MFAC
MALTA FISCAL ADVISORY COUNCIL

An Assessment of the Macroeconomic Forecasts for the Maltese Economy prepared by the Ministry for Finance in October 2015

A report prepared by the
Malta Fiscal Advisory Council

October 2015

MALTA FISCAL ADVISORY COUNCIL

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Dear Minister

LETTER OF TRANSMITTAL

In terms of article 13 of the Fiscal Responsibility Act, 2014 (Cap 534), I have the honour of transmitting a report by the Malta Fiscal Advisory Council (MFAC) with regard to the assessment of the macroeconomic forecasts prepared by the Ministry for Finance (MFIN) for the years 2015-2016 presented within the Draft Budgetary Plan 2016.

The MFAC's assessment recognizes that on the basis of the latest available information for 2015, the projected increase in the headline real GDP figure of 4.2% for the current year may indeed be feasible. It is the view of the MFAC that the 2015 forecasts are within its endorsable range, taking into account the methodology and the plausibility of the judgements made. Like other institutions, primarily the Central Bank of Malta and the European Commission, the MFIN is expecting growth in 2015 to be higher than that registered in 2014 and to be mainly driven by the final domestic demand component of the economy. The MFAC notes that the macroeconomic forecasts project economic growth above potential over the period 2015-2016, characterised by low inflation and low unemployment. This scenario appears to be in line with the robust growth which the country has experienced in 2014 and during the first half of 2015, as well as the current low inflationary environment and the vibrant labour market.

The MFAC considers the continuation of this momentum as likely for the rest of 2015, though there is an element of risk should investment expenditure be less buoyant than projected. Indeed, of importance to the updated forecasts for 2015 is the projected trajectory of gross fixed capital formation for the remaining part of this year. Such risks appear to be somewhat contained given that this expenditure component has already registered significant growth during the first half of 2015, supported by a number of public and private investment projects. However, the historical volatility of this component and the significant revisions noted in the investment projections from one forecast round to another, introduce a certain element of risk which could impinge onto the attainment of the GDP growth rates as presented in the Draft Budgetary Plan. Moreover, given the small size and openness of the local economy, developments within a single component of GDP could have a considerable impact on other areas of the local economy.

With regard to the projected increase in real GDP for 2016, the view of the MFAC is that, although plausible, this forecast is subject to downside risks and, in particular, depends critically on the expected performance of the external sector. The substantial fall in gross fixed capital formation projected by the MFIN is expected to restrain the contribution of final domestic demand to GDP growth, which is thus forecast to have a subdued role in 2016. The MFAC notes that while the direction of the overall headline real GDP growth rate envisaged by the MFIN is consistent with the projections by the other institutions reviewed in its assessment, with a slower growth in 2016 relative to 2015, there are divergences with regard to the drivers of growth. In particular, unlike the other institutions, the MFIN is projecting an export led growth scenario for 2016. While noting the risks conditioning the latest MFIN forecasts, the MFAC acknowledges that these forecasts are based on more updated information than those of the other institutions and possibly on better knowledge about specific public sector projects, which thus support the MFAC's view that the forecasts presented by MFIN are to be considered as plausible.

The MFAC once again positively acknowledges the well documented and structured process used by the Economic Policy Department throughout the forecast round. This ensures that all available information up to the cut-off date is taken on board in the preparation of the forecasts. The main external sector assumptions, which impinge significantly onto the local economy, are based on the forecasts published by international reputable organisations. This practice is to be encouraged as it provides an element of confidence in the forecasts. The MFAC is also satisfied that, to the best of its knowledge, no significant information has been excluded from the assumptions which would render the forecasts biased. The MFAC therefore deems the forecasting framework as sound and the assumptions used to produce the forecasts as valid.

One also notes that the timing of the publication of the macroeconomic forecasts within the Draft Budget Plan 2016 has been shifted forward by a number of weeks when compared to previous years, to better align the Government semester to the European semester. This change has put further pressure on the need to achieve more streamlining and coordination between the entities responsible in providing inputs into the forecast round. While appreciating that the bringing forward of the budget process has resulted in very tight deadlines for the preparation by the MFIN of the official macroeconomic forecasts, the MFAC recommends that the MFIN would review certain procedures in order to ensure that enough lead time is available to users of such forecasts who need the outputs by the MFIN as a base for their reports and analysis.

Finally, the MFAC would like to express once again its appreciation to the MFIN staff, particularly at the Economic Policy Department, for their assistance and cooperation in providing the necessary information and support for the preparation of this assessment.

Yours sincerely

Rene Saliba
Chairman

c.c. Mr Alfred Camilleri, Permanent Secretary, Ministry for Finance

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Abbreviations

CBM	**Central Bank of Malta**
CBM JUN	**Forecast exercise undertaken by the Central Bank of Malta in June 2015**
COM	**European Commission**
COM SPR	**European Commission Spring Forecast 2015.**
DBP	**Draft Budgetary Plan 2016**
ECB	**European Central Bank**
EPD	**Economic Policy Department**
ESA	**European System of National and Regional Accounts**
EU	**European Union**
GDP	**Gross Domestic Product**
HICP	**Harmonized Index of Consumer Prices**
IMF	**International Monetary Fund**
LFS	**Labour Force Survey**
MFAC	**Malta Fiscal Advisory Council**
MFIN	**Ministry for Finance**
MFIN APR	**Forecast exercise undertaken by the Ministry for Finance in April 2015**
MFIN OCT	**Forecast exercise published by the Ministry for Finance in October 2015**
NAO	**National Audit Office**
NPISH	**Non-Profit Institutions Serving Households**
NSO	**National Statistics Office**
STG	**British pound**
USD	**United States dollar**
USP	**Update of Stability Programme 2015-2018**

1. Executive Summary

This report provides an assessment of the overall plausibility of the macroeconomic forecast prepared by the Ministry for Finance (MFIN) for the years 2015-2016 within the Draft Budgetary Plan (DBP) 2016, together with an assessment of the main assumptions which underpin the forecast estimates. This assessment recognizes that on the basis of the latest available information for 2015, the projected increase in the headline real Gross Domestic Product (GDP) figure of 4.2% for the current year may indeed be feasible. Like other institutions, primarily the Central Bank of Malta (CBM) and the European Commission (COM), the MFIN is expecting growth for 2015 to be higher than the rate registered for 2014 and to be mainly driven by the final domestic demand component of the economy. Of significant importance to the current short term forecasts for 2015 is the projected growth rate for gross fixed capital formation which is expected by the MFIN to remain a major driver of growth, supported by a number of public and private investment projects. However, the historical volatility of this component and the significant revisions noted in the investment expectations from one forecasting round to another introduce a certain element of risk which could impinge onto the attainment of the GDP growth rates in the DBP for 2016. Moreover, given the small size and openness of the local economy, developments within a single component of GDP will have a considerable impact on other areas of the local economy. In particular, the projected trajectory of the external sector for 2015 is expected to very much depend on the realization of the gross fixed capital formation component for the year.

With regard to the projected increase in real GDP for 2016, the view of the Malta Fiscal Advisory Council (MFAC) is that, although plausible, this forecast is set to be very much dependent on the expected performance of the external sector. The significant projected fall in gross fixed capital formation is expected to restrain the contribution of the final domestic demand component of GDP growth which is thus forecast to play a subdued role in 2016. The MFAC notes that while the direction of the overall headline real GDP growth rate envisaged by the MFIN is consistent with the projections by the other institutions reviewed in its assessment, with a slower growth in 2016 relative to 2015, there are divergences with regard to the drivers of growth. In particular, unlike the other institutions, the MFIN is projecting an export led growth scenario for 2016. There is a certain element of risk associated with this forecast view particularly due to the ever changing international economic climate which surrounds the Maltese economy.

The MFAC once again positively acknowledges the well documented and structured process used by the Economic Policy Department (EPD) within MFIN in the undertaking of the forecasting exercise. This ensures that all available information to date is taken on board in the preparation of the forecast. Moreover, the main assumptions primarily related to variables which describe external factors and which impinge significantly onto the local economy, are based on the forecasts adopted by international reputable organisations. This practice is to be encouraged as it provides an element of confidence in the forecast. One also notes that the timing of the publication of the macroeconomic forecasts within the Draft Budgetary Plan 2016 has been shifted forward by a number of weeks compared to previous years, to better align the Government semester to the European semester. This development has put further pressure on the need to achieve more streamlining and coordination between the entities responsible in providing inputs to the forecast exercise. The MFAC recommends that the MFIN should review certain procedures in order to ensure that enough lead time is available to users of such macroeconomic forecasts who need the outputs of MFIN as a base for their reports and analysis.

2. Introduction

This report presents an assessment of the macroeconomic forecasts prepared by the MFIN and presented in the DBP 2016 document. This is in fulfillment of the responsibilities set for the MFAC in terms of the Fiscal Responsibility Act, 2014 (Cap. 534) by virtue of which, the MFAC shall monitor the Government's compliance with the fiscal rules and shall assess both the macroeconomic and the fiscal forecasts prepared by the Government throughout the year.

The macroeconomic forecasts prepared for the current year 2015 and for the year 2016 are the main focus of this report. The forecasts presented within the DBP include the inputs from various entities within Government, primarily the EPD within the MFIN which takes a leading role within this exercise. A cut-off date of the 4th of September 2015 was set by the EPD in preparation of the forecast whilst a full and final set of data for assessment was presented to the MFAC on the 7th of October 2015. The forecasting exercise takes into account all the latest and published data provided by the National Statistics Office (NSO) and other relevant authorities in conjunction with all the ad-hoc information made available to the EPD by the set cut-off date.

In comparison to previous assessments of macroeconomic projections carried out by the MFAC and formerly by the National Audit Office, one notes that this exercise has now been shifted forward by a number of weeks to better align the Government's semester to the European semester. Whilst appreciating the resultant very tight deadlines for the preparation by the MFIN of this macroeconomic forecast, it is the opinion of the MFAC that the MFIN should review certain procedures to ensure that data in relation to the macroeconomic forecasts is presented to the MFAC in line with set pre-agreed target dates, thereby facilitating a smoother running of the overall process of assessment.

The following sections will constitute this report:

i) An overview of the underlying methodology adopted by the EPD in the preparation of the forecasts.
ii) A review of the assumptions underlying the forecasts and an assessment of their plausibility in view of the latest information available.
iii) A description of the main macroeconomic variables underpinning the current forecast.
iv) A comparison of the current forecasts to those published by MFIN earlier in the year, in April 2015, as well as a comparison of the forecasts published by other institutions, namely, the European Commission (COM) and the Central Bank of Malta (CBM).

In preparation of this report and in fulfillment of its functions as set by the Fiscal Responsibility Act, the MFAC has held regular meetings and consultations with the various institutions responsible for the forecasting of macroeconomic data within the Government. The MFAC also consults and refers to a number of reports published by reputable international and local entities providing an assessment of the performance of the Maltese economy from time to time.

3. The forecasting methodology

As stated in similar assessments published by the MFAC, the forecasts presented by MFIN are based on a Keynesian macroeconometric model which is maintained by the EPD within MFIN. The model is the main tool utilized in the preparation of the forecast, comprising of a number of identity and behavioural equations. Furthermore, a number of variables are treated as exogenous to the system and are thus based on the latest available information to date. The macroeconometric modelling framework used in this forecasting exercise serves to provide a sound basis for the overall modelling exercise carried out by MFIN. This is complemented by the most up to date ad-hoc information which is available to the experts working on the model. Such information is acquired through the continuous monitoring and feedback received by EPD officials from various Government departments and other entities throughout the year. The forecasts being assessed in this report represent an updated set of the macroeconomic forecasts when compared to the forecast presented by MFIN in the Update of Stability Programme 2015-2018 (USP) published in April 2015. The MFAC positively notes that a number of other documents have been published by MFIN in the interim to the publication of this forecast as these add to the transparency of the fiscal framework. [1]

As stated earlier in this report, the cut-off date for the data included within this forecasting exercise was set by the EPD as the 4th of September 2015. The MFAC was informed by MFIN that due to a number of constraints, the data which serves as a base for the macroeconometric modelling framework within the DBP only included data published by the NSO prior to this date, and thus the macroeconometric data inputted as a base for this forecast exercise did not include the latest national accounts data published in the news release 163/2015. The base data within the modelling framework is thus based on the news release 108/2015 covering the January-March 2015 period published by the NSO on the 8th June 2015.

To ensure that all available information is taken on board in the preparation of the forecast, the EPD has however undertaken a comparative assessment of the forecasts prepared using data up to and including the first quarter of 2015 with the most recent trends extracted from the January–June 2015 published data. Any major divergences noted following the publication of the most recent data were taken on board as ad-hoc exogenous information within the econometric modelling framework. The MFAC notes the commitment of the EPD to include within the forecast all the published information available up to the set cut-off date.

Although the MFAC acknowledges that all ad-hoc data and information have been taken on board by the EPD in the forecasting exercise, the overall exercise would have benefited if all the latest data published by the NSO for the second quarter of the year had been directly incorporated within the base forecasts of the macroeconometric model. A number of assumptions within this forecasting round had to be implemented by the EPD to ensure that all data reflects the most recent trends published in the NSO release. In view of the above, the forecasts are thus based on an element of expert input and judgement. Whilst recognizing the particular time constraints experienced throughout this forecasting round, the MFAC recommends that, where possible, all available data published from official sources should be incorporated within the baseline of any prepared forecast. Towards this end, there is a need

[1] The 2014 Annual Report and the Medium Term Fiscal Strategy 2015-2018 were published by MFIN in June 2015 and the 2015 Half-Yearly Report in July 2015. An assessment of these three reports was published by the MFAC on 30th September 2015 in fulfillment of the obligations set out in the Fiscal Responsibility Act (2014).

for more coordination and planning between the various institutions involved in the forecast exercise to ensure a smoother transition between the publication of data and the incorporation of such data within the forecasting framework in a timely and efficient manner.

It is positive to note that the MFIN forecast process is well documented and adequately backed up by a structure of internal meetings with key stakeholders in the economy. The econometric model used in the preparation of this forecasting exercise ensures that all the information collated from the different sources adequately feeds up within the estimation process. A number of variables are treated within this forecasting exercise as completely exogenous to the system. This is particularly important in view of the smallness of the local economy and its reliance on international developments. The implicit volatility of the external sector is expected to have a considerable impact on the local economy and, to this effect, the information provided by a number of international reputable organisations is used as a base for the projections. Forecast assumptions are adopted from the International Monetary Fund (IMF), Consensus Economics[2] and the European Central Bank (ECB). The inclusion of these assumptions within the base structure of the forecasts is deemed as a good practice in view of the expected impact of such variables on the local economy.

The MFAC also notes, from the discussions it had with MFIN, that the macroeconomic forecasts presented in the DBP acknowledge a certain element of risk within a number of variables and to this effect, the EPD has undertaken a number of risk scenarios to assess the validity of its own forecast estimates. The MFAC feels that this exercise in the quantification of risk helps to improve on the robustness of the latest macroeconomic forecasts as published in the DBP.

4. Assessment of the main assumptions underlying the macroeconomic forecasts

This section overviews a number of variables which are treated as completely exogenous within the current modelling framework. The expected developments within such variables are of prime importance to the underpinnings of the Maltese economy. Such variables are mainly related to the external sector and are thus not expected to be affected by changes within the Maltese economy. The relative small size of the local economy and its degree of openness in terms of the global economy leads to an element of volatility and instability which is primarily internationally driven. In this regard, such variables are assumed to develop in line with the expectations provided by a number of international reputable organisations. Table 1 provides a list of the main variables treated as exogenous within this forecasting exercise together with information on the data source used for each of the variables under consideration. The use of the IMF and Consensus Economics as the main sources of data in this regard is positively acknowledged by the MFAC. This helps to provide a reliable platform of the international economy within which the Maltese economy operates. The assumptions adopted by EPD in this forecast exercise have a cut-off date of 31st August 2015.

Indeed, the assumed forecasts presented in Table 1 reflect the most recent developments in both the economic and geopolitical factors which are expected to affect the local economy. In particular, the forecasted values for the Euro exchange rate with respect to the US dollar

[2] Consensus Economics is a leading international economic survey organization which polls a vast number of forecasts to derive projections for a number of key macroeconomic variables.

and the British pound in 2015 and 2016 are expected to remain at practically the same levels of the current 2015 rates. Such expectations are very similar to what was expected in the latest forecast round carried out by MFIN in April 2015. This also applies to the short term interest rates and the long term interest rates which are projected to remain at the same levels as expected back in April 2015.

Table 1: Main macroeconomic forecast assumptions

Variable	Data source (2015-2016)	2014 (Actual)	2015	2016
Short-term interest rate[3] (annual average)	Consensus Economics	0.18[4]	0.05	0.05
Long-term interest rate (annual average)	Consensus Economics	1.70	1.60	1.60
USD/€ exchange rate (annual average)	Consensus Economics	1.304	1.090	1.072
STG/€/ exchange rate (annual average)	Consensus Economics	0.797	0.710	0.708
Real GDP Growth of main trading partners	Consensus Economics	1.20	1.50	2.00
Oil Prices (Brent, USD/barrel) (annual average)	IMF	99.02	57.11	63.00

Sources: Economic Policy Department, Ministry for Finance

Of significant importance to the Maltese economy are the economic developments over the short term period within Malta's main trading partners. It is expected that economic activity in Malta's main trading partners increases by 1.5% in 2015 and by 2.0% in 2016. Such growth rates are fairly in line with the expected developments back in April 2015 although one notes a slightly lower rate of growth for the current 2015 year. A positive outlook is being projected by the COM for most of the EU countries in the near term future years although there is some concern of whether the pace of economic activity could be sustained beyond the short term period. The most recent data suggests that growth in most countries could be sustained as economies are expected to receive some boost from a number of factors over the next few months. In particular, the low oil prices, a weaker euro and the quantitative easing policy adopted by the ECB are all expected to have a positive impact on the EU economy. This is expected to also have an impact on the projected growth rates of the external sector for the Maltese economy.

The latest geopolitical developments in the international economy are the main factors influencing the variation in the price of oil per barrel. Oil prices are assumed to remain below the $60 per barrel in 2015 and increase only slightly above this mark in 2016. The expected increase in oil prices is lower than the projected increase expected back in April 2015 and thus pressure on oil prices from the external sector is expected to be overall lower in the short term horizon.

[3] If necessary purely technical assumptions.
[4] 0.25% with effect from 13th November 2013; 0.15% with effect from 11th June 2014; 0.05% with effect from 10th September 2014.

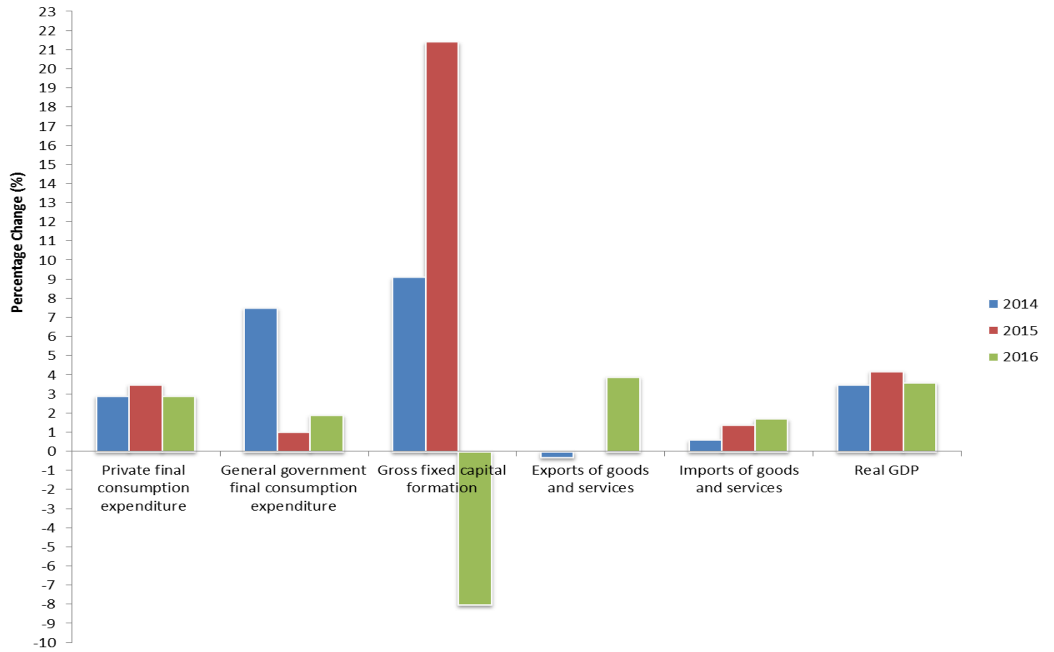
The role of the inventory component within the modelling framework is expected to remain the same as in previous forecast rounds. An analysis of the recent data available for this variable shows that this component has been characterised by significant fluctuations over time and in such circumstances the assumption adopted by the EPD to maintain a zero contribution of this variable to GDP growth over the forecast years is deemed plausible and considered adequate. The inventory component is thus assumed not to contribute materially to GDP growth over the forecast years.

A number of other assumptions, mainly of a domestic nature are also incorporated within the modelling framework and such variables are treated exogenously within the system. This helps to provide some degree of stability to the model in view of the difficulty in modelling the behaviour of certain specific components within the local economy. This also provides an element of flexibility to the modelling structure by enabling for the adequate incorporation of the impact from very particular government policies and initiatives undertaken within the economic system.

5. Description and evaluation of the macroeconomic forecasts presented within the Draft Budgetary Plan 2016

This section provides a description and analysis of the main macroeconomic variables which were forecasted for the period 2015 to 2016 by the EPD. The overall aim of the section is to provide a comprehensive assessment of the estimates over the forecast horizon within the context of the main risks associated to their realization. The forecasted macroeconomic projections together with the recorded 2014 figures, which are in line with the NSO release No.163/2015 published on the 4th September 2015, are illustrated in Figure 1 and presented in Table 2.

Figure 1: Estimates of selected macroeconomic variables valued at chain linked volumes by period (reference year 2010) over the forecast horizon



Sources: Economic Policy Department, Ministry for Finance, National Statistics Office.

Table 2: Macroeconomic projections 2015 - 2016[5]

	2014	2015	2016
At current prices	**Actual**		
Private final consumption expenditure[6]	2.8	4.3	4.9
General government final consumption expenditure	8.9	2.9	5.2
Gross fixed capital formation	11.9	27.2	-6.5
Exports of goods and services	0.1	2.5	5.7
Imports of goods and services	0.3	3.8	3.0
Nominal GDP	**5.4**	**6.5**	**6.2**
At chain linked volumes by year (reference year 2010)			
Private final consumption expenditure	2.9	3.5	2.9
General government final consumption expenditure	7.5	1.0	1.9
Gross fixed capital formation	9.1	21.4	-8.0
Exports of goods and services	-0.3	0.0	3.9
Imports of goods and services	0.6	1.4	1.7
Real GDP	**3.5**	**4.2**	**3.6**
Contributions to real growth (percentage points)[7]			
Final domestic demand	4.7	6.1	0.3
Inventories	0.1	0.0	0.0
Net exports	-1.3	-1.9	3.3
Deflators			
Private final consumption expenditure	-0.1	0.8	2.0
General government final consumption expenditure	1.4	1.8	3.2
Gross fixed capital formation	2.8	4.4	1.9
Exports of goods and services	0.4	2.5	1.7
Imports of goods and services	-0.3	2.4	1.3
GDP Deflator	**1.9**	**2.3**	**2.5**
Inflation rate			
HICP	0.8	1.0	1.8
Labour market			
Employment growth [8]	3.1	1.9	2.0
Unemployment Rate [9]	5.9	5.8	5.6
Compensation per Employee[8]	2.2	2.7	3.2
Labour productivity, persons[8,10]	0.4	2.3	1.6
Potential output and Output gap			
Potential Output	3.1	3.8	3.4
Output Gap (% of potential output)	0.1	0.4	0.6
External balance			
External Goods & Services Balance (% of GDP)	6.4	4.4	8.0

[5] Forecast estimates represent growth rates unless stated otherwise.
[6] Includes NPISH final consumption expenditure.
[7] Chain-linking by volumes gives rise to the contributions of GDP not adding to the aggregate real GDP.
[8] The estimates for the percentage change in employment growth, for compensation per employee and for labour productivity in the DBP are based upon the Eurostat Labour Force Survey (LFS) definition of total employment based on the resident population concept.
[9] The estimate for the unemployment rate in percentage terms follows the Eurostat harmonized definition.
[10] Real GDP per persons employed.

The positive outlook for 2015 in terms of real GDP growth is expected by the EPD to be spurred by the components of final domestic demand, whereas net exports are expected to generate a negative contribution to growth. The contribution to growth of final domestic demand is projected to increase from the 4.7 percentage points realized in 2014 to 6.1 percentage points in 2015. Following a similar pattern to what was observed in 2014, net exports in 2015 are projected to yield a negative contribution to real GDP growth amounting to 1.9 percentage points. This negative contribution is the result of an expected growth of 1.4% in imports of goods and services which will coincide with a levelling off in exports of goods and services. Partly supporting this anticipated negative contribution of net exports in 2015 is the expectation of a significant increase in imports related to a number of major investment projects.

In contrast to 2015, real GDP growth in 2016 is anticipated to be driven primarily by the external sector of the economy. Final domestic demand in 2016 is anticipated to contribute solely 0.3 percentage points to real GDP growth, such that, following the assumption that inventories do not contribute materially to GDP growth, the external sector is anticipated to thus contribute 3.3 percentage points to the overall growth in real GDP of 3.6% expected over 2016.

Based on the forecast projections presented in Table 2 it is evident that the EPD expects a significant turnaround in terms of the position of the external sector as well as the role that final domestic demand is expected to play with respect to the contribution to real GDP growth between 2015 and 2016. It should be noted that the volatile nature of gross fixed capital formation and the underlying risks which condition to a high degree the external sector, particularly the growth in exports of goods and services, are two factors which should be acknowledged as the main elements of risk surrounding the realization of the overall path for real GDP growth forecast over 2016. Furthermore, of significant importance to the projected impact that net exports have on real GDP growth, are the expected developments in both the import and export deflators.

Private final consumption expenditure[11] in nominal terms is expected to accelerate from the actualized 2.8% in 2014 to 4.3% in 2015 and to gather further momentum, by a further 0.6 percentage points, to 4.9% in 2016. In real terms, private final consumption expenditure is expected to retain the positive momentum observed in 2014 and grow by 3.5% in 2015 before expanding at the more subdued pace of 2.9% in 2016. The expansionary path of private final consumption expenditure both in real and in nominal terms, over 2015, is principally supported by the expected developments within the labour market. The anticipated expansion of total employment coupled with an anticipated low unemployment rate in 2015 is conducive to a higher overall level of private final consumption expenditure. Furthermore, the expected sustained acceleration in the growth of compensation per employee over the forecast horizon implies an appreciation in wages and therefore an increase in household disposable income which should further spur on the expansion of private final consumption expenditure. It should be noted that underpinning the path of real private consumption expenditure over the forecast horizon is the expectation of a deflator for private final consumption expenditure which is forecasted to accelerate at roughly the same pace as the HICP over both 2015 and 2016.

[11] It should be noted that within this report the figures presented for private final consumption expenditure also include Non-Profit Institutions Serving Households (NPISH).

In 2014, general government final consumption expenditure grew in nominal terms by 8.9% and by 7.5% in real terms. The forecast trajectory for government final consumption expenditure growth in real terms is still expected to be positive but its pace is expected to be much more restrained. In 2015, growth within general government final consumption expenditure in nominal terms is expected to decelerate to 2.9% and thereafter accelerate, to 5.2% in 2016. In real terms, the growth of government final consumption expenditure is expected to significantly decline in 2015, to 1.0%. Underpinning the increase in government final consumption expenditure is an expected increase in both intermediate consumption and compensation per employee. Further explaining the more subdued growth expected in 2015 is also the expectation of a higher level of market output, which following national accounting conventions effectively contributes to a reduction in the estimate of government final consumption expenditure. In 2016, final government consumption expenditure, in real terms, is subsequently expected to accelerate by 1.9%. The MFAC notes that the forecasted trajectory of general government final consumption expenditure does reflect the latest information in line with the government's fiscal consolidation plan. However, the actualization of the projected growth rates over 2015 and 2016, which are expected to be both more subdued than in 2014, are dependent on the level of commitment the Government will be able to demonstrate with respect to the attainment of its budgetary targets.

Following the actualized growth of 11.9% in nominal terms (9.1% in real terms) in 2014, over 2015, gross fixed capital formation both in nominal and real terms is expected to expand significantly and grow by 27.2% and 21.4% respectively. It should be noted that the anticipated high growth rate for 2015 is supported by the growth (in nominal terms) of 19.0%[12] which was experienced over the first six months of 2015. The expansion expected for 2015 is anticipated to be driven by a higher level of investment in the energy sector and a number of private investment projects which are expected to materialize. The EPD are expecting that in 2016 gross fixed capital formation will contract by 6.5% in nominal terms and by 8.0% in real terms implying a substantial turnaround from the developments expected for 2015, which illustrates the underlying highly volatile nature of this component of final domestic demand. Driving this contraction is the expectation of a level of investment within the public and private sector over 2016 which is positive and substantial, but nonetheless, of a lower magnitude than that anticipated for 2015, implying that the contraction may be attributed to a base effect from 2015. It should be noted that following the practice employed in previous forecast exercises these projected investment streams were incorporated by the EPD via information gained through a number of meetings with the relevant entities. It should be recognized that the actualization of both the 2015 and 2016 forecast estimates are surrounded by an element of risk relating to the effective absorption rate of the anticipated investment within the stipulated time-frame.

As previously noted, in 2014, the external sector of the economy yielded a negative contribution to real GDP growth. This was the result of the growth in imports of goods and services expanding by 0.6%, whilst the growth in exports effectively contracting by 0.3%. Exports of goods and services over 2015, in nominal terms, are expected to grow at 2.5%, whilst in real terms, exports of goods and services are expected to remain at the levels recorded in 2014. In 2016, exports of goods and services in nominal terms are expected to pick up significantly and grow by 5.7% in nominal terms and by 3.9% in real terms.

[12] The growth rate for the first six months of 2015 was derived by utilizing the data published within the NSO news release 163/2015.

The EPD is expecting that this acceleration in export growth will be supported by a number of factors. Of importance to the actualization of these forecast estimates is the assumed positive outlook in terms of GDP growth for Malta's main trading partners as well as the assumed persistence of a weak Euro which together are expected to aid the export performance of a number of manufacturing and service industries as well as to help to further stimulate the tourism sector. At the sectoral level the EPD is expecting the increase in exports of goods and services to be driven by the expectation of strong performance in the pharmaceuticals industry, remote gaming sectors, other business activities and in the tourism sector.

The MFAC recognizes that there is an inherent element of risk associated to the realization of the projected growth in exports over 2016. Downside risks could stem from a scenario wherein growth within Malta’s main trading partners could turn out to be less favorable than what is being assumed. This may be due to variations with respect to the assumed projected path for the Euro and the possible impact on trade and tourism which could be affected from possible changes in the international geopolitical scenario. Such uncertainties may be viewed as one of the main elements of risk which have to be acknowledged within the evaluation of the underlying forecast estimates.

In 2015, imports of goods and services are expected to expand by 3.8% in nominal terms and by 1.4% in real terms. This anticipated increase is expected to be driven by the significant expected growth in gross fixed capital formation of 27.2% (21.4% in real terms), combined with private household consumption expenditure which is expected to increase over the same period. It should be noted that the expected developments within the import component over 2015 are thus highly contingent on the realization of various key public and private investment projects which implicitly contain a relatively high import content. Over 2016 imports of goods and services are expected to expand by 3.0% in nominal terms and 1.7% in real terms. Underpinning the positive growth in imports is the expectation of a sizeable expansion within a number of export oriented industries and the anticipation of an expansion of private household consumption expenditure.

The Harmonized Index of Consumer Prices (HICP), which is the main indicator for inflation and price stability within the economy, is expected to remain subdued but nonetheless marginally increase from the 0.8% rate actualized in 2014 to 1.0% in 2015 and to accelerate further by 1.8% in 2016. The marginal increase in HICP in 2015 is conditional on the anticipated rise in the average price level of unprocessed foods. The acceleration in HICP in 2016 is expected to be supported by the assumed increase in oil prices coupled with an increase in the average price level of processed foods.

The positive developments which were experienced within the labour market in 2014 are expected to be sustained throughout both 2015 and 2016. Employment growth[13] is anticipated to reach 1.9% over 2015 and expand at roughly the same pace over 2016. The unemployment rate is expected to marginally decline from the 5.9% observed in 2014 to 5.8% in 2015 and to 5.6% in 2016. The EPD also forecasts a substantial increase in the annual percentage change of labour productivity from the 0.4% actualized in 2014 to 2.3% anticipated for 2015 and a further increase of 1.6% in 2016. It should be noted that this estimate is of particular importance to Malta's overall competitiveness and is viewed as a measure of overall labour

[13] The estimates for the percentage change in employment growth, for compensation per employee and for labour productivity (persons) in the DBP are based upon the Eurostat Labour Force Survey (LFS) definition of total employment which in turn is based on the resident population concept.

efficiency. The positive developments expected for the labour market over 2015 and 2016 are supported by both anticipated improvements in numerous sectors of the economy, most notably the tourism sector, as well as by the expected positive impact which should originate from a higher female employment rate. This reflects the impact of the various active labour market policies undertaken by the Government in recent years aimed towards increasing the female participation rate as well as policies aimed at increasing employment flexibility in terms of labour hours. Compensation per employee is also expected to undertake an expansionary path over the forecast horizon growing from the 2.2% recorded in 2014 to 2.7% over 2015 and accelerating by a further 3.2% in 2016.

The projected developments in potential output and subsequently the output gap for the 2015 and 2016 periods are presented within Table 2. As was already pointed out in the MFAC's previous assessment pertaining to the macroeconomic projections published in April 2015, the EPD generates these two estimates utilizing a methodology commonly agreed upon with the COM, namely, the production function approach. In 2015, the EPD is projecting an increase in potential output from the 3.1% observed in 2014, to 3.8% in 2015 and to 3.4% in 2016. Underpinning the level of potential output growth for 2015 is the anticipated exceptional rise in gross fixed capital formation coupled with the positive developments within the labour market. Supporting the attainment of the forecast estimates for 2016 is the positive outlook for employment growth and the expected improvements in total labour productivity. The EPD projects a positive and marginally widening output gap[14] over the forecast horizon, this trajectory is underpinned by the anticipated developments in real GDP growth and the EPD's estimated level of potential output.

6. A comparative analysis of the macroeconomic projections presented in the Draft Budgetary Plan 2016

This section starts with an analysis of the main divergences in the forecasts presented in the DBP 2016 (MFIN OCT) to those which had been presented by MFIN in the USP in April 2015 (MFIN APR). This section continues with a comparative analysis of the forecasts presented in the DBP with those prepared by other institutions, particularly the COM and the CBM. It is important to highlight that different institutions produce forecasts at different points in time and thus discrepancies between the estimates could be influenced by the level of information available at the set cut-off date for the relative forecasts.

The projected macroeconomic estimates are summarized in Table 3 overleaf. Furthermore, Figure 2 and Figure 3 provide a graphical illustration of the differences in the estimated individual components of real GDP which are provided by the various institutions for 2015 and 2016 respectively.

[14] A positive output gap denotes that actual output growth is projected to exceed potential output growth.

Table 3: Comparison of macroeconomic projections [15]

	2015				2016			
At chain linked volumes by year (reference year 2010)	**MFIN OCT 2015**	**MFIN APR 2015**	**COM SPR**	**CBM JUN**	**MFIN OCT 2015**	**MFIN APR 2015**	**COM SPR**	**CBM JUN**
Private final consumption expenditure	3.5	3.4	3.0	3.2	2.9	2.7	2.7	2.9
General government final consumption expenditure	1.0	0.6	1.5	1.8	1.9	1.2	3.7	4.1
Gross fixed capital formation	21.4	23.6	19.9	12.3	-8.0	13.1	5.6	3.5
Exports of goods and services	0.0	2.8	4.6	3.0	3.9	2.4	3.0	3.5
Imports of goods and services	1.4	5.0	6.3	3.6	1.7	3.5	3.2	3.7
Real GDP	**4.2**	**3.4**	**3.6**	**3.6**	**3.6**	**3.1**	**3.2**	**3.0**
Contributions to real growth (percentage points) [16]								
Final domestic demand	6.1	6.3	5.7	4.5	0.3	4.6	3.4	3.1
Inventories	0.0	0.0	0.0	-0.2	0.0	0.0	0.0	0.0
Net exports	-1.9	-2.9	-2.2	-0.6	3.3	-1.6	-0.3	-0.1
Deflators								
Private final consumption expenditure	0.8	0.9	1.3	N/A	2.0	1.5	1.9	N/A
General government final consumption expenditure	1.8	3.2	N/A	N/A	3.2	3.0	N/A	N/A
Gross fixed capital formation	4.4	1.9	N/A	N/A	1.9	1.9	N/A	N/A
Exports of goods and services	2.5	2.4	4.0	N/A	1.7	2.3	3.2	N/A
Imports of goods and services	2.4	3.1	5.5	N/A	1.3	2.1	3.1	N/A
GDP Deflator	**2.3**	**1.3**	**1.4**	**N/A**	**2.5**	**2.1**	**1.8**	**N/A**
Inflation rate								
Overall HICP	1.0	1.0	1.3	1.4	1.8	1.8	1.9	1.8
Labour market								
Employment growth [17]	1.9	2.0	2.4	2.8	2.0	1.8	2.4	2.3
Unemployment Rate [18]	5.8	5.8	5.9	5.9	5.6	5.7	5.9	5.8
Compensation per employee [17]	2.7	3.1	2.0	1.5	3.2	3.7	2.0	2.0
External balance								
External Goods & Services Balance (% of GDP)	4.4	2.3	2.3	5.9	8.0	0.8	1.9	5.4

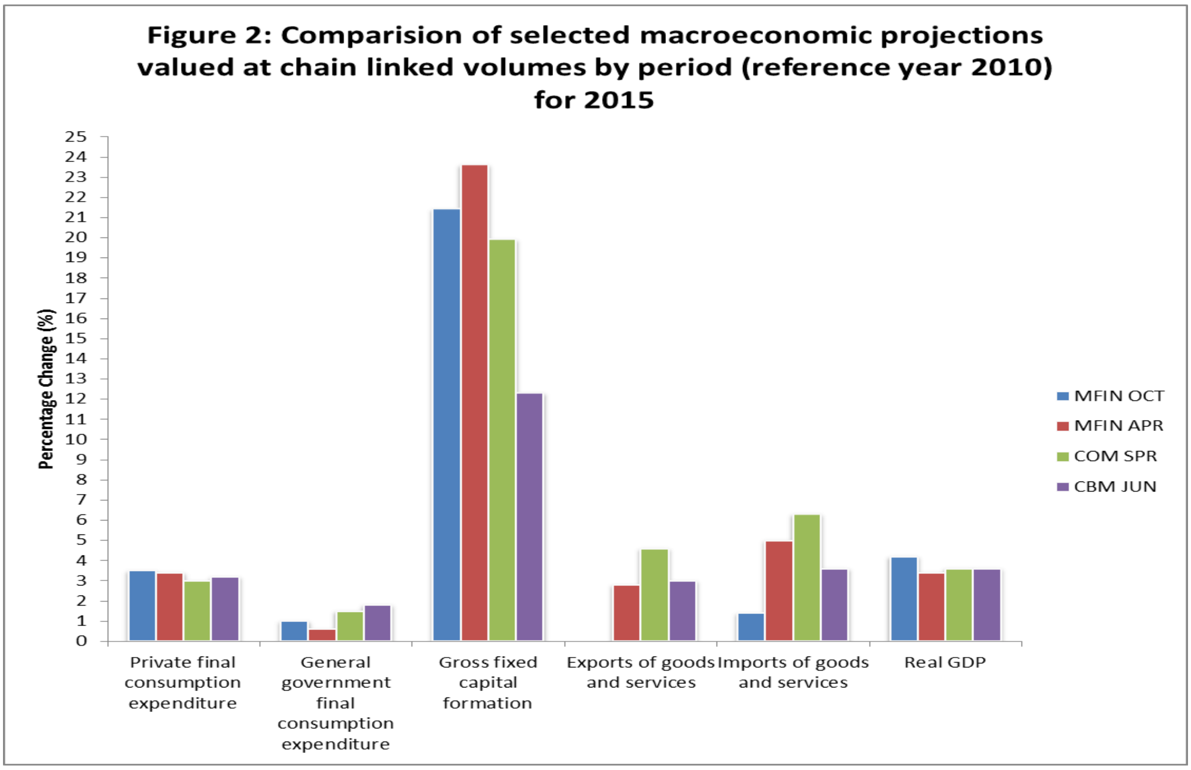
Sources: Ministry for Finance, Central Bank of Malta, European Commission

[15] Forecast estimates represent growth rates unless stated otherwise.

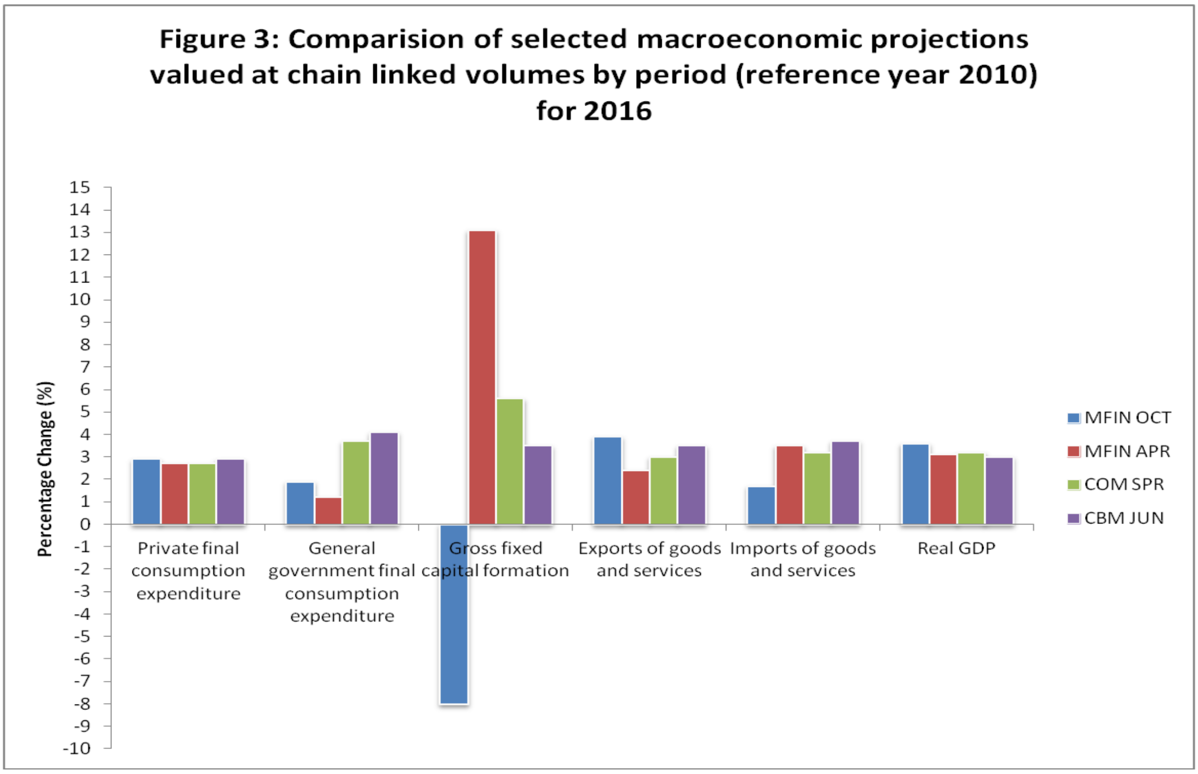
[16] Chain-linking by volumes gives rise to the contributions of GDP not adding up to the aggregate real GDP series.

[17] Figures for employment growth and compensation per employee may not be directly comparable between the various forecast estimates of the various institutions. MFIN OCT makes use of the LFS definition of total employment, based on the resident population concept, whilst on the other hand MFIN APR, CBM and COM adopt the Eurostat national accounts definition.

[18] The estimates for the unemployment rate in percentage terms follow the Eurostat harmonized definition.



Sources: Ministry for Finance, Central Bank of Malta, European Commission



Sources: Ministry for Finance, Central Bank of Malta, European Commission

6.1 A comparison of the macroeconomic projections in the Draft Budgetary Plan 2016 with those generated by the MFIN in their Update of Stability Programme 2015-2018

This section of the report provides a comparative assessment of the forecasts for 2015 and 2016 for the macroeconomic variables estimated within MFIN OCT evaluated against those within MFIN APR. The MFIN APR forecast estimates, which are presented in Table 3, carry a cut-off date of the 18th March 2015 and are therefore not based on any published actualized data for 2015. The following evaluation aims to describe and assess the main forecast revisions which were implemented by MFIN since April 2015. The relevant projections of the MFIN's April forecast for 2015 and 2016 are also shown in Figure 2 and Figure 3 for ease of comparison.

The MFAC notes a number of significant revisions between the two forecasting rounds. In general a more buoyant economy is being projected for 2015 and 2016 within MFIN OCT. The rate of growth of real GDP expected for 2015 has in fact been revised upwards from 3.4% to 4.2% indicating an overall more positive outlook for the year. This upward revision is however not underpinned by a stronger final domestic demand component, which has effectively been revised downwards by 0.2 percentage points, but by a weaker negative contribution of net exports to overall real GDP growth. Nonetheless, it should be noted that comparing the two forecast exercises there is very little diversion with respect to the components of growth which drive the economic expansion in 2015.

Assessing the individual expenditure components of GDP, it may be observed that gross fixed capital formation is anticipated within MFIN OCT to grow at a more subdued pace relative to the MFIN APR figures, while exports of goods and services are now anticipated to remain at 2014 levels compared to the projected 2.8% growth in April 2015. The lower expectation in the growth of exports of goods and services over 2015 is in line with the revision undertaken to the assumption of a slower real GDP growth rate expected for Malta's main trading partners. These two downward revisions partly explain the lower growth rate of imports of goods and services from 5.0% to 1.4% now expected for 2015. The revisions made to the external sector of the economy for 2015 are such that the net impact results in a lower negative contribution of net exports to real GDP growth over 2015. The other components of final domestic demand have remained roughly on the same trajectory as that forecasted in April, with only a marginal increase in the expectation of private consumption expenditure and an upward revision of 0.4 percentage points in government final consumption expenditure.

The main drivers to overall growth are therefore still expected to remain private household consumption expenditure, driven primarily by higher employment growth, and gross fixed capital formation which is expected to be spurred on by investments in the energy sector. An evaluation of the actualized data for the first six months of 2015 supports the more buoyant expectations for the growth rates of both real GDP and private final consumption expenditure. Furthermore, it should be highlighted that revisions have been carried out within all the deflators of the various expenditure components which, given the structure of the forecasting methodology, also partially condition the revisions made to the expenditure components of real GDP. The MFAC notes no variation in terms of the main risks surrounding the actualization of the 2015 forecast estimates between the two forecast exercises, which thus remain the risks associated to the materialization of the anticipated investments in both the private and the public sector.

As for the revisions undertaken for 2016 between the April and October EPD forecast exercises, these are of a considerably higher degree. The EPD has significantly reduced the predominant role which final domestic demand was expected to contribute to real GDP growth, from 4.6 percentage points in MFIN APR to 0.3 percentage points in MFIN OCT. It has also completely overturned the expected impact that the external sector is anticipated to have on real GDP growth. These two factors have led to a very different outlook with respect to the overall drivers of economic growth over 2016. In fact, within MFIN APR, growth was expected to be driven predominately by the components of final domestic demand and net exports were to act as a drag on real GDP growth (-1.6 percentage points). In contrast, within MFIN OCT, real GDP growth is expected to be driven almost exclusively by the expected developments within the external sector (3.3 percentage points).

As previously noted in this section there is a considerable divergence in the main drivers of economic growth for 2016 between the two forecast exercises. The largest divergence in terms of overall magnitude is the revision undertaken to real gross fixed capital formation, which in the April forecast was estimated to expand by 13.1%, and is now anticipated to contract by 8.0%. Underpinning this significant revision is the frontloading to 2015 of the investment which was previously assumed to take place in 2016 and the implicit impact of the base effect from 2015 to 2016. The developments pertaining to the reduced gross fixed capital formation anticipated for 2016 underpin the downward revision in the growth rate of imports of goods and services which has been scaled down from 3.5% to 1.7%. The MFIN's October forecasts for the other two components of final domestic demand in 2016, these have remained broadly in line with the estimates generated in April. The MFAC also notes that a general evaluation of the comparison between the overall risks surrounding the MFIN forecast exercises of October compared to April highlights the more prominent role that the risks pertaining to expected developments to the external sector now have on the actualization of the forecast estimates for 2016.

As regards the forecast estimates for both 2015 and 2016 pertaining to the developments in inflationary pressures, the MFAC notes that these have not been revised between the two forecast exercises, implying a subdued growth in HICP of 1.0% over 2015 and 1.8% over 2016 spurred on by the expectation of a rise in oil prices. The MFAC also notes no significant divergences relating to the outlook on labour market developments[19] for both 2015 and 2016 in relation to the unemployment rate.

6.2 A comparison of the macroeconomic projections in the Draft Budgetary Plan 2016 with those generated by the European Commission in its Spring Forecast 2015

The COM published its Spring forecast on the 5th of May 2015. The European Economic Forecast publication has a cut-off date of the 21st of April 2015, implying that data on the first two quarters of 2015 was not incorporated within the COM forecasting exercise. Data for the main components of the forecasts are presented in Table 3 of this report. The COM projects a real GDP increase in 2015 of 3.6%, slightly above the recorded rate of 3.5% for 2014. In 2016, the COM anticipates a more moderate increase in the growth rate of real GDP of 3.2%. Divergences between the COM and MFIN projections could be partly explained by the fact

[19] It is important to note that no comparison can be made with respect to both employment growth and compensation per employee figures due to a variation in the definitions employed to generate the forecast estimates between the two forecast exercises.

that the forecasts prepared by the two institutions are based on information available at different points in time. This section compares the projections and expected contribution of the various components of economic activity which constitute real GDP growth for 2015 and 2016 as seen by the COM and MFIN.

Both real GDP growth rates projected by the COM for 2015 and 2016 are below the respective rates projected by MFIN. The main driver of growth for 2015, the final domestic demand side of the economy, is a common source of growth in both forecast exercises. The COM projects a slightly lower increase in the private final consumption expenditure component and a slightly higher increase for the public final consumption expenditure when compared to the rates projected by MFIN. The projected growth rates of MFIN for these components are backed by the most recently available data for the first six months of 2015. One notes that the projection for the rate of investment growth for 2015 is fairly similar for both institutions. The COM thus expects a contribution from the final domestic demand component to GDP growth in 2015 of 5.7 percentage points, which although still considered to the high is below the 6.1 percentage points being projected by MFIN. The contribution to GDP growth from the external sector in 2015 expected by the COM is similar in both size and magnitude to that of MFIN, reaching a negative of 2.2 percentage points. Furthermore, the individual growth rates of both exports and imports significantly differ between the two institutions. The higher growth rates for real imports of goods and services expected by the COM are backed by a higher expected increase in exports of goods and services for 2015.

The COM projects a growth rate of 3.2% for real GDP in 2016 which is mainly attributable to the continuing positive performance of the final domestic demand sector of the economy. The COM forecasts a contribution of 3.4 percentage points from the final domestic demand component to GDP growth. This is in contrast to the contribution expected by the Maltese authorities who are envisaging only a marginal contribution from the final domestic demand side of the economy for the year 2016. The Commission's expectation for final domestic demand is backed by an increase in private final consumption expenditure of 2.7% and an increase of 3.7% for government final consumption expenditure. The COM and the MFIN both expect a slight slowdown in the growth rate of private final consumption expenditure for 2016 in comparison to 2015. One notes that the COM expects the increase in government final consumption expenditure for 2016 to be higher when compared to the projections by the Maltese authorities. A major difference between the two institutions is the expectation for developments within the gross fixed capital formation component. Underpinning this difference is the latest information available to MFIN which indicates that investment in 2016, although positive would be less than that expected to be recorded for 2015.

Major differences between the COM forecast and the MFIN forecasts are also identified for the external sector of the economy. In line with the expected developments in the final domestic demand component of the economy the COM expects a lower increase in the growth rate of imports of goods and services for 2016 compared to 2015. Exports are forecasted to also register an increase in 2016 which is of lower magnitude when compared to that expected for 2015. In total a negative net exports contribution of 0.3 percentage points is expected by the COM. This differs significantly from the expected positive contribution towards real GDP growth of 3.3 percentage points by MFIN.

A similar trajectory is being projected by both institutions for price developments in 2015 and 2016. The inflation rate is expected to accelerate in 2015 and to further accelerate in 2016 by both the COM and MFIN. The rates projected by the COM are slightly higher reaching 1.3%

in 2015 and 1.9% in 2016. Developments in the labour market for 2015 and 2016 are expected to follow similar paths with both institutions expecting the continuation of further growth for this important determinant of activity within the economy. The rate of unemployment is expected to remain below the 6% mark by both the COM and MFIN for both 2015 and 2016. It is important to note that rates of growth for employment are not strictly comparable between the two institutions given the differences in the respective methodologies used to obtain the estimates.

6.3 A comparison of the macroeconomic projections in the Draft Budgetary Plan 2016 with those generated by the Central Bank of Malta (June 2015)

The forecast presented in Table 3 for the CBM carry a cut-off date of the 20th May 2015 and do not include national accounts data published by the NSO for 2015. Divergences between the forecasts of the two institutions can be partly explained by the fact that they have been based on information available at different points in time. The relevant projections of the CBM for 2015 and 2016 are also added to Figure 2 and Figure 3 for ease of comparison. The CBM is forecasting a sustained growth rate in real GDP for both 2015 and 2016 on top of the expansion recorded for 2014. A real GDP growth rate of 3.6% and 3.0% is being forecasted for the respective years. These rates are roughly around 0.5 percentage points below those being forecasted by MFIN in this latest forecast round.

The CBM forecasts portray the final domestic demand side of the economy as the main driver of economic growth in both years 2015 and 2016. One particularly notes the significantly lower expected increase in gross fixed capital formation for 2015 within the CBM forecasts as compared to the much higher expected increase in this component of expenditure by MFIN. This leads to a contribution from the final domestic demand side of 4.5 percentage points in the CBM forecast compared to the 6.1 percentage points projected by the MFIN results. Differences in developments for this component in 2016 reflect the different base effects projected for 2015 and the latest information available to MFIN which is being incorporated in this forecast round. The CBM forecast expects private final domestic expenditure to grow at a slower pace in 2015 compared to projected MFIN rates and by similar rates as projected by MFIN for 2016. Whilst relatively similar rates of growth for 2015 are projected by the CBM and the MFIN for government final consumption expenditure, there is a significant difference in the projected increase of this component between the two institutions for 2016. The CBM projects an increase of 4.1% in relation to the 1.9% increase expected by MFIN.

In view of these developments one notes considerable differences between both institutions in the expected contribution of the final domestic demand component to GDP for 2016. The forecasts presented by the CBM expect the economy to grow in 2016 on the basis of developments in the final domestic demand component (3.1 percentage points) whilst the forecasts presented by MFIN expect only a minor contribution from this component to overall growth.

The noted differences between both institutions with regard to the components of final domestic demand have an impact on the expected developments within the external component of the economy. Whereas the CBM is projecting relatively no contribution to growth from the external sector of the economy the MFIN growth rates for 2016 are primarily driven by increases in exports of goods and services which are in excess of the increase in imports of goods and services. Indeed the main difference is due to the projected path for investment growth in 2016 and thus the impact on the import component given that both institutions expect exports to pick up relatively well in 2016.

Both institutions expect the inflation rate to accelerate in 2015 compared to 2014 and to grow at a slightly faster pace in 2016. The CBM's projected inflation is slightly above that expected by MFIN for 2015 whilst both institutions forecast an inflation rate of 1.8% for 2016. Although developments within the labour market are not directly comparable due to the different definitions used by the two institutions one still notes similarities in the expected trajectory for employment growth and unemployment over the 2015 and 2016 years. Both institutions expect employment to grow in 2015 with the rate of growth expected by the CBM to be relatively higher (2.8% compared to 1.9%). Lower rates of growth are expected for this important indicator of employment activity within the economy for 2016 by both institutions. The unemployment rates forecasted by both institutions for 2015 and 2016 are expected to reflect the ongoing active labour market policies, thus contributing to reach rates which are below the expected overall EU averages for this indicator of economic activity.

7. Conclusion

This MFAC assessment acknowledges a number of risks to the current forecasts, particularly in respect of the expected contribution of the gross fixed capital formation component within the forecast years and the expected contribution of the external sector to the overall growth in the local economy. The MFAC's evaluation recognizes that on the basis of the latest available information for 2015, the projected increase in the headline real GDP figure of 4.2% for the current year may indeed be feasible. Like other institutions, primarily the CBM and the COM, the MFIN is expecting that growth for 2015 will be higher than in 2014 and that this will be mainly driven by the final domestic demand component of the economy. Of crucial importance to this prediction is the expected trajectory of gross fixed capital formation over the remaining part of the current year given that this component of expenditure has already registered significant increases during the first half of 2015. The historical volatility of the investment component and the significant revisions noted in the investment expectations from one forecasting round to another, introduce a certain element of risk which could impinge onto the attainment of the GDP growth rates in the DBP 2016.

Moreover, given the small size and openness of the local economy, developments within a single component of GDP will have a considerable impact on other areas of the local economy. In particular, the projected trajectory of the external sector for 2015 is again very much dependent on the realization of the gross fixed capital formation component for the year.

With regard to the projected increase in real GDP for 2016, the view of the MFAC is that, although plausible, this forecast is subject to downside risks and, in particular, depends critically on the expected performance of the external sector. The substantial projected fall in gross fixed capital formation projected by the MFIN is expected to restrain the contribution of final domestic demand to GDP growth. The MFAC notes that while the direction of the overall headline real GDP growth rate envisaged by the MFIN is consistent with the projections by the other institutions reviewed in its assessment, with a slower growth in 2016 relative to 2015, there are divergences with regard to the drivers of growth. In particular, unlike the other institutions reviewed in this assessment, the MFIN is projecting an export led growth scenario for 2016. There is a certain element of risk associated with this forecast view particularly due to the ever changing international economic climate which surrounds the Maltese economy. However, while noting the risks conditioning the latest MFIN forecasts, the MFAC acknowledges that these forecasts are based on more updated information than those of the other institutions and possibly on better knowledge about specific public sector projects, which thus support the MFAC's view that the forecasts presented by MFIN are to be considered as plausible.

The MFAC once again positively notes the well documented and structured process used by the EPD throughout the forecasting exercise. Moreover, the main assumptions primarily related to variables which describe external factors and which impinge significantly onto the local economy, are based on the forecasts adopted by international reputable organisations. This practice is to be encouraged as it provides an element of confidence in the forecasts. The MFAC is also satisfied that, to the best of its knowledge, no significant information has been excluded from the assumptions which would render the forecasts biased. The MFAC therefore deems the forecasting framework as sound and the assumptions used to produce the forecasts as valid.

One also notes that the timing of the publication of the macroeconomic forecasts within the DBP 2016 has been shifted forward by a number of weeks in comparison with previous years, thereby better aligning the Government semester to the European semester. This development has put further pressure on the need to achieve more streamlining and coordination between the entities responsible in providing inputs to the forecast exercise. While appreciating that the bringing forward of the budget process has resulted in very tight deadlines for the preparation by the MFIN of the official macroeconomic forecasts, the MFAC recommends that the MFIN should review certain procedures in order to ensure that enough lead time is available to other institutions adopting MFIN’s macroeconomic forecasts as a base for their reports and analysis.