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IMFC Statement by Pier Carlo Padoan
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Italy

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

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Developments in the Constituency

Since the last Annual Meetings, the macroeconomic outlook in the countries of the constituency has further improved. In 2016 Malta continued to experience very strong growth, Albania and Portugal accelerated, while Italy and San Marino consolidated their recovery. In Greece GDP stabilized. Based on macroeconomic projections, the positive economic phase should extend into 2017, with GDP growth strengthening in countries where the expansion has so far been weaker. Besides improved cyclical conditions – both domestic and external – the recovery is benefitting from the important structural reforms that have been undertaken on several fronts in all the countries of the constituency.

The improved macroeconomic outlook is reflected – albeit only gradually – into the labor market. Although to different degrees in the various countries, employment is being created and unemployment rates are decreasing. However, unemployment remains too high (with the only exception of Malta where labor market conditions are particularly buoyant). Moreover, youth unemployment in several countries continues to be a reason for concern. On the back of the still rather subdued developments in commodity prices and – in most cases – of the persistently negative output gaps, inflation remained low and well below target everywhere, and is expected to increase only gradually going forward.

External positions have generally improved: current accounts are now in surplus everywhere in the constituency but in Greece – where the position is broadly balanced – and in Albania – where the deficit is shrinking and is increasingly financed by an acceleration in FDIs.

Albeit generally moderate, the ongoing recovery has been instrumental for tackling the legacies of the crisis and avoiding self-defeating strategies/adverse loops. To address the remaining vulnerabilities, it is now essential to strengthen actual and potential growth by combining further structural reforms with a growth-friendly policy mix. While expansionary monetary policies are still of the essence to bring inflation back to target, fiscal policies need to strike a delicate balance aiming at replenishing buffers while not compromising the recovery underway. The countries of the constituency remain committed to prudent policies and rank the steady decrease of their public debt-to-GDP ratios among the highest priorities.

Two countries of the constituency have been recently relying on financial assistance programs: Albania with the IMF, and Greece with the ESM. Following the decision of the IMF Executive Board, in February the EFF program with Albania has now been successfully completed. Over the three years of the arrangement, SDR 295.42 million were made available to the country, and a comprehensive reform strategy aiming at promoting growth and job creation in a context of fiscal and financial stability has been efficaciously pursued. The engagement with the Fund is now set to continue within the post-program monitoring framework. Regarding Greece – and following the recent important agreement reached by the Eurogroup in

Malta on the main overarching elements of the post-program policy package – the second review of the ESM Financial Assistance Agreement could be completed relatively soon – once a full Staff Level Agreement is reached between the institutions and Greece – thereby marking a further step on the way to the recovery of the Greek economy.

Italy. In 2016 the Italian economy continued to expand at a moderate pace; annual growth (0.9 percent) was slightly higher than the latest official projections (i.e. 2017 Draft Budgetary Plan). Domestic demand was the main driver of the recovery, whilst net exports provided a small negative contribution. Private consumption expanded, benefiting from improvements in the labor market, as well as from subdued inflation. Investment grew for the second year in a row, accelerating on the back of accommodative financial conditions, improving demand and targeted tax incentives. Construction investment increased in the second part of the year, on the heels of a more active property market. The external position continued to improve, with the current account surplus raising to 2.8 percent of GDP.

Besides more favorable macroeconomic cyclical conditions, structural reforms (Jobs Act) and tax incentives on permanent contracts had positive effects on the labor market, supporting permanent job positions. Employment grew by 1.4 percent and the unemployment rate declined, reaching 11.5 percent in February 2017 (it was 11.9 percent on average in 2015). Consumer price inflation hovered around zero for most of the year, due to the still subdued developments in energy prices, while core inflation remained positive (0.5 percent). Following the increase in international energy prices, inflation has now increased to 1.3 percent year-on-year in March 2017; however, core inflation remains low.

The latest consumer and business surveys point to an acceleration of economic activity. Confidence is rising, particularly in the manufacturing industry: in March the PMI, at 55.7, recorded the highest level since 2007.

The new official forecasts in the 2017 Stability Program feature a real GDP increase of around 1.0 percent in the next four years. This reflects ambitious fiscal consolidation targets and a prudent assessment of the outlook. Net borrowing of the general government in 2016 declined to 2.4 percent of GDP, from 2.7 percent in 2015, with a primary surplus of 1.5 percent of GDP. Net borrowing is expected to decline further in 2017, to 2.1 percent of GDP, thanks also to additional fiscal measures worth 0.2 percent of GDP that have just been issued via a law decree. The new Stability Program foresees a sharp decline in the general government deficit to 1.2 percent of GDP in 2018, 0.2 in 2019 and zero in 2020.

The structural deficit is projected to widen from 1.1 percent in 2016 to 1.5 percent of GDP in 2017, a level below that planned in the Draft Budgetary Plan of October 2016 (1.6 per cent of GDP). The deviation from the downward path required by the Stability Pact is due to extraordinary expenditures for earthquake assistance, security and immigration flows. In addition, the government judged that a 0.3-percent-of-GDP reduction in the headline deficit, the same as in 2016, was appropriate given the still-slow pace of economic recovery. The structural balance will then improve more markedly in the next three years, broadly achieving Italy's Medium Term Objective in 2019, and fully in 2020. The intention of the Government with respect to the 2018 Budget is that the bulk of deficit reduction will come from the Spending Review, a cut in tax expenditures, and new measures to combat tax evasion. The gross debt-to-GDP ratio is expected to decline to 132.5 percent this year, from 132.6 in 2016. It should then fall more markedly in the next three years, reaching a level of around 126 percent in 2020.

The Italian banking sector is on the way to a steady recovery. During 2016 growth in credit to the private sector returned into positive territory. The ratio between bad loans and total credit declined, as the rate of entry into nonperformance fell and banks reduced their exposure while raising provisions. Only one Italian bank did not pass the stress tests performed by the EBA last summer. The government subsequently readied a recapitalization facility that can be used in the event of risks to financial stability (as long as the banks involved are deemed viable). We are confident that with this tool, and in close cooperation with regulators and the European Commission, the most relevant cases will be solved over the course of this year.

Indeed, Italy is also making progress on the implementation of reforms in the governance of the banking system. Large mutual banks have merged and the reorganization of cooperative banks is at an advanced stage. The ECB and the Bank of Italy will issue recommendations to banks on the disposal of nonperforming loans. A government facility for the provision of guarantees on the securitization of NPLs (GACS) is available to banks and the NPL market is taking off. Insolvency and credit recovery procedures have been reformed, and parliament is reading enabling legislation for a comprehensive overhaul of bankruptcy law.

Albania. In 2016, the pace of expansion of the Albanian economy increased further (to around 3.5 percent), while key economic, fiscal and financial stability indicators improved. The authorities have continued to pursue their reform agenda, aimed at enhancing growth potential and increasing the resilience of the economy. The recently-completed IMF-supported program has been instrumental to such a purpose.

On the back of higher private investments, increased consumption and a pick-up in exports, the acceleration of the economy led to a sizable fall of the unemployment rate (to 14.5 percent at end-2016, from 17.7 at end-2015). Core and headline inflation picked-up, on a path towards reaching the inflation target of the Bank of Albania. The current account deficit contracted benefitting from higher exports, while the acceleration of foreign direct investments in energy and extracting industries eased financing requirements. High frequency indicators point to a sustained growth momentum also for the first half of 2017.

Fiscal consolidation remains on track. After more than two decades of almost continuous primary deficits, a structural primary surplus is being recorded since 2016; the public debt-to-GDP is now set on a steady downward trajectory. Such results also reflect ongoing efforts to improve public financial management, from both the revenue and the expenditure side, including through reforms of the pension and energy sectors. The Albanian authorities have institutionalized their commitment to sound fiscal policies through a newly approved fiscal rule aimed at an ambitious reduction of public debt.

On the monetary side, the sustainable return of inflation to target requires maintaining an expansionary monetary policy stance in the near term and carefully normalizing monetary policy over the medium-term. Moreover, the Bank of Albania will remain committed to further advancing financial stability. The banking system is sound, liquid, profitable and well-capitalized.

As part of a comprehensive strategy for tackling the vulnerabilities stemming from Non-Performing Loans, several legal and regulatory changes have been initiated. A new Bankruptcy Law has been adopted, and the Law on the Registration of Immovable Properties, the Law on Securing Charges, and the Private Bailiffs Law have been amended with the goal of protecting the rights of lenders and strengthening collateral enforcement. In addition, new measures are being put in place to increase the recourse to out-of-court debt restructuring, as well as to implement a medium-term de-euroization strategy, in order to alleviate potential financial stability risks and increase the efficacy of the monetary policy transmission mechanism.

Going forward, economic growth and resilience will be further supported by strengthened fundamentals, enhanced confidence and business environment, the gradual easing of domestic financial conditions, as well as by an improved external environment. Importantly, the authorities remain fully committed to their reform agenda in the pursuit of sustainable growth and the EU convergence process.

Greece. In 2017, the signs of stabilization and recovery of the Greek economy that first appeared in 2016 are continuing. GDP remained stable in 2016, while for first time since 2010 two consecutive quarters of growth were reported. The unemployment rate, while still high in absolute terms, dropped to the lowest level in five years (23.5 percent, down from 24.9 in 2015 and 26.5 in 2014). The decline in prices (0.8 percent) was also more moderate that in 2015 (-1.7 percent). Bank deposits have risen in 2016. The current account was broadly balanced.

Following the completion of the first review of the 3rd Economic Adjustment Program, the second review started in October and is now approaching its conclusion. The second review includes deliverables and prior actions in the following areas: public finances, public revenue administration, tax and social contributions collection, safeguarding financial stability (particularly by tackling NPLs), structural reforms to enhance competitiveness and growth in product markets as well as in the energy market, labor market reforms, privatizations, the establishment of the National Fund for managing public property (HCAP), and the modernization of the state and of public administration.

Upon conclusion of the second review, debt relief discussions will resume in order to define medium and long term debt relief measures. This approach – defining further relief following the completion of the second review – is based on the Eurogroup decision of May 25th 2016, which reflected the consensus reached between the four institutions. At that time, a decision was made to break down debt relief into short-, medium-, and long-term measures. The short-term measures have already been defined and are currently being implemented by the ESM.

The Greek authorities note that the successful completion of the second review would also constitute the first significant step towards opening the way for the ECB to include the Greek bonds in the Quantitative Easing Program. This step, will increase liquidity in the Greek economy, promote credit expansion, lower Government Bond yields and reduce the overall cost of funding for Greece, while facilitating access to international capital markets.

All these developments should ultimately make possible to achieve the authorities' final objective of removing the remaining capital controls; the government has already eliminated one of the three main pillars of capital controls by lifting all restrictions on early, partial or total repayments of loans with credit institutions. The relaxation of the second pillar – limitations on cash withdrawals – is ongoing, and will be followed by gradual relaxation of the third and final pillar, namely the ability to transfer funds abroad.

The successful completion of the second review, access to QE, debt relief, promoting the return of deposits and consequent expansion of credit, as well as significant further relaxation of capital controls, should all reinforce the process of further economic stabilization and recovery.

Malta. The Maltese economy maintained a fast pace of expansion, with real GDP growth standing at 5.0 per cent in 2016, largely driven by net exports. Although private consumption continued to rise at a solid pace, investment decreased slightly following a 50 per cent increase in 2015. As a result, domestic demand contributed mildly to growth last year.

The labor market remained dynamic, with continued strong growth in employment and further declines in unemployment. The unemployment rate fell to 4.1 per cent in December, with administrative data showing further falls in the number of registered unemployed at the start of 2017.

Cost and price pressures remain contained. Industrial producer price inflation was low or negative throughout 2016, while the annual rate of inflation based on the Harmonized Index of Consumer Prices (HICP) averaged 0.9 per cent. Although HICP inflation rose above 1.0 percent in the first two months of 2017, it remains low both from a historical perspective and when gauged against the buoyant pace of economic activity. Wage pressures also remain relatively contained given economic fundamentals, aided by a steady influx of foreign workers and measures encouraging labor market participation.

The emergence of new business services sectors and the expansion of existing industries, such as gaming and aviation services, has led to a widening of the surplus on the current account of the balance of payments, which in 2016 was equivalent to 7.9 per cent of GDP.

Favorable macroeconomic conditions and progress with fiscal consolidation have enabled progress towards the medium-term target of a close-to-balance structural position. On a four-quarter moving sum basis, the general government balance showed a surplus of 0.6 per cent of GDP in the third quarter of 2016. Meanwhile, the general government debt-to-GDP ratio is expected to have fallen below the 60 per cent threshold in 2016 (it was at 59.7 per cent in September). Central government data for 2016 also signal a significant improvement in the fiscal position.

The financial system continues to benefit from a favorable macroeconomic environment, prudent business practices and an enhanced macro prudential framework, including strengthened capital buffers and stress tests. Banks remain characterized by ample liquidity and capitalization and their profitability is substantially above EU average. Their asset quality improved in 2016, as the non-performing loan ratio declined. Financial institutions remain prudent in their operations and there is no undue risk accumulation.

Looking ahead, GDP growth is expected to moderate from the exceptional annual average rate of 7 per cent during 2014-16. However, the economy is still expected to register solid rates of expansion, of around 3.5 per cent, as large projects in the energy sector are superseded by new ones in health, transport and education, and as tourism and services exports continue to respond to the authorities' diversification efforts. Inflation is expected to rise further towards 2 percent as international commodity prices pick up and tight labor market conditions begin to leave their mark on wages.

Portugal. Since the 2016 Annual Meetings, developments in the Portuguese economy have been encouraging: growth is strengthening, labor market conditions continue to improve, fiscal consolidation is proceeding and uncertainties related to the financial sector are receding.

In 2016, GDP grew by 1.4 percent, with a significant acceleration in the second semester – a promising evolution for this year. In fact, in early 2017 short term indicators for investment have been positive and confidence remains high among economic agents. Most importantly, key indicators confirm the ongoing rebalancing towards exports, which remain an important driver of Portuguese economic growth. Also, last year the current account improved reaching 0.8 percent of GDP; inflation remained subdued at 0.6 percent, and the unemployment rate decreased further to 11.1 percent, reinforcing the positive trend in the labor market since 2013.

The headline fiscal deficit in 2016 stood at 2.1 percent of GDP, paving the way for Portugal to formally exit the EU's Excessive Deficit Procedure this year. When compared to the figure reported in 2010 (11.2 percent of GDP), the significant fiscal adjustment effort is evident.

A strong commitment to sound policies remains of the essence. Growth is still constrained by structural bottlenecks and high debt levels across institutional sectors. In the banking sector, decisive operations in key banks earlier this year contributed to greater clarity and decreased downside risks. However, achieving stronger profitability remains an important challenge. In this context, reducing NPL levels is a priority, requiring a coherent approach on several fronts, to be pursued at national and European levels, as NPL ratios remain high in many countries and spillover effects could be relevant.

The outlook for the Portuguese economy has certainly improved, also in a more favorable external environment. In 2017 growth is projected to reach 1.8 percent, largely on the back of strong export performance, and inflation is forecasted to increase to around 1.6 percent. This notwithstanding, sustainable growth will require continued determination to tackle remaining imbalances.

San Marino. At the end of 2016, a new government took office in San Marino after early elections. Government and central bank are working to address the legacy of the global crisis with an aim to boost potential growth, complete the cleaning up of the financial system and strengthen international cooperation.

The recovery is consolidating. The economy is projected to grow at a moderate but steady pace of about 1 percent of GDP in the medium term, mainly sustained by domestic demand. The number of registered enterprises continued to increase, especially in the manufacturing sector, and unemployment stabilized at 8.5 percent at the end of the year. Public debt is stable at around 21 percent of GDP. In order to replenish fiscal buffers and further reduce debt, the fiscal strategy for 2017 envisages extraordinary revenue measures, a reform of the indirect taxation system, and further expenditure cuts. The adoption of the 2014 spending review plan will be competed, including the pension reform; expenditures for 2017 have been frozen projecting total savings of approximately 2 million euro, and technical work for the introduction of a VAT system (probably in 2019) is underway. The overarching goal is to ensure a fiscal correction without harming the fragile economic recovery underway.

The Central Bank of San Marino (CBSM) underwent an external audit to enhance supervisory practices, independence and overall governance. In the meantime, an asset quality review for the whole banking system was launched to identify potential weaknesses in governance, risk management, capital requirements. In parallel, the management of the largest bank of the country, Cassa di Risparmio di San Marino (CRSM), is being replaced by the government in coordination with the CBSM to reflect the stronger role of the State in the governance of the bank after the significant public recapitalization during the crisis.

Ongoing structural reforms include a revision and modernization of the labor market legislation to better focus on human capital investment, labor retention and new hiring, and the creation of a one-stop-shop to simplify new enterprises' registration.

San Marino remains deeply committed to greater transparency in the framework of the restructured OECD's Global Forum on Transparency and Exchange of Information. The Republic joined the Early Adopters Group that will apply the new standards in 2017 and more recently the OECD's inclusive framework to tackle Base Erosion and Profit Shifting (BEPS).

IMF governance and resources

We remain committed to the completion of the 15th General Review of Quotas, including a possible new quota formula, by the Spring Meetings of 2019 and no later than the Annual Meetings of 2019. At the same time, we recall that the current quota formula has proved to capture well the main developments in the world economy, and we look forward to further data updates in the coming months. In any case, we believe that both GDP and openness should remain the main variables of the quota formula. We also reiterate that the approach should consider all the relevant elements in an integrated package and – while acknowledging that the Fund should remain a quota-based institution – we deem that voluntary financial contributions from member countries should be appropriately recognized in the upcoming quota and governance discussions.

In this respect, we wish to recall that – in line with a long-standing tradition – this constituency is continuing to make substantive efforts to ensure that the Fund remains adequately resourced to deliver on its mandate. Italy and Banco de Portugal have recently renewed their commitments as NAB participants for, respectively, EUR 8.77 billion and EUR 1 billion. Moreover, Italy and Malta have committed to contribute to the new Bilateral Borrowing Agreements with the Fund for an amount equal to, respectively, EUR 23.48 billion and EUR 0.26 billion. Also, Italy has recently committed to renew its long-standing support to the Poverty Reduction and Growth Trust for an amount of 0.4 billion SDR.

Enhancing IMF surveillance

Aiming at enhancing the Fund's policy advice in the context of the so-called three-pronged approach, important progress has been achieved in recent months.

On the fiscal side, the completion of the framework laid out by IMF staff to assess systematically and consistently the availability – or lack thereof – of fiscal space in member countries is very welcome. It is now important to operationalize such a framework by identifying clearly, in bilateral and multilateral surveillance, both the countries that need to replenish their buffers and those that – having fiscal space – should use it to promote actual and potential growth. To the extent that the two group of countries are also characterized by, respectively, external debtor and creditor positions, such policies would also provide an important contribution to the rebalancing of the world economy.

Besides the work on mainstreaming macrofinancial analysis – which is well underway and that we fully support – IMF staff have recently launched also a new framework to enhance the focus on structural reforms in surveillance, while taking into account the broader macroeconomic context. The initiative is timely and relevant, given the need for addressing the persistent slowdown in productivity affecting a large part of the membership. For the new framework to be effective, however, three elements need to be considered. First, when assessing structural and policy gaps, third-parties indicators should be used cautiously – particularly when they are perception-based – since they have frequently proved to be inaccurate; on the contrary, a close and constructive dialogue with country authorities is essential to identify relevant issues and policy solutions. Second, while developing a toolkit with country examples and experiences is certainly useful, a one-size-fitsall approach would not adequately serve the membership; country-specificities should be factored in properly. Third, being mindful of its core mandate, the Fund, in evaluating structural reform strategies, should enhance its collaboration with other agencies with greater expertise in structural reforms, particularly when in-house expertise is not available at the Fund. As a final point, we note that – in order to enhance traction – it would be important for the Fund to assess the actual payoffs realized by member countries through the adoption of structural reforms, and to compare them with the related costs.

Among the most relevant macrocritical issues of the current juncture, the widespread rise of inequality across the Fund's membership is prominent. We thus very much welcome the increased attention dedicated by Fund staff to distributional aspects, both in bilateral and multilateral surveillance. In order to promote more inclusive and equitable growth, fiscal policies can provide an important contribution in the context of comprehensive and coherent policy packages, particularly through the adoption of progressive income taxation and the fight against tax avoidance and evasion. To be effective, however, it is critical that national efforts in these areas are backed by effective implementation and coordination of international tax rules.

Lending toolkit

Since the aftermath of the financial crisis, much progress has been achieved to enhance the Global Financial Safety Net (GFSN). The progress has occurred not only at the Fund level but also in its many other different layers. Nonetheless, further improvements can be accomplished, and the ongoing work on revisiting and enhancing the Fund's lending toolkit is fully warranted. As we stated in previous occasions, it is key to ensure that going forward any change effectively addresses significant perceived gaps and that, as such, responds to a clear demand of the membership. Furthermore, the assessment of the adequacy of any possible new instrument should also incorporate a thorough cost-benefit analysis.

Another fundamental element for the enhancement of the GFSN is an effective coordination among its different layers. In this context, we look forward to the discussions on the Fund's work on its future cooperation with Regional Financial Arrangements. It is critical that the respective mandates, roles and institutional frameworks of the other institutions involved are duly reflected in these discussions. The same principles hold true also for the forthcoming discussion for program design in currency unions.

Support for Low Income Countries (LIC)

Continued support to the most vulnerable parts of the Fund's membership is needed. Fund's advice, financing and catalytic role are key to supporting their quest for strong, sustainable, and inclusive growth. For that, having an adequately endowed and self-sustainable Poverty Reduction and Growth Trust is of the essence; to this end, as recalled, Italy has recently renewed its commitment.

Furthermore, in the context of increasing public debt among LICs, strengthening the framework to assess debt sustainability is at a premium. While we understand that the framework needs to ensure that the countries' borrowing ability to tackle their multiple development needs is not unduly constrained, at the same time debt accumulation must not jeopardize their medium term fiscal sustainability. In this context, the on-going work of reviewing the LIC Debt Sustainability Framework is very welcomed.