Creditreform Sovereign Rating

Creditreform Rating

Rating Object	Rating Information	
REPUBLIC OF MALTA	Assigned Ratings/Outlook: **A+ /stable**	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 20-10-2023 "Sovereign Ratings" "Rating Criteria and Definitions"

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Rating Action

Neuss, 20 October 2023

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. Strong expansion of GDP per capita in 2022 and relatively robust real GDP growth in the first half of 2023, the latter buttressed by a recovering tourism industry and a firm response by the authorities to rising energy prices; despite an increasingly diversified services sector, we still expect real economic activity to slow down this year in light of weaker external demand and tight monetary policy
2. Constructive medium-term growth perspectives, backed by sound labor market conditions and the planned implementation of structural reforms and investments in the context of the Recovery and Resilience Plan (RRP); low R&D expenditure and shortages of skilled labor are to be monitored, while Malta's significant dependence on energy imports could act as a drag on economic growth
3. Benefits related to EU/EMU membership enhance Malta's generally strong institutional set-up; efficiency gaps in the justice system and challenges pertaining to control of corruption, as corroborated by the recent publication of the World Bank's Worldwide Governance Indicators (WGI)
4. Risks to fiscal sustainability are mitigated by the sovereign's moderate public debt levels, its favorable maturity profile, and still affordable debt; we expect the headline deficit to remain pronounced and the general government debt ratio to rise somewhat over the medium term, although remaining still moderate by euro area standards; imminent changes in global corporate taxation entail uncertainty about potential tax revenue losses, calling for continuous monitoring; while the activation of macroprudential tools should provide further stability to the banking sector, developments in mortgage loans need to be followed closely
5. Track record of very high, positive net international investment positions (NIIP), which will need to be monitored closely, has contributed to the accumulation of external buffers, mitigating risks stemming from the recent deterioration in the current account balance and

related to the small size and high degree of openness of the economy; we expect Malta's current account deficit to narrow this year and turn positive over the medium term, given the normalization of tourism to pre-pandemic levels and the deceleration of energy prices, although this improvement could be delayed if energy prices were to rise again

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

Our credit assessment reflects the sovereign's overall strong macroeconomic profile, with high and rising per capita income levels and a favorable digital ecosystem. While Malta's economic structure is characterized by a high degree of service orientation, we note that its service sector features an increasingly diversified base, notably including tourism, ICT, gaming and financial and insurance activities. The tourism sector is on track to reach pre-pandemic levels in terms of inbound tourists, overnight stays and expenditure this year, improving growth prospects in the short and medium term. Malta's very high dependence on energy imports exposes it to price volatility in global commodity markets, and will need to be followed closely. Structural reforms and investments in the context of the RRP are proving conducive to medium-term growth perspectives, including the recent approval of Malta's modified RRP. Cost competitiveness does not appear to have deteriorated significantly, but we will continue to monitor real unit labor costs in this respect. At the same time, there is room for improvement in research and innovation, which weighs on the business environment. Risks to the medium-term outlook pertain to the impact of the international corporate taxation on the business landscape, and private sector debt in combination with rising interest rates.

Following extremely high economic growth in 2021, Malta's economy grew strongly again last year, expanding by 6.9%, exceeding both euro area (EA) GDP growth (3.3%) and our forecast in our last review (Sep-22: 6.0%). The expansion of real GDP in 2022 was driven by gross fixed capital formation, contributing 6.5 percentage points (p.p.) to output growth. While real economic activity also benefited from the ongoing recovery in tourism, imports related to the one-off purchase posed a drag, causing net exports to take 4.0 p.p. off real economic growth. Supported by very buoyant employment growth, private consumption added to a considerable extent (4.1 p.p.), whereas the positive impact of government consumption was moderate (0.4 p.p.).

As a corollary of the continued economic expansion, Maltese per-capita income has seen rapid growth. Drawing on IMF estimates, GDP per capita leapt by 13.3% to about USD 59,408 (PPP terms, current prices) between 2021 and 2022, which corresponds to the highest level of the sovereigns in our A-rated universe ('A' median: USD 43,624 in 2022).

Looking at the first half of the current year, Malta was largely able to keep up its growth momentum, rising by 0.6% and 1.1% q-o-q in Q1 and Q2, respectively, firming the impression that the Maltese economy has weathered the successive shocks well. Net exports and fixed investment were the main drivers of real GDP growth in the second quarter. Household spending continued to add positively. Real economic expansion was impeded in particular by a significant reduction in inventories and, to a lesser extent, by public consumption.

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[1] This rating update takes into account information available until 16 October 2023.

The structure of the Maltese economy is largely dominated by the service sector, in particular tourism-related activities, which made the country vulnerable to the pandemic shock. However, the relatively high gross value added (GVA) shares of information and communication, professional and administrative services, as well as financial and insurance activities, strengthened economic resilience. Similarly, the strong GVA of arts, entertainment and recreation, which includes the gaming industry, provided another source of diversification.

According to National Statistics Office (NSO) data, the number of inbound tourists came close to 2.3mn in 2022 (83.1% of the 2019 level), reflecting an increase of 136.2% compared to 2021. The recovery has continued in the current year, with the number of inbound tourists exceeding 1.6mn during the first seven months, rising by more than a third compared to the same period last year. In a similar vein, tourist expenditure increased substantially, amounting to 90.6% of 2019 tourist expenditure in 2022. From January to July 2023, total tourist expenditure continued to expand, by 40.7% compared to the same period of the previous year, lending confidence that the 2019 level is within reach this year.

The ongoing recovery of the travel sector should act as a supportive pillar for export growth. Despite the normalization of the tourism industry, the anticipated positive contribution of Malta's net exports to real GDP growth in 2023 could be somewhat dampened by slower economic activity in main trading partners, since Malta's small open economy remains sensitive to international trade dynamics.

Thanks to the government's intervention in the energy market, inflation in Malta has not risen as sharply as it did in some other euro area economies. Moreover HICP inflation has fallen markedly in the six months to September, when it stood at 4.8%. Core inflation (excluding energy, food, alcohol and tobacco) has decelerated as well, posting at 4.0% in September (March 2023: 6.5%). Although we expect inflation to remain elevated this year, private consumption should be buttressed by wage increases and continued upward pressure on wages in light of the tight labor market. In addition, the authorities have signaled their commitment to keep energy inflation contained this year and next. If sustained, Malta's growing population would also support expectations for private consumption to remain a pillar of growth further out. In 2022, net migration was 21,798, following net immigration of 4,639 one year earlier.

Focusing on the very strong labor market developments, we observe that Malta's unemployment rate fell from 3.4% in 2021 to 2.9% in 2022, corresponding to a historic low and comparing very favorably to the euro area average (2022: 6.8%). On a monthly basis, Malta's unemployment rate declined even further, standing at 2.7% in August 2023 (Eurostat, s.a.). Meanwhile, labor participation continued to trend upwards, standing at 81.2% as of Q2-23 (EA: 75.1%, s.a., not c.a.). After rising at a moderate pace throughout the pandemic, rather than falling, employment grew vigorously in 2022 (6.2%), significantly stronger than in the euro area overall (2.3%).

Due to the base effect associated with the aforementioned exceptional boost to investment in machinery and equipment in 2022, which led to a sharp rise in gross fixed capital formation by 31.2%, we expect fixed investment to decline in 2023. Moreover, financial tightening is causing firms to defer investment projects into the future. However, against the backdrop of progress on RRP milestones and targets, we view the overall investment outlook as constructive.

Public spending under NGEU should support overall gross fixed capital formation in the coming years. The EC disbursed the first tranche of EUR 52.3mn in March 2023, which was contingent on the fulfillment of 16 milestones and 3 targets, inter alia comprising national anti-fraud and corruption strategies, as well as reforms concerning R&I and the digitalization of the justice system. More recently, the EC approved Malta's modified RRP, which includes a REPowerEU chapter and devotes a higher share of the total financial resources to the green transition (68.8% instead of 53.8%). Following the positive assessment of Malta's request to transfer part of its EUR 40mn Brexit Adjustment Reserve to the plan, the total allocation of the modified RRP is now EUR 328mn with a total of 31 reforms and 16 investments.

At this stage, we expect real GDP to expand by 3.9% in 2023, partly due to a significant carry-over effect, and by 3.6% in 2024. Our projections take into account data revisions to GDP since 2018 and the fact that uncertainty surrounding these projections remains high against the backdrop of unpredictable events related to heightened geopolitical tensions.

Notwithstanding a limited dependence on Russian fossil fuels, Malta is highly dependent on energy imports, with 97.1% of the energy needs covered by imports in 2021 (EU-27: 55.5%, EA-20: 60.4%). In addition, Malta is exposed to global price fluctuations as a significant part of its electricity needs is supplied via an interconnector located in Italy. Electricity supplied through this interconnector is subject to daily spot prices, leaving Malta vulnerable to price shocks in the near term.

Medium-term growth prospects are encouraging in light of the recent progress in the RRP and ongoing commitment to timely fulfilment of agreed targets and milestones. Comparing favorably with the euro area, potential growth is estimated to be at 4.5% in 2023 and to remain virtually stable at 4.4% in 2024 (EA: 2023: 1.3%, 2024: 1.4%), with the labor share expected to be the main driver. With the Pre-Insolvency Act, the Insolvency Practitioners Act and the Commercial Code enacted by the parliament in December 2022, there has been important progress with regard to overhauling the insolvency framework, which should prove conducive to improving the business environment.

Moreover, as concerns digitalization, Malta is well positioned and continuously improves its connectivity and digital public services. At the same time, the digitalization of businesses is high. According to the Digital Decade Country Report 2023, 78% of Maltese SMEs have at least a basic level of digital intensity. In addition, the use of advanced digital technologies such as big data analytics and cloud computing is higher than the EU average. Some challenges relate to the limited supply of ICT specialists, and gaps in digital skills among less educated and older groups.

Malta continues to lag somewhat behind the EU average in terms of research and innovation. Despite slightly narrowing the performance gap with the EU, the European Innovation Scoreboard 2023 classifies Malta as a moderate innovator. Overall, Malta's innovation performance seems to be held back by low R&D expenditure, possibly compounded by a persistent shortage of skilled labor. At 0.65% of GDP, Malta's R&D expenditure (all sectors, GERD) was the second lowest among the EU-27 countries in 2021 (EU-27 average: 2.27% of GDP). As a countermeasure, the ongoing Smart Specialization Strategy 2021-2027 aims to boost research and innovation. Malta performs comparatively well in the UN's Global Innovation Index (2023), ranking 25th out of 132 economies, with key strengths in the innovation pillars of 'creative outputs' and 'infrastructure'. Recent developments in this realm include the government's announcement of a EUR 10mn Venture Capital fund to support innovative tech start-ups (Sep-23).

Confirming our impression of a little changed competitive position from a cost perspective, Malta's share of global exports of goods and services decreased slightly from 0.09% in 2021 to 0.08% in 2022. The share of global services exports, decreasing from 0.36% to 0.32%, remained above its pre-pandemic level. Whilst comparing somewhat unfavorably over a five-year period (2022 vs. 2017), Malta's real unit labor costs have posted a larger decline than main European trading partners and the euro area as a whole more recently. Due to a fall in real compensation per employee, and a concurrent increase in real labor productivity per person, real unit labor costs declined by 3.0% from 2021 to 2022.

As regards risks to the medium term growth outlook, we would flag potentially longer-lasting adverse effects from the recent intensification of geopolitical tensions and possible negative repercussions on global demand, as well as on the supply and price of energy commodities. We continue to pay attention to the ongoing global corporate taxation reforms, which, among other things, introduce a uniform taxation of multinational companies with an effective tax rate of 15%, and could potentially weigh somewhat on Malta's attractiveness of as a financial and business hub.

Institutional Structure

Our credit assessment reflects the sovereign's generally strong institutional framework, which is enhanced by significant benefits related to its EU/EMU membership, including access to deep and broad capital markets, free trade, and ample EU funds. That said, judging by the recent edition of the Worldwide Governance Indicators (WGIs), there is still room for improvement. While removal from the Financial Action Task Force's (FATF) 'grey list' underscores the authorities' decisive action to address AML/CFT deficiencies, the Maltese justice system displays potential to catch up in terms of its efficiency. Whilst progress on country-specific recommendations over the period 2019-2022 appears somewhat limited, we expect the government's parliamentary majority to be conducive to further implementation of reforms and investments under the now-modified RRP.

Drawing on the latest set of WGIs (reference year 2022) and the four pillars on which we place the highest emphasis when assessing a sovereign's institutional quality, Malta's perceived performance continues to lag that of the euro area as a whole, while being broadly in line with the relative ranks of our A-rated sovereigns (respective medians).

While Malta improved its relative rank as regards 'voice and accountability' by two places to 35th (out of 208), its performance on the remaining three indicators deteriorated compared to 2021. Specifically, Malta slipped by one, two and three places respectively in terms of 'government effectiveness' (rank 50 out of 213), 'rule of law' (rank 51 out of 213) and 'control of corruption' (rank 82 out of 213). With regard to the extent to which public power is exercised for private gain (i.e. control of corruption), there remains a notable gap compared to the median rank of 54 of our A-rated peers and the euro area median rank of 49. In addition, we note that the sovereign's relative rank in terms of 'rule of law' in 2022 was its weakest since the inception of the WGIs in 1996.

Tying in with that, the EU Justice Scoreboard 2023 indicates scope to improve as regards the efficiency of the justice system. The estimated time needed to resolve administrative cases was the longest in the EU in 2021. At the same time, the rate of resolving civil, commercial administrative and other cases was the lowest in the EU. In this context, we note that the number of judges per person remains low by European standards, which is likely to exacerbate efficiency issues. On a more positive note, the perceived level of judicial independence remains high and the digitalization of the justice system can be described as advanced.

We reiterate that decisive action by the authorities led to a swift removal from the FATF's 'grey list' last year, underscoring commitment to strengthening the anti-AML/CFT framework and its implementation. The national AML/CFT plan 2021-2023 further enhances coordination and supervision to mitigate and address related risks. That said, we recall that Malta's investor citizenship scheme, although modified, still poses corruption risks according to the Rule of Law Report 2023. The EC referred it to the Court of Justice of the EU on the grounds that it views the scheme as potentially incompatible with EU law. We gather that the Court has not yet addressed the issue.

Focusing on greening the economy, in the context of the recently endorsed modified RRP, the topped-up allocation of RRF grants to implement the green transition should support Malta on its path towards becoming a carbon neutral economy by 2050 and achieving its interim target of reducing emissions by 19% in 2030 compared to 2005 levels. In addition to efforts to reduce Malta's reliance on fossil fuels, the government is aiming to improve the energy efficiency of buildings, foster a circular economy, and work towards decarbonizing the transport sector. As a small island state, Malta is vulnerable to climate change. Therefore, a vulnerability risk assessment is currently being conducted by the Maltese authorities, aiming to identify economic sectors with a need for adaptation.

Malta's greenhouse gas emissions were the lowest among the EU-27 countries, at 4.6 tons per head in 2021 (Eurostat data). In terms of the overall share of energy from renewable sources, however, there remains ample room for progress, with Malta displaying the second lowest reading in the EU. Only around a tenth of its gross electricity consumption as well as energy used for transport comes from renewable sources. Similarly, Malta performed relatively poorly in the 2022 version of the EC's Eco-Innovation Index. However, based on the EIB investment survey, investments in energy efficiency measures accounted for 16% in Malta in 2021, whilst the corresponding share at the EU level stood at 10%.

Fiscal Sustainability

Significant headline deficits continue to prevent a reduction of the public debt ratio this year and next, partly due to fiscal support to mitigate the impact of the energy crisis and the planned resolution of Air Malta and the envisaged replacement. While we expect the debt-to-GDP ratio to increase only modestly in the medium term, the debt level should remain moderate as compared to the euro area as a whole, providing the sovereign with ample leeway to address structural challenges. As a result, we assess risks to the sustainability of Malta's public finances as limited. Adding to this, debt affordability should remain high despite a likely deterioration. Downside risks pertain to the high degree of reliance on corporate tax revenue, which could be adversely affected by the international corporate tax reform, as well as concerns regarding the future of the Citizenship by investment program, which the EC referred to the ECJ. Whilst the banking sector remains in a relatively healthy state, we will continue to monitor developments related to mortgage lending and the housing market overall, in the context of the ECB's ultimately aggressive hiking cycle.

Although the adoption of energy support measures posed a burden on public finances, Malta's general government balance narrowed by 2 p.p. in 2022, posting at -5.8% of GDP. Previously, the Covid-19 crisis had caused a sharp deterioration in the headline balance, resulting in two successive and marked deficits. Last year's fiscal balance benefited from the phasing out of a substantial part of the pandemic-induced measures, offsetting the additional costs stemming from cushioning the impact of soaring energy prices and, most importantly, from higher (nominal) revenue streams.

Tax receipts were the main contributor to expanding government revenue in 2022, with VAT, capital taxes, current taxes on income and wealth as well as taxes on production and imports all boasting double-digit growth rates. Rising by 8.3%, net social contributions benefitted from fast employment growth. Overall, total general government revenue mounted by 9.1% as a result of these developments.

On the expenditure side, we observe that final consumption expenditure and subsidies constituted the main elements for the 5.5% increase in total general government outlays in 2022, with assistance for the energy crisis and the Air Malta early retirement schemes boosting subsidies. While intermediate consumption and public wages added to this outcome, we note that gross fixed capital formation and interest payments declined by 2.1% and 2.3%, respectively.

Budget execution data for this year show that the headline deficit is set to narrow further, with total recurrent revenue increasing by 14.7% from January to August 2023 compared to the same period one year earlier (cash basis). Income tax (+25.8%), grants (+120.1%) and social security (+8.8%) were the main contributors to revenue growth. Total expenditure rose by 5.7% y-o-y over the first eight months of 2023. Apart from recurrent expenditure, interest and capital expenditure expanded considerably.

We expect the general government balance in 2023 to be adversely affected by the fiscal measures to mitigate the impact of the energy price shock. According to the Draft Budgetary Plan 2024 (DBP24), energy support measures designated for the current year will amount to 1.7% of GDP, which is roughly half of what was envisaged in the Draft Budgetary Plan 2023. At the same time, the withdrawal of the remaining Covid-19 measures should work in favor of an improvement in the headline balance.

Against this background, and in light of our economic growth projection, we project Malta's general government deficit to decline to -5.1% of GDP in 2023. As the volume of discretionary measures related to the energy crisis and the national airline retirement schemes should in our view decrease going forward, while interest expenditure is set to rise only moderately, the headline deficit could narrow to about -4.7% of GDP in 2024. Uncertainty around these projections remains high, not least in light of further intensified geopolitical risks and abovementioned structural features concerning Malta's government revenue base. We note that the headline deficit is expected to remain above 3% of GDP by 2026, as per Draft Budgetary Plan 2024.

Despite last year's broad-based tax increases, Malta's dependence on corporate income tax (CIT) remains pronounced, indicating susceptibility to economic shocks, whilst total government revenue volatility is high in the European context. According to latest available Eurostat data, the share of CIT remained the second-highest among the EU members in 2021, at 20.8%. Furthermore, we highlight that the international tax reform, once fully implemented, could weigh somewhat on future revenue streams. However, the impact might be limited, particularly due to the ultimately low presence of multinational enterprises with global sales over EUR 750mn. The IMF gauges that the global tax reform might cause a revenue loss of about 0.75% of GDP due to a potential migration of firms (Feb-23). More recently, the OECD announced the release of a multilateral convention to implement Amount A of Pillar One, with the impact on the Maltese tax intake remaining unclear at this stage. We will monitor closely any new developments in this matter.

Following high nominal GDP growth and a shrinking headline deficit, Malta's public debt ratio fell to 52.3% of GDP in 2022 (latest MoF data), comparing very favorably against the debt level of the euro area as a whole. In light of our projections that Malta will continue to display marked headline deficits in 2023/24 and due to likely debt-increasing stock-flow adjustments, we anticipate an increase in the debt-to-GDP ratio to 53.9% in 2023 and 57.0% in 2024. Although public guarantees are estimated to post at 6.1% of GDP in 2023 and 5.5% of GDP in 2024 (MoF), contingent liability risks remain to be monitored against the backdrop of the upcoming shutdown of Air Malta in March next year and the plans for its replacement.

Debt issuance costs have continued to rise since our last review. The yield on 10-year government bonds increased from 3.48% on 23-Sep-22 to 3.91% as of 22-Sep-23 (weekly data). The bund spread narrowed over the same period, decreasing from 145bp to 117bp. Fiscal sustainability risks are in our view mitigated by sound debt management and still affordable debt. Malta's interest-to-revenue ratio fell to 2.9% in Q1-23, which is close to the median of the EU-27 countries. While refinancing conditions have deteriorated materially since the ECB started to tighten its monetary policy stance, Malta's average weighted maturity has remained relatively stable over the last year, posting at 8.0 years in August 2023 (August 2022: 8.3 years, ECB data).

In its September monetary policy meeting, the ECB decided to raise key policy rates again by 25bp. The main refinancing rate now stands at 4.50%, and the Governing Council has sent some signals that interest rates may be maintained at the current peak for some time. We expect the ECB to keep interest rates on hold for the remainder of the year, with no rate cuts taking place before the second half of 2024. Having stopped the reinvestment of principal payments from maturing securities, the winding down of the APP portfolio progresses as planned. On the other hand, the ECB will continue to reinvest principal payments of maturing securities under the PEPP until at least the end of 2024.

Featuring strong capitalization, liquidity and profitability, Malta's large and concentrated banking sector appears well-equipped with sizeable buffers against external shocks, as highlighted by recent stress tests conducted by the Central Bank of Malta (CBoM). As of Q2-23, the CET1-ratio amounted to 20.4%, well above the EU average of 16.0% (EBA data). Rising interest rates increased the profitability of banks, with return on assets climbing to 0.9% (EU: 0.7%). Judging by the NPL ratio, the banking sector's asset quality remains somewhat below the EU level overall (Q2-23: 2.3% vs. EU: 1.8%), but has improved over time.

Due to some concentration risks for the Maltese banking sector arising from its high exposure to residential real estate (RRE) and the prominent role of mortgage loans in the loan portfolio, the CBoM and the Malta Financial Services Authority decided to phase in a sectoral systemic risk buffer (sSyRB), starting from the end of September 2023, with an initial sSyRB rate set at 1.0%. As of the end of March 2024, credit institutions in Malta that extend domestic RRE mortgages secured by domestic RRE collateral will be subject to a sSyRB of 1.5%. The sSyRB will be reviewed biennially. Partly due to the introduction of the sSyRB, the CBoM has so far refrained from raising the CCyB, which remains at 0%.

Given a relatively high share of mortgage loans in total outstanding loans to the private sector (57.5% in August 2023, based on ECB data) and marked annual increases in outstanding mortgage loans to private households (Aug-23: +7.8% y-o-y), developments on the housing market may have to be monitored, despite signs of slowing. Furthermore, house price dynamics have abated somewhat, with the annual growth rate decelerating to 4.5% as of Q2-23 (Q2-22: 7.6%). The three-year rate of change increased slightly to 18.4% (EA: 14.9%).

Further out, demographic challenges are set to weigh on Malta's longer-term fiscal sustainability. While awaiting the 2024 EC Aging Report, pension expenditure is forecast to increase in particular between 2045 and 2070 (see EC Aging Report 2021), calling for determined counteraction. As a more recent and ongoing action, the government is incentivizing pensioners to work beyond retirement age by gradually exempting pensionable income from taxation.

Foreign Exposure

As a business and financial hub, and given its overall high degree of trade openness, Malta is generally sensitive to global economic developments. Related data remains subject to pronounced fluctuations, at times rendering the assessment of underlying development challenging. Currently, ongoing efforts to integrate broader and more granular sets of data on the balance of payment and international investment position present challenges with regard to an assessment. Whilst bearing this in mind and expecting further updates on Malta's highly positive NIIP, we believe that external risks are largely contained at this stage. Thanks to the resurgence of tourism and decelerating import prices, Malta's current account deficit declined somewhat in the first half of 2023, and we assume the current account balance will improve further over the medium term.

After posting moderate surpluses during the pandemic, Malta's current account balance shifted into negative territory in 2022 (-3.0% of GDP), contrasting with its long-term average surplus of 2.1% of GDP over 2010-2019. Last year's marked deterioration in the current account balance came on the back of a significant widening in the goods surplus, in turn induced by more costly energy imports and investments in the aviation industry. The tourism-related improvement in the services balance could not make up for the movement in the goods component, while the primary and secondary income also recorded a slight deterioration.

More recently, receding energy prices have led to a partial reversal of the developments seen throughout last year. Drawing on the four-quarter average, the current account deficit narrowed to -1.3% of GDP as of Q2-23 (Eurostat, BoP data). We expect the current account deficit to decline further in 2023 overall and over the medium term, as import prices should continue to ease somewhat, and travel exports are likely to reach pre-pandemic levels, contributing to an even larger services surplus.

While we generally view Malta's high and positive NIIP as favorable, we note that the abovementioned ongoing work on data integration has so far entailed extreme swings in the direct investment, portfolio investment and other investment components, for now leading to a massive leap of the positive NIIP from 50.3% of GDP in 2021 to 78.8% of GDP in 2022 (Central Bank of Malta data). With that, Malta would exhibit the largest positive NIIP among the EU-27 countries. In any case, we will closely monitor developments around this.

Rating Outlook and Sensitivity

Our rating outlook on the Republic of Malta's long-term credit ratings is stable, reflecting our view that downside risks with regard to its macroeconomic development and public finances are broadly balanced by a robust recovery of tourism, very strong labor market conditions, a more diversified service structure and favorable medium-term outlook due to the expected RRP progress. Additionally the sovereign will likely maintain its sizeable fiscal and external buffers.

We could contemplate raising the rating or outlook if the economy grows at a faster pace over a sustained period, and public finances improve markedly, leading to a reversal in the sovereign's debt-to-GDP ratio. Enhanced fiscal resilience related to a broadening tax base would also add to upward pressure on our rating or outlook. We regard lasting improvements to the institutional set-up as particularly conducive to considerations of a positive rating action.

Conversely, we could lower our rating or outlook if the implementation of reforms and investments related to the RRP stalls or proceeds significantly more slowly than envisaged, weighing on medium-term growth prospects. We could also consider a downgrade if the public debt ratio pursues an upward trend over a protracted period, potentially due to renewed hikes in energy prices, which might require larger fiscal support, or substantial revenue gaps deriving from a longer phase of weak global economic developments, possibly compounded by the international corporate taxation reform. An escalation of the geopolitical conflict, or a major setback in terms of institutional quality could also result in a downgrade of the rating or outlook.

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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

Environ-mental Quality	Ecological Risks	Ressource Management	Education	Health	Demo-graphics
Labor	Equality	Technology & Infrastructure	Safety & Security	**Judicial System**	**Quality of Public Services**
Integrity of Public Officials	Quality and Efficacy of Regulations	**Civil Liber-ties/ Political Participation**	Market Access	**Business Environment**	Data Transparency

Environment	Social	Governance	Highly significant	Significant	Less significant	Hardly significant

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 an economy's competitive stance by e.g. the World Bank, the World Economic Forum, the European Commission, and IMD Business School and the

World Intellectual Property Organization (UN) add further input to our rating or adjustments thereof, we judge the ESG factor 'Business Environment' as significant.

While Covid-19 may exert 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 on public finances. To be sure, we will follow ESG dynamics closely in this regard.

Economic Data

[in %, otherwise noted]	2017	2018	2019	2020	2021	2022	2023e	2024e
Macroeconomic Performance								
Real GDP growth	10.9	7.4	7.1	-8.1	12.3	6.9	3.9	3.6
GDP per capita (PPP, USD)	44,868	47,756	50,161	44,804	52,418	59,408	63,481	66,716
Credit to the private sector/GDP	80.8	78.7	76.6	87.4	80.7	77.5	n/a	n/a
Unemployment rate	4.0	3.7	3.6	4.4	3.4	2.9	n/a	n/a
Real unit labor costs (index 2015=100)	101.8	107.1	108.0	119.1	112.6	109.2	n/a	n/a
World Competitiveness Ranking (rank)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Life expectancy at birth (years)	82.4	82,5	82.9	82.3	82.5	82.7	n/a	n/a
Institutional Structure								
WGI Rule of Law (score)	1.1	1.0	0.9	0.9	0.8	0.8	n/a	n/a
WGI Control of Corruption (score)	0.7	0.5	0.2	0.3	0.3	0.2	n/a	n/a
WGI Voice and Accountability (score)	1.2	1.1	1.1	1.1	1.1	1.1	n/a	n/a
WGI Government Effectiveness (score)	1.0	0.9	0.8	1.0	0.9	0.8	n/a	n/a
HICP inflation rate, y-o-y change	1.3	1.7	1.5	0.8	0.7	6.1	5.7	3.4
GHG emissions (tons of CO2 equivalent p.c.)	5.3	5.2	5.3	4.5	4.6	n/a	n/a	n/a
Default history (years since default)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Fiscal Sustainability								
Fiscal balance/GDP	3.3	2.0	0.5	-9.7	-7.8	-5.8	-5.1	-4.7
General government gross debt/GDP	47.8	43.4	40.0	52.2	54.0	52.3	53.9	57.0
Interest/revenue	4.7	3.9	3.6	3.6	3.1	2.8	n/a	n/a
Debt/revenue	126.6	114.4	110.6	146.3	152.5	152.2	n/a	n/a
Total residual maturity of debt securities (years)	9.1	8.8	8.3	7.7	8.0	8.4	n/a	n/a
Foreign exposure								
Current account balance/GDP	5.9	6.3	9.0	2.2	1.2	-3.0	n/a	n/a
International reserves/imports	13.9	15.1	12,7	16.3	16.1	14.1	n/a	n/a
NIIP/GDP	56.6	55.2	52.8	59.4	50.3	78.8	n/a	n/a
External debt/GDP	751.5	673.9	612.5	661.8	608.2	984.0	n/a	n/a

Sources: IMF, World Bank, Eurostat, AMECO, ECB, NSO, CBoM, 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
Monitoring	20.10.2023	A+ /stable

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) 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 and Employment and the Central Bank of Malta participated in the credit rating process, as they provided additional information during the credit rating process. In addition, the Ministry for Finance and Employment commented on a draft version of the report. Thus, this report represents an updated version, which was augmented in response to the factual remarks of the Ministry for Finance and Employment during their review. However, the rating outcome as well as the related outlook remained unchanged.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	YES
With Access to Internal Documents	NO
With Access to Management	NO

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology (v1.2, July 2016) in conjunction with its basic document "Rating Criteria and Definitions" (v1.3, January 2018). CRAG 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 CRAG´s rating methodologies and basic document "Rating Criteria and Definitions" is published on our website.

To prepare this credit rating, CRAG 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, World Intellectual Property Organization (WIPO), IMD Business School, Central Bank of Malta, National Statistics Office (NSO), Ministry for Finance and Employment Malta, Malta Fiscal Advisory Council.

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 the event 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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