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
- Fiscal risks and contingent liabilities
- Lingering institutional and administrative deficiencies

Rating rationale:

Strong growth potential: Malta has experienced a very robust economic recovery in recent years, with real growth of 11.8% and 6.9% in 2021 and 2022 respectively. Strong growth in key sectors, development of higher-value added activities and inflows of skilled workers will support medium-term growth despite the short-term pressures from the war in Ukraine.

Strong record of fiscal prudence: Malta achieved one of the strongest debt reductions among peers in the years preceding the Covid-19 crisis. Strong fiscal outcomes, the withdrawal of support measures and a robust growth outlook underpin our view that debt will stabilise at slightly below the 60% of GDP threshold in the medium term.

Strong external position: Euro area membership and a large external creditor position mitigate risks linked to 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 the financial oversight and supervision frameworks and the deteriorating governance metrics.

Malta's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	a	EUR [+1]	0	A+
Public Finance Risk		20%	a-		+1/3	
External Economic Risk		10%	bbb-		-1/3	
Financial Stability Risk		10%	aaa		0	
ESG Risk	Environmental Factors	5%	aa		0	
	Social Factors	7.5%	bb+		0	
	Governance Factors	12.5%	a-		-1/3	
Indicative outcome		**a+**			**0**	
Additional considerations					**0**	

Note: *The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment 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.

Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced.

Positive rating-change drivers

- Structural reform support economy diversification and resilience
- Fiscal discipline returns public debt to a firm downward trajectory

Negative rating-change drivers

- Structural deterioration in growth
- Weakening fiscal outlook
- Institutional fragilities re-emerge and pose a threat to economic attractiveness

Ratings and Outlook

Foreign currency

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

Local currency

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

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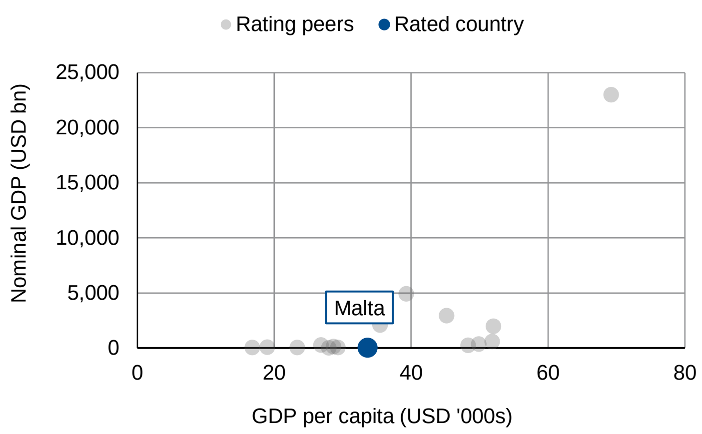
Domestic Economic Risks

- **Growth outlook:** Despite the challenges posed by the pandemic and the ongoing Russia-Ukraine war, Malta's economy has demonstrated resilience, owing in part to the decisive support measures implemented by the government to mitigate the impact on the economy. In 2022, Malta experienced robust economic growth of 6.9%, largely driven by domestic demand and net exports. The tourism sector, which contributes significantly to Malta's exports, has outperformed expectations in 2022, with total yearly inbound tourism returning to 83% of 2019 levels. However, the country’s exports will be adversely impacted by the slowdown in European trading partners from 2023 onwards. As a result, we expect the Maltese economy to grow by 3.3% in 2023 and 3.6% in 2024. Public investments and reforms under the recovery plan, will support medium-term economic growth of around 3.5%.
- **Inflation and monetary policy:** Malta's HICP increased from 0.7% on average in 2021 to 6.1% on average in 2022, primarily driven by international energy and food prices. Despite this, Malta's HICP of 6.8% in January 2023 was the third lowest in the EU. According to the Central Bank of Malta, HICP inflation will decline to 4.5% in 2023, driven by services and fixed domestic energy prices. However, core inflation remained high at 6.4% in January 2023, above the EU average, reflecting higher prices of imported goods. The ECB has raised rates by 3pps since last summer to the highest levels since 2008. We expect further rate hikes as the ECB signalled its intention to raise rates by another 50bps in March.
- **Labour markets:** Malta's labour market has performed well since the peak of the Covid-19 crisis. Labour market conditions are currently tight, although this has not put upward pressures on wages so far. The unemployment rate remained stable at around 3% throughout 2022. Employment grew by 3.8%% in first three quarters of 2022, although this is likely to moderate over the coming years. Labour shortages and skill mismatches continue to be the primary limiting factors in production. However, the increase in net migration and normalisation of international travel are expected to help curb some of these pressures, providing relief to the labour market.

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

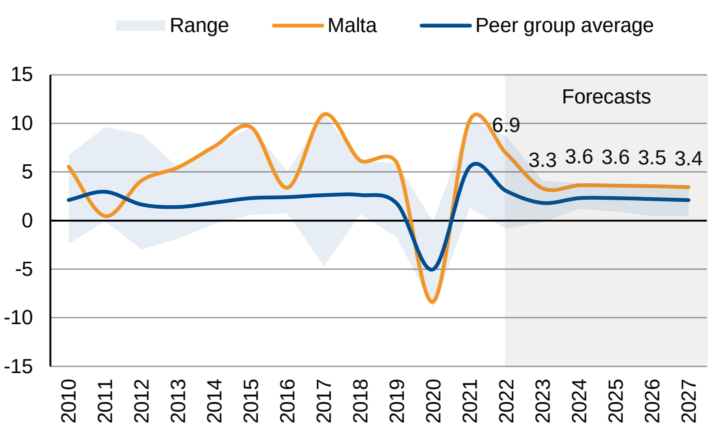
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Strong	+1/3	High growth potential, supported by structural reforms, high growth sectors, and strong labour markets
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective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

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

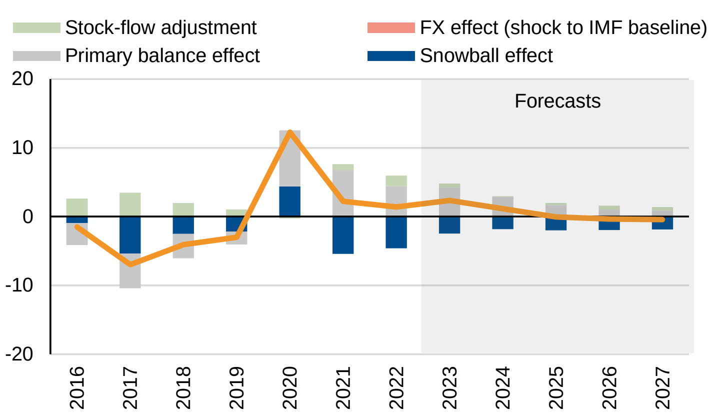
Public Finance Risks

- **Fiscal outlook:** Malta's budgetary deficit is estimated to have narrowed to 5.6% of GDP in 2022, from 7.8% of GDP in 2021. This was thanks to the country's strong economic performance and despite additional supporting measures announced by the government in 2022 to counter the cost-of-living crisis. This included subsidies to mitigate rising energy prices, totalling around 2.4% of GDP. The government will maintain its energy price subsidies and social measures for households in 2023, with a budgeted cost of 3.4% of GDP and 0.4% of GDP respectively. We expect the budget deficit to decline moderately to 5.3% of GDP in 2023, before returning to below 3% of GDP by 2025. Significant fiscal risks remain given outstanding government guarantees, totalling 7.2% of GDP in June 2022, as well as long-term ageing-related cost pressures. Malta is among the EU countries for whom the total cost of ageing will increase the most over the coming decades, estimated at 8pps of GDP over 2019-70 by the European Commission.
- **Debt trajectory:** Large primary deficits increased Malta's debt-to-GDP ratio, estimated at 55% in 2022 from 41% in 2019. We project public debt to rise moderately to 58% of GDP by 2024 and stabilise thereafter, 17pps higher than pre-Covid levels. However, robust growth and improving budget balances provide Malta the opportunity to consolidate its public finances longer-term. Furthermore, the low and stable interest payment burden underpins debt sustainability, with interest expenditure projected to remain below 1.6% of GDP over the forecast horizon, despite the significant increase in the debt stock since 2019 and rising interest rates.
- **Debt profile and market access:** Malta's debt structure is favourable. The average maturity of debt was 8.1 years in 2021, with long-term debt accounting for 86% of total debt and virtually no foreign exchange exposures. This will further help mitigate the impact of rising interest rates on Malta's interest payment burden. The country benefits from a solid domestic investor base, with residents holding 75% of total government debt and increased domestic investor appetite for Malta's debt securities in recent months.

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

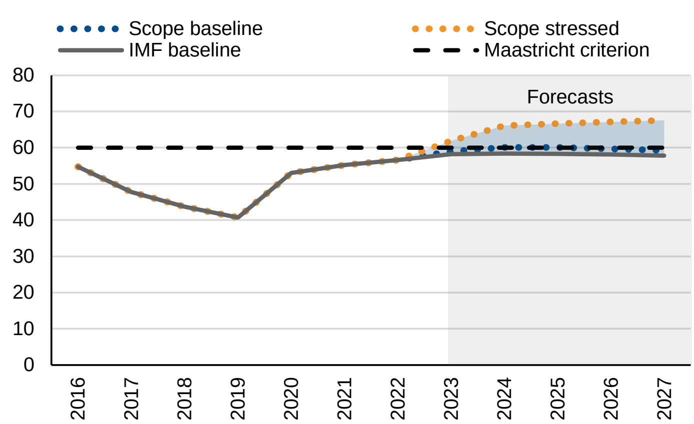
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Fiscal policy framework	Strong	+1/3	Good record of consolidation, and over-achieving of fiscal targets; countercyclical policies
	Debt sustainability	Neutral	0	Stabilisation of debt trajectory over the medium term; contingent liabilities pose long-term 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: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

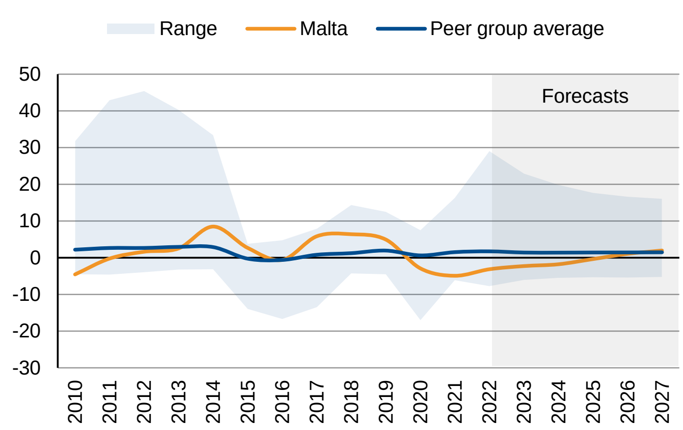
External Economic Risks

- **Current account:** Malta has consistently recorded wide current account surpluses since the global financial crisis, with its current account balance averaging 4% of GDP over 2015-19. The current account turned to a deficit of 3% of GDP over 2020-22 due to a fall in exports and rising import prices. Malta's current account position faces pressures from a still recovering tourism sector, weakening external demand, although risks of terms of trade deterioration are mitigated by the pass through of higher input costs to export prices. We expect the current account to improve as the fiscal position strengthens and export performance recovers, reaching a deficit of 2.2% of GDP in 2023 and returning to a surplus by 2026.
- **External position:** Over the past decade, Malta has maintained a significant net external asset position. However, the country's net international investment position was volatile in 2020-21, ranging from 50% to 61% of GDP. According to the IMF, the net international investment position will decline from 51.8% of GDP in 2021 to 38.2% of GDP in 2022. Despite this, the majority of the country's liabilities are direct investments, and the large gross asset position helps mitigate risks. External debt is expected to improve from 621% of GDP in 2021 to 555% of GDP in 2022. The majority (76.5%) of the external debt is associated with liabilities of offshore financial institutions that have minimal connections to the economy. Additionally, these liabilities are generally offset by assets. The government and central bank's share of the total external debt is only 1.5% and 0.8%, respectively, as of September 2022.
- **Resilience to shocks:** Malta is susceptible to external shocks caused by disruptions to global financial conditions and trade linkages given its small, open economy with strong ties to international financial markets. However, the country's high dependence on domestic funding for government and core domestic banks limit financial spill-overs. Furthermore, Malta's large net creditor position and membership in the euro area mitigate external risks.

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

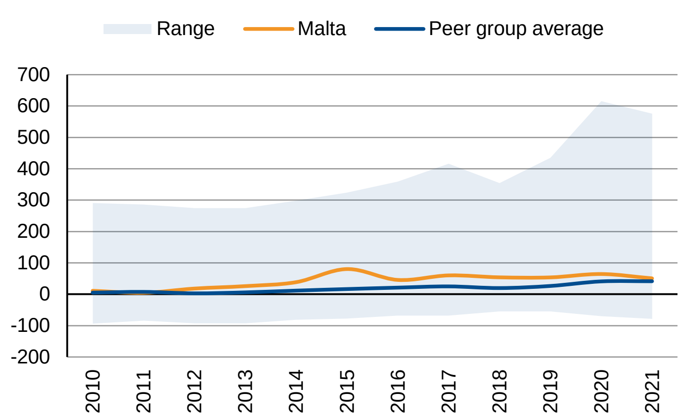
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb-	Current account resilience	Weak	-1/3	Small open economy exposed to current account volatility due to reliance on a few key service sectors
	External debt structure	Neutral	0	Large external liabilities are offset by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

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

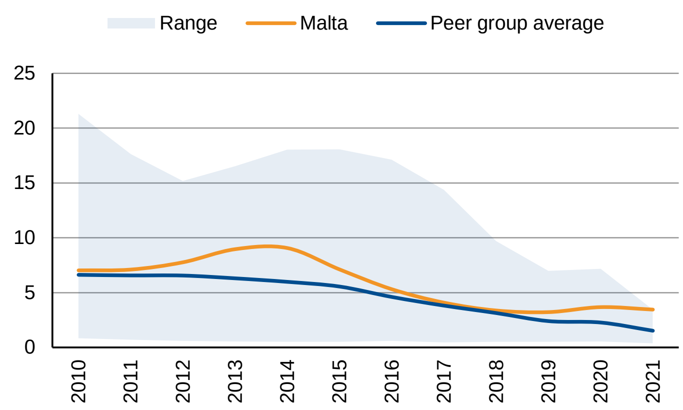
Financial Stability Risks

- **Banking sector:** Malta's banking sector has weathered the Covid-19 crisis well and is proving resilient in the context of the Russia-Ukraine war. Exposures in loans and deposits to both countries are below 1% of GDP. Banks remain well-capitalised with a Tier 1 ratio at 18.6% as of September 2022. Profitability benefitted from higher interest and non-interest income, although it remains below peers and declined over the last year, with ROE and ROA contracting by 3.3pps and 0.3pps, respectively, in Q3 2022 compared to Q3 2021. This decline was mainly due to a one-off cost for one domestic core bank and higher provisions. The NPL ratio continued to decline to 2.9% in Q3 2022, from 3.6% in Q3 2021 while liquidity coverage ratios improved substantially and reached 390% in Q3 2022. Stress testing by the Central Bank of Malta confirmed the solid solvency and liquidity positions of the Maltese banking system overall but highlighted some weaknesses in the liquidity position for a few banks in systemic events, reflecting in part severe scenario assumptions.
- **Private debt:** Unconsolidated private debt is elevated compared to euro area peer countries, at 212% of GDP in 2021, versus a euro area peer average of 167%, reflecting Malta's status as a financial hub. However, at 129% of GDP, consolidated private debt is below the euro area average of 162%, reflecting the importance of intra-company lending in the economy. While private debt has edged up in the context of the Covid-19 crisis, we note that the private sector has been deleveraging in recent years. Consolidated debt remains below the 2009 peak of 172% of GDP and household debt remains comparable to that of other euro area countries.
- **Financial imbalances:** In line with other advanced economies, real estate prices have increased in recent years, along with banks' exposure to the housing market due to higher mortgage lending. Since 2015, the residential price index has increased by 61%, worsening housing affordability and household indebtedness. The latest assessment of the euro area residential real estate market by the European Systemic Risk Board, shows 'medium' levels of real estate market vulnerabilities for Malta, though the macroprudential policy response was deemed both appropriate and sufficient to mitigate these risks.

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

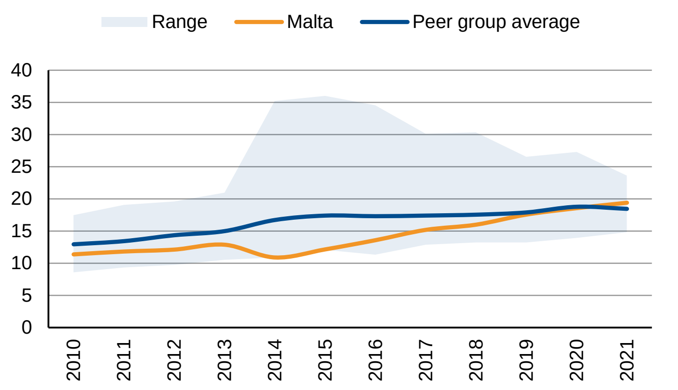
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Profitable and adequately capitalised banking sector
	Banking sector oversight	Neutral	0	Historical shortcomings in supervision though reforms to enhance oversight have been adopted 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

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

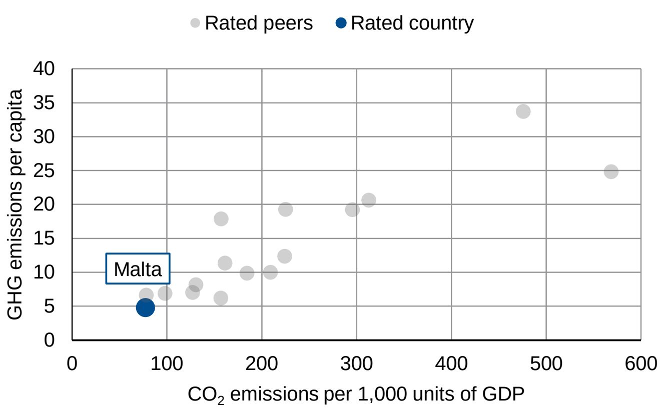
ESG Risks

- **Environment:** The country's service-based economy, as well as its geography, and expanding GDP and population, complicate emissions reductions, reflected in the highest expected relative distance to its 2030 effort sharing target among EU countries. Investments under Malta's Recovery and Resilience plan will contribute to its green transition, amongst other EU and national resources, with 54% of the plan supporting climate and environmental objectives. The Low Carbon Development Strategy outlines the country's decarbonisation strategy through 2050 and prioritises on cost-effective measures to increase energy efficiency and promote renewables. As a small island-state that imports many of its goods and most of its energy, Malta is significantly exposed to resource risks. Natural risks are very low, with the country ranking among the safest ones when it comes to the prospect of a natural disaster according to the World Risk Report.
- **Social:** Malta performs relatively well in terms of social outcomes, with low poverty rates, low income inequality and high social inclusion and protection. The government has been taking steps to improve social outcomes across all segments of the population. Social policies, combined with broad based growth has helped improve social conditions substantially in Malta, though there is room to improve educational outcomes and the labour force participation, especially in view of the country's labour shortages. Malta faces important demographic challenges, ranking as one of the EU countries that will see its old age dependency ratio increase the most in coming decades, by around 33pps over 2019-70, versus an EU average of 25pps.
- **Governance:** Malta has been addressing long-standing institutional weaknesses in line with recommendations of international institutions, including the EC, IMF and Council of Europe. Reforms included in Malta's recovery and resilience plan aim at strengthening the independence and effectiveness of the judiciary, as well as the country's capacity to tackle corruption and money laundering. On 26 March 2022, Malta held legislative elections where the incumbent Labour party secured a 55% majority, with the next general elections planned for in 2027. We therefore expect broad policy continuity over the coming years.

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

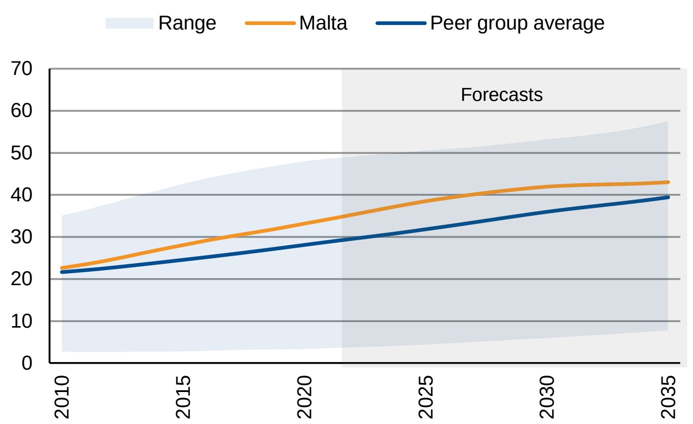
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Environmental factors	Neutral	0	Low carbon emissions per capita; mitigation costs are high and emissions are set to increase
	Social factors	Neutral	0	Adverse demographics and skill mismatches; stronger employment dynamics as well as social inclusion reflecting broad-based growth
	Governance factors	Weak	-1/3	Positive reform momentum but institutional deficiencies remain

Emissions per GDP and per capita, $mtCO_2e$



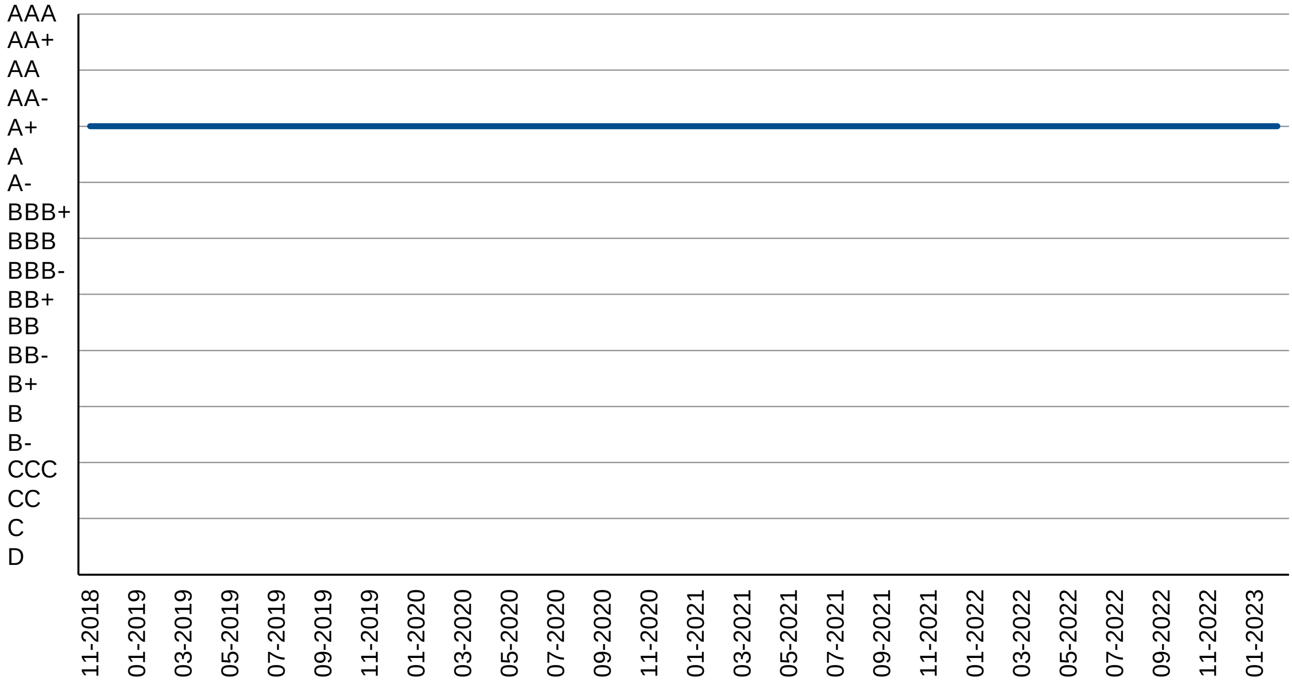
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history (foreign-currency long-term debt)



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

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, including a methodological reserve-currency adjustment.

Peer group*
Belgium
Croatia
Czech Republic
Estonia
France
Italy
Japan
Lithuania
Slovenia
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 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2017	2018	2019	2020	2021	2022
Domestic Economic	GDP per capita, USD '000s	IMF	29,295	32,176	31,867	28,997	33,667	32,912
	Nominal GDP, USD bn	IMF	13.5	15.3	15.7	14.9	17.4	17.2
	Real growth, %	IMF	10.9	6.2	5.9	-8.3	10.3	6.2
	CPI inflation, %	IMF	1.3	1.7	1.5	0.8	0.7	5.9
	Unemployment rate, %	WB	4.0	3.7	3.6	4.3	3.5	-
Public Finance	Public debt, % of GDP	IMF	47.8	43.7	40.7	53.4	56.4	57.0
	Interest payment, % of revenue	IMF	4.7	4.0	3.6	3.6	3.1	3.0
	Primary balance, % of GDP	IMF	5.1	3.6	1.9	-8.1	-6.8	-4.4
External Economic	Current account balance, % of GDP	IMF	5.9	6.4	5.0	-2.9	-4.9	-3.1
	Total reserves, months of imports	IMF	0.3	0.4	0.4	0.4	0.4	-
	NIIP, % of GDP	IMF	60.1	53.8	53.7	64.5	50.5	-
Financial Stability	NPL ratio, % of total loans	IMF	4.1	3.4	3.2	3.7	3.4	-
	Tier 1 ratio, % of risk-weighted assets	IMF	13.5	15.2	15.8	17.3	18.3	18.6
	Credit to private sector, % of GDP	WB	74.4	72.5	71.6	82.0	-	-
ESG	CO_2 per EUR 1,000 of GDP, $mtCO_2e$	EC	77.6	74.6	75.1	77.4	76.1	-
	Income share of bottom 50%, %	WID	20.0	20.4	20.4	20.5	20.5	-
	Labour-force participation rate, %	WB	71.2	73.3	74.4	-	-	-
	Old-age dependency ratio, %	UN	27.7	27.7	27.7	27.7	27.7	28.2
	Composite governance indicators*	WB	1.1	1.0	0.8	0.9	0.8	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

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

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