Republic of Malta
Rating Report

SCOPE 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 very 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 growth outlook remains strong despite short-term pressures from the war in Ukraine.

Strong track record of fiscal prudence: 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, the withdrawal of support measures and a robust growth outlook underpin our view that debt will stabilise in the medium term.

Strong external position: Euro area membership, consistent current account surpluses 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 scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	a		0	
Public Finance Risk		25%	a+		+1/3	
External Economic Risk		10%	bbb+		-1/3	
Financial Stability Risk		10%	aaa		0	A+
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 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. In line with our methodology, movements between indicative ratings are not immediate but are executed after analyst review of CVS results. The rating committee approved an implied core variable scorecard (CVS) rating of 'a'. 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 reforms support economy diversification and resilience
- Fiscal discipline is maintained, returning debt to a firm downward trajectory

Negative rating-change drivers

- Structural deterioration in growth
- Weakening in fiscal outlook
- Institutional fragilities re-emerge and pose a threat to Malta's 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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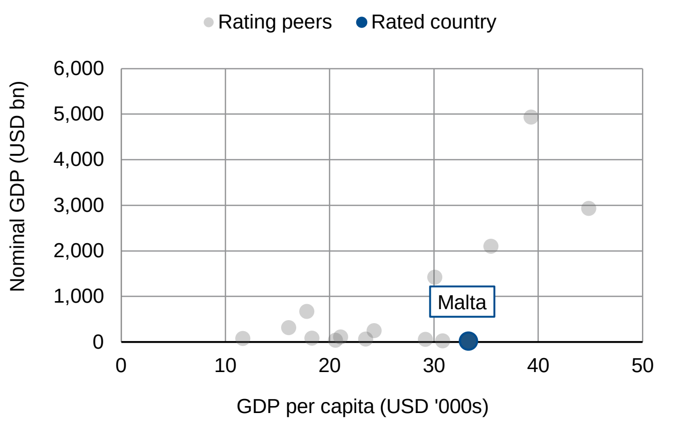
Domestic Economic Risks

- **Growth outlook:** Malta has been recovering swiftly from the Covid-19 crisis. After GDP shrank by 8.3% in 2020, the country posted 10.3% growth in 2021, well above expectations and among the strongest growth rates in the EU. The weakening global outlook in the context of the Russian invasion of Ukraine and associated supply-side bottlenecks and rising inflationary pressures, weigh on the economic outlook. Still, Malta is demonstrating notable resilience. The growth outlook is strong, supported by domestic consumption, sustained recovery in important sectors such as tourism and pro-active government intervention to mitigate the impact of higher prices for households and corporates. We project the Maltese economy to grow by 4.8% in 2022 followed by a gradual convergence to its medium-run potential of 3.5%. Growth should average around 3.8% over 2022-27 with Malta ranking as one of the top performing EU economies.
- **Inflation and monetary policy:** Inflation has increased substantially in recent months, following the Russian invasion of Ukraine but remains moderate compared to peers thanks to forceful government measures to contain rising energy prices. Headline (HICP) inflation averaged 6% in the six months to August 2022 (the lowest in the EU) from 0.7% in 2021, while core inflation averaged 5.7% as inflation has spilled over from food and non-energy industrial goods to other prices. The ECB's decision to hike its policy rates by 75bps and embark on a policy normalisation path from negative interest rates should help curb inflationary pressures.
- **Labour markets:** Labour markets have continued to strengthen since the height of the Covid-19 crisis and despite more recent headwinds. The unemployment rate reached 2.9% in July 2022, an all-time low, down from the August 2020 peak of 4.9%. The employment rate has also reached historical high levels, standing at 76.1% in March 2022. The Central Bank of Malta projects employment growth to remain buoyant, at 3.5% in 2022 and then to moderate to 2.1% by 2024. Malta continues to face supply-side labour market pressures given historically high labour shortages and skills mismatches. The increase in net migration as international travel normalises will help curb some of the pressures.

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

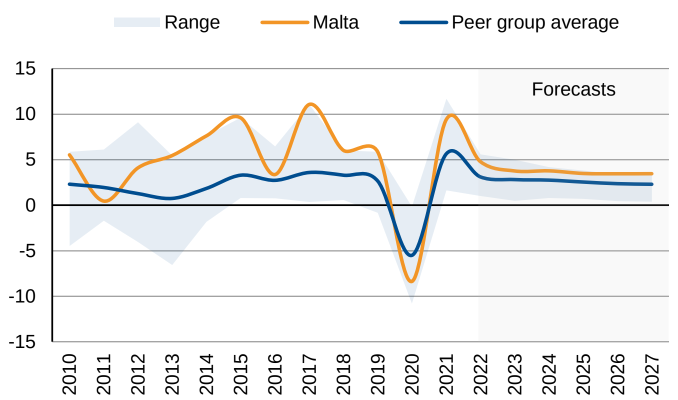
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a	Growth potential of the economy	Strong	+1/3	High growth potential, supported by structural reforms and strong employment dynamics
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central bank; effective policy framework and transmission through the cycle
	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

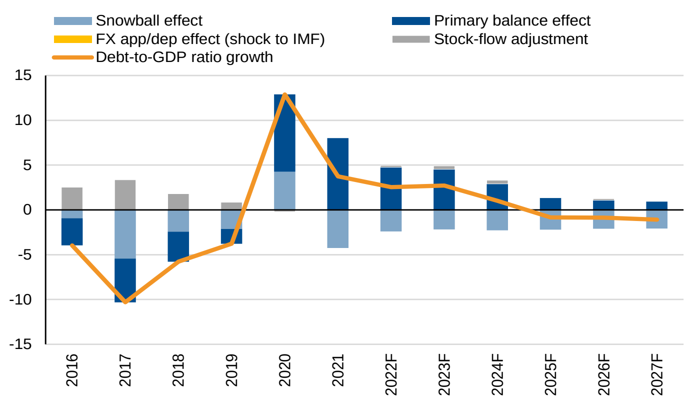
Public Finance Risks

- **Fiscal outlook:** Malta's budgetary performance has been gradually recovering from the Covid-19 crisis though the fiscal stance remains supportive in the near term. The deficit stood at 7.9% of GDP in 2021, down from 9.4% in 2020, thanks to a strong economic performance and despite the extension of Covid-related measures. In 2022, the government announced additional measures to mitigate the impact of rising prices on households and companies totalling around 2.5-3.0% of GDP, on top of around 1.9% of GDP in Covid-related measures. We expect the government to return to fiscal discipline once the exceptional circumstances related to the current crisis dissipate and note that it has already secured tangible budgetary savings to offset the cost of crisis-related measures. We expect Malta's budget deficit to continue declining to 5.9% of GDP in 2022, driven by the buoyant economic growth and the gradual unwinding of crisis-related measures, and return to below 3% of GDP by 2025. Tangible fiscal risks remain, however, given large government guarantees outstanding (12.8% of GDP at end 2021) and long-term ageing-cost pressures.
- **Debt trajectory:** Strong economic growth and the budgetary performance in 2021 have led to a lower-than-expected increase in Malta's public debt-to-GDP ratio, standing at 57% of GDP in 2021 versus a forecasted 65% of GDP in Malta's 2021-24 Stability Programme. We project debt to increase to 63% of GDP by 2024, 23pps higher than pre-Covid levels. Thereafter, strong growth and improving budget balances should return debt on a declining trajectory. Importantly, debt sustainability is underpinned by a low and stable interest payment burden, with interest payments expected to remain below 1.2% of GDP over the forecast horizon, despite the sharp increase in the debt stock and rising interest rates.
- **Debt profile and market access:** The debt structure is favourable. In 2021, the average maturity of debt stood at 8 years and 11 months while long-term debt represented 86% of total debt, which will mitigate the impact of rising interest rates on Malta's interest payment burden. In addition, Malta has virtually no foreign currency exposure. Malta benefits from a solid domestic investor base with residents holding 75% of total government debt. Government bond yields have been increasing due to rising inflation and the ECB's policy normalisation. The 10-year government bond yield reached 3% in August 2022, the highest level since 2014.

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

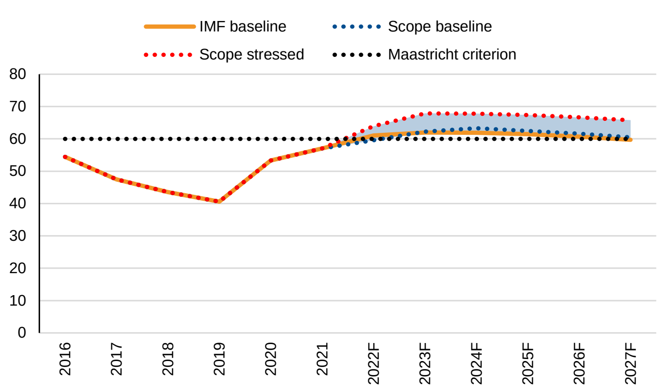
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Fiscal policy framework	Strong	+1/3	Good record of consolidation, prudent fiscal management and over-achieving of fiscal targets
	Debt sustainability	Neutral	0	Stabilisation of debt trajectory over the medium term; contingent liabilities and rising age-related costs 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: Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

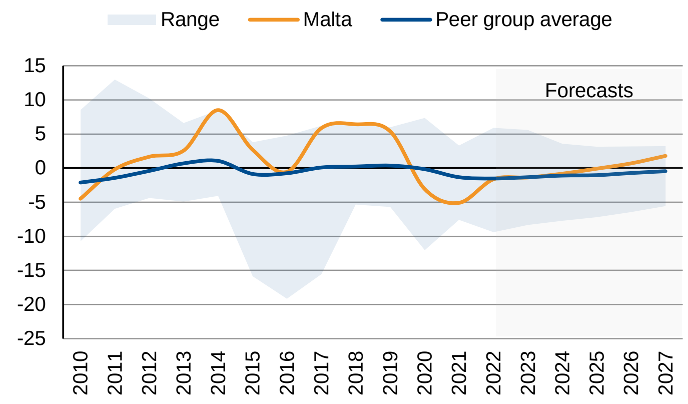
External Economic Risks

- **Current account:** Malta has a strong record of wide current account surpluses since the global financial crisis and up to the Covid-19 crisis. Its current account balance averaged 4% of GDP over 2015-19. The drop in exports, mostly related to tourism, due to the Covid-19 crisis pushed the current account balance into a deficit of 2.9% of GDP in 2020. In addition, deteriorating terms of trade given strong import price pressures and the inability of exporters to fully pass on the increase in costs to higher prices, as well weakening external demand have weighed on the current account which reached a deficit of 4.6% of GDP in 2021. The current account is expected to improve in coming years as the fiscal position improves and export performance picks up.
- **External position:** Consistent current account surpluses have resulted in Malta's large net creditor position. Its net international investment position displayed some volatility in 2020-21, fluctuating between 50% and 61% of GDP before stabilising at 53.3% of GDP by March 2022, broadly in line with pre-crisis levels. In March 2022, external debt stood at 624% of GDP. Malta's external debt levels have improved substantially in recent years, dropping from a 2012 peak of 1,156% of GDP, supporting its external position. The external debt is mainly related to financial institutions (76.5%) and is typically matched by assets, while the government and the central bank account for only 1.8% 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, the country's large net creditor position and euro area membership constitute important mitigants to external shocks.

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

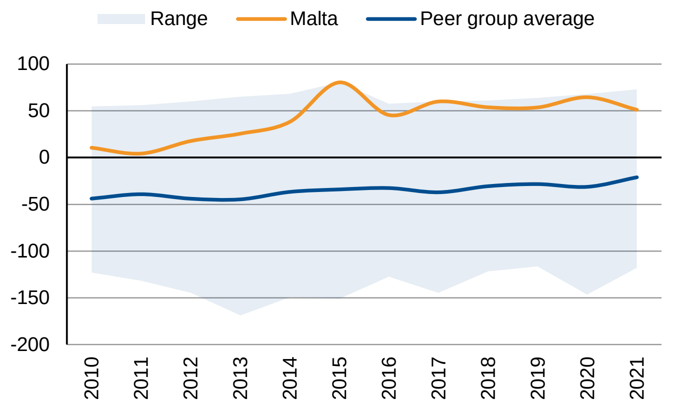
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Current account resilience	Weak	-1/3	Small open economy exposed to current account volatility due to the reliance on a few key service sectors
	External debt structure	Neutral	0	Large external liabilities are offset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

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings GmbH

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings GmbH

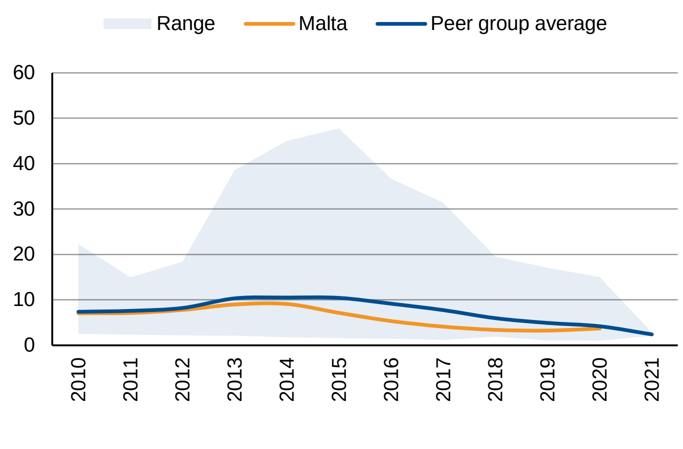
Financial Stability Risks

- **Banking sector:** Malta's banking sector has proved resilient throughout the Covid-19 crisis. Tier 1 ratios improved from 17.6% at year-end 2019 to 19.1% in March 2022. In addition, asset quality has only moderately deteriorated with the non-performing loan ratio rising mildly from 3.2% to 3.5% over the same period, after peaking at 3.9% in June 2021, and remaining at comfortable levels. Liquidity coverage ratios also improved substantially and reached almost 360% in 2021. 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 in systemic events for a few banks, reflecting in part the extreme assumptions applied. Pressures on correspondent banking relationships are likely to subside gradually given Malta's successful removal from the Financial Action Task Force's greylist.
- **Private debt:** Unconsolidated private debt is elevated compared to euro area peer countries, at 229% of GDP in 2020, versus a euro area peer average of 163%, reflecting Malta's status as a financial hub. However, at 135% of GDP, consolidated private debt is slightly lower than the euro area average of 150%, 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, that consolidated debt levels remain below the 2009 peak of 171% of GDP and that 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 mortgage lending. Since 2015, the property price index has increased by 39.5%, worsening housing affordability and exacerbating household indebtedness. According to the latest assessment of the euro area residential real estate market by the European Systemic Risk Board, Malta presents 'medium' levels of real estate market vulnerabilities, though the macroprudential policy response was deemed both appropriate and sufficient to mitigate these risks. No significant price corrections have been observed to date and house prices remain broadly in line with fundamentals. Still, an unabated increase in real estate prices could pose long-term financial stability challenges.

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

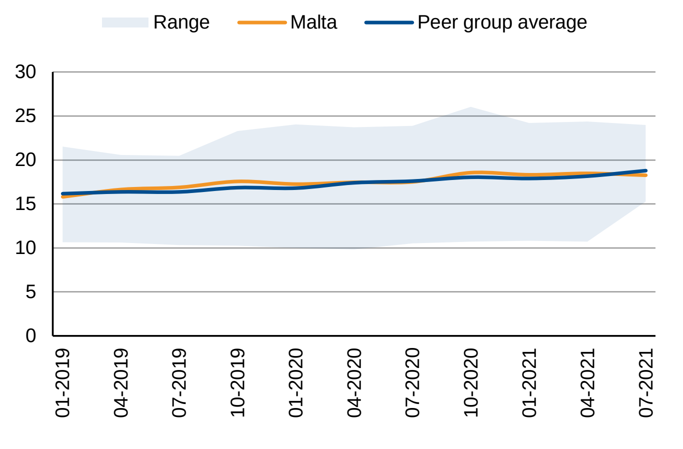
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Profitable and adequately capitalised banking sector.
	Banking sector oversight	Neutral	0	Historical shortcomings in supervision though reforms to enhance oversight have been adopted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

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

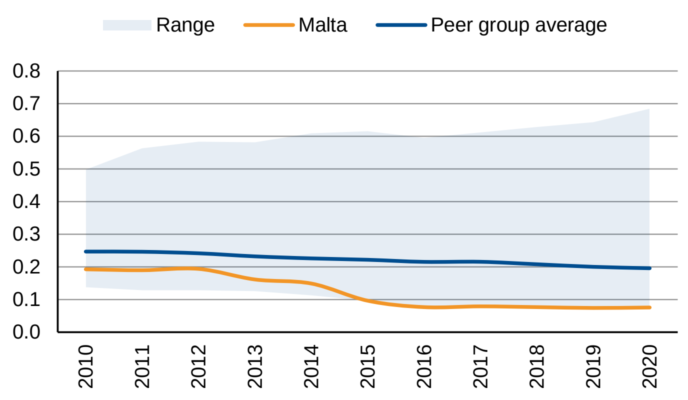
ESG Risks

- **Environment:** Malta has achieved one of the greatest reductions in its greenhouse gas emissions intensity, going from above EU average levels in 2005 to one of the lowest levels across the EU in 2019. The country's service-based economy, as well as its geography, demographics and expanding GDP, make further gains in emissions reductions more challenging. In addition, Malta has by far the highest expected relative distance of any EU country to its 2030 effort sharing target. The country's recovery and resilience plan is expected to contribute substantially to its green transition, with 54% of the plan supporting climate and environmental objectives. In addition, the country is exposed to resource risks as a small island-state that imports many of its goods and much of its energy needs. Natural risks are very low, with Malta ranking as the second safest country 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. Forceful 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 according to the European Commission.
- **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*

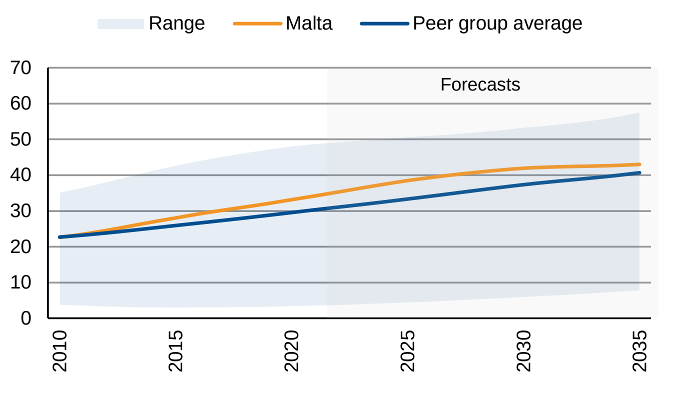
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a	Environmental risks	Neutral	0	Resource-constrained, service-based economy underpin high mitigation costs; low carbon emissions per capita.
	Social risks	Neutral	0	Adverse demographics and skills mismatches; stronger employment 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

CO_2 emissions per GDP, $mtCO_2e$



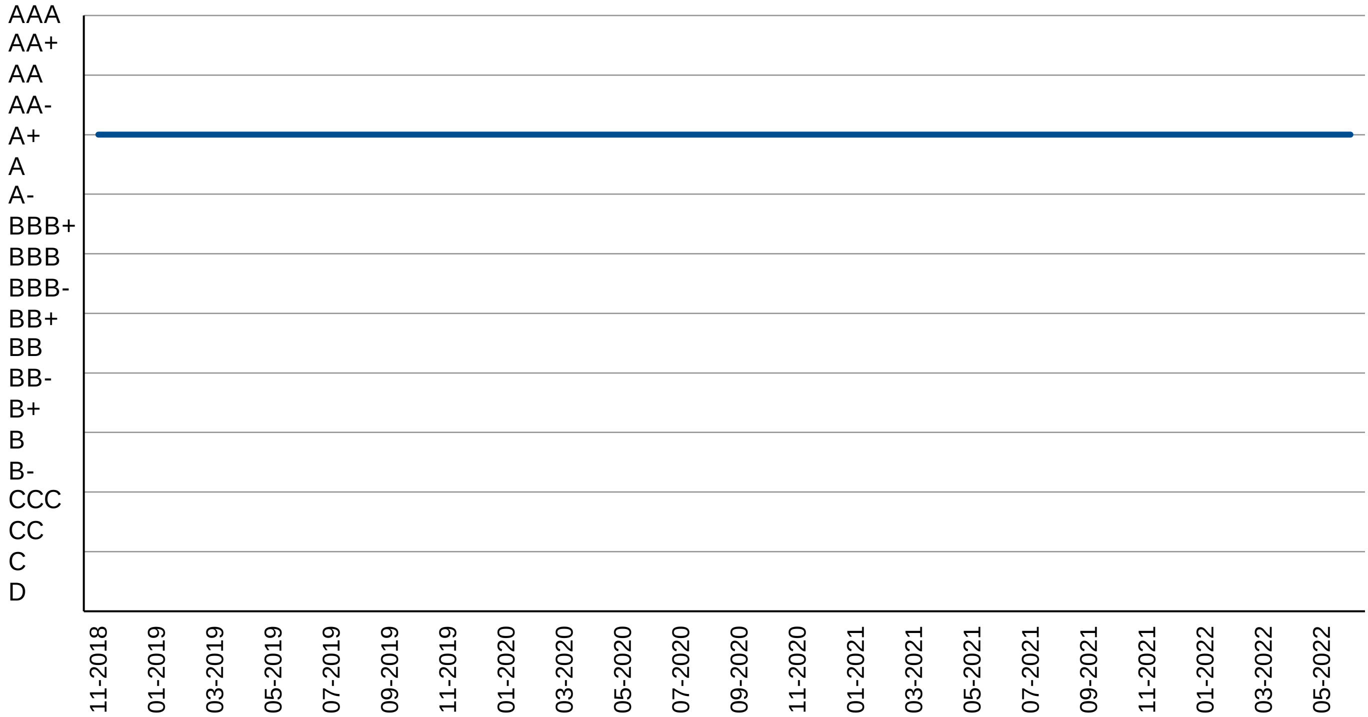
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



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 embedding a methodological reserve-currency adjustment.

Peer group*
Bulgaria
Cyprus
France
Italy
Japan
Latvia
Lithuania
Malta
Poland
Portugal
Slovakia
Slovenia
Spain

*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 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021	2022F	2023F
Domestic Economic Risk								
GDP per capita, USD '000s	25.9	29.3	32.2	31.9	29.0	33.3	33.1	35.5
Nominal GDP, USD bn	11.7	13.5	15.3	15.7	14.9	17.2	17.3	18.6
Real growth, %[1]	3.4	10.9	6.2	5.9	-8.3	10.3	4.8	3.8
CPI inflation, %	0.9	1.3	1.7	1.5	0.8	0.7	4.7	2.8
Unemployment rate, %[1]	4.7	4.0	3.7	3.6	4.4	3.6	3.5	3.5
Public Finance Risk								
Public debt, % of GDP[1]	54.5	47.5	43.5	40.6	53.3	57.0	59.5	62.3
Interest payment, % of government revenue	5.6	4.7	4.0	3.6	3.6	3.6	3.2	3.2
Primary balance, % of GDP[1]	3.0	4.9	3.4	1.7	-8.6	-8.0	-4.7	-4.5
External Economic Risk								
Current account balance, % of GDP	-0.6	5.9	6.4	5.4	-3.1	-5.1	-1.7	-1.4
Total reserves, months of imports	0.3	0.3	0.4	0.4	0.4	0.4	-	-
NIIP, % of GDP	45.5	60.0	53.8	53.7	64.6	51.1	-	-
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	19.4	19.1	-
Credit to private sector, % of GDP	81.8	74.3	72.5	71.6	82.1	-	-	-
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	4.9	-	-	-	-
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
[2] Average of the six World Bank Worldwide 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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