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COMMISSION OPINION

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING MALTA

3. On the basis of the Draft Budgetary Plan for 2016 submitted on 15 October 2015 by Malta, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. Malta is subject to the preventive arm of the Pact and should achieve a fiscal adjustment of 0.6 % of GDP towards the medium-term budgetary objective in 2015 and 2016. As the debt ratio stood at 68.3% of GDP in 2014, Malta also needs to comply with the debt rule.

5. The macroeconomic scenario underlying the Draft Budgetary Plan assumes an acceleration in real GDP growth from 3.5% in 2014 to 4.2% in 2015. GDP growth is expected to decelerate to 3.6% in 2016. The real GDP growth projections underlying the Draft Budgetary Plan have been revised upwards compared to the ones underlying the Stability Programme, which projected real GDP growth of 3.4% in 2015 and 3.1% in 2016, due to a more favourable outlook for net exports, partly offset by a significant downward revision for investment in 2016. The Commission 2015 autumn forecast projects real GDP growth of 4.3% in 2015 and 3.6% in 2016, broadly in line with the Draft Budgetary Plan. Inflation is expected to accelerate gradually to 1.0% in 2015 and to 1.8% in 2016 according to the Draft Budgetary Plan. This is in line with the projections underlying the 2015 Stability Programme and the Commission 2015 autumn forecast. The Draft Budgetary Plan's macroeconomic scenario appears plausible for 2015 and 2016. Upside risks to these projections could come from higher investment related to the materialisation of additional infrastructure projects, while downside risks are linked to the uncertain external environment and its potential impact on trade.

6. Regulation (EU) No 473/2013 requires the draft budget to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been endorsed by the Malta Fiscal Advisory Council, which is an independent body. In its endorsement of the forecasts, the Malta Fiscal Advisory Council nevertheless flagged that the macroeconomic scenario for 2015 and 2016, albeit plausible, was subject to downside risks related to external trade developments in 2016.

7. The Draft Budgetary Plan confirms the deficit targets of 1.6% of GDP and 1.1% of GDP for 2015 and 2016 respectively, as set in the 2015 Stability Programme, despite a higher GDP growth in the macroeconomic scenario underpinning the Draft Budgetary Plan. However, in nominal terms, both revenue and expenditure have been revised upwards compared to the 2015 Stability Programme. These revisions for 2016 are also explained by the measures included in the 2016 budget, which have a slightly expansionary impact. Nevertheless, as a result of the favourable macroeconomic environment, the headline balance remains unchanged in 2016 compared to the 2015 Stability Programme. Overall, both revenue and expenditure are expected to contribute to the deficit reduction in 2015, while in 2016 the consolidation is expected to be mainly expenditure-based. In structural terms, the government plans imply an improvement in the balance amounting to ¼ pp. of GDP in 2015, in line with the improvement expected in 2015 Stability Programme. Regarding 2016, the projected ½ pp. of GDP improvement in the structural effort is much lower compared to what was expected in the 2015 Stability Programme due to a substantial upward revision in the output gap.

   Declining interest expenditure contributed around 0.4% of GDP to fiscal consolidation between 2012 and 2015 while the overall improvement in the structural balance reached 2.8% of GDP over the same period. According to the DBP, interest expenditure is expected to contribute another 0.2% of GDP to the structural improvement in 2016. Overall, it appears that these windfall gains may have used to increase primary expenditure.

8. The Commission 2015 autumn forecast projects the 2015 deficit at 1.7% of GDP. The 0.1% of GDP difference with the authorities' target is explained by higher current expenditure, especially compensation of employees and intermediate consumption (although partly compensated by lower net capital expenditure). On the other hand, the Commission projects higher direct and indirect taxes compared to the forecast included in the Draft Budgetary Plan, especially for income taxes. For 2016, the Commission projects the deficit at 1.2% of GDP; the 0.1% of GDP difference with the authorities' target is explained by the worse starting position in 2015 and a different composition of revenue and expenditure, i.e. more dynamic current expenditure and lower public investment. Risks to the deficit targets are mainly linked to the state owned enterprises, namely Enemalta (the public energy utility corporation) and Air Malta, which could lead to additional subsidies. There is also a risk of slippages in the public sector wage bill and in intermediate consumption. On the other hand, net capital expenditure could be lower than planned and current revenue could turn out more buoyant than expected i.a. due to a more favourable economic environment.

9. The Draft Budgetary Plan projects a further decrease in the general government debt-to-GDP ratio in 2015, reaching 66.6% of GDP, from 68.3% of GDP in 2014. It is projected to decrease further in 2016, reaching 65.2% of GDP. According to the Commission forecast, the debt ratio is projected to reach 65.9% of GDP in 2015 and to decrease further in 2016 to 63.2% of GDP. The difference compared to the Draft Budgetary Plan is mainly explained by the lower stock-flow adjustment in the Commission forecast.

10. The government's 2016 budget includes some revenue-increasing measures, such as increases in indirect taxation, the phasing out of the eco contribution and the introduction of an environmental contribution to be paid by tourists, partly compensated by the lowering in income tax for low income earners, with a net

impact of about 0.1% of GDP. On the expenditure side, the budget envisages several deficit-increasing social measures for 0.2% of GDP, among which the upward adjustment of the minimum contributory pension and the partial funding of the cost of home care for elderly and an expropriation compensation. Overall, the budget measures are estimated to have a net deficit-increasing impact of 0.1% of GDP, which appears plausible.

11. The Draft Budgetary Plan does not include sufficient information to assess compliance with the debt rule. However, based on the Commission 2015 autumn forecast, the debt rule is expected to be met in 2015 and 2016.

12. According to the Draft Budgetary Plan, the annual change in the (recalculated) structural balance of 0.3% of GDP in 2015 is below the required adjustment of 0.6% of GDP, pointing to a risk of some deviation from the required adjustment towards the MTO. At the same time, the growth rate of government expenditure, net of discretionary revenue measures, is in line with the applicable expenditure benchmark rate. This warrants an overall assessment. On the one hand, the medium-term reference rate of potential growth underpinning the expenditure benchmark does not fully reflect the recent improvement in the macroeconomic economic outlook, leading to an underestimation of the allowed expenditure growth. On the other hand, the planned net growth rate of public current expenditure in the Draft Budgetary Plan appears overly cautious thereby leading to an overestimation of the fiscal effort based on the expenditure benchmark. On balance, the overall assessment points to a risk of some deviation from the adjustment path towards the MTO in 2015 based on the Draft Budgetary Plan. Based on the Commission 2015 autumn forecast, the structural balance is projected to improve by 0.3% of GDP, leading to some deviation. The growth rate of government expenditure net of discretionary revenue measures is expected to exceed the benchmark by 0.9% of GDP, pointing to a significant deviation as a result of more dynamic current expenditure in the Commission forecast compared to the Draft Budgetary Plan. As mentioned above, the structural balance is based on a more appropriate estimate of potential growth. Therefore, the overall assessment based on the Commission forecast points to the risk of some deviation from the adjustment path towards the MTO.

In 2016, according to the Draft Budgetary Plan, the projected 0.4% of GDP improvement in the structural balance would lead to some deviation from the required 0.6% of GDP adjustment towards the MTO and net expenditure growth would exceed the benchmark by 1.3% of GDP, thereby pointing to a significant deviation. Similarly, for 2016, the Commission forecast points to a risk of some deviation from the required adjustment towards the MTO based on the structural balance (gap of 0.2% of GDP) and to a risk of significant deviation based on the expenditure benchmark (gap of 1.5% of GDP). As in 2015, the structural balance is based on a more accurate estimate of potential growth. However, the main reason for the difference between the structural balance and the expenditure benchmark pillar is related to the projected significant drop in EU-funded investments which negatively impacts the assessment based on the expenditure benchmark. Therefore, the structural balance seems to be a better indicator of the fiscal effort at the current juncture and the overall assessment points to a risk of some deviation from the adjustment path towards the MTO based on both the government plans and the Commission forecast in 2016.

13. Malta's Draft Budgetary Plan contains one measure that affect the tax wedge on labour, namely the lowering of the income tax for low income earners. This measure

follows a number of reforms introduced in the previous years, such as the introduction of a separate tax regime for parents which had benefitted primarily those on low to middle incomes. In addition, the 2013 budget introduced a tax reform aimed at gradually reducing the overall income tax levels. These measures are part of the strategy of the Maltese authorities to continue the shift from direct to indirect taxation.

14. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Malta, which is currently under the preventive arm and subject to the debt rule, is broadly compliant with the provisions of the Stability and Growth Pact. In particular, according to the Commission 2015 autumn forecast, there is a risk of some deviation from the required adjustment towards the MTO. The Commission therefore invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2016 budget will be compliant with the SGP.

    The Commission is also of the opinion that Malta has made some progress with regard to the country-specific recommendations issued by the Council in the context of the 2015 European Semester relating to fiscal governance and invites the authorities to make further progress. A comprehensive assessment of progress made with the implementation of the CSRs will be made in the 2016 Country Reports and in the context of the Country Specific Recommendations adopted by the Commission in May.

Done at Brussels, 16.11.2015

For the Commission
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Member of the Commission