# International Monetary and Financial Committee

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**IMFC Statement by Pier Carlo Padoan**
**Minister of Economy and Finance, Italy**

On behalf of the Albania, Greece, Italy, Malta, Portugal, San Marino

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## Developments in the Constituency

Since the last Spring Meetings, macroeconomic conditions in many countries of our constituency have improved. In Italy a stronger-than-expected recovery is underway while the economic expansion continued in Portugal and Albania and further strengthened in Malta. In San Marino economic activity has remained weak also in 2014, though to a lesser extent than in the previous year.

Due to high uncertainty in the first half of this year, the economic outlook in Greece has deteriorated; however, the new ESM loan and the measures already undertaken by the Greek authorities will sustain confidence and support a gradual recovery. In the quarters ahead, for most countries of our constituency, GDP projections point to a consolidation of the recovery on the back of the commodity prices fall, accommodative monetary policies, improved financial conditions and the positive impact from the implementation of structural reforms.

Progress also affected the external sector of the countries in our constituency, with further gains in the surpluses of Malta and Italy and a reduction in the current account deficit in Albania. On the labor market, unemployment remains high in some countries (Greece, Portugal, Italy), particularly among the young and the long-term unemployed, but positive signals are emerging with some employment creation, including in Italy where, thanks to the Jobs Act, the share of new hires is skewed toward permanent contracts. Malta enjoys very good labor market developments, with strong job creation and low unemployment. Inflationary pressures remain subdued and are expected to remain moderate going forward.

Overall, fiscal policy remains prudent across the constituency and aims at a more growth-friendly composition of public expenditures. Going forward, authorities remain committed to further improve their fiscal positions and put public debt-to-GDP ratios on a steadily declining path. Financial conditions have also broadly improved. The banking systems are sound and relatively well-capitalized. In some countries, non-performing loans remain elevated and on several fronts efforts are underway to address the issue in order to strengthen banks' balance sheet and enhance private sector's credit growth.

The Board completed the fourth review of the IMF-supported EFF program with Albania in May 2015. As far as Greece is concerned, Last August Greece and the European Institutions agreed upon a new ESM Loan whose first tranche by € 26 billion was approved on August 20, 2015.

**Developments in the Members of the Constituency**

**Italy:** In the first two quarters of the year, GDP grew respectively by 0.4 and 0.3 percent quarter-on-quarter, confirming that economic recovery is underway. Private consumption benefited from the pickup in demand for durable goods driven by larger disposable income, reflecting cuts in the tax wedge. Gross fixed capital was driven in Q1 by the transportation component, followed in Q2 by a gain in machinery and equipment. Inventory restocking also supported GDP growth while construction investment remained subdued.

As for the external side, despite contained evolution of world trade, export growth slightly exceeded official projections. Imports' increase was substantial due to internal demand and high purchases of intermediate goods. In the first seven months of 2015, the trade surplus rose to €26.5 billion (excluding energy €47 billion). In the same period, the current account surplus increased to €18.9 billion.

On the labor market, employment grew by around 0.5 percent in the first two quarters and continued to rise also in August, when the unemployment rate fell to 11.9 per cent (from 12.4 percent in Q2). The recently enacted Jobs Act reform and incentive measures raised the share of permanent contracts for newly hired employees, with a welcome composition shift.

In September, consumer inflation rose by 0.2 percent year-on-year, with its core component decelerating to 0.7 percent. Inflation appears to have bottomed out, especially core inflation. Financial conditions have improved. According to the latest Bank Lending Survey, credit standards on loans to firms and households continued to ease. The most recent information bodes well for the economic recovery and a continued expansion of the manufacturing sector.

The new official forecast in the Update of the 2015 Stability Program (approved by the Cabinet on September 18, 2015) posts an upward GDP revision: Italy's real GDP is now expected to increase by 0.9 per cent in 2015 (from 0.7 percent in April's 2015 Stability Program) and by 1.6 percent in 2016 (from 1.4 per cent).

Fiscal consolidation will continue. The budget deficit is expected to decline from 2.6 percent of GDP this year to 2.2 next year, almost entirely due to an improvement in the primary balance. Budget balance is to be nearly achieved in 2018. The path toward improving the structural balance would be more gradual than previously foreseen, although this is affected by conservative estimates of potential output growth. In 2016 the government intends to make full use of the flexibility clauses regulated in the Treaties; thus the structural budget deficit, equal to 0.4 per cent of GDP in 2015, will temporary move up to 0.7 percent in 2016. Looking ahead, it will fall again to 0.3 per cent in 2017 and reach balance in 2018. In 2016 the debt-to-GDP ratio is projected to decrease for the first time after eight years, declining down from 132.8 percent to 131.4 next year and then fall gradually to 119.8 percent in 2019, including financial support to other Euro area countries. This consolidation path is consistent with the rules adopted by the European Union.

The fiscal policy actions supporting these targets include: (i) further spending cuts under the ongoing spending review; (ii) the repeal of the property tax on main residences, agricultural land and machinery; (iii) broader safety net for the unemployed and measures to fight poverty, promote energy efficiency and the Southern regions' economy; (iv) the cancellation of the escape clause according to which indirect taxes would have been hiked in 2016. A reduction in the taxation of corporate profits is planned for 2017.

**Albania:** The Albanian economy maintained its positive momentum in the first half of 2015. Growth accelerated further while some crucial economic and financial stability indicators improved. The Albanian authorities have continued to pursue their stability-oriented economic policies and growth-enhancing reform agenda. Developments in Greece, with which Albania has extensive trade and financial links, prompted decisive and successful actions by Albanian authorities in order to avoid possible contagion.

Economic growth accelerated in the first half of the year, largely due to higher investments and an improved trade balance. Leading indicators point to continued growth in the second half of the year. However, economic activity remains below potential. Spare capacity is reflected in the continued undershooting of the inflation target and weak demand hinders the fiscal consolidation efforts. Nevertheless, inflation expectations appear to be well-anchored, public debt remains under control, and the drive for fiscal consolidation remains unchanged. The current account deficit contracted while foreign direct investments were substantially higher, due to accelerated investments in the extracting and oil industry.

We expect the pace of growth to pick up further in the following years. This acceleration will be based on the solid fundamentals of the Albanian economy, on expected improvement in the external economic and financial environment, and on further structural reforms which will improve the business climate and risk-taking incentives in the private sector.

The Albanian government remains committed to its fiscal consolidation targets, as detailed in its Macroeconomic and Fiscal Framework. Despite some revenue underperformance this year, the government has embarked in a widespread reform to fight informal economy, with the goal of boosting fiscal revenues and improve business environment. The pension system was put on a sustainable footing and budgetary risks related to the energy sector were reduced. The fiscal consolidation process will continue to target further improvements in the public expenditure management framework.

The Bank of Albania remains focused on its price stability mandate. This will require the pursuit of an expansionary monetary policy for the foreseeable future. At the same time, the Bank of Albania will continue to diligently exert its banking supervision and regulation functions. The financial system remains sound, underscored by a liquid, profitable and well-capitalized banking system.

Financial system reform will continue, drawing from the FSAP recommendations, with the ultimate goal of creating a sound, efficient and resilient financial system. The Albanian authorities will also continue to implement broader structural reforms, in order to improve the medium- and long-term growth potential of the country. The recent reforms in the administrative and territorial governance and in the education system were successful. The government is also planning to initiate a long-awaited reform to overhaul the current structure and functioning of the judicial system.

The Albanian authorities remain committed to their sustainable growth agenda. They reiterate their intent of anchoring their policies in the on-going IMF-supported program and to pursue with a relentless conviction their EU integration process.

**Greece**: The new ESM Loan Agreement resolves the financing problem of Greece for the next 36 months and paves the way for the gradual but rapid lift of capital controls. It offers stability and improves business and household expectations on the economic outlook going forward. It provides sufficient time to restore fiscal credibility, address endemic pathologies and build new institutions. On August 20, 2015, the first tranche of financial assistance for Greece of €26 billion was approved. €13 billion were disbursed immediately to be used for budget financing, payment of arrears and debt servicing needs while €3 billion will be disbursed at the latest by the end of November, once Greece has completed additional prior actions. The remaining €10 billion will be used for potential bank recapitalization. The IMF is expected to consider further financial support for Greece after the completion of the first review of the ESM program, taking into account the policy reforms and debt relief measures.

The Greek economy has fallen into another period of recession and the unemployment is expected to rise again, leading to a negative impact on public finances. However, the lower targets for the primary balances (-0.25 percent of GDP for 2015 and 0.5 percent for 2016 compared to 3.5 and 4.5 percent respectively) allow a more gradual fiscal adjustment and add credibility to the Programme. In the medium-term, and as growth gets momentum, the Greek authorities remain committed to primary surpluses. Regarding the banking sector the signature of the ESM loan agreement has restored depositors’ confidence and there has been a considerable net inflow of deposits since the suspension of the bank holiday. The new economic environment allows for a speedier relaxation of capital controls than initially anticipated. The Asset Quality Review and stress tests will be concluded by mid-October and the bank recapitalization will follow. The aim is to recapitalize banks in line with real capital needs, while bail-in of depositors is ruled out.

The Greek Government elected on September 20, 2015, is committed to implement a wide-range of reforms in order to restore fiscal sustainability, safeguard financial stability and boost growth. To that effect, the Government aims at mending or designing new institutions that foster fairness and social inclusion in the key areas of labor and product markets and the social safety net. A priority in the reform agenda of the Government is an equal allocation of the burden of adjustment by correcting the key endemic pathologies of tax evasion. Following the first positive review, the Greek authorities expect a discussion of the restructuring of the public debt. They believe that measures reducing the annual debt servicing needs will create much needed fiscal space, improve expectations and strengthen investors’ confidence on the medium-term outlook of the economy. The Greek Government has already taken the initiative to start detailed technical preparations on all feasible debt relief solutions.

**Malta:** After recording a 3.5 percent GDP growth rate in 2014, the Maltese economy maintained a solid pace of expansion in the first half of 2015. During this period, real GDP increased at an average annual rate of 5.1 percent, mainly supported by domestic demand.

Robust expansion in economic activity continues to support employment growth and a further decline in unemployment. Employment rose at an annual rate of 1.3 percent in the first quarter of the year, while the unemployment rate fell to 5.7 percent.

Price pressures remain contained, despite buoyant activity. Consumer inflation averaged 0.9 percent during the twelve months to August 2015, up slightly from 0.8 percent in 2014. Inflation is being driven by prices of food and services, but is being held back by declining energy costs.

The general government deficit-to-GDP ratio narrowed further in 2014, to 2.1 percent of GDP, while the debt-to GDP ratio declined to 68.5 percent. Reflecting these developments and the European Commission's expectation of a further improvement in the fiscal position over the coming years, in July 2015 the EU Council abrogated the Excessive Deficit Procedure. Both ratios are expected to decline in the medium term. From an institutional perspective, following the enactment of the Fiscal Responsibility Act last year, an independent fiscal council was set up, further reflecting the Government's commitment to fiscal discipline. It began to operate in 2015.

Malta continues to record a surplus on the current account of the balance of payments. This reached 3.3 percent of GDP in 2014, reflecting a positive balance on trade in services. The current account balance remained in surplus during the first quarter of this year.

The financial system remains sound and resilient. The core domestic banks' capital levels remain healthy and their liquidity levels ample. Loan-to-deposit ratios, moreover, are among the lowest in the euro area. Meanwhile efforts remain under way to raise provisions against non-performing loans and ease companies' access to finance, partly through the creation of a Development Bank and a framework for venture capital funds.

The economic outlook remains favorable, with real GDP expected to continue expanding strongly this year and the next, supported by policies aimed at increasing labor market participation, stimulating investment and enhancing energy efficiency, as well as by an improving external environment. Price pressures are expected to normalize inflation closer to but below 2 percent throughout 2016.

**Portugal:** Amidst a moderate and uneven global recovery, the Portuguese economy remains on a favorable path, building on the substantial adjustment of key macroeconomic imbalances, improving prospects for the euro area and significant gains in market confidence. Financing conditions facilitated the improvement in the structure of public debt, and early repayment of IMF credit is proceeding as planned.

Real GDP grew by 1.5 percent year-on-year in the first two quarters of 2015, with an increasing contribution from domestic demand (which benefited from the recovery in business investment) and resilient export growth. Going forward, growth should continue to gain from the dynamism of exports, as fiscal consolidation and the decreasing but still high levels of non-financial private sector indebtedness will continue to weigh on domestic demand. Credit conditions continue to improve, with flows increasingly channeled to the most dynamic and productive firms. Labor market conditions improved markedly from the crisis troughs. However, unemployment remains high, with large long-term and structural components. Inflation is projected to remain at low levels.

The Portuguese banking system solvency levels have been improving, recourse to Euro-system refinancing continues to decrease and the deposit base remains robust. Profitability is slowly recovering but still poses a challenge, amidst the slow economic recovery, an ongoing process of private sector deleveraging, the low levels of interest rates, and still high levels of non-performing loans. Overall, a carefully balanced strategy to facilitate corporate debt restructuring must be pursued in parallel with additional efforts by the banking sector to restore sustainable levels of profitability, including through further adjustment of the cost structure.

Looking forward, important challenges still lie ahead and a strong and broad-based commitment to credible and consistent policies remains of the essence, namely to lock in progress achieved, ensure investors' confidence, promote sustainable growth and employment and keep public and private sector debt on a downward trajectory. A credible and dynamic structural reform agenda and the institutional deepening of the EMU are both necessary conditions for the continued correction of external and internal imbalances through the reorientation of the economy to the most productive sectors.

**San Marino**: In 2014, the prolonged decline in GDP eased, but the consequences of the global financial crisis continue to negatively affect the economy: unemployment reached unprecedented levels (8.65 percent in June 2015) and GDP is estimated to have fallen by 1 percent in 2014, though to a lower extent than in 2013. This year is projected to mark the end of the recession, with GDP growth estimated at 1 percent in 2015 and at 1.1 percent in 2016.

The 2014 State Budget will close with an operating surplus of €3.85 million. For 2015 the projected deficit is about €13.7 million, but the Government intends to pursue the goal of a balanced budget. This objective can be achieved through policies aimed at reducing public spending and structural reforms to stimulate growth and tax revenues. Economic development laws and the tax reform entered into force in early 2014 are expected to attract foreign investors, consolidate tax revenues, and stimulate the economy. A system of indirect taxes inspired by the VAT model, in line with European tax systems, will soon be submitted to the Parliament with a view to making tax consumption compliant with best practices, simplifying tax administration and boosting trade with the European Union.

On 18 March 2015, San Marino, Andorra and Monaco officially started the negotiations for the conclusion of an Association Agreement with the European Union.

Bilateral relations with Italy have strengthened and, after its removal from the black list in 2014, San Marino was also included in the tax white list and in the anti-money laundering white list. The double taxation agreement and the economic and financial cooperation agreements are in force. The issue of the Memorandum of Understanding between the Central Banks of the two States is still pending and it is hoped that it will soon be concluded.

San Marino is strongly committed to internationalizing its economy. In this regard, negotiations with the USA for the FATCA agreement have been concluded and those with the EU on the new savings directive are being completed. Moreover, in late 2014 the OECD Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information was finalized, with the inclusion of San Marino in the Early Adopters Group.

After almost 5 years of negative performances, the financial system is now showing good signs of improvement. The main challenges of the system include implementing efficient strategies for non-performing loans management, strengthening bank asset quality and maintaining adequate liquidity buffers, also considering the risks related to the Italian voluntary disclosure, which could negatively influence the bank deposits levels.

A real financial system recovery needs a new business model, featuring a more diversified mix of financial services. This strategy could be fully efficient only through a higher internationalization of the country's economy. The authorities are working for the legal framework to be compliant with the *acquis communitaire* in financial matters, reflecting the obligations pursuant to the San Marino-EU Monetary Agreement, and in search of bilateral and multilateral agreements to support a wider openness of San Marino's financial market.

## Role of the IMF

### International Monetary System

*SDR Basket*

Last July the IMF Board held an informal meeting to have a first discussion on the review of the composition and valuation of the Special Drawing Rights (SDR) basket. The formal review of the SDR is scheduled toward the end of this year. We believe that the aim of this review should be to ensure that the basket reflects the relative importance of the major currencies in the world trade and financial systems. In this context, we note that the Chinese renmimbi is becoming increasingly important as a global currency and we are open to consider its possible entry into the SDR basket once the Chinese currency meets the relevant criteria assessed through a rigorous assessment so as to preserve the role of the SDR as a reserve asset.

### Low-Income Countries

*Poverty Reduction and Growth Trust (PRGT)*

We welcome the progress made by the Fund in supporting its poorest members. The need for raising further development resources, coupled with the scarcity of available concessional funding, induced the Fund to make some changes to its PRGT-eligibility framework. A sharper specification of cases when short-term vulnerabilities are important and a more accurate assessment on countries' market access were established. In doing so, four countries could graduate and be removed from the eligibility list. The changes made were small but important, as they guarantee the Trust's overall self-sustainability, while ensuring that concessional resources are targeted to the poorest and most vulnerable countries. However, in the future, the Fund should continue to be careful in the treatment of countries whose eligibility is on the borderline and preserve some flexibility, so as to avoid the need for later revisions in the eligibility assessment.

More broadly, the changes to the eligibility framework should be considered as part of a broader picture, where the Fund is called to preserve not only the sustainability but also the effectiveness of the PRGT. In this vein, we supported the new policy for the members' Poverty Reduction Strategies (PRSs) process and documentation, as it reinforces the link between PRSs and Fund's supported programs and encourages national ownership.

*Financing for Development*

2015 is a paramount year for the development agenda and the IMF has appropriately been showing its commitment to support its most vulnerable members. The Fund's policy advice and capacity building in areas such as domestic revenue mobilization and efficiency of public spending are fundamental. In countries where development needs are numerous, they help ensure that all resources are tapped and that they are used in the most effective manner. At the same time, the changes to the financing facilities for developing countries, that were approved earlier this year, shall make IMF's financing more effective. Targeting concessional resources to the poorest countries, while increasing the access to all facilities by 50 percent, should improve our ability to respond to the Fund's membership needs.

## Governance

*Interim Steps on Quotas*

We continue to be disappointed with the protracted delay of the ratification of the 2010 Quota and Governance Reform, whose full implementation should be the highest priority for the Fund. Pending this implementation, we are open to consider interim measures able to advance the goals of such reforms. As a principle, feasible solutions should not entail changes in relative quotas that go beyond those envisaged under the 14$^{th}$ General Review of Quotas. We believe that a meaningful adjustment can be achieved while complying with this principle.

*2012 Borrowing Agreements – Second one-year extension*

We agree with the commitment of the international community that the Fund should remain a strong, well-resourced and quota-based institution able to provide an adequate global safety net. Against this background, and considering the delay in the ratification of the 14th General Review of Quotas, a number of countries including Italy and Malta in our constituency signed the 2012 Borrowing Agreements.

Pending the delay in the ratification of the 14th General Review of Quotas, last year Italy and Malta concurred with the proposed one-year extension of the bilateral agreements until this fall. In light of the lingering delay in the ratification of the quota reform and the need for the Fund to maintain adequate resources, Italy and Malta support the proposed second one-year extension of their bilateral agreements.

**Long-term trends**

*Climate Change*

The international community is called to take stronger actions to address climate change and the Fund can contribute effectively to this process, within its mandate and building on the established expertise. Climate change has both short- and long-term fiscal implications and has an impact on external and macroeconomic stability, especially in developing countries. A coordinated action is needed not only to build buffers against its spillover effects but also to mitigate and prevent its impact. While technical assistance may be suitable for members aiming at designing specific expenditure and tax measures to mitigate climate change effects, bilateral surveillance is an opportunity to discuss its fiscal and macroeconomic consequences. Finally, multilateral surveillance may a good chance to discuss international cooperation in fiscal issues to address spillover effects, including measures to reduce national emissions.