result of large international banks de-risking strategies. Failure to effectively implement the AML/CFT framework would weaken Malta's attractiveness as a financial and business location, with adverse effects on tax revenues, foreign investment, jobs, and the external position.
Policy response: Effectively and swiftly implement and enforce the AML/CFT framework, address supervisory capacity constraints, and further improve collaboration between the National Competent Authorities (NCAs).		
Sharp correction in housing prices. A sharp decline in housing prices could affect financial stability with adverse effects on lending and growth.	Medium **(ST, MT)**	**Medium** Property-related loans account for a significant fraction of the loan portfolio of core domestic banks, thus increasing their vulnerability to possible property market shocks. Significantly lower house prices could weaken bank and household balance sheets—and lead to widespread distress through an adverse feedback loop of decreased lending and investment affecting financial stability and growth. However, mitigating factors include banks' strong capital and liquidity positions as well as households' high financial wealth, low default rates, and the low share of population with mortgages and negative equity.
Policy response: Monitor risks and further refine existing macro-prudential measures. Limit exposure of banks to property-related loans if a bubble begins to emerge. Ensure that fiscal measures related to the property market, including the Individual Investor Program and the reduce tax rate on income rental, do not exacerbate imbalances, and address potential constraints to housing supply. Ensure proper enforcement of new regulation of the rental market.		
Possible changes in international corporate and personal taxation. International reforms could reduce Malta's attractiveness as a low tax jurisdiction.	Medium/ Low **(MT)**	**High/Medium** Malta's attractiveness as a financial and business location may weaken, and demand for its Individual Investor Program (IIP) could decrease, with adverse effect on tax revenues, foreign investment, and the external position.
Policy response: Continue diversifying the economy and accelerate structural reform implementation to remove impediments to growth, boost productivity and enhance competitiveness. Strengthen quality of public finances, improve spending efficiency, and enhance revenue collection to reduce the heavy reliance on CIT and IIP revenues.		
[1]The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.		

Annex V. Vulnerabilities and Contagion Risks Through Inter-Company Linkages[1]

A. Overview of the Maltese Corporate Sector Vulnerability

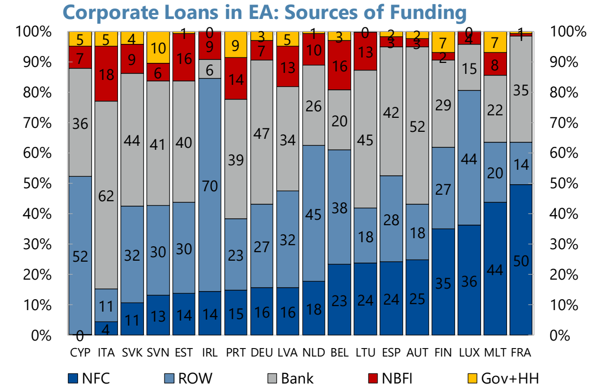
1. Maltese corporates have successfully diversified their financing by developing a significant domestic inter-company lending market. Intercompany loans have replaced bank loans and became the main source of non-financial corporate (NFC) financing. The share of inter-company loans in total corporate loans has increased from 25 percent to 44 percent since 2007, while loans from banks fell from 49 percent to merely 22 percent. Malta's corporate loan contribution to corporates' total funding is the second largest among euro area countries. These loans have so far provided a stable source of funding, but risk management practices remain opaque suggesting potential hidden vulnerability.

Corporate Loans



Sources: ECB and IMF staff calculations.

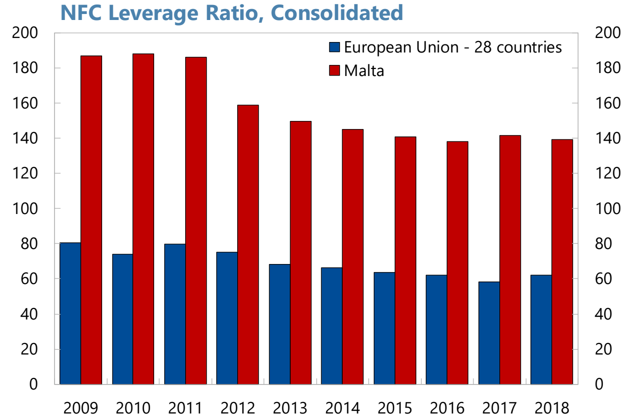
Corporate Loans in EA: Sources of Funding



Sources: European Central Bank and IMF Staff Calculations

2. At the same time, NFCs in Malta are more indebted than European peers, with considerable heterogeneity at the sectoral level. Although corporate leverage has trended down since the financial crisis, it remains twice as large in Malta as in the rest of EU. Over-leveraged corporates could be more vulnerable when facing adverse shocks. They could also refrain from profitable investment opportunities in order to repay debts. Firm-level data from Orbis BvD[2] indicate that the manufacturing sector and the wholesale and retail trade sector tend to have higher debt burdens and smaller profit margins. Recent data suggest that

NFC Leverage Ratio, Consolidated



Sources: Eurostat and IMF staff calculations.

[1] Prepared by Yu Shi (EUR).

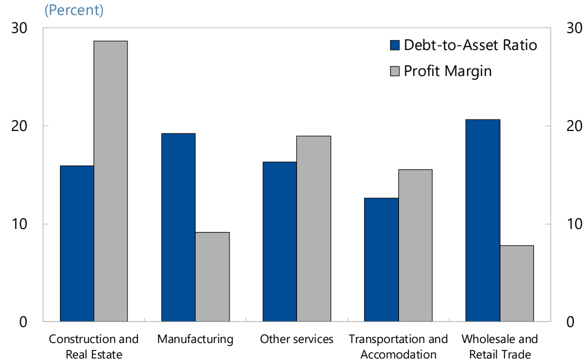
[2] The Orbis BvD data includes 17,504 companies with key financial indicators available for 2017.

leverage is on the rise in the construction sector as developers have started to exhibit preference for debt financing over equity.[3]

3. Simple stress tests show that the construction and manufacturing sectors are the most vulnerable to adverse shocks.

- We assess corporate vulnerability by looking at the interest coverage ratio (ICR), defined as the ratio between firms' earnings before interest, taxes, depreciation and amortization (EBITDA), and their interest expenses.[4] A firm with an ICR between 1 and 2 is generally regarded as being at "heightened risk", while an ICR below 1 implies "technical default". Maltese NFCs see better interest coverage in all sectors compared to 2014.[5] The median ICR in the construction and the manufacturing sectors remain the lowest at barely above 2.

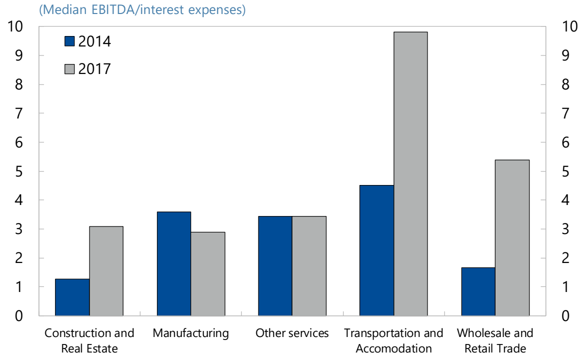
Malta: Debt-to-Asset Ratio and Profit Margin
(Percent)



Sources: Orbis BvD Database and IMF staff calculations

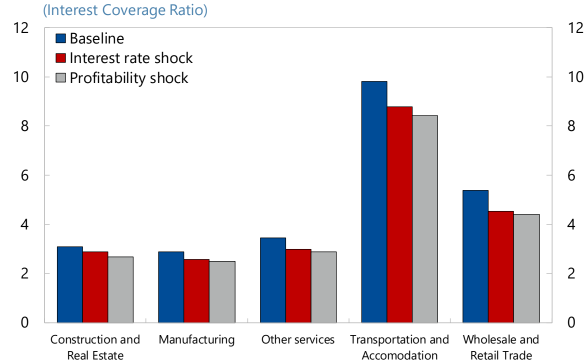
- For testing firms' resilience to adverse shocks, we consider two types of shocks[6]—a 400 bps interest rate shock to 40 percent of corporate debt (roll-over assumption) and a 15 percent decline in operating turnover. Our exercise indicates that both adverse shocks will bring the construction sector and the manufacturing sector very close to the region with "heightened risk", suggesting the need for enhanced monitoring given the important concentration of construction-related loans in banks' portfolios.

Malta: Interest Coverage Ratio by Sector
(Median EBITDA/interest expenses)



Sources: Orbis BvD database and IMF staff calculations

Malta: NFC Resilience to Shocks, 2017
(Interest Coverage Ratio)



Sources: Orbis BvD database and IMF staff calculations

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[3] See "Construction Industry and Property Market Report 2019", KPMG

[4] The Orbis BvD database provides limited information on interest expenses and depreciation and amortization (DA) at the firm level. To overcome this issue, we estimate the effective interest rate (interest expense divided by lagged debt value) and DA rate (depreciation and amortization divided by earnings before interest and taxes) as functions of time and firm size, then use the function to fill in the missing values of interest expenses and DA.

[5] See Malta: Selected Issues, IMF Country Report No. 17/57, 2017.

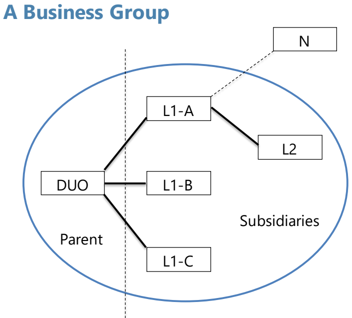
[6] Following Malta: Selected Issues, IMF Country Report No. 17/57, 2017.

B. Macro-Financial Risks in the Inter-Company Lending Market

4. A closer look at the NFC loan market shows that business groups, spanning multiple sectors, have contributed the most to the rise in inter-company lending in Malta. Business groups typically consists of a parent company and legally independent subsidiaries, possibly operating in different sectors, that function through a common source of control. The parent company has controlling rights on subsidiaries' businesses and typically directs funds within the group to achieve group-level profit maximization.[7]

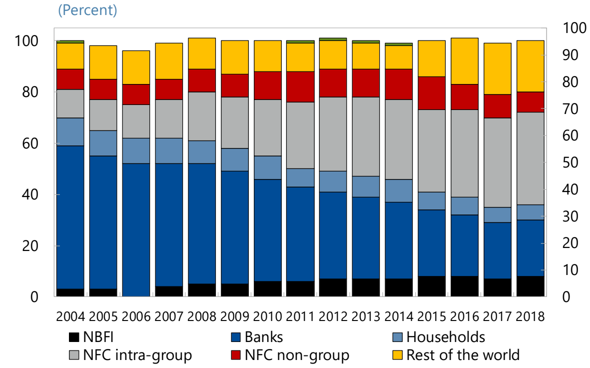
5. Theoretically, financing within business groups could have implications on corporate default decisions. On the one hand, companies within the same business group that specialize in different sectors could hedge idiosyncratic sectoral-level risks through intra-group financial market, resulting in higher resilience at the group level to economic downturns. On the other hand, a parent company could invest in risky projects and raise debt cheaply by leveraging the better-performing members of the group, possibly through bank lending. A negative outturn could then be propagated to healthy members of the group and trigger default at the group level. Given the prevalence of business group lending in Malta, a better understanding of the operation of intra-group capital markets is warranted.

Example: A Business Group



Note: Thick solid line - equity shareholding > 50%; dashed line - equity shareholding <= 50%.
"DUO" is the parent company of the business group;
"L1" and "L2" refer to different levels of subsidiaries;
"N" is outside of the group as "L1-A" does not own the majority of its shares.

NFC Loans by Counterpart Sector
(Percent)



Sources: Central Bank of Malta

6. In the absence of granular information on firms' credit exposure to other NFCs, we rely on the ownership network structure of Maltese business groups to gauge the extent of sectoral inter-connectedness. Domestic business groups are identified as follows:

- For each Maltese firm, the controlling shareholding company is defined as another company owning more than 50 percent of its equity shares.

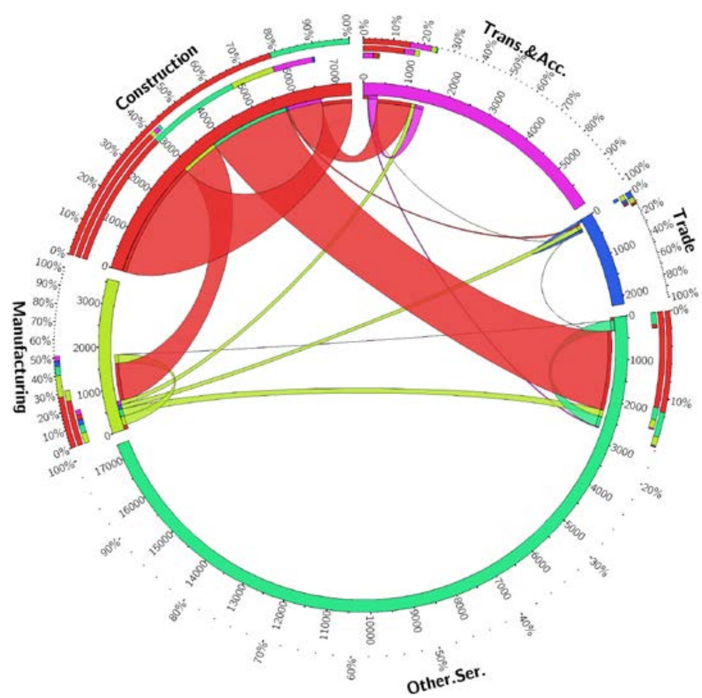
[7] See Yu Shi, Robert Townsend, and Wu Zhu "Internal Capital Markets in Business Groups and the Propagation of Credit Supply Shocks", IMF Working Paper No. 19/111, 2019

- We trace the controlling shareholders upwards until the domestic ultimate owner (DUO), which is an independent firm with no other domestic controlling shareholders.[8]

- For each DUO, we find its direct and indirect subsidiaries (up to level 3) as pertaining to the same business group.

7. A significant fraction of firms in both the construction and manufacturing sectors control subsidiaries in other sectors, suggesting potential cross-sectoral spillovers. A large fraction of financial-sector loans to NFCs are concentrated in the construction and manufacturing sectors, from which detrimental defaults could occur if parent companies do not manage risks effectively in intra-group markets. In addition, given that the construction and manufacturing sectors are the most vulnerable to interest rate and profitability shocks (see paragraph 3), negative shocks to these two sectors could spill over to other sectors through intra-group linkages and harm the overall economy.

Malta: NFC Network through Business Groups



Note: The color or each ribbon corresponds to the sector of the parent company in each business group. The size of each sector is measured by total asset value in sample.

[8] According to Orbis BvD, a company is defined as DUO when no other domestic company holds more than 25 percent of its shares. A DUO could be different from its global ultimate owner (GUO), in which case the DUO would have one controlling shareholder outside of Malta but not within.

Annex VI. Debt Sustainability Analysis

Malta's debt sustainability has been improving in recent years, thanks to prudent fiscal policy, strong growth, and favorable financing conditions. Public debt is assessed to be sustainable and its dynamics are robust to several adverse macroeconomic shocks. However, vulnerabilities may arise, particularly from contingent liability risks. Malta's external debt sustainability appears robust to various shocks.

Public Debt Sustainability

1. **Malta's public debt ratio has continued to decline**. Gross public debt declined from 50.4 percent of GDP in 2017 to 45.6 percent of GDP in 2018, reflecting primary fiscal surpluses and strong nominal GDP growth. In the baseline scenario, further decline is projected over the medium term against the background of continued primary surpluses (partly supported by IIP proceeds), strong economic activity, and reduced interest payment burdens amid favorable financing conditions. Public debt is projected to decline to 28 percent of GDP in 2024. The share of short-term public debt recently rose but from low levels (the stock of short-term debt stood around 5 percent of GDP in 2018), leading to some increase in gross financing needs. The path of gross financing needs is assumed to moderate over the projection horizon.

2. **While declining, contingent liabilities remain significant.** The stock of government guarantees stood at 10 percent of GDP in 2017. Much of them are provided to non-financial state-owned enterprises (SOEs) whose liabilities represented 15 percent of GDP in 2017. Other contingent liabilities related to public-private partnerships account for about 1 percent of GDP.

3. **Debt sustainability is resilient to most standard adverse macroeconomic shocks, while it is more vulnerable to low growth.**

- **Growth shock:** This scenario envisages a reduction of real GDP growth by 3.8 percentage points per year over 2020–21 (equivalent to one standard deviation of growth over the past ten years) and a 1 percentage-point drop in inflation (based on the GDP deflator) relative to the baseline projection. Nominal interest rates increase by 43 and 88 basis points in 2019 and 2020, respectively, reflecting higher risk premiums. Debt would peak at 46 percent of GDP in 2021, about 9 percentage points higher than in the baseline, and would then decline to 36 percent of GDP in 2024.

- **Primary balance shock:** A cumulative reduction of 1.8 percent of GDP in the primary balance (equivalent to one standard deviation shock) in 2020–21, coupled with a 25 basis point increase in the interest rate, would increase the debt ratio by about 2 percentage points relative to the baseline over the medium term.

- **Interest rate shock:** A sustained increase of 200 basis points in spread throughout the projection period would slow down the debt reduction modestly, by less than 1 percent of GDP by 2024.

- **Real exchange rate shock:** A 13 percent real exchange rate depreciation with pass-through to the inflation rate is assumed in 2020. Given that public debt is almost entirely denominated in local currency, this scenario would decelerate the debt reduction only negligibly.

- **Combined macro-fiscal shock:** This scenario combines the four above-mentioned shocks. The debt ratio would rise to 46 percent of GDP by 2021, 9 percentage points higher than the baseline, falling thereafter to 37 percent of GDP in 2024.

4. Debt sustainability could be materially affected by some sources of fiscal vulnerability, especially contingent liabilities.

- **Financial contingent liability shock:** The scenario analyzes the impact of a one-time increase in non-interest expenditures equivalent to 10 percent of the size of the banking sector's assets, coupled with slower real GDP growth (a one standard deviation reduction in the growth rate over 2020–21), inflation decreasing by 0.25 percentage points for every one percentage point reduction in growth, and interest rate spread rising by 0.25 basis points for every one percent of GDP deterioration in the primary balance. While the revenue-to-GDP ratio is assumed to remain the same as the baseline, the shock would deteriorate the primary balance to minus 26 percent of GDP in 2020, largely reflecting the effect of bank assets. The debt ratio is projected to rise sharply to around 70 percent of GDP in the near term. It would then decline to 63 percent of GDP at the end of the projection horizon.

- **Government guarantee shock:** This scenario analyzes a contingency liability risk from SOEs and other government guaranteed debt, by assuming a one-time increase in expenditures equivalent to 50 percent of SOE liabilities. Additional shocks follow the same assumptions as for financial contingent liability shock above, including slower growth, higher inflation and higher interest rate spreads. With these shocks combined, the debt-to-GDP ratio would increase to 49 percent in 2020, about 10 percentage points higher than the baseline scenario. The debt ratio would resume a declining trend afterwards, reaching 39 percent of GDP at the end of the projection period.

- **IIP proceed shock:** The sustainability of the debt without proceeds from the IIP is analyzed by completely excluding such proceeds from non-interest revenues and assuming modest increases in interest rate spreads. The pace of decline in the debt ratio would decelerate relative to the baseline, but the debt ratio still declines to 31 percent of GDP at the end of the projection horizon, 3 percentage points higher compared to the baseline.

External Debt Sustainability

5. Malta's external position remains strong with large holdings of external assets. Gross external debt was large at 740 percent of GDP in 2018, but this was more than covered by large amount of external assets. On the back of current account surpluses, very large and positive NIIP positions are projected to continue boosting external assets over the medium term. External debt continues to largely represent stable intercompany lending and liabilities of offshore financial institutions that have limited links to the domestic economy. Total net external debt was about minus 179 percent of GDP at end-2018, and is projected to fall gradually over the medium term with expected current account surpluses. Standard tests suggest that Malta's external position would be robust to most adverse shocks.

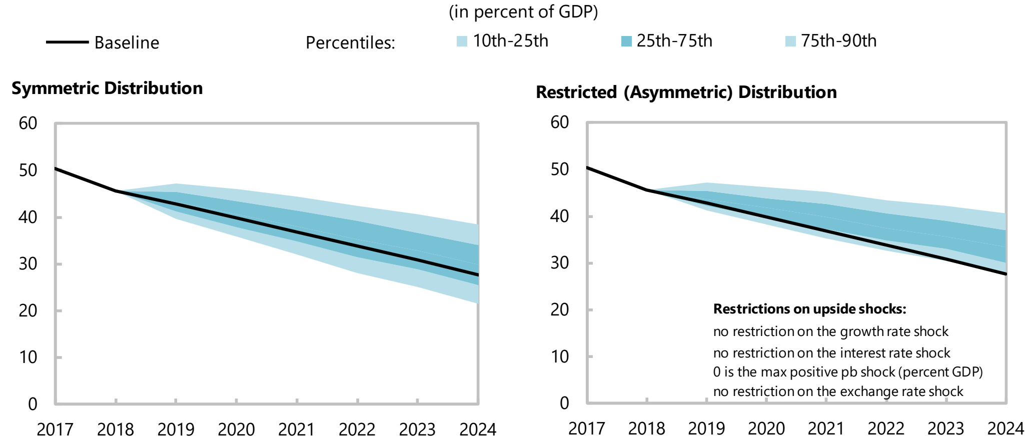
Malta: Public DSA Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

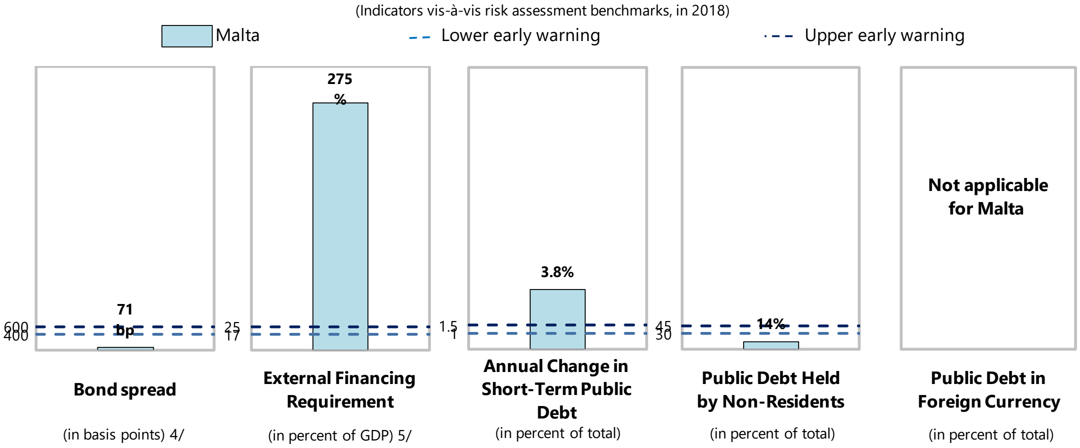
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

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

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

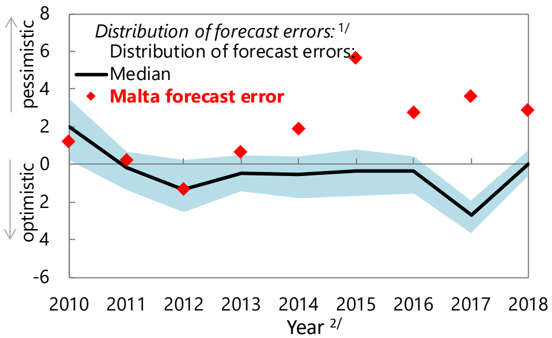
4/ Long-term bond spread over German bonds, an average over the last 3 months, 17-Sep-19 through 16-Dec-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

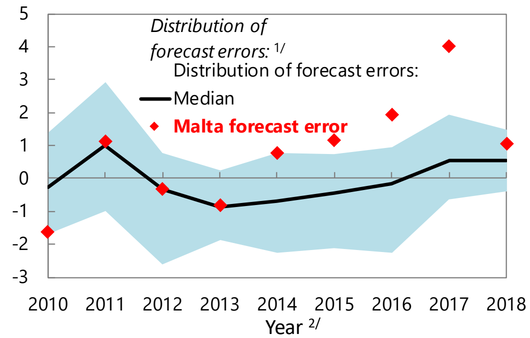
Malta: Public DSA – Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

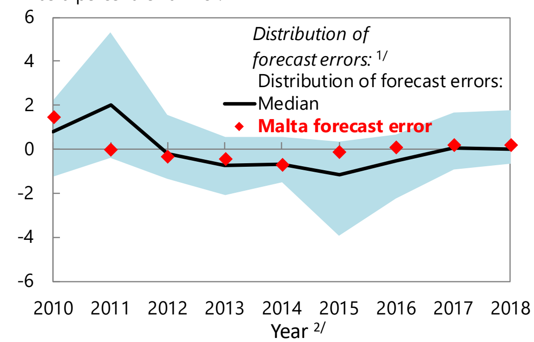
Real GDP Growth
(in percent, actual-projection)
Malta median forecast error, 2010-2018: **1.90**
Has a percentile rank of: **96%**



Primary Balance
(in percent of GDP, actual-projection)
Malta median forecast error, 2010-2018: **1.06**
Has a percentile rank of: **85%**

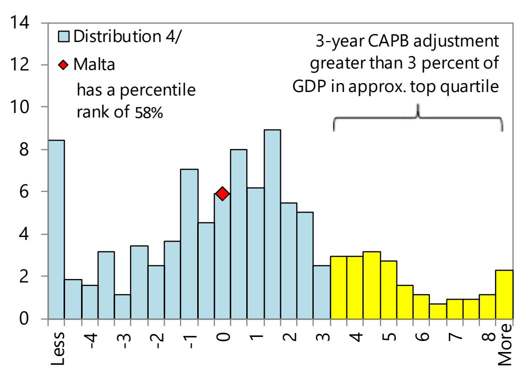


Inflation (Deflator)
(in percent, actual-projection)
Malta median forecast error, 2010-2018: **-0.01**
Has a percentile rank of: **55%**

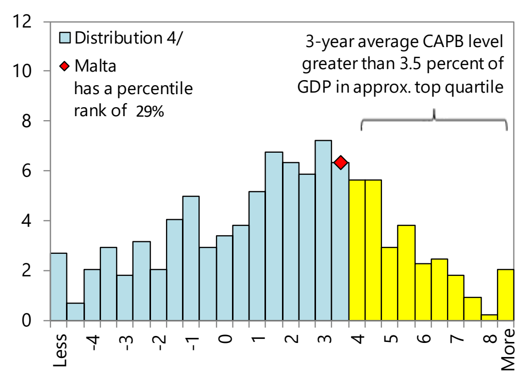


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

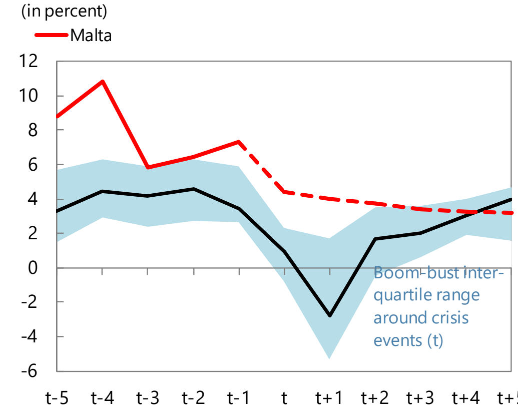


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



Source : IMF Staff.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Malta has had a positive output gap for 3 consecutive years, 2016-2018. For Malta, t corresponds to 2019; for the distribution, t corresponds to the first year of the crisis.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Malta: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP unless otherwise indicated)

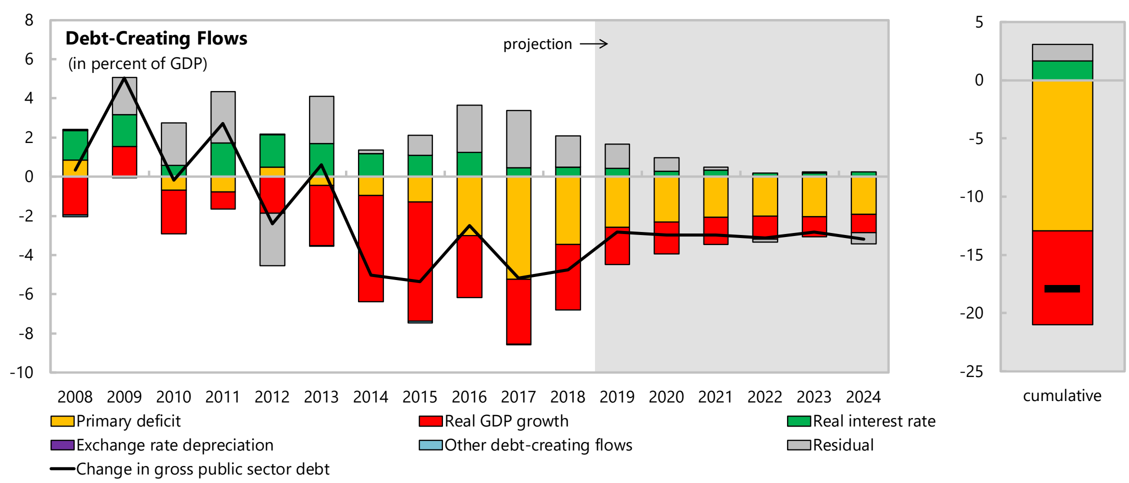
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2008-2016 [2]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	64.5	50.4	45.6	42.8	39.8	36.9	33.7	30.9	27.7
Public gross financing needs	20.5	5.8	10.3	11.4	4.5	4.1	3.5	2.2	2.7
Net public debt	64.5	50.4	45.6	42.8	39.8	36.9	33.7	30.9	27.7
Real GDP growth (in percent)	4.3	6.5	7.3	4.4	4.0	3.7	3.4	3.3	3.2
Inflation (GDP deflator, in percent)	2.4	2.5	2.1	2.3	2.4	2.1	2.2	2.2	2.1
Nominal GDP growth (in percent)	6.8	9.1	9.6	6.8	6.5	5.9	5.6	5.6	5.3
Effective interest rate (in percent) [4]	4.7	3.6	3.3	3.4	3.1	3.1	2.9	2.9	3.0

As of December 16, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		65
5Y CDS (bp)		N/A
Ratings	Foreign	Local
Moody's	A2	A2
S&Ps	A-	A-
Fitch	A+	A+

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	-0.7	-5.2	-4.7	-2.8	-3.0	-3.0	-3.1	-2.8	-3.2	-17.9	
Identified debt-creating flows	-1.9	-8.1	-6.3	-4.0	-3.7	-3.1	-3.0	-2.9	-2.6	-19.3	
Primary deficit	-0.7	-5.2	-3.4	-2.6	-2.3	-2.1	-2.0	-2.0	-1.9	-12.9	-0.7
Primary (noninterest) revenue and grant	38.7	39.3	38.5	38.7	38.1	37.6	37.3	37.1	37.0	225.8	
Primary (noninterest) expenditure	38.1	34.1	35.1	36.2	35.8	35.6	35.3	35.0	35.0	212.9	
Automatic debt dynamics [5]	-1.2	-2.8	-2.9	-1.5	-1.4	-1.0	-1.0	-0.9	-0.7	-6.4	
Interest rate/growth differential [6]	-1.2	-2.8	-2.9	-1.5	-1.4	-1.0	-1.0	-0.9	-0.7	-6.4	
Of which: real interest rate	1.4	0.5	0.5	0.4	0.3	0.3	0.2	0.2	0.2	1.7	
Of which: real GDP growth	-2.6	-3.3	-3.4	-1.9	-1.6	-1.4	-1.2	-1.0	-0.9	-8.0	
Exchange rate depreciation [7]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
ESM and euro area loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8]	1.1	2.9	1.6	1.2	0.7	0.1	-0.2	0.1	-0.6	1.4	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

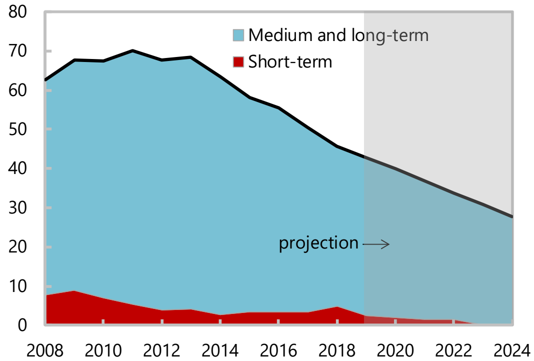
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

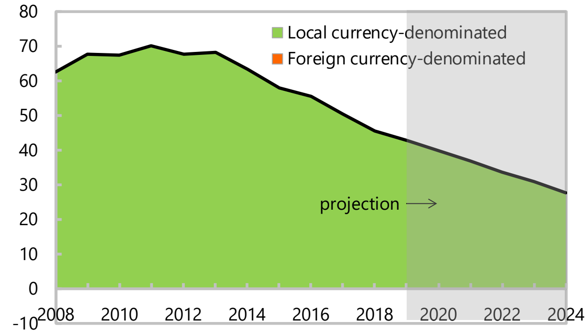
Malta: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



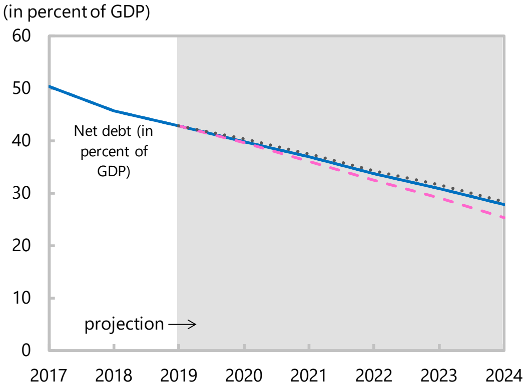
By Currency
(in percent of GDP)



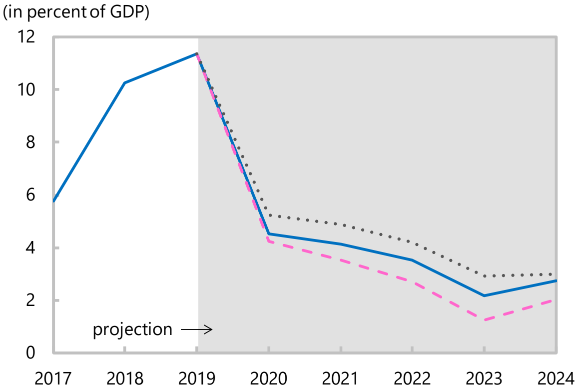
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

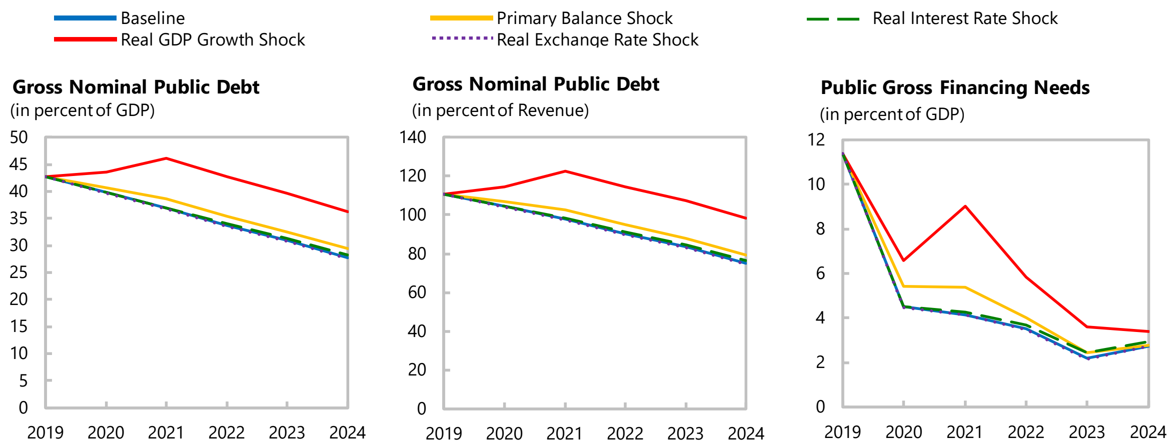
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	4.4	4.0	3.7	3.4	3.3	3.2
Inflation	2.3	2.4	2.1	2.2	2.2	2.1
Primary Balance	2.6	2.3	2.1	2.0	2.0	1.9
Effective interest rate	3.4	3.1	3.1	2.9	2.9	3.0
Constant Primary Balance Scenario						
Real GDP growth	4.4	4.0	3.7	3.4	3.3	3.2
Inflation	2.3	2.4	2.1	2.2	2.2	2.1
Primary Balance	2.6	2.6	2.6	2.6	2.6	2.6
Effective interest rate	3.4	3.1	3.1	2.9	2.9	3.0

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	4.4	4.9	4.9	4.9	4.9	4.9
Inflation	2.3	2.4	2.1	2.2	2.2	2.1
Primary Balance	2.6	1.5	1.5	1.5	1.5	1.5
Effective interest rate	3.4	3.1	3.3	3.1	3.2	3.4

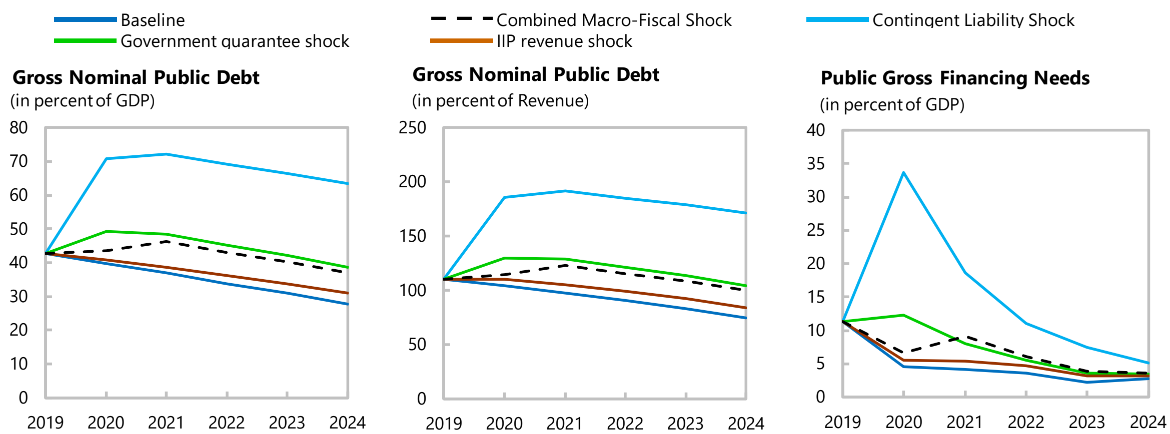
Source: IMF staff.

Malta: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

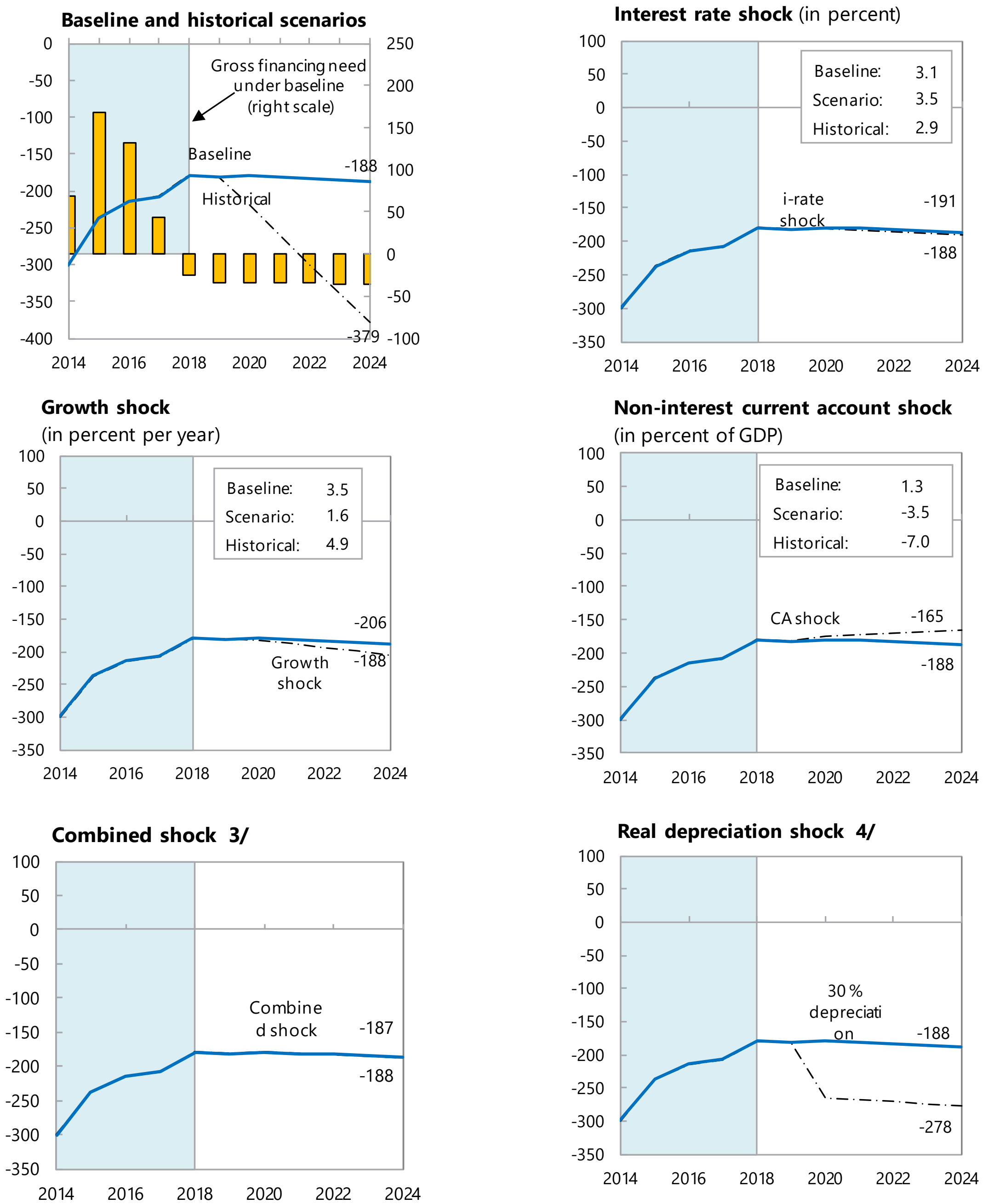
Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	4.4	4.0	3.7	3.4	3.3	3.2
Inflation	2.3	2.4	2.1	2.2	2.2	2.1
Primary balance	2.6	1.4	1.2	2.0	2.0	1.9
Effective interest rate	3.4	3.1	3.1	2.9	2.9	3.0
Real Interest Rate Shock						
Real GDP growth	4.4	4.0	3.7	3.4	3.3	3.2
Inflation	2.3	2.4	2.1	2.2	2.2	2.1
Primary balance	2.6	2.3	2.1	2.0	2.0	1.9
Effective interest rate	3.4	3.1	3.4	3.3	3.4	3.6
Combined Shock						
Real GDP growth	4.4	0.2	-0.1	3.4	3.3	3.2
Inflation	2.3	1.4	1.2	2.2	2.2	2.1
Primary balance	2.6	0.6	-1.5	2.0	2.0	1.9
Effective interest rate	3.4	3.1	3.4	3.3	3.5	3.7

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	4.4	0.2	-0.1	3.4	3.3	3.2
Inflation	2.3	1.4	1.2	2.2	2.2	2.1
Primary balance	2.6	0.6	-1.5	2.0	2.0	1.9
Effective interest rate	3.4	3.1	3.1	2.9	2.9	3.1
Real Exchange Rate Shock						
Real GDP growth	4.4	4.0	3.7	3.4	3.3	3.2
Inflation	2.3	2.8	2.1	2.2	2.2	2.1
Primary balance	2.6	2.3	2.1	2.0	2.0	1.9
Effective interest rate	3.4	3.1	3.1	2.9	2.9	3.0
Contingent Liability Shock						
Real GDP growth	4.4	0.2	-0.1	3.4	3.3	3.2
Inflation	2.3	1.4	1.2	2.2	2.2	2.1
Primary balance	2.6	-26.3	2.1	2.0	2.0	1.9
Effective interest rate	3.4	3.5	5.8	4.4	4.5	4.6

Source: IMF staff.

Malta: External Debt Sustainability: Bound Tests 1/ 2/

(Net external debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2017.

Malta: External Debt Sustainability Framework, 2014–2024
(Net external debt, in percent of GDP unless otherwise indicated)

	Actual							Projections						
	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	-300.2	-237.1	-214.2	-207.9	-179.3			**-181.5**	**-179.6**	**-181.2**	**-183.3**	**-185.4**	**-187.6**	**-8.4**
2 Change in external debt	74.9	63.1	22.9	6.2	28.6			-2.2	1.9	-1.6	-2.1	-2.2	-2.2	
3 Identified external debt-creating flows (4+8+9)	-53.2	-63.9	-32.0	19.8	5.4			-18.4	-15.0	-14.7	-14.7	-14.4	-14.0	
4 Current account deficit, excluding interest payments	0.7	3.8	1.3	-6.0	-5.5			-3.7	-2.1	-1.4	-1.2	-1.0	-0.7	
5 Deficit in balance of goods and services	-11.9	-9.7	-13.8	-21.3	-20.7			-19.8	-19.0	-19.2	-19.6	-20.0	-20.4	
6 Exports	147.9	154.2	152.0	149.7	144.1			139.8	133.3	130.9	129.1	127.4	125.9	
7 Imports	136.0	144.5	138.2	128.4	123.4			119.9	114.3	111.7	109.5	107.4	105.5	
8 Net non-debt creating capital inflows (negative)	-82.6	-43.7	-43.8	8.4	-10.8			-17.8	-14.8	-14.3	-13.9	-13.6	-13.3	
9 Automatic debt dynamics 1/	28.8	-24.1	10.6	17.4	21.6			3.1	1.9	1.0	0.4	0.3	0.1	
10 Contribution from nominal interest rate	-9.4	-6.6	-5.1	-4.5	-4.9			-4.7	-5.0	-5.2	-5.3	-5.4	-5.5	
11 Contribution from real GDP growth	29.6	34.5	12.9	12.4	13.3			7.8	6.9	6.2	5.7	5.6	5.5	
12 Contribution from price and exchange rate changes 2/	8.6	-51.9	2.8	9.4	13.3			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	128.0	127.0	54.9	-13.5	23.2			16.3	17.0	13.1	12.6	12.2	11.8	
External debt-to-exports ratio (in percent)	-203.0	-153.7	-140.9	-138.9	-124.5			-129.9	-134.7	-138.4	-141.9	-145.5	-149.0	
Gross external financing need (in billions of US dollars) 4/	7.7	17.9	15.0	5.4	-3.6			-5.1	-5.3	-5.8	-6.3	-6.8	-7.2	
in percent of GDP	68.0	167.8	131.0	42.7	-24.7	10-Year	10-Year	-34.6	-33.8	-34.4	-35.0	-35.5	-36.0	
Scenario with key variables at their historical averages 5/								**-181.5**	**-218.6**	**-259.9**	**-300.2**	**-339.8**	**-378.9**	**-52.5**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	8.8	10.9	5.8	6.5	7.3	4.9	3.8	4.4	4.0	3.7	3.4	3.3	3.2	
GDP deflator in US dollars (change in percent)	2.3	-14.8	1.2	4.6	6.8	0.3	6.8	-3.0	2.4	3.1	2.9	2.7	2.7	
Nominal external interest rate (in percent)	2.8	2.1	2.3	2.3	2.7	2.9	0.9	2.7	2.9	3.1	3.1	3.1	3.1	
Growth of exports (US dollar terms, in percent)	4.9	-1.4	5.5	9.7	10.3	5.9	4.9	-1.8	1.6	5.0	4.9	4.7	4.6	
Growth of imports (US dollar terms, in percent)	0.5	0.4	2.4	3.5	10.1	13.3	26.4	-1.6	1.5	4.5	4.3	4.0	4.0	
Current account balance, excluding interest payments	-0.7	-3.8	-1.3	6.0	5.5	-7.0	9.5	3.7	2.1	1.4	1.2	1.0	0.7	
Net non-debt creating capital inflows	82.6	43.7	43.8	-8.4	10.8	61.0	41.0	17.8	14.8	14.3	13.9	13.6	13.3	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels

Appendix I. Draft Press Release

IMF Executive Board Concludes 2020 Article IV Consultation with Malta

FOR IMMEDIATE RELEASE

WASHINGTON, DC – April 6, 2020

On April 6, 2020 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Malta and considered and endorsed the staff appraisal without a meeting on a lapse-of-time basis[2] (see below an important note on the timing of the report which precedes the outbreak of COVID-19).[3]

Malta is facing significant challenges owing to the recent COVID-19 outbreak. Entire sections of the Maltese economy, especially in the services sector, are forced to operate well below normal capacity due to reduced labor supply and administrative closures. Sectors related to tourism and transportation, which provide major sources of income for the Maltese people, are especially affected. The authorities' near-term efforts are rightly focused on limiting and containing the adverse social and economic effects of the COVID-19 outbreak.

In light of recent developments, the risk to the outlook is undoubtedly skewed to the downside and the extent of the downturn will depend on how long normal economic activity is subject to pervasive disruptions related to the COVID-19 epidemic. Malta's main medium-term challenge is to mitigate financial integrity risks by continuing to address deficiencies identified in the anti-money laundering and combating the financing of terrorism (AML/CFT) framework. The focus should be on improving and demonstrating the effectiveness of the AML/CFT regime.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

[3] The Staff Report was prepared by a staff team of the IMF for the Executive Board's consideration on April 6, 2020. The staff report reflects discussions with the Maltese authorities in February 2020 and is based on the information available as of February 28, 2020. It focuses on Malta's near and medium-term challenges and policy priorities and was prepared before COVID-19 became a global pandemic and resulted in unprecedented strains in global trade, commodity and financial markets. It, therefore, does not reflect the implications of these developments and related policy priorities. The outbreak has greatly amplified uncertainty and downside risks around the outlook. Staff is closely monitoring the situation and will continue to work on assessing its impact and the related policy response in Malta and globally.

Executive Board Assessment

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

The Maltese economy has continued to overperform European peers. Prudent fiscal policy and timely structural reforms have helped boost employment and build fiscal buffers while promoting social inclusion. Growth remained strong in 2019, even though it weakened from 2018. Domestic demand is expected to remain the main engine of growth as the economy gradually reaches cruising speed and the large current account surplus declines. The risks to the outlook are skewed to the downside and a lot will depend on how pervasive and long-lasting disruptions related to the Coronavirus epidemic will be.

Continued efforts are needed to mitigate financial integrity and stability risks. As pressures on CBRs intensify, it is critically important to continue to address deficiencies identified with the AML/CFT system. The focus should be on improving and demonstrating effectiveness of the AML/CFT framework. In particular, the understanding of risks and the monitoring and supervision of banks and other high-risk sectors and programs—such as remote gaming, VFAs, and the IIP—should continue to be strengthened. It is also key to enhance AML/CFT enforcement actions, including through timely and adequate sanctions in case of breaches.

Supervisory capacity should be further enhanced and remaining deficiencies in the crisis management framework addressed. The operational and financial independence of the financial supervisor should be assured. Despite commendable progress, the MFSA remains under strain due to the large number of financial institutions under supervision, the evolving regulatory environment, and challenges associated with new and complex products. The legal framework for bank insolvency should also be updated and streamlined. An administrative regime for the orderly closure and liquidation of a failing bank should be introduced to avoid that supervisory actions are unduly delayed through judicial appeal.

Further improving the analysis of potential risks developing outside of the banking sector will help uphold financial stability. Inter-company lending is gradually displacing bank lending as the main source of corporate funding, posing new challenges to supervision. A better understanding of the flow of funds between corporates and of their risk-management practices could help identify potential financial risks and contagion channels to the financial system. In the meanwhile, it is important to avoid over-exposure to large, indebted and interconnected corporates and to monitor developments on the housing market, standing ready to tighten the recently introduced borrower-based macroprudential measures in due course.

Prudent fiscal policy needs to be maintained. Maintaining gradual consolidation excluding the proceeds from the IIP is warranted due to fiscal vulnerabilities from contingent liabilities, age-related spending pressures, and heavy reliance on corporate income tax revenues Current-expenditure also needs to be kept in check to ensure enough space within the budget limits for necessary public investment in transport, health, education, the environment and additional expenses targeted at improving social inclusion.

Further enhancing public investment management and reducing fiscal risk should be key priorities. As public investment rises, enhancing its management is critical. Efforts should focus on adopting general guidelines for project appraisal and selection, implementing cost-benefit analysis for major projects and addressing weaknesses in the public procurement system. Continued efforts are also needed to further reduce fiscal risks. The new legal framework for managing government guarantees should be implemented, ongoing work to release statements on financial performance of public corporations should be completed, and sound strategies to put financially vulnerable public corporations on a stronger footing need to be adopted. To address long-term age-related spending pressures, measures that increase the effective retirement age and further encourage enrollment in voluntary savings schemes should be prioritized, while the institutionalization of the CSRs should be completed. Finally, to diminish Malta's potential vulnerability to international taxation regime changes, options to strengthen and diversify revenues outside of CIT should be explored.

Pursuing structural reforms will help sustain Malta's growth performance while promoting social inclusion. The focus should continue to be on encouraging female and elderly participation in the labor market, upskilling the labor force and stimulating innovation. Moreover, to safeguard the business climate, remaining governance shortcomings should be addressed without delay, including by stepping up the fight against corruption and by increasing the efficiency of the judicial system while ensuring its independence. Improving access to affordable housing remains a key priority in support of greater inclusion.