



# **International Monetary and Financial Committee**

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

On behalf of  
Albania, Greece, Italy, Malta, Portugal, and Republic of San Marino

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**Minister of Economy and Finance, Italy**

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**Developments in the Constituency**

In the first half of 2017 growth accelerated in all the countries of our constituency. On the back of structural reforms, favorable financial conditions and benign external developments, the positive cyclical phase is expected to continue in the second half of the year. The economic recovery has resulted in an increase in employment; however, with the exceptions of Malta, unemployment rates, while declining, are still too high, notably among the young.

The improvement in labor market conditions has strengthened domestic demand and investment has started to recover in Italy and Portugal. FDI has continued to be buoyant in Albania. The positive external environment has helped increase exports in almost all the countries of the constituency, and the external current account position is projected to remain in surplus in Italy, Malta, and Portugal, while in Albania the current account deficit has been reduced.

The reduction of unemployment has not led to wage pressure, and inflation remains subdued. The countries of our constituency have pursued prudent fiscal policies with the aim of achieving both fiscal consolidation and supporting growth. They remain strongly committed to ensuring a steady reduction in their public debt-to-GDP ratios. The positive macroeconomic environment provides an opportunity for structural reforms, which remains a priority for all members of our constituency.

In July, following the positive conclusion of the second review of the ESM program, the IMF approved in principle a precautionary Stand-By Arrangement of SDR 1.3 billion with Greece, which will be completed in August 2018, as will the ESM program. Such developments back the authorities' efforts and the further improvement of economic conditions in Greece.

**Italy.** Reinforced by a firming domestic demand and a more dynamic external environment, the Italian economy has continued to improve, growing at a pace faster than expected. Investment has increased as well, and a further strengthening is expected also as a result of targeted tax incentives and an improved business climate. While growth for 2015 and 2016 was revised up to around one percent in both years, in the last three quarters real GDP increased by 0.4 percent quarter on quarter (1.6 percent at an annual rate). The latest consumer and business surveys point to an acceleration of economic activity in the second half of 2017. In August, the manufacturing PMI (at 56.3) recorded its highest level since 2011.

Supported by the favorable economic cycle and structural reforms (including the Jobs Act), labor market conditions have also improved, bringing employment to above 23 million in July, the highest level since 2008. The unemployment rate has declined by 1.4 percentage point since its peak in 2014,

but is still high (at 11.3 percent) partly due to a higher participation rate. Inflation remains slightly below the euro area average (in August CPI was at 1.2 percent and annual core inflation was close to 1.0 percent). Italy's external position remains strong with the current account surplus at 2.5 percent of GDP in 2016, a level that is expected to be broadly maintained in the coming years.

The September Update to the 2017 Stability Program projects GDP growth at 1.5 percent in 2017-2019 and 1.3 percent in 2020. These projections reflect a prudent assessment of the outlook, in the context of ambitious fiscal consolidation targets.

The general government's deficit declined from 2.6 percent of GDP in 2015 to 2.5 percent in 2016 and is projected to further decline in 2017 to 2.1 percent of GDP, with a primary surplus of 1.7 percent of GDP, thanks also to the additional fiscal measures worth 0.2 percent of GDP introduced last April. The Update to the Stability Program foresees a steady decline in the deficit to 0.2 percent of GDP in 2020.

The structural deficit is projected to steadily decrease from 1.3 percent in 2017 to 0.2 percent of GDP in 2020, broadly achieving Italy's Medium Term Objective (MTO) of a balanced structural budget.

The decision of the Italian government to pursue a more gradual convergence path towards the MTO compared to the 2017 Stability Program aims to strike a better balance between supporting the ongoing recovery and ensuring fiscal sustainability. The revision follows the European Commission's decision to use a margin of discretion in assessing compliance of 2018 Draft Budgetary Plans within the preventive arm of the SGP. Such discretion is motivated by the remaining slack in the euro area economy, global deflationary pressures, and concerns about the plausibility of output gap estimates.

After having broadly stabilized in the last two years, the public debt-to-GDP ratio is expected to decline to 131.6 percent this year, from 132.0 percent in 2016. The Update to the Stability Program targets a decrease in the debt ratio to 123.9 percent in 2020.

Finally, growth in bank lending to the private sector is increasing and credit quality continues to improve, benefitting from the favorable macroeconomic conditions. New Non-Performing Loans (NPLs), as a share of total loans, have fallen to the levels prevailing before the crisis, and the ongoing decline of the NPL stock will profit from significant disposals and guarantee-enhanced securitizations that a number of banks are currently undertaking or have recently announced. Besides, net bad loans declined by about 25 percent in the first eight months of 2017. Earlier this year, the government selectively intervened to recapitalize or wind up the weakest banks, thus taking action on three banking institutions. Consequently, the tail risk that was weighing on the whole banking sector has been removed. The measures were well received by markets and analysts. The banking system, as in most other countries, needs to continue adjusting to a changing economic and technological environment. We are confident it is on the right path, thanks also to the reforms in the governance of banks and in the insolvency procedures that Italy has implemented over the past two years.

**Albania.** Driven by domestic demand and underpinned by a well-balanced policy mix and structural reforms, the Albanian economy further strengthened in 2016. The stronger domestic demand was sustained by favorable financial conditions, improved confidence, higher FDIs and a reduction in unemployment. The main economic and financial stability indicators have improved, while spare capacity in labor and capital markets has decreased. The Albanian authorities have continued to firmly pursue their reform agenda, aimed at enhancing potential growth and increasing the resilience of the economy.

In 2017, as a result of increased investment, higher consumption, and sustained increase in exports, the economy has continued its upward trend. The economy has been operating slightly below full capacity while the unemployment rate has been falling. The current account deficit has declined. While headline inflation is converging toward the Bank of Albania's medium term target, the stronger exchange rate has reduced external inflationary pressures.

Parliamentary elections were held in June 2017. The authorities remain firmly committed to fiscal consolidation and further improving public financial management. The government has maintained structural primary surpluses as a result of increased efforts on both the revenue and the expenditure side, and the public debt remains on a declining trajectory.

The current accommodative stance of monetary policy has supported growth well. The reduction of risk premia and improved lending conditions have increased the credit to the real sector, mainly in domestic currency. The supportive monetary policy stance remains appropriate for the moment. Any normalization of monetary policy will be driven by convergence of inflation to the target.

Structural reforms and further strengthening of banks' balance sheets will reinforce financial stability, improve monetary transmission and boost potential growth. Banks remain liquid, profitable and well-capitalized. NPLs have been further reduced (to 15.14 percent in August from 18.2 in December 2016), paving the way for additional improvement of lending. Further progress is expected as the new bankruptcy legislation is implemented. The Bank of Albania's supervisory capacity has been strengthened, and the Albanian authorities will step up their efforts in order to enhance the supervision of non-bank financial institutions and ensure that high transparency and governance standards are embedded in developing capital market institutions.

Looking forward, growth is expected to remain solid, supported by continued FDIs inflow, as well as improved external conditions. Such favorable environment will help structural reforms, fostering new economic and investment opportunities, confidence and a better business climate. The Albanian authorities remain fully committed to their reform agenda in the pursuit of steady and sustainable growth and the EU convergence process.

**Greece.** The Greek economy has moved during the last two years from a state of prolonged economic crisis to a state of economic recovery. The first signs of solid growth, declining unemployment rate, and increasing confidence in the economy are now evident. Early data on 2017 signal a trend of positive GDP growth, forecast by the European Commission and the IMF at 2.1 percent. Fiscal performance has strengthened significantly in recent years, producing a primary surplus of 4.2 percent of GDP in 2016, significantly exceeding the program's target of 0.5 percent. The headline fiscal balance also turned positive for the first time in 2016 (0.7 percent of GDP), allowing the European Commission to recommend a conclusion of the Excessive Deficit Procedure (EDP). Unemployment is on a downward trend, from 24.9 percent in 2015 to 21.2 percent in June 2017.

Additionally, soft data on expectations show a further improvement in 2017. In the first half of the year, the business expectations index in industry outperformed the level reached in the corresponding half of 2016 (91.6 bps versus 91.3 bps) and the economic sentiment indicator improved to 93.9 bps versus 90.5 bps in the first half of 2016.

Increased confidence in the economy, following the conclusion of the second review of the ESM program and the approval in principal of a Stand-By-Arrangement by the IMF, is expected to boost consumption and private investment, also through improved economic sentiment.

The focus on medium-term, lasting results gave greater credibility to the ESM program, which should effectively turn into a swift pick-up in confidence. Moody's and Standard and Poor's have already changed Greece's outlook from stable to positive, and impetus has been given to Greece's return to international financial markets at sustainable rates. In July 2017 Greece succeeded in accessing international markets, as EUR 3bn worth of 5-year bonds were issued at an interest rate of 4.625 percent. This bond issue is a milestone in the seven-year financial crisis, and paves the way to proceed with further bond issues before the end of the ESM program. The fact that part of the issued bonds was used to replace a previous 5-year bond, maturing in 2019 and part to accumulate a cash buffer at the Bank of Greece shows that Greece is making all necessary preparations to end its dependence on international rescue loans when the program ends in August 2018.

In the upcoming months, efforts will be focused on the successful conclusion of the 3rd review of the ESM program, so that focus can concentrate on issues such as creating a sufficient cash buffer for debt servicing, establishing a sustainable access to the markets and specifying the medium and long term debt measures. The objective is to achieve a successful exit from the program.

**Malta.** Driven by net exports and private consumption, the Maltese economy continued to expand at a rapid pace in the first half of 2017, with GDP growth accelerating to 6.3 percent, following 5.5 percent in 2016. While investment fell below the extraordinary levels recorded in the previous year, it remained elevated from a historical perspective.

Labour supply continues to benefit from the increased participation of Maltese nationals, who are responding to the active labour market policies implemented in recent years, and from strengthening inflows of migrant workers. Persistently strong growth in private market services and a pick-up in manufacturing and construction activity generated sufficient job opportunities to accommodate this increased supply. Unemployment remains at a historical low (4.1 percent in July).

Although the labour market is increasingly tight, wage growth and inflation pressures remain contained. Annual inflation averaged 1.2 percent during the first eight months of the year. While this reading is above the 0.9 percent average of 2016, it remains well below long-run averages. This partly reflects low services inflation and weak growth in prices of non-energy industrial goods.

The shift towards highly productive services activities with low-import intensity has led to a widening of the current account surplus, which reached 10.9 percent of GDP over the four quarters to June.

The general government balance is also expected to show a surplus this year of 0.8 percent of GDP. The general government debt-to-GDP ratio fell below 60 percent of GDP in 2016 and is expected to decrease further to 55 percent by the end of this year.

Favourable macroeconomic conditions and an enhanced macro-prudential framework have served the financial sector well. The core domestic banks, which have the closest links with the Maltese economy, remain adequately capitalised, liquid and profitable. Asset quality continues to improve, with the NPL loan ratio decreasing further during the first half of this year. Core domestic banks have continued to build provisions, pushing up the coverage ratio to above 46.0 percent in June. Financial stability risks from other institutions remain contained, as they have continued to perform positively, underpinned by conservative business operations and prudent investment strategies.

Looking ahead, growth is expected to remain robust as a result of increasing labour market participation and increased infrastructural investment that should enhance productivity and potential growth. Inflation should pick up, as wages begin to respond to tight labour market conditions.

**Portugal.** Portugal's economic recovery is proving to be robust. Positive results have been consistent across all fronts and recently prompted one of the three main credit rating agencies to reinstate an investment grade status to Portuguese sovereign debt. This confirms the effectiveness of Portugal's strategy to regain regular market access, which has already allowed the early repayment of 63 percent of the IMF loan.

In the first half of 2017 GDP grew by 2.9 percent year-on-year: exports, and tourism, in particular, continue to make an important contribution; investment is also picking up, with gross fixed capital formation recording a 10.1 percent increase in the first half of the year. Such developments, together with the sustained gains in market share in recent years, confirm the economy's rebalancing towards the tradable sector. Labor market conditions continue to improve: the unemployment rate dropped below 10 percent earlier this year and is now in line with euro area average.

Last spring Portugal exited the EU's Excessive Deficit Procedure. Although public debt remains high, both recent and projected developments in the primary balance and GDP growth are encouraging.

The banking system is now better positioned to fulfill its intermediation role, following a deep adjustment process which has allowed the continued improvement in capital and liquidity positions and the reshuffling of credit towards sectors with better economic and financial indicators. In 2017, positive developments in four major banks have reduced uncertainty and enhanced the system's ability to tackle the remaining challenges. Notwithstanding a decline in the NPL ratio from 17.5 percent at end-2015 to 16.7 percent at end-March 2017, their level remains high, impacting profitability and market perception. Profitability also remains impaired by the persistently low interest rate environment. A comprehensive and coordinated strategy to promote NPL reduction is thus crucial, involving all relevant stakeholders, with banks taking center stage. This entails improving overall conditions through legal/judicial/tax reforms, and prudential supervisory action, as well as other targeted initiatives, such as a platform to enhance coordination of NPL management, currently being developed by a number of banks.

After a prolonged recession, Portugal is now rapidly transforming into a dynamic and balanced economy. The authorities are aware that continued efforts are needed to address the substantial crisis legacy and remain strongly committed to reforms to sustainable and inclusive growth.

**San Marino.** Mainly sustained by domestic demand, the recovery is strengthening with a growth rate of 1.2 percent of GDP in 2017 and 1.3 percent expected in 2018. The number of registered enterprises has continued to increase, especially in the manufacturing and e-commerce sectors, and unemployment, after stabilizing in 2016 at 8.5 percent, is projected to decrease to 8.0 percent in 2017.

The new government, which took office at the end of 2016, intends to increase fiscal consolidation by finalizing the pension reform, revising the indirect taxation system by 2019 and improving tax administration and compliance. The recent budgetary settlement act envisages continuous expenditure cuts from the requalification of public spending, while on the revenue side targets a rise in capital inflows through the real estate market opening to nonresidents and the introduction of the elective residence procedures.

Public debt is projected to increase slightly to 23.2 percent of GDP in 2017, but is projected to decline to around 22 percent of GDP in 2018.

Structural reforms aim at enhancing the business environment, and include the upgrading of the urban planning system to increase investment in the territory and a full-fledged plan to simplify red-tape and administrative procedures.

The Central Bank of San Marino (CBSM) concluded the first phase of the asset quality review on the whole banking system to identify weaknesses and capital needs. The next step will consist of bilateral surveillance discussions with the individual credit institutions to define tailored action and medium term prospects. New management was appointed at the Cassa di Risparmio di San Marino (CRSM) and a strategic plan to relaunch the bank was adopted. CRSM will become the new cornerstone of San Marino's financial system.

International cooperation is at the forefront of the foreign policy of the Republic, notably the continuous dialogue and collaboration with the Italian authorities and the negotiation with the European Union to reach an Association Agreement, mainly aimed at participating in the common market. San Marino continues its path to full implementation of international best standards and practices, signing the OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) in June 2017.

### **IMF Governance and Resources**

We reiterate our commitment to work towards the completion of the 15th General Review of Quotas by the agreed deadlines. Issues related to the size of the Fund, potential quota increases, their distribution, and the quota formula are all components of an integrated package that requires an appropriate sequencing to succeed. The Fund should remain at the center of the Global Financial Safety Net, with its role not being limited to a catalytic one. While the Fund should remain a quota-based institution, voluntary financial contributions from member countries should be appropriately recognized. We believe that the current quota formula is still able to appropriately capture the main developments in the world economy, with GDP and openness to remain its main variables.

With a view to continue supporting the Fund's lending capacity, Italy and Malta signed bilateral borrowing agreements with the Fund for amounts of, respectively, EUR 23.48 billion and EUR 0.6 billion. Italy also confirmed its enduring engagement in the Poverty Reduction and Growth Trust by providing SDR 400 million to support lending to Low Income Countries. Finally, Italy was one of the first contributors to the Financial Sector Stability Fund (FSSF) with EUR 2 million in 2017.

### **Supporting Sustainable and Inclusive Growth, and Enhancing IMF Surveillance**

Growth perspectives have strengthened in the near-term and provide a favorable environment for adopting policies to increase potential output and enhance resilience against downside risks. The development of the framework to enhance the focus on structural reforms in surveillance is timely; however, effective dialogue with the authorities and cooperation with other institutions with strong competencies in structural areas will be key to providing members with appropriate advice. We welcome the Fund's efforts to operationalize fiscal space assessments; the use of fiscal space, where available, will help reform implementation and might have positive spillover effects in other countries.

Increasing potential growth is necessary, but not sufficient. Economic gains should be appropriately shared, and we are concerned about the increase in inequality experienced in advanced economies.

Inequality is a multi-faced concept, even if it may derive primarily from an uneven sharing of the gains from technological progress and globalization. It is a topical issue that bears further analysis. An effective policy response requires multidimensional and country-specific approaches, and the Fund's analysis – such as the last Fiscal Monitor - and advice may well support members in shaping their actions.

Sustainable and inclusive growth also needs strong institutions. While governance and corruption have been addressed occasionally in the Fund's surveillance so far, the incoming update of the Fund's policies on these issues provides the opportunity to improve the framework. We look forward to more in-depth assessments of the impact of corruption phenomena by the Fund, as the current approach - mainly based on the use of third-party indicators - presents clear limits and vulnerabilities. However, this is not an easy endeavor and the Fund's added value will mostly depend on the ability to provide more granular advice which will likely rely on sizeable resources assigned to this workstream so as to replicate the success achieved through the Fund's involvement in AML/CFT.

Sustainable policies are needed over time. We welcome the successful conclusion of the review of the Debt Sustainability Framework for Low-income Countries (LIC-DSF). More encompassing and tailored to the countries' characteristics, while simpler and clearer, the revised instrument is expected to better inform borrowing and lending decisions. At this stage, we look forward to the review of Market-Access Countries (MAC) Debt Sustainability Analysis.

Surveillance can also benefit from macroprudential measures (MPMs), with the aim of mitigating a build-up of systemic risks. The framework being developed can be a useful tool to help the Fund sharpen its policy advice to the membership at a time where financial stability risks potentially stemming from necessary accommodative monetary conditions require utmost attention. We reiterate the view that MPMs or Capital Flow Management measures may be regarded as an available tool, especially in difficult times, provided they are not a complement, and not a substitute, for sound macroeconomic policies and structural reforms. Further input to enhance Fund surveillance can come from the review of the mandatory Financial Stability Assessments under the FSAP.

The forthcoming Interim Comprehensive Surveillance Review will provide the opportunity to incorporate the issues that have come up from recent experience – some highlighted above – as well as to assess the progress made in implementing the recommendations resulting from the Managing Director's Action Plan that followed up on the 2014 Triennial Surveillance Review. Evidently, any innovation cannot be done at the expense of the mandated macro-financial focus of the Fund's surveillance. We can build on the recent progress in better integrating bilateral and multilateral surveillance and with the aim of enhancing consistency and clarity of the Fund's main policy messages.

### **Further Strengthening the Global Financial Safety Net**

A strong and effective Global Financial Safety Net (GFSN) remains critical for preserving global macro-financial stability and improving crisis prevention. Substantive progress has been achieved since the financial crisis and cooperation between its different layers has been improving.

The approval of the framework for collaboration between Regional Financing Arrangements (RFAs) and the Fund, and the establishment of the Policy Coordination Instrument (PCI) are welcome steps. The conceptual framework and the operational principles for flexible modalities of collaboration between the RFAs and the Fund would allow tailoring the Fund's engagement depending on the specific features and mandate of the RFA concerned. Going forward, continuous dialogue and



engagement with the RFAs will be key to the success of the new policy. The establishment of the PCI - with its signaling role - will help unlock financing from other institutions, thus increasing coordination across the GFSN layers and efficient resource allocation.

The Fund has also strengthened the financial safety net for countries affected by natural disasters. With innovations made in access to the Rapid Credit Facility (RCF) and the Rapid Financing Instrument (RFI) in the case of large-scale disasters, the Fund is now more able to tackle these countries' needs, even considering the increased incidence of such events due to climate change.

Looking ahead, the Fund should continue its work of further reinforcing the GFSN. The ongoing exercise of revisiting and enhancing the Fund's lending toolkit is warranted, and we look forward to the forthcoming review of the Low-Income Countries' facilities. As we stated on previous occasions, it is critical to ensure that any change in the toolkit effectively addresses remaining gaps against actual and perceived risks, that it responds to the demand of the membership, and that its impact on the Fund's resources is thoroughly assessed.