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 12-11-2021 "Sovereign Ratings" "Rating Criteria and Definitions"

Rating Action

Neuss, 12 November 2021

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.

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Key Rating Drivers

1. Strong GDP growth record and labor market development prior to the pandemic have added to Malta's comparatively high per-capita level; the expected resumption of economic growth in tandem with envisaged RRP-measures to strengthen economic resilience should enable the sovereign to continue on this path, notwithstanding some downside risks mainly related to international developments
2. Lingering uncertainty over the evolution of the coronavirus will likely delay a full recovery of tourism; imminent changes to international corporate taxation might have some adverse effects on Malta's attractiveness as a business/investment location, potentially weighing on the medium-to-longer term growth outlook
3. Generally strong institutional framework, buttressed by EU/EMU membership; latest set of World Bank Governance Indicators suggests some improvement as regards key institutional conditions; whilst prolonged placement on the Financial Action Task Force's (FATF) grey list would likely create reputational challenges going forward, the government is working closely with the FATF and Moneyval to address identified shortcomings, positively affecting our perception of responsiveness to recommendations by international institutions
4. Public debt ratio deteriorated markedly due to the pandemic and unlikely to fall significantly over the medium term, but persistently high debt affordability remains a mitigating factor, whilst debt-to-GDP still compares as moderate in the European context; upcoming reorganization of international corporate taxation and changes to Maltese investor citizenship schemes highlight persistent vulnerabilities with regard to the revenue base
5. High and positive net international investment position, until last year bolstered by ongoing current account surpluses, somewhat balances vulnerabilities associated with being a very open economy; while there is only limited visibility at the current stage, the agreed international corporate tax framework and FATF's greylisting might also impact on Malta's external position further out

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

The sovereign's strong macroeconomic performance profile is buttressed by a track record of vivid growth and strong labor market development prior to the outbreak of the coronavirus, a high wealth level in terms of GDP per capita, and an ongoing shift towards more diversified export-oriented services. Envisaged measures to strengthen economic resilience and drive the digital and green transition should, if implemented as foreseen, improve the medium-term growth outlook. The still pronounced role of tourism continues to present downside risks in the face of ongoing uncertainty over the evolution of the pandemic, notwithstanding progress in European vaccination campaigns. We will follow the imminent reorganization of international corporate taxation closely, as this might entail risks for Malta's attractiveness as a business and financial hub.

Malta boasted a robust GDP growth record in the phase prior to the outbreak of the Covid-19 pandemic. Apart from Ireland, the Maltese economy showed the strongest economic expansion among the EU countries over the period 2015-19 (7.2%, EU-27: 2.2%). However, real GDP plunged by 8.3% last year, representing one of the most pronounced declines in the EU, compounded by muted tourism activity and comparatively rigorous restrictions during the first wave of infections, judging by the respective index provided by Blavatnik School of Government. In terms of expenditure components, last year's GDP was mainly dragged down by the negative impact exerted by net exports (-5.5 p.p.) on the back of a steeper fall in exports than in imports, as well as by contracting private consumption (-4.7 p.p.). At the same time, decreasing gross fixed capital formation took 1.5 p.p. off GDP growth.

In order to cushion the fallout from the health crisis for households and businesses, the government provided a support package of temporary measures amounting to 5.2% of GDP in 2020, including wage supplement schemes. Liquidity measures such as tax deferrals and guarantees came to 3.9% of GDP last year. Nevertheless, in light of the drastic decline in economic output, GDP per capita fell by 11.0% to USD 43,656 as of 2020 (IMF data, PPP terms, current prices), although remaining well above the median of our A-rated sovereigns (2020: USD 38,443), as well as broadly on par with the EU income level (2020: 97%), thus emphasizing Malta's still relatively high wealth level.

Given the significance of tourism, GDP growth was strongly affected by travel bans and other restrictions linked to tourist spending. According to WTTC data, total GDP contribution from travel and tourism fell from 15.9% in 2019 to 5.4% for Malta in 2020. While respective WTTC data for employment indicate a decline of jobs in travel and tourism by 12.1% last year, official employment data provided by NSO paint a more positive picture, as full-time employment in food and accommodation (NACE 55-56) even increased by 1.5% in 2020. As a partly offsetting force, Malta's ICT sector, financial services, and gaming industry, accounting for total GVA shares of 9.7%, 9.8%, and 7.8% respectively last year (Eurostat and Malta Gaming Authority), contributed positively to growth, illustrating a more diversified services structure that adds to resilience, especially with a view to the nature of this latest global crisis.

[1] This rating update takes into account information available until 05 November 2021.

Turning to more recent developments, Maltese GDP recorded negative quarter-on-quarter GDP growth in Q2-21 (Eurostat, sa, ca), following a recovery from the second half of last year and burdened by another round of relatively strict containment measures in spring amid resurging infections early in 2021. Compared to Q4-19, real GDP thus posted 6.7% below its pre-crisis level in Q2-21 (sa, ca), comparing unfavorably against the euro area (EA) overall (Q2-21 vs. Q4-19: -2.7%).

The third quarter is likely to see some rebound. Brightening consumer confidence and rising tourist arrivals in Q3-21 should have supported private consumption, as also suggested by two consecutive increases in monthly retail sales by August. In addition, a new round of spending vouchers redeemable at restaurants, bars, and retail outlets, and services particularly affected by the containment measures, which amounted to EUR 50mn was launched in May-21. However, partly affected by worldwide supply bottlenecks for certain products, industrial production shrank in July and August, and the Economic Sentiment Indicator (ESI, EC) on average clouded somewhat in Q3-21 vs. Q2-21.

At the beginning of the current quarter, signals from survey indicators seem to remain mixed, with the overall ESI posting another decline in October, whereas consumer confidence recorded an increase. Picking up on consumer sentiment, we expect private consumption to remain supported by the Wage Supplement Scheme, which has helped to protect employment and is supposed to remain in place until the end of 2021. Compensation per employee could increase by a good 2% this year. Looking at negotiated wages, we note an annual increase of 2.3% in Aug-21 vs. Aug-20 (Ministry for Finance, MOF). Moreover, the government envisages ramping up pensions and benefits for 2022.

Bolstered by the extensive government support, Malta's labor market, which went into the pandemic from a position of strength, proved comparatively robust last year. Contrary to many other European countries, the sovereign displayed an overall rise in employment last year (2.7%, EA: -1.5%, Eurostat, domestic concept). As of Q2-21, employment growth seemed to be picking up after the more subdued period during the most acute phase of the pandemic, recording an increase of 0.6% q-o-q. Even though the unemployment rate rose from 3.6% in 2019 to 4.4% in 2020, it remained well below the rate in the euro area as a whole (2020: 7.9%, Eurostat, LFS-adj.) and, on a monthly basis, even fell below its pre-crisis level in Jul-21 (3.3%, Eurostat, s.a., Sep-21: 3.2%).

Besides the currently favorable outlook for private consumption, gross fixed capital formation also looks set to increase, backed by ongoing benign financing conditions and a boost from NGEU-related investment. The Council of the EU greenlighted Malta's Recovery and Resilience Plan (RRP) on 5 October, paving the way for a performance-based disbursement of funds totaling EUR 316.4mn (2.4% of 2020 GDP) in grants over the period 2021-26. However, we note that RRF grants appear rather low as compared to other prime tourism destinations in the EU.

More than half of the allocated means (54%) are dedicated to climate protection, including greening the transport sector, among others by financing a new ferry-landing site and free public transport for Maltese and Gozo citizens. More than a quarter of the RRP (26%) is to be directed towards enhancing digitalization, including that of the public administration, health sector and justice system.

Contrary to domestic demand, net external trade will likely make a negative contribution this year and a moderately positive one next year, given that travel exports are likely to take longer

to recover. In this context, it seems worth mentioning that the United Nations World Tourism Organization (UNWTO) deems a return of international tourism to 2019 levels before 2023 as unlikely. Drawing on recent NSO data, tourist arrivals to Malta from Jan-Aug-21 were 20.0% below their respective level in 2020 over the same period, and 76.9% below their 2019 levels.

That said, in Aug-21 the number of inbound tourists was up by 45.0% on Aug-20, albeit amounting to just under half of the level (49.3%) reached in Aug-19. Other export categories should benefit from the ongoing global recovery, with exports in the ICT sector, financial services, and gaming likely to continue growing. Overall, we expect real GDP to expand by 5.2% this year, followed by some acceleration to 6.2% in 2022, which would see GDP reaching its pre-pandemic level in the second half of 2022.

Owing to the high degree of openness of the Maltese economy, downside risks relating to the evolution of the coronavirus remain in place, added to by supply bottlenecks currently hampering economic developments in a number of countries. While Malta is among those EU countries with the highest vaccination rates (91.7% as of 5-Nov, full vaccination of adult population, ECDC), inbound tourism to Malta could still be impaired by less progress in other countries, although further headway should be made on this front.

Malta's medium-term growth outlook is supported in our view by the envisaged measures for fostering education and enhancing inclusion on the labor market, as well as for driving the green and digital transformation forward, which should increase the chances of attaining more sustainable and broad-based growth, as well as higher levels of employment. According to projections mentioned in Malta's National Employment Policy launched this October, the employment rate is to increase from 78.0% in 2020 to 84.6% in 2030. As for the growth effect of the RRP, we note that Maltese authorities expect the respective reforms and investments to lift economic output by an average of 0.53% compared to the baseline over the projected rollout period 2022-25. The EC reckons that the RRP impact on the Maltese GDP could amount to 0.7-1.1% by 2026.

Importantly, we would highlight as positive a strong fifth rank in the European Commission's (EC) latest Digital Economy and Society Index (DESI) as a testament to Malta's favorable position from which to implement its digital agenda. In this context, becoming the first EU member to join the IP Register in blockchain in Jul-21 seems to underscore the sovereign's ambition in terms of building on existing strengths and further boosting use of advanced digital technologies. As to developments of other recently well-performing areas, we will pay some attention to the envisaged long-term strategy for the financial services industry, with the preparation of which the recently established Malta Financial Services Advisory Committee is tasked.

To be sure, a comparatively low level of R&D expenditure (all sectors) by European standards in the recent past (2019: 0.6% of GDP, EU: 2.2%, Eurostat) seems to emphasize the significance of respective investment to further broaden Malta's economic base. Despite continued improvements over recent years, Malta is deemed to be a moderate innovator, according to the latest European Innovation Scoreboard (2021). Whilst the GVA share of the ICT sector is relatively high, as mentioned above, the same cannot be said about R&D intensity in this vital sector, bearing in mind that the level of business R&D expenditure (BERD) measured against value added in the ICT sector was comparatively low (DESI 2020). We understand that Malta's Smart Specialization Strategy 2021-27, which is currently being developed, is partly meant to address such challenges, focusing on fostering business R&I and public-private cooperation.

We likewise consider the establishment of a Ministry for Equality, Research and Innovation, and the Coordination of Post Covid-19 Strategy in Dec-20 as potentially beneficial to improving Malta's productivity on the back of envisaged higher R&I spending. In connection with the planned re-/upskilling of parts of the labor force, and the strengthened administrative framework, we think this could bolster potential growth. While underlying growth is estimated to have been at 2.5% in 2020, well above the EU level (2020: 1.1%, AMECO), it is projected to fall short of pre-pandemic levels in the near term, reaching 3.3% in 2021 and 3.9% in 2022, against an average of 6.2% in the period 2015-19.

On the other hand, medium-term prospects may be curbed somewhat by heightened uncertainty over the agreed reorganization of international corporate taxation, given Malta's status as a financial and business hub. The recent OECD International Tax agreement saw consensus in principle among 136 countries on two main pillars, involving a redefinition of the tax base among states as far as large international companies are concerned and an effective minimum corporate tax rate of 15%, with details still to be negotiated. In addition, FATF's decision to put Malta on its so-called grey list (see below) might have some adverse effects on its financial services sector and correspondent banking relationships, especially if it were perceived that it might take some time for it to be removed.

We also note that metrics relating to cost competitiveness, such as real unit labor cost data, have compared somewhat unfavorably against the euro area and main European trading partners more recently (2020 vs. 2017: +12.5%, EA: +3.2%), although admittedly the exceptional year 2020 likely distorts the outcome. In any case, detrimental effects from this seem to have been limited so far, as suggested by Malta's global export market share, which in fact edged up from 0.08% to 0.09% last year, driven by a more meaningful increase by 0.05 p.p. to 0.33% as regards its market share in services.

Apart from that, the abovementioned reforms and investments may contribute to strengthening Malta's non-cost competitiveness. In this vein, we would still take into account that Malta exhibited a rather low relative rank (88 out of 190 economies) in the latest vintage of the World Bank's Ease of Doing Business report, which, however, has been discontinued. While an update of the World Economic Forum's Global Competitiveness Report is due, we recall that Malta was ranked 38 out of 141 countries overall, and 18th among the EU-27, thus indicating scope for a significant improvement.

As regards further potential growth-limiting factors, we observe that Malta's NFC debt-to-GDP ratio climbed by 6.6 p.p. to 84.4% in the year to Q2-21 (ECB data, non-consolidated), moving in the upper middle-range among EU countries with respect to this metric and hinting at somewhat less room to absorb further economic shocks in the private sector going forward.

Institutional Structure

Malta's credit rating is underpinned by its generally strong institutional framework. This includes the benefits entailed by EU/EMU membership, and more recently added to by the access to NGEU funding, which should be instrumental in supporting the digital and green transition in a pivotal phase. With the exception of the 'rule of law' indicator, the latest set of Worldwide Governance Indicators (WGIs) suggests some improvement as regards institutional conditions, and there is considerable progress as far as AML/CFT efforts and improvements in the justice system are concerned. While we assess as positive the authorities' responsiveness to recommendations made by international institutions, we

follow developments regarding the FATF's decision in June to put Malta on the list of jurisdictions under increased, vigilant monitoring which ultimately underscores room to improve on AML/CFT issues.

Judging by the latest vintage of WGIs provided by the World Bank, Malta performs slightly better or is roughly on par with the median of our A-rated sovereigns with regard to the WGIs we consider. We note that the sovereign continues to lag behind the median of our A-rated countries and the euro area when it comes to control of corruption, despite improving by six ranks compared to the previous year (2020: relative rank 74 out of 209, A median: 54, EA: 32). On the other hand, in terms of government effectiveness, the sovereign climbed a remarkable nine places to rank 39/209 (EA: 35) in the 2020 ranking. Looking at voice and accountability, Malta edged up to 33/208 (EA: 33), while inching down two ranks to 45/209 when it comes to the WGI rule of law (EA: 32).

Concerning some weaknesses in the realm of preventing money laundering and terrorist financing, as mentioned during our last reviews, Malta has made significant progress, as also underscored by the latest Moneyval report (Apr-21). The report concluded that Malta is considered largely or fully compliant with respect to all of the 40 recommendations evaluated over recent years. We note that the sovereign has made headway in terms of strengthening its supervisory framework with a view to AML/CFT, among others reinforcing the risk-based approach and empowering prosecutors as regards investigation and pressing charges regarding ML cases.

Having said this, we pay heightened attention to the FATF decision to put Malta on the list of jurisdictions under increased monitoring in Jun-21. For one, the decision reflects perceived remaining strategic deficiencies when it comes to AML/CFT, and secondly the sovereign's commitment to resolve these within an agreed time frame.

On these points, we gather that the government is working closely with the FATF and Moneyval to address the issues identified, with a recent agreement by the Malta Business Registry and the Financial Intelligence Analysis Unit (FIAU) on information sharing and collaboration on investigations constituting one step on this path. Moreover, new mechanisms have been introduced for identifying potentially inaccurate beneficial ownership information after the FATF decision. We will closely monitor developments in this regard, as we think that adverse effects on doing business would increase with the duration of increased monitoring on behalf of FATF.

Further to our perception of responsiveness to recommendations made by international institutions, we would highlight as positive the Notice Law on the Transfer of Prosecutions, entering into force on 1 October 2021, geared towards reducing delays in the criminal justice system, and generally to improve on the quality of prosecution procedures. We understand that new appointments with regard to judges have been made as well, in addition to extending the retirement age of judges and magistrates. These measures should contribute to strengthening the quality of the justice system. Moreover, the government approved a National Anti-Fraud and Corruption Strategy for 2021-24 this March.

Related to the issue of responsiveness, we are aware of ongoing discord over citizenship schemes between Malta and the EC. Malta's Individual Investor Program (IIP), with regard to which the EC had launched an infringement procedure, is no longer in force since Oct-20, but was replaced by the Maltese Exceptional Investor Naturalization (MEIN). MEIN offers Maltese citizenship, subject to a number of conditions including a substantial so-called Exceptional Direct Investment, and the total number of citizenship certificates granted under MEIN is limited to 400 per year. In a second letter of formal notice in Jun-21, the EC has expressed its concern

about the new scheme. We recall that an infringement procedure could bode ill from a reputational point of view.

Turning to domestic politics and bearing in mind that parliamentary elections would have to be held next year, we will continue to monitor developments around the possibility of an early election, whilst gathering that a snap election in 2021 has been ruled out. Current polls suggest that the ruling Labor Party (PL) maintains a considerable lead over opposition parties. Overall, we would expect broad policy continuity.

Concerning Malta's progress in greening its economy, we observe that the sovereign has some catching-up potential. Looking at the EC's eco-innovation Index, the sovereign occupies one of the lowest ranks among the EU members (2021: index score of 67, EU: 121). Moreover, it displays one of the lowest shares of use of energy from renewable sources (2019: 8.5%, EU-27: 19.7%), although this share has been increasing over recent years. This said, Malta boasts a relatively low level of greenhouse gas emissions per capita, coming to 5.3 tons of CO2 equivalent in 2019 (EU: 8.2).

The government has reiterated its commitment to aim for net-zero carbon emissions by 2050 in its Draft Budgetary Plan for 2022, and in its National Energy and Climate Plan (NECP, Dec-19) expressed the intention for the share of energy from renewable sources to move into double-digit territory from 2022, envisaged to reach 11.5% in 2030. Measures intended to contribute to reaching such goals, as set out in the RRP, include the promotion of the use of electric vehicles with regard to the private sector, and decarbonizing the public transport fleet.

Fiscal Sustainability

Despite a significant deterioration of its public finances in the wake of the pandemic, Malta's debt-to-GDP ratio compares as relatively benign against the overall euro area level, owing to ample fiscal space when the corona crisis hit. While we think that risks around fiscal sustainability seem manageable overall, the public debt ratio looks unlikely to fall significantly over the medium term, and heightened uncertainty around revenue streams from corporate income tax and the Citizenship by Investment program constitute downside risks, exacerbated somewhat by increased contingent liabilities in light of the Covid-19 crisis. However, high debt affordability should continue to act as a mitigating factor for the foreseeable future. At the same time, the sovereign's track record before the crisis gives us some confidence in the authorities' readiness and ability to consolidate public finances once the dust around the pandemic has settled. As regards a longer-term outlook, demographic developments could put pressure on age-related spending.

Malta's headline fiscal metrics were at comparatively comfortable levels before the outbreak of the pandemic, putting the government in a favorable position to provide a forceful fiscal response to combating the virus. In total, the government's measures amounted to about 5.2% of GDP in 2020, contributing to a headline deficit of 9.7% of GDP last year on the heels of four consecutive years of headline surpluses averaging 1.7% of GDP (2019: 0.5% of GDP). Drawing on MOF information, the government has spent about EUR 1.5bn to maintain jobs in the course of this crisis.

The overall rise in total outlays (18.8%) recorded in 2020 was mainly driven by subsidies (+233.8%) and social benefits (+8.2%). Amid contracting income and wealth tax receipts (-7.5%) as well as regarding production and imports (-13.4%), total government revenue fell by 7.5% last year. At the same time, net social contributions increased by 5.1%.

With economic output resuming its expansion from Q3-20, the general government balance narrowed to a deficit of 6.3% of GDP in the second quarter of the current year (Eurostat data). By the end of August, the government's Consolidated Fund reported a deficit of EUR 753.2mn, shrinking from a deficit of EUR 1,086.2mn over the respective period in 2020. According to MOF, recurrent revenue increased by 27.6% in the first eight months of 2021 vis-à-vis the respective period of the preceding year, owing chiefly to higher tax revenues, whilst total expenditure rose by 10.1%.

At this stage, we expect the general government deficit to rise to about 10.9% of GDP in 2021, as a number of supporting measures was extended in the course of the year. Looking at non-temporary measures, a negative impact (-0.29% of GDP, MOF) is also expected to stem from lower revenue in connection with the IIP, as well as from support to Air Malta (-0.21% of GDP). In the face of an ongoing economic recovery, and with Covid-19 support measures linked to the wage supplement scheme and tax deferrals due to expire at the end of the current year, the deficit should shrink markedly to about 6.0% of GDP in 2022.

The recently presented Draft Budgetary Plan for 2022 (DBP22) comes with a strong focus on improving social inclusion, along with measures to foster underlying growth. Among other things, it includes enhancements to various benefits and allowances, e.g. for carers at home, the in-work benefit scheme, and an extension of free childcare services to enhance the disposable income of low and middle-income earners and to add to work incentives. Moreover, it envisages increasing most pensions by more than the customary cost-of-living adjustment (COLA), and raising the taxable income ceiling. With regard to housing, the First-Time Buyer Scheme is to be enhanced. General government gross fixed capital formation, which averaged 3.3% of GDP over the period 2011-20, is to be stepped up markedly and expected to increase to 4.7% of GDP this year, and to 4.9% in 2022.

We gather that the overall impact of discretionary measures with a budgetary impact – and not financed via the RRF - would come to a net positive impact of about 3.6% of GDP in 2022, with the major part thereof relating to the phasing-out of temporary measures in the wake of the Covid-19 Business Assistance Program and the Economic Regeneration Voucher Scheme. As regards non-temporary measures, the government expects the budgetary impact to exert a further negative effect equal to -0.1% of GDP in 2022, after -1.0% of GDP in 2021. In this context, we would highlight an ongoing negative impact on the budget from smaller expected revenue associated with the IIP, which is estimated to decrease further to an annual EUR 42mn from 2022-24 (2020: 110.99mn, 2017: 242.09mn, MOF data).

Apart from risks related to the evolution of the coronavirus, further uncertainty is thus added by these schemes, as well as by the development of energy prices and possibly a broader range of price increases. While to some extent accounted for in the 2022 budget proposal, the government has signaled willingness to cushion the impact of further rising energy prices with respect to households and businesses if deemed necessary (DBP22).

Prospectively, the changes to international corporate taxation, intended to enter into force from 2023, would add to risks as regards government revenue. We recall that the latter seems relatively exposed to cyclical developments to start with, as illustrated by the relatively high share of corporate income tax (including holding gains) in total tax receipts in the European context (2020: 15.3%, EA: 5.8%, Eurostat), thus causing a comparatively high degree of overall revenue volatility as compared to other EU members. In 2020, CIT revenue (including holding gains) fell by 20.9%, representing one of the strongest declines among the EU.

Against this backdrop, the government's expectation of the headline balance to remain in deficit over the medium-term, projecting it to shrink to below 3% only from 2024 (2.9% of GDP, DBP22), in our view suggests a prudent approach to policy-making. Against this background, we assess as positive the government's expressed intention to work towards achieving more prudent medium-term fiscal positions, including control on current spending.

Amid severely contracting GDP and the large deficit of the general government balance, Malta's public debt ratio leapt by 12.7 p.p. to 53.4% of GDP last year, the highest level since 2016, but still considerably below the euro area level (2020: 97.3% of GDP). We currently expect general government debt to surge again to roughly 61.4% of GDP in 2021, and edge up further to about 63.3% of GDP next year before starting to stabilize around this level. Prior to the outbreak of the virus, the debt-to-GDP ratio was on a firm downward trajectory that saw the debt ratio shrink from 70.0% in 2011 to 40.7% in 2019, giving us some confidence in the authorities' readiness and ability to consolidate public finances once the dust around the pandemic has settled.

While risks to fiscal sustainability overall seem manageable, and reiterating the perception of a higher emphasis on the quality of sovereign debt on the European level, against the backdrop of the twin transition with regard to greening the economy and enhance use of digital technologies, we would highlight some factors that require monitoring from our point of view.

With regard to contingent liabilities, we note that Malta Development Bank's (MDB) Covid-19 Guarantee Scheme (CGS), providing guarantees to commercial banks for lending to businesses of all sizes, has been extended by a further three months to Dec-21. The CGS has supported roughly 610 businesses with approx. EUR 510mn in working capital loans as of the end of Sep-21, corresponding to roughly 12.5% of total bank loans to NFCs at this stage. According to the DBP22, contingent liabilites are estimated to decline from a projected 9.4% of GDP for 2021 to 8.4% of GDP in 2022 (2020: 9.1% of GDP, USP21). We gather that the government intends to support Air Malta, but that the EC's state aid decision is still pending.

Malta's banking sector, which in terms of assets-to-GDP counts among the larger ones in the EU (Q1-21: 330.6% of GDP, Q1-20: 294.0% of GDP, ECB data), remained rather resilient over the course of the pandemic. Banks seem well capitalized, with their CET1 ratio considerably above EU levels as of Q2-21 (19.2%, EU: 15.8%, EBA data) following a recent peak at 20.5% as of Q4-20. Asset quality as measured by the NPL ratio compares less favorably against the EU level (Q2-21: 3.2%, EU: 2.3%, EBA), but has improved somewhat compared to end of last year (Q4-20: 3.5%). However, bank moratoria are in place until Dec-21, suggesting that developments as regards asset quality would have to be monitored upon their expiry.

Drawing on EBA stage 2 loan data relating to Q2-21, there have been some mixed signals lately as far as a deterioration for loans under moratoria are concerned. Maltese banks displayed a share of 24.8% of these loans with regard to non-expired moratoria, lower than the respective share of loans in the EU overall (Q2-21: 28.2%), and having more than halved compared to Q1-21. Still, compared to Q2-20 (17.3%), this represents a somewhat more elevated level. Meanwhile, the share of stage 2 loans with expired moratoria has climbed to 26.5% as of Q2-21 (EU: 24.4%), rising by 16 p.p. as compared to Q2-20.

House prices have continued to rally (Q2-21: 5.3% y-o-y), keeping the 3y-rate of change within the 15-20% range observed since 2016 (Q2-21: 16.3%). While some of the supporting measures for the property market are to end in Jun-22, the reduction schemes in stamp duty for first-time buyers, second-time buyers, and buyers of property in Gozo has been extended for another

year (DBP22). While risks from the housing market seem limited overall, we would pay some attention to further developments here in connection with the stronger rise in mortgage lending.

We continue to think that high debt affordability remains a key mitigating factor to fiscal sustainability risks. Interest payments declined by a further by 7.1% in 2020 (2019: -5.3%). With this, interest costs remained at a low 1.3% of GDP, or 3.6% of total revenue last year. The ECB's PEPP, with an overall envelope of EUR 1,850bn, will run until at least 31 March 2022. Reinvestments of maturing principal payments from securities purchased under PEPP until at least 31 December 2023 will add further to the accommodative stance.

At its September meeting, the ECB decided to reduce its monthly PEPP purchases for the first time, but the monetary policy stance remains unchanged. Notwithstanding some uncertainty regarding the pace of this program over the next quarters, we believe that the ECB will continue to deliver significant stimulus through its exceptional monetary operations, including the APP. As of Oct-21, the Eurosystem's purchases of Maltese government bonds amounted to 12.6% of 2020 GDP. Also worth mentioning, EU funding via SURE came to EUR 420mn (3.2% of 2020 GDP).

Foreign Exposure

As a very open economy and international financial and business center, Malta remains subject to external vulnerabilities. Continued current account surpluses prior to the outbreak of the corona crisis have supported the highly positive net international investment position (NIIP), although volatility in trade and financial flows, as well as frequent pronounced revisions owing to the economic structure, balance this somewhat. A likely slow recovery of tourism amid still high uncertainty over the further evolution of the pandemic presents challenges to the short-term outlook, which would be compounded by a prolonged placement on the FATF grey list.

With the Covid-19 crisis heavily affecting tourism exports last year, Malta's current account balance swung into a deficit of 2.9% of GDP (2019: +5.4% of GDP), mainly due to the plunging services surplus which amounted to 18.7% of GDP in 2020, down from 26.3% of GDP in the preceding year. At the same time, the deficit in the goods trade balance shrunk by 0.9 p.p. to -10.8% of GDP.

Available data for the current year, drawing on a 4-quarter moving sum, point to an increased current account deficit as of Q2-21 (-4.0% of GDP). Against the backdrop of tourism numbers showing some recovery in the third quarter, supply shortages impairing trade to some degree, and a mix of progressing vaccination and surging infections amid virus mutation, we expect the current account balance to remain in deficit regarding the whole year 2021.

On the back of the expected acceleration of economic recovery in the course of 2022 as some of the supply-side bottlenecks fade and booster vaccinations are administered, we anticipate the current account to move closer to balance, not least bolstered by the export of non-tourist services. While we would assume a return to a surplus in the medium term, implementation of the RRP may come with a boost to imports over the coming years.

Meanwhile, Malta's highly positive NIIP increased to 60.3% in terms of GDP in 2020, while standing at 58.4% of GDP as of Q2-21, exhibiting one of the highest positive positions among the EU

members. While gross liabilities mainly consist of negative net direct investment, which are generally less crisis-prone, these may see some negative impact in the event of a prolonged placement of the sovereign on the FATF grey list.

Rating Outlook and Sensitivity

Our rating outlook on the Republic of Malta's long-term sovereign ratings is stable. We see risks related to epidemiological developments, regarding the perception of buttressing the AML/CFT supervision, and with respect to uncertainty surrounding some revenue sources. Still, we view these as broadly balanced by the economy's underlying macroeconomic strength and a more diverse export structure by now, as well as by an overall still moderate debt level and high debt affordability.

We could lower Malta's credit ratings or outlook if the medium-term growth outlook fails to improve, with negative reverberations for the fiscal outlook, notwithstanding a still comparatively moderate debt level. Reasons for this might be pandemic-related setbacks weighing on tourism, while efforts to further broaden the economic growth base are still underway, as well as setbacks with regard to revenue streams owing to changes to the international corporate taxation regime and the revised investor citizenship scheme, which remains challenged by the EC. Malta remaining on the FATF grey list for a prolonged period, which could cause reputational challenges and hamper FDI, would also constitute a credit negative element.

Conversely, we could consider raising Malta's ratings or outlook if medium-term growth outperforms our expectations, on the back of decisively implemented reforms to increase the robustness of the economic model, and irrespective of changes in global corporate taxation. A timely removal from the FATF's grey list in tandem with continued progress regarding AML/CFT would also seem beneficial, as would broadening and firming the tax base, thus improving the medium-to-longer-term fiscal and growth outlook.

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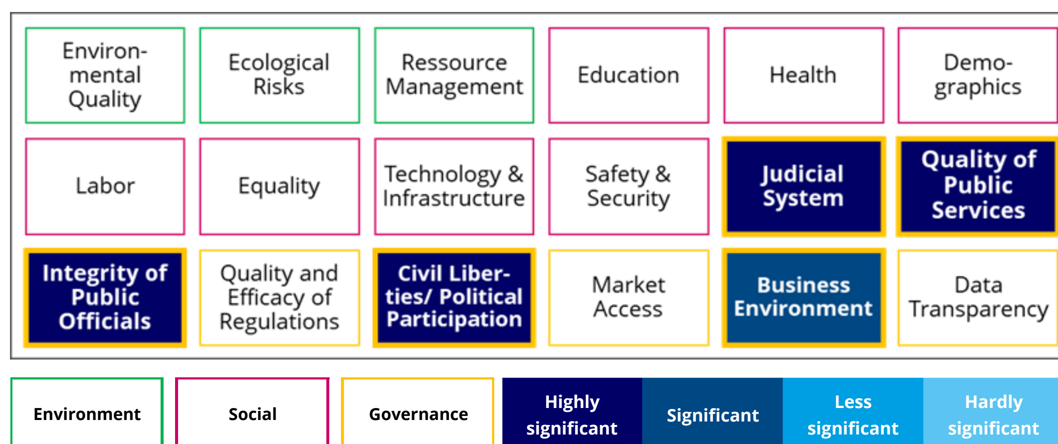
Ratings*

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

ESG Factor Box



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 what follows, we explain how and to which 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 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.

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 competitive stance of the sovereign such as the World Bank's Ease of Doing Business index and the World Economic Forum's Global Competitiveness Indicator 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	2021e	2022e
Macroeconomic Performance							
Real GDP growth	3.8	11.0	6.1	5.7	-8.3	5.2	6.2
GDP per capita (PPP, USD)	40,234	44,954	47,273	49,038	43,656	47,152	50,850
Credit to the private sector/GDP	89.0	80.6	79.1	77.9	89.4	n/a	n/a
Unemployment rate	4.7	4.0	3.7	3.6	4.4	n/a	n/a
Real unit labor costs (index 2015=100)	104.6	102.8	105.0	106.2	115.6	n/a	n/a
Ease of doing business (score)	64.8	65.2	65.5	66.1	n/a	n/a	n/a
Life expectancy at birth (years)	82.6	82.4	82.5	82.9	82.6	n/a	n/a
Institutional Structure							
WGI Rule of Law (score)	1.0	1.1	1.1	1.0	0.9	n/a	n/a
WGI Control of Corruption (score)	0.7	0.7	0.6	0.2	0.4	n/a	n/a
WGI Voice and Accountability (score)	1.2	1.2	1.1	1.1	1.1	n/a	n/a
WGI Government Effectiveness (score)	1.0	1.0	1.0	0.9	1.0	n/a	n/a
HICP inflation rate, y-o-y change	0.9	1.3	1.7	1.5	0.8	0.7	1.7
GHG emissions (tons of CO2 equivalent p.c.)	5.0	5.3	5.2	5.3	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
Fiscal Sustainability							
Fiscal balance/GDP	1.1	3.2	1.9	0.5	-9.7	-10.9	-6.0
General government gross debt/GDP	54.6	47.7	43.6	40.7	53.4	61.4	63.3
Interest/revenue	5.6	4.7	4.0	3.6	3.6	n/a	n/a
Debt/revenue	146.3	127.1	116.2	111.8	147.5	n/a	n/a
Weighted average maturity of debt (years)	8.7	9.1	8.8	8.3	7.7	n/a	n/a
Foreign exposure							
Current account balance/GDP	-0.6	5.8	6.4	5.4	-2.9	n/a	n/a
International reserves/imports	0.1	0.1	0.2	0.1	0.2	n/a	n/a
NIIP/GDP	47.7	56.5	55.4	53.2	60.3	n/a	n/a
External debt/GDP	820.7	750.1	677.2	623.7	678.6	n/a	n/a

Sources: IMF, World Bank, Eurostat, AMECO, ECB, NSO, 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

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. The Ministry for Finance (MOF) participated in the credit rating process as the authorities provided additional data and information and held a conference call with Creditreform Rating staff. Moreover, the Ministry commented on a draft version of the rating report. Thus, this report represents an updated version, which was augmented in response to the factual remarks of MOF 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	YES
With Access to Management	YES

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, European Investment Bank, Blavatnik School of Government, ECDC, 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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