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

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

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Developments in the Constituency

Since the Annual Meetings in Lima, the economic recovery in many countries of our constituency has continued. In 2015 Italy returned to growth with GDP expanding above initial expectations. Malta accelerated further, posting the second highest growth rate among advanced economies; Portugal and Albania consolidated their expansion. In San Marino economic activity has resumed, exiting a prolonged recession.

In Greece, the economic activity showed signs of stabilization after the massive GDP loss experienced between 2008 and 2013. The ESM loan agreed in July 2015 and the wide range of structural and economic reforms being undertaken by the Greek authorities will support the return to confidence and growth. In this context, the completion of the first review of the ESM program, whose discussions are ongoing, will be key to strengthening economic prospects.

Despite more challenging international conditions, GDP projections point to a continuation of the recovery in the countries of our constituency also on the back of an overall more balanced policy mix. An expansionary cyclical phase is a necessary ingredient to tackle the remaining legacies of the crisis spurring a virtuous circle of growth and reforms.

The external current account position continued to broadly improve. The surplus in Malta, Italy and Portugal further expanded; Greece balanced its position and Albania reduced its deficit. On the labor market, the high unemployment rates in several countries of our constituency have started to come down, though they remain high, particularly in Greece. Employment creation also continued, against the background of growth-friendly measures, particularly in Italy. Malta continued to enjoy strong labor market developments, with robust job creation and low unemployment.

Inflation remains generally low and weaker than expected and is projected to increase only gradually. In Greece, in December inflation recorded a positive rate for the first time after 33 months.

Overall, fiscal policy across the constituency is geared towards a more growth-friendly composition of the budget while remaining consistent with the strategy of gradual fiscal consolidation. Going ahead, authorities remain committed to ensuring a declining public debt-to-GDP ratio.

Despite the volatility of financial markets at the beginning of the year, financial conditions remain broadly accommodative. The banking systems remain resilient and well-capitalized. Nonetheless, in some countries, non-performing loans (NPLs) – as a legacy of the deep economic recession – are still elevated and represent a significant challenge that the authorities are addressing with determination and a multi-pronged strategy to repair banks' balance sheet and enhance private sector's credit.

The Board completed the fifth and sixth reviews of the IMF-supported EFF program with Albania in February 2016. In Greece, this year the prospects of the economy are significantly improving and closely linked to the successful conclusion of the 1st review of the ESM Financial Assistance Agreement decided upon last August by Greece and the European Institutions.

Developments in the Members of the Constituency

Italy: In 2015 the Italian economy returned to growth (0.8 percent) after three years of contraction. The outcome came very close to the latest official projections published in the 2016 Draft Budgetary Plan. In the second half of the year, GDP growth slowed down due to weaker export growth and an inventory drawdown in the fourth quarter. On the other side, domestic final demand continued to expand, as private consumption benefited from improved labor market and financial conditions.

In 2015, gross fixed capital formation expanded at a moderate pace, led by transport equipment. Construction investment bottomed out in the second half of the year. Exports grew by 4.3 percent, while imports rebounded (6.0 percent) owing to the recovery in domestic demand. The trade surplus rose to €45.2 billion, from €41.9 billion in 2014. The current account surplus expanded to 2.1 percent of GDP, surpassing the level reached in the late nineties. Employment grew by 0.8 percent and the unemployment rate averaged 11.9 percent, down from 12.7 in 2014. Structural reforms, including the Jobs Act, and tax incentives on new labor contracts boosted permanent employment positions, reducing the dualism of the Italian labor market. Consumer price inflation remained close to zero due to the drop in energy prices and a still wide output gap. The GDP deflator grew by 0.8 percent, bringing nominal GDP growth to 1.5 percent.

The latest data and survey evidence suggest that quarter-on-quarter growth probably picked up in the first quarter of this year, following a softening in the fourth quarter of 2015. Based on the data for January and February, we estimate that industrial production in the first quarter grew by close to 1 percent quarter-on-quarter. The new official forecast contained in the 2016 Stability Program (approved by the government on April 8, 2016) features a real GDP increase of 1.2 percent in 2016, 1.4 percent in 2017 and 1.5 percent in 2018.

Concerning public finances, net borrowing of the general government in 2015 declined to 2.6 percent of GDP, down from 3.0 percent in 2014. Interest expenditure decreased, and the primary balance recorded a surplus of 1.6 percent of GDP. Net borrowing in 2016 is expected to decline further, to 2.3 percent of GDP. For the coming years, the Stability Program targets a net borrowing of 1.8 percent of GDP in 2017, 0.9 percent in 2018 and a slight surplus of 0.1 percent of GDP in 2019.

The structural deficit in 2016 is projected to widen to 1.2 percent of GDP, from 0.6 percent in 2015, making use of the flexibility clauses in the Stability and Growth Pact. The structural deficit would then improve to 1.1 percent of GDP in 2017, 0.8 in 2018 and 0.2 per cent in 2019, nearly achieving Italy's Medium Term Objective of a balanced structural budget.

The intention of the Government with respect to the 2017 Budget is to replace the VAT hikes envisaged in the 'safety clauses' with alternative measures. The savings will come from another round of the Spending Review, reduced tax expenditures and administrative measures aimed at reducing the 'tax gap.' The 2017 budget package will be readied in the coming months, ahead of the October deadline for delivering a Draft Budgetary Plan to Parliament and to the European Commission.

The gross debt-to-GDP ratio in 2016 is expected to decline to 132.4 percent (from 132.7 in 2015) and to fall more markedly in the next three years, reaching 123.8 percent in 2019.

Albania: The Albanian economy has sustained its recovery in the second half of 2015. Economic growth picked up, reflecting higher investment activity and an improved trade balance, while financial stability indicators improved further. Economic growth reached 2.6 percent in 2015, marking the second year of growth acceleration. Leading indicators of domestic demand point to a sustained pace of recovery in the first quarter of 2016, though low oil prices are hampering Albanian exports.

The Albanian authorities have intensified their reform agenda in order to ensure a sustainable economic growth trajectory. Despite continued growth, under-utilized capacities are still prevailing in labor and capital markets, resulting in high unemployment and subdued inflationary pressures. In particular, CPI inflation has been recently subject to disinflationary pressures coming from the external economy. On the upside, inflation expectations are anchored to around the inflation target, the commitment of the authorities for fiscal consolidation is unequivocal, and public debt is within the programmed parameters. The primary deficit declined by 1.5 GDP percentage points in 2015.

Economic growth is expected to accelerate further in the subsequent years, based on higher domestic demand, an expected improvement of the external financial environment, and the impact of business-friendly structural reforms.

The Albanian government is determined in its fiscal consolidation efforts. Some revenue underperformance during the second half of 2015 prompted the authorities to maintain their expenditures in check with the aim of not breaching deficit targets. Fiscal reform initiatives were designed in a drive to expand the tax base and incentivize small- and medium-enterprises. Expenditure risks stemming from the energy sector were reduced further and initiatives to ensure tax compliance have yielded initial positive results in terms of decreased informality in the economy. Fiscal consolidation will continue to target further improvements in the public expenditure management framework.

The Bank of Albania remains committed to fulfill its legal mandate of price stability in the medium term. Monetary policy is set to remain expansionary for the foreseeable future, with the expected trajectory communicated regularly to the markets through forward guidance.

In terms of safeguarding financial stability, the macro-prudential policies of the Bank of Albania will be aimed at sustaining a resilient banking system. Targeted macro-prudential measures have facilitated a system-wide reduction in NPLs. The NPL ratio decreased to 18.2 percent by end 2015, down from a peak of almost 25 percent in September 2014. This will help lower credit risk in the economy and strengthen financial intermediation. The banking system is resilient, underpinned by adequate capitalization, high liquidity and profitable banking institutions.

The Albanian authorities will continue to concentrate on implementing all-encompassing structural reforms, with the aim of scaling up the growth potential of the economy and securing a sustainable long-term growth. The authorities' judiciary reform, expected to revamp the functioning of the judicial system, is in the final stages of negotiation amongst the stakeholders.

The Albanian authorities are committed to pursuing macroeconomic policies in conformity to IMF-supported program and in support of a long-term sustainable growth agenda as well as concentrate all their efforts on the EU integration process.

Greece: Between 2008 and 2013, the Greek economy experienced a cumulative GDP loss of 26 percent. In 2014 and 2015 GDP showed signs of stabilisation resulting in a small drop in 2015 (0.2 percent). Regarding employment, in 2015 there was an increase of 3.0 percent, making it the second consecutive year of employment growth. Moreover, the number of unemployed persons fell by 5.7 percent. As a result, average unemployment decreased from 26.5 percent in 2014 to 24.9 percent in 2015, remaining however, the highest in the EU-28. Finally, regarding price levels, deflation in 2015 continued for the third consecutive year, recording a rate of -1.1 percent, although in December 2015 the general level of prices recorded a positive rate of change after 33 months of continuous decline.

Reforms were a significant component of economic policy in 2015. The Greek Government has underscored the wide range of economic and structural reforms that are being implemented and that are expected to improve economic performance. Their significant reform agenda, adopted in a very short period, affects important areas of the Greek state, economy and society. Areas of intervention include the financial sector, the healthcare and pension system, the judicial and the tax system. Furthermore several reforms have been implemented that are expected to improve the performance and effectiveness of public administration, as well as the competitiveness of the Greek economy.

Finally, a successful recapitalisation of Greek banks was carried out with increased private sector participation. The four systemic banks covered the required funds which resulted from the adverse scenario of the ECB stress tests.

For 2016 the prospects of the Greek economy are significantly improved and closely linked to the successful conclusion of the 1st review of the financial assistance agreement. The latter is expected to boost confidence and facilitate the return of deposits in the Greek banking system improving its stability and accelerating the abolishment of the currently active capital controls.

Factoring in the recapitalisation of Greek banks and the expected resolution of the significant problem of NPLs (between 2008 and 2014 the NPLs in the Greek economy rose from 5.0 percent to 33.8 percent of bank loans and estimated to have risen to 35.6 percent in 2015), the successful conclusion of the 1st review will increase the liquidity of the financial system, improve the ability of banks to increase funding to the private sector, reduce the financing costs and thus foster economic growth. In the medium term, the successful conclusion of the 1st review will allow for the discussion of debt related measures aiming at ensuring the gross financing needs remain at a sustainable level so to free up resources for growth enhancing investments.

Malta: The Maltese economy continued to expand strongly in 2015, with real GDP growth accelerating to 6.3 percent, from 3.7 percent in 2014. Growth in 2015 was driven by domestic demand, particularly investment and private consumption, whereas net exports had a dampening effect. The labor market remained buoyant, with continued strong growth in labor supply and employment. The unemployment rate fell further, standing at 5.3 percent in 2015, down from 5.8 percent in 2014.The surplus on the current account of the balance of payments widened to 9.9 percent of GDP in 2015 following 3.4 percent in the previous year. Although the trade surplus narrowed as a share of GDP, the balance on the income component turned positive. Average annual inflation, measured on the basis of the Harmonized Index of Consumer Prices (HICP), edged up to 1.2 percent in 2015, from 0.8 percent in 2014. This pick-up mainly reflected developments in unprocessed food prices.

According to the budget presented in November 2015, the general government deficit is estimated to have narrowed to 1.6 percent of GDP in 2015, from 2.1 percent in 2014. The general government debt-to-GDP ratio declined to 64.0 percent. Both ratios are expected to fall further in 2016.

Maltese banks continue to pursue a prudent business model and remain well capitalized, with ample liquidity and well diversified portfolios. Soundness indicators compare favorably with those in other European countries and exceed minimum regulatory requirements. The health of the banking sector is also reflected in the limited use of Eurosystem facilities by domestic banks in the course of the year. Despite the low interest environment, banking sector profitability generally improved, with the after-tax return on equity for the core domestic banks standing at 9.9 percent in December.

Economic activity in Malta is projected to remain robust in 2016 and 2017, though moderating following the strong growth achieved in 2015. As in 2015, growth is expected to be driven by domestic demand, particularly private consumption and investment. The annual average rate of HICP inflation is set to remain broadly stable in 2016, reflecting an environment of subdued external price pressures and moderate increases in domestic labor costs, but should pick up in 2017, in the context of a buoyant domestic economy and a gradual normalization of international commodity prices.

Portugal: The Portuguese economy continues to recover gradually, as the adjustment efforts are bearing fruits and financing conditions in the euro area remain favorable. In 2015, GDP growth accelerated to 1.5 percent and the unemployment rate declined further, to 12.4 percent. Progress was also evident in the external and public accounts: the trade balance surplus widened and the public debt-to-GDP ratio decreased vis-à-vis 2014. In the banking sector, positive developments included the continuing improvement in liquidity and the return to positive levels of profitability in aggregate terms. Additionally, the early repayment of IMF credit is ongoing and the Treasury continues to tap the markets regularly and successfully.

While these results are noteworthy and encouraging, the legacy of the crisis is still relevant and potential growth is limited by structural bottlenecks. Public debt is now on a downward path, but remains high, requiring persistent and strong commitment to ensure fiscal discipline. Private debt is also significant, calling for continued deleveraging efforts from households and firms. In this regard, although the reduction in interest rates has proven beneficial, this trend is not without risks and its reversal would not be without costs. Against this background, credit resources must continue to be channeled to firms with high credit quality, namely in sectors underpinning the recovery such as manufacturing and exports. In fact, deleveraging in the private sector needs to proceed in tandem with further adjustment in the banking sector. Given the challenges facing Portuguese banks – heightened by the current macroeconomic environment and the uncertainty of the global economic outlook –, renewed efforts are required to improve profitability and strengthen banks' balance sheets, most notably through the reinforcement of a comprehensive strategy to address the high stock of NPLs.

The authorities are well aware that continued progress on fiscal consolidation and structural reform is of the essence to preserve market confidence and pave the way for sustained, dynamic and inclusive economic growth.

San Marino: After years of recession, San Marino's economy is showing signs of recovery. The economy stabilized in 2015 and is projected to growth by 1 percent in 2016. The number of businesses operating in the country is increasing as well as the volume of their activity. This is reflected in the decline of financial support for temporary unemployment. Reflecting the expected lags in the recovery of employment, the unemployment rate has hovered at somewhat below 10 percent.

Despite the difficult economic conditions of the past years, the deterioration in Government finance has been contained. Actions have been taken to reduce current spending and consolidate revenue collection. The budget deficit was moderate in 2015 and is projected to remain so for 2016. Looking ahead, resources are being allocated to strategic infrastructures, which are expected to crowd in private investments. These efforts are being made within the overall framework of returning to a balanced budget.

The indirect tax system is being reformed with the intent of introducing a VAT system. This reform will complement the wider review of San Marino's tax system, already partly implemented in relation to direct taxation. San Marino has made important progress in aligning its legislation with international standards of transparency and tax cooperation, and is participating in the exchange of tax information in line with OECD and FATCA standards.

With the end of the period of voluntary disclosure at the end of 2015, there has been a withdrawal of deposits by Italian customers. However, there are neither liquidity tensions nor stress at a systemic level. The adoption of a strategy for the management and resolution of non-performing loans is a priority. The authorities are also strongly involved in developing an overall strategy for the international re-positioning of the financial system. In this light, a review of the Central Bank governance has been initiated notably with the appointment of a new top management with international experience. Moreover, in the spring of 2015, negotiations for an Association Agreement between San Marino and the EU were started, in order to combine the adoption of the EU *acquis* to the greater integration of San Marino's banking and financial system in the EU market.

The IMF and the International Monetary System

We welcome the informal discussions held by the IMF Executive Board to initiate a reflection on the state of the International Monetary System, the Global Financial Safety Net

(GFSN) and the adequacy of the Fund's resources. At this stage, we broadly share the analysis provided by IMF staff, with some qualifications.

We concur with staff that strengthening the GFSN, and particularly its core component, the Fund's resources, is the key issue. It is important that the GFSN, and particularly the IMF, be perceived *ex ante* to be sufficiently endowed to cope with potential financing needs of the membership. There is thus a need to fix the current setting in order to ensure that there are sufficient available resources and that they can be fully, efficiently and rapidly used when necessary.

In this regard, enhancing coordination among the different layers of the GFSN is certainly critical. Equally important is that the Fund remains adequately resourced, broadly maintaining its current lending capacity. Against this background, three issues need to be considered as follows:

1) burden sharing. The IMF lending capacity relies on both permanent quotas and temporarily borrowed resources, with the latter starting to expire soon. The possible extension of the bilateral borrowing agreements requires a fairer burden sharing among the membership.

2) *modus operandi* of the IMF. The Fund should continue to play a leading role in the GFSN and, hence, in the monetary system. This goes well beyond a limited catalytic function. A well-resourced Fund should not shy away from playing a primary role in financing its member countries.

3) lending toolkit. Further refinements to the IMF facilities could be warranted, for example exploring avenues to strengthen precautionary facilities. On a more general note, we see merit in considering possible ways to expand state-dependent lending instruments in the Fund's toolkit, which would allow improvements in terms of reliability of resources. It would also be consistent with the lessons learned in the recent "Crisis Program Review", namely that the resolution of modern crises might imply longer periods of adjustment.

Finally, as we welcome the entry into force of the 14th General Review of Quotas, we look forward to the 15th Review as a way to maintain the Fund adequately resourced with permanent quotas. In order to facilitate a constructive and comprehensive discussion among the membership, we continue to favor the so-called "package approach" whereby all relevant variables and parameters in the quota formula are simultaneously considered to deliver a suitable outcome, while avoiding unreasonable expectations and unworkable scenarios.