INTERNATIONAL MONETARY FUND

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MALTA

2020 ARTICLE IV CONSULTATION—PRESS RELEASE AND STAFF REPORT

April 2020

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2020 Article IV consultation with Malta, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 30, 2020 consideration of the staff report that concluded the Article IV consultation with Malta.
- A **Staff Supplement** updating information on recent developments.
- The **Staff Report** was prepared by a staff team of the IMF for the Executive Board's consideration on lapse of time bases. The staff report reflects discussions with the Maltese authorities in February 2020 and is based on the information available as of February 28, 2020. It focuses on Malta's near and medium-term challenges and policy priorities and was prepared before COVID-19 became a global pandemic and resulted in unprecedented strains in global trade, commodity and financial markets. It, therefore, does not reflect the implications of these developments and related policy priorities. The outbreak has greatly amplified uncertainty and downside risks around the outlook. Staff is closely monitoring the situation and will continue to work on assessing its impact and the related policy response in Malta and globally.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR20/141

IMF Executive Board Concludes 2020 Article IV Consultation with Malta

FOR IMMEDIATE RELEASE

WASHINGTON, DC – April 9, 2020

The Staff Report was prepared by a staff team of the IMF for the Executive Board's consideration on April 8, 2020. The staff report reflects discussions with the Maltese authorities in February 2020 and is based on the information available as of February 28, 2020. It focuses on Malta's near and medium-term challenges and policy priorities and was prepared before COVID-19 became a global pandemic and resulted in unprecedented strains in global trade, commodity and financial markets. It, therefore, does not reflect the implications of these developments and related policy priorities. The outbreak has greatly amplified uncertainty and downside risks around the outlook. Staff is closely monitoring the situation and will continue to work on assessing its impact and the related policy response in Malta and globally.

On April 8, 2020 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Malta and considered and endorsed the staff appraisal without a meeting on a lapse-of-time basis.[2]

Malta is facing significant challenges owing to the recent COVID-19 outbreak. Entire sections of the Maltese economy, especially in the services sector, are forced to operate well below normal capacity due to reduced labor supply and administrative closures. Sectors related to tourism and transportation, which provide major sources of income for the Maltese people, are especially affected. The authorities' near-term efforts are rightly focused on limiting and containing the adverse social and economic effects of the COVID-19 outbreak.

In light of recent developments, the risk to the outlook is undoubtedly skewed to the downside and the extent of the downturn will depend on how long normal economic activity is subject to pervasive disruptions related to the COVID-19 pandemic. Malta's main medium-term challenge is to mitigate financial integrity risks by continuing to address deficiencies identified in the anti-money laundering and combating the financing of terrorism (AML/CFT) framework. The focus should be on improving and demonstrating the effectiveness of the AML/CFT regime.

Executive Board Assessment

In concluding the Article IV consultation with Malta, Executive Directors endorsed the staff's appraisal as follows:

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

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The Maltese economy has continued to overperform European peers. Prudent fiscal policy and timely structural reforms have helped boost employment and build fiscal buffers while promoting social inclusion. Growth remained strong in 2019, even though it weakened from 2018. Domestic demand is expected to remain the main engine of growth as the economy gradually reaches cruising speed and the large current account surplus declines. The risks to the outlook are skewed to the downside and a lot will depend on how pervasive and long-lasting disruptions related to the Coronavirus epidemic will be.

Continued efforts are needed to mitigate financial integrity and stability risks. As pressures on CBRs intensify, it is critically important to continue to address deficiencies identified with the AML/CFT system. The focus should be on improving and demonstrating effectiveness of the AML/CFT framework. In particular, the understanding of risks and the monitoring and supervision of banks and other higher-risk sectors and programs—such as remote gaming, VFAs, and the IIP—should continue to be strengthened. It is also key to enhance AML/CFT enforcement actions, including through timely and adequate sanctions in case of breaches.

Supervisory capacity should be further enhanced and remaining deficiencies in the crisis management framework addressed. The operational and financial independence of the financial supervisor should be assured. Despite commendable progress, the MFSA remains under strain due to the large number of financial institutions under supervision, the evolving regulatory environment, and challenges associated with new and complex products. The legal framework for bank insolvency should also be updated and streamlined. An administrative regime for the orderly closure and liquidation of a failing bank should be introduced to avoid that supervisory actions are unduly delayed through judicial appeal.

Further improving the analysis of potential risks developing outside of the banking sector will help uphold financial stability. Inter-company lending is gradually displacing bank lending as the main source of corporate funding, posing new challenges to supervision. A better understanding of the flow of funds between corporates and of their risk-management practices could help identify potential financial risks and contagion channels to the financial system. In the meanwhile, it is important to avoid over-exposure to large, indebted and interconnected corporates and to monitor developments on the housing market, standing ready to tighten the recently introduced borrower-based macroprudential measures in due course.

Prudent fiscal policy needs to be maintained. Maintaining gradual consolidation excluding the proceeds from the IIP is warranted due to fiscal vulnerabilities from contingent liabilities, age-related spending pressures, and heavy reliance on corporate income tax revenues Current-expenditure also needs to be kept in check to ensure enough space within the budget limits for necessary public investment in transport, health, education, the environment and additional expenses targeted at improving social inclusion.

Further enhancing public investment management and reducing fiscal risk should be key priorities. As public investment rises, enhancing its management is critical. Efforts should focus on adopting general guidelines for project appraisal and selection, implementing cost-benefit analysis for major projects and addressing weaknesses in the public procurement system. Continued efforts are also needed to further reduce fiscal risks. The new legal framework for managing government guarantees should be implemented, ongoing work to release statements on financial performance of public corporations should be completed, and sound strategies to put financially vulnerable public corporations on a stronger footing need to be adopted. To address long-term age-related spending pressures, measures that increase the effective retirement age and further encourage enrollment in voluntary savings schemes should be prioritized, while the institutionalization of the CSRs should be completed. Finally, to diminish Malta's potential vulnerability to international taxation regime changes, options to strengthen and diversify revenues outside of CIT should be explored.

Pursuing structural reforms will help sustain Malta's growth performance while promoting social inclusion. The focus should continue to be on encouraging female and elderly participation in the labor market, upskilling the labor force and stimulating innovation. Moreover, to safeguard the business climate, remaining governance shortcomings should be addressed without delay, including by stepping up the fight against corruption and by increasing the efficiency of the judicial system while ensuring its independence. Improving access to affordable housing remains a key priority in support of greater inclusion.