Republic of Malta
Rating Report

A+ STABLE OUTLOOK

Credit strengths

- Strong growth potential
- Record of prudent fiscal management
- Strong external position

Credit challenges

- Externally dependent, resource constrained economy
- Elevated contingent liabilities
- Lingering institutional challenges

Rating rationale:

Strong growth potential: Malta has experienced robust economic growth in recent years, with average real growth rates of 7.2% over 2015-19, thanks to structural shifts in the economy to higher-value added sectors, inflows of skilled workers and substantial increases in productivity. The war in Ukraine will slightly hamper the recovery but the medium-term growth outlook remains strong.

Strong record of fiscal prudence and effective consolidation: Malta achieved one of the strongest debt reductions among peers in the years preceding the Covid-19 crisis. Better than expected fiscal outcomes in 2021, withdrawal of government support measures, and a robust growth outlook underpin our view that debt will stabilise in the medium term at around 63% of GDP.

Strong external position: Malta's external resilience benefits from its euro area membership. In addition, a record of current account surpluses and large external creditor position mitigate risks stemming from Malta's small, open economy.

Rating challenges include: i) an externally dependent and resource constrained economy, which presents risks to the stability and sustainability of Malta's growth model; ii) fiscal risks in the form of age-related cost pressures and elevated government guarantees issued to state-owned enterprises; and iii) lingering, albeit improving, institutional challenges related to financial oversight.

Malta's sovereign rating drivers

Risk pillars		Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	a-		0	A+
Public Finance Risk		25%	a-		+1/3	
External Economic Risk		10%	a-		-1/3	
Financial Stability Risk		10%	aaa		0	
ESG Risk	Environmental Risk	5%	aa		0	
	Social Risk	5%	bbb-		0	
	Governance Risk	10%	a		-1/3	
Overall outcome		a		+1	0	

Note: The sum of the qualitative adjustments, capped at 1 notch per rating pillar, is weighted equally and rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket.
For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings GmbH

Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced over the next 12 to 18 months.

Positive rating-change drivers

- Higher growth potential raised sustainably via structural reform
- Fiscal discipline is maintained, returning debt to a firm downward trajectory

Negative rating-change drivers

- Structural deterioration in growth
- Substantial weakening in fiscal outlook
- Failure to effectively address institutional deficiencies in a timely fashion

Ratings and Outlook

Foreign and local currency

Long-term issuer rating	A+/Stable
Senior unsecured debt	A+/Stable
Short-term issuer rating	S-1+/Stable

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Bloomberg: RESP SCOP

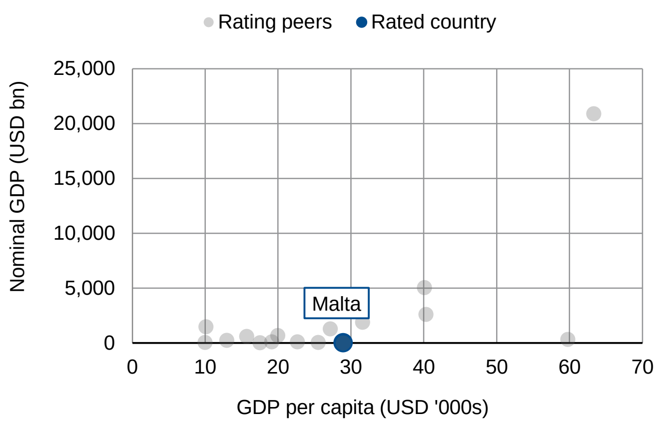
Domestic Economic Risks

- **Growth outlook:** The Maltese economy contracted significantly during the Covid-19 pandemic, shrinking by 8.3% in 2020. The economy started to recover in Q1 2021 and has expanded rapidly, supported by strong household demand, rising investment and recovering external demand. According to the latest government estimates, GDP growth reached 9.4% in 2021, a much stronger performance than anticipated and placing Malta both among the fastest recovering EU economies, outperforming growth expectations. While the growth outlook is strong, the recovery is hampered by the effects of the war in Ukraine. We expect growth to be around 4% in 2022, 5% in 2023, followed by a gradual convergence to the medium-term potential of 3.5%. Growth will be supported by continued buoyant household demand and investment conditions, the gradual recovery in the tourism sector and the rollout of the government's recovery plan. Long-term economic pressures could emerge if Malta remains on the Financial Action Task Force's (FATF) grey list for a prolonged period of time. Initial assessments by the FATF signal good progress on related reforms.
- **Inflation and monetary policy**: Inflationary pressures due to post-crisis recovery and supply bottlenecks have increased but remain limited relative to EU peers. Annual HICP inflation was 4.2% in February 2022, higher than February 2021 levels (0.2%) but still the lowest among all EU countries and well below the EU average of 7.1%. Forceful government support measures to limit energy price increases have cushioned the economy from inflationary pressures. Inflation should increase to 3-4% in 2022 before progressively declining to slightly below the ECB's 2% policy target.
- **Labour markets**: Malta was able to contain the unemployment rate during the pandemic to 4.4% in 2020 and 3.6% in 2021, among the lowest levels in Europe, thanks also to the effective assistance measures from the government such the Wage Supplement Scheme, which mitigated the economic consequences of the pandemic. The unemployment rate is now expected to decrease slightly to 3.5% in 2022, before stabilizing at that level over the forecast horizon. In addition, a gradual a normalisation of net migration flows should alleviate the labour shortages experienced in many sectors during 2021, as expected by the Central Bank.

Overview of Scope's qualitative assessments for Malta's *Domestic Economic Risks*

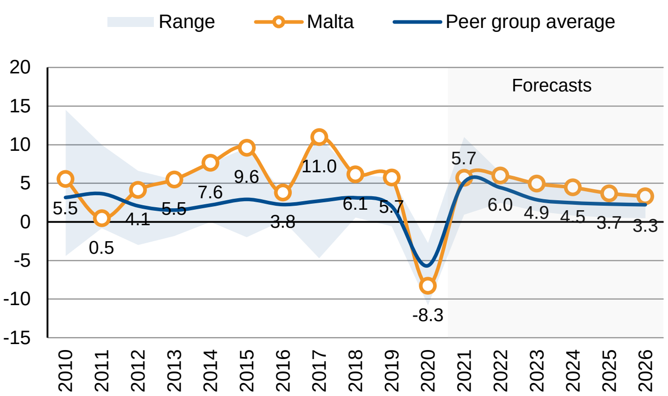
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Growth potential of the economy	Strong	+1/3	High growth potential, supported by structural reforms and strong employment dynamics
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central bank
	Macro-economic stability and sustainability	Weak	-1/3	Small, open economy subject to volatility; reliance on foreign demand and investments

Nominal GDP and GDP per capita, USD '000s



Source: IMF WEO, Scope Ratings GmbH

Real GDP growth, %



Source: IMF WEO, Scope Ratings GmbH

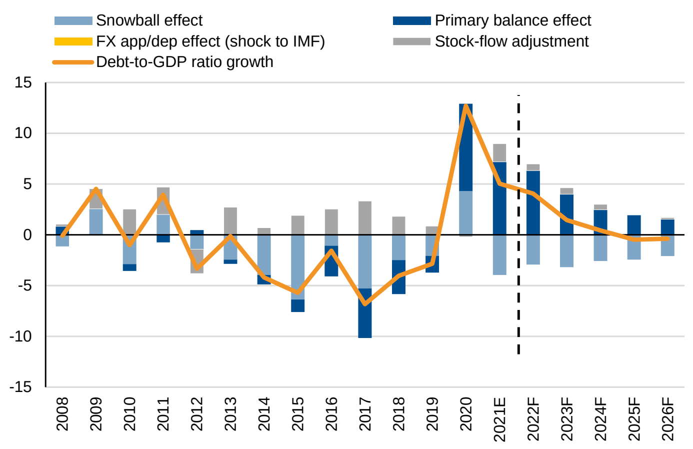
Public Finance Risks

- **Fiscal outlook:** Prior to the Covid-19 crisis Malta was able to improve its public debt sustainability significantly thanks to its prudent fiscal approach, strong economic growth and favourable financing conditions. The Covid-19 crisis led to a large fiscal deficit of 9.7% of GDP in 2020, with direct fiscal outlays of 5% of GDP for temporary Covid support measures, excluding liquidity support measures of 1.6 % of GDP in tax deferrals and around 1% of GDP through the Covid-19 loan guarantee scheme. The government's medium-term budgetary strategy balances the need to provide discretionary support for the economic recovery and return public finances to a sound footing longer-term. After an expected budget deficit of 8.5% of GDP in 2021, we expect the deficit to gradually narrow to below 3% of GDP by 2026, in line with the government's fiscal strategy. Consolidation will mostly rely on expenditure side measures via unwinding of Covid-19 supportive measures, the levelling-off of vaccinations and treatment costs, and controlled current spending.
- **Debt trajectory:** Our baseline projections see Malta's public debt-to-GDP ratio rising short-term given the continued supportive fiscal stance. We project the debt ratio to increase and stabilise at around 64% of GDP in 2023. Strong growth prospects and the renewed commitment to fiscal discipline supported by the government's record of prudent fiscal management underpin this view. Importantly, debt sustainability is underpinned by a low and stable interest payment burden, with interest payments expected to remain below 1.3% of GDP over the forecast horizon, below pre-crisis levels despite the sharp increase in the debt stock.
- **Debt profile and market access:** The debt structure is favourable with long-term debt representing 85% of total debt and no foreign currency exposure as of September 2021. Malta benefits from a good domestic investor base. As of end February 2022, total debt held by residents amounts to 81%, while only 19% is held by non-residents. Thanks to the ECB's accommodative monetary policy the benchmark 10-year government yield remained very low at around 0.5% on average during 2021. The 10-year yield has increased in recent months, reaching 1.5% towards the end of March, still at favourable funding conditions.

Overview of Scope's qualitative assessments for Malta's *Public Finance Risks*

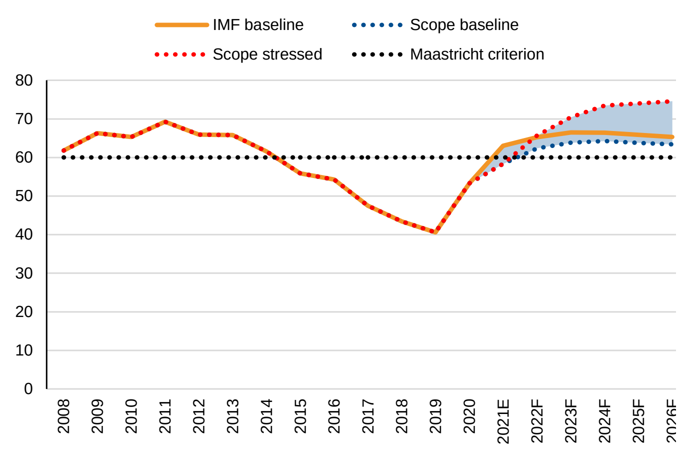
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Fiscal policy framework	Strong	+1/3	Good record of fiscal consolidation, prudent fiscal management and exceeding fiscal targets
	Debt sustainability	Neutral	0	Stabilisation of debt trajectory over the medium term; contingent liabilities and rising age-related costs pose fiscal risks
	Debt profile and market access	Neutral	0	Favourable debt profile; low interest payment burden

Contributions to changes in debt levels, pps of GDP



Source: Scope Ratings GmbH

Debt-to-GDP forecasts, % of GDP



Source: Scope Ratings GmbH

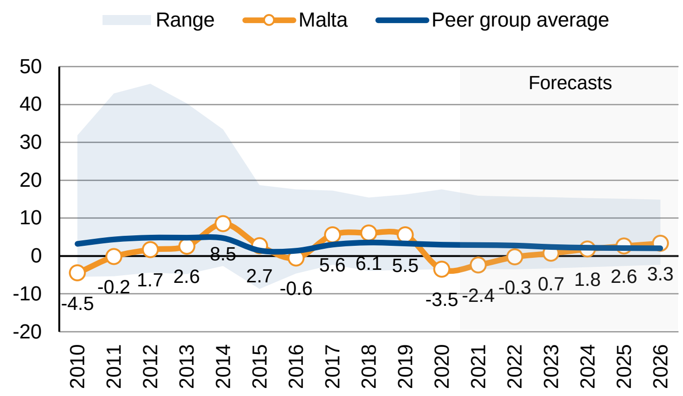
External Economic Risks

- **Current account:** Malta's economy is highly export oriented, with exports representing 148% of GDP in 2021. The external position is strong compared to peers, as Malta has typically run a positive current account balance in the years prior to the pandemic, with its current account balance averaging 3.7% between 2015-2019. It turned negative in 2020, to -2.9% of GDP, mostly due to a significant decrease in tourism activity. The current account deficit is expected to narrow this year given the gradual normalisation of tourism activity. Still, persistent supply chain pressures in the wake of the Russia-Ukraine war could limit this recovery.
- **External position:** Malta benefits from its large net creditor position. Its net international investment position has remained broadly stable since the start of the Covid-19 crisis and reached 39% of GDP in 2021. At year-end 2021 external debt amounted to 641% of GDP, 36pps lower than at year-end 2020. Around 77% of external debt has a long-term maturity and this share has been on an increasing trend during the last decade, having increased by 37pps from 2014. The external debt is mainly related to financial institutions and is typically matched by assets, while the government and the central bank account for only 1.6% and 0.7% of the total external debt respectively.
- **Resilience to shocks:** As a small open economy that is highly integrated with international financial markets, Malta is vulnerable to external shocks through trade linkages and disruptions to global financial conditions. Still, financial spill-overs are limited given the high reliance of government and core domestic banks on domestic funding. In addition, euro area membership provides an important mitigant to external shocks.

Overview of Scope's qualitative assessments for Malta's *External Economic Risks*

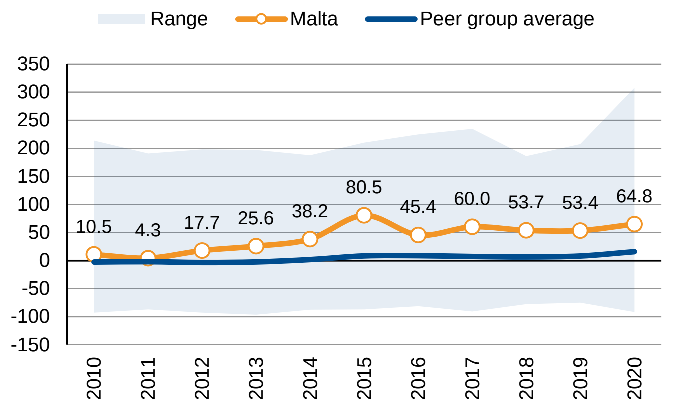
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Current account resilience	Weak	-1/3	Small open economy exposed to current account volatility due to the reliance on a few key service sectors
	External debt structure	Neutral	0	Large external liabilities are offset by large external assets; debt structure has improved
	Resilience to short-term shocks	Neutral	0	Euro-area membership mitigates exposure to international markets

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF WEO, Scope Ratings GmbH

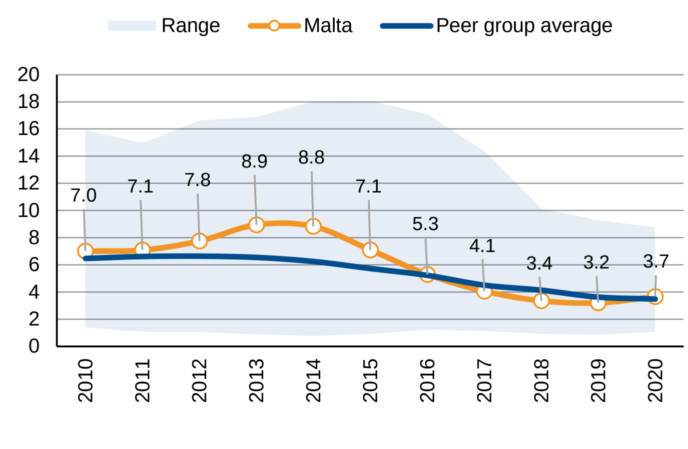
Financial Stability Risks

- **Banking sector:** The banking sector remained resilient during the Covid-19 crisis, with the Tier 1 ratio even improving from 21.8% in 2019 to 23.5% in June 2021 and the liquidity coverage ratio rising from 348% to 426% over the same period. The NPL ratio has increased only moderately since the end of 2020 and stood at 3.5% in June 2021. Stress tests by the Central Bank of Malta show that the banking sector is resilient and able to withstand severe shocks, including a drop in real estate prices, credit quality deterioration and liquidity shocks. Maltese banks are facing some operational pressures as some correspondent banking relationships, which play an important role in facilitating transactions in foreign currencies, have been retracted over heightened risk perceptions linked to anti money laundering concerns.
- **Private debt:** Unconsolidated private debt is relatively higher compared to euro area peer countries, at 288% of GDP in 2020, versus a euro area average of 242%. However, at 136% of GDP, consolidated debt stands slower that the euro area average of 144%. The unconsolidated Non-Financial corporate debt is significantly higher with total debt of 234% of GDP in 2020. High corporate debt levels also reflect Malta's position as a financial hub. However, the consolidated debt is much more contained at 83% of GDP. Household indebtedness is also relatively high at around 54% of GDP in 2020, but still below the euro area average of 60%.
- **Financial imbalances:** In line with other advanced economies, housing prices have increased in recent years, along with mortgage lending. Since 2015, residential prices have increased by 38%, though below the average increase for euro area rating peers (42%). No significant price corrections have been observed to date. In addition, according to the latest assessment of the euro area residential real estate by the European Systemic Risk Board, Malta is among the countries that present medium levels of real estate market vulnerabilities, broadly in line with peers. The ESRB has also deemed that the macroprudential policy response in Malta is both appropriate and sufficient to mitigate these risks thanks to loan-to-value, debt service and maturity limits as well as stricter risk weighting schemes.

Overview of Scope's qualitative assessments for Malta's *Financial Stability Risks*

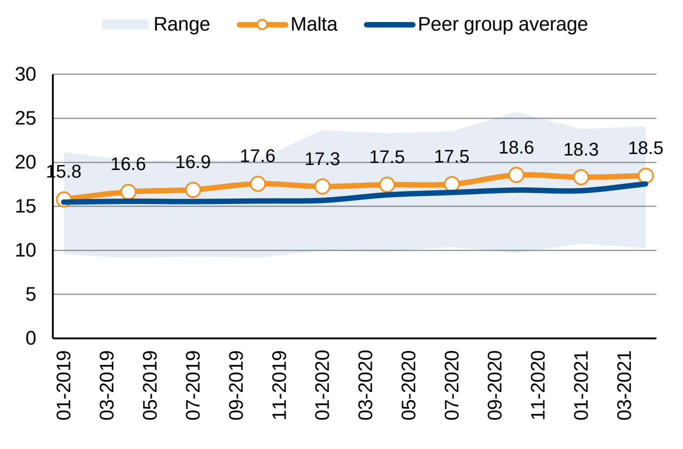
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Profitable and adequately capitalized banking sector
	Banking sector oversight	Neutral	0	Historical shortcomings in supervision, though reforms to enhance oversight have been adopted and are being effectively implemented
	Financial imbalances	Neutral	0	Elevated private debt levels and rising house prices, in line with peers; appropriate and sufficient macroprudential policy response

NPLs, % of total loans



Source: IMF WEO, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF WEO, Scope Ratings GmbH

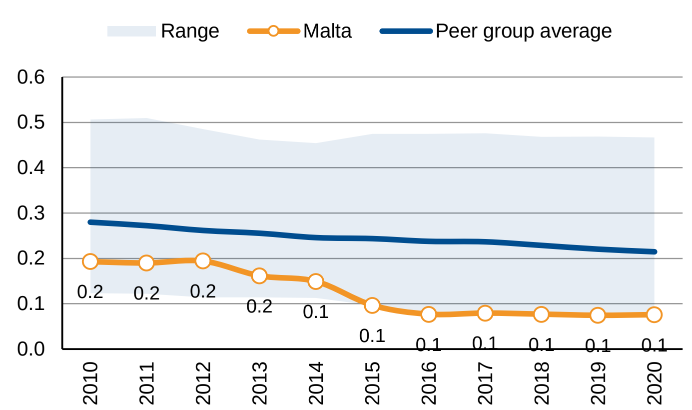
ESG Risks

- **Environment:** The Maltese economy is the least carbon intensive among peers and has achieved one of the greatest reductions in carbon intensity among EU countries, lowering its carbon intensity from above EU average levels in 2005 to one of the lowest levels across the EU in 2019. Substantial emission cuts were achieved in recent years thanks to the completion of an underwater interconnection to mainland Europe, which allowed the country to shift from heavy fuel oil to less carbon intensive natural gas. The country is exposed to resource risk as a small island-state that imports many of its goods and, more recently, much of its energy needs. It is the EU member state with the highest degree of energy dependence. The country's service-based economy limits its climate mitigation capacities, which is reflected in its less stringent emissions targets pursuant to the Effort Sharing Regulation.
- **Social:** Malta's demographic trends are broadly in line with that of peers with the old-age dependency ratio expected to rise from 27.9% in 2020 to 40.2% in 2050. The country performs relatively well in terms of inequality, poverty rates, gender inequality, social protection and inclusion and has been taking steps to improve social outcomes across all segments of the population. Forceful social policies, combined with broad based growth has helped improve social conditions substantially in Malta. In addition, the country benefits from good levels of social cohesion and civic engagement. Still, educational outcomes and labour force participation remain weaker than peers.
- **Governance:** Institutional deficiencies have been highlighted by international institutions, including the EC, IMF and Council of Europe, which have pointed to shortcomings in governance frameworks, including the independence of the judiciary and inefficiencies in the judicial proceedings. Reforms to enhance the rule of law and governance have been implemented in 2020, and additional reforms under the forthcoming government are expected. On 26 March 2022, Malta held legislative elections where the incumbent Labour party secured a 55% majority. We therefore expect broad policy continuity over the coming years.

Overview of Scope's qualitative assessments for Malta's *ESG Risks*

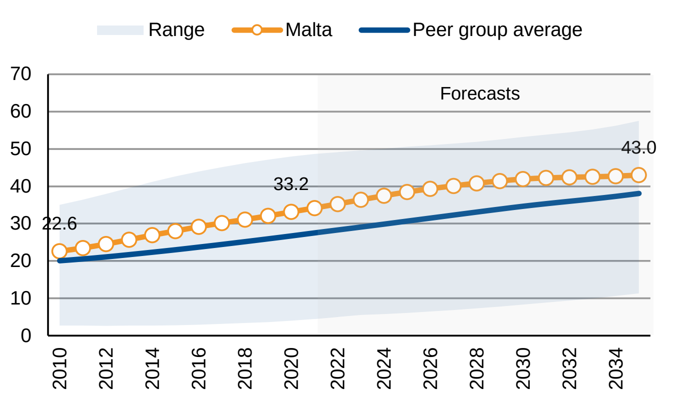
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a	Environmental risks	Neutral	0	Resource-poor, service-based economy with high mitigation costs; low carbon emissions per capita
	Social risks	Neutral	0	Adverse demographics and skills mismatches; stronger employment dynamics as well as social inclusion reflecting broad-based growth
	Institutional and political risks	Weak	-1/3	Positive reform momentum under the current administration but institutional deficiencies remain

CO2 emissions per GDP, mtCO2e



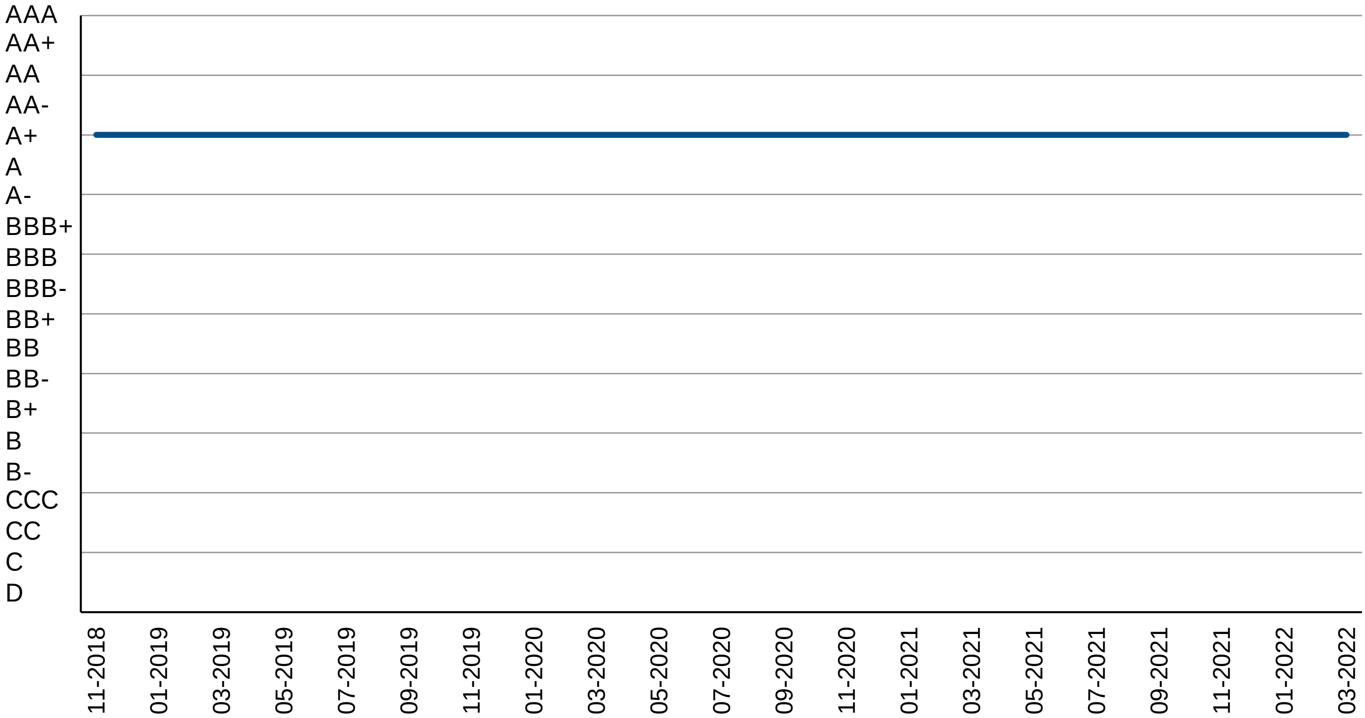
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard.

Peer group*
Bulgaria
France
Italy
Japan
Latvia
Poland
Russia
Slovakia
Slovenia
Spain
United States

Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021E	2022F	2023F
Domestic Economic Risk								
GDP per capita, USD 000s'	26.0	29.3	32.2	31.9	29.0	32.0	34.6	37.1
Nominal GDP, USD bn	11.7	13.5	15.3	15.7	14.9	16.7	18.2	19.7
Real growth, %[1]	3.8	11.0	6.1	5.7	-8.3	9.4	4.0	4.9
CPI inflation, %	0.9	1.3	1.7	1.5	0.8	0.7	1.8	2.0
Unemployment rate, %[1]	4.7	4.0	3.7	3.6	4.3	4.0	3.5	3.5
Public Finance Risk								
Public debt, % of GDP[1]	54.3	47.5	43.4	40.6	53.3	58.3	62.4	63.5
Interest payment, % of government revenue	5.6	4.7	4.0	3.6	3.6	3.8	3.4	3.4
Primary balance, % of GDP[1]	3.0	4.9	3.3	1.7	-8.6	-7.2	-6.3	-4.0
External Economic Risk								
Current account balance, % of GDP	-0.6	5.6	6.1	5.5	-3.5	-2.4	-0.3	0.7
Total reserves, months of imports	0.29	0.34	0.40	0.37	0.37	-	-	-
NIIP, % of GDP	45.4	60.0	53.7	53.4	64.8	-	-	-
Financial Stability Risk								
NPL ratio, % of total loans	5.3	4.1	3.4	3.2	3.7	-	-	-
Tier 1 ratio, % of risk weighted assets	13.6	15.2	16.0	17.6	18.6	18.3	-	-
Credit to private sector, % of GDP	81.4	75.9	74.6	74.0	83.6	-	-	-
ESG Risk								
CO^2 per EUR 1,000 of GDP, $mtCO^2e$	76.6	79.0	76.6	74.1	75.5	-	-	-
Income quintile share ratio (S80/S20), x	4.4	4.5	4.4	-	-	-	-	-
Labour force participation rate, %	70.0	71.2	73.3	74.4	-	-	-	-
Old age dependency ratio, %	29.2	30.2	31.1	32.1	33.2	34.2	35.3	36.4
Composite governance indicator[2]	1.0	1.1	1.1	0.9	0.9	-	-	-

[1] Forecasted values are produced by Scope and may differ from those presented in the charts of the previous sections
[2] Average of the six World Bank Governance Indicators
Source: European Commission, IMF WEO, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps)	N/A

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