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REPUBLIC OF MALTA	Assigned Ratings/Outlook: <b>A+ /stable</b>	Type: Monitoring, Unsolicited with participation
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	25-11-2016 11-11-2022 "Sovereign Ratings" "Rating Criteria and Definitions"

## Rating Action

Neuss, 11 November 2022

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of "A+" for the Republic of Malta. Creditreform Rating has also affirmed Malta's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "A+". The outlook is stable.

## Key Rating Drivers

1. Robust economic growth in the first half of 2022 on the heels of last year's strong GDP rebound, also backed by recovering tourism, likely to be followed by moderation in the near term; downside risks from war in Ukraine mainly via higher prices for commodities and dependency on external demand, but fiscal support should soften the adverse effects, and a higher degree of diversification in service exports provides some counterweight
2. Medium-term growth outlook remains supported by envisaged measures to drive the twin transition (green and digital) and enhance social inclusion as per the Recovery and Resilience Plan, and mainly financed by EU-level funding; improvements regarding the business environment to be monitored
3. Latest update of World Bank Governance Indicators confirms some further room for improvement regarding the generally strong institutional set-up; Malta's removal from the Financial Action Task Force's (FATF) grey list earlier this year underscores authorities' firm commitment to strengthening the AML/CFT framework; we will monitor decisions by the European Court of Justice pertaining to Malta's Citizenship by Investment program
4. Public debt ratio unlikely to improve in the medium term, but expected to move at a comparatively moderate level in the European context; additional fiscal support to alleviate the burden from higher commodity prices is likely to slow reduction of the headline deficit over the next few years; although set to become less favorable, debt affordability should remain a mitigating factor in the medium term; agreed reorganization of international corporate taxation and any potential changes to the Maltese investor citizenship scheme could entail adverse effects on fiscal revenue
5. Dependency on energy imports and high commodity prices likely pushes back timing of the current account balance returning to a surplus, despite improving situation of tourism amid ebbing pandemic threats; highly positive net international investment position to continue to provide some buffer against external vulnerabilities coming with status as a

### Contents

Rating Action .....	1
Key Rating Drivers .....	1
Reasons for the Rating Decision and Latest Developments .....	2
Macroeconomic Performance .....	2
Institutional Structure .....	5
Fiscal Sustainability .....	7
Foreign Exposure .....	9
Rating Outlook and Sensitivity .....	10
Analysts .....	10
Ratings* .....	11
ESG Factors .....	11
Economic Data .....	12
Appendix .....	13

very open economy and international business and financial hub; the agreed international corporate tax framework may cause some fluctuation in this respect

### Reasons for the Rating Decision and Latest Developments<sup>1</sup>

#### Macroeconomic Performance

*A strong economic growth record prior to the corona crisis and a material recovery following the most acute phase of the pandemic have translated into high and rising per capita income. Coupled with somewhat more diversified service exports and fiscal support adding to the resilience of the labor market, these factors underpin our positive assessment of Malta's macroeconomic performance profile. While the recovery in the tourism sector still has some way to go to reach pre-pandemic levels, subject to some remaining uncertainty around possible new virus strains, tourism should contribute to an overall constructive outlook in the medium term. Structural reforms and initiatives around the digital and green transformation, and social inclusion as set out in the Recovery and Resilience Plan (RRP), also back constructive medium-term growth perspectives, flanked by efforts to improve the business environment. Apart from Malta's dependency on energy imports, we will monitor the impact of upcoming changes to international corporate taxation on medium-term growth, as well as developments around household indebtedness in connection with vivid mortgage lending and dynamic house price developments.*

Malta's credit rating is supported by a comparatively high income level, which in terms of GDP per capita increased to about USD 50,005 in 2021 (+1.9% vs. 2019, IMF data, PPP), following a considerable drop in 2020, thus well exceeding the median level of our A-rated sovereigns (2021: USD 41,838). Having displayed stronger average real GDP growth than the euro area (EA) as a whole over the years 2015-19, the pandemic hit Malta as a popular tourist destination hard in 2020, compounded by relatively strict social distancing requirements. However, swift and extensive government support, eventual removal of the containment measures, and re-opening to international tourists alongside a high Covid-19 vaccination rate enabled a strong economic rebound in 2021, lifting real GDP (s.a., c.a., chain-linked) above its pre-pandemic level in last year's final quarter.

Over the whole of 2021, total economic output grew by 10.3% (2020: -8.3%), with gross fixed capital formation (3.7 p.p.) and private consumption (3.3 p.p.) constituting major contributors, added to by net exports (2.4 p.p.) and government consumption (1.4 p.p.). Last year's very strong increase in gross fixed capital formation (+17.3%, 2020: -7.7%) was boosted by a massive rise in investment in machinery and equipment on the back of a base effect from exceptional investment in the aviation sector.

The recovery continued well into the present year, with Q1- and Q2-22 recording robust real GDP growth rates (1.0% and 0.8% q-o-q, s.a., c.a., chain-linked), despite increasing headwinds linked to Russia's war against Ukraine as well as to China's anti-Covid-19 regime adding to supply bottlenecks. While Malta's direct trade exposure to Russia and Ukraine is limited, it is highly

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<sup>1</sup> This rating update takes into account information available until 04 November 2022.

dependent on imported energy, receiving e.g. most of its electricity supply from Italy, with Italy in turn being forced to reduce its relatively high share of gas imports from Russia.

While the geopolitical and the related external economic backdrop has been worsening, tourism is becoming a stabilizing pillar, with pandemic-related risks appearing more remote lately, albeit not entirely eliminated. In 2021, the number of inbound tourists reached about 968,000 (35.2% of the 2019 number), corresponding to an increase of 47.0% compared to 2020 (NSO data). During the first seven months of 2022, the number of inbound tourists recovered further, reaching approximately 1.169mn or 77.3% of the 2019 level over a corresponding period on the back of lifted pandemic restrictions and the regained confidence of travelers amid vaccination progress. Total tourist expenditure over the first eight months more than tripled compared to the same period in 2021, while falling short of the corresponding period in 2019 by about 14.1%. We note that the government harbors somewhat cautious expectations for the near future, assuming inbound tourism to surpass 85% of 2019 levels in 2023 (Draft Budgetary Plan 2023, DBP23) and to catch up with the pre-pandemic level by 2025.

Apart from tourism, Malta's economic structure, which comes with a comparatively high significance (gross value added) of the ICT sector, financial services as well as remote gaming, which have continued to outperform over recent quarters, should prove conducive to stabilizing economic development. In particular regarding remote gaming, Malta's tapping into new markets could prove beneficial. While some of its European export destinations are more exposed to Russian energy commodities, causing some downside risks to Malta's economic output via the external channel, the domestic economy is also not immune, as upward pressure on commodity prices is affecting consumer prices and pushing up input costs for producers, thus bearing down on consumer confidence and business climate.

In October 2022, the inflation rate (HICP) continued to climb to 7.5%, with food and non-alcoholic beverages as major drivers. The government's intervention in the energy price market is putting a lid on energy prices through wholesale price regulation, with the government compensating for losses incurred at largely state-owned (67%) Enemalta.

Even though cost pressure is likely to weigh on private consumption, we nevertheless expect household expenditure to continue to represent a vital pillar to economic output expansion this year and next as the government continues to mitigate the burden of higher energy and food prices. According to the Ministry of Finance (MoF), energy price support measures in 2022 will exceed EUR 390mn. For 2023, roughly EUR 608mn in government support is to be put towards subsidizing energy and food (see below). While real wages are likely to decrease for the time being, given current consumer price developments, the labor market continues to remain tight, underpinning upward pressure on wages with a view to the upcoming negotiating rounds for 2023.

Labor market conditions remain a supportive factor. Malta's average annual unemployment rate fell to an all-time low of 3.4% in 2021, having gone up in the first year of the pandemic (2020). More recently, looking at monthly data, it stood at 3.0% as of September 2022 (Eurostat, s.a.). Employment growth, after years of strong performance, also continued over the pandemic phase, albeit at a more moderate pace compared to the years prior to the outbreak of coronavirus, but remained well above rates recorded in the euro area as a whole (2021: +2.9%, EA: 1.3%, Eurostat data, domestic concept). Since 2018, Malta's labor participation rate has exceeded the euro area's, climbing further to 80.3% as of Q2-22 (EA: 74.7%, s.a., not c.a.).

Skill shortages remain a pressing issue, judging by recent survey results (European Commission, EC), especially in Malta's vital service sector, and could ultimately restrain economic growth to some extent. Looking at remaining structural challenges concerning the labor market, the relatively high share of low-skilled workers by EU comparison is being addressed with the RRP and the government's active labor market policies.

Employment expectations in the service sector have ebbed somewhat over the last few months, but they generally point towards positive hiring intentions. Although businesses may become more hesitant to invest against the backdrop of heightened economic uncertainty and less favorable financial market conditions amid monetary policy tightening, we deem key service industries in Malta to be comparatively resilient to some of the current geopolitical risks. To be sure, following an exceptional increase in the transport sector in 2021, overall gross fixed capital formation will likely decline in 2022, dragged down by the base effect. Nevertheless, we continue to see fixed investment supported by the Recovery and Resilience Facility (RRF) funds Malta is set to receive until 2026, amounting to EUR 258.3mn. Moreover, Malta is allocated EUR 838mn (5.7% of 2021 GDP) of Cohesion Funds.

In particular, given Malta's high emphasis on the abovementioned export-oriented services (ICT, financial services, gaming) and partly flanked by recovering tourism, net exports should make a positive growth contribution this year and next, notwithstanding an otherwise deteriorating export outlook amid the weakening economic performance of key European trade partners. Service exports expanded by 10.4% y-o-y in the first half of 2022, chiefly driven by rebounding travel exports as well as further increases in cultural and recreational services (9.3% y-o-y). The positive net balance of goods and services combined saw an increase of 46.5% in HY1-22 vs. HY1-21 (Eurostat, BoP data).

At the current juncture, we expect Malta's real GDP to rise by about 6.1% this year, benefiting from strong carry-over effects to the tune of 4.2 p.p. Assuming a weaker growth profile over the turn of the year, GDP growth should roughly halve to about 3.0% in 2023. However, economic activity is likely to accelerate in the second half of 2023, as consumer prices could moderate, while tourism should further recover.

Over the medium term, growth prospects in our view remain positive against the backdrop of the RRP and ongoing commitment to foster the green and digital transformations, as well as social inclusion. With efforts to meet the agreed milestones and targets under way, we gather that a first RRF payment request could be made this fall, with a second payment request currently foreseen for the end of Q2-23 (DBP23).

With a relatively strong 6th rank among the EU members as regards the EC's 2022 Digital Society and Economy Index, fostering the digital transformation seems to build on a favorable basis. Initiatives to foster the digital presence of and absorb available funding to micro enterprises and SMEs, such as through Tech.mt in 2021, may serve as examples for ongoing advancements in terms of digitalization.

Social (micro) enterprises are to be supported by the envisaged extension of the Micro Invest scheme, making them eligible for tax credit of up to EUR 70,000 and over a 3-year period (Budget 2023). Malta's potential growth, estimated to climb to 3.7% in 2022 and 3.8% in 2023 following a marked slowdown in the most acute pandemic phase (avg. 2015-2019: 6.5%, EA: 1.2%, AMECO data) looks set to be driven primarily by the labor share in the near term.

Some challenges continue to relate to a relatively low level of R&D expenditure (all sectors, GERD), which at 0.7% of GDP in 2020 was still well behind respective ratios registered for the euro area as a whole (2.4% of GDP, Eurostat data). In the same vein, Malta is perceived as a moderate innovator among the EU countries, with the gap to the EU having become larger according to the 2022 European Innovation Scoreboard (EC). This said, the Smart Specialization Strategy, which is work in progress, addresses this issue. Moreover, the Budget 2023 foresees investments in research and innovation through the new Technology Extension Support program.

Looking at the country's competitive stance from a cost perspective, we note that real unit labor costs have developed somewhat unfavorably over the last few years when compared against main European trade partners and the euro area as a whole. However, any adverse effects seem to have been limited so far, judging by Malta's relatively stable global export market share over recent years. Rather, the share in global service exports has edged up since the pandemic, stabilizing at 0.32% in 2021 compared to the preceding year (2019: 0.28%, Eurostat).

As suggested by indicators included e.g. in the Global Competitiveness Report provided by the World Economic Forum, Malta's business environment leaves scope for improvement. We will thus follow developments around announced reform proposals (Oct-22) pertaining to the Maltese insolvency framework, which may include an early detection system, a training strategy for insolvency practitioners and an overhaul of the insolvency process including timeframes. With its Budget 2023, the government announced the launch of a 'one-stop-shop' to assist business start-ups for 2023. We generally view Malta's removal from the Financial Action Task Force's (FATF) grey list earlier this year (see below) as beneficial in terms of its attractiveness as a target for foreign direct investments.

We note that private sector debt has increased recently, in particular household debt on the back of a higher volume of loans for house purchases. Given a comparatively high share of mortgage loans in total outstanding loans to the private sector (Aug-22: 57.6%) when set against other EU countries, and given that mortgages subject to variable interest rates are dominating, we would pay some attention to developments here in the context of monetary policy tightening (see below).

While ultimately not appearing excessive by European comparison, household debt-to-disposable income increased to 86.6% as of Mar-22 (Central Bank of Malta, CBoM data). Meanwhile, NFC debt-to-GDP stood at 76.2% as of Q2-22 (Eurostat, consolidated data), having fallen back to pre-pandemic levels following an intermediate increase in the ratio. With that, the NFC debt ratio moves in the middle range among EU countries.

Prospects regarding the implementation of the OECD International Tax agreement remain somewhat vague, not least as the timing for implementation seems to have been pushed back somewhat, but we would continue to flag some possible downside risks related to the reorganization of international corporate taxation given Malta's status as a financial and business hub.

#### Institutional Structure

*Malta's credit ratings reflect its generally strong institutional framework, which is further buttressed by significant advantages linked to the small open economy's EU/EMU membership, including access to the large single market and EU funding bolstering the twin transition. The latest set of the World*

*Bank's Worldwide Governance Indicators (WGI) points to room for improvement, while Malta's removal by FATF from the 'grey list' of countries subject to the FATF's increased monitoring process underscores a firm commitment to enhancing the quality of governance. We continue to follow developments over controversy with the European Commission on the issue of Malta's Citizenship by Investment program, over which the EU has referred Malta to the European Court of Justice.*

Picking up on the latest vintage of WGIs, relating to the year 2021, we observe that with regard to the four pillars on which we put the highest emphasis when assessing the sovereign's institutional quality, Malta's relative ranks remained rather stable when compared to the preceding year. This holds for the WGIs 'voice and accountability' (relative rank 34 out of 209 economies), 'control of corruption' (74 out of 209) and 'rule of law' (rank 47 out of 209). As far as 'government effectiveness' is concerned, the sovereign slipped by 8 ranks to relative rank 47 out of 209. Compared to the median of the euro area members, Malta thus continues to be perceived as underperforming, while it remains somewhat more in line with the median of our A-rated sovereigns.

That said, we view as positive the considerable headway made in terms of strengthening its AML/CFT framework as reflected by FATF's assessment and subsequent decision that Malta should no longer be subject to the enhanced supervisory procedure, pointing to timely and decisive action on the part of the Maltese authorities following last year's (Jun-21) placement on the grey list. The decision should prove conducive to at least limiting any reputational damage, also regarding relations with (potential) correspondent banks. We also draw on the EC's Jul-22 Rule of law report, which testifies to some progress with regard to reforms of the Maltese justice system and the framework on anti-fraud and corruption, while the report highlights that some challenges related to these issues remain to be tackled.

The general election held in March 2022 yielded an outright majority to the incumbent labor party, which obtained 38 of the unicameral 67-seat House of Representatives. The nationalist party won the remaining 29 seats, highlighting that the political system remains largely dominated by the two parties at this stage. While for the first time citizens from the age of 16 were allowed to vote, the turnout can be characterized as relatively low by Maltese standards, although at 85.5% very high in a European context. Owing to the leading party retaining its majority, coherent policy formulation thus looks likely, with ongoing effort to ensure implementation of the measures and initiatives entailed by the RRP.

In this context, key deliverables for 2023 involve stepping up recruitment to strengthen prosecution services, further enhancing the combat against corruption and some steps towards reducing the level of aggressive tax planning.

When it comes to greening the economy, major goals for 2023 include a reform of the waste collection system and contracting energy-efficient renovation of public buildings. Malta remains committed to achieving carbon neutrality by 2050 and aims to reduce greenhouse gas (GHG) emissions by 19% by 2030 (measured against 2005 levels). Electrification of the Maltese fleet within the next ten years thus remains a priority, with EUR 50.3mn of the RRP funds to be allocated for the uptake of electric vehicles in the private sector from 2022 to 2024. In 2023, 1,000 grants are foreseen to foster the purchase of electric vehicles in the private sector for this purpose.

By European comparison, Malta occupies one of the lower ranks with regard to the EC's Eco innovation index, and it displays the lowest overall share of renewable energy sources (2020: 10.7%, EU-27: 22.1%, Eurostat), arguably emphasizing vulnerabilities against price movements



of fossil energy, albeit partially mitigated through hedging agreements. In terms of energy security, a second electricity interconnector cable between Malta and Italy is planned to be commissioned by the end of 2025 (DBP23), with the project expected to provide more resilience to the electricity grid and facilitate accommodation of renewable energy generation on a larger scale in the future. We note, however, that Italy itself has been highly dependent on Russian gas imports.

#### Fiscal Sustainability

*Given the recent succession of crises and the associated fiscal support, which continues to weigh on Malta's public finances, Malta's public debt ratio remains above its pre-pandemic level and looks unlikely to decline over the medium term. Nevertheless, it compares as relatively moderate in the EU context. A favorable debt profile, a still high degree of debt affordability, as well as available EU funding, constitute ongoing risk-mitigating factors with regard to debt sustainability. While the sovereign's large banking sector seems resilient, we would pay attention to the further evolution of recently dynamic mortgage lending and health of loan portfolios given their significance for the sector. Uncertainty over revenue streams related to the Citizenship by Investment program poses and changes to international corporate taxation could pose some downside risks. More generally, the sovereign's relatively high dependence on corporate tax intake as a source of revenue comes with some vulnerability vis-a-vis economic shocks, and the estimated VAT gap compares as relatively high.*

Following a recent phase seeing Malta generate fiscal surpluses averaging 1.8% of GDP (2016-2019), the general government balance concluded the two years of Covid-19 crisis in deficit, with the negative balance shrinking from -9.4% of GDP in 2020 to -7.8% of GDP last year, despite relatively strong economic growth in 2021. Support measures to shield households and businesses against negative effects from the pandemic put a heavy burden on public finances, coming to about 4.8% of GDP last year (Pre-budget consultation document 2023).

Overall, total general government outlays rose by 9.4% in 2021, following an increase by 18.8% in the first year of the pandemic, which had largely been driven by subsidies. While the latter rose considerably less dramatically last year, government expenditure was to a larger degree boosted by higher public wages (+11.2%, 2020: +5.2%). Amid strong tax intake, headline revenue soared by 13.5% in 2021, with current taxes on income, wealth etc. mounting by 20.4%. Taxes on production and imports climbed by 13.1%.

Looking at budget execution data available for 2022, the headline balance seems on course for improvement, aided by further increasing economic output and at least less expenditure on pandemic issues. Positive developments on the revenue side continued, with total intake marking an increase by 11.7% y-o-y over the first nine months of the year (recurrent revenue data, NSO) on the back of rising VAT, income tax and social security contributions. Over the same period, expenditure rose by a mere 0.1% y-o-y. The Covid-19-related measures are expected to be reduced to 1.8% of GDP in the current year (MoF).

It seems worth pointing out that capital expenditure fell by 7.3% y-o-y in the first nine months of 2022, mostly due to lower expenditure on road construction and property, plant and equipment. Against this backdrop, public investment reaching 4.0% of GDP in 2022 (DBP23), which would exceed the average over the ten years to 2021 (3.4% of GDP), could seem somewhat ambitious.

With its Budget 2023, the government presented a near-term fiscal outlook focusing on shielding the private sector from adverse effects linked to the geopolitical tensions and resulting economic burden, in particular from higher energy prices. According to the Ministry of Finance, energy price support measures in 2022 are expected to exceed EUR 390mn and to mount to about EUR 630.5mn in 2023. Moreover, support to vulnerable households through social measures is expected to come to 0.4% of GDP in 2023 (DBP23). Further initiatives, benefiting businesses, involve e.g. a EUR 40mn fund for cash grants to SMEs and rent subsidies for eligible businesses. Uncertainty around the further evolution of the war in Ukraine and any potential further escalation remains high, constituting potential downside risks to the fiscal outcome, as more government support may be deemed necessary.

This notwithstanding, the government expressed its commitment to bringing public finances back on a sounder footing in the medium-term, aiming to reduce the deficit to below 3% of GDP in 2025. At this stage, we expect Malta to conclude 2022 with a headline deficit of about 5.3% of GDP, followed by a somewhat smaller negative balance of 4.7% in 2023. Apart from the uncertainties related to the situation in Ukraine, we would also recall some uncertainties pertaining to the investor citizenship program, for which the government has budgeted about EUR 42mn in revenue this year, followed by EUR 70mn in 2023 and EUR 55mn for 2024 and 2025, respectively (MoF data).

Amid the high deficit and despite last year's strong nominal growth, the public debt ratio climbed by 3.0 p.p. to 56.3% of GDP in 2021. As of Q2-22, it had decreased to 55.1% of GDP, continuing to compare as relatively moderate among the euro area members (EA 2021: 95.4% of GDP) and remaining below the 60% Maastricht threshold. Given our assumptions for nominal GDP and the general government balance this year and next, as well as prospective stock-flow adjustments, we expect Malta's debt level to edge up to about 57.2% of GDP in 2022 and further to 59.3% of GDP in 2023.

With regard to contingent liabilities, we note that public guarantees are expected to amount to 7.6% of GDP in 2022, decreasing somewhat to 7.3% of GDP in 2023 (DBP23). As of Jun-22, out of a maximum of contingent liabilities of 12.2% of GDP, 7.2% of GDP were estimated to have been taken up. While awaiting final figures, state aid to Air Malta could add to that. Moreover, public finances could be subject to further burden due to subsidies for Enemalta (see above).

Malta's comparatively large banking sector, assets of which totaled 298.1% of GDP in Q1-22 (Eurostat), has shown resilience during the pandemic. Metrics pertaining to the capitalization level and asset quality remain at relatively healthy levels, with the CET1 ratio posting at 18.0% as of Q2-22 (EU average: 15.2%, EBA data), and the NPL ratio declining to 2.6% in Q2-22 (EU: 1.8%, EBA data), constituting a multi-year low. Profitability as measured by return on assets turned negative again in Q2-22 after a brief episode in negative territory in 2020, but in light of rising interest rates against the backdrop of monetary policy tightening, prospects may be brighter.

Having raised its policy rates by another 75bp at its October meeting, lifting the total amount of increases to 200bp since the start of the rate tightening cycle this July, we assume that the ECB will hike its policy rates by another 50bp by the end of the year and continue with the somewhat slower pace in the first half of 2023. A shrinking of its accumulated asset purchases could start in 2023, but this issue will likely be discussed at the upcoming monetary policy meeting in December.



Amid the forceful monetary policy tightening by the ECB, we will pay heightened attention to developments around the housing market and mortgage lending, as well as respective loan portfolios in the banking sector, given that loans to households for house purchases accounted for close to 60% of banks' outstanding loans to the private sector as of Aug-22 (57.6%). Moreover, variable-rate mortgage loans have become increasingly dominant more recently. About three quarters of new mortgage loans were subject to a floating rate or initial rate fixed for up to one year as of Aug-22 (ECB data).

House prices have seen considerable increases since the middle of the last decade, with the annual growth rate posting at 7.7% and the 3-year rate of change standing at 17.9% in Q2-22, respectively (Eurostat data). To be sure, higher dynamics in the property market more recently could partly reflect some front-loading in light of tax relief schemes introduced during the more acute phase of the pandemic and repeatedly extended, most recently until the end of June 2023. Apart from that, we are aware that CBoM had introduced borrower-based measures to strengthen lenders' resilience in 2019. While the CBoM is monitoring the situation, the CCyB buffer rate currently remains at 0%.

Despite refinancing conditions on financial markets becoming less favorable due to central banks' hiking cycle, debt affordability still remains a mitigating factor in our assessment of fiscal risks, in combination with sound debt management. In 2021, interest outlays fell by a further 1.9%, amounting to 3.1% of total revenue (-0.5p.p. vs. 2020) or 1.1% of GDP. As of Sep-22, cumulative net purchases of Maltese government bonds under the ECB's discontinued PSPP and PEPP amounted to about EUR 2.02bn or about 13.8% of 2021 GDP.

In the longer term, fiscal pressure could rise on the back of unfavorable demographic developments and associated age-related costs. In this regard, the RRP foresees to address the sustainability of Malta's pension system, with measures expected to be adopted by the end of 2022.

#### Foreign Exposure

*The sovereign's high degree of openness and its status as a business and financial hub continue to render it susceptible to sudden changes in global growth and trade dynamics, as well as in capital flows. Some resulting volatility regarding respective statistics can thus complicate the assessment of underlying movements. The recent succession of crises is pushing back expectations of a return of the current account balance to its previous surplus position, while Malta's net international investment position (NIIP) remains one of the highest positive ones in the EU and provides some buffer to external vulnerabilities.*

The pandemic had driven Malta's current account balance into a deficit in 2020 on the back of collapsing tourism in the most acute phase of the corona crisis. While last year's economic recovery also came with some progress towards a normalization of tourist numbers, partly reflected in an increasing surplus in the services trade balance, the service surplus remained well below its pre-pandemic level. Rather, the marked widening in the goods trade balance (-6.1 p.p.) caused the current account deficit to become more pronounced in 2021 (-4.6% of GDP, 2020: -2.9% of GDP).

Looking at more recent developments including balance of payment data until Q2-22, improvements in the service balance have continued. Drawing on the four-quarter moving sum, the current account deficit narrowed somewhat to -4.1% of GDP as of Q2-22 (Eurostat, BoP data). Going forward, we expect the current account balance to remain in deficit in the near future,

assuming a narrowing tendency as energy prices and the related import prices begin to moderate at some point. Further recovery in tourism numbers should continue to improve the service balance.

Malta's highly positive NIIP, one of the highest among the EU members, widened slightly in terms of GDP in 2021, amounting to 52.8% of GDP (+1.8 p.p. vs. 2020). Both the direct investment and portfolio investment components, which are subject to some distortions due to the presence of special purpose entities, had experienced pronounced movements in the first year of the pandemic, which were largely reversed last year.

## Rating Outlook and Sensitivity

Our rating outlook on the Republic of Malta's long-term credit ratings is stable. Downside risks relate to economic fallout, including high energy prices from the war in Ukraine, uncertainty regarding a reversal in Malta's debt trend and – although less so – remaining risks associated with the development of the pandemic. However, these are more or less balanced by advancing macroeconomic resilience, progress regarding the perception of improving AML/CFT supervision, as well as an ultimately relatively moderate debt level and prudent fiscal policymaking.

We could consider raising the sovereign's ratings or outlook if, on the back of timely implemented reforms to increase the robustness of the economic model, high growth rates can be sustained over the medium term, enabling a swift return to a downward-sloping public debt ratio. A broadening tax base improving fiscal resilience could also have us consider a positive rating action. Sustainable improvements as regards the institutional framework would seem beneficial as well.

Conversely, a downward revision of our outlook and/or the ratings could be prompted if the deterioration in the sovereign's fiscal metrics becomes more entrenched, i.e. if we see continued and more pronounced increase in the public debt ratio. This could be the case if geopolitical tensions escalate further and associated negative effects on energy and other commodity prices require prolonged or larger-scale fiscal responses; or if, contrary to what we expect, Covid-related developments worsen substantially, once again affecting tourism to a larger extent. Set-backs with regard to revenue streams, e.g. linked to changing international corporate taxation and/or the Citizenship by Investment program, could also add to downward pressure on our outlook and/or ratings, as could reversing progress in governance.

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## Ratings\*

Long-term sovereign rating	A+ /stable
Foreign currency senior unsecured long-term debt	A+ /stable
Local currency senior unsecured long-term debt	A+ /stable

\*) Unsolicited

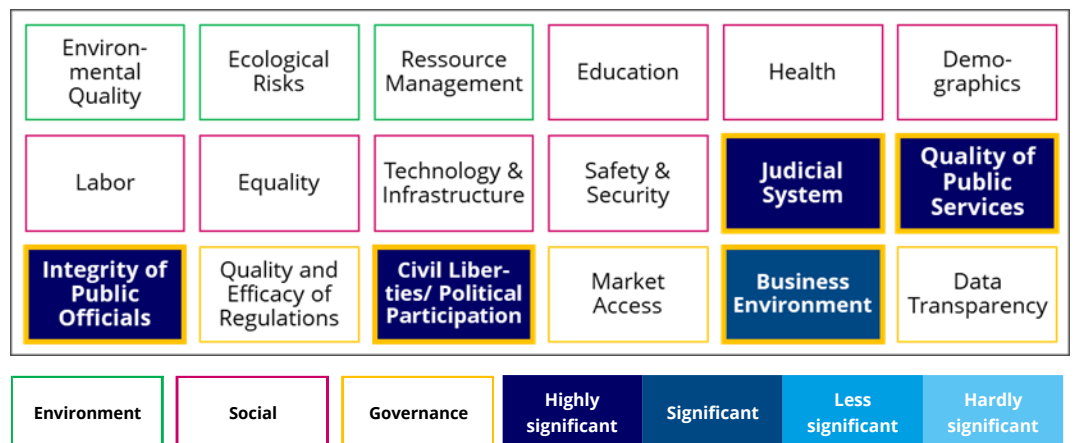
## ESG Factors

Creditreform Rating has signed the ESG in credit risk and ratings statement formulated within the framework of the UN Principles for Responsible Investment (UN PRI). The rating agency is thus committed to taking environmental and social factors as well as aspects of corporate governance into account in a targeted manner when assessing creditworthiness.

While there is no universal and commonly agreed typology or definition of environment, social, and governance (ESG) criteria, Creditreform Rating views ESG factors as an essential yardstick for assessing the sustainability of a state. Creditreform Rating thus takes account of ESG factors in its decision-making process before arriving at a sovereign credit rating. In the following, we explain how and to what degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor, and outline why these ESG factors were material to the credit rating or rating outlook.

For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and to Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down [key principles of the impact of ESG factors on credit ratings](#).

## ESG Factor Box



The governance dimension plays a pivotal role in forming our opinion on the creditworthiness of the sovereign. As the World Bank's Worldwide Governance Indicators Rule of Law, Government Effectiveness, Voice and Accountability, and Control of corruption have a material impact on Creditreform Rating's assessment of the sovereign's institutional set-up, which we regard as a key rating driver, we consider the ESG factors 'Judicial System and Property Rights', 'Quality of Public Services and Policies', 'Civil Liberties and Political Participation', and 'Integrity of Public Officials' as highly significant to the credit rating.

Since indicators relating to the assessment of a economy's competitive stance by e.g. the World Bank, the World Economic Forum, the European Commission, and IMD Business School add further input to our rating or adjustments thereof, we judge the ESG factor 'Business Environment' as significant.

While Covid-19 may have significant adverse effects on several components in our ESG factor framework in the medium to long term, it has not been visible in the relevant metrics we consider in the context of ESG factors – though it has a significant bearing concerning economic prospects and public finances. To be sure, we will follow ESG dynamics closely in this regard.

## Economic Data

[in %, otherwise noted]	2016	2017	2018	2019	2020	2021	2022e
<b>Macroeconomic Performance</b>							
Real GDP growth	3.4	10.9	6.2	5.9	-8.3	10.3	6.1
GDP per capita (PPP, USD)	40,137	44,884	47,211	49,058	43,658	50,005	56,338
Credit to the private sector/GDP	89.2	80.8	79.3	77.9	89.2	84.0	n/a
Unemployment rate	4.7	4.0	3.7	3.6	4.4	3.4	n/a
Real unit labor costs (index 2015=100)	104.2	101.6	103.0	104.1	114.3	109.6	109.5
World Competitiveness Ranking (rank)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Life expectancy at birth (years)	82.6	82.4	82.5	82.9	82.3	82.9	n/a
<b>Institutional Structure</b>							
WGI Rule of Law (score)	1.0	1.1	1.0	0.9	0.9	0.9	n/a
WGI Control of Corruption (score)	0.7	0.7	0.6	0.2	0.4	0.3	n/a
WGI Voice and Accountability (score)	1.2	1.2	1.1	1.1	1.1	1.1	n/a
WGI Government Effectiveness (score)	1.0	1.0	1.0	0.9	1.0	0.9	n/a
HICP inflation rate, y-o-y change	0.9	1.3	1.7	1.5	0.8	0.7	5.8
GHG emissions (tons of CO2 equivalent p.c.)	4.9	5.2	5.2	5.3	4.5	n/a	n/a
Default history (years since default)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Fiscal Sustainability</b>							
Fiscal balance/GDP	1.1	3.3	2.1	0.6	-9.4	-7.8	-5.3
General government gross debt/GDP	54.7	47.8	43.7	40.7	53.3	56.3	57.2
Interest/revenue	5.6	4.7	4.0	3.6	3.6	3.1	n/a
Debt/revenue	146.0	126.6	115.4	111.1	145.5	152.0	n/a
Total residual maturity of debt securities (years)	9.4	9.1	8.6	8.3	7.7	8.7	n/a
<b>Foreign exposure</b>							
Current account balance/GDP	-0.6	5.9	6.4	5.0	-2.9	-4.6	n/a
International reserves/imports	0.1	0.1	0.2	0.1	0.2	0.2	n/a
NIIP/GDP	47.8	56.6	55.5	53.5	51.0	52.8	n/a
External debt/GDP	822.6	751.2	678.5	623.5	677.1	633.5	n/a

Sources: IMF, World Bank, Eurostat, AMECO, ECB, NSO, MoF, own estimates

## Appendix

### Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	25.11.2016	A+ /stable
Monitoring	24.11.2017	A+ /stable
Monitoring	23.11.2018	A+ /stable
Monitoring	22.11.2019	A+ /positive
Monitoring	22.05.2020	A+ /stable
Monitoring	20.11.2020	A+ /stable
Monitoring	12.11.2021	A+ /stable
Monitoring	11.11.2022	A+ /stable

### Regulatory Requirements

In 2011 Creditreform Rating AG (CRA) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation. The rating was not endorsed by Creditreform Rating AG from a third country as defined in Article 4 (3) of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. Malta's Ministry for Finance participated in the credit rating process as the authorities provided additional data and information and held a conference call with Creditreform Rating staff. Moreover, authorities commented on a draft version of the report. Thus, this report represents an update version, which was augmented in response to the factual remarks of MoF during their review. However, the rating outcome as well as the rating outlook remained unchanged.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	YES
With Access to Internal Documents	YES
With Access to Management	YES

The rating was conducted on the basis of CRA's ["Sovereign Ratings" methodology](#) (v1.2, July 2016) in conjunction with its basic document ["Rating Criteria and Definitions"](#) (v1.3, January 2018). CRA ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRA's rating methodologies and basic document "Rating Criteria and Definitions" is published on our [website](#).

To prepare this credit rating, CRA has used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, IMD Business School, European Center for Disease Prevention and Control (ECDC), Blavatnik School of Government, Central Bank of Malta, National Statistics Office

Malta, Ministry for Finance Malta, Malta Fiscal Advisory Council, Malta Gaming Authority, FIAU, UNWTO.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG's "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: <https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>.

An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

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