Republic of Malta
Rating Report

A+ STABLE OUTLOOK

Credit strengths	Credit challenges
• Strong growth potential • Record of prudent fiscal management • Solid external position	• Externally dependent, resource constrained economy • Fiscal risks and contingent liabilities • Lingering institutional and administrative weaknesses

Rating rationale:

Strong growth potential: Malta has experienced a very robust economic recovery in recent years, with real growth of 11.8% in 2021 and 7.1% in 2022. Strong growth in key sectors, development of higher-value-added activities and inflows of skilled workers support its robust medium-term potential growth of around 3.5% despite ongoing headwinds and economic uncertainty.

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 Maastricht 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%	bbb+	EUR [+1]	0	A+
Public Finance Risk		20%	a		0	
External Economic Risk		10%	a+		0	
Financial Stability Risk		10%	aaa		0	
ESG Risk	Environmental Factors	5%	aa		0	
	Social Factors	7.5%	bbb-		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	Negative rating-change drivers
• Structural reform support economy diversification and resilience • Fiscal consolidation returns public debt to a firm downward trajectory	• Structural deterioration in growth • Weakening in 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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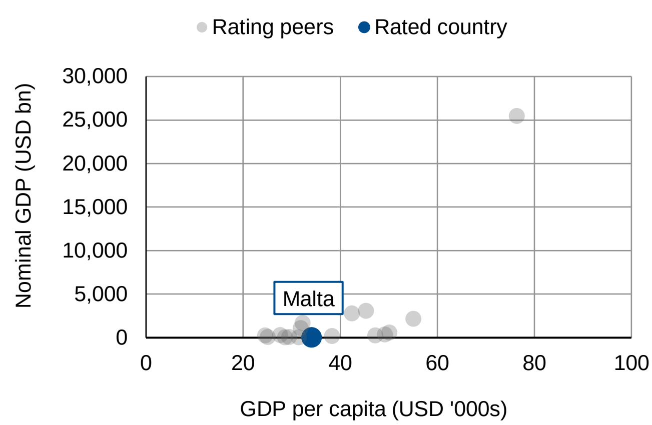
Domestic Economic Risks

- **Growth outlook:** Malta's growth momentum remains strong despite the ongoing headwinds stemming from an uncertain economic environment, slowdown among trading partners, still elevated inflation, and tightening monetary policies. Growth reached 7.1% in 2022, underpinned by robust domestic consumption (4.8pp contribution) and investment (6.2pps), while net exports weighed on economic performance. The tourism sector has performed strongly, with total inbound tourists reaching 1.2m in the first six months of 2023, up 44% from the first half of 2022. We expect growth to slow to 3.7% in 2023 and stabilise at around 3.5% thereafter, in line with the country's strong medium-run potential growth, with continued support from reforms and investments under the country's recovery and resilience plans.
- **Inflation and monetary policy:** HICP inflation remains elevated, at 5.6% in July 2023 but has declined from the 7.4% peak in October 2022 and is below the EU average of 6.2%. The government has implemented largescale measures to mitigate the impact of elevated commodity prices for households and companies, which have kept inflation below most EU member states. We expect inflation to decline to 3.4% on average in 2024 as commodity prices normalise more broad-based inflationary pressures dissipate. The ECB raised its rates by 425bps since last summer to the highest levels since 2000 and is gradually reducing its balance sheet securities holdings.
- **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 has remained stable at around 3% since year-end 2021. Employment grew by 5.3% year-on-year in Q1 2023, although this is likely to moderate over the coming years. The employment rate for those aged 15 to 64, at 78% in March 2023, is the second highest in the EU after the Netherlands. Labour shortages and skill mismatches continue to constrain production, especially in ICT, construction, and trade. However, the increase in net migration and normalisation of international travel should help curb some of these pressures, providing relief to the labour market.

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

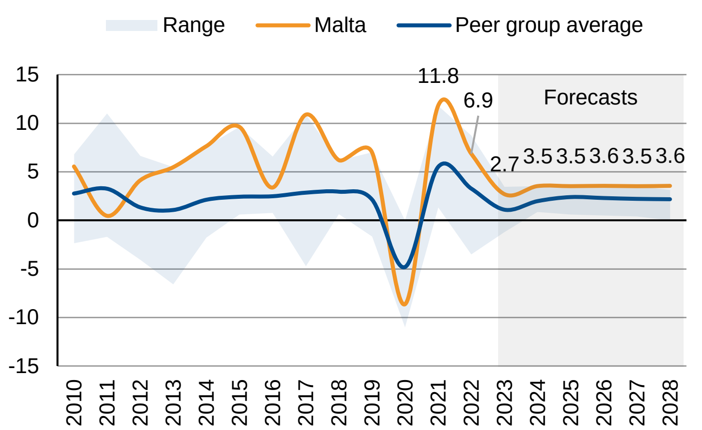
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Growth potential of the economy	Strong	+1/3	High growth potential, supported by structural reforms, high growth sectors, and strong labour markets
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective 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

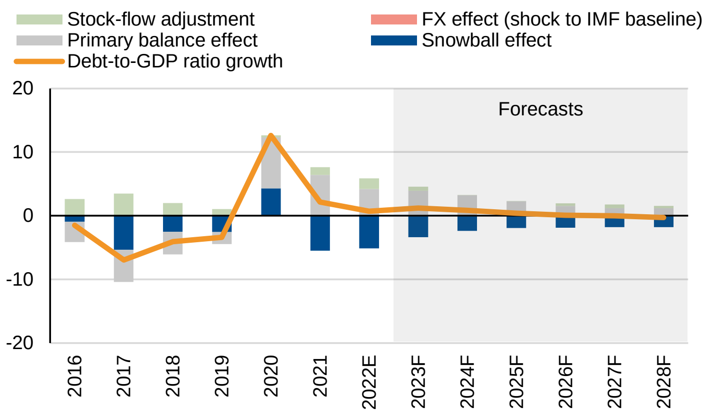
Public Finance Risks

- **Fiscal outlook:** Malta's budgetary deficit narrowed to 5.3% of GDP in 2022, from 7.5% of GDP in 2021 thanks to strong economic performance and despite additional supporting measures announced by the government in 2022 to counter the cost-of-living crisis. Subsidies to mitigate high food and energy prices are large but should cost less than anticipated, estimated at 1.7% of GDP for 2023, versus a budgeted 3.4%. The government will maintain its energy price subsidies for coming years, for an average cost of 1.4% of GDP through 2026, though spending will depend on commodity price developments. We expect the budget deficit to decline only moderately to 5.1% of GDP in 2023, before returning to below 3% of GDP by 2026. Significant fiscal risks remain given large government guarantees, totalling 6.9% of GDP in 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:** Malta's debt-to-GDP ratio stood at 56% of GDP in 2022. We project public debt to rise moderately to 58% of GDP by 2024 and stabilise thereafter as strong growth and moderately elevated inflation offset the debt-increasing effect of significant primary deficits. 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 Malta's debt sustainability, with interest expenditure projected to remain below 1.3% 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 years and 4 months in 2022, with long-term debt accounting for 85% 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, with the 10-year government bond yield at 3.7% in August 2023, up from around 0.3% in 2020. The country benefits from a solid domestic investor base, with residents holding 78% 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*

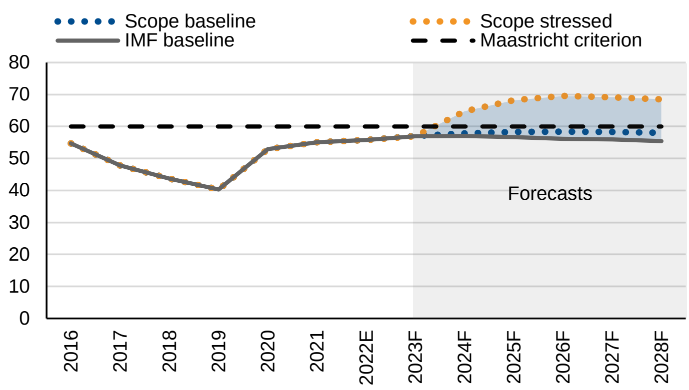
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a	Fiscal policy framework	Neutral	0	Good record of consolidation, and over-achieving of fiscal targets; wide post-crisis deficits reflect less ambitious consolidation strategy
	Debt sustainability	Neutral	0	Stabilisation 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

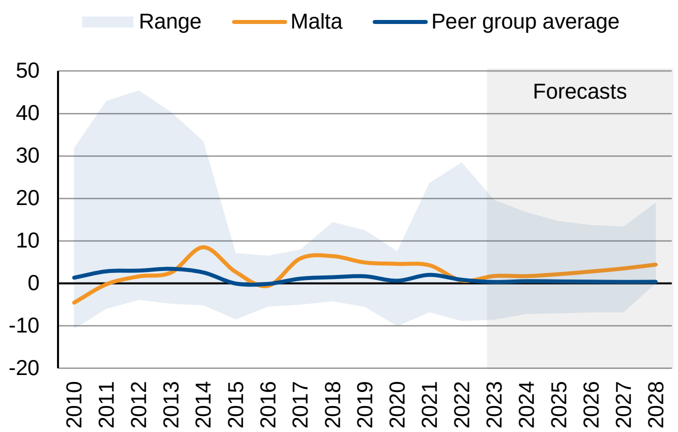
External Economic Risks

- **Current account:** The current account balance turned to a deficit of 2.7% at end 2022, from a 1.2% of GDP surplus at end-2021 due to a deterioration in the goods balance amid weak external demand, higher net outflows from the primary and secondary income and rising import prices. However, export services recovered strongly driven by the transport and tourism sectors. In Q1 2023 the number of inbound tourists surpassed the level recorded in Q1 2019 by around 4%. We expect the current account to improve and return to a surplus in coming years as the fiscal position strengthens, energy prices normalise further and export performance recovers.
- **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 60% of GDP and deteriorated to 42% of GDP in Q3 2022. Large gross liabilities and assets could present some risks, but most of the country's liabilities are direct investments, and the large external creditor position helps mitigate risks related to the volatility of financial flows and investment returns in a context of high inflation and uncertainty of interest rates. External debt declined to 555% of GDP in Q1 2023 from 620% of GDP at end-2021. The majority (76.4%) of the external debt is associated with liabilities of offshore financial institutions that have minimal connections to the economy and are generally offset by assets. The government and central bank's share of the total external debt is only 1.4% and 0.4%, respectively, as of March 2023.
- **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 and sizable gross external liabilities. However, the country's high dependence on domestic funding for government and core domestic banks limit financial spillovers. 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*

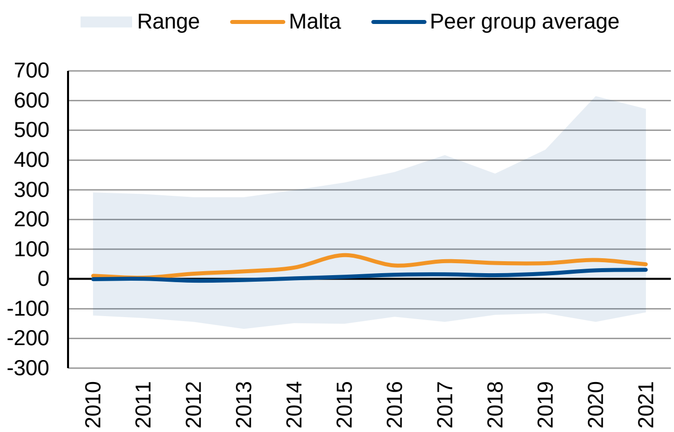
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Current account resilience	Neutral	0	Small open economy exposed to current account volatility; current account surpluses underpinned by competitive export sectors
	External debt structure	Neutral	0	Large external liabilities 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

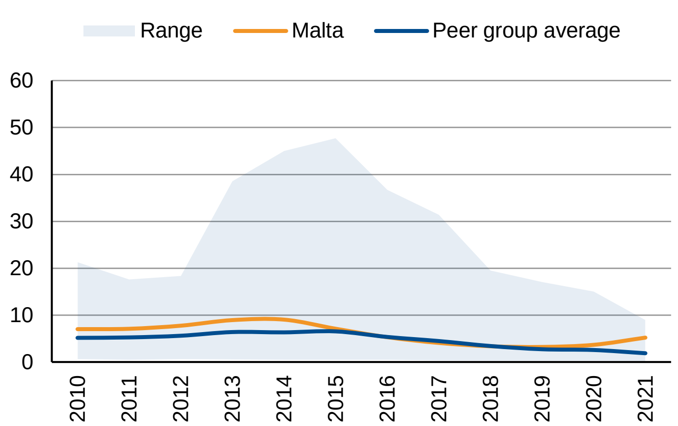
Financial Stability Risks

- **Banking sector:** Malta's banking sector has been resilient in the current global macroeconomic environment. Banks remain well-capitalised with a Tier 1 ratio at 19.1% as of March 2023. Profitability benefits from higher interest and non-interest income, as well as from a recovery in provisions. EBA data show an improvement in ROA to 0.8% in Q1 2023 from 0.3% one year earlier, while ROE increased to 4.1% in Q4 2022 after a decline to -4.2% in Q1 2022. Still, profitability remains below peers, mainly due to a one-off litigation cost for one domestic core bank occurred in the first half of 2022. The NPL ratio continued to decline to 2.4% in Q1 2023, from 3.2% in Q1 2022, while liquidity coverage ratios improved substantially and reached 426% in Q1 2023. Stress testing by the Central Bank of Malta confirmed the solid capital and liquidity positions of the Maltese banking system overall but highlighted potential risks stemming from further inflationary pressures and interest rate hikes, which could affect borrowers' repayment capabilities and eventually lead to asset quality deterioration.
- **Private debt:** Unconsolidated private debt is elevated compared to euro area peer countries, at 180% of GDP in Q1 2023, versus an EU average of 141%, according to ECB data. This is due in part to Malta's status as a financial hub. However, at 129% of GDP in 2021, consolidated private debt is below the euro area average of 134%, 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 debt has declined in recent years and stands at the lowest level since year-end 2007.
- **Financial imbalances:** Growth in house prices has picked up in recent months, averaging 6.6% year-on-year in the four quarters to Q1 2023, versus 5.6% in the four quarters to Q1 2022, on the back of fiscal support, tax incentives towards the real estate sector, and the sharp increase in construction costs. Higher mortgage lending and loan exposure to real estate companies also played a role and led to higher concentration in banks' loan book and higher households' leverage. To effectively address potential risks from excessive credit growth, the Central Bank of Malta introduced a sectoral systemic risk buffer targeting mortgage loans and complementing borrower-based measures including loan-to-value and debt-service limits.

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

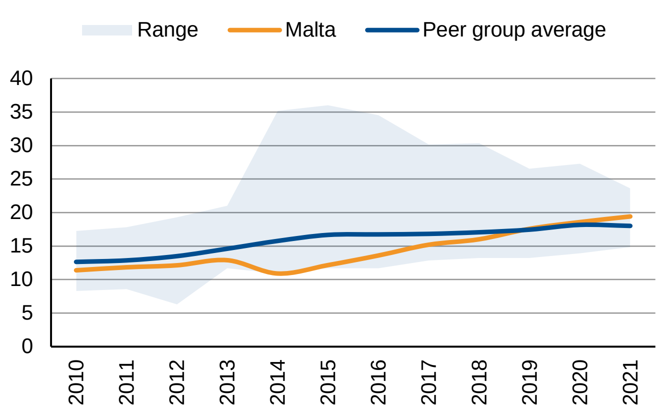
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Profitable and adequately capitalised banking sector
	Banking sector oversight	Neutral	0	Historical shortcomings in supervision though reforms to enhance oversight have been adopted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

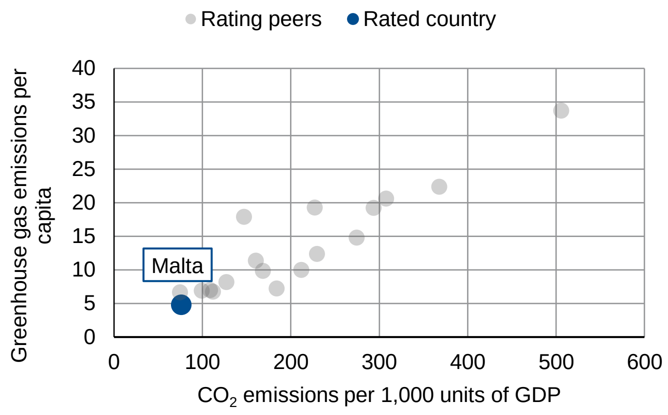
ESG Risks

- **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. The share of renewables in the country's gross final energy consumption was only 12% in 2021, versus 22% in the EU. Malta's Recovery and Resilience plan will contribute to its green transition, with 54% of the plan supporting climate and environmental objectives. This will be complemented by the National Strategy for Environment 2050, aimed at improving environmental quality, protect freshwater availability, and streamline waste and land resource management. As a small island-state that imports many of its goods and virtually all its energy, Malta is significantly exposed to resource risks.
- **Social:** Malta performs relatively well in terms of social outcomes, good employment prospects, strong medical care systems and low poverty, though some segments of the population face social inclusion challenges. 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*

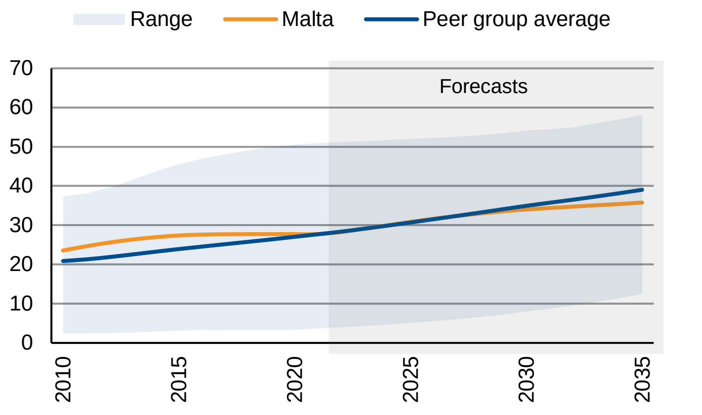
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Environmental factors	Neutral	0	Low carbon emissions per capita; mitigation costs are high and emissions are set to increase
	Social factors	Neutral	0	Adverse demographics and skill mismatches; stronger employment dynamics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

Emissions per GDP and per capita, $mtCO_2e$



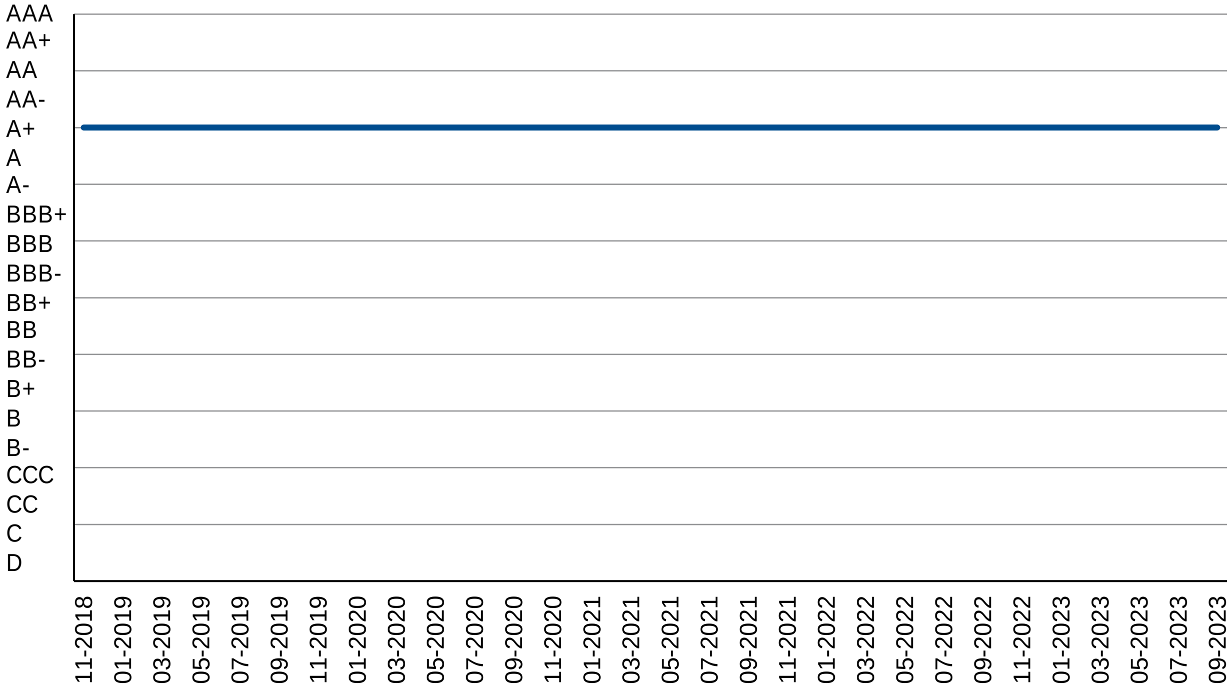
Source: European Commission, Scope Ratings

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
Cyprus
Czech Republic
Estonia
France
Japan
Lithuania
Portugal
Slovenia
United Kingdom
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	2018	2019	2020	2021	2022
Domestic Economic	**GDP per capita, USD '000s**	IMF	32.2	32.2	29.2	34.4	34.1
	Nominal GDP, USD bn	IMF	15.3	15.9	15.0	17.8	17.8
	Real growth, %	IMF	6.2	7.0	-8.6	11.8	6.9
	CPI inflation, %	IMF	1.7	1.5	0.8	0.7	6.1
	Unemployment rate, %	WB	3.7	3.6	4.4	3.5	2.8
Public Finance	**Public debt, % of GDP**	IMF	43.7	40.3	52.9	55.1	55.8
	Net interest payment, % of revenue	IMF	4.0	3.6	3.6	3.1	3.0
	Primary balance, % of GDP	IMF	3.6	1.9	-8.0	-6.4	-4.2
External Economic	**Current-account balance, % of GDP**	IMF	6.4	4.9	4.6	4.3	0.7
	Total reserves, months of imports	WB	0.4	0.3	0.3	0.4	0.4
	NIIP, % of GDP	IMF	53.8	53.1	64.0	49.5	-
Financial Stability	**NPL ratio, % of total loans**	IMF	3.4	3.2	3.7	5.2	3.7
	Tier 1 ratio, % of risk-weighted assets	IMF	15.2	15.8	17.3	18.3	19.1
	Credit to the private sector, % of GDP	WB	73.0	71.5	81.9	76.1	-
ESG	**CO_2 per EUR 1,000 of GDP, $mtCO_2e$**	EC	74.6	75.1	77.4	76.1	-
	Income share of bottom 50%, %	WID	20.4	19.6	19.8	19.8	-
	Labour-force participation rate, %	WB	74.9	75.9	77.1	77.8	-
	Old-age dependency ratio, %	UN	27.7	27.7	27.7	27.7	28.2
	Composite governance indicators*	WB	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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